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# Report on the 2003 Corporate Governance Index Survey
## －Summary and Recommendations－

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### Overview

The purpose of a corporate governance system is to assure that the managers of a corporation maintain healthy, sustainable corporate performance over the long term. Therefore, an effective corporate governance system should result in superior performance. The Japan Corporate Governance Research Institute has developed the JCGIndex, which measures corporate governance in Japanese firms, based on the principle of separation between governance by the board of directors and management by senior executives. For the second consecutive year, JCGR surveyed Tokyo Stock Exchange First Section firms. The JCGIndex measures the state of corporate governance in the responding firms. Both this year and last year, we found that high JCGIndex firms achieved superior performance, as measured by ROA, ROE, stock returns, and employment growth. We believe that the JCGIndex demonstrates the importance of corporate governance in today's business environment, with its challenges of globalization and rapid technological advancement. We hope that firms will share their JCGIndex results with investors, their employees, and the general public. We sincerely thank all that firms that responded to our survey.

(1) In July 2003, the Japan Corporate Governance Research Institute sent a mail survey to all Tokyo Stock Exchange First Section firms (1523 firms as of July 2, 2003). We received valid responses from 201 firms. We used these responses to generate corporate governance index scores (JCGIndex) to assess how closely governance practices of these firms conformed to JCGR's Corporate Governance Principles.

(2) This was the second annual JCGR survey. Of the 159 firms that responded to last year's survey, 72 firms responded to this year's survey. Therefore, a total of 288 firms have, either this year or last year, received JCGIndex scores. Due to the revision of the Commercial Code to introduce the committee board structure (in April 2003), the questions in this year's survey are slightly different from those of last year. The index scores between the two years, however, are

generally comparable.

(3) The average JCGIndex for the 201 firms that responded to this year's survey was 37.8 out of 100 possible points (standard deviation 12.0). This is 1.5 points higher than last year's average of 36.3 points (standard deviation 11.2). Given the slight difference in questions from last year, we do not consider this to be a significant change. The low average JCGIndex indicates that the actual corporate governance practices of Japanese firms are still very far from JCGR's governance model.

(4) The JCGIndex consists of four categories. In general, firms scored the lowest in Category II, structure and function of board of directors, indicating that developments in this aspect of corporate governance have lagged the others. This tendency was also clear in last year's survey.

Four categories of the JCGIndex

| category | | score |
|---|---|---|
| I | Corporate objectives and CEO responsibility | Cg1 |
| II | Structure and function of board of directors | Cg2 |
| III | Management system | Cg3 |
| IV | Transparency and communication to shareholders | Cg4 |

(5) The distribution of the JCGIndex ranged from a maximum of 73 to a minimum of 12, indicating a wide divergence in corporate governance practices across firms. Last year, the maximum was 73 and the minimum, 13.

(6) In order to better understand the relationship between the JCGIndex and corporate performance, we selected a group of firms for which the JCGIndex was particularly high and a group of firms for which the JCGIndex was particularly low. The high JCGIndex group (30 firms) consisted of firms with JCGIndex of over 1 standard deviation from the mean. The low JCGIndex group (25 firms) consisted of firms with JCGIndex of over 1 standard deviation below the mean. Return on assets (ROA), return on equity (ROE) and stock returns were higher for the high JCGIndex group, indicating that firms with the highest JCGIndex had superior capital efficiency and delivered greater returns to shareholders. These results are consistent with our results for last year. The consistency between the different samples of firms in the two years increases our confidence in these results, despite the low response rates.

(7) Over the past 3 years, firms in the low JCGIndex group decreased their number of employees, while those in the high JCGIndex group added employees. We found a similar pattern last year. Although it is often said that it is necessary to sacrifice employees to increase shareholder value, our results suggest that both shareholders and employees benefit simultaneously in high JCGIndex firms.

(8) This year, for the first time, we examined the relationship between corporate performance and each of the four JCGIndex sub-categories listed in item (4) above, by comparing the performance of groups of the highest and lowest scoring firms in each sub-category. We found that with the exception of Category II, “Structure and Function of the Board of Directors”, the higher a firm’s category score, the better its performance. This indicates that the external form of corporate governance, as shown by the form of the board of directors, will not lead to higher performance unless it is accompanied by substance, as measured by the other categories.

(9) The combination of all four categories determines a firm’s corporate governance. The high JCGIndex group received high scores relative to the low JCGIndex group across all categories. In other words, there was no single category that led to high JCGIndex levels. To achieve a high JCGIndex, a firm had to receive high scores in all four categories.

(10) The category most closely related to performance was Category IV, Transparency and Communication to Shareholders. It is not clear whether performance is the cause or the effect of excellent transparency and disclosure, but it indicates that high-performing firms tend to take this aspect of governance very seriously.

(11) JCGR believes that corporate governance must be based on the fundamental attitude of the firm and its CEO. A firm’s corporate governance system must be built to support this attitude, and cannot exist in form only. Our results for the 4 categories are consistent with this.

(12) The survey results over two years, covering 288 firms, clearly demonstrate the relationship between the JCGIndex and firm performance. While the relationship between the JCGIndex and corporate performance reported here is a correlation and we cannot prove causality, it is possible to infer from these results that firms with higher JCGIndex are delivering greater value to their shareholders.

(13) We urge Japanese firms to pay attention to their corporate governance systems, and speed the pace of reform in order to achieve the government systems required in today’s global environment.

(14) The top 10 JCGIndex firms and their JCGIndex results.

| rank | firm | JCGIndex |
|---|---|---|
| 1 | Orix Corp. | 73 |
| 2 | Nomura Holdings, Inc. | 72 |
| 3 | Konica Minolta Holdings, Inc. | 71 |
| 4 | Hitachi, Ltd. | 70 |
| 5 | Omron Corp. | 68 |
| 6 | Teijin Ltd. | 67 |
| 7 | HOYA Corp. | 63 |
| 8 | Parco Co., Ltd. | 61 |
| 9 | Yamaha Motor Co., Ltd. | 60 |
| 10 | Sumida Corp. | 59 |

Our analyses demonstrate that the JCGIndex is useful not only to firms seeking to reorganize their corporate governance systems, but also to fund managers and other investors seeking to better understand firms. We hope that firms that have responded to this survey will disclose their JCGIndex results and use the index as a means to communicate with their investors, employees, and the general public.