

## **Rating Methodology for Incorporated Educational Institutions**

JCR takes into consideration corporate forms which establish schools in determination of rating for educational institutions. Such forms are classified into private (incorporated educational institution), national (national university corporation) and municipal (municipal university corporation). JCR means these corporations collectively as “incorporated educational institutions, etc.” JCR describes below outline of rating methodology for an incorporated educational institution, which establishes a private university (hereinafter “incorporated university”), among incorporated educational institutions, etc. primarily and adds points to be noted specifically for national and municipal universities.

### **1. Evaluation of Business Base**

#### **(1) Characteristics and Management Environment of Educational Institutions**

An incorporated university has the following special characteristics: (1) Specialty and diversity of each academic discipline; (2) Difficulty in measurement of educational outcome; (3) Publicness (necessity of inefficient field); (4) Diversity of stakeholders; (5) Non-existence of owners; (6) Multitiered governance structure; and (7) Non-repetitive nature of (educational) services. Although it is necessary to fully recognize differences with a general business corporation, which performs reproduction on an enlarged scale and dividend payments, as a nonprofit organization, and places emphasis on qualitative aspects, approach for evaluation itself is not different basically from that applied to a general business corporation. An incorporated university per se, which is viewed as a pure economic entity, is a business model that can limit both business risk and financial risk to a small degree essentially, because there are no drastic changes in business environments as seen in business corporations if it can secure the fixed number of students to be enrolled stably, can allocate staff appropriately, and can accumulate funds which match with capital investments to be made in the future. On the other hand, it has difficulty in diversifying revenue sources compared with such business corporations, and is considered a management entity that has a limited chance of strategic option of manipulation of personnel expense accounting for large proportion of total expenses. Setting aside a period when an incorporated university can ensure a good number of students stably, once its cash flow cycle is impaired, there is a fear that its lack of resilience will be highlighted and its business risk will rise sharply. This is a characteristic of an incorporated university. Although situations differ from one university to another, there are structurally worsening factors in external environment such as decrease in the number of children, financial difficulties and global competition.

#### **(2) Standing and Competitive Strength in Incorporated Educational Institutions, etc.**

In evaluation of creditworthiness of each incorporated educational institution, regional

characteristics or faculty organizations have a significant impact on it. JCR will examine industrial structure and population composition in its locality and then will analyze trend of rival educational institutions and competitive situation there. Specifically, its position (corporate forms, that is, whether it is national, municipal or private school) in its locality, faculty composition, establishment of affiliated schools, composition of birthplace or academic level of the enrolled students, and production of talented persons within the local area are the things to be analyzed.

### **(3) Characteristics of an Incorporated Educational Institutions**

#### **(i) History and Foundation Spirit (Climate and Culture)**

History affects formation of basic character and school tradition of a current incorporated university to a large degree. It is meaningful that history of an incorporated university is evaluated by linking it to a decision on its current and future business base instead of following that history simply. With foundation spirit being abstract and conceptual often, JCR checks interpretation of it when the incorporated university was founded and today's interpretation, and pays attention to how this spirit can be embodied in its activities of education of students and production of talented persons.

#### **(ii) Management / Governance**

Understanding of the top management's management ability, performance and business attitude are important in terms of rating. JCR evaluates what kind of management policy an incorporated educational institution sets forth in response to changes in environment, and what kind of measures it takes in order to achieve its goal by way of hearing from its president or each school principal who is the top management. The more uncertain its external environment becomes, the more likely it is that the top management's ability is questioned. In management of incorporated educational institutions, there are many cases in which top down, especially top-imposed leadership styles as seen in corporations are not effective. Too much expansion in self-government or range of discretion of its faculty meeting might lead to the stalled discussions. In some cases, discretion of decision-making as a corporate body hardly works. The following are the points to be noted: Whether or not an incorporated educational institution looks for a common vision; How it defines role sharing between corporate body and education and whether or not it has established a framework in which coordination and constraint between both organizations can be promoted fully; and Process and staff organization to practice and verify the above.

#### **(iii) Risk Management / Organization Structure**

JCR evaluates whether or not an incorporated university has an organization structure or a personnel assignment that can respond appropriately to the management policy, relationship between corporate body and education and changes to the relationship, strength of self-government of a department, planning and drafting for cross-faculty education and research projects, establishment of

an organization to carry out such projects, operation status, etc. in relation to the foundation spirit, faculty members' morale and school tradition. JCR also checks scandals by faculty members or students and enhancement of risk management system for asset management inside school.

#### **(iv) Ensuring Human Resources and Its Management**

JCR understands characteristics of the number of staff members, age structure, average tenure, pay level, relationship with teachers' union, etc. together with comparisons with rival schools while checking recruitment policy for teaching staff and other staff and subsequent training programs for them. With respect to an organization structure or capacity for education and research activities, JCR considers it necessary to check also personnel evaluation system, relations between such evaluation system and remuneration or promotion, and present situation of organizational activities such as competency development of faculty. In the meantime, JCR pays attention quantitatively to comparison with the required number of staff members under the standard of establishment of universities, the number of students per teacher, efficiency per faculty, etc.

#### **(4) Capacity to Acquire Students**

Since stability analysis of student tuition fee, which comprises major portion of cash flows of an incorporated educational institution, occupies an important place in rating for an incorporated educational institution, JCR examines trends in applicants for admission and enrolled students for each school. In examination of these trends, it is necessary to evaluate not only factors that has effects directly on financial aspects such as changes in student retention rate, tuition level, and replenishment rate of student quotas but also factors including status of use of open campus, enhancement of admission publicity and visits to high schools, trend in applicants for admission by admission forms (general / testing center examination, AO (admission office) admission, recommendation, etc.) over the medium and long term, competitive strength of its affiliated schools and internal advancement to college.

#### **(5) Capacity for Educational Activities**

Although educational ability is a driving force for growth of an incorporated educational institution, and one of the important factors for determination for the future of an incorporated educational institution, purpose of rating lies in evaluation of credit risk and not in evaluation of education or guarantee of it. Therefore, JCR grasps whether or not an incorporated educational institution has established a framework in which it can improve its educational organization, curriculum, education method, and measurement of educational outcomes and whether or not such framework is operated while checking evaluation results from each certified evaluation and accreditation organization and also self-assessment and evaluation report underlying the evaluation. The above policy is based on JCR's knowledge that it is highly likely that stability and sustainability of the cash flows generated from

activities complete with such bases will be high. The points to be noted are the following: (i) Recent newly-established departments or courses of study or concept for reorganization; (ii) Setting of career planning or subjects that can spread its foundation spirit; (iii) Course organization in consideration of relations between the fulfilling liberal arts education and the professional education; (iv) Systematic school advisory activities; (v) Trends in the number of dropouts or the number of students who leave school before graduation and its background analysis; (vi) Trend in students who repeat a year or leave school, its attribution analysis, countermeasure, and effects from admission forms; (vii) Employment rate, career decision rate, conditions of passing qualifying examinations, and evaluations from place of employment; (viii) Establishment and operation of systematic faculty development (FD) and staff development (SD) and considerations for such activities; (ix) Applications of research themes for competitive funds and their adoptive situations; and (x) Establishment of self-assessment system and its improvement.

#### **(6) Capacity for Research Activities**

Evaluation of research content itself is not a purpose of rating, and for persons who are not in academia, even if they try to evaluate research activities, it will be extremely difficult. However, JCR pays attention to an increase in capacity for research activities, because the increase will lead to acquisition of various research funds. From this point of view, JCR evaluates applications for and achievements in adaptation of various institutional competitive funds while checking establishment of cross-faculty research system, support for an increase in acquisition of external funds, establishment, maintenance and use of teachers database. The same is true for joint research or delegated research. JCR also checks teachers' evaluation system for an increase in their motivations, reflection of such evaluation in research funds or remuneration of them, and its way of thinking for introduction of term limit system, and further checks whether or not the president or the like can allocate management resources to the promising research projects at its discretion.

#### **(7) Domestic Cooperation / International Expansion and Social Contribution Activities**

The domestic cooperation, international expansion and social contribution activities do not contribute to an increase in cash flows directly and shortly excluding acquisition of education and research funds, and rather costs for them precede benefits in many cases. However, given medium- to long-term trend of higher education administration, financial support from the central government for interchange and cooperation with domestic and international educational institutions (and the students) might increase in the future. Return of intellectual resources to local residents and contribution to promotion of local industries are considered fulfillment of social responsibility by a university, and these activities are considered activities that can get “understanding and support” from stakeholders in a long-term sustainable fashion. Although it cannot expect anything in return from such activities over the short term, JCR considers that these activities will become more important over the long term and JCR

checks its attitude.

## **(8) Concept for the Future / Management Plan / Information Disclosure**

Study on management plan based on the future management policy is extremely important in determination of rating. Information on management philosophy, policy for its medium- to long-term plan or status of practice for a short-term action plan obtained by hearing from the management is an important point in determination of rating. JCR decides validity and feasibility in a comprehensive way from various materials related to management plan of an incorporated educational institution and also from information at the interview. JCR also thinks it important for an incorporated educational institution to disclose information on its initiatives (1) through (7) above to its stakeholders effectively and appropriately, and checks its publicity system, activity performance and plan.

## **2. Evaluation of Financial Base**

### **(1) Revenue Composition and Diversification in Revenue Sources**

Although many of incorporated educational institutions rely heavily on student tuition fee for their revenues, JCR analyzes status of their recent initiatives such as raising contribution, profit-making business, investment activities, initiatives for diversified cash flow generation sources and trend in performance. In doing this, JCR makes a decision by taking into consideration acquisition status of external research funds such as grants-in-aid for scientific research that is reflected only partly in its financial statements.

### **(2) Expenditure Composition and Flexibility in Expenditure Structure**

Personnel expense accounts for the greater part of expenditures of an incorporated educational institution. As majority of education and research expenses or management costs have a characteristic of fixed expenses, their expenditure structure is rigid and the break-even point is likely to be high. While checking changes in age structure of faculty (trends in personnel expense and retirement payment), it is a key that how efficiently an incorporated educational institution allocates and uses its funds in order to maintain and improve quality of education and research. Specifically, JCR checks budgeting, management process, presence of management resource allocation system by which discretion of the president or faculty dean can work, trend in revision of pay structure, room for cost reductions by outsourcing of part of business process.

### **(3) Asset Management / Management Policy and Control System**

An incorporated educational institution, which adopts endowment fund system, accumulates assets systematically to replace its permanent property, as its basic financial activity. Therefore, its financial risk is low generally. JCR evaluate an incorporated educational institution, given its state in which its interest-bearing debt is little and investible asset is sufficient in a sense. Thus, JCR observes adequacy of

assets reserved for particular purposes, robustness of its managed assets, margin of and stability in recurring financing, assuming its long-term plan for replacement of facilities, and then decides financial soundness and endurance of an incorporated educational institution. JCR also pays attention to a presence of self-disciplined and appropriate securities management system based on a definite asset management rule as an incorporated educational institution and status of risk control over it.

#### **(4) Financial Ratio Analysis**

JCR not only traces figures or compares financial indicators of an incorporated educational institution against average figures for the incorporated educational institutions with the same size and the same form or compares with other rival schools, but JCR reads such figures in relation to qualitative factors such as trend in financial support from Ministry of Education, Culture, Sports, Science and Technology, changes in strengths of its business base and shift in management policy, and JCR uses these understanding to forecast future earnings. Concerning gross income ratio (gross revenue – gross expenditures / gross revenue), which is one of the important indicators, if this figure is constantly negative, that situation is a concern. However, if an incorporated educational institution with a low gross income ratio has a definite investment policy for its facilities and also a definite education and research policy and shows a stable trend of it within the assumed scope of the future financial management, JCR sometimes decides that such situation is not considered a problem in evaluation of credit risk.

### **3-1. Characteristics Inherent in National University Corporation**

National university corporations are centers of Japan's academic study and play an important role in embodying Japan's higher education policy directly as important bases that can contribute to the regional education development and industrial development. However, they were incorporated in 2004 all at once in a situation where there was a gap between their accumulations of material and immaterial management resources. The incorporation did not start with the gap among universities in terms of education and research resources being reset until that time. This gap might become a factor that leads to an expansion in differences in acquisition opportunities for education and research funds from public and private sectors. Framework of rating analysis for a national university corporation under these understandings is determined based on both individual circumstances as a national university corporation and trend in the credit enhancement by the central government (national university corporation system) in a comprehensive way under the perceptions of the national university corporation system and business environment. Incorporation of the government's credit enhancement into the rating for a national university corporation, however, does not mean that JCR determines across-the-board rating level for a national university corporation as an independent corporation supported by the government without taking into consideration its individual circumstances as a stand-alone national university corporation, although a certain floor (the lower limit on rating) can be laid unlike the case of a private university. JCR considers that credit risk of a national university corporation should be evaluated in the context of the

individual circumstances of the corporation itself primarily and it is appropriate that “gap” in such individual circumstances among national university corporations is reflected in rating outcomes. There is a chance that the national university corporation system may change due to financially induced factors and that gap among the corporations will expand or integration among them will be implemented. JCR considers that trend in the institutional developments in the future may have impact on credit risk of each corporation in no small way.

### **3-2. Characteristics Inherent in Municipal University Corporation**

As for framework of rating analysis for a municipal university corporation, which is a local incorporated administrative agency, JCR determines the rating with three viewpoints that are “evaluation of a university’s capacity to acquire internal revenue source” as a base, “evaluation of credit enhancement by municipality which is its establishing body” and “economic strength of the municipality itself” in a comprehensive way based on its business environment. Incorporation of the municipality’s credit enhancement into the rating for a municipal university corporation, however, does not mean that JCR determines across-the-board rating level for a municipal university corporation as being supported by the municipality without analyzing the individual circumstances as a stand-alone municipal university corporation. Namely, JCR considers that credit risk of a municipal university corporation should be evaluated in the context of the individual circumstances of the corporation itself primarily, and JCR reflects gap in the individual circumstances among the municipal university corporations in the rating outcomes. On the other hand, it is true that a municipal university corporation receives financial support from the municipality in both assets / liabilities and income / expenses aspects and human resource support from the municipality as evidenced by dispatch of staff from it as given, even with an assumption that there is no change in educational administration policy of the municipality, which is the establishing body. This point is an essential difference with an incorporated educational institution, which establishes university. JCR considers this a point that discretion of municipality can work easier.