Japan's Capital Markets Perspective - Note on the Structural Transformation (20th January 2026)

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Table of Contents

List of Figures

1. Introduction

From my own perspective as someone who has been active in the markets for many decades, the transformation of Japan's capital markets over the past few years has been nothing short of extraordinary. Recognizing that this change is structural rather than temporary, and wanting to convey a sense of urgency to our investee companies, I wrote a letter to our portfolio companies in 2023 titled ***"Six Suggestions.[1]"*** In that letter, I explained the costs and benefits that came with Japan's postwar cross-shareholding which, in fact, was critical in shaping and empowering economic growth during Showa era. I also laid out what I believe listed companies need to do as this cross-shareholding structure continues to unwind at an accelerating pace. In 2024, as a follow-up to the above, I argued that the long-standing, unspoken customary rules[2] of Japan's capital markets no longer hold in light of the "Guidelines for Corporate Takeovers" issued by the Ministry of Economy, Trade and Industry. In this whole new landscape, I asserted that each listed company should seriously reconsider and redefine what it truly means to remain a public company — and that companies should not dismiss the option of going private in pursuit of growth simply because of a stubborn attachment to their listed status. These views were set out in my paper, ***"Merits and Challenges of Being Publicly Listed in the Era of Unsolicited Takeovers.[3]"***

The move toward the "true capitalization" of Japan's capital markets has only just begun. This is driven by several structural realities. First, capital has become highly mobile on a global scale. Second, relative to the size of the economy, Japan's listed companies have a strikingly small aggregate market capitalization, despite the large number of companies that are publicly listed. At the same time, Japan has already entered a period of population decline. In this circumstance, companies have little choice but to further pursue economies of scale or to strengthen their competitiveness and generate growth overseas. As a result, alliances and consolidation across industries are inevitable which has little room for debate on this point. And I believe there is a broad consensus on this issue among the Ministry of Economy, Trade and Industry ("METI"), the Financial Services Agency ("FSA"), and the Tokyo Stock Exchange ("TSE").

As shown in Figure 1 below, the number of listed companies in Japan is nearly on par with that of the United States, whose GDP is roughly seven times larger than Japan's. Yet Japan's average market capitalization of a listed company is USD 1.58 bn—approximately one-tenth that of the United States. In addition, according to a similar OECD survey, as of the end of 2024 there were about 44,000 listed companies worldwide in total, with an aggregate market capitalization of USD 125 tn. This implies an average global market capitalization of USD 2.84 bn, which is 80% larger than Japan's average. Even in comparison with listed companies globally, Japan's equity market is one where, to put it bluntly, there are simply many small listed companies. There is little doubt that the excessive number of listed companies relative to the size of the economy has a meaningful impact on overall economic in-efficiency. And again, I believe there is a certain level of shared understanding on this issue among METI, FSA and TSE.

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1 [Six-Suggestions-Hibiki-Path-Advisors-Aug-2023.pdf]
2 Often called as "Ah, Un (あ、うん)" rules, meaning non-verbally expressed ambiguous offer-acceptance process
3 [Merits-and-Challenges-of-Being-Publicly-Listed-Oct.2024.pdf]

Figure 1: Number of Listed Companies and Average Market Capitalization in Major Markets (End of 2024)

Unit: USD bn

Country/Region	Number of Listed Companies	Market Capitalization	Average Market Cap per Company
Japan	4,038	6,381	1.6
United States	4,440	62,869	14.2
Europe*	6,500	16,250	2.5

*Europe has approximately 6,500 listed companies.

(Source: Processed from OECD data)

This time, in making the third and final round of my "capital market series," I decided to write a new white paper since, despite the unprecedented increase in unsolicited takeovers and shareholder proposals from both domestic and international institutional investors, I have observed that many corporate executives and directors have yet to fully digest these changing times — or the unequivocal shift in the shape of capitalism taking place in Japan. For example, not only the management of companies targeted by unsolicited takeovers, but also employees (including labor unions) and even business partners, often express strongly emotional concerns. In some cases, court decisions appear to reinforce such sentiments. Similarly, shareholder proposals that apparently enhance corporate value — such as distributing excess capital to shareholders where Balance Sheet is extravagantly metabolic — are frequently dismissed outright under slogans like "a medium- to long-term perspective" or "multi-stakeholderism." Observing these reactions, I am left with the cynical impression that, even as the market undergoes structural transformation, the underlying mindset of many executives has changed only slightly (although I hope my intuition is wrong). If anything, I sometimes sense that, while the narrative of those executives excuses and antagonism toward new-wave of capitalism is carefully managed through euphemistic language, emotional resistance to the capital market itself may in fact be deepening.

If such mismatch, a kind of "buttoning mistake," so to speak, between Japanese companies and foreign institutional investors continues to widen, the outlook for Japan's capital markets is going to be bleak and it is certainly not a great thing. This is particularly ironic given that these foreign investors are precisely the source of capital that Japan's markets must attract as domestic pension scheme will shrink amid population decline and cross-shareholdings continue to unwind. My personal view is that capital remains overwhelmingly powerful globally, and that resisting its influence is ultimately futile. As leadership is gradually passed to a younger generation of more rational-minded executives even here in Japan — many of whom have no vested interests with the era of cross-shareholdings or the bubble economy — "true capitalization" will likely be realized sooner or later, whether in ten years or in twenty. That said, a separate and far more important question remains: whether Japan will, ten years from now, be able to compete on equal footing globally, having genuinely internalized the essence of capitalism, understood its significance, and positioned itself to lead rather than follow.

In the above-mentioned Guidelines for Corporate Takeovers, METI has already stated that corporate value is a "quantitative concept." In practice, however, genuinely quantitative discussions of corporate value are rarely undertaken until a company becomes the target of a takeover, begins to consider a privatization such as an MBO, or otherwise enters what would be described in the United States, under the Revlon standard, as a "company for sale" situation. There are, of course, exceptions. A small number of companies — typically those that have launched unsolicited takeovers or have long treated M&A as a core growth driver — consistently remain aware of the gap between their intrinsic value and the valuation implied by their current market price. These companies actively monitor opportunities while also paying close attention to the valuations and share prices of other listed companies. Still, based on my own intuitive assessment, companies whose executives or boards as a whole hold this mindset likely account for no more than a few percent of all listed companies. That is why I am concerned that unless far more companies truly internalize the "essence of capitalism," the gap between this small minority and the rest of the market will continue to widen, and Japan's capital markets will not be meaningfully strengthened.

Japan, particularly during its postwar high-growth period, developed a range of innovative and distinctive corporate management and governance systems, including the convoy system[4], cross-shareholdings, and lifetime employment. Originally very dynamic, and even sometimes cannibalistic, capitalism that was introduced from the West after the Meiji Restoration by famous figures such as Eiichi Shibusawa, Yataro Iwasaki, Tomoatsu Godai, Zenjiro Yasuda, and Kihachiro Okura was gradually transformed, almost imperceptibly, through the process of post–World War II reconstruction and subsequent economic growth. Over time, a distinctly "Japanese" form of capitalism—one that incorporated "household-like" and "inner-circle-like" values as part of its corporate culture—came to re-dominate. Even after the collapse of the bubble in the 1990s and the advance of globalization, I continue to observe that many senior executives still carry a strong imprint of this Japanese-style capitalist mindset.

That said, when viewed through the lens of Japan's distinctive historical path dependency — most notably its experience of nearly 300 years of national seclusion during the Edo period — it is perhaps understandable that the sudden exposure, over the most recent several years, to what can be perceived as a Western, shareholder-centric model, grounded in the long-established mainstream of capitalism and characterized by an uncompromisingly rational mindset, has caused a sense of bewilderment. At the same time, it is worth recalling that only one generation ago, at the height of Japan's bubble economy in the 1980s, Japanese companies aggressively applied the logic and rules of capitalism to acquire companies and real estate around the world, export consumer electronics and automobiles on a massive scale, and, in the process, generated significant geopolitical friction, including U.S.–Japan trade disputes and the phenomenon known as "Japan-bashing." What must not be forgotten is that, throughout this historical process, Japan itself enjoyed substantial benefits from competing on, and succeeding within, the global capitalism playing field. Returning to the present, amid the dynamic transformation of today's capital markets, if corporate executives feel even slightly as though capital is "entering the house with its shoes on[5]," such a reaction unfortunately reflects a weak awareness of the very foundations upon which a corporation is formed. It also betrays an extremely naïve and sentimental mindset—one that amounts to little more than nostalgia for the distinctive capitalist system of Japan's Showa era.

The "basso continuo" of capitalism framework is unarguably the rule of law, which shares the same underlying as the governance of the nation itself. At its core, capitalism can be understood as a tool for humanity in which people collectively embrace life and wealth through prudent contracts and transactions—rather than through plunder or invasion driven by conquests and war.

[4] The convoy system refers to a postwar Japanese regulatory and administrative framework in which competition was deliberately constrained and government support was coordinated so that weaker firms were protected and moved forward at roughly the same pace as stronger ones, with systemic stability placed ahead of market discipline.

[5] Japanese people usually take their shoes off at home so it will be considered unethical to go into somebody's house with their shoes on.

It is for this reason that legal framework was developed as needed, so that people can participate in economic transactions with trust to others. As an effective means of carrying out such activity at scale, corporations and partnerships are formed. And to ensure fairness and discipline in pursuing objectives and making decisions within these highly specialized and divided collective organizations, the concept of governance has evolved and continuously adapted over time, driven by necessity in each era. Concept of Corporate Governance is not some irritating set of rules suddenly imposed from somebody by force. Rather, it is a concept that has evolved almost unconsciously through countless failures, adjustments, and trial and error, as a core element in the long painful development of capitalism itself. In this sense, it represents the very opposite of arbitrary regulation. For example, the struggles and evolution of the East India Company—developed in the Netherlands and England in the seventeenth century, and discussed in Chapter 3—offer a rich repository of the essence of governance issues. In fact, one could argue that the fundamental nature of governance has not changed for more than 400 years! I expect that once readers work through that discussion, their understanding of Corporations and Corporate Governance will be fundamentally reshaped.

"Capitalism," along with the corporations and legal entities that constitute it, and their evolved form—the listed company—are concepts that humanity has refined over millennia, enduring countless trials and repeated failures, while continuing to evolve through what Adam Smith famously called the "invisible hand." They may be likened to a venerable tree, thousands of years old, with countless branches and hollows. When I reflect on the grand "historical essence of capitalism," which embraces both the virtues and the flaws of the market—even accommodating actors who might appear driven by "money worship" or short-termism—I find that one's perception of recent changes in capital markets can shift dramatically to embrace it rather than to antagonize.

In the coming five to ten years, during which Japan's capital markets will inevitably undergo "true capitalization", if more people acquire a deep historical perspective on the essence of capitalism, and if they can act by viewing these changes not with a sense of tragic resignation as though the changes are being forced upon them, but as a chance to shift their mindset and treat them as useful tools for stepping into a new competitive arena, then I believe Japan's future as a whole will be bright. This does not mean that I seek to deny Japan's good old history; rather, it is a process of growing through constructive critique, grounded in an affectionate understanding of the long history of humanity.

2. The History of Company, Limited Liability, and Governance

It is often said that the market-based capitalist system, along with the corporate structures that support it, took on a form close to what we recognize today during the Industrial Revolution in 17th-century England. The trigger is commonly attributed to the enactment of the Limited Liability Act of 1855, which allowed many ordinary private businesses to establish limited-liability corporations without requiring special government charter. Since limited liability is a system that allows shareholders to walk away from its creditors, government authorization (a charter) was always required prior to 1855. England, however, crossed the Rubicon because (i) the economy as a whole demanded enormous amounts of capital for projects such as railway construction, and (ii) the concept of limited liability had already gained a degree of credibility. That said, a deregulation of this magnitude does not occur as a sudden mutation. The development of capitalism and the corporate system—including its formative stages—rests upon a long and complex historical trajectory, shaped by countless human trials and hardships.

Born from the fundamental challenge of how to govern "power" under the law, the rule of law eventually came to regulate economic activity through relationships of rights and obligations rather than through "power". These economic activities were gradually organized into the more effective and sustainable vehicle we now call "the company". Over time, society as a whole came to be structured—and in many ways dominated—by companies. Today, Japan's capital markets have entered a new phase, with relentless debates unfolding over corporate strategy, capital policy, and governance. Yet, in truth, the rare act of asking the fundamental questions—"What is a company?" and "Why did companies emerge in the first place?"—is both essential and urgently in Japan's interest. I believe there is tremendous value in pausing to reflect on this long history.

To begin with, what is regarded as the earliest evidence that "legal (corporate) organizations" played an important role within a nation's economic society appears not in the Industrial Revolution, but far earlier, in the era of the Roman Republic around the 5th century BCE, when Japan was still in the Jomon period where there were not even any linguistic communication method in place. I would like to start this historical journey from Republic of Rome.

(1) The Roman Republic and the *Societas Publicanorum* (Associations of Public Works Contractors)

The Roman Republic era refers to the period from the overthrow of the monarchy in 509 BCE to 27 BCE, when Augustus established the Principate and Rome transitioned to the Empire. It was a dynamic 500-year period during which Rome expanded from a city-state on the Italian Peninsula to domination over the entire Mediterranean. In the Roman Republic, where the ideal of "small government" was central, the entities that supported—or at times maneuvered behind—the increasingly complex administration were known as the Societas Publicanorum (associations of public works contractors). The term Societas Publicanorum is particularly fascinating. Publicani were individuals who contracted with the state to carry out public works, such as construction and military supply, and to collect taxes. Societas is a Latin word meaning "association," "company," or "community." Accordingly, the Societas Publicanorum was a business association composed of multiple Publicani and is said to have undertaken public services, including the right to collect taxes on behalf of the state. For convenience, in this letter I will refer to the Societas Publicanorum as "Roman Republic corporations." The long history of Ancient Rome—still captivating countless people today—is a hallmark of Professor Nanami Shiono, author of The Story of the Roman People. However, the rise and fall of the Societas Publicanorum contains an exceptionally important early lesson for modern governance issues. This idea is encapsulated in the following words, attributed to the 19th-century British historian Lord Acton:

Power tends to corrupt, and absolute power corrupts absolutely.

Around 450 BCE, the Roman Republic established the Twelve Tables, marking a transition from a world governed by orally transmitted customary law to an era of written law. As Rome expanded across the Italian Peninsula, it had already developed a sense of order as a "state," along with an awareness among its citizens of their rights and obligations, supported by a system of governance characterized by separation of powers and mutual checks and balances through the Senate, popular assemblies, and magistracies. In this context, one could say that the foundational concepts of governance and accountability were already in place. Within this framework, the concept of the contract emerged as a cornerstone for regulating economic activity, with the rights and obligations of contracting parties explicitly defined.

These Roman Republic corporations were involved in a wide range of activities, including the construction of public facilities such as bathhouses and roads, the development of mines, and the collection of taxes in newly acquired territories. In many cases, they bid for government projects to acquire the rights to undertake them and then sought to recoup their investment from the revenues generated by that project. It is also said that, for high-risk undertakings, a concept resembling modern limited liability had already been introduced.

Among the historical anecdotes, the episode from 215 BCE involving Publius Cornelius Scipio (the father of the famous Scipio Africanus who defeated Carthage) is particularly striking. Hannibal, the formidable Carthaginian general and central figure on the opposing side in the Second Punic War, arguably the greatest crisis of the Roman Republic, was renowned as a brilliant warrior. It is well known that he marched from Africa through Spain, crossed what is now the French Alps with an army that included elephants, and advanced southward into Italy to attack Rome. At that same time, Cornelius Scipio was also forced into a grueling struggle in the Iberian Peninsula against successive armies arriving from Carthage with continuous logistical support.

In 215 BCE, Cornelius Scipio is said to have written a desperate letter to the Roman Senate explaining that both supplies and funds were nearly exhausted, and that, if nothing changed, Rome would lose its stationed soldiers as well as all of Spain, and he requested additional support. However, Rome itself had virtually depleted its treasury while facing the direct threat of Hannibal. As a last-resort stratagem, the state turned to its citizens. The appeal was as follows: "If brave citizens deliver clothing, food, weapons, and other supplies to comrades in Spain using their own funds, the state will make full payment once the treasury has recovered." Three Roman Republic corporations, comprising nineteen individuals, are said to have responded. The conditions they demanded in return were essentially a form of limited-responsibility contract: (i) exemption from personal military service, and (ii) compensation for losses if supplies were lost at sea due to shipwreck or pirate attacks. While this may not constitute full limited liability, the inclusion of clauses designed to avoid uncontrollable, natural-disaster-like risks indicates that an early concept of limited liability, one of the key features of corporations, already existed within contracts as well as rights and obligations.

As a result, ample food and supplies were delivered to Spain by these three Roman Republic corporations possessing both patriotism and business sense. Rome secured victory in the battles there, which also made it increasingly difficult for Hannibal to sustain his logistics. Hannibal was ultimately forced to abandon the conquest of Rome and return to his homeland, resulting in Rome achieving the historic comeback victory.

Even taking into account that historical narratives inevitably reflect their authors' perspectives, the fact that this story has endured for millennia as a legendary anecdote is telling. Of course, there are limits to what we can concretely take from an episode that happened thousands of years ago, but for anyone curious about the origins of corporations, this anecdote offers three key takeaways.

First, it shows that (i) profit-driven enterprises—essential for a capitalist-style economy—already existed even in the Roman Republic, (ii) the concept of limited liability was already in play, and (iii) the power of a small number of enterprises had already grown strong enough to shape the fate of a nation.

It should be etched into one's mind that such enterprises, protected by contracts that organized "rights" and "obligations" under the rule of law, and that skillfully balanced people's motives of "self-interest" and "altruism," served as a foundation for governance and economic development in the Roman Republic era that existed in an unimaginably ancient world Before Christ (B.C.).

These Roman corporations gradually grew in scale, and they seem to have had mechanisms for reporting to what we might call shareholders—similar in some ways to modern shareholders' meetings—as well as accounting practices, such as recording revenues and profits, to support those reports. In that sense, we can see the "first sprouts" of what would much later evolve into a governance structure. Some theories even suggest the existence of roles resembling today's executive officers and directors, along with a market for trading ownership rights—in other words, a form of stock market.

In any case, Roman corporations were indispensable to the governance system of the Roman Republic, which was founded on the principle of small government. Yet, because there was no legal framework to supervise or regulate them, these corporations often operated behind the façade of contractual protection, engaging in exploitative practices—whether toward laborers or through taxation of newly acquired territories—and extracting excessive profits, effectively abusing their power. Over time, they became targets of scrutiny and attack from the Senate. After Julius Caesar was assassinated in 44 BCE, Augustus, the first emperor of Rome, implemented a series of tax reforms that gradually stripped these corporations of their entrenched privileges by moving to direct tax collection. Subsequent legal reforms continued along this trajectory, and by around the 2nd century CE, such private enterprises had largely disappeared.

Regrettably, although the relationships of "rights" and "obligations" that defined the scope of corporate activity were in place, the methods by which profits were secured ultimately relied on the "ethics" of the principal owners. As a result, many of these corporations arguably collapsed from within due to a lack of execution-level internal governance (we will call this internal governance) awareness—the rigorous discipline of internal governance would later become central to the development of the British East India Company, as we would discuss below. As Lord Acton famously observed that "absolute power corrupts absolutely", these Roman corporations, which in a sense came to dominate the Roman Republic without bearing sufficient accountability, ultimately destroyed themselves because they held unchecked power and ego in their own hands.

That said, the Roman system of outsourcing public tax collection to private operators through auctions—where contractors paid a lump sum to the state and then collected taxes from residents to recoup their payment—was extremely convenient for governments, as it reduced the risk associated with tax collection. This system was subsequently widely adopted across Europe. Similar models were introduced in medieval England, France, the Netherlands, Prussia, the Ottoman Empire, and elsewhere, with tax farmers and tax contractors effectively carrying a portion of state governance. In England, a gradual shift toward direct collection by bureaucrats began in the late 17th century, eventually abolishing tax farming. In contrast, in France, this system of tax contracting created structures of re-exploitation and is said to have become one of the triggers of the French Revolution at the end of the 18th century.

(2) The Dutch and British East India Companies

Although the corporate system of the Roman Republic ultimately collapsed under its own weight due to a lack of execution-level governance, the issue of corporate governance remained a conscious concern throughout the subsequent development of capitalism in Europe. As in Roman times, the farther business activities occurred from the center—whether tax collection in newly acquired distant territories or mining operations in the Alps—the less oversight could reach them. With different languages and communication delays that could take weeks or even months, relying solely on the assumption that people are "inherently good" meant that the expansion of power inevitably led to corruption.

The Medici Bank in Florence, often regarded as the birthplace of double-entry book keeping—one of humanity's greatest inventions—grew into a vast family enterprise that dominated trade and financial flows across Europe. It also played a major role in fostering Italian Renessance culture, sponsoring figures such as Leonardo da Vinci and Michelangelo. Yet careless management, often mixing public and private interests, coupled with governance failures, ultimately led to the bank's collapse.

After centuries of such trials, corporate governance was elevated to a new level through the Dutch and British East India Companies, established around 1600 CE to conduct the highly profitable spice trade. These companies, with many shareholders and active trading of shares, provide a treasure trove of insights into governance challenges that still resonate today. The fundamental challenge at the heart of this governance was how to protect the rights of shareholders who provided risk capital under the law, distribute returns fairly, and develop the business in a just and orderly manner.

In studying the evolution of the East India Companies, we can see the institutionalization of core concepts that underpin capitalism itself: limited liability, accountability, a market for trading shares, shareholders' meetings, directors' duties, and more. <u>Two factors</u> played a particularly crucial role. <u>First, both East India Companies were joint-stock enterprises that raised capital from many numbers of investors. Second, their business model was long-haul overseas trade, which involved long cycles where the time from initial investment to return was lengthy, as well as extremely high risk.</u>

Before examining these two triggers in detail, it is important to consider a critical background factor of the East India Company. That is, the notion of the "going concern". In this respect, the Netherlands was more advanced than the British East India Company at the time, even though the latter was founded several years earlier. Initially, the dominant model was to raise funds for each individual voyage, settle accounts after goods were sold, and distribute profits, in other words, a project-finance-style approach. This produced a one-hit wonder business that was extremely high-risk and high-return. The Dutch concluded that the only way to mitigate this risk was to treat the trade as a going concern. Believing that overwhelming capital scale was essential to that goal, they created the United East India Company (VOC)[6] by consolidating multiple Dutch trading companies, permanently fixing capital, issuing shares, and paying dividends — thus establishing what is widely regarded as the world's first fully-fledged joint-stock corporation.

The VOC raised more than ten times the capital of the earlier British East India Company. Yet the "killer content" added to the company's statute to attract a broad base of investors, including ordinary citizens, was the "limited liability" system introduced in (1). Thanks to this, a large number of shareholders, strangers to one another and ranging from the wealthy to ordinary citizens, invested without hesitation. It also enabled the company to run multiple voyages simultaneously and reduce risk. Moreover, because the VOC decided at the outset not to return capital to shareholders for the first ten years, the need to provide periodic reports to shareholders on the progress of the business arose, leading to the establishment of governance processes for financial accounting and reporting. Furthermore, for those who inevitably needed liquidity along the way, a market for trading shares emerged organically. The fact that a true "going concern" was devised in the Netherlands, then Europe's most commercially advanced society shaped by a Protestant culture of discipline and diligence, where wealth, talent, and information were concentrated—and

[6] Derived from its official name, *Vereenigde Oostindische Compagnie*

that stock markets subsequently emerged, was far from a historical accident. Notably, in the same period, during the 1630s, the Netherlands also experienced the "Tulip Mania Bubble", the world's first speculative bubble.

However, the very foundation of capitalist development lies in "competition." After observing the success of the Dutch VOC, the British East India Company adopted the going-concern structure and limited liability between 1657 and 1662 and subsequently grew rapidly. While the company was ultimately dissolved in 1874 under government instruction after a series of problems, it survived for 275 years from its founding. Considering that the average life expectancy in England at the time was around 50 years, the company effectively lasted roughly five human generations as a going concern. By comparison, the VOC, after a long period of decline, collapsed in 1799 due to reckless management (and was nationalized and liquidated). In contrast, the British East India Company's remarkable longevity is attributed to several factors, most notably a highly advanced and effective governance system. This system ensured that shareholders' rights were protected "as seen from the shareholders' own perspective," and that "supervision" and "execution" of business were clearly separated internally. I will introduce the details of such interesting case study below in sub-section (3). I hope it would make clear that the Corporate Governance that today's executives like you hear almost every day is not some afterthought addition, but rather a concept that was established and refined over centuries of historical experience to meet the requirements of a functioning capitalist society.

(3) The Governance Revolution of the British East India Company

When discussing the governance system of the British East India Company, it is useful to organize the analysis around the two structural triggers noted earlier—namely, the presence of many shareholders and the nature of long-haul trade—and to distinguish between (i) "supervisory governance," which concerns accountability to shareholders, and (ii) "internal governance," which concerns the actual operation of an enterprise in which a single voyage could take two to three years. The overall system appears remarkably well designed in terms of institutional dispersion of power and the creation of mutual checks. That said, this design was by no means the result of abstract theory; rather, it emerged through repeated failures and extensive trial and error.

I begin with (i) supervisory governance. Unlike family-controlled enterprises such as the Medici bank, where ownership and management were effectively unified, the clear separation between owners and managers inevitably gives rise to what is now known as the principal–agent problem[7], in which the objectives of shareholders and those executing management on their behalf begin to diverge. To address this structural tension and to ensure that management acted in a manner aligned with shareholder interests, the institution known at the time as the Court of Committees—what we now call the board of directors—was introduced. In corporate governance perspective, this can fairly be described as a "Columbus's egg."

It is worth noting that the Dutch VOC also had a similar body, the Heeren XVII (the Seventeen Lords), which functioned as a supervisory council of major stakeholders. However, its members were appointed as representatives of cities, rather than being elected by shareholders through a general meeting. This distinction proved decisive. Because the VOC's highest decision-making body was not structurally grounded in the mindset of "managing for shareholders," it tended over time toward weak strategic discipline and excessive, poorly controlled dividend distributions,

[7] Region Growth Partners Blog July 18, 2025 (Japanese only)

resulting in a growing gap in long-term execution quality relative to the British East India Company.

The board of the British East India Company consisted of twenty-five directors, with a chair elected from among them. Directors were chosen by a vote of shareholders who met a minimum ownership threshold—500 pounds at the time—clearly anticipating the modern shareholders' meeting. In addition, there was initially a higher bar for candidacy: prospective directors were required to be among the largest investors, typically those who had committed at least 2,000 pounds[8]. It is particularly striking in two fronts. First, from its inception, the board was conceived explicitly as a shareholder oversight mechanism, separated from executing body. Second, it was taken as self-evident that directors should be major shareholders who bore substantial financial risk themselves. One can see here a conscious attempt to retain the positive intensity and commitment found in family enterprises, while avoiding their structural weaknesses.

Directors served four-year terms and were required to step down at the end of each term without exception. Reappointment was only possible after a mandatory cooling-off period of at least one year. This was a deliberate governance protocol aimed at preventing corruption and excessive concentrations of power before they could take root. At every stage, the system was anchored in the principle of protecting the collective rights of shareholders who had committed risk capital. By participating in governance as directors, selected shareholders represented the interests of all investors and supervised business execution with an eye to fair value measurement and distribution.

In practice, the board reportedly met on a weekly basis. Standing committees, including those responsible for trade and finance, were established and required to report upward, ultimately seeking approval from the shareholders' meeting. Once strategy was set, detailed written instructions were prepared for overseas bases throughout Asia, specifying what goods to purchase, in what quantities, at what prices, as well as negotiating tactics with local authorities. Outpost leaders were expected to execute strictly in line with these directives. In reality, however, this system faced obvious constraints: in an era when messages could take more than six months to arrive, execution was rarely straightforward.

A well-known illustrative episode is that of Elihu Yale, who arrived in Madras (modern-day Chennai) in 1672 as a junior resident officer, effectively an apprentice. By 1687, he had risen to become head of the Madras settlement. During his tenure, he accumulated immense private wealth by engaging independently in activities well beyond the company's instructions, including diamond trading and the slave trade. In 1692, following extensive criticism of these activities, he was dismissed for corruption and fined by the directors. Even so, he returned to London an extremely wealthy man. In later life, he donated books from his personal collection to a new college founded in 1718 in New Haven, and the proceeds from their sale funded the construction of campus buildings, ultimately leading to the institution being named Yale University—a story often told as a heroic legacy.

These anecdotes underscore why <u>(ii) internal governance was equally critical</u>. As the company expanded, it established dozens of overseas posts stretching from India to Java. Those tasked with running operations on the distant and dangerous frontiers of foreign lands were often individuals operating perilously close to the line separating merchant from pirate. In such an environment, where direct oversight was minimal and assumptions of innate goodwill were unrealistic, the

[8] According to many historical studies, £2,000 at the time would correspond—by modern standards—to a sum ranging from several hundred thousand to several million U.S. dollars, an amount that only a very small group of wealthy individuals could have afforded to contribute.

board's real skill lay in acknowledging both the clean and dirty realities of human behavior and in harnessing ambition through a calibrated mix of incentives and punishments to generate returns for shareholders. This, in essence, was internal governance.

In this extraordinarily challenging long-haul trade business—where time and distance themselves imposed severe constraints—internal governance rested on three pillars: (i) meticulous record-keeping and documentation, (ii) a rigid promotion system, and (iii) structured mutual monitoring among senior officers. Overseas posts kept not only detailed financial accounts but also comprehensive records of disputes with local populations and day-to-day operational issues, all of which were preserved and subject to audit by the directors. The lowest position, "Writer", was quite literally a record-keeping role. Advancement was slow and rule-bound: at least five years were required before promotion to "Factor", followed by another three years before one could become a "Merchant" with actual transactional authority. From there, further promotion was possible, but misconduct at any stage led to swift and unforgiving dismissal. Outpost executive councils, typically comprising six to nine senior officers including the settlement head, were designed to enforce mutual supervision and to prevent purely personal or arbitrary decision-making even at the top execution level.

Through the powerful combination of supervisory governance and internal governance, the British East India Company grew brilliantly in an exceptionally dangerous and difficult long-haul trade business, gradually taking market share from the Dutch VOC, which had succeeded earlier. Regarding the failure of the VOC due to complacent and bloated management, I previously wrote a post relating to DOE and would refer readers to that[9] . The East India Company began with spices such as pepper and nutmeg, then later made a major strategic shift into new fields such as Indian-origin silk and calico used as clothing materials, and ultimately expanded freely into trading in tea, coffee, opium, and even slaves. One must not forget that behind this success was managerial capability born from the thorough enforcement of governance concepts. And behind the execution of such governance protocols, there were undoubtedly many incidents in which individuals like Yale slipped through the cracks. Yet the key to success, especially when comparing to the VOC, was that "the ultimate purpose of running the company in the first place" was bottom-lined into a single simple point: "under the supervision of the directors, increase profits, report and distribute the business fairly to investors." So long as that purpose remained central, not only shareholders but also executives and employees could accumulate enormous wealth commensurate with the risk. This, as you would agree, is the fundamental reason-of-existence and undisputed origin of what corporations should be.

The most important origin of the "company" as I know it today is the East India Company, and I believe it is now clear how both "limited liability" and "governance" were indispensable as systems for "controlling human desires and turning them into results". Thereafter, in Britain, capital expanded rapidly through the steam engine revolution (the Industrial Revolution), and in the United States as well, companies were founded by many immigrants and capitalism became a global phenomenon. In particular, in the United States, capital grew enormous and shareholders became increasingly dispersed, and by the 1940s new problems emerged such as "shareholder apathy" and "managerial control," producing what came to be called the managerial revolution. As a counterreaction, the 1960s and 1970s saw waves of shareholder counterrevolution with the increased institutional ownership triggered by the ERISA act of 1974. In essence, this can be seen as a phenomenon caused by many people forgetting the original pains of establishing a "company." and what we are experiencing in Japan today as well in the structural changes. For more on this,

[9] A Brief Essay About 'Dividends'- Hibiki Path Official Website

I would refer readers to Chapter 6, "The History of Shareholder Structure in the United States," in "Six Suggestions[10] " , the first work in this series.

3. Lightness of Shareholder Votes, and Managerial Revolution

Now, I would like to turn my attention to Japan's historical trajectory. From the perspective of corporate governance, I believe that two key items sands out to be the antonyms to Western traditional capitalism: "Lightness of votes" and "managerial revolution"

In the 17th century, while the British and Dutch East India Companies were sweeping across Asia — engaging in trade with various countries and dynasties and, at times, exercising military power to the point of colonization — Japan remained under national isolation (Sakoku) (1639–1854) and thus largely outside the global tide of early capitalism. During this period, India was almost entirely under the ruling by the British East India Company, then China's Qing dynasty was weakening following successive defeats in the First and Second Opium Wars, and lastly much of Southeast Asia was governed by Britain, the Netherlands, and Spain.

As noted in my earlier "Six Suggestions," when Japan reopened its doors to the world through the Meiji Restoration, the government realized the hard cold fact of an overwhelming power gap relative to the Western powers, alongside the stark reality that many nations had already fallen under foreign dominance. Guided by the slogans "enrich the country, strengthen the military（富国強兵）" and "promote industrialization（殖産興業）," the government pressed ahead with domestic economic development with single-minded determination. It recognized that supporting capable entrepreneurs and risk-takers, such as Eiichi Shibusawa, would be crucial for strengthening national economic power. Accordingly, in 1872 (the fifth year of the Meiji era), modeled on the U.S. national banking system, the government enacted the National Bank Act without extended debate, thereby introducing Japan's first limited-liability regime and joint-stock corporate system[11]. I suspect that a fundamental mismatch in notion between the Western traditional capitalism and Japanese version of it was embedded from this very outset.

We are aware that businesses during the Edo period was fundamentally based on "family". In 17th-century Japan, the major industries included rice, cotton, and textiles, and even toward the end of the Edo period, the system remained centered on family-run enterprises. Typical examples include the Mitsui family, who achieved remarkable success in selling kimono cloth (long fabric used for traditional Japanese robes) and other textiles, later forming the core of what is now the Mitsui Sumitomo Group, and the Ito family of now what is called C.Ito, the major trading conglomerate (伊藤忠). In such time, Japan introduced this very new limited liability system in a ***single leap***, a stark contrast to the many aching centuries for this concept to develop and mature in Europe. What was truly outstanding about the first generation of capitalism promoters, represented by Eiichi Shibusawa, was that—much like the East India Companies—shareholders themselves actively participated in management. In doing so, they skillfully integrated the strengths of the long-established family-business model, where ownership, control, and responsibility were closely aligned.

However, there was no clear distinction between directors responsible for supervision and managers running day-to-day operations. This was likely because Japan was not dealing with

[10] Six Suggestions-Hibiki-Path-Advisors-Aug-2023.pdf
[11] Vol. 339, Series Feature No. 9: "The Joint-Stock Company System and Household Portfolio Choice from a Historical Perspective (Part 2)" | *Naruhodo! TSE Economics Classroom* (Japanese only)

businesses requiring massive capital or long investment-recovery cycles like the East India Companies, nor did it require widely dispersed shareholders as in a typical joint-stock company. Instead of a formal structure with directors representing shareholders, governance developed naturally through shareholders being directly involved in management. In other words, while Japan appeared to be adopting a modern corporate form, in practice it largely continued the family-centered management style that had prevailed since the Edo period. I see this as a pragmatic choice, made under the pressing need to achieve economic growth amid the sweeping changes of the Meiji Restoration. At the same time, this approach probably played a key role in preventing Japan to become colonized.

Because Japan introduced this joint-stock corporate form in what was essentially a super rushed process, there is little evidence that the significance of both going concern concept and limited liability concept was truly well understood, or that the core idea of Governance —"increase profits, report to shareholders the business condition with honesty, and distribute the retained earnings fairly to all shareholders ***under board of director supervision***" — was properly put into practice. Instead, the corporate form mainly served to reinforce the existing family-centered management. Share ownership was not broadly spread, but concentrated in the hands of Zaibatsu holding companies, founding families, and a few major shareholders. By holding effective control and governance, these actors enabled the Zaibatsu to expand their power explosively.

What is particularly noteworthy is that from the early stages of Japan's corporate development, many corporate charters included explicit provisions that curtailed the voting rights of large shareholders—for example, clauses stipulating that voting rights would not be recognized for shares held beyond a certain threshold, or that an upper limit would be imposed on the number of shares for which voting rights could be exercised. Formally, such provisions were justified as mechanisms to prevent excessive dominance by major shareholders and to encourage broader participation. In practice, however, because Zaibatsu groups and founding families exercised decisive influence through personnel appointments and commercial relationships that lay outside formal voting mechanisms, the substance of shareholder voting was hollowed out from the outset.

This erosion operated along two dimensions. (i) from the perspective of major shareholders, even if formal voting rights were capped in order to pass on more power to smaller shareholders, effective control could still be maintained by mobilizing the family influences in nomination of the board, and/or business relationships with group companies . Voting rights, in this sense, became increasingly symbolic rather than determinative. (ii) from the perspective of minority shareholders, much like today's debates surrounding parent–subsidiary listings, the existence of a dominant controlling entity meant that minority votes were effectively weightless anyway.

Personally, I see this as one of the earliest structural reasons why shareholder democracy — built on voting rights of shareholders — never really took root in Japan the way it did in the West. I want to be careful not to draw too direct a line from this history to the complex feelings today's corporate executives have about rising shareholder activism, but I believe the narrative is hard to ignore. Adding to that, early stock trading in Japan was mostly cash-settled (without the delivery of share certificate to secure your votes), much like the long-standing rice markets, effectively separating economic value of stock from corporate control. Due to such circumstantial evidences, it is hard to deny that voting rights were designed to be "light" from the very early days of capitalism evolution in Japan.

As discussed in Chapter 5 of Six Suggestions paper in 2023, this pattern of lightness of voting rights quietly re-emerged in the postwar era through the expansion of cross-shareholdings, even after the Zaibatsu were formally dismantled following World War II. This inner-circle-style capitalism — distinctively Japanese in its reliance on rock solid mutual trust — undoubtedly served as a hidden engine of the postwar high-growth period of the country, particularly when combined with the single-minded, convoy-style industrial policy that prioritized stability over competition. At the same time, the postwar dismantling of the Zaibatsu helped accelerate another powerful trend: the managerial revolution, which, in fact, had been unfolding in the United States since the 1940s and would come to define the modern Japanese corporation – what we see as salaried manager company.

Figure 2: Composition of Executives by Career Background

	1900	1928	1962
Owner-managers	62.5%	22.1%	11.8%
Employed managers (Lifetime employees)	5.5%	22.9%	47.8%
Employed managers (External hires)	31.8%	55.0%	40.4%

(Source: Quoted from *The Origins of the Contemporary Japanese Economic System* by Tetsuji Okazaki and Masahiro Okuno)

As shown in Figure 2, in 1900, during the mid-Meiji period, owner-managers accounted for a clear majority of corporate managers, representing 62.5% of the total. After the postwar dissolution of the Zaibatsu, many owner-managers were purged from public status, and the management cohort as a whole became markedly younger, and salaried. By 1962, however, as postwar corporate groups were steadily reconstituted, the number of hired managers expanded sharply — particularly those bred under the lifetime-employment system.

In other words, within this inner-circle-style of capitalism, individuals who had spent many years inside the company, demonstrated loyalty to its ethos, and absorbed the subtle, unspoken rules of tacit coordination naturally rose into management and leadership positions. Over time, this internal promotion track — still widely regarded today as the standard path to senior executive roles in Japanese companies — became firmly established. By that point, the image of a supervisory board focused on strict accountability to shareholders had already vanished in its entirety.

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The phenomenon of votes lightness and the managerial revolution can, on one hand, be seen as forces that underpinned Japan's rapid economic growth during the Showa era. On the other hand, they can also be seen as underlying factors behind the 160-year period since Meiji-restoration in which Japan pressed forward without fully confronting the essential significance of the corporate system — a concept refined through centuries of global experience. History cannot be changed. We (Japanese citizens) must therefore fully acknowledge this path dependence, embracing both its strengths and distortions, and recognize anew that the following four developments in capital markets and the broader economy are now compelling Japan — after having long postponed its "checking of answers" — to confront how it should engage with global capitalism going forward. Let us start with the recognition of current as per below.

(A) the rapid unwinding of cross-shareholdings;
(B) the rise of shareholder activism;
(C) the creation of an environment that enables unsolicited takeovers; and
(D) inflation.

This reflects a combination of (A) structural factors, (B) phenomenon-driven factors, (C) policy factors driven by the guidelines announced by METI in 2023, and (D) macroeconomic factors. When elements with such completely different underlying causes overlap in a unique complex way, it is, by common sense, a sign that a historically significant wave is forming, and resisting it is difficult.

As a result of these forces, the “shareholder counterrevolution” that took shape in the United States in the 1970s has, for the first time in Japan, begun to unfold over the past few years. It is widely known that, with domestic pension capital already shrinking, foreign capital — mainly from the U.S. and Europe—now hold a large share of the market. Most of the institutional investors behind this capital are, to be honest, unfamiliar with Japan’s complex history and probably have no true incentives to learn them in detail unless they are interested in the cultural aspect of “now”. Yet at the core of their (foreigners) thinking — almost as naturally as breathing — lies a clear understanding of rights and obligations that stretches back to Roman times; governance by law rather than by sentimental assumptions of inherent goodwill, born out of the necessity of forming and sustaining nations composed of diverse ethnic groups; and, building on that, a governance mindset shaped over centuries by the evolution of corporate systems. That is Capitalism.

No matter how different Japan’s history and culture may be from that of these increasingly influential foreign investors, I will assert that it is both dangerous and also disrespectful to overlook the deep lessons of trial and error embedded in global capitalism history, or the enormous contribution this painful paths of enlightenment has made to economic development worldwide. At least, having the awareness of the historical path is essential for future leaders and directors of listed companies – my personal view. Building on that foundation, in the next chapter I will share my perspective on the stance Japanese companies should take as they navigate this new era.

4. Governance and the Invisible Hand of God

As mentioned here earlier, the core foundation of capitalism is governed by the rule of law, which actually syncs with the principles of the governing a nation. Under these rules, corporations have emerged as tools to conduct economic activity efficiently, and the concept of governance has evolved over time. Within this process, both individuals and companies have competed fiercely, and through selection, replacement, and renewal, many of today’s world-class companies were born. At the peak of Japan’s bubble era in 1988, 32 Japanese companies ranked among the world’s top 50 by market capitalization. Today, however, only one, Toyota, remains.

There are many reasons why Japan fell behind in this global market-capitalization race over the past 30 years. One regrettable factor, which I have a strong confidence in my view, is that the strong supervisory governance mindset — anchored in the duty to enhance corporate value for shareholders — was essentially emasculated by long-term cross-shareholdings relationships, even though that sch long-term perspective of “lets grow together” mindset was initially a wonderful mind-alignment-tool for companies to share common ambition as well as to create stability. I sadly recognize this as part of Japan's own dependent path, BUT it is also true that, without constructive criticism, the future will be bleak.

Market capitalization alone should not determine a company's quality. Yet in the world of capitalism, market capitalization is "power". In today's globally flattish and hyper digitalized world, companies with capital firepower can deploy it across borders without restriction. They acquire companies with depressed share prices, and in some cases replace the entire management team to integrate operations. It is a harsh "eat or be eaten" environment. Even historically, the Dutch East India Company lost to the British East India Company, exactly due to differences in the quality of corporate governance.

This issue about power – which can be translated into "scale" - is made even clearer by global M&A trends. In Figure 3 below, I show the size of the global M&A market in 2024, the latest year for which data is available.

Figure 3: Global M&A Market Trends in 2024

	M&A Deal Value ($bn)	Number of M&A Deals	Average Deal Size ($mn)
Global	3,910	43,101	91
United States	1,770	11,412	155
Japan	131	4,700	28

(Source: Data from Recof Corporation and Ropes & Gray LLP, processed by Hibiki Path Advisors SPC)

(Note 1) Total global transaction values vary depending on each research institution's deal-size cutoff definitions.
(Note 2) U.S. and Japan figures represent the combined total of domestic and cross-border transactions, and I assume that Japan–U.S. deals may be double-counted.

As the figure indicates, global M&A transactions in 2024 are estimated to have totaled approximately USD 3.9 tn. Deals involving the United States — including domestic, inbound, and outbound transactions — amounted to roughly USD 1.8 tn, representing about 45% of the global total. This aligns broadly with the U.S. share of global listed-equity market capitalization, which is around 50%[12]. By contrast, Japan, as noted above, recorded USD 131 bn by value—roughly one-thirteenth of the United States — and about 4,700 deals by volume, only around 40% of the U.S. deal count. Given that Japan's GDP is roughly one-tenth that of the U.S., this may appear reasonable in one sense. Yet in another sense, considering that Japan has a similar number of listed companies, around 4,000, the inference is that corporate turnover is relatively low, company scale is smaller, and Japan lags significantly in the M&A lifecycle itself.

As an aside, Nvidia — the cutting-edge GPU manufacturer driving global computing capability — was reportedly involved in close to 100 venture fund and direct equity investments just in 2025 alone, many aimed at strengthening the AI ecosystem. On top of that, on December 24th, near year-end, Nvidia announced the acquisition of the Language Processing Unit (LPU) division of leading ASIC manufacturer, Groq, for USD 20 bn (approximately JPY 3.1 tn)[13]. The scale, speed,

[12] How the U.S. Beats the World - The Globalist
[13] GPU vs. ASIC: Nvidia buys Groq for $20B

and lock-in strategy reportedly surprised the world, leaving a vivid impression of how cutting-edge capitalism is all about.

Among Japan's most prominent examples of a company that lost in fierce global competition, collapsed, and was subsequently revitalized under a new sponsor through M&A is the case of ***Elpida Memory ("Elpida")***, which filed for corporate reorganization proceedings in 2012. Elpida was formed through the consolidation of the DRAM divisions of NEC, Hitachi, and Mitsubishi Electric. It was Japan's only major pure-play DRAM manufacturer, and even at the time of its collapse, it ranked third globally by market share. While DRAM is currently becoming re-evaluated due to AI related memory demand, at the time, DRAM was back then a classic commodity business, and competition became a "scale and investing contest" against Korean players such as Samsung and Hynix, as well as U.S. and Taiwanese competitors. The business model was extremely volatile, where even slight market deterioration could push the company into massive losses.

The direct causes of Elpida's failure included: (i) a sharp decline in DRAM prices from 2011 to 2012, to roughly one-third of their prior level within a year, and (ii) further loss of competitiveness due to the historically strong yen during the same period. Elpida had been temporarily supported under the Industrial Revitalization Act in 2009 by the government (JPY 30 bn in preferred equity plus JPY 10 bn in government-guaranteed loans). However, as market conditions worsened, it could not secure additional support, and with liabilities of JPY 448 bn, it filed for corporate reorganization proceedings on February 27, 2012.

What matters most in relation to this report, however, is what happened afterward. In 2013, Micron Technology ("Micron"), a major U.S. DRAM maker, became the sponsor/buyer and initiated Elpida's revitalization. Over the eight years following the acquisition, Micron reportedly invested JPY 1.82 tn in Elpida's former Japanese operations. A retrospective article in the Nikkei in 2022 noted that R&D spending increased by 50% compared with the Elpida era, and Micron actually promoted former-Elpida employee to become the head of DRAM design and process development division, Micron's core edge. This was a clear demonstration of placing the right people in the right roles.

By enhancing scale and productivity, Micron accelerated its global competitiveness. The acquisition of Elpida became a major milestone supporting Micron's subsequent leap forward. At the foundation of that success was undeniable managerial capability: identifying Elpida's comparative advantage in mobile DRAM, appropriately appointing talent, dynamically modernizing facilities through massive investment, and competing head-on in global markets. Central to that managerial capability was Micron's aggressive governance mindset — honed over years under strong shareholder pressure as a U.S.-listed company — focused on evaluating and taking risks to increase corporate value, with the board of directors fully committed to that objective. Notably, in 2012, when Micron decided on the Elpida acquisition, it was itself struggling due to DRAM market deterioration and recorded a net loss of USD 1 bn. By 2014, however, due to market recovery and Elpida's full contribution, Micron achieved a record net profit of approximately USD 3.1 bn. Micron's market capitalization rose from USD 6.2 bn at the end of 2011 to USD 37.6 bn at the end of 2014 — roughly a sixfold increase. As of the end of 2025, Micron's market capitalization stands at USD 321.3 bn, a further 8.5-fold increase. The dynamism of U.S. companies is truly astonishing.

Some may view this revitalization under foreign capital sentimentally as a "loss of national wealth." I would strongly argue that this is a mistaken interpretation. Under new management, Micron made large-scale investments based on appropriate decision-making, and overall performance expanded significantly as a return on those investments. There is nothing irrational about Micron shareholders enjoying that outcome. On the contrary, compared with the worst-case scenario in which all of Elpida's factories would have been shuttered, the positive effects of reviving the Hiroshima plant — on employment, wages, investment, and infrastructure — represent a major benefit not only for Japan's high-tech industry but also for the broader economy.

As shown in Figure 1 on page 3, Japan has a disproportionately large number of listed companies relative to the size of its economy, and their market capitalizations tend to be small. From the standpoint of efficiency and economic power, Japan already appears to be at least one full lap behind the rest of the world. Perhaps for this reason as well, M&A activity in Japan cannot yet be described as fully developed when compared with global standards. In my view, there is only one way to break out of this situation: to focus relentlessly — much like the board of directors of the East India Company once did — on increasing corporate value, particularly equity value, which lies at its core, and to place a single, clear question at the center of every management decisions: ***does this choice enhance corporate value or not?*** With the release of the M&A Guidelines and an environment in which unsolicited takeovers are likely to increase, it is easy to foresee both domestic consolidation and growing acquisition interest from foreign companies. In that context, inorganic expansion through M&A can become a clear winning strategy — not only for acquirers, but also for companies on the receiving end of those acquisitions.

When we return to the origins of the corporate system, what ultimately matters is maintaining an open mindset toward all possible outcomes – I hope we can all agree on that since doing so is not optional; it is precisely what fulfilling the duty to shareholders requires. I briefly touched on the "principal–agent problem" in Chapter 2. This issue inevitably arises within the modern corporate system, where managers (directors) hold informational advantages over external shareholders, and the relationship with shareholders is not a clearly defined employment or contractual relationship, but is instead governed by trust. Ultimately, resolving this problem requires shareholders to exercise their democratic right to appoint and dismiss directors. There is, in truth, no external method to validate with certainty whether directors — shareholders' agents — are fully focused on maximizing corporate value. Yet in today's world, where capital markets have become more efficient and transparent, the most trusted barometer for such is ultimately the **"stock-price valuation"** whether that be Price-to-earnings, Price-to-Book or else.

Figure 4: Example of Stock-Price Valuation

	Net Income	Market Capitalization	P/E Ratio
Company A	JPY 10bn	JPY 100bn	10x
Company B	JPY 10bn	JPY 300bn	30x

(Source: Created by Hibiki Path Advisors)

Let us look into a very simple case study that would intuitively describe what would happen. For example, as shown in Figure 4, suppose there are two companies in the same industry —Company A and Company B — each earning JPY 10 bn in net income for the fiscal year. Company A has a market capitalization of JPY 100 bn, while Company B has a market capitalization of JPY 300 bn. In other words, Company A trades at a P/E multiple of 10x, whereas Company B trades at 30x, simple! What options does Company A's board have in responding to its shareholders, who would likely be very unhappy due to low valuation from the market (and likely dismal stock price performance)? Assuming that there is (1) no cross-shareholdings or (2) controlling owner-shareholders – (which some of you have), and assuming that voting rights are exercised totally rationally and fairly, we can easily imagine following five outcomes:

1. **Seek reappointment from shareholders by raising valuation through adequate capital policy, and a robust/compelling future strategy.**
2. **Quickly go private through a management buyout or similar measures.**
3. **Change management structure proactively under current leadership and execute a renewed growth strategy.**
4. **Shareholders to dismiss current directors and establish a new management team from scratch.**
5. **Shareholders sell the company to other company who can run it better.**

Whichever scenario ultimately plays out, it is the board of directors that examines the available options and puts them before the shareholders' meeting. The final decision, however, rests with the shareholder base. In particular, if a company seeks to preserve the status quo under Scenario 1, shareholders must be persuaded by a credible and compelling narrative that this option is superior to all alternatives in terms of enhancing corporate value! If that case cannot be made, directors will not be reappointed, and the situation will naturally migrate toward Scenarios 3 through 5. More recently, the introduction of the M&A Guidelines has increased the likelihood of Scenario 5, in which acquisition interest emerges from industry peers toward undervalued companies. Focusing solely on this scenario, the most rational outcome between the two companies discussed above would be for Company B — generally viewed as the better-managed entity — to integrate and acquire Company A. Such a transaction would open the door to a serious and balanced evaluation of potential value creation for both sides.

At first glance, the integration benefits may seem to accrue mainly to Company B's shareholders, much like in the Elpida case. In reality, however, the picture is more balanced. (i) Company A's shareholders would also enjoy, to some extent, a control premium, and (ii) Company A's employees could also benefit meaningfully from the integration, as expanded scale and stronger R&D capabilities generate excess profits. If post-integration earnings and corporate value rise, wages and the value of stock options would likely increase as well.

For Company A's management, such a scenario may initially feel like one to be avoided, given the possibility of dismissal or reassignment after integration. That said, if management holds a meaningful equity stake, it too can benefit through what might be described as an honorable transfer of control — namely, an increase in corporate value and realization of value.

I now truly hope you realize why share price is so important, in conjunction with the management capability to realize such value. Historically, the orthodox form of the joint-stock company, tracing back to the East India Companies, rests on a simple principle: directors are entrusted by shareholders to supervise the execution of management. Running a company in a way that can withstand scrutiny and pressure from shareholders and markets pressure — this is what I would call "the invisible hand of governance." As cross-shareholdings continue to unwind, I expect the relationship between shareholders and directors in Japan to evolve toward a much simpler and more transparent structure, similar to the one described above. I believe it to be the matter of time frame rather than if or if not.

Looking ahead, it may become increasingly common for "Company A" in this example to be a foreign company. In such cases, however, an antithesis emerges: the national economic security issues. In recent years, many different governments have more actively defined strategic boundaries around goods and services that can confer national advantage — AI technologies, biotechnology, and even mineral resources such as rare earth—and have used these boundaries as leverage in external economic and diplomatic negotiations. I believe it is worth elaborating on these points.

Even today, Japan continues to lead the world in many fields—electronic components, semiconductor manufacturing equipment, precision machinery, functional chemicals, gaming, IP and anime, among others. Yet when competition is framed in terms of scale against overseas peers, Japanese companies are, in most cases, smaller, and lacking fire power. I believe this is largely the legacy of cross-shareholdings and the historical lack of sufficiently robust legal and institutional frameworks for M&A, which delayed industry consolidation to create larger and stronger companies. Looking forward rather than backward, both global competition and international economic security considerations suggest that consolidation in these sectors will naturally take on greater strategic importance. Avoiding such changes would indicate that Japanese companies may not become strong enough to compete in an increasingly competitive global landscape.

Candidly speaking, in my view, this wave of consolidation is unavoidable across virtually all industries — both domestic-demand sectors and export-oriented ones — particularly as Japan's population decline and aging accelerate. At the same time, the outcome of the "all-Japan" DRAM strategy involving NEC, Hitachi, and Mitsubishi Electric, - the Elpida case already mentioned, has already made one lesson clear: a superficial simple "1 + 1" alliance without true integration risks repeating past failures. Ultimately, regardless of a company's specific circumstances, the purpose of corporate management must be reduced to a single focal point: act from the perspective of enhancing corporate (shareholder) value, report business performance fairly to investors, and distribute returns fairly – ***under strict board supervision***. The governance capability to align the entire organization — through strong momentum in both supervision and execution — is the most critical element of being a strong company.

Whether management chooses bold reform, rapid DX, a fundamental overhaul of performance evaluation systems, or new strategic challenges, ***keeping corporate value enhancement at the center of everything*** allows business strategy to be sharpened without falling into the trap of micro optimization. The benefits of enhanced corporate value are ultimately shared not only by shareholders, but, through appropriate incentives, by executives and employees, business partners, and, in the end, will accrue to national wealth! This is precisely the trust in the ecosystem of the invisible hand that Adam Smith and Max Weber identified as the Holy Grail of capitalism.

5. Conclusion

Up to this point, I have traced the key concepts of the corporation — limited liability and governance — again through a historical lens. Exploring the origins of capitalism in their historical context has long been my personal interest. And as the roar of a major structural transformation and one that is likely to accelerate in capital markets of Japan has begun to grow louder, I felt compelled to share these reflections with the top executives of the companies I trust and invest in. Even if you are so busy, it is something you can not ignore.

I sincerely hope that the powerful wave now sweeping through capital markets will not be dismissed as a collection of isolated or temporary noise, nor reduced to something that can simply be waited out. I am particularly concerned that a mindset may spread in which change is not something to be actively confronted and overcome, but rather something to cunningly circumvent. In this regard, I view the takeover defense measures that have suddenly come into vogue from

2025 onward — so-called ***contingency-triggered schemes***[14]—as an especially hideous trend, one that risks hollowing out the very ideals of capitalism. While such measures are formally justified by being submitted to shareholders for approval at the time of adoption, their substance — including how "value destructive bidder" is defined — is often left largely to the discretion of the board. This creates a profound risk that they become tools for evading, rather than engaging with, pressure to maximize corporate value.

Precisely because we live in an era saturated with noise and temptation, I would urge all directors — executive and outside directors alike — to pause and engage in frank discussion from a clean slate. ***What does maximizing corporate value truly mean at the deepest level?*** And what should governance look like as the means to achieve it? I would also encourage boards to revisit their companies' histories of business success and failure without bias, to internalize those lessons, and to re-examine fundamentally how the company ought to be run going forward. Through this process, it should become possible to confront—clearly and honestly—the meaning of remaining a listed company, or alternatively, the meaning and cost of continuing to exist as a standalone entity, and then to choose a direction with both confidence and resolve.

As we begin 2026, I, Yuya Shimizu, have chosen to integrate the very business that I have owned and managed for the past ten years into another company. This was a significant decision, reached only after careful and prolonged deliberation. I made this choice by placing the highest priority on a single criterion: ***how to maximize, over the medium to long term, the expansion of the value of my activities — that is, the impact I can deliver to clients, investee companies, and the market as a whole***. In this sense, I am also putting into practice one of the central assertions of this letter. I feel fully committed and excited to have renewed responsibility on my investment and engagement activities.

Lastly, looking back from 2036, ten years later from now, I hope I will be able to say with confidence that 2026 marked a true turning point for Japan — the beginning of a "decade of great leap forward" for our capital markets and corporate society. With that hope in mind, I would like to close by sincerely wishing that this Year of the Fire Horse will be a healthy and a prosperous one for all of you. Thank you.

EOD

[14] In many cases, such policies are typically titled "Policy Regarding Large-Scale Purchases of Our Company's Shares and Other Securities, Taking into Account …."