December 7, 2013

Corporate Governance Survey Report 2013

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This report outlines the results of the 12th annual Corporate Governance Survey (JCGIndex) 2013 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 2013 to October 2013, we surveyed all companies listed on the First Section of the Tokyo Stock Exchange (1,749, as of August 9, 2013), of which 120 responded to the survey.

We switched to an online survey three years ago, but this time, we returned to the postal survey in response to several requests for it.

We have received responses from 864 distinct companies (and a cumulative total of 2,694) 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), 131(2012), and 120(2013).

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. Since the directors are selected through shareholders' meeting, determining the candidates of directors to submit to the shareholders' meeting is vital.

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. That is the current best practice of corporate governance.

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

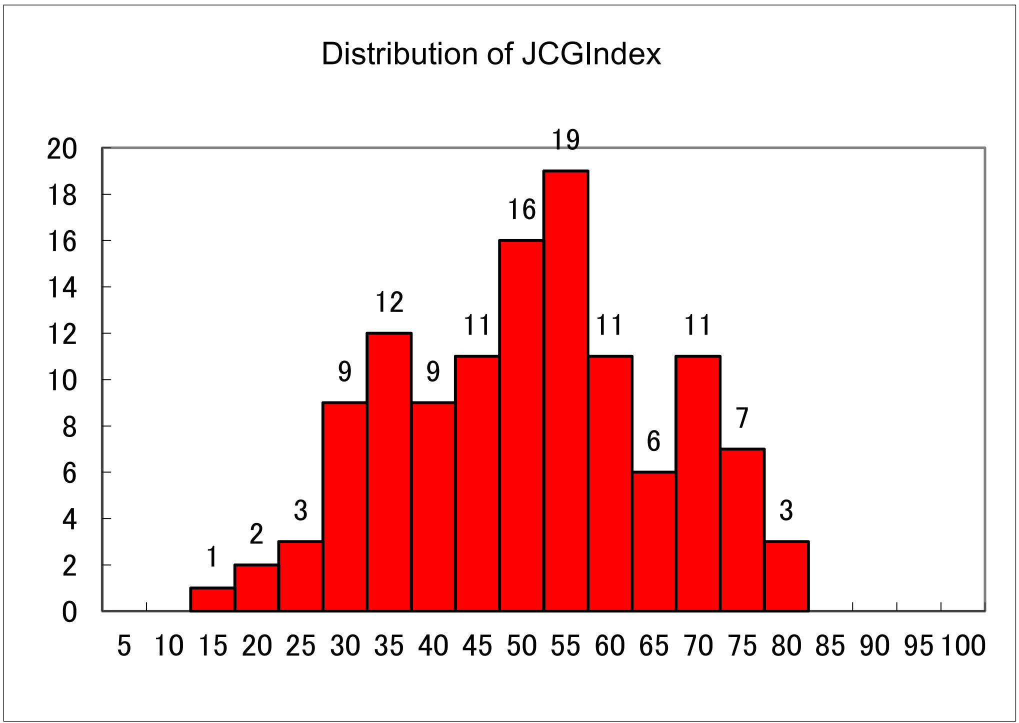
These 48 questions in total are recategorized into 4 categories to calculate sub-scores for each category. Each category represents the following perspective:

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 120 companies that responded to our survey in 2013 turned out as the graph in the below shows. This time, we changed some questions and options. Besides, proportions were modified to take the enhanced understanding on corporate governance into account. As a result, the mean JCGIndex dropped to 49.01 from 52.08 of 2012, while the standard deviation saw a very slight decrease to 15.00 from the previous 15.01. The maximum JCGIndex in 2013 decreased to 78 from 80 in 2012, but the minimum increased to 14 from 13.

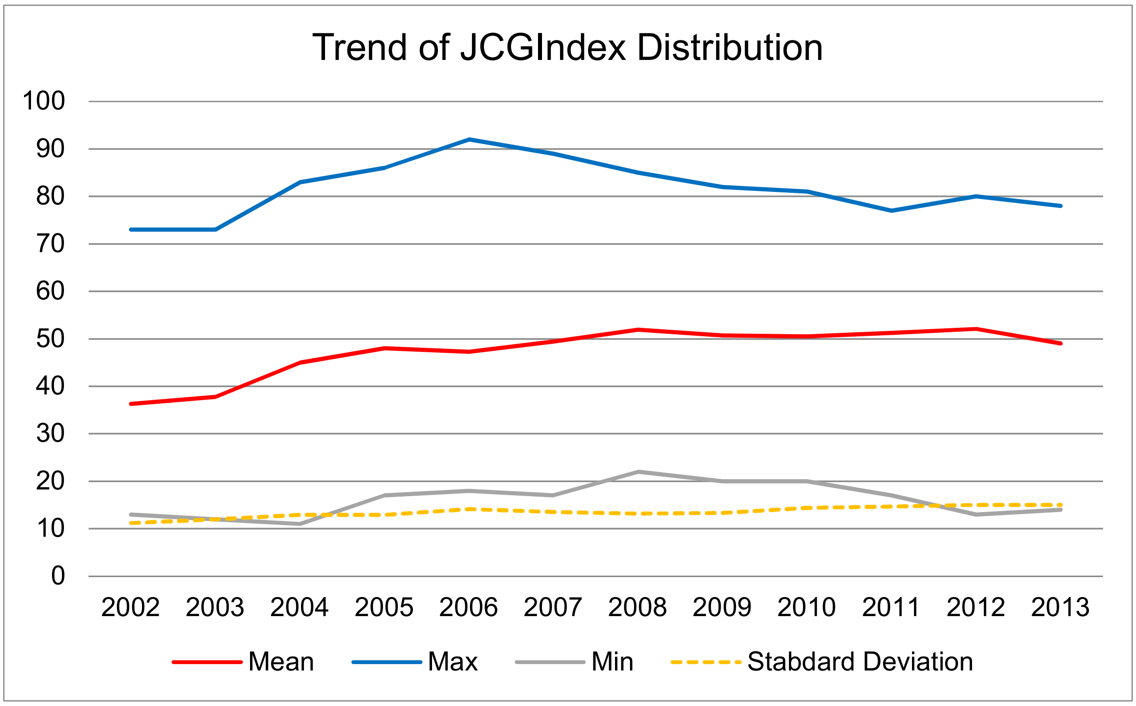


Man：49.01　　Sandard deviation：15.00

4. Trend of the distribution of JCGIndex

The trends of mean, maximum and minimum in the past 11 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 2013, and proportions alone moderately changed in 2009. As explained above, we made even more revisions this time. 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.

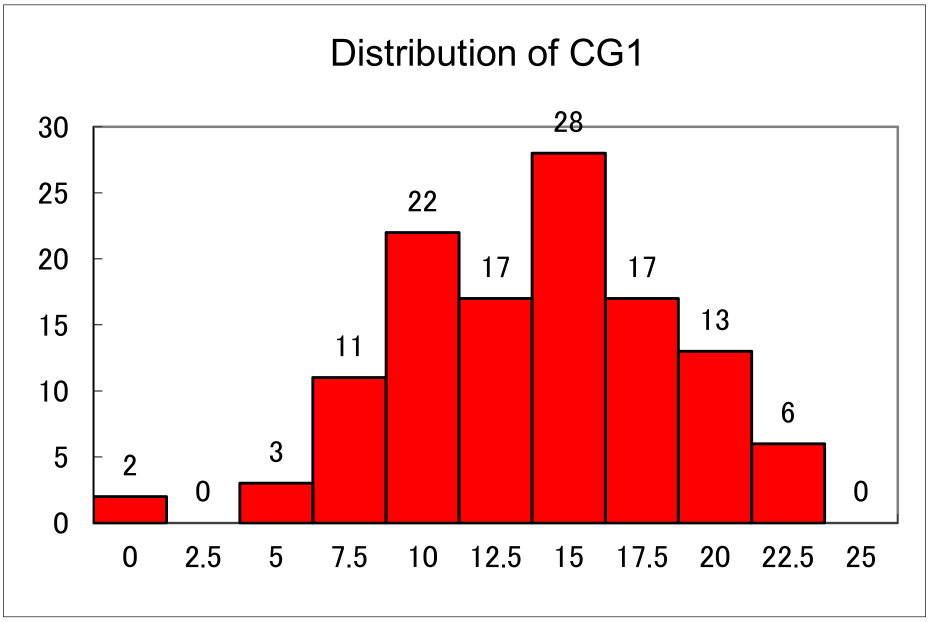
Category scores and Achievement Rates

Category		Weight (A)	Mean (B)	Achievement rate (B) / (A)
I	Performance targets and structure of responsibilities of management	29 (29)	13.00 (11.97)	44.8% (41.3%)
II	Functions and composition of board of directors	26 (26)	8.45 (11.69)	32.5% (45.0%)
III	Executive management structure of top management	25 (25)	14.09 (14.94)	56.4% (59.8%)
IV	Communication with shareholders and transparency	20 (20)	13.48 (13.47)	67.4% (67.4%)
JCGIndex		100 (100)	49.01 (52.08)	

*Results in 2012 are in parentheses.

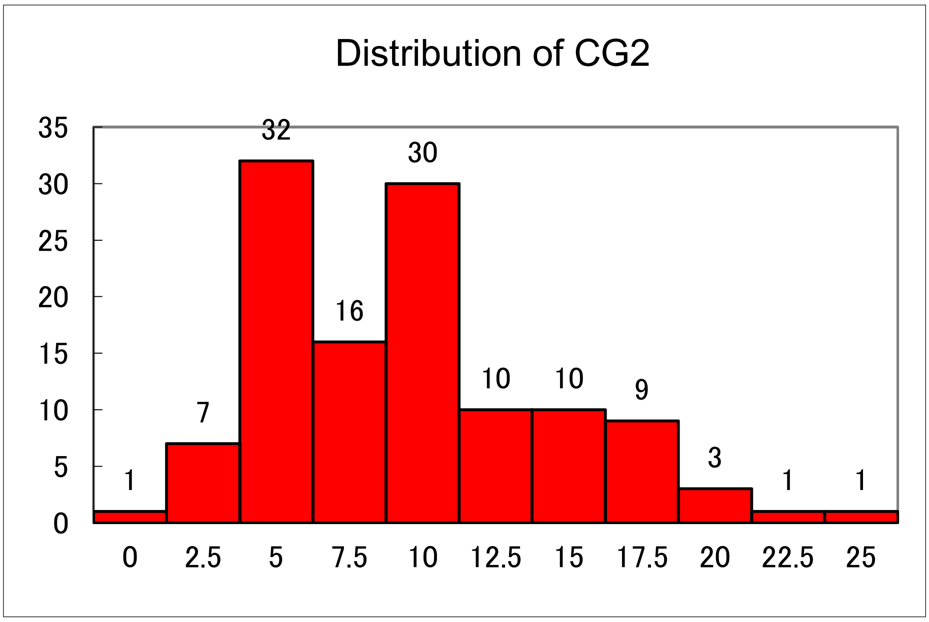
Just as the same as the previous surveys, the achievement rates of Categories Ⅰ and Ⅱ for corporate governance remain still low. This clearly implies the overall inadequacy of Japanese corporate governance but could be also interpreted that management reforms are preceding in Japanese companies. Nonetheless, the achievement rates for Categories Ⅲ and Ⅳ are still not sufficient (about 56% and 67%, respectively), which might attest “no good governance, no good management.” Below are figures for Distribution of Category Scores.

Category Ⅰ Performance targets and structure of responsibilities of management



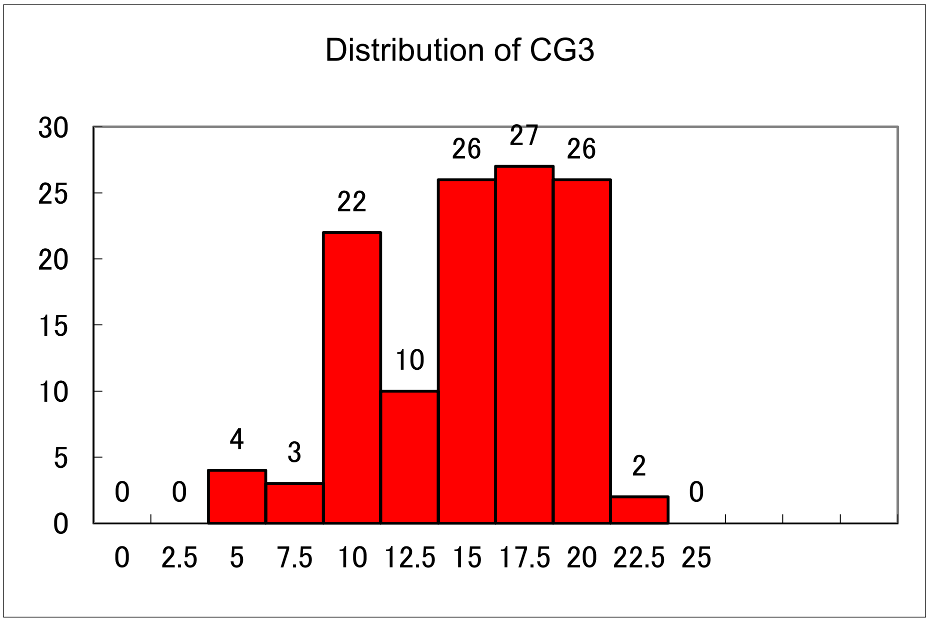
Mean：13.00 Standard deviation：4.78

Category Ⅱ Functions and composition of board of directors



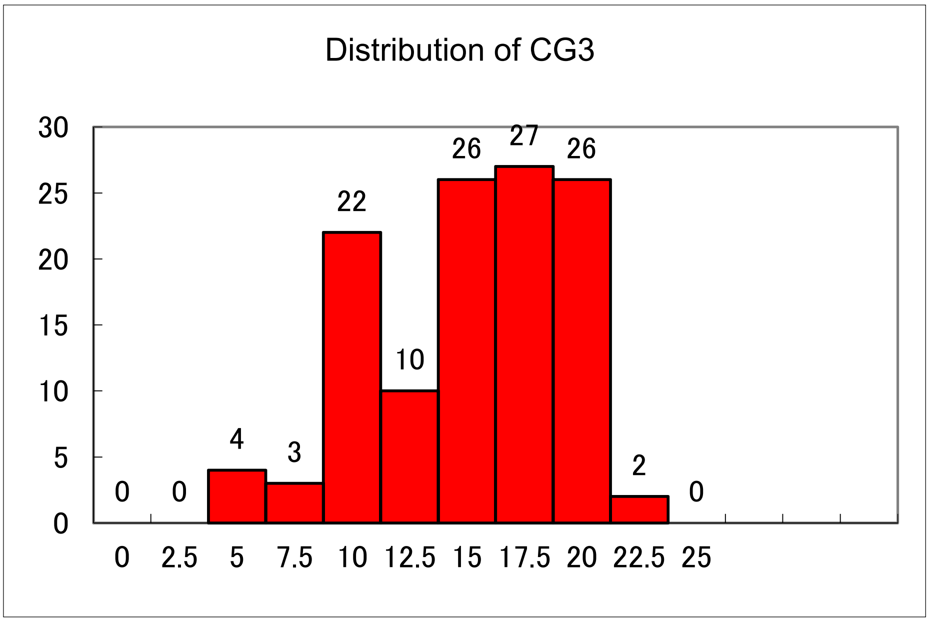
Mean：8.45 Standard deviation：4.93

Category Ⅲ Executive management structure of top management



Mean：14.09 Standard deviation：4.08

Category Ⅳ Communication with shareholders and transparency



Mean：13.48 Standard deviation：4.33

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

	mean	Standard error	median	Mode	Standard deviation	minimum	maximum
JCGIndex	49.01	1.37	49.5	49	15.00	14	78
Category Ⅰ	13.00	0.44	13	14	4.78	0	23
Category Ⅱ	8.45	0.45	8	8	4.93	0	23
Category Ⅲ	14.09	0.37	15	17	4.08	3	22
Category Ⅳ	13.48	0.40	14	16	4.33	1	19

6. 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 between 0.5 and 0.6, with the maximum being 0.6647 for Categories Ⅲ and Ⅳ. 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.

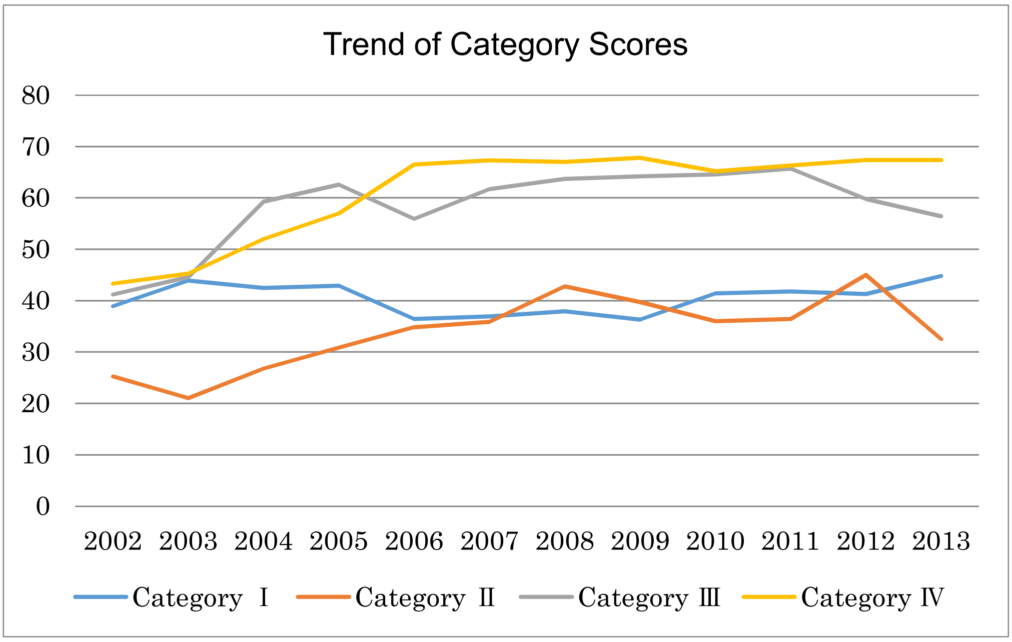
Correlation Coefficient between JCGIndex and Category Scores

	Category Ⅰ	Category Ⅱ	Category Ⅲ	Category Ⅳ	JCGIndex
Category Ⅰ	1.0000				
Category Ⅱ	0.5581	1.0000			
Category Ⅲ	0.5508	0.6046	1.0000		
Category Ⅳ	0.5032	0.6042	0.6647	1.0000	
JCGIndex	0.7974	0.8458	0.8386	0.8289	1.0000

7. Trends 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.



8. High JCGIndex companies and low JCGIndex companies

The mean of JCGIndex is 49.01, and the standard deviation of JCGIndex is 15.00 for 2013. Mean plus a standard deviation equals to 64.01 and mean minus a standard deviation equals to 34.01. From these calculations, we define JCGIndex of 64 or more to be high JCGIndex, and JCGIndex of 34 or less to be low JCGIndex. With the actual number of high JCGIndex companies being 25 and low JCGIndex companies 25, 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.

JCGIndex and Category Scores of High and Low Index Companies

	Category				JCGIndex
	Ⅰ	Ⅱ	Ⅲ	Ⅳ	
High JCGIndex companies	18.7	15.7	18.0	17.6	70.0
Low JCGIndex companies	7.9	3.3	8.7	7.8	27.6

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

2013 marks the 12th JCGIndex Survey. As the number of companies that responded to the survey slightly decreased from 2012, 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 2013（29 companies）

Rank	JCGIndex	Company
1	78	Eisai Co., Ltd.
2	77	Ichiyoshi Securities Co., Ltd.
3	76	Nissen Holdings Co., Ltd.
4	75	Shiseido Company, Limited
4	75	Sumida Corporation
6	74	Nippon Sheet Glass Co., Ltd.
7	73	Toshiba Corporation
7	73	Sony Corporation
9	72	Konica Minolta Japan, Inc.
9	72	Hitachi, Ltd.
11	70	Resona Holdings, Inc.
11	70	Yamato Holdings Co., Ltd.
13	69	Terumo Corporation
13	69	Meitec Corporation
15	68	*（1 company）
16	67	Lawson, Inc.
16	67	Ricoh Co., Ltd.
16	67	*（1 company）
19	66	Ube Industries, Ltd.
19	66	Anritsu Corporation
19	66	Yamaha Corporation
22	65	Omron Corporation
22	65	NKSJ Holdings, Inc.
22	65	*（1 company）
25	64	Kao Corporation
26	62	Showa Denko K.K.
26	62	Taiyo Yuden Co., Ltd.
28	60	Akebono Brake Industry Co., Ltd.
28	60	*（1 company）

Asterisks represent a company that declined to disclose its name.