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THE EVOLUTION AND INFLUENCE OF THE HONG KONG AND SHANGHAI BANKING CORPORATION: IMPACTS OF INTERNATIONAL TRADE AND FINANCIAL MANAGEMENT STRATEGIES

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Abstract. The Hong Kong and Shanghai Banking Corporation (HSBC) stands as a testament to the intricate interplay between international trade and financial management. Founded in the mid-19th century primarily to facilitate commerce between Europe and China, HSBC has transformed significantly into one of the globe's largest banking and financial services entities, spanning over 55 countries. With approximately 40 million clients and a workforce of around 235,000, HSBC serves as a pivotal player in monitoring and adapting to fluctuating economic landscapes while providing essential banking services. This evolution has been propelled by strategic expansion, notable acquisitions, and a diverse portfolio that encompasses retail, commercial, global, and private banking. This article investigates HSBC's emergence as a global banking powerhouse, analyzing its interrelation with international trade dynamics and the consequential effects of exchange rate fluctuations. HSBC's core activities in international finance include facilitating cross-border transactions and providing trade finance services, segments that account for over 20% of its revenues and represent vital links to global commerce. The examination reveals that a correlation exists between HSBC's financial performance and the volume of international trade, underscored by historical data reflecting revenue trends relative to global export variations. Moreover, the influence of exchange rate movements poses distinct challenges for HSBC, impacting profits and necessitating robust risk management strategies. Strategies such as currency hedging and diverse geographical operations have been adopted to mitigate currency risk, demonstrating HSBC's proactive approach to navigating the complexities of the international financial landscape. Additionally, the bank's liquidity management frameworks emphasize the importance of maintaining adequate cash reserves and employing stress testing to withstand potential economic shocks. This analysis culminates in recommendations for HSBC to reinforce its market position, including prioritizing digital transformation, diversifying revenue streams in emerging markets, and enhancing risk management practices concerning forex volatility. By adapting to the fast-evolving global landscape, HSBC can ensure its sustained relevance and operational efficacy in a competitive banking ecosystem. This exploration of HSBC serves not only to illuminate the factors influencing its historical and current operations but also reflects broader trends applicable to the global finance sector at large.

Keywords: HSBC, international trade, financial management, exchange rate, global banking, liquidity management.

JEL Classification: G21, F31, F36, G32, E44

1. Introduction

The Hong Kong and Shanghai Banking Corporation (HSBC) has emerged as a critical player in the global banking landscape, evolving from its humble beginnings in 1865 as a facilitator of trade between Europe and China into a multinational conglomerate with operations spanning over 55 countries. Initially established to serve European merchants conducting business in China, HSBC quickly expanded its services to meet the growing demands of an increasing number of international clients engaging in cross-border commerce. This expansion not only solidified its position within Asia but propelled its growth into markets across North America and Europe, significantly broadening its reach and influence.

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The mid-1990s marked a pivotal phase in HSBC's trajectory, characterized by a series of influential acquisitions that laid the groundwork for its current robust global presence. Notably, the acquisition of Midland Bank in the UK was a landmark event that enabled HSBC to make substantial inroads into the UK retail banking sector – a move that redefined consumer banking services and established HSBC as a household name across the Western world. Subsequently, the bank continued its strategic growth through a series of targeted investments, including the acquisition of Marine Midland Bank in the US and Banco Bamerindus in Brazil, ultimately reinforcing its status as a global banking powerhouse.

HSBC's business activities are multifaceted, encompassing various domains such as retail banking, commercial banking, global banking, and wealth management. The institution effectively caters to a diversified clientele that includes individuals as well as small to medium enterprises (SMEs), supporting them with an array of financial services, including mortgages, credit cards, trade finance, and cash management solutions. Importantly, HSBC has established itself as a leading player in international trade finance, providing vital support to businesses engaged in global commerce, thereby aligning its business model closely with the dynamics of international trade.

Moreover, HSBC's significant operations in strategic regions further contribute to its global stature. The bank commands a dominant position in Hong Kong, with over 25% of the market share, while also maintaining prominent operations in mainland China, the Middle East, and across Europe and North America, including substantial engagements in the UK, the US, Canada, and Mexico. This diverse geographical footprint not only diversifies its revenue streams but also mitigates risks associated with economic volatility in individual markets.

As a major player in the finance sector, HSBC operates under stringent regulatory frameworks set forth by various governing bodies, including the European Central Bank, Federal Reserve, Hong Kong Monetary Authority, and the China Banking and Insurance Regulatory Commission. These regulatory guidelines necessitate rigorous compliance and risk management practices, ensuring the bank's operations remain robust amid the complexities of international finance.

The relationship between HSBC and international trade is particularly salient, with research indicating that countries engaged in significant trading activities tend to exhibit healthier financial systems. HSBC's core operations highlight this interconnection, as trade finance services not only contribute over 20% to its revenues but are also crucial in sustaining the flow of global commerce. This paper will delve deeper into HSBC's evolution, intricacies of its international trade linkages, and the implications of exchange rate fluctuations on its financial management strategies. Through a comprehensive examination, this analysis aims to reflect broader trends in the global finance sector while identifying strategic recommendations for HSBC to enhance its competitive positioning moving forward.

By understanding the evolution of HSBC through the lens of international trade and financial management, we can glean insights into the resilience required to thrive in a constantly changing marketplace. As we navigate this critical intersection, it becomes clear that the future of HSBC will depend on its ability to adapt and innovate within the realms of finance and trade, retaining relevance in an increasingly interconnected world.

2. A Brief History of How it Emerged as a Global Firm

Main purpose of creation of the bank was facilitation of trading between Europe and China, supplying banking services to European merchants in China. Over time, the bank expanded widely in Asia. North America and Europe became the next activity destination.

In the middle of 1990s, HSBC Holdings made significant acquisitions, including the acquisition of Midland Bank in the UK, Marine Midland Bank in the US, and Banco Bamerindus in Brazil. The acquisition of Midland Bank was particularly significant as it marked the organization's entry into the UK retail banking sector.

Since then, HSBC Holdings has continued to expand its operations globally.

HSBC Holdings works in the following major activity directions: retail, commercial, global and private banking and wealth management. The bank's services are supplied to individuals and businesses, including mortgages, credit cards, and personal loans. The commercial banking segment provides services to small and medium-sized enterprises and commercial clients, including trade finance and cash management. The global banking department supplies investment and capital management services globally. High-net-worth individuals are served in private banking department.

HSBC Holdings is the largest bank in Hong Kong and has a market share of over 25%. The bank also has a strong presence in mainland China and is one of the largest foreign banks in the country.

The bank has significant operations in the Middle East, Europe, and North America.

HSBC's operations in Europe are mostly focused on the United Kingdom. The bank also has operations in France, Germany, and Switzerland.

In North America, HSBC Holdings operates in the United States, Canada, and Mexico.

HSBC Holdings is subject to various regulatory frameworks. The bank's operations in Europe are primarily regulated by the Central Bank of Europe. The Federal Reserve regulates HSBCs operations in US.

The Monetary Authority of Hong Kong oversees HSBCs activities in Hong Kong. The China Banking and Insurance Regulatory Commission has regulatory oversight over HSBC's operations in mainland China.

3. Impact of International Trade on HSBC

Research conducted by Cieslik and Ryan (2018) has shown that countries with important levels of international trade have healthier financial systems. This is due to the increased demand for trade finance services and the potential for higher profits. The same logic applies to large banks.

According to a report by the World Trade Organization (2021), trade policies such as tariffs, quotas, and trade agreements can affect the HSBC Holdings operations and profitability. For example, changes in trade policies can impact the demand for HSBC's services and products, which can affect its revenue and profitability.

Global commerce is a critical driver of HSBC's value. The bank's international commercial division has established itself as a primary facilitator of trade between regions. According to HSBC's Annual Report 2020, the bank supplied USD 1.4 trillion in trade finance and processed 4.4 million trade transactions. The trade finance and global market division are responsible for over 20% of the bank's revenues.

The valuation of HSBC's holdings is impacted by global economic conditions, as the bank operates in several markets. The bank's revenues and profitability are affected by changes in economic policies, interest rates, and investor sentiments in various regions of the world. For example, the COVID-19 pandemic restrictions resulted in a decline in global trade, evident in HSBC's revenue losses. According to the Annual Report 2020, HSBC's revenue declined by 10.8% from the previous fiscal year.

Consider 2 graphs: graph 1 shows the evolution of global exports of goods and services, and graph 2 represents the evolution of HSBC income since 1999 to 2018. These 2 graphs illustrate the strong impact of global exports on HSBC's income. The upward trend in export value followed by an uptrend in HSBC's income. This can be observed from 1999 to 2008 and vice versa - when global exports after 2008 turn into a horizontal volatile trend, HSBC revenue figures begin to decline, which confirms the strong financial dependence of HSBC value on international trade.

Cross-border transactions are an essential aspect of international trade, and they can affect the value of the HSBC Holdings. Cross-border transactions refer to transactions that occur between individuals or businesses in different countries. According to a study by Jeon, Olivero, and Wu (2019), cross-border transactions can affect the HSBC Holdings' financial performance in various ways. For instance, cross-border transactions can generate revenue for the HSBC Holdings, but they can also expose the company to various risks such as currency risk and non-payment risk.

4. Impact of Exchange Rate Movements

Many studies in financial literature have focused on analyzing how the financial performance of multinational corporations is affected by fluctuations in exchange rates. Experts have examined how currency exchange rates effect the profits, cash flows and valuations of companies. According to Bodnar et al. (2012), exchange rate fluctuations can negatively impact firm's profitability and cash flows, particularly for firms with high exposure to currency risk. Chowdhury et al. (2014) examined the impact of currency risk on the

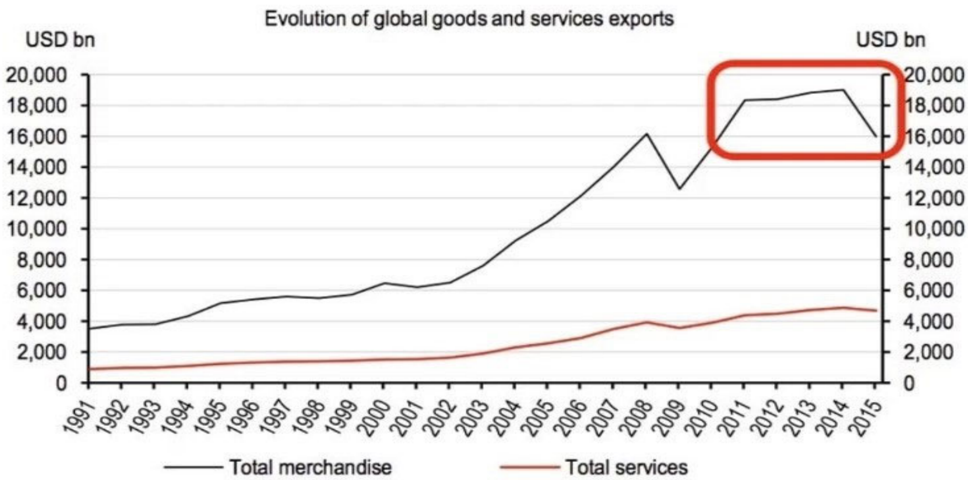

Figure 1. The evolution of global exports of goods and services

Source: Developed by the author

Figure 2. The evolution of HSBC income since 1999 to 2017

Source: Developed by the author

valuation of multinational firms, finding that currency risk negatively impacts firm's valuation.

Numerous studies have also analysed the hedging strategies employed by multinational corporations to manage currency risk. According to Froot et al. (1998), firms can use hedging strategies to improve their performance and effectiveness.

This research indicates that HSBC Holdings is highly exposed to currency risk, given its global presence and multinational operations. Over the period from 2015 to 2020, the financial performance of the HSBC was substantially influenced by fluctuations in exchange rates. Stronger US dollar against other major currencies, including the pound sterling and euro, negatively impacted the company's profits and revenue. HSBC Holdings recognized a net exchange loss of $1.4 billion in 2015 due to the strengthening of the US dollar against other currencies. Similarly, the company recognized a net exchange loss of $1.2 billion in 2018 due to the same factor.

Exchange rate movements can affect HSBC Holding's financial performance in several ways. Firstly, changes in exchange rates can affect the company's revenue and profitability. An increase in the value of a local currency relative to foreign currencies reduces the value of revenue earned in foreign currencies when converted back to the local currency. Conversely, a decrease in the value of a local currency increases revenue.

Secondly, exchange rate movements can affect the company's cost of sales. When a local currency depreciates relative to foreign currencies, the products purchased from abroad rise. Conversely, when a local currency appreciates – the products purchased from abroad drop in value.

Thirdly, exchange rate movements can affect the company's balance sheet. Such movements may lead to appreciation or depreciation of denominated assets and liabilities held by the company. For example, a depreciation of the British pound relative to the US dollar results in a gain on US-dollar denominated assets and a loss on British-pound denominated liabilities. Conversely, an appreciation of the British pound results in a loss on US-dollar denominated assets and a gain on British-pound denominated liabilities.

As an example of the cross-currency impact on HSBC, in 2019 the company recognized a $1.3 billion gain on foreign exchange forward contracts.

HSBC Holdings has implemented several strategies to mitigate exchange rate risk. To reduce translation exposure, HSBC hedges its foreign currency positions through the use of currency forwards, options, and swaps. Revenues earned in foreign currency are converted into the home currency at stable rates. Additionally, HSBC's well-established presence in Asia where growth rates are higher can offset headwinds from a strong pound or around-term interest rates in the US.

HSBC has also implemented structural measures to reduce its exposure to foreign currency risks. These include:

– Branching out into different geographic locations to diversify its revenues and reduce concentration risk.
– Ensuring that each region has a self-funding model that matches the funding and asset base.

International financial markets and HSBC Holdings

Managing the finances of HSBC Holdings is heavily reliant on the function of the international financial markets. The company's international presence creates different financing needs and the financial markets provide an opportunity for the company to raise funds in different currencies and from different investors. HSBC Holdings has various funding sources, including deposits, debt capital markets, and equity markets.

HSBC's treasury department is responsible for managing the company's financing needs. The treasury department uses various financing techniques to fund the company's operations, including debt issuance, securitization, and assetbacked financing. The treasury department also manages the company's liquidity and cash flow needs, ensuring that the corporation possesses an adequate amount of resources to fulfill its duties.

5. The Management of HSBCs Finances Through the Global Financial Market

The management of capital in HSBC's finance is an increasingly important issue given the global nature of their operations and the complexity of financial systems.

One of the primary sources of funding for HSBC's finance is deposits from customers. As a retail, commercial and investment bank, HSBC enjoys a significant deposit base of retail and corporate customers worldwide. These deposits provide a stable and reliable source of funding for the bank, reducing its reliance on volatile short-term borrowing from the interbank market.

In addition, HSBC also raises funds from debt capital markets. The bank regularly issues bonds and other debt instruments to raise the capital needed to support its activities. These instruments are typically classified as Tier 2 capital, which is a form of subordinated debt, which means it ranks lower in the event of the bank's liquidation, thus providing banks with a degree of loss absorbency.

The regulatory framework surrounding the management of capital in HSBC's finance is primarily driven by the Basel III Accord. The universal regulatory framework aims to improve the soundness of global banking systems by ensuring that financial institutions maintain sufficient levels of capital to offset possible losses. To comply with regulations, the bank is required to uphold a Tier 1 capital ratio of no less than 6% and an overall capital requirement of 8%. Furthermore, the bank must also hold additional capital buffers.

HSBC employs several strategies to manage its capital effectively. One such strategy is to optimize the balance sheet by ensuring that the bank holds the appropriate level of capital against the risks that it assumes. The bank uses a riskbased approach to determine its capital requirements and the products and services that it offers to its customers.

Another strategy employed by HSBC is to manage its asset and liability mix to optimize the return on equity. The bank adjusts its funding sources and the duration of its assets to maximize its profits while minimizing its risk exposure.

Liquidity management is an essential aspect of banking operations. It involves managing a bank's assets and liabilities to assure that the organization has an adequate amount of liquid assets and cash to satisfy its financial responsibilities. HSBC's employment of stress testing constitutes one of the vital components in its liquidity management practices. Such tests are periodically administered on the bank to evaluate its capacity to endure unfavorable situations such as economic downturns or credit losses. This aids in the detection of potential liquidity gaps and the implementation of corrective actions to alleviate such risks. Another key aspect of HSBC's liquidity management practices is the use of cash buffers. The bank maintains a significant amount of cash and liquid assets as a buffer to cover unforeseen liquidity needs. In addition to the above, the bank has established policies and procedures to identify, measure, and manage liquidity risk and has a dedicated team responsible for overseeing its liquidity position.

HSBC's financial management strategies proved its effectiveness during the financial crisis of 2008. Many financial institutions struggled to survive the economic downturn, with some going bankrupt or requiring government bailouts. However, HSBC emerged relatively unscathed from the crisis, despite having significant exposure to the US subprime mortgage market.

6. Conclusion and Recommendations for HSBC

In conclusion, The Hong Kong and Shanghai Banking Corporation (HSBC) has successfully navigated the intricate landscape of international finance while maintaining its status as a vital facilitator of global trade. Its historical significance and adaptability to fluctuating market conditions highlight a remarkable resilience against external shocks, such as economic downturns and regulatory changes. The intertwined relationships between HSBC's financial performance, international trade trends, and exchange rate movements underscore the necessity for strategic foresight in managing financial risks.

Moving forward, HSBC should consider several key recommendations to strengthen its competitive edge and ensure sustained growth. Firstly, the bank should enhance its focus on digital transformation, investing in fintech solutions and customer-centric platforms to streamline operations and improve service delivery. This will not only meet the evolving preferences of its clients but also bolster efficiency.

Secondly, diversifying its revenue streams through targeted investments in emerging markets can mitigate risks associated with economic fluctuations in established regions. By deepening its presence in high-growth economies, HSBC can leverage the advantages of emerging market dynamics.

Finally, HSBC must continue to refine its risk management frameworks, particularly concerning forex volatility and geopolitical uncertainties. Implementing more sophisticated hedging techniques and enhancing liquidity buffers will fortify the bank against potential market disruptions.

By embracing these recommendations, HSBC can further solidify its position as a leading global bank, adeptly positioned for the challenges and opportunities of the future.

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