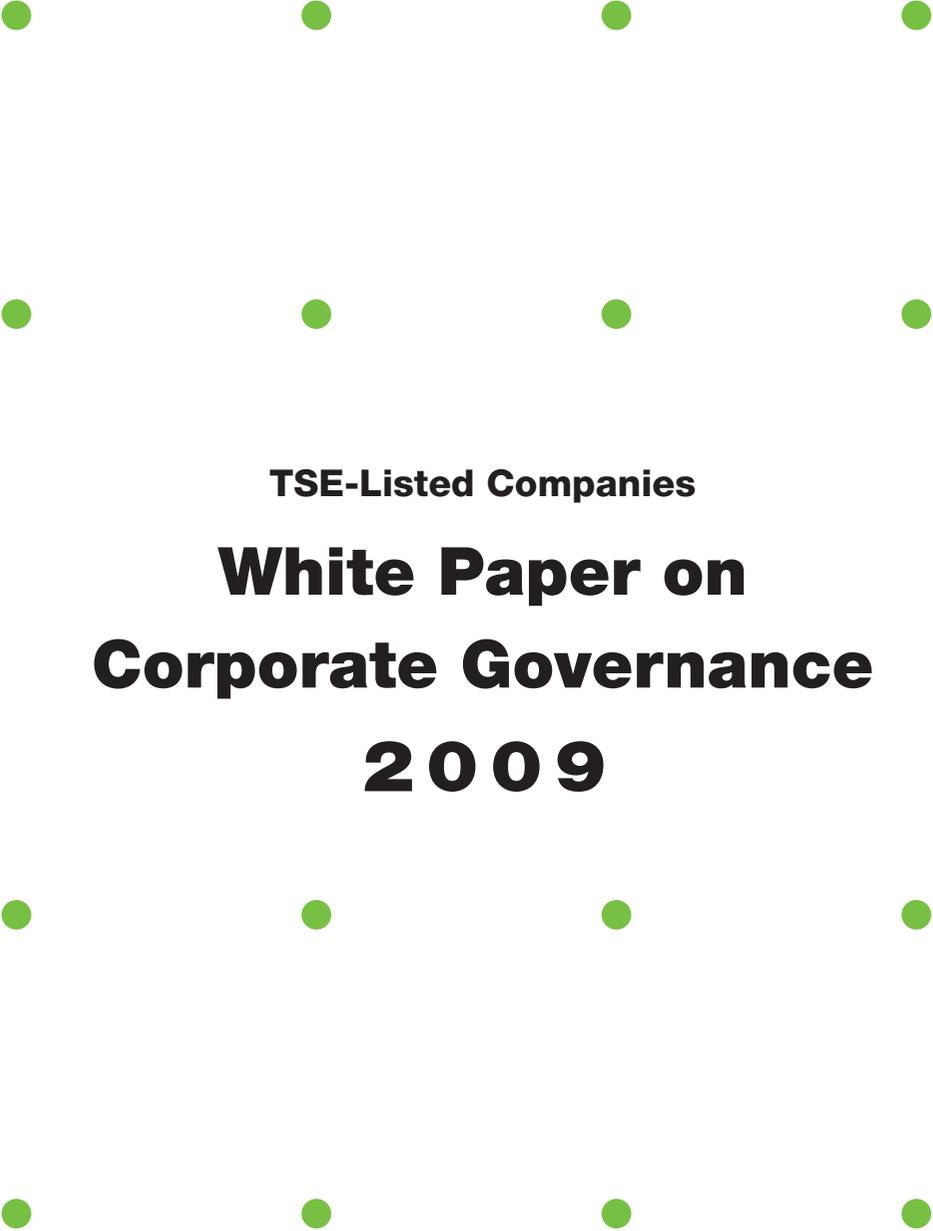




**TSE-Listed Companies  
White Paper on  
Corporate Governance  
2009**

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**TSE-Listed Companies**

**White Paper on**

**Corporate Governance**

**2009**

January 2009  
Tokyo Stock Exchange, Inc.

## Introduction

Since active discussion on corporate governance started in Japan, the government has created certain legal arrangements, including but not limited to, strengthening statutory auditor's (*Kansa-yaku*) functions and introduction of a corporate governance system named "Company with Committees." Tokyo Stock Exchange (the "Exchange" or "TSE") has also taken various measures including formulation of Principles of Corporate Governance for Listed Companies and development of the system for filing Report on Corporate Governance (the "Report"). Each of the listed companies has been steadily making efforts to improve and enhance its corporate governance, for example, by establishing management monitoring mechanism by external parties, in order to avoid corporate scandals or to increase efficiency of management and enhance corporate values.

On the other hand, while the listed companies are increasingly introducing takeover defense measures and cross-shareholdings seem to be resurging, some point out that there are a sign of removing shareholders who are against the intention of the management as well as lack of transparency in treatment of foreign capital, and raise a question whether efforts for improving and enhancing corporate governance remain stagnant. Furthermore, as shown in the case where a certain companies have taken corporate actions which seriously damage the shareholders' interests, there have been some situations where past efforts for improving and enhancing corporate governance in Japan are questioned to be genuine.

Under such circumstances and amid falling stock prices worldwide due to the recent financial crisis, the restoration of market confidence is the primary task for the Exchange which aims at strengthening its international competitiveness by attracting high-quality risk money from and providing investment opportunities to both domestic and foreign investors. To achieve that, the Exchange considers it essential to improve a framework necessary for corporate governance to perform the expected role properly. Also in connection with improvement of listing system, the Exchange has placed the top priority on this task during the fiscal year 2008 and carried out various considerations and measures for it.

This White Paper on Corporate Governance 2009 (the "White Paper") represents one of such measures, being a sequel to the previous White Paper on Corporate Governance 2007 (the "Previous White Paper"). To identify the status and progress of corporate governance efforts by the entire TSE-listed companies from various angles, this White Paper provides comprehensive analysis on the current corporate governance status of the TSE-listed companies based on the data from the Reports. The Exchange considers it critical to review the current status of TSE-listed companies in detail, as premises for making the market internationally competitive in terms of protection of shareholders' rights and corporate governance based on it, so that domestic and foreign investors can make investments without anxiety.

From the perspective of respecting continuity of the data, concerning numerical values and trends found in this research, the White Paper provides comparisons with the findings of the Previous White Paper, wherever possible, to ensure comparability for the convenience of investors. Enhanced comparability for investors would pose a stringent test of listed companies' corporate governance, and at the same time provide a ground where companies which established excellent corporate governance system receive acclaims. It would be a pleasure if this White Paper could help each of the listed companies to fully understand the progress of corporate governance efforts across the country and to enhance the company's corporate governance.

Finally, we would like to acknowledge the great assistance rendered by Corporate Practice Partners, Inc. for the preparation of White Paper.

January 2009  
Tokyo Stock Exchange, Inc.

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## Analysis Targets

This analysis utilized data from the Reports of all the domestic companies<sup>1</sup> listed on the Exchange (the "TSE-Listed Companies") as of August 21, 2008<sup>2</sup>. Furthermore, the data

was compared with the results of the previous analysis (as of the end of October 2006), and increases or decrease in numeric values<sup>3</sup> are referred to, where appropriate.

As shown in Chart 1, the number of listed companies (classified by market section) included in this analysis is 2,378 companies (increased by 22 companies from the previous analysis). It comprises of 1,717 companies (increased by 30 companies) listed on TSE First Section, 466 companies (decreased by 29 companies) listed on TSE Second Section, and 195 companies (increased by 21 companies) listed on TSE Mothers.

**Chart 1 Market Section**

Market	Number of companies		Ratio	
		Change from 2006		Change from 2006
TSE First Section	1,717	30	72.2%	0.6%
TSE Second Section	466	-29	19.6%	-1.4%
TSE Mothers	195	21	8.2%	0.8%
Total	2,378	22	100.0%	0.0%

## Methodology for the Analysis

Until recently the format for the Report to be filed with the Exchange was standardized using Excel, and the data stored in Excel was converted into PDF files for public disclosure on the TSE's website. The data submitted on or after July 7, 2008 is now converted into XBRL files. For the purpose of this analysis, the Exchange used the data in Excel right before conversion into PDF files, and the data in XBRL files for those submitted on or after July 7, 2008.

This White Paper is basically structured by chapter corresponding to topics in the Report, extracting data from corresponding topical sections in the Report. To make it easy to capture the characteristics,

<sup>1</sup> In accordance with the revisions of the regulations which came into effect on December 1, 2006 (Partial amendments of the Securities Listing Regulations, etc. in line with improvement of the listing system under the Comprehensive Improvement Program for Listing System), companies whose foreign stocks, foreign stock depository receipts, or preferred equity investment securities (excluding companies whose foreign stocks or foreign stock depository receipts are listed principally on a market other than TSE) are also required to file the Report effective from March 2007. However, as their Reports are not filed via the format of the report generation tool at the moment, they have not been included in the analysis.

<sup>2</sup> The topic of II.3.(1) "Policy to protect minority shareholders upon transactions with controlling shareholders" is newly added in line with improvement of the system in July 2008. Due to the interim measure requiring such contents to be included in the Report by the end of September 2008, the data as of the end November 2008 was utilized for the analysis for this topic is to ensure such inclusion.

<sup>3</sup> The columns titled "Increase/decrease 2006-2008" in charts in this White Paper show comparison with the data in the Previous White Paper (as of the end of October 2006), and time-series comparisons between 2006 and 2008 in graphs are based on the data as of the end of October 2006 and those as of August 21, 2008.



comparative analysis is performed by classifying the data by capital structure or corporate attribute, and aggregating the data of each attribute.

Charts are provided to show the overall trends of the TSE-Listed Companies, and list numerical values corresponding to categories such as two types of organizational forms, namely Companies with Statutory Auditors and Companies with Committees.

The classification and aggregation of numerical data are based on the quantified data in the Report<sup>4</sup>, and expressed as percentages (to the first decimal place) by dividing the number of companies whose responses fall into certain category by the total number of companies with the attribute which the respondent companies belong to. The data of directors, extracted from the Report in number of persons, is expressed as numbers of persons (to the second decimal place).<sup>5</sup>

To analyze the overall trends of topics in free-text description sections other than multiple choice sections, the Exchange defined several keywords representing directions of corporate governance in the same manner as the Previous White Paper, and aggregated the number of the data containing such keywords in the descriptions. As a new feature, typical and characteristic examples of such descriptions are also cited in this White Paper.

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<sup>4</sup> As numerical data on charts is rounded, a sum of individual data on a chart may not equal 100%, or a sum of figures for some items on a chart may not coincide with a figure in the relevant text.

<sup>5</sup> For "Attributes of Outside Directors," "Relation between Outside Director and Company," "Outside Director who entered into Limited Liability Agreement with Company" and "Reasons for Appointing Outside Directors," ratios to the total number of outside directors are shown. For "Attributes of Outside Statutory Auditors," "Relation between Outside Statutory Auditor and Company," "Outside Statutory Auditor who entered into Limited Liability Agreement with Company" and "Reasons for Appointing Outside Statutory Auditors", ratios to the total number of outside statutory auditors are shown. For "Scheduling General Shareholders' Meeting Avoiding Concentrated Dates," ratios to the total number of companies whose fiscal year ends in March are shown. "Eligible Persons for Stock Options," ratios to the companies adopting stock option system are shown. For "Description concerning Strategies for Takeover Defense Measures," ratios to the companies adopting strategies for takeover defense measures are shown.

## Underlying Concept of Corporate Governance

With respect to the underlying concept of corporate governance, prior to the start of the Report system, Exchange required listed companies to describe, in their financial highlights, their basic policies and objectives for corporate governance, and priorities of corporate governance compared with other management issues. At that time, such disclosures did not include significant descriptions focusing on their awareness of the need for management monitoring, or descriptions about the positioning of their stakeholders including shareholders, key players in governance. As a result, shareholders/investors had difficulties to understand their position in such companies. Therefore, the Exchange added this chapter<sup>6</sup> in the Report to clarify their perception of the above matters and purposes of corporate governance.

In the Reports, 50.2% (up 2.0 percentage points; any up/down in this chapter refers to a change from the previous research) - almost half of the companies - describe "corporate value" in connection with fundamental policies for and/or purposes of corporate governance efforts. As net sales (consolidated) or foreign shareholding ratio<sup>7</sup> increase, the percentage tends to increase commensurately. Discussions on takeover defense measures have been becoming active in recent years, and an increasing number of companies have adopted takeover defense measures. Under such a circumstance, the term "corporate value" seems to be widely used as an important keyword.

Many companies expressed that the objective of corporate governance is enhancement of corporate value, as shown in the following specific descriptions: "Basic principle of corporate governance is to enhance efficiency and transparency of management and to maximize corporate value," "We regard corporate governance as the key management issue to enhance corporate value as well as management transparency for shareholders," and "In order to continue to make profits from business activities and enhance corporate value, we consider it essential to develop corporate governance system as the framework to govern such activities."

Concerning management monitoring function, 41.7% (down 1.2 percentage points) of all companies referred to "monitoring" or "supervision. The overall ratio is lower than the previous research because Companies with Statutory Auditors showed a decline to 40.8% (down 1.2 percentage points), while 81.8% (up 3.9 percentage points) of Companies with Committees referred to those keywords. The gap has been widening. The same tendency is observed for the term "execution." The overall ratio declined to 42.4% (down 2.1 percentage points) and the gap between Companies with Committees and Companies with Statutory Auditors widened, while the former shows the ratio of 85.5% (up 4.1 percentage points) and the latter shows the ratio of 41.4% (down 2.1 percentage points). Clear distinction between business execution and supervision is a characteristic of organizational structure of Companies with Committees,

<sup>6</sup> These are items in the Report for which fundamental policies (rationale for the policies) on the initiatives on the corporate governance and the objective of corporate governance are described concretely. In addition, companies are required to describe the positioning of their shareholders and other stakeholders (all the interested parties related to the companies including shareholders, employees, consumers, etc.), their management monitoring function, and the concept of the group as a whole.

<sup>7</sup> This means shares held by corporations founded under any foreign law or non-Japanese individual investors (in accordance with the definitions for annual securities reports) as the percentage of outstanding shares issued.

and the majority of those companies described this characteristic, as reflected to the higher ratio.

Specific descriptions on management monitoring include: "Aiming at maintaining appropriateness of business execution by strengthening management monitoring function," "The management maintains high level of corporate ethics, secures sound management and transparency, makes the management monitoring mechanism led by Statutory Auditors fully work, and enhances the corporate value. This is a fundamental of corporate governance." A number of companies described that strengthening the function to monitor the management is the fundamental of corporate governance.

As a significant part of corporate value, more than half of the companies referred to "stakeholders"<sup>8</sup>, showing further growth from the previous research to 57.9% (up 1.9 percentage points). The result suggests that the companies are aware to an appreciate degree that it is essential to establish good relations not only with shareholders, but also with wide range of interested parties such as employees, customers, business partners (including creditors), consumers and communities in order to achieve better corporate governance. While some companies placed greater emphasis on their shareholders as well as showing certain considerations to their stakeholders, a distinctive trend is that shareholders and other stakeholders are described on an equal basis, as shown in phrase "aiming at enhancing corporate value through relationship with the stakeholders."

In recent years, respect for stakeholders has been represented by growing attention to corporate social responsibility, or CSR. Also in this research, 27.1% of all companies, which is higher than the previous research result by 0.8 percentage points, referred to "social responsibility."<sup>9</sup> What is found characteristic is a trend toward emphasis on activities in consideration of social responsibility as the basic policy of the companies.

In addition, even though it was not required in the preparation guideline<sup>10</sup> for "the Report on Corporate Governance" (the "Reporting Guideline"), "compliance"<sup>11</sup> was mentioned by 41.4% (up 0.2 percentage points) of the companies from the viewpoint of sound corporate management. The high ratio would be partly because discussion on corporate governance in Japan has been provoked by efforts for prevention of corporate scandals. Conducting business activities in compliance with laws and regulations as well as social norms is the minimum requirement expected by the entire nation and society. This result shows high level of corporate awareness of this expectation as well as consideration for corporate social responsibility.

The related keyword "internal control," however, shows rather low ratio of 19.9% (up 1.0 percentage points), even though its significance has been emphasized in the Company Act and the Financial

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<sup>8</sup> With respect to the item "stakeholders," any company using any one of the following keywords is included: "stakeholder," "employee," "region and community," "interested party," "customer," "consumer," "creditor," "any parties involved in transaction," or "residents in the region."

<sup>9</sup> With respect to the item "social responsibility," any company using any one of the following keywords is included: "CSR," "social responsibility," "responsibility for society," or "corporate ethics."

<sup>10</sup> Available from TSE's website effective from July 7, 2008 <http://www.tse.or.jp/rules/cg/index.html> (Japanese version only)

<sup>11</sup> With respect to the item "compliance," any company using any one of the following keywords is included: "compliance," "observance" and "compliance (written in Japanese character)."

Instruments and Exchange Act (hereinafter referred to as "FIEA"). This may be because the Report has a separate section dedicated to internal control.

Similarly, as an overall corporate management issue, 68.7% of the companies referred to "transparency," maintaining a high ratio from the previous research. It is understood that this element has been widely spread as an important concept of management. Furthermore, 7.4% of the companies mentioned directors' accountability: Specifically, many companies described that enhancement of or adherence to accountability is recognized as a part of strengthening corporate governance. As shown in the result of "Listed Company Corporate Governance Questionnaire for Investor" (the "Investor Survey")<sup>12</sup> which the Exchange conducted in June-July 2008, there is a strong demand of investors for strengthening accountability upon issuance of new shares, etc. through private placement to a third party, cross-shareholding, reverse stock split which deprives many shareholders of their shareholders' rights, takeover defense measures, etc. The companies seem to have addressed such investors' increasing demand for corporate accountability with regards to how to inform investors of management monitoring procedures.

**Chart 2 Underlying Concept of Corporate Governance**

		Corporate Value		Shareholders' value		Monitoring & supervision		Execution	
		Ratio	Change from 2006	Ratio	Change from 2006	Ratio	Change from 2006	Ratio	Change from 2006
Total		50.2%	2.0%	6.4%	-0.1%	41.7%	-1.2%	42.4%	-2.1%
Organizational Form	Companies with Statutory Auditors	50.3%	1.9%	6.2%	-0.1%	40.8%	-1.2%	41.4%	-2.1%
	Companies with Committees	47.3%	4.9%	18.2%	1.2%	81.8%	3.9%	85.5%	4.1%

		Decision making		Internal control		Stakeholders		Social Responsibility	
		Ratio	Change from 2006	Ratio	Change from 2006	Ratio	Change from 2006	Ratio	Change from 2006
Total		41.6%	-1.6%	19.9%	1.0%	57.9%	1.9%	27.1%	0.8%
Organizational Form	Companies with Statutory Auditors	41.1%	-1.9%	20.0%	1.0%	58.0%	1.8%	27.1%	0.8%
	Companies with Committees	61.8%	9.3%	16.4%	1.1%	54.5%	5.4%	28.8%	0.3%

		Compliance		Transparency		Efficiency		Soundness	
		Ratio	Change from 2006	Ratio	Change from 2006	Ratio	Change from 2006	Ratio	Change from 2006
Total		41.4%	0.2%	68.7%	-0.1%	19.0%	0.0%	22.0%	0.7%
Organizational Form	Companies with Statutory Auditors	41.5%	0.0%	68.5%	-0.1%	19.0%	0.0%	22.3%	0.7%
	Companies with Committees	32.2%	6.0%	78.0%	0.2%	20.3%	1.5%	6.8%	0.5%

<sup>12</sup> [http://www.tse.or.jp/english/rules/ls-improvements/opinions\\_summary.pdf](http://www.tse.or.jp/english/rules/ls-improvements/opinions_summary.pdf) (English version) (for Japanese version, [http://www.tse.or.jp/rules/seibi/2008toushika\\_iken.pdf](http://www.tse.or.jp/rules/seibi/2008toushika_iken.pdf))

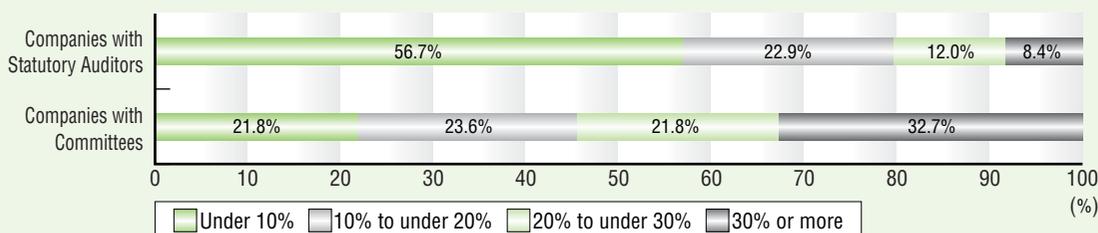
# Capital Structure, Corporate Attributes, and Other Fundamental Information

## 1. Capital Structure<sup>13</sup>

### (1) Foreign shareholding ratio

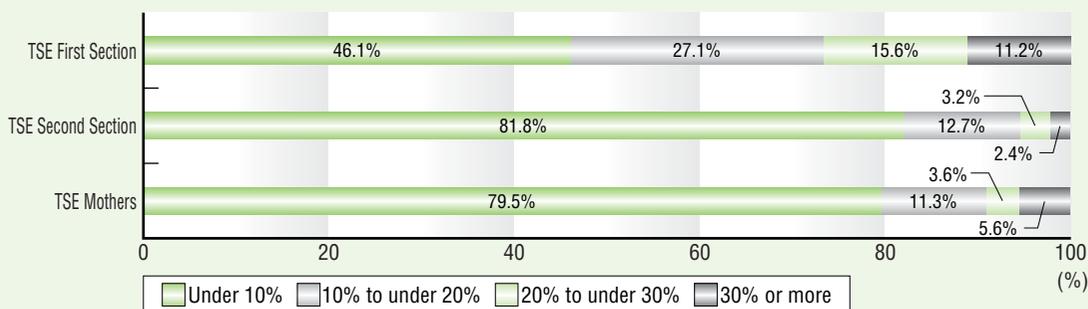
Classification by foreign shareholding ratio is as shown in Chart 3. The ratio of the Companies with Committees at least 30% of whose shares are held by foreign investors is 32.7% (down 1.2 percentage points; any up/down in this chapter refers to a change from the previous research). Nonetheless, the higher the foreign shareholding ratio is, the higher percentage share the Companies with Committees account for, similarly to the previous results.

**Chart 3 Classification by Foreign Shareholding Ratio**

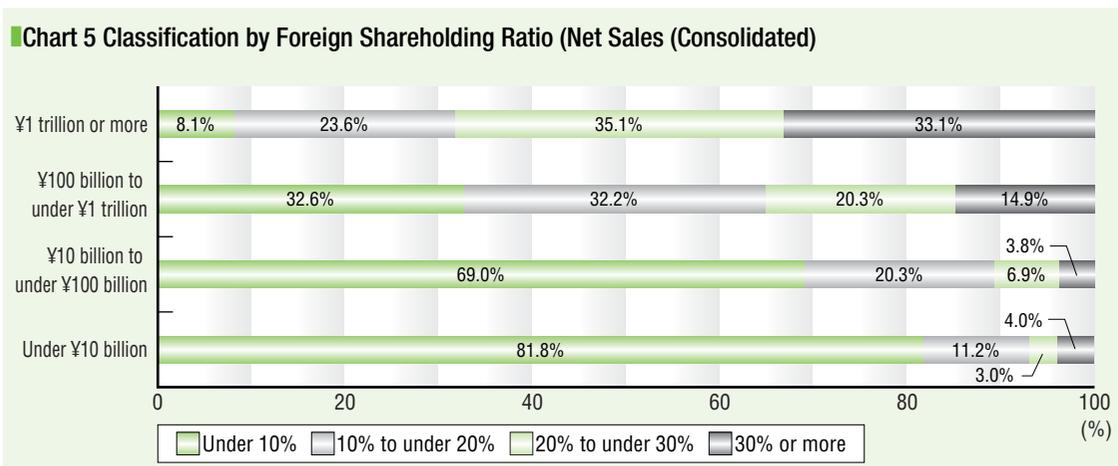


As for relation with market section, percentage shares of the companies with higher foreign shareholding ratio tend to be greater among those listed on TSE First Section, compared with those listed on TSE Second Section or TSE Mothers. (See percentage shares of foreign shareholding of no less than 30%: The companies listed on TSE First Section show higher 11.2%, compared with 2.4% of those on TSE Second Section and 5.6% of those on TSE Mothers.) Furthermore, as for relation with net sales (consolidated), as shown in Chart 5, the greater net sales (consolidated) are, the higher percentage shares the companies with higher foreign shareholding ratio account for.

**Chart 4 Classification by Foreign Shareholding Ratio (Market Section)**



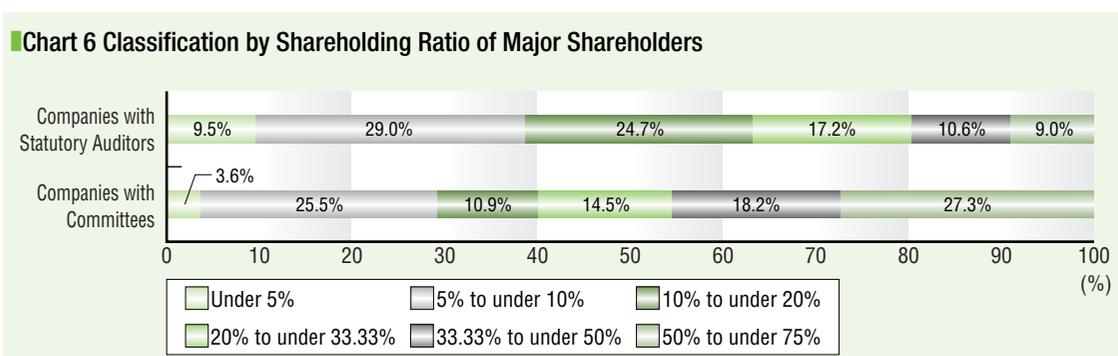
<sup>13</sup> The Report basically requires the description of conditions existing as of the end of the immediately preceding fiscal year.



## (2) Major shareholders<sup>14</sup>

Chart 6 shows classification by shareholding ratio of major shareholders.

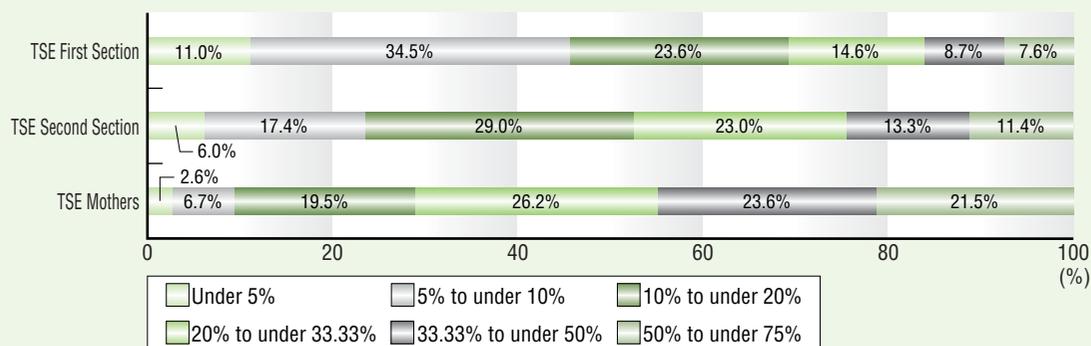
In case of the Companies with Statutory Auditors, fewer companies belong to categories of higher percentage ownership held by major shareholders, except the category of less than 5%. On the contrary, in case of the Companies with Committees, the companies no less than 50% of whose shares are held by major shareholders comprise the highest proportion, 27.3% (down 4.9 percentage points). It would be attributed to such background that entire companies under certain enterprise groups adopted the company with committees system.



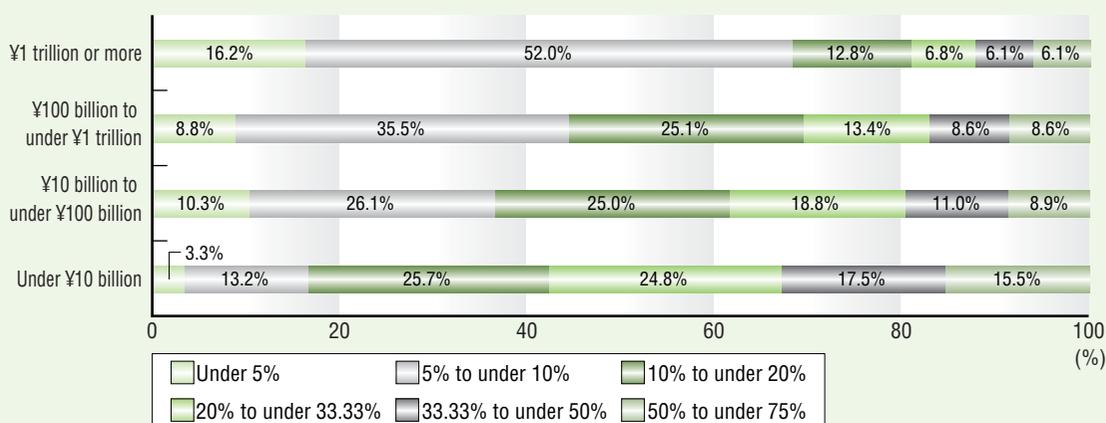
As shown in Chart 7 by market section, the companies listed on TSE First Section show lower percentage ownership held by major shareholders than others. Chart 8 indicates that the higher net sales (consolidated) are, the lower the percentage ownership held by major shareholders is. It indicates that such companies tend to show high ownership dispersion.

<sup>14</sup> For the Report, this corresponds to the item in a annual securities report for which the description of "major shareholders" is required based on the descriptions contained in the list of shareholders.

**Chart 7 Classification by Shareholding Ratio of Major Shareholders (Market Section)**



**Chart 8 Classification by Shareholding Ratio of Major Shareholders (Net Sales (Consolidated))**



## 2. Corporate Attributes<sup>15</sup>

### (1) Listed exchange and market section

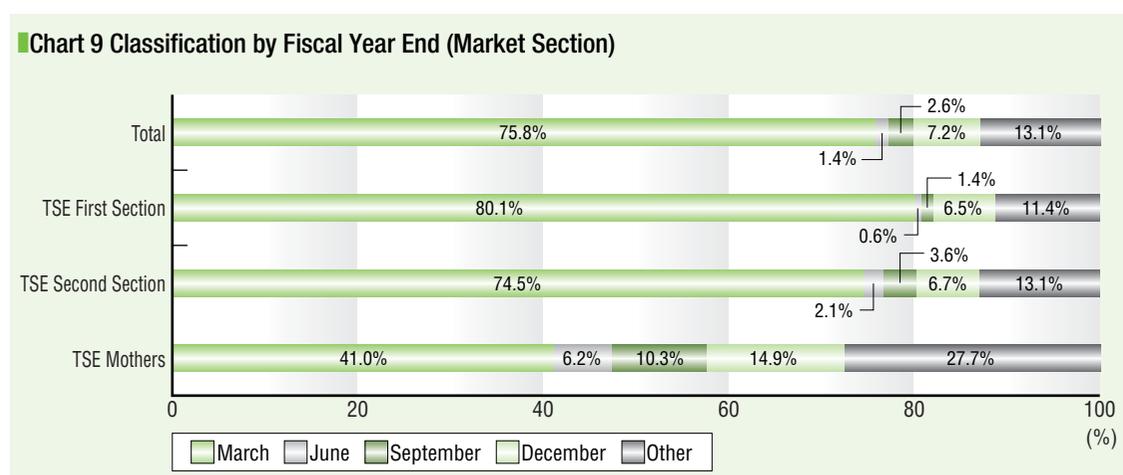
The numbers and ratios of the TSE-Listed Companies by market section are shown in Chart 1. Furthermore, 832 companies, 35.9% of all TSE-Listed Companies, are listed on other domestic exchange (dual listing). While all TSE Mothers-listed companies are single listing, the percentages of single listing companies listed on TSE Second Section and First Section are 82.6% and 56.3%, respectively. In respect of markets for such dual listing, 592 companies, 25.5% of all TSE-Listed Companies, are listed on the first section of Osaka Securities Exchange, which ranks first in dual listing, followed by the first section of Nagoya Securities Exchange where 233 companies or 10.0% of the same are listed.

<sup>15</sup> The Report basically requires the description of conditions existing as of the end of the immediately preceding fiscal year.

## (2) Fiscal year end

Chart 9 shows classification by ending month of fiscal year. The fiscal year of 75.8% of all TSE-Listed Companies (down 0.7 percentage points) ends in March.

As characteristics by market section, the majority of the companies listed on TSE First Section (80.1%; down 0.6 percentage points) and TSE Second Section (74.5%; up 0.2 percentage points) adopt a fiscal year ending March. However, only 41.0% (down 0.4 percentage points) of TSE Mothers-listed companies adopt a fiscal year ending March, while the remaining companies adopt a fiscal year ending December (14.9%) or September (10.3%).



## (3) Number of employees<sup>16</sup>

Chart 10 shows classification by number of employees. 55.5%, more than a half, of the companies has no less than 1,000 employees. Although not included in the chart, as far as the Companies with Committees are concerned, the percentage is as high as 80.0%.

**Chart 10 Classification by Number of Employees (Consolidated)**

net sales (consolidated)	Number of companies		Ratio	
		Change from 2006		Change from 2006
Under 100	129	-2	5.4%	-0.1%
100 to under 500	486	4	20.4%	0.0%
500 to under 1000	443	-17	18.6%	-0.9%
1000 or more	1,320	37	55.5%	1.1%
Total	2,378	22	100.0%	0.0%

<sup>16</sup> The Report requires companies preparing consolidated financial statements to make their descriptions on a consolidated basis.

#### (4) Net sales<sup>17</sup>

Classification by net sales is as shown in Chart 11.

**Chart 11 Classification by Net Sales (Consolidated)**

number of employees (consolidated)	Number of companies		Ratio	
		Change from 2006		Change from 2006
Under ¥10 billion	303	28	12.7%	1.1%
¥10 billion to under ¥100 billion	1,209	-62	50.8%	-3.1%
¥100 billion to under ¥1 trillion	718	37	30.2%	1.3%
¥1 trillion or more	148	19	6.2%	0.7%
Total	2,378	22	100.0%	0.0%

#### (5) Existence of parent company<sup>18</sup>

12.6% (down 0.9 percentage points) of the TSE-Listed Companies have parent companies, 85.7% (10.8% of the total) of which are listed companies. One reason for such high listing ratio of the parent companies would be that as one of the requirements for a subsidiary's initial listing until January 1, 1996, a parent company had to be listed on TSE. Another reason would be that because TSE's Securities Listing Regulations requires any unlisted parent companies to disclose corporate information to the same extent as listed companies<sup>19</sup>, listing of a subsidiary tends to be a heavy burden for an unlisted parent company.

As for percentage of the companies which have parent companies by market section, while the companies listed on TSE First Section show relatively low 10.5% (down 0.1 percentage points), those listed on TSE Second Section show 19.3% (down 3.5 percentage points) and TSE Mothers shows 14.9% (down 0.6 percentage points).

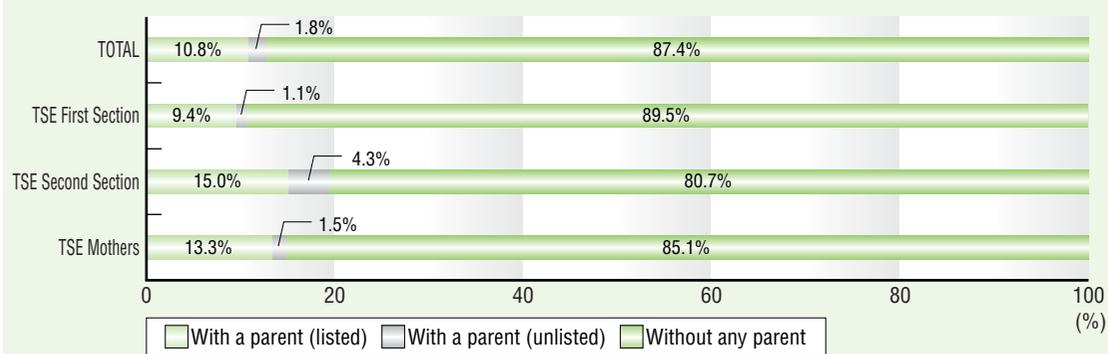
As far as companies whose largest shareholders own more than 50% of the shares are concerned, 82.7% (down 3.4 percentage points) have parent companies, and 17.3% do not. It suggests that the percentage of controlling shareholders other than companies (usually individuals) is relatively low. Nonetheless, speaking of percentages of such companies whose largest shareholders hold the majority ownership, TSE Mothers shows 19.0% which is a relatively high ratio compared with TSE First Section (6.1%) and TSE Second Section (10.1%). In case of so called start-up companies whose stocks are listed on TSE Mothers, controlling shareholders tend to be such individuals as the founders.

<sup>17</sup> The Report requires companies preparing consolidated financial statements to make the descriptions on a consolidated basis using the annual net sales of the immediately preceding fiscal year.

<sup>18</sup> This refers to the parent company defined in Article 8, Paragraph 3 of the Rules Concerning the Terms and Format for Financial Statements and the Methods for Preparing Financial Statements ("Rules on Financial Statements").

<sup>19</sup> Article 406 of the Securities Listing Regulations (Until November 2007, pursuant to TSE's criteria for listing examination, one of the eligibility requirements was that stock of the parent company has been listed on a domestic securities exchange (or the parent company commits to disclose corporate information to the same extent as listed companies); Section 1.(2) d (d) of Interpretation for Criteria for Listing Examination)

**Chart 12 Classification by Existence of a Parent Company (Market Section)**



In June 2007, the Exchange announced that it is not appropriate to uniformly prohibit listing subsidiaries in light of its significance in the national economy as well as the expected role of stock exchanges to provide investors with diverse investment instruments, but that listing subsidiaries is not necessarily a desirable capital policy for various market players including investors<sup>20</sup>. In this respect, the Exchange requested the listed companies which have parent companies to be keen to shareholders' rights and interests, and to ensure accountability for market players including investors diligently. Furthermore, in October 2007, the Exchange together with other exchanges announced that listing of core subsidiaries of listed companies would be dealt prudently through cooperation among exchanges out of concern about possible intention to gain double benefits from initial public offerings<sup>21</sup>.

### (6) Number of consolidated subsidiaries

Chart 13 shows classification by number of consolidated subsidiaries.

**Chart 13 Classification by Number of Consolidated Subsidiaries**

Number of consolidated subsidiaries	Number of companies		Ratio	
		Change from 2006		Change from 2006
Under 10	1,385	-1	58.2%	-0.6%
10 to under 50	775	-1	32.6%	-0.3%
50 to under 100	124	17	5.2%	0.7%
100 to under 300	74	5	3.1%	0.2%
300 or more	20	2	0.8%	0.1%
Total	2,378	22	100.0%	0.0%

<sup>20</sup> TSE "The Exchange's View on Listing of a Company Which Has a Parent Company" TSE Listing No. 11 (June 25, 2007)

<sup>21</sup> TSE "The Exchange's View on Listing of a Core Subsidiary" TSE Listing Examination No. 235 (October 29, 2007)

### 3. Other Special Conditions with Potentially Significant Effects on Corporate Governance

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The Report contains a section titled "Other Special Conditions with Potentially Significant Effect on Corporate Governance" for free-text descriptions of company-specific circumstances which are not directly linked to each section in the Report but may significantly affect corporate governance, or supplementary explanation to other sections. The following section (1) outlines descriptions concerning the subject, which is a newly-added reporting requirement for the listed companies with controlling shareholder<sup>22</sup> in accordance with improvement of the listing system in July 2008<sup>23 24</sup>. The following section (2) provides descriptions concerning other matters applicable to optional free-text descriptions in the subject section as in the past.

#### (1) Policy to protect minority shareholders upon transactions with controlling shareholder

Due to improvement of the listing system, a listed company with controlling shareholder is now required to describe guidelines for policy to protect minority shareholders upon transactions with the controlling shareholder. Controlling shareholders herein include a parent company, individual controlling shareholder, etc. When a listed company conducts a business transaction with its controlling shareholder, it is highly probable that the transaction conditions are determined in favor of the controlling shareholder and it causes damages to the minority shareholders. This issue has been raised in the context of listing subsidiaries, and therefore the Exchange addressed the issue from the aspect of disclosure first.

Concerning the guidelines for policy to protect minority shareholders, it is expected to specifically describe such matters as a policy for developing company structure, internal procedures for decision-making and use of external bodies, in order to prevent damages to a company and further to its minority shareholders as a result of a transaction which benefits a controlling shareholder due to their influence.

As for criteria of transactions with controlling shareholder subject to the guidelines, in principle it is desirable to consider all transactions with controlling shareholder. Yet as it is assumed that the level of influences may differ by size and structure of companies, in effect to limit to transactions of a size which may affect the minority shareholders to a certain extent, it is considered that each company may establish specific criteria which they find appropriate.

This analysis covers 380 TSE-Listed Companies with controlling shareholders, and their approaches for describing the subject matter are classified into two categories. One is to describe their policies for

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<sup>22</sup> For definition of "controlling shareholder", refer to Article 2, Item 42-2 of the Securities Listing Regulations, and Article 3-2 of the Enforcement Rules for the Securities Listing Regulations.

<sup>23</sup> Executed in accordance with the revision of the related regulations on July 7, 2008 (partial amendment of the Business Regulations and others based on the Comprehensive Improvement Program for Listing System 2007 (the second phase)).

<sup>24</sup> See footnote 2.

transaction conditions, and another is to refer to their procedures of transactions with the controlling shareholders.

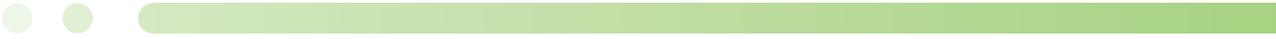
Out of these two approaches, 229 companies, or 60.3% of TSE-Listed Companies with controlling shareholders, referred to their guidelines for such transaction conditions. Specifically, considerable number of the companies described their policies that transactions with the controlling shareholders are to be carried out in a fair and equitable manner as in those with other business partners taking into account the terms of such contracts and market prices, so that they do not conduct any transactions which adversely affect the minority shareholders' interests. Some companies stated that while not having business relationship with their controlling shareholders at the moment, they would take the same policy as above. There are companies which expressed their policy not to conduct any transactions with their controlling shareholder in principle.

123 companies, or relatively high 32.4%, referred to their procedures of transactions with the controlling shareholders. Many of them adopt such a basic policy for minority shareholders protection that upon each of such transactions, a company itself judges right or wrong about the transaction through the Board of Directors' discussion and resolution with regards to the appropriateness of transaction contents and conditions. Other procedures expressed include: a company asks for opinions of outside directors other than those from the parent company for more objective decision-making in order to prevent any transaction which benefits the parent company and also causes damages to the minority shareholders; a company makes a decision by consulting with external specialists, when needed, to ensure that transaction conditions in question are reasonable and appropriate; and as a difference from ordinary transactions, a company requires a resolution of the Board of Directors regardless of transaction amount in question. Nonetheless, many companies seem to regard it sufficient to have such basic policies to protect minority shareholders that the said decisions are independently made by the Board of Directors of the subsidiaries, not based on instructions from the parent companies. Yet they are expected to explain more about whether directors under the parent companies' influence can make a fair decision.

As for descriptions from procedural aspect, some companies wrote about regulations stipulating internal procedures pertaining to making decisions on transaction conditions for the purpose of securing operational appropriateness in general transactions, and about adequacy in audits by statutory auditors and internal audit divisions, etc.

Aside from transaction conditions and procedures, in case a controlling shareholder assumes a role of director, company rules such as code of ethics prohibit such a director to conduct conflict of interest transactions, which cause or may cause conflicts between the director's interests and the company's interests. There are certain companies which prohibit unfairly favorable or unfavorable transactions compared with transactions with third parties, or transactions for the purpose of transferring profits or losses/risks, clearly in their rules as policies to protect minority shareholders.

In addition to the above, there are cases where a policy to protect minority shareholders was not clear while explanation on its controlling shareholder was given, and where a company stated that it secures independence or self-reliance in business asserting that the existence of director and/or statutory auditor



having a duty in the parent company does not impede independent management decisions, but without concrete explanation. It may be because the Reports were prepared immediately after the improvement of the system. Yet the Exchange found that not a few companies need to reconsider such contents, and expects the listed companies with controlling shareholders to make further efforts.

## **(2) Other**

As described in the Reporting Guideline, the matters applicable to optional free-text descriptions in the subject section include the following matters: (i) in case a company has a parent company - views on, and measures and policies for, maintaining independence from the parent company; (ii) in case a company has a listed subsidiary - views on, and measures and policies for, maintaining independence of the subsidiary.

Concerning (i), out of 299 companies which have the parent companies in this research, 62 companies (20.7%) referred to independence from the parent companies. Specifically they explained independence from the parent companies showing such examples as whether or not there are matters for approval in business activities, pricing power with regards to conditions of transactions (sales, procurement, etc.) with enterprise groups including parent companies, and the situation of Companies with Committees where a number of directors sent from the parent companies in each committee must be less than the majority.

Concerning (ii), out of 95 listed companies with subsidiaries, only 10 companies specifically referred to considerations to the minority shareholders. Such companies described that respect for the minority shareholders' interests are included in the basic internal control policy, that the parent company is committed to respect managerial independence of its listed subsidiary to the maximum extent in the agreements of capital subscription and others, and that transaction conditions are determined in accordance with appropriate procedures or as the same conditions with other companies.

## Corporate Governance System

As the matters concerning governing bodies and conduct of organizations, the Report has a section on statutory auditors in case of Companies with Statutory Auditors, or executive officers and each of statutory committees in case of Companies with Committees, in addition to a section on directors. Decision-making procedures and supervising/auditing functions for business execution vary depending on organizational form of a company. Therefore, it is considered that explanations in line with such organizational forms serve as useful information for making investment decisions from the perspective of understanding the status of corporate governance.

### 1. Organizational Form

As for organizational forms of the companies which submitted the Corporate Governance Reports, those who adopted the Companies with Committee system account for only 2.3% (down 0.2 percentage points; any up/down in this chapter refers to a change from the previous research) of all TSE-Listed Companies. Overwhelming majority of the companies (97.7%) are Companies with Statutory Auditors. Background factor behind the results would be that Japanese stock companies (*kabushiki kaisha*) have traditionally adopted the statutory auditor system under the former Commercial Code, and that only large or deemed-large companies were allowed to shift to the Companies with Committees system<sup>25</sup> at the time when the committees system was first introduced as "Companies with Committees, etc." under the former Commercial Code and the Act on Special Provisions of the Commercial Code concerning Audits, etc. of Kabushiki Kaisha (the "former Special Provisions on Audits") on April 1, 2003. Currently a company, regardless of the company size, may adopt the Companies with Committees system by stipulating so in its own articles of incorporation.<sup>26</sup>

**Chart 14 Organizational Form of TSE-Listed Companies**

Organizational form	TSE First Section			TSE Second Section			TSE Mothers		
	Number of companies	Ratio	Change from 2006	Number of companies	Ratio	Change from 2006	Number of companies	Ratio	Change from 2006
Companies with Statutory Auditors	1,670	97.3%	0.2%	462	99.1%	0.6%	191	97.9%	-0.9%
Companies with Committees	47	2.7%	-0.2%	4	0.9%	-0.6%	4	2.1%	0.9%
Total	1,717	100.0%	0.0%	466	100.0%	0.0%	195	100.0%	0.0%

<sup>25</sup> Article 1-2, Paragraph 3 of the former Special Provisions on Audits.

<sup>26</sup> Article 326, Paragraph 2 of the Companies Act.

**Chart 15 Organizational Form of TSE-Listed Companies (Foreign Shareholding Ratio)**

Foreign Shareholding Ratio	Companies with Statutory Auditors		Companies with Committees		Total
	Number of companies	Ratio	Number of companies	Ratio	Number of companies
Under 10%	1,316	99.1%	12	0.9%	1,328
10% to under 20%	533	97.6%	13	2.4%	546
20% to under 30%	278	95.9%	12	4.1%	290
30% or more	196	91.6%	18	8.4%	214
Total	2,323	97.7%	55	2.3%	2,378

**Chart 16 Organizational Form of TSE-Listed Companies (Shareholding Ratio of the Largest Shareholder)**

Shareholding Ratio of the Largest Shareholder	Companies with Statutory Auditors		Companies with Committees		Total
	Number of companies	Ratio	Number of companies	Ratio	Number of companies
Under 5%	220	99.1%	2	0.9%	222
5% to under 10%	673	98.0%	14	2.0%	687
10% to under 20%	573	99.0%	6	1.0%	579
20% to under 33.33%	400	98.0%	8	2.0%	408
33.33% to under 50%	247	96.1%	10	3.9%	257
50% or more	210	93.3%	15	6.7%	225
Total	2,323	97.7%	55	2.3%	2,378

In the analysis of the ratio of the Companies with Committees by market section as shown in Chart 14, TSE First Section shows a slightly higher ratio (2.7%). With respect to number of employees (consolidated), net sales (consolidated), and number of consolidated subsidiaries, the results of each of these elements show that the higher the figure is (meaning, the larger the companies are), the more likely the companies have adopted the committees system. As mentioned earlier, this would be under the influence of the fact that only large companies and deemed-large companies were allowed to adopt the committees, etc. system at the time the system was introduced.

Regarding foreign shareholding ratio (see Chart 15), there is a trend that the higher the ratio is, the higher the percentage of Companies with Committees is. Where the shareholding ratio of the largest shareholder exceeds 50%, the percentage of the Companies with Committees appears to be higher (see Chart 16). In this background, there was a case where the entire companies under certain enterprise groups adopted the committees system.

## 2. Directors and the Board of Directors

### (1) Chairperson of the Board of Directors meetings

Concerning chairperson of the Board of Directors meetings, the Report requires each company to inform whether or not a chairperson exists, and an attribute of the chairperson, if any, by checking an

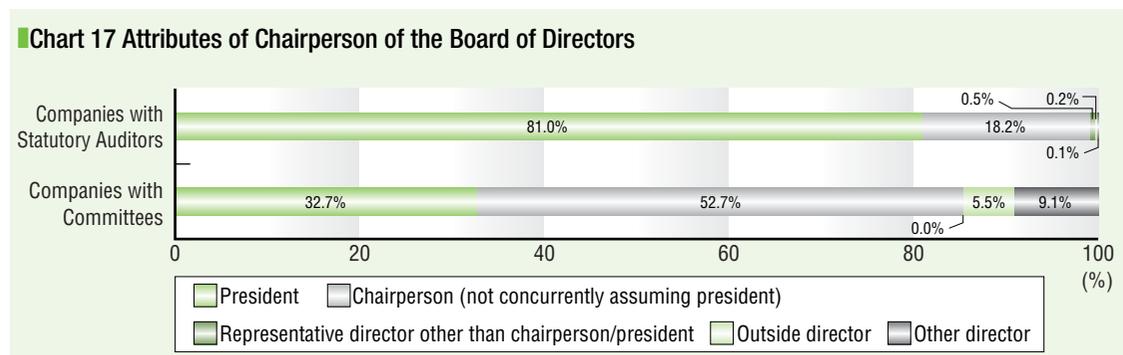
appropriate answer among the following categories: (1) president (*shacho*), (2) company chairperson (*kaicho*) (excluding a person who concurrently assumes the position of president; hereinafter the same shall apply), (3) representative director other than company chairperson/president, (4) outside director, or (5) other director.

First of all, there is no TSE-Listed Company without a chairperson of the Board of Directors meetings.

As for the attributes of chairperson of the Board of Directors, an overall trend is that president chairs the Board of Directors in the most companies, making up 79.9% of all TSE-Listed Companies (down 0.7 percentage points), followed by company chairperson who chairs the Board in 19.0% (up 0.5 percentage points) of the companies. In 98.9% (down 0.2 percentage points) of the companies, either president or company chairperson chairs the Board of Directors.

In the analysis by market section, whereas president chairs the Board of Directors in 75.0% (company chairperson: 23.2%) of the companies listed on TSE First Section, such ratios of TSE Second Section and TSE Mothers are 90.8% (company chairperson: 8.8%) and 97.4% (company chairperson: 1.5%), respectively. As number of employees (consolidated), net sales (consolidated), and number of consolidated subsidiaries get larger (in other words, in larger companies), percentage of president who chairs the Board tends to decline, while percentage of company chairperson who chairs the Board tends to increase.

In the comparative analysis of the chairpersons' attributes between the Companies with Statutory Auditors and the Companies with Committees (see Chart 17), while president and company chairperson who chairs the Board of the Companies with Statutory Auditors comprise 81.0% (down 0.8 percentage points) and 18.2% (up 0.7 percentage points), respectively, the respective ratios in the Companies with Committees show 32.7% (up 0.5 percentage points) and 52.7% (down 1.5 percentage points). In the latter companies, the cases company chairperson chairs the Board shows a higher ratio. This would not be interpreted as a difference between the Companies with Statutory Auditors and the Companies with Committees. Rather it would be due to the trend that the Companies with Committees system are more likely to be adopted by larger companies (see the above 1. Organizational Form).



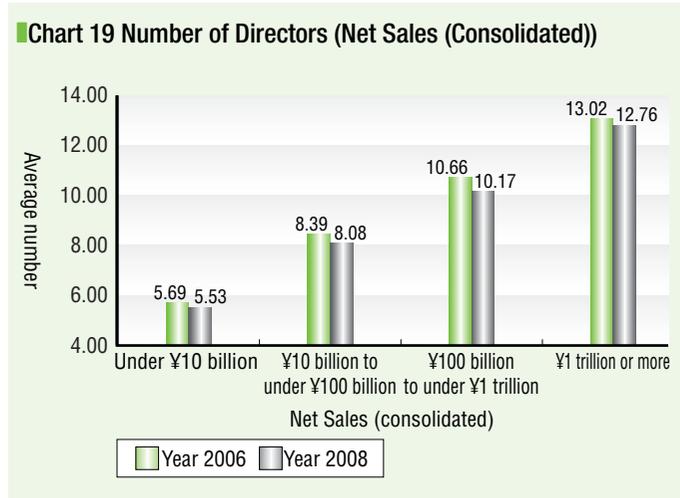
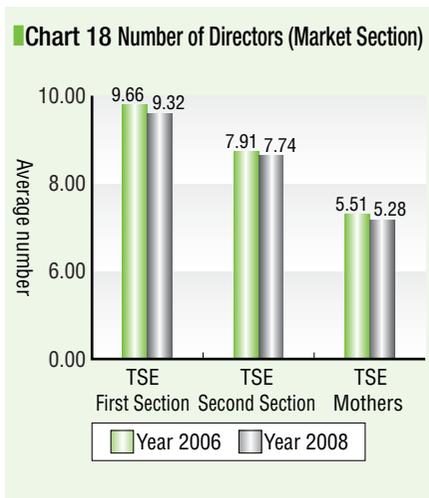
## (2) Number of directors

Substantial downsizing of the Boards of Directors has been observed in the past decade. Consequently, the current average number of directors per company for all TSE-Listed Companies is 8.68 (down 0.31 persons).

Despite of an overall decline in number of directors, there are 20 companies which have more than 20 directors, and 10 companies among them do not have any outside director. In contrast, there are 411 companies which have no more than 5 directors. Among them, the size of the Board of Directors is equal to the size of the Board of Statutory Auditors in 18 companies; and number of directors exceeds number of statutory auditor by only 1 person in 100 companies. Furthermore, upon dividing the number of directors by the number of the statutory auditor, 209 companies shows no more than double, including 139 companies showing no more than 1.5 times, indicating that statutory auditors has been gaining more power.

In the analysis by market section (see Chart 18), companies listed on TSE First Section have 9.32 directors in average (decreased by 0.34 persons) in contrast to 7.74 directors (decreased by 0.17 persons) in TSE Second Section and 5.28 directors (decreased by 0.23 persons) in TSE Mothers, while all of them showing declines.

In addition, as shown in Chart 19, there is a notable feature that the larger the net sales (consolidated)<sup>27</sup> are (that is, when a company size is larger), the more directors companies tend to have.



When classified by foreign shareholding ratio, the analysis finds that the higher the ratio is the more directors the companies have. This would not be related to higher foreign shareholding ratio itself; rather it would be because foreign shareholding ratios tend to be higher in larger companies (see the above II.1.

<sup>27</sup> The similar trends are observed in analysis by (consolidated) number of employees, and number of consolidated subsidiaries.

(1) Foreign Shareholding Ratio).

As for major shareholders, the lower the shareholding ratios of the largest shareholder are, the more in number the companies tend to have directors. This would be due to a trend that the lower shareholding ratio of the largest shareholder, the larger companies are (see the above II.1. (2) Major Shareholders).

### **(3) Appointment of outside directors**

#### **(a) Appointment of outside directors and number appointed**

##### **(i) Overview**

Companies which appoint outside directors<sup>28</sup> account for 45.4% (up 3.1 percentage point) of all TSE-Listed Companies. When limited to the Companies with Statutory Auditors, the corresponding ratio is 44.1% (up 3.3 percentage points), showing an increase from the previous research. While the Companies with Committees are required to have more than a half of outside directors in each committee under the Companies Act (Article 400, Paragraph 3 of the Companies Act), the Companies with Statutory Auditors, which are not subject to such a requirement, are increasingly appointing outside directors voluntarily.

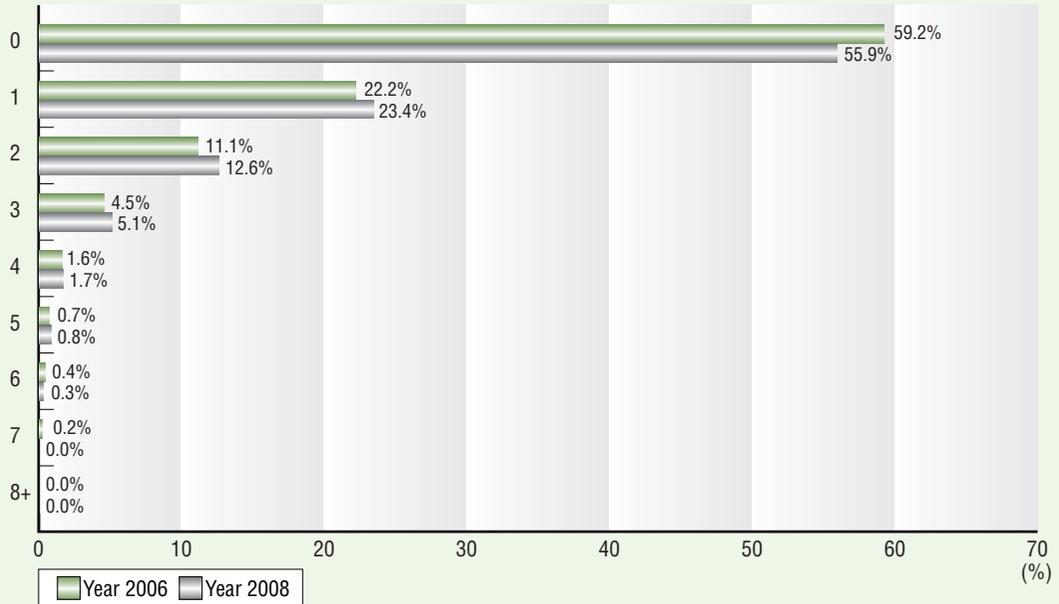
As for average number of outside directors per company, it is 0.86 (increased by 0.05 persons) for all TSE-Listed Companies (1.90 persons, when limited to those who have outside directors), 0.78 (increased by 0.06 persons) for the Companies with Statutory Auditors (1.76 persons, when limited to those who have outside directors), and 4.47 (increased by 0.10 persons) for the Companies with Committees.

Chart 20 and 21 show percentages of companies classified by numbers of outside directors in the Companies with Statutory Auditors and the Companies with Committees, respectively. What is found from the data is that 20.7% of the Companies with Statutory Auditors (or 47.0% of those who have outside directors) have multiple (2 or more) outside directors.

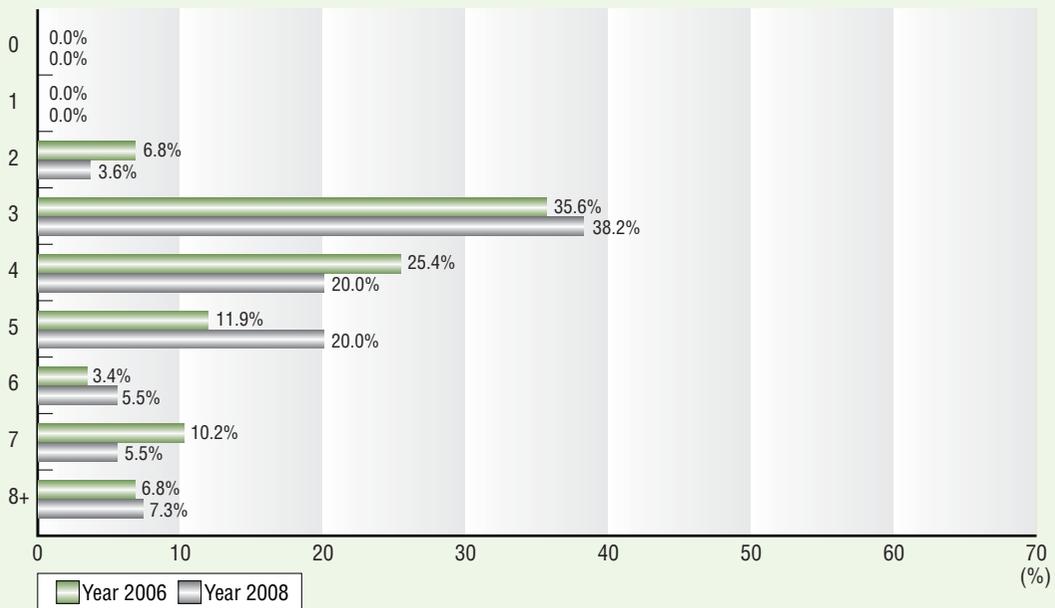
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<sup>28</sup> Definition of outside director is subject to Article 2, Paragraph 15 of the Companies Act.

**Chart 20 Number of Outside Directors (Companies with Statutory Auditors)**

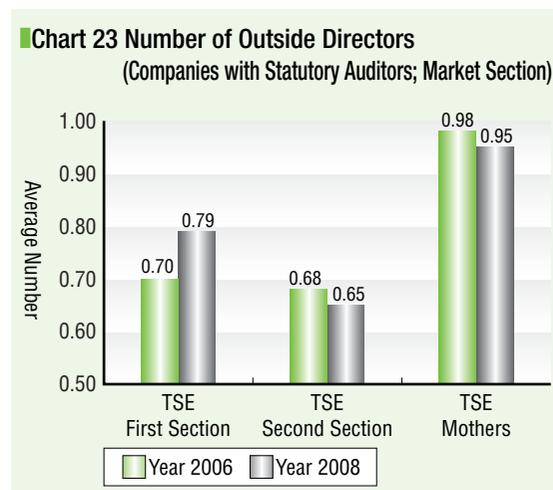
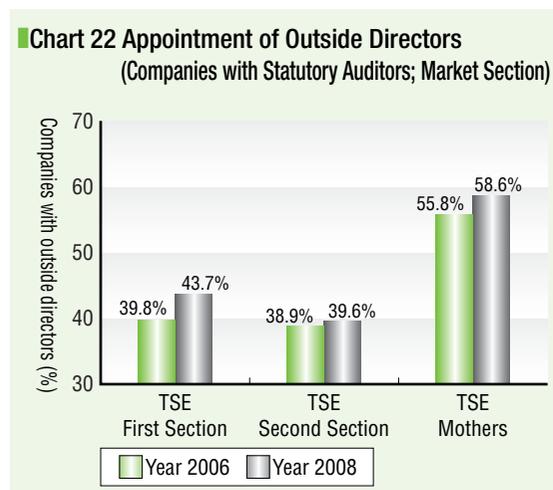


**Chart 21 Number of Outside Directors (Companies with Committees)**



### (ii) Relation with market section

In the analysis by market section, outside directors are appointed in 45.2% (up 3.6 percentage points) of all companies listed on TSE First Section (43.7%, when limited to those with the statutory auditor system), showing 0.89 as the average number of outside directors (0.79, when limited to those with the statutory auditor system). TSE Mothers-listed companies show the higher ratio of appointment of outside directors at 59.5% (58.6%, as above), with the average number of 1.03 (0.95, as above). This can be explained that TSE Mothers is a relatively new market for start-up companies, whose initial listings were mostly carried out when the concept of outside directors began to take root in Japan, and therefore, in the process of establishing corporate governance structures upon their initial listings, those companies may have been less uncomfortable with appointing their Board members from outside the companies compared with the companies listed on the main markets.



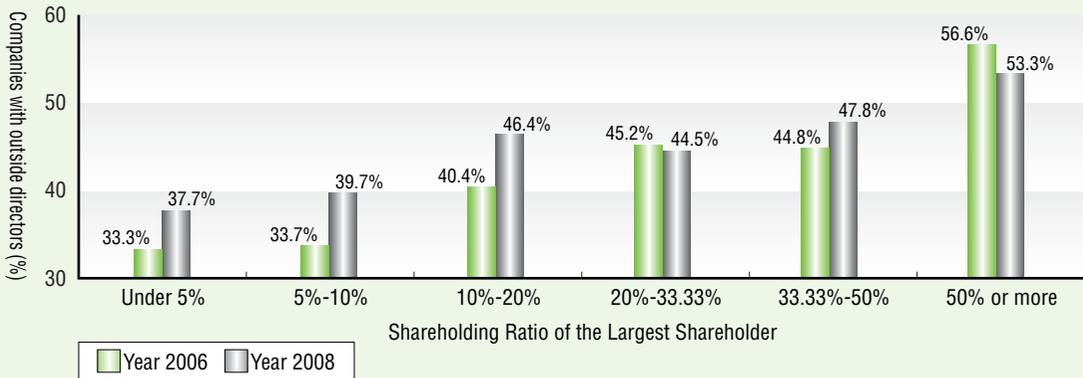
### (iii) Relation with shareholding ratio of the largest shareholder

In case of the Companies with Statutory Auditors, from the analysis on relation between appointment/number of outside directors and major shareholders, it is found that as shareholding ratios of the largest shareholder declines, percentages of the companies with outside directors as well as number of outside directors tend to decline (see Chart 24 and Chart 25).

As a potential reason for such trends, it is assumed that companies with higher shareholding ratios of the largest shareholder need to appoint outside directors to project an image of independence of the Board of Directors from the companies. On the other hand, as the shareholding ratio of the largest shareholder increases, the ratio of outside directors appointed from parent or affiliated companies to the entire outside directors tends to increase. Accordingly, it is also interpreted that outside directors from those companies are contributing to raise the ratio of the companies with outside directors as well as the number of outside directors.

The time-sequential comparison finds a recent trend that the companies whose largest shareholders hold less than 20% of ownership are increasingly moving toward appointing outside directors, compared with other companies.

**Chart 24 Appointment of Outside Directors (Companies with Statutory Auditors; Shareholding Ratio of the Largest Shareholder)**



**Chart 25 Number of Outside Directors (Companies with Statutory Auditors; Shareholding Ratio of the Largest Shareholder)**

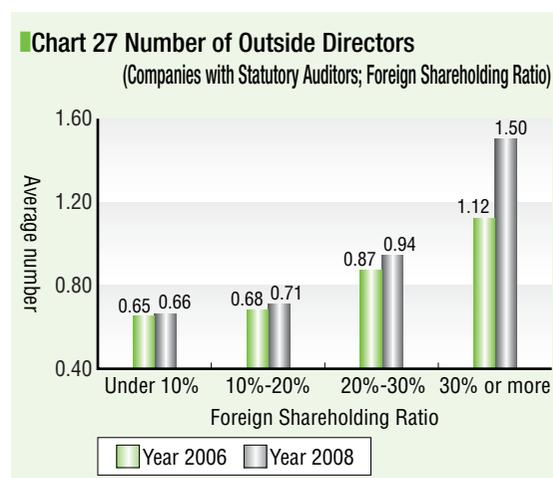
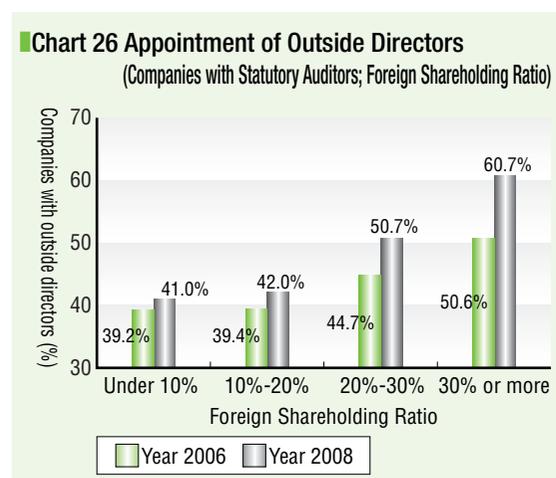


**(iv) Relation with company size**

In case of the Companies with Statutory Auditors, from the analysis on relation between appointment/number of outside directors and company size, it is found that larger companies do not necessarily have more outside directors. Especially in relation with number of employees (consolidated), the lowest category, that is companies with less than 100 employees, include the largest number of companies with outside directors (51.2% of the Companies with Statutory Auditors).

On the contrary, concerning relation between appointment/number of outside directors and foreign shareholding ratio among the Companies with Statutory Auditors, there is a distinctive trend that the

higher the foreign shareholding ratio is, the higher the percentage of the companies with outside directors and the more the number of outside directors is. (In the category of Companies with Statutory Auditors whose foreign shareholding ratio is no less than 30%, 60.7% (up 10.1 percentage points) have outside directors, with an average number of 1.50 (up 0.38 persons), showing a significant growth (see Chart 26 and Chart 27)). The results indicate that there is a strong demand for outside directors among foreign investors. Similarly, upon conducting the Investor Survey, the Exchange found a strong demand for appointing outside directors, whereas 30 out of 41 responses were from foreign institutional investors.



### (b) Attributes of outside directors

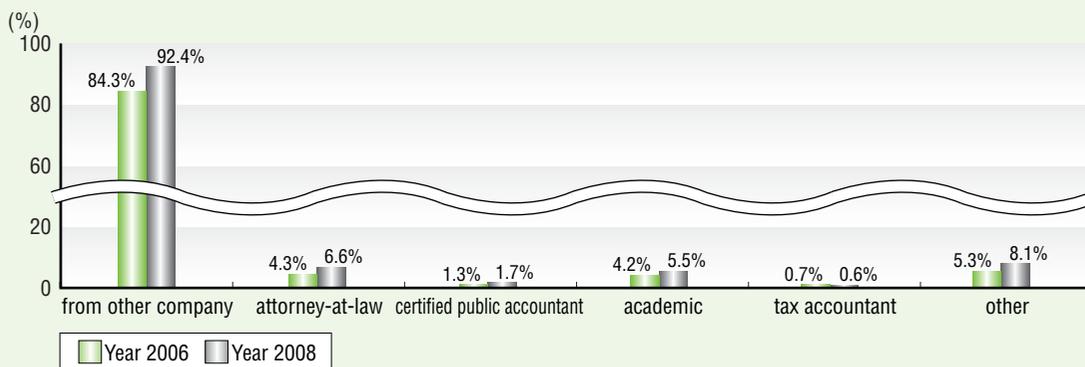
The Report is designed to select each outside director's attribute from the following categories: "from other company,"<sup>29</sup> "attorney-at-law," "certified public accountant," "tax accountant," "academic," and "other."

In this respect, the overwhelming majority of outside directors of all TSE-Listed Companies are appointed "from other company," making up 90.0% (up 7.1 percentage points). While the Companies with Statutory Auditors shows even higher percentage, 92.4% (up 8.0 percentage points) for this category, the Companies with Committees shows lower 72.4% (down 1.3 percentage points) for those from other company in contrast to higher percentages for attorney-at-law (9.3%) and certified public accountant (5.7%).<sup>30</sup>

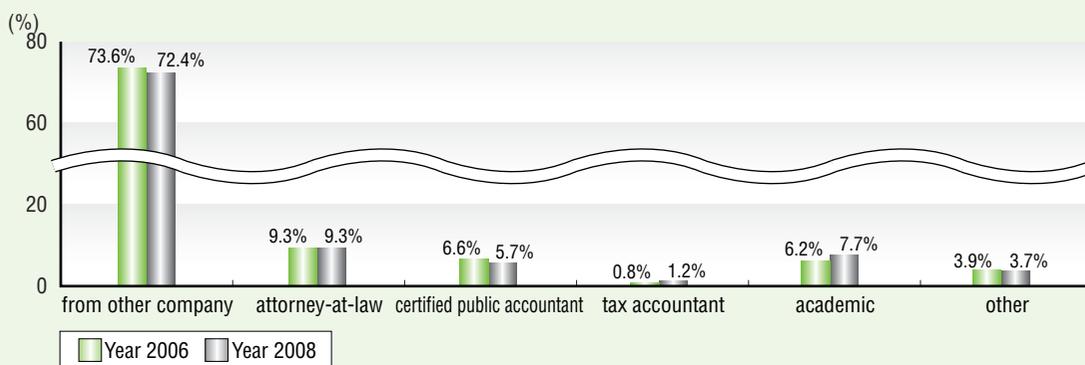
<sup>29</sup> The term "from other company" means that a person currently works for or has previously worked for other company.

<sup>30</sup> See footnote 5. As multiple answers are allowed, a sum of data for each attribute exceeds 100%.

**Chart 28 Attributes of Outside Directors (Companies with Statutory Auditors)**



**Chart 29 Attributes of Outside Directors (Companies with Committees)**



**(c) Relation between outside directors and the company**

The report requires detailed disclosure of relations between outside directors and the company. Before the Report system was introduced, the Exchange required the listed companies to disclose, in their financial highlights, the qualitative information including human, capital, and business relationships. This information is considered essential for judging independence/neutrality of outside directors under the Companies Act, and enhanced disclosures are required in their annual business reports and reference materials for general shareholders' meetings where outside directors are to be elected. Under this circumstance, the Report provides the following list of relations, among which the respondents make a choice (multiple answers allowed), so that readers of the Reports can understand relations between outside directors and companies at a glance, unlike judging the same from statutory documents, and also comprehend whether outside directors meet certain independence criteria. (The following list of relations is also used for 3.(4) "Relation between outside statutory auditors and the company" in this chapter.)

- a. Appointed from the parent company;
- b. Appointed from other affiliated company;<sup>31</sup>
- c. Major shareholder<sup>32</sup> of the company;
- d. Concurrently assumes a position of outside director or outside statutory auditor of other company;
- e. Assumes executive director or executive officer or the like<sup>33</sup> of other company;
- f. Spouse or relative within the third degree or their equivalent of an executive director and/or executive officer or the like of the company or a special related entity<sup>34</sup> of the company;
- g. Receives compensation,<sup>35</sup> etc. as an officer from the parent company, or a subsidiary of the parent company;
- h. Has entered into a limited liability agreement<sup>36</sup> with the company; or
- i. Other

#### (i) Overview

Charts 30 and 31 show which of the above-mentioned categories the outside directors of the TSE-Listed Companies belong to. (As multiple answers are allowed, an outside director may be included in multiple categories.)

According to the charts, outside directors of the TSE-Listed Companies, who concurrently assume executive directors or executive officers or the like, account for 46.0% (up 0.7 percentage points) of the Companies with Statutory Auditors, and 31.7% (down 5.5 percentage points) of the Companies with Committees, showing unchanged or declining trend. On the other hand, percentages of those who concurrently assume outside directors or outside statutory auditors of other companies rose to 45.7% (up 3.5 percentage points) of the Companies with Statutory Auditors, and 60.6% (up 3.2 percentage points) of the Companies with Committees.

<sup>31</sup> The term "other affiliated company" is as defined in Article 8, Paragraph 17, Item 4 of the Rules on Financial Statements.

<sup>32</sup> The term "major shareholder" means any shareholder who holds 10% or more of the outstanding shares issued (excluding treasury shares). It includes an outside director who works for a company being a major shareholder.

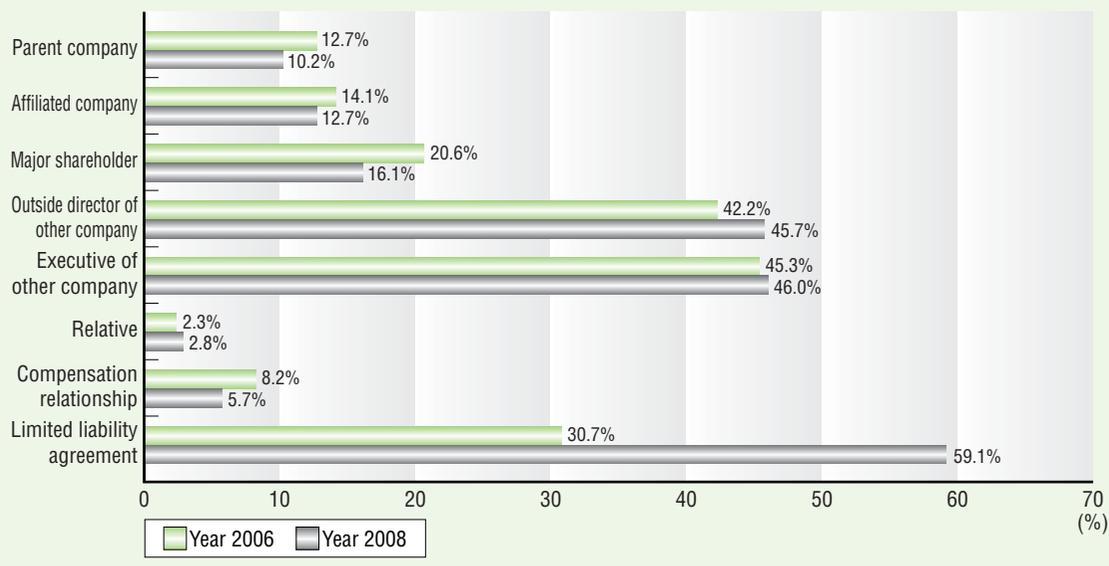
<sup>33</sup> The term "executive officer or the like" means executive officers, or members who execute the business (including any person who executes duties defined in Article 598, Paragraph 1 of the Companies Act) or employees (in accordance with Article 124, Item 1 or 3 of the Enforcement Rules for the Companies Act).

<sup>34</sup> The term "special related entity" means any person stipulated by Article 2, Paragraph 3, Item 19 of the Enforcement Rules for Companies Act.

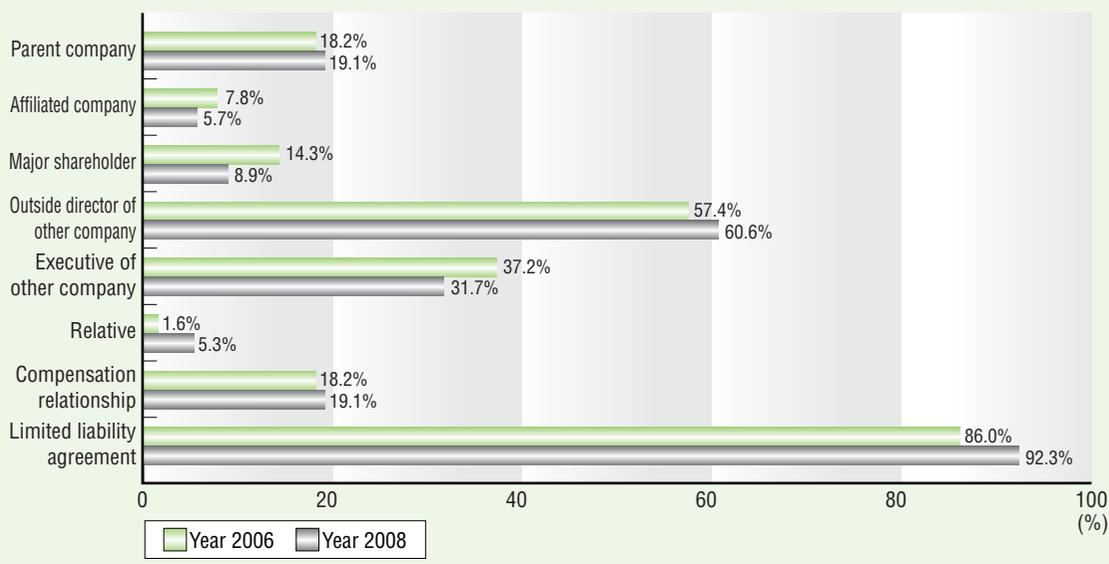
<sup>35</sup> The term "compensation, etc." refers to any compensation, bonus, or other interest in assets received from a stock company in exchange for execution of business.

<sup>36</sup> The term "limited liability agreement" means that a certain limit of the liability of an outside director is determined by virtue of the agreement between the company and an outside director in accordance with the Articles of Incorporation (i.e., the agreement prescribed in Article 427, Paragraph 1 of the Companies Act).

**Chart 30 Relation between Outside Director and Company (Companies with Statutory Auditors)**



**Chart 31 Relation between Outside Director and Company (Companies with Committees)**



**(ii) Outside directors from parent or affiliated company**

In the Companies with Statutory Auditors (see Chart 30), outside directors from parent companies and "other affiliated companies" account for 10.2% (down 2.5 percentage points) and 12.7% (down 1.4 percentage points), respectively, of all outside directors, both showing declines. As for outside directors

who are major shareholders or work for companies which are major shareholders, their ratio decreased to 16.1% (down 4.5 percentage points). Also in the Companies with Committees (see Chart 31), all the categories of relations, except those from the parent companies, show declines. In both types of the companies, on-going efforts to maintain outside directors' independence/ neutrality can be observed.

For the analysis of companies with parent companies, Chart 32 provides number of outside directors per company (and the ratio to all directors of the companies with parent companies), and number of outside directors from parent companies per company (and the ratio to all outside directors of the companies with parent companies). According to this data, 67.5% (up 1.8 percentage points), more than two thirds, of outside directors of the TSE-Listed Companies with parent companies came from such parent companies. Out of such outside directors of listed companies with parent companies, those who receive compensation, etc. as directors from the parent companies or their subsidiaries account for 59.4% (down 9.2 percentage points), still maintaining a high level despite of a decline from the previous research.

**Chart 32 Relation between Company with a Parent Company and Outside Director**

		Number of listed companies with parent companies		Number of outside directors, per company		Number of outside directors from parent companies, per company		Number of paid outside directors from parent companies, per company	
			Ratio to listed companies		Ratio to directors		Ratio to outside directors		Ratio to outside directors from parent company
Companies with Statutory Auditors	2006	296	12.9%	1.04	12.4%	0.70	67.8%	0.43	61.5%
	2008	286	12.3%	0.93	11.9%	0.63	67.5%	0.34	54.2%
Companies with Committees	2006	22	37.3%	3.68	46.3%	2.14	58.0%	2.14	100.0%
	2008	13	23.6%	3.77	51.0%	2.54	67.3%	2.23	87.9%
Total	2006	318	13.5%	1.22	14.6%	0.80	65.7%	0.55	68.6%
	2008	299	12.6%	1.05	13.5%	0.71	67.5%	0.42	59.4%

Focusing on independence of outside directors (see Chart 33), the ratios of "independent outside directors" (meaning outside directors who do not fall under any of the above categories a, b, c, f, and g; hereinafter the same shall apply) to all outside directors are high both in the Companies with Statutory Auditors and the Companies with Committees, making up 70.6% (up 6.3 percentage points) and 72.4% (up 1.8 percentage points), respectively. When limited to outside directors of companies with takeover defense measures, the independence ratio is even higher, at 88.6%, nearly nine tenths. Yet when limited to companies with parent companies, the independence ratio is just 24.5%.

The ratio of companies all of whose outside directors meet certain independence criteria is over half (50.9% (up 6.8 percentage points)) of the Companies with Committees, yet the same ratio for the Companies with Statutory Auditors shows low 28.2% (up 4.6 percentage points). Furthermore, when limited to the companies with parent companies, such ratio is only 7.4% (up 1.7 percentage points), which suggests that outside directors of the companies with parent companies are less independent.

From time-sequential comparison, it is found that the ratios of appointing independent outside directors have increased in each case, therefore it is considered that the awareness of independence has been increasing in general.

### Chart 33 Appointment of Outside Directors Meeting Certain Independence Criteria

\* For the purpose of this White Paper, "outside directors meeting certain independence criteria" (or "independent outside directors" in short) means outside directors who do not fall into any of the following categories; "parent company," "affiliated company," "major shareholder," "relative," or "compensation relationship."

	Average number of outside directors, per company		Average number of independent outside directors, per company		Ratio of independent outside directors out of all outside directors		Ratio of companies with outside directors		Ratio of companies all of whose outside directors are independent	
		Change from 2006		Change from 2006		Change from 2006		Change from 2006		Change from 2006
Companies with Statutory Auditors	0.78	0.06	0.55	0.09	70.6%	6.3%	44.1%	3.3%	28.2%	4.6%
Companies with Committees	4.47	0.10	3.24	0.15	72.4%	1.8%	100.0%	0.0%	50.9%	6.8%
Companies with outside directors	1.90	-0.01	1.35	0.10	70.8%	5.7%	100.0%	0.0%	63.4%	6.3%
Companies with parent companies	1.05	-0.17	0.26	-0.02	24.5%	2.1%	56.5%	-3.9%	7.4%	1.7%
Companies with takeover defense measures	1.00	-0.03	0.88	-0.06	88.6%	-3.9%	52.6%	4.5%	44.8%	4.3%

#### (iii) Limited liability agreement

Outside directors who concluded limited liability agreements with the companies account for 63.1% (up 24.9 percentage points) of all outside directors of the TSE-Listed Companies. This is mainly due to a significant increase in the Companies with Statutory Auditors, which account for 59.1% (up 28.4 percentage points). The Companies with Committees shows a moderate increase to 92.3% (up 6.2 percentage points), yet still much higher ratio than the Companies with Statutory Auditors.

One of the reasons would be that appointment of outside directors is mandatory for Companies with Committees (Article 400, Paragraph 3 of the Companies Act), and they often make use of limited liability agreements to invite such outside directors. A company cannot conclude a limited liability agreement with an outside officer without relevant provisions in their articles of incorporation (Article 427, Paragraph 1 of the Companies Act; Article 266, Paragraph 19 of the former Commercial Code). While companies which intend to adopt the Committees system are required to amend their articles of incorporation (Article 326, Paragraph 2 of the Companies Act; the same in case of Companies with Committees, etc. under the former Commercial Code (Article 1-2, Paragraph 3 of the former Special Provisions on Audits)), many companies used such amendment opportunities to include provisions on limited liability agreement in their articles of incorporation as well.

#### (d) Reasons for appointing outside directors

The Report requires companies with outside directors to describe reasons for appointing of each outside director. The Reporting Guideline specifies that each outside director's expertise and the relevance to business of the company are to be included in the reasons for appointment.

Examples of descriptions on expertise in the Reports include capacities of specialists such as attorney-at-law or certified public accountant, and profound knowledge of the industry. With respect to the relevance to the business, many companies explained that the outside directors in question are from parent companies, or major shareholders, or officers of their business partners. For example, in case such directors are from the parent companies, information sharing with such parent companies as well as appropriate advice or guidance from the managerial viewpoint of the parent companies is emphasized. In case such directors are the major shareholders, they are expected to perform check-and-balance functions as representative of the shareholders.

According to keyword search in descriptions of outside directors of the TSE-Listed Companies, the term "independence"<sup>37</sup> is included in 18.9% (down 3.3 percentage points; 25.5% of Companies with Committees and 17.6% of Companies with Statutory Auditors) of such descriptions. The term "expertise"<sup>38</sup> is included in 56.3% (up 15.7 percentage points; 78.2% of Companies with Committees and 52.4% of Companies with Statutory Auditors) of such descriptions.

#### **(4) Reasons for not appointing outside directors**

The Report requires Companies with Statutory Auditors which do not appoint any outside directors to describe reasons for adopting their current system.

As the reasons, the majority of such companies stated that governance structures led by (the board of) statutory auditors including outside statutory auditors who play the central role there, mutual check-and-balance among directors, or advisory boards are sufficiently functioning.

Out of all Companies with Statutory Auditors which do not appoint any outside director, 80.6% (up 5.9 percentage points) referred to the keyword "outside statutory auditor" in the subject descriptions, which coincides with the fact many companies point out management monitoring function by outside statutory auditors as a reason for not appointing outside directors. However, when analyzing the numerical values of appointing statutory auditors, while the companies with outside directors have 3.87 statutory auditors, 67.9% of which are outside statutory auditors, the companies without outside directors have 3.77 statutory auditors, 66.3% of which are outside statutory auditors. Even though the latter asserts effectiveness of outside statutory auditors as the reason for not appointing any outside directors, such assertion is not necessarily reflected to the number of statutory auditors or the ratio of outside statutory auditors, compared with the companies with outside directors. From the viewpoint of enhancing accountability to investors, further efforts are required in explaining reason for not appointing outside directors, for instance, by describing how governance by outside statutory auditors is functioning, in a way to illustrate a clear difference from the companies with outside directors. It is important to pay attention to opinions, voiced mainly by foreign investors, that outside statutory auditors cannot substitute

<sup>37</sup> With respect to "independence," any company using any one of the following keywords is included: "independent," "objective," or "neutrality."

<sup>38</sup> With respect to "expertise," any company using any one of the following keywords is included: "specialty," "knowledge," or "insight."

for outside directors because they do not have rights to vote in the Board of Directors meetings or rights to appoint or discharge directors.<sup>39</sup>

Among those who referred to mutual check-and-balance among directors, there are companies which invited directors from outside, such as financial institutions, even though they are not recognized as outside directors under the Companies Act. It is worth noting that some of them assert they can incorporate outside perspectives into business execution by such arrangements. This is a good example to show that definition of outside directors in Japan is recognized insufficient in terms of "independence."

In addition to the above, some companies, while showing positive attitude to outside directors, are counting on external consultative bodies like advisory boards, such as compensation advisory committees and compliance committees, which include external committee members, for such functions at this moment. There also were companies seeing lack of appropriate personnel as a problem.

In contrast, an opinion showing negative attitude to outside directors was presented on the ground that directors are in charge of business execution, and the Board of Directors, as the highest executive organ, needs to equip deep knowledge and experience in business to direct the employees. For this reason, a commenter was questioning the outside directors system itself.

### 3. Statutory Auditor and Board of Statutory Auditors

#### (1) Existence of the Board of Statutory Auditors

The Report includes information on whether a company has the Board of Statutory Auditors. Before the Companies Act came into effect, only large companies<sup>40</sup> were allowed to establish the Boards of Statutory Auditors (Article 18-2 of the former Special Provisions on Audits). Now, under the Companies Act, companies other than large companies may optionally establish the Boards of Statutory Auditors (Article 328, Paragraph 1 of the Companies Act). Nonetheless, as establishment of the Board of Statutory Auditors is not mandatory for listed Companies with Statutory Auditors, except large companies, under the Companies Act, nor included in the requirements for initial listing on TSE markets, there remain a small number of TSE-listed companies which do not have the Board of Statutory Auditors. Given that, in November 2007, the Exchange incorporated the "Code of Corporate Conduct" into the Securities Listing Regulations. The Code of Corporate Conduct include fundamental issues related to corporate governance to enhance the quality of listed companies, and requires all listed companies, even if they do not fall under the category of large companies under the Companies Act, to establish the Board of Statutory Auditors (or committee) (Article 439 of the Securities Listing Regulations).

As the provisions of the above Article are not to apply for a period of one year from the date of

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<sup>39</sup> See Investor Survey p.12 [Evaluation of auditors' functions and roles].

<sup>40</sup> The term "large companies" means companies with a share capital of ¥500 million or more or liability of ¥20 billion or more (Article 2, Item 6 of the Companies Act; Article 1-2, Paragraph 1 of the former Special Provisions on Audits).

enforcement,<sup>41</sup> application of the provisions was not made when the Exchange collected data from the Reports this time. Nonetheless, although 2 companies listed on the First Section and 9 companies listed on the Second Section did not have the Board of Statutory Auditors at the time of the previous research, it is confirmed upon this research that all the companies listed on the First and Second Sections now have the Boards of Statutory Auditors. On the other hand, in TSE Mothers, there are still 17 listed companies (8.9% of companies listed on Mothers) without the Board of Statutory Auditors, although the number decreased from the previous 41 companies (see Chart 34).

According to the Companies Act, in case the Board of Statutory Auditors is established, the companies must fulfill the following requirements: (1) no less than 3 statutory auditors must be appointed (Article 335, Paragraph 3 of the Companies Act); (2) The half or more of the statutory auditors must be outside statutory auditors (*ibid.*); and (3) full-time auditor(s) must be appointed (Article 390, Paragraph 3 of the Companies Act). The Exchange examined whether companies without the Board of Statutory Auditors also satisfy the above criteria. First, as for the number of the statutory auditors, 35.3% (6 companies) of the companies without the Board of Statutory Auditors have 3 or more statutory auditors, as shown in Chart 35. Second, in 94.1% (16 companies) of those without the Board of Statutory Auditors, the half or more of statutory auditors are outside statutory auditors, as shown in Chart 36. Third, in 29.4% (5 companies) of those without the Board of Statutory Auditors, there are 3 or more statutory auditors and the half or more of statutory auditors are outside statutory auditors. The analysis found that a relatively high number of the Companies without the Board of Statutory Auditors fulfill the above requirements as well.

**Chart 34 Number of Companies without the Board of Statutory Auditors (Market Section)**

	2006		2008	
	Number of companies	ratio by market section	Number of companies	ratio by market section
TSE First Section	2	0.1%	0	0.0%
TSE Second Section	9	1.8%	0	0.0%
TSE Mothers	41	23.8%	17	8.9%
Total	52	2.3%	17	0.7%

**Chart 35 Number of Statutory Auditors (Companies without the Board of Statutory Auditors)**

	2006		2008	
	Number of companies	Ratio	Number of companies	Ratio
2 persons	29	55.8%	11	64.7%
3 persons	21	40.4%	6	35.3%
4 persons	2	3.8%	0	0.0%

**Chart 36 Ratio of Outside Statutory Auditors (Companies without the Board of Statutory Auditors)**

	2006		2008	
	Number of companies	Ratio	Number of companies	Ratio
Less than 50%	6	11.5%	1	5.9%
50% or more	46	88.5%	16	94.1%

## (2) Number of statutory auditors and outside statutory auditors

In all Companies with Statutory Auditors listed on TSE, average number of statutory auditor per

<sup>41</sup> Rule 3 of the supplementary rules for the Securities Listing Regulations revised on November 1, 2007.

company is 3.81 (up 0.01 persons), and 2.52 (66.1% of Statutory Auditors; up 0.06 persons) among them are outside statutory auditors<sup>42</sup> (see Chart 37). Among those companies, there are 23 companies with a relatively large number of, specifically no less than 6, statutory auditors.

In analysis by market section (see Chart 38), while average number of statutory auditors per company listed on TSE First Section is 3.97 including 2.53 outside statutory auditors, the average numbers are 3.51 (including 2.43 outside statutory auditors) for companies listed on TSE Second Section, and 3.14 (including 2.58 outside statutory auditors) for TSE Mothers-listed companies.

As for relation with company size (see Chart 39), the higher the net sales (consolidated)<sup>43</sup> are (or the larger the company size is), the more statutory auditors are appointed. Such trend can be observed in the relation between number of outside statutory auditors and company size, though less remarkable. The similar tendency can be found in the analysis of directors: the larger the company size is, the more directors the company has; yet such a trend is not so substantial in case of the number of outside directors of Companies with Statutory Auditors.

With respect to major shareholders (see Chart 40), the lower the shareholding ratio of the largest shareholder is, the more statutory auditors tend to be appointed. (In contrast, there is no such a trend in case of outside statutory auditors.) It is considered that this is because the less the shareholding ratio of the largest shareholder, the larger the company size (see the above II.1. (2) Major shareholders).

When classified by foreign shareholding ratio, there is correlation with number of outside directors (see the above III.2.(3)(a) Appointment and number of outside directors), but no correlation with numbers of statutory auditors or outside statutory auditors.

**Chart 37** Number of Statutory Auditors and Outside Statutory Auditors (Companies with a Board of Statutory Auditors)

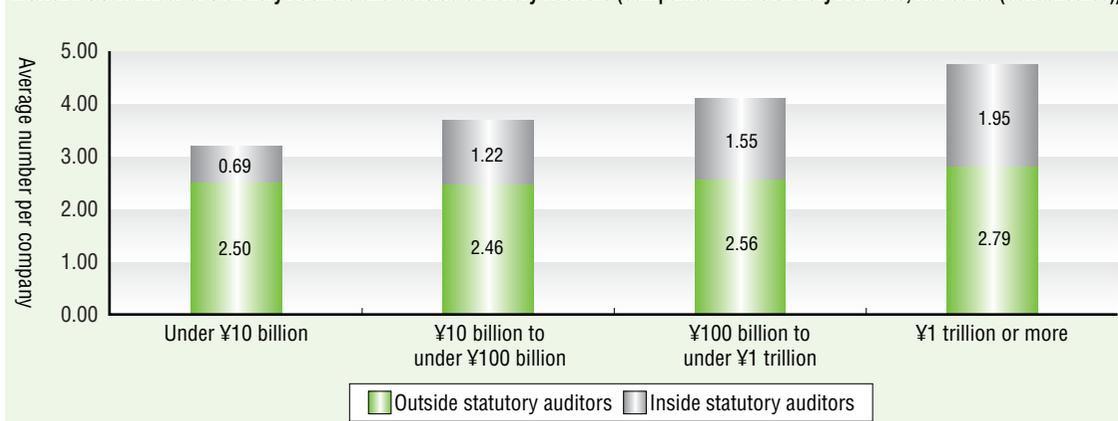
	2006	2008
	Statutory Auditors (outside statutory auditors)	Statutory Auditors (outside statutory auditors)
Average number per company	3.80 (2.46)	3.81 (2.52)

**Chart 38** Number of Statutory Auditors and Outside Statutory Auditors (Companies with Statutory Auditors; by Market Section)



<sup>42</sup> For the definition of outside statutory auditors, see Article 2, Item 16 of the Companies Act.

<sup>43</sup> The similar trends are observed in the analysis classified by number of employees (consolidated), and number of consolidated subsidiaries.

**Chart 39** Number of Statutory Auditors and Outside Statutory Auditors (Companies with Statutory Auditors; Net Sales (Consolidated))**Chart 40** Number of Statutory Auditors and Outside Statutory Auditors (Companies with Statutory Auditors; Shareholding Ratio of the Largest Shareholder)

### (3) Attributes of outside statutory auditors

Similarly to the attributes of outside directors (see III.2.(3)(b) Attributes of outside directors), the Report is designed to select each outside statutory auditor's attribute from the following categories: "from other company," "attorney-at-law," "certified public accountant," "tax accountant," "academic," and "other."

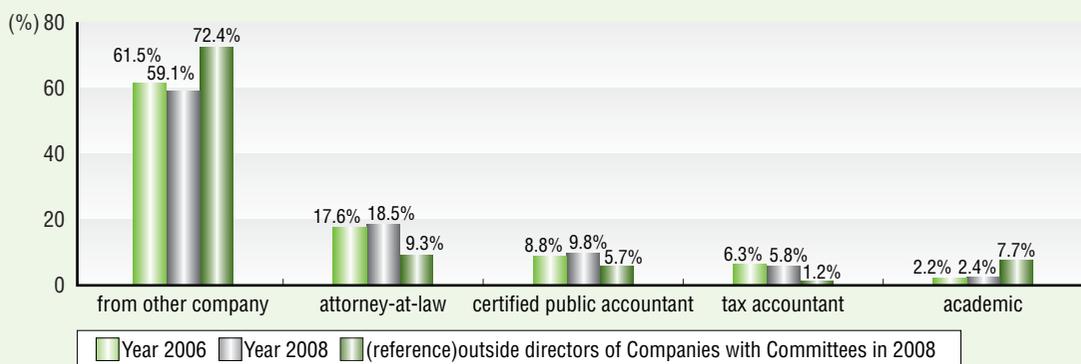
In this respect, among all statutory auditors of the TSE-Listed Companies with Statutory Auditors, those "from other companies" account for 59.1% (down 2.4 percentage points), followed by attorney-at-law (18.5%; up 0.9 percentage points), certified public accountant (9.8%; up 1.1 percentage points), tax accountant (5.8%; down 0.5 percentage points), and academic (2.4%; up 0.2 percentage points).<sup>44</sup>

Outside statutory auditors of the Companies with Statutory Auditors and outside directors of the

<sup>44</sup> See footnote 30.

Companies with Committees play similar roles, yet the comparative analysis of their attributes found that outside statutory auditors show lower percentage of those "from other companies," and higher percentages of attorney-at-law, certified public accountant, and tax accountant. The same trend was observed in the previous research. The reasons would be that while an outside statutory auditor's fundamental authority is to audit directors' execution of duties (Article 381 Paragraph 1 of the Companies Act), an outside director of a Company with Committees not only audits business execution as an Audit Committee member (Article 404, Paragraph 2, Item 1 of the Companies Act), but also is engaged in decision-making on business execution including basic management policies as well as supervision of executive officers' execution of duties (Article 416, Paragraph 1 of the Companies Act), and therefore the position of outside director requires a higher level of expertise in management.

**Chart 41 Attributes of Outside Statutory Auditors**



#### (4) Relation between outside statutory auditors and the company

Concerning relation between each outside statutory auditor and a company, the Report requires each company to select applicable relation(s) (multiple answers allowed) from the list of relations introduced in the section of relation between outside directors and company (see the above III.2.(3)(c) Relation between outside directors and company).

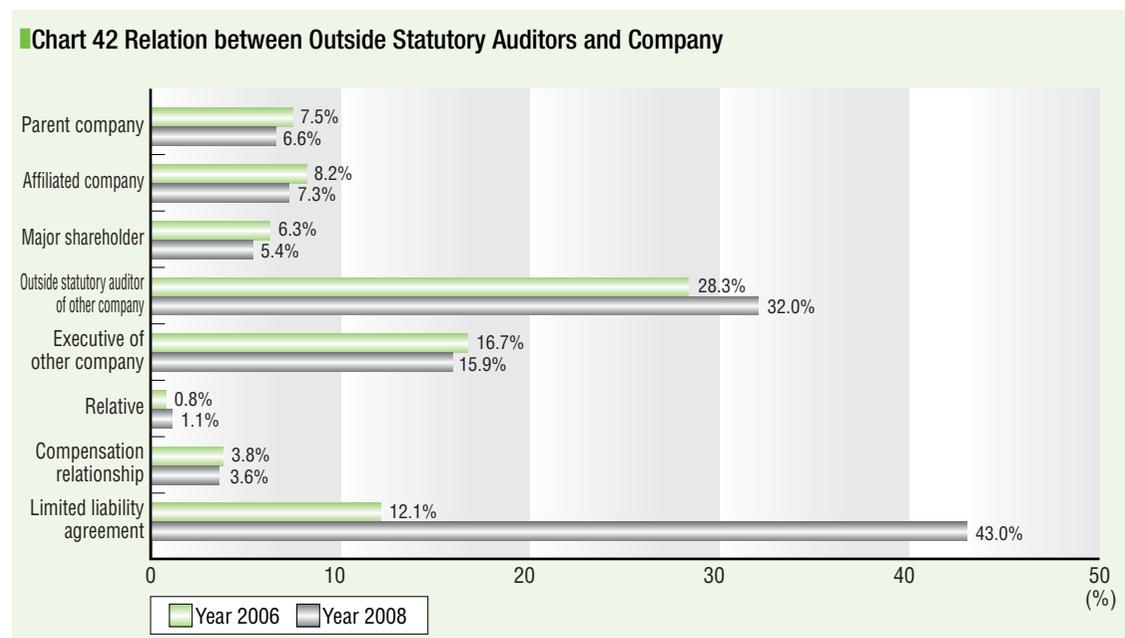
##### (i) Overview

Chart 42 shows which categories of relations the outside statutory auditors of the TSE-Listed Companies falls under. (As multiple answers are allowed, an outside statutory auditor may be included in multiple categories.)

Compared with the results of the relations between outside directors and companies, each category shows a lower percentage. One reason would be that higher percentages of outside statutory auditors are attorneys-at-law and certified public accountant, who have generally not worked for other companies, compared with outside directors.

Out of outside directors of the TSE-Listed Companies, those who concurrently assume the positions of

outside directors or outside statutory auditors of other companies account for 32.0% (up 3.7 percentage points), and those who concurrently assume executive directors or executive officers or the like account for 15.9% (down 0.8 percentage points).



#### (ii) Outside Statutory Auditors from parent or affiliated company

In the Companies with Statutory Auditors, outside statutory auditors from parent companies account for 6.6% (down 0.9 percentage points) and those from "other affiliated companies" account for 7.3% (down 0.9 percentage points) of outside statutory auditors. The cases where outside statutory auditors are either major shareholders or work for companies which are the major shareholders show 5.4% (down 0.9 percentage points). The percentages of these categories are decreasing.

Limited to the Companies with Statutory Auditors which have parent companies, Chart 43 shows number of outside statutory auditors per company (and their ratio to statutory auditors of the companies with parent companies) and number outside statutory auditors from parent companies, per company (and their ratio to outside statutory auditors of the companies with parent companies). According to the chart, as for outside statutory auditors of the Companies with Statutory Auditors which have parent companies, 51.7% (down 3.2 percentage points), or the majority, of them come from the parent companies. As mentioned earlier, almost two thirds of outside directors of the companies with parent companies come from the parent companies. These results illustrate that the majority of officers from outside are appointed from the parent companies, when the companies have parent companies.

Furthermore, 47.3% (up 3.4 percentage points) of outside statutory auditors of the Companies with Statutory Auditors which have parent companies receive compensation or other property interest as

officers from the parent companies or subsidiaries of such parent companies.

**Chart 43 Relation between Company with a Parent Company and Outside Statutory Auditors**

		Number of listed companies with parent companies		Number of outside statutory auditors, per company		Number of outside statutory auditors from parent companies, per company		Number of paid outside statutory auditors from parent companies, per company	
			Ratio to listed companies		Ratio to statutory auditors		Ratio to outside statutory auditors		Ratio to outside statutory auditors from parent company
Companies with Statutory Auditors	2006	296	12.9%	2.59	69.4%	1.42	54.9%	0.63	43.9%
	2008	286	12.3%	2.60	69.9%	1.35	51.7%	0.64	47.3%

Similarly to the analysis of outside directors meeting certain independence criteria, the Exchange analyzed independence of outside statutory auditors (see Chart 44). The ratio of "independent outside statutory auditors" (means outside statutory auditors who do not fall under any of the earlier-mentioned categories a, b, c, f, and g in terms of relations with the company; hereinafter the same shall apply) to all outside statutory auditors currently serving the Companies with Statutory Auditors is as high as 82.3%. When it is limited to outside statutory auditors of the companies with takeover defense measures, the independence ratio even exceeds nine tenth, showing 93.1%. On the other hand, when it is limited to outside statutory auditors of the companies with parent companies, the ratio grossly falls to 38.7%.

In 72.8% of the Companies with Statutory Auditors, all of the outside statutory auditors satisfy certain independence criteria. Such ratio even reaches to 85.0%, when limited to the companies with takeover defense measures. On the contrary, when limited to the companies with parent companies, the same ratio is as low as 17.4%. Compared with the same analysis of outside directors, the aforementioned percentage is not lower, but the trend of relatively low independence of outside statutory auditors of companies with parent companies is similar.

As for time-sequential comparison, appointment ratios of independent outside statutory auditors remain almost unchanged, yet it is found that the ratios are maintained at a higher level in case of the Companies with Statutory Auditors in general.

**Chart 44 Appointment of Outside Statutory Auditors Meeting Certain Independence Criteria**

\* For the purpose of this White Paper, "outside statutory auditors meeting certain independence criteria" (or "independent outside statutory auditors" in short) means outside statutory auditors who do not fall into any of the following categories; "parent company," "affiliated company," "major shareholder," "relative," or "compensation relationship."

	Average number of outside statutory auditors, per company		Average number of independent outside statutory auditors, per company		Ratio of independent outside statutory auditors out of all outside statutory auditors		Ratio of companies with outside statutory auditors		Ratio of companies all of whose outside statutory auditors are independent	
		Change from 2006		Change from 2006		Change from 2006		Change from 2006		Change from 2006
Companies with Statutory Auditors	2.52	0.05	2.07	0.08	82.3%	1.4%	99.9%	0.0%	72.8%	0.1%
Companies with parent companies	2.49	0.08	0.96	0.11	38.7%	3.4%	95.7%	2.6%	17.4%	0.7%
Companies with strategies of takeover defense	2.45	0.01	2.28	-0.04	93.1%	-1.9%	98.0%	1.9%	85.0%	-2.0%

### (iii) Limited liability agreement

Outside statutory auditors who concluded limited liability agreements with the companies account for 43.0% (up 30.9 percentage points), which is rather low considering that outside directors who concluded the same account for 63.1% (up 24.9 percentage points) (59.1% of outside directors of the Companies with Statutory Auditors; up 28.4 percentage points). This would be because the former Commercial Code allowed companies to conclude limited liability agreements only with their outside directors, and limited liability agreements with outside statutory auditors were permitted only upon enactment of the Companies Act (See Article 266, Paragraph 19 of the former Commercial Code, and Article 427 of the Companies Act). In addition, it suggests that as outside directors have been increasingly appointed by the Companies with Statutory Auditors, the gap is significantly narrowed down with an effort to have consistency and more companies are increasingly recognizing outside statutory auditors' great responsibilities.

## 4. Cooperation in Audit

### (1) Cooperation between statutory auditors (or Audit Committees) and accounting auditors

The Report requires the Companies with Statutory Auditors to describe existing cooperation between their statutory auditors (Audit Committees in case of Companies with Committees) and accounting auditors. As the Reporting Guideline suggests descriptions of frequency and details of meetings between them, if any, the majority of descriptions were about exchanges of opinions and information through such regular meetings. Specific descriptions include statutory auditor's attendance to accounting audits, and accounting auditors' reporting to statutory auditors on outline audit plans, focus of audits, progress of audits, internal control systems, risk management, etc.

Furthermore, some referred to involvement of internal audit departments for enhanced exchange of information. Some also referred to statutory auditors' capacities in evaluation of accounting auditors such as verification of accounting audit qualities by (the boards of) statutory auditors, or requests for submission of a proposal to dismiss accounting auditors (in case of Companies with Statutory Auditors) or rights to determine contents of a proposal to dismiss accounting auditors (in case of Companies with Committees), or rights to dismiss accounting auditors if they violate or neglect their duties.

Analyzing keywords included in the above descriptions (see Chart 45), keywords related to audit planning<sup>45</sup> are used in the descriptions of 48.9% (up 0.6 percentage points) of the companies; keywords related to coordination<sup>46</sup> are used by 91.3% (up 1.3 percentage points) and keywords related to reporting<sup>47</sup> are used by 69.2% (up 0.8 percentage points) of the companies; and companies which used keywords

<sup>45</sup> With respect to "audit planning," any company using any one of the following keywords is included: "planning," "policy," or "regulations."

<sup>46</sup> With respect to "coordination," any company using any one of the following keywords is included: "coordination," "consultation," "regular," "exchange," "discussion," "meeting," or "conference."

<sup>47</sup> With respect to "reporting," any company using any one of the following key words is included: "reporting," "results," "explanation," "verification," or "control."

from all three categories account for 37.8% (up 1.2 percentage points). All of the categories show slight increases from the previous research, and it suggests enhanced cooperation between statutory auditors (Audit Committees) and accounting auditors.

## (2) Cooperation between statutory auditors (or Audit Committees) and internal audit departments

The Report requires the Companies with Statutory Auditors to describe existing cooperation between their statutory auditors (Audit Committees in case of Companies with Committees) and internal audit departments<sup>48</sup>. As the Reporting Guideline suggests descriptions of frequency and details of meetings between them, if any, similarly to cooperation with accounting auditors, such descriptions are observed, but much less than those with accounting auditors.

The similar trend is observed in keyword search (see Chart 46). Percentages of TSE-Listed Companies which used keywords related to audit planning, coordination, and reporting, similarly to the above, show 39.2% (up 1.5 percentage points), 78.8% (up 4.7 percentage points), and 69.6% (up 6.7 percentage points), respectively. Companies which used keywords from all three categories account for 28.1% (up 3.5 percentage points). The percentages of all the categories are lower than those in the descriptions on cooperation with accounting auditors, yet all of the categories show slight increases from the previous research, and enhanced cooperation can be confirmed.

**Chart 45 Cooperation between Statutory Auditors (Audit Committee) and Accounting Auditors**



**Chart 46 Cooperation between Statutory Auditors (Audit Committee) and Internal Audit Departments**



<sup>48</sup> The term "internal audit department" generally refers to a department independent from administration or a business department, which makes comprehensive and objective assessments of the adequacy of the internal management system within the organization and provides recommendations for issues pointed out to be in need of improvement, or implements follow-up auditing.

## 5. Support System for Outside Directors and Outside Statutory Auditors

The Report provides a section to explain supporting system for outside directors and outside statutory auditors. As mere invitation of external human resources to officers may not necessarily be effective, the subject section is included to clarify how appointed outside officers perform their duties under what kind of system, focusing on specific communication structures with such outside officers.

The majority of the companies reported that they have a department in charge. Regarding support contents, "distribution of information, communication, and cooperation related to information" are mentioned by 21.5% (up 0.1 percentage points), and "prior distribution of and/or briefing on reference materials" are mentioned by 44.5% (up 1.5 percentage points) of the companies.<sup>49</sup>

As a specific department for the support, in addition to Corporate Secretariat, such core departments as corporate planning department and general administration department are named by a number of companies. Their specific supports include prior distribution of related documents, prior submission of reference materials via e-mail and briefing on the contents, and distribution of meeting minutes.

As a support system to statutory auditor, 217 companies (9.1%) have a dedicated section named "Statutory Auditor Office." Some reported on special arrangements for the staff member of the department in terms of assignment or treatment, in order to maintain independence of statutory auditors and Statutory Auditor Office. For instance, they have such arrangements that the staff members must be the company employees who are not under control of directors, and that personnel transfer and performance appraisal of such employees require prior consultation between human resources department and full-time auditors. Specific support methods reported include: coordination for productive on-site audits and inspection visits by statutory auditors, including support for establishing cooperative relations with site managers and attending on-site inspections; and explanation given by full-time auditors concerning the company's financial condition, audit status, discussions in management meetings, activities of management audit department, activities of corporate ethics/CSR committee, etc.

## 6. Committees and Executive Officers

Companies with Committees are required to establish three committees, namely Nomination Committee, Compensation Committee, and Audit Committee (Article 2, Item 12 of the Companies Act), each of which consists of 3 or more directors, the majority of which must be outside directors (Article 400, Paragraphs 1 and 3 of the Companies Act). Furthermore, in the Companies with Committees, the Board of Directors may delegate decisions on business execution substantially to executive officers whom it appointed (Article 416, Paragraph 4 of the Companies Act). The Report requires the Companies

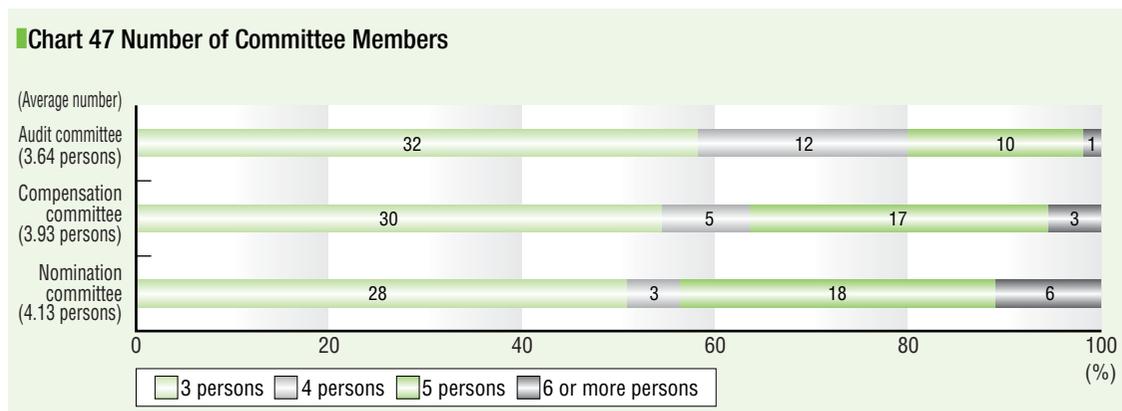
<sup>49</sup> With respect to "distribution of information, communication, and cooperation related to information," any company using any one of the following keywords is included: "information," "distribution (of information)," "communication," or "cooperation." With respect to "prior distribution of and/or briefing on reference materials," any company using any one of the following keywords is included: "prior," "distribution (of documents/materials)" or "explanation."

with Committees to describe composition of each committee, executive officers' other capacities such as directors or employees, from the perspective to find the status related to distinctive features of the committees system. The status of and trends in unique features of the Companies with Committees are introduced below.

## (1) Each Committee<sup>50</sup>

### (a) Number of committee members

Chart 47 shows number of directors consisting of each committee. In most cases, each committee comprises of 3 to 5 members. As for average number of its members, the Nomination Committees show 4.13 (up 0.01 persons), which is the largest, followed by 3.93 (up 0.03 persons) in the Compensation Committees, and 3.64 (up 0.11 persons) in the Audit Committees. As an overall trend, committees consisting of 3 directors are most frequently observed in any category. While the average numbers of all committee members slightly increased from the previous research, the Audit Committees show the highest increase.



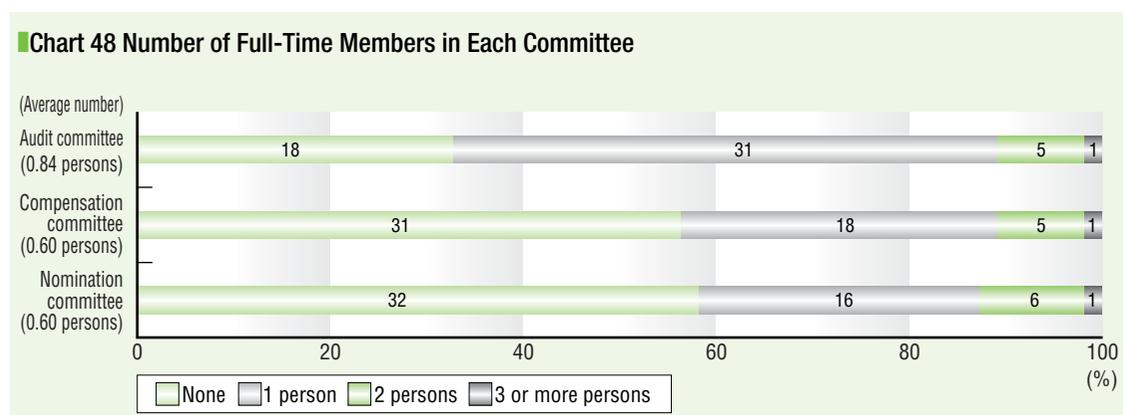
### (b) Ratio of full-time members

In the analysis of ratio of full-time member in each committee, the Audit Committees show the highest ratio of 23.1% (down 0.9 percentage points) among these 3 committees. On the other hand, the Nomination Committees and the Compensation Committees show relatively low percentages, 14.5% (down 0.7 percentage points) and 15.2% (down 0.4 percentage points), respectively. Slight declines in the ratios of full-time members in the Audit and Compensation Committees would be indicating a trend

<sup>50</sup> The term "each committee" refers to such statutory committee as Audit Committee, Compensation Committee, and Nomination Committee which are mandatory for the Companies with Committees. Regarding composition of the committees, the Report requires the companies to classify members of each committee into the following categories: full-time member (for the purpose of the Report, "full-time member" means a person who is in principle exclusively engaged in duties of each committee of the company during the business hours without having any other full-time position), inside director, or outside director.

that companies are strengthening monitoring system by committee members from outside the companies. Unlike full-time auditors of the Companies with Statutory Auditors, it is not mandatory for the Companies with Committees to have full-time committee members. However, as shown in Chart 48, a significant number of companies have at least 1 full-time Audit Committee member. In terms of average number of full-time member per company, the Audit Committees show a higher number of 0.84 (down 0.01 persons) than the Nomination Committees (0.60) and the Compensation Committees (0.60). This trend was also observed in the previous research.

Among three committees, the Audit Committees would meet more frequently, and smooth information distribution would be practically required for close cooperation with accounting auditors and internal audit departments. In addition, it is also considered that necessity for directors who monitor business execution on a day-to-day basis like "full-time statutory auditors" is being recognized to some extent.



### (c) Composition of directors in each committee

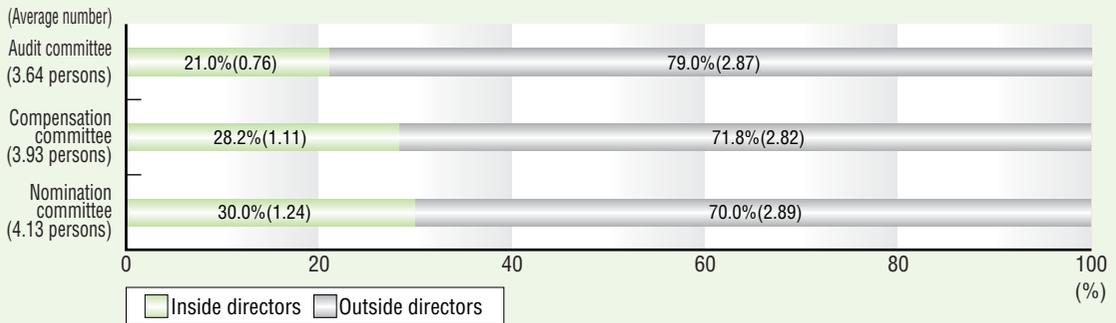
According to Article 400 of the Companies Act, the majority of each committee members must be outside directors. In connection with this requirement, Chart 49 shows numbers of outside directors and inside directors as well as their percentage shares in each committee of all TSE-Listed Companies. Percentage shares of outside directors in each committee are 79.0% (up 0.2 percentage points) in the Audit Committees, while being 70.0% (up 1.7 percentage points) in the Nomination Committees and 71.8% (up 0.9 percentage points) in the Compensation Committees. The results here also remain almost unchanged from the previous research.

One of the reasons would be that the Audit Committees are expected to be more independent from the companies than others, as demonstrated by a requirement that any Audit Committee member should not be an executive officer or employee of the company, or executive director, executive officer or employee of the subsidiary company (Article 400, Paragraph 4 of the Companies Act).

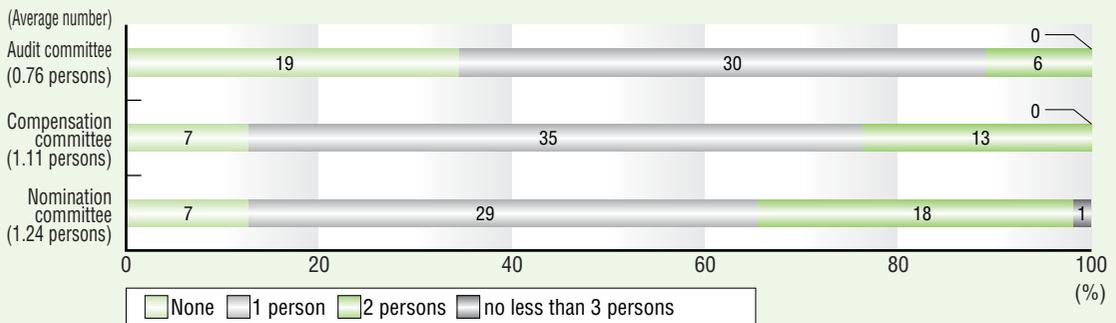
This trend can be seen also in the numbers of inside directors (see Chart 50) and outsiders directors (see Chart 51) in each committee. As far as the Audit Committees are concerned, 34.5% (19 companies) of

the companies do not have any inside director.

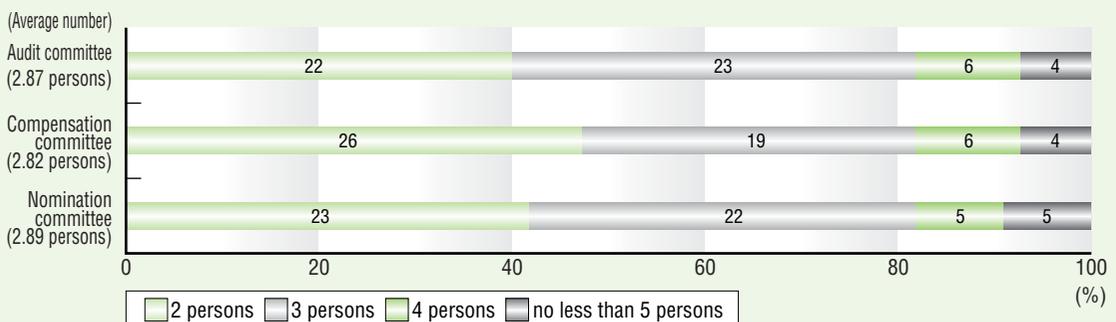
**Chart 49 Composition of Inside Directors and Outside Directors in Each Committee, and Average Number**



**Chart 50 Number of Inside Directors in Each Committee**



**Chart 51 Number of Outside Directors in Each Committee**



Regarding attributes<sup>51</sup> of committee chairpersons in each committee as shown in Chart 52, ratios of outside directors who chair each committee show 50.9% (up 3.5 percentage points) in the Audit Committees, 47.3% (up 3.2 percentage points) in the Compensation Committees, and 50.9% (up 10.2 percentage points) in the Nomination Committees. In all committees, the ratios of outside directors to all committee chairpersons rose from the previous research.

**Chart 52 Attributes of the Chairperson of Each Committee (Ratio of Outside Directors)**



## (2) Executive officers

It is mandatory for the Companies with Committees to have at least one executive officer (Article 402, Paragraph 1 of the Companies Act), and the Board of Directors may delegate substantial part of decisions on business execution to executive officers (Article 416, Paragraph 4 of the Companies Act), and executive officers execute business (Article 418, Item 2 of the Companies Act).

An average number of executive officers of all TSE-Listed Companies is 12.51 per company (down 0.34 persons).

Executive officers with authority to represent a company (CEO: chief executive officer) account for 16.7% (up 1.7 percentage points) of all executive officers, and a company has 2.09 CEOs (increased by 0.16 persons) in average.

An executive officer may concurrently assume a position of director (Article 402, Paragraph 6 of the Companies Act). In this respect, the research found that one fourth of the executive officers (25.0%; down 0.3 percentage points) concurrently assume the position of directors. Furthermore, 7.6% (down 0.1 percentage points) of the executive officers concurrently assume the position of the Nomination Committee members in the capacity of directors, and 7.0% (unchanged) of the executive officers concurrently assume the position of the Compensation Committee members in the capacity of directors. As for Audit Committee members, executive officers are prohibited to assume the

**Chart 53 Other Positions Held by Executive Officers**



<sup>51</sup> The Report requires the companies to select relevant attributes by checking any of following items: "inside director," "outside director" or "n/a."

concurrent responsibilities (Article 400, Paragraph 4 of the Companies Act).

32.5% (up 2.1 percentage points) of the executive officers also hold positions as employees.

## **7. Items in Relation to Respective Decision-Making Functions with Respect to the Execution of Business, Audits, Supervision, Nominations, and Remuneration<sup>52</sup>**

### **(1) Overview of business execution method**

As overview of business execution methods, companies mainly described the positioning of the Board of Directors, frequency of the Board meetings, the roles of the Board of Directors such as planning and decision-making on fundamental management policies, establishment of system other than the Board of Directors for swift decision-making and the relationship between such system and the Board of Directors. Some Companies with Committees explained delegation of authorities of decision-making and business execution to their executive officers and speedy decision-making as a consequence.

Among the Companies with Statutory Auditors, some reported that they voluntarily established committees to employ a similar governance structure as a Company with Committees.

The Reporting Guideline requires companies to describe procedures to strengthen their business execution and management monitoring functions, if they have launched such procedures. A number of Companies with Statutory Auditors referred to significant decision-making bodies other than the Board of Directors, such as management committee, to make decisions swiftly. Those who referred to management committee and executive committee, both of which are typical conference bodies in Japanese corporations, account for 43.2% (up 0.5 percentage points) and 12.3% (down 1.5 percentage points), respectively. Such conference bodies tend to meet more frequently in larger companies, and they undertake preliminary discussion before submitting agenda to the Board of Directors, while established from the perspective of smooth business execution.

While business scale is expanding, based on the standpoint to expedite management decision-making and streamline business execution and to clarify responsibilities, adoption of executive officer system was mentioned by 46.2% of the companies, showing an increase by 5.5 percentage points from the previous research. A Move toward clear-cut division of duties between supervision and execution can be confirmed. Notable features of companies which referred to executive officers are: larger companies tend to refer to executive officers; there are a significant number of companies which referred to downsizing of the Board of Directors by reducing directors and clear separation between decision-making function and execution function of management performed by the Board of Directors. These trends remain unchanged from the previous research.

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<sup>52</sup> The Report provides a section in which companies may make voluntary qualitative descriptions bearing in mind that such descriptions should focus on a decision-making process. In the case of companies with statutory auditors, for example, a company which has adopted a process to reinforce the functions of business execution or supervision functions is expected to describe the actual nature of such process.

Besides, 12.0% (up 0.5 percentage points) of the companies referred to advisory committees<sup>53</sup> or the like consisting of third parties. As already found in previous research, it is confirmed that a certain number of companies established organs to provide advice on or evaluate overall management by inviting outside experts and/or management specialists. Again larger companies tend to refer to such organs. Voluntary establishment of such committees suggests that although not adopting the Company with Committees system, the companies have better understanding of active utilization of such committees either as advisory organs for the Board of Directors or to strengthen the Board functions. On the other hand, a reason for not adopting the Company with Committees system may be that advisory committees are generally managed in accordance with unique decision-making procedures of individual companies, and the companies are not inclined to lose such flexibility by adopting the statutory committees.

**Chart 54 Items Relating to Decision-Making Functions with Respect to the Execution of Business, Audits, Supervision, Nominations, and Remuneration (Net Sales (Consolidated))**

	Management Committee		Executive Officer		Executive Committee		Advisory Committee	
		Change from 2006		Change from 2006		Change from 2006		Change from 2006
Under ¥10 billion	34.0%	-3.5%	28.7%	3.6%	3.3%	-0.7%	6.6%	-1.8%
¥10 billion to under ¥100 billion	41.9%	1.0%	42.1%	4.5%	14.6%	-1.9%	7.7%	0.0%
¥100 billion to under ¥1 trillion	47.5%	0.1%	55.6%	6.8%	13.0%	-0.9%	18.7%	1.6%
¥1 trillion or more	52.0%	3.2%	70.3%	9.0%	8.8%	-0.5%	25.7%	-0.7%

## (2) Descriptions on auditing and supervision

Descriptions on auditing and supervision are classified into such categories as matters mainly related to statutory auditors and the Board of Statutory Auditors, matters related to internal audits, and matters related to accounting audits.

Specific example of the matters mainly related to statutory auditors and the Board of Statutory Auditors include frequency of the Board of Statutory Auditors meetings and their resolutions, and activities of each statutory auditor such as attendance to important meetings, examination of documents, and inspections of the subsidiaries. Descriptions on matters related to internal audits include personnel allocation, audit activities, reporting lines of audit results, and authority concerning recommendations for improvement. As for the matters related on accounting audits, the majority are mere routine descriptions showing the names of audit corporations and certified public accountants in charge, as well as absence of special relationship between the companies and such audit corporation or certified public accountant, while few companies referred to cooperation between accounting auditors and the companies.

Among descriptions by the Companies with Committees, some referred to the roles of each committee, especially Audit Committee.

<sup>53</sup> With respect to "advisory committee," any company using any one of the following key words is included: "advisory," "advisory (in Japanese character)," "advice," or "consultation."

### **(3) Other**

In addition, descriptions under this subject include specific risk management measures and compliance systems which have been increasingly drawing attention of corporations, as well as importance of ensuring the effectiveness of such measures and systems.

## **8. Reasons for Adopting the Companies with Committees System**

Given that the Companies with Committees made decisions to convert their organizational form from traditional Statutory Auditors system to the Committees system, the Report requires those companies to describe the reasons for adopting such organizational form.

Reasons for adopting the Committees system (55 companies in total) include: aiming at clear division of duties between supervision and execution (52 companies; 94.5%); to strengthen execution function (53 companies; 96.4%); quick and speedy decision-making by executive officers as top management (43 companies; 78.2%); delegation of authority to execution function (22 companies; 40.0%); strengthening checking function by outside directors (22 companies; 40.0%) and securing management transparency in a consequence. In addition, 4 companies referred to global or overseas relations.

# IV Incentives and Remuneration

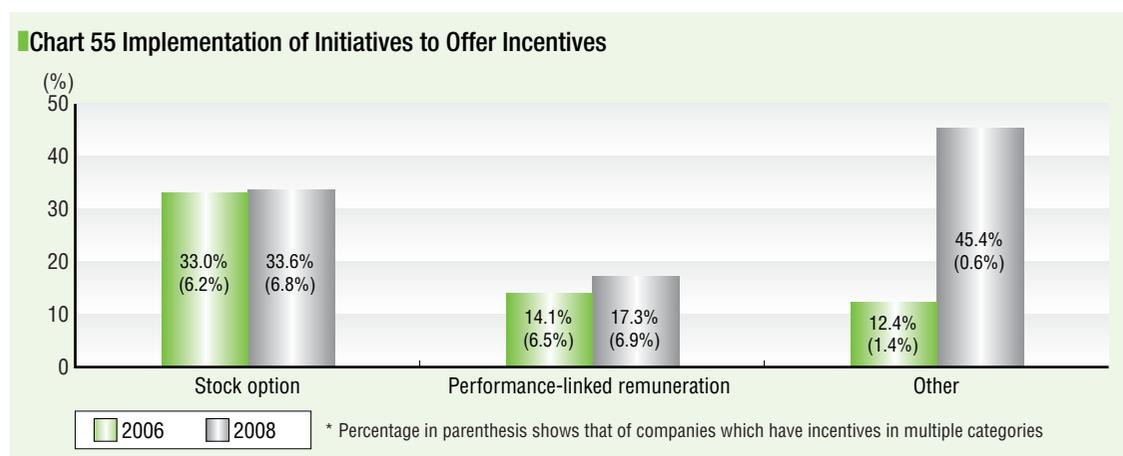
## 1. Implementation of Initiatives to Offer Incentives

The Report requires disclosure of implementation status on initiatives to offer incentives to directors. In connection with their functions to audit or supervise corporate management, information on incentives to directors is naturally considered to have a significant weight from the perspective of corporate governance. Specifically, the companies are required to select applicable incentives (multiple answers allowed) from such categories as "introduced stock option plan," "introduced performance-linked remuneration system" or "other" in case they are offering such incentives, or select "none" in case they are not offering any. In either case, supplementary explanations are required to the utmost extent.

### (1) Overview of incentives

Companies implementing any initiatives to offer incentives account for 88.1% (previously 52.5%) of TSE-Listed Companies. The reason for the substantial rise from the previous research is increase of incentives categorized into "others." As it was controversial whether bonuses are included in remunerations under the former Commercial Code, the majority of the companies, at the time of the previous research, did not recognize performance-linked remunerations in a broad sense, including directors' bonuses, as the incentives. This time, as the Companies Act explicitly stipulates that bonuses are included in remunerations (Article 361 of the Companies Act) and retirement benefits have been increasingly recognized as incentives, such trends seem to have boosted the percentages of initiatives to offer incentives.

Regarding each category of initiatives to offer incentives, the stock option plans are introduced in 33.6% (down 0.5 percentage points; any up/down in this chapter refers to a change from the previous research) of the TSE-Listed Companies, and the performance-linked remuneration system and other initiatives are introduced in 17.3% (up 3.2 percentage points) and 45.4% (up 33.0 percentage points), respectively, of the companies (see Chart 55).



## (2) Introduction of stock option plans

In the analysis of the companies adopting the stock option plans by market section as shown in Chart 56, TSE Mothers-listed companies show an outstandingly higher ratio, 85.6% (up 5.8 percentage points), than TSE First Section (30.8%; down 0.1 percentage points) and TSE Second Section (21.9%; down 2.2 percentage points). This distinctive feature was already clear in the previous research. In terms of a relation with number of employees (consolidated), as shown in Chart 57, companies with fewer employees<sup>54</sup> (meaning smaller companies) tend to show a higher level of adoption of the stock option plans.

In contrast, as for a relation with number of consolidated subsidiaries, companies which have more subsidiaries tend to show a higher level of adoption of the stock option plans. Regarding a relation with foreign shareholding ratio (see Chart 58), the higher the foreign shareholding ratio, the higher the ratio of implementing the stock option plans. Again, these trends were also observed in the previous research.

**Chart 56 Implementation of Initiatives to Offer Incentives (Market Section)**

	Stock option		Performance-linked remuneration		Other	
		Change from 2006		Change from 2006		Change from 2006
TSE First Section	30.8%	-0.1%	21.3%	4.3%	45.1%	31.3%
TSE Second Section	21.9%	-2.2%	7.5%	-0.2%	60.7%	50.8%
TSE Mothers	85.6%	5.8%	5.6%	1.0%	11.8%	5.5%

**Chart 57 Implementation of Initiatives to Offer Incentives (Number of Employees (Consolidated))**

	Stock option		Performance-linked remuneration		Other	
		Change from 2006		Change from 2006		Change from 2006
Under 100	68.2%	-0.5%	5.4%	0.8%	27.1%	21.8%
100 to under 500	39.9%	3.6%	8.4%	-0.5%	45.5%	36.3%
500 to under 1000	26.0%	-2.3%	13.5%	2.0%	56.0%	45.3%
1000 or more	30.4%	0.4%	23.0%	5.0%	43.6%	28.6%

**Chart 58 Implementation of Initiatives to Offer Incentives (Foreign Shareholding Ratio)**

	Stock option		Performance-linked remuneration		Other	
		Change from 2006		Change from 2006		Change from 2006
Under 10%	29.1%	1.9%	11.9%	2.7%	51.9%	40.5%
10% to under 20%	34.1%	-2.2%	17.6%	2.5%	42.9%	31.2%
20% to under 30%	38.6%	-2.8%	27.9%	6.3%	35.2%	18.4%
30% or more	52.8%	1.8%	36.0%	1.8%	25.7%	10.4%

<sup>54</sup> Similarly, companies with lower net sales (consolidated) tend to show a higher level of adoption of the stock option plans.

164 companies provided supplementary explanations regarding their stock option plans. While the majority simply described the details of past issues of stock options, some expressed such effects that the plans contribute to securing human resources, and encouraging employees to have a higher level of awareness and morale. Speaking of advantages of the stock option plans, some referred to effects not only in motivating their employees but also in promoting shareholders' interests.

While 66.4% of the companies have not adopted such stock option plans, they stated reasons for non-adoption from the various angles. Specifically, some companies are currently preparing for introducing the plans, while there are companies which once had adopted and then abandoned the plans, finding it inappropriate as incentives. Some companies consider that their current remuneration structures are sufficient, and some question the idea of the stock option plan on the ground that remunerations should not be offered in the short-term perspective. As a reason for judging it inappropriate as incentives, there was an explanation that the stock option plan is a program to receive capital gains without taking risks associated with a drop in stock price, and therefore conflicts with the shareholders' interests.

### **(3) Implementation of performance-linked remuneration system**

In the analysis of implementation of performance-linked remuneration system by market section, TSE First Section clearly shows a higher ratio of adoption at 21.3% (up 4.3 percentage points) than TSE Second Section (7.5%; down 0.2 percentage points) and TSE Mothers (5.6%; up 1.0 percentage points), similarly to the previous research (see Chart 56).

In terms of a relation with company size, as shown in Chart 57, companies with larger number of employees (consolidated)<sup>55</sup> (meaning larger companies) tend to show a higher ratio of implementing the performance-linked remuneration system. In addition, there is a trend that the higher the foreign shareholding ratio, the higher the ratio of implementing the performance-linked remuneration system (see Chart 58).

Along with wide-spread adoption of the performance-linked remuneration system, an increasing number of companies which decided to abolish the retirement benefits system due to its seniority element. In the Reports, 174 companies referred to abolition of their retirement benefits systems. In addition, some clearly stated that they would cut directors' remunerations upon business downturn.

### **(4) Other**

Companies which selected "other" as their initiatives to offer incentives mostly described that they consider business performance and directors' contributions or efforts when deciding provisions of directors' remunerations or bonuses. In fact, out of 707 companies (increased by 414 companies) which selected "others," 67.8% (479 companies) referred to either "remuneration" or "bonus" in their supplementary explanations of the initiatives.

In the said supplementary explanations, 3.5% (25 companies) of those who selected "other" referred to "employee shareholding association."

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<sup>55</sup> The similar trends are observed in analysis by net sales (consolidated) and number of consolidated subsidiaries.

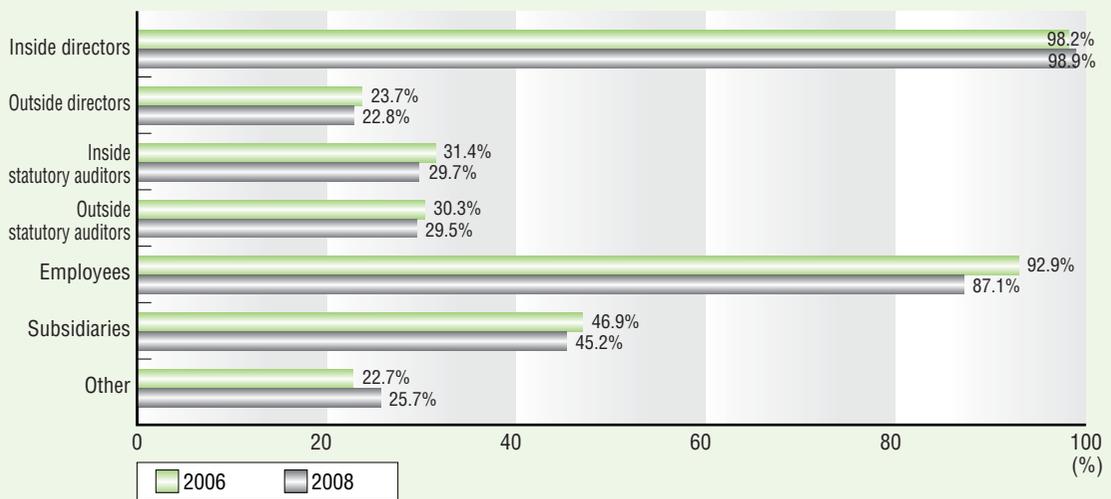
## (5) Eligible persons for stock options

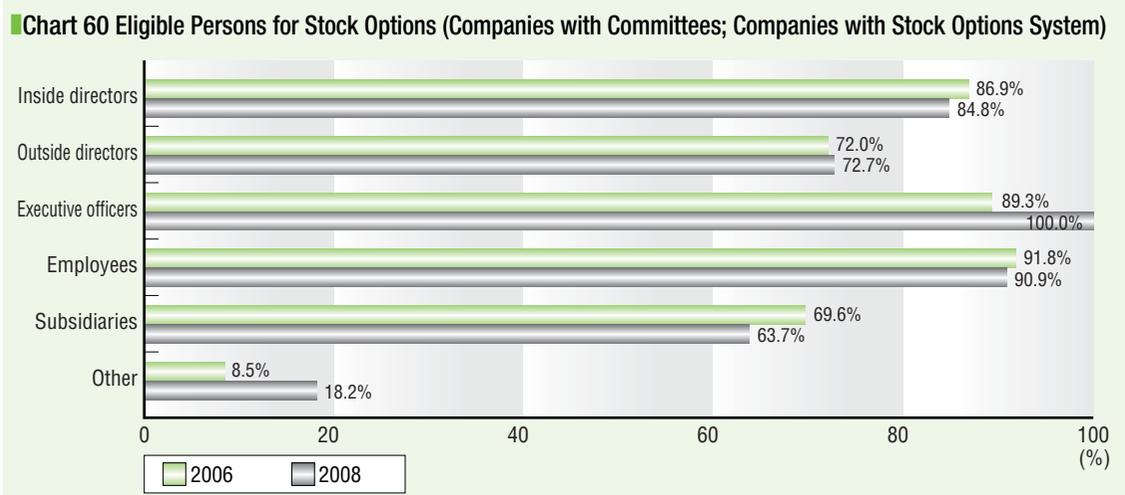
The Report requires companies implementing the stock option plans to specify the eligible persons by selecting one(s) from the following categories: "inside directors," "outside directors," "inside statutory auditors," "outside statutory auditors," "executive officers," "employees," "subsidiaries" or "other" (multiple answers allowed).

Chart 59 and Chart 60 show the composition of eligible persons, when the population is limited to TSE-listed companies with the stock option plans. It is found that the companies offer their stock option plans mostly to the inside directors (98.9% of the Companies with Statutory Auditors, and 84.8% of the Companies with Committees) and the employees (87.1% of the Companies with Statutory Auditors, and 90.9% of the Companies with Committees). As for companies offering the plans to the outside directors, the ratio to all TSE-Listed Companies is just 8.4% (down 0.6 percentage points); yet, when limited to the companies with outside directors, the ratio shows 24.9% (down 1.2 percentage points).

As supplementary explanations regarding eligibility for stock options, while some companies stated that the eligibility was expanded from directors to statutory auditors, to employees of the companies and their subsidiaries, there was an opinion that it is not appropriate to offer a stock option program to those who assume the responsibility of audit.

**Chart 59 Eligible Persons for Stock Options (Companies with Statutory Auditors; Companies with Stock Options System)**



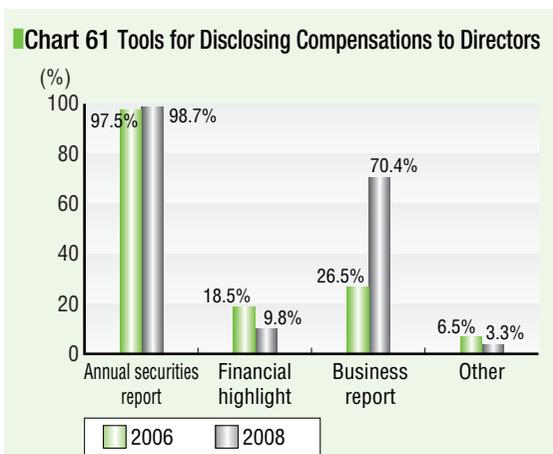


## 2. Disclosure of Directors' Remuneration

### (1) Tools of disclosure

The Report requires the companies to specify how the companies disclose information on directors' remunerations by selecting applicable tool(s) from the following categories: "annual securities reports," "financial highlights," "business reports," or "other" (multiple answers allowed).

As shown in Chart 61, the TSE-Listed Companies mostly disclose by means of their annual securities reports, which account for 98.7% (up 1.2 percentage points).



### (2) Contents of disclosures

The Report requires the companies to specify contents of disclosure on directors' remuneration by selecting one from the following categories: "total amount for all directors," "total amounts for inside directors and outside directors separately" and "other." In case a company discloses an individual amount for each director (including the case where individual amounts only for higher remunerations are disclosed), it is required to select "other" and provide supplementary explanations.

Among all TSE-Listed Companies, as shown in Chart 62, those who disclose only the total amount for all directors account for 66.6% (down 9.0 percentage points), and those who disclose the total amounts for

inside directors and outside directors separately account for 29.1% (up 9.9 percentage points). Although they are increasingly disclosing the amounts separately, they do not specify amounts for any individuals. In fact, only one company disclosed an individual amount for each director and statutory auditor.

**Chart 62 Disclosures in Relation to Compensations for Directors**



# V Implementation of Measures for Shareholders and Other Interested Parties

## 1. Efforts for Active General Shareholders Meetings and Smooth Exercise of Voting Rights

It is fundamental for the stock company (*kabushiki kaisha*) system that shareholders proactively exercise their rights pertaining to proposals for resolution at general shareholders meetings. The Exchange has requested each listed company to create an environment to facilitate the exercise of shareholders' voting rights at general meetings.<sup>56</sup> Furthermore, in November 2007, the Exchange incorporated the Code of Corporate Conducts into the Securities Listing Regulations, which stipulates obligations to make efforts for facilitating the exercise of voting rights at general shareholders meetings, including scheduling of the meetings avoiding the peak day, early notification of general shareholders meeting, English translation of convocation notices, etc., and exercise of voting rights by electronic means.<sup>57</sup>

Creation of a better environment for the exercise of shareholders' voting rights is considered essential also from the perspective of making corporate governance work more effectively. Particularly, these days, fruitful communications between listed companies and shareholders have been called for. This section in the Report is designed for confirming the progress of the efforts to create an environment conducive to shareholders' active participation in general meetings and proper exercise of their voting rights, assessing how the listed companies communicate with their shareholders and investors on a routine basis, and ensuring that the shareholders and investors have fair and easy access to information.

### (1) Early notification of general shareholders meeting

From the data in the Reports, it is found that 33.0% (up 1.3 percentage points; any up/down in this chapter refers to a change from the previous research) of the companies provide early notification of general meetings to their shareholders.<sup>58</sup>

In the analysis by market section as shown in Chart 63, companies providing early notification account for 39.7% (up 1.3 percentage points) of companies listed on TSE First Section, showing the much higher ratio compared with TSE Second Section (16.3%; down 0.5 percentage points) and TSE Mothers (13.3%; up 3.6 percentage points). As shown in Chart 64, companies with larger net sales (consolidated) are more likely to provide early notification,<sup>59</sup> indicating that so called large companies tend to provide early notification.

Another notable feature is, as shown in Chart 65, that companies with higher foreign shareholding ratios are more likely to provide early notification.

<sup>56</sup> TSE "Request for creating an environment to facilitate the exercise of shareholders' voting rights at general meetings of shareholders" TSE (*jo-sa*) No. 255 (March 18, 2003)

<sup>57</sup> Article 438 of the Securities Listing Regulations; Article 437 of the Enforcement Rules for the Securities Listing Regulations.

<sup>58</sup> The term "early notification" means the case a company sends convocation notice of the most recent ordinary general meetings of shareholders at least 3 business days prior to the statutory date.

<sup>59</sup> Relations with number of employees (consolidated) and number of consolidated subsidiaries also show the same trends. (i.e. the larger the number, the higher ratio of early notification).

## (2) Avoidance of peak day

75.8% (up 1.2 percentage points; see Chart 9) of all TSE-Listed Companies close their books in the end of March. Since fiscal year ending March remains predominant, most companies hold their ordinary general meetings of shareholders in end June because the companies must ensure that shareholders' rights are to be exercised within 3 months from the Record Dates (Article 124, Paragraph 2 of the Companies Act). Consequently, setting the ordinary general shareholders meeting on such a "peak day" - the date most other listed companies also hold the ordinary general meetings of shareholders - is considered to hinder shareholders' participation, and the Exchange stipulated an obligation to make efforts to diversify the general shareholders meeting dates in the Code of Corporate Conduct.<sup>60</sup>

Out of all companies whose fiscal year ends in March, 38.4% (down 2.1 percentage points) of the companies schedule general shareholders meetings avoiding the peak day.<sup>61</sup> In the analysis of companies whose fiscal year ends in March by market section, companies avoiding the peak day account for 50.0% (up 8.9 percentage points) in TSE Mothers, showing the higher ratio than those of TSE First and Second Sections which show 39.6% (up 0.7 percentage points) and 30.8% (down 7.2 percentage points), respectively (see Chart 63). On the contrary, no distinct correlation was found between the size (expressed by net sales (consolidated), etc.) of companies whose fiscal year ends in March and avoidance of the peak day,<sup>62</sup> similarly to the previous research. Another similar finding in both researches is that relatively larger companies and smaller companies tend to schedule their ordinary general meetings of shareholders avoiding the peak day.

Likewise, the higher the foreign shareholding ratio, the more likely the companies are to avoid the peak day (see Chart 65).

## (3) Exercise of voting rights by electronic means

The exercise of voting rights by electronic means has been permitted since the revision of the Commercial Code in 2001, subject to the resolution by the Board of Directors (Article 1, Paragraph 1, Item 4 and Paragraph 4 of the Companies Act; Article 239-3 of the former Commercial Code). Meanwhile, the Exchange has striven to foster an environment where institutional investors may accurately exercise their rights via ICJ<sup>63</sup> which operates Electronic Voting Platform for Institutional Investors.

According to the Report, companies which have established infrastructure for the exercise of voting rights by electronic means account for 20.4% (up 3.4 percentage points) of all TSE-Listed Companies. Despite of an increase from the previous research, most companies are still in the process of developing such

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<sup>60</sup> Article 438 of the Securities Listing Regulations; Article 437, Paragraph 1 of the Enforcement Rules for the Securities Listing Regulations.

<sup>61</sup> The term "peak day" means a date when the most of listed companies hold their ordinary general meetings of shareholders (the most concentrated day in a year), determined based on the most recent dates for shareholders meetings.

<sup>62</sup> There is no correlation with number of employees (consolidated) or number of consolidated subsidiaries, either.

<sup>63</sup> ICJ stands for Investors Communications Japan. As of January 5, 2009, 313 listed companies expressed their intention to participate in the ICJ platform. For details, please visit its website (<http://www.icj-co.com>).

infrastructure. Yet it can be also interpreted that development efforts are gradually going ahead led by large companies as mentioned below.

In the analysis by market section, companies allowing the exercise of voting rights by electronic means account for 25.4% (up 4.5 percentage points) in TSE First Section, the ratio of which is higher than those of TSE Second Section (6.2%; up 0.5 percentage points) and TSE Mothers (10.3%; down 1.8 percentage points) (see Chart 63). Companies with larger net sales (consolidated)<sup>64</sup> (meaning larger companies) obviously shows much higher ratio of allowing exercise of voting rights by electronic means (see Chart 64). For example, among the companies with the net sales (consolidated) of exceeding ¥100 billion (866 companies; 36.4% of all companies), 39.3% (341 companies) of them allow the exercise of voting rights by electronic means.

Furthermore, with respect to relation with the foreign shareholding ratio, similarly to the previous research, companies with higher ratios are more likely to allow the exercise of voting rights by electronic means. Compared with the previous research, each category, except those under 10%, shows an upward trend (see Chart 65).

**Chart 63 Efforts for Active General Shareholders Meetings (Market Section)**

	Early notification of general shareholders meeting		Scheduling general shareholders meetings avoiding peak day (FY end: March)		Exercise of voting rights by electronic means	
		Change from 2006		Change from 2006		Change from 2006
TSE First Section	39.7%	1.3%	39.6%	0.8%	25.4%	4.5%
TSE Second Section	16.3%	-0.5%	30.8%	-7.1%	6.2%	0.5%
TSE Mothers	13.3%	3.6%	50.0%	8.5%	10.3%	-1.8%

**Chart 64 Efforts for Active General Shareholders Meetings (Net Sales (Consolidated))**

	Early notification of general shareholders meeting		Scheduling general shareholders meetings avoiding peak day (FY end: March)		Exercise of voting rights by electronic means	
		Change from 2006		Change from 2006		Change from 2006
Under ¥10 billion	14.9%	1.4%	40.1%	-12.0%	7.3%	0.0%
¥10 billion to under ¥100 billion	23.2%	0.0%	34.5%	-2.3%	10.1%	1.0%
¥100 billion to under ¥1 trillion	47.8%	1.2%	39.5%	-0.4%	31.6%	6.2%
¥1 trillion or more	77.7%	1.7%	58.0%	-1.6%	77.0%	4.9%

<sup>64</sup> Relations with number of employees (consolidated) and number of consolidated subsidiaries also show the same trends (i.e. the larger the number, the higher ratio of allowing exercise of voting rights by electronic means).

**Chart 65 Efforts for Active General Shareholders Meetings (Foreign Shareholding Ratio)**

	Early notification of general shareholders meeting		Scheduling general shareholders meetings avoiding peak day (FY end: March)		Exercise of voting rights by electronic means	
		Change from 2006		Change from 2006		Change from 2006
Under 10%	22.2%	1.4%	33.3%	-3.4%	8.6%	0.0%
10% to under 20%	34.4%	-4.0%	38.7%	-0.7%	22.5%	2.9%
20% to under 30%	58.3%	10.9%	47.1%	-3.3%	42.8%	14.2%
30% or more	61.7%	-2.1%	54.7%	2.5%	57.9%	7.9%

#### (4) Other

In case companies are making efforts for active general shareholders meetings and smooth exercise of voting rights in addition to the above-mentioned measures, they are supposed to check the category "other" and provide supplementary explanations on such efforts. In particular, the Reporting Guideline shows such measures as posting convocation notice on a company website and translation of convocation notice into English as examples of this category. The Exchange also incorporated these points into the Code of Corporate Conduct as obligations to make efforts in establishing framework enabling investors to receive convocation notices and reference documents by electromagnetic means, and preparing and providing summaries of convocation notices, etc. in English.<sup>65</sup>

In the review of supplementary explanations in the Reports, it is found that 16.4% (up 3.6 percentage points) of the TSE-Listed Companies referred to use of the company websites.<sup>66</sup> Descriptions related to visual presentation<sup>67</sup> account for 9.5% (up 2.5 percentage points), and descriptions related to English translation account for 8.3% (up 1.2 percentage points). Both ratios indicate the companies' active efforts.

In the analysis of the ratios of using keywords related to use of the company website and visual presentation by market section as well as net sales (consolidated), number of employees (consolidated) and number of consolidated subsidiaries, TSE First Section shows higher ratios. Obviously the larger companies tend to show the higher ratios.

As further efforts to reduce distance between companies and shareholders, some companies hold events such as receptions or factory tours after the general shareholders meetings in the presence of representative directors and/or other management; or provide unique services or entertainments to the participants of the general shareholders meetings, taking advantages of their own products or services. For the convenience of shareholders to attend the general shareholders meetings, various explanations were presented including: setting the dates on weekends, location selection criteria such as convenient

<sup>65</sup> Article 438 of the Securities Listing Regulations, Article 437, Items 3 and 4 of the Enforcement Rules for the Securities Listing Regulations.

<sup>66</sup> With respect to "the company website," any company using any one of the following keywords is included: "the company website," "homepage," "HP," or "www."

<sup>67</sup> With respect to "visual," any company using either "visual" or "PowerPoint" as keywords is included.

access and large capacity, facilitating participation not only by increasing meeting locations by preparing a satellite room but also by making the best use of communication tools.

Furthermore, for the convenience of increasing foreign investors, not a few companies referred to preparation of convocation notices in English and posting such information on the company websites. While there are some securities transfer agents which run portal sites posting English versions of convocation notices collectively for foreign investors, some companies cited such sites in their explanations. On the contrary, some pointed out problems arising from preparation of convocation notices in English with time constraints and expressed reservation about it.

## 2. Investor Relations (IR) Activities

From the perspective of enhanced communications between the listed companies and shareholders/investors, in addition to efforts promoting more active participation in general shareholders meetings and the facilitated exercise of voting rights, emphasis should be placed on dialogue with the market through IR activities.

Amidst rapid changes in the environment surrounding companies in recent years, corporate management faces an unprecedented need to find methods for helping their shareholders and investors more appropriately understand their actual corporate conditions, as well as to fulfill their public responsibility of explaining management decision-making processes. The Exchange asserts that activities to enhance this public accountability form an integral part of any plan to promote corporate governance.

"IR activities" is a simple phrase, but individual companies have applied a variety of approaches for that purpose. In order to capture the overall trends, this part of the Report comprises of the following topics to enable companies to respond with a focus on contact with investors: "regular seminars for individual investors," "regular seminars for analysts and institutional investors," "regular seminars for overseas analysts," "the posting of IR data on the company website," and "the formation of a department (or responsible person) responsible for IR activities."

### (1) Regular seminars

Seminars are an important means for establishing direct contact between listed companies and investors. The Exchange has required applicants for initial listings on TSE Mothers to file with the Exchange a commitment in writing that the applicants will hold seminars on investment at least twice a year for three years subsequent to the listing<sup>68</sup> and have thereby improved their communications with investors.

#### (a) For individual investors

In total, 26.9% (up 4.8 percentage points) of the TSE-Listed companies have held regular seminars<sup>69</sup> for individual investors. Of these companies, those who mentioned that a representative attends the

<sup>68</sup> Article 219, Paragraph 1, Item 4 of the Enforcement Rules for the Securities Listing Regulation

seminars as a speaker account for 83.3% (up 7.6 percentage points), comprising 22.4% (up 5.6 percentage points) of all TSE-Listed Companies.

In the supplementary explanations, a number of companies brought up presentation by their representative directors, and reported the number of participants, locations, and the number of seminars held. As formats of seminars, some reported that they have held IR seminars after the general shareholders meetings, and some described their active efforts for enhancing investors' understanding on their businesses by combining IR seminar with a factory visit. With respect to organization of such seminars, in addition to seminars hosted by the companies themselves, a number of companies reported on participation in joint seminars organized by securities companies, media, IR organizations, or other institutions for information dissemination to individual investors.

In case of targeting individual investors, while some companies have held seminars associated with the corporate characteristics by focusing on certain regions or female investors for example, some companies expressed their concerns about unfair information dissemination to a limited number of individuals and emphasized their policies not to carry out selective disclosures where only certain investors take advantage of receiving corporate information including business conditions prior to full public disclosures.

#### **(b) For analysts and institutional investors**

Companies which have held regular seminars for analysts and institutional investors account for 70.9% (down 0.5 percentage points) of all TSE-Listed Companies. Of these companies, those who mentioned that a representative attends the seminars as a speaker account for 98.4% (up 4.3 percentage points), comprising 69.8% (up 2.5 percentage points) of all TSE-Listed Companies. The increase of the ratio of such representative's presentation suggests that companies are increasingly becoming to place more emphasis on dialogue with their shareholders.

In the analysis by market section (see Chart 66), probably because of the above-mentioned commitment filed upon application for initial listing, ratios of companies which have held seminars are higher in TSE Mothers: those who have held seminars for individual investors account for 47.2% (up 5.2 percentage points) and those who have held seminars for analysts and institutional investors account for 89.7% (down 2.2 percentage points) in contrast with TSE First Section (26.6% and 76.3%, resp.) and TSE Second Section (19.5% and 43.3% resp.)

When limited to the companies listed on TSE First Section, companies with larger number of employees (consolidated), net sales (consolidated) and number of consolidated subsidiaries (meaning the larger companies) are more likely to have held regular seminars for both individual and institutional investors.

In the supplementary explanations, companies mainly wrote about dates of seminars and attributes of institutional investors. As for dates of holding seminars for institutional investors, while the overwhelming majority stated that they have held the seminars after announcements of final financial

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<sup>69</sup> The term "regular seminars" refers to the case where seminars are held annually at a certain frequency (expected to be held at least once in a year).

results, not a few companies reported that they have held seminars on the quarterly basis. Efforts for enhancing investors' understanding on their companies through factory tours, etc. are also observed.

With respect of how such seminars are organized for professional institutional investors, arrangements of internet-based or telephone network-based distance seminars were reported. Unlike the case with individual investors, ad-hoc individual meetings were also mentioned. Again, issues arising from information dissemination to a limited number of investors are raised, and based on such recognition, some companies reported that they deliver the contents of such seminars held for institutional investors to public.

### (c) For foreign investors

Companies which have held regular seminars for foreign investors account for 16.3% (up 0.7 percentage points) of all TSE-Listed Companies. Of these companies, those who mentioned that a representative attends the seminars as a speaker account for 90.0% (up 6.3 percentage points), comprising 14.3% of all TSE-Listed Companies.

In the analysis by market section, TSE First Section shows the highest ratio of 20.9% (up 1.2 percentage points), followed by TSE Mothers at 9.2% (down 2.8 percentage points) and TSE Second Section at 2.4% (down 0.7 percentage points) (see Chart 66). As shown in Chart 67, companies with higher foreign shareholding ratio are more likely to have held regular seminars for foreign investors.

When limited to companies listed on TSE First Section, there is a distinct trend that companies with larger number of employees (consolidated), net sales (consolidated) and number of consolidated subsidiaries (meaning the larger companies) are more likely to hold regular seminars for foreign investors.

With respect of how such seminars are organized, a common method reported is that directors go abroad to speak in such seminars or individual meetings. Destinations are mainly the U.S. and Europe, followed by Hong Kong and Singapore reflecting the recent growth of Asia. The frequency is generally reported to be once a year. Similarly to the seminars held in Japan, some companies described that they have held orientation sessions on their factories at their local factories, or during events or fairs abroad, to enhance investors' understanding of the companies. Such measures as internet-based seminars and improvement of annual reports were also reported.

**Chart 66 Regular Seminars for Investors (Market Section)**

	For individual investors		For analysts and institutional investors		For foreign investors	
		Change from 2006		Change from 2006		Change from 2006
TSE First Section	26.6%	4.3%	76.3%	-0.5%	20.9%	1.2%
TSE Second Section	19.5%	4.8%	43.3%	-2.7%	2.4%	-0.7%
TSE Mothers	47.2%	5.2%	89.7%	-2.2%	9.2%	-2.8%

**Chart 67 Regular Seminars for Investors (Foreign Shareholding Ratio)**

	For individual investors		For analysts and institutional investors		For foreign investors	
		Change from 2006		Change from 2006		Change from 2006
Under 10%	23.3%	3.6%	58.7%	1.1%	5.3%	0.0%
10% to under 20%	27.8%	5.2%	83.2%	-2.3%	17.4%	0.3%
20% to under 30%	35.9%	6.9%	90.3%	-2.3%	40.3%	2.4%
30% or more	35.0%	7.5%	89.3%	-5.1%	49.1%	0.6%

## (2) Posting on the company website

The disclosure of IR data<sup>70</sup> via company websites is a very convenient and useful tool for providing information to investors and market participants. As such, the Report requires companies to state whether they post IR data on their own websites and to explain the URLs of such website and the types of information for investors they post on their websites as supplemental explanations on IR activities, if they do post such data (e.g., information on earnings results, timely disclosure materials other than earnings results, annual securities reports, etc., materials relating to seminars, status of corporate governance, convocation notices of general meetings of shareholders, etc.).

Of all TSE-Listed Companies, 2,081 companies reported their posting of IR data on the company websites, making up 87.5% (down 5.1 percentage points). This high ratio proves that they have striven to improve their activities using any channel easily and widely available to general investors. In the analysis by market section as shown in Chart 68, TSE Mothers (87.7%) and TSE First Section (88.9%) show relatively higher ratios of posting on the company websites. In relation with foreign shareholding ratio (see Chart 69), companies with higher foreign shareholding ratios are more likely to post IR data on the company websites.

With respect to the contents of IR data posted on the company websites, 24.0% (up 0.6 percentage points) of TSE-Listed companies mentioned "earnings results" in their supplemental explanations, followed by "annual securities reports" at 36.9% (up 4.8 percentage points), "public announcement of earnings results" at 3.2% (up 1.9 percentage points) and "convocation notices" at 8.3% (up 1.9 percentage points). Almost all of the companies which provided supplementary explanations reported that they post the annual securities reports, timely disclosure materials, and annual reports. It is assumed that this trend is also shared by most of the companies which did not provide supplementary explanations this time, and that the company websites are widely used. Furthermore, cases of posting videos on the websites in addition to documents were reported as efforts in visualization.

<sup>70</sup> "IR data" refers to any documents or electromagnetic data prepared or compiled by a company for the purpose of contributing to the appropriate understanding and assessment of the present conditions of the company by investors, etc. (investors, financial analysts, parties involved in transactions with the company or shareholders).

### (3) Department responsible for IR (responsible person)

In total, 80.7% (down 1.1 percentage points) of TSE-Listed companies mentioned that they have a department responsible for IR activities (including responsible persons).<sup>71</sup> In terms of market sections, 85.6% (down 7.5 percentage points) of TSE Mothers-listed companies have such a department. This is the highest ratio, while TSE First Section and Second Section show the corresponding ratios at 84.0% (down 0.8 percentage points) and 66.5% (down 1.4 percentage points), respectively (see Chart 68).

The majority of the companies which have a department responsible for IR stated that it is a department dedicated to IR. In terms of organizational structure, such a department is reported to be under direct control of Executive Secretary's Office, or under Business Planning Division or Corporate Strategy Division.

**Chart 68 Posting of IR Data on the Company Websites and Formation of IR Department (Market Section)**

	Posting of IR Data on the Company Websites		Formation of IR Department	
		Change from 2006		Change from 2006
TSE First Section	88.9%	-4.8%	84.0%	-0.8%
TSE Second Section	82.2%	-5.3%	66.5%	-1.4%
TSE Mothers	87.7%	-8.3%	85.6%	-7.5%

**Chart 69 Posting of IR Data on the Company Websites and Formation of IR Department (Foreign Shareholding Ratio)**

	Posting of IR Data on the Company Websites		Formation of IR Department	
		Change from 2006		Change from 2006
Under 10%	85.1%	-5.8%	74.1%	-1.3%
10% to under 20%	88.1%	-5.6%	86.4%	-1.4%
20% to under 30%	91.7%	-2.4%	91.7%	1.1%
30% or more	95.3%	-3.7%	92.1%	-3.4%

### (4) Other

The Report provides a section in which companies may provide optional descriptions on IR activities, and 278 companies (11.7% of the TSE-Listed Companies) provided explanations from various angles.

In specific descriptions, 187 companies (67.3% of those provided the subject descriptions) referred to individual visits to, individual meetings, and small group meetings with analysts, institutional investors or major shareholders. Out of these companies, some explained specific persons, such as representative directors and directors in charge, who attend such activities.

<sup>71</sup> A department responsible for IR activities, a director responsible for IR activities (the person responsible for the surveillance of IR activities of the listed company), and a person responsible for IR-related communications are included.

In the context of fair disclosure, some described measures to respect individual shareholders and investors such as posting video of earnings results briefing on the company websites soon after the briefing. In the context of information dissemination to shareholders, the following examples were presented: distribution of IR information via e-mail newsletters, delivery of business reports to the shareholders at least twice a year, and distribution of public relations magazines or quarterly magazines to the shareholders. In addition, some companies described their basic policies on information disclosure by representing that they formulated and announced their disclosure policies and disclose information in accordance with such policies.

Other descriptions include posting of convocation notices of general shareholders meetings on the website for domestic and foreign institutional investors, regular site tours, and hospitality programs for shareholders.

### **3. Measures to Ensure Due Respect for Stakeholders**

Corporate governance of listed companies is expected to create corporate value, create jobs, and promote the maintenance of sound corporate management through stable relationships established between companies and stakeholders. For the purpose of the Report, the Exchange addressed issues to be tackled by listed companies as they strive to establish stable relationships with stakeholders other than shareholders. In this regard, the Exchange has presented the following keyword themes focused on the development of corporate culture and the improvement of internal systems for respecting the positions of stakeholders: (1) rules on respect for the positions of stakeholders under internal regulations; (2) environmental preservation activities and CSR activities; and (3) development of policies in relation to the provision of information to stakeholders.

Companies which responded to the above (1) account for 56.6% (up 3.9 percentage points) of TSE-Listed Companies, and 208 companies provided supplementary explanations. While the majority of these companies explained that they adopted code of conduct and set high ethical standard, a certain companies further described that they carry out activities to ensure effectiveness of such internal regulations.

Companies which responded to the above (2) account for 64.3% (up 0.8 percentage points). These companies emphasized on their efforts to cope with environmental issues, for example, introduction of environment management system. Furthermore, some companies recognized CSR in a broader sense covering not only environmental issues but also labor issues and CS improvement, and described each relevant activity.

Companies which responded to the above (3) account for 41.5% (up 3.6 percentage points), and 168 companies provided supplementary explanations, the majority of which were focusing on how to inform their concepts and policies of corporate governance.

In the analysis of such efforts by market section, as shown in Chart 70, a high percentage of companies listed on the TSE First Section have made all three efforts. It suggests that efforts to ensure due respect

for stakeholders have been widely made by the companies listed on the First Section. For example, 72.7% (up 0.4 percentage points) of companies listed on the TSE First Section have implemented environmental preservation activities or CSR activities, while only 19.0% (unchanged) of Mothers-listed companies have taken the same actions. This trend was already observed in the previous research and remains unchanged. Furthermore, as shown in Chart 71, companies with larger net sales (consolidated)<sup>72</sup> (meaning the larger companies) seem more proactive in these efforts.

In addition to the above measures (1) to (3), 201 companies explained "other" efforts such as global environment or social action programs.

Efforts to ensure due respect for stakeholders represent the commitment of a company as a member of society to behave in a manner responsible for stakeholders. These efforts can be viewed as more proactive activities when compared with activities performed to comply with laws and regulations. An environment in which companies are encouraged to proactively carry out activities for the preservation of the environment and to contribute to their communities beyond the scope of their businesses is becoming widespread in the whole market.

**Chart 70 Efforts for Respecting the Positioning of Stakeholders (Market Section)**

	Stipulation in Internal Regulations		Environmental Preservation and CSR Activities		Development of Policies on Information Provision	
		Change from 2006		Change from 2006		Change from 2006
TSE First Section	63.4%	4.0%	72.7%	0.4%	45.8%	3.0%
TSE Second Section	43.1%	5.4%	52.1%	3.3%	29.0%	3.9%
TSE Mothers	28.2%	-1.1%	19.0%	0.0%	33.3%	5.7%

**Chart 71 Efforts for Respecting the Positioning of Stakeholders (Net Sales (Consolidated))**

	Stipulation in Internal Regulations		Environmental Preservation and CSR Activities		Development of Policies on Information Provision	
		Change from 2006		Change from 2006		Change from 2006
Under ¥10 billion	28.1%	1.1%	26.4%	-0.1%	30.0%	3.5%
¥10 billion to under ¥100 billion	51.5%	5.0%	59.6%	0.7%	35.2%	3.5%
¥100 billion to under ¥1 trillion	69.6%	2.2%	81.5%	0.9%	49.0%	3.2%
¥1 trillion or more	92.6%	2.6%	97.3%	-0.4%	79.7%	-2.4%

<sup>72</sup> Relations with number of employees (consolidated) and number of consolidated subsidiaries also show the same trends.

# VI Basic Policy of Internal Control Systems and the Progress of System Development

## 1. Basic Policy of Internal Control Systems and the Progress of System Development

The development of systems to ensure appropriate governance has recently been growing in importance, and companies are thus required to develop internal control systems for the implementation of sound management. Under the Companies Act enforced from May 2006, large companies (Article 362, Paragraph 4, Item 6 and Paragraph 5 of the Act) or companies adopting a committee system (Article 416, Paragraph 1, Item 1 (v) and Paragraph 2 of the Act) are required to develop a "system to ensure appropriate company management" (a so-called internal control system).

In light of this situation, recognizing that companies need to inform general investors of the basic policy characterizing their internal control systems, the Exchange requires listed companies to describe relevant items in the Report. The Exchange also requires companies to describe the concepts (basic policies) they implement to ensure the appropriate fulfillment of operations. These concepts should illustrate how a company can manage organizations to attain management strategies or business purposes, and how a company can comply with laws, regulations, and its articles of incorporation.<sup>73</sup>

With respect to the basic concept of internal control systems and the development of the systems themselves, many companies have made descriptions according to the items prescribed in the Companies Act and the Enforcement Rules for the Companies Act (Articles 100 and 112 of the Enforcement Rules for the Companies Act).

Specifically, 30.2% (up 2.6 percentage points; any up/down in this chapter refers to a change from the previous research) of all TSE-Listed companies referred to the term "the Companies Act."<sup>74</sup> In total, 74.3% (up 6.7 percentage points) of the companies referred to "risk management," and more companies, reaching 94.0% (up 6.9 percentage points), referred to "compliance"<sup>75</sup> (See Chart 72).

With respect to "system for management and storage of information on execution of duties by directors/executive officers" (Article 100, Paragraph 1, Item 1 and Article 112, Paragraph 2, Item 1 of the same Rules), as most of information is in the form of documents, 1,170 companies referred to development of internal regulations on documents management.

Concerning "rules and system for management of risk of loss" (Article 100, Paragraph 1, Item 2 and Article 112, Paragraph 2, Item 2 of the same Rules), 1,599 companies reported that rules on risk management have been adopted. Specific descriptions include establishment of individual rules addressing each specific risk, and preparation of measures to be taken when risk situations arise including establishment of a risk management committee.

Regarding "system to ensure proper execution of duties by directors/executive officers" (Article 100, Paragraph

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<sup>73</sup> The Report further requires to describe the status of compliance system, risk management system, and information management system to ensure the status of creating necessary framework.

<sup>74</sup> Overwhelming majority of the companies described their basic policies in accordance with the provisions of the Companies Act, even though they do not use the term "the Companies Act."

<sup>75</sup> With respect to the item "compliance," any company using any one of the following keywords is included: "regulatory compliance," "observance" and "*compliance* (written in Japanese character)."

1, Item 3 and Article 112, Paragraph 2, Item 3 of the same Rules), 1,657 companies provided a wide variety of descriptions. Generally, such descriptions focused on management system taking corporate governance into account, and management procedures with management cycle in mind.

"System to ensure that employees' execution of duties comply with relevant laws and regulations as well as the articles of incorporation" (Article 100, Paragraph 1, Item 4 and Article 112, Paragraph 2, Item 4 of the same Rules) was mentioned by 1,462 companies. Most frequently observed descriptions are formulation of guidelines including codes of conduct and compliance rules. To enhance effectiveness of such rules, some companies further referred to establishment of responsible committees and implementation of related training, as well as consultation service for employees and internal reporting system (whistle blowing program). Furthermore, some described that internal audit office or the like conducts internal audits to judge effectiveness of the subject system and provide feedback to management. In that connection, some made reference to the roles of statutory auditors and outside directors, and outside attorney's check of legal compliance as well as compliance with the articles of incorporation.

"System to ensure proper business operations of the business group consisting of the stock company and its parent company and subsidiaries" (Article 100, Paragraph 1, Item 5 and Article 112, Paragraph 2, Item 5 of the same Rules) was referred to by 1,597 companies. While being generally the same as descriptions concerning the headquarters, the descriptions include formulation of group management rules, formation of compliance department responsible for managing affiliated companies, internal control system overseeing subsidiaries and overseas business, and consultative meetings of statutory auditors across the group. With respect to control over subsidiaries, two different policy directions are observed: some expressed it necessary to strengthen control over their subsidiaries and appoint outside directors and outside statutory auditors of such subsidiaries from the parent company; and other emphasized independence of subsidiaries from the parent companies.

As for "matters concerning employees who assist statutory auditors when requested" (Article 100, Paragraph 3, Item 1 of the Enforcement Rules for the Companies Act) and "matters concerning independence of the employee from directors set forth in the preceding item" (Article 100, Paragraph 3, Item 2 of the Enforcement Rules for the Companies Act), descriptions were generally in line with the Act. The companies made due consideration of their independence in terms of appointment and discharge, performance evaluation, and personnel transfer. The similar explanations were made concerning Audit Committee member of the Companies with Committees (Article 112, Paragraph 1, Items 1 and 2 of the Enforcement Rules for the Companies Act).

Regarding "system for reporting from directors, employees and others to statutory auditors" (Article 100, Paragraph 3, Item 3 of the Enforcement Rules for the Companies Act) and "other system to ensure that statutory auditors conduct audits effectively" (Article 100, Paragraph 3, Item 4 of the Enforcement Rules for the Companies Act), companies referred to rules concerning statutory auditors' rights to participate in certain significant meetings, and rights to review material documents. In addition, there was a case allowing employees to report directly to statutory auditors.

These internal control systems in accordance with the Companies Act can be recognized as systems to monitor internal structure including management in terms of the development of a system to ensure the appropriate business of the companies. Discussions on internal control systems have been proceeding concurrently as a premise for the reliability of financial reporting. Under the Financial Instruments and Exchange Act ("FIEA"), it is mandatory for listed companies to file internal control system reports with assessments of the effectiveness of internal control related to the financial reporting from fiscal year starting on or after April 1, 2008 (Article 24-4-4 of FIEA). Listed companies will have to develop internal control systems which incorporate all of the legal requirements. In this research, 336 companies described in their Reports how they respond to FIEA's requirements for preparation of internal control reports.

**Chart 72 Basic Policy of Internal Control Systems and the Progress of System Development**

		Companies Act		Risk management		Compliance		Information management	
		Ratio	Change from 2006	Ratio	Change from 2006	Ratio	Change from 2006	Ratio	Change from 2006
All the data		30.2%	2.6%	74.3%	6.7%	94.0%	6.9%	20.7%	0.7%
Organizational form	Companies with Statutory Auditors	30.0%	2.5%	74.4%	6.9%	94.1%	6.9%	20.7%	0.6%
	Companies with Committees	40.0%	9.5%	72.7%	-0.2%	90.9%	6.2%	20.0%	3.1%
Market section	TSE First Section	32.5%	2.4%	75.5%	4.8%	95.4%	6.0%	22.0%	0.4%
	TSE Second Section	24.7%	2.7%	71.9%	9.7%	91.2%	9.2%	18.2%	1.7%
	TSE Mothers	23.6%	4.0%	70.3%	16.8%	88.2%	8.9%	14.9%	0.5%

		Ethics		Decision making		Antisocial Force	
		Ratio	Change from 2006	Ratio	Change from 2006	Ratio	Change from 2006
All the data		56.9%	10.0%	56.0%	10.8%	94.7%	93.6%
Organizational form	Companies with Statutory Auditors	56.8%	9.7%	56.1%	10.7%	94.6%	93.8%
	Companies with Committees	61.8%	22.8%	50.9%	13.6%	96.4%	84.5%
Market section	TSE First Section	59.5%	9.1%	56.9%	9.7%	96.1%	94.9%
	TSE Second Section	51.1%	10.3%	51.9%	12.9%	93.8%	93.0%
	TSE Mothers	48.7%	18.3%	57.4%	14.3%	84.1%	83.5%

## 2. Matters concerning Establishment of System for Eliminating Anti-social Forces —

The Exchange has been striving for elimination of anti-social forces centering its efforts on initial listing examinations. Recently, adoption of effective measures to tackle with anti-social forces in securities trading and crime prevention has become pressing issues. For the purposes of preventing abuse of securities market by anti-social forces and maintaining order and confidence of securities market, the Exchange established a new system in February 2008. Specifically, in relation with a section "Basic Policy of Internal Control Systems and the Progress of System Development" in the Report, the

Exchange requires companies to provide additional information on their efforts for elimination of anti-social forces.<sup>76</sup> In line with "The guideline to prevent private corporations from anti-social forces" announced by the Japanese Government in June 2007 incorporating a recommendation which reads "it is necessary to clearly include prevention of damages caused by anti-social forces in internal control system," the Exchange added this subject in the Report as a matter related to internal control.

In principle, the Exchange expects companies to describe their policies to prevent involvement of anti-social forces in business activities or damages caused by such forces; and status of creating an environment for the above prevention, including establishment of code of ethics, code of conduct, internal regulations, etc. as well as corporate structure enabling company-wide response.

Given that, 94.7% (94.6% of the Companies with Statutory Auditors; 96.4% of the Companies with Committees) of the companies provided the relevant descriptions. High response ratios in all three markets (96.1% of TSE First Section; 93.8% of TSE Second Section; and 84.1% of TSE Mothers), proving that actions have been taken by wide most of the companies.<sup>77</sup>

Concerning policies for eliminating anti-social forces, companies generally described that they have no relationship with such anti-social forces as corporate extortionists or organized crime syndicates, and stand firmly against them. Concerning system for eliminating anti-social forces, 1,401 companies, nearly 60% of all companies, mentioned cooperation with police agencies. In addition to police agencies, a number of companies referred to exchange of information with organizations against such special crimes (i.e. crimes against corporations) and consultation with corporate lawyers. Furthermore, development of basic policies and manuals, implementation of employee trainings, and appointment of responsible persons were addressed.

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<sup>76</sup> This was implemented in accordance with the revision of the regulations on Feb. 6, 2008 (partial amendment of the Securities Listing Regulations, etc. for improvement of listing system for elimination of anti-social forces). At the same time, the Code of Corporate Conduct in the Regulations was amended to require companies for effort to develop internal framework to prevent damages caused by anti-social forces as well as anti-social forces' involvement in each corporate activity (Article 444 of the Securities Listing Regulations)

<sup>77</sup> These numerical data is based on data provided in this section of the Reports. Some companies may have provided comments related to this section elsewhere in the Reports, such as "I. Underlying Concept of Corporate Governance," by describing this topic together with compliance, etc.

## VII Matters Concerning Takeover Defense Measures

Any company which introduced<sup>78</sup> takeover defense measures<sup>79</sup> is required to give an overview of the scheme in the Report and describe the purposes for introducing it. Many companies have been concerned about hostile takeovers and a growing number are now introducing takeover defense measures. These types of measures have a large impact on the rights of shareholders and investors, and they have the potential to be abused to serve the interests of directors or officers. In this respect, the Report requires companies with these measures to describe both the schemes and propriety of the scheme structures.

Companies which described adoption of takeover defense measures in the Reports account for 19.4% of all TSE-Listed Companies, showing a significant increase up to 460 companies (up 13.7 percentage points; up 329 companies; any up/down in this chapter refers to a change from the previous research).<sup>80</sup> The ratios by market section show 23.8% (up 16.9 percentage points) in TSE First Section, 9.0% (up 6.6 percentage points) in TSE Second Section, and 5.1% (up 4.0 percentage points) in TSE Mothers (see Chart 73). Concerning relation with company size, larger companies are more likely to have introduced takeover defense measures (in terms of relation with net sales (consolidated); see Chart 74). As for relation with foreign shareholding ratio (see Chart 75), the highest adoption ratio is marked by companies in the range of "20% to under 30%," which account for 36.2% (up 25.4 percentage points), followed by companies in the range of "10% to under 20%," which account for 24.2% (up 15.9 percentage points). From the fact companies with foreign shareholding ratio exceeding 30% comprise as low as 18.7% (up 12.1 percentage points), it is confirmed that higher foreign shareholding ratios do not trigger adoption of takeover defense measures.

In respect of relation with shareholding ratio of the largest shareholder (see Chart 76), an overall trend is that companies with lower shareholding ratio are more likely to have introduced these measures. As if the shareholding range from 5% to less than 10% provides companies with a guideline to consider takeover defense measures, the adoption ratio in this range is the highest 32.3%.

Regarding existence of parent companies, since companies with a parent company are less likely to face takeover risks, only one company described takeover defense measures, similarly to the previous research.

On the other hand, out of all companies without a parent company, those who described takeover defense measures account for 22.1% (up 15.7 percentage points).

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<sup>78</sup> The term "introduce" or "adopt" here means a resolution to determine actual contents of a scheme, including a resolution to issue new shares or new share reservation rights.

<sup>79</sup> The term "takeover defense measure" means any measure introduced by a listed company, before any unwanted takeover attempt is actually initiated against that company, to fend off any attempt by a third party to acquire the company (attempt to acquire a sufficient number of shares to have a significant influence on the company), through the issuance of new shares or new share subscription rights. Any issuance of new shares or new share subscription rights principally for business purposes such as fundraising shall not be regarded as takeover defense measures.

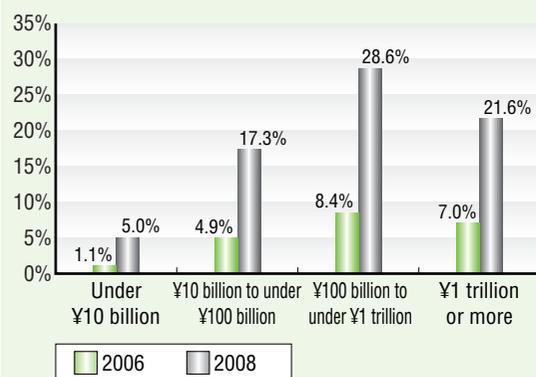
<sup>80</sup> For the purpose of aggregation related to takeover defense measures in the White Paper, as the Reports is not designed to check "yes" or "no" to answer whether a company has introduced the relevant measures, the Exchange reviewed the qualitative descriptions and counted number of companies which described specific anti-takeover system such as advance warning-type or trust type.

The analysis by industry found that the ratios of introduction of takeover defense measures are rather high in the following industries: mining (33.3%; previously 0.0%), foods (37.1%; 7.6%), steel (34.1%; 18.6%), precision instruments (35.3%; 11.4%), other products (36.9%; 11.1%), and land transport (31.7%; 17.5%).

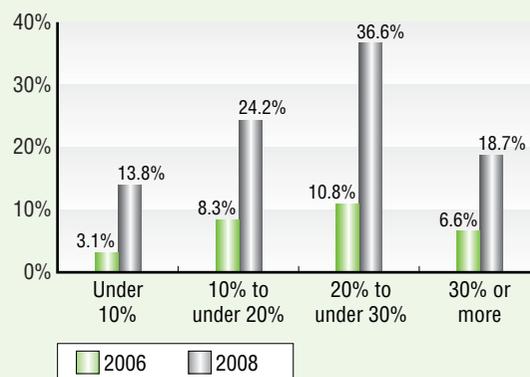
**Chart 73 Adoption of Takeover Defense Measures (Market Section)**



**Chart 74 Adoption of Takeover Defense Measures (Net Sales (Consolidated))**



**Chart 75 Adoption of Takeover Defense Measures (Foreign Shareholding Ratio)**



**Chart 76 Adoption of Takeover Defense Measures (Shareholding Ratio of the Largest Shareholder)**

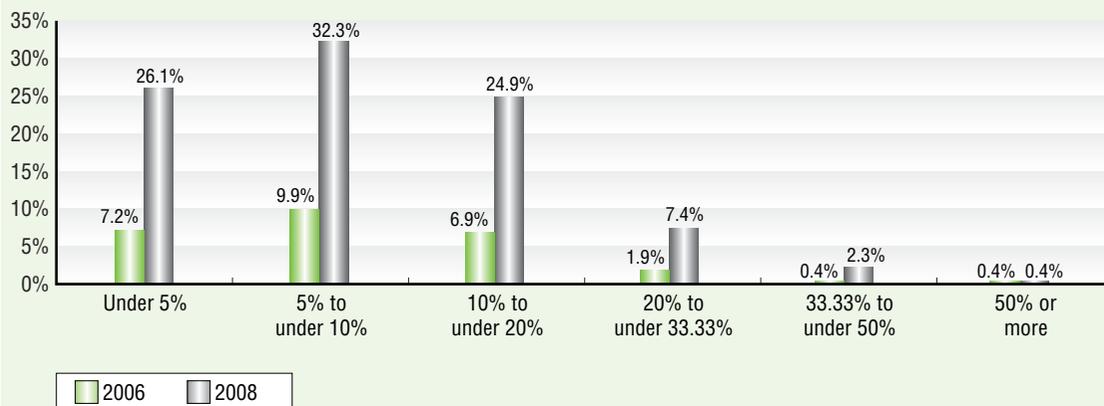


Chart 77 shows status of corporate governance system by classifying companies depending on whether or not they have adopted takeover defense measures. With respect to average number of directors per company, adopting companies have 9.74 directors, surpassing average number 8.42 of non-adopting companies (at the time of the previous research, the numbers were 10.15 and 8.92, respectively). As for appointment of outside directors, 52.7% (up 4.6 percentage points) of adopting companies appointed outside directors, whereas 43.6% (up 1.7 percentage points) of non-adopting companies appointed outside directors.

Average number of outside directors is higher in adopting companies, showing 1.00 (including 0.88 independent outside directors) compared with 0.83 (including 0.55 independent outside directors) in non-adopting companies. Concerning average numbers of statutory auditors and outside statutory auditors, no significant difference was observed between adopting and non-adopting companies. Yet concerning average number of independent outside statutory auditors, there is a slight difference between adopting and non-adopting companies, showing 2.28 and 1.96, respectively, unlike the case of outside statutory auditors.

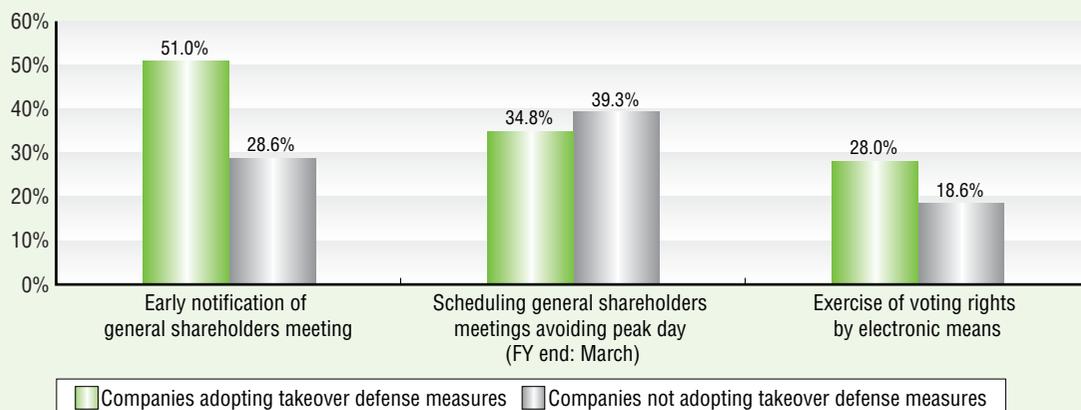
With respect of measures for shareholders and investors implemented by adopting companies, as efforts for active general shareholders meetings, those who provide early notification account for 51.0% (vs. 28.6% of non-adopting companies), those who schedule general shareholders meetings avoiding the peak day account for 34.8% (vs.39.3%), and those who allow the exercise of voting rights by electronic means account for 28.0% (vs.18.6%). The results suggest that adopting companies are generally proactive in these efforts (see Chart 78). Concerning seminars for investors (see Chart 79), companies which have held seminars for individual investors account for 27.1% (vs. 26.9%), companies which have held seminars for analysts and institutional investors account for 80.5% (vs. 68.6%) and companies which have held seminars for foreign investors account for 21.0% (vs.15.1%). Again higher ratios are marked in all three cases. Moreover, with respect to IR activities, 89.6% (vs.87.0%) of adopting companies post IR information on their company websites, and 86.7% (vs. 79.2%) have a responsible department: high percentages here as well. In connection with such policies, whether or not presentations are given by top management of a company indicates the company's attitude toward shareholders and investors. Analyzing ratios of companies whose top management have directly given messages in regular seminars or on the company website, adopting companies show higher ratio than non-adopting companies, indicating that adopting companies are more proactive in these efforts for shareholders and investors.

While not a few companies emphasized that they take due account of stakeholders other than shareholders upon adoption of takeover defense measures, companies which adopted such defense measures show higher ratios in the following criteria: 68.3% (vs. 53.8% of non-adopting companies) stipulated rules to respect the positions of stakeholders in their internal regulations; 80.2% (vs. 60.5%) implement environmental preservation or CSR activities; and 45.9% (40.4%) developed policies on information provision. The results prove that companies which introduced takeover defense measures are more inclined to take measures to respect the positions of stakeholders (see Chart 80).

**Chart 77 Relation between Adoption of Takeover Defense Measures and Governance**

	Average number of directors		Ratio of adopting outside directors		Average number of outside directors		Average number of independent outside directors	
		Change from 2006		Change from 2006		Change from 2006		Change from 2006
Companies adopting takeover defense measures	9.74	-0.41	52.7%	4.6%	1.00	-0.02	0.88	-0.06
Companies not adopting takeover defense measures	8.42	-0.50	43.6%	1.7%	0.83	0.03	0.55	0.04

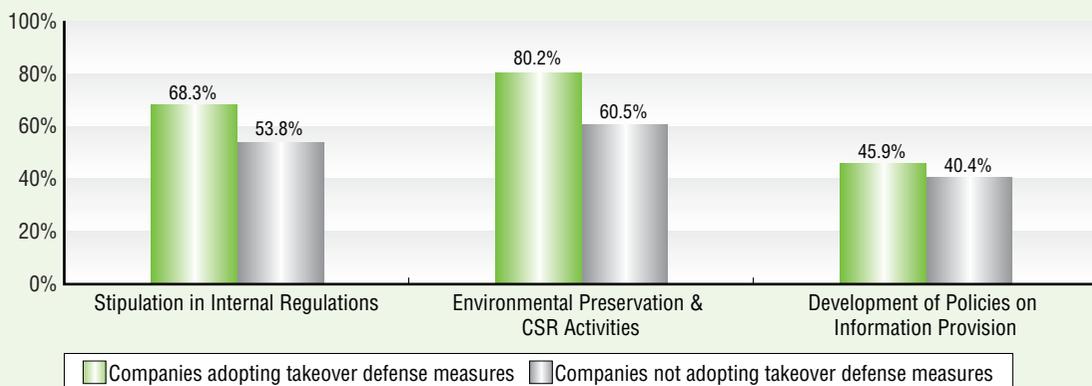
	Average number of statutory auditors		Average number of outside statutory auditors		Average number of independent outside statutory auditors	
		Change from 2006		Change from 2006		Change from 2006
Companies adopting takeover defense measures	3.93	0.02	2.45	0.01	2.28	-0.04
Companies not adopting takeover defense measures	3.67	-0.03	2.46	0.06	1.96	0.04

**Chart 78 Relation between Adoption of Takeover Defense Measures and Efforts for Active General Shareholders Meetings**

**Chart 79 Relation between Adoption of Takeover Defense Measures and Regular Investment Seminars**



**Chart 80 Relation between Adoption of Takeover Defense Measures and Respect for Stakeholders**



While adoption status of takeover defense measures are outlined as above, specific contents of such measures have been increasingly becoming standardized with increasing adoption of takeover defense measures: first of all, a company set out certain procedures for bulk purchase of shares; then, in case a purchaser does not comply with such procedures, or in case a company finds any bulk purchase may damage common interests of the shareholders, the company takes a countermeasure by providing a new share subscription right, etc. to a third party other than the bulk purchaser. Such shareholders' rights plan in advance warning type is typically found in the descriptions. Furthermore, many adopting companies have introduced a framework such as an independent committee consisting of external parties to eliminate potential arbitrary decisions by the current management upon imposing a countermeasure.

Out of all non-adopting companies, 425 companies provided the reasons for not adopting takeover defense measures. Most of these companies expressed that maximization of corporate value is the most effective takeover defense measure, and represented such approaches that they enhance their corporate values by strengthening relationships with their stakeholders, and proactively implement IR activities in order for

the market to judge stock prices properly.

Despite no intention to introduce takeover defense measures, certain companies articulated the following approaches: always remaining careful about their stock prices and composition of shareholders; preparation of risk management manuals to address risks of hostile takeover attempts; and making efforts to increase long-term shareholders through shareholding associations for clients, employees and directors as well as cross-shareholdings with business partners. Some companies mentioned that they would continue discussion on adoption while watching trends of the society.

Among those who filed the Reports used for this research, there are companies which had once introduced takeover defense measures but ceased to maintain such takeover defense measures after reviewing how such measures should be. The reasons for such a decision include: they consider that whether or not to accept a buyout offer should be judged by the shareholders; and they can maximize the corporate value by carrying out their mid-term business plan steadily and, as a consequence, secure or enhance common interests of shareholders.

## ■ Prospective Challenges-Concluding Remarks

For this White Paper, the Exchange has striven to make an objective analysis of the Reports from various angles to illustrate a wide range of features of corporate governance practices of listed companies in the same manner as the Previous White Paper. It should be noted, however, that the data used for this analysis was collected solely from the Reports and therefore no crossover comparison was made with other corporate governance-related information contained in statutory disclosure documents or elsewhere. Similarly, time-sequential comparison is limited to comparison with the data collected from the Reports as of October 2006, which was used for the Previous White Paper. For more in-depth analysis of corporate governance practices of listed companies in Japan, analysis using the data from other sources would be required in the future.

In "Listing System Improvement FY 2008" announced in May 2008, the Exchange recognized improvement of an environment to enhance corporate governance of listed companies as one of the prime policy themes, and identified policy concerning corporate governance as the top priority issue of this fiscal year. The Exchange is fully aware of the market operator's responsibility for facilitating improvement of a framework enabling shareholders and investors to easily find corporate governance status of the listed companies at all times.

Furthermore, the Exchange has been making efforts to improve a framework to provide investors with comparability of corporate governance information of the listed companies, including corporate governance information services which are the system for public inspection of the Reports, expecting to enhance usability for making investment decisions. The Exchange will further incorporate XBRL technology in information disclosure system to provide a higher level of convenience for investors and users in the future.

In a bid to make good practices of corporate governance accepted generally and adequately, it will be essential to improve the framework surrounding corporate governance. Moreover, there is no question that management of the listed companies together with shareholders, investors, and other parties related to the listed companies will contribute to the actual implementation of corporate governance practices. The Exchange will be deeply ingratiated if this White Paper assists these related parties as they strive to implement genuine corporate governance structures in their organizations and contribute to the development of corporate governance as a whole in Japan.



**Tokyo Stock Exchange, Inc. Listing Department**  
2-1 Nihombashi-Kabuto-cho Chuo-Ku, Tokyo 103-8220, Japan  
URL: <http://www.tse.or.jp/>