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Corporate Governance Survey Report 2012

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This report outlines the results of the 11th annual Corporate Governance Survey (JCGIndex) 2012 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 September 2012 to November 2012, we surveyed all companies listed on the First Section of the Tokyo Stock Exchange (1,679, as of September 7, 2012), of which 131 responded to the survey. We feel sorry for the inconvenience that happened when we switched to an online survey two years ago. Having reflected the initial confusions two years ago and your opinions, we continued surveying online this year, and managed to get responses from more companies than last time.

We have received responses from 849 distinct companies (and a cumulative total of 2,574) 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), 120（2011）, and 131（2012）.

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.

The Corporate Governance Survey has been funded by the University of Michigan Ross School of Business Mitsui Life Financial Research Center since 2008.

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

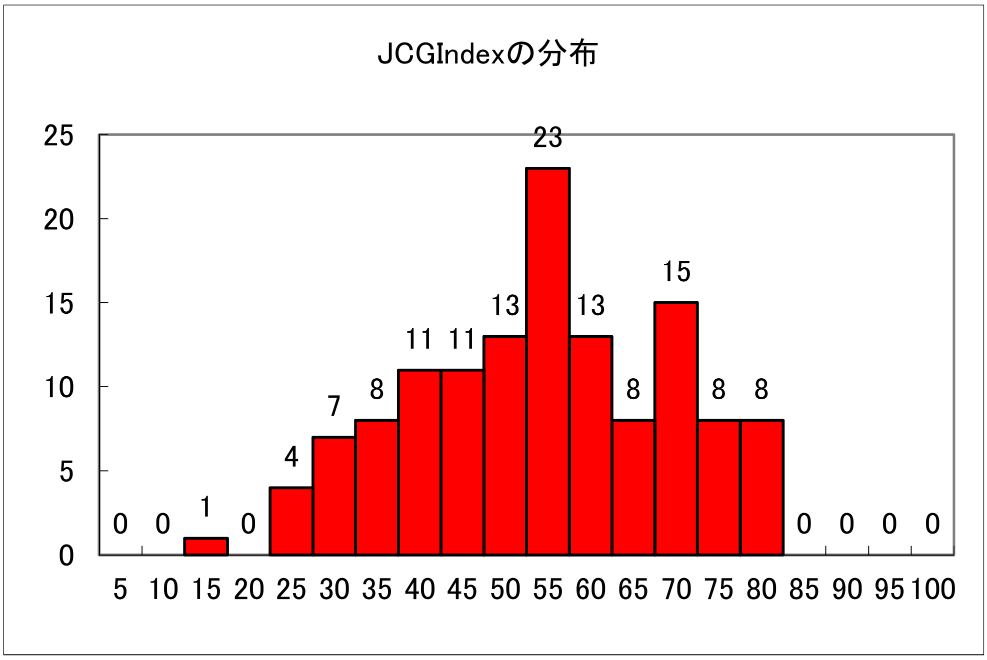
These 48 questions in total are recategorized into 4 categories to calculate sub-scores for each category. Each category represents the following perspective:

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 131 companies that responded to our survey in 2012 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 2011: the former to 52.08 from 51.28, the latter to 15.01 from 14.68. The maximum JCGIndex in 2012 increased to 80 from 77 in 2011, but the minimum decreased to 13 from 17.

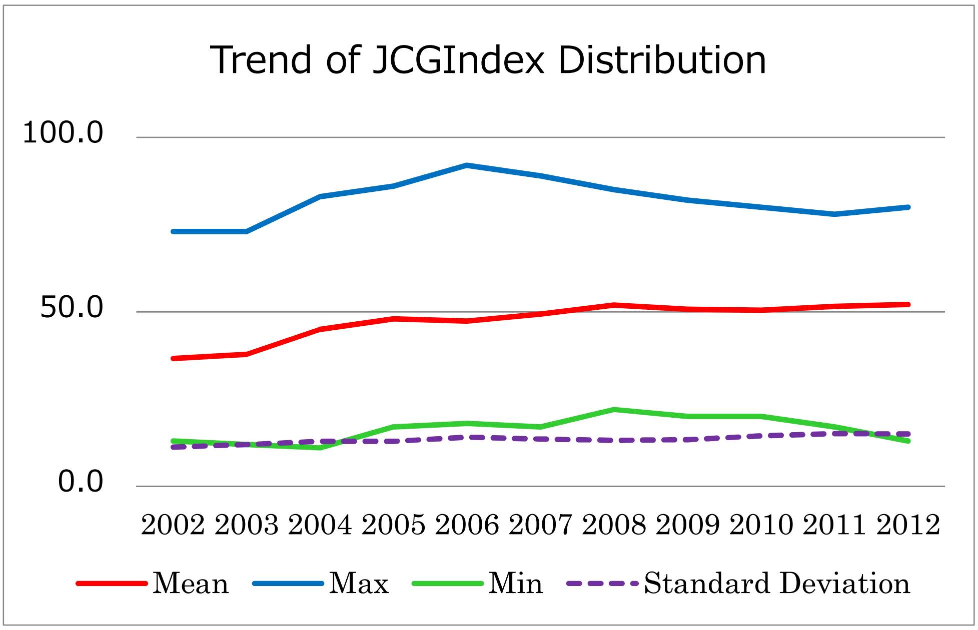


Mean：52.08　Standard deviation：15.01

4. Trend of JCGIndex distribution

The trends of mean, maximum and minimum in the past 10 surveys for JCGIndex are presented in the figure 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. Category scores and achievement rates

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 (about 60% and 67%, respectively), which might attest "no good governance, no good management."

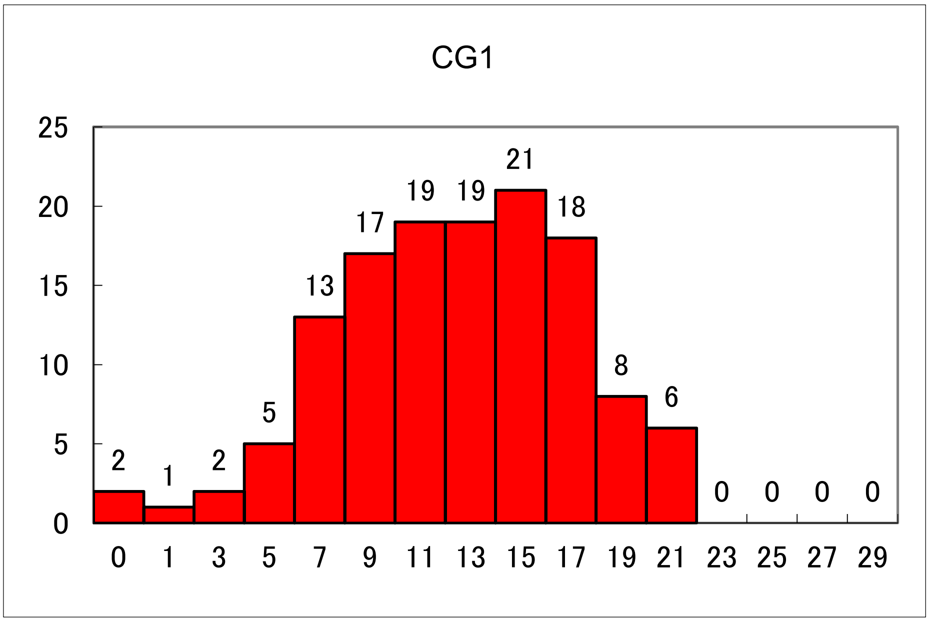
Sub-scores and achievement rates by category

Category		Weight (A)	Mean (B)	Achievement rate (B) / (A)
I	Performance targets and structure of responsibilities of management	29 (29)	11.97 (12.13)	41.3% (41.8%)
II	Functions and composition of board of directors	26 (26)	11.69 (9.46)	45.0% (36.4%)
III	Executive management structure of top management	25 (25)	14.94 (16.43)	59.8% (65.7%)
IV	Communication with shareholders and transparency	20 (20)	13.47 (13.26)	67.4% (66.3%)
JCGIndex		100 (100)	52.08 (51.28)	

*Results in 2011 are in parentheses.

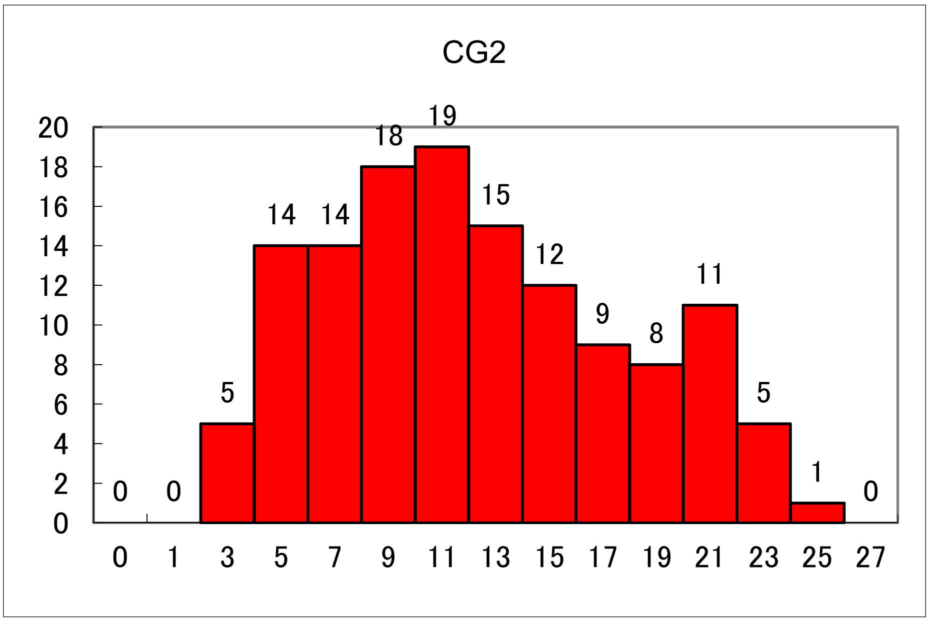
Below are tables for distribution of sub-scores by category. This time, we especially made the scoring standard stricter for the functions of the board of directors. Companies that merely follow the law on the composition of the board get no score. Those that are reluctant to separate governance and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

Category Ⅰ Performance targets and structure of responsibilities of management



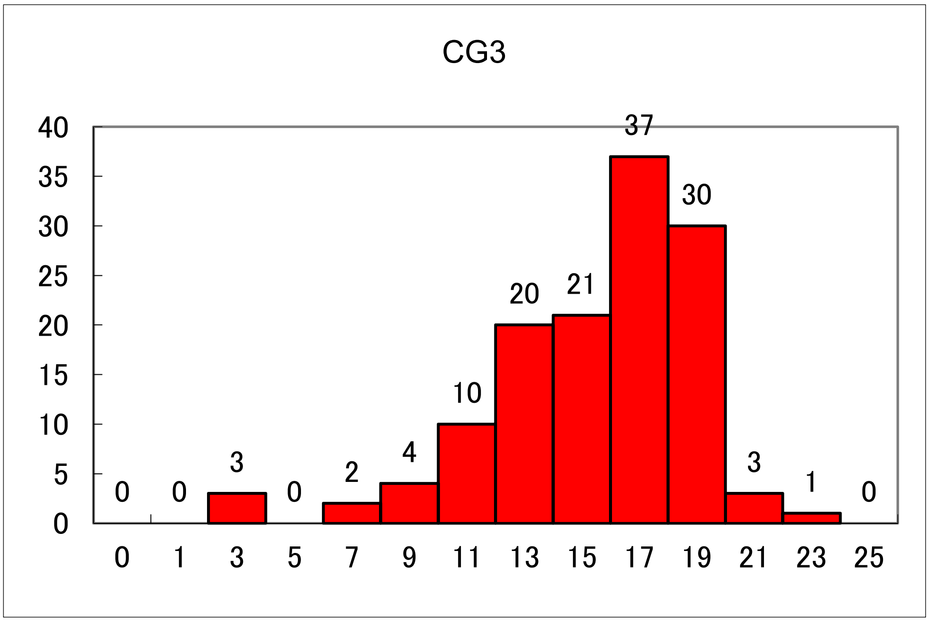
Mean:11.97 standard Deviation:4.60

Category Ⅱ Functions and composition of board of directors



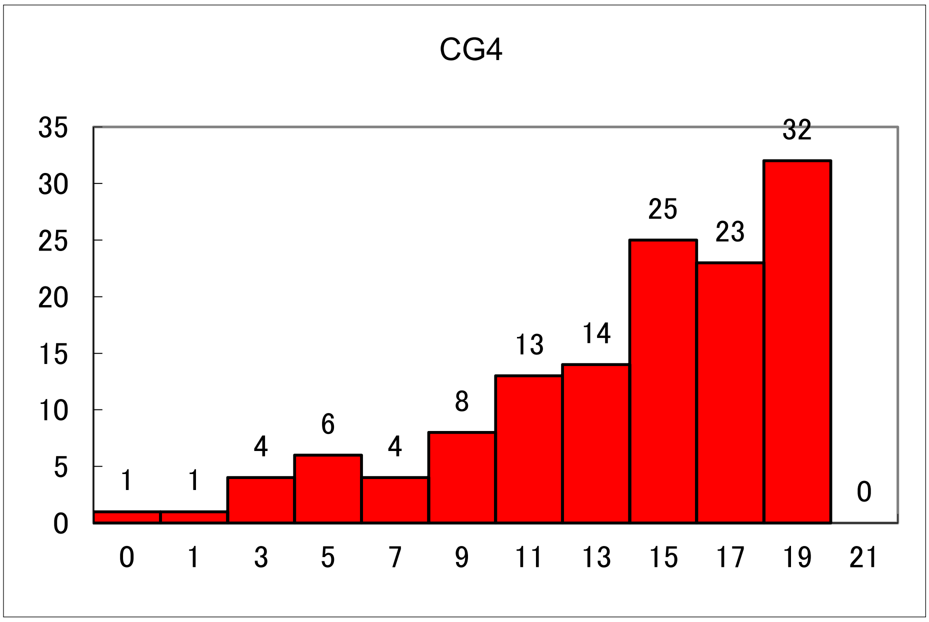
Mean:11.69 Standard deviation:5.50

Category Ⅲ Executive management structure of top management



Mean : 14.94 Standard deviation : 3.58

Category Ⅳ Communication with shareholders and transparency



Mean : 13.47 Standard deviation : 4.63

Descriptive statistics values of sub-scores by category and JCGIndex are as follows.

	Mean	Standard error	Median	Mode	Standard deviation	Min	Max
JCGIndex	52.08	1.31	53	40	15.01	13	80
Category Ⅰ	11.97	0.40	12	14	4.60	0	20
Category Ⅱ	11.69	0.48	11	10	5.50	2	24
Category Ⅲ	14.94	0.31	16	16	3.58	2	22
Category Ⅳ	13.47	0.40	15	18	4.63	0	19

6. Correlation coefficient between JCGIndex and category scores

The table below shows correlation coefficients between categories and between a category and JCGIndex. The correlations among categories are roughly between 0.5 and 0.6, with the maximum being 0.6042 for Categories Ⅰ and Ⅱ. 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	0.6042	1.0000			
Category Ⅲ	0.5557	0.5333	1.0000		
Category Ⅳ	0.5424	0.5743	0.5301	1.0000	
JCGIndex	0.8275	0.8556	0.7674	0.8112	1.0000

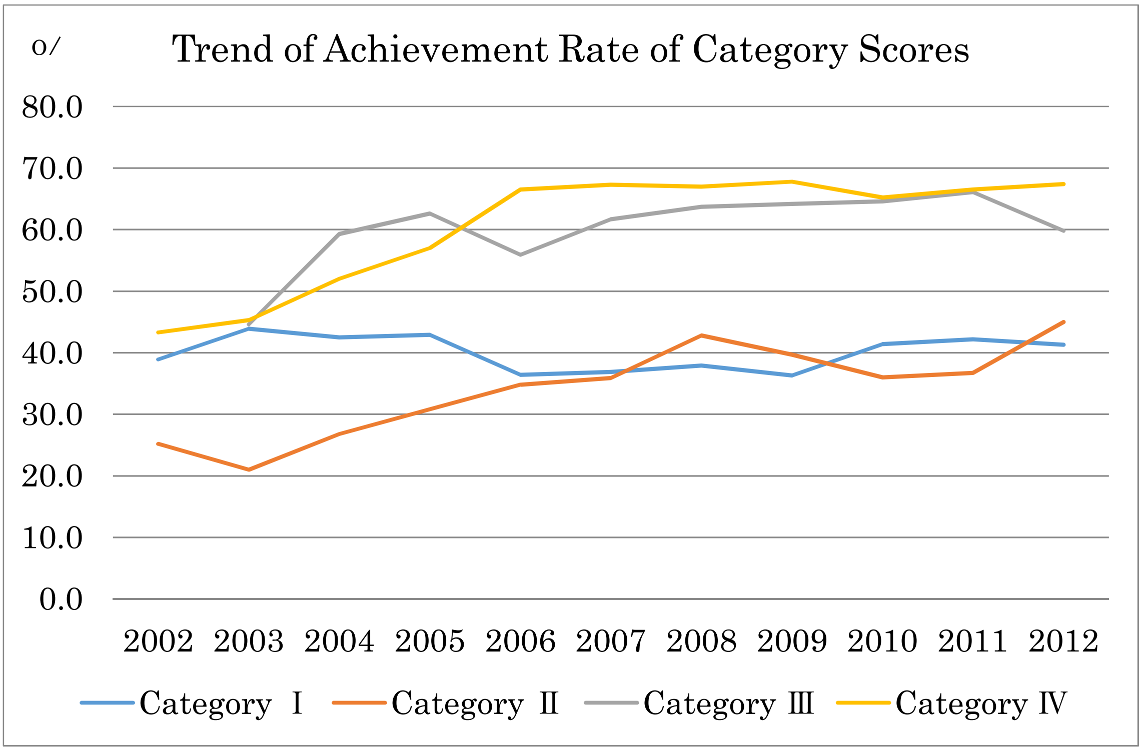
7. Trend of achievement rate by category

The table below depicts the trend of achievement rates by category. It is remarkable that in 2012, the rate for Category Ⅱ representing the functions and composition of board of directors (which is to say corporate governance itself) surged but the rate for Category Ⅲ representing the management system dropped. 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, while the rate for Category Ⅲ began to decrease, as explained above, after having been 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.

Table Trend of achievement rates by category



8. High JCGIndex companies and low JCGIndex companies

The mean of JCGIndex is 52.08, and the standard deviation of JCGIndex is 15.01 for 2012. Mean plus a standard deviation equals to 67.09 and mean minus a standard deviation equals to 37.07. From these calculations, we define JCGIndex of 68 or more to be high JCGIndex, and JCGIndex of 37 or less to be low JCGIndex. With the actual number of high JCGIndex companies being 24 and low JCGIndex companies 24, 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 21 for each).

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

JCGIndex and category scores of high and low JCGIndex companies

	Category				JCGIndex
	Ⅰ	Ⅱ	Ⅲ	Ⅳ	
High JCGIndex companies	17.7	20.0	18.0	17.5	73.3
Low JCGIndex companies	6.4	5.7	10.34	6.8	29.3

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

2012 marks the 11th JCGIndex Survey. Although the number of companies that responded to the survey slightly increased from 2011, this year could not see a reversal of a declining trend of respondents.

Even though the Japanese stock market has been buoyant since the end of 2012, when the government returned to the Liberal Democratic Party from the Democratic Party of Japan, the downward trend that had lasted for more than 20 years has not turned around yet. Prime Minister Abe vows to revitalize the country’s economy, but it fully depends on whether the Japanese companies can revitalize themselves. It is the management who are responsible for the revitalization of the companies. Since the purpose of governance is to induce good management, the success in corporate governance reforms is the key to the successful economic revival of Japan.

As we assert every time, 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. Mr. Abe talks of economic revitalization without making enough remarks about corporate management. Economy cannot get back on track without reviving the corporate performance, and once again, the sound corporate governance is the starting point of reviving the companies.

【Appendix】

Companies with 60 or higher JCGIndex in 2012（40 companies）

Rank	JCGIndex	Company
1	80	Sumida Corporation
1	80	Nissen Holdings Co., Ltd.
3	78	*（1 company）
4	77	Ube Industries, Ltd.
4	77	Eisai Co., Ltd.
6	76	Shiseido Company, Limited
6	76	Toshiba Corporation
6	76	Omron Corporation
9	75	Sony Corporation
9	75	Ricoh Co., Ltd.
9	75	Meitec Corporation
12	74	Ichiyoshi Securities Co., Ltd.
13	72	Daiwa Securities Group Inc.
14	71	Ajinomoto Co., Inc.
14	71	Konica Minolta Japan, Inc.
14	71	Mitsubishi Electric Corporation
17	70	Lawson, Inc.
17	70	Terumo Corporation
17	70	Hitachi, Ltd.
17	70	Mitsui & Co., Ltd.
21	69	Yokogawa Electric Corporation
21	69	PARCO Co., Ltd.
21	69	Resona Holdings, Inc.
24	68	*（1 company）
25	67	Tokio Marine Holdings, Inc.
25	67	*（1 company）
27	66	Kao Corporation
27	66	Taiyo Yuden Co., Ltd.
27	66	***（3 companies）
32	65	Kirin Holdings Company, Limited.
32	65	Anritsu Corporation
34	63	Komatsu Ltd.
34	63	*（1 company）
36	62	**（2 companies）
38	61	HORIBA, Ltd.
38	61	Tokyo Electron Limited
40	60	*（1 company）

*An asterisk represents a company that declins to disclose its name.