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JCGR Corporate Governance Survey 2008 Final Report

-A summary-

Japan Corporate Governance Research Institute (JCGR)

<http://www.JCGR.org/>

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For questions regarding this survey, please contact: <mailto:webmaster@JCGR.org>**Outline of the Survey**

The objective of corporate governance is to assure long-term corporate performance by establishing a system that makes management accountable for achieving corporate goals. A good corporate governance system leads to excellent corporate performance because it brings out superior management.

In the corporation (*kabushiki gaisha*), shareholders have responsibility for governance and exercise their rights through voting, etc. Over the last 10 years, in the face of the business environment of the 21st century, with its intensifying global competition and rapid technological change, corporations have begun to strengthen the monitoring function of their boards of directors through means such as appointment of independent directors by the annual shareholders' meeting. As a result, a corporate governance system that separates execution by managers (management) and monitoring by the board of directors (governance) has been spreading around the world. Even in Japan, the Commercial Code was revised to allow firms beginning in April 2003 to either introduce a new corporate governance system, called the Board with Committees, or maintain the existing system of statutory corporate auditors. Furthermore, in May 2005, the Company Law, which emphasizes strengthening of corporate governance, was established.

Since 2002, the Japanese Corporate Governance Research Institute has conducted an annual survey of corporate governance of all firms listed on the First Section of the Tokyo Stock Exchange. This survey assesses how close a firm's corporate governance adheres to this desirable state of separation between management and governance, and reports the results for each firm in terms of

the JCGIndex.

Between August and October 2008, we carried out our survey for the seventh time. This year, we received responses from 252 firms, for a response rate of 14.7%, which is less than our response rate of 18.0% (311 firms) for 2007. However, we received responses from 45 firms that have not responded to our survey in the past, which shows that interest in corporate governance continues to deepen. In the analyses that follow, we report results for the 251 firms of the total 252 firms which are listed on the First Section of the Tokyo Stock Exchange (one moved to the second section). The results of our analyses show that consistent with the previous six years, high JCGIndex firms enjoy higher financial performance as measured by ROA and ROE. However, different from previous years, it was the low JCGIndex firms that had a greater return to shareholders in terms of returns on equity investment.

Taking the past 7 years of survey results as a whole, we can say that there is a correlation between the JCGIndex and corporate performance, suggesting that separation between governance and management, which is the basis of the JCGIndex, is the appropriate form of governance for corporations in today's business environment. We hope that the JCGIndex and the results of our analyses will be used by both investors and managers and will be useful in promoting continued corporate governance reform in Japan. Last, but not least, we are very grateful to the companies that responded to this survey and offer them our sincere thanks for their cooperation.

Since we have begun to conduct the JCGIndex survey, the situation faced by companies has changed significantly, with changes in the legal environment and increasing globalization. For this reason, we have made some changes in the questions and choices for answers, and have changed some of the point allotments in this year's survey. We realize that this is not desirable in terms of continuity with previous years, but we also believe that it is important to change the index to reflect the changing business environment. Some firms may experience a change in their JCGIndex of up to 10 points, as compared to previous years, as a reflection of these changes in the survey, rather than in their actual governance.

7 Important Results

1. Response rate indicates a continued increase in interest in corporate governance

From August to November 2008, the Japan Corporate Governance Research Institute surveyed all firms listed on the First Section of the Tokyo Stock Exchange (1,719 firms as of July 29, 2008), and received responses from 252 firms. Survey questions were based on the "JCGR Corporate Governance Principles." The JCGIndex is based on responses to these questions.

This is the seventh consecutive year that we have carried out the survey. In 2002, we received responses from 159 firms. In 2003, 201 firms responded, in 2004, 341 firms, in 2005, 405 firms, in 2006, 312 firms, in 2007, 311 firms. In 2008, this year, 252 firms responded, and of these 45 were for the first time. Over the past seven years, we have received a total of 1,981 responses from 778 firms, which represents about 44% of all firms listed on the First Section of the Tokyo Stock Exchange. The analyses presented in this report are based on results for the 251 firms (since one of the 252 firms moved to the Second Section of the Tokyo Stock Exchange).

2. Characteristics of the responding firms: Large firms with high performance

Firms that responded to the survey tended to be very large. The average assets, sales, and number of employees of responding firms (averaged over 2003-2007) were over twice those of the average listed firm. The performance of responding firms was also higher than that of all listed firms. The ROA of responding firms was 7.20%, compared to 7.00% for all listed firms: ROE was 8.91% versus 7.12%. However, as was the case last year, the return on common stock was lower for responding firms than for the average (14.17% versus 20.01%).

3. Distribution of the JCGIndex: A wide range, but increased average score

This year, the average JCGIndex for the 251 responding firms is 51.9 (standard deviation 13.2), compared to an average of 49.4 (standard deviation 13.5) for last year.

As takeover bids are increasingly launched from the perspective of improving returns to shareholders, interest in and understanding of corporate governance among Japanese firms has deepened. However, 51.9 points is less than one half of the total of 100 possible points, and from this it can be concluded that the state of corporate governance in most Japanese firms is far from the ideal state of our governance model.

The range between the highest and lowest JCGIndex firms is quite large, as in previous years. This year the highest JCGIndex was 85 and the lowest was 22. Last year the highest JCGIndex was 89 and the lowest 17. This year, the standard deviation, 13.2 was somewhat greater than last year's of 13.5.

4. Average points by category: Governance reform is unbalanced

The JCGIndex is the sum of the points in 4 separate categories (Cg1, Cg2, Cg3, Cg4). Categories I and II contain items that evaluate the level of governance, while the Categories III and IV evaluate

the quality of the management system.

The following table reports the average points in each category for the 251 firms responding. In all categories except for Category IV, the ratio of mean to total possible points increased. In Categories III and IV, firms on average achieved over 50% of all possible points. The achievement rates for Categories I and II were far lower.

In total, these results suggest that in management reforms in the aftermath of the “lost decade” of the Japanese economy in the 1990’s, firms have improved management systems and disclosure. In contrast, progress in reform in the essence of governance, CEO accountability and board function, has been relatively slow. Note that we have included the achievement rate for the previous year in parentheses.

Category	Mean/Total possible points	Achievement rate* (mean/total possible points)
I Corporate objectives and CEO responsibility	10.6/28	37.9% (36.9%)
II Structure and function of board of directors	10.7/25	42.8% (36.9%)
III Management system	17.2/27	63.7% (61.7%)
IV Transparency and communication with shareholders	13.4/20	67.0% (67.3%)

5. Characteristics of high and low JCGIndex firms

To compare the characteristics of high and low JCGIndex firms and to examine the relationship between the JCGIndex and corporate performance, we constructed two groups: high and low JCGIndex firms. The high JCGIndex group consists of the 38 firms with a JCGIndex of 66 or more points (over one standard deviation above the mean) and the low JCGIndex group consists of the 39 firms with a JCGIndex of 38 or less (over one standard deviation below the mean).

(1) Characteristics of high and low JCGIndex firms: The percentage of foreign ownership is higher.

The average percentage of shares held by foreigners in the high JCGIndex group is 30.9%, while

the average for responding firms is 21.7%, and the average for low JCGIndex firms is even lower at 12.70%. As we will see below, the financial (accounting) performance of well-governed companies is strong. It is not clear if foreigner investors purchase shares of these companies because they are well governed, or if the companies improve their governance because they have a high level of foreign ownership. Whichever direction this relationship runs, we have found a strong positive relationship between governance level and foreign ownership every year that we have conducted this survey.

The average age of the CEO for high JCGIndex firms is 61.7 while the average age for low JCGIndex firms is 61.6..

(2) High JCGIndex firms are bigger

The total assets, sales, and number of employees are over 10 times greater in the high JCGIndex firms than the low JCGIndex firms.

(3) High JCGIndex firms are strong in all aspects of corporate governance

High JCGIndex firms have achieved high points in all four categories, indicating that a high JCGIndex cannot be achieved with high scores in only one or two categories. The JCGIndex captures the complete picture of a company's corporate governance capabilities and is not determined by any single category.

	Categories I	Categories II	Categories III	Categories IV
High JCGIndex firms	16.1	19.8	20.8	16.9
Low JCGIndex firms	6.5	5.6	12.3	9.0

6. JCGIndex and firm financial performance: A clear relationship

The objective of corporate governance is to assure excellent corporate performance. Is there really a relationship between corporate governance and corporate performance? In the 2008 JCGIndex survey, as well as in surveys for previous five years, we found that high JCGIndex companies have superior performance.

(1) High JCGIndex firms enjoy superior financial performance

Based on 5-year averages, ROA (7.20% versus 7.00%) and ROE (8.91% versus 7.12%) are higher in high JCGIndex firms. However, results are slightly different for return on common stock. For the three-year average, return on common stock is lower in high JCGIndex firms than in low JCGIndex firms (15.02% versus 15.76%). Similarly, for the five-year average, return on common stock is lower in the high JCGIndex firms than in the low JCGIndex firms (14.17%

versus 20.01%)

(2)The rate of growth in employment lower in the high JCGIndex firms, complete reversal from previous years

Based on the 3-year average (2005-2007) of growth of employment, high JCGIndex firms have a lower growth rate than low JCGIndex firms (5.68% versus 5.98%). This is completely different from our results over the last 6 years, and we would like to analyze this in greater depth.

7. Relationship between each category and performance: Strongest for structure and function of the board of directors and transparency and communication with shareholders

To determine whether or not there was a similar relationship between performance and each of the categories of the JCGIndex, we constructed high and low JCGIndex groups in each of the 4 categories, choosing the firms one standard deviation above the mean or one standard deviation below the mean for each of the categories. In the surveys for previous years, the groups with high points in each category had higher performance than firms with low points. This year, however, we could not see a clear relationship between points in individual categories and performance. We did, however, see evidence of a relationship between performance and points for Category II, structure and function of board of directors, and Category IV, transparency and communication with shareholders

The generally positive relationship between the JCGIndex as a whole and performance indicates that corporate governance is not a question of a single category, but rather, of all the categories taken together.

Corporate governance reform is key to the revival of the Japanese economy

The JCGR surveys over the past 7 years have demonstrated that corporate governance is related to corporate performance. Although the response rate of the survey has not been high in any given year, over the past five years we have received 1981 responses for 778 distinct firms. Though in recent years, the negative relationship between the JCGIndex and return on common stock is puzzling, the general picture is that good governance is related to higher performance. Based on this, we feel that it is appropriate to conclude that corporate governance reform is a necessary condition for Japanese firms to compete in the 21st century business environment. We hope that investors and managers will use the JCGIndex to promote corporate governance reform.

Investors are particularly important to governance reform. From the perspective of managers, there is not much incentive to promote corporate governance, as corporate governance reform makes them more accountable for corporate performance. For investors, on the other hand, corporate governance reform has a close relationship to the improvement of the performance of their investment, and therefore, they have a strong incentive to push for reform. This is especially true for institutional investors, who manage such a large share of investment capital today.

As investors become more aware of the importance of corporate governance reform, shareholder activism, including exercise of voting rights and establishment of governance funds, will increase. We hope that the JCGIndex will be used as an important weapon in these activities. For this reason, while we, in principle, did not disclose JCGIndex results for the first two years, from the third time that we conducted the survey, we have asked all responding companies to disclose their JCGIndex results. As part of the survey, we asked firms to give us permission to disclose their name if they were in the top 50% of the JCGIndex. Fortunately, most of the companies answered “yes.” From the third year of the survey, we have disclosed the list of all responding companies, and we have been able to add a list of the top 50% JCGIndex firms. We respect the courage of firms that permitted the disclosure of their names, and are very grateful to them. We hope that firms and investors will find many uses for the JCGIndex.

JCGIndex 2008: Firms with 50 or greater points

Rank	JCGIndex	Company name
1	85	TOSHIBA CORPORATION
2	83	Daiwa Securities Group Inc.
3	81	SONY CORPORATION
3	81	SUMIDA CORPORATION
3	81	*
6	78	Sojitz Corporation
7	77	TEIJIN LIMITED
7	77	OMRON Corporation
7	77	Nissen Holdings Co., Ltd.
7	77	PARCO CO., LTD.
7	77	*
12	76	ASAHI BREWERIES, LTD.
12	76	Resona Holdings, Inc.
12	76	**
16	75	KONICA MINOLTA HOLDINGS, INC.
16	75	Mitsubishi Corporatio
16	75	*
19	74	Asahi Glass Company, Ltd.
19	74	*
21	73	YAMATO HOLDINGS CO., LTD.
21	73	**
24	71	COSMO OIL COMPANY, LTD.
24	71	***
28	70	MITSUI & CO., LTD.
28	70	Sompo Japan Insurance Inc.
30	69	*
31	68	THE JAPAN WOOL TEXTILE CO., LTD.
31	68	Shiseido Company, Ltd.
31	68	NEC Corporation
34	67	Kao Corporation
34	67	Hitachi Information Systems, Ltd.
36	66	SANTEN PHARMACEUTICAL CO., LTD.
36	66	Tokyo Electron Limited
36	66	*
39	65	Showa Denko K. K.

39 65 Ube Industries, Ltd.
39 65 Marubeni Corporation
39 65 MEITEC CORPORATION
39 65 ***
46 64 Yamaha Motor Co., Ltd.
46 64 **
49 63 Ajinomoto Co., Inc.
49 63 ITOCHU Techno-Solutions Corporation
49 63 SUMITOMO HEAVY INDUSTRIES, LTD.
49 63 Yokogawa Electric Corporation
49 63 Taiyo Yuden Co., Ltd.
49 63 Takashimaya Company, Limited
49 63 NIPPON TELEGRAPH & TELEPHONE CORPORATION
49 63 **
58 62 Sekisui House, Ltd.
58 62 NIPPON MEAT PACKERS, INC.
58 62 Lion Corporation
58 62 NIPPON MINING HOLDINGS, INC.
62 61 Mitsubishi Chemical Holdings Corporation
62 61 MEC COMPANY LTD.
62 61 FUJI ELECTRIC HOLDINGS CO., LTD.
62 61 SEIKO EPSON CORPORATION
62 61 Sharp Corporation
62 61 The Sumitomo Trust & Banking Co., Ltd.
62 61 Chubu Electric Power Company, Inc.
62 61 *
70 60 WACOAL HOLDINGS CORP.
70 60 Sekisui Chemical Co., Ltd.
70 60 ADVANTEST CORPORATION
70 60 **
75 59 KIKKOMAN CORPORATION
75 59 MITSUBISHI MATERIALS CORPORATION
75 59 Sumitomo Mitsui Financial Group, Inc.
78 58 The Chiba Bank, Ltd.
78 58 **
81 57 The Furukawa Electric Co., Ltd.
81 57 TOSHIBA TEC CORPORATION
81 57 Mitsubishi Heavy Industries, Ltd.

81 57 The Bank of Yokohama, Ltd.
81 57 FAST RETAILING CO., LTD.
81 57 *
87 56 TOA CORPORATION
87 56 GLORY LTD.
87 56 ****
93 55 TAISEI CORPORATION
93 55 NICHIREI CORPORATION
93 55 ACOM CO., LTD.
93 55 Mitsui O.S.K. Lines, Ltd.
93 55 The Tokyo Electric Power Company, Inc.
93 55 ****
102 54 GUNZE LIMITED
102 54 WATABE WEDDING CORPORATION
102 54 BRIDGESTONE CORPORATION
102 54 TAKARA PRINTING CO., LTD
102 54 MITSUI SUMITOMO INSURANCE GROUP HOLDINGS
102 54 *
108 53 RICOH LEASING COMPANY, LTD.
109 52 NEC TOKIN Corporation
109 52 TAMURA CORPORATION
109 52 NAGASE&CO., LTD
109 52 HANWA CO., LTD.
109 52 NEC Leasing, LTD.
109 52 THE KANSAI ELECTRIC POWER COMPANY, INC.
109 52 ***
118 51 TOTETSU KOGYO CO., LTD.
118 51 APAN VILENE COMPANY, LTD.
118 51 Nabtesco Corporation
118 51 NTN CORPORATION
118 51 Mitsubishi Estate Company, Ltd.
118 51 ***
127 50 SEVEN & I HOLDINGS CO., LTD.
127 50 OPTEX Company, Limited
127 50 Imasen Electric Industrial Co., Ltd.
127 50 JASTEC Co., Ltd.
127 50 MINISTOP CO., LTD.
127 50 ARCS COMPANY, LTD.

127 50 **

* Represents companies that did not allow their name to be disclosed. Number of * represents number of companies.

** Goodwill achieved 52 points, but during the period of the survey, moved to the Second Section of the Tokyo Stock Exchange so its JCGIndex is not reported.