

Succeeding in a Global Marketplace

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Good morning ladies and gentlemen. It's a great pleasure to be in Prague today and to offer you my thoughts about succeeding in a global marketplace.

I must admit that Prague would not have been my first choice of location for this subject matter. I think it is unquestionable that HSBC is a global bank and, I believe, a pretty successful one at that, but we are not well-represented in this part of the world. Of our 10,000 offices around the world, we have only a handful in the Czech Republic.

Banking, like any other industry, is not immune to the vagaries and vicissitudes of fashion, and when I started thinking about this subject, my first question was, is global banking in or out of fashion?

In some respects it would seem to be very much in fashion – as evidenced by, say, the current competition for control of ABN Amro.

But, in other respects, global banks are not the 'new black' of the equity markets today. The shares of large cap banks have not been valued by the market as highly as those of the mid cap banks. And this underperformance is a trend that you can trace back some five years or so.

This begs the question as to why?

I think there are a combination of reasons.

Firstly, that large cap companies overall have been somewhat out of favour, and trading at a discount to the market for some time. So to an extent, large cap banks are reflecting a broader market trend.

Secondly, given the recent tendency towards consolidation in many banking markets, it seems likely that some of the exuberance in the share prices of smaller banks is an anticipated acquisition premium. Smaller banks are takeover targets in a way that huge ones are not. At least, I hope I am right!

Thirdly, that despite much talk of the synergies and efficiencies that a larger organisation can achieve, I think we have to concede that there is a distinct lack of empirical evidence that size equals efficiency. Certainly, economies of scale are achievable and achieved. But with size comes complexity, and managing that complexity can be time-consuming and expensive.

So why the continued pursuit of larger franchises, in-country and cross border? Even in the domestic arena, the trend is towards upsizing and consolidation – banks are becoming bigger and their absolute numbers are falling in markets such as the US and in a number of European countries. And we are beginning to see an increasing number of cross-border deals, not least in central and eastern Europe.

So perhaps the better question is, is it possible to be small and global? And it seems to me that the answer there is unequivocally 'no'. You need scale in individual markets if you are to provide international services to internationalising clients.

So it is against this backdrop that I'd like to look first at the opportunities – and later some of the hurdles – that await the globalising bank.

The first trend I'd like to highlight is one that is familiar to you all. The overall trend towards globalisation and economic integration. This is a subject that has had tremendous exposure in the last five years, and I don't plan to reprise it here, other than to make one point. Before the emergence of China and the fall of the Berlin wall, the number of people in the world who contributed to the world economy was about three billion. Today the potential participants in the global marketplace have virtually doubled to around six billion. Small wonder then that globalisation is changing the nature of virtually every business sector and massively re-shaping the world economy.

One of the effects of this phenomenon has been to make people and business more international today than in the past.

On the personal side, individuals travel more on business and leisure, buy properties overseas and generally have a far greater need for cross-border services than in the past. It is hard to believe that as late as 1979, the UK still had exchange controls and that you could take only £50 out of the country and the amount you took would be stamped in the back of your passport.

I digress. We estimate the number of people who fit this category of customer to be something in the order of 200 million – a massive potential market for any bank that can get its service proposition right. We think we have made tremendous headway in this regard, with the launch of a new service called Global Premier. This aims to reach the parts that purely domestic banks cannot –

**people and business
are more
international**

giving customers a portable credit history, a single view of all their accounts across borders, and a single telephone number – 1 9 0 8 Premier – to contact us on wherever they are in the world.

Another phenomenon resulting from more open markets has been the growing numbers of people who migrate around the world in search of better work and higher living standards. One of the most obvious recent examples has been the movement of people from central and eastern Europe to western Europe – in particular to Britain – in search of work. These flows of people echo a long-established tradition of economic migration – of Mexicans to the US – Chinese people to Vancouver – or going back to the 19th century, of Chinese people to California in the years of the Gold Rush.

So the phenomenon is not new, and nor is the opportunity it creates. However, it is one that is being sought and exploited in new locations.

In the UK, we serve migrants with a dedicated account called Passport – it has attracted customers from over 200 countries around the world. Similar opportunities exist in the Middle East, where I worked for many years, which has a very large non-resident Indian population, and of course, in the US, where people of Hispanic origin now account for some 14 per cent of the population. And there are many other examples around the world.

In many instances, the individual sums and accounts involved are small – but taken in combination, this has the potential to become a very big business, one that is growing rapidly, and one that purely domestic banks cannot easily serve.

And in other areas of financial services, such as the still nascent, but very rapidly growing Islamic finance industry, global banks have obvious opportunities to transfer skills and product expertise between markets, increasing speed to market and reducing development costs.

These are important – and in many ways obvious – potential markets for a global bank. But there is a larger opportunity still in serving the domestic banking needs of individuals around the world. It is still true that most people don't need a massively international service for their day to day banking. But the number of people who don't have access to domestic banking services today is very large.

I said earlier that globalisation had virtually doubled the size of the global economy in terms of the number of potential participants to it. We have seen many economies embrace market principles, triggering massive economic growth. China and India are the obvious examples, but they are by no means the only ones. Vietnam – a country with a population as large as Germany's – is on a similar growth trajectory. As these

and other emerging economies develop, people's living standards and disposable incomes rise; inevitably demand for financial services will rise also. According to an article in *The Banker* last summer, the number of bank customers globally could have doubled by 2015. In Mexico, for instance, just one in five people has a bank account today.

Likewise, on the product front, these markets are underdeveloped – but growing rapidly. Loans to individuals in the four BRIC countries tripled between 2001 and 2005 to US\$477 billion. It's still a small sum compared with loans outstanding in any major developed market, but rapid growth potential is very attractive.

Especially when in their home markets banks are reaching natural limits to their size. In each of the UK, France, Italy and the Netherlands, the market share of the top five banks is over 50 per cent, and as high as 89 per cent. So the high growth potential for financial services in emerging markets makes these domestic markets an attractive destination for global banks.

But. Breaking into domestic markets is not necessarily an easy task; I will come back to some of the hurdles later.

Moving on to the business community. Here, we at least are seeing demand for global services growing exponentially – reflecting the rapid internationalisation businesses large and small. At the top end, corporates have long had a need for international services; the surprise today is the increasing proportion of small and medium sized commercial clients who have similar needs – 40 per cent of our commercial clients now have some international requirements.

By putting our own global network at the disposal of our business customers, we can create a very compelling proposition for these customers, some of whom will have limited experience in overseas markets. So we continue to seek ways to do this over and above transactional banking services – to add value if you like, through using our own experience and international network. For example, we set up a global referral system for commercial customers who transact international business. Last year, this led to international referrals with an aggregate facility value of US\$3 billion, which were set up with relationship managers in over 50 locations.

Another aspect of globalisation has been the explosive growth of the offshoring business. In spite of the sometimes hostile media coverage, offshoring in the services sector is following a well-established pattern – that of the manufacturing industry before it. We are seeing the same rapid transfer of capacity from the developed to the developing world **combined with** the ability to split the work into numerous component parts.

bank customers to double by 2015

Conceptually, this is easier to understand from a manufacturing perspective. If you order a Dell laptop, for example, it could have been designed in the US and Taiwan; assembled in Malaysia; with a processor from Costa Rica, memory from Korea, a graphics card from China, a keyboard from Taiwan, a display made in Japan ... and so on through its 100+ components.

Bank work – and you will all know that call centres account for only a fraction of it – can be parcelled up like this and transferred to parts of the world where it can be done most efficiently. And it is worth bearing in mind that this transfer of work is not just from the developed world to the developing; it is not just about moving work to the cheapest locations, but about securing the right combination of efficiency, skills and stability. So, for example, we have been consolidating our data centres from over 100 a decade ago, into just four data centre ‘pairs’ around the world in the UK, the US, Hong Kong and Mexico. Although the transfer of work has to be handled sensitively, it seems to me to be not just an inevitable consequence of globalisation, but a desirable one too. Work migrates to the location where it can be done most efficiently.

If these are some of the opportunities, there are also plenty of hurdles to aspiring global banks. Let me highlight a few.

One of the most significant is the undercurrent of protectionism in many markets. This reflects a broader truth – that in many industries, banking principal among them, governments and regulators seek to preserve national champions.

This is a common feature of economies right across the world. Even in the UK, whose record is better than most and whose financial services sector is arguably the most international, the biggest banks are overwhelmingly domestic. There is really only one significant non-national player in UK banking. And it's not HSBC! Although we tend to consider ourselves an international bank, the UK is our corporate home.

Similarly, when you look at the world's largest banks you will find they are still predominantly domestic players. Of the world's 10 largest banks by market value, we are unique in that we earn three quarters of our profits outside our home market; barely any others generate even half their earnings outside their home market.

In Europe, despite the advent of the single currency in 1999, which launched a wave of consolidation in European banking, the consolidation has occurred overwhelmingly in domestic markets. Although there are signs that cross border mergers are becoming more attractive. Unicredit's acquisition of HVB, Santander's of Abbey, and BNP Paribas's of Banca Nazionale del Lavoro, all completed since 2004, are three of the four largest mergers ever done.

The pattern in developing markets is similarly mixed. Some have liberalised rules on foreign investment. In Mexico, for example, over 85% of banking assets are owned by foreign banks. But this may present political challenges in the event of domestic economic difficulties in the future. Meanwhile, other developing nations, such as India, keep a tight rein on foreign involvement in their financial systems.

A second hurdle is overcoming what I term the ‘herd mentality’. Global banks might be out of fashion with the stock markets, but global banking is not out of fashion among banks. But the decision to build a global banking platform needs to be a hard-headed one; it needs to be based on a realistic analysis of competitive advantage and your ability to succeed in new and often very different markets. It cannot be a decision based on following the example of others.

The lessons of the past are that in seeking a global base, many banks have come severely unstuck. And while global banking can be a successful model, it is not the only one and, coming back to the point that large international banks have not shown that clear economies of scale exist, this is one of the greatest challenges we and our peer group face – providing a quality service with appropriate local flavours at a lower cost than the larger domestic competitors.

So perhaps knowing when to say no is at least as important as knowing when to say yes. As markets go through the consolidation process, it is often the case that overseas banks are prepared to pay a premium for access to a market that local or international incumbents might not consider justified. This, of course, raises costs all round. The counter side to this is that incumbents need to factor the growth and rationalisation potential into the prices they are willing to pay for greater market access.

A third hurdle to international ambitions, especially for those banks wishing to develop a domestic banking franchise in a new market, is the danger of underestimating the quality of local competitors.

Being a domestic player does not make a bank uncompetitive. And this is as true for developing markets as it is for developed markets. When I think of places like Turkey, Singapore and Brazil, I see countries with sophisticated banks, which are intensely competitive.

New entrants to any market need to understand the complexities of the market they are moving into and the quality of the domestic competition if they are to compete. Especially as customers tend to prefer the local player over the foreign one, and so have an inbuilt and inherent advantage.

Finally, I'd like to say a few words about managing complexity. Inevitably, with increasing size comes

protectionist undercurrents

increasing complexity, much of it arising from the need to be simultaneously global and local.

The complexity starts with regulation. Regulators are primarily responsible for protecting a domestic market, and yet have to regulate a business that is very international. At the last count, HSBC was regulated by 510 supervisory authorities worldwide, with the cost of compliance totalling US\$635 million in 2005, the last year we disclosed the figure.

It continues with internal processes and technology. These are areas where, traditionally, cost efficiencies are talked up. And the reality is that cost efficiencies can be achieved through the introduction of common, shared platforms and by standardising processes in the back office. But they have to be worked for and, arguably, banking as an industry is somewhat behind other sectors in effective production processes and use of technology.

And being international adds complexity to the process. As well as seeking the benefits of standardisation, products and services will also need to have an appropriate domestic flavour if they are to succeed. So systems design needs to allow flexibility for local tailoring.

And finally, a few words about branding. Our strapline, the world's local bank, is both an aspiration ... and a challenge.

Like most big, globalised companies, we have grown to a large extent through acquisition. One of the

complexities we must manage is to make the transition from being a federation of companies to becoming one that is a unified whole. It is a journey that HSBC is on currently. A single global brand creates a clear opportunity for a company to differentiate itself from the competition, but it will only be able to do so if the customer and brand experience is right, and consistent across markets. This is easy to say, tough to achieve.

What do the opportunities and obstacles add up to for the industry as a whole? Given the direction of the global economy, it seems inevitable that our industry will become more international. The question is what percentage of the industry can go truly global? Not every bank has the capacity to do it, and it would be inherently inefficient for the whole market to go this way. Regional alliances – such as those between Austrian banks and central European ones – provide an alternative model, as do the monocline, single service providers such as credit card companies.

So my prediction is that it will be quite a small percentage of banks that become truly global. But I could be wrong: maybe a few global players will be split up if they don't demonstrate sufficient ability to generate brand and shareholder value. The future is notoriously difficult to predict. After all, it was Bill Gates, whose latest Windows operating system uses something like 87 billion gigabytes, who once said, "640k should be enough for anyone..."

Thank you ladies and gentlemen.