

IN-DEPTH: Dalton on new chapter for shareholder activism in Japan

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In a record year for board seat wins, activists targeting the Asia market secured 37 seats at Japan-based companies, a significant uptick on 2024 when just seven seats were gained and up 28% when compared to 2023.

Below, Dalton Investments' Japan-based Masumi Nishida spoke to DMI about how a new common language around valuation has opened the door to constructive dialogue and board seats.

2025 was a record year for activists operating in the Japan market in terms of board seat gains. What changes made this possible?

In 2023, the Tokyo Stock Exchange (TSE) launched the price-to-book 1.0 initiative, which covered metrics like cost of capital, return on equity and price-to-book ratio. With that in mind, we now have a common language that we can use with management. Now the TSE has said that the stock price is actually part of the management's mandate. Therefore, they have to care about return on equity, return on invested capital and the cost of capital.

With this common language between shareholders and management, activists can target specific issues where management may be lacking.

You have referenced “stock-price-aware” management. How is that being implemented in Japan?

The headline is that management should be more aware of the cost of capital and of the share price. The TSE suggests that every listed company should analyze the cost of capital, return on equity, return on invested capital, and price-to-book.

Because it's exchange-wide, companies have to make these things public. We're still in the early stages, maybe the second or third inning of the change in Japan. The first inning was the change in corporate governance that took place in 2015; the second was the TSE reform, and the third is the change in M&A guidelines.

With the TSE reforms having increased accountability for cost of capital and stock-price-aware management, where are you seeing the biggest execution gaps?

The capacity to execute is greater at larger companies because

they have more resources, more people and more talent.

So, the step-change or acceleration in change will probably come through the larger caps first.

During 30 years of deflation, management learned that if you did nothing and just kept cash, value was preserved. In an inflationary world, management needs to change. They are finally realizing that companies are not just personal piggy banks. You have to spend capital to remain competitive and to pay people properly.

Historically, Japanese wages have been low, but with demographics and fewer people in the workforce, it is harder to attract talent. To attract talent, you have to pay more, and to pay more, you have to generate better returns.

In your letters, you often refer to the “best owner.” What does that mean in the Japanese context?

It's quite important in Japan because traditionally there have been many conglomerates. Historically, there was no debate about the “best owner” concept, the idea that the person who is willing to spend capital most efficiently should own the asset. We used to joke that some companies in Japan run an elevator business, a nuclear reactor business, a semiconductor business, a consumer electronics business and even a hospital at the same time.

But that's changing. I sit on the board of a listed company and when I speak with financial advisors and ask whether it's possible to buy a very bad or a highly profitable business out of a conglomerate, historically the answer would have been “no way.” Now, financial buyers feel they have a chance. As a result, we're seeing more spin-offs, carve-outs and private transactions.

Japan has seen a lot of M&A, management buyouts and buybacks. How do you decide when buybacks are better than selling to a third party?

The mental hurdle of selling their own company to a third party is significant for Japanese management. Many may have been working for the same company for 40 years, so it's very difficult mentally to sell to an outsider.

But if price-to-book is below 1.0, you are effectively always buying the company at a discount to book. If you don't have an M&A engine in place—and many have never done M&A—the lowest-hanging fruit is to buy back the company's own stock that trades at a discount.

I think the trend of buybacks will continue and the amount will be significant.

What have been the most reliable catalysts for a re-rating of Japanese stocks in your experience?

It is difficult to say precisely what drives multiple re-ratings, especially when profitability does not change. Our most successful cases have been at companies that had a reputation of “never

changing.” When those companies make even a small step-change, or a significant change, in the way they spend capital, or pursue a go-private transaction and pay a premium to the market, the stock can double in 12 months.

The biggest wins have been where companies take significant action: changing capital allocation, cleaning up portfolios or going private and taking themselves out of a situation where they are listed with chronically low valuations.

What are Dalton’s main priorities as you move to engage with Japanese companies in 2026?

Every year, we go back to the same three core ideas. The first is the balance sheet, or in Japan terms, improving return on equity. Good businesses tend to hold a lot of cash because they are spenders by nature, so balance sheet efficiency is critical. The second is governance. We believe all companies should have a majority of independent directors. That’s a mandate in the U.S., a guideline in some other markets, but that’s not the case for many Japanese boards. The third is alignment of interest between management and shareholders. We want better alignment through compensation and ownership structures.

Looking ahead, what should investors be focusing on in the Japan market?

They should be watching the continued impact of the TSE reforms and changes in the M&A guidelines. We need to see how many more activist cases we get and how many more engagement funds, especially from the U.S., which I call “newcomers,” come back to Japan.

Some of those newcomers will probably fall into the traditional value trap in Japan because the value trap is still very prevalent. Those with better experience and local knowledge will probably do a better job. Structurally, a lot of things now work in favor of Japanese companies: the shift from deflation to inflation, better capital discipline and improved governance. So, I think the long-term story for Japan is still very positive.