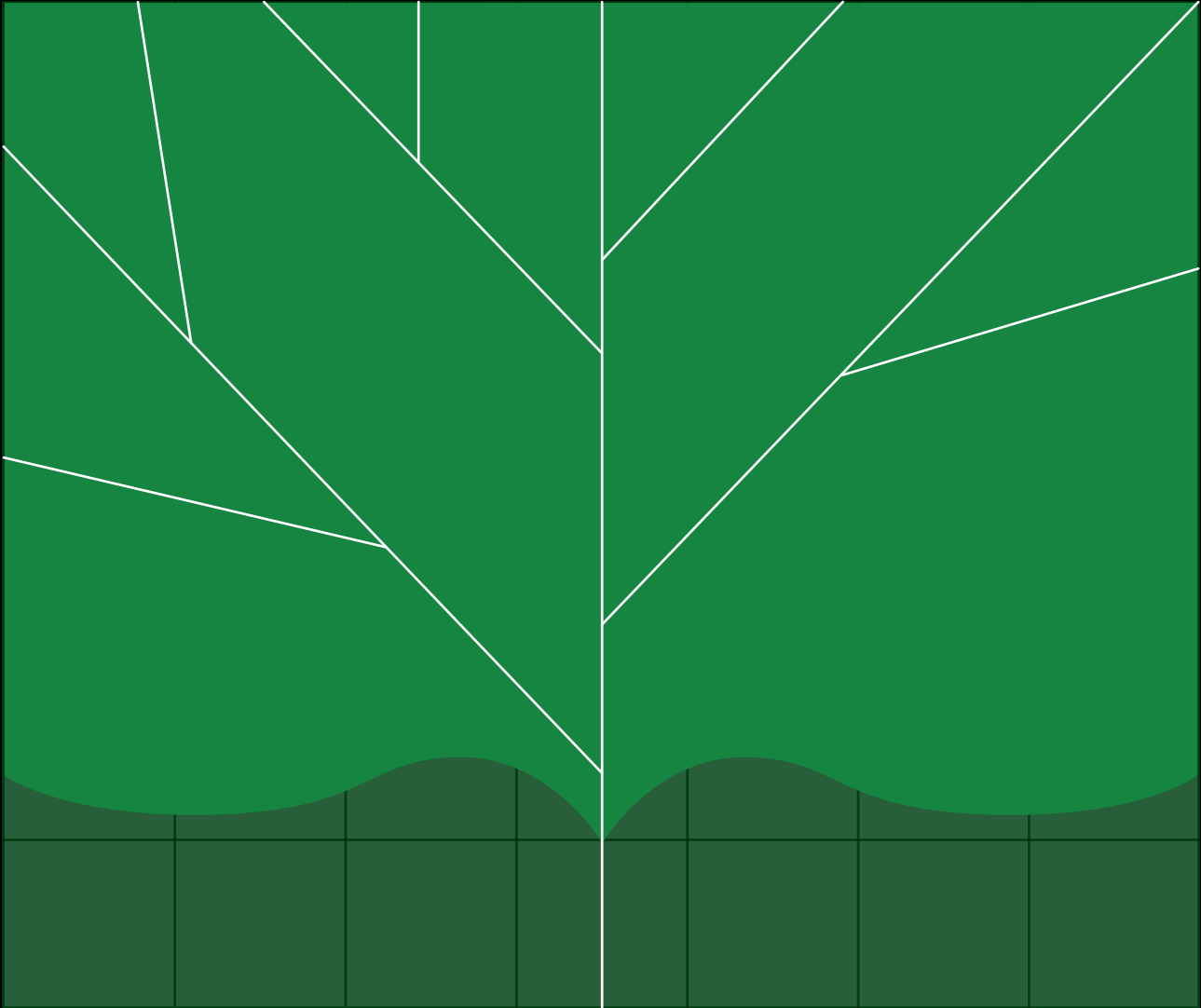


WHAT'S NEXT FOR JAPANESE MEGABANKS?



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Why read this paper?

The Japanese banking industry is among the largest in the world, but equity investors do not value Japanese megabanks like global leaders in the industry. The valuation gap to global peers is 70% today. We believe this valuation gap will remain stubbornly wide unless the megabanks take action to address investor concerns.

The old news is that the organizational and operational complexity of the domestic megabank model is a major concern for investors — this will take time to address and may never be fully resolved. What is new in our study is that investors see more immediate opportunities for the megabanks to close the valuation gap. Japanese banks have a generational opportunity to build a wealth management franchise that generates returns now common in other markets, delivering ~150% in price-to-book improvement. Investors also see significant untapped value in a pan-Asian banking platform that can capture local growth opportunities and extract synergies from regional operations, potentially delivering ~115% in price-to-book improvement. Each opportunity presents a path to break through the critical 1x price-to-book threshold the Tokyo Stock Exchange demands.

This is a critical moment for Japanese banks. All eyes are turning toward Japan and Japanese banks will need to move quickly to capture the opportunity that everyone sees.

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EXECUTIVE SUMMARY

Japanese megabanks are enjoying a rare moment in the sun. Economic tailwinds have boosted returns and replenished capital buffers, giving these institutions more room to maneuver and the opportunity to pursue substantive strategic moves.

However, investor skepticism of the “megabank miracle” remains. Despite a strong rally over the past 18 months, shares still trade at a significant discount to North American peers and do not meet targets set by the Tokyo Stock Exchange (TSE) for all listed companies to maintain >1x price to book ratio (P/B).^{1,2}

Global investors will need to see more evidence of structural change to re-rate share prices. Japanese megabanks can learn from the experience of their peers in North America and Europe, which have optimized their capital, and structured business models and clear investor narratives around activities that command higher valuation multiples. The specific path(s) the megabanks follow will be different, but the playbook should be the same. Japanese megabanks will be expected to take action in the following three areas.

Reduce complexity and inefficiencies in the operating model: Japanese megabanks have fragmented governance and sprawling legal entity structures that global investors struggle to analyze. For years, the megabanks have been exploring potential governance and structural simplification. To some extent, these structures are features of Japan’s legal, regulatory, and business environment. However, the current economic tailwinds provide an opportunity to convince investors that the megabanks can overcome this complexity to deliver stronger returns over an extended time horizon. Investors will focus on outcomes (e.g., profitability and returns), but a clear narrative on how the operating model is evolving to reduce complexity, control risks, and improve efficiency will show the way.

Build credible strategies in activities that investors reward: Investors tend to reward stable, profitable businesses supported by sustained economic tailwinds (e.g., wealth management, transaction banking). The domestic wealth and asset management opportunity in Japan fits the profile, but the business model will need to evolve to capture its full potential. The recent transformation of the US wealth management industry offers a playbook for Japanese megabanks that we believe can deliver ~150%³ price-to-book improvement.

1 Yuasa, K. (2023, January 26). Tokyo Stock Exchange plans ultimatum: Shape up by 2026 or delist. [Nikkei Asia](#).

2 Most recent published financials used for Japanese banks (JFY 2023).

3 Calculated using the megabank average for JFY 2023 (April 2022 - March 2023) and estimated maximum improvements based on Oliver Wyman analysis.

Leverage domestic scale on the global stage: Japanese megabanks are better positioned to take share and generate attractive returns outside Japan, driven in part by the strength of their domestic franchises (e.g., sticky customer deposits, flexible capital position). However, building a successful economic model will demand more focused strategies with greater integration of international operating models and infrastructure. We believe that successful execution can potentially deliver ~115%⁴ in price-to-book improvements. Replicating the complexity of the domestic banking model in Japan will erode the fleeting advantage that megabanks have abroad.

Failure to capitalize on this moment may keep the megabanks locked in a valuation trap. On the current path, analyst consensus today is for Japanese megabanks to continue trading at a significant discount to their North American peers and remain below the 1x P/B target set by the TSE.

The greater risk is competition from international competitors, at home and abroad. The Japanese domestic market (and many of the international markets where Japanese megabanks have built market share in recent years) are increasingly attractive to international competitors. Time is of the essence for Japanese megabanks, as the window of opportunity to break out of the valuation trap may soon close.

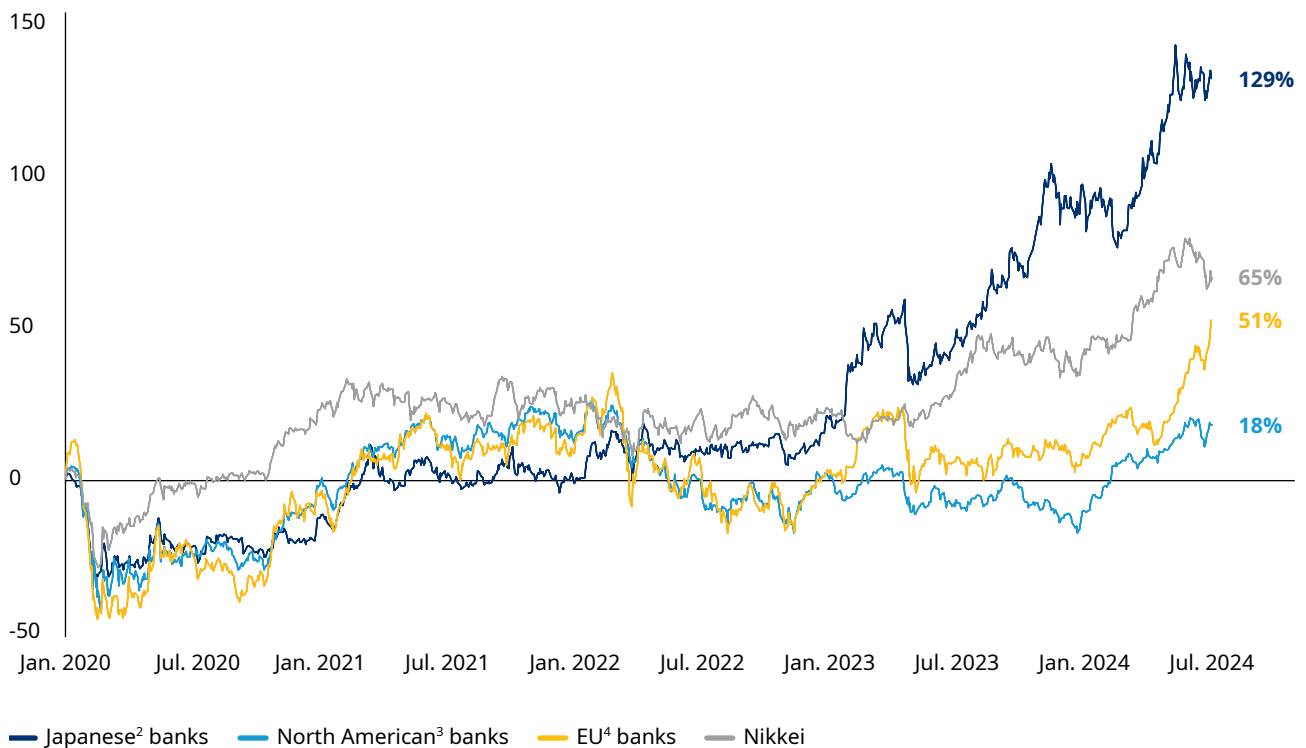
⁴ Calculated using the megabank average for JFY 2023 (April 2022 - March 2023) and estimated maximum improvements based on Oliver Wyman analysis.

A MOMENT OF OPPORTUNITY

Japanese banks have become a focal point of global investor attention after decades in the shadows. The triumvirate of Sumitomo Mitsui Financial Group (SMFG), Mitsubishi UFJ Financial Group (MUFG), and Mizuho Financial Group (MHFG) posted encouraging earnings in 2023. And investor sentiment on the market has improved, as recent policy rate hikes by the US Federal Reserve and other central banks have propelled share prices to outperform not only the Nikkei but also North American and European peers. Total shareholder return (TSR) has followed a similar trend: Japanese banks increased TSR by 151% versus European (68%) and North American (30%) banks over the same period.

Exhibit 1: Investor sentiment and bank stock prices¹ post-COVID

% change since Feb. 2020

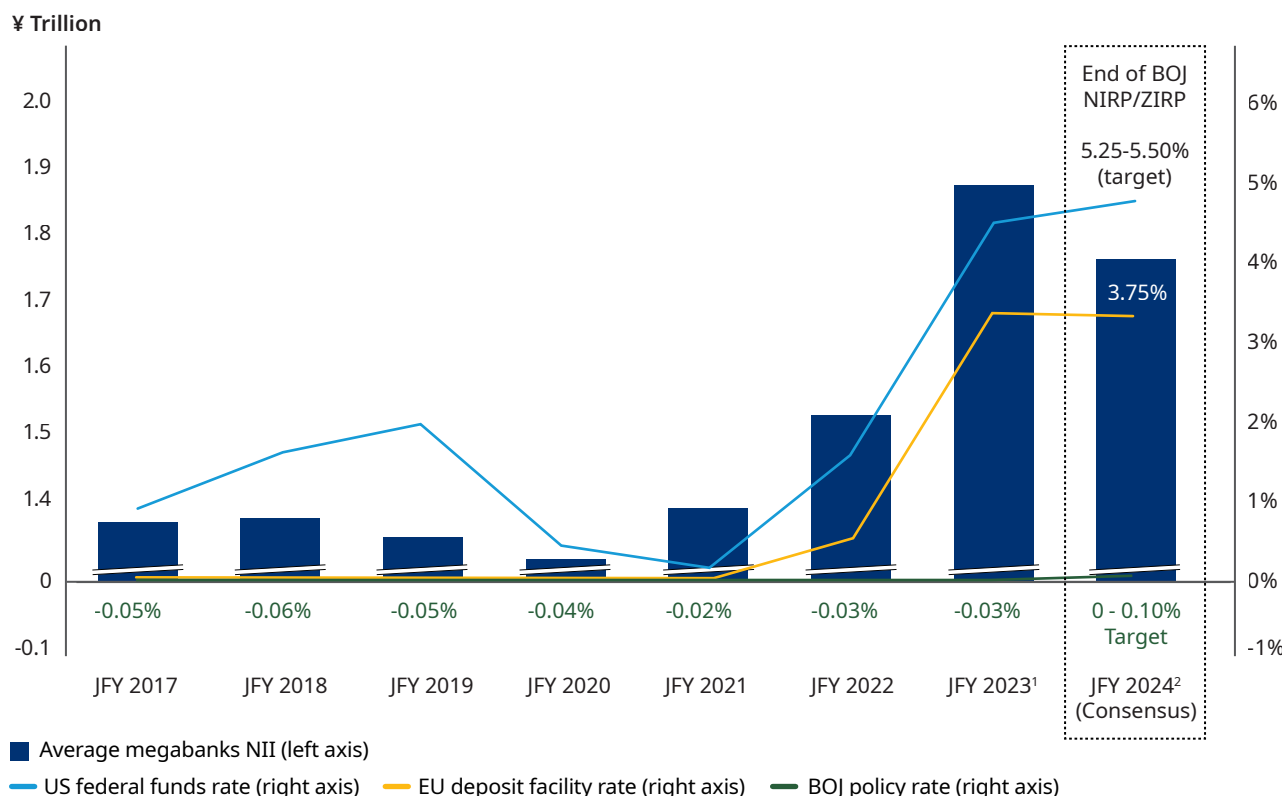


1. Calculated using stock prices denominated in local currencies and by averaging change since February 2020 for select banks.
 2. Mitsubishi UFJ Financial Group (MUFG), Sumitomo Mitsui Financial Group (SMFG), Mizuho Financial Group (MHFG).
 3. JP Morgan Chase (JPM), Bank of America (BAC), Citigroup (C), Royal Bank of Canada (RBC).
 4. Santander (SAN), BNP Paribas (BNP), Deutsche Bank (DB), Barclays (BARC).

Source: LSEG Datastream

The optimism in Japanese banking is largely a result of shifting macro conditions. The big driver of recent performance has been rising interest rates overseas, allowing for ~30% growth in average net interest income (NII) across the megabanks since Japanese fiscal year (JFY) 2019. These institutions all enjoy a funding cost advantage in their domestic operations, which they have deployed aggressively in international markets to capture wide margins and boost earnings. Meanwhile, macro conditions in the domestic market have shifted in ways that will support improving economics at home. The Bank of Japan (BOJ) announced in March that it would reverse course from its long-standing negative/zero interest rate policy (NIRP/ZIRP), and the bull market has boosted capital markets activity in Japan. All of this has provided Japanese banks with greater flexibility to pursue their strategic priorities.

Exhibit 2: Japanese megabanks NII versus major policy rates



1. Japanese fiscal year spans April to March (example, April 2022 - March 2023 is JFY 2023).
 2. Policy rates for 2024 show the midpoint of the latest target range for US and Japan and the latest ECB policy rate (3.75% as of 12 June 2024).
 Source: Visible Alpha (consensus estimates as of June 2024), LSEG Datastream, and central bank websites

A MOMENT OF CHALLENGE

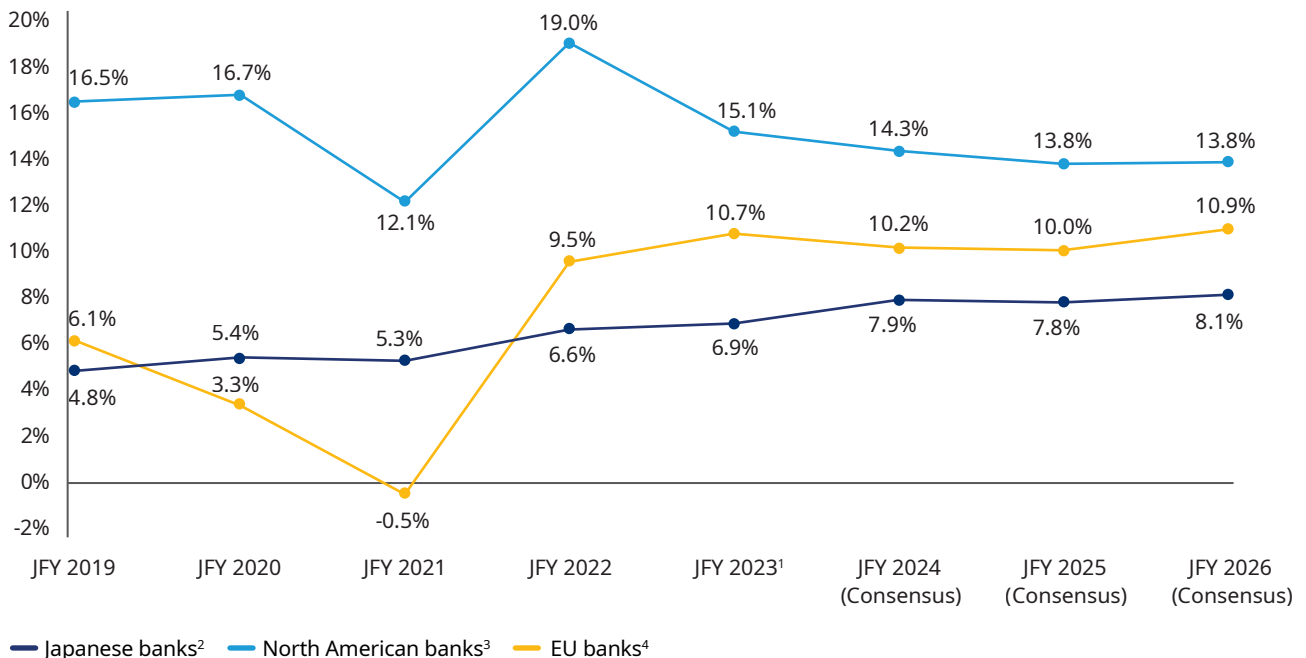
So, have Japanese banks truly turned the corner or is this simply a moment in the sun?

Investors will be keen to see if Japanese megabanks can sustain the recent momentum and address both historic and new challenges. Skepticism on their returns lingers from the past decade, affecting valuations, while the interest rate environment presents new challenges.

RETURNS CONCERNS

Despite the recent stock rally, investors have been asking how megabanks plan to improve returns sustainably over future cycles. On a return on tangible common shareholder equity (ROTCE) basis, Japanese megabanks have lagged North American and European peers, struggling to take advantage of their scale to generate attractive returns for shareholders. These gaps are projected to narrow over the next three years, but not materially enough to change the story.

Exhibit 3: Return on tangible common shareholder equity (ROTCE)



1. JFY 2023 refers to April 2022–March 2023 for Japanese banks, November 2021–October 2022 for RBC, and January 2022–December 2022 for et al.
 2. Mitsubishi UFJ Financial Group (MUFG), Sumitomo Mitsui Financial Group (SMFG), Mizuho Financial Group (MHFG).
 3. JP Morgan Chase (JPM), Bank of America (BAC), Citigroup (C), Royal Bank of Canada (RBC).
 4. Santander (SAN), BNP Paribas (BNP), Deutsche Bank (DB), Barclays (BARC).
 Source: Visible Alpha (consensus estimates as of June 2024)

Low returns have impacted megabanks' valuations, which remain below those of US peers. While expected to trend up over the next few years, megabanks are expected to remain well below 10% ROTCE and at least 250 bps behind European peers and 500 bps behind North American peers.⁵ Investors forecast improvement in JFY 2026 with a range of 0.7–1.1x price to tangible book value (P/TBV) but only expect one of the three megabanks (MUFG) to surpass the 1x P/TBV threshold. See Exhibit 4.

A tempting lever to increase shareholder returns is through dividends and share buybacks, but megabanks' payout ratios are already in line with peers. While further increases may boost share prices in the short term, they fail to address investor concerns about sustained profitability. See Exhibit 5.

In addition to investors, the TSE recently announced a directive calling on listed companies with a P/B ratio⁶ of less than 1x to articulate plans to improve their valuations or risk being demoted or even delisted. Though the actual likelihood of a megabank delisting is low, the directive serves as a stark reminder that banks are not yet out of the woods. To enforce this initiative, the TSE has begun a monthly publication of firms adequately disclosing capital efficiency plans, thereby indirectly drawing public attention to those that have not yet done so.⁷

The call for higher P/B ratios was the latest in a line of actions the TSE has taken to raise standards for listed companies. In 2021, the TSE announced a revision to its Corporate Governance Code (CGC) that asked companies to increase independence, diversity, and sustainability measures, or explain their non-compliance.

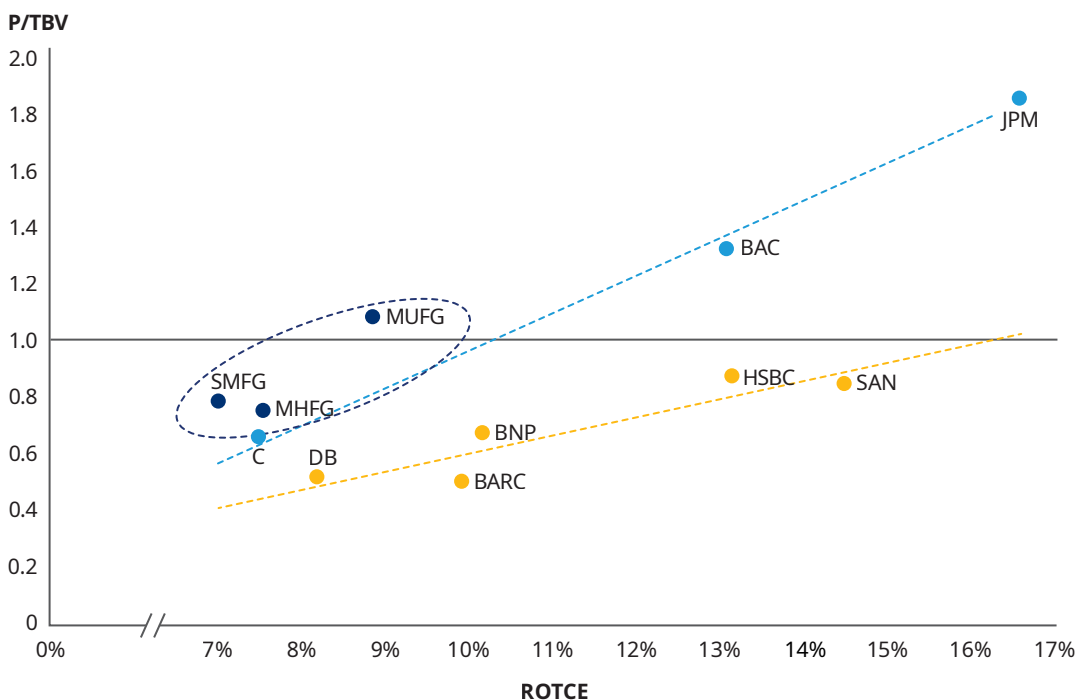
5 A three-factor DuPont analysis of Japanese megabanks reveals that lower ROEs are primarily driven by a costly asset base. Megabanks are also more highly levered than their American and European peers with an asset/equity ratio of ~approximately 25x.

6 The TSE called for 1x P/B, but this paper will generally examine P/TBV especially in relation to ROTCE.

7 Bridge, A. (2024, January 15). Explainer: What is the Tokyo Exchange's new list of firms disclosing capital efficiency plans? [Reuters](#).

Exhibit 4: ROTCE and P/TBV

	JFY 2023 ¹ & FY 2023 ²		JFY 2026 ³ & FY 2025 ⁴		2023-2025 Trend
	ROTCE	P/TBV	ROTCE	P/TBV	
Mitsubishi UFJ Financial Group (MUFG)	7.08	0.64	9.12	1.08	↗
Sumitomo Mitsui Financial Group (SMFG)	7.01	0.61	7.35	0.80	↗
Mizuho Financial Group (MHFG)	6.52	0.55	7.85	0.75	↗
JP Morgan Chase (JPM)	20.76	1.98	16.66	1.86	↘
Bank of America (BAC)	13.46	1.38	13.23	1.33	↘
Citigroup (C)	4.90	0.60	7.83	0.65	↗
Santander (SAN)	15.17	0.79	14.60	0.85	↘
BNP Paribas (BNP)	8.99	0.71	10.44	0.67	↘
Deutsche Bank (DB)	7.44	0.44	8.51	0.51	↗
Barclays (BARC)	9.00	0.47	10.18	0.50	↗
Hong Kong and Shanghai Banking Corporation (HSBC)	15.66	0.99	13.30	0.87	↘

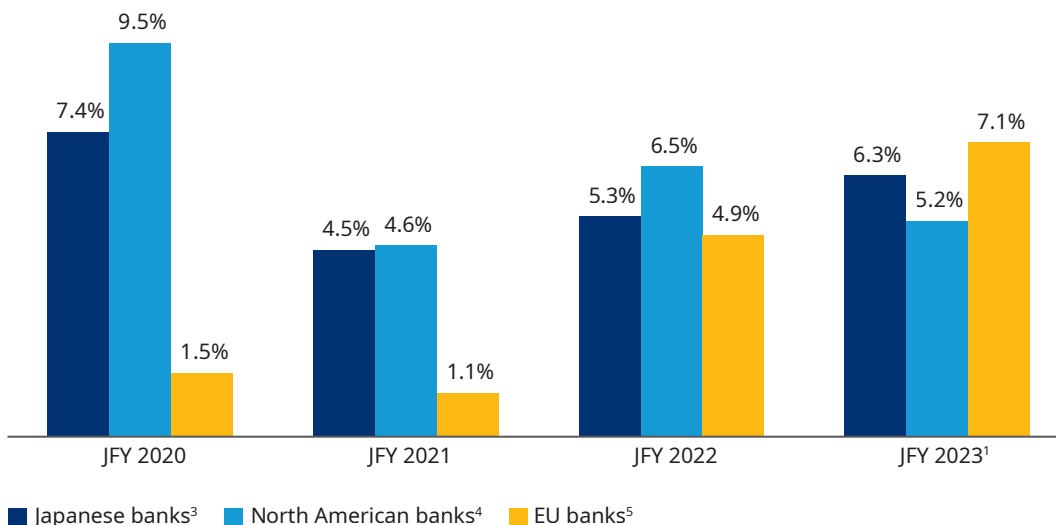


● Japanese banks⁵ (JFY 2026³) ● North American banks⁶ (FY 2025⁴) ● EU banks⁷ (FY 2025⁴)

1. JFY 2023 spans April 2022–March 2023.
2. FY 2023 spans January 2023 - December 2023.
3. JFY 2026 (consensus) spans April 2025–March 2026.
4. FY 2025 (consensus) spans January 2025–December 2025.
5. Mitsubishi UFJ Financial Group (MUFG), Sumitomo Mitsui Financial Group (SMFG), Mizuho Financial Group (MHFG).
6. JP Morgan Chase (JPM), Bank of America (BAC), Citigroup (C).
7. Santander (SAN), BNP Paribas (BNP), Deutsche Bank (DB), Barclays (BARC), Hong Kong and Shanghai Banking Corporation (HSBC).

Source: Visible Alpha (consensus estimates as of June 2024)

Exhibit 5: Redistributions to shareholders²



1. JFY 2023 refers to April 2022–March 2023 for Japanese banks, November 2021–October 2022 for RBC, and January 2022–December 2022 for et al.
 2. Including common dividends and buybacks (calculated using dividends per share, change in shares outstanding, and FY end stock price in local currencies).
 3. Mitsubishi UFJ Financial Group (MUFG), Sumitomo Mitsui Financial Group (SMFG), Mizuho Financial Group (MHFG).
 4. JP Morgan Chase (JPM), Bank of America (BAC), Citigroup (C), Royal Bank of Canada (RBC).
 5. Santander (SAN), BNP Paribas (BNP), Deutsche Bank (DB), Barclays (BARC).
 Source: LSEG Datastream, Visible Alpha, and Oliver Wyman analysis

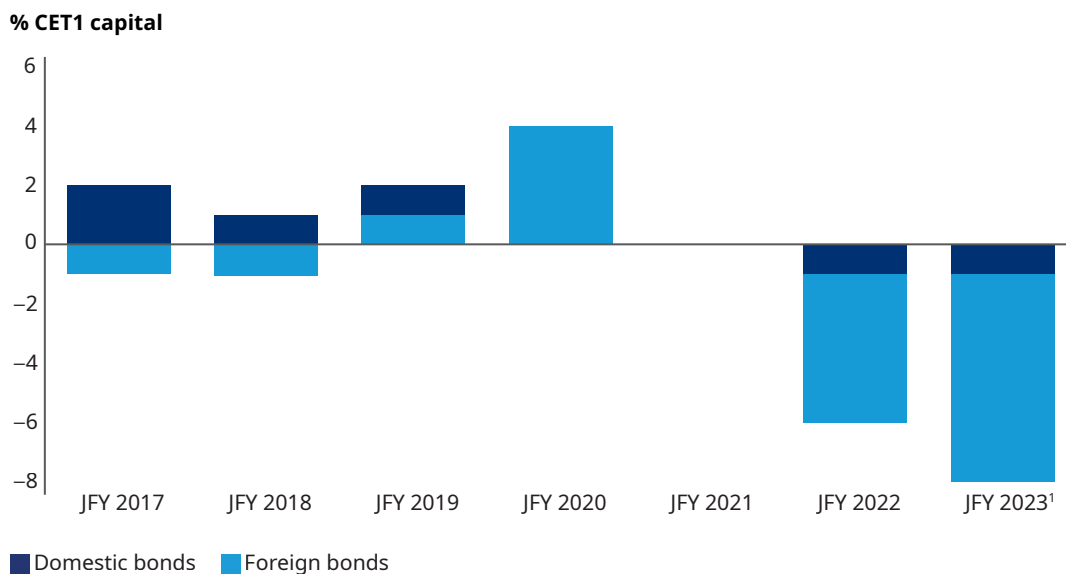
INTEREST RATE MANAGEMENT CONCERNS

For Japanese banking executives, this is the first time in a generation that they need to manage a dynamic interest rate environment both domestically and abroad. While rate changes have yielded key benefits (e.g., international NII expansion), the associated risks need to be closely managed, given the sensitivity of the balance sheet and loan book to rate movements. International banks have already been pushed to “relearn” interest rate risk management after decades of relatively low and stable rates, and Japanese megabanks will need to follow suit in adopting best practices to stabilize NII and protect their capital base.

One implication of rising rates on Japanese megabanks’ balance sheets is the accumulation of unrealized losses. As of JFY 2023 (calendar year April 2022–March 2023), unrealized losses on foreign bonds amounted to ~7.4% of common equity tier 1 (CET1) capital. Between 2022 and 2023, unrealized losses on domestic bonds increased by 0.25% to total 0.8% of CET1 capital. These losses will continue to accumulate if international rates remain high and domestic rates rise.

Unrealized losses can have significant consequences, which have already been felt by Norinchukin — unrealized losses in additional other comprehensive income (AOCI)⁸ surpassed US \$11 billion (JP ¥1.79 trillion), which triggered a decision to raise US \$7.7 billion (JP ¥1.2 trillion) to offset a 29% decline in CET1 capital.⁹

Exhibit 6: Japanese megabanks' unrealized gains/losses^{2,3}



1. Japanese fiscal year spans April to March (example, April 2022–March 2023 is JFY 2023).

2. Calculated using unrealized gains/losses on domestic and foreign bonds; not representative of total reported unrealized gains/losses.

3. Calculated using the aggregate value of the megabanks.

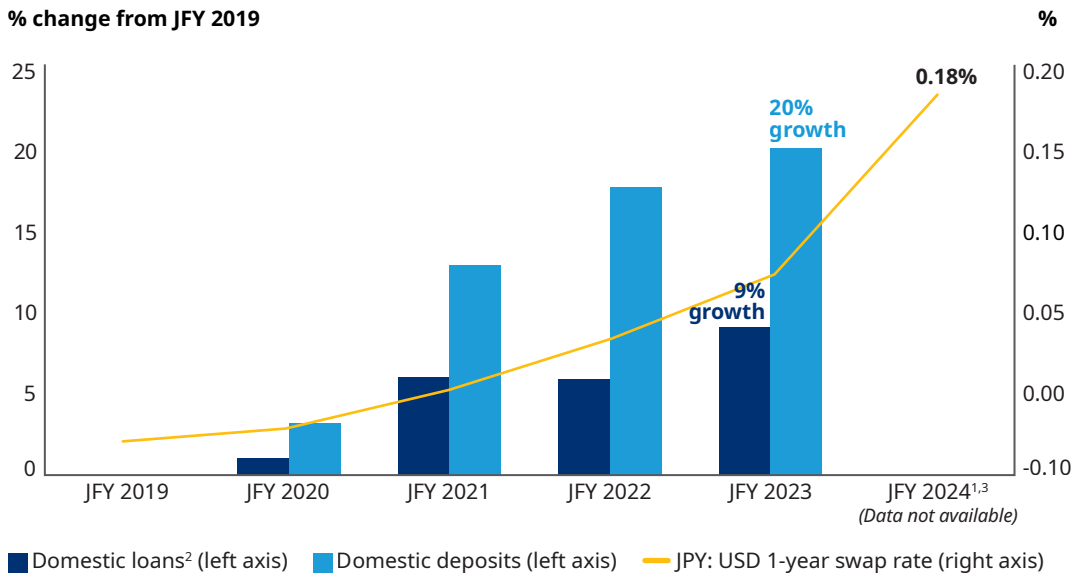
Source: Data books for MHFG, SMFG, and MUFG; Financial Results — Supplementary Information reports for SMFG (JGAAP)

Increases in the JPY/USD swap rate have also begun to carve into the realizable NII of Japanese megabanks. Since JFY 2019, yen-denominated deposits are up 20% while domestic loan activity has only expanded by 9%. This surplus of cheap deposits provides a funding advantage, but low domestic loan growth has focused attention on lending opportunities outside of Japan. A scenario in which domestic Japanese rates remain suppressed while rates abroad rise could lead to pricier swaps, making it difficult to fund these businesses and remain competitive abroad.

⁸ AOCI is largely comprised of a bank's income/losses from securities.

⁹ Walker, J. (2024, May 30). Norinchukin's paper losses double to record high. [Risk.net](https://www.risk.net).

Exhibit 7: Domestic loans and deposits (average of three megabanks)



1. Japanese fiscal year spans April to March (example, April 2023–March 2024 is JFY 2024). JFY 2024 is not available for Japan.

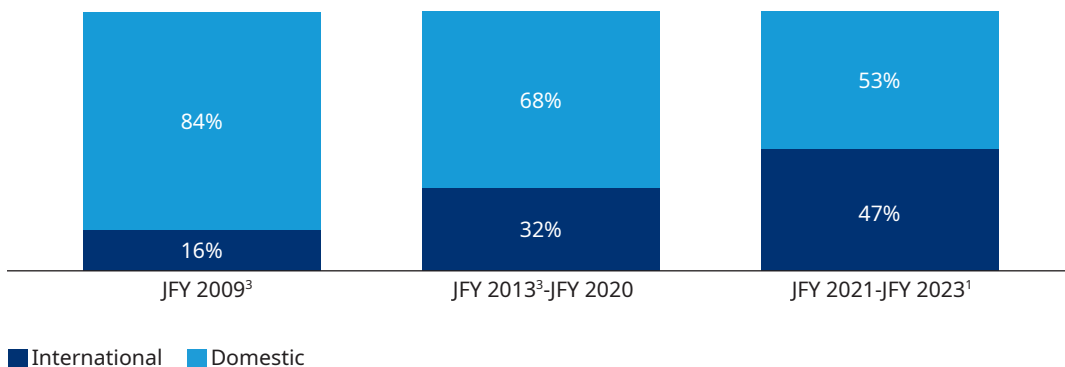
2. Domestic loans for MUFG includes commercial domestic, residential, card, and other line items.

3. Swap rates at the end of the period are displayed.

Source: 20-F reports for MHFG, SMFG, and MUFG

Japanese banks are also susceptible to declines in international interest rates. Since 2009, the proportion of NII earned by Japanese banks from their international business has increased by more than 30 percentage points. In a scenario where US/EU rates decline more rapidly than domestic rates rise, banks are at risk of a squeeze on earnings.

Exhibit 8: Share of net interest income (NII)²



1. Japanese fiscal year spans April to March (example, April 2022–March 2023 is JFY 2023).

2. Shares calculated using the average of NII across all three Japanese megabanks. Data is drawn from non-consolidated reporting, so may not equal NII numbers found in consolidated reporting from MHFG, SMFG, and MUFG.

3. MHFG data is not available before 2013, so for years before 2013 data shares the aggregate of NII across SMFG and MUFG.

Source: Data books for MHFG, SMFG, and MUFG

SEIZING THE MOMENT

Investor perceptions are driven by many factors, but perspectives from current and former equity analysts suggests there are a few broad actions megabanks can take to better articulate a compelling equity story: (1) addressing organizational and operational inefficiencies, (2) growing stable and well-valued businesses such as wealth management franchises, and (3) delivering a differentiated international strategy and operating model. These strategies in tandem will allow banks to navigate the external landscape while also answering the question of how they seek to sustainably grow.

Strategy 1

ADDRESS ORGANIZATIONAL AND OPERATIONAL INEFFICIENCIES

Making foundational improvements to address organizational and operational deficiencies is key to convincing investors of megabanks' ability to close the returns gap with global peers. Across all three megabanks, there are universally applicable enhancements that would help move the dial for investors.

Active resource management

As financial resources have become more expensive under new global and domestic capital regulations, international banks have built frameworks to measure and manage resource deployment across businesses, geographies, and clients. This has been a persistent challenge for Japanese banks, complicated by siloed organizational structures and financial data across these banks. Adopting a more consistent measure of capital (and return on capital) would allow for more efficient deployment of resources to high-return activities and more transparent communication with investors on the strategy the megabanks are pursuing to boost returns.

Governance

Fragmentation between the trust, securities, and banking businesses (and across legal entities) has generally limited Japanese banks' ability to operate as efficiently as their global peers in international markets, and to some extent domestically. Taking steps to integrate and modernize governance structures will help unlock value, limit trapped resources, and signal better coordinated decision-making to investors.

Support model

Technology and platform enhancements are critical to supporting future growth ambitions. These programs take several years to deliver successfully, and megabanks have tended to focus on quick fixes as incentivized by short executive tenures. Technology is especially important for Japanese banks to continuously monitor risks and potential opportunities. Integrating and re-platforming technology could position megabanks to achieve full benefits.

Coverage and employment model

Human resources is a critical component to drive product cross-selling while also building brand recognition and unity. Peer practices have shown that operating as “one team” can improve client visibility into the full product suite and promote revenue cooperation through cost efficiency.

These areas are foundational to improving the perception of Japanese banks in investors’ eyes, and improvements will serve as building blocks to execute on more substantive strategic initiatives. A decisive shift in operating practices is necessary to break out of the valuation trap, and the window to act has finally opened. Failure to capitalize may result in continued mediocre assessments of megabanks reminiscent of the past two decades.

Strategy 2

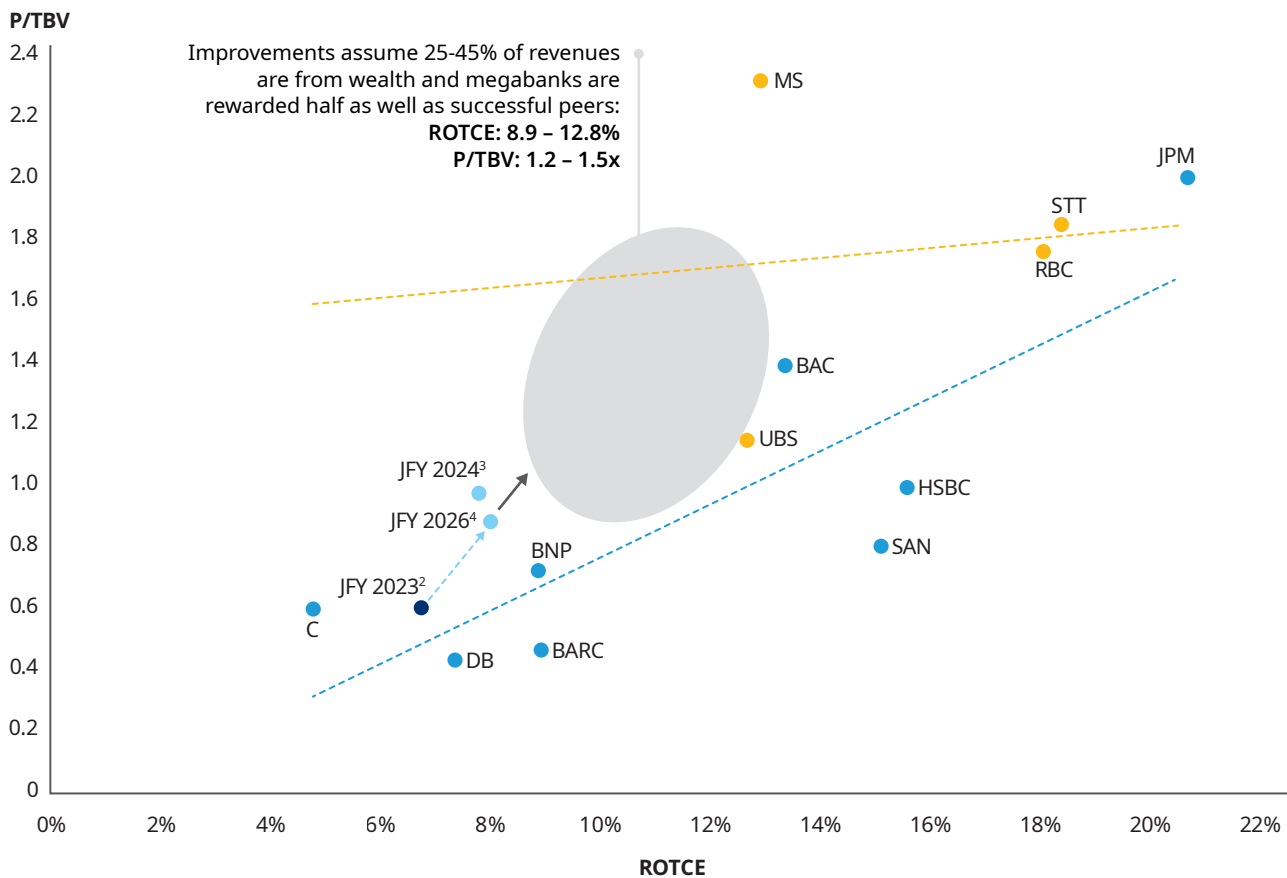
DEVELOP CLIENT-ORIENTED WEALTH BUSINESS

Investors tend to value firms that excel in a few select business lines as opposed to acting as a “jack-of-all-trades”, and investors have a particularly positive outlook on firms with a clear wealth and asset management focus given their predictable and stable earnings profile (see Exhibit 9). Wealth franchises have been historically difficult to build in Japan, prompting megabanks and large financial groups to pursue partnerships with market leaders to expand their services (e.g., MUFG with Morgan Stanley and SuMi Trust with UBS). Thus far, these partnerships have had a targeted audience in mind, articulated by UBS SuMi as “high net worth and ultra-high net worth clients.”¹⁰ However, as the deflationary environment winds down and supportive policy plans are implemented, building an organic wealth model catered toward a broader base of clients is more viable than ever.

If Japanese megabanks enhance their wealth management franchises, they could earn a valuation boost. Achieving even the partial success of peers, we estimate Japanese megabanks could see ROTCE climb to the 9–13% range, and command P/TBV ratios of 1.2–1.5x.

¹⁰ UBS Media Releases. (2021, August 10). display-page. [Global](#).

Exhibit 9: Closing the wealth gap



- Japanese banks⁵ (JFY 2023)²
- Global universal banks⁷ (FY 2023)¹
- Megabank average consensus⁵
- Wealth management⁶ (FY 2023)¹

1. FY 2023 spans January 2023–December 2023 except RBC where FY 2023 spans November 2022–October 2023 and UBS spans January 2022–December 2022.

2. JFY 2023 spans April 2022–March 2023.

3. JFY 2024 (consensus) spans April 2023–March 2024.

4. JFY 2026 (consensus) spans April 2025–March 2026.

5. Mitsubishi UFJ Financial Group (MUFG), Sumitomo Mitsui Financial Group (SMFG), Mizuho Financial Group (MHFG).

6. Morgan Stanley (MS), State Street (STT), Royal Bank of Canada (RBC), and Union Bank of Switzerland (UBS).

7. JP Morgan Chase (JPM), Bank of America (BAC), Citigroup (C), Santander (SAN), BNP Paribas (BNP), Deutsche Bank (DB), Barclays (BARC), Hong Kong and Shanghai Banking Corporation (HSBC).

Source: Visible Alpha (consensus estimates as of June 2024) and Oliver Wyman analysis

Previous efforts to grow wealth have not been enough to move the needle on investor valuations. Rather than what is being offered, *how* Japanese megabanks are pursuing wealth management may be holding back valuations, and there are lessons to be learned from successful peers.

Megabanks to date have focused primarily on developing and marketing sleek wealth management products. Successful market peers, on the other hand, have developed a rigorous foundational understanding of their client segments, and oriented their business model and structure around how they can best serve prospective customers. This is especially pertinent when attempting to capture sophisticated clients with different needs from traditional retail customers.

For example, wealth clients tend to value accessibility to a “one-stop shop” capable of offering the full suite of wealth management products through a single point of contact.

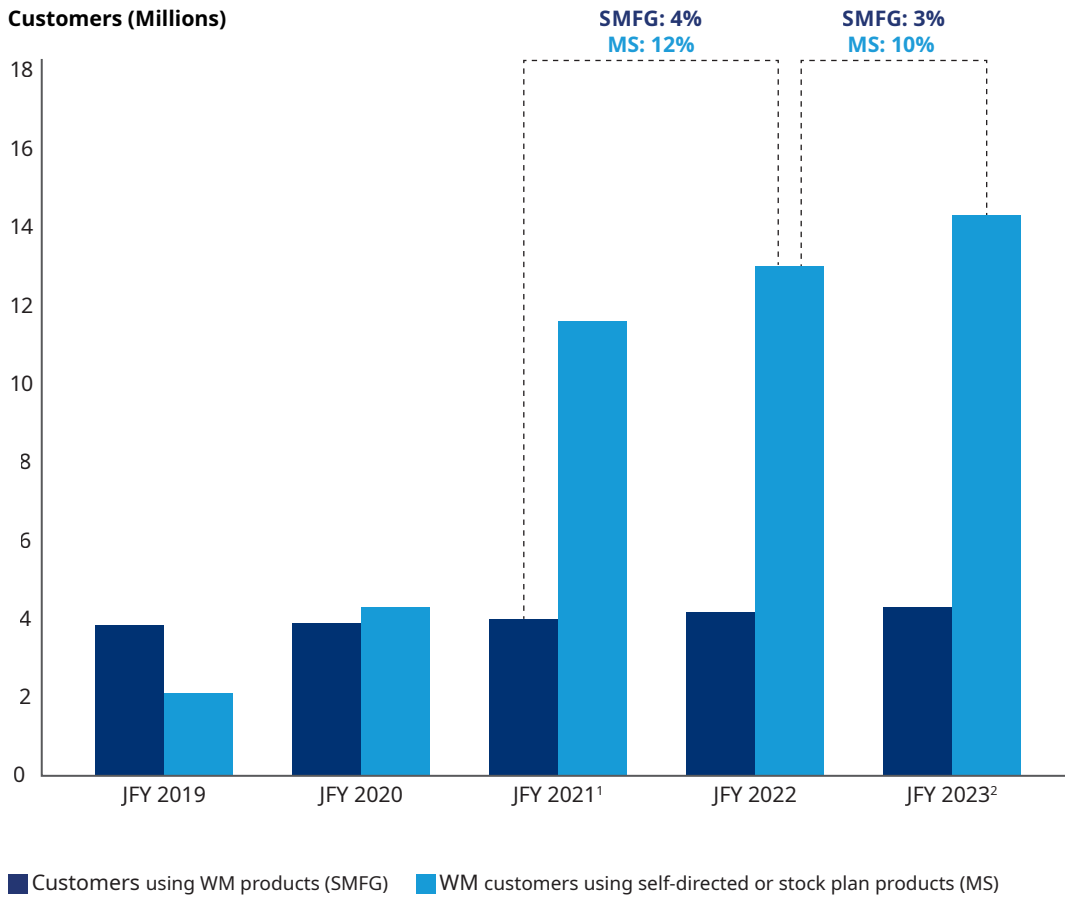
Leading firms have optimized this model to make the client experience as seamless as possible (example, through tenured, lifelong relationship managers). This in turn has allowed them to offer more products and services to more clients via cross-sales. To date, megabanks have struggled to replicate this model. And while the product suites may be similar, they are provided by different pillars in the three-legged organizational structure (banking, securities, trust), and are dependent on maintaining multiple points of contact.

Without prioritizing client-oriented considerations, further investment into expanding product offerings will have limited appeal. This approach has notably not translated into successful client acquisition compared to peers. For example, despite having similar product offerings, SMFG experienced only a 4% annualized growth rate in customers using wealth management products between JFY 2021 and JFY 2023, whereas MS achieved an 11% annualized growth rate in customers using self-directed or stock plan products between 2020 and 2022. See Exhibit 10.

Separately, Japanese megabanks can consider alternative revenue models to enhance the profitability of their wealth management franchise (e.g., transitioning away from commission-based fee structures). As of December 2022, agency commissions dominate the investment management fee structure in Japan, representing roughly half of fees charged on both passive and active funds.¹¹ This is not dissimilar to Morgan Stanley's fee structure over a decade ago in 2011. Since then, transaction-based revenue has declined while asset management (advisory fees charged as a percentage of AUM balances) and interest income have increased. This has led to a notable increase in returns. See Exhibit 11 and Exhibit 12.

¹¹ Financial Services Agency. Financial Services Agency. (2023). Progress Report 2023 for Enhancing Asset Management Business in Japan — [Recommendations for improving trust and transparency](#).

Exhibit 10: Customers using WM products



1. Increase in Morgan Stanley (MS) customers between JFY 2020 and JFY 2021 is largely driven by the acquisition of E*Trade.
2. Japanese fiscal year spans April to March (example, April 2022–March 2023 is JFY 2023). MS is aligned to the FY with the most overlap (example, JFY 2023 corresponds to January 2022 to December 2022).

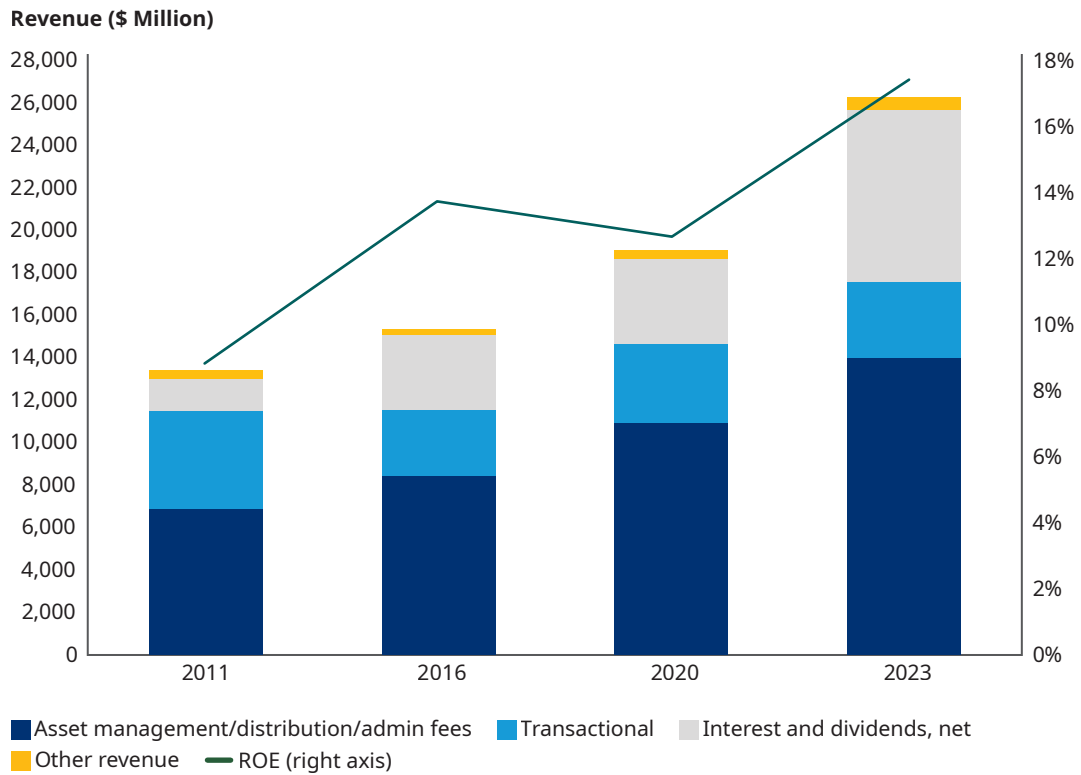
Source: 2023 annual report for SMFG; 10K reports for MS

What has worked for global leaders in wealth management provides a useful guide for how Japanese megabanks can develop a strategic tilt to win over investors. Shifting to a client-centric, integrated, and fee-based model may develop wealth management into a profitable, scalable offering.

If the megabanks do not build their wealth management franchises, international competitors may mobilize quickly to take advantage of the opportunity. As of 2023, the Japanese government publicly welcomed foreign banks to participate in its US \$5 trillion asset management industry — an open invitation for global banks with more mature wealth and asset management businesses to expand into Japan.¹²

¹² Yamazaki, M. (2023, September 21). Japan's Kishida seeks to shake up to \$5 trillion asset management industry. [Reuters](#).

Exhibit 11: Morgan Stanley's wealth management revenue by component and RoE



Source: Autonomous

Exhibit 12: Share of total net revenues

	2011	2016	2020	2023	Trend
ROE	9%	14%	13%	17%	↑
Other revenue	3%	2%	2%	2%	→
Interest and dividends, net	11%	23%	21%	31%	↑
Transactional	35%	20%	19%	14%	↓
Asset management/distrib/admin fees	51%	55%	57%	53%	↑

Source: Autonomous

Strategy 3

ESTABLISH A PAN-ASIAN BANKING POWERHOUSE

Beyond adding new services to their business mix, Japanese megabanks can aim to establish themselves as premier pan-Asian banking institutions. International business has become a sizable portion of the megabanks' profile, with international revenues exceeding domestic revenues for the past five or more years.

The megabanks have taken steps to capitalize on this trend by pursuing M&A deals to grow outside of Japan, while also pulling out of areas that no longer are profitable. For example, MUFG's divestment of Union Bank in 2022 for US \$11 billion was viewed positively by investors, confirming that stakeholders do not always interpret "bigger" as "better."

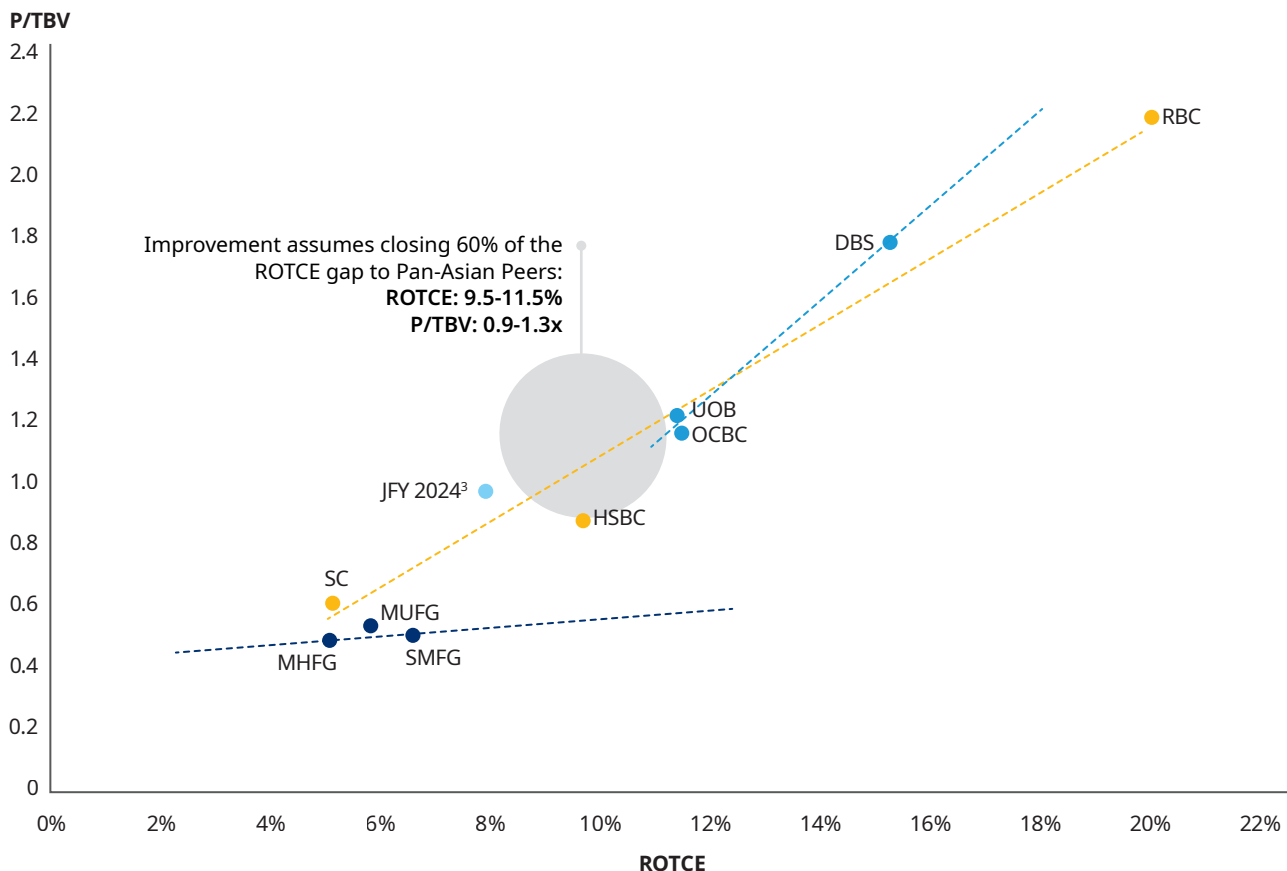
While megabanks have expanded globally, investors appear skeptical of how they are positioning their international footprint to operate coherently.

For example, the Asia-Pacific (APAC) region (ex. Japan) has been the megabanks' most profitable market, yet they trail in returns and valuation against regional peers. Given the megabanks' scale alone, there is clear opportunity here to foster greater intra-regional revenue synergy and cross-sales.

Banking opportunities in each geography are heavily linked to their specific role in the broader region's trade and financing corridors. The APAC banking market is disproportionately oriented to corporate and transaction banking (CTB), driven in part by the region's role in international trade and the necessity of facilitating significant cross-border flows across many jurisdictions. And while the numerous geographies and associated jurisdictions present a challenge from an operational perspective, they also present an opportunity to service and take advantage of those flows.

Higher valued APAC-based peers (particularly Singaporean banks like OCBC) have explicitly oriented their strategy around understanding and capturing these cross-border flows. To unlock trapped value, Japanese banks must develop an overarching APAC strategy linked to their vision of what the region's corridors and interconnections look like today and what they expect them to look like in the next 10 to 20 years. Directing this strategy through a simplified governance model will allow them to tilt resources effectively to generate higher returns, while integrating their footprint more holistically can improve their customer experience. These actions in tandem will help communicate a compelling equity story to investors who have so far struggled to understand how to piece the international puzzle together. Doing so successfully and closing even a fraction of the gap with competitors would allow ROTCE to climb to the 9–11.5% range and improve P/TBV ratios to 0.9–1.3x.

Exhibit 13: Five-year average ROTCE and P/TBV



- Japanese banks⁴ (JFY 2019 to JFY 2023)¹
- Regional peers⁵ (FY 2019 to FY 2023)²
- Megabank average consensus⁴
- Global peers⁶ (FY 2019 to FY 2023)²

1. JFY 2023 spans April 2022 to March 2023 and JFY 2019 spans April 2018 to March 2019.
 2. FY 2023 spans January 2023 to December 2023 and FY 2019 spans January 2019 to December 2019 except RBC where FY 2023 spans November 2022 to October 2023 and FY 2019 spans November 2018 to October 2019.
 3. JFY 2024 (consensus) spans April 2023 to March 2024.
 4. Mitsubishi UFJ Financial Group (MUFG), Sumitomo Mitsui Financial Group (SMFG), Mizuho Financial Group (MHFG).
 5. Development Bank of Singapore (DBS), United Overseas Bank (UOB), Oversea-Chinese Banking Corporation (OCBC).
 6. Royal Bank of Canada (RBC), Hong Kong and Shanghai Banking Corporation (HSBC), Standard Chartered (SC).

Source: Visible Alpha (consensus estimates as of June 2024) and Oliver Wyman analysis

As discussed earlier, effectively capitalizing on this strategy requires reducing inefficiency and simplifying governance structures and reporting lines. These actions are critical to scale efficiently and to make it easier for investors and analysts to understand and appreciate megabanks’ strengths.

Japanese megabanks tend to be viewed in the market more as a collection of regional businesses, and geographic expansion has added layers of complexity with convoluted reporting lines, siloing, and multiple layers of management. The current megabank setup multiplies reporting lines due both to the three-pillar governance structure (banking, securities, trust) and the tendency for regional businesses to operate relatively independently (sometimes under a separate franchise).

Some megabanks have attempted to solve this problem by creating additional regional leadership layers, but this can result in a separate dotted line hierarchy that can make accountability more diffuse.

This is particularly evident given that megabank valuations trail those of peers even in geographies where they have a sizeable presence. HSBC, for example, has a similar global footprint but has outperformed Japanese megabanks, as has DBS, a smaller regional peer with a large and growing APAC presence.

A good guiding principle in the simplification process is to understand the profile of key client segments being targeted and “work backward” to define structure. If the clients are more global (e.g., large international corporates), a global service model may be the best fit, while target client segments with more regional variation may require localized governance structures. Taking this fit-for-purpose approach to restructuring preserves resources and can help to create a competitive edge in each geography.

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