

Rating Methodology for Incorporated Educational Institutions

JCR takes into consideration corporate forms, which establish schools in determination of rating for educational institutions. Such forms include private (incorporated educational institution) and national (national university corporation), etc. 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 university corporations.

1. Assessment 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 investment effect (education 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 between a nonprofit organization and a general business corporation, which performs reproduction on an enlarged scale and pay dividends to shareholders and to place emphasis on qualitative aspects, approach for assessment on an incorporated university itself is not different basically from that applied to a general business corporation. Both business risk and financial risk of an incorporated university are essentially low, because it is difficult to assume that a drastic change can happen to business environment surrounding an incorporated university, if it can secure the fixed number of students to be enrolled stably, can allocate staff appropriately, and can accumulate funds, which match with future investments. On the other hand, it has difficulty in diversifying revenue sources compared with business corporations, and its cost structure is rigid. The business risk may increase rapidly when it can no longer secure students stably in number. There are also structurally worsening factors in the 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 assessment of creditworthiness of each incorporated university, 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 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 things to be analyzed.

(3) Characteristics of an Incorporated University

(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 seen as a clue for forecasting future business developments instead of following that history simply. Since foundation spirit is 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 management's management ability, performance and business attitude are important in terms of rating. JCR assesses management policy in response to changes in environment, and measures it takes in order to achieve its goals by way of hearing from its president or each school principal. In management of an incorporated university, there are many cases where top down leadership style as seen in corporations is not effective. Too much expansion in self-government or range of discretion of its faculty meeting might lead to disappearance of discretion of the corporate body. JCR focuses its attention on whether or not an incorporated university has found a common vision between the corporate and faculty bodies, defined role sharing between them and established a framework, in which coordination and constraint can work fully between them. JCR also checks process and staff organization to practice and verify the above.

(iii) Risk Management / Organization Structure

JCR assesses 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 faculty and changes to the relationship, strength of self-government of a department, planning and drafting for cross-faculty education and research projects, formulation and operation conditions of an organization to carry out such projects, 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 Their 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. JCR considers it is 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 of the number of staff members with the required number of staff members under the standard of establishment of universities, the number of students per teacher, efficiency per a faculty member, etc.

(4) Capacity to Acquire Students

Analysis of stability in student income, which comprises major portion of revenue of an incorporated university, is important. JCR places emphasis on trends in applicants for admission and enrolled students for each school. In examination of these trends, JCR assesses not only factors that have 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.) in the medium run, competitive strength of its affiliated schools and internal advancement to college.

(5) Capacity for Educational Activities

Education ability is a driving force for growth of an incorporated university, and is one of the important factors for determination for future of an incorporated university. JCR checks whether or not an incorporated university has established and operates a framework, in which it can improve its educational organization, curriculum, education method and measurement of educational outcomes, based on evaluation results from each certified evaluation and accreditation organization and also self-assessment/evaluation report underlying the evaluation. JCR thinks that it is highly likely that an incorporated university can ensure cash flows with high stability and sustainability when having a developed management/operational base for educational activities. The points to be noted are the following: (i) Concepts for recent creation of new departments/courses of study or reorganization/realignment; (ii) Setting of career planning or subjects that can spread its foundation spirit; (iii) Course organization in consideration of relations between fulfilling liberal arts education and professional education; (iv) Systematic school advisory activities; (v) Trends in the number of dropouts 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) Formation 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) Formation of self-assessment system and its improvement.

(6) Capacity for Research Activities

JCR thinks that an increase in capacity for research activities will lead to acquisition of various research funds. JCR assesses applications for and achievements in adaptation of various competitive funds, while checking formation of cross-faculty research system, support for an increase in acquisition of external funds, formation, maintenance and use of teachers database. The same is applied 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 for them, and introduction of term limit system, and further checks whether or not the president or the like can allocate management resources to a promising research project 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 revenue, excluding acquisition of education and research funds, and rather costs for them precede benefits in many cases. Facing rapidly advancing globalization in society and industry, however, universities are required to contribute to increasing Japan's global competitiveness. At the same time, approaches towards globalization are essential factors for acquisition of excellent students for universities. Financial support from the central government for interchange and cooperation with domestic as well as international educational institutions (and the students) might increase in the future. Return of intellectual resources to local residents and contribution to developing local industries are considered a fulfillment of social responsibility by a university, and these activities are considered activities that can get "understanding and support" from stakeholders. JCR therefore checks these activities from a long-term perspective.

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

Analyses of concept for the future and management plan are extremely important in terms of rating. JCR assesses validity and feasibility in a comprehensive way, based on various materials related to management plan, information on management philosophy, policy for its medium- to long-term plan and status of practice for a short-term action plan obtained by hearing from the management. JCR thinks it is necessary for an incorporated university 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. Assessment of Financial Base

(1) Revenue Composition and Diversification in Revenue Sources

Since many incorporated universities rely heavily on student income for their revenues, JCR assesses status and actual results of their initiatives such as appeal for donations, for-profit business,

investment activities, etc. from a perspective of diversification of cash flow generation sources. 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 large part of expenditures of an incorporated university. As majority of education and research expenses or management expenses have a characteristic of fixed expenses, their expenditure structure is rigid and the break-even point is likely to be high. While checking trends in personnel expense and retirement payment, JCR thinks it is a key that how efficiently an incorporated university 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 where 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 university accumulates assets systematically to renew its endowment assets as its basic financial activity. Therefore, its financial risk is low generally. JCR assesses its financial soundness and tolerance by analyzing adequacy of designated assets, firmness of its investment assets, margin of and stability in recurring financing, etc. based on its long-term plan for renewal of facilities. JCR also pays attention to whether an incorporated university has formulated an appropriate securities investment management system and risk management system.

(4) Financial Ratio Analysis

JCR not only traces figures or compares financial indicators of an incorporated university with rival universities, but JCR reads such figures in relation to qualitative factors such as trend in financial support from the government, changes in its business base and shift in management policy to forecast future earnings. Key important financial indicators include recurring revenue/expenditure balance to recurring revenue ratio and revenue/expenditure balance to revenue ratio before transfer to capital funds of current fiscal year. Even if these indicators are low or negative figures, JCR sometimes assesses that such situation is not considered a problem, if these indicators are within a scope of JCR's assumptions in line with a definite investment policy for its facilities and/or education and research policy.

New accounting standards for incorporated educational institutions are to be applied beginning in FY 2015. JCR will assess the financial indicators by correcting them in an appropriate manner in order to keep continuity of the old and new accounting standards.

Key financial indicators:

- Recurring revenue/expenditure balance to recurring revenue ratio

- Revenue/expenditure balance to revenue ratio before transfer to capital funds of current fiscal year
- Recurring revenue/expenditure balance to recurring revenue ratio before depreciation
- Personnel expense to student income ratio
- Interest-bearing debt divided by recurring revenue/expenditure balance before depreciation
- Net assets ratio ((total capital funds + revenue/expenditure balance to be carried forward to next year)/total assets)
- The number of applicants for enrollment
- The number of applicants to the number of students to be admitted
- Replenishment rate of student quotas

3. Characteristics Inherent in National University Corporation

National university corporations are centers of Japan's academic research 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, there are gaps in a build-up of material and immaterial management resources among them. These gaps might become a factor that leads to an expansion in differences in opportunities among national university corporations to acquire education and research funds in the future. Being aware of these facts and possibilities, JCR assesses a rating for a national university corporation in a comprehensive way from perspectives of both individual circumstances facing a national university corporation and trend in credit support by the government (national university corporation system). Unlike an incorporated educational institution that establishes a private university, a certain floor can be set for ratings of national university corporations, because JCR takes into consideration credit support from the government. At the same time, however, gaps among them in the individual circumstances are reflected in ratings for them. JCR thinks that when distribution method of the management expenses grants by the government changes in the future and if gap among national university corporations widens, or if those corporations become integrated into other corporations, such consequences will have a considerable impact.

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