2020 18th
JCGR Corporate Governance Survey
<<JCGIndex Survey>>
Report

December 1, 2020

Japan Corporate Governance Research Institute

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Introduction

The corporate governance reforms pursued under Abenomics have now raised expectations for corporate governance through the capital market. Recognizing that Japanese companies are no longer at the stage of introducing corporate governance, the Japan Corporate Governance Research Institute (JCGR) has started to conduct a new Corporate Governance Survey in 2019. This report outlines the results of the annual Corporate Governance Survey 2020 (JCGIndex Survey 2020) that well reflects the new situation in Japan. We are grateful to all companies that responded to this survey.

The JCGR defines the period from 2002 to 2017 as Phase I, and the 16 surveys conducted in Phase I as Phase I Surveys. Surveys conducted in or after 2019 are defined as Phase II Surveys.

1. Background and results of this survey

Within a short period, corporate governance reforms have been implemented in an unprecedent scale under the second Abe administration's new Growth Strategy. The Financial Services Agency formulated Japan's Stewardship Code in 2014 (revised in 2017 and 2020); the amendment of the Companies Act in 2015 introduced company with audit and supervisory committee; and the Tokyo Stock Exchange made the Corporate Governance Code part of its Securities Listing Regulations in 2015 and then revised the Code in 2018. The reforms expect institutional investors to enhance the investee companies' corporate value and sustainable growth through "purposeful dialog" as shareholders for the sake of mid- to long-term investment return for the clients and beneficiaries. For companies, five principles are proposed based on OECD's Principles of Corporate Governance, in expectation of rational and fair corporate governance under independent directors and internationally competitive management: Securing the Rights and Equal Treatment of Shareholders, Appropriate Cooperation with Stakeholders Other Than Shareholders, Ensuring Appropriate Information Disclosure and Transparency, Responsibilities of the Board, and Dialogue with Shareholders.

These reforms apply in fact a soft-law approach of “Comply or Explain”, assuming an Anglo-Saxon rational stock market. It is questionable that the Japanese stock market is rational enough, but at any rate, corporate governance reforms are indispensable to regain Japan’s international competitiveness, and worth public interests.

Looking into the JCGIndex Survey for 2020 from this perspective, the results presented in this paper give us the impression that the corporate governance reforms are still yet to bear fruit. We hope that governance reforms will bring about management reforms, but it is hard to achieve the change in a short period since both governance and management are deeply tied to the society and history. Yet we have no other choice but to speedily address the drastic change the world is experiencing. The fact that hasty actions are undesirable cannot justify slowing down the reform. Investors, executives and all members of the public need to make a commitment to corporate governance.

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

From September 2020 to October 2020, we surveyed all companies listed on the First Section of the Tokyo Stock Exchange (2,170, as of August 28, 2020), of which 175 responded to the survey.

In Phase I, we received responses from 986 distinct companies (and a cumulative total of 3,260) 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), 120 (2013), 118 (2014), 147 (2015), 150 (2016) and 151 (2017). In Phase II, 165 companies responded to the survey in 2019 and 175 in 2020.

3. Overview of questions

3.1 Governance model for current companies

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 by sharing retained earnings. Retained earnings is equal to the sales minus various expenses, and therefore risky (i.e., not predetermined at all). It is shareholders who bear this risk of business.

Joint-stock companies that operate large-scale business with money contribution from a large number of shareholders assume separation of ownership and management.

Although shareholders do not directly participate in management, they instead elect directors at the shareholders' meeting and entrust the management to the board of directors. In the form of electing directors who realize business execution (in another word, management) in line with shareholders' interests, shareholders control companies. That is what governance by shareholders means. In most countries under such a system, board of directors makes important decisions on business, and selects CEO and other executive officers (as for Japan, representative directors are selected in companies with board of corporate auditors and companies with audit and supervisory committee, and executive officers in companies with nominating committee, etc.) to entrust business execution. In doing so, directors steer executive officers to the management in line with shareholders' interests. That is governance by board of directors, a substitution for governance by shareholders.

To ensure the effective governance by board of directors, those who are independent from executive officers and other stakeholders are selected as independent directors, who are the sole constituent of nominating committee, compensation committee and audit and supervisory committee. The nominating committee determines candidates of directors to submit to the shareholders' meeting. It plays an important role of choosing the competent directors, who as members of board of directors select (and dismiss) the CEO and executive officers. The compensation committee sets up performance-linked incentives to provide an incentive for good management to the CEO and other executive officers selected by the board. The audit and supervisory committee check the independence of internal and external auditors to ensure impartial and effective management.

This best practice of separating governance and management by promoting good use of independent directors has spread to the world in the last quarter century. Although directors, whose duty is to monitor executive officers, 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 in order to survive fierce competitive environments of globalization and innovation. Under this model of separation, board of directors should be centered on independent directors and focus on governance to bring about good management from executive officers, who are selected by board of directors and entrusted with management. Executives establish the management system under the governance by board of directors to pursue profit through business operations and then distribute the profit to shareholders.

3.2 Contents and categorization of questions

The current best practice in corporate governance can be characterized by (1) board of directors where outsiders play a vital role as independent directors, (2) separation of directors and executive officers, (3) nomination, compensation, and audit functions exercised by the board of directors to supervise executive officers, and (4) transparency in management.

Based on such a model, JCGIndex Survey's questions are comprised of the following 6 parts:

Part I Performance targets, leadership of CEO 9 questions
Part II Corporate governance－Directors and board of directors－ 34 questions
Part III Management system－Execution, evaluation and compensation－ 12 questions
Part IV Management of consolidated subsidiaries and cross-owned shares 9 questions
Part V Communication with shareholders 11 questions
Part VI Officers' Compensation Survey 11 questions

Part VI aims at grasping the current situation of officers' compensation in Japanese companies and is not incorporated into JCGIndex. The remaining 75 questions from Part I to Part V are recategorized into 4 categories to calculate sub-scores for each category. Each category represents the following perspective:

Category I Performance targets and leadership of management
Based on Part I
Category II Corporate governance structure
Based on Part II
Category III Executive management structure of top management
Based on Part III and Part IV
Category IV Communication with shareholders and transparency
Based on Part V

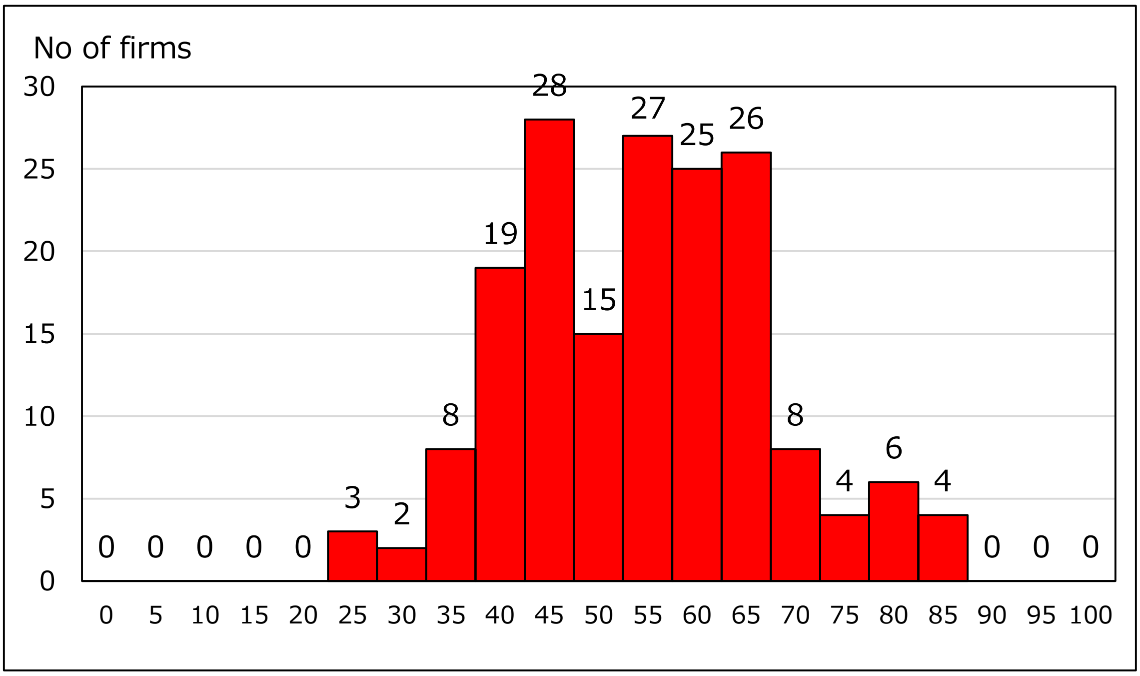
Categories I and II are related to corporate governance system, and III and IV are about corporate management system. Although it is possible to evaluate the corporate governance through Categories I and II alone, Categories III and IV are incorporated into JCGIndex, based on the belief that good management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

4. Distribution of JCGIndex

The distribution of JCGIndex for the 175 companies that responded to our survey in 2020 is as the graph in the below shows. The mean JCGIndex was 52.0, and the standard deviation was 12.5.

It is impossible to compare this year's results to previous results because we have made drastic changes in questions for Phase II. For the trend of the distribution of JCGIndex in the surveys conducted in Phase I, see the report for the 16th survey (2017).

Table: Distribution of JCGIndex



Mean：52.0 Standard Deviation：12.5

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.

Table Sub-scores and achievement rates by category

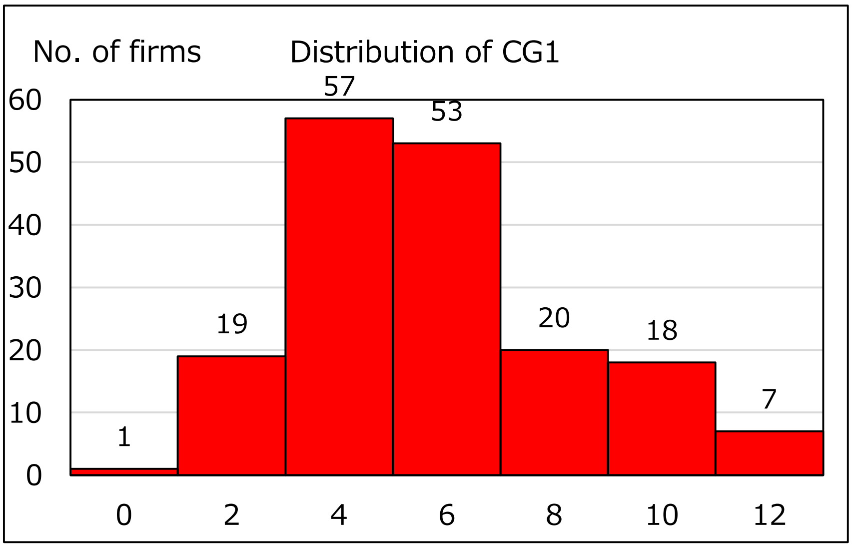
	Category	Weight (A)	Mean (B)	Achievement rate (B) / (A)
I	Performance targets and leadership of management	14.1 (14.1)	4.79 (4.82)	33.95% (34.2%)
II	Corporate governance structure	46.3 (46.3)	21.11 (20.91)	45.60% (45.2%)
III	Executive management structure of top management	24.0 (24.0)	16.40 (16.27)	68.31% (67.8%)
IV	Communication with shareholders and transparency	15.6 (15.6)	9.69 (10.20)	62.15% (65.4%)
JCGIndex		100	51.99 (52.21)	51.99% (52.2%)

*Results in 2019 are in parentheses.

6. Distribution of sub-scores by category

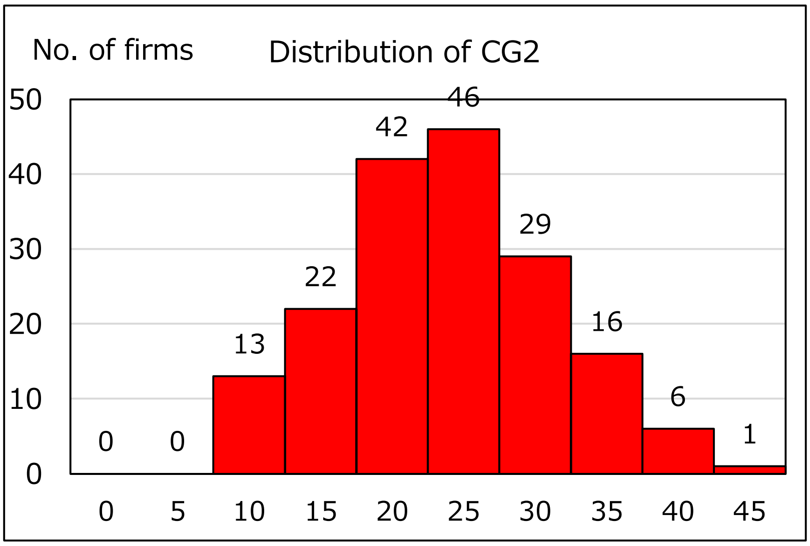
Below are tables for distribution of sub-scores by category. CG1, CG2, CG3 and CG4 stand for sub-scores for each category. These four constitute the JCGIndex.

Category I: Performance targets and leadership of management



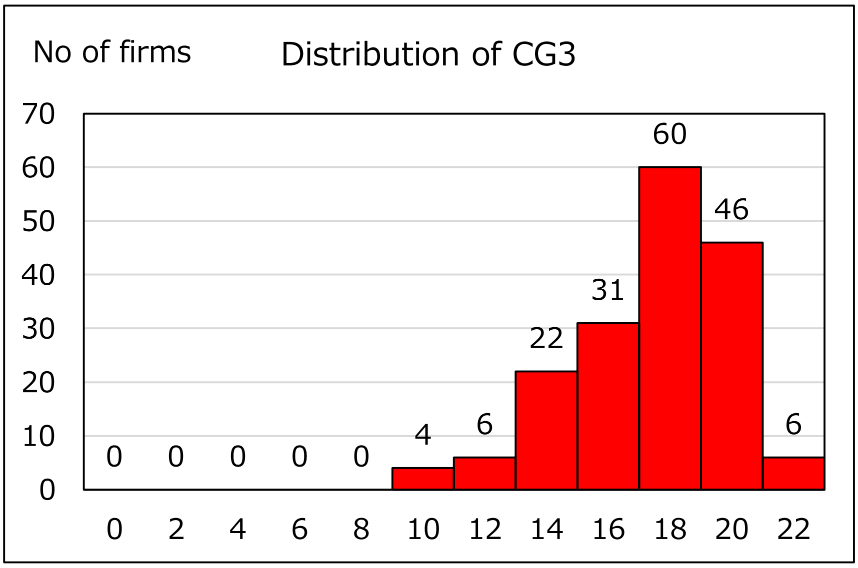
Mean：4.79　Standard Deviation：2.52

Category II: Functions and Composition of the Board



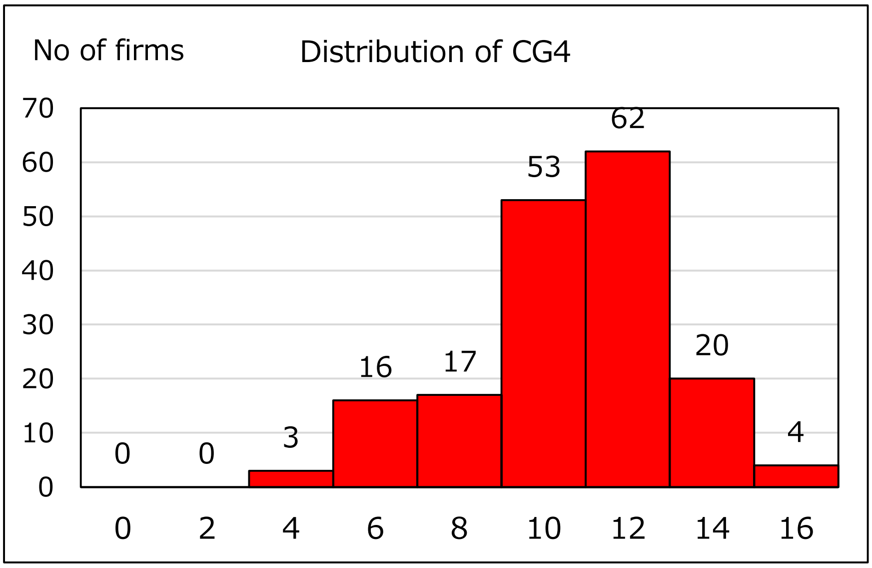
Mean：21.11　Standard Deviation：7.53

Category III: Executive management structure of top management



Mean：16.40　Standard Deviation：2.57

Category IV　Communication with shareholders and transparency



Mean：9.69　Standard Deviation：2.37

7. Descriptive statistics values of JCGIndex and sub-scores

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

Table Descriptive statistics values of sub-scores by category and JCGIndex

	mean	standard error	median	mode	minimum	maximum	standard deviation
JCGIndex	52.0 (52.2)	0.95 (0.96)	51.93 (53.12)	60.8 (56.0)	22.3 (27.2)	82.9 (82.9)	12.50 (12.30)
Category I	4.8 (4.8)	0.19 (0.19)	4.45 (4.00)	3.7 (3.0)	0.00 (0.0)	11.6 (12.0)	2.52 (2.39)
Category II	21.1 (20.9)	0.57 (0.58)	20.77 (21.00)	20.2 (22.0)	5.04 (6.0)	40.9 (39.0)	7.53 (7.40)
Category III	16.4 (16.3)	0.19 (0.19)	16.77 (17.00)	16.6 (18.0)	8.16 (7.0)	22.0 (21.0)	2.57 (2.49)
Category IV	9.7 (10.2)	0.18 (0.19)	9.64 (10.00)	9.64 (10.0)	2.97 (3.0)	14.8 (16.0)	2.37 (2.40)

*Results in 2019 are in parentheses.

The table below shows the coefficients of variation (=standard deviation/mean) for each sub-score by category and JCGIndex.

Table Coefficients of variation of sub-scores by category and JCGIndex

	Category I	Category II	Category III	Category IV	JCGIndex
Coefficient of variation	0.526	0.356	0.157	0.245	0.240

The coefficients of variation for Categories I and II for governance evaluation are larger than those for Categories III and IV for management evaluation, meaning that the level of governance varies among companies compared to the level of management. In the future, we might see corporate governance improve more rapidly than corporate management in Japan.

8. Correlations among sub-scores and JCGIndex

The table below shows correlation coefficients between categories and between a category and JCGIndex. Not only are the correlations among categories below 0.5 (except for the correlation between Category I and Category II and the correlation between Category II and Category III) but also every category shows higher correlation with JCGIndex than with any other category, which means that each category does not overlap with others greatly and rather covers distinctive factors. It is therefore meaningful to calculate JCGIndex with these four categories by setting two separate categories for both governance and management as the result of governance.

During Phase I, scores for Categories I and II tended to be low while scores for Categories III and IV tended to be relatively high. For the trend of each Category's score, see the report for the 16th survey (2017).

Table Correlations among sub-scores and JCGIndex

	Category I	Category II	Category III	Category IV	JCGIndex
Category I	1.0000				
Category II	0.6147 (0.6302)	1.0000			
Category III	0.4713 (0.4676)	0.5988 (0.6182)	1.0000		
Category IV	0.4802 (0.4706)	0.5039 (0.4947)	0.3896 (0.4355)	1.0000	
JCGIndex	0.7595 (0.7600)	0.9446 (0.9459)	0.7350 (0.7503)	0.6700 (0.6723)	1.0000

*Results in 2019 are in parentheses.

Category II has the highest figure for correlation among the four Categories, which may be because the category occupies the most weight. (JCGIndex is merely the sum of the sub-scores for the four categories.) Still, since the correlations among categories are low as the table above shows, every category represents distinctive factors of corporate governance.

9. High JCGIndex companies and low JCGIndex companies

The mean of JCGIndex is 51.99, and the standard deviation of JCGIndex is 12.50 for 2020. Mean plus a standard deviation equals to 64.49 and mean minus a standard deviation equals to 39.49. From these calculations, we define JCGIndex of 64.49 or more to be high JCGIndex, and JCGIndex of 39.49 or less to be low JCGIndex. With the actual number of high JCGIndex companies being 22 (12.6% of the total) and low JCGIndex companies 25 (14.3% of the total), 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).

The table below exhibits the sub-scores by category and JCGIndex of the high and low JCGIndex companies. Figures for the remaining intermediate JCGIndex companies are presented just for reference.

To clarify the difference of sub-scores by category and JCGIndex between high and low JCGIndex companies, the ratios of high JCGIndex companies' scores to those of low JCGIndex companies are presented at the bottom of the table. High JCGIndex companies achieve more than twice as much JCGIndex as low JCGIndex companies.

The table presents, however, that the ratio of difference between high and low JCGIndex companies is more than twice for Categories I and II for governance evaluation, but less than twice for Categories III and IV for management evaluation. This implies that a company's corporate governance is well characterized by Categories I and II, and thus is consistent with the proposition in Section 3.2 that it is possible to evaluate the corporate governance through Categories I and II alone. In other words, the governance model that the survey assumes well reflects the JCGR's corporate governance principle.

Table High JCGIndex companies and low JCGIndex companies

	Category				JCGIndex
	I	II	III	IV	
High JCGIndex companies (22)	8.75 (8.61)	33.77 (32.35)	18.80 (18.64)	12.17 (12.89)	73.50 (72.50)
Intermediate JCGIndex companies (128)	4.56 (4.57)	20.93 (20.94)	16.71 (16.68)	9.73 (10.27)	51.93 (52.46)
Low JCGIndex companies (25)	2.45 (2.72)	10.93 (11.66)	12.66 (12.84)	7.33 (7.81)	33.37 (35.03)
Ratio of difference between high and low JCGIndex companies	3.57 (3.17)	3.09 (2.77)	1.49 (1.45)	1.66 (1.65)	2.20 (2.07)

*Results in 2019 are in parentheses.

10. Conclusion

This report reorganized the questionnaire results of the 18th Corporate Governance Survey (the second Phase II Survey) relevant to JCGIndex (i.e., excluding Officers' Compensation Survey) into the basic statistics. The overall results and analysis are to be published later.

Although it is ideal that each company's JCGIndex is shared by society, the JCGR only discloses JCGIndex of the companies that have approved the disclosure of their JCGIndex, conceding that it might be inconvenient for some companies to disclose their JCGIndex. The list of the companies with high JCGIndex and their JCGIndex is added to this report. For the list of all companies that responded to the survey and companies that fall in the upper half of the JCGIndex rankings, see List of responding firms and List of companies in the upper half.

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

【Appendix】

Companies with high JCGIndex in 2020（22 companies）

Rank	JCGIndex	Company
1	82.9	Sony Corporation
2	82.6	Ebara Corporation
3	81.6	Eisai Co., Ltd
4	80.6	Hitachi, Ltd.
5	78.3	Konica Minolta Japan, Inc.
6	77.9	Omron Corporation
7	75.8	Yamato Holdings Co., Ltd.
8	75.5	Ichiyoshi Securities Co., Ltd.
9	75.2	J. FRONT RETAILING Co., Ltd.
9	75.2	Nippon Sheet Glass Co., Ltd.
11	73.3	Terumo Corporation
12	72.3	Resona Holdings, Inc.
13	71.5	Seven & i Holdings Co., Ltd.
14	71.2	SWCC Showa Holdings Co., Ltd.
15	69.7	Hitachi Transport System, Ltd.
16	69.6	*(1 company)
17	69.1	Meitec Corporation
18	67.7	JVCKENWOOD Corporation
19	67.4	*(1 company)
20	66.9	Shionogi Pharma Co., Ltd.
21	66.8	BicCamera Inc.
22	65.9	Daito Trust Construction Co., Ltd.

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