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Corporate Governance Survey Report 2011

Japan Corporate Governance Research Institute
JCGIndex Survey Group
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This report outlines the results of the 10th annual Corporate Governance Survey (JCGIndex) 2011 of the Japan Corporate Governance Research Institute（JCGR）. We are grateful to all companies that responded to this survey.

1. Scope/period of this survey, and number of companies that responded

From August 2011 to October 2011, we surveyed all companies listed on the First Section of the Tokyo Stock Exchange (1,668, as of August 8, 2011), of which 120 responded to the survey. We feel sorry for the inconvenience that happened when we switched to an online survey last year. Having reflected the initial confusions last year and your opinions, we continued surveying online this year, and managed to get responses from roughly the same number of companies as last time. Note that one company had to be omitted for analysis due to the significant incompleteness of its response.

We have received responses from 822 distinct companies (and a cumulative total of 2,443) throughout the surveys. The numbers of companies that responded to our survey for each year are as follows: 159 (2002）, 201(2003）, 341(2004), 405 (2005), 312 (2006), 311（2007), 252（2008), 215（2009）, 127（2010), and 120（2011）.

2. Contents and categorization of questions

Companies have social responsibility of serving for the benefits of all stakeholders—employees, managers, customers, suppliers, creditors, shareholders, governments, and local communities to name some— because the support from these stakeholders are necessary for the companies' existence. In the framework of joint-stock company, however, companies are in reality (not by law) treated as private property of shareholders, who contribute money to the company and in turn exercise the control over the company as owners. Moreover, they take responsibility for the consequences of the business and bear this risk of business. However, shareholders do not directly participate in management, because joint-stock companies adopt separation of ownership and management. They instead elect directors at the shareholders' meeting and entrust the management to the board of directors. The thus elected board acts as the agent of the shareholders and controls the company. That is governance by board of directors.

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In the last 20 years, separation of governance and management has become the foundation of corporate governance. Although directors used to simultaneously serve as executive officers all over the world, it is now the global understanding that directors should be separate from executive officers against the backdrop of fierce competitive environments of globalization and innovation. Under this model of separation, board of directors should focus on governance to bring about good management from executive officers, who are selected by board of directors and entrusted with management.

Here, the board of directors is tasked with nomination, compensation, and audit functions for the effective governance. It selects good candidates of executives through its nomination function. It exercises the compensation function of providing an incentive for goal-oriented management to executive officers in the form of performance-linked compensation system. Furthermore, the function of auditing the management’s business execution is indispensable to fulfill the current needs of compliance. Executives establish the management system under the governance by board of directors to pursue profit through business operations.

Based on the above described best practice, JCGIndex Survey’s questions are comprised of the following 7 parts:

Part Ⅰ	Performance targets, leadership of CEO	9 questions
Part Ⅱ	Efforts on corporate governance	4 questions
Part Ⅲ	Board of directors	10 questions
Part Ⅳ	Management system	10 questions
Part Ⅴ	Evaluation of management, compensation system	5 questions
Part Ⅵ	Management of consolidated subsidiaries	2 questions
Part Ⅶ	Communication with shareholders	8 questions

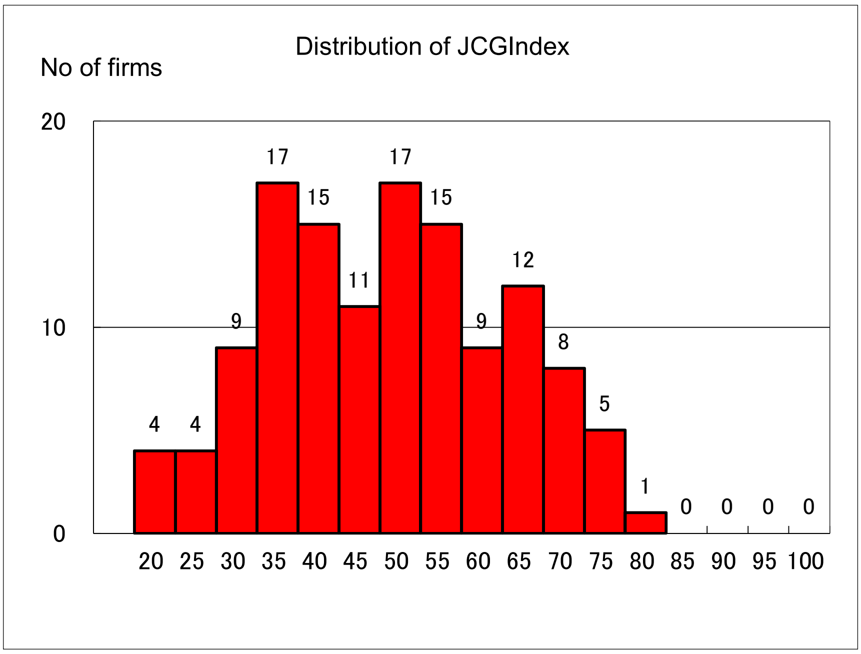
These 48 questions in total are recategorized into 4 categories to calculate sub-scores for each category. Each category represents the following perspective:

Category Ⅰ Performance targets and structure of responsibilities of management
Based on Part Ⅰ and Part Ⅱ
Category Ⅱ Functions and composition of board of directors
Based on Part Ⅲ
Category Ⅲ Executive management structure of top management
Based om Part Ⅳ, Part Ⅴ and Part Ⅵ
Category Ⅳ Communication with shareholders and transparency
Based on Part Ⅶ

Categories Ⅰ and Ⅱ are related to corporate governance system, and Ⅲ and Ⅳ are about corporate management system. Although it is possible to value the corporate governance through Categories Ⅰ and Ⅱ alone, Categories Ⅲ and Ⅳ are incorporated into JCGIndex, based on the belief that good management system is established under the good governance system.

3. Distribution of JCGIndex

The results of JCGIndex for the 119 companies that responded to our survey in 2011 turned out as the graph in the below shows. While this time's questions are exactly identical to those in the last survey, we have made the scoring standard stricter for some questions, since (1) understanding and interest in corporate governance are now enhancing and (2) the relevant systems on internal control and independent directors were revised. However, both the mean JCGIndex and the standard deviation slightly increased from 2010: the former to 51.3 from 50.5, the latter to 14.7 from the previous 14.4. The maximum JCGIndex in 2011 decreased to 77 from 81 in 2010, and the minimum also decreased to 17 from 20.

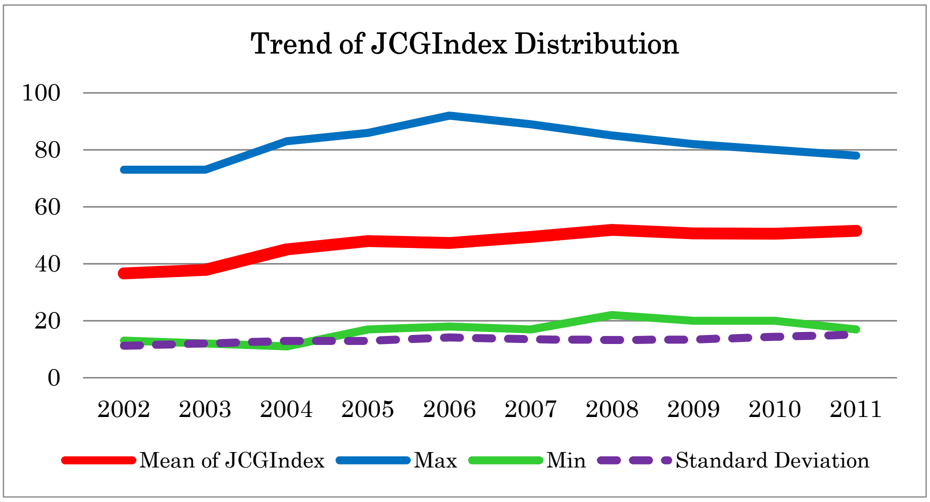


Mean：51.28 Standard Deviation：14.68

4. Trend of the distribution of JCGIndex

The trends of mean, maximum and minimum in the past 10 surveys for JCGIndex are presented in the table above. It should be noted that the figures for each year cannot be simply compared to those for another, because the samples change year by year. Furthermore, questions and proportions were modified in 2006, and proportions alone moderately changed in 2009. Still, an upward trend in JCGIndex is observed.

Even though only a couple of companies achieve JCGIndex of the maximum or near level, the maximum has consistently decreased from 2006, which can be largely attributable to the changes in questions and proportions.



5. Sub-scores and achievement rates by category

To clarify the companies' performance for each category having different weight, the table below converts the mean figure into achievement rate in percentage. The table also contains JCGIndex and the previous year's results (in parentheses) just for reference。

Just as the same as the previous surveys, the achievement rates of Categories Ⅰ and Ⅱ for corporate governance remain still low. This clearly implies the overall inadequacy of Japanese corporate governance but could be also interpreted that management reforms are preceding in Japanese companies. Nonetheless, the achievement rates for Categories Ⅲ and Ⅳ are still not sufficient (both about 66%), which might attest "no good governance, no good management."

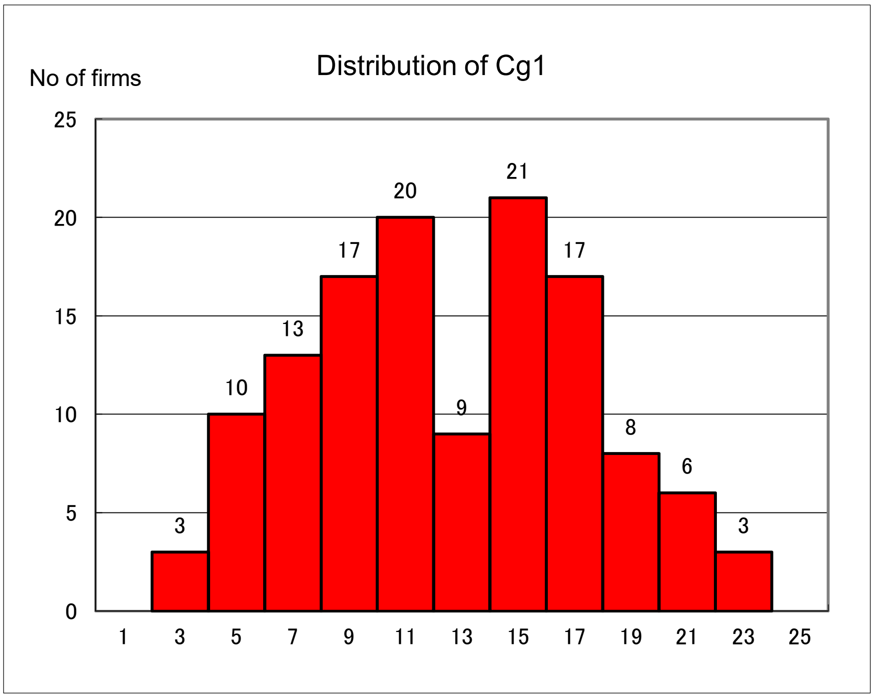
Sub-scores and achievement rates by category

Category		Weight (A)	Mean (B)	Achievement rate (B) / (A)
I	Performance targets and structure of responsibilities of management	29 (29)	12.13 (12.0)	41.8% (41.4%)
II	Functions and composition of board of directors	26 (26)	9.46 (9.35)	36.4% (36.0%)
III	Executive management structure of top management	25 (25)	16.43 (16.14)	65.7% (64.6%)
IV	Communication with shareholders and transparency	20 (20)	13.26 (13.03)	66.3% (65.2%)
JCGIndex		100 (100)	51.28 (50.52)	

*Results in 2010 are in parentheses.

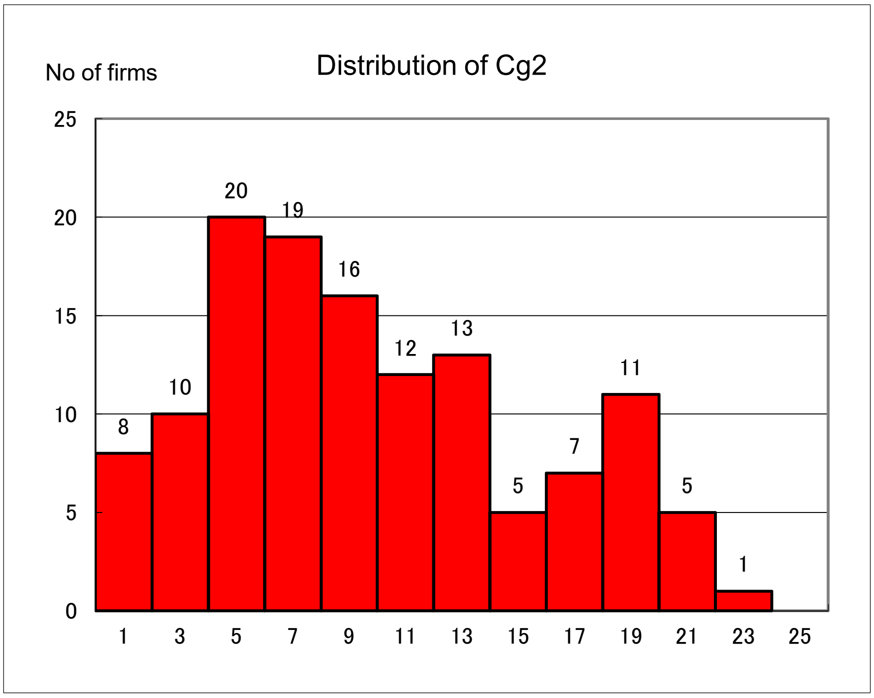
Below are tables for distribution of sub-scores by category. This time, we especially made the scoring standard stricter for the functions of the board of directors. Companies that merely follow the law on the composition of the board get no score. Those that are reluctant to separate governance and management or introduce independent directors even lose scores. As a result, some company got -1 for Category Ⅱ.

Category Ⅰ Performance targets and structure of responsibilities of management



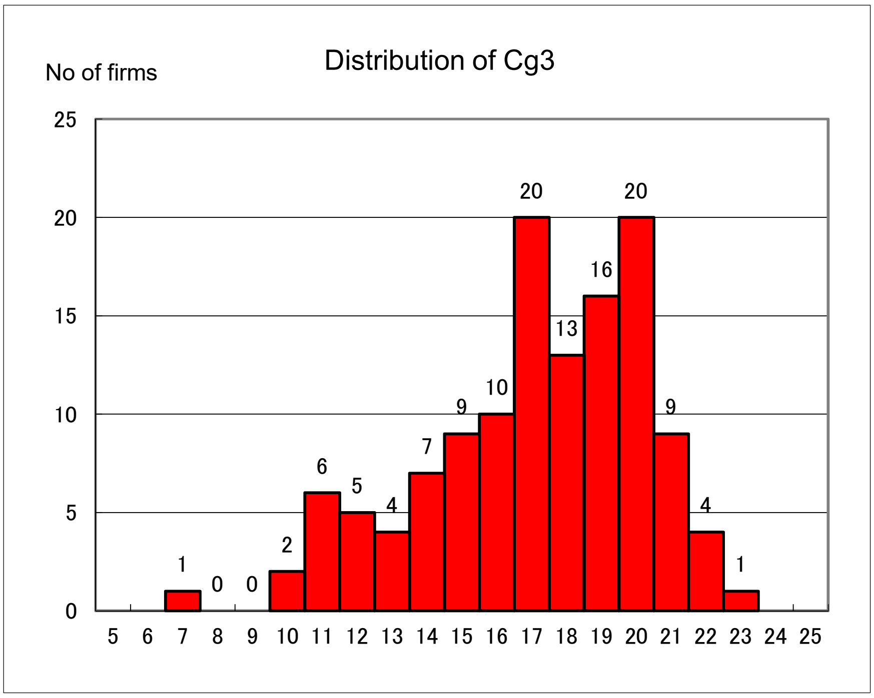
Mean:12.13 Standard Deviation:4.80

Category Ⅱ Functions and composition of board of directors



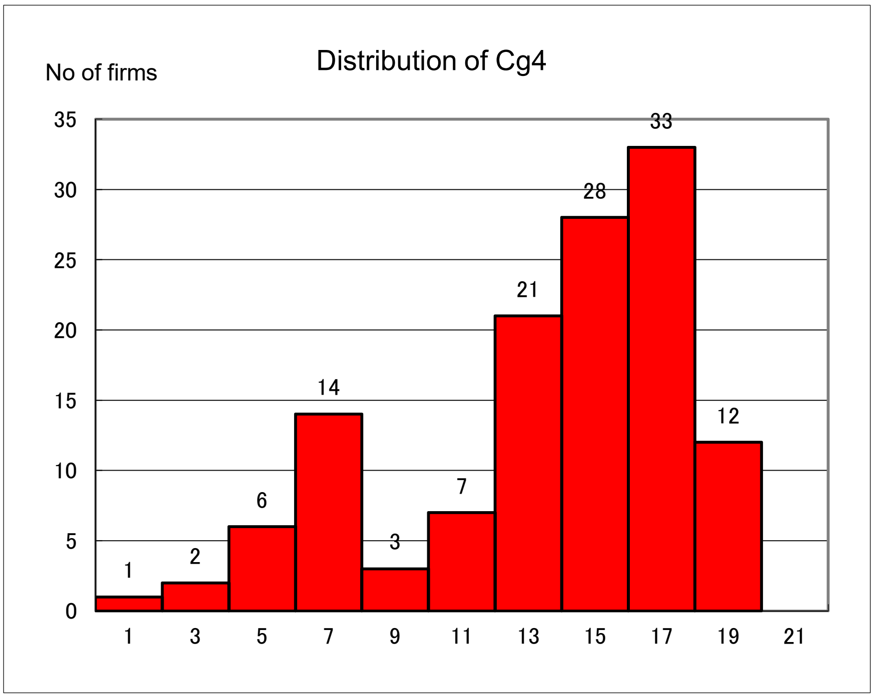
Mean:9.46 Standard Deviation:5.84

Category Ⅲ Executive management structure of top management



Mean：16.43 Standard deviation：3.17

Category Ⅳ Communication with shareholders and transparency



Mean：13.26 Standard deviation：4.28

5. Correlations among sub-scores and JCGIndex

The table below shows correlation coefficients between categories and between a category and JCGIndex. The correlations among categories are roughly around 0.5, with the maximum being 0.6526 for Categories Ⅱ and Ⅲ. That means that each category does not overlap with others greatly and rather covers distinctive factors. It is therefore meaningful to measure the condition of corporate governance with these four categories.

Correlations among sub-scores and JCGIndex

	Category Ⅰ	Category Ⅱ	Category Ⅲ	Category Ⅳ	JCGIndex
Category Ⅰ	1.0000				
Category Ⅱ	0.5329	1.0000			
Category Ⅲ	0.5661	0.6526	1.0000		
Category Ⅳ	0.5194	0.4979	0.4708	1.0000	
JCGIndex	0.8121	0.8576	0.7973	0.7607	1.0000

Below is the result of regression analysis for the relationships between JCGIndex and Categories Ⅰ and Ⅱ (t-statistics are in parenthesis).

JCGIndex= 18.75 + 1.52×Category Ⅰ + 1.49×Category Ⅱ R^2=0.911
(16.9) (15.2) (18.2)

Below is the result of regression analysis for the relationships between JCGIndex and Categories Ⅲ and Ⅳ.

JCGIndex= -14.22 + 2.62×Category Ⅲ + 1.70×Category Ⅳ R^2=0.823
(-4.70) (12.9) (11.3)

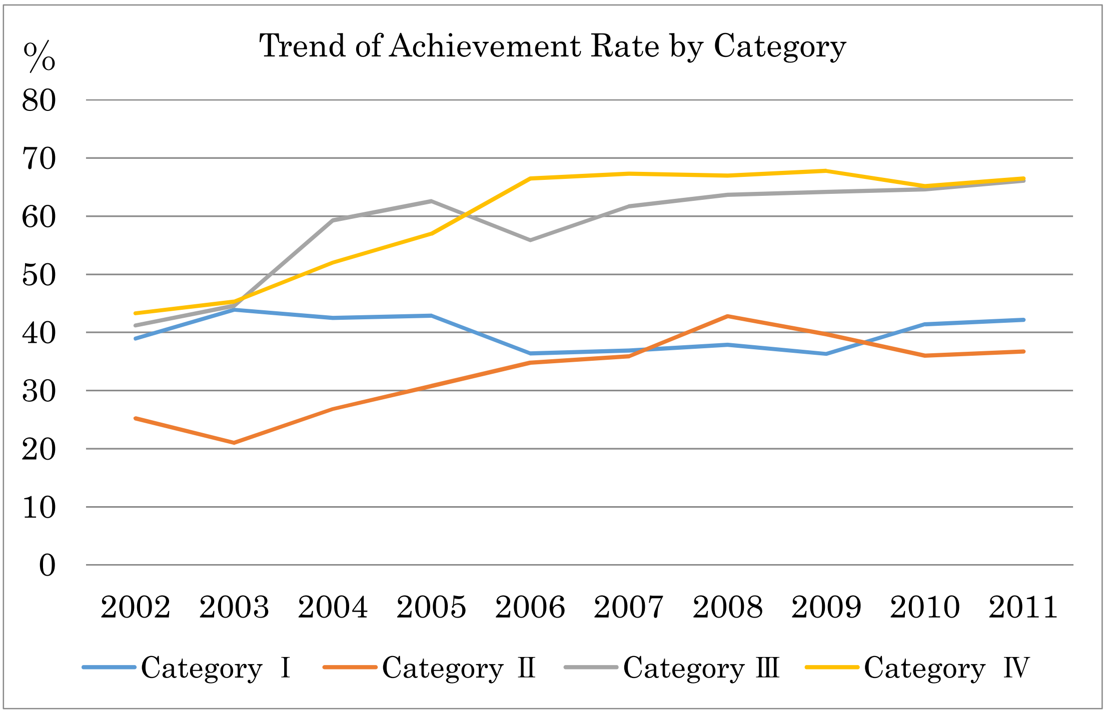
Comparing the t-statistics, it is predictable that while Categories Ⅲ and Ⅳ for management have strong correlation with the JCGIndex, Categories Ⅰ and Ⅱ for governance have even stronger correlation with the JCGIndex.

6. Trends of achievement rate by category

The table below depicts the trend of achievement rates by category. It is remarkable that the rate for Category Ⅱ representing the functions and composition of board of directors (which is to say corporate governance itself) increased until 2008. On the other hand, the rates for Category Ⅰ do not present a clear trend throughout the survey.

What is significant is that Category Ⅳ representing disclosure and transparency saw the rate rapidly increase until 2006 and remains high afterward and the rate for Category Ⅲ representing the management system is consistently on an upward trend. That could indicate that the management reforms are progressing (still, not sufficient yet).

It is significant that the achievement rates for the management categories of Ⅲ and Ⅳ constantly exceed those for the governance categories of Ⅰ and Ⅱ throughout the surveys. That is a clear indication that governance systems are far from developed.



7. High JCGIndex companies and low JCGIndex companies

The mean of JCGIndex is 51.28, and the standard deviation of JCGIndex is 14.68 for 2011. Mean plus a standard deviation equals to 65.97 and mean minus a standard deviation equals to 36.60. From these calculations, we define JCGIndex of 66 or more to be high JCGIndex, and JCGIndex of 36 or less to be low JCGIndex. With the actual number of high JCGIndex companies being 23 and low JCGIndex companies 21, the distribution of JCGIndex is close to normal distribution (in a normal distribution, companies above/below a standard deviation would constitute approximately 15.9% for each, so the number would be 19 for each).

The table below exhibits the sub-scores by category and JCGIndex of the high and low JCGIndex companies.

High JCGIndex companies and low JCGIndex companies

	Category				JCGIndex
	Ⅰ	Ⅱ	Ⅲ	Ⅳ	
High JCGIndex companies	18.0	17.9	19.3	16.4	71.7
Low JCGIndex companies	6.5	3.2	12.4	6.7	28.9

High JCGIndex companies achieve 2.5 times as much JCGIndex as low JCGIndex companies. In addition, the sub-scores for High JCGIndex companies are far better than those for low JCGIndex companies in every category. This indicates that every category functions as a condition for high JCGIndex companies.

The table above presents, however, that the difference between high and low JCGIndex companies is relatively small in Categories Ⅲ and Ⅳ for management evaluation and significantly large in Categories Ⅰ and Ⅱ for governance evaluation. The difference is especially remarkable in Category Ⅱ for functions and composition of board of directors, clearly implying that high JCGIndex companies and low JCGIndex companies are differentiated with board of directors as the center of corporate governance system. As for management system, the companies see larger difference in Category Ⅳ for disclosure and transparency.

9. Companies with high JCGIndex

See the list of companies with high JCGIndex attached to this report.

10. Closing remarks

2011 marks the 10th JCGIndex Survey. Even though as many as 405 companies responded to the 4th survey in 2005, the number has been steadily declining. We ourselves are partly to blame for this situation, considering that the number sharply decreased in 2010 when we switched to an online survey. Nonetheless, this consistent downward trend would be mostly attributable to waning interest in corporate governance in Japan.

The stock prices in Japan have been consistently on a downward trend since 1990, while those in the West and the emerging economies are largely on an upward trend. In other words, the stock market has been lowering its expectation toward the Japanese economy. Since the majority of the transactions in the Japanese stock market are done by foreign investors, that concludes that Japanese companies have been losing value on a global scale.

Japanese companies have no time for hesitating to revitalize themselves, and it is worth keeping an eye on their management. Good governance induces good management. Good management embraces governance as tutor. Governance and management are like the two wheels of a cart, so there is no good management where there is no good governance. As the results of the JCGIndex Survey for ten years clearly illustrates, Japan is in urgent need of governance reforms.

Capitalism centering on the joint-stock company system aims to make society safer and richer through companies' profit-making in the framework of market economy under competition. Shareholders, who exercise governance over corporate management, are responsible for companies' commercial success. In Japan, where the roles and responsibilities of shareholders are hardly taken into consideration, the lack of corporate governance is apparent. That makes the companies too fragile in the fierce global competition.

The scandals of Olympus Corporation and Daio Paper Corporation are raising awareness of on corporate governance, but preventing misconduct is not the sole objective of governance. The main objective of corporate governance is to establish a management system for pursuing profit without any wrongdoing. We should not just focus on corporate scandals. We should enhance understanding on corporate governance, and seriously make efforts to develop the governance.

【Appendix】

Companies with 60 or higher JCGIndex in 2011（37 companies）

Rank	JCGIndex	Company
1	78	Sony Corporation
2	77	Toshiba Corporation
2	77	TDK Corporation
2	77	Nissen Holdings Co., Ltd.
2	77	Daiwa Securities Group Inc.
6	76	Sumida Corporation
7	75	Ube Industries, Ltd.
7	75	Nomura Holdings, Inc.
9	74	Ichiyoshi Securities Co., Ltd.
10	72	Mitsubishi Electric Corporation
10	72	*（1 company）
12	71	Eisai Co., Ltd.
12	71	Ricoh Co., Ltd.
14	70	Konica Minolta Japan, Inc.
14	70	*（1 company）
16	69	Shiseido Company, Limited
16	69	Nidec Corporation
18	67	Cosmo Oil Co., Ltd.
18	67	AUTOBACS SEVEN Co., Ltd.
20	66	Kao Corporation
20	66	Terumo Corporation
20	66	Hitachi, Ltd.
20	66	Tokio Marine Holdings, Inc.
24	65	JS Group Corporation
24	65	*（1 company）
26	64	Lawson, Inc.
26	64	Resona Holdings, Inc
28	63	Sojitz Corporation
28	63	Tokyo Electron Limited
30	62	Anritsu Corporation
30	62	Akebono Brake Industry Co., Ltd.
30	62	Yamaha Corporation
30	62	*（1 company）
34	61	Lion Corporation
35	60	Taiyo Yuden Co., Ltd.
35	60	SKY Perfect JSAT Holdings Inc.
35	60	*（1 company）

An asterisk represents a company that declined to disclose its name.