



Insights | October 2026

Kei Okamura
Portfolio Manager

Cruising Altitude: Growth-Focused Governance Reform May Propel Japanese Equities to New Heights

While Japanese equities have been in ascent, we believe ongoing governance reform could add even more lift.

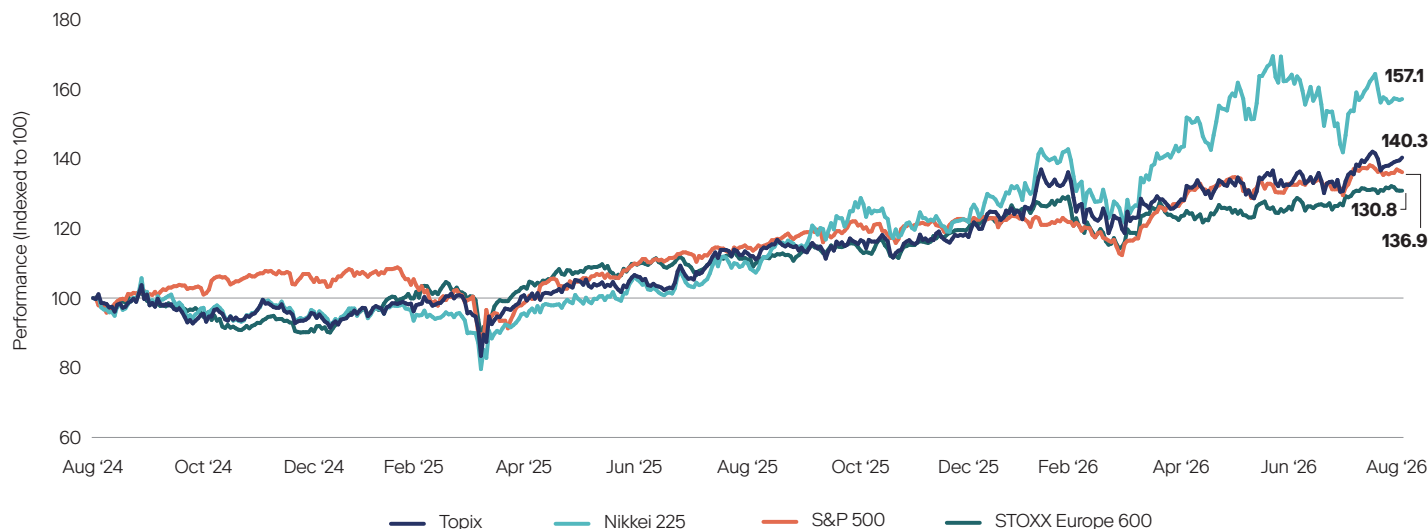
Japan's equity market appears to be entering the next phase of a two-decade structural transformation: Like a jumbo jet heading toward cruising altitude, we believe that ongoing growth-oriented governance and capital-management reforms may encourage Japanese companies to further improve return on investment and accelerate earnings growth.

This article explores why we believe further governance reforms may support long-term value creation and present potentially attractive opportunities for active equity managers.

Charting Japan's Ascent

Japanese equities have been on an impressive run: Over the last 24 months, both the Topix Index and the narrower Nikkei 225 Index have outperformed their global peers (see Figure 1). While expectations of accelerated earnings growth from AI-related capex investment have stoked Japan's momentum, we believe a more fundamental transformation—rooted in corporate governance and capital management reforms set in motion nearly two decades ago—is now well underway.

Figure 1: Japanese Equities Have Outperformed Global Peers Over the Last Two Years



Source: Bloomberg (USD, total return), data as of August 31, 2026. **Historical trends do not imply, forecast or guarantee future results.** Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed or any historical results.

We believe these growth-oriented reforms may drive a longer-term rerating of this overlooked, under-researched and undervalued equity market, similar to a jumbo jet reaching cruising altitude.

The taxiing phase of Japan's ascent began during the early years of the late Japanese Prime Minister Shinzo Abe's "Abenomics" policy. As part of its "third arrow" of reforms, the aim was to increase the effectiveness of corporate boardrooms and lay the foundations for further progress.

The takeoff phase began in early 2023 with the Tokyo Stock Exchange's (TSE) Price-to-Book Guideline (PBR),¹ which sought to address why many Japanese companies tended to trade at perennial discounts, often less than one times their book value.

One problem, the TSE found, was that too many companies did not fully consider their cost of capital when allocating resources. The PBR guideline advised that companies in the TSE Prime and Standards markets² should conduct a thorough review of their capital allocation plans and publicly disclose their findings on an annual basis. (The idea: Better disclosure would invite pressure from investors and ultimately improve corporate performance.)

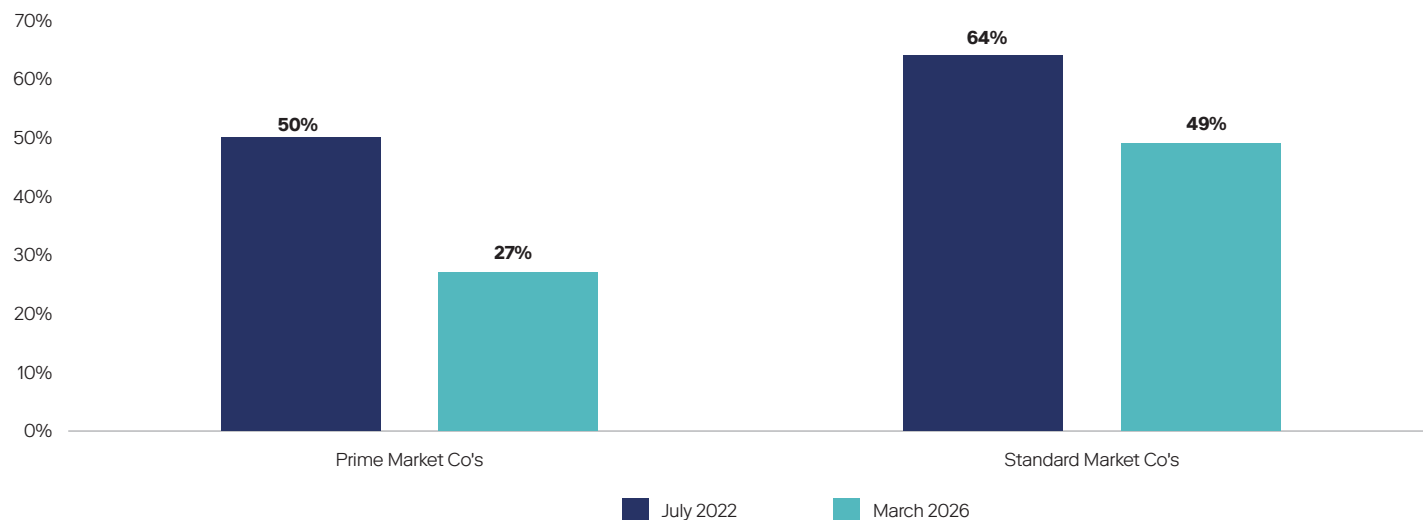
We believe this initiative catalyzed an increase in shareholder returns via more share buybacks and dividends, ultimately fueling a market rally starting in the second half of 2023 and significantly reducing the number of companies now trading below one-times book value (see Figure 2).

¹ In reference to the Tokyo Stock Exchange's "Action on Cost of Capital-Conscious Management and Other Requests". April 14, 2023.

² In April 2022, the TSE introduced three distinct market segments: Prime, Standard and Growth. The Prime market (1,550 companies) includes large, established companies with sufficient liquidity to attract a broad institutional and global investors base. The Standard market (1,557 companies) includes small- and mid-sized domestic companies with sufficient liquidity and governance levels to sustain smooth trading in their shares. Finally, the Growth market (598 companies) includes younger companies with lower profitability and liquidity but potentially higher growth potential. Data as of August 31, 2026.

Figure 2: Recent Reforms Have Helped Reduce the Number of Japanese Companies Trading at Discounts

The Ratio of Companies Trading for Less Than 1X Book Value



Source: Tokyo Stock Exchange, data as of July 1, 2026. **Historical trends do not imply, forecast or guarantee future results.** Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed or any historical results.

Now we believe Japan's equity market is entering the "cruising altitude" phase of its transformation as companies look to increase shareholder value over the long-term.

In this phase, we believe Japanese companies will seek to further improve return on equity (ROE) while accelerating earnings growth as the economy emerges from its "Lost Decades" of deflation. Over the last half-decade, Japan has faced cost-push price pressure from COVID-19 supply chain shocks and a weak, import-price inflating yen. Now demand-pull factors are kicking in as businesses of all sizes are hiking pay to secure workers, driving structurally higher inflation (see Figure 3) and raising concerns about future earnings growth.

Figure 3: Rising Structural Inflation Is Putting Pressure on Japanese Companies to Spur Earnings Growth

Year-over-year



Source: Japan Ministry of Internal Affairs and Communications and Bank of Japan; Bloomberg, data as of July 31, 2026. **Historical trends do not imply, forecast or guarantee future results.** Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed or any historical results.

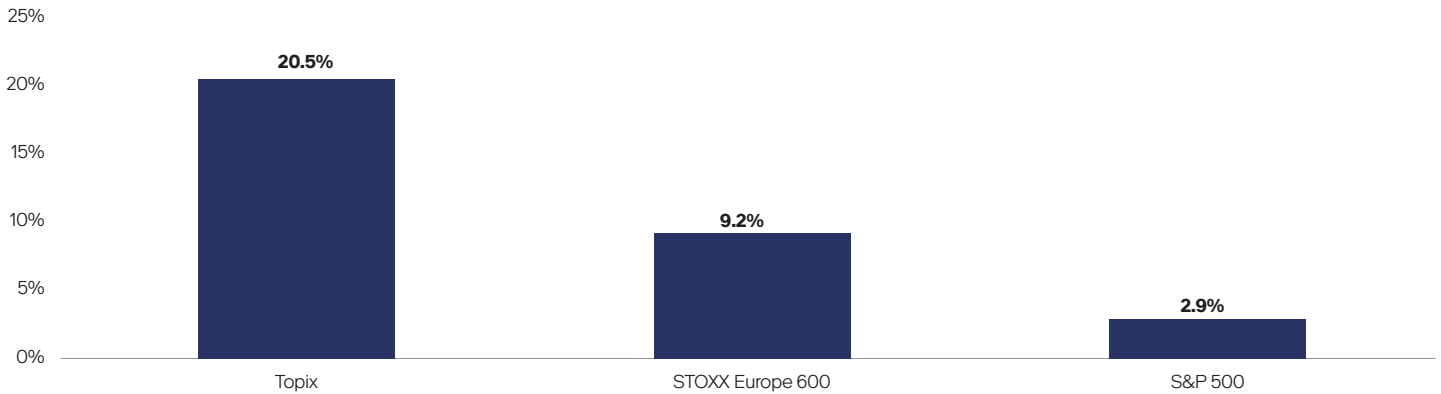
As a result, we find that many companies are reviewing their growth strategies and in some cases are overhauling their mid-term business plans to focus on accelerating both organic growth and investment activity, including M&A.

Japan Goes All In on Growth

Early in 2026, recently elected Prime Minister Sanae Takaichi and her administration announced a public-private investment initiative that would aim to deploy 370 trillion yen (\$2.3 trillion)³ across 17 strategic sectors deemed critical from a growth and national security standpoint, including AI, semiconductor production and shipbuilding.⁴ The government sees private sector participation as critical to the success of this grand scheme and has eyed Japanese companies' large cash hoard, the highest among developed markets, as a key funding source (see Figure 4).

Figure 4: Japanese Companies Tend to Hoard More Cash Than Global Competitors

Cash-to-Market Capitalization Ratio

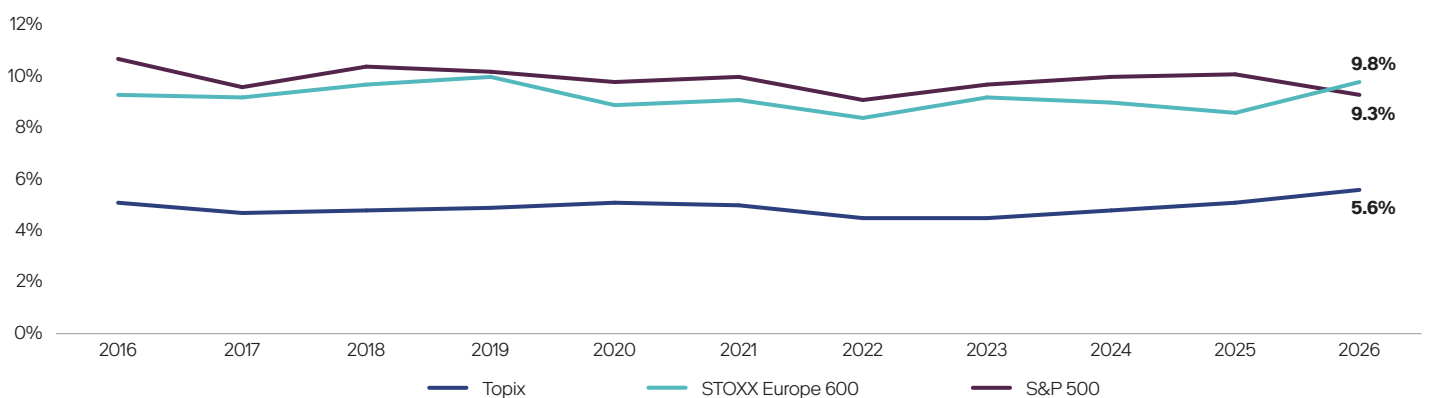


Source: Bloomberg. Data as of August 29, 2026. Historical trends do not imply, forecast or guarantee future results. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed or any historical results.

To date, Prime Minister Takaichi has repeatedly raised concerns about Japan's low level of “growth investment”, including R&D and capex (see Figure 5), and has often cited underinvestment as a key reason for the nation's diminishing technological superiority in key industries.

Figure 5: Japanese Companies Tend to Underinvest in Capex Relative to Global Peers

Capex Investment as % of Revenue



Source: Bloomberg. Data as of August 31, 2026.

To encourage companies to better utilize their capital, Japan's government has implemented sweeping updates to various corporate governance and capital management regulations.

³ As of August 31, 2026.

⁴ “Takaichi's first major economic policy approved”, NHK News, July 22, 2026.

Governance Reform: The Key to Unlocking Overcapitalized Balance Sheets

Perhaps one of the most significant changes was the revision to Japan's Corporate Governance Code that came in the summer of 2026. Formulated by the TSE and the Financial Services Agency (FSA) in 2015, the Code is a set of fundamental principles for effective corporate governance that Japanese listed companies should abide by on a comply-or-explain basis.

While the Code has undergone several revisions over the last decade, this was arguably the biggest revamp, in which the TSE and FSA streamlined the number of Principles from 83 items to 30. Several shareholder-protection provisions, including those addressing anti-takeover measures, were reclassified from binding Principles to non-binding Interpretive Guidance, with no comply-or-explain requirement.⁵ While this move raised concerns among institutional investors that Japan was rolling back its corporate governance reforms,⁶ Japanese regulators contend—and we concur—that the remaining binding reforms will now carry even more weight, thereby supporting the overall transition from box-ticking compliance to high-quality governance.

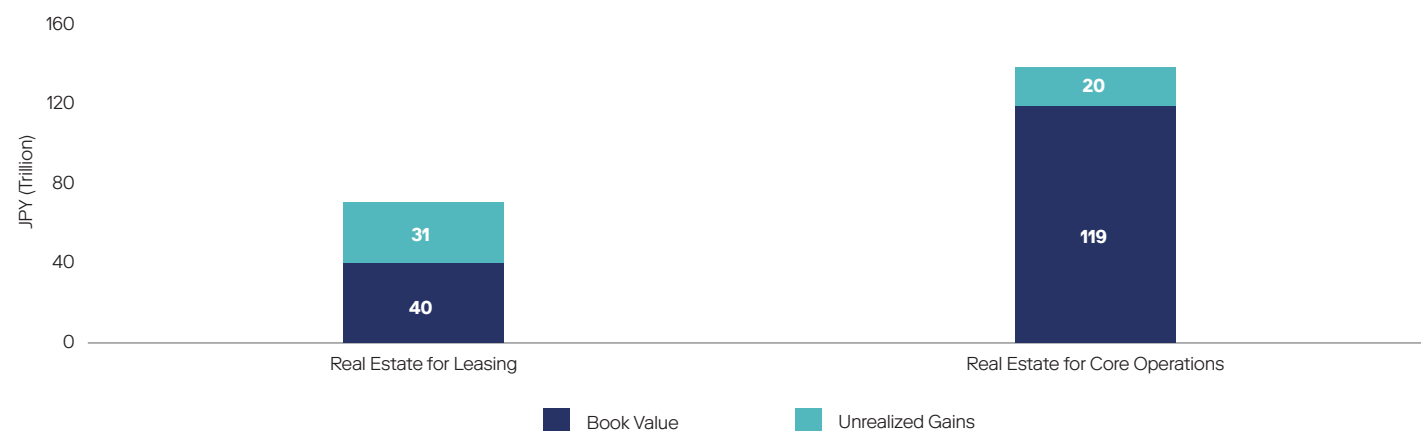
In just one important update, still-binding Principles 4.1 and 4.2 (Roles and Responsibilities of the Board I & II) now strongly encourage boards to evaluate business strategies on their potential to increase earnings and allocate capital efficiently; these updates are necessary, in our view, given Japanese firms' patchy track records in generating returns on their capital investments. According to the Ministry of Trade's own estimates, roughly 65% of Japanese companies fail to clear their working average cost of capital, resulting in negative economic profit.⁷ The Ministry believes the negative spread between return and cost of capital is a drag on corporate value and recommends that companies seek to close it by restructuring their operations around core growth segments.

While there remain no legal penalties for non-compliance, we believe the updated Corporate Governance Code will indeed hold Japanese boards more accountable for seeking higher returns on investment capital. For example, the latest Code revision calls for a more strategic use of “real assets”, which in our view may include potentially valuable real estate used for “core” business purposes, such as corporate headquarters or manufacturing facilities. Companies that need capital have the option of managing these properties off their balance sheets by selling them to a REIT or other third-party vehicle. We believe selling those assets and leasing them back could generate growth capital while streamlining balance sheets—the very sort of efficient capital management encouraged by the Code.

As shown in Figure 6, Japanese companies hold an estimated 71 trillion yen (\$451 billion)⁸ in real estate leased for capital gains purposes; meanwhile, commercial properties for core business operations (which have far limited disclosure in public securities filings) could be nearly double that amount, at 139 trillion yen (\$890 billion),⁹ roughly equivalent to 10% of Japan's entire market capitalization.¹⁰ We believe realizing hidden gains within corporate real estate properties could help Japanese firms free up a significant pool of capital for reinvestment in longer-term growth initiatives.

Figure 6: Realizing Hidden Value Within Core Real Estate Holdings Could Free Up Growth Capital and Streamline Corporate Balance Sheets

Value of Japanese Companies' Real Estate Holdings



Source: Nikkei Newspaper. Data as of July 21, 2026.

⁵ Japan's Corporate Governance Code: Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-Term, Tokyo Stock Exchange. July 21, 2026.

⁶ “Comments on Proposed Revisions to Japan's Corporate Governance Code”, Asian Corporate Governance Association (ACGA), May 15, 2026.

⁷ “Guidance for Growth Investment”, Ministry of Economy, Trade and Industry (METI), July 21, 2026.

⁸ As of September 3, 2026.

⁹ “Headquarters and Logistics Facilities of Listed Companies Hold 20 Trillion Yen in Unrealized Gains”, Nikkei Newspaper, May 7, 2026 (USD/JPY rate as of September 3, 2026).

¹⁰ Tokyo Stock Exchange Market Capitalization Data, JPY. As of July 31, 2026.

Another key development is the TSE's pending rebalance of the benchmark Topix Index in October 2026. To increase the equity market's overall attractiveness to international investors, the TSE has been taking steps to implement stricter liquidity requirements for listed companies.

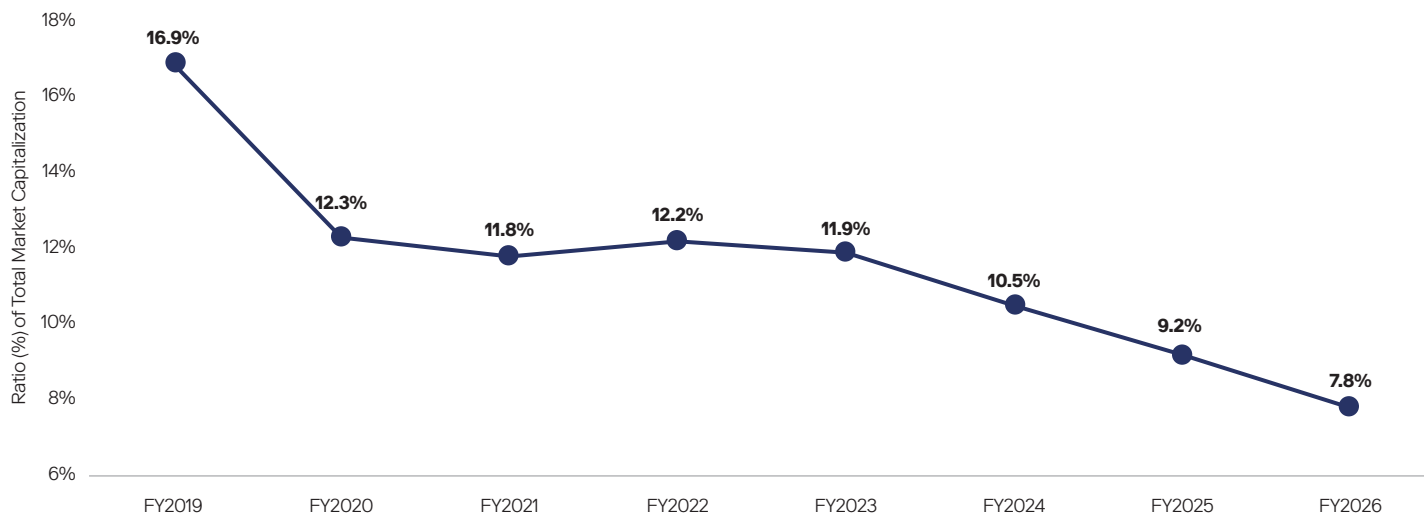
In the first stage of revisions, from April 2022 to January 2025, the TSE took aim at TSE Prime Market-listed companies with a tradable market capitalization of under 10 billion yen (\$6 million).¹¹ Weightings of those smaller issuers were reduced in stages, decreasing the number of index constituents from approximately 2,200 to 1,700.

In the next stage of the rebalancing, starting October 2026, the TSE will aim to broaden the Topix's coverage area by offering potential inclusion to companies across Japan's Prime, Standard and Growth markets; at the same time, the TSE plans to impose additional minimum-liquidity requirements that may further shave the total number of Topix constituents to less than 1,000¹² by October 2028.¹³ Regular reconstitutions are set to happen once a year moving forward.

We believe index rebalancing will continue to drive capital efficiency enhancements and corporate governance improvements as Japanese companies look to unwind cross-shareholdings to meet the TSE's free-float requirement and remain a Topix constituent. [We have long advocated](#) that these capital alliances have hindered much-needed corporate reforms (due to passive proxy voting in favor of incumbent management) and have led to a substantial amount of effectively trapped capital. In fact, capital alliances still equate to nearly 8% of the Topix Index's total market capitalization (see Figure 7), and while that figure has fallen in recent years, we believe unwinding those positions could provide significant capital for reinvestment.

Figure 7: Further Unwinding of Cross-shareholdings—Still Nearly 8% of the Total Topix Market Capitalization—Could Unlock Additional Capital for Growth Reinvestment

Cross-shareholdings Among Japanese Companies, 2019 – 2026 (Fiscal)



Source: SMBC Nikko Securities, data as of March 31, 2026.

Updating the Corporate Governance Code and rebalancing the Topix Index are just two ways the Japanese government is pushing to promote growth and attract investment. Other examples include the Ministry of Trade's update on the "Fair M&A Guidelines",¹⁴ as well as the Ministry of Justice's ongoing revision of the Companies Act, which we believe would unlock even more shareholder value.

¹¹ As of September 2, 2026.

¹² SMBC Nikko Securities data. As of August 31, 2026.

¹³ "Overview of Revisions of TOPIX and Other Indices", JPX Market Innovation & Research, Inc., May 13, 2026.

¹⁴ "Guidelines for Corporate Takeovers: Enhancing Corporate Value and Securing Shareholders' Interests", Japan Ministry of Economy, Trade and Industry. As of August 31, 2023.

Board Quality: The Litmus Test for Sustainable Growth

As more Japanese companies strive to boost return on invested capital and achieve sustainable growth, we believe board independence and skillset diversity will play increasingly important roles as well. Despite good progress on the independence front, the percentage of Japanese companies that carry a majority of independent board members remains at a relatively low 18.5%.¹⁵

Furthermore, we observe that while many Japanese boards are filled with internal directors skilled in specific operational areas like manufacturing or sales, they tend to lack directors who have experience in traditional finance and management. One recent survey of leading Japanese companies found significant disparities in management and finance experience among board members at Japanese companies versus those in the U.S. and U.K. (see Figure 8). In our view, this relative dearth of experience may continue to hamper returns on invested capital and the market's overall ability to generate shareholder value.

Figure 8: Japanese Boards Have Relatively Fewer Members with Finance and Management Experience

% of Board Members with Traditional Finance and Management Experience



Source: Japan Research Institute, Nikkei Newspaper. Data as of July 21, 2026.

On the other hand, more businesses, lobbyists and lawmakers contend that past reforms have disproportionately favored minority shareholders, leading to chronic underinvestment in long-term growth. This chorus argues instead that regulators should seek to strike a better balance between shareholder rights protection and management discretion.

To that end, Japan's ruling Liberal Democratic Party has called for changes to Japan's Companies Act and Financial Instruments and Exchange Act, including revisions aimed at the shareholder proposal process, replacing the long-standing "300 voting units or more" requirement¹⁶ with a straight 1% ownership stake.¹⁷ Example: Under the current legal framework, a shareholder of a \$100 billion market cap company trading at \$10 per share would need to hold \$300,000 of stock for more than six months to bring a proposal; under the new requirement, that same shareholder would need to hold 1% of total voting rights, which may equate to \$1 billion.

Supporters of this and other proposed revisions believe the new rules would boost overall capital efficiency and ultimately put Japan on more of an "equal footing" relative to regulations in developed markets in the U.S. and Europe. Furthermore, they argue that curbing demand for short-term capital returns would help channel capital into longer-term growth investments. We expect amendments to the Companies Act, now in deliberation within the Ministry of Justice, to be submitted during the ordinary Diet session in 2027.

¹⁵ "Appointment of Independent Directors/Establishment of Nomination and Remuneration Committees by TSE-Listed Companies", Tokyo Stock Exchange. As of July 21, 2026.

¹⁶ In Japan, the minimum trading unit is 100 shares. As such, the minimum trading unit rule of "300 units" equates to 30,000 shares. The investor would also need to hold the shares for more than six months.

¹⁷ "Growth-Oriented Corporate Governance Proposal" (provisional translation), Liberal Democratic Party of Japan's Judicial System Research Council and Growth-Oriented Corporate Governance Project Team, July 29, 2026.

Japanese Equities: Case Studies in Active Management

We believe the Japanese equity market continues to create potentially attractive opportunities for active managers able to distinguish companies that are prioritizing strategic growth and strong governance from those that may still be struggling to navigate the transition. Here are just two recent examples.

Company A: Discount Drugstore Company Makes a Dubious Pivot

“Company A”, a discount drugstore with significant market share in one region, had delivered above-industry-average profitability for decades thanks to strong pricing power and rigorous cost controls. Many investors believed that strengthening its pharmacy business, which shared synergies with the core drugstore operation, would generate solid growth over the medium term.

However, in early 2026, the company made a surprise announcement to expand into the unrelated field of hotel development. Management said it would deploy several billion yen to this new pillar of growth yet didn't provide any return projections or implementation timeline.

We worried that potentially large capital outlays and depreciation expenses could threaten the company's return on equity and hurt its valuation. The sudden change in strategic direction also raised questions about how the company's board of directors had vetted such a deal. Of the six board members, just two were company outsiders and both had legal and accounting experience but no management or corporate finance background.¹⁸ Since making the announcement, the firm's shares have fallen by 9%, underperforming the Topix Index by 24%.¹⁹

Company B: Electronics Products & Equipment Conglomerate Plans Strategic Expansion

Over the last decade, Company B gradually shifted its focus from consumer to industrial electronics while generating strong growth by manufacturing batteries for electric vehicles (EV). Yet in recent years revenue began to wane as global EV demand slowed.

Management responded by making the bold-yet-strategic decision to apply its battery-production expertise to the niche-but-growing field of energy management for AI data centers. In 2025, the firm announced it would commit several hundred billion yen to develop data center components over the next three years. Company B claims it has secured customer commitments for all back-up battery units it produces through 2029 and, according to one projection, its strategic investment could return more than 30% within that period.²⁰

Unlike Company A, we concluded Company B had a potentially more effective board with a broader range of skills in critical areas that supported management's decision making. Of its 13 members, seven came from outside the firm, with four having an international business management background and three with corporate finance experience.²¹ Since the company officially announced its expansion into the data-center component business, its shares have gained 130%, outpacing the Topix Index by 100%.²²

Conclusion

Like a jumbo jet in ascent, we believe Japan's equity market is entering the cruising-altitude phase of a two-decade structural transformation. In this next phase, we believe ongoing growth-oriented governance and capital-management reforms will encourage Japanese companies to further improve return on investment, accelerate earnings growth and ultimately deliver sustainable value over the longer term.

At the same time, not all companies are created equal, in our view. Against a potentially challenging backdrop of structurally higher input costs and interest rates, we believe companies with pricing power and strong corporate governance may be poised to take market share and expand margins at the expense of inferior peers. It is these winners, in our view, that have the greatest potential to manage through the current economic and geopolitical turbulence to reach cruising altitude.

¹⁸ Board Skill Set, Company A Annual Shareholder Meeting circular. As of August 7, 2026.

¹⁹ Bloomberg (JPY, total return). Data as of August 31, 2026.

²⁰ SMBC Nikko Securities data. As of January 9, 2026.

²¹ Board Skill Set, Company B Annual Shareholder's Meeting circular. As of May 29, 2026.

²² Bloomberg (JPY, total return). Data as of August 31, 2026.



Disclaimers

This material is provided for informational and educational purposes only and nothing herein constitutes investment, legal, accounting or tax advice. This material is general in nature and is not directed to any category of investors and should not be regarded as individualized, a recommendation, investment advice or a suggestion to engage in or refrain from any investment-related course of action. Investment decisions and the appropriateness of this material should be made based on an investor's individual objectives and circumstances and in consultation with his or her advisors. Information is obtained from sources deemed reliable, but there is no representation or warranty as to its accuracy, completeness or reliability. All information is current as of the date of this material and is subject to change without notice. Any views or opinions expressed may not reflect those of the firm as a whole. Neuberger products and services may not be available in all jurisdictions or to all client types.

This material may include estimates, outlooks, projections and other "forward-looking statements." Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed. Investing entails risks, including possible loss of principal. Investments in hedge funds and private equity are speculative and involve a higher degree of risk than more traditional investments. Investments in hedge funds and private equity are intended for sophisticated investors only. Indexes are unmanaged and are not available for direct investment. **Past performance is no guarantee of future results.**

Index Definitions

The **S&P 500 Index** consists of 500 U.S. stocks chosen for market size, liquidity and industry group representation. It is a market value-weighted index (stock price times number of shares outstanding), with each stock's weight in the Index proportionate to its market value.

The **Tokyo Price Index (TOPIX)** is a capitalization-weighted stock market index that tracks the performance of all large firms listed in the first section of the Tokyo Stock Exchange.

The **Nikkei 225 Index** is a price-weighted index that lists the top 225 blue-chip companies traded on the Tokyo Stock Exchange.

The **STOXX Europe 600 Index** is a market capitalization weighted stock index of 600 large-, mid-, and small-cap companies across 17 European countries, covering about 90% of Europe's free-float market cap.

This material is being issued on a limited basis through various global subsidiaries and affiliates of Neuberger Berman Group LLC. Please visit www.nb.com/disclosure-global[1] communications for the specific entities and jurisdictional limitations and restrictions.

The "Neuberger" name and logo are service marks of Neuberger Berman Group LLC.

Illustration(s) may have been generated by AI.

NEUBERGER

1290 Avenue of the Americas
New York, NY 10104-0001
neuberger.com