Report

A study on business development of global service providers in Asia : "Glocal management" of HSBC

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Introduction

A growing number of Japanese companies are expanding their businesses globally, especially in emerging markets in Asia, where business prospects are fueled by strong economic growth expectations and rise of the middle class. Companies in Japan's service sector following manufacturing sector, which have expanded into foreign markets ahead of other industries, are now entering such markets.

However, when it comes to activities of service-sector companies (hereinafter referred to as "Service Companies") in Asia including banking, insurance and retail sectors, major Western companies have already established a strong presence. Thus analyzing and understanding their strategies and activities can provide useful implications for the business development of Japanese Service Companies in Asia, and contribute to their sales and profit growth.

To this end, in this first paper I present a case study of HSBC as a typical financial group led by a bank. I examine factors contributing to its business success worldwide and in Asia in particular, omitting a detailed analysis of its business and financial condition due to space limitations. I will look at how HSBC has put into practice "Glocal Management" under its well-known slogan as "The world's local bank" in its actual strategies and business activities.

1. Asia's transition to a service-dominated economy and the strong presence of global companies

Total expenditure on services in Asia increased 1.6-fold in the decade from 1998 to 2008 and is expected to grow further as the service sector accounts for a growing proportion of the world economy (Japan's *White Paper on International Economy and Trade 2010*). Thus Asia's service sector has expanded in tandem with economic development (Petty-Clark's Law). Furthermore, our research on each segment of the service sector shows that many companies with a significant presence in Asia are based or were established in advanced countries. These companies include Carrefour Group (France), Wal-Mart Stores (U.S.), TESCO (U.K.) and Metro Group (Germany) in the retail sector, and AIA Insurance (U.S.), and Prudential (U.K.) and Manulife Financial (Canada) in the life insurance sector. HSBC was established in Hong Kong, Citibank (U.S.) and Standard Chartered Bank (U.K.) have a large market share in the banking sector and provide a wide range of services including retail banking for local customers on a larger scale than Japanese banks, which focus heavily on providing financial services to Japanese corporate customers.

Although Japanese Service Companies are expanding globally including in Asia, they do not have the same presence or long history as Japanese automobile and electrical appliance manufacturers or Western Service Companies. Therefore it is worthwhile to study the cases of Western Service Companies to help identify factors that could contribute to the success of Japanese Service Companies.

From this point of view, I will examine the features and strengths of the global business development of HSBC, a major financial group led by a bank, including the Asian region. Although HSBC started as the Hongkong and Shanghai Banking Corporation Limited (referred to below as the "Bank"), it has since increased its lines of business and expanded its operating areas as described below. I will look at the whole group (consolidated basis) controlled by HSBC Holdings plc, the group's holding company, as well as the Bank, which is the group's flagship company and a core bank in Asia even today. When other lines of business or other group companies are mentioned, they will be identified appropriately.

2. Outline of HSBC

(1) Brief history

HSBC is one of the world's largest full-service financial groups, and is controlled by HSBC Holdings plc, which brings together a number of companies including the Bank under its umbrella. Its core business is commercial banking. HSBC is based in London, and has around 8,000 offices in 87 countries, and around 300,000 employees providing financial services to 100 million customers. Total assets are USD 2.4 trillion (according to the latest data on its website). The group has used "HSBC" as its unified group-wide brand name since 1999. According to *The Banker* magazine, HSBC is ranked fourth in total assets (in the July 2010 issue), fifth in Tier 1 capital (the same issue), and first in brand power (February 2010 issue; see Table 1). *Euromoney* magazine named HSBC as the "Best Global Bank" in its 2009 annual awards.

The Bank was established mainly by the British in Hong Kong in 1865 for the main purpose of financing the trade between the U.K. and China, was the group's first company and "HSBC" comes from the Bank's abbreviation. The Bank is ranked fifth in terms of total assets among banks in Asia excluding Japanese banks (*Asia Week* 2010). The top four banks are the four largest state-owned banks in China. In this connection, other high-ranked banks include the State Bank of India (8th, India), Kookmin Bank (12th, Korea), and Development Bank of Singapore (14th, Singapore). The Bank opened a Yokohama Branch in 1866. The Bank was one of three banks issuing Hong Kong dollar banknotes in Hong Kong and had taken the role of Hong Kong's central bank until the Hong Kong Monetary Authority was established in 1993. Hang Seng Bank, a subsidiary of the Bank, is a well-known bank in Hong Kong and the namesake of the "Hang Seng" Index of the Hong Kong Stock Exchange.

The Bank established a large number of branches and agencies in various parts of Asia for a short period of time including the Shanghai and London branches in its inauguration year, expanding its operating areas (Yokohama branch was established in 1866). The Bank's branch network included branches in China, Japan, Indonesia, Philippine, Singapore, India, Burma (now Myanmar), Thailand, Malay Peninsula, Ceylon (now Sri Lanka), Vietnam, the United States (New York and San Francisco), France (Lyon), and Germany (Hamburg). The Bank was hurt by the turmoil of World War I and II, and many branches were closed on mainland China when the Communist Party took power. Meanwhile, in this period of confusion, the Bank supported many entrepreneurs who flowed into Hong Kong from mainland China, and transactions with such entrepreneurs resulted in a stronger relationship with local customers and business expansion including retail banking. These factors contributed significantly to the Bank's growth, along with the industrialization of Hong Kong, especially the rise of textile and other manufacturing industries. The Bank reorganized its businesses across Asia, excluding mainland China, under such conditions shortly after World War II.

Although the Bank had expanded its business by increasing branches and agencies fundamentally as a financial institution focused in Asia until the middle of 1950s, from the late 1950s the Bank established subsidiaries and acquired existing banks with the aim of establishing a group system that could offer banking services worldwide including in Europe and North America. In this early period, the Bank established the Hongkong and Shanghai Banking Corporation of California based in San Francisco in 1955, acquired The British Bank of the Middle East and The Mercantile Bank in 1959, both of which were based in London, and bought a controlling interest in The Hang Seng Bank based in Hong Kong in 1965. However, it appears that most acquisitions were made to help local banks with financial difficulties within its operating areas in response to requests from local governments and the banks themselves. The

Bank accelerated its strategic acquisitions from the 1980s to expand its geographic scope and to diversify risks (it wanted to reduce the risks from its excessive reliance on business activities in Hong Kong ahead of the handover to China in 1997). In addition to banks, companies acquired by HSBC include brokerage firms, insurance companies and non-bank finance companies. Although HSBC operates businesses worldwide now, it was not among the top 100 banks (in terms of total assets) in the world until around 1977. After acquiring a majority stake in New York-based Marine Midland Bank in 1980, HSBC became the 30th ranked bank in 1985. In 1992, it became one of the largest financial groups in the world by purchasing a 100 percent stake in Midland Bank (now HSBC Bank plc), one of the four largest banks in the U.K., in what is still the largest M&A deal in banking history. It has expanded its business through such active M & A activities from the 1990s.

HSBC resumed operations in mainland China, opening representative offices in Beijing, Guangzhou, Shenzhen and Amoy in 1980. It obtained the first bank license granted to a foreign bank in the People's Republic of China in 1984, and established the Shenzhen Branch. HSBC started operations as a foreign bank permitted to conduct renminbi business in mainland China in 1997 and expanded its branch network there. The head office in China was moved from Hong Kong to Shanghai in 2000 and renamed as the China General Representative office. In 2007, it started operations as the first locally licensed bank in China (Standard Chartered Bank, Citibank and The Bank of East Asia started operations at the same time). The Bank acquired an 8 percent stake in the Bank of Shanghai in 2001, and a 10 percent stake of Ping An Insurance Company of China, a local major life insurance company (its stake was later raised to 19.9 percent) and a 19.9 percent stake in Bank of Communications in 2004 (also, Hang Seng Bank acquired a 15.98 percent stake in the Industrial Bank of China in the same year). As a result, it boasts the largest branch network and size of operations among foreign banks.

HSBC has expanded its network by establishing branches and subsidiaries in Southeast Asia, India, Australia, France, Central and Eastern Europe and Central and South America (Table 2 presents a good overview of active measures in Asia, as prepared by Mr. Peter Wong, CEO, Asia Pacific).

HSBC Holdings plc, a holding company, was formed in 1991 in London and controls group companies under a pyramid-shaped structure.

(2) Outline of business

As mentioned above, the group's structure is one in which HSBC Holdings plc brings together a number of group companies including regional holding companies and banks under its umbrella (the Bank controls affiliated companies which provide overall financial services including banking, securities and insurance in the Asia-Pacific and Middle East, maintaining a large presence in the group). The group adopts a matrix management system in which principal regions and lines of business are taken into account.

The holding company is in charge of preparing management policies of the whole group, determining subsidiaries' risk limits, establishing the group's common computer system, and standardizing office procedures. There is significant empowerment with respect to decision-making or management of business in each region and line of business in HSBC, and the personnel system enables officers and upper managers of the holding company to manage significant subsidiaries as officers of such subsidiaries, resulting in smooth collaboration between headquarters and subsidiaries. These factors reflect the high value placed on laws and regulations, the actual state of transactions and business practices, and the sense of value and culture in each operating area. On the other hand, to improve scale efficiency throughout the Group, it consolidates its computer systems, risk management, standardization of office procedures and call-center business globally or in each region. Also, it considers allocation of strategic and management resources from a global point of view, standardizes and consolidates necessary operations, and carries out businesses in accordance with the features and actual situations of each region, thereby implementing "glocal management."

Main group companies and corporate governance including officers of the holding company and financial results on a consolidated basis (including information by region and line of business) are as follows.

(a) Principal subsidiaries (former company name is shown in parentheses)
The Hongkong and Shanghai Banking Corporation Limited: Hong Kong and throughout Asia
Hang Seng Bank: Hong Kong
HSBC Bank plc: U.K. (Midland Bank)
HSBC France: France (CCF: Credit Commercial de France)
HSBC Finance: U.S. (Household International), consumer finance and other businesses
HSBC Bank USA: U.S.　(Marine Midland Bank)
HSBC Bank Brasil-Bank Multiptol: Brazil
HSBC Mexico: Mexico
HSBC Private Banking holdings (Suisse): Switzerland, Private banking

(b)Corporate governance in the holding company
(ｉ)　18 Members of the Group Board
* 6 Executive Directors

Most of them including Mr. S K Green, Group Chairman, and Mr. M F
Geoghegan, Group CEO, have spent most of their careers in the HSBC group, reached their current position through internal promotion, and have been in charge of major divisions and offices. Although originally from Europe or the U.S., many of them have extensive experience working in various places in the world (the chairman has been stationed in Hong Kong, New York, the Middle East, and London, and the CEO in the Americas, Asia, Middle East, and Europe).
* 12 Non-Executive Directors (Outside Directors who head prominent
companies)
In addition to the above Directors, there is one Secretary and one Adviser to the Board.

(ii) Principal Committees
Committees consist of the Group Management Board, Group Audit Committee, Remuneration Committee, Nomination Committee, Corporate Sustainability Committee, and Group Risk Committee, all of which are occupied by the Directors mentioned above.

(c) Overall financial results and segment information by region and line of business
HSBC recorded pretax profit of USD 7.1 billion in FY 2009, a 24 percent decline compared to a year earlier, mainly because of a goodwill impairment loss related to a financial crisis in North America. Pretax profit, excluding the item, rose 56 percent to USD 13.3 billion. Although the Royal Bank of Scotland (RBS) and Citibank, which are major banks ranked with HSBC, suffered a huge loss in North America and Europe and received an injection of public funds, HSBC has continued to post profits every year despite such losses because of profits generated by its businesses in Asia. This shows that its geographically diversified and wide-spread businesses lead to stable financial results.
Furthermore, its capital adequacy ratio and Tier 1 capital ratio stand at 13 percent and 10.8 percent, respectively. Thus its capital is at a satisfactory level. Its profits and capital adequacy ratio improved in the first half of FY 2010. Pretax profit in the Asian region accounts for 52.8 percent in the overall pretax profit in the period.

Globalized large bank groups including HSBC and Citibank are characterized by their efforts to concentrate resources on local retail businesses. On this point, they are different from the four largest state-owned banks in China, which do not operate businesses outside mainland China, despite their massive size, or Japanese banks, whose overseas businesses still focus heavily on providing financial services to Japanese corporate customers.

3. Management policy and strategy

HSBC focuses on generating growth and profits based on the group's tradition, financial techniques, and investments with a vision of serving as "The world's local bank" over a long period of time, according to its website and business and financial reports. They also mention that the Bank's strength lies in its pre-eminent position as the largest international emerging markets bank with a long experience in Asian operations, widespread global network and customer base, international management culture, and solid financial strength.

HSBC operates four major lines of business (personal finance services, commercial banking, global banking and markets, and private banking) under five business principles (outstanding customer services, effective and efficient operations, strong capital and liquidity, prudent lending policy and strict expense discipline). HSBC claims to place equal weight on morality and profit in its business conduct.

Based on its understanding that recent world trends point to high growth of emerging economies, trade expansion, and population aging in advanced countries, the Bank gives priority to investments in high growth markets. In doing so, it makes good use of its global network and specialized skills and know-how in its operations in advanced countries, while strategically maintaining its financial strength. To attain its objectives, HSBC considers it necessary to: increase value-added through closer collaboration between each business division and regional offices in the Group; boost profitability by utilizing the unified brand and its global network, manage the Group efficiently through economies of scale; and find and recruit capable officers and employees by offering incentives under an objective assessment system. Relocation of the principal office to Hong Kong demonstrates the increasing importance of its business in Asia.

4. Global Business Development of HSBC (Strategy and Business Activities)

(1) Features of global management of HSBC

As seen by its history, HSBC is unique in that as the Group's first company, the Bank was formed in Hong Kong by the British and people of various other nationalities at the end of the 19th century. Since it operated businesses mainly in Asia in its early stage, people who worked for the Bank accumulated experiences under quite different cultural and business circumstances from the West. The Bank emphasized deposit and loan transactions in addition to foreign exchange transactions with local customers in Hong Kong and other Asian areas, unlike other British banks at the time who were mainly concerned with businesses (interests) related to the U.K. and India. The Bank's stance resulted in the acceptance and development of the Bank in various parts of Asia (its recent approach to Islamic finance is also a good example).

The Bank also performed the role of Hong Kong's central bank until The Hong Kong Monetary Authority was established in 1993. This provided a good opportunity for the Bank to consider how finance should be approached from a higher perspective. Furthermore, it faced failures of large debtors, uncollectible loans, and sea changes caused by World Wars I and II and China's evolving political system.

Apparently, the Bank learned from experience that it is important to avoid relying too much on business relations with specific industries or customers or locations. Thus the Bank established an independent business management policy for transactions with a wide range of customers, adopted a conservative policy on lending and write-offs, and trained employees to be specialists in international business. I think these factors formed the basis of today's management and helped enable the Bank to adopt a global vision. This led to a strategy and policy to standardize operations and computer systems worldwide, including operating the matrix system smoothly in the "glocal management" under the slogan of "The world's local bank," and operating businesses in each region while taking into account regional characteristics. The Bank is also engaged in regional contribution activities in regions where the Bank operates in accordance with regional needs.

(2) HSBC's unified brand and effort to raise brand awareness

The Group has used the "HSBC" brand and the hexagon logo since 1999 to strengthen the Group's corporate identity with the aim of raising brand awareness in international markets and value recognition by stakeholders. The initials "HSBC" are prefixed to the names of many companies in the Group. The unified brand is meaningful, as the Bank offers comprehensive services to customers throughout the world who recognize and trust the brand, by means of the Internet or telephone, although changing a company name which is locally well-known may cause some risks (for example, Midland Bank, a larger bank in the U.K.). The brand is widely recognized around the world as arguably the world's most valuable banking brand, as mentioned earlier, as a result of its concentrated efforts over a short period of time. (HSBC recognizes the necessity of the unified brand, as seen by the following anecdote: when a customer of Midland Bank met with trouble while traveling in Thailand, he was unable to solve it because he thought no HSBC offices were nearby.)

HSBC
The world's local bank

Provided courtesy of HSBC

(3) Training employees to be specialists in international business

HSBC is a company with a worldwide network of offices and officers and employees of various nationalities (in the last year, new employees came from 50 countries or regions) and it considers such diversity to be a strength. It is important to note that most upper level managers have extensive work experience in foreign counties.

Furthermore, when it comes to global business development, we should pay particular attention to a position at HSBC called “International Manager” (IM), who are among the Bank’s key employees. They are employed on the condition that they agree to work in any office throughout the world and to engage in various lines of business. At present, HSBC has 380 IMs working in 57 countries or regions, and plans to employ more. IMs have a long history at the Bank, which was originally established by trading merchants in Hong Kong who conducted business far and wide. Whenever problems arose in a foreign country or region, international officers (IOs), as they were once called, were dispatched to settle them.

IMs are reassigned to a different office in any part of the world every two to three years. Typically, over a 30-year career, they will work at ten different offices, and be in charge of international business, including integration of operations and organizations in M&A, dealing with a wide variety of problems, according to recruitment information on the HSBC website and a book edited by the Global Management Committee (2009). They are generalists in international business, not specialists in a specific business or line of business. Their role as a conveyor of the group’s basic policy and culture is important, and many of the group’s executives were once IMs. Special allowances and holiday allowances are provided due to the strict working conditions.

My impression is that the IM is similar to the “International Staff” of Citibank, as introduced by Mr. John Reed in *DIAMOND Harvard Business Review* (2005). He says that a person in the position “has a role to play in conveying the company culture to employees throughout the world and is a member of corps which station abroad as a permanent overseas resident and needs to prepare for going to any place at any time on receiving an order.” There are also similarities between the IM and the “regional specialist program” of Korea’s Samsung Group, which has attracted attention recently. I think training employees to be specialists in international business as well as employing capable people in each country or region give the Company a competitive edge that is indispensable to the smooth conduct of global business operations, in which complex problems often arise abruptly.

5. Features and Strengths of HSBC from the Viewpoint of International Management Theory

Earlier research on the theory of international management of multinational enterprises focused on manufacturing industries. Leading theories were the oligopolistic theory of S. Hymer, C.P. Kindleberger and R. Caves, the product lifecycle theory developed by R. Vernon, the internalization theory of P.J. Buckley, M. Casson and A.M. Rugman, and the eclectic theory of J.H. Dunning (also known as the OLI paradigm), which is notable and regarded as a comprehensive theory. Dr. Dunning asserts that the theory can be applied to the overseas business expansion of service industries. I will enumerate and examine the features and strengths of HSBC by applying this theory after tidying up my arguments.

The theory states that a company will decide to make an overseas direct investment when it can claim to have three advantages: ownership-specific advantages, location-specific advantages, and internalization incentive advantages. I would like to examine these advantages with respect to HSBC.

However, I would first like to point out some features of the services provided by Service Companies which differ from manufactured products such as: intangibility (services cannot be identified until they are purchased), inseparability (services cannot be separated from their providers) perishability (services cannot be stored); difference in satisfaction standards (consumers become concerned about whether services are satisfactory); and participation of customers in the service provision process (customer attitudes influence the quality of services).

These features indicate that customer confidence, awareness and reputation are considered more important when it comes to providing services than in the manufacturing sector, where products can be easily compared. Thus it can be more difficult for Japanese Service Companies to expand into overseas local markets and try to reach customers there. Unlike manufacturers, who can easily compare product specifications and performance against competitors and take definite measures, Services Companies face a more complex set of factors that influence competition, and thus require a different approach.

Thus when examining HSBC from the viewpoint of the three advantages of the eclectic theory, I take into account the unique features of services and the different competitive environment among Service Companies. The results are as follows.

(1) *Ownership-specific advantages (competitive advantages in goods, technologies and business management methods):* capable and veteran employees (officers and employees with extensive experience and expertise); access to management resources (including fundraising advantages in certain stock markets and ability to issue bonds at more favorable conditions because of higher ratings); owning a broad and efficient network (network of offices and consolidated IT and back office operations); accumulation of working experience and know-how of multinational businesses; provision of specialized services to particular customer groups in response to their banking needs (syndicated loans, project finance, sovereign loans or private

banking services for high-wealth individuals); creditworthiness and brand power; and advanced and superior sales methods and fund management.

Thus thinking with a global vision and on a global scale, concentrating management resources, and supplying financial products and technologies at an appropriate timing are great advantages of a global financial institution.

(2) *Location-specific advantages (cost advantages and market opportunities of the location):* expansion of emerging markets and local investment opportunities; acquisition of projects in large advanced markets; establishment of business processing centers and call centers in low-cost areas; profiting from interest rate differences (borrowing funds at a low interest rate to invest at a higher interest rate).

(3) *Internalization incentive advantages (of overseas direct investment and an investment incentive program.):* sharing information, knowledge, and know-how; sharing competent human resources among group companies;. abolition or deregulation of restrictions on foreign investment in promising markets of emerging countries.

6. Summary and Conclusion

When first established, the Bank possessed a global perspective and opened branches in various places around the world, apparently with the intention to conduct global business operations from the beginning. Yet the Bank was not very active in its overseas business development until around the 1970s, and exhibited a "neutral" stance and mostly passive behavior. The hand over of Hong Kong to China in the 1990s, combined with the recognition of its risk, prompted the Bank to adopt a strategy to expand its business activities globally. As a result, the Bank became aggressively engaged in M & A activities and formed the HSBC group.

Significant factors in the Group's success are its accumulated "DNA" of overseas business development, organizational learning through the experience of dealing with its own financial difficulties and training specialists in international business to steadily develop a management staff of IMs (previously IOs) with extensive overseas business experience.

I regard HSBC as one of the few financial groups which come under the category of "transnational enterprise" characterized by management that is unified globally although the peculiarity of local markets is considered, coordination of activities across the worldwide organization to provide balance between central control and local independence, and transfer of knowledge, know-how, and human resources within the worldwide organization. These characteristics are consistent with a higher level of multinational enterprise which Bartlett and Ghoshal advocate.

While many leading financial institutions were hard hit by the global financial crisis and needed capital injections, HSBC was not among them. It has posted net profits and its financial performance has been recovering. This shows that the risk diversification resulting from global business development is meaningful. However I think it is necessary to watch its businesses in the U.S., where HSBC suffered losses and still faces a challenge.

My analysis of HSBC has focused on the strategic features of its global business development. As such, I have selectively omitted a wide range of activities not directly relevant from the viewpoint of the internationalization of enterprises. Although John Dunning states that it is possible to apply the eclectic theory to service industries, he also states we should pay attention to differences among various service industries because each service industry is unique. Thus I think this study should be pursued further including a more detailed study of the Group's individual factors, as well as a comprehensive study based on various theories of internationalization of service industries and achievements of prior research on retail and other industries.

HSBC (Hong Kong)

Provided courtesy of HSBC

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