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### Feature Articles

This month's focus: **ROE Improvement and Enterprise Value**



### Articles



As return on equity (ROE) represents the overall capital productivity of an economy, it is desirable to attain high ROE in order to achieve long-term economic growth.

The prolonged stagnation of ROE in the Japanese economy is caused by the malfunctioning of corporate governance, which needs to be transformed from governance by banks to that by shareholders. Asset holders and asset managers cannot discipline firms because they are trapped in a certain kind of "bad equilibrium". We need to implement fundamental reform of the investment chain as a whole.



In recent years, the "Ito Review", Japanese version of the "Stewardship Code", and "Corporate Governance Code" have been introduced by the authorities in Japan, leading to the enhanced recognition of constructive dialog (engagement) between investors and companies for value creation. Under such circumstances, taking into account the implications of a global investor survey conducted by the author, the thesis here offers a value proposition of engagement agenda and 'Equity Spread' as proxy to improve the medium-to-long term corporate value of Japanese companies.



This paper discusses the mechanism of how ROE affects corporate value on the basis of the Residual Income Model. I would like to demonstrate an experiment to show the relationship between ROE and corporate value using the data of Japanese companies. As a result, companies whose PBR is less than 1.0, which means their ROE cannot exceed their cost of capital, will not increase their corporate value even if they raise ROE in the Japanese market. I call this 'asymmetric PBR'. At the same time, I will show that more than 60% of Japanese listed companies cannot exceed their cost of capital.

This paper explores shareholder return policy worldwide, and proposes quantitative models for Japanese companies.

These models support the efficient evaluation of an appropriate shareholder return policy and enhance effective management decisions to increase ROE and shareholder value.

At the end, we provide a sample analysis of a fictitious company.

## Prospects



## Economic and Industrial Analysis