MANAGING FOR VALUE :

A CASE STUDY ON THE CORPORATE STRATEGY OF HSBC BEYOND 1997

by

CHOY CHUNG SHING

蔡宗承

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Professor Denis Wang

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ABSTRACT

Hongkong changed from a British colony to a mainland China "Special Administrative Region" (SAR) In 1997. Shortly afterwards, the Asian Financial Crisis swept most Asian countries, and Hongkong suffered. HSBC, being the largest commercial bank in Hongkong, was deemed to experience a structural change as Hongkong economy gets through the two events.

Shortly after the outbreak of the Asian Financial Crisis, HSBC had announced and instituted a few structural changes. A shift in some of the core business values is noticed. The value shift is located to be an extension of the new corporate strategy "Managing for Value". This project is a study on the new corporate strategy of HSBC in times of great environmental challenges. The various structural changes of HSBC will be examined, and the shift in corporate values will also be studied. The external environmental changes and the advent of technology in the banking industry will also be investigated. These changes will be compare and contrast with the new corporate strategy of HSBC to see if the changes in corporate strategy will constitute a sensible move in re-building HSBC.

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CHAPTER I

HSBC – A BRIEF HISTORY

The Hongkong and Shanghai Banking Corporation Limited, also known for short as the "Hongkong Bank", was established in March 1865 by a Scot Thomas Sutherland to finance the growing trading activities between China and the various European countries. Throughout the late 19th century and the early 20th century, the Hongkong and Shanghai Banking Corporation Limited established a network of agencies and branches based mainly in China and the various South East Asia countries. Historically, Hongkong was the Headquarter of HSBC until the Midland acquisition in 1992, and Hongkong remains the principal profit centre of HSBC until 1998. In a restructure effort, the "HSBC Holdings plc" was set up in 1993 to be the holding company and headquarter for the HSBC Group after the Midland acquisition. The HSBC Holdings plc, or simply the HSBC, provides a full set of international banking services and financial services such as retail banking, corporate banking, trade finance.

The "Hongkong Bank" enjoyed a privilege status under the ruling of the British colonial Hongkong government. The Chairman of Hongkong Bank was an ex officio member of the executive council in the colonial Hongkong government, which is the equivalent of cabinet. The Hongkong Bank is one of the note-issuing banks in Hongkong, and its notes dominate the shares over the Standard Chartered Bank and also the late comer Bank of China. The Hongkong Bank was the principal banker to the colonial Hongkong government and the subsequent Hongkong SAR government. The Hongkong Bank also run the Hongkong Dollar Clearing House until the "New Accounting Arrangement" with the Exchange Fund in 1988. The Hongkong Bank shared the alternate Chairmanship of the "Hongkong Association of Banks" with the Standard Chartered Bank until 1996, when the Bank of China was introduced to share the rotating Chairmanship. In the colonial days and before the establishment of the HKMA, the Hongkong Bank was generally considered to be the quasi-central bank in Hongkong.

The "Hongkong Bank" is the largest commercial bank in Hongkong. The "Hongkong Bank", the "Hang Seng Bank", the "Wardley" and the "James Capel", represented the widespread presence of HSBC in Hongkong, and the extensive branch network of "Hongkong Bank" and Hang Seng Bank in the Hongkong territory is formidable. The close association of "Hongkong Bank" with Hongkong was one of the core competence of HSBC, and the particular close relationship with Hongkong had brought one of the strong and stable streams of income to the bank group.

In 1983, the Joint Declaration between the British Government and the mainland China Government agree to the hand over of Hongkong to mainland China in the year 1997. As "Hongkong Bank" lost its operations in mainland China after the Communist Party come to power, and the memories of dreadful experience still lingers. The Hongkong Bank management decided to achieve globalization and business diversification before the 1997 handover of Hongkong. Then Hongkong Bank started its aggressive expansion into the various overseas markets under then Chairmanship of Michael Sandberg. The next Chairman, William Purves, push the acquisition game to its highest with the acquisition of the Midland Bank plc in 1992.

After the Second World War, "Hongkong Bank" started to diversify its geographic reach and its business through acquisitions and alliances slowly. To name a few major transactions, "Hongkong Bank" acquired the "British Bank of the Middle East" and the "Mercantile Bank" in 1959. Then on 1965, "Hongkong Bank" acquired a controlling stake in the "Hang Seng Bank", the largest local chinese bank in Hongkong once managed and owned by domestic local chinese. In 1981, "Hongkong Bank" acquired the "Bank of British Columbia" in Canada and soon renamed it as the "Hongkong Bank of Canada". In 1987 "Hongkong Bank" acquired the "Marine Midland Bank" in U.S.. Finally in July 1992, "Hongkong Bank" acquire the "Midland Bank plc" of U.K.. The Midland Bank was one of the four clearing bank in the city of London, and the Midland acquisition was largest in the HSBC history up to then. Soon in 1993, a new headquarter, the HSBC Holding plc, was established as the holding company of the bank group, and HSBC move its base of headquarter to

London. The "Hongkong Bank" in Hongkong, once ultimate parent company of the bank group, was demoted to be an ordinary member under the new structure.

Although the establishment of the HSBC Holdings plc changed the structure of HSBC group, however, the organization remained a loose and decentralized structure. The HSBC group operates in different continent with different brandname or franchise based on the old corporate structure. The rationale behind the arrangement is to recognize the essential localized nature of the acquired business to fully leverage and exploit the valuable localized brandname franchise like the "Midland Bank". In the Asia Pacific region, the dominant player was the "Hongkong Bank", while the Midland Bank brandname prevail in Britain and some European countries. And in North America, the bank group presents itself as the Marine Midland Bank in the U.S., and the Hongkong Bank of Canada in Canada.

CHAPTER II

HSBC IN ASIAN FINANCIAL CRISIS

The year 1998 will be a memorable year for both the HSBC Holdings plc and the newly appointed HSBC Banking Group Chairman Sir John Bond. Sir John Bond had succeed Sir William Purves as the Group Chairman of the HSBC Holdings plc in May 1998, and Sir John Bond's first year into the group chairmanship met the unprecedented uproar of the Asian Financial Crisis. The HSBC Group experienced a difficult and tough year, and so does Sir John Bond.

The Asian Financial Crisis, which eventually spread beyond the border of Asia, has thrown up crisis all over the world and had busted some of the famous and well-established industrial and financial institutions. HSBC Holdings is no exception and suffered much in the Asian Financial Crisis. The net profit of HSBC Holdings plc in the financial year 1998 had dropped 21% from 1997, which is the first time of net profit drop in over ten years for the HSBC Holdings plc.

However, Sir John Bond and the HSBC management team are not sitting still. Rather, new strategies are formulated to steer the bank group to rebuild its own competitive advantage in the midst of the international financial turmoil. As the Asian Financial Crisis unfold and the global banking business environment deteriorates, HSBC is undergoing dramatic changes in attempt to better position itself to survive the challenges ahead.

The commence of the entire re-engineering process can be date back to November of 1998, when HSBC Holdings plc announced to unify the brandname and logo for the entire banking group. Under the leadership of Sir John Bond, the HSBC Holdings plc may have survived the Asian Financial Crisis better than any financial institutions in Hongkong.

Asian On Fire

The devaluation of the Thai Baht on 02 July 1997 is generally accepted as the official onset of the Asian Financial Crisis. At first sight, the Thai Baht devaluation was no different from the usual emerging market country disaster hit by a short-lived economic boom and bust cycle. The emerging economy starts to boom and attracts foreign capital to invest in local industry, the high growth carry on for a short period of time and the country expanded with borrowed money. The domestic currency value was supported as a result of the foreign capital inflow. As the economic boom cannot sustain and lost heat, the subsequent domestic economic downturn will drive away the hot money and causing the local currency value to collapse. What distinguish the Asian Financial Crisis from the other crisis was its huge scale, its destructive impact, and its contagious nature. Furthermore, the Asian Financial Crisis had destroyed the once admirable myth of "Asian Miracle" or "Asian Values" that keep the strong economic growth of the New Industrial Countries (NICs) or the Tiger Economies in the Southeast Asian region for over a decade.

The Asian financial Crisis also set an example and a stage for a special type of institutional investors, the hedge fund, to participate and profit from the financial chaos. Previously, hedge funds are investment fund taking hedged positions so that its investment portfolio will be largely neutral to market movement. However, as more and more hedge funds emerged to strive for investors' money, some hedge funds turn aggressive and voluntarily take open positions in their investment portfolio, such that the valuation of the portfolio response to certain market movement. Prominent examples of these aggressive hedge funds participating in the Asian Financial Crisis included the Tiger Fund managed by Julian Robertson Jr., and the Quantum Fund under financier George Soros.

These aggressive hedge funds speculate on the Asian currencies with which the national economic performance are already under stress. Usually the hedge fund portfolio adds further pressure to the weakening exchange rate, thus accelerate and exaggerate the process of devaluation. The hedge funds make a profit when the currencies eventually devaluated. Successful speculation in turn enriches the hedge funds with financial resources to start renewed attack on another victim countries. The Asian financial Crisis turns contagious and spread throughout to almost the entire South East Asian region. The vicious cycle reinforce itself and the situation simulates a Domino effect, with the knock down process hastened and the destructive cycle deepened. Eventually the scope of the Asian Financial Crisis extended beyond the Asia Pacific region and reached outward to countries like Brazil, Argentina, and Russia.

Soon after the Thai Baht devaluation, the Malaysia Ringgit was devaluated by mid-July, the Indonesian Rupiah was depreciated by mid-August, and the New Taiwan Dollar was allowed to float in October. The Hongkong economy faced the first round of turmoil in October 1997. However, the hedge funds did not hit a home run on the Hongkong Dollar attack as the economic fundamentals of Hongkong poses a little different situation from other Asian emerging countries. Although the Hongkong economy was under pressure, it was not distressed. The Hongkong Monetary Authority (HKMA), which manage the huge foreign exchange reserve for the Hongkong SAR government, mobilized the foreign exchange reserves to defend the Hongkong currency. As the Hongkong pegged exchange rate system stands firm, the Hongkong Dollar did not devalue, and these hedge funds could not benefit much from repeating the old trick and soon left.

As a result of the defense mechanism instituted by HKMA, a drain on the Hongkong Dollar money market liquidity was resulted and the Hongkong Dollar interest rate skyrocketed. The overnight Hongkong Dollar interest rate once surged above 300 percent and the three-month benchmark interest rate once rose above 30 percent. The high volatility of interest rate fluctuation was unprecedented. The subsequent high level of interest rate reduced the leveraged positions in the Hongkong stock market and caused the Hongkong stock market to tumble, with the resulting Hang Seng Index falling from above 16,820 points level in August 1997 to around 8,800 points level by November of 1997.

The Hongkong economy stumble, but the Hongkong economic fundamental was strong enough to endure and soon show signs of recovery. The Hang Seng Index climbed back to 11,900 points level by March 1998. Some other Asian countries did not enjoy the same turnaround as Hongkong does, their currency value depreciate one after another. South Korea and Taiwan, long had been treated as well developed economies in the Asian Pacific region, also suffered and went down like dominos. The scope of the Asian Financial Crisis had developed further away from Asia, reaching the regime like Russia and Brazil. Then in less than one year's time, Asia returns to the stage and become the focus of destruction again.

The Hongkong economy faced a second round of turmoil in August 1998. The hedge funds expected the HKMA to repeat the same defense mechanism, which means to attack the Hongkong currency alone will not be profitable. However, the defense mechanism by the HKMA and the subsequent knee-jerk stock market reaction capture their attention. The hedge funds formulated new strategy and tried a multi-dimensional attack on the Hongkong economy. They short-selling the Hongkong stock index first, then established short position in the Hongkong Dollar forward market so as to benefit from higher Hongkong interest rate. Then these hedge funds start their attack on the Hongkong currency after all these preparation had been done.

History repeats itself, as the HKMA adopted the same defense mechanism and drain liquidity from the market, the Hongkong Dollar interest rate jerk up instantly but to a lessor extent. Hedge funds then keep establishing further short positions on Hongkong stocks in order to maximize their profit and the stock market collapse more drastically. The Hang Seng Index collapse from above 10,000 points level to near 7,000 points level, and the dim economic outlook shaken the general public's confidence on the Hongkong economy.

Under the consideration to protect the confidence of investors and the general public in the Hongkong economy, the Hongkong SAR government act to combat the destructive speculative activities of hedge funds by mid-August 1998. The Hongkong SAR government undertook an unprecedented action and intervened in the Hongkong stock market directly, using the foreign exchange reserves to buy up large quantity of blue chips stocks to support the Hang Seng Index. HSBC, with its heavy capitalization weight in the Hang Seng Index, is a logical choice of buy to support the Hongkong stock market. The Hong Kong SAR government accumulated a 8.9% stake in the HSBC through its defense against the hedge funds attack, and had became the single largest shareholder of HSBC.

Impact of Asian Financial Crisis on HSBC

The Asian Financial Crisis hit the HSBC Holdings in several aspects. First of all, the Asian Financial Crisis deteriorated the business environment of Hongkong and most South East Asian countries, which are the geographic operation that used to contribute the largest share of profit to HSBC. The deteriorated Asian Pacific business environment could diminish future business opportunity and return, as well as sharply raise the bad debt of HSBC.

The adverse effect had been reflected on the financial result of the financial year 1998. HSBC announced a sharp fall in profit in the 1998 financial year, with the group profits before tax fell to USD 6.57 Billion, down 19% from 1997 figure of USD 8.13 Billion. Also in 1998, the Hongkong and Asian Pacific operation of HSBC contributed 39% of the group profit only, while the British and European operation contributed 42.3%. The Financial Year 1998 marks the first time in the HSBC history that the profit contribution from the Hongkong and Asian Pacific operation was surpassed by another regional operation. On the other hand, the bad debts provision of HSBC rose more than double in 1998 to USD 2.628 Billion from USD 1.034 Billion of 1997. The surging bad debts were caused mainly by the Asian Financial Crisis, with the majority of the bad debt originated from countries like Thailand, Indonesia, Malaysia and Hongkong. The level of bad and doubtful debt provisions required to meet the usual HSBC management's prudent policy on non-performing loans resulted in a 21% drop in profit, which far exceed the market expectation.

Second, the Asian Financial Crisis provided a rare opportunity for the speculators to drive down the HSBC stock price from the historical high of HKD 279 on 17 July 1997 to a low of HKD 132 on 21 September 1998. Although the HSBC stock price soon recovered, the high volatility on HSBC stock price forced some long-term investors such as insurance companies and investment fund to divest the HSBC stock. Some investors might abandoned the HSBC stock for the denomination of stock price on Hongkong Dollar, as the volatile Hongkong Dollar interest rate and the possibility of the "unpeg" of the Hongkong Dollar exchange rate pose additional financial risk to these long term investors. Other investors might dump the HSBC stock for its heavy dependence on the Hongkong and mainland China related business, which is expected to deteriorate after the Asian Financial Crisis.

On a merger and acquisition perspective, the volatile stock price also put HSBC into the rare situation of being a possible prey in the merger and acquisition game. The Asian Financial Crisis had demonstrated that the supply and demand relationship of the HSBC stock can be temporarily distort in such a way to lower the stock price of HSBC drastically. And the depressed stock price will give an attractive "Price / Earning" ratio given the extensive geographic coverage and business opportunity of HSBC. Furthermore, the single largest shareholder of HSBC, the Hongkong SAR government, will probably want to sell its stock holding in HSBC some time in the future. The stock unloading by the Hongkong SAR government could easily turn into a golden opportunity for international players that wish to takeover HSBC to start their hostile attack.

Re-engineering

The HSBC management were alarm by the emergency circumstance. Shortly after Hongkong was swept by the first round of Asian turmoil, Sir John Bond and his top management team had got themselves prepared, and had started their fight back. A series of re-engineering actions were planned and execute to re-vitalize the entire organization for the challenges ahead.

First Action – Re-branding

On 27 November 1998, HSBC Holdings plc unveiled a major decision to create a unified brandname for the entire banking group. Under the brandname unification exercise, the marketing names of all of HSBC

Holdings' wholly owned commercial banking subsidiaries will change to "HSBC" and will all adopt the hexagon symbol in red and white. The legal structure of the group will be unchanged, while the legal names of the HSBC Group companies will be reviewed and changed where appropriate as soon as possible. Certain majority-owned subsidiaries will incorporate the HSBC name into their existing legal names.

The re-branding changes will be made on branch signage and interiors, cheque books, credit cards, stationery, and advertising materials to build and reinforce the brand. The re-branding exercise is projected to complete by 01 January 2000, with the estimated cost of USD 50 Million excluding advertising cost. The major initiative of the re-branding exercise is to achieve full brandname recognition for the HSBC as one of the world's largest and most successful financial services institution. In the speech made by HSBC Group Chairman John Bond, he underline the rationale for undertaking the re-branding exercise as follow. "***Over the years the HSBC Group has grown both organically and by acquisition. Historically, we have operated under different names in different places. Our policy of retaining the separate identities of the companies we acquired because they were well-known names in their local markets served as well for many years. However, times change and we must change with them.***"

Second Action – Primary listing on NYSE

HSBC held the Annual General Meeting on 22 February 1999 and announced a sharp fall in profits in financial year 1998 as due to the impact of the Asian Financial crisis. On the AGM, the HSBC management also announced another re-engineering exercise which include a series of changes to re-organize the internal capital structure of HSBC. Furthermore, the HSBC management announced the intention to list the HSBC stock in U.S., and propose that HSBC to have primary listing on the largest stock exchange in U.S., the New York Stock Exchange (NYSE).

Historically, HSBC stocks had primary listing on the Stock Exchange of Hongkong (SEHK). The HSBC stock was listed on the London Stock Exchange (LSE) as a result of the acquisition of the Midland Bank in 1992. There are two classes of ordinary stocks of HSBC in circulation, with the stock par value denominated in H.K. Dollar and British Pound trading side by side. Through the second re-engineering exercise, HSBC will consolidate the existing two classes of ordinary stocks with different par value into one single class of ordinary stocks with the new par value denominated in U.S. Dollar.

Then, the HSBC stock will be split in a one into three ratio. At a later stage, HSBC will apply for the full listing of its stocks on the NYSE. The first two action serves to re-organize the internal stock capital structure and are perceived as measures to facilitate the full listing on the NYSE. The NYSE listing is an ultimate step to enable HSBC stocks to be available in the largest equity market in the world, such that the HSBC stocks are traded actively round the clock and round the world.

The co-existence of two classes of HSBC ordinary stocks was confusing to some investors, and the proposed stock consolidation exercise could help to clear up the confusion. Furthermore, splitting one existing stock into three new stocks will increase the total number of stock in circulation, thus improving the market liquidity of the new HSBC stock. The lower unit stock price of the new stock can also lower the entry barrier of investment, and the HSBC stocks could cater for more investors.

HSBC stocks are already trading in the U.S. Over-The-Counter (OTC) market through the American Depository Receipt (ADR) program. However, the turnover and liquidity of ADR trading at OTC market cannot be compare to stocks having full listing on NYSE. Also, a full listing on the NYSE could boost the international image of HSBC. The trading of ADR on existing HSBC stock was migrated from the OTC market to the NYSE floor on 16 July 1999. This can be considered as a minor step taken towards a full listing on NYSE.

Third Action - Acquisition

On 10 May 1999, HSBC announced to acquire Republic New York Corp., the holding company of the Republic National Bank of New York (RNB), and the closely associated Safra Republic Holdings SA. (Safra) together for USD 10.3 Billion. The RNB acquisition is a cornerstone to the HSBC expansion strategy, it represent HSBC's first foray into a globalize institution, and to achieve significant diversification beyond the two hometown of HSBC, Britain and Hongkong.

The RNB acquisition is the largest acquisition in HSBC's history in terms of monetary value, exceeding the 1992 purchase of Midland Bank for USD 6.1 Billion. The RNB acquisition represents a strong push into the U.S. market by HSBC. The purchase of RNB and Safra will bring HSBC around 30,000 high net-worth individual customers, with an estimated USD 56.5 Billion of assets, as well as 83 retail branches in the New York area. The combined branch network of the Marine Midland Bank and the RNB will be the third largest network in the New York area just behind Citibank and Chase Manhattan Bank. HSBC expects to generate around USD 300 Million in cost savings from combining the RNB businesses after restructuring charges of USD 450 Million have been taken.

The RNB acquisition is not a piecemeal deal, rather it is a strategic purchase that add a missing piece to fill an existing gap in the HSBC expansion gap. The acquisition fits it strategy of focusing on "wealth management". The lucrative private banking business of RNB and Safra are the gems of the deal that HSBC had long been wish to develop. Through integrating the private banking business of RNB and Safra to the HSBC portfolio, HSBC is ready and capable to compete against the world's best leading private banking giants like Deutsche banking, United Bank of Switzerland (UBS), and Citibank.

In Sir John Bond's own words in the press release, " ….. ***there is almost no front office overlap [between HSBC and RNB business].*** " and " ….. ***an acquisition in the US will kick into earnings much more quickly than one in a country in difficulties,*** ….. ***and [the acquisition of RNB] can balance the exposure roughly 50-50 between OECD and emerging markets.*** …..". The RNB acquisition serves to add productive resources to the U.S. operation of HSBC immediately, which will further diversify the income stream sources of HSBC into the U.S. market. The principal advantage of the deal is that the RNB operation can immediate contribute to the profit of HSBC. HSBC would benefit from unprecedented economies of scale and be best positioned to further expansion in the U.S. in the global wave of consolidation. HSBC is buying a tremendous growth potential opportunity in the U.S. banking industry.

However, the RNB transaction was not widely appraise by the market as RNB was subsequently charged with certain corruptive practice. The deadline to the completion of the transaction was soon delayed.

Then in an episode to the RNB purchase, HSBC announced a placement of HSBC Holdings stocks for U.S. Dollar 3 Billion. The deal involved the sale of 88 Million new ordinary stocks of HSBC, which formed part of a financing package to fund the purchase of RNB and Safra. As the Hongkong SAR government was not invited to the stock placement, the HSBC stock holding by the Hongkong SAR government was subsequently diluted by a fraction of a percent point.

Still More Arrows in the Quiver ??

In the following sections, these above mentioned re-engineering strategies will be compare and contrast against the ideas behind the new corporate strategy "Managing for Value" as advocated in the HSBC Annual Report 1998. Afterwards, an inference will be drawn on the rationale behind the above mention actions taken by HSBC. Then the changing business in Hongkong and mainland China, Britain and Europe, and the U.S. will be examined. The expansion strategy of HSBC will be examined based on the different business environment. Finally, a possible direction of future development is outline to close the project.

CHAPTER III

MANAGING FOR VALUE

In the midst of a period of hard time, when the end of the Asian Financial Crisis is not yet clearly visible and the much anticipated global economic recovery is still doubtful, is it worthy for HSBC to invest its valuable financial resources in an exercise just to rebuild the corporate brandname ? What would be the new corporate brandname mean to the banking group ? What does the new corporate brandname mean to existing customers ? Does the new corporate brandname really helps to enhance recognition among customer ? And as HSBC abandon the few valuable franchise, does HSBC also abandon something undesirable?

Furthermore, why is HSBC so eager to be listed on NYSE given the low operation presence of HSBC in the U.S. ? What are the benefits that HSBC is really looking for through the full listing on NYSE ? Does the RNB acquisition worth the price ? Does HSBC make the right choice in choosing the U.S. as the next geographic market to enter ? Does HSBC possibly overlook any other market worth trying ?

Perhaps the HSBC Annual Report 1998 can shed light on the rationale behind the entire re-engineering process. In the first paragraph of the "Group Chairman's Statement" of the HSBC Annual Report 1998, Sir John Bond mentioned that, HSBC will have a new corporate strategy named "Managing for Value". The special chapter "Managing for Value" was inserted in the eye-catching position in the Annual Report to capture readers' attention. For the first time, the HSBC management found it necessary to state clearly its corporate mission, and have it thoroughly communicated to its shareholders.

The chapter "Managing for Value" outlines the management vision of HSBC over a five year period from 1999 to 2003. This could be view as the choice of corporate strategy by the management to build HSBC in the post Asian Financial Crisis business environment. The new strategy claimed to design to place the shareholders of HSBC at the most important position.

The chapter "Managing for Value" was divided into several sections emphasizing different focuses. In the section titled "What We aim to Do", the HSBC management defined the governing objective of the bank group, that is "***to achieve a minimum to double shareholder return over a five-year period***". Here shareholders' return was defined as to include capital gain as well as dividend payment. The average annual growth of stock price would have to be at least 14.8% if the dividend payment was assumed to be negligible. The identification of such a target demonstrates that the HSBC management wish to have its stock price to grow steadily, giving its shareholders a steady earning in long term. This section addresses the message that the HSBC management will try the best to avoid further violent stock price fluctuation, which indirectly suggest that the high volatility of stock price as seen during the Asian Financial Crisis was undesirable to the HSBC management and the shareholders.

In the next section titled "Our vision", the HSBC management defined its vision is "***to be able to balance its earnings between the OECD countries and the emerging markets.***" HSBC had root its strength from its two hometowns, Hongkong and Britain. The prominent position in the Hongkong and British market had been one of the core competence for HSBC. As the earning from the Asian Pacific operation was expected to drop and will not recover in short period of time, therefore there is a pressing need for HSBC to develop new stream of earnings. Thus, increased globalize operation is one way to address and fulfill this corporate mission.

In the section titled "What We Will Do", the HSBC management outlines its future business focus. ***"We will concentrate on delivering 'wealth management' to our key markets around the world."*** and ***"We mean offering [customer] the full range of financial services, including savings, pension, investments and insurance."*** The financial return to the business of "wealth management" is based on fees and commission, which are considered to be a less volatile earning stream category. On the other hand, the return to lending business is the interest margin, but at the same time the bank is taking credit risk as well as interest rate mismatch risk. The HSBC management, by choosing to focus more on wealth management business, demonstrates its wish to distance itself away from the volatile and riskier type of business.

Corporate Strategy

Sir William Purves, the immediate predecessor of John Bond, had led HSBC into a series of acquisitions and expands into the overseas market. William Purves's ambitions appeared boundless, he transformed the then-HSBC from a regional bank of the Asia Pacific region into a banking giant with decentralised operation all around the world. William Purves had group the various franchises under the banking giant, where operation was divided geographically with each franchise operating in their respective market with relatively de-centralised management structure. The old structure of HSBC was a geographically de-centralized structure, with pieces of operation adhere together loosely. The old structure of HSBC was dedicated to cater for widely scattered entities, each operation serves a well established market and franchaise in different geographic area, and minimal overlapping between different geographic operations.

A little over one years since Sir John Bond took over the chairmanship, the banking giant is in the midst of a historical overhaul that is transforming its business and its culture in adapting to the new global business environment. Sir John Bond is reshaping the banking giant by putting a new and unified image to replace the various big and powerful franchises held by HSBC.

Sir John Bond faces a dilemma. He served as the Group CEO when William Purves was the Group Chairman. He had assisted in formulating the old structure of HSBC, and he knows the merits and limitation of the old structure of HSBC better than anyone. To achieve the new corporate strategy means to un-do part of the achievement of Sir William Purves. The re-engineering actions taken by HSBC are perceived as measures to counterbalance out the negative effect from Asian Financial Crisis, and also serve to re-build the momentum for HSBC to pursue the role of a global financial service player. Each of these steps taken by Sir John Bond is ambitious in its own right. Taken together, they from a new strategy, and will led the HSBC eventually to top the global league of banks.

Brandname Management Strategy

Sir John Bond is getting the HSBC group to charge into new geographic businesses frontier, and his work did not stop here. The hardest part of the entire re-engineering process could be the effort to rebuild investor confidence in HSBC. Trust is highly intangible and hard to build up with, and the task is even more difficult in an industry where trust is the cornerstone to success. First and foremost, customers look for brand, and the battle for brand recognition is getting more and more intense.

What's in a name for HSBC. A good brandname start with brandname recognition. A successfully build brandname bring a direct understanding and reference to the company, its product and the level of services quality. There's huge value in establishing a widely recognized brandname. In the banking industry, a widely recognized brandname could be the most valuable asset of a bank.

In the colonial days, the "Hongkong Bank" brandname is an incredibly strong brandname with a unique message, it brings a quick and immediate recognition with the British colony and implicitly suggest the close relationship between Hongkong Bank and Hongkong. The Hongkong Bank Headquarter building was a major landmark in Hongkong, it forms part of the Hongkong skyline. Those bank notes in Hongkong issued by Hongkong Bank bears the Hongkong Bank brandname and also the image of the Hongkong Bank Headquarter building, which give a subtle promotion to HSBC. The authority to issue bank note in Hongkong implicitly suggests the entrusted position of HSBC in Hongkong, and highlights the privilege position of HSBC in Hongkong. For a long time, HSBC was pleased that the Hongkong Bank brandname bring along quick association with Hongkong for it attract huge business through the brandname recognition and trust.

However, the Asia Financial Crisis changes the fundamentals. As the Asian emerging markets were under attack, anything that bears a direct or indirect link to the Asian countries were perceived as negative. Investors are now taking another look at the prospect and valuation of the once high-flying emerging markets. The devaluation of one Asian currency after another drive foreign investors to dump investment in Asian regional irrespective of the actual intrinsic value, and HSBC was one of the victims. The wide recognized HSBC brandname draw attention to the close relationship of HSBC to the suffering Hongkong economy. All of a sudden, the jewel on the crown lost its glamour and become so unpleasant as a fly in the ointment. The "Hongkong Bank" brandname is now a contamination, and the re-branding exercise is an attempt to limit the spread of contamination before it spoil the entire organization.

The two major operations of HSBC are the Asian Pacific operation and the British operation. As HSBC wish to unify the corporate brandname, a logical choice is to extend one of the regional franchise to represent the entire banking group. Thus, one important motivation for the HSBC to drop the brandname could be to distance itself from Hongkong, at least to lower the direction association as the name itself suggested. As the HSBC management wishes to distance the banking group from the emerging markets operation, then the brandname franchise in the developed countries would be preferred to represent the banking group.

Another strong brandname that could represent the banking is the Midland Bank brandname. However, the Midland Bank franchise was not being chosen as the new corporate brandname. Rather, the HSBC management settled for a completely new brandname, HSBC. As the "Hongkong and Shanghai Banking Corporation" brandname was printed on the Hongkong bank note that it issued, HSBC might risk losing its note-issuing status if the Midland Bank franchise was adopted. The choice of the brandname "HSBC" could be out of a political consideration, as "HSBC" bears the initials of the old brandname of the "Hongkong and Shanghai Banking Corporation".

Under the ambitious restructure plan of Sir John Bond, the various regional operations of HSBC will be unified together, with the global operation cemented together and work under the same brandname of HSBC. By undertaking the re-branding exercise, HSBC had also undertake a painful decision to abandon the valuable goodwill behind the various well established brandname such as the "Midland Bank", the "Marine Midland Bank", "James Capel", "Wardley", and also the brandname of the corporate flagship "Hongkong and Shanghai Banking Corporation".

By establishing a new brandname, HSBC is well positioned to participate fully in the global competition. The importance of a strong and trusted brandname is becoming essential in underpinning a bank's franchise value. However, Sir John Bond understands that brandname unification alone would not put HSBC back to track. HSBC had to significant expand its border to achieve the breakthrough and the necessary growth, which could eventually expand and diversify the earning.

Expansion Strategy

HSBC will be listed on the NYSE at a later time. However, it will be unreasonable for a company to list on the NYSE but at the same time lacking a meaningful operation in the U.S.. Therefore, a logical next step for HSBC will be to add to its operation and presence in the U.S. through organic growth or acquisition. At the same time, an expansion of operation in the U.S. will clearly mean a dilution of proportion of the weighting of Hongkong and British operation.

HSBC was reputable in buying up ailing banks and heals them back to healthy track under the leadership of Sir William Purves. Now in the RNB acquisition, HSBC is paying the full price for a healthy and attractive business that can fit into its own business. The synergy between HSBC and RNB is an almost complementary one. The RNB acquisition significantly boosts the distribution channel of HSBC in the U.S., and allows a quick penetration into the expanding U.S. market. The complementary business focus and the joint capital size would create a new joint platform to consolidate leadership in the global banking industry. The U.S. market that grows explosively recently, where the growing U.S. economy could further extend the gain to HSBC. The most important factor that justifies the expensive RNB purchase was that, the RNB operation could add to the bottom line immediately once the consolidation was completed. This could helps to achieve a more diversified income stream in terms of geographic operation.

Through the unusual decision to acquire an expensive but healthy RNB, Sir John Bond is leading HSBC into radically new business opportunities. The RNB acquisition is a competitive response to the industrial trend of globalization and consolidation, it fits in very nicely with the expansion strategy, giving HSBC the chance to get into a growing market. The growth strategies being pressured by both companies can be implemented faster and more successfully on a joint force basis. The combined activities will enable the merged entity to become a contender to the leading global financial giants. But on the flip side, the RNB acquisition is expensive. HSBC need to pay a high price in order to get into the premium market.

The NYSE listing will be a significant corporate achievement and is instrumental to the growth of HSBC, it allows more members of the investment community to participate in the success of HSBC, and will generate a broader level of exposure for HSBC. The inclusion on NYSE will facilitates greater access to capital markets to enable HSBC to expand business in U.S., particularly through acquisition. Furthermore, HSBC have a strong balance sheet to support the acquisition activities.

CHAPTER IV

CHALLENGES ON HOMETOWNS

HSBC used to get support from its two hometowns, Hongkong and Britain. HSBC should preserve the two prominent profit centre as far as it could. However, clear and keen competition was seen developing on both hometown and the business environment are turning more and more unfavourable to HSBC.

The Hongkong and Asia Pacific regional operation count for about 40% of the income in the financial year 1998. And given Hongkong is only a small city with a population over 6 million, the efficiency in generating profit could be the highest within the group. The Asian Financial Crisis had changed the business landscape of Hongkong, such that HSBC was needed to explore other earning sources to replace the position of Hongkong..

On the European frontier, a fundamental change had happened and could ultimately change the European market as well, that is the launch of the common currency Euro and the forthcoming unification of the European market. A pan-European central bank, the European Central bank (ECB), had been created to coordinate and execute the monetary policy in place of the various central banks of individual nations. The unified European market economy could easily dominant the entire European time zone, and the banks of the newly unified E.U. could invade the British market eventually.

For the first time, HSBC found its dominant position in both hometowns threatened. What used to be admired as the core competence of HSBC is now criticized as over-dependence on one or two specific market.

Hongkong

The Asian Financial Crisis took almost everybody off guard, just like what the Intel Chairman Andrew Grove quoted as a "10 X" change in his book "Only the Paranoid Survive". The Asian Financial Crisis had changed the economic fundamental of so much countries, destroy economy after economy from Asia to Europe and Latin America.

As Hongkong took its turn of suffering in the crisis, the myth of ever-lasting prosperous scenario ruptures. The corporate landscape of Hongkong is undergoing a revolutionary transformation. The Hongkong property and stock prices collapsed, companies went bust, and unemployment rose to a 20 years high. Hongkong has lost its competitiveness as the gateway to mainland China, the rents and wages are among the highest in the world, and the Hongkong currency is too strong compare to those depreciated Southeastern Asian currencies. Major banks, domestic and foreign, had lent heavily to the property sector during the boom time, thus further downward pressure on the property prices would definitely be negative to commercial banks. The structural weakness of Hongkong, the high dependence on the property sector, becomes a hurdle to the recovery of Hongkong. And HSBC realise and found itself situated in a deteriorating business environment that was turning more and more unfavourable.

First of all, Hongkong was the gateway to do business with China for over a century due to the unique historical circumstance of being a British colony. However, the hand over of Hongkong to China in 1997 had taken away the once unique gateway position of Hongkong. Foreign companies begin to deal directly with their counterparts in mainland China and bypass the middlemen in Hongkong. As HSBC still cannot establish a meaningful operation in the highly regulated mainland China, the role to finance China trade business was losing to the competitors in mainland China.

Second, the Asian Financial Crisis had destroyed the once cozy business climate in Hongkong. With the pegged exchange rate system of Hongkong unchanged, the domestic prices undergo a prolonged period of depreciation in an internal adjustment process to re-gain the competitiveness of Hongkong. This results in a spiral of price fall, and stock price, property price, and salary are affected. Corporate downsizing was common, and massive layoff was seen. Bad debts are on the rise, bankruptcies skyrocketed, and the demand for credit crunched. Banks suddenly found themselves holding too many deposits while there were too little quality lending opportunities available. As a result of falling credit demand, interest rate on loans dropped. The recent mortgage loan price war between banks in Hongkong has led to a decline in mortgage loan interest to below the prime lending rate, which cut sharply into the profit margin of banks. A cutthroat competition had developed in the Hongkong mortgage loan market. Consequences are simple, with profit margin narrows, the Hongkong banking business is not as profitable as before.

Third, the Hongkong banking industry is undergoing another prominent structural change. In the good old days, the Hongkong Association of Banks, of which HSBC is one of the rotating Chairman, dictates the Hongkong Dollar deposit interest rate that a commercial bank can pay its customer. HSBC benefits as retail customer will tend to place deposits with a bank having a stronger presence and respected image in Hongkong. However, the HKMA had enforce the new "Interest Rate Deregulation" which allows banks to quote their own Hongkong dollar deposit interest rate for their customers. The final stage of interest rate deregulation will be commencing by Mid-2000, and banks will be able to quote interest rate to their own customer freely. The banking environment is thought to be increasingly competitive as smaller banks would then be able to attract deposits by quoting higher interest rate to their customers.

Fourth, the Bank of China Group rise as a formidable competitor to HSBC after 1997. The Bank of China had been the State owned foreign banking operation in mainland China and take up a usual commercial bank operating in Hongkong previously. However, the influence of the Bank of China Group in Hongkong financial matter increase as Hongkong was hand over to mainland China. For example, the Bank of China was being invited to be the rotating Chairman of the Hongkong Association of Banks in 1996. Furthermore, the Bank of China Group is planning to consolidate the various member banks under the Bank of China brandname in the near future. This planned consolidation could helps to unify the "Bank of China" brandname, to rationalize retail branches locations and operations, and to streamline resources allocation within the banking group, and thus improve overall efficiency and achieve cost reduction. The competition from the re-vitalized Bank of China is surely on the rise.

Fifth, the direct competition between "Hongkong Bank" and "Hang Seng Bank" is undesirable. The strong growth of the Hongkong economy for the past 20 years was able to accommodate the co-existence of Hongkong Bank and the Hang Seng Bank with acceptably low competition. Now, with the business environment turn unfavourable, it might be better for HSBC to achieve some degree of "Division of Labour" between its two franchises co-exist in the same market. As HSBC does not planned to integrate "Hongkong Bank" and Hang Seng Bank together, then it would be preferrable to identify and separate the two institutions from competing with each other. As Hang Seng Bank focus its strength entirely on the domestic Hongkong market, its dependence on the Hongkong market is comparatively higher, therefore it might not be cost effective for Hang Seng Bank to start explore another market. Thus the higher international exposure of "Hongkong Bank" could be the definite factor to conclude "Hongkong Bank" should paid more attention to the overseas market.

Sixth, the problem loan restructure negotiation process surrounding the GuangDong Enterprise (GDE) and the GuangDong International Trust and Investment Corporation (GITIC) had cast doubt on the legal framework and the financial market supervision and regulation in mainland China. The GDE and GITIC events could have stumble the development in the financial market and possibly slowdown the foreign direct investment in mainland China. The reputation of the China market declined to a low, and certain capital was attracted to invest in other South-Eastern countries. The pending status of China joining the World Trade Organization (WTO) add another dimension of uncertainty, which further complicated the business decision to invest in mainland China, and could frustrated many investment opportunities. As the flow of China trade slip, Hongkong is stand to lose.

The above arguments suggest that, in the foreseeable future, HSBC would face a higher degree of competition in the domestic Hongkong market. And a direct consequence is a fall in revenue that could lead to a reduction in the shareholders' value. If HSBC continue to further invest in Hongkong, then it might acting against its corporate strategy as laid down in "Managing the Value". Therefore, a logical next step for HSBC is to get out of the matured and low growth market.

ExpansionOpportunities

HSBC has its root originated from the Asia Pacific region, could choose to expand its Asian Pacific operation beyond the scope of Hongkong. While Japan is the dominant economy in the Asian Pacific market, does the Japan market provide the necessary growth potential to HSBC ?

Japan

Japan is the second largest economy in the world, and it is the leading economy in the Asia Pacific region. What's more, HSBC does not yet have a meaningful presence in Japan. It seems Japan could be a prospective candidate for HSBC to expand its operation at the first sight. But a detailed look on the current Japanese economic fundamentals do not seems to suggest the Japan market is a potential market to enter.

The banking industry in Japan has long been treated as a sacred cow, and was protected and highly regulated by the government through the Ministry of Finance (MOF). Outsiders wish to bypass these regulatory barriers had to set up alliance with a local or regional Japanese bank. However, the protective culture and nature among Japanese means it is extremely difficult to pick up a partner in Japan. Moreover, the Japanese economy is currently undergoing its longest recession since the Second World War.

The economic downturn began to develop since the beginning of the decade. The Japanese government first take up free spending fiscal policy to foster an imminent recovery. Large amounts of money were pump into massive public construction work and the government expect the economy will turnaround shortly. However, the typical Keynesian stimulative scheme failed to work sufficient domestic demand.

The Asian Financial Crisis further decreases the external demand of Japanese goods, thus diminishes Japanese exports, and adds to competition for exports, which further suffocates the Japanese economy and slowdown the recovery process. As a result, case of bankruptcies further increased. The Japanese government try to bail out falling companies at first, but the increasing number of bankruptcies soon alarm the unavoidable truth, that the Japanese government is running out of money to keep companies from falling. The Japanese government had spent more than JPY 100 Trillion over the past decade to drag the economy out of the longest recession since Second World War.

With the Japanese economy struggling in a severe depression, Japanese banks had step up their effort to scale down or retreat from overseas operation and focus on the domestic market. The Japanese banks suffered with the high corporate bad debt and low credit demand, where corporate bankruptcies in turn increase the bad debt of banks, which further push banks away from lending. The economic downturn had already cause one of the "Big City Japanese Bank", the Hokkaido Takashuku Bank, to declare bankruptcy. Then the Japanese government had later takeover the distressing Nippon Credit Bank (NCB) and also the Long Term Credit bank (LTCB) to avoid further spreading of bankruptcy leading to a possible domino effect which might knock down the entire Japanese financial system.

The Japanese government turn to monetary policy to rescue the economy as the fiscal policy was not effective enough to kick start a recovery. The Bank of Japan (BOJ) keep lowering the interest rate and evenutally adopted an unusual step on February 1999 by setting the discount interest rate to 0.01%, which is practically charging commercial banks zero interest rate for funding. BOJ intended to use the super-easy credit policy to help induce the domestic demand to rebuild the economy. However, as taxpayers worry the government will soon increase tax to pay for the government debt, household consumption remained low.

Pressure for Japan's banks to consolidate are building, and an alliance fever is spreading through Japan's debt-plagued financial sector. Consolidation combine assets and customer base, thereby achieve some positive credit risk implications for the merging institutions. Conventional big banks are teaming up to try to dominate the market with an extended network of branches. One prominent example is the planned merger of the Fuji Bank, Daiichi Kangyo Bank (DKB), and Industrial Bank of Japan (IBJ) to form the Mizuho Financial Group. With the formation of the Mizuho group setting the precedent, the rest of Japanese banks rushed to look for a partner. Within a month's time, the Sakura Bank and the Sumitomo Bank soon announced their full-fledged merger. The Asahi Bank and the Tokai Bank, which already engaged in line-up talk, soon invited the Sanwa Bank to join the alliance and end up with a three-way merger. The formation of super banking giants through the intensified merger activities will undoubtedly heighten the domestic competition later.

Although bank consolidations could improve credit consideration in short term, however, the long term answer to strengthening the weak banking system lies in the ability to address the impaired assets, bad debts and non-performing loans. The Japanese banking system is in need of fresh capital injection to strengthen the capital base of banks and their industrial partners. Forced sales of Japanese assets to foreign corporations, which are unheard of in the past, finally happen in the industrial sector. Foreign investors and corporations finally crack open the closed "Keiretsu" system of Japanese corporate, of which Japanese companies form groups with cross share-holding. The General Motors Corp of U.S. had bought stake in Fuji Heavy Industries, the French automaker Renault SA had purchased a minority stake in Nissan Motor. Recently, DaimlerChrysler AG had announced to take a substantial stake in the Mitsubishi Motors Corp. On the financial sector, the U.S. stock brokerage Merrill Lynch had acquired the bankrupt Yamaichi Securities. However, low credit demand and low profitability still haunt the Japanese banking industry. The intense consolidation and competition makes the domestic business environment not so promising for entry of newcomer.

Given the Japanese economy is still struggling to recover, chances are slim that the credit demand will go up rapidly. HSBC might not be interested to invest in the Japanese market in time of economic hardship. The rising bad debt provision of HSBC would put HSBC on the prudent side of the decision-making. If HSBC enters the Japanese market, the unattractive Japanese economic fundamental would unavoidable adversely affect the bad debt provision of HSBC, which is highly undesirable at a time of distress. As a matter of fact, HSBC would prefer some sort of operation which can add to its profit immediately, therefore the HSBC management team should avoid entering the Japanese market in a recession time.

Britain and Europe

Then where should HSBC invest to expand ? The next hometown of HSBC, Britain, could be a logical choice and deserves a good look. The City of London was the largest and the most important financial centre in the European time zone. The British banking industry was deemed to face formidable competition from banks in Europe. The British government was planning to join E.U., but a timetable was not yet confirmed. As the Britain was forced to leave the European Monetary Union in 1992 under the Conservative Party, the Labour Party government is hesitate to join E.U. again in a hurry. Does the British and European Union (E.U.) market show a possible direction of development to HSBC ? Would it be a good idea for HSBC to shift the business focus from Hongkong to Britain as the Midland Bank had its origin deep rooted in Britain?

Britain

The Midland Bank was one of the four clearing bank in the City of London, and the British and European operation of HSBC contributed the largest share of profit to the HSBC group on the year 1998. The opportunity for HSBC to further expand its operation in Britain through acquisition is not so promising as the acquisition of another clearing bank would be considered as anti-competitive. However, minor acquisitions could not serve to quickly diversify the income stream of the banking group. Therefore further expansion in the British market might not be possible and attractive to HSBC at the moment.

At the same time, British banks are exploring all kinds of alliances that could potentially expand or enhance their services and operation, in order to prepare for the future of joining the E.U. battlefield. In an earlier time, the Barclays Bank had abandoned Barclays de Zoe Wedd, while the National Westminster Bank (NatWest) had abandoned NatWest Markets. Both British banks had chosen to dispose of the merchant banking business and retreat to focus on the domestic market. On the other hand, the Lloyds Bank had merged with

Trust & Saving Bank to form Lloyds TSB Group. Then at a later time, the Lloyds TSB was merged with the insurance company Scottish Widow to pursue the combination of business in banking and insurance.

NatWest soon follow suit and planned to join the bancasurrance business model by bidding for Britain's second largest life and pension group, "Legal & General Group plc" (L&G). NatWest aims to become the biggest bancassurer in the city of London with the proposed acquisition. However, the GBP 10 Billion takeover bid of L&G backfired as shareholders rejected NatWest's high valuation on L&G. The NatWest stock price falls and soon attracts undesirable consequence for NatWest. The Bank of Scotland (BOS) and the Royal bank of Scotland (RBS), both much smaller size than NatWest, separately tender their hostile bid for the NatWest. Finally, RBS beat BOS among the NatWest shareholders and announced victory. RBS and NatWest will soon merge to form the "RBS NatWest" later.

The launch of Euro had create a dominant European market which will be much larger and possess higher growth potential than the British market. The European Union will united Germany and France, currently the third largest fourth largest economy in the world, and the other European countries as well. The economic strength of the aggregate E.U. economies will be able to challenge the economic leadership of the U.S., and the future of British banking will be relying on the European market as well. Instead to be contended to position HSBC as the major player in Hongkong and Britain, Sir John Bond want to see HSBC on the global stage, competing with the players like Citibank, United Bank of Switzerland, Deutsche, and Chase. Therefore, the next foothold of HSBC should land on the continental European frontier.

Continental Europe

Europe had suffered from a prolong recession since the early 1990s. The unification of the West Germany and the East Germany had consumed the ability of Germany to lead the European economies to growth. The stern discipline of the German Bundesbank to work strict monetary policy to restrict inflation had been the principal cause to the Economic Monetary Union (EMU) turmoil in 1992. However, the various

European countries was not despair. The Economic and Monetary Union soon regain confidence and come up with the Maastricht Treaty. The eleven core E.U. member countries still manage to come together again and launch a common currency by the start of 1999.

The common currency, Euro, is now limited to settle transactions between institutions only. The notes and coins of Euro will be issued for circulation and daily use by individual countries in 2002. By that time, the majority of Europe will a one big step towards a unified market, which could possibly challenge the economic leadership of the U.S.. A wide acceptance of the Euro could challenge to displace the U.S. Dollar as the international currency, and also the foreign reserves of other countries. But in the short term, the presence of the Euro and the forthcoming unification of Europe has already act as a catalyst to banking consolidation in Europe. The banking consolidation so far has taken a largely domestic orientation. But after a considerable domestic consolidation was established, the natural extension is for banks in different country to merge.

In financial services, customer base, capital base, and geographic reach has been important. The European banking industry had been highly fragmented along national borders historically, and massive consolidation across the banking industry was needed to improve the overall efficiency of banking operations across Europe. Following the launch of the Euro, investors increasingly see the E.U. as one single market, and the national borders are gradually fading. The single currency will takes away the numerous niche markets previously protected by the national border and the difference in currency circulation.

In less than one year's time, Euro had succeed in creating a pan-European capital market for corporations to tap funding. The establish of a mature and liquid capital market provide the necessary financial resources for corporate consolidation, and result in a boom in leverage merger and acquisitions. One prominent example is the transatlantic acquisition in the automobile industry had taken place with Germany automaker Daimler Benz AG merge with U.S. automaker Chrysler to form DaimlerChrysler AG.

A number of financial institutions in E.U. had already rush to merge, both to reduce operating cost and to strengthen their own position within their respective home countries. In Germany, the Bayerische

Vereinsbank had merged with the Bayerische Hypo Bank to form the Bayerische Hypo Vereinsbank. Also, the Deutsche Bank had just announced plan to merged with the Dresdner Bank, where the new Deutsche Bank would be the largest bank in Europe, and estimated to possess twice the asset size of the Citigroup.

In France, Societe Generale (SocGen) planned a friendly merger with Banque Paribas. Then Banque Nationale de Paris (BNP) suddenly step in and announce a hostile takeover plan to bid for both SocGen and Paribas to form a three way merger. The shareholders of Paribas give in, but those of SocGen did not. Finally, BNP got Paribas, and SocGen was left alone looking for fresh opportunities.

In Spain, Banco Santander had merged with Banco Central HispanoAmericano to form the largest bank in Spain, the Banco Santander Central Hispano (BSCH). While its rival, Banco Bilbao Vizcaya (BBV) and Argentaria, merged to from Bance Bilbao Vizcaya Argentaria (BBVA).

In the Nordic countries, though Denmark and Sweden had not yet join E.U., but respective timetable are being discussed. The banks in the Nordic countries already start to merge. The Unibank of Denmark planned to merge with Marita Nordbanken, which is the merged entity of Marita of Finland and Nordbanken of Sweden. In Switzerland, Union Bank of Switzerland had merged with Swiss Bank Corp to form the United Bank of Switzerland, and Credit Suisse had merged with insurance company Winterthur to form the CS Holdings.

Regional E.U. banking giants starts to emerge from these merger activities. Until recently, most consolidation has been done within national borders, but the pace of cross-border deals is going to intensify. Later on, cross border mergers will eventually take place to form super-regional banking giants. The merger between these super giants will eventually be the final champion in the inter-continental. Under the new European economic landscape, Britain will needed to defend its role as the dominant financial centre in the European time zone.

The pace of changes in the E.U. region was hasten further by another transatlantic hostile takeover in the telecommunication industry, that Anglo-American telecommunication company Vodafone AirTouch plc raid a hostile bid for Germany telecommunication and manufacturing company Mannesmann AG. The hostile bid turn into a success, and the transaction had marked the first time successful hostile takeover of a Germany company. The acquisition also serves to unlock the potential for mergers in the pan-European landscape. Almost instantly, European institutions are looking around and talk to one another for possible action or protection. At the other end of the spectrum of financial institutions, the financial exchanges in Europe also consolidate to improve competitiveness. The Paris, Amsterdam and Brussels stock exchange had announced to merge to form the largest stock exchanges among the eleven E.U. countries, surpassing the Deutsche Bourse in Frankfurt. Although London remained European's largest stock market, its dominant positions was being challenge by the presence of potential rival in Europe.

The coming battlefield for British banks will be focused on the Europeand frontier, and HSBC had better strengthen itself and possibly start its offensive move before too late. Undoubtedly, HSBC will shift part of the group reousrces to foucs on the British market, and to prepare itself for the E.U. battlefield. HSBC had to defend its dominamce in Britain, and to expand into the E.U. market as well.

Although there is no observable acquisition undertaking by HSBC on the European region, but it does not rush to the conclusion that HSBC is not interested expansion in E.U.. One possible explanation is that, the competitive merger happening among E.U. banks had bid up stock price of banks that the current values of European banks are not attractive enough for HSBC to act upon.

Beyond the hometowns

The U.S. is the largest economy in the world. The U.S. market is a market that any bank wishes to be a truly global bank cannot miss. However, the presence of HSBC in the U.S. was limited to the Marine

Midland operation up to the Asian Financial Crisis. The U.S. market could be a logical choice of market for HSBC to explore.

North America

U.S. is currently enjoying the longest period of economic growth in history, and the U.S. economy is possibly the only economy in the world which benefits from the Asian Financial Crisis. As the various Asian countries struggle to increase export to turn around the sagging economy, the depreciated currency value and the low export price means U.S. are importing at a much lower cost than few years ago. With imports far outpaced exports, the U.S. is the only growing economy that is pulling the rest of the global economy along. With the U.S. Annualised Gross Domestic Product grew at 4.2 percent in the financial year of 1999, the U.S. economy is not showing any signs of slowdown.

The ever-expanding economy attracts capital elsewhere from the world. The improved labour productivity couple with low labour cost had formed the basis for sustaining growth with minimal inflation risk. Furthermore the recent period of technological innovation had created a vibrant economy which had enhanced living standards among a large majority of households. The technological change has spawned so many opportunities for business to expand the range and the value of their services, and the growing use of information technology throughout the economy has make the current economic boom unique from the previous one. The U.S. stock market had a major Bull Run for five years and the Dow Jones Industrial Average Index had hit and break above the 10,000 points mark last year. The wealth effect from the skyrocketing stock market had spill over to induce dramatic domestic demand, and imports from overseas surged. The trade deficit take on the record high level, and was one of the major economic imbalance deep rooted in the U.S. economy.

Under such stage of economic boom, the U.S. market seems an ideal market for HSBC to develop and expand its operation. In an expanding market, the pool of potential customer is enlarging. It is always easier to compete for new customer rather than competing in a declining market where every bank will strive their best to retain existing customers. However, the competition from the domestic U.S. banks is no easier than elsewhere.

In U.S., merger activities and consolidation also happen across the nation to form banking super giants. For example, NationsBank had merged with Bank of America to form the new Bank of America which is the largest bank in the U.S. The Chemical Bank had acquired the Chase Manhattan Bank to form the new Chase Manhattan Bank, where the Chase Manhattan bank franchise was retained for its goodwill. Also, the First Union Bank had acquired the CoreStates Bank to strengthen the regional reach of institutions, and Banc One had acquired the First National Bank of Chicago NBD to for the new Bank One Corp.

Consolidations also happen in the U.S. where the top players are eager to capture the benefits of demolition of the Glass-Stegall Act that prohibit banks and insurance company to come together. The Citicorp had merged with the Travelers Group to form the Citigroup which is the largest financial services company in the U.S.. The Citigroup will combine banking, insurance, and stock broking services together that can provide its customer a one-stop financial services centre. Also, the Chase Manhattan Bank had just announced to acquire the British merchant bank and fund management "Robert Fleming" to add to its investment banking capability.

Execution of Expansion Strategy

Based on above fundamental analysis, the actions and strategies adopted by the HSBC management were justified in pursuing its objective and mission as described in "Managing for Value". The new strategy is very clear. HSBC is focusing on the long-term return for investors. By investing more now, HSBC increase the chance of achieving more in the future.

After the Asian Financial Crisis, it is no longer in the shareholders' interest for HSBC to continue to grow its business focus on Hongkong. The resources of HSBC will be invested in more fruitful way elsewhere in the world. As HSBC will constantly look for maximum shareholders' return, the allocation of resources could not be restricted in the small Hongkong market only.

Previously, the emerging market show extremely high growth potential and HSBC had developed a higher proportion of operation in emerging markets, especially Hongkong. Now, as the growth among emerging markets had slow down, HSBC might wish to reverse its previous strategy and develop a higher proportion of operation among the developed countries. Thus, in pursuit of the shareholders' value, HSBC should decrease its investment in Hongkong although historically Hongkong is one hometown of HSBC.

Britain is a saturated market given the clearing bank status of HSBC. The potential for further growth in the British market would be limited if not impossible. However, as the prospect of the forthcoming unified European market show growth potential, HSBC would best secure its foothold in Britain, and leverage its dominant position in Britain to expand into the European market.

The U.S. market seemed to show the highest growth potential for HSBC. There is still room for expansion through organic growth or acquisition after the RNB acquisition. However, the pressing need of acquisition is satisfied to certain degree after the RNB acquisition, therefore HSBC might shift its focus to consolidate its operation with RNB for a while and wait for the next potential opportunity.

Thus, the HSBC management should pursue a global business network to extend its geographic coverage. As the first priority, HSBC should add to its operation in the U.S. and E.U. in order to fill a gap in its existing business coverage. At the same time, HSBC should also try to maintain its dominant position in its two hometowns, Hongkong and Britain. Finally, HSBC should market in recession like Japan.

As a direct consequence of globalization, HSBC would undoubtedly add to its international presence, while the Hongkong operation will be overshadowed within the banking group. Further to serve the objective of diversification, HSBC is going to play down the once close relationship with Hongkong. As one of the obvious outcome, the globalize HSBC will definitely no longer be a domestic local bank in Hongkong, and the importance of the Hongkong market to HSBC will gradually diminished. On the flip side, the commitment of HSBC to Hongkong would also scale down gradually.

In a bid to re-build investors' confidence, HSBC had to downplay its close relationship with Hongkong. However, there are so many quick association that can bring back the memory on the close relationship between HSBC and Hongkong, for example, the landmark Headquarter office building of HSBC and the Hongkong bank notes issued by HSBC. Furthermore, the HSBC stock was trade on the Stock Exchange of (SEHK) and was a heavyweight of the Hang Send Index. All these intimate links could serve to remind investors and shareholders about the once close relationship of HSBC with Hongkong.

By changing the corporate brandname to HSBC, the direct reference of the close relationship of "Hongkong Bank" with Hongkong was being severed. The new corporate brandname was a powerful tool to pass the message across. The new corporate brandname also serves to solidify the various franchises together. The last ditch of quick association of HSBC to a regional bank will be dropped. Perhaps in a few years' time, we might as well forget about the original full name of HSBC, and forget about the fact that, the "H" character once stands for Hongkong. The new brandname could thoroughly demonstrate that HSBC is going to pursue a global business, and will be devoted fully to achieve it.

CHPATER V

SURVIVING THE ASIAN FINANCIAL CRISIS

As HSBC stepped up their effort to fight the undesirable business environment changes bring along by the Asian Financial Crisis, other financial institutions in Hongkong show a wide range of different response towards the same deteriorating Hongkong fundamentals.

Some domestic local chinese banks in Hongkong have the entire scope of business rooted in Hongkong, they have no choice but to strengthen their Hongkong operation and to reduce operating cost in order to retain their competitiveness in the Hongkong market. On the other hand, some foreign banks also wish to develop their operation in Hongkong as a measure to diversify their business from their home country. However, there are still a few foreign banks turn aggressive and try to expand and capture the market share left by those retreat from Hongkong. Some foreign banks were frustrated by the drastic changes happened in the Hongkong market and scale down the operation in Hongkong. Some banks choose to abandon their operation in Hongkong and focus on their hometown market and other profitable markets elsewhere.

Aggressive Players

The Chase Manhattan Bank in Hongkong had cherry-picked Anthony Leung from Citibank Hongkong to lead the Chase "Hongkong and Greater China" operation. By supporting a high profile political role of Anthony Leung in the Hongkong SAR government, the Chase Manhattan Bank secure a higher commitment in Hongkong than ever. Furthermore, Chase had just announced to acquire the British merchant bank and fund management house of "Robert Fleming". Through the Robert Fleming transaction, Chase now own the "Jardine Fleming" operation in Hongkong which is a dominant figure in the investment banking business in Hongkong.

Another player expanding its presence in the Hongkong market is the Development Bank of Singapore (DBS). DBS had been a strategic alliance partner of a local bank, the "Wing Lung Bank", through a strategic stock holding. Recently, while Fuji Bank wish to dispose of its holding in the local bank "Kwong On Bank", DBS was quick acquire Fuji Bank's stock holding on the Kwong On Bank. Shortly after, the Kwong On Bank is renamed to "DBS Kwong On Bank" to fully reflect the new relationship with DBS.

The Dutch bank giant "ABN Amro Bank" (ABN) had enter the lucrative Hongkong property mortgage loan business since 1994. After the Asian Financial Crisis, ABN started to rebuild the retail banking business in Hongkong, with more and more retail branches are being established. The ABN had positioned itself as a prominent player in the Hongkong mortgage business, and frequently show up in promotion events held by estate developers to promote the ABN mortgage loan business. ABN is one of the rare example that that a foreign bank expand its retail banking operation in Hongkong after the Asian Financial Crisis.

On the investment banking frontier, the French bank Banque Nationale de Paris (BNP) had step up their effort to build the investment bank business in Hongkong. After the Asian Finacial Crisis, BNP had acquired the falling investment boutique "Oakreed" from the Bank of East Asia and the Long Term Credit Bank. Then, BNP acquired Peregrine, the once mighty investment bank in Hongkong found by Francis Leung and Philip Tose. BNP then merge the Peregrine operation with its own investment bank, "BNP Prime East" to form a combined entity "BNP Prime Peregrine". BNP Prime Peregrine, lead by Francis Leung, is active in investment banking business especially on the listing of "State Owned Enterprise" and other corporate of mainland China on the Stock Exchange of Hongkong.

The "Bank of East Asia" (BEA), a local bank owned and managed by local chinese, had initiate an internal re-organization in 2000. The internal departments are aligned into three separate lines of business, namely personal banking, corporate banking, and investment banking. The re-organization exercise was aimed to better position the bank to serve its customers, and to build a more aggressive image for the bank in order to attract more customer of younger age and middle level income professional. Furthermore, BEA is the first local commercial bank to aggressive push for the internet banking concept through its "Cyber Banking" services. Other local banks in Hongkong, such as the Wing Lung Bank and the Shanghai Commercial Bank, happen to launch banking services through the internet at a later time.

Retreating Players

Before the 1997 hand over, some foreign banks had shift part of their operation away and scale down the Hongkong operation. Prominent examples are the Deutsche Bank, the National Westminster Bank (NatWest), and the Union Bank of Switzerland (UBS) before its merge with Swiss Banking Corp. (SBC). Some banks simply fold their Hongkong operation and retreat, like the Royal Bank of Scotland (RBS) and the Toronto Dominion Bank (TorDom).

With the Japanese economy still suffering the longest recession since Second World War, the Japanese banks in Hongkong take the largest instance of withdrawal from the Hongkong market. The Japanese Head Office of the Daiwa Bank had decided to abandon all overseas operations, and the Daiwa Bank Hongkong operation cease to operate by the end of 1999 and surrender the banking liscense to HKMA. Another Japanese bank, the Fuji Bank, had sold its holdings in the local bank "Kwong On Bank" and lower its business commitment in Hongkong. A regional Japanese bank, the "Bank of Kinki", abandon its operation in Hongkong and subsequently surrender its Hongkong banking liscense to HKMA in order to focus on domestic Japanese business.

CHAPTER VI

MORE FRONTIER

A possible open battlefield for HSBC to attack is the internet banking arena. The rapid growing network had revolved the retailing industry and could spread the e-commerce business across to other industry as well. The e-commerce business model has the greatest potential to revolutionize the banking industry. Recently, e-commerce face limitations such as security, legal framework, and bandwidth. However, these technical limitations should be overcome in short term. While the cost of accessing the internet was persistently declining, the prospect of growth on the internet was growing indefinitely, and the e-commerce business model shows much potential in its development. Online banking is expanding, and the wireless connection to internet could be the next battleground for online banking and financial services.

The Internet

The advent of the internet connect the global financial market together, and is usually referred to as the "New Economy". Previously, technology is a supportive operation to support frontline core banking business. But the rapid technology advancement change that all, nowadays the sophistication of technology had become more and more a consideration of competitive advantage to financial institutions. Those banks that are technologically deprived will fall even further behind. Some skeptic perceive the internet as a marketing tools only, and a majority of the current activities on the internet are limited to following links and accessing websites. However, the evolution of the internet is pointing to the direction of having business transaction in a much more user-friendly and secured environment.

The internet offer a new broadcasting and promotion channel for banks, and e-commerce could leverage the internet as a channel for extending global reach. Financial institutions create new opportunities and benefits for customer via the internet, and realise the inevitability of the increasing role of e-commerce. The internet provide a way to keep in touch with the customer at low cost, and there are already increasing commitment from the various global banking players to embrace the e-commerce model. While much of the world is still trying to figure out how the internet will influence their business model, some banks had already take action and try to achieve the first mover advantage. The internet could be another business scope that the HSBC should put its focus on beyond the geographic coverage.

To that end, national borders break down in the face of internet, and global banking giants could easily locate, invade, and conquer the profitable niche market through the reach of the internet. The internet could ultimately change the business landscape of banking services. A definitely trend observed was that, transaction activities were migrating over to the internet. "Business to Business" (B2B) and "Business to Customer" (B2C) are the two hottest topic in the technology world. The battle for e-commerce business comes as more and more industrial and financial institutions banks are pushing for the e-commerce business model.

First movers to the internet demonstrate commitment to e-commerce model and help to build trust and confidence on the internet. The U.S. retail stock brokerage house Charles Schwab, emerge from nowhere, opt to offer barebone stock broking services over the internet. In just a few years, Charles Schwab had become a household name and was now the dominant force of online stock broking powerhouse.

Beyond the financial sector, the "Amazon.com" had successfully established and executed its unique and innovative business model of book-selling on the internet, and the brick and mortar book shops like "Barnes and Noble" and "Borders" soon trying to catch up the effort on the internet. However, the Amazon.com had already dominate the online book-selling market and use that dominance to expand into other field of business like music, toys, and online auctions, and had evolved itself quickly into the business "electronic retailing", or "e-tailing". Nowadays, the business model of Amazon.com resembles that of Wal-Mart than simply an online bookseller. Who knows whether the same thing might happen to the banking business or not in the future ?

Since the internet show great potential for first movers to dominate the new market and new environment on the internet, some first movers have taken the idea and develop into an amazing business. The first "pure" internet bank on the world wide web is the "Security First National Bank" which was later acquired by the Royal Bank of Canada. In U.S., some of the large "brick and mortar" banks had established their own websites and use the website to promote and deliver the banking services to customers. For example, the Chase Manhattan Bank had launch the "Chase.com", the Citibank had the internet banking service "Citibank Financial Interactive Network"(citifi), the Morgan Guaranty and Trust had launch "LabMorgan", and the Bank One had the "eMoneyMall" services and the pure internet bank "WingspanBank.com".

In Europe, internet banking pioneer BNP has established three different and separate internet channels, "BNP.Net", "eCortel", and "Banque Cirecte", and BNP had already occupied around 30% of the French online banking market share. In Spain, BBVA planned to merge its online banking "Uno-E" with the Dublin based internet bank "First-E" to form the "UnoFirst" for a larger European market share. In Britain, Prudential insurance had its own internet banking services "EGG", and the Barclays Bank has the "Barclays B2B.com". And as part of the announced merger of Deutsche Bank with Dresdner Bank, the new Deutsche Bank will spin off the combined branch network to allow the new Deutsche bank focus its future expansion on the internet.

In Hongkong, a bank run by the local chinese, the Bank of East Asia, had launched their "Cyber Banking" services which deliver the banking services through the internet, mobile phone, and other channel. Other local banks are quick to follow. The Wing Lung Bank had quietly build their own website that the customers can access for account information and banking transaction. The Shanghai Commercial Bank soon announce and promote the internet banking services "iBanking". The Wing Hang Bank, which is wholly owned by the Bank of New York, had just launched the "ezfinancial" for payment services of stock transaction and also the "Cyber Wing Hang" banking services.

Although "Hongkong Bank" had established websites based on the existing franchises, such as "www.hsbc.com" and "www.hangseng.com". However, these websites are used to dispose corporate information, and was not used to secure business transaction over the internet. The "Hongkong Bank" and the Hang Seng Bank had just announced plan to introduce internet banking services in Hongkong by mid-2000, it seems HSBC had lag behind in offering services through the internet and had to play catch up soon.

CHAPTER VII

LESS THAN SURPRISE

On 02 April 2000, HSBC announced a friendly takeover of the French retail bank Credit Commercial de France (CCF) for EUR 160 per CCF share, totaling EUR 11 Billion. The acquisition is a natural extension to the expansion strategy of HSBC in the European frontier, and does not bring much surprise. The price tag of the CCF deal trumps that of the RNB transaction and tops the list of HSBC acquisition. The retail operation of CCF adds over one million retail customers in the middle and upper class in E.U. to the HSBC customer base. The CCF acquisition suggests the HSBC had step up its effort to attack the E.U. market, in the long run and on the strategic front. Now, HSBC had successfully established foothold in the two largest economies of the continental Europe, with CCF in France and "HSBC Trinkaus & Burkhardt" in Germany. HSBC becomes a serious player on the E.U. front as well after the CCF acquisition.

Once again, HSBC is paying a expensive price for a healthy institution which can fit into its strategic front. The CCF acquisition should enable HSBC to provide a wide range of services in Europe, and strength its position in Europe that could form a platform to integration further operation elsewhere in Europe. Some degree of consolidation between the Germany operation and French operation of HSBC is expected, and further acquisition is still possible. Further expansion into the largest E.U. member economy, Germany, is still possible. Also, HSBC might be interested to pursue an operation in the third largest E.U. member economy, Italy.

With the RNB and CCF acquisition accomplished, the urgency for HSBC to shop around is decreasing. The two acquisition are positive for HSBC, and will contribute to HSBC's business profile. After that, HSBC now possess a very strong position as one of the world's largest and most diversified brandname in the banking industry. Now, HSBC do not need a large scale acquisition in order to remain competitive. The objective to fill the gap in geographic operation was somehow achieved. HSBC could grow satisfactorily based on its global business without further acquisition of large size. The principal task of HSBC might shift to the integration of the RNB and CCF operation into the HSBC structure, and to streamline the operation and to achieve cost reduction. However, if opportunities arise, HSBC will definitely be interested to act to further strengthen its muscle.

Another event that brings a little surprise comes as the proposed merger between Deutsche bank and Dresdner Bank collapse. The failed merger had left both big German banks in embarrassment. Disagreement over the fate of Dresdner Kleinwort Benson, the investment banking arm of Dresdner, was the key to killing the merger. The Deutsche Bank chairman wish to dispose of the entire or a majority of Dresdner Kleinwort Benson, while Dresdner Bank want it integrated into the merged entity. The Dresdner Bank Chairman was shock to know the plan to abandon Dresdner Kleinwort Benson and announced to abort the merger plan with Deutsche bank.

The Dresdner Bank Chairman then voluntarily submit his resignation after the failed merger, and the Dresdner Bank is in search of a concrete business strategy for future growth. However, the failed merger exposed the weakness of Dresdner Bank in maintaining its independence. Dresdner Bank is seen as lacking a coherent business strategy and is now vulnerable to takeover and several banks have been mooted as the possible bidder for the now vulnerable Dresdner Bank. Possible bid could be come from candidates including Bayerische Hypo Vereinsbank, Citigroup, ABN Amro Bank, Internationale Nertherlanden Group (ING), Banque Nationale de Paris (BNP), and HSBC.

Final word

As the HSBC management team continues the momentum of the business along the three geographic operations, and continues to re-build customer trust, the re-engineering process could eventually realise and unlock the tremendous stock value of HSBC. The milestone re-engineering process is based on the desire to build a truly international organization. HSBC does stand a good chance of becoming a global player in the banking industry.

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