The Beginning of Quarterly Earnings Reporting in Japan

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In February 2003, Japan's stock exchanges and the Japan Securities Dealers Association, which is responsible for operating the OTC market, made it a requirement for all companies listed in Japan to report their quarterly earnings (sales). This applies to companies with a business year beginning in April 2003 or later. As a result, companies began to report their earnings for April-June 2003 in July. This report collates and analyzes the April-June reports of companies whose business year ends in March 2004.[1]

1. The Beginning of Quarterly Earnings Reporting in Japan

In February 2003, the Tokyo Stock Exchange published an amendment to its "Timely Disclosure Rules for Issuers of Listed Securities," making it a requirement for companies listed in Japan to report their quarterly earnings ("quarterly reports"). Japan's other stock exchanges and the Japan Securities Dealers Association, which is responsible for operating the OTC market, have also amended their disclosure rules, making it a requirement for all companies listed in Japan with a business year beginning in April of 2003 or later to report their quarterly earnings.[2] In July-August 2003 the first companies whose business year ends in March 2004 reported their earnings for the first quarter under the new rules.

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1 The companies covered in this report had to satisfy the following two conditions: (1) be listed on either one of Japan's three main stock exchanges (1st or 2nd Section of Tokyo, Osaka and Nagoya exchanges) or one of its three venture markets (the OTC, Mothers and Hercules markets) and (2) have a business year ending in March 2004 with a first quarter from 1 April to 30 June 2003. Of the 2,683 companies that satisfied these conditions, 2,474 (92.2%) had reported their earnings for that quarter by 20 August. Market listing and sector grouping (33-sector classification system) are as of 30 June. Any companies whose existence was threatened were excluded.

2 According to the Tokyo Stock Exchange, 266 of the companies listed on the Exchange whose business year ends March 2003 reported their earnings for October-December 2002.

The only quarterly earnings information that companies are required to report under the new rules is sales (see box). In its "Action Program for Quarterly Financial Disclosure" published in June 2002, the Tokyo Stock Exchange stated its policy of requiring companies whose business year begins in April 2004 or later "to report quarterly financial and earnings information of a quality comparable to that in other countries." The Exchange intends to extend this requirement at a future date to include summaries of profit and loss accounts and balance sheets in order to improve the quality of disclosure.

Disclosure Requirements of Tokyo Stock Exchange's New Rules

a) Companies are required to report the following information for the group to which they belong (or, if they do not produce consolidated financial statements, for themselves) for the quarter in question: sales or the equivalent of sales ("sales"); comments on those sales; and, if there has been any change in the method by which they account for their sales from the method recognized in their latest fiscal year (or, if they do not produce consolidated financial statements, their latest business year), this fact and the details.

b) Companies are required to report any material change in the financial condition or business performance of the group to which they belong in the quarter in question.

Even before the February amendments, the Mothers and Hercules markets had required companies to report their quarterly earnings, while a number of companies had done so voluntarily. An analysis of the April-June earnings information reported under the new rules shows considerable variation in the degree of detail reported, with some companies (especially those which had already reported their quarterly earnings voluntarily) reporting detailed information such as financial statements and segment data while others that were reporting their quarterly earnings for the first time gave only their sales figures or reported simply that they would be revising their earnings forecasts.

2. Analysis of Quarterly Earnings Reports for April-June 2003

1) Breakdown of reporting companies by market and sector

The number of companies whose current business year ends in March 2004 is as follows for each market: 1,310 1st Section companies, 693 2nd Section companies and 680 venture companies. Of these, 1,217 (92.9%) 1st Section companies, 634 (91.5%) 2nd Section companies and 623 (91.6%) venture companies had reported their April-June earnings by 20 August. This shows that, at least so far, there have been no significant differences between the markets in the percentage of companies complying with the new rules.

As far as the number of companies reporting in each sector is concerned, we grouped together all the sectors with only a small number of companies as "Other" to give a total of 26 sectors rather than 33. In 22 of these 26 sectors, including securities and other financing business, where all the companies concerned had reported quarterly earnings, 90% or more of the companies concerned had already reported their quarterly earnings (Figure 1). In contrast, a relatively small percentage of companies in the iron & steel (69.6%) and land transportation (78.8%) sectors had reported as of 20 August.

Figure 1 Analysis of Quarterly Earnings Reports by Sector

Sector	Companies reporting (A)	Companies reported (B)	Rate of progress (B/A) (%)	Days required
Wholesale Trade	282	260	92.2	34.8
Electric Appliances	242	219	90.5	33.8
Machinery	208	189	90.9	35.4
Construction	194	185	95.4	32.1
Chemicals	184	171	92.9	35.4
Communication	181	173	95.6	34.0
Services	154	142	92.2	35.1
Retail Trade	137	127	92.7	35.0
Foods	104	101	97.1	35.0
Transportation Equipment	104	97	93.3	34.5
Banks	92	88	95.7	35.2
Other Products	83	77	92.8	35.7
Metal Products	77	71	92.2	34.5
Textiles & Apparels	72	64	88.9	34.6
Land Transportation	66	52	78.8	40.1
Iron & Steel	56	39	69.6	35.2
Glass & Ceramics Products	54	51	94.4	36.1
Real Estate	51	49	96.1	32.5
Pharmaceutical	45	43	95.6	31.5
Nonferrous Metals	41	37	90.2	35.2
Precision Instruments	39	35	89.7	37.0
Warehousing & Harbor Transportation Services	37	34	91.9	37.3
Other Financial Business	35	35	100.0	31.8
Seculities	34	34	100.0	27.3
Pulp & Paper	22	20	90.9	35.1
Other sectors	89	81	91.0	37.4
All sectors	2683	2474	92.2	34.6

Note: Companies have been grouped as of 30 June 2003 using the 33-sector classification system. Sectors with 20 or fewer companies have been grouped together as "Other." "Rate of progress" shows the number of companies that had reported their quarterly earnings by 20 August ("Companies reported (B)") as a percentage of the number of companies whose business year ends in March 2004 ("Companies reporting (A)"). "Days required" is an average figure.

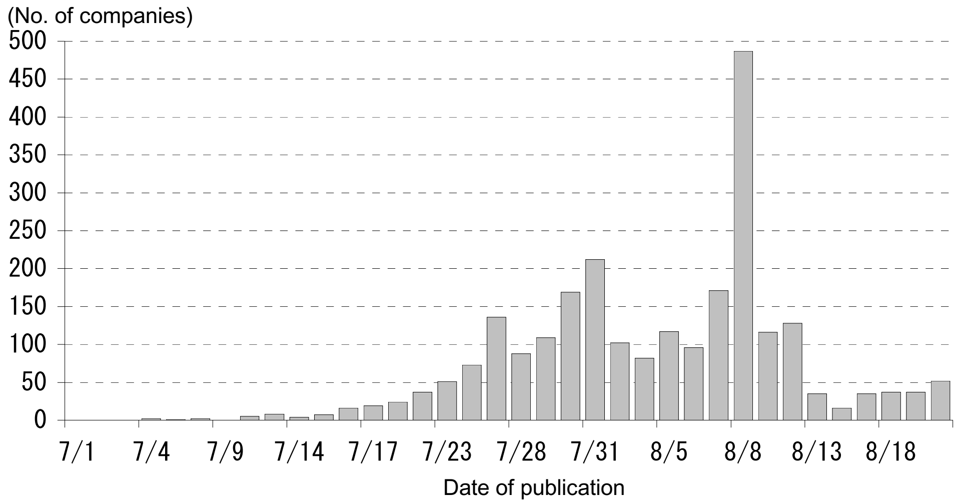
Source: NRI, from quarterly earnings reports of the companies concerned.

2) Average number of days required to produce a quarterly earnings report

(1) Average number of days for each market and sector

The first company to report its quarterly earnings for April-June did so on 4 July. Also, the date on which the largest number of companies reported their quarterly earnings was 8 August (39 days after the end of the quarter), when 487 companies reported (Figure 2). Overall, the average number of days required to produce a quarterly earnings report was 34.6. This compares with an average of 33.7 days for the 240 companies that reported their April-June quarterly earnings voluntarilyin 2002, according to a survey by the Tokyo Stock Exchange.

Figure 2 Distribution of Dates on Which Companies Reported Their Quarterly Earnings



Source: NRI, from quarterly earnings reports of the companies concerned.

There was little difference in the average number of days for each market: 34.8 for the 1st Section and 2nd Section markets, and 34.2 for the venture markets. As far as the average number of days for each sector is concerned, securities was the shortest (27.3 days), with other financing business, pharmaceuticals and construction also relatively short, while land transportation, other and warehousing were longest. Within the "Other" sector, fishery, agriculture & forestry, insurance and marine transportation were the longest (Figure 1).

(2) Relation between content of reports and average number of days required to produce them

One might assume that the average number of days required to produce an earnings report would vary according to whether a company's priority was speed (in which case, it might report only key items such as sales) or detail (in which case, it might take longer to report).

We therefore divided all the companies into three groups: (1) those companies that reported only sales (i.e., minimum disclosure); (2) those that reported their profit and loss accounts, balance sheets and segment data (i.e., full disclosure); and (3) the rest (i.e., those in between).[3] We then compared the average number of days required to produce an earnings report for each group: 34.8 days for the first group (834 companies); 34.5 days for the second (590 companies); and 34.6 days (1,050 companies) for the third. Contrary to what we expected, there was little difference in the degree of disclosure between the three groups.

Some companies even went out of their way to try to offer both speed and detail in their reporting. One venture capital company eager to report as quickly as possible reported the key items from its profit and loss account on an approximate basis less than 10 days after the quarter had ended and then its actual profit and loss account and balance sheet 20 days after that. An approach such as this, which takes into account the needs of investors, should serve as a model for others.

(3) Comparison of the average number of days required to produce a quarterly earnings report in Japan and the United States

The Securities Exchange Act of 1934 introduced quarterly earnings reporting (on Form 10-Q) in the United States, and US companies are required to produce earnings reports not later than 45 days after a quarter has ended. However, following the accounting scandals at Enron and other companies, this was reduced—to not later than 40 days after the end of a business year ending on or after 15 December 2003 and to not later than 35 days after the end of a business year ending on or after 15 December 2004—in order to give investors more information. We compared the number of days required to produce a quarterly earnings report in the United States, where, as we have seen, quarterly reporting is well established, and Japan (Figure 3).[4]

We found that the US companies took 10 or more days less than their Japanese counterparts to produce their reports. Whereas 83.9% of the US companies had produced their reports not later than 30 days after the end of a quarter, only 28.0% of the Japanese companies had done so. Also, whereas all of the US companies had produced their reports not later than 45 days after the end of a quarter, 13.8% of the Japanese companies had still not done so. Furthermore, whereas the US companies

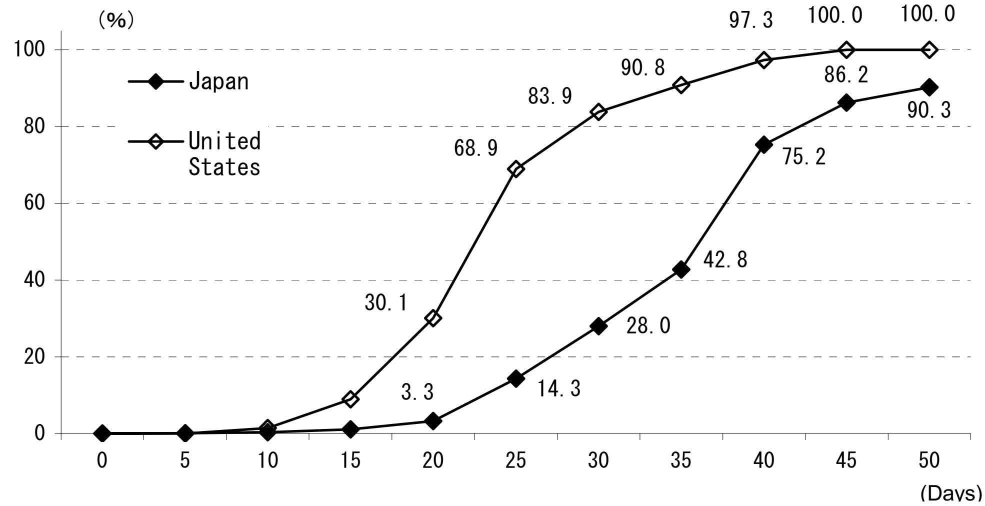
3 For the purposes of this report we have treated all information about sales by division, product or region (whether in diagrammatic or textual form) as segment data.

4 The US companies concerned are the 415 constituents of the S&P 500 with a quarter ending in June.

reported their earnings in detail (e.g., in the form of financial statements), a considerable number of the Japanese companies still only reported sales.

Just as US companies will have to reduce the number of days they take to produce a quarterly earnings report, Japanese companies can also be expected to come under pressure to do so.

Figure 3 Comparison of the Number of Days Required to Produce a Quarterly Earnings Report in Japan and the United States



Note: Number of companies concerned: 2,683 Japanese and 415 US companies.
Source: NRI, from quarterly earnings reports of the companies concerned and Bloomberg.

3) Reporting of quarterly earnings and financial data

(1) Breakdown of reporting companies by accounting method

Of the 2,474 Japanese companies that reported quarterly earnings, 1,900 (76.8%) did so on a consolidated basis and 574 (23.2%) on a nonconsolidated basis (Figure 4).[5]

Under the existing system, those companies that report on a consolidated basis and whose business year ends on or before 30 March 2005 will have a transition period in which they will be allowed to produce their quarterly earnings reports on a nonconsolidated basis. As a result, 208 of the companies that reported their earnings on a consolidated basis in fiscal 2002 reported their quarterly earnings on a nonconsolidated basis. Of these, 92 belonged to the construction sector.

5 Companies reporting on both a consolidated and nonconsolidated basis have been counted as reporting on a consolidated basis.

Figure 4 Breakdown of Reporting Companies by Consolidated and Nonconsolidated Figures

	Consolidated	Nonconsolidated
Total number of companies reporting	1,900 (76.8%)	574 (23.2%)
Total number of companies reporting (excl. Mothers)	1,888 (77.1%)	562 (22.9%)
1st Section	1,075 (88.3%)	142 (11.7%)

Source: NRI, from quarterly earnings reports of the companies concerned.

(2) Use of a certified public accountant or audit corporation

At the moment, with the exception of companies listed on the Mothers market, Japanese companies are not required to use a certified public accountant or audit corporation when they produce their quarterly earnings reports. Of the companies covered in this report, only 39 (1.7%) indicated that they had done so, and 24 of these were listed on the Mothers.

However, this may be because many of the companies baulked at stating that they had "used an accountant" when, in the absence of any system for auditing quarterly financial data, there is no clear definition of "the use of a certified public accountant." It would therefore be wrong to conclude purely from the results in this report that most companies do not use a certified public accountant at all when they produce and report their quarterly financial data.

(3) Main earnings indicators

Figure 5 shows the percentage of companies that reported each of the following main earnings indicators: sales, operating profit, recurring profit, and quarterly net profit. "Sales" includes revenue, orders received, banks' ordinary income and insurance companies' net premium income, while "recurring profit" includes pre-tax earnings.

Altogether 2,365 companies (95.6% of those that produced a quarterly earnings report) reported their sales. Of the 109 companies that failed to report their sales, 88 were banks that reported mainly their financial data, while 21 companies simply revised their earnings forecasts rather than report their quarterly earnings. In contrast, only about 40% of the companies reported their operating, recurring and (quarterly) net profit, although this will be compulsory from April-June 2004. Although it is easy to say that this is not yet compulsory, it is a rather unsatisfactory result.

Figure 5 Breakdown of Reporting Companies by Earnings Indicators

	Sales	Operating profit	Recurring profit	Net profit	Comparative figures
Total number of companies reporting	2,365 (95.6%)	1,007 (40.7%)	1,016 (41.1%)	929 (37.6%)	940 (39.7%)
Total number of companies reporting (excl. Mothers)	2,341 (95.6%)	983 (40.1%)	992 (40.5%)	905 (36.9%)	933 (39.9%)
1st Section	1,125 (92.4%)	607 (49.9%)	610 (50.1%)	575 (47.2%)	411 (36.5%)

Note: "Comparative figures" gives the number and percentage of the companies that provided sales figures for the same period in the previous year.
Source: NRI, from quarterly earnings reports of the companies concerned.

Any analysis of quarterly earnings will rely heavily on the figures for the same period in the previous year. However, of the 2,365 companies that reported their sales figures, only 940 (roughly 40%) gave their figures for the same period in the previous year. Quite a few of those that did so were companies that had never reported their quarterly earnings before but wanted to make it easier for investors to put the figures in context, while most of the 1,425 companies that did not do so gave as their reason the fact that this was their first quarterly earnings report.

A considerable number of companies also explained the effect of seasonal factors on their quarterly earnings. As well as using text to explain this, some companies used charts showing their quarterly sales for the previous year or two in order to help investors understand any seasonal changes.

(4) Financial and cash flow data

As far as financial data are concerned, 861 (34.8%) of the companies reported their total assets and shareholders' equity as of the end of the quarter (Figure 6). Similarly, 553 (22.4%) of the companies reported their main cash flow items (i.e., operating, investing and financing cash flows).

Figure 6 Breakdown of Reporting Companies by Financial Data and Cash Flow

	Total assets Shareholders' equity	Cash flow (operating, investing and financing)
Total number of companies reporting	861 (34.8%)	553 (22.4%)
Total number of companies reporting (excl. Mothers)	837 (34.2%)	530 (21.6%)
1st Section	534 (43.9%)	328 (27.0%)

Source: NRI, from quarterly earnings reports of the companies concerned.

(5) Earnings forecasts

2,317 (93.7%) of the companies either gave figures for or commented on their likely future sales or profits (Figure 7). Likewise, 318 (12.9%) of the 2,474 companies took the opportunity presented by reporting their quarterly earnings to revise their earnings forecasts.[6] While 309 companies revised their interim forecasts, 234 revised their full-term forecasts and 225 both.

In order to make it easier for investors to understand these revisions, some companies also gave their original forecasts for comparison while others explained the reasons for the change. However, some companies simply going through the motions of reporting failed to indicate whether their forecasts were upward or downward revisions or even revisions at all, leaving the reader to figure this out for himself.

Figure 7 Breakdown of Reporting Companies by Earnings Forecasts

	Explanation of forecast	Earnings revision
Total number of companies reporting	2,317 (93.7%)	318 (12.9%)
Total number of companies reporting (excl. Mothers)	2,295 (93.7%)	317 (12.9%)
1st Section	1,092 (89.7%)	183 (15.0%)

Note: "Explanation of forecast" includes cases where companies have not provided any figures for their earnings forecast but simply indicated that it has not changed since they announced their full-term results.
Source: NRI, from quarterly earnings reports of the companies concerned.

6 We have only counted those companies that revised the earnings forecasts in their quarterly earnings reports. Therefore companies that announced an earnings revision soon after they reported their quarterly earnings have not been counted.

(6) Financial statements (profit and loss account, balance sheet and cash flow statement)

The number of companies that produced profit and loss accounts, balance sheets and cash flow statements (whether comprehensive or summary) was 823 (33.3%), 802 (32.4%) and 496 (20.0%), respectively (Figure 8).

Figure 8 Breakdown of Reporting Companies by Financial Statements

	Profit & loss	Balance sheet	Cash flow
Total number of companies reporting	823 (33.3%)	802 (32.4%)	496 (20.0%)
Total number of companies reporting (excl. Mothers)	799 (32.6%)	778 (31.8%)	472 (19.3%)
1st Section	517 (42.5%)	504 (41.4%)	299 (24.6%)

Source: NRI, from quarterly earnings reports of the companies concerned.

(7) Overall explanations and segment data

2,153 (87.0%) of the companies provided either explanations of their quarterly earnings or segment data (Figure 9) while 1,307 (52.8%) provided segment data in some shape or form. It would be fair to say that most of the companies made an effort to explain the background to their quarterly earnings in qualitative terms. Not surprisingly, this varied from detailed comments on different segments to one-word comments.[7]

Figure 9 Breakdown of Reporting Companies by Overview and Segment Data

	Overview or segment data	Segment data
Total number of companies reporting	2,153 (87.0%)	1,307 (52.8%)
Total number of companies reporting (excl. Mothers)	2,129 (86.9%)	1,285 (52.4%)
1st Section	1,009 (82.9%)	688 (56.5%)

Source: NRI, from quarterly earnings reports of the companies concerned.

7 Comments in the section of the reporting form entitled "Overview of sales for quarter" such as "No particular changes" or "Sales in the quarter were ¥…" are not very informative. For the purposes of this report companies making such comments have therefore been treated as not having provided an overview.

3. Reaction to New System

By and large, investors appear to have reacted positively to the new system. According to QUICK's August survey, 92% of respondents indicated that they thought quarterly earnings reports were important (18% "very important", and 74% " important") (Figure 10). Also, the fact that 82% of respondents thought that the new system was good suggests that it is generally welcomed.

Figure 10 Investor Reaction to New System

	"How do you rate the new system?"			
"How important do you think quarterly earnings reports are?"	"Good"	"Not very good"	"Don't know"	Total
"Very important"	17%	0%	1%	18%
"Important"	63%	5%	6%	74%
"Not very important"	2%	5%	1%	8%
Total	82%	10%	8%	100%

Note: Based on 161 valid responses.
Source: QUICK's monthly survey.

However, there is a widespread view that companies could improve the contents of their quarterly earnings reports. According to the QUICK survey, a high proportion of the 10% of respondents who thought that the new system was "not very good" complained about the lack of detail, saying, for example, that not enough items were disclosed, that there were still not enough segment data or that the basis for the earnings forecasts was unclear. Even among the respondents who thought that the new system was good there were some who commented, for example, that there was a lack of quarterly data for the previous year and that it was difficult to form an opinion without analyst forecasts or that the reports were not detailed enough and only contained information on sales.

However, the requirement that companies report their sales from the April-June quarter of this year is only a rehearsal for the full disclosure of quarterly financial data that comes into effect next fiscal year. Therefore it is hardly surprising that investors should be less than satisfied with the degree of disclosure they provide.

At the same time, there have been reports in the press and other media that some of the companies that reported their quarterly earnings were also not very happy, saying, for example, that their share price had become more volatile or that investors had become excessively interested in the companies' short-term performance and that their share price was below its fair value.

While it is true that some share prices have been volatile since the companies concerned started to report their quarterly earnings, earnings reports and revisions of earnings forecasts have always had a major impact on share prices, so it is hardly surprising that they should react to quarterly earnings reports. Even if the volatility is greater than the company concerned expected, that only demonstrates the size of the gap between the information in the report and the information discounted by the market: it does not demonstrate any particular shortcoming in the system of quarterly reporting itself.

Generally speaking, if a company feels that its share price is undervalued in relation to its long-term earnings forecast, rather than complain it would be better advised to send the market a clear message by, for example, devoting more resources to investor relations or carrying out more share buybacks.

4. The Future of Quarterly Earnings Reporting

On 11 August the Tokyo Stock Exchange published some proposals concerning the "Action Program for Quarterly Financial Disclosure" it published in June of last year.[8] According to these proposals, the Exchange will require listed companies to publish an outline of their quarterly financial data and earnings from their first business year beginning in or after April 2004. They will be required to report four earnings items (sales, operating profit, recurring profit and net quarterly profit) and two financial items (total assets and shareholders' equity).[9] There are no specific requirements concerning certified public accountants.

However, there will be a three-year transition period to allow listed companies and their consolidated subsidiaries to make the necessary adjustments (e.g., to their computer systems). Even during this period, however, the Exchange has indicated that it will expect companies to do their best to publish an outline of their quarterly financial data and earnings, and may modify the interim measure in line with its objectives if the degree of progress warrants it. This suggests that the Exchange might shorten the transition period and bring forward the date on which the requirement comes into effect. In fact, given that listed companies have been preparing to publish an outline of their quarterly financial data and earnings in a year's time, a three-year transition period may even be too long.

8 Available [in Japanese] at http://www.tse.or.jp/news/200308/030811_b.html.
9 Companies that produce consolidated financial statements will have to report these items on a consolidated basis while other companies will be able to do so on a nonconsolidated basis. Although it is left to individual companies whether they provide segment data, cash flow statements and earnings forecasts, the disclosure of such items is clearly desirable.

In addition to these proposals, there has been a report by a committee set up by the Exchange to examine the preparation and reporting of quarterly financial data.[10] This committee has produced a draft set of guidelines on what information companies should include in their quarterly reports and how they should value their securities portfolios. These draft guidelines allow companies producing their quarterly financial reports to use a simpler approach than that laid down in the Standards for Producing Interim Financial Statements and suggest how companies should go about this. Hopefully, these guidelines will help companies to produce more detailed quarterly reports.

Although there is considerable room for improvement in the quarterly earnings reports for April-June 2003, it should not be forgotten that it was the first time for most of the companies to produce such a report. Companies' attitudes to disclosure are changing, and the amount of information being made available to investors is increasing slowly but surely. Let us hope that the earnings reports for the third quarter of fiscal 2003, which will start to appear in January 2004, will be produced more quickly and in greater detail than those for the first quarter.

[10] Available at http://www.tse.or.jp/news/200308/030811_a.html.