

MIDDLE MARKET BANKING GROUP

The Middle Market Banking Group is responsible for the Bank's business with Japan's vast army of small and medium-sized corporations. The Group operates from a network of 14 Middle Market Banking Divisions and 121 Middle Market Banking Departments, as of March 31, 2000.

Results in Fiscal 1999

Demand for corporate loans remained sluggish during 1999 due to the difficult economic conditions prevailing during the period. In addition, there was continuing pricing pressure on loans, partly due to the fact that city banks were obligated, under prevailing accords with the government to increase lending to this sector. Nevertheless, while meeting its commitments under the government restructuring plans, the Group also made headway in pricing loans at more rational levels. Loan margins improved by an average of 16 bp over fiscal 1998, primarily reflecting a higher level of service, which itself is attributable to the Group's concentration on corporate business following the restructuring. In addition, fee income also increased as the Bank promoted its solutions business. Gross profits consequently rose by 16.2 billion yen to 213.6 billion yen, while expenses fell by 4.5 billion yen to 87.9 billion yen. Profits after expenses surged to 125.7 billion yen, up 20.7 billion yen over the previous year.

The Group's Business Strategy

The core of this Group's business strategy is as follows:

To build a dedicated network of specialists providing a high level of service to small and medium-sized corporations in Japan.

To promote rational pricing throughout its loan portfolio with loan rates being set at levels consistent with the level of risk incurred.

To supplement the traditional lending business with a range of value-added services with an eye to promoting a stable stream of fee income.

Traditionally, Japanese banking staff have been responsible for the provision of services to all entities physically located in their particular local area. Since this could, and often did, involve servicing all sizes of corporations as well as consumers, the ability of such staff to respond to individual needs was limited. A major objective underlying the formation of the Middle Market Banking Group has been to rectify this situation and promote a richer variety of products and services directed specifically to the needs of financially sound small and medium-sized enterprises. The Bank believes that its ability to achieve its other goals for this segment of the market can only be achieved through specialization and focus. The new approach has been met with a warm reception as evidenced by the Group's improved profitability during fiscal 1999.

Provision of loans is, and will remain, the principal activity of this Group. As of March 31, 2000, the Group maintained a loan book of approximately 12 trillion yen. Central to its long-term health is the ability to earn adequate risk-adjusted returns on these loan assets. To this end, the Bank has made major improvements to its ability to price loans at appropriate levels and to manage loan portfolios as described in the section on risk management earlier in this report. It remains the case, however, that oversupply continues to depress pricing. The Bank will continue to support its repricing efforts by exploiting its ability to provide superior services.

In this context, the provision of new value-added services is key to achievement of future earnings growth in this Group.

One such innovation is the introduction of a range of services drawing on the capital markets skills of the Bank. Thus, the Group has assigned full-time specialists in derivatives, foreign exchange transactions, international services and electronic banking to its 14 Middle Market Banking Divisions. It has also placed specialists in fields including M&A, MBO, securitization, syndication and IPO advisory as well as asset management services into head office's Specialized Finance Department. The Bank is, therefore, well positioned to offer the widest possible range of financial services to its corporate customers drawing both on its traditional commercial bank strengths as well as the investment banking skills deriving from its Capital Markets Group and Daiwa SBCM.

A notable example of the value-added "solution business" being promoted by the Bank is a patented electronic banking product named "PERFECT." This service provides a means of simplifying and streamlining customers' remittance receipt confirmation procedures by applying the revolutionary concept of "virtual branches," of which it now has 8, and "virtual accounts." The Bank started offering this service in August 1998, and presently has more than 900 corporate customers, utilizing 80 million virtual accounts to receive incoming remittances. Of these 900 customers, only roughly 35% maintain a main bank relationship with the Bank. PERFECT improves customers' operational efficiency, while at the same time yielding increased fee income as customers' remittances are concentrated in the Bank.

Sumitomo Bank was granted a patent for this business model in February 2000 by the Japanese Patent Office, thereby providing it with a competitive edge vis-a-vis other banks seeking to offer similar services.

The Bank also sees opportunities to add value by leveraging its advanced technological capability. For example, the Bank has established "Value Net" to provide comprehensive support to small and medium-sized corporations in response to the explosive growth in Internet business. Specific functions include not only settlement operations but also remote one-to-one communication with customers, access to SMC Net, the provision of information and consulting services, and "i-sourcing," which allows customers to quickly and easily select companies for outsourcing projects via the Internet.

Finally, the Bank is committed to adding value to its service line by exploiting the synergies and the strength of affiliated companies wherever possible. Affiliates with key roles in this respect include SB Investment Co., Ltd., which provides venture capital to growth companies, SB Leasing Co., Ltd., which conducts leasing operations and is the second largest company in the industry, Sumigin General Finance Company Limited, which handles factoring and mortgages, and The JRI Business Consulting Limited, which provides corporate management information and consulting services.