

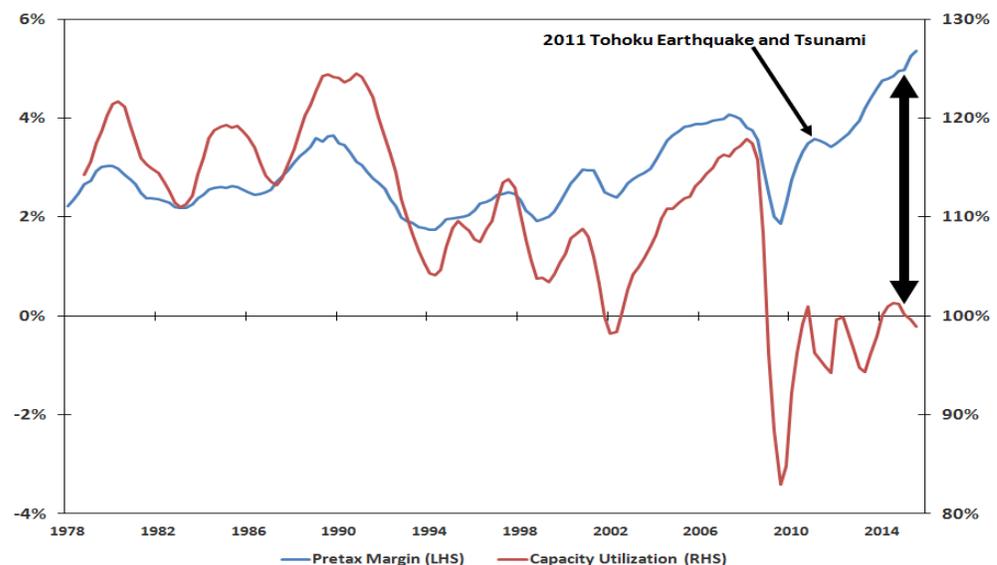
Japan's Corporate Governance Reform: A Powerful Driver of Earnings Growth



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- **A Shift in Corporate Priorities.** For decades, Japan's corporations were managed to protect market share, headcount and influence, all at the expense of profits. Today, driven by a shift in corporate priorities, pretax margins are at record highs even as economic growth has been lackluster.
- **Two Phases of Reform.** Even before some recent government initiatives largely aimed at boosting ROEs, a shift in corporate priorities got underway around 2009 and continued until the 2011 earthquake ("Phase 1"). The natural disaster proved to be only a temporary interruption of reforms that resumed in 2012 ("Phase 2").
- **The Yen: a Catalyst not a Cause.** A key catalyst for reform during Phase 1 was Yen appreciation that undermined the competitiveness of the export sector. However, in Phase 2, Yen weakness has *not* been the predominant driver of profitability, as margins of domestic services industries have also surged.
- **Recent Catalysts for Enhanced Corporate Governance.** Separate from steps by corporations to increase margins, the government has recently promoted initiatives that should improve ROEs to the benefit of shareholders.
- **Japan remains top ranked in our strategy model.** Since its introduction in April 2014, the Cornerstone Capital regional strategy model has been Overweight Japan.

Figure 1: Japan's Corporate Governance Payoff
Pretax Profit Margin and Capacity Utilization in Japan





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