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JCGR Corporate Governance Survey 2005: Final Report

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 August and October 2005, we surveyed Tokyo Stock Exchange First Section Firms. The response rate increased by 16 percent from the previous year's survey, reflecting 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.

The findings of the JCGIndex surveys in 2005 and the previous 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

1. Response rate indicates a continued increase in interest in corporate governance

From August to October 2005, the Japan Corporate Governance Research Institute surveyed all firms listed on the First Section of the Tokyo Stock Exchange (1,649 firms as of July 22, 2005), and received responses from 395 firms. Survey questions were based on the "JCGR Corporate Governance Principles." The JCGIndex is based on these questions.

This is the fourth 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, 341 firms responded, 189 for the first time. In 2005, 112 firms responded for the first time. Over the past four years, we have received responses from 589 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 2000-2004) was about twice the size of the average listed firm. ROA of responding firms was 5.52%, compared to 5.19% for all listed firms: ROE was 4.07% versus 2.36%. Unlike in the previous three years, there was no difference in return on common stock between responding and all listed firms (2.60% versus 2.59%).

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

This year, the average JCGIndex for the 395 responding firms is 48.0 (standard deviation 12.9), compared to an average of 45.0 (standard deviation 12.9) for last year.

The increase in average levels suggests that the state of corporate governance in Japan continues to advance. However, 48 points is only slightly greater 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 86 and the lowest was 17. Last year the highest JCGIndex was 83 and the lowest 11.

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 395 responding firms.

In Categories III and IV, firms on average achieved over 60% 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		Mean/Total possible points	Achievement rate* (mean/total possible points)
I	Corporate objectives and CEO responsibility	12.0/28	42.9% (42.5%)
II	Structure and function of board of directors	7.7/25	30.8% (26.8%)
III	Management system	16.9/27	62.6% (59.3%)
IV	Transparency and communication with shareholders	11.4/20	57.0% (52.0%)

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

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 62 firms with a JCGIndex of 61 or more points (over one standard deviation above the mean) and the low JCGIndex group consists of the 63 firms with a JCGIndex of 35 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 27.5%, while the average for responding firms is 16.3%, and the average for low JCGIndex firms is even lower at 8.2%. The average age of the CEO for high JCGIndex firms is 61.0 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 18.8 points (versus 7.3 points for low JCGIndex firms). In Category II, this was 13.7 versus 4.9, in Category III, 21.3 versus 11.0, and in Category IV, 15.6 versus 7.1. 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 2005 JCGIndex survey, as well as in surveys for previous years, we found a close relationship between the two.

(1) High JCGIndex firms enjoy superior performance on most dimensions

Based on 5-year averages, ROA (6.25% versus 4.85%) and ROE (4.09% versus 3.78%) are higher in the high JCGIndex firms than in the low JCGIndex firms. However, this year for the first time, return on common stock was lower in the high JCGIndex firms than in the low JCGIndex firms (2.80% versus 8.68%). This is because for almost half of the high JCGIndex firms, return on common stock was negative for 2004. This short-term phenomenon resulted in a negative return on common stock for the 3-year average. This is the first time that we have observed this reversal, and we will be analyzing it further.

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

Based on the 3-year average (2002-2004) of growth of employment, high JCGIndex firms have a higher growth rate than low JCGIndex firms (3.31% versus -.58%). 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 the surveys for previous years, the groups with high points in each category had higher performance (averaged over the past 5 years) than firms with low points. This year, however, we found clear differences across categories in the relationship to performance. The generally positive relationship between the JCGIndex as a whole and performance indicates that corporate governance is not a question of a single category, but rather, of all the categories taken together.

This year, as in previous years, 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.

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

The JCGR surveys over the past 4 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 1,096 responses for 589 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.

Investors 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 investors, 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 investors 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]）

Toshiba Corp. (*) Nomura Holdings, Inc. (*)	86	Santen Pharmaceutical Co., Ltd. Sky Perfect Communications Inc. TDK Corp. Marubeni Corp. Sumitomo Corp. Japan Airlines Corp.	68
Sony Corp. (*) Daiwa Securities Group Inc. (*)	83	Asahi Breweries, Ltd. Showa Shell Sekiyu K.K. Daiwa Seiko, Inc.	67
Eisai Co., Ltd. (*) Orix Corp. (*)	81	Nomura Research Institute, Ltd. Hitachi Construction Machinery Co., Ltd. (*) Mitsui Sumitomo Insurance Co., Ltd. Hitachi Information Systems, Ltd. (*) **************	66
Omron Corp. Shinsei Bank, Ltd. (*)	80	**************	65
Teijin Ltd. Aeon Co., Ltd. (*) Nikko Cordial Corp. (*)	78	Ube Industries, Ltd. NTN Corp. Fuji Seal International, Inc. (*)	64
Mitsubishi Electric Corp. (*)	77	Nichirei Corp. Yokogawa Electric Corp. Yamato Holdings Co., Ltd. Tokyo Theatres Co., Inc. **************	63
Meitec Corp.	76		
Konica Minolta Holdings, Inc. (*) Sumida Corp. (*) Mitsui & Co., Ltd. Millea Holdings, Inc.	74		
Asahi Glass Co., Ltd. Hitachi, Ltd. (*)	73		
Ryohin Keikaku Co., Ltd. Parco Co., Ltd. (*) Benesse Corp. **************	71		
Anritsu Corp.	70		
Komatsu Ltd. Yamaha Motor Co., Ltd. **************	69		

(note) (*) firms adopting board with committees

I. A description of the survey and the survey results

1. An overview of the JCGIndex survey

Between August and October 2005, the Japan Corporate Governance Research Institute (JCGR) sent its third annual survey to all Tokyo Stock Exchange First Section firms (1649 firms as of July 22, 2004). We received responses from 395 firms. The names and industries of these firms are listed in the Appendix. This is the fourth consecutive year that we have carried out the survey.

159 firms responded in 2002, 201 firms in 2003, and 341 firms in 2004. 477 firms responded in one or all of the three years. 283 of these firms responded again in 2005, and 112 firms responded for the first time. Over the four years that we have administered the survey, we have received 1,096 responses, from a total of 589 firms.

2. The objective of the JCGIndex survey

The objective of the JCGIndex is to measure the current state of corporate governance in Japanese firms through indexation. We hope that the JCGIndex will help Japanese people to look at Japanese firms in a new light. Furthermore, we hope that the JCGIndex will help the foreign business community better understand the corporate governance situation in Japan. We believe that in the process of responding to the questions in the JCGIndex survey, Japanese companies will gain a deeper understanding of our corporate governance model and hope that the JCGIndex is helpful to Japanese firms in realizing the corporate governance that they desire.

3. About the JCGIndex

The objective of corporate governance is to give corporate executives a clear goal for corporate performance and to create a system by which they assume responsibility to reach those goals. For this reason, it is important to separate the execution of management (management) by executive officers from the monitoring of management (governance) by the board of directors, and to maintain transparency to shareholders and all stakeholders regarding the state of the corporation.

The JCGIndex is based on 51 questions, drawn from the "JCGR Corporate Governance Principles." These principles are:

- governance from the perspective of shareholders
- clear and measurable corporate goals
- a system to assure the responsibility of CEO and top management team for realizing the goals
- an independent board with capability to monitor and motivate management
- systems for managerial decision-making, implementation, and risk-management

- accountability to shareholders
- provision of appropriate information to shareholders through investor relations activities
- maintenance of transparency through disclosure to all stakeholders

The JCGIndex consists of four categories:

I. Corporate objectives and CEO responsibility
II. Structure and function of board of directors
III. Management system
IV. Transparency and communication with shareholders

The JCGIndex is the sum of the points in these four categories. If all points in all four categories are achieved, a firm receives a JCGIndex of 100. The fewer the points achieved, the closer the JCGIndex is to 0.

II. Characteristics of responding companies and the JCGIndex

1. A comparison of responding companies to all listed companies

The 395 responding companies represent 24% of the companies listed on the Tokyo Stock Exchange First Section. The table below presents comparisons of financials of responding companies and all listed companies, based on 5-year averages (2000-2004). The averages do not include companies that did not report financials in all five years.

Companies that responded to the JCGIndex survey were far larger than average in terms of total assets, sales, and number of employees. ROA, ROE, and return on common stock, which are not related to firm size, were larger for responding companies than for the average listed companies and their variance was smaller than that for all listed companies. The differences in these measures of size and performance for responding firms and all listed firms were significant in all cases.

5-year averages

total assets (consolidated)	firms	average	minimun	maximum	standard deviation
listed firms	1,362	411,777.06	1,367.20	20,905,197.80	1,276,610.43
responding firms	346	830,290.38	3,496.40	20,905,197.80	1,944,604.17

(million yen)

sales (consolidated)	firms	average	minimun	maximum	standard deviation
listed firms	1,362	345,842.01	724.20	16,086,259.20	1,087,227.87
responding firms	346	734,750.92	7,607.80	16,086,259.20	1,767,134.66

(million yen)

ROA (consolidated)	firms	average	minimun	maximum	standard deviation
listed firms	1,302	5.189	-14.69	28.91	3.98
responding firms	334	5.517	-1.47	20.97	3.68

(%)

ROE (consolidated)	firms	average	minimun	maximum	standard deviation
listed firms	1,289	2.364	-454.99	303.45	19.83
responding firms	331	4.069	-96.18	28.39	8.49

(%)

employees (consolidated)	firms	average	minimun	maximum	standard deviation
listed firms	1,359	7,065.53	30.20	316,272.40	20,688.63
responding firms	346	14,405.07	92.60	316,272.40	34,918.51

(number of employees)

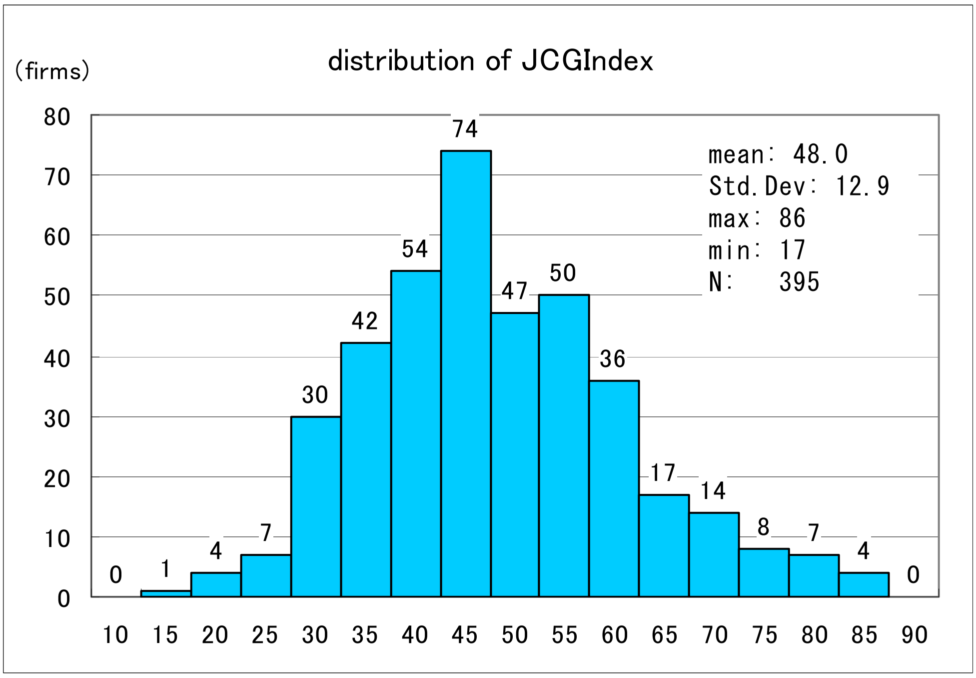
stock return (consolidated)	firms	average	minimun	maximum	standard deviation
listed firms	1,249	2.590	-37.60	47.50	10.02
responding firms	322	2.604	-26.80	29.20	10.23

(%)

2. Distribution of the JCGIndex

The JCGIndex for individual companies was distributed widely, ranging from a maximum of 86 to a minimum of 17. Given that the maximum possible number of points was 100, even the firms with the highest JCGIndex were far from the ideal level of corporate governance according to JCGR's corporate governance principles.

The mean JCGIndex was 48 (last year, 45.0), the standard deviation was 12.9 (last year, 12.9), and there was a normal distribution around the mean.



(note) The x axis depicts a range of +/- 2.5 around the number indicated. For example, the number 15 depicts a range greater than 12.5 and less than 17.5. Because the JCGIndex is rounded to the nearest integer, the reported range is 13 to 17.

3. Board with committees and JCGIndex

From April of 2003, the Commercial Code was revised to allow the introduction of the Board with Committees structure. The spirit of this revision, to facilitate the separation of governance by an independent board of directors and management by executive officers, is similar to the JCGR corporate governance principles. In the 21st century business environment, characterized by increasing globalization and rapid technological change, a governance system that ensures transparency, clarifies the responsibility of management for performance, and ensures that management makes its best efforts is critical.

Although the Board with Committees structure makes it easier to create this kind of governance structure, it is still possible to establish this sort of governance with the existing statutory auditor system. The JCGIndex is designed so that even if a firm has not introduced the Board with Committees structure, if its governance structure assures the separation of management and monitoring, these efforts will be duly reflected in a higher JCGIndex.

Of the 395 firms that responded to the 2005 JCGIndex survey, 26 firms had introduced the Board with Committees structure. Of the top 23 companies in the JCGIndex, 14 companies had introduced the Board with Committees structure. Of the top 50 companies, 17 companies had introduced this structure, and 9 of the top 11 firms had introduced it. Thus, while the Board with Committees structure is well-represented in the list of high JCGIndex firms, not all high JCGIndex firms had introduced this structure.

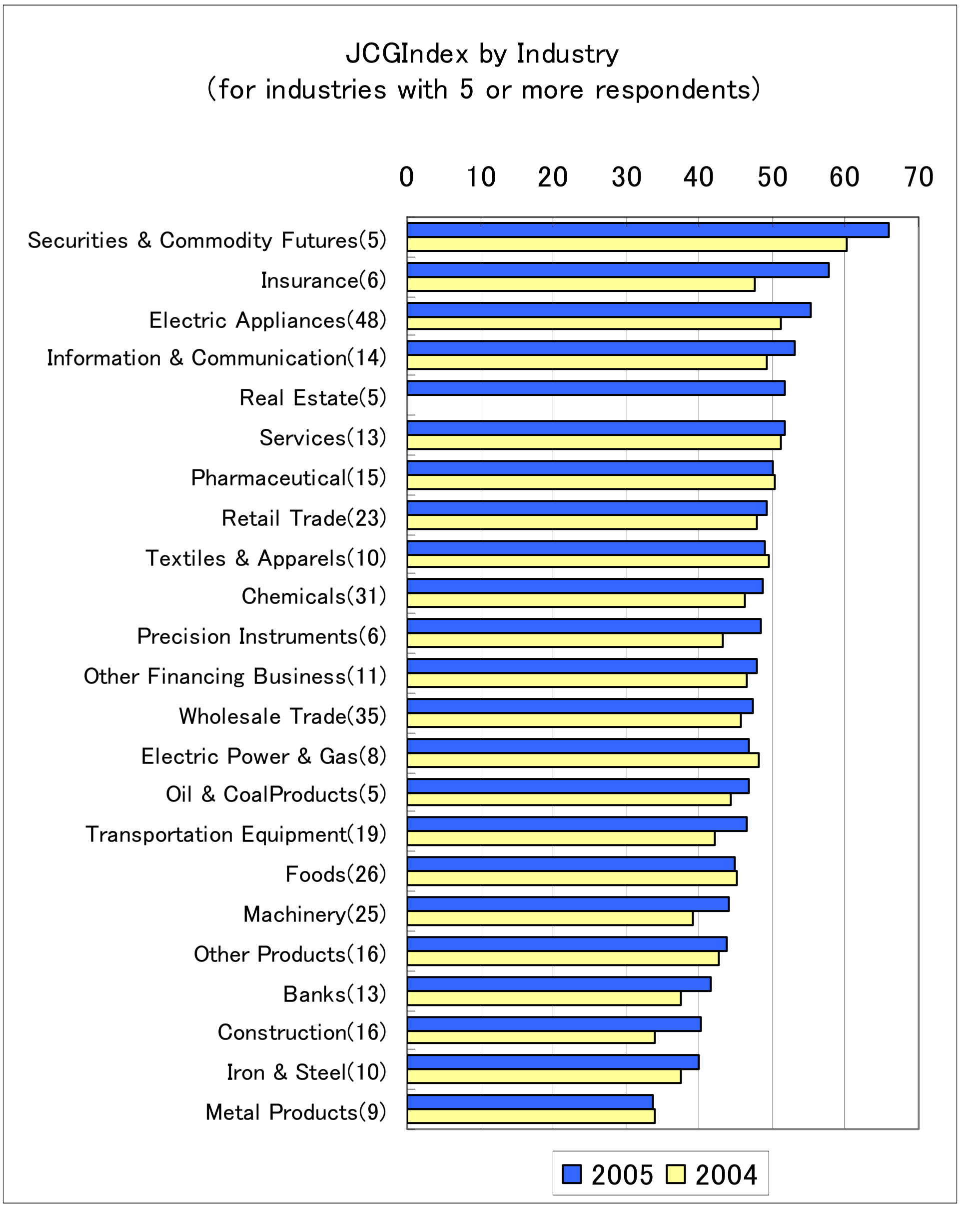
Whether or not a company has a Board with Committees structure, if it has clarified its structure for management accountability and has satisfied the necessary conditions in each category, it can obtain a high JCGIndex equivalent to that of a company that has adopted the Board with Committees structure.

Questions of the structure of the board aside, even the top JCGIndex firms are still far from the maximum 100 points and there are many challenges ahead both for companies that have adopted this structure and those that have not.

4. The JCGIndex by industry

The following table shows the average JCGIndex by industry for 2005 and 2004. We report results only for industries for which 5 companies or more responded.

The average JCGIndex for all almost industries have increased, but the amount of increase differs by industry, and we believe that this reflects the different speed in corporate governance reform across industries.



(note) Name of industry. The number in parentheses is the number of firms in each industry that responded to the survey.

5. Points by category

The following table reports the average points by category for the 395 responding firms. While firms achieved a relatively high percentage of total possible points in Categories III and IV, the achievement rate for Categories I and II was much lower. In particular, average points for board structure and function were quite low, indicating that the separation between the governance and management through independent boards has yet to be fully accomplished. This pattern is the same as that found in surveys of the previous three years.

The results indicate that companies that have embarked on corporate governance reform have tended to focus on restructuring of management systems and improvements in disclosure, while reforms to core of governance, in other words, clarifying management accountability and board reform, have progressed much more slowly.

	Category	Maximum points (A)	Mean (B)	Achievement rate* (B) / (A)
I	Corporate objectives and CEO responsibility	28 (28)	12.0 (11.9)	42.9% (42.5%)
II	Structure and function of board of directors	25 (25)	7.7 (6.7)	30.8% (26.8%)
III	Management system	27 (27)	16.9 (16.0)	62.6% (59.3%)
IV	Transparency and communication with shareholders	20 (20)	11.4 (10.4)	57.0% (52.0%)

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

III. Analyses based on financial data

In this section, we analyze differences between high and low JCGIndex firms in financial performance and compare performance for high and low firms in each of the 4 categories of the JCGIndex. This report presents comparisons of unadjusted data. We have also created a supplementary report that shows comparisons of data adjusted for industry. The differences in these two sets of analyses are not great, suggesting that our results are stable and robust to industry differences.

1. The definition of high and low JCGIndex groups

To analyze the relationship between the JCGIndex and firm characteristics, we constructed two groups: high JCGIndex firms, with JCGIndex greater than one standard deviation above the mean (mean is 48.0 points, standard deviation is 12.9 points) and low JCGIndex firms, with JCGIndex greater than one standard deviation below the mean.

High JCGIndex firms: 62 firms with JCGIndex above 61 (48+12.9=60.9)
Low JCGIndex firms: 63 firms with JCGIndex below 35 (48.0-12.9=35.1)

We also used this method to construct groups of high and low firms for each of the four categories that make up the JCGIndex.

2. Analysis of relationship between JCGIndex and firm performance

(1) Method of analysis

We used the high and low JCGIndex groups constructed as described above to compare financial characteristics of high and low JCGIndex firms, and to compare these to all responding firms. Comparisons are shown in the form of graphs. We show the differences in means and report the degree of statistical significance.

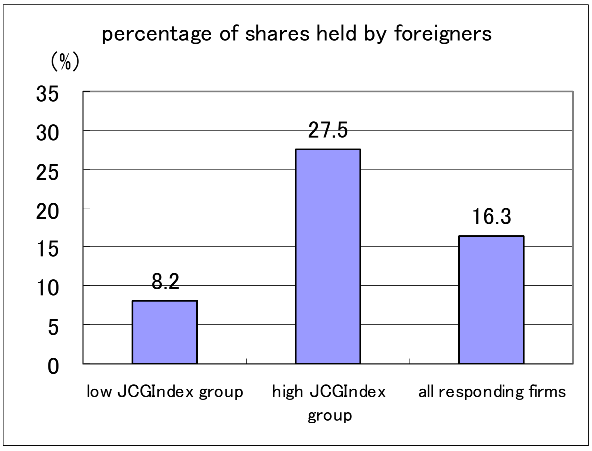
Financial information is averaged over the previous 3 years (2002-2004) and 5 years (2000-2004), using consolidated reports. Firms that did not report data for the entire period were excluded from our comparison, so there is some variation in the number of firms used for each of the comparison.

Return on assets (ROA) is profits after tax and payment of interest divided by total assets (averaged across beginning and ending of period). Return on equity (ROE) is profits after tax divided by total shareholders equity (averaged across beginning and ending of period). The return on common stock is the sum of the dividends and capital gains (or capital loss) for the period, divided by the share price at the beginning of the period.

(2) Characteristics of firms responding to the JCGIndex

First, we present some of the more interesting differences between the characteristics of firms in the high and low JCGIndex groups. These results are generally similar to those from 2002 and 2003.

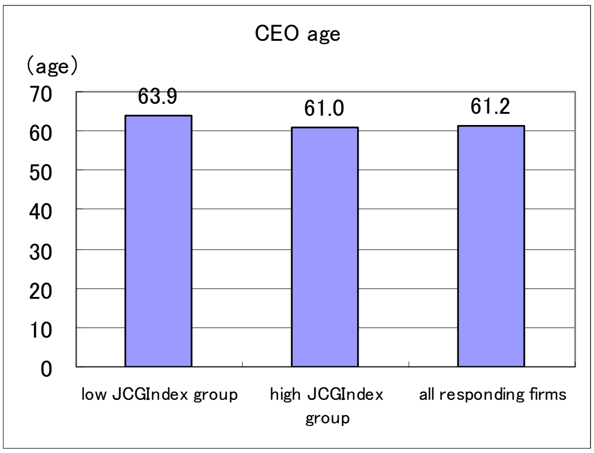
a. Percentage foreign ownership



Foreign ownership is higher in high JCGIndex firms than in low JCGIndex firms, and this difference is statistically significant (at the 1% level).

Total responding firms: 371
High JCGIndex firms: 62
Low JCGIndex firms: 57

b. Age of CEO

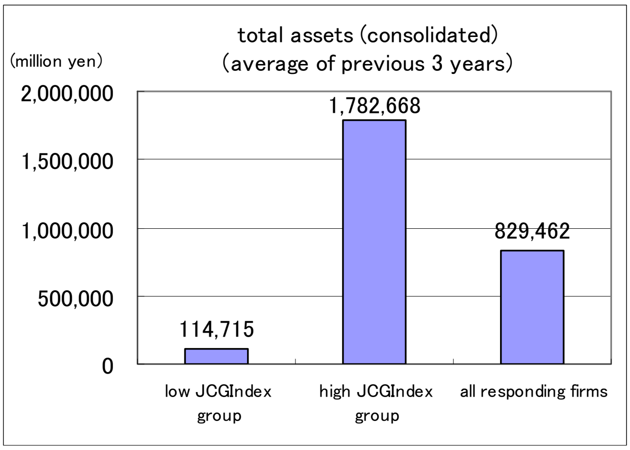


The CEOs of high JCGIndex firms are younger than CEOs of low JCGIndex firms, and this difference is statistically significant (at the 1% level).

Total responding firms: 372
High JCGIndex firms: 60
Low JCGIndex firms: 59

(3) JCGIndex and firm size

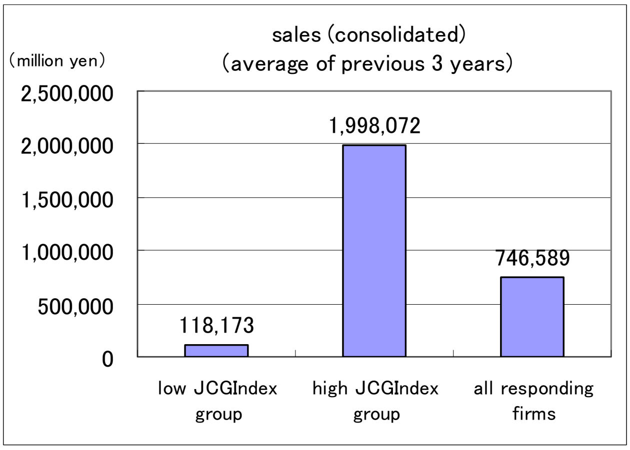
a. Total assets (consolidated, 3 years)



Total assets of high JCGIndex firms are greater than total assets of low JCGIndex firms, and this difference is statistically significant (at the 1% level). This result is the same for the 5-year average of total assets.

Total responding firms: 354
High JCGIndex firms: 55
Low JCGIndex firms: 55

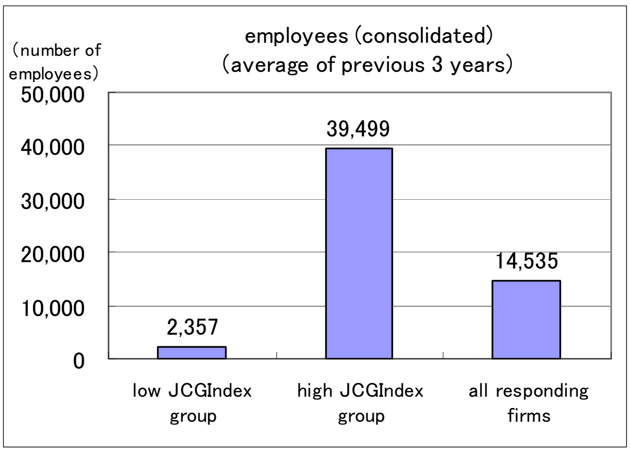
b. Total sales (consolidated, 3 years)



Total sales of high JCGIndex firms are greater than total sales of low JCGIndex firms, and this difference is statistically significant (at the 1% level). This result is the same for the 5-year average of total sales.

Total responding firms: 354
High JCGIndex firms: 55
Low JCGIndex firms: 55

c. Number of employees (consolidated, 3 years)



Number of employees of high JCGIndex firms is greater than number of employees in low JCGIndex firms, and this difference is statistically significant (at the 1% level). This result is the same for the 5-year average of number of employees.

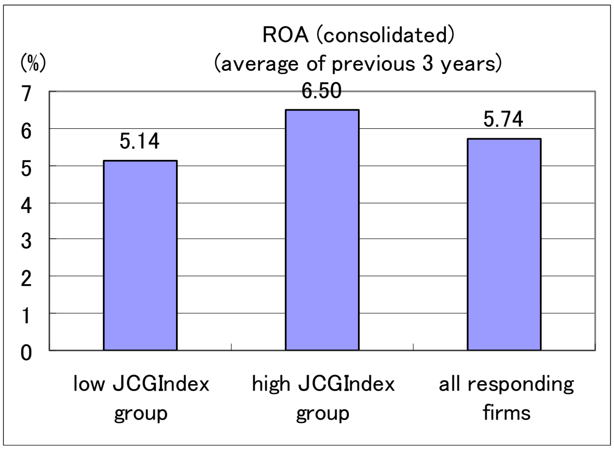
Total responding firms: 354
High JCGIndex firms: 55
Low JCGIndex firms: 55

(4) JCGIndex and firm performance

The essence of corporate governance from the perspective of shareholders is to maintain a return on capital invested. We compared return on total assets (ROA) and return on shareholders' equity (ROE) between high and low JCGIndex groups. For both 3- and 5-year averages, ROA and ROE are higher for high JCGIndex than for low JCGIndex firms.

a. ROA (consolidated, 3 years and 5 years)

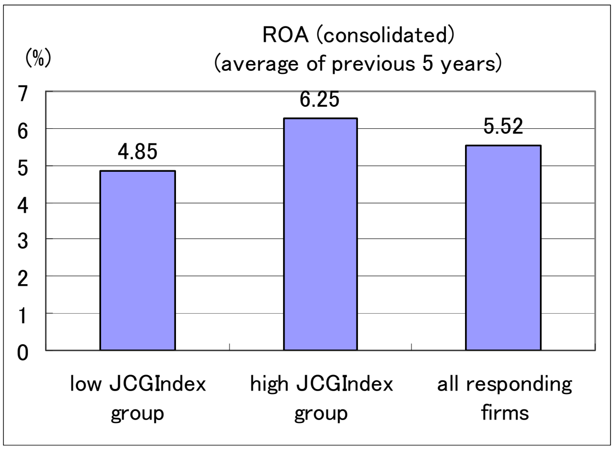
3 years



ROA for high JCGIndex firms is higher than ROA for low JCGIndex firms, and this difference is statistically significant (at the 10% level).

Total responding firms:	344
High JCGIndex firms:	52
Low JCGIndex firms:	55

5 years

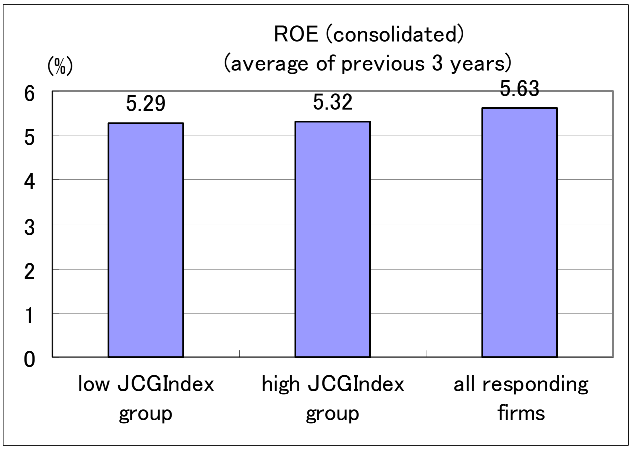


ROA for high JCGIndex firms is higher than ROA for low JCGIndex firms, and this difference is statistically significant (at the 5% level).

Total responding firms:	334
High JCGIndex firms:	51
Low JCGIndex firms:	55

b. ROE (consolidated, 3 years and 5 years)

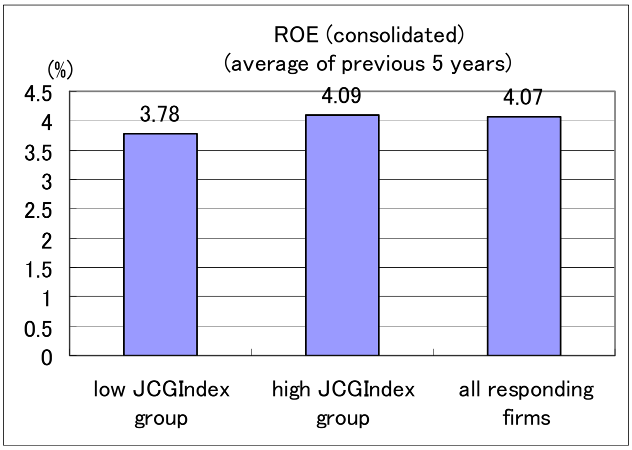
3 years



ROE for high JCGIndex firms is higher than ROE for low JCGIndex firms, but this difference is not significant (at the 10% level).

Total responding firms: 341*
High JCGIndex firms: 52
Low JCGIndex firms: 54*
* We removed one outlier with a level of 6,248.26.

5 years

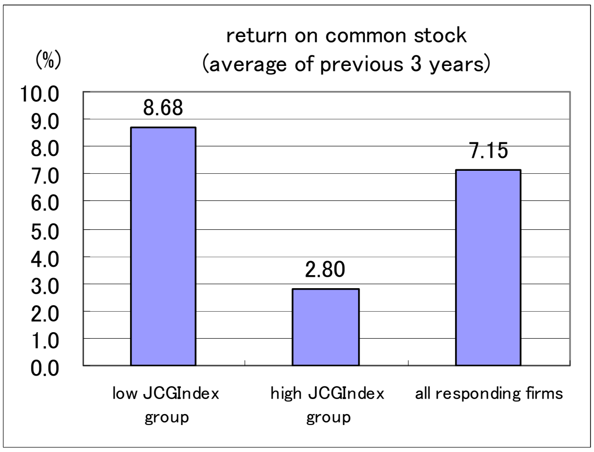


ROE for high JCGIndex firms is higher than ROE for low JCGIndex firms, but this difference is not significant (at the 10% level).

Total responding firms: 331
High JCGIndex firms: 51
Low JCGIndex firms: 54

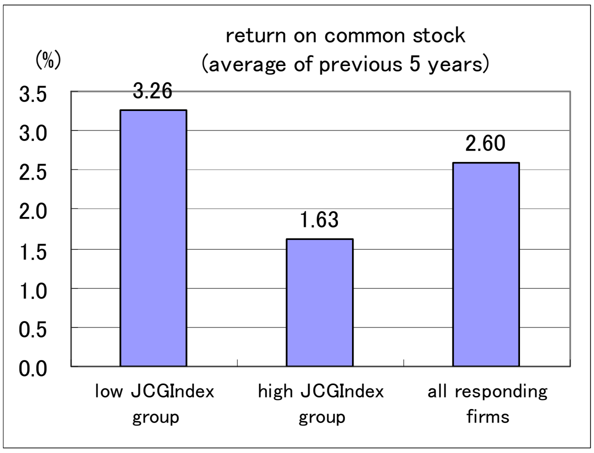
(5) JCGIndex and return on common stock (3 years and 5 years)

In the surveys of the previous three years, taking into consideration the measure of investment risk, beta (β), high JCGIndex firms had higher returns on investment. This time, this pattern has reversed due to a short-term phenomenon: over half of the high JCGIndex firms had negative return on common stock in 2004, and the average return on common stock over the previous three years was negative. This shows that the investment performance must be observed over a long period.



3 years

Total responding firms: 348
High JCGIndex firms: 54
Low JCGIndex firms: 58



5 years

Total responding firms: 322
High JCGIndex firms: 52
Low JCGIndex firms: 51

<adjustment for risk>

In a world where there is risk, return (in other words, average profitability in past years or future expected profit) cannot be evaluated without thinking about differences in risk. In modern capital markets, high risk=high return and low risk=low return, for both individual stocks and entire portfolios. This degree of risk is measured by the beta (β), and the risk-adjusted expected return of an investment is calculated as follows:

$$\text{Expected return} = \text{interest rate} + \beta \times (\text{expected market return} - \text{interest rate})$$

This formula is called the CAPM, or capital asset pricing model. According to this model, the expected return of a stock is a function of the risk-free rate (interest rate) plus the difference between the expected market return and risk-free rate, times a beta (β). The beta represents the contribution of a single stock to the total variance of the market portfolio, and thus is a measure of the relative risk of a stock. Predictions for the return for stocks listed on the first section of the Tokyo Stock Exchange in excess of the risk-free interest rate are in the range of 3% to 5%. The beta of the market portfolio is set at 1 and is the weighted average of betas of all listed stocks. Thus, betas of individual stocks are distributed around 1.

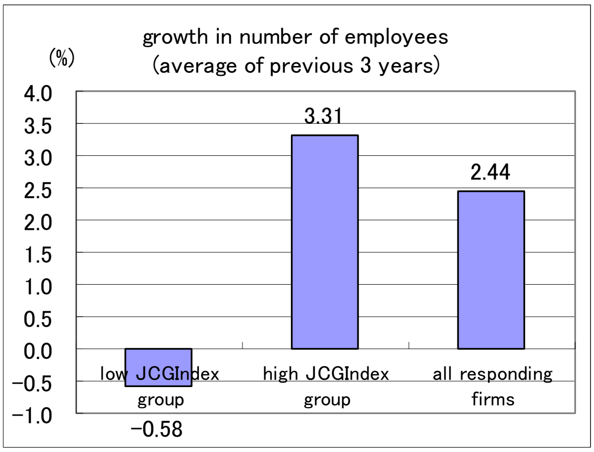
Based on this logic, if the excess return in the market is 4%, and the beta is 0.1 greater than that for other stocks, the return is expected to be 0.4% higher.

The following table shows the betas of high and low JCGIndex firms for 3 and 5 years. The significance level of the difference between the betas of high and low JCGIndex firms is 1% for 3 years, and 5% for 5 years. The three-year figure is based on data for return on common stock for 36 months from 2002 to 2004. The five-year figure is based on return on common stock for 60 months from 2000 to 2004.

During this period, some of the downside risk of the high JCGIndex firms is seen, and the return on common stock was lower for these firms. In the previous 3 years, shareholders of high JCGIndex firms received returns in excess of the risk.

	β 3 year	β 5 year
High JCGIndex firms	1.179	1.027
Low JCGIndex firms	1.020	.886
All responding firms	.991	.897

(6) JCGIndex and growth in number of employees (consolidated, 3 year)



Growth in employment for high JCGIndex firms is higher than growth in employment for low JCGIndex firms, is statistically significant (at the 1% level).

Total responding firms: 352*

High JCGIndex firms: 55

Low JCGIndex firms: 55

*We removed 2 outliers.

IV: Results by category and firm performance

1. Category specific results and their relationship to the entire JCGIndex

The following table shows the average number of points for each of the 4 categories that make up the JCGIndex for the high and low JCGIndex groups. In the parentheses, we report the contribution of each category expressed as a percentage of the total points. The difference between the high and low JCGIndex groups in the contribution of each category to the total is relatively small, with the exception of Category II, structure and function of board of directors. This indicates that high- and low- JCGIndex groups do not score particularly well or particularly poorly on a single category.

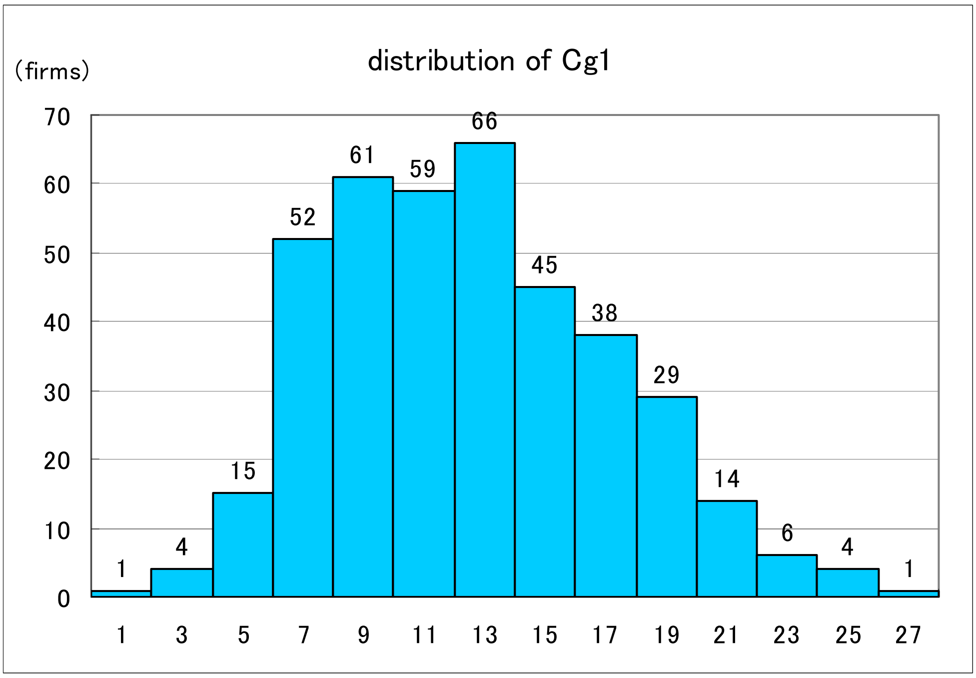
category	I	II	III	IV	JCGIndex
High JCGIndex firms	18.8 (27.1%)	13.7 (19.7%)	21.3 (30.7%)	15.6 (22.5%)	69.3 (100%)
Low JCGIndex firms	7.3 (24.1%)	4.9 (16.2%)	11.0 (36.3%)	7.1 (23.4%)	30.3 (100%)

2. High and low firms by category and performance

In the following section, we create groups of high and low firms for each category and compare their performance. We calculated the high and low groups in the same way as we calculated the high and low JCGIndex groups. The high groups consist of firms for which the points in a given category are over one standard deviation above the mean for that category, while the low groups consist of firms for which the points in a given category are over one standard deviation below the mean.
We refer to the total points received in categories I, II, III, and IV as Cg1, Cg2, Cg3, Cg4.

3. Category I (Corporate objectives and CEO responsibility)

(1) Distribution of Category I, and definition of high and low Cg1 groups



Distribution of Cg1

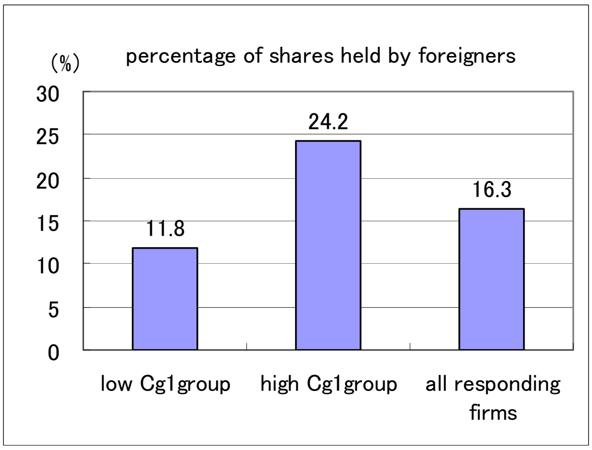
Mean: 12.0, standard deviation: 4.7, maximum, 27, minimum 0

High Cg1 group: 73 firms for which Cg1 is 17 or more

Low Cg1 group: 72 firms for which Cg1 is 7 or less

(2) Cg1 and firm characteristics

a. Percentage foreign ownership



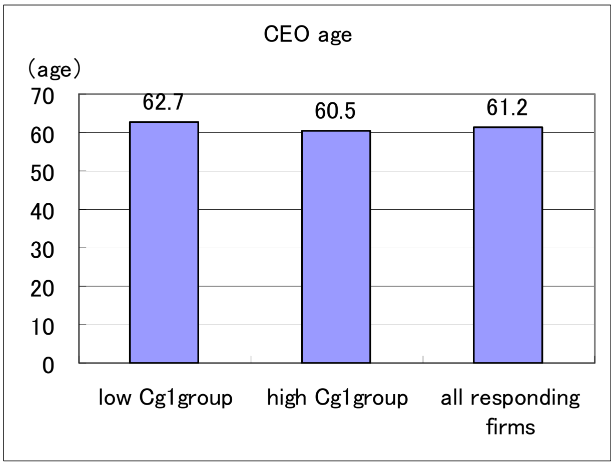
Foreign ownership is higher in high Cg1 firms than in low Cg1 firms, and this difference is statistically significant (at the 1% level).

Total responding firms: 371

High JCGIndex firms: 72

Low JCGIndex firms: 66

b. Age of CEO

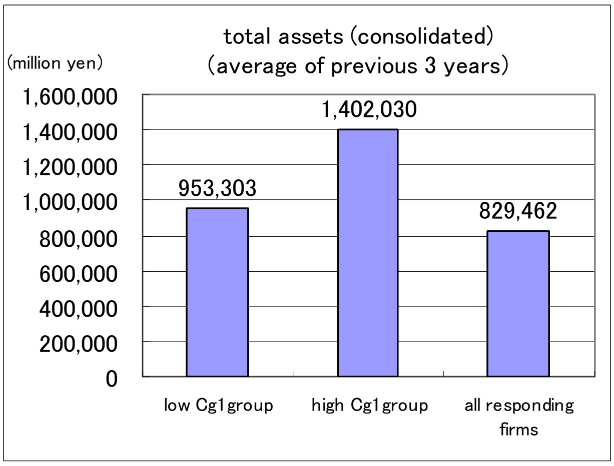


The CEOs of high JCGIndex firms are slightly younger than CEOs of low JCGIndex firms, and this difference is statistically significant (at the 5% level).

Total responding firms: 372
High JCGIndex firms: 71
Low JCGIndex firms: 69

(3) Cg1 and firm size

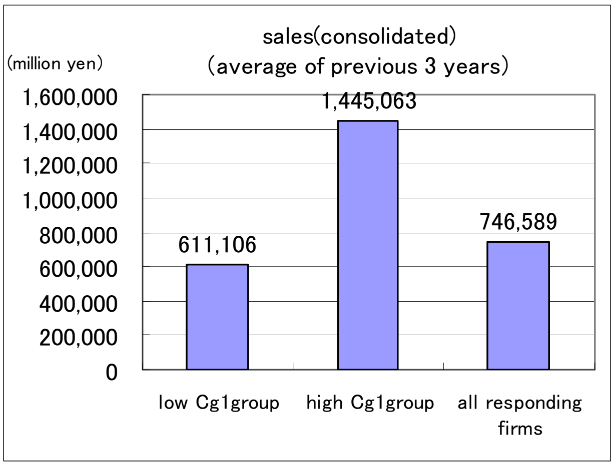
a. Total assets (consolidated, 3 years)



Total assets of high Cg1 firms are greater than total assets of low Cg1 firms, but this difference is not statistically significant (at the 10% level).

Total responding firms: 354
High JCGIndex firms: 66
Low JCGIndex firms: 63

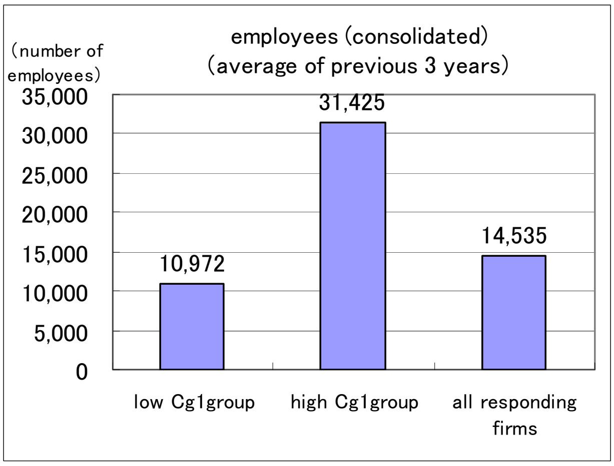
b. Total sales (consolidated, 3 years)



Total sales of high Cg1 firms are greater than total sales of low Cg1 firms, and this difference is statistically significant (at the 5% level).

Total responding firms: 354
High JCGIndex firms: 66
Low JCGIndex firms: 63

c. Number of employees (consolidated, 3 years)

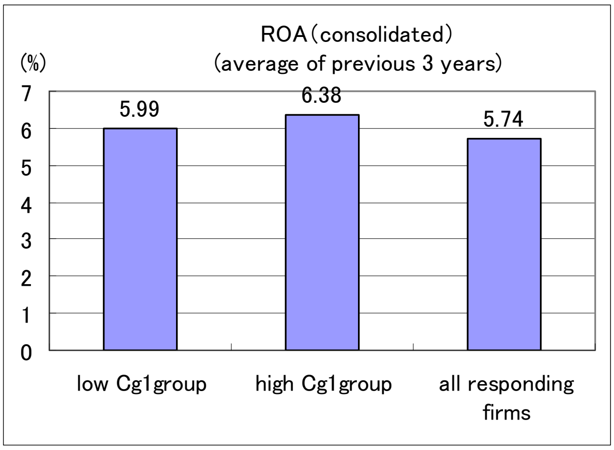


Number of employees of high Cg1 firms is greater than number of employees in low Cg1 firms, and this difference is significant (at the 1% level).

Total responding firms: 354
High JCGIndex firms: 66
Low JCGIndex firms: 63

(4) Cg1 and firm performance

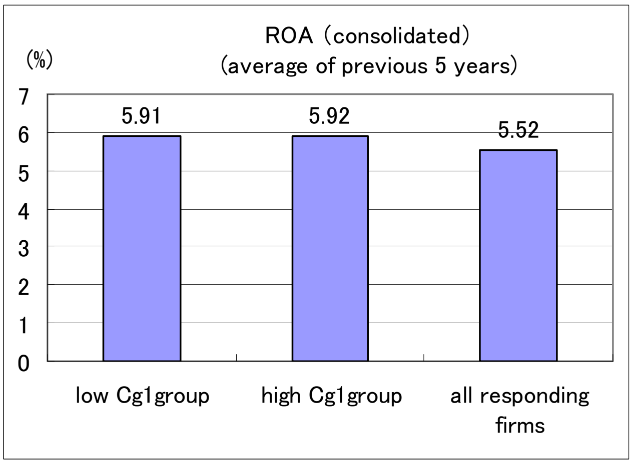
a. ROA (consolidated, 3 years and 5 years)



3 years

ROA for high Cg1 firms is higher than ROA for low Cg1 firms but this difference is not statistically significant (at the 10% level).

Total responding firms: 344
High JCGIndex firms: 63
Low JCGIndex firms: 61

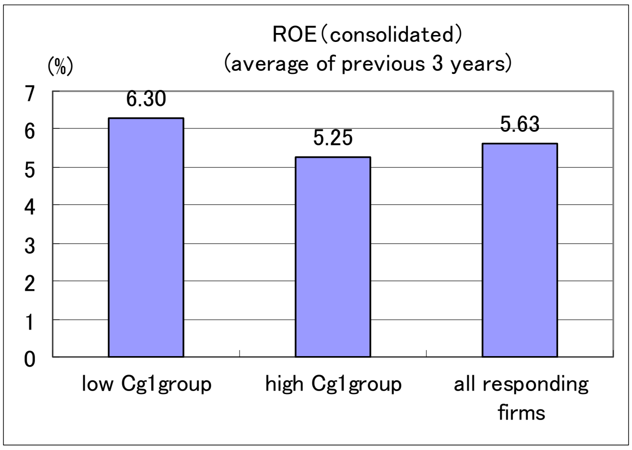


5 years

ROA for high Cg1 firms is higher than ROA for low Cg1 firms but this difference is not statistically significant (at the 10% level).

Total responding firms: 334
High JCGIndex firms: 63
Low JCGIndex firms: 59

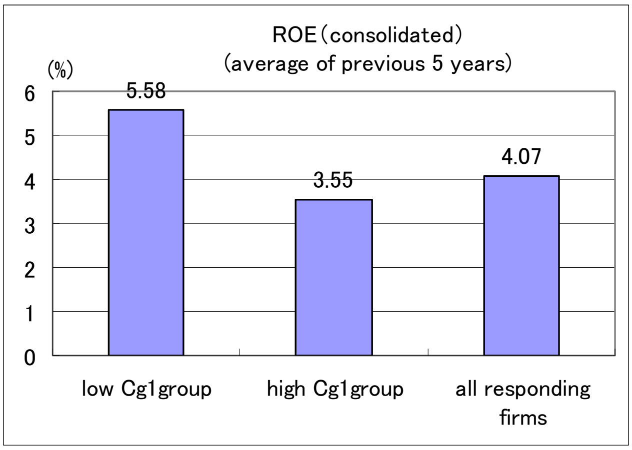
b. ROE (consolidated, 3 years and 5 years)



3 years

ROE for low Cg1 firms is higher than ROE for high Cg1 firms but this difference is not statistically significant (at the 10% level).

Total responding firms:	341
High JCGIndex firms:	63
Low JCGIndex firms:	60

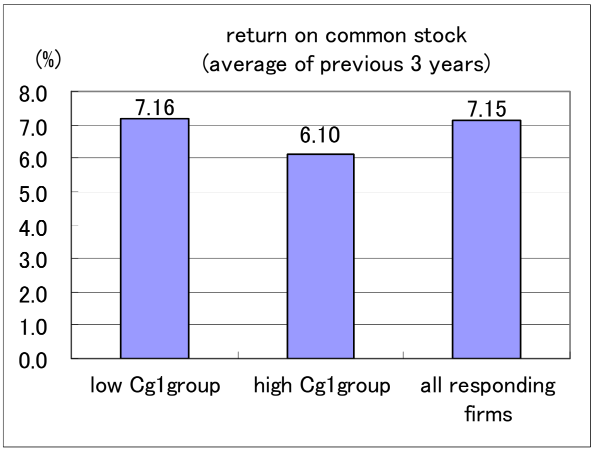


5 years

ROE for low Cg1 firms is higher than ROE for higher Cg1 firms and this difference is statistically significant (at the 10% level).

Total responding firms:	331
High JCGIndex firms:	63
Low JCGIndex firms:	58

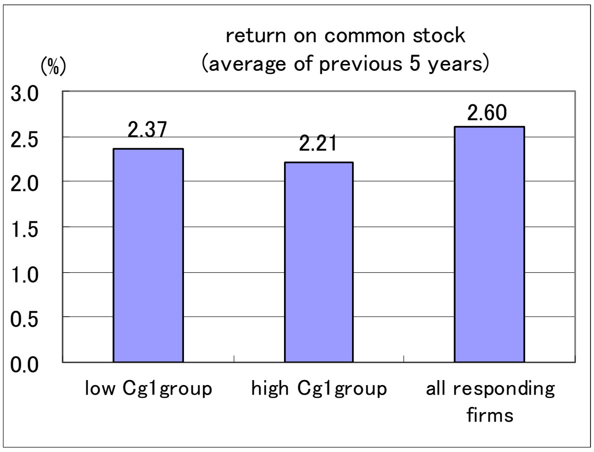
(5) Cg1 and return on common stock (3 years and 5 years)



3 years

Return on common stock for low Cg1 firms is higher than for high Cg1 firms, but this difference is not statistically significant (at the 10% level).

Total responding firms: 348
High JCGIndex firms: 64
Low JCGIndex firms: 63



5 years

Return on common stock for low Cg1 firms is higher than for high Cg1 firms, but this difference is not statistically significant (at the 10% level).

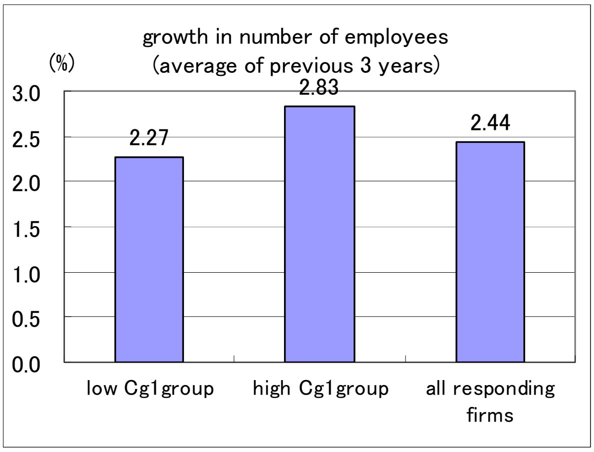
Total responding firms: 322
High JCGIndex firms: 63
Low JCGIndex firms: 55

<adjustment for risk>

The following table shows the betas of high and low Cg1 firms for 3 and 5 years. The difference between betas for the two groups is statistically significant in both cases (at the 1% level).

	β 3 year	β 5 year
High Cg1 firms	1.163	1.074
Low Cg1 firms	.904	.818
All responding firms	.991	.897

(6) Cg1 and growth in number of employees (consolidated, 3 year)



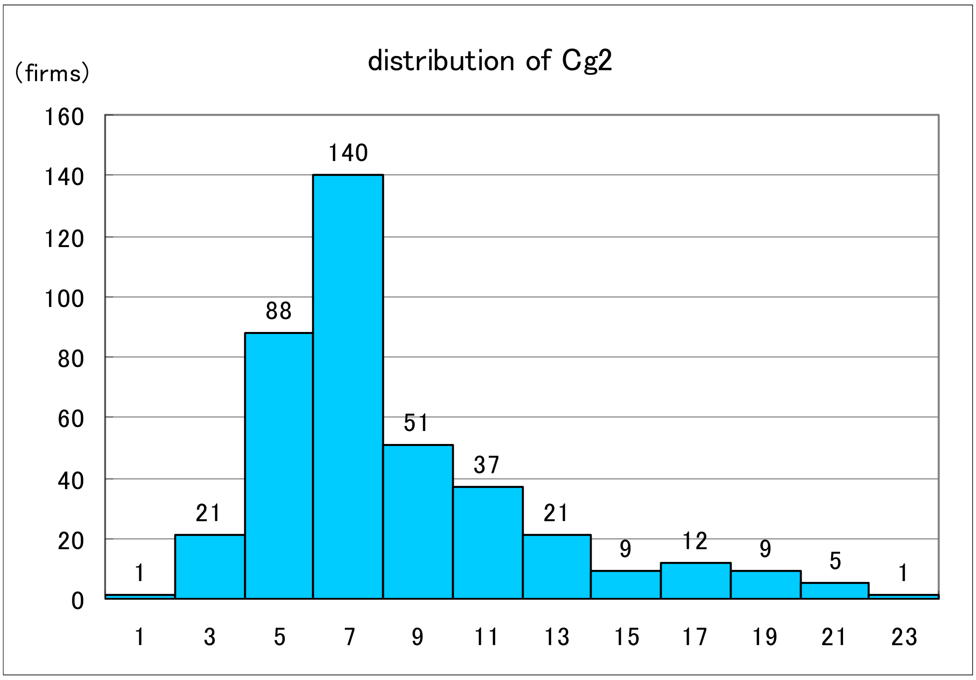
Growth in employment for high Cg1 firms is higher than growth in employment for low Cg1 firms, but this difference is not statistically significant (at the 10% level).

Total responding firms: 352*
High JCGIndex firms: 66
Low JCGIndex firms: 63

*one outlier was removed

4. Category II (Structure and function of board of directors)

(1) Distribution of Cg2, and definition of high and low Cg2 groups



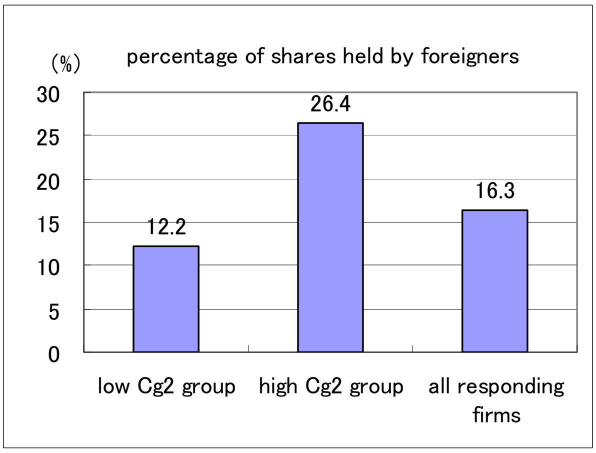
Mean: 7.7, standard deviation: 3.9, maximum, 22, minimum 0

High Cg2 group: 57 firms for which Cg2 is 12 or over

Low Cg2 group: 22 firms for which Cg2 is 3 or under

(2) Cg2 and firm characteristics

a. Percentage foreign ownership



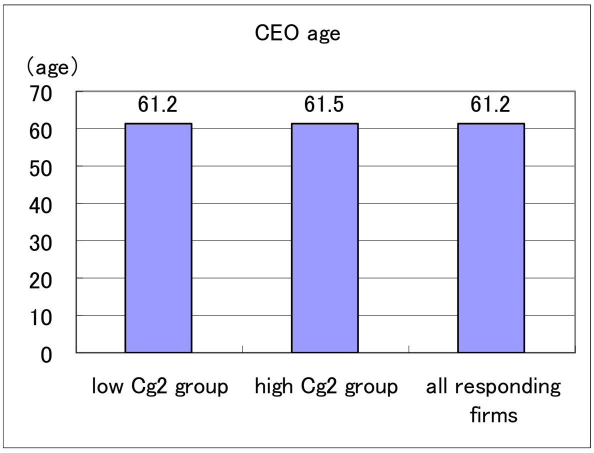
Foreign ownership is higher in high Cg2 firms than in low Cg2 firms, and this difference is statistically significant (at the 1% level).

Total responding firms: 371

High JCGIndex firms: 54

Low JCGIndex firms: 19

b. Age of CEO

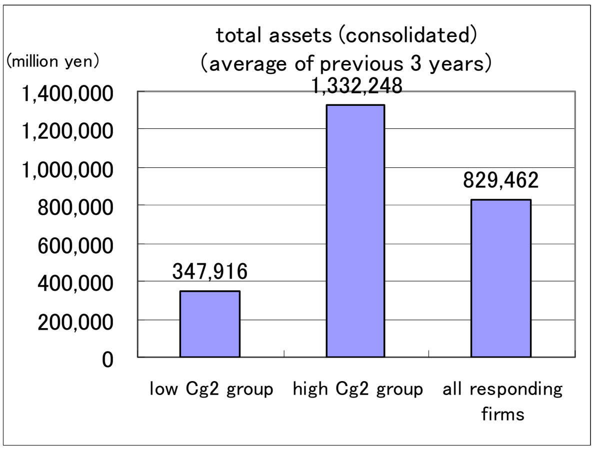


The CEOs of high Cg2 firms are slightly younger than CEOs of low Cg2 firms, but this difference is not statistically significant (at the 10% level).

Total responding firms: 372
High JCGIndex firms: 56
Low JCGIndex firms: 19

(3) Cg2 and firm size

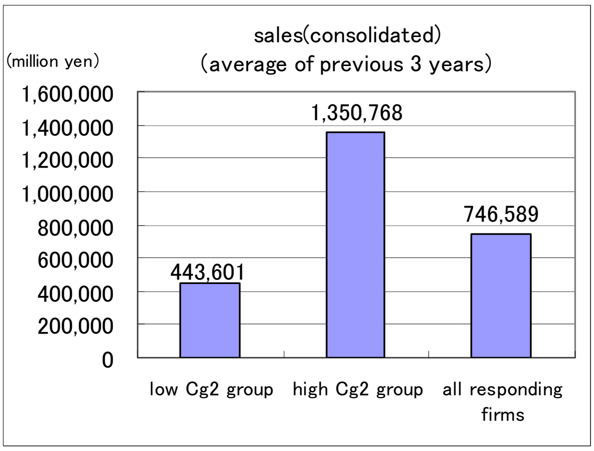
a. Total assets (consolidated, 3 years)



Total assets of high Cg2 firms are greater than total assets of low Cg2 firms, and this difference is statistically significant (at the 1% level).

Total responding firms: 354
High JCGIndex firms: 49
Low JCGIndex firms: 20

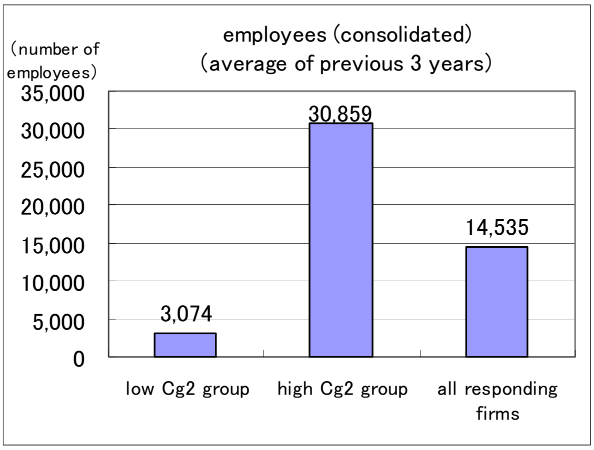
b. Total sales (consolidated, 3 years)



Total sales of high Cg2 firms are greater than total sales of low Cg2 firms, and this difference is statistically significant (at the 1% level).

Total responding firms: 354
High JCGIndex firms: 49
Low JCGIndex firms: 20

c. Number of employees (consolidated, 3 years)

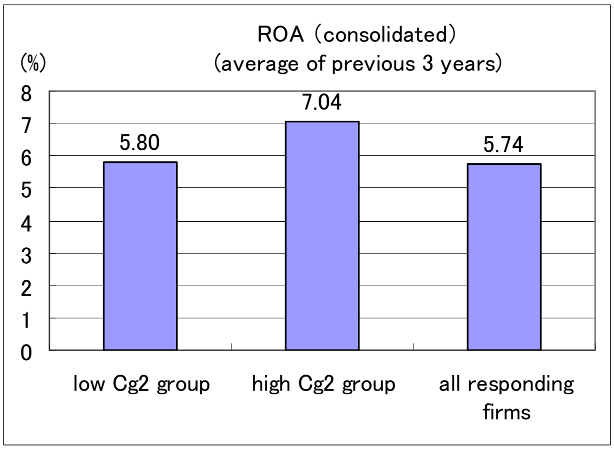


Number of employees of high Cg2 firms is greater than number of employees in low Cg2 firms, and this difference is significant (at the 1% level).

Total responding firms: 354
High JCGIndex firms: 49
Low JCGIndex firms: 20

(4) Cg2 and firm performance

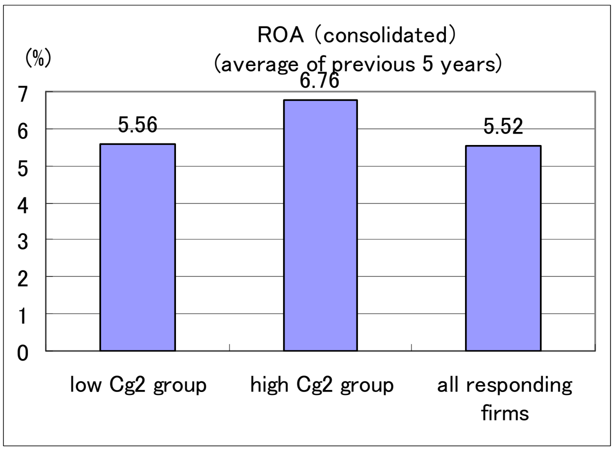
a. ROA (consolidated, 3 years and 5 years)



3 years

ROA for high Cg2 firms is higher than ROA for low Cg2 firms, but this difference is not statistically significant (at the 10% level).

Total responding firms: 344
High JCGIndex firms: 47
Low JCGIndex firms: 19

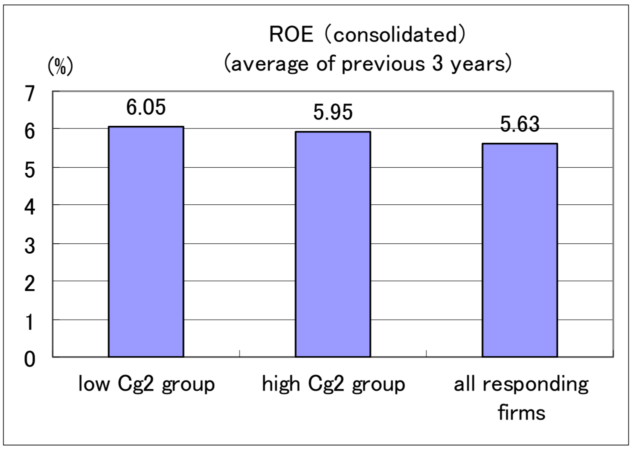


5 years

ROA for high Cg2 firms is higher than ROA for low Cg2 firms, but this difference is not statistically significant (at the 10% level).

Total responding firms: 334
High JCGIndex firms: 45
Low JCGIndex firms: 19

b. ROE (consolidated, 3 years and 5 years)



3 years

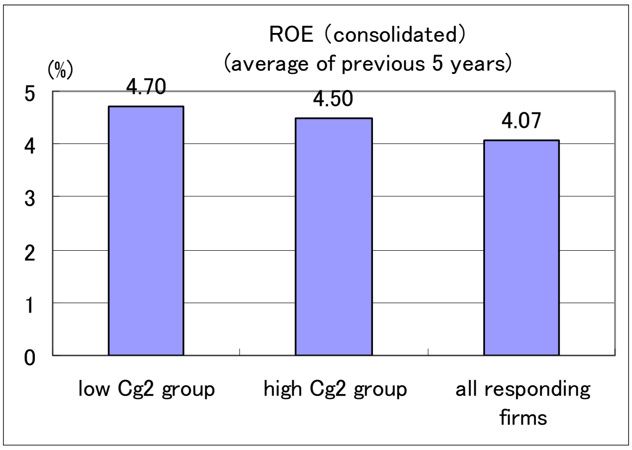
ROE for low Cg2 firms is higher than ROE for high Cg2 firms, but this difference is not statistically significant (at the 10% level).

Total responding firms: 341*

High JCGIndex firms: 47

Low JCGIndex firms: 18*

* 1 outlier removed



5 years

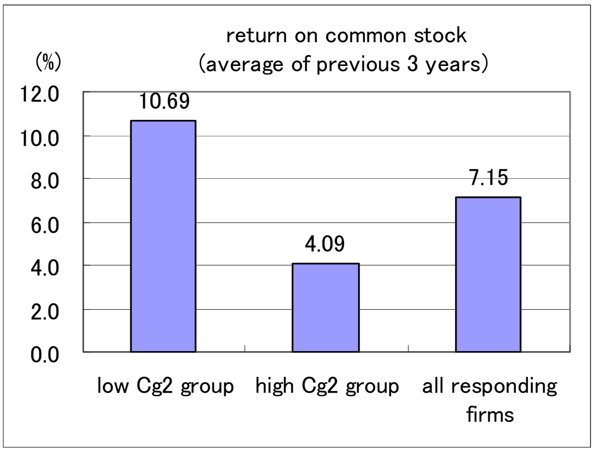
ROE for low Cg2 firms is higher than ROE for high Cg2 firms, but this difference is not statistically significant (at the 10% level).

Total responding firms: 331

High JCGIndex firms: 45

Low JCGIndex firms: 18

(5) Cg2 and return on common stock (3 years and 5 years)



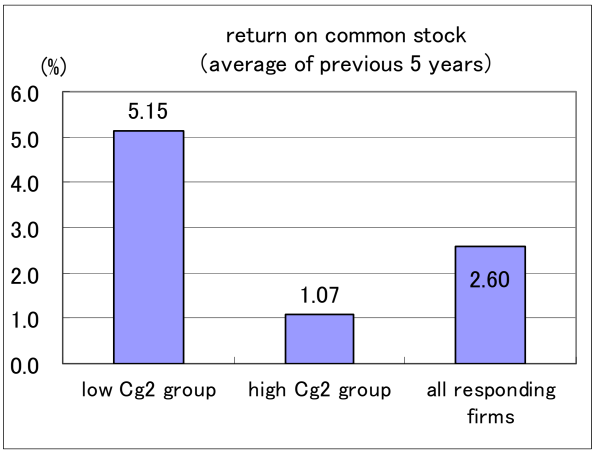
3 years

Return on common stock for low Cg2 firms is higher than return on common stock for high Cg2 firms, and this difference is statistically significant (at the 5% level).

Total responding firms: 348

High JCGIndex firms: 49

Low JCGIndex firms: 18



5 years

Return on common stock for low Cg2 firms is higher than return on common stock for high Cg2 firms, and this difference is statistically significant (at the 10% level).

Total responding firms: 322

High JCGIndex firms: 45

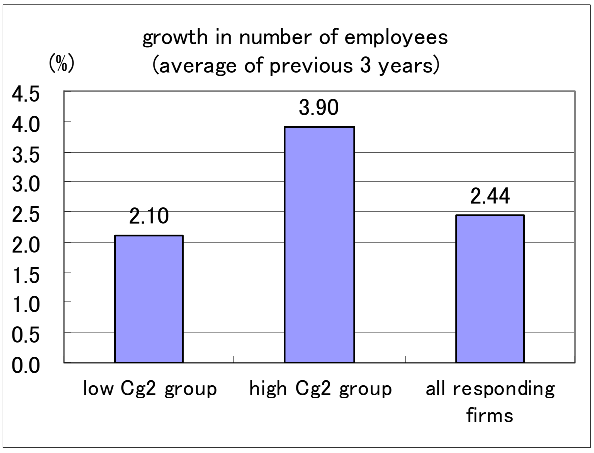
Low JCGIndex firms: 16

<adjustment for risk>

The following table shows the betas of high and low Cg2 firms for 3 and 5 years. The difference between betas for the two groups is not statistically significant (at the 10% level).

	β 3 year	β 5 year
High Cg2 firms	1.082	.962
Low Cg2 firms	.928	.837
All responding firms	.991	.897

(6) Cg2 and growth in number of employees (consolidated, 3 year)



Growth in employment for high Cg2 firms is higher than growth in employment for low Cg2 firms, but this difference is not statistically significant (at the 10% level).

Total responding firms: 352*

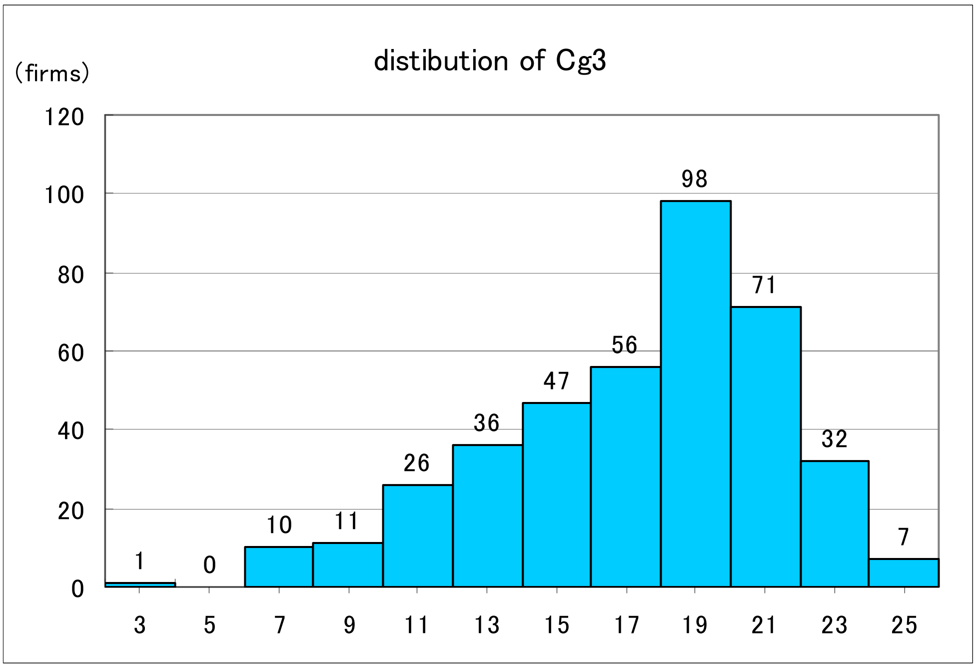
High JCGIndex firms: 49

Low JCGIndex firms: 20

*2 outliers were removed

5. Category III (Management system)

(1) Distribution of Cg3, and definition of high and low Cg3 groups



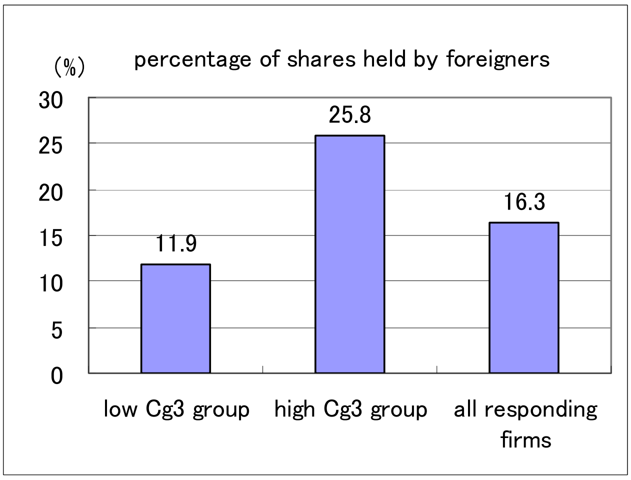
Mean: 16.9, standard deviation: 4.1, maximum, 25, minimum 3

High Cg3 group: 71 firms for which Cg3 is over 21

Low Cg3 group: 67 firms for which Cg3 is under 12

(2) Cg3 and firm characteristics

a. Percentage foreign ownership



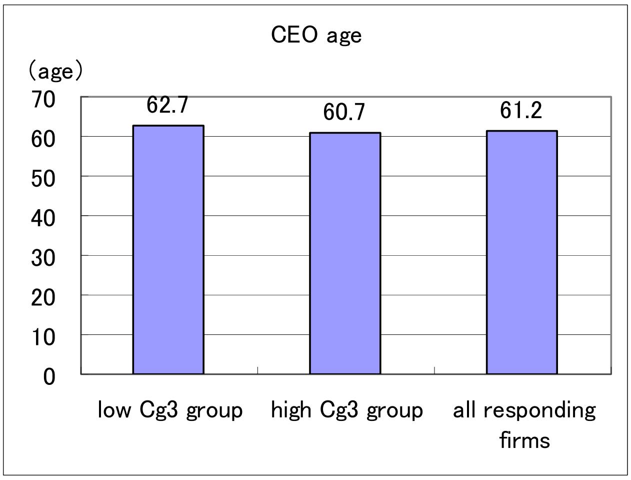
Foreign ownership is higher in high Cg3 firms than in low Cg3 firms, and this difference is statistically significant (at the 1% level).

Total responding firms: 371

High JCGIndex firms: 70

Low JCGIndex firms: 63

b. Age of CEO

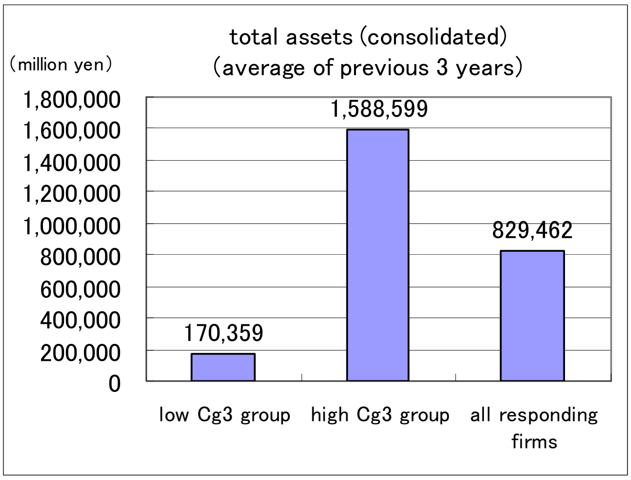


The CEO's of high Cg3 firms are younger than CEO's of low Cg3 firms, and this difference is statistically significant (at the 5% level).

Total responding firms: 372
High JCGIndex firms: 68
Low JCGIndex firms: 64

(3) Cg3 and firm size

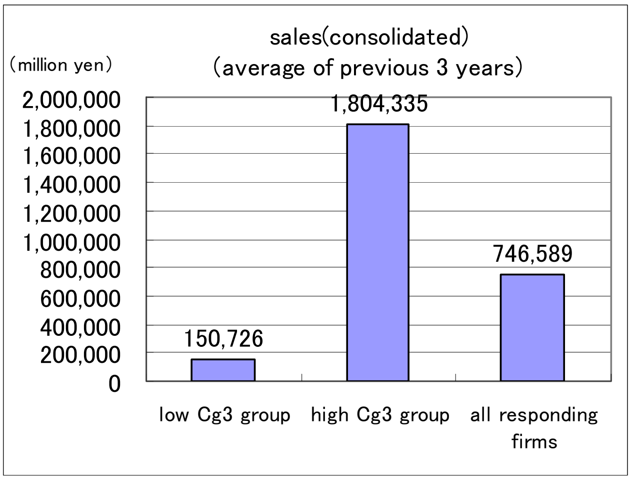
a. Total assets (consolidated, 3 years)



Total assets of high Cg3 firms are greater than total assets of low Cg3 firms, and this difference is statistically significant (at the 1% level).

Total responding firms: 354
High JCGIndex firms: 64
Low JCGIndex firms: 59

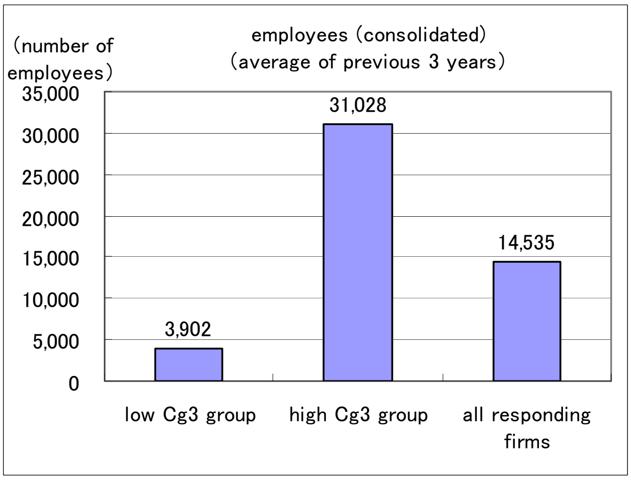
b. Total sales (consolidated, 3 years)



Total sales of high Cg3 firms are greater than total sales of low Cg3 firms, and this difference is statistically significant (at the 1% level).

Total responding firms: 354
High JCGIndex firms: 64
Low JCGIndex firms: 59

c. Number of employees (consolidated, 3 years)

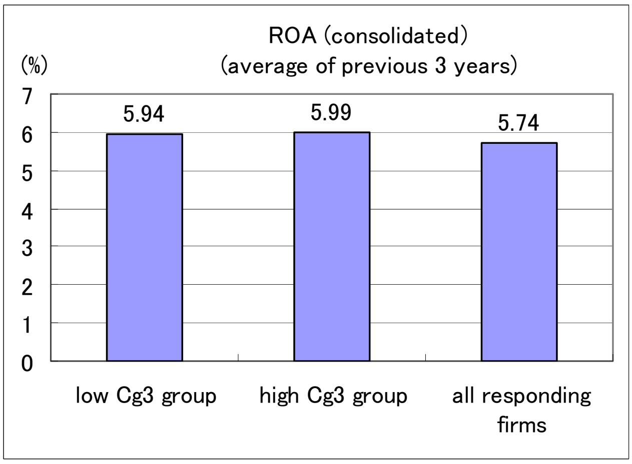


Number of employees of high Cg3 firms is greater than number of employees in low Cg3 firms, and this difference is statistically significant (at the 1% level).

Total responding firms: 354
High JCGIndex firms: 64
Low JCGIndex firms: 59

(4) Cg3 and firm performance

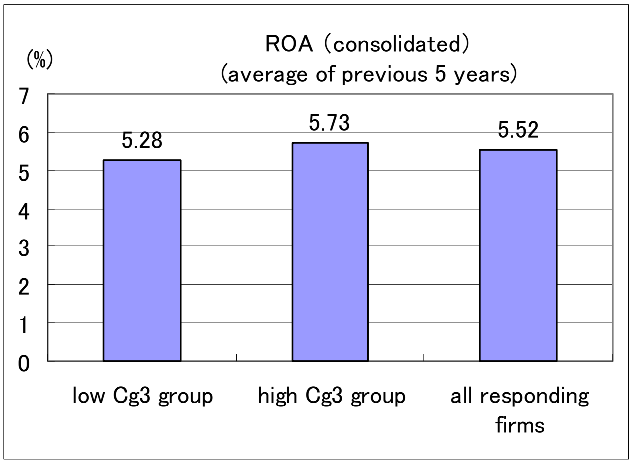
a. ROA (consolidated, 3 years and 5 years)



3 years

ROA for high Cg3 firms is higher than ROA for low Cg3 firms but this difference is not statistically significant (at the 10% level).

Total responding firms: 344
High JCGIndex firms: 61
Low JCGIndex firms: 59

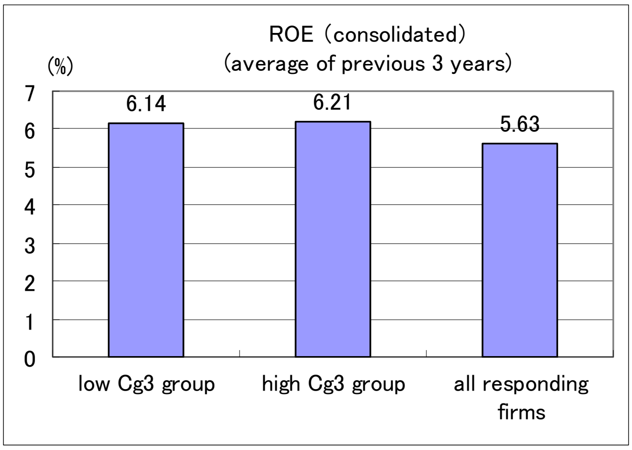


5 years

ROA for high Cg3 firms is higher than ROA for low Cg3 firms, but this difference is not statistically significant (at the 10% level).

Total responding firms: 334
High JCGIndex firms: 61
Low JCGIndex firms: 58

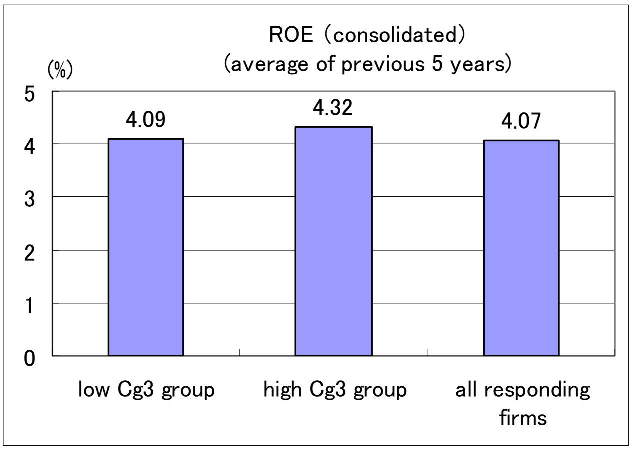
b. ROE (consolidated, 3 years and 5 years)



3 years

ROE for high Cg3 firms is lower than ROE for low Cg3 firms but this difference is not statistically significant (at the 10% level).

Total responding firms: 341*
High JCGIndex firms: 61
Low JCGIndex firms: 58*
*1 outlier removed

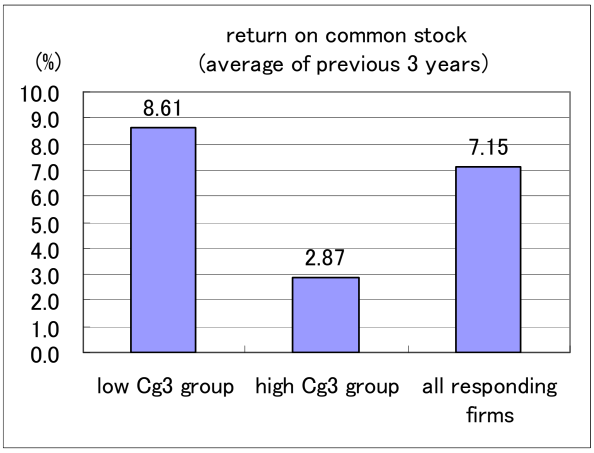


5 years

ROE for high Cg3 firms is higher than ROE for low Cg3 firms, but this difference is not statistically significant (at the 10% level).

Total responding firms: 331
High JCGIndex firms: 61
Low JCGIndex firms: 57

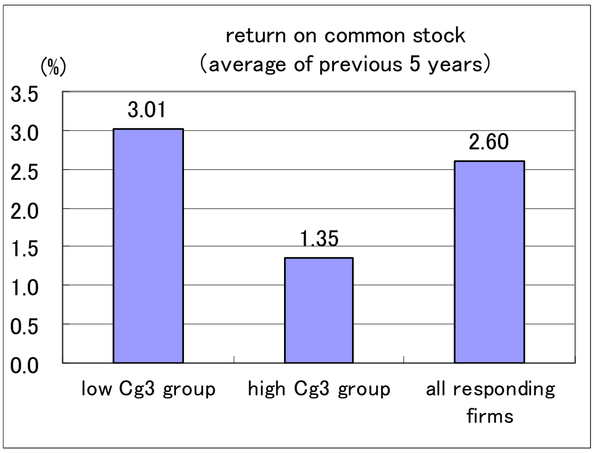
(5) Cg3 and return on common stock (3 years and 5 years)



3 years

Return on common stock for low Cg3 firms is higher than return on common stock for high Cg3 firms, and this difference is statistically significant (at the 5% level).

Total responding firms: 348
High JCGIndex firms: 64
Low JCGIndex firms: 62



5 years

Return on common stock for low Cg3 firms is higher than return on common stock for high Cg3 firms, but this difference is not statistically significant (at the 10% level).

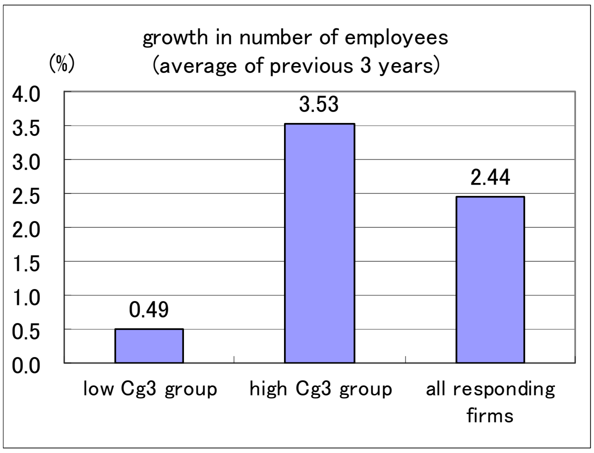
Total responding firms: 322
High JCGIndex firms: 62
Low JCGIndex firms: 54

<adjustment for risk>

The following table shows the betas of high and low Cg3 firms for 3 and 5 years. The difference between betas for the two groups is statistically significant in both cases (at the 1% level).

	β 3 year	β 5 year
High Cg3 firms	1.074	.976
Low Cg3 firms	1.032	.887
All responding firms	.991	.897

(6) Cg3 and growth in number of employees (consolidated, 3 year)

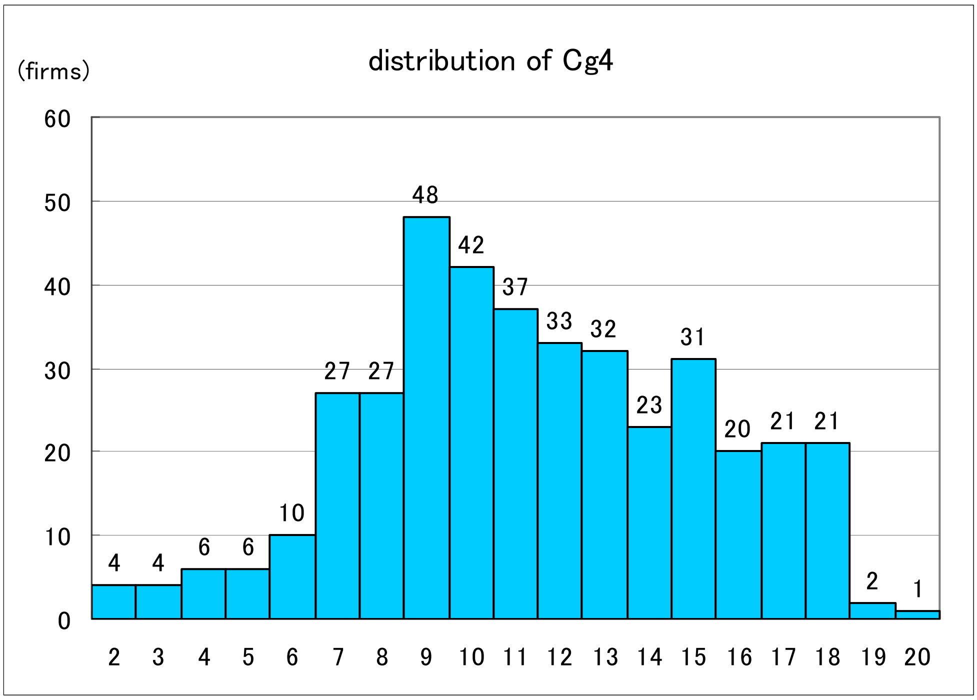


Growth in employment for high Cg3 firms is higher than growth in employment for low Cg3 firms, and this difference is statistically significant (at the 5% level).

Total responding firms: 352*
High JCGIndex firms: 64
Low JCGIndex firms: 59
*2 outliers were removed

6. Category IV (Transparency and communication with shareholders)

(1) Distribution of Cg4, and definition of high and low Cg4 groups



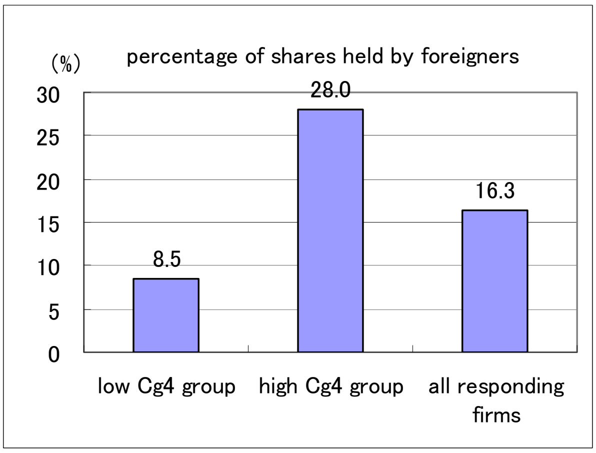
Mean: 11.4, standard deviation: 3.7, maximum, 20, minimum 2

High Cg4 group: 65 firms for which Cg4 is over 16

Low Cg4 group: 57 firms for which Cg4 is under 7

(2) Cg4 and firm characteristics

a. Percentage foreign ownership



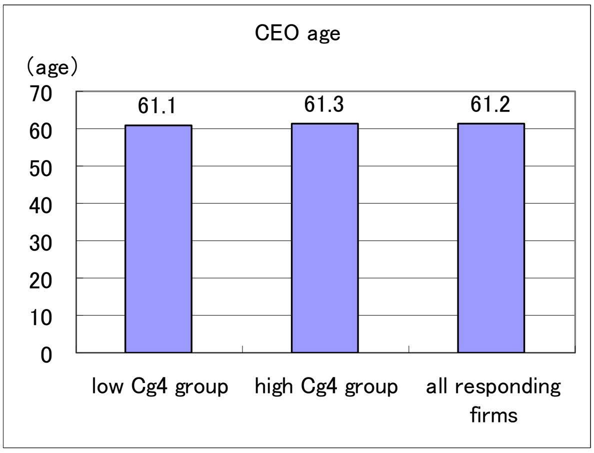
Foreign ownership is higher in high Cg4 firms than in low Cg4 firms, and this difference is statistically significant (at the 1% level).

Total responding firms: 371

High JCGIndex firms: 65

Low JCGIndex firms: 50

b. Age of CEO

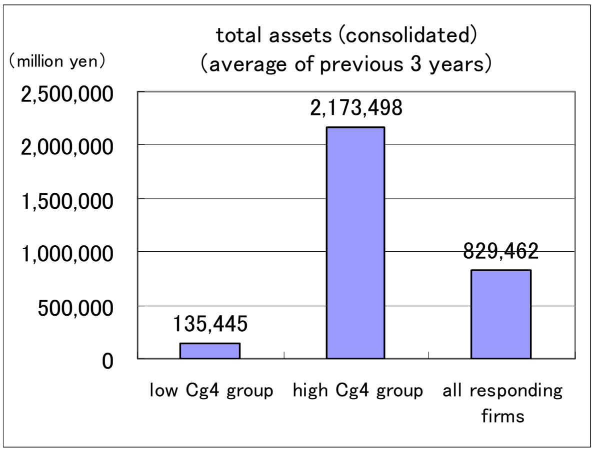


The CEOs of high Cg4 firms are younger than CEOs of low Cg4 firms, but this difference is not statistically significant (at the 10% level).

Total responding firms: 372
High JCGIndex firms: 61
Low JCGIndex firms: 51

(3) Cg4 and firm size

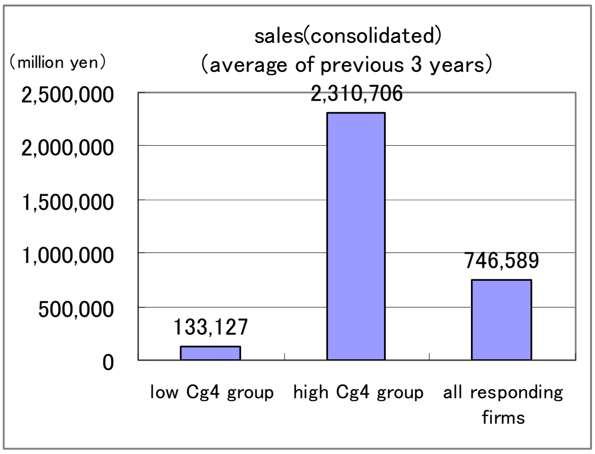
a. Total assets (consolidated, 3 years)



Total assets of high Cg4 firms are greater than total assets of low Cg4 firms, and this difference is statistically significant (at the 1% level).

Total responding firms: 354
High JCGIndex firms: 57
Low JCGIndex firms: 53

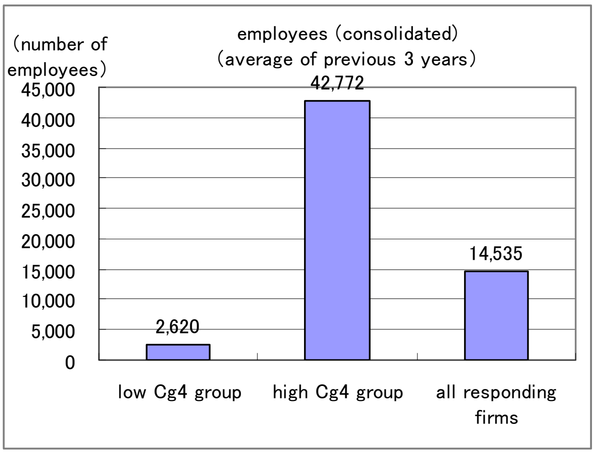
b. Total sales (consolidated, 3 years)



Total sales of high Cg4 firms are greater than total sales of low Cg4 firms, and this difference is statistically significant (at the 1% level).

Total responding firms: 354
High JCGIndex firms: 57
Low JCGIndex firms: 53

c. Number of employees (consolidated, 3 years)

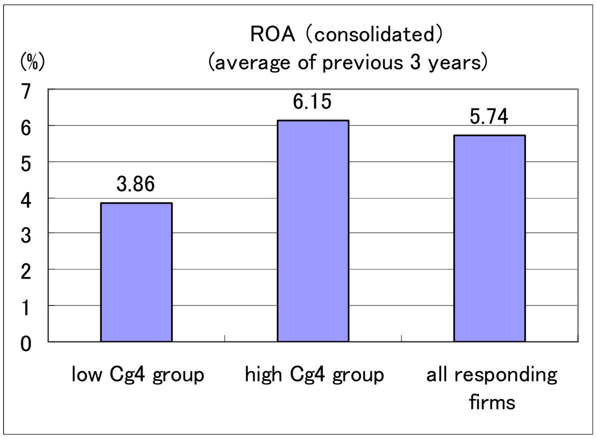


Number of employees of high Cg4 firms is greater than number of employees in low Cg4 firms, and this difference is statistically significant (at the 1% level).

Total responding firms: 354
High JCGIndex firms: 57
Low JCGIndex firms: 53

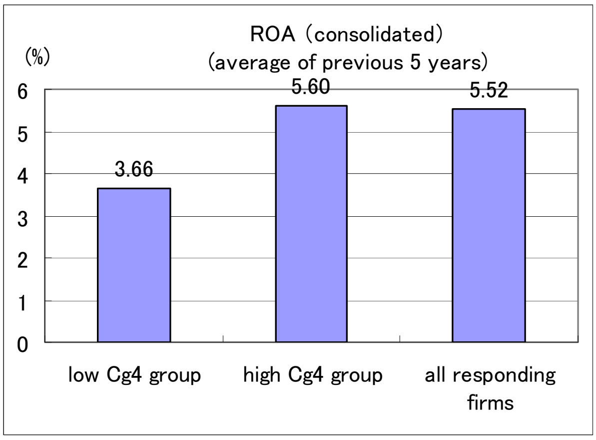
(4) Cg4 and firm performance

a. ROA (consolidated, 3 years and 5 years)



3 years
ROA for high Cg4 firms is higher than ROA for low Cg4 firms and this difference is statistically significant (at the 1% level).

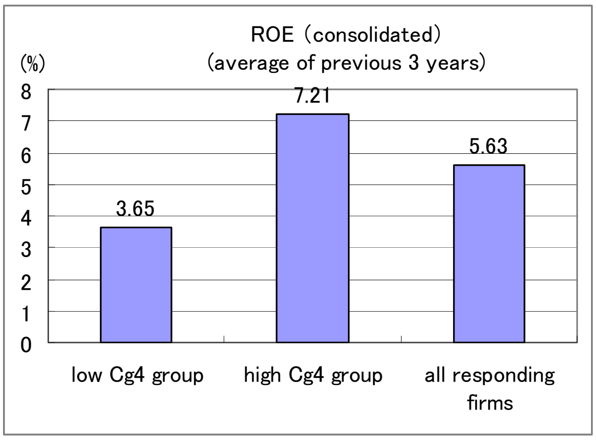
Total responding firms: 344
High JCGIndex firms: 50
Low JCGIndex firms: 52



5 years
ROA for high Cg4 firms is higher than ROA for low Cg4 firms, and this difference is statistically significant (at the 5% level).

Total responding firms: 334
High JCGIndex firms: 47
Low JCGIndex firms: 52

b. ROE (consolidated, 3 years and 5 years)



3 years

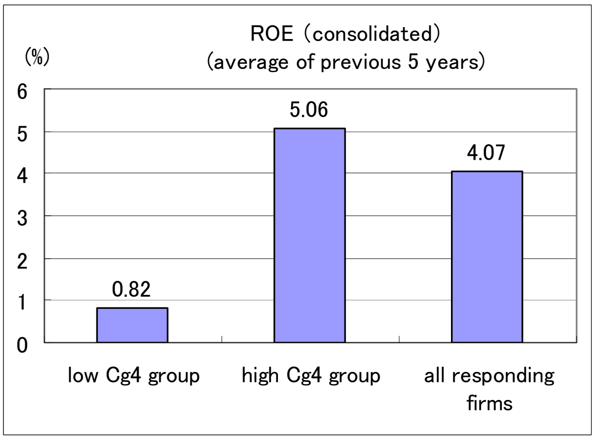
ROE for high Cg4 firms is higher than ROE for low Cg4 firms and this difference is statistically significant (at the 5% level).

Total responding firms: 341*

High JCGIndex firms: 50

Low JCGIndex firms: 50*

*1 outlier removed



5 years

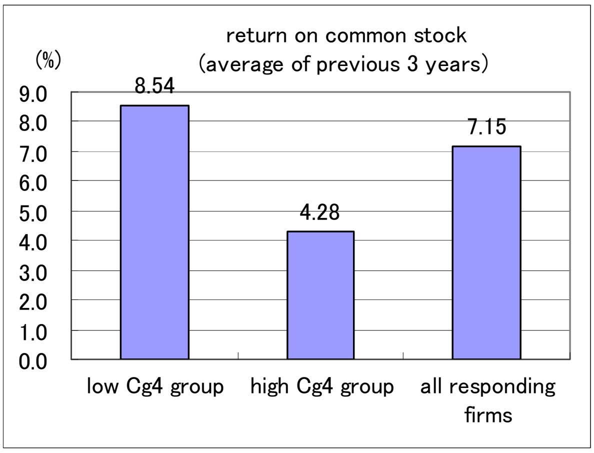
ROE for high Cg4 firms is higher than ROE for low Cg4 firms, and this difference is statistically significant (at the 1% level).

Total responding firms: 331

High JCGIndex firms: 47

Low JCGIndex firms: 50

(5) Cg4 and return on common stock (3 years and 5 years)



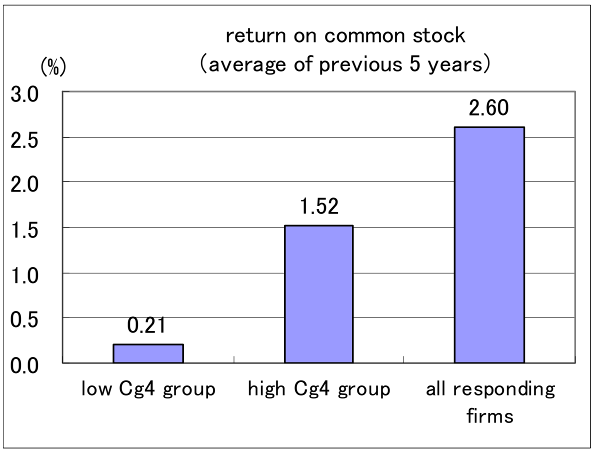
3 years

Return on common stock for low Cg4 firms is higher than return on common stock for high Cg4 firms, and this difference is statistically significant (at the 5% level).

Total responding firms: 348

High JCGIndex firms: 57

Low JCGIndex firms: 56



5 years

Return on common stock for low Cg4 firms is higher than return on common stock for high Cg4 firms, but this difference is not statistically significant (at the 10% level).

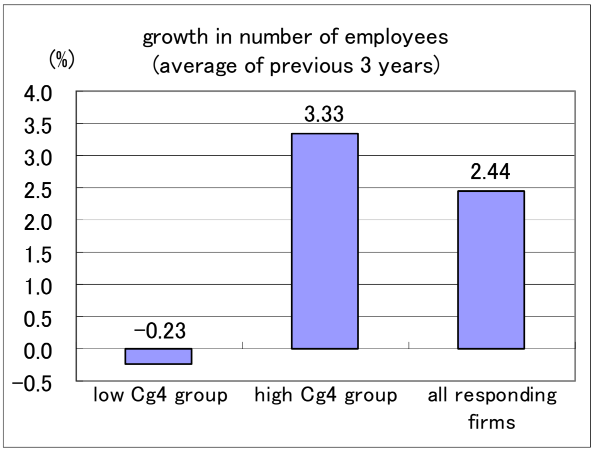
Total responding firms: 322
High JCGIndex firms: 55
Low JCGIndex firms: 54

<adjustment for risk>

The following table shows the betas of high and low Cg4 firms for 3 and 5 years. The difference between betas for 5 years only is statistically significant (at the 10% level).

	β 3 year	β 5 year
High Cg4 firms	1.120	1.025
Low Cg4 firms	1.017	.911
All responding firms	.991	.897

(6) Cg4 and growth in number of employees (consolidated, 3 year)



Growth in employment for high Cg4 firms is higher than growth in employment for low Cg4 firms, and this difference is statistically significant (at the 1% level).

Total responding firms: 352*
High JCGIndex firms: 57
Low JCGIndex firms: 53
*2 outliers were removed

Conclusion

Over 4 consecutive years, a total of 589 firms have responded to the JCGIndex survey. In each year, these responses have shown a clear relationship between the JCGIndex and firm performance. High JCGIndex firms enjoy superior performance to low JCGIndex firms. The closer a firm's governance system is to the JCGR corporate governance model, the more value it provides to its shareholders.

Compared to last year, however, the level of statistical significance in comparisons of performance for high and low JCGIndex groups has declined, and high JCGIndex did not provide a higher return to shareholders. This is particularly clear in the three-year averages. One possible explanation is that firms that have recently been experiencing poor performance have embarked on governance reforms. As a result, the high JCGIndex group mixes firms that have excellent performance and governance with troubled firms that have recently revised their governance systems. We are conducting further research to better understand this phenomenon.

When evaluating the results, it is necessary to keep the following in mind: First, these results reflect past performance and do not necessarily mean a future relationship. Second, while the sample size of 395 is in itself is not small, it represents only 24% of the about 1,700 Tokyo First Section listed firms. However, over the last three years, we have found very similar results among different sets of responding firms. This suggests that while the annual sample size has been small, our findings are robust. Third, the relationship between the JCGIndex and financial results that we show here is correlation, and not causation, and further research is necessary to establish causal relationships.

An explanation of the data used for analysis

1. Industry classifications

Tokyo Stock Exchange industry classifications

2. Financial data

Source: NEEDS (Nikkei Shinbunsha data bank)

Firms covered: Tokyo Stock Exchange First Section firms (1,687 firms as of November 19, 2005).

Items: Total assets, sales, number of employees, ROA, ROE (firm-based and consolidated)

Period: January 2000 to December 2004

3. Return on common stock

Source: Nihon Shoken Keizei Kenkyusho 2004 Kabushiki Toshi Shueki Ritsu

Firms covered: Tokyo Stock Exchange First Section firms (1,687 firms as of November 19, 2005).

Items: Monthly returns on individual stock and market

Period: January 2000 to December 2004

4. Beta

Calculated by Fujitsu Research Institute

Source: Toyo Keizai Inc., "Stock Price CD-ROM 2005"

5. Calculation of characteristics of the responding firms

Average, minimum, maximum and standard deviation of the responded firms were compared with those of the Tokyo Stock Exchange First Section firms, based on consolidated financial data for the previous 3 or 5 years.

	item	consolidation	term	data	formula
1	total assets	○	3year-average	NEEDS total assets (FB144)	total assets＝total debts＋total equities
2	sales	○	3year-average	NEEDS sales (FC001)	revenue from sales activities as operating activities
3	ROA	○	3year-average	NEEDS ROA：(FP01034)	return on asset＝（operating income＋interest and discount charge income）／total of debt・minority interest・assets of 2 period -average×100
4	ROE	○	3year-average	NEEDS ROE(FP01147)	return on equity＝net income／total equities of 2period-average×100
5	employees	○	3year-average	NEEDS employees (FE056)	number of employees at year-end
6	stock return	—	3year-average	Nihon Shoken Keizei Kenkyusho stock return	① Calculated monthly stock return ② Calculated average of period covered（1year、5years、10years）

Note 1) Tokyo Stock Exchange First Section firms: 1,687 firms as of 11/19/2005

The number of Tokyo Stock Exchange First Section firms was 1,649 when JCGR sent the mail survey as of 07/22/2005.

Note 2) Consolidated accounting takes priority according to SEC accounting requirements.