



# CONFRONTING STRONG HEADWINDS

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## **In a Calm Sea, Everyone Is a Pilot.**

**J**apan's financial sector, our mother market, faces a challenging environment with accelerating population decline and aging, a domestic economy that continues to suffer from years of anemic growth, a negative interest rate environment, and the COVID-19 pandemic. Furthermore, we are witnessing the increasing presence of new competitors in the financial sector and the increased unbundling and re-bundling of financial and non-financial services and products. Given this trend, while the need for financial functions such as deposits, loans, and settlements may remain, there is no guarantee that customers will select traditional players such as SMBC Group to provide them with those functions.

## MESSAGE FROM THE GROUP CEO

However, by no means does this challenging business environment cause me to feel any pessimism. Rather, I have every confidence that SMBC Group will continue to grow as a global financial institution in a sustainable manner.

What we must not forget is that regardless of the business environment, there will also be opportunities for growth. In recent years, we saw a rapid acceleration in the pace of technological innovation and changing customer needs, for example the shift to cashless payments in the BtoC sector and the global move toward electronic vehicles in the automobile sector followed by advancements toward the commercialization of self-driving vehicles. At the base of such changes lie irreversible megatrends with some examples being enhanced convenience due to the digital shift and increased expectations of society toward ESG. This being the case, I expect these trends to accelerate even further going forward. In such an operating environment, traditional industry status and sales networks will not always function as an advantage. In fact, they could hinder innovation due to concerns regarding legacy and sunk costs. However, I believe it is possible to realize sustainable growth in a market such as Japan where growth in the size of the overall pie is not expected if we can create alternative demand and other new needs while also building the necessary platforms to address those needs.

Furthermore, advances in technology have provided humanity with new ways of facing and fighting threats. For example, in terms of COVID-19, scientists from around the world worked to identify the underlying virus and released the results of the genome sequence analysis online in January 2020, a time when the virus was still limited to parts of China. Effective vaccines were not only developed less than one year from this

breakthrough, the large-scale production of those vaccines was realized. Furthermore, we were able to resume business activities at a level similar to that before the global health crisis through the use of web conferencing and other digital tools as we combated the spread of the virus by curbing our activities while we waited for the rollout of vaccines. Humanity was essentially powerless in its efforts to combat past pandemics such as the Spanish Flu and SARS. Past efforts were limited to quarantining infected individuals and placing restrictions on the movement of people, after which there was no real effective means that could be implemented other than to wait for the pandemic to run its course. As you can see humanity has made great progress in its ability to combat pandemics and other threats. The COVID-19 pandemic continues to have a tremendous impact on the lives of people all over the world, and I sincerely wish nothing more than to see this pandemic brought to an end at the earliest possible date, but I am also encouraged to see humanity pooling its wisdom and using innovation to minimize economic disruption while controlling the spread of the virus.

“In a calm sea, everyone is a pilot.” This is the English equivalent of the saying “*Shippu ni Keiso wo Shiru*” from the *Book of the Later Han* in China which illustrates that people and organizations that remain like a *Keiso* (wind resistant blade of grass) stand out in the face of *Shippu* (strong headwinds). SMBC Group is facing a number of headwinds, and our true strength as a financial institution is being challenged. Having said this, I have no doubt that we will overcome these headwinds and realize sustainable growth through tireless innovation and by finding new opportunities for growth. I will share the reasons for my confidence in a later part of my message.

## Commencing Our Journey in a Storm

**W**e kicked-off our current Medium-Term Management Plan last spring during Japan's first state of emergency. At that time, we were not able to predict with any level of certainty how serious the impact of this unknown pandemic would be. As such, we had to launch the Medium-Term Management Plan in a volatile and highly uncertain business environment with all SMBC Group employees having to display ingenuity on a daily basis to carry-out their responsibilities.

First, as part of the financial infrastructure on which retail and wholesale customers rely to support their daily business and nonbusiness needs, we placed the highest priority on providing undisrupted financial services. For example, SMBC continued operating all of its branches and ATMs while implementing extensive safety precautions. Furthermore, the bank also enhanced online services to allow customers to perform transactions without having to visit a branch. SMBC Group also strived to fulfill its social responsibilities as a global financial institution by committing at its peak a total of ¥10 trillion to support domestic and overseas customers to overcome the impact of the COVID-19 pandemic.

In terms of business results, although I considered our progress in the first half of FY2020 as insufficient due to a slowdown in business activities and in the execution of our various initiatives, in the second half of the year we were able to accelerate initiatives targeting

our seven key strategies by leveraging online tools and enhancing marketing-related efforts in terms of both quality and quantity. While our consumer finance, aircraft leasing, and Asia business suffered from a slowdown in the global economy and decreased consumption due to the COVID-19 pandemic, we managed to generate consolidated net business profit which was close to the FY2019 figure thanks to the strong performance of our wealth management and overseas securities businesses. In addition, our final credit cost was lower than initially anticipated due to government support and liquidity support from banks, and our bottom line, while not at a level that reflects our true capabilities, exceeded initial expectations by a substantial amount.

Although the COVID-19 pandemic continues to reap havoc around the world, vaccinations are steadily progressing, and customers and SMBC Group are using digital technology to adapt our corporate activities to the current business environment. We also now possess a much clearer picture of the impact the global health crisis is having on our financial results. While we will continue to see volatility in the business environment, I believe immediate uncertainties have cleared. Now, not only can we clearly see the path we must follow in the short-term, we can also see an end to the disruptions caused by the COVID-19 pandemic.

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## MESSAGE FROM THE GROUP CEO

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### **No Change to the Path We Must Follow**

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**T**he path we must follow is none other than the path laid out in the current Medium-Term Management Plan that was established as the first step toward the realization of our Vision: “A trusted global solution provider committed to the growth of our customers and the advancement of society.” The COVID-19 pandemic was an unexpected factor that was not reflected in the original planning of the Medium-Term Management Plan, but certain trends we witnessed during FY2020 such as the acceleration of cashless payments, increased momentum of ESG, and the deepening of geopolitical risks are trends that we had identified prior to the COVID-19 pandemic. What the global health crisis changed is the momentum and the applicable timelines of those trends. As such, there is no need to change the overall direction of the Medium-Term Management Plan, and we will continue to proceed with its execution with the utmost confidence.

Of course, we will finetune our strategies in a flexible and precise manner based on the issues and strategies requiring acceleration which became clearer due to our experiences during the COVID-19 pandemic.

For example, if we look at our overseas securities business, we can see that although SMBC Nikko Securities' gross profit for FY2020 was the highest since it joined SMBC Group, our competitors with more extensive and established overseas securities business operations were able to generate much larger profits. The reason is that financial markets

boomed before we could strengthen our overseas securities business framework to the extent targeted in the Medium-Term Management Plan. For cashless payments, the base of user clients and participating stores expanded due to the growing popularity of online shopping and touchless payment. We will further accelerate the strategies we established in the Medium-Term Management Plan targeting such business areas as we expect them to continue growing in the medium- to long-term.

On the other hand, our consumer finance, aircraft leasing, and Asia business were forced to operate under a challenging environment in FY2020. However, there is no change to those businesses' medium- to long-term growth potential, and they retain their competitive and strategic importance in our overall business strategy. In FY2021 we will turn to the offensive and proactively expand our activities in those markets in light of the expected normalization of domestic consumption and the global economy.

While we expect for FY2022, the final year of the Medium-Term Management Plan, to be impacted to a certain degree by the COVID-19 pandemic I am confident that we can overcome the negative impact by accelerating the above strategies and focusing very closely on opportunities to reduce costs. We will continue our efforts to realize sustainable growth and there is no change to our goal of generating bottom-line profit of more than ¥700 billion in the final year of the Medium-Term Management Plan.

## One Step Ahead of Customers' Needs

I have repeatedly stressed the need to adhere to three key themes if we are to realize sustainable growth. These themes are the result of repeated deliberations aimed at identifying the role SMBC Group can play, the strengths we can leverage, and whether we can form partnerships with players from outside the financial sector to address issues in a future when the needs of customers and society will undergo a substantial change from the present day.

The first theme is data oriented.

Information and data are very valuable assets that are not represented on a company's balance sheet, and businesses around the world, not only those in the financial sector, are striving to monetize these assets.

The second theme is to build platforms.

In Japan, we provide services to 43 million individual customers and SMBC extends loans to 80 thousand companies. By leveraging this robust customer base, SMBC Group can become a platformer that uses its financial capabilities as foundations to provide a variety of services.

The third theme is to become a solutions provider.

We can add value which truly enhances our customers business only if we look beyond immediate services such as loans and payments. We must identify the reasons for customers engaging in those services and provide comprehensive, top-tier solutions by proactively collaborating with companies from outside the financial sector if required.

These three themes are not independent of each other, rather, they are closely intertwined. While all the initiatives established under the Medium-Term Management Plan reflect these themes, I will take this opportunity to share with you three examples.

### Advertising Business

A tremendous amount of payment and credit data is accumulated in our banking, securities, and consumer finance businesses. In other words, you could say that we are one large platform with finance at its base. We are currently contemplating a number of new businesses which will allow us to leverage this data, and in July 2021 we established SMBC Digital Marketing, Ltd., a company that operates an advertising and marketing services business utilizing financial big data. We will strive to create new value by developing a business that uses our platform to analyze customers' needs and then transmit information and advertisements that are believed to reflect those needs. Of course, any concerns regarding the protection of personal data and the implementation of necessary security protocols will be addressed first.

### Elder Business

The SMBC Elder Program is a business we launched as a result of thinking outside the traditional boundaries of the finance sector in response to the ongoing diversification of customers' needs in Japan's super-aging society. The concerns of senior citizens are not limited to securing sufficient funds to cover living expenses following their retirement. Their concerns encompass a diverse range of matters such as inheritance, health and nursing care, housework, security, and their relationship with family members. In order to offer a one-stop solution to such issues, we will develop a financial service focused platform that also provides services that SMBC Group does not offer, such as housekeeping and security, by proactively collaborating with players from outside the financial sector.

MESSAGE FROM THE GROUP CEO



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**Expanding Our Franchise in Asia**

Under our Multi-franchise strategy, we are devising and implementing initiatives based upon a time span of ten or twenty years in order to build a second and third SMBC Group in Asia's developing economies. We made three commitments when formulating our Multi-franchise strategy, which are: "We will become a full-line financial services provider in the target market," "The franchise will have a strong home-market focus with its foundations firmly embedded in the local economy," and "We will not retreat even when faced with changes in the business environment." As such, even after COVID-19 spread throughout Asia, we made no change to the Multi-franchise strategy as we continued to search for seeds that had the potential to blossom into future platforms.

Such efforts allowed us to secure the opportunity to acquire a 49% stake in FE Credit, a leading Vietnamese consumer finance company. FE Credit has a robust retail business network and a highly competitive business model, allowing us to obtain a 50% market share of Vietnam's fast growing consumer market sector. FE Credit has also maintained a high level of profitability with an ROE of more than 20% and is expected to continue experiencing robust growth in its assets and profits. Furthermore, we

entered into a capital partnership with Rizal Commercial Banking Corporation, a mid-tier commercial bank in the Philippines, while also obtaining a substantial retail finance platform in India, which is expected to become the most populous country in the world in the near future, through our acquisition of Fullerton India, a top tier nonbank that possesses a retail and SME business network throughout the country, as part of efforts to establish SMBC Group franchises in each of those countries.

Our businesses in these countries have traditionally involved the approaching of large local and Japanese firms through SMBC branches. The above deals allow SMBC Group to expand into the mid-tier corporate, SME, and fast-growing retail sectors, and combined with our earlier acquisition of BTPN in Indonesia move us one step closer to achieving our goal of establishing full-banking capabilities in Asia's developing economies.

We will continue to pursue high quality inorganic opportunities in a disciplined manner as part of efforts to realize sustainable growth while also enhancing shareholder returns, a topic I will address later.

See page **051** for details.

*Initiatives in Growth Fields in Asia and Other Markets*

## Passing On a Green Earth to Future Generations

**T**here is a 460 meter “The Trails of the Earth” at Furano Field which represents the earth’s 4.6-billion-year history. Furano Field is led by the screenwriter Mr. Soh Kuramoto, and SMBC Group has extended our support since its establishment. How long do you think Homo sapiens’ 200 thousand year history is in the “The Trails of the Earth”?

A mere two centimeters. When we read history books it feels that the birth of humanity took place a very, very long time ago, but the reality is, from the earth’s perspective, the history of the human race is about the same length as your fingertip. The 200 years following the Industrial Revolution, a period which saw the start of global warming, is a mere 0.02 millimeters. “The Trails of the Earth” continues into the future and at its end lies a stone monument with the words: “We are merely borrowing the earth from future generations.” I believe that Furano Field is trying to convey a very important message through “The Trails of the Earth.” There is no special technique or method to realize sustainability. Rather, there is an obvious solution, we must create a society in which the current generation can achieve happiness and enjoy the benefits of economic growth while also ensuring that we pass on the earth to future generations in a green, vibrant state. We must also accept that humanity, in return for enjoying the benefits of advancements in civilization, rapidly advanced global warming in a time frame that is only 0.02 millimeters of the earth’s total history.

In order to pass on a green earth to future generations, SMBC Group established a long-term road map to enhance our climate change-related efforts. First, SMBC Group will achieve net zero greenhouse gas emissions by 2030. We will also execute ¥30 trillion of sustainable finance by 2030 to support customers’ climate change-related initiatives and their transition to a green business model. Furthermore, we will commence efforts to identify the greenhouse gas emissions of our loan and investment portfolio while engaging in discussions with customers regarding the decarbonization of their business models as the first step to realizing a carbon-neutral supply chain by 2050. However, the expectations of society continue to grow even as we engage in such efforts, and I believe that climate change has the potential to become a game changer not only for the financial sector but for a wide range of business sectors. We will further enhance our efforts while continuing to update our decarbonization-related procedures and action plans in a flexible manner.

In order to successfully enhance our climate change-related initiatives, I would like to stress that we must also turn our attention to the short-term and conduct calm and objective analyses of the current status of business sectors and customers, after

See page **084** for details.

*Initiatives to Realize Sustainability*



MESSAGE FROM THE GROUP CEO

which we would determine the best possible course of action that can be executed in the immediate future. The consistent execution of such actions must be balanced with the pursuit of long-term goals. Given our global relationships with customers from a variety of business sectors, and our role as a supplier of finance, the lifeblood of the modern economy, we must take great care in how we address the issue of climate change. If we abruptly turn to and proceed down the wrong path, not only

could we disrupt the steady supply of energy, we may also impede customers' efforts to develop technologies that could support the decarbonization of their business models and society. Together with our customers, we will strive to realize the decarbonization of society while engaging in careful discussions with all stakeholders, paying close attention to the impact our efforts will have on businesses and to trends in energy transition and innovation.



Discussion with Mr. Soh Kuramoto, the founder of Furano Field

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## **A Work Environment Where Employees Can Realize Their Dreams**

**A** financial group's most important resource is its people, and the workplace is an important stage where employees can grow and pursue their aspirations. An important responsibility of a CEO is to prepare a stage that is large enough for employees to truly challenge themselves and to write a script that allows them to demonstrate their unique potential, so that all employees can put on their best performance.

In recent years, we have seen a material change in employees' mindsets, especially in our younger employees, with a growing number of employees placing greater importance on how their company contributes to society. All our employees possess various ideas and have the backbone to pursue new challenges. Ever since assuming leadership of SMBC Group, I have urged employees to "Break the Mold," and I have supported employees attempting to pursue new challenges without being bound by precedent or fixed ideas. I have assigned management resources to employees who have stepped forward and established new companies for them to lead, even in cases when the employee was of a junior or mid-level rank. So far, 10 companies have been established through my "Producing CEO" initiative. The purpose of this initiative is to raise employees' motivation by instilling a "I can succeed if I try" mentality, and I look forward to seeing the new companies grow to a stage where they can contribute to SMBC Group's profitability or to the enhancement of customer services.

I will accelerate the following two initiatives so that this flow of innovation will become even stronger, diverse, and sustained.

The first is Midoriba, our internal SNS which we launched last year. More than 20 thousand employees at SMBC have joined the service with 6 thousand of those employees being active users who regularly post a variety of ideas and information. Promising business ideas receive helpful advice and constructive comments regardless of age or departments. Online communities in which employees support their colleagues in pursuing challenges are naturally developing. A number of new business ideas have already been identified as having the potential for commercialization. We plan on introducing Midoriba to other SMBC Group companies in the future.

The second is diversity and inclusion. Innovation that opens the door to the future is the result of employees with a diverse range of characteristics such as gender, age, and nationality coming together to combine their uniqueness and varied views while freely collaborating with players from outside their business sector. SMBC Group is comprised of companies that possess distinct characteristics, and its businesses are run by more than 100 thousand employees coming from diverse backgrounds spread across 40 countries and areas. We must not relax our efforts to further accelerate our diversity-related initiatives given that customers' needs and businesses are becoming increasingly diverse and global. We will strive to realize true diversity and inclusion through the diversification of our senior management team, the empowerment of female employees, and by supporting the balancing of professional responsibilities with life events.

MESSAGE FROM THE GROUP CEO

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## **Maximizing Shareholder Value from Both Financial and Non-Financial Perspectives**

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**T**he COVID-19 pandemic has not changed our policy of focusing on the enhancement of SMBC Group's corporate value on an ongoing basis and distributing profits to our shareholders. A progressive dividend policy remains our principal approach to shareholder returns, and our goal is to realize a dividend payout ratio of 40% during the course of the Medium-Term Management Plan. In FY2020 we maintained our dividend payment at ¥190 although we saw a substantial decrease in our bottom line. As a result, our dividend payout ratio rose to 51% but by no means do we view this as having reached our goal. Our goal is to realize a dividend payout ratio of 40% while achieving our target profit attributable to owners of parent of over ¥700 billion. As a first step toward realizing this goal we increased our dividend forecast for FY2021 to ¥200.

We will also pursue opportunities to execute share buybacks as part of our efforts to enhance shareholder returns. We decided not to announce share buybacks when we released our financial results of FY2020 in May given the re-extension of Japan's state of emergency and other uncertainties in the business environment resulting from the COVID-19 pandemic. However, we will pursue

opportunities for share buybacks in FY2021 while continuing to pay careful attention to the ongoing impact of the COVID-19 pandemic and movements in overseas markets given our discounted share price and the fact that we expect to be able to maintain our capital levels at sufficient levels even after factoring in investments in inorganic growth opportunities.

Furthermore, in order to increase SMBC Group's corporate value over the medium- to long-term, in addition to improving ROE and other quantitative financial metrics, it is vital that we also enhance the non-financial value of SMBC Group such as data, personnel, and ESG which are not reflected on our balance sheet. We will enhance our human capital, intellectual capital, and social capital by accelerating sustainability-related initiatives and the creation of a work environment that allows employees to pursue their hopes and dreams. We will maximize the disclosure of both financial and non-financial information and engage with all of our shareholders in an appropriate manner to minimize information asymmetry and decrease the cost of shareholder's equity so that we may realize the sustained growth of SMBC Group's corporate value.

## No Such Thing as Coincidence

“**H**ave the heavens granted me this mission by coincidence? No, this is surely not the case.” This is an approximate English translation of an excerpt from literature compiled during the Song dynasty in China and illustrates the importance of carrying out one’s duties, regardless of the circumstances. Roughly 40 years have passed since I joined the banking sector, and I have experienced firsthand many challenges such as the collapse of Japan’s bubble economy, Japan’s big bang financial reforms, the Lehman Crisis, and the current COVID-19 pandemic. However, I never forgot the importance of carrying out my responsibilities regardless of changes in the environment or the challenges I had to face.

The same can be said of companies. Bill Gates’s quote, “Banking is necessary, banks are not” addresses the fundamental issue of whether “banks” as a business format are essential to society or whether finance as a “function” is essential. I view this as having its roots in the same concept as the pessimistic theory which argues that modern society does not require banks. However, since the answer

is clearly the latter choice, we must continue to be the provider of essential functions without being bound by our past track record or the fact that we are a bank. In order to accomplish the mission we have been granted by the heavens, we must identify growth opportunities and tirelessly innovate so that we can contribute to customers and society through our financial functions.

Going forward, our world will change at an even faster rate, and our future will hold both numerous opportunities and challenges. SMBC Group will strive to realize further growth by driving our roots even deeper and wider as we press onward. I would like to ask for the continued support and understanding of all our stakeholders as I will stand at the forefront of our efforts to overcome the strong headwinds, and SMBC Group will put forth a united effort to overcome the challenging environment.

***I will stand at the forefront of our efforts to overcome the strong headwinds, and SMBC Group will put forth a united effort to overcome the challenging environment.***

