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JCGR Corporate Governance Survey 2004
－Summary and Recommendations－

Japan Corporate Governance Research Institute (JCGR)
Corporate Governance Index Research Group
http://www.JCGR.org/

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Outline of the Survey

The objective of corporate governance is to assure long-term corporate performance by establishing a system that makes management accountable for achieving corporate goals. A good corporate governance system leads to excellent corporate performance because it brings out superior management.

In the face of the business environment of the 21st century, with its intensifying global competition and rapid technological change, a corporate governance system that separates execution by managers (management) and monitoring by the board of directors (governance) has been spreading around the world. Even in Japan, the Commercial Code was revised to allow firms beginning in April 2003 to either introduce a new corporate governance system, called the Board with Committees, or maintain the existing system of statutory corporate auditors.

Since 2002, the Corporate Governance Index Group of the Japanese Corporate Governance Research Institute has conducted an annual survey of corporate governance of all firms listed on the First Section of the Tokyo Stock Exchange. This survey assesses how close a firm's corporate governance adheres to this desirable state of separation between management and governance, and reports the results for each firm in terms of the JCGIndex.

Between July and October, 2004, we surveyed Tokyo Stock Exchange First Section Firms. The response rate jumped by 70% from the previous year's survey, reflecting what we believe is an increased interest in corporate governance. The results of our analyses of the relationship between the JCGIndex and performance were generally similar to results of previous years: high JCGIndex companies enjoy superior performance, as measured by higher ROA, ROE, and return on common stock.

The findings of the JCGIndex surveys in 2004 and the previous two years demonstrate that a corporate governance system that separates governance and management is the best model in today's business environment. We hope that the JCGIndex and the results of our analyses will be used by both investors and managers and will be useful in promoting continued corporate governance reform in Japan. We are very grateful to the companies that responded to this survey.

7 Important Results from the 2004 Survey

1. Response rate: A significantly higher response rate indicates an increase in interest in corporate governance

From July to October 2004, the Japan Corporate Governance Research Institute surveyed all firms listed on the First Section of the Tokyo Stock Exchange (1,560 firms as of July 2, 2004), and received responses from 341 firms. Survey questions were based on the "JCGR Corporate Governance Principles." The JCGIndex is based on these questions.

This is the third consecutive year that we have carried out the survey. In 2002, we received responses from 159 firms. In 2003, 201 firms responded, 129 for the first time. In 2004, 189 firms responded for the first time. Over the past three years, we have received responses from 477 distinct firms.

Many of the firms that responded to the survey for the first time in 2004 are large, mainstream, "traditional" Japanese firms, indicating that interest in corporate governance has spread even to the largest and most influential Japanese firms.

2. Characteristics of the responding firms: Large firms with high performance

Firms that responded to the survey tended to be very large. The average size of assets, sales, and number of employees of responding firms (averaged over 1999-2003) was as much as twice the size of the average listed firm. The performance of responding firms was also higher than the average for listed firms. ROA of responding firms was 5.20%, compared to 4.95% for all listed firms: ROE was 3.04% versus .795%, and return on common stock was -.46% versus –1.23%.

3. Distribution of the JCGIndex: Increased average score but wide range

This year, the average JCGIndex is 45 (standard deviation 12.9), compared to an average of 37.8 (standard deviation 12.0) for last year. It is difficult to make a direct comparison between these two years, however. This is because in response to revisions in the Commercial Code and an increased interest in corporate social responsibility among Japanese firms, we made changes in about 20% of the questions.

The highest JCGIndex levels have increased considerably, suggesting that even considering changes in the questions, the state of corporate governance in Japan has advanced over the previous years. Nevertheless, the average of 45 points is less than one half of the total of 100 possible points, and from this it can be concluded that the state of corporate governance in most Japanese firms is far from the ideal state of our governance model.

The range between the highest and lowest JCGIndex firms is quite large, as in previous years. This year the highest JCGIndex was 83 and the lowest was 11. Last year the highest JCGIndex was 73 and the lowest 12.

4. Average points by category: Governance reform is unbalanced

The JCGIndex is the sum of the points in 4 separate categories (Cg1, Cg2, Cg3, Cg4). The following table reports the average points in each category for the 341 responding firms.

In Categories III and IV, firms on average achieved over 50% of all possible points. The achievement rates for Categories I and II were far lower. In particular, average points for Category II, the structure and function of board of directors, were particularly low, indicating that the separation of monitoring by the board of directors (governance) and execution by managers (management) has yet to spread widely.

These results suggest that in corporate governance reform, firms have focused on corporate restructuring, and have improved management systems and disclosure. In contrast, reform in the essence of governance, which is CEO accountability and board function, has not progressed as far.

Category		Maximum points (A)	Mean (B)	Achievement rate* (B) / (A)
I	Corporate objectives and CEO responsibility	28 (28)	11.9 (12.3)	42.5% (43.9%)
II	Structure and function of board of directors	25 (29)	6.7 (6.1)	26.8% (21.0%)
III	Management system	27 (26)	16.0 (11.6)	59.3% (44.6%)
IV	Transparency and communication with shareholders	20 (17)	10.4 (7.7)	52.0% (45.3%)

(note) results from last year's survey are in parentheses

In the table above, results for 2003 are shown in parentheses. The point allocation for each category has changed somewhat from 2003, due to the change in questions as noted above.

5. Characteristics of high and low JCGIndex firms

To compare the characteristics of high and low JCGIndex firms and to examine the relationship between the JCGIndex and corporate performance, we constructed two groups: high and low JCGIndex firms. The high JCGIndex group consists of the 51 firms with a JCGIndex of 58 or more points (over one standard deviation above the mean) and the low JCGIndex group consists of the 55 firms with a JCGIndex of 38 or less (over one standard deviation below the mean).

(1) Characteristics of high and low JCGIndex firms: The percentage of foreign ownership is higher and the CEOs are younger.

The average percentage of shares held by foreigners in the high JCGIndex group is 26.1%, while the average for listed firms is 13.8%, and the average for low JCGIndex firms is even lower at 8.3%. The average age of the CEO for high JCGIndex firms is 60.9 while the average age for low JCGIndex firms is 63.9.

(2) High JCGIndex firms are bigger

The total assets, sales, and number of employees are over 10 times greater in the high JCGIndex firms than the low JCGIndex firms.

(3) High JCGIndex firms are strong in all aspects of corporate governance

High JCGIndex firms have achieved high points in all four categories, indicating that a high JCGIndex cannot be achieved with high scores in only one or two categories. In Category I, high JCGIndex firms achieved on average 18.1 points (versus 6.7 points for low JCGIndex firms). In Category II, this was 12.4 versus 4, in Category III, 20.9 versus 10.1, and in Category IV, 15.2 versus 6. The JCGIndex captures the complete picture of a company's corporate governance capabilities and is not determined by single category.

6. JCGIndex and firm performance: A clear relationship

The objective of corporate governance is to assure excellent corporate performance. Is there really a relationship between corporate governance and corporate performance? In the 2004 JCGIndex survey, as well as in surveys for 2002 and 2003, we found a close relationship between the two.

(1) High JCGIndex firms enjoy superior performance

Based on 5-year averages (1999-2003), ROA (6.30% versus 4.66%) and ROE (4.12% versus –1.82%) are higher in the high JCGIndex firms than in the low JCGIndex firms. Return on common stock is also higher in the high JCGIndex firms then in the low JCGIndex firms (1.93% versus –1.82%).

(2) The rate of growth in employment is higher in the high JCGIndex firms

Based on the 3-year average (2001-2003) of growth of employment, high JCGIndex firms have a higher growth rate than low JCGIndex firms (1.43% versus .60%), although this difference is not significant at the 10% level. While it is often said that in order to increase profits it is necessary to sacrifice employment, our result suggests that high JCGIndex companies are establishing high performance without cutting costs through reducing employment.

7. Relationship between each category and performance: Strongest for structure and function of the board of directors and transparency and communication with shareholders

To determine whether or not there was a similar relationship between performance and each of the categories of the JCGIndex, we constructed high and low JCGIndex groups in each of the 4 categories, choosing the firms with points of one standard deviation above the mean or one standard deviation below the mean for each of the categories. In general, the groups with high points in each category had higher performance (averaged over the past 5 years) than firms with low points, though this difference was not significant in all cases. There were statistically significant differences for two categories: Category II (structure and function of the board of directors) and Category IV (transparency and communication with shareholders). In the last year's survey, we did not find a clear relationship between structure and function of the board of directors and performance. We are not sure why this relationship changed over the last year, and this is a topic for further research.

This year, as in the survey for last year, there was a close relationship between transparency and communication with shareholders, measured by Category IV, and performance. This may be because companies with high performance are much more enthusiastic about disclosure.

Category I Corporate objectives and CEO responsibility: The group of high firms had a higher return on common stock than low firms (1.03% versus –1.79%). In ROA (5.00% versus 5.14%) and ROE (3.00% versus 3.59%) low firms showed higher performance, though this was not statistically significant at the 10% level.

Category II Structure and function of board of directors: For all performance metrics, high firms performed better, at the 5% level of statistical significance. ROA was 6.62% versus 4.70%, ROE was 4.44% versus 1.75%, and return on common stock was 1.23% versus –3.07%.

Category III Management system: For all of the indicators, the high firms had better performance. ROA was 5.86% versus 4.92%, ROE was 2.92% versus 1.45%, and return on common stock was .95% versus –3.26%. Except for return on common stock, which was significantly significant at the 5% level, none of the other differences were statistically significant at the 10% level.

Category IV Transparency and communication with shareholders: For all of the indicators, the high firms had higher performance. ROA was 5.20% versus 4.02%, and was significant at the 5% level. ROE (4.13% versus .56%) and return on common stock (2.17% versus –2.51%) were all significant at the 1% level.

Corporate governance reform is key to the revival of the Japanese economy

The JCGR surveys over the past 3 years have demonstrated that corporate governance is strongly related to corporate performance. Although the response rate of the survey has not been high in any given year, over the past three years we have received 701 responses for 477 distinct firms, and each year shows a similar relationship between JCGIndex and performance. Based on this, we feel that it is appropriate to conclude that corporate governance reform is a necessary condition for Japanese firms to compete in the 21st century business environment. We hope that investors and managers will use the JCGIndex to promote corporate governance reform.

Shareholders are particularly important to governance reform. From the perspective of managers, there is not much incentive to promote corporate governance, as corporate governance reform makes them more accountable for corporate performance. For shareholders, on the other hand, corporate governance reform has a close relationship to the improvement of the performance of their investment, and therefore, they have a strong incentive to push for reform. This is especially true for institutional investors, who manage such a large share of investment capital today.

As shareholders become more aware of the importance of corporate governance reform, shareholder activism, including exercise of voting rights and establishment of governance funds, will increase. We hope that the JCGIndex will be used as an important weapon in these activities. For this reason, this year, we have asked all responding companies to disclose their JCGIndex results. As part of the survey, we asked firms to give us permission to disclose their name if they were in the top 50% of the JCGIndex. Fortunately, most of the companies answered “yes.” Thus, this year, we are able to report a list of the top 50% JCGIndex firms, as well as a list of all responding companies. We are very impressed by the courage of firms that permitted the disclosure of their names, and are very grateful to them. We hope that firms and investors will find many uses for the JCGIndex.

【Appendix】The top 50 JCGIndex firms and their JCGIndex results

（see [Firms in the Top 50% of the JCGIndex]）

<table>
<tr><td>Toshiba Corp. (*)</td><td>83</td><td>Komatsu Ltd.</td><td rowspan="2">65</td></tr>
<tr><td>Teijin Ltd.</td><td>81</td><td>Anritsu Corp.</td></tr>
<tr><td>Sony Corp. (*)</td><td rowspan="2">80</td><td>Nichirei Corp.</td><td rowspan="4">64</td></tr>
<tr><td>Nikko Cordial Corp. (*)</td><td>Showa Shell Sekiyu K.K.</td></tr>
<tr><td>Omron Corp.</td><td rowspan="2">79</td><td>HOYA Corp. (*)</td></tr>
<tr><td>Sanyo Electric Co., Ltd.</td><td>Marubeni Corp.</td></tr>
<tr><td>Orix Corp. (*)</td><td>76</td><td>Yamaha Corp.</td><td rowspan="2">63</td></tr>
<tr><td>Konica Minolta Holdings, Inc. (*)</td><td rowspan="2">75</td><td>Mitsui O.S.K. Lines, Ltd.</td></tr>
<tr><td>Daiwa Securities Group Inc. (*)</td><td>Yokogawa Electric Corp.</td><td rowspan="3">62</td></tr>
<tr><td>Matsushita Electric Works, Ltd.</td><td>74</td><td>Bandai Co., Ltd.</td></tr>
<tr><td>Sumida Corp. (*)</td><td rowspan="2">73</td><td>(anonymous 1 firm).</td></tr>
<tr><td>Meitec Corp.</td><td>Sohgo Security Services Co., Ltd.</td><td>61</td></tr>
<tr><td>Eisai Co., Ltd. (*)</td><td>72</td><td>Takeda Pharmaceutical Co., Ltd.</td><td rowspan="4">60</td></tr>
<tr><td>Hitachi, Ltd. (*)</td><td rowspan="2">71</td><td>Tokyo Electron Ltd.</td></tr>
<tr><td>Mitsubishi Electric Corp. (*)</td><td>Sumitomo Corp.</td></tr>
<tr><td>Asahi Glass Co., Ltd.</td><td rowspan="2">70</td><td>Resona Holdings, Inc. (*)</td></tr>
<tr><td>Benesse Corp.</td><td>Natori Co., Ltd.</td><td rowspan="5">59</td></tr>
<tr><td>Nomura Holdings, Inc. (*)</td><td>69</td><td>Yamaha Motor Co., Ltd.</td></tr>
<tr><td>Nomura Research Institute, Ltd.</td><td rowspan="2">68</td><td>Nifco Inc.</td></tr>
<tr><td>NEC Corp.</td><td>Hitachi Software Engineering Co., Ltd. (*)</td></tr>
<tr><td>Asahi Breweries, Ltd.</td><td rowspan="2">67</td><td>CSK Corp.</td></tr>
<tr><td>Mitsui & Co., Ltd.</td><td>Hitachi Chemical Co., Ltd. (*)</td><td rowspan="4">58</td></tr>
<tr><td>Sankyo Co., Ltd.</td><td rowspan="2">66</td><td>Nippon Steel Corp.</td></tr>
<tr><td>Aeon Co., Ltd. (*)</td><td>Tokyo Gas Co., Ltd.</td></tr>
<tr><td></td><td></td><td>(anonymous 3 firms).</td></tr>
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(note) (*) firms with committees