

U.S. Shareholder Activism: Convergence with Japan

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I. INTRODUCTION

Shareholder activism in the U.S. has evolved over many decades, facilitated by regulatory changes triggered by large economic shocks that prompted public demand for increased corporate accountability. The origins of the latest evolution that has broadly shaped current practices in the U.S. can be traced to the Great Financial Crisis of 2008–2010. It was this event—which led to dramatically increased funding from institutional investors and competition among activists—that prompted the more sophisticated and nuanced tactics that characterize hedge fund activism today.

Over the past 10–15 years, hedge fund campaigns have been defined by an increased focus on shareholder value. This has been marked by a notable shift from aggressive public campaigns designed to pressure boards and management to quiet engagement with target companies. There are different types of activists; this article focuses specifically on hedge funds. It does not address so-called “gadfly” activists, social issue activists, or union

* The links provided were last verified on 23 June 2025.

pension activists, all of which played important roles in the development of shareholder engagement with companies during earlier periods.

This article does not claim to be a comprehensive history of shareholder activism in the U.S., nor does it seek to present a new interpretation of this complex subject. Rather, it attempts to place current trends in Japan, a country which has seen a dramatic increase in shareholder engagement with target companies, in the context of the long history of U.S. shareholder activism. It observes how strategies in the U.S. have evolved over time in a way that has converged with the current state of the market in Japan, making Japanese companies more receptive to the current style of U.S. activist engagement.

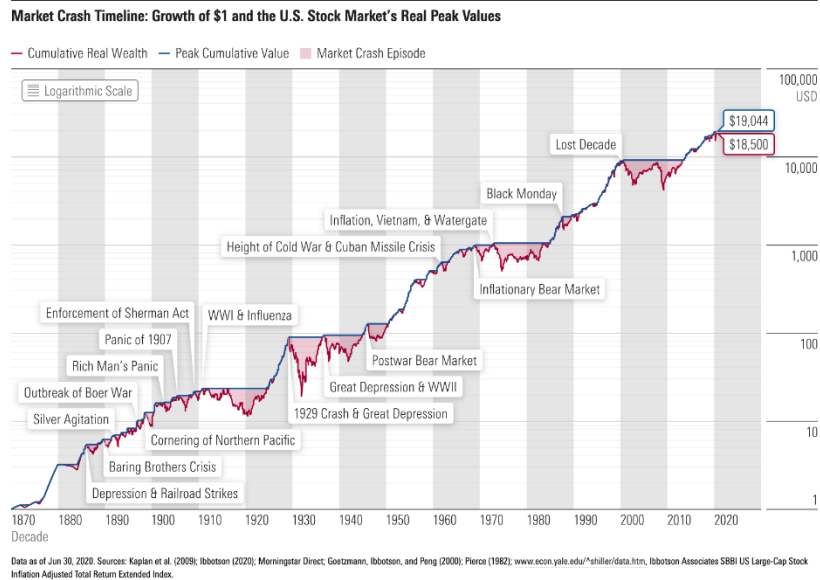
II. HISTORICAL DEVELOPMENT

1. Origins

The history of corporate governance in the U.S. can be viewed within the framework of the balance of power (or the degree of “separation”) between shareholders and corporate management—i.e., between widely dispersed owners and the managers to whom they delegate the responsibility of operating the enterprise. Boards owe duties to such owners to oversee management in this role.¹ Major disruptions to the value of investments in the U.S. stock market over the past 100 years prompted public shareholder and government regulatory responses that facilitated a gradual shift of power from boards and management to shareholders.

The significance of such responses can be illustrated by the value over 150 years of \$1.00 invested in 1870 in the U.S. public markets. Whereas such an investment was worth approximately \$19,000 in 2020, major crises significantly disrupted the overall upward trend during the Great Depression in 1929 (89% decline), during the political and inflationary shocks of the 1970s-1980s (40% decline), during the corporate scandals coinciding with the Dotcom bust in 2000–2002 (43% decline in the S&P 500), and during the Great Financial Crisis in 2008–2010 (50% decline in the S&P 500). Such events have triggered dramatically increased public scrutiny of the effectiveness of boards and management.

¹ This is the standard U.S. framework, which differs from the stakeholder corporate governance model that has been standard in Japan until its relatively recent and gradual move towards a more shareholder-centric model. The duties of boards and management under relevant U.S. law differ, and many activists target boards specifically. However, because of their overlapping roles as targets of corporate underperformance, for purposes of this paper the terms “board” and “management” are used interchangeably as descriptive proxies for the target corporation.



Source: <https://www.morningstar.com/features/what-prior-market-crashes-can-teach-us-in-2020>

This context is important for understanding the rise of shareholder activism in the U.S. Large public swings in the perception of management effectiveness in protecting shareholder interests has been a key driver of the growth and acceptance of activist campaigns over many decades.

2. Early Development

Shareholder activism in the U.S. is not a new phenomenon. In the early 1900s, American financial institutions such as insurance companies, mutual funds, and banks were active participants in U.S. corporate governance. But over the three or four decades following the stock market crash of 1929, laws aiming to limit the power of financial intermediaries led to a decline in their active role in corporate governance.²

The current form of U.S. shareholder activism dates from the SEC's introduction in 1942 of the predecessor of today's proxy rule 14a-8 that first allowed shareholders to submit proposals for inclusion on corporate ballots.³ The fundamental regulatory structure governing such activities was estab-

2 S. L. GILLAN/L. T. STARKS, *The Evolution of Shareholder Activism in the United States* (2007), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=959670.

3 GILLAN/STARKS, *supra* note 2, 3.

lished during this time. SEC Rule 14a-8, also known as the Shareholder Proposal Rule, allows public company shareholders to submit proposals for inclusion in the company's proxy materials for voting at the annual shareholder meeting. Shareholders can propose resolutions on various issues, including environmental, social, and governance (ESG) topics, for a vote at the annual shareholder meeting.⁴

From 1942 through the end of the 1970s, shareholder activism was dominated by individual investors. As of the late 1940s only 7–8% of the equity in U.S. corporations was held by institutional investors (Coffee, 1991).⁵ Individuals were the predominant filers of shareholder proposals, with a significant number of such proposals focused on social issues. Starting in the mid-1980s, shareholder activists began to work in organized numbers, led by public pension funds, and a number of shareholder rights associations worked to “upgrade shareholder awareness” by submitting proposals to companies during the annual shareholder meeting season.⁶

The 1980s represented the return of institutional investors, with a significant rise in their corporate ownership, which started to narrow the separation between institutional shareholders and corporate management.⁷ The delegation of management responsibilities by owners to managers started to weaken as institutional shareholders began to demand increased accountability for performance. This period also saw the rise of corporate raiders—perhaps the ultimate activists—who used the market for corporate control to try to impose discipline on corporate boards and management.

As noted above, institutional investors held only about 7% of U.S. equities in 1950, but their ownership percentage had jumped to 40% by 1980, and over 60% by the end of 2005.⁸ Now, together with hedge funds and private equity funds, they own over 80%.⁹ In addition, the Department of Labor, through its oversight of ERISA rules, began to pressure corporate

4 For a general overview of the legal and regulatory framework relating to shareholder rights, activism, and engagement in respect of U.S. publicly traded companies, see F. J. AQUILA/L. BOEHMKE, United States, in: Aquila (ed.), *The Shareholder Rights and Activism Review* (8th ed., 2023) 179, 180–184.

5 J. C. COFFEE, Jr. *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, *Columbia Law Review* 91 (1991) 1277, 1291, https://scholarship.law.columbia.edu/cgi/viewcontent.cgi?article=1028&context=faculty_scholarship.

6 GILLAN/STARKS, *supra* note 2, 7.

7 “Institutional investors” include endowment funds, commercial banks, mutual funds, hedge funds, pension funds, sovereign wealth funds, and insurance companies.

8 GILLAN/STARKS, *supra* note 2, 8.

9 *Pensions & Investments, 80% of Equity Market Cap Held by Institutions* (25 April 2017), <https://www.pionline.com/article/20170425/INTERACTIVE/170429926/80-of-equity-market-cap-held-by-institutions>.

pension funds to assume a more active role in monitoring the companies in their portfolios. They pushed for the voting of proxies by the pension funds rather than delegating that responsibility to their external managers, arguing that voting was one of their fiduciary duties.¹⁰

3. *Takeover Era*

The takeover era of the 1980s provides a useful contrast to the current style of hedge fund activism. It marked the emergence of a number of legal innovations by companies to protect themselves from increasingly aggressive shareholder demands. Activist tactics during this time were focused on countering such moves, arguing that they entrenched underperforming boards and management.

The activist investment strategy at this time was focused more on short-term results based on taking advantage of increases in a company's stock price under their traditional long-short and arbitrage strategies. During this era activists operated largely alone and on the fringes of the large private equity and raider-driven transactions, relying on capital raised from high net worth individual investors. Regulators and courts in this environment were relatively deferential to boards and management in dealing with aggressive shareholders, evidenced by their tendency to uphold various defenses against shareholder demands,¹¹ while balancing board and management duties to shareholders as a whole. In situations where hedge fund activists took principal positions, they tended to be in smaller target companies, bounded by the amounts they had under management from their high net worth clients.

Through the 1990s and into the 2000s, as institutional investor activity increased in search of higher returns, their interests started aligning with the activist agenda, and they began investing more money with hedge funds to push for improved corporate governance and higher levels of performance of target companies.¹² The emergence of proxy advisors during this period arose from institutional investors' need for advice on the voting of their directly owned shares.

With the increased backing of institutional investors and proxy advisors, proposals for larger structural changes at companies began appearing on the

10 GILLAN/STARKS, *supra* note 2, 10.

11 Examples include shareholder rights plans, classified boards, plurality voting for board elections, by-law advance notice provisions, etc.

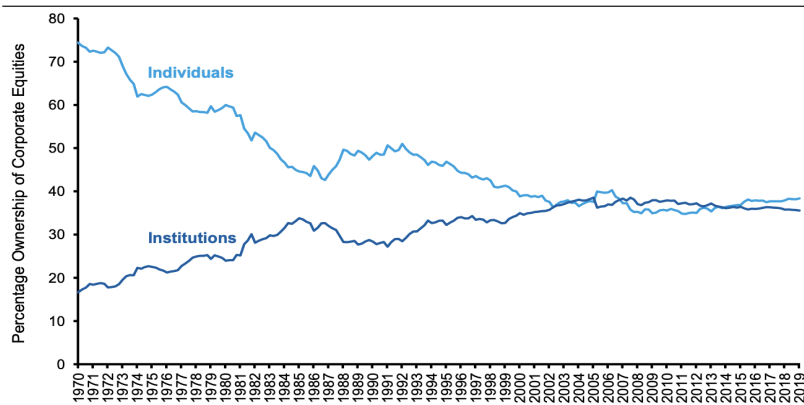
12 GILLAN/STARKS, *supra* note 2, 9; M. TONELLO, Hedge Fund Activism: Findings and Recommendations for Corporations and Investors (The Conference Board Research Working Group Series, 17 September 2008) 11, <https://ssrn.com/abstract=1107027> or <http://dx.doi.org/10.2139/ssrn.1107027>.

activist agenda, and public campaigns gained more attention and influence. The regulatory landscape also started shifting towards shareholder empowerment during this period through a series of new SEC rules, such as permitting short slates of directors on proxy cards and permitting private solicitations of an unlimited numbers of shareholders without making any public disclosures.¹³

In the meantime, companies were relatively passive in dealing with shareholders, exercising caution under the advice of those who warned about the potential pitfalls of boards directly engaging with shareholders.¹⁴ Such caution was driven by regulatory concerns with such matters as selective disclosure and confidentiality.

The slide below shows the dramatic rise in institutional shareholder ownership of U.S. companies over the timeline given above, from 1970 to 2019. Note the top line (percentage of individual shareholders) compared to the bottom line (percentage of institutional shareholders).¹⁵ The initial peak in the rise of institutional shareholders occurred during the 1980s, with a continuing rise occurring since then.

Exhibit 8: Shift in U.S. Equity Investors from Individuals to Institutions, 1970-2019



Source: Federal Reserve.

Note: Institutional investors include insurance companies, private pension funds, mutual and closed-end funds, and ETFs.

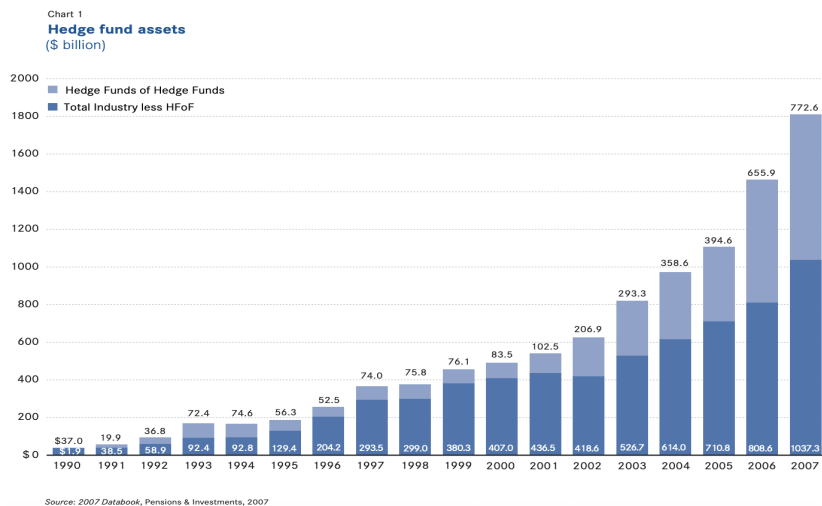
- 13 M. LIPTON, Will a New Paradigm for Corporate Governance Bring Peace?, Harvard Law School Forum on Corporate Governance and Financial Regulation (5 October 2015), <https://corpgov.law.harvard.edu/2015/10/05/will-a-new-paradigm-for-corporate-governance-bring-peace/>.
- 14 L. THOMPSON Jr., The Dos and Don'ts of Board-Shareholder Communication, Compliance Week (March 2013).

III. TURNING POINT

1. Great Financial Crisis

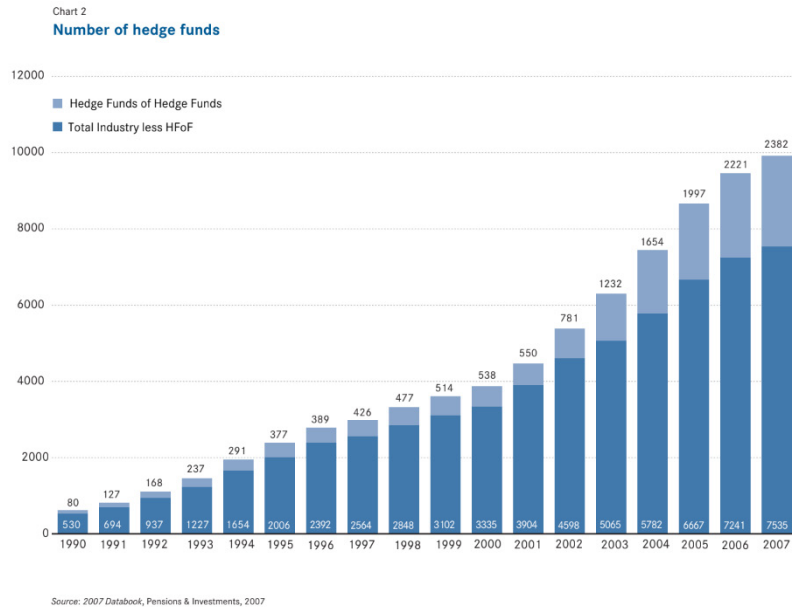
The Great Financial Crisis¹⁶ (GFC) marked a major turning point. Many of the changes in the current evolution of shareholder activist tactics had occurred during the 1990s in the wake of the shifting balance between shareholders and management. But the public reaction to management and board performance during the crisis accelerated the pressure on regulators to act and for corporations to change their approach to governance. This was a result of increased scrutiny by shareholders of managerial performance and public anger at the perceived failures of management accountability.¹⁷ The origins of current activist strategies have their roots in a noticeable shift in regulatory and hedge fund activity in the wake of the 2008–2010 financial crisis.

In the run-up to the GFC, the amount of assets managed by hedge funds, and the number of hedge funds, had exponentially increased. The chart below shows the amounts managed by hedge funds between 1970 and 2007, right up to the moment of the crisis.¹⁸



- 15 This convergence, which is narrower than the figures cited earlier, can be attributed to different methodologies for counting institutional and individual shareholdings.
- 16 For general background information, see <https://www.investopedia.com/terms/g/great-recession.asp>.
- 17 S. F. ARCANO/R. J. GROSSMAN, *Activist Shareholders in the U.S.: A Changing Landscape* (Harvard Law School Forum on Corporate Governance, 17 June 2013), <https://corpgov.law.harvard.edu/2013/06/28/activist-shareholders-in-the-us-a-changing-landscape/>.

The chart below shows the number of hedge funds during the same period.¹⁹ The dramatic increase in their financial reserves, and the competition created among them by their increasing numbers, created important incentives to accumulate larger stakes and diversify their strategies in search of greater returns.



In the decade immediately preceding the crisis, therefore, the hedge fund market had already undergone a dramatic transformation: together with exponential growth, hedge funds had become more institutionalized, had diversified their clientele, and had adopted a wider array of investment strategies.

By 2007, capital flows into hedge funds were no longer provided solely by the wealthy individuals who had funded the industry up to that point. Long-term institutional investors (including private and public pension funds, endowments, and foundations) were focused on diversifying their portfolios and increasing performance. They were now interested in absolute-return strategies and increasingly viewed hedge funds as an integral part of their asset allocation decisions.²⁰

18 TONELLO, *supra* note 12, 11.

19 TONELLO, *supra* note 12, 12.

20 TONELLO, *supra* note 12, 11.

As they grew in numbers, hedge funds explored new approaches to shareholder engagement and correspondingly refined their strategies. After 2003, in the run-up to the crisis, the market was already seeing hundreds of instances of shareholder activism involving hedge funds. During this pre-crisis period, activists became focused on a few courses of action that were very different than those of the 1980s. (The investment strategies typical of the 1980s still exist to varying degrees, but their approach and emphasis have evolved.) For example, they would:

- Push to leverage a company’s balance sheet in order to return cash to shareowners and achieve short-term financial gains.
- Try to assume an operating role, blurring the lines between themselves and private equity (an alternative strategy with longer investment timelines) with the objective of increasing performance and shareholder value.
- Advocate a quick sale of the company in search of a market premium higher than otherwise attainable under existing ownership.
- Request structural changes such as the repeal of defensive measures, including staggered boards and shareholder rights plans, in order to facilitate governance changes that would lead to greater influence over management.
- Seek an outright change in top management in order to achieve the same influence.²¹

By the spring of 2007, New York corporate lawyer Martin Lipton asserted that “attacks by activist hedge funds constitute the number one key issue for directors”.²² When the crisis arrived later that year, the foundation for a significant shift in activist strategies was already in place, and the funds were well positioned for the next stage of their evolution.

The significance of the financial crisis in accelerating the development of shareholder activism into its current form can be summarized by several observations. The leading legal responses represented a combination of legislative, regulatory, and governance reforms that led to a marked shift in the balance of power between boards and management on the one hand, and shareholders on the other. These included the passage of the Sarbanes-Oxley Act in 2002 and the Dodd-Frank Act in 2010 (which mandated increased disclosure and transparency as well as enhanced reporting requirements), and revisions to U.S. Securities and Exchange Commission rules which loosened requirements for submitting shareholder proposals.²³

21 TONELLO, *supra* note 12, 12.

22 TONELLO, *supra* note 12, 12.

23 LIPTON, *supra* note 13, 2–3.

The financial crisis led to increased motivation by traditional institutional shareholders to champion corporate governance reforms, and it led to greater influence of proxy advisory services (e.g., ISS, Glass Lewis), whose voices were relied upon to advise on such measures. This arose from distrust of management and increased unwillingness to accept management responses to shareholder proposals or unsolicited approaches by third parties. Boards and management of companies, recognizing this trust deficit, struggled to regain the confidence of the markets; an increasing number of companies decided to voluntarily dismantle some of their structural defenses as a signal of receptivity to shareholder frustrations (e.g., redemption of shareholder rights plans; declassification of boards; adoption of majority voting for the election of directors).

The focus of institutional shareholders on governance reforms led to their increased willingness to support hedge funds in bringing pressure on boards and management to force changes. This included a willingness to support the election of minority slates of hedge fund nominees to allow funds to agitate for change, particularly influenced by the willingness of proxy advisors to recommend dissident minority slates.

The fallout from the GFC gradually coalesced into a combination of continuing regulatory responses and an evolution towards more nuanced and sophisticated forms of activist engagement that were increasingly focused on quiet partnership with companies to promote changes that enhance value, as opposed to adversarial tactics designed to apply public pressure.

IV. CURRENT STRATEGIES

1. Regulatory Developments

In the years after the GFC, SEC rulemaking continued to shift toward increased empowerment of shareholders. Most notably, the SEC amended the proxy solicitation rules in 2022 to require use of a universal proxy. Under the new regime, company and dissident proxy cards are required to list both the company's candidates and the dissidents' candidates. Before, shareholders could only vote for candidates from one side: either from the dissident slate or from the company slate, but not both.²⁴

In practice, the proxy access mechanism has rarely been used and only as a last resort. Nevertheless, the new universal proxy standards expanded proxy access to all companies and all shareholder groups, free from prior ownership percentage requirements. Effectively, any shareholder has the

²⁴ A. BAKER et al., *The Evolving Battlefronts of Shareholder Activism* (6 March 2023), <https://ssrn.com/abstract=4380801>.

right to launch a campaign subject to a limited number of requirements. The universal proxy card regime is also likely to further increase the role and power of proxy advisory firms for investors who rely on them to evaluate nominees.²⁵

On the other hand, certain revised SEC policies under the Trump administration can be interpreted as swinging the pendulum back towards broader protections of boards and management. Recently issued guidance from the SEC staff regarding the use of passive shareholding reports on Schedule 13G broadens the scope of governance-related topics that will be interpreted as seeking to control or influence a company, which would require filing a Schedule 13D.²⁶ Institutional investors, which are generally reluctant to project the appearance of putting direct public pressure on companies (which such a filing could signal), may become more wary of engagement that could be interpreted as exceeding the new bounds.²⁷

2. *Activist Characteristics*

The closer partnership between institutional investors and activist hedge funds, including increased amounts invested with such funds combined with evolving engagement methodologies in light of increased competition among the funds, has led to the emergence of new characteristics of shareholder activism over the past 10 years.

First, the dramatically increased amount of funding directed to hedge funds started permitting activists to target large and mega-cap companies (defined as those with over \$25 billion market capitalization).²⁸ By 2014 the numbers of such targets had tripled; activist hedge funds became able to influence even the largest companies with less than a 1% stake. 5% used to be the threshold required to exert influence over targets (corresponding to Schedule 13D filing requirements), which made acquisitions of influential stakes in large cap companies prohibitively expensive. However, after the financial crisis the effective use of the media, combined with a smaller stake, has been enough to exert significant influence. As of 2014, almost 60% of

25 BAKER, et al, *supra* note 24.

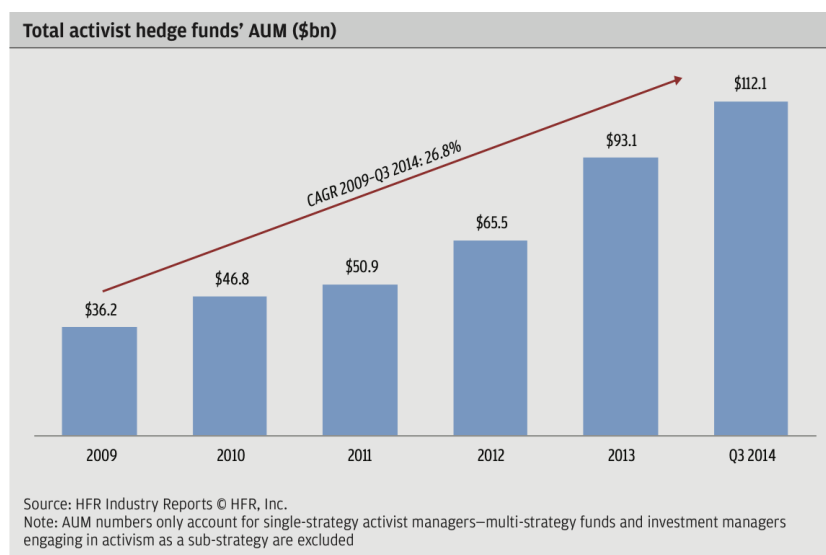
26 Debevoise & Plimpton, SEC Provides New Guidance on Schedule 13G Eligibility (13 February 2025), <https://www.debevoise.com/insights/publications/2025/02/sec-provides-new-guidance-on-schedule-13g>.

27 Skadden, Arps, Slate, Meagher & Flom LLP, Prepare for Changes to the Shareholder Engagement Process (7 March 2025), <https://www.skadden.com/insights/publications/2025/03/prepare-for-changes-to-the-shareholder-engagement-process?sid=db870855-06b6-4616-800b-30e9e26e0482>.

28 JP Morgan, The Activist Revolution (January 2015) at 6, <https://www.jpmorgan.com/content/dam/jpm/cib/complex/content/investment-banking/archive/pdf-59.pdf>.

campaigns targeting \$25 billion-plus market cap companies were initiated by activists having less than a 1% stake at the time of announcement.²⁹

The chart below shows the dramatic increase in the amount of assets under management available to activist hedge funds in the post-GFC period.³⁰



Second, hedge fund activists have demonstrated a willingness to be more patient with their engagement, as indicated by longer holding periods for their stakes. A common perception is that activist holding periods are short, but the data reveals a more complex picture. Although roughly half of activist campaigns 10 years ago ran less than six months, more than 15% of the positions at that time were held for longer than 24 months. And there is every reason to believe that this percentage has grown significantly since then.³¹

The foregoing factors, perhaps combined with the need of hedge funds to distinguish themselves from competitors in an increasingly competitive market, have led to a broader range of strategies ranging from relatively quiet engagement to overtly hostile approaches. There has been a notable shift to more quiet engagement; relatively few campaigns proceed to a proxy fight. Most forms of engagement range from public disclosure of holdings coupled with private conversations (lowest pressure), to threats of proxy fights (increased pressure), publicly disclosed letters and presenta-

²⁹ JP Morgan, *supra* note 29.

³⁰ JP Morgan, *supra* note 29, 1.

³¹ JP Morgan, *supra* note 29, 7.

tions to management (more pressure), and direct letters to shareholders (the highest level before an actual proxy fight or hostile takeover).³²

By far the most significant impact on the success of shareholder activism has been the changing attitudes and behavior of traditional long-only institutional investors, namely public pension funds, institutional investors, and money managers. For the reasons noted earlier, the environment after the GFC made them for the first time more comfortable supporting hedge fund activists, although they are, generally speaking, reluctant to project the appearance of pressuring their investee companies directly.³³

From the target company perspective, attitudes have dramatically changed over the past 10–15 years or so from cautious engagement with shareholders to proactive outreach and engagement. The uniform and widely provided advice of financial and legal advisors now is the importance of having a proactive engagement strategy, with detailed guidelines on how to navigate the legal and regulatory risks and requirements.³⁴

When engaging with target companies, hedge fund activists tend to focus their pressure on several investment themes. During the timeline above, and especially over the past 10 years, activists have gradually rebranded themselves from corporate agitators to defenders of shareholder value. And while the nature of their campaigns has changed, their core themes continue to follow several lines.

Without doubt, the most significant core weakness of a target company that attracts activists is underperformance. This thesis posits that the target has underperformed relative to peers, requiring changes to its strategy, which may be coupled with management change. A company's capital allocation decisions also can be an important thematic focus, particularly if the target company has excess liquidity that the activist will argue is not being productively used and therefore should be returned to shareholders or utilized in alternative ways. Another theme is corporate clarity, which argues that the target is not focused enough and should divest assets or businesses, a streamlining that will increase the overall value of the business. At the structural end of the spectrum, the activist will seek to influence corporate control, by arguing that the target should sell itself, ask for a higher price in a proposed sale, or abandon a pending acquisition. Or an activist will follow a theme centering around governance—e.g., the board is not independ-

32 JP Morgan, *supra* note 29.

33 JP Morgan, *supra* note 29, 8.

34 TONELLO, *supra* note 12, 7; C. BROMILOW et al., Director Dialogue with Shareholders, The Corporate Board (May/June 2014).

ent enough, management is paid too much, and barriers to shareholder voice are too high.³⁵

3. *Engagement Strategies*

As noted above, the post-GFC period has been marked by the emergence of quiet engagement by activist funds, representing a shift away from “transformation-only” adversarial tactics.³⁶ Hedge fund activists have widely varying approaches; some engage quietly first and then go public if they do not make progress. Others go public first to assess the reaction and then engage quietly. The overall trend has been to focus more on quiet, partnership-style forms of engagement, with an evolution of sliding scale and hybrid tactics—e.g., quiet to public, public to quiet, and a mix of the two.³⁷

Their style of investing has evolved into strategies that have expanded in numerous directions. Some hedge funds are part-time activists. Some are dedicated to a particular sector, geography, or market cap. But many of them are now focused on returns generated by long-term improvements in performance.

Activists examine the causes of underperformance. As noted above, they develop their approaches according to different themes. Sometimes they believe the full value of the company cannot be realized unless it goes private. Sometimes they think there needs to be more focus on a company’s core assets; the company may have grown too big with too many non-core businesses that are distracting the company. There may be multiple combinations of core themes that drive the strategy.

A number of activists may have some interaction with the company before they buy substantial amounts of shares. They may start with the company’s investor relations department and methodically work their way up to higher levels of management. And they may have held an investment for some time by the point they are having substantive conversations with the board.

There is a significant amount of preparatory work that goes into an activist campaign, including pre-engagement shareholder consensus-building. Many activists will not launch a campaign unless they believe they have a critical

35 JP Morgan, *supra* note 29, 5.

36 See generally AQUILA/BOEHMKE, *supra* note 4, 185–188, for a summary overview of key trends in shareholder activism in the U.S.

37 For a fuller account of hedge fund activist strategies from which the description below has been drawn, see A. B. STEBBINS/E. R. GONZALEZ-SUSSMAN/T. WHITE, *Is an Activist Targeting Your Company?*, The Informed Board Podcast (18 February 2025), <https://www.skadden.com/insights/podcasts/2025/02/is-an-activist-targeting-your-company>. The recording also can be accessed at <https://player.captivate.fm/episode/246ca91c-9a90-4846-b83b-cd6861a327e1>.

mass of like-minded shareholders that will support them. They may use proxy advisors as a communication channel to reach out to other key constituencies in order to build such support in advance of launching a campaign.

By the time an activist approaches a company, the other shareholders, and the proxy advisors, they will have been engaged with a company for some time, sometimes years. They will have done a significant amount of research and have become convinced that a company is undervalued by the public markets. They look at the risk profile of what they think needs to change. They investigate how long it will take to implement change in light of macro factors in the industry.

In researching a company's underperformance, an activist will now focus more deeply on the qualitative aspects of its governance, which accounts for the reason why partnership instead of adversarial confrontation is deemed more suited to improving shareholder value. Activists no longer define a board as poorly governed just because it is classified or has implemented a rights plan or did not adopt majority voting, issues which had been the focus in the pre-GFC period. Extensive research informs the activist about a company's situation in detail, which provides important insights that help to formulate opinions about a company's effectiveness and its culture that will be used in the engagement process.

V. JAPAN'S CONVERGENCE

The foregoing evolution of hedge fund strategies in the U.S. provides important context for the current rise of shareholder activism in Japan. This section will compare how Japan's slow movement towards market reform has converged with the evolution of shareholder activism in the U.S. in a manner that has facilitated the importation of U.S. techniques into the country.

1. *Pre-Financial Crisis*

While during the 1990s and into the 2000s the U.S. was experiencing the beginnings of an alignment between institutional investors and hedge fund activists—this together with regulatory changes that began to narrow the separation between shareholders and management³⁸—Japan was mired in its post-bubble decline. During this time Japan focused on revitalizing the economy through reactive measures such as technical amendments to corporate and commercial laws to facilitate corporate restructurings.³⁹ Market pressures

38 See the text accompanying footnotes 6–9, *supra*.

39 See M. D. WEST, *The Puzzling Divergence of Corporate Law: Evidence and Explanations from Japan and the United States*, *University of Pennsylvania Law Review* 150 (2001) 527.

started loosening the cross-shareholdings that had acted as a shield protecting corporate boards and management from external market pressures, but such developments did not fundamentally change the dynamics of the shareholder-management relationship which was still distinctly separated and largely deferential to management. The market did not provide opportunities for the type of transformative transactions that the U.S.-style hedge fund activists were engaged in at the time⁴⁰—the structural barriers were still too high.

2. *Great Financial Crisis*

While U.S. institutional investor inflows into hedge funds dramatically increased during the period straddling the GFC in the mid- to late 2000s, the period following the financial crisis created increased pressure in Japan for change in the shareholder-management power balance. Nevertheless, a number of factors continued to impede the development of a market that would make management receptive to robust shareholder engagement. Stable shareholder groupings characterized by cross-shareholdings, although slowly unwinding, continued to predominate, together with a general reluctance of stakeholders to challenge management policy. Few institutional investors were willing to support activist agendas. With very few successful cases of activist campaigns, the Japanese market lacked the robust ecosystem of the U.S. As a structural matter, shareholder rights continued to be relatively weak compared to the U.S., with proxy fights and hostile takeovers rare and discouraged by regulation and practice. On the policy level, Japan's post-GFC recovery efforts focused more on macro-economic stimulus and monetary easing. This was in contrast to promoting corporate restructurings or governance reforms to actively address the sort of critical appraisals of corporate performance that opened the door in the U.S. for activists to push for improved efficiency and shareholder returns.

3. *Abenomics*

However, the gradual unwinding of cross-shareholdings, the significant undervaluation of Japanese equities, and a number of high profile corporate scandals attracted the attention of foreign investors, which over time accumulated a significant portion of the public market, jumping to over 30% by 2014.⁴¹ This increase in foreign investors pushing for higher returns was

40 See the text accompanying footnote 20, *supra*.

41 M. FUJIKAWA, Foreign Ownership of Japan Shares Hits All-Time High, *The Wall Street Journal* (19 June 2014), <https://www.wsj.com/articles/foreign-ownership-of-japan-shares-hits-all-time-high-1403173422>; see also J. R. FRANKS/C. MAYER/H. MIYAJIMA, *The Ownership of Japanese Corporations in the 20th Century*

significant in light of the importance of activists' ability to enlist the support of fellow shareholders for their campaign agendas. The turning point for Japan came during Prime Minister Shinzo Abe's second term, between 2012 to 2020. Government attention on the economy during this period, as embodied by Abenomics and its focus in particular on shareholder returns ("return on investment" or "ROI" continues to be a buzzword for the new capital allocation mindset), together with Abe's personal encouragement of foreign hedge fund investments in Japan, was the first real opening for U.S. activist funds to seriously engage with the emerging opportunities in the country. The adoption of the Corporate Governance Code (2015) and Stewardship Code (2014) represented an alignment of Japanese government policy with the fundamentals of the shareholder rights movement in the U.S. The result was a marked shift in the balance of power towards shareholders through increased transparency, oversight, and influence, with an emphasis on shareholder empowerment and value. Notable corporate scandals (e.g., Olympus 2011, Toshiba 2015) also attracted the attention of foreign hedge funds, which led to the first high-profile emergence of activists during this period. On a broader level, hedge funds started to increase their investments, albeit at relatively low volumes and amounts. Notwithstanding the new focus on governance reform, the level of corporate and shareholder receptivity to the tactics commonly associated with activists at the time, which still involved public pressure and agitation, also remained relatively low.

4. *U.S. Convergence*

The timeline above illustrates how the gradual change in the balance of power between ownership and control in Japan coincided with the shifts in U.S. hedge fund strategies previously outlined.

The run-up to the GFC and the transformation of U.S. activist strategies created by the increased financial power of hedge funds, combined with institutional investor and proxy advisor support, came at the time when Japan was in the early stages of moving towards a more market-driven (as opposed to a state-guided) economy. And as U.S. hedge fund activists were shifting their tactics—moving from public campaigns, high pressure, and proposals for structural change towards a focus on larger targets, smaller percentage stakes, and longer holding periods, with a broader range of engagement styles with companies—Japan was making its first serious efforts to narrow the separation between shareholders and management by shifting the corporate balance of power more in favor of shareholders.

(17 February 2014). European Corporate Governance Institute (ECGI) – Finance Working Paper No. 410/2014, <https://ssrn.com/abstract=2397142> or <http://dx.doi.org/10.2139/ssrn.2397142>.

During the Abenomics period (2012–2020), the U.S. hedge fund focus on undervaluation, underperformance, shareholder value creation and—especially—quiet engagement started aligning with not only the preferred style of shareholder engagement by Japanese companies, but also their strategic priorities, i.e., an increased focus on improving ROI. The true story behind this convergence is not just one of policy decisions in Japan that opened the door to foreign activism; it is, rather, a story of timing. The opportunities in Japan arising from corporate governance reform and increased emphasis on shareholder returns came at a time when more hedge funds themselves were finding success with the type of engagement that Japanese companies could accept and work with. When observing the U.S. activist experience in Japan, it is striking how often U.S. activists uniformly cite the quiet engagement approach as the one they recognize as most effective and the one they prefer to use. And there are increasing numbers of hedge funds now building significant experience in how to use such tactics effectively in the Japanese context.

VI. CONCLUSION

In many respects, the current boom in shareholder activism in Japan comes as a surprise to many observers who had long been accustomed to slow, incremental change—even in the face of intense external pressures for reform during the “lost decades” of the post-bubble era. The market conditions that eventually resulted in the policy changes that began to attract foreign investors in significant numbers created the opening for U.S.-style activists. However, the current market would not have emerged but for the parallel evolution of U.S. hedge fund tactics over a number of years, which saw a shift to a more nuanced and sophisticated approach towards target companies based on partnership and dialogue, in contrast to oppositional relationships and public campaigns. This evolution was driven by a number of developments in the U.S. market that aligned institutional investors with activists, leading to dramatically increased amounts of capital available for campaigns, coupled with a correspondingly sharp increase in the numbers of funds focused on increasing shareholder value. The resulting competition among funds led them to develop alternative forms of engagement with target companies that made them more effective in Japan.

The dramatic increase in activism in the Japanese market over the past several years is arguably attributable to this convergence of multiple changes both in the U.S. and Japan, which broadly culminated in an alignment of long historical preparation on the U.S. side and opportunity created by necessity on the Japanese side.

SUMMARY

To many observers long accustomed to slow, incremental change, the current boom in shareholder activism in Japan comes as a surprise. The opening for U.S.-style activists was created by market conditions that eventually resulted in policy changes that attracted significant numbers of foreign investors. However, even the current market would not have emerged without a parallel evolution in U.S. hedge-fund tactics, which gradually shifted over a number of years to a sophisticated and more nuanced approach, one based on partnership and dialogue with target companies, in contrast to adversarial relationships and public campaigns. This article attempts to place current trends in Japan, which has seen a dramatic increase in shareholder engagement with target companies, in the context of the long history of U.S. shareholder activism. It describes how strategies in the U.S. have evolved over time to converge with the current state of the market in Japan, making Japanese companies more receptive to the current style of U.S. activist engagement. The dramatic increase in activism in the Japanese market over the past several years is arguably attributable to this convergence of multiple changes on either side that has culminated in an alignment between long historical preparation in the U.S. and opportunity, created by necessity, in Japan.