BACK TO BASICS:
THE CURRENT COMPETITIVE STRATEGY OF HSBC BANK CANADA

by

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ABSTRACT

This paper analyzes HSBC Bank Canada's current strategy for competing within the Canadian banking industry.

HSBC Bank Canada has enjoyed considerable financial success over the past couple of decades. However, the overall direction of the industry is towards lower, interest-rate spreads and intensified competition. Many of the bank's primary competitors are reducing costs through a variety of means, such as centralization and automation of processes.

In order for HSBC Bank Canada to succeed in this increasingly challenging market, it must look at differentiating itself from the competition. It does not enjoy the same size-related advantages as the larger Canadian banks.

Historically, HSBC Bank Canada used customer service as its primary differentiator. This advantage is slipping for a variety of reasons outlined in the paper. A refocus on the bank's principal resources is recommended to ensure HSBC Bank Canada's future remains as strong as its past.

Keywords: Bank, Banking, Strategy, Competitive

Subject Terms: Strategic Direction, Competitive Strategy, Competitive Analysis, Canadian Finance

DEDICATION

To my family members, who are always there when I need them and who continue to support me in each new endeavour.

To my friends and co-workers at HSBC Bank Canada who have also helped me achieve this goal.

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LIST OF ABBREVIATIONS AND ACRONYMS

ABM	Automatic Banking Machine
BMO	The Bank of Montreal
BNS	The Bank of Nova Scotia
$CDN	Canadian Dollars
CEO	Chief Executive Officer
CIBC	The Canadian Imperial Bank of Commerce
GIC	Guaranteed Investment Certificate
Holdings	HSBC Holdings plc
HSBC	HSBC Bank Canada
ING	ING Canada Inc.
IT	Information Technology
LIBOR	London Interbank Offered Rate
KSF	Key Success Factor
NIR	Non-Interest Revenue
OSFI	Office of the Superintendent of Financial Institutions
PCM	Payments and Cash Management
RBC	Royal Bank of Canada
SME	Small-and Medium-Sized Enterprises
TDCT	Toronto Dominion Canada Trust
$US	US Dollars

1 INTRODUCTION TO COMMERCIAL BANKING AT HSBC BANK CANADA

This paper provides a strategic analysis of HSBC Bank Canada and its place, past and present, within the Canadian banking industry. This analysis is conducted from the perspective of commercial financial services. It provides an overall commercial banking review of the industry and focuses on significant trends occurring within the commercial sector. It then analyzes HSBC Bank Canada, including the impacts associated with the global activities of its parent company. Finally, the paper offers recommendations for the future strategic direction of the company.

This paper has been prepared for HSBC's Executive Vice President of Commercial Financial Services. It is designed to serve as a review of the Canadian banking industry and the factors that contribute to HSBC's position within the industry. It sets the stage to discuss future strategic alternatives for HSBC's commercial services operations.

The Canadian banking industry, a mature oligopoly, is in a state of continuous change. The five largest banks, Royal Bank of Canada ("RBC"), TD Canada Trust ("TDCT"), Bank of Nova Scotia ("BNS"), Bank of Montreal ("BMO"), and Canadian Imperial Bank of Commerce ("CIBC"), exert considerable influence on each other and on the smaller players competing within the industry. However, new competitors continue to enter the field in search of niche markets. As well, technological advances constantly challenge traditional methods of banking. All of these factors are forcing the players within the industry to become stronger adversaries.

1.1 HSBC Bank Canada: Ownership and Influence

HSBC Bank Canada is a wholly owned subsidiary of HSBC Holdings plc, which is headquartered in London, England. The shares of HSBC Bank Canada are not publicly-traded, but those of HSBC Holdings plc are traded on the London, New York, Hong Kong, Paris and Bermuda stock exchanges.[1] The primary objective for most publicly-traded companies is to create value for the shareholders. Value is usually recognized when the share price increases.

HSBC Holdings plc first entered the Canadian market in July 1981 by incorporating a subsidiary under the name of HongKong Bank of Canada. The incorporation came shortly after the 1980 Bank Act, which created significant revisions to the regulations guiding Canadian-bank ownership. Before this 1980 act, no single individual or group of individuals were permitted to own more than 10 per cent of a bank's voting shares. This regulation prevented a concentration of control from being held too tightly by a single party and it also ensured continued Canadian ownership. The Bank Act retained these ownership restrictions for existing banks, now referred to as Schedule 1 banks, and it also introduced Schedule 2 banks or foreign-owned banks. These foreign entities were then allowed to operate legally in Canada. In November 1986, the HongKong Bank of Canada acquired almost all of the assets and liabilities of the Bank of British Columbia moving it from the twentieth largest bank in Canada to the ninth largest. Since that date, the HongKong Bank of Canada has made numerous other acquisitions, such as Lloyds Bank of Canada, James Capel Canada Inc., Metropolitan Trust Company of Canada, M.K. Wong and Associates Ltd., Barclays Bank of Canada. In June 1999, it renamed itself HSBC Bank Canada.

HSBC Bank Canada represents a rather small portion of HSBC Holdings plc's total assets. The combined contribution from the Canadian and USA subsidiaries is only 21.1 percentage of Holdings' profit before tax (HSBC Holdings plc, 2007). On a stand-alone basis, the Canadian

[1] As of 2005, it is possible to buy non-cumulative, redeemable preferred shares of HSBC Bank Canada on the TSE, but not voting shares.

subsidiary ranks fifth in terms of net contribution to Holdings profitability, just edging out the French subsidiary. However, it is important to note that there is a significant variance between the top three countries and the rest of the group. Furthermore, the North American combined subsidiaries combined represent only 27.5 percentage of Holdings' total assets (HSBC Holdings plc, 2007).

The CEO of HSBC Bank Canada reports directly to the CEO of HSBC Bank USA who, in turn, reports to Holdings. As such, HSBC Bank USA has significant influence over HSBC Bank Canada: furthermore, the actions of both the USA and Canadian subsidiaries are heavily influenced by the parent company.

1.2 Overview of HSBC Bank Canada's Business

Historically, the financial services industry in Canada was made up of four pillars: banking, investment, insurance and trust. A fifth pillar that has become more noteworthy is the co-operative credit movement. The number of credit unions within this fifth pillar has grown substantially over the past several years; many have merged over the last five years making them considerably larger. Over the past 20 years, government legislation, that kept all five of these pillars separate and distinct, has relaxed. For instance, in 1987 banks were allowed to acquire investment dealers and in 1992 banks were allowed to acquire trust companies (Neufeld, 2001). The most notable example of the latter is the Toronto Dominion Bank's acquisition of Canada Trust in 2002. Many Canadian companies now compete within several, if not all, of the financial service pillars. The relaxation of regulations has come at the hands of both the federal and provincial governments.

The relaxation of regulations has also resulted in a significant change to the composition of the financial services sector in Canada. This sector now includes banks, trust and loan companies, credit unions and Caisse populaires, life and health insurance companies, property and casualty (P&C) insurance companies, securities dealers and exchanges, mutual fund companies and distributors, finance and leasing companies, as well as independent financial advisors, pension fund managers and independent insurance agents and brokers (Department of Finance Canada, 2005).

HSBC operates within and competes with players from each of the service sectors mentioned above. HSBC offers a wide array of commercial, personal and investment services. Through its subsidiaries, HSBC Securities (Canada) Inc., HSBC Investments (Canada) Limited, and HSBC Trust Company (Canada), the bank is able to operate within both investment and trust pillars. HSBC also competes within the insurance pillar through its lesser known subsidiary, HSBC Insurance Agency (Canada) Inc. This latter company offers life and health insurance products in six of the ten Canadian provinces.[2] Until early 2004 it also owned Canadian Direct Insurance before selling to Canadian Western Bank.

This paper focuses on the commercial financial services offered by HSBC and its subsidiaries despite the numerous financial services which come under its umbrella. Although HSBC Bank Canada is the fifth largest subsidiary within the HSBC Holdings plc group of companies, it has the third largest commercial banking operation in all of the 82 countries that Holdings operates.

1.3 Commercial Credit Financial Services at HSBC Bank Canada

Table 1 below highlights the primary commercial financial services offered by HSBC and the commercial customer segments that use these services. The "✓" indicates those customer segments that regularly use each commercial service. This table was adapted from the Product Customer Matrix created by Boardman and Vining in 1996. Many of HSBC's commercial services are applicable to multiple customer segments. Other services are more unique to specific

[2] Provinces: British Columbia, Alberta, Saskatchewan, Ontario, Quebec and Nova Scotia

customer segments, for example, import and export services only apply to seven of the twelve customer groups. Although the matrix does not include every customer segment that HSBC does business with, it does represent the dominant commercial customer groupings.

Marketing a service to as many different customers segments as possible allows the bank to achieve certain economies of scale. But, services that appeal to large customer groups are often provided by many of the larger financial institutions operating in Canada. Therefore to secure its place within this world and to differentiate itself from the larger banks, HSBC has adopted a strategy to offer several unique services that appeal to specific market niches, such as the trade-finance customer segment.

The majority of HSBC's commercial financial services have been outlined in Table 1, but because of the limited scope of this paper the analysis performed in subsequent sections is limited to the following services:

- Terms and operating credits
- Import / export financing (also referred to as Trade Finance)
- Equipment leasing
- Cash management (also referred to as Payments and Cash Management ("PCM")

Of the four services indicated above, 'term and operating credits' is typically the most common service offered by all banks. The other three services are somewhat more unique and serve as potential differentiators between HSBC and other Canadian banks.

Table 1 **Summary of HSBC's Commercial Financial Services and Customer Segments**

Services	Customers											
	Automotive	*Knowledge Based*	*Agricultural*	*Manufacturing*	*Real Estate Developers*	*Transportation*	*Importers/ Exporters*	*Energy/ Mines*	*Forestry Related*	*Wholesale*	*Retail*	*Food & Hospitality*
Term & Operating Credits	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Import / Export Financing				✓		✓	✓		✓	✓	✓	
Equipment Leasing	✓			✓	✓	✓		✓	✓	✓	✓	
Investment Capital Financing		✓		✓	✓	✓		✓	✓	✓	✓	
Treasury	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Deposit Services	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Cash Management	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Asset Management	✓			✓	✓	✓	✓	✓	✓	✓	✓	✓
Electronic Banking	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓

1.3.1 Terms and Operating Credits

Term and operating credits are a common, commercial financial service. HSBC provides terms loans that are subject to a wide variety of terms and conditions. Ultimately, a terms loan is a credit facility whereby HSBC may demand repayment at its discretion. Typically, term loans range in size from a few thousand to several million dollars. The pricing may have fixed-rate or floating-rate options. For example, a floating-rate option may be based on HSBC's prime lending rate, bankers acceptances, London Interbank Offered Rate ("LIBOR").[3] A fixed-rate option may also be based on HSBC's prime lending rate or HSBC's cost of funds rate, Government of Canada bonds or GIC. Customers request term loans for many reasons. They use these proceeds for such activities as, commercial property acquisitions, equipment financing, bridge financing and to meet working-capital needs. In most cases, terms loans are provided by HSBC to acquire company assets, both current and long term.

Operating loans are a revolving facility. More specifically, the borrower has the ability to borrow funds, repay them and then borrow again. Operating loans are typically used to finance short-term assets and assist with cash-flow management.

Both term loans and operating loans are very common services offered by all major Canadian banks. There may be slight variances from bank to bank with regards to pricing, loan-to-values, or other terms and conditions, but they are all quite similar in function.[4] Term and operating credits are not key differentiators for any of the Canadian banks.

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[3] Bankers acceptances are short-term credit investment created by a non-financial firm and guaranteed by a bank; LIBOR, the London Interbank Offered Rate, is a daily reference rate based on the interest rates at which banks offer to lend unsecured funds to other banks in the London wholesale money market (or interbank market).

[4] Loan-to-value refers to the percentage of financing offered against the value of the collateral.

1.3.2 Trade Finance

HSBC's trade finance services facilitate international trade. Some of these services, such as documentary letters of credit and shipping guarantees, appeal to importing customers. Others services, for example export documentary credit advising, export documentary collections and contract bonding, appeal to exporting clients. The primary objective for all trade services is to protect the customer from credit risks associated with international trade. More specifically, these services protect importers from risks associated with the slow delivery of a product, no delivery of a product, and low-product quality. They also protect exporters from lack of payment or partial payment once the product has been shipped.

1.3.3 Equipment Leasing

HSBC has a separate leasing department whose sole purpose is to provide a leasing option to HSBC's commercial customers. This form of financing is different from a term loan or operating loan because HSBC actually retains ownership of the asset being financed. The customer usually has the option of purchasing the asset from HSBC at the end of the contract, but until then HSBC holds title. This form of leasing service provides certain tax advantages. For instance, taxes are broken down so they can be paid over the term of the lease. If the customer purchased the equipment outright, all of the taxes would be due immediately. Furthermore, leasing services allow the customer to return the goods at the end of the lease; this option is advantageous for customers operating in industries associated with continuous technological change, such as the biotech industry. Obsolete or dated equipment can be returned at the end of the lease and replaced with updated apparatus.

There are two kinds of leases: operating and capital leases. With operating leases the lessee does not assume the risks of ownership. Furthermore, the equipment being financed is typically not declared as an asset or liability on the balance sheet. With a capital lease the opposite is true. If a customer has serious concerns about showing too much debt on its balance sheet, it will likely opt for an operating lease. In some cases the customer is less concerned about the amount of debt showing and would like to show the leased assets on the balance sheet to indicate ownership. In these particular cases, the capital lease makes more sense. There are certainly advantages and disadvantages with both operating and capital leases.

Lease financing is typically cheaper than term financing. HSBC establishes its lease rates using GIC interest yields plus a spread. Leasing also provides the customer with the ability to obtain up to 100 per cent financing. Under HSBC's conventional term loans, the bank will only lend up to 75 per cent on new equipment purchases and 60 per cent on used equipment purchases.

1.3.4 Payments and Cash Management

Payments and cash management services allow a business or institution to make better use of its cash resources. These services allow customers to generate interest income from cash deposits. They also facilitate quicker and more efficient payment of payables and collection of receivables. One benefit associated with improved cash management is the ability for a business to use its cash more effectively. For example, if a customer is able to collect its receivables in a timelier manner, it does not have to borrow as much money from HSBC. HSBC benefits from the larger deposit balances. HSBC then takes the deposit balances and lends them out, with a spread, to generate income.

Another key component of payments and cash management services is the ability to make payments or transfers through electronic alternatives. Although there is considerable debate as to how much it really costs to write a commercial cheque, most agree that at a minimum it is $10CDN. HSBC has made considerable investments into its PCM service capabilities to provide customers with the ability to complete transactions using various electronic means. The end result is a considerably cheaper alternative to traditional cheque writing.

HSBC has performed well historically with its commercial credit services; HSBC's market share was 14 per cent for 2005 (HSBC Bank Canada, 2007). For the same period its market share for transactional banking (i.e. PCM) was only 10 per cent. The risk-adjusted return on capital is approximately 80 per cent for cash management services and less than 20 per cent for term and operating credits (HSBC Bank Canada, 2007). Therefore, a much a stronger and renewed focus on PCM is no surprise.

1.4 HSBC's Customer Segments

HSBC's exposure to each of the customer segments varies considerably.

Agriculture is one industry in which HSBC does not have a strong presence. The bank has recently relaxed its lending criteria with regards to the agriculture industry, in particular dairy and poultry farming. Provincial governments control the supply of milk, chickens and eggs with quota systems. These controls make the industry attractive to lenders as they reduce price fluctuations. However, interest rates in the agriculture industry are low in comparison to many of the other industries with which HSBC deals. This low pricing is a reflection of a lower-perceived risk. Regardless, HSBC does not have the same expertise in this area as many of the larger banks. Many of these larger banks employ agriculturalists as relationship managers. These employees are specialists who have agricultural degrees and manage customer portfolios that consist only of farm accounts. HSBC must increase its employees' level of expertise if it truly wants be competitive in the agricultural industry. The services that HSBC typically provides to these customers are term loans and operating facilities. Larger operations may borrow by way of bankers acceptance, which requires treasury services. Most farm operations are net borrowers and seldom have substantial credit balances. However, for the few that do, the bank offers deposit and cash management services.

Unlike the agricultural sector, HSBC is very competitive in the field of automotive lending. The bank has set up a separate department, HSBC Auto Finance, to facilitate the financing of new vehicle inventory directly from manufacturers. The automotive industry is also finely priced. However, many of HSBC's automotive customers carry large credit balances which helps to offset the lower pricing. The equipment financing needs of most automotive dealerships are associated with their repair shops and computer systems. Leasing services are becoming an increasingly attractive alternative method of financing capital investments. Automotive financing typically requires a substantial amount of administrative time and energy. There are numerous controls, audits and reporting that must be completed on a monthly basis that are not necessary when lending to other industries.

The number of knowledge-based companies operating in Canada continues to grow; they present a challenge to the bank and its services because of their rapid pace of technological change. Technological advances have the ability to make some knowledge-based industries obsolete overnight. It is often difficult to offer term loans and operating facilities to these companies as there are seldom sufficient tangible assets for the bank to take as security. Many companies operating within the high-tech field are global in nature: they are service and information providers. HSBC's cash management and electronic services are particularly appealing to these customers as its global network makes them more accessible. Customers can open accounts with HSBC in multiple countries and access them all with internet-banking services. The cash management applications with internet-banking services permit the customer to wire money from one country to the next all within the comfort of his or her own office.

Manufacturing and transportation continue to be on the bank's list of preferred customer segments. All of the commercial services indicated in Table 1 are provided to customers in these sectors. Typically, customers operating within these industries are capable of providing adequate current and fixed assets for collateral purposes. Most of the Canadian banks have favourable outlooks towards the manufacturing and transportation industries, which shifts some of the negotiation power to the customers' favour. The heavy equipment required by companies operating within these two areas is often purchased from other countries. The more often fixed assets are purchased off shore, the greater the need for trade-finance services. Many of companies that turn their fixed assets over every few years prefer the option of leasing to purchasing. HSBC's strong, trade finance and leasing capabilities allow the bank to differentiate itself from the other major Canadian banks. Regardless, the ever-expanding manufacturing capacity of China has forced HSBC to adopt a more cautious approach to financing Canadian manufacturing companies. The lower cost of labour and larger economies of scale in China pose credible threats to Canadian and American manufacturers. The apparel industry is particularly affected by these developments.

Real estate development continues to be a strong source of non-interest revenue ("NIR"). Growing NIR is a focus for all the Canadian banks as interest rate spreads continue to decrease. The cyclical nature of real estate development typically results in the customer requiring term loans and operating facilities during the initial stages of development and then becoming a net depositor towards the end of the cycle as sales are completed. The number of trades and suppliers involved in development creates a heavy demand of cash management services. HSBC is also able to provide leasing services for much of the equipment needed during the construction phases (e.g. forklifts and cranes). Regardless, the bank has experienced considerable success in the real estate development industry. HSBC must monitor the number of real estate loans it advances in order to protect itself from being over-exposed in this industry.

Importing and exporting industries are well regarded and highly important to HSBC. As previously discussed, HSBC has very strong expertise in providing trade-finance services. This is another industry that provides excellent NIR for the bank. Issuing letters of credit, which represents a significant portion of the bank's trade-finance business, is primarily fee based.

Furthermore, since HSBC's competitors are not strong providers of this service, the bank is able to charge a premium. It is well regarded as one of the few Canadian banks capable of providing highly proficient trade finance services. Therefore, it is a clear opportunity for the bank to win over all the banking needs for customers that import or export, not just the trade-finance business. Many importing and exporting customers use treasury services with regards to foreign currency exchanges. These customers also use cash management services and electronic banking services since they must be able to move money and monitor transactions all around the world.

HSBC has a strong desire to deal with businesses operating within the natural resource sectors, particularly energy, mining and forestry. Customers operating within these segments typically have a heavy, fixed-asset need, which presents a great opportunity for HSBC to provide leasing services. Despite a global demand for natural resources, the Bank acknowledges that these industries pose notable risks. For instance, the energy sector is environmentally sensitive; the bank's involvement in this sector poses significant risk to HSBC's reputation. Furthermore, the forestry sector has experienced lower profitability because of the American duties and tariffs imposed on Canadian exports. Regardless, the bank continues to seek out larger profitable companies operating in the natural resource sectors as they often require many, if not all, of the bank's commercial services.

The wholesale and retail industries are also attractive customer segments for HSBC. The majority of Canada's small businesses are retail. As such, the bank cannot afford to ignore this sector. Generally speaking, HSBC is able to obtain better rates of return from these smaller retail businesses, which is a reflection of the greater amount of risk associated with lending to this customer group. Customers operating within the wholesale and retail industries are very diverse in terms of size and complexity of operation. The bank is able to provide all of its commercial services to these two industries.

HSBC does not consider the food and hospitality industries as attractive as the other eleven industries identified. These industries typically do not require the bank's specialty services, such as trade finance and leasing. Companies operating within these sectors are often difficult to lend to as their fixed assets do not represent strong collateral from the bank's perspective. However, the well established companies within these industries often require deposit, cash management and electronic services. Without credit facilities, these accounts are relatively low risk and provide the bank with a cheap source of deposits, as well as activity-based service charge revenue.

2 THE CANADIAN BANKING INDUSTRY

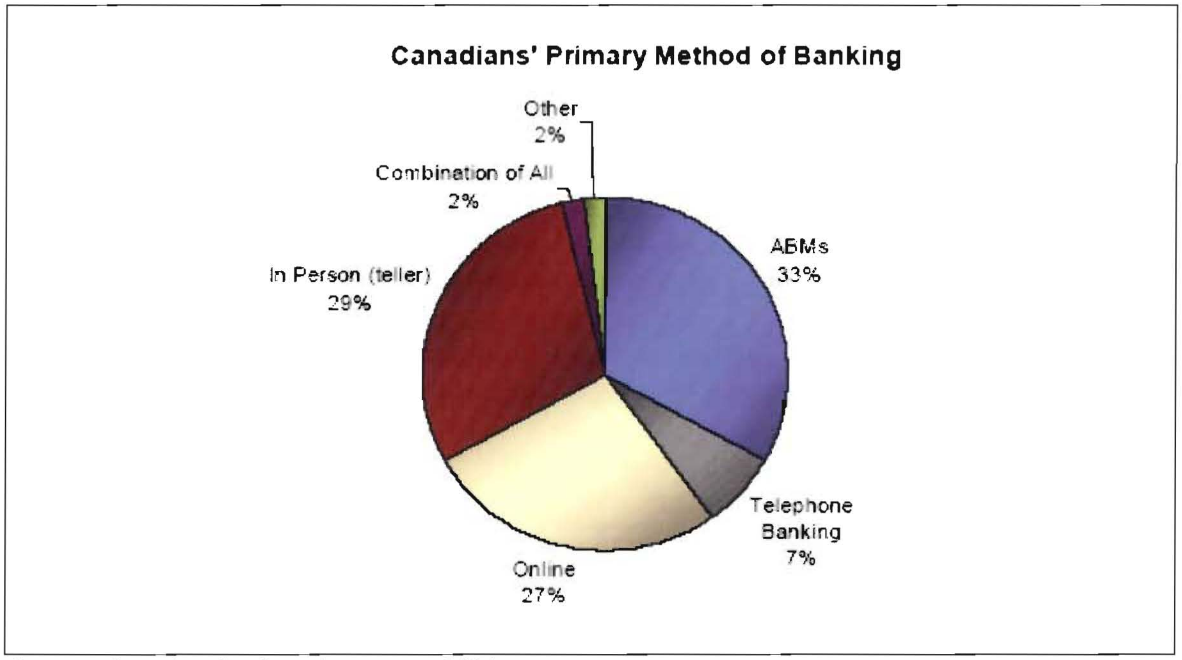
2.1 Scope of the Canadian Financial Services Industry

The Canadian financial services sector continues to offer strong rates of return. The top seven banks in Canada had a combined net income in excess of $9.6 billion CDN for the fiscal year ending in 2006. Due to the strong profitability experienced in this industry, it is becoming increasingly competitive in nature. But, the oligopoly structure persists. Over the past few years, rivalry in this industry has increased because of recent changes to the federal regulatory framework and to technological innovations (Department of Finance Canada, 2005). In particular, the rapid advance of internet banking capabilities has had a significant impact on this industry. This is especially prevalent knowing that, as of April 2004, more than 42 per cent of Canadians do at least some of their banking online (Canadian Bankers Association, 2007).

As indicated in Figure 1, Canadians no longer need to stand in line at their bank to transact their financial business. With advances in technology, the use of alternative distribution channels continues to expand. Canadians can access their accounts from almost anywhere in the world at almost any time.

The financial services sector offers numerous benefits to the Canadian economy. This sector provides a means of channelling savings into various investment opportunities, which in turn drives economic growth. It furnishes the capital necessary for the growth of new and existing businesses and facilitates government financing of new debt issues which support various social programs and services. It also enables Canadians to carry out their everyday financial transactions, including chequing, savings and wealth management, while insuring against risk and unexpected events. The sector is a significant contributor to Canada's economic growth and to job creation. In 2003, over 600,000 Canadians were employed by the financial services industry with a yearly payroll in excess of $35 billion CDN. Furthermore, in 2003 the industry also represented 6 per cent of Canada's gross domestic product and contributed close to $13 billion CDN in taxes to all levels of government (Department of Finance Canada, 2005).

Figure 1 Percentage Share; the Industry is Moving Away from In-Person Banking



Source: Canadian Bankers Association 2006

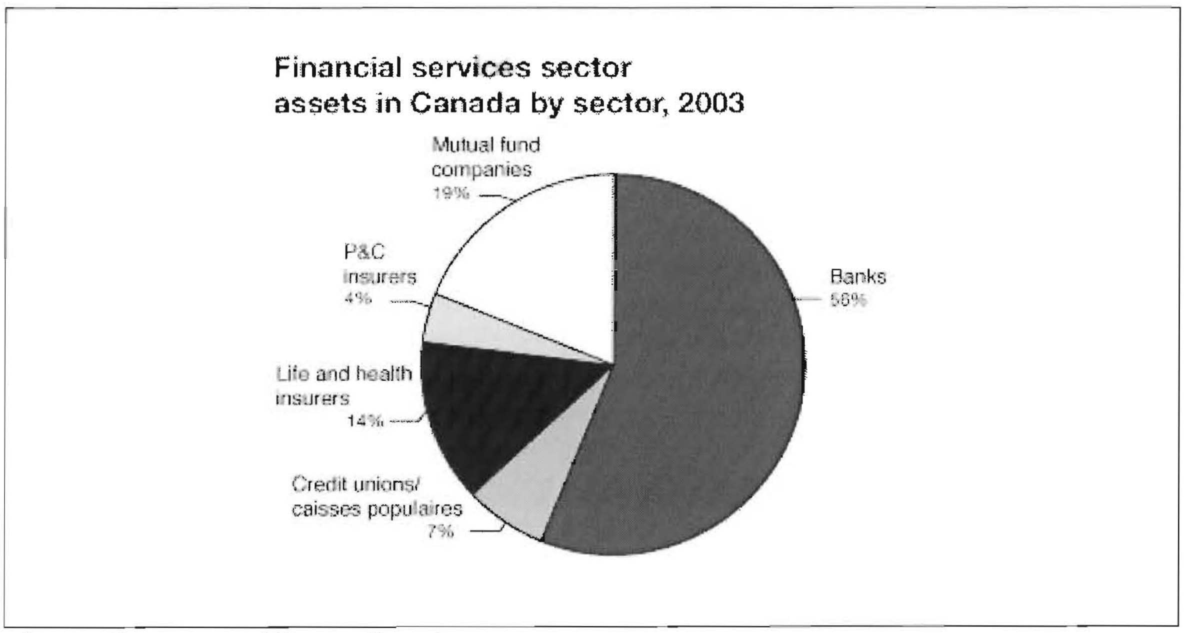
Banks were the single largest employers in the financial services sector (Table 2) in Canada in 2003. That same year, banks also controlled the greatest percentage of assets within this industry (Figure 2).

Table 2 **Breakdown of the Financial Services Sector; Banks Remain a Key Contributor of Employment**

Sector	Number of active firms	Employment
Banks	69	237,000
Credit unions/Caisse populaires	1,298	53,000
Trust companies	29	n/a
Life and health insurance companies	108	118,000
P&C insurance companies	230	100,000
Mutual fund companies	270	70,000[4]
Securities dealers	207	37,000
Finance and leasing companies	250	n/a

Source: Department of Finance Canada 2003

Figure 2 **Non-Banks Continue to Grow Their Market Share**



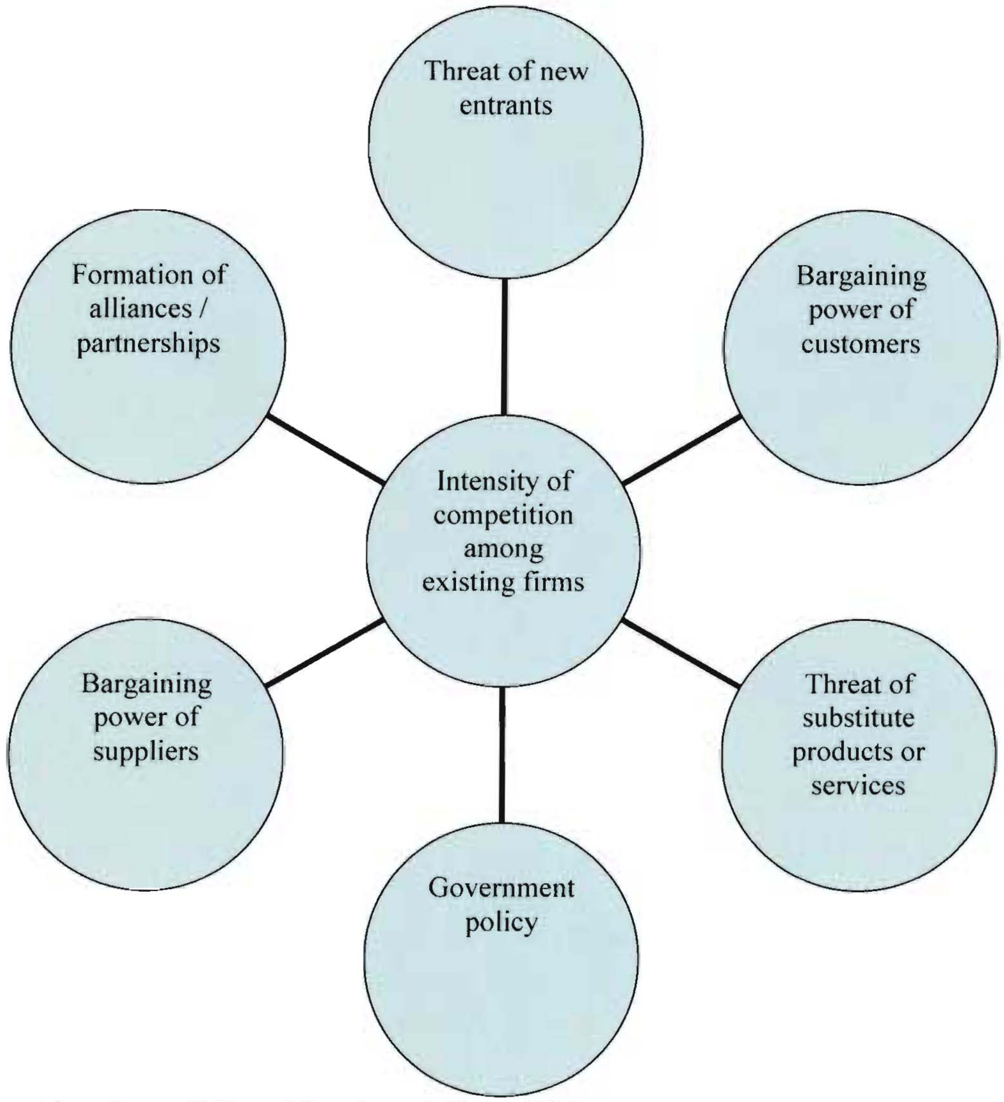
Source: Department of Finance Canada

2.2 Competitive Analysis

Michael Porter's Five Forces Model is largely used to analyze the Canadian financial services sector from the perspective of an economic and industry attractiveness (Porter, 1979). This model is amended to assist in identifying what are the key factors of success within the industry. According to the original model, there are five primary forces that drive profitability: new entrants, supplier power, buyer power, substitute products and competitive rivalry. As evidenced in Figure 3, this original model has been adapted to include two additional forces that have the ability to significantly alter the stability of the Canadian banking industry: government policy and the formation of alliances / partnerships. In the banking industry, government policy plays a particularly important role; the industry is very heavily regulated.

Technological advances are also playing an increasingly important role in the Canadian banking industry. The Canadian banks are increasing their reliance on technology which is resulting in intensification of competition. Although the significance of technology is worthy of its own section, as presented in this paper, it is not considered a force on its own.

Figure 3 Six Forces that Influence the Intensity of Competition, 2007



Adapted from Porter 1979, and Boardman & Vining 2003

2.2.1 Intensity of Competition

HSBC Bank Canada is the largest Schedule II bank operating within the Canadian banking industry. It is also the seventh largest bank in Canada based on total assets.[5] To put things in perspective, HSBC is approximately one tenth the size of RBC, the largest bank in

[5] The six largest bank, following the 'big five,' is the National Bank of Canada (the only bank with its head office in Quebec).

Canada. RBC's total assets are $37 billion CDN, whereas HSBC's are $57 billion CDN (Royal Bank of Canada, 2007; HSBC Bank Canada 2007). HSBC does not benefit from the same cost advantages as do the larger Canadian banks because of its smaller size. For instance, HSBC's distribution network is significantly smaller than those of the other major Canadian banks, with 127 branches across Canada, whereas RBC has 1,400. As a result, HSBC does not have the same economies of scale with which to compete.

Despite its size disadvantage in Canada, HSBC Bank Canada is able to lean on its parent company's global presence. HSBC Holdings plc, the parent company, is the largest bank in the world based on Tier 1 Capital and the fourth largest bank in the world based on total assets, for year ending 2005 (Canadian Bankers Association, 2005). HSBC thus offers superior international services to its commercial customers than the other major Canadian banks.

The intensity of competition is very strong in this mature oligopoly. The bigger market players react quickly to new threats. Market share must be taken from the existing players in order to make substantial gains in growth. Unfortunately, the six largest Canadian banks are very well established, have strong brand identities and are capable of fighting back aggressively in order to preserve their market share.

Many Canadian banks are competing on a cost basis. One exception to this rule seems to be TDCT, which appears to be competing with a customer-service differentiation strategy. This is demonstrated by TDCT's longer hours of operation and its significant investments into online capabilities. TDCT's branch network provides the most hours of operation in a week (i.e. open late on evenings and weekends, even in more remote locations), of all the major Canadian banks. Even TDCT's technology-related services are superior to most of the other Canadian banks. It allows its customers to transfer funds from a TDCT account to an account held at another financial institution, something most other Canadian banks do not allow. Furthermore, this bank just posted a record year in terms of profitability.[6]

HSBC has also enjoyed very strong financial performances over the past three years.[7] One of its core operations continues to be its commercial financial services department. HSBC is not known as a low-cost provider of commercial financial services, but it does have a strong reputation for providing excellent customer service to this market segment. As in any service-related industry, customer service plays an important role. The successes enjoyed by TDCT and HSBC confirm that customer service is a key success factor ("KSF") in the Canadian banking industry.[8]

The banking industry receives plenty of media attention in Canada. The last thing a bank needs is bad publicity with regards to its service. Positive word of mouth in a community can result in considerable customer growth, whereas negative word of mouth can result in a mass exodus of customers. Since HSBC prides itself on superior customer service with its commercial financial services and there is reliable evidence that this strategy works, the bank must continue to protect this reputation.

Most of the larger Canadian banks are moving towards a cost strategy. Following a differentiation strategy represents a real opportunity for HSBC to distinguish itself from the majority of the competition (recognizing that TDCT is also pursuing this strategy). RBC is certainly one of the market leaders in the Canadian banking industry. This institution appears to be opting for a cost strategy. RBC has streamlined many of its processes, such as loan applications, and has removed numerous positions in the middle-management range.

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[6] TDCT's net income for fiscal year ending October 31, 2006 is CAD4.6 billion.

[7] HSBC's net income for the past three fiscal years has steadily increased from CAD353 million (Dec. 31/04), CAD470 million (Dec. 31/05), and CAD515 million (Dec. 31/06).

[8] A KSF is a feature of a particular industry that plays an important role in determining whether or not an individual company will be successful.

Some of the other major Canadian banks, such as RBC, BNS and BMO, have been limiting the growth of new branch locations. Furthermore, these banks have moved some of their commercial banking departments out of existing branches, especially in rural areas, in an effort to consolidate them into 'hub' centres.[9] For example, BMO and BNS have both moved commercial banking departments out of their Chilliwack, BC, branches and into Abbotsford, BC, branches within the past five years. The Canadian banks are taking such actions to reduce costs. As the industry continues to experience tighter interest rate spreads (both commercial and personal), cost management becomes an increasing concern. HSBC faces the same issues as the six larger Canadian banks and has resorted to centralizing departments as well. Approximately three years ago, for example, HSBC moved the commercial banking department from its Maple Ridge, BC, branch into its White Rock branch.

The centralization of commercial services within branches has a material affect on the commercial customers' ability to access relationship managers and other key bank personnel.[10] Customer convenience is a major concern. Commercial customers must be able interact with their relationship managers in a timely and convenient manner. It is essential for many SME customers to have access to these within the community in which they operate.[11] As technology continues to advance, this concern has lessened for some, but for many commercial customers it remains extremely important to be close to their money. Although customers have the ability to make deposits and withdrawals and other payment functions at a retail branch, they often prefer to have all of their needs met at one full service branch within close proximity.

[9] 'Hub' is a term used by HSBC to describe the centralization of services from many branches into one branch.
[10] Relationship managers are responsible for a portfolio of clients; they serve as the primary contact between the bank and the customers.
[11] Canadian Bankers Association defines SME customers as having CAD1 million or less in bank borrowings.

HSBC is at a convenience disadvantage compared to the larger Canadian banks. This position is a result of HSBC having a smaller distribution network. Without a broad-based distribution network, a bank cannot adequately service its customers. Therefore, having a strong distribution network is a KSF within the Canadian banking industry.

HSBC encourages its relationship managers to make frequent customer visits to neutralize the effects of a smaller branch network and to reduce the number of times that the customer must venture to the branch. It also comes across as a strong service differentiator; most customers really appreciate it when their relationship manager takes the time to come visit them. Based on several discussions with HSBC customers who have banked elsewhere, most of the big five banks do not seem to make this a regular practice.

2.2.2 The Impact of Technology on the Intensity of Competition

Banks were some of the first companies in the world to adopt computer technology; it first began with advances in telecommunications. These initial steps allowed banks to link their branch networks on both a national and an international scale. The more recent onset of internet technology has lead to even greater movement in operational efficiencies. With quicker access to more information, banks are in a much better position to monitor risks and provide improved service.

Improvements in technological capabilities have allowed banks to centralize much of their data processing. Many of the banks, including HSBC, have centralized the security preparation process for residential mortgages. More specifically, all of the mortgage security documentation is sent to one location where a specialized team is responsible for ensuring that everything is in order and filed correctly. Some of the big five Canadian banks have already begun to centralize commercial banking processes. HSBC trails the major banks slightly in this area; however, it will likely centralize its security administration in the near future.

It is important to note that many of the centralization initiatives require substantial capital investments. Consequently, economies of scale must be factored into the decision; the combined cost savings must warrant the investment. This makes sense for many larger institutions but tougher to justify for smaller ones. Again, the big five Canadian banks have an advantage over HSBC because of their size and hence, potential for greater cost savings.

Another strong technology-related benefit for the banks is the increased ability to outsource certain functions. For instance, many of the banks now use independent companies to conduct flooring audits on their automotive customers. As another example, several Canadian banks are also looking to outsource the margining process for lines of credit.[12] Technology allows both the banks and the outsourcing company to effectively communicate in a timely manner. As a result, many time-consuming and expensive duties are being completed by outside companies with expertise in these particular fields. Outsourcing of duties provides the banks with significant cost reductions.

Internet banking, ABMs, debit cards and telephone banking have all resulted in a reduced need to physically be in a branch to conduct business. In Canada alone, there were 16,190 bank-operated ABMs in 2006 (Canadian Bankers Association, 2007). Customers can now perform many banking activities from almost anywhere in the world, twenty four hours a day, seven days a week. From a commercial banking perspective, these alternative methods of banking are extremely useful for transfers, bill payments and payroll services. However, it is important to remember that most businesspeople still prefer to conduct negotiations and develop rapports with their commercial relationship managers on a face-to-face basis.

[12] Many commercial lines of credit are margined, typically against accounts receivables and inventory, on a monthly basis to ensure that the bank has up-to-date valuations of the current assets securing these revolving facilities.

From the banks' perspective, the various methods of electronic banking represent cheaper alternatives to many in-person services. Herein lays a strategic opportunity for HSBC over its competitors. HSBC has a much smaller branch network; therefore, it can place a greater reliance on technology to reach its expanding customer base. Although HSBC continues to expand its branch network, it can do so on a smaller scale without sacrificing its growth objectives. The bank can offset partially the need to open branches by encouraging customers to use various methods of electronic banking. Therefore, HSBC should be able to open fewer and smaller branches while still meeting objectives for customer growth. Branches that are being opened should be smaller because of greater centralization of many back-office processes. With fewer and smaller branches, HSBC's cost-to-income ratio should continue to be lower than the competition's. Ultimately, it will grow its customer base and improve its customer service with less up-front capital costs and lower operating expenses (i.e. lower salaries).

A key point to remember is the virtual banks have already implemented this strategy on a large-scale basis. Although they are somewhat limited in the number of services they can offer, especially commercial services, they are certainly low-cost providers. As a result, the operational savings are reflected in the superior pricing of their services and they are a credible threat in this area.

Credit-card and debit-card usage also continue to increase in popularity. There were 61.1 million credit cards in circulation in 2006, almost double the 31.9 million cards for 1997 (Canadian Bankers Association, 2007) while the number of ABM transactions logged in 2006 was 1.05 billion (Canadian Bankers Association, 2007).

A debit card is essentially a means of electronically transferring funds from a purchaser's bank account to a vendor's bank account. This payment option is known as Interac Direct Payment, which is under the guidance of the Interac Association. This association was founded in 1984 by RBC, CIBC, Toronto Dominion Bank of Canada, BNS and Caisse populaires et d'economie Desjardins. Its primary purpose is to provide customers with access to cash though a wide network of ABMs in Canada.

Many think the next biggest technological advancement in banking will be smart card technology. Although this technology is not new, there has yet to be a mainstream adoption by the Canadian banking industry.[13] A smart card has a computer chip rather than a magnetic strip; the chip holds considerably more information, it speeds up the processing of transactions and offers improved security. One of the primary reasons this technology has not been accepted broadly within the banking industry is its cost. Having said this, over recent years there has been a greater number of occurrences and sophistication of fraud with credit and debit cards. If this trend continues, smart cards will become a more attractive alternative. Banks will be forced to recognize that the costs associated with smart-card technology are lower than dealing with increased levels of fraud elsewhere.

As the industry moves towards more internet-based distribution systems, a bank's information systems and technology represent an increasingly important KSF. The six largest banks in Canada spent a combined CAD4.4 billion on technology in 2006 (Canadian Bankers Association, 2007). HSBC's technology-related expenditures have been considerably lower than the industry averages although it increased its internet budget for 2007 by $10 million CDN: a 40 per cent increase over its 2006 expenditures.

Despite the substantial amount of money being spent on banking technology across the industry, online service is still considered inadequate by many Canadian consumers (*National Post*, April 5, 2004). Therefore there is a considerable opportunity for any of the Canadian banks to differentiate themselves with higher quality internet-related service.

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[13] Smart card technology was first developed in the 1970s.

2.2.3 New Competitors to the Industry

The threat of entry into the Canadian banking industry is moderate. A new entrant would have to endure a substantial amount of regulatory process and reporting. The nature of an oligopoly makes it even more difficult; one would expect the incumbent banks to react very aggressively towards a new entrant, offering lower pricing or superior service.

A KSF in the Canadian banking industry is a strong, national distribution network. As the global economy continues to develop, it is increasingly important to develop an international distribution network as well. Therefore, one of the greatest challenges a new entrant would have is to establish these networks. HSBC Holdings plc entered the Canadian banking industry by acquiring an existing bank, the Bank of British Columbia, thereby obtaining an existing distribution network (albeit one limited to Alberta and British Columbia). It is fair to assume another large global player could also enter the Canadian banking industry with an acquisition entry approach. However, one must recognize that the new entity is not really new; rather, it is an existing competitor with a new ownership structure, a new identity and a perhaps a new strategy. Regardless, distribution represents a considerable barrier for new entrants.

HSBC continues to target large national and multinational firms as customers. These firms often require access to multiple branches across Canada and around the world. Therefore, it is essential that the bank also have offices across the country and around the world. Customer demand for greater distribution networks continue to grow as the world moves towards a global economy.

The strength of the Canadian economy is highly dependent upon international trade. An increasing number of Canadian businesses are involved in importing and exporting. Canada's balance of trade for 2006 was CAD53.6 billion (Statistics Canada, 2007). As such, the movement of funds in and out of Canada is becoming increasingly important. However, after such events as the terrorist acts of 9/11, many American banks are making it harder for businesses to move money in and out of the USA. One way for Canadian businesses to simplify this process is to open an American bank account with a US bank. HSBC Bank USA has many cross border arrangements with HSBC Bank Canada. Therefore, existing HSBC Bank Canada commercial customers are encouraged open accounts with the American HSBC counterpart. This distribution advantage represents another obstacle for a new entrant into the Canadian banking industry. Although all of the other major Canadian Banks have purchased American banks over the years, HSBC also has a presence in most European, Asian and Latin American countries. Therefore, it has a distinct advantage over both new entrants and the existing Canadian banks. Clearly, this is an advantage that HSBC should continue to exploit.

Advances in technology have the potential to help level the playing field for new entrants. It is becoming easier for banks to reach customers via internet banking, phone banking and roaming salespeople. In BC, for example, RBC, Vancity Credit Union and BMO are just some of the financial institutions that have commercial relationship managers that spend the better part of each day in their vehicles visiting customers. All correspondence back to the branch networks is conducted via laptop computers or cell phones. Although this does not eliminate the need for a branch-based distribution network, it minimizes the amount of capital needed to develop or acquire bricks and mortar.[14]

The insurance companies operating in Canada represent a credible threat of entry to existing banks. These companies are actively lobbying to compete with banks on many fronts. For example, in June 2001 the Government of Canada allowed life insurance companies (and money market mutual fund dealers and securities dealers) access to the Canadian Payments System, a clearing and settlement system for processing cheques and other types of payments

[14] Bricks and mortar is a term used to describe the physical buildings owned by banks.

between financial institutions (Department of Finance Canada, 2005).[15] Insurance companies are now able to offer more sophisticated payment options. There has also been a trend within the Canadian financial services industry towards consolidating Canadian insurance companies. As these companies grow organically and through mergers and acquisitions, their lobbying efforts become a much more credible threat to Canadian banks. Unfortunately for the banks, there continues to be resistance by the federal government to allow bank mergers. This legislation will hurt banks in the domestic marketplace if they are forced to compete against entrants such as insurance companies. Large insurance companies are able to offer an increasing number of bank services while the Canadian banks are unable to offer insurance products. This legislation also prevents Canadian banks from being competitive in the international marketplace.

Creating brand identity is another major hurdle for a new entrant. Since many of the services offered by Canadian banks are similar in nature, the ability to develop brand identity is an extremely important KSF. The Canadian banking sector is a mature industry with well established players; creating a new brand identity to compete with these players would likely be very expensive. For instance, the value of the RBC brand is worth an estimated $13.6 billion CDN according to the Millward Brown ranking (McArthur, 2007).[16] Not only are the advertising costs expensive, but most people are reluctant to simply move their financial affairs to an unproven bank. As such, trust is also an important KSF. Customers are not simply taking their cars into a service station for an oil change; they must be able to trust the financial institution with very personal and important financial matters. Generally speaking, the large, existing Canadian banks have established strong reputations for being trustworthy. In comparison, a new entrant would have to prove its trustworthiness, an expensive and timely exercise.

[15] The Canadian Payment System includes the Interac debit and credit system.
[16] Millward Brown determines a brand's value not on how widely known it is, but on its ability to generate current and future earnings.

HSBC Holdings plc's hexagon symbol is well recognized throughout the world. However, it does not have the same impact in Canada. Based on advertising, history and size, the five largest banks in Canada have a distinct advantage. However, as the trend towards globalization persists, more and more Canadians (especially new immigrants and those Canadians who travel internationally) are beginning to realize that HSBC Bank Canada is part of a much larger and more global organization. In other words, the brand identity of HSBC will continue to get stronger in Canada.

A new competitor must also consider the cost to a business when it switches from one financial institution to another. Although it is not uncommon for a Canadian business to change banks, there are certainly expenses associated with doing so, such as legal fees, penalties and convenience. Having to deal with someone new and to explain one's business all over again is an important, non-tangible cost. Since commercial banking arrangements are often complex in nature, this can materially affect one's decision. New entrants would have to provide some sort of compelling reason for customers to leave their existing institution. Providing such an incentive would likely prove quite difficult and expensive.

Another difficulty for a new entrant to the Canadian banking industry pertains to the substantial, capital costs associated with setting up a new bank. A few of the start-up costs would include the following. Not only must the distribution network be addressed (as discussed earlier), but the entrant must hire and compensate a brand new workforce, it must spend considerable advertising dollars, and it must source start-up money to lend to its customers. The new entrant must also acquire at least some real estate for its head office. Furthermore, the new entrant has to spend considerable money setting up its reporting requirements. Competing against existing players, which have huge economy of size and scale advantages, is the greatest challenge for a new entrant. The existing banks are able to operate with considerably lower cost structures.

2.2.4 Strong Bargaining Power of Buyers

The power of buyers is high. These stakeholders are obviously critical to HSBC's survival. Although the number of buyers is much larger than the number of firms in the business, many of these buyers are sensitive to price. With advances in technology, information asymmetry is also increasing. Buyers are able to learn more about each financial institution's services in a fairly quick manner. As a result, search costs are reduced substantially. As customers become better informed, their negotiation power increases.

Buyers have no trouble absorbing potentially high switching costs if the cost of borrowing is lower or the deposit rates are higher with the new institution. Customers can easily calculate how long it would take to recoup the costs through improved savings. As such, price is a clear KSF; however, it is not the only one. Many customers continue to stay loyal to their bank knowing that they could possibly get a slightly better rate at another institution. Two key determinants that help reduce the importance of price are: A) the type of services offered and B) the quality of the services offered. A standardized service, such as a basic term loan to purchase a commercial building, requires little or no advice. In that scenario, pricing plays a much greater role. However, when a business requires a specialized service, such as trade finance, pricing is no longer the final determinant.

HSBC's parent company has a strong global presence with its international distribution network. HSBC Holdings plc was originally founded on trade finance. HSBC has more than 5,000 offices in 82 countries and a proven ability to meet the needs of its importing and exporting customers. It also has a clear advantage over its larger Canadian competitors in the trade finance market. However, it is important to note that HSBC must continue to offer the more basic term loan and operating credits as these services complement the more specialized services. HSBC does not have to be the low-cost provider of basic services if it can attract and maintain customers with its ability to offer unique services and/or appeal to niche markets. With this strategic approach, HSBC is able to neutralize the effects of pricing as a KSF. However, if HSBC decides to compete directly with the larger banks using standardized services, then pricing becomes much more critical.

Another approach to minimize the relevance of pricing pertains to HSBC's ability to deepen its customer relationships. More specifically, the bank must continue to cross sell more of its commercial services in an attempt to solidify its relationships. The greater number of services a customer uses, the greater the frustration and hassle associated with moving to a new institution.

Since HSBC is considerably smaller than the big five Canadian banks, it faces certain disadvantages regarding economies of size and scales. However, being smaller allows for greater flexibility from an operational perspective. Many banks are now investing considerably greater resources into expanding their electronic and internet capabilities. As more Canadian businesses use electronic alternatives to meet their daily banking needs, the urgency for an extensive branch network is reduced. Although it remains vital to have a branch network in place as customers still need to conduct some of their banking business in person, perhaps the number of branches and size of its branches are less critical.

Most banks offer at least some similar services. If buyers can easily obtain the same service at another institution, their negotiation position is that much stronger. However, if the services offered are specialized or customized in any way then the buyers' power is reduced; they cannot play one bank off another in an attempt to strike the best deal. The level of expertise displayed by HSBC employees has a material impact on the bank's negotiation strength. Superior expertise translates into excellent customer service, which is a clear KSF. Unfortunately, HSBC has not ranked as well as some of its direct competitors in this area. TDCT was ranked highest amongst all Canadian banks and credit unions for overall customer service in 2005 and 2006 (JD Power and Associates, October 17, 2006). RBC held the title in 2004

(National Post, April 5, 2004). Therefore, although HSBC is known for being a strong provider of commercial banking services, it is by no means the strongest provider overall. HSBC must continue to attract top salespeople in order to provide above industry average customer service. As it stands right now, HSBC should be rated mid-range in terms of the customer service it provides when compared to the other major Canadian banks.

Attracting top quality employees represents an opportunity for HSBC to strengthen its customer-service rating within the Canadian banking industry. If HSBC is able to consistently attract high performers who are well informed and dedicated, buyers will find it increasingly difficult to obtain the same level of service elsewhere.

Another circumstance that works in HSBCs' favour is the customer's inability to backward integrate.[17] Due to many of the issues highlighted in the 'New Competitors to the Industry' section (2.2.2), it would be extremely difficult for an individual buyer to set up operations and become a credible threat.

As with the threat of new entrants, one way for HSBC to minimize the power of buyers is to continuously improve its brand identity. HSBC Holdings plc has the 28th most valuable brand in the world (Frampton, 2006). However, HSBC Bank Canada does not seem to enjoy the same recognition in the Canadian banking industry. Only in the past few years has HSBC made considerable efforts to capitalize on the HSBC brand logo. HSBC now sponsors the Vancouver Canucks (a professional hockey team), the Calgary Flames (a professional hockey team), the Toronto Blue Jays (a professional baseball team), the HSBC Festival of Lights fireworks show in Vancouver, and the Stars on Ice (figure-skating tour).[18] HSBC is targeting a more affluent market of Canadians with these new advertising initiatives; people who have above-average disposable

[17] Backward integrate refers to the customer's ability to form its own bank.
[18] Note: HSBC Bank Canada is the only major bank in Canada that has its headquarters on the west coast (Vancouver); hence, more adverting dollars are spent in Western Canada.

income, travel for business or pleasure and enjoy an active lifestyle. The goal is to have the target market identify with the HSBC brand. Once the customers develop a sense of belonging, they become increasingly loyal to the brand image and less concerned about price. Although HSBC has made significant strides in making it's name better recognized, it still does not have the same exposure as the big five Canadian banks.

2.2.5 The Strength of the Industry's Suppliers

The bargaining power of suppliers is significant. Since banking is a service-related industry, one of the most important supplies for a bank is its employees. Employees are the primary contact between the company and its customer base. Therefore, educated and experienced employees play a vital role in HSBC's overall success; high quality employees are considered a KSF. This is especially true since the Canadian financial services industry is becoming increasingly complex. For example, the need to understand and provide treasury services, such as bankers acceptances, is now almost a requirement when competing for commercial loans in excess of $3 million CDN.

There is little doubt that qualified and experienced banking personnel are currently in demand. This is evidenced by a noticeably higher amount of employee turnover in the industry. The industry continues to experience difficulty in filling the positions of commercial relationship manager. Level of service is often a key differentiator when customers decide with which bank they want to deal.

HSBC has a reputation for attracting and training intelligent employees, evidenced by the constant headhunting of HSBC's commercial-relationship managers. Although there are various opinions within HSBC as to why this is the case, the general consensus is that experienced HSBC relationship managers have strong competencies in a variety of industries. Other major Canadian banks encourage their talented employees to specialize in specific industries. Admittedly, in some major city centres HSBC does practice specialization, it is not done to the same extent as in the big five banks. For instance, in Vancouver alone, RBC has specialized commercial lending teams for such industries as real estate, film, manufacturing, automotive and agriculture. In comparison, HSBC has a minimal number of specialty commercial teams across Canada. Other than its energy team in Calgary, HSBC's commercial department has very few structured teams with a single-industry focus.

HSBC commercial relationship managers, having greater exposure to multiple industries, are able to play more of an advisory role to the customer. This knowledge enables them to provide a greater level of service to the customer. The distinction here is that an advisory role offers greater benefits to the customer than a relationship manager who is simply geared toward being a salesperson. The real benefit to the commercial customer lies within the advice provided by a knowledgeable bank employee. But, having this skill set also provides these employees with greater negotiation power. Recognizing that they are in demand allows these managers to switch employers with relative ease. As a result, it follows that retaining superior quality employees costs the Canadian banks more in terms of higher salaries and other benefits.

HSBC invests a substantial amount of time and money training its commercial relationship managers to become good at what they do; it takes time to become a proficient lender with a diverse portfolio of customers. If a Canadian bank is competing solely on price, then the cost associated with providing each service becomes extremely critical. In other words, if price is a KSF, then it follows that cost is too. However, if HSBC is able to segment its service mix to include unique services that appeal to niche markets, it will be able to pay higher salaries and pass these costs on to the customer in terms of higher pricing. Customers are often willing to pay a premium for superior customer service and specialized knowledge. HSBC can use this differentiation strategy to minimize the critical factors of price and cost as KSFs.

Several circumstances work in HSBC's favour to counter some of the suppliers' power. Firstly, there are numerous positions in HSBC currently filled with seasoned personnel who are likely to either retire or reduce the number of hours worked in a week. As a result, there will be many opportunities for younger, aggressive employees looking to further their careers. By communicating this reality to its staff, it should help deter some employees from leaving the bank. It should be noted, however, that many other Canadian banks are experiencing the same situation with their baby boomers.[19]

Although HSBC continues to lose commercial relationship managers to the competition, according the Executive Vice President, Jeff Dowle, "HSBC has attracted many more employees from the competition than it has lost" (personal conversation). This trend is a strong indicator that HSBC continues to take care of its employees and to recognizes their value to the organization. The fact that the bank does not attempt to be the highest-paying employer is further evidence that there are other factors that contribute to attract and retain key personnel. HSBC continues to closely monitor the Canadian banking industry to determine the average salaries being paid; these salaries are based on the complexity and overall importance of the customer portfolios being managed.

One dominant means of attracting employees pertains to an organization's culture. Even more important is that the culture of a Canadian financial institution is not directly related to salary. Rather, culture is a KSF that must be developed and nurtured. With regards to this particular KSF, HSBC seems to have a clear advantage over its competition. According to the *Financial Post*, HSBC was ranked one of the top ten employers to work for in Canada (Koven, 2007). This ranking is a reflection of the organization's overall culture. A few common trends shared by all ten of the companies thus identified are exceptionally low-turnover rates and rapid

[19] A baby boomer is a person born between 1946 and 1960 in North America. Following World War II, North America experienced an unusual spike in birth rates, a phenomenon commonly known as the baby boom.

recruitment. Furthermore, the ten companies identified are all growing quicker than their competitors. Table 3 illustrates the percentage growth for HSBC's total staff (including the corporate offices) and the branch staff over the past four years. This growth is a strong indication that the bank provides a favourable working environment. Consequently, this facilitates the movement of negotiation power from existing and potential employees to HSBC. It also gives HSBC an advantage over the competition when trying to attract the best possible service providers.

Table 3 Employee Growth

Year	Total Bank Employees	Branch-Only Employees
2003	5,152	2,715
2004	5,330	2,833
2005	5,593	2,923
2006	6,008	3,133
% increase from 2003 to 2006:	**16.6%**	**15.4%**

Source: HSBC Bank Canada, Human Resources Department

Although the demand for highly qualified and experienced employees is strong right now, typically as the national economy slows down so too does the demand for these employees; and often some of them are laid off during poor economic times. However, since HSBC is a smaller player and looking to grow no matter how the economy is performing, the bank continues to hire even during economic downswings. In fact, HSBC has historically grown more at the expense of the competition during slower economic times. Therefore, it is able to improve its negotiating power by offering greater job security than the competition.

Each Canadian bank must develop its culture over time to ensure that it is in line with the company's vision. This process takes time and a top-down communication approach. HSBC seems to have an advantage over its competitors in this regards. Being smaller, the bank is in a better position to communicate its desired behaviour. Furthermore, it is easier to control / change the direction of a culture with a smaller number of employees. Regardless, it should be recognized that changing the culture of a more than 6,000-employee organization is not easy. In order to operate efficiently and effectively, the appropriate culture needs to be relayed to each employee.

One significant characteristic that works in the suppliers' favour is the expense associated with training employees. For example, HSBC pays a new commercial relationship manager trainee \$40,000 - \$50,000 per annum and trains the person for one to one-and-a-half years before posting them. Although they are working at a branch while training, the trainees' productivity is quite low as they are not given a customer portfolio to manage. Once all of the courses provided, wages paid, and mentors' time have been factored, HSBC has made a substantial investment in each new trainee. As such, the bargaining power of these employees strengthens considerably. This strength has forced HSBC to relax its rule of being able to place trainees anywhere in Canada for their first postings. Instead, trainees now have a much greater say in where they would like to go.

2.2.6 Availability of Substitute Services

The threat of substitute services is another credible threat to HSBC. Probably the closest substitute to the bank is a credit union, although the two represent distinct strategic groups. Credit unions are created to serve their members as determined by a board of directors. The primary goal for banks, on the other hand, is to create value for their shareholders. However, as the credit unions in Canada continue to consolidate and become bigger, they represent a greater threat to the banks.

Credit unions have certain limitations due to Canadian law. They are not able to cross provincial lines and membership must be a defined segment of the population.[20] It is important to note that credit unions are limited in size and do not have the same national exposure or clout, but, most offer services comparable to those offered by the banks.

Credit unions seem to operate in a much more cyclical manner than banks, primarily because of their size. More specifically, they must watch their loan and deposit growth much closer than the banks. If they become offside (e.g. have given out too many commercial loans), they cut off their commercial lending until their deposits reach a certain level. This can render them a dangerous threat or it can represent a real opportunity for the banks. Following the example above, when a credit union needs deposit growth it often offers higher-than-industry average investment rates. Banks are usually reluctant to match credit union rates. As such, the credit unions are able to attract deposit money. Still using the same example, the credit union can also stop lending money to its commercial customers. This makes the commercial customers more vulnerable to solicitation efforts from the banking industry. As long as local HSBC branches are able to closely monitor the credit unions operating in the same geographical markets, the bank can take advantage of the cyclical nature of credit unions.

Switching costs remain a consideration, based on the individual customer's current financial situation. In other words, is the customer locked into a collateral mortgage or is he or she simply a deposit customer whose term deposits have just matured? The cost of switching financial institutions for most borrowing commercial customers can be significant. A customer, for example, can expect to pay at least $5,000 in appraisal and legal fees alone if a commercially zoned property is required by the bank for security purposes. Often, the greatest financial burden

[20] A credit union membership may be defined geographically, by occupational group, by employment with a specific company, by worship, etc.

a customer endures when switching institutions is the pre-payment penalty.[21] The industry norm for calculating a pre-payment penalty is to base it on three months of lost interest revenue. For loan balances in the low seven figure range, pre-payment penalties can add up to tens of thousands of dollars.

Another major threat to the traditional Canadian banks is the emergence of virtual banks, such as ING. These substitutes represent a credible threat as they do not require a substantial physical presence. This absence allows virtual banks to compete almost solely on price. Although there are still costs associated with setting up on-line network systems, these costs are typically much less than having to establish a branch network. Virtual banks represent a greater threat of substitution for personal banking services than commercial banking services because commercial banking typically requires more face-to-face contact. Although commercial savings accounts are a relatively simple service to provide, commercial credit facilities are often more complex. Face-to-face contact is very important with commercial banking; therefore, a branch distribution network is usually required, which is a critical KSF for the Canadian banking industry. Not surprisingly, ING does not offer many commercial services other than savings accounts. For this reason, the virtual banks do not pose a strong threat to HSBC in the area of commercial banking.

It should be recognized that there is also an inconvenience factor associated with virtual banking. Most of their customers are forced to keep bank accounts with traditional banks to obtain those basic services not offered by the virtual banks (e.g. the ability to obtain a draft). Furthermore, many of the banks, including HSBC, have responded to this threat of substitution by introducing their own 'online savings accounts'. These new accounts offer high interest rates comparable to those of the virtual banks. Like the virtual banks, these savings accounts may only

[21] A prepayment penalty helps the lenders recoup expenses incurred when putting a new loan on the books. If the loan is to be repaid ahead of schedule, the lender may incur a loss, as it has not had time to make up the costs it advanced. Lenders also know a mortgage prepayment penalty discourages prepayment.

be accessed online. In order to get money in or out of these accounts, the funds must be transferred electronically via the internet.

The threat of commercial brokers, such as Colliers International and Royal LePage Commercial Inc., must also be considered. These types of firms are able to access funds from multiple sources. They may have their own funds to invest, they may have extensive networks of private and/or institutional investors or they may ultimately shop their deals to banks. Depending on how they source their funds, these brokers may not impose as many conditions as would banks and having fewer controls can translate into cheaper financing. As identified in the previous sections, trust and customer service are KSFs within the Canadian banking industry. A commercial broker would simply not be able to provide the same level of customer service due to limited resources. Also due to their smaller size, commercial brokers typically have greater difficulty matching the level of trust instilled by long-standing reputable organizations, such as the larger Canadian banks. For this reason, the smaller independent commercial brokers do not represent a strong threat at this time.

Strengthening relationships is a particularly important KSF for banks when faced with the threat of substitutes. Locking in a customer with several services makes it more inconvenient for them to move. HSBC is capable of offering a wide array of commercial financial services. If it is successful in selling these services to its customer base, the customers are then more reluctant to move as the sheer hassle and expense associated with moving from one financial institution to another deters many. Also, many of the substitutes (credit unions, virtual banks, brokers, etc.) are unable to offer all of the services HSBC can. Cross-selling services locks in customers, thereby reducing the threat of substitute service providers. Selling more services also facilitates greater profits for HSBC.

Again brand identity, which is an industry KSF, plays an important role. HSBC should continue to lock in its customers with brand loyalty, thereby making it more difficult for customers to try a substitute service provider.

2.2.7 Likelihood of Alliance and/or Partnership Formations

There is always the possibility that strategic alliances or partnerships will form between the big five Canadian banks and other international banks (e.g. Citigroup Inc.). This would have the potential to seriously dissolve HSBC's advantage with its global-parent company. However, because of the cutthroat nature of international banking, this threat has yet to materialize in any significant way and continues to be unlikely. The primary reason for this unlikelihood stems from the strict banking regulations within Canada and abroad. Rather than forming alliances with foreign banks, these foreign banks are just entering Canada on their own. If fact, it is now possible for foreign banks to set up branches in Canada, without having to form subsidiary companies.

Since Canada is such a small market on a global scale, most large international banks are simply entering the country independently rather than forming an alliance with one of the already-established big five Canadian banks.

No matter their method of entry, there are now many foreign banks operating within Canada's borders. The larger American-based banks, such JP Morgan Chase, Citigroup Inc. and Bank of America, now have a presence in the country. There is also an increasing presence of Asian banks now operating in Canada; these include The Bank of China (Chinese bank), Bank of Tokyo (Japanese bank), Korea Exchange Bank of Canada (Korean bank) and CTC Bank of Canada (Taiwanese bank).

The development of a correspondent banking network among Canadian banks would certainly facilitate the ability of the Canadian banks to provide greater trade finance services. The greater the network size, the greater power a bank could leverage in an international marketplace. This network would also serve as a considerable deterrent to potential entrants to commercial banking within Canada.

Many governments have strict regulations that prevent the formation of strategic alliances. Therefore, the overall threat of alliance and/or partnership is low.
Two areas where the banking industry is seeing greater cooperation among banks is data processing and information sharing. The larger Canadian banks and information technology businesses have already begun forming alliances. For instance, in the late 1990s, RBC, IBM, and 15 US Banks formed a company called Integrion Financial Network. This entity further integrated with Microsoft, Intuit and Checkfree to create software called Open Financial Exchange which facilitates improved electronic-banking services. Essentially, this service allows banks to share information over the internet with Web users and users of software, such as Quicken and Microsoft Money. Another example of banks cooperating is the joint venture between RBC, BMO and TD Bank called Symcor Services Inc.; this company was designed to handle cheque and information processing for these three institutions.

2.2.8 Government Regulation – A Strong Potential Threat to the Status Quo

Canada's banking industry is regulated both provincially and federally. The Office of the Superintendent of Financial Institutions ("OSFI") is a federal entity that regulates and supervises Canadian banks. The primary objective of OSFI is to guarantee that confidence in the Canadian banking industry remains high. It also has the responsibility to minimize risk and, more specifically, reduce the possibility of undue losses by depositors.

OSFI uses capital adequacy requirements to control bank related risks.[22] The Bank for International Settlements ("BIS") Committee, an international organisation which fosters international monetary and financial cooperation, is in the process of setting up worldwide capital adequacy standards with its Basel II Framework initiative. Canada is a supporter of BIS. The Basel II Framework initiative is forcing banks around the world to improve their risk management abilities.

The BIS Committee requires that banks have capital equal to eight per cent of their assets; Tier 1 capital must not fall below four per cent of assets.[23] Essentially, the required capital must be sufficient to protect depositors and counterparties from the risks of the institution's on- and off-balance-sheet risks. There are different categories of bank assets; each category has its own level of risk. Commercial loans, for example, are considered riskier than government loans. As such, banks must keep more capital on hand when it advances a commercial loan versus a government loan. There is also a lesser known ratio, Tier 2 capital, which cannot exceed Tier 1 capital.[24] Total capital is the sum of Tier 1 and Tier 2 capital.

The Canadian banks' ability to compete in other financial service industries, such as the trust, insurance and securities industries, also means that they are forced to adhere to additional federal regulation.

The potential for Canadian bank mergers is also worthy of mention. The Bank of Canada has prevented these mergers to date. However, there is speculation that the Bank of Canada may reverse its policy thus permitting Canadian banks to merge. The primary question that must be

[22] Capital adequacy is a measure of a bank's financial strength usually expressed as a ratio of its capital to its assets.
[23] Tier 1 capital consists of common equity, non-cumulative preferred shares and non-controlling interests in subsidiaries, less unamortized goodwill. It is considered long-term capital and a core measure of a bank's financial strength, from a regulator's point of view.
[24] Tier 2 capital includes undisclosed reserves, revaluation reserves, general provisions, hybrid instruments and subordinated term debt.

answered is, "will bank mergers increase or decrease competition?" If the answer is "decrease competition," than the current regulation will likely remain.

Despite the overall restrictions on Canadian bank mergers, it is important to note that one significant merger between a major Canadian bank and a trust company did occur in 2000. The Canadian Competition Bureau concluded that the merger between the Toronto Dominion Bank and Canada Trust would increase competition. More specifically, the bureau felt that prices would not increase while the level of customer service would increase. The bureau determined that the increased level of service would lead to increased competition within the industry.

2.3 Key Success Factors

The following table (Table 4) summarizes the KSF for the commercial-financial services segment of the Canadian banking industry. It also compares HSBC to the other key commercial service providers operating within the Canadian financial services industry. Rather than naming the big five banks as one category, I have elected to use RBC and TDCT as representative banks. These two banks were chosen since they are the largest Canadian banks and because one uses a cost-based strategy (RBC) whereas the other uses a differentiation strategy (TDCT).

There are three ratings within Table 4: HIGH, MEDIUM and LOW. A HIGH rating indicates that the competitor is outperforming the industry average and poses a credible threat to the other competitors. A MEDIUM rating means that the competitor is essentially meeting the industry average. A LOW rating means that the competitor is performing at a level lower than the industry.

Table 4 **Commercial Banking: Key Success Factors and Competitive Comparison**

Key Success Factors	Relevant Category of Threat	HSBC	RBC	TDCT	ING (Virtual Bank)	Credit Unions
Price	New Entry and Substitute	MEDIUM	MEDIUM / HIGH	MEDIUM / HIGH	HIGH	MEDIUM / HIGH
Cost of Labour	Supplier	MEDIUM / HIGH	MEDIUM	MEDIUM	HIGH	MEDIUM
Brand Recognition	New Entry and Substitute	MEDIUM (improving trend)	HIGH	HIGH	MEDIUM	LOW
Distribution Network (National)	New Entry and Buyer	LOW	HIGH	HIGH	LOW	LOW
Distribution Network (International)	New Entry, Buyer and Substitutes	HIGH	HIGH	HIGH	LOW	LOW
Range of Service Offerings	New Entry, Buyer and Substitutes	HIGH(er)	HIGH	HIGH	LOW	LOW / MEDIUM
Customer Service	Buyer and Substitutes	HIGH	HIGH	MEDIUM	LOW	HIGH
Deepening Relationships	Buyer and Substitutes	MEDIUM	MEDIUM	MEDIUM	LOW	MEDIUM
Culture	Supplier	HIGH	HIGH	HIGH	LOW	MEDIUM
Technology Innovations	New Entry and Buyer	MEDIUM	HIGH	HIGH	MEDIUM / HIGH	MEDIUM
Trust	New Entry and Buyer	HIGH	HIGH	HIGH	MEDIUM	MEDIUM

Source: Author 2007.

Price is a key success factor that is directly related to economies of scale. Although HSBC does not have the same size advantages as the larger Canadian banks, it must be able to offer attractive pricing, at least on the more generic service offerings. Credit unions are perceived to be a threat as they operate with different mandates. Credit unions are considered non-profit organizations or alternatively, for-profit organizations only concerned with making money for their members (not shareholders). The members may decide that they are willing to sacrifice some degree of profitability for other benefits, such as superior service. Credit unions may not have the same cost structure advantages as the larger banks, but they still pose a credible price threat because members are not completely focussed on profit maximization. Credit unions often pay better interest rates on deposits and charge lower interest rates on loans than do the banks.

For such items as term loans and operating credits, HSBC must find a way to offer competitive pricing or it stands a greater chance of losing this business to the larger banks. Although HSBC may offer unique and specialized services, it must remain price competitive on the more commodity-like services, such basic term-loans; these services are considered to be essential by commercial customers.

HSBC appears to be in a slightly better position than its competitors in terms of attracting and retaining talented employees while not having to pay too much of a premium. Although HSBC pays competitively, it has also developed a reputation as a one of Canada's best publicly-owned companies for which to work. It has also built itself a reputation for providing strong learning and development skills for its commercial banking employees. Because of these circumstances, HSBC is able to attract employees that are not concerned solely with salary; they are also concerned with work-life balances and career development. Although many of HSBC's employees know that RBC has a reputation for paying quite well, if not the highest in the industry, they still seek employment with HSBC. As such, HSBC is able to select highly skilled employees and still manage to control its labour costs.

Brand recognition is certainly one of the most important key success factors. HSBC's brand is well recognized on a global scale. However, the big five Canadian banks have an advantage over HSBC in Canada. HSBC, however, continues to spend millions of dollars of its advertising budget supporting key sporting events and team sponsorships. This choice was made in an effort to attract a more affluent and active customer base. By also appealing to those that conduct business or travel internationally, HSBC is in a better position to leverage the brand identity associated with its parent company and subsidiaries all over the world. Therefore, based on the inherent nature of globalization and HSBC's strong international presence, HSBC is well positioned to continue strengthening its brand recognition within Canada.

HSBC's Canadian distribution network is at a disadvantage to the larger Canadian banks that have significantly more branches across the country. Having said this, banking continues to be heavily influenced by technology, and in this regard, more Canadians are having their banking needs met through online banking, telephone banking and ABM networks. This trend does not negate the need for face-to-face contact that a branch network provides. However, it does alter the size of the network required to be competitive. The larger banks will likely reduce the number and size of their branches over the next few years. HSBC, on the other hand, continues to expand its Canadian presence. Therefore, it can control its costs by opening smaller, more strategic locations while continuing to promote the technology-driven alternative distribution methods. Credit unions are clearly not a threat to distribution as they are quite limited to geographical boundaries, as they are legislatively bound by provincial borders.

Again, HSBC's parent company represents a significant advantage over the Canadian competition. HSBC Holdings plc provides a global distribution network for HSBC Bank Canada's international customers. For those commercial customers that do business around the worlds, HSBC is a natural fit. None of the other big five Canadian banks have anywhere close to the international exposure of HSBC Holdings plc. This is a clear advantage that continues to work in HSBC's favour as it builds its brand recognition in Canada. Although such virtual banks as ING also have international and domestic exposure, their ability to offer a wide variety of commercial financial services is very limited. Again, the lack of face-to-face contact further reduces the virtual banks' ability to effectively compete with HSBC's commercial financial services.

Another key differentiator among the banks is the range of services offered. If one bank cannot offer a particular service, it becomes more vulnerable to competition. All of the major Canadian banks offer an extensive line of services. However, there is certainly room to differentiate based on the level of expertise and scope associated with each service. HSBC has a distinct advantage in most trade-finance related services. It has also become quite dominant in its leasing capabilities. In fact, leasing facilities are often provided as a means of HSBC getting its foot-in-the-door with prospective businesses. Banks continue to expand their range of services to minimize the threat of rivals. HSBC's position is fairly evenly matched with the larger banks but has a clear advantage over the credit unions and virtual banks that are limited in size and capabilities. HSBC must continue to promote the services it provides that the competition does not, or at least promote the services that it executes better.

Customer service, closely tied to range of services, is a KSF. Although it is one thing to offer a particular service, HSBC must also execute the service experience as smoothly as possible. Since commercial banking is often complex, many customers rely on the relationship manager's advice. It is therefore critical to have intelligent and well-experienced employees who can demonstrate strong people skills. Furthermore, strong customer service often reduces the effects of pricing. HSBC has the ability and expertise to offer superior service, primarily because of more expansive training / exposure a commercial lender receives at HSBC than at some of the other big five banks (e.g. RBC). HSBC's culture and reputation as an excellent employer also often works in the bank's favour in terms of attracting high-quality commercial relationship managers. RBC, typically viewed as one of the best, if not the best, paying bank in Canada, is also able to entice strong talent. It is important to note here that although TDCT has been ranked very strongly in terms of customer service, this distinction primarily reflects this institution's retail service. The TDCT does not have a strong customer service reputation for its commercial banking services.

Most credit unions have a mandate to provide strong customer service. Furthermore, credit unions typically experience lower employee turnover than banks; banks are more national / international in scope and experience a greater rotation of relationship managers. Alternatively, the continuity of the credit union employees leads to improved customer service; customers do not have to keep teaching new relationship managers about their businesses.

In terms of deepening relationships, HSBC must do a better job of encouraging its customers to use multiple services in order to lock them in with HSBC.[25] The more services a customer is using, the more of an inconvenience it is to leave; it often becomes more expensive to leave as well. This is one area that the other Canadian banks are more proficient in than HSBC (HSBC Bank Canada, 2007).

Although culture is one of the hardest key success factors to measure, it is an area in which HSBC's commercial banking department takes pride. Commercial banking remains one of HSBC's strongest profit centres and an area of great success throughout HSBC's history in Canada. Many relationship managers are attracted to HSBC due to the aggressive nature of the commercial department. The bank has a disproportionately high market share of Canada's commercial banking business. Most of the larger Canadian banks are strict about enforcing their lending guidelines. The employees within HSBC's commercial credit department are often seen as deal-makers, not deal-breakers.[26] The employees within this department look at the overall strength of the deal without being too intimidated by exceptions to the bank's lending guidelines. This approach gives the relationship managers the freedom and flexibility to aggressively pursue new business, often at the expense of the big five's market share.

[25] 'Locking' in a customer is more commonly referred to as bundling.
[26] HSBC's commercial credit department is the entity responsible for reviewing commercial credit applications and either approving or declining them.

HSBC is adequately positioned amongst the other major banks with regards to technological innovations. For security purposes, HSBC is often a follower of new technology rather than a leader. More specifically, HSBC likes to determine whether or not each new advance is secure prior to offering it. For example, internet-banking was introduced by all of the big five Canadian banks and most of the credit unions well in advance of HSBC. The larger banks represent a moderate threat to HSBC and the credit unions because larger banks having significantly higher technology related budgets. However, any advantage gained by the big five banks are usually short-lived as the rest of the industry is quick to adopt similar capabilities.

Trust remains a strong key success factor in the financial services industry. HSBC's global dominance helps evens out the playing field with the big five banks, who are larger and longer established in Canada. Due to their size, credit unions cannot offer the same security. Some of the virtual banks may be large in size, but have difficulty instilling trust when customers are unable to speak in person with bank representatives.

2.4 Summary of Industry Attractiveness

The following table (Table 5) summarizes the strength of each force discussed in 'The Canadian Banking Industry' section (2). A rating is also provided with regards to the impact of technology on the intensification of competition. The overall competitiveness of the Canadian banking industry is rated medium to high.

Table 5 Final Assessment of Industry Attractiveness

Porter's Five Forces:	**Degree of Threat**
Intensity of Competition	**High**
Threat of New Entrants	**Low / Medium**
Power of Buyers	**High**
Power of Suppliers	**Medium**
Threat of Substitute Services	**Low / Medium**
Additional Considerations:	**Ability to Alter Status Quo**
Impact of Technology	**High**
Threat of Alliances / Partnerships	**Low**
Government Regulation	**High**
OVERALL COMPETITIVENESS OF INDUSTRY	**MEDIUM to HIGH**

Source: Author 2007.

3 A LOOK INSIDE HSBC

3.1 HSBC's Strategic Tools

This section examines HSBC's resources according to their functional types. Their tangible resources include financial resources, fixed assets and human resources. HSBC's intangible assets include technology resources, reputation and culture.

3.1.1 Financial Resources

HSBC has access to an incredible amount of financial resources. HSBC Holdings plc, the parent company, had $1,861 billion US in assets as of December 31, 2006 (HSBC Holdings plc, 2007). The USD/CAD exchange rate at this time was 1.1652. Therefore, HSBC Holdings plc's total assets on that date were worth $2,167 billion CDN while HSBC's total assets were $56 billion CDN as at December 31, 2006 (HSBC Bank Canada, 2007).[27] Consequently, HSBC's assets represent approximately 2.6 per cent of its parent company's total. HSBC has experienced strong growth and profitability over the past several years, which has put this subsidiary company in good standing within HSBC Holdings plc; and, therefore it has little difficulty obtaining funds from its parent company if required.[28] HSBC has substantial borrowing capacity, which enables it to easily source financial capital to fund loans and strategic acquisitions.

HSBC's internal source of funds is strong. The bank operates a very balanced book in terms of deposits and loans. The deposit-to-loan ratio is 1.26:1, which implies that the bank has

[27] December 31, 2006 was a Sunday. Therefore, the 1.1652 exchange rate indicated above is actually the exchange rate for December 29, 2006.
[28] Despite the ability to borrow from its parent company, a primary objective for HSBC is to grow a balanced book and become self-sufficient. Furthermore, it is often cheaper for HSBC to borrow short-term funds from the Bank of Canada than from HSBC Holdings plc.

$1.26 CDN on hand in deposits for every $1 CDN it lends out.[29] The bank had a surplus of deposits over loan in the amount of CAD11 billion as of December 31, 2006 (HSBC Bank Canada, 2007).

3.1.2 Fixed Assets

HSBC has very few fixed assets in relation to its total assets. The bank's $121 million CDN in land, buildings and equipment represents 0.2 per cent of its total assets (HSBC Bank Canada, 2007). HSBC leases the majority of its premises. The bank rationalizes that it can obtain a higher rate of return on its capital by lending out funds rather than buying real estate. In 2005 HSBC sold its head office building for $143 million CDN in a sale and leaseback agreement.[30]

Return-on-assets is a key ratio used by stock analysts when analyzing a bank's performance. Therefore, it is prudent for a bank to switch its non income-producing assets, such as land, buildings and equipment, into income-producing assets, such as loans.

3.1.3 Human Resources

HSBC's primary tangible assets are its employees. The bank is constantly looking for more commercial relationship managers to keep up with its growth initiatives. As previously mentioned, these managers are exposed to numerous industries and tend to develop a diverse skill set which enables the bank to be well regarded in the Canadian banking industry for its commercial banking services. HSBC's challenge going forward will be its ability to attract and retain strong performers.

[29] The bank's loans are broadly categorized into three distinct customer segments, Business and government, residential mortgages, and consumer loans (less provision for credit losses). The bank's deposits are broadly categorized into three categories as well, regulated financial institutions, individuals, and business and government.
[30] Located at 885 W. Georgia Street, Vancouver, BC.

HSBC does not want to lose its ability to attract and retain strong talent. The number of commercial banking employees has grown 24.3 per cent from December 31, 2004 to December 31, 2006 (HSBC Bank Canada, 2007). The bank has set aggressive targets for asset growth for the next five years and its demand for experienced commercial relationship managers is expected to increase proportionately with the bank's overall growth.

The internal-credit application systems at HSBC are a source of frustration for the commercial relationship managers. Over the past five years, HSBC has implemented many application, reporting and monitoring systems in an effort to meet industry standards. Many of these changes are required to be compliant with the Basel II Accord. Although difficult to measure, the number and magnitude of the changes have taken a toll on many these managers. Currently, more than ten senior-relationship manager positions are waiting to be filled in BC alone. Although less-than-ideal, there is a perverse positive to this situation: HSBC's commercial banking employees are well regarded and often aggressively recruited by employment agencies and hired by other Canadian financial institutions. Therefore, although commercial relationship managers are a core strength, more must be done to retain them.

3.1.4 Technological Resources

HSBC's internal technology systems are widely regarded as inferior when compared to those of the big five Canadian banks. This situation continues to be evidenced by employees who have left other banks to work for HSBC. Although HSBC has made considerable strides with improving its customer-interface technology, such as internet banking, the internal systems must be improved. The current credit application systems are unable to pull data from one central customer database. The relationship managers are, therefore, required to input data in multiple fields within any one credit application, a time consuming and frustrating situation for both customer and employee. As few of the bank's systems are integrated, it results in considerable inefficiencies. The relationship managers spend an unnecessary amount of time completing credit applications instead of concentrating on sales-related activities. As a result, HSBC is sacrificing its primary objective – growth.

There are significant opportunity costs with HSBC's cash-management services. For example, many businesses require a pooling of accounts to effectively manage cash flows. The bank is manually performing this function for some customers but is unable to provide such a service for many larger, prospective customers. However, automation of pooling services is high on the bank's agenda and its availability is expected by late 2007. With the bank's increased funding towards cash-management services, HSBC anticipates that these services will become core strengths much like trade finance and leasing services. HSBC is attempting to match the success the parent company has obtained with its cash-management services in Europe[31].

HSBC's limited budget means that some of the areas requiring technological improvements are receiving funding prior to others. Revenue-generating services usually take priority over systems that are not visible to the customer. However, the bank is now aware that its internal systems are of equal importance. HSBC will continue to lose key personnel if technological improvements are not made.

Overall, HSBC's technology resources are not a core strength. The bank has many areas that require improvement in order to meet industry standards.

3.1.5 Reputation

One of HSBC's core strengths is its reputation. The bank's continued growth in Canada confirms that HSBC is well recognized and accepted by the Canadian population. HSBC is well regarded in the corporate world as reflected by its AA credit rating from Standard & Poor's

[31] HSBC Holdings plc was named Euromoney's 2006 top, international cash-management bank (Euromoney, 2006). HSBC's parent company finally beat out Citigroup Inc. who had held top honours for the past five years.

(Standard and Poor's, 2007). Increased sponsorship of key sporting and entertainment events has improved HSBC's visibility. The bank should continue to play on its parent company's size. Large and well established banks tend to inspire confidence in customers.

3.1.6 Culture

HSBC's culture is currently strong. The commercial-banking experience provides an excellent opportunity to learn and to develop. There are numerous opportunities within HSBC to move up the corporate ladder as the bank continues to grow. The bank has little difficulty attracting new talent. It is well publicized as a great place to work. HSBC must now address some key issues that nurture this favourable momentum. As previously discussed, there are two key points that have the potential to materially reverse HSBC's strong, commercial-banking culture: excessive change and poor, internal technology-related systems. The President and CEO of HSBC Holdings plc, Stephen Green, recently recognized this concern. Mr. Green is pushing a new mandate for each of the HSBC subsidiaries operating around the world: to become market leaders with respect to their internal and external systems within the coming months.

3.2 How HSBC Adds Value

HSBC adds value to the commercial-banking experience by managing a network of customers with complementary needs. At a very basic level, HSBC serves as an intermediary that links depositors with borrowers. Providing excellent customer service and leveraging its expertise in niche markets allows HSBC to differentiate itself from other Canadian banks. HSBC does not attempt to be a low-cost provider, as it does not have the economies of scale to compete against the larger Canadian banks. Rather, HSBC competes with a differentiation strategy. Figure 4 provides a graphical representation of the flow of HSBC's service process.

Figure 4 HSBC's Value Chain: Differentiation Service

FIRM INFRASTRUCTURE:

Top management commitment to increase brand identity and improve the electronic and branch distribution networks.

HUMAN RESOURCE MANAGEMENT:

- encourages diverse industry experience; mentoring programs; extensive training for product knowledge
- hires employees with diverse skills (often employees who have worked abroad)
- creates an aggressive credit culture
- promotes talented employees; high expectations; aggressive goal setting
- initiates pay-for-performance bonus incentives; restructures duties to segregate sales roles from administration roles to free time for better sales people

TECHNOLOGY DEVELOPMENT:

	- create new cash mgmt services - improve user-friendliness of website - improve internal application processes (reduce delivery of service time)	- creation/improvement of international technology (i.e. internet) platforms - 24/7 account accessibility from around the world

PROCUREMENT:

Network Promotion and Contract Management

- strong sponsorship of sports and recreational events
- cater to well travelled and affluent
- appeal to image conscious
- offer full service offering (i.e. include personal and investment services to complement commercial services)
- well established and secure bank (especially with regards to internet security)

Service Provisioning

- high quality of advice
- superior trade finance services
- superior cash management services
- superior leasing services
- access to unlimited funds
- global presence
- flexible service offerings; ability to customize commercial services

Infrastructure Operation

- operate branch network and selectively increase # of locations
- operate internet banking
- operate phone banking
- operate ABM network
- maintain access to funds (primarily for lending purposes)
- maintain close links between subsidiaries around the world

Adapted from Porter 1985, and Stabell & Fjelstad 1998.

HSBC adds value to its commercial-services offerings by creating a dependable network. The value created is not a one-time effect; rather, the real value resides in belonging to the network. The bank, with the assistance of its subsidiary companies, is able to offer almost every possible banking product imaginable to the customer. Furthermore, HSBC provides specialized knowledge in key areas, such as trade finance and leasing. Cash management is expected to be HSBC's next core strength; it will be developed further over the course of the coming year. HSBC's international bank network provides the single greatest advantage over the larger existing Canadian banks, enabling it to attract large commercial depositors with its niche market services, as indicated in the Service Provisioning section of Figure 4.

Technological development has already increased the amount of commercial services offered online. Customers are now able to issue their own documentary letters of credit, wire funds internationally and book treasury rates. These services are all available with HSBC's exclusive, commercial internet-banking service, HSBCNet. Although this feature is fairly expensive at $150 CDN/month, in relation to internet banking services provided by other banks, it has permitted HSBC to distinguish itself in the market place. The organization also offers basic services for those customers that do not need the more unique services and are, therefore, unwilling to pay for them.

Technology is expected to play a greater role for HSBC in terms of cost reduction. Improving internal processes, risk management and credit application systems will receive a much greater focus over the next five years (HSBC Bank Canada, 2007). The bank recognizes that it does not have the same economies of scale as the larger Canadian banks, but it must still look at reducing its cost structure where possible. The more efficient the bank's systems and processes become, the greater the level of customer service and consequently, satisfaction. The customers will receive quicker responses to credit inquiries and the relationship managers will have more time to spend with their customers.

HSBC has already outsourced some of its more routine duties to third parties. For instance, HSBC now contracts Douglas Guardian Services Corp. to conduct audits for automotive dealership. The rational behind this decision is primarily cost; Douglas Guardian Services Corp. specializes in this service and is able to do it for less money while providing greater consistency in reporting. The bank is currently looking to outsource the margining of overdraft accounts. The purpose of outsourcing certain tasks is to free the relationship managers' time. The bank wants to increase the level of customer service to previous levels by increasing the amount of time available to spend with existing and prospective customers.

HSBC has adopted a pay-for-performance mentality when it comes to providing incentives to its employees. The bank has increased the bonus structure for those employees who significantly surpass their annual objectives. All objectives are tied to asset growth and increased net contribution (i.e. profitability). Furthermore, top-performing employees are also eligible to earn incentive shares of HSBC Holdings plc. Lastly, HSBC introduced the "President's Awards" program four years ago; this program takes the top 40 employees in Canada each year and sends them (with spouses) to a tropical destination or on a cruise. All of the above incentives are designed to attract and retain more ambitious employees. However, it should be noted that RBC uses a salary plus commission-based incentive program. Therefore, there is no limit to the commission and bonus a commercial relationship manager can earn.

All of the top Canadian banks continue to upgrade their websites with greater product knowledge and more services. As previously mentioned, both RBC and TDCT have won customer-service awards for their websites. However, HSBC has an advantage over them because its internet banking is able to connect accounts held with HBC subsidiaries all around the world. HSBC is not likely be a market leader in terms of new internet-based technology; it does not have the same technology budget as do the big five Canadian banks. Also, HSBC purposely chooses to take a wait-and-see approach to new technology; strategy allows the bank to ensure that most security breaches have been identified and properly addressed prior to HSBC implementing its version. It is important to stress that each new technological development does not form the basis of a strong differentiation strategy on its own. The other banks are quick to implement similar services within very short periods of time.

The big five Canadian Banks must appeal to the entire Canadian public to grow. Herein lies HSBC's advantage; because of its smaller size, it can be more selective in the markets in wants to attract and still be able to grow its asset base. HSBC continues to push its commercial services towards well travelled and affluent customers. The company's brand is designed to appeal to an image conscious market. Admittedly, the larger Canadian banks also have service lines that appeal predominantly to these groups. However, these same banks have multiple advertising campaigns that target various sectors of the population, whereas HSBC's message is relatively focussed. Its advertising efforts create a brand image associated with exclusivity. HSBC is trying to develop a sense of belonging with its target market, rather than trying to send a generic message. As with any other strong brand, from Coke to Nike, people are willing to pay premiums to associate themselves with a well regarded service or product provider.

3.3 HSBC's Current Direction

The generic strategy of HSBC is based on a differentiation approach and finding niche markets. Its commercial banking operation has enjoyed strong success over the past couple of decades. This success was primarily based on offering superior, customer service. It can be argued strongly that HSBC has now lost its competitive edge with regards to customer service. The number of process changes, combined with poor internal technology, has resulted in slower customer response times. A substantial increase to the amount of required reporting has claimed even more time from the relationship managers. With more administrative duties assigned and increased growth objectives, HSBC's relationship managers have less time to spend with their commercial customers. To further compromise the bank's position in the industry, the larger Canadian banks have improved the level of their customer service over the past decade.

In response to the growing intensity of competition, HSBC continues to increase its brand awareness and exploit its international connections associated with the HSBC Holdings plc.

group of companies. The global links have contributed to competitive advantages in trade finance and the growing Asian-based commercial markets in Canada. HSBC has also focussed its efforts in commercial-leasing services and, more recently, in cash-management services.

In summary, HSBC's current strategy is to continue offering differentiated services in niche markets. As seen in Table 6, the bank is positioned in the product uniqueness section. However, the close proximity to the low cost section should not be overlooked. HSBC must continue to look for ways to reduce costs as Canadian companies are becoming increasingly powerful negotiators. As these companies effectively reduce the banks' overall interest and fee-based returns, all Canadian banks must look at cost reduction to maintain current profit levels.

Table 6 HSBC's Current Strategy

Target Scope	Advantage	
	Low Cost	**Product Uniqueness**
Broad	Cost Leadership Strategy	Differentiation Strategy
Narrow	Focus Strategy	**HSBC**

Adapted from Porter 1979.

HSBC is a full-service institution and, as such, it is closely positioned to the 'broad' section of Table 6, but it focuses on a few key commercial services to differentiate itself from the larger Canadian banks. It does, however, offer the full spectrum of commercial financial services which produces two primary benefits. Firstly, it locks in existing customers and discourages them from splitting their banking with other financial institutions and, secondly, it attracts customers who are looking for one-stop banking.

Essentially, HSBC is a differentiated, niche player within the Canadian banking industry. It provides a mixture of marketing-oriented and process-oriented facilities. The bank is constantly trying to use marketing to increase its brand loyalty and to grow its market share. HSBC's marketing is evident at a community level (for example, individual business development efforts from the relationship managers) and at a national scale (such as, advertisements in national newspapers and television). It is also very process-driven; it continues to outsource when it is cost-effective. Although there is considerable room for improvement, the bank is attempting to streamline its application systems.

Overall, HSBC's marketing efforts appear to be quite effective, although some of its process amendments are proving to be ineffective. More specifically, the credit application systems and internal programs actually demand excessive amounts of time from the commercial relationship managers.

3.4 Financial Performance

3.4.1 Market Position

HSBC continues to have a strong presence in the Canadian commercial banking market. Table 7 (below) outlines the number and percentage of branches operated in Canada by the country's top seven banks. This table also outlines the dollar value and percentage of commercial footings provided by these banks.[32] It can be seen that HSBC's commercial banking market share percentage is approximately double its percentage of branches. This statistic confirms that HSBC is a strong, commercial-banking institution within the Canadian banking industry.

[32] Commercial footings include business & government loans and deposits.

Table 7 HSBC: Market Share by Region[33]

(in CDN millions unless otherwise stated)

Rankings by Total Assets	Bank	Number of branches (2006)	% of total branches	Total business and government footings (in CAD millions)	% of total business and government footings	Business and government footings per branch (in CAD millions)
1	RBC	**1117**	19.2	250347	25.0	224
2	TDCT	**1036**	17.8	140599	14.0	136
3	BNS	**970**	16.7	217805	21.7	225
4	BMO	**963**	16.6	156878	15.7	163
5	CIBC	**1055**	18.1	137872	13.8	131
6	National Bank	**546**	9.4	54677	5.5	100
7	HSBC	**127**	2.2	43484	4.3	342
	TOTAL	**5814**	**100%**	**1001662**	**100%**	

Source: Author 2007.

In the right-hand column of Table 7, the average amount of commercial footings per branch is provided. HSBC manages approximately $342 million CDN commercial footings per branch, which is 52 per cent higher than BNS, the second largest. Admittedly, it is difficult to gauge how many of the competition's branches are full service and how many are strictly retail.[34] However, these figures suggest that HSBC commercial relationship managers have heavier workloads than do their competitors. The analysis also supports the notion that HSBC's level of customer service for its commercial financial services may be slipping.

3.4.2 Analysis of Asset Growth

HSBC continues to grow at a more aggressive pace than the other big five Canadian banks. RBC, TDCT and BNS, the three largest Canadian banks, are considered representative of the Canadian banking industry; as such, they are used in Tables 8 and 9 for comparison purposes. RBC and BNS, in fact, are the two largest commercial banks in Canada.

[33] Figures are representative of the top seven banks in Canada (listed in order based on total assets). The figures do not represent the entire Canadian banking industry.
[34] Commercial financial services are typically not offered in a retail branch.

HSBC grew its total assets at a rate of approximately 145 per cent better than the second fastest growing bank, RBC, over the past five years. HSBC is increasing its business and government footings (loans and deposits) almost twice as fast as each of the other banks Canadian banks. The balance-sheet growth substantiates the bank's aggressive growth targets and growth culture.

Table 8 Total Asset Growth

(in CAD millions)	2002	2003	2004	2005	2006	Percentage increase over 5 years
HSBC Total Assets	35189	37509	43263	49210	56770	61.3%
RBC Total Assets	376956	403033	426222	469521	536780	42.4%
TDCT Total Assets	278040	273532	311027	365210	392914	41.3%
BNS Total Assets	296380	285892	279212	314025	379006	27.9%

Source: Author 2007.

HSBC's total asset growth from 2005 to 2006 outperformed the competition, but not as dramatically as it did over the previous five-year period. The growth in the past year alone was 15.4 per cent versus 14.3 per cent for RBC. TDCT's total asset growth was considerably lower at 7.59 per cent. The comparison between HSBC and RBC suggests that the other big five Canadian banks are also placing a greater focus on growth. This conclusion has been confirmed through several discussions with representatives from RBC, TDCT, BNS and BMO.

As indicated in Table 9, HSBC's business and government footings continue to experience strong growth and commercial banking remains a core strength within the bank. HSBC continues to have a strong market share in commercial banking despite its overall smaller asset base. The growth of TDCT's business and government footings in the past year (1.3 per cent) is noticeably smaller than that of HSBC (17.8 per cent) and RBC (16.7 per cent). TDCT's slower growth is reflective of its weaker commercial banking operations. BNS, on the other hand, experienced the strongest growth in commercial footings, with a growth rate of 26.6 per cent.

Table 9 Growth of Business and Government Loans

(in CAD millions)	2002	2003	2004	2005	2006	Percentage increase over 5 years
HSBC Business and Government footings	*25131*	*26438*	*31845*	*36904*	*43484*	*73.0%*
RBC *Business and Government footings*	181342	186490	181081	214219	250347	38.1%
TDCT *Business and Government footings*	108204	89245	106338	138737	140599	29.9%
BNS *Business and Government footings*	171011	157854	151509	172070	217805	27.4%

Source: Author 2007.

Table 10 above illustrates the average amount of commercial deposits and loans managed by a commercial employee at HSBC. It is evident that the number of commercial employees has not matched the growth in commercial assets. The above table also does not illustrate the considerable increase in risk management reporting for which each relationship manager is now responsible. Therefore, HSBC's commercial employees are being asked to manage more accounts and perform more administrative duties each year, and there is little doubt that the level of customer service will continue to decline if this trend persists.

Table 10 Assets Managed Per Commercial Employee at HSBC

(in CAD millions)

Business and Gov't assets managed per Commercial Employee	**2004**		**2005**		**2006**	
Business and Gov't Footings Total number of Commercial Employees	31845 523	**60.9**	36904 576	**64.1**	43484 650	**66.9**

Source: Author 2007.

3.4.3 Analysis of Profitability

As indicated in Table 11, HSBC's profitability has improved over each of the past five consecutive years. This growth has set a very strong trend for HSBC; the net income in 2006 is almost double that of 2002. It is also important to note that the other major Canadian banks have also produced strong results over the same time frame. BNS's increased profitability is quite similar to HSBC's, on a percentage basis from 2002 to 2006. TDCT has made considerable strides since its loss of $67 million CDN in 2002 to a record profit of $4.6 billion CDN in 2006. RBC's performance over the five year period is also very strong.

Table 11 Profitability

(in CAD millions)	**2002**	**2003**	**2004**	**2005**	**2006**
HSBC Net Income	*260*	*300*	*353*	*470*	*515*
RBC Net Income	2762	2968	2803	3387	4728
TDCT Net Income	(67)	1076	2232	2229	4603
BNS Net Income	1797	2422	2908	3209	3579

Source: Author 2007.

All of the Canadian banks have demonstrated strong profitability and improving equity trends over the past several years. You will note that HSBC's net income is considerably smaller than that of the other banks (Table 11); however, when HSBC's performance is presented as a percentage of its equity base and total asset base, the results are significantly different (Tables 12 and 13). These two subsequent tables benchmark net income against equity and total assets, respectively. The purpose of demonstrating return on equity and return on assets is to reduce the discrepancies associated with size.

Table 12 Return on Equity

(in CAD millions unless otherwise stated)

Return on Equity: Net Income Shareholder's Equity	**2004**		**2005**		**2006**	
HSBC	*353* *2197*	***16.1%***	*470* *2596*	***18.1%***	*515* *2868*	***18.0%***
RBC	2803 17904	**15.7%**	3387 19847	**17.1%**	4728 22123	**21.4%**
TDCT	2232 12668	**17.6%**	2229 15866	**14.0%**	4603 19632	**23.4%**
BNS	2908 14985	**19.4%**	3209 16082	**20.0%**	3579 17547	**20.4%**

Source: Author 2007.

Return on equity is a key ratio used by analysts when assessing a bank's share value. As per Table 12, the returns on equity for HSBC and BNS have been consistent over the past three years. More importantly, the return on equity percentages for RBC and TDCT has seen considerable improvement in the past year. RBC and TDCT outperformed both HSBC and BNS for the 2006 fiscal year. Not only have RBC and TDCT experienced greater returns than HSBC, their earnings per common share are greater. In 2006 HSBC's earnings per common share were $1.02 CDN; the earnings per common share for RBC, TDCT, and BNS were $3.65 CDN, $6.39

CDN and $3.59 CDN, respectively. The larger Canadian banks are providing greater value for their shareholders than HSBC.

It is important to note that banks are able to manipulate the return on equity percentages; they can lower the equity by paying greater dividends to the preferred and common shareholders. Lowering the equity base creates a better percentage return, all else being equal. Whatever the reason, greater dividend payments still represent a win-situation for the shareholders.

Another important way to assess the profitability of a bank is to look at its return on assets. With this ratio it is more difficult to manipulate the denominator in order to improve the overall return. As seen in Table 13 below, HSBC's return on assets was better than RBC's and TDCT's in 2004 and 2005. In 2006 RBC made considerable strides to close this gap while TDCT and BNS both outperformed HSBC.

Table 13 Return on Assets

(in CAD millions unless otherwise stated)

Return on Assets: *Net Income* Total Assets	**2004**		**2005**		**2006**	
HSBC	*353* *43263*	***0.82%***	*470* *49210*	***0.96%***	*515* *56770*	***0.91%***
RBC	2803 426222	**0.66%**	3387 469521	**0.72%**	4728 536780	**0.88%**
TDCT	2232 311027	**0.72%**	2229 365210	**0.61%**	4603 392914	**1.17%**
BNS	2908 279212	**1.04%**	3209 314025	**1.02%**	3579 379006	**0.94%**

Source: Author 2007.

In summary, 2006 was not an especially strong year for HSBC; the bank appears to have lost some of the momentum it enjoyed in the preceding years. This should be considered a warning sign that the current strategy may no longer be as effective as it once was.

3.4.4 Analysis of Operating Efficiency

Financial analysts pay particular attention to operating efficiency when valuing a bank's stock price. The ratio expressed in Table 14 is a very basic method of calculating operating efficiency. Non-interest expenses are essentially the bank's fixed costs, such as general and administrative expenses. Therefore, dividing non-interest expenses by total revnue reveals how much of a bank's revenue goes towards operating the company. HSBC is clearly a more efficient operator than the other major Canadian banks. Furthermore, HSBC's operating efficiency ratio is improving year over year. It is important to note that all three of the other banks mentioned in the table also have improving trends from 2004 to 2006. As previously discussed, there is a growing trend in the Canadian banking industry to become more efficient operators, which causes the industry to look seriously at alternatives to reduce costs. In most cases, cost reductions result in lower levels of customer service. The industry in general, including HSBC, appears to be moving away from customer service. This movement could put HSBC in serious peril because its successes have been built historically on superior customer service. The only comforting notion derived from this analysis, and a minor one at that, is perhaps the other major Canadian banks are experiencing equal or greater reductions to the level of their customer service.

Table 14 Operating Efficiency

(in CAD millions unless otherwise stated)

Operating Efficiency: Non-Interest Expenses / Total Revenue	2004		2005		2006	
HSBC	796 / 1422	**56.0%**	824 / 1580	**52.2%**	906 / 1766	**51.3%**
RBC	10833 / 17802	**60.9%**	11357 / 19184	**59.2%**	11495 / 20637	**55.7%**
TDCT	8007 / 10656	**75.1%**	8782 / 11897	**73.8%**	8727 / 13104	**66.6%**
BNS	5862 / 9631	**60.9%**	6043 / 10170	**59.4%**	6443 / 10992	**58.6%**

Source: Author 2007.

Attracting and retaining employees are a key success factor. It follows that average or better than average compensation should be offered to keep the more talented employees. In Table 15, HSBC appears to be providing below average compensation in relation to net interest income. As alluded to earlier, RBC has the industry reputation of being one of the best-paying banks. RBC paid its employees more than 108 per cent of what it earned from net interest income. Of course, RBC made substantial gains with its non-interest income, which helped relieve the salary expense. As interest rate spreads continue to compress, all of the banks are resorting to fee-based income to maintain and improve overall profitability. The second most conservative paying bank is BNS and; HSBC's salary-to-net interest income ratio is 13.7 per cent lower than that of BNS. Although these results may suggest that HSBC should look at increasing the salaries it pays its employees, it has a decent industry reputation for fairly compensating its commercial relationship managers. HSBC should really look to improve its operating systems and remove the continuous incremental adjustments to several of its processes. These amendments would likely result in improved job satisfaction as much as would an increase in salaries.

Table 15 Salaries to Net Interest Income

(in CAD millions unless otherwise stated)

Salaries to Net Interest Income: *Salaries** *Net Interest Income*	**2004**		**2005**		**2006**	
HSBC	*423* *896*	***47.2%***	*442* *1010*	***43.8%***	*503* *1115*	***45.1%***
RBC	6701 6398	**104.7%**	6736 6770	**99.5%**	7340 6762	**108.5%**
TDCT	3780 5773	**65.5%**	4218 6008	**70.2%**	4485 6371	**70.4%**
BNS	3452 5701	**60.6%**	3488 5871	**59.4%**	3768 6408	**58.8%**

*Includes employee benefits

Source: Author 2007.

4 HSBC: ASSESSMENT OF THE PRESENT SITUATION

The Canadian banking industry is attractive. The majority of Canadian banks have experienced considerable profits over the past several years. The Canadian government's intervention in this industry also makes it attractive, especially to a new entrant; the government continues to restrict any one of the big five Canadian banks from limiting competition. The primary objective of the federal government is to protect the consumers (both individuals and businesses) from undue hardship. However, this does not change the fact that the Canadian banking industry is an oligopoly. The response from the existing players within this market is aggressive towards new entrants. Furthermore, each bank is fighting for limited market share. Many of the larger Canadian banks are now looking internationally to expand their businesses.

HSBC is well positioned. Its smaller size provides it with greater flexibility to adapt to changes in the marketplace. Furthermore, HSBC already has the international exposure and connections that the other larger Canadian banks are now looking to develop.

HSBC has competitive advantages in certain niche markets within the Canadian banking industry. Expertise in trade finance and leasing, combined with an aggressive growth culture all contribute to HSBC's profitable operation. Superior customer service was an area of expertise for HSBC. However, in recent years it appears that HSBC has lost its edge in this area and it is one that the bank may have to revisit when assessing its future strategic direction.

It is unlikely that the Canadian economy will remain as strong as it is currently. As the Canadian dollar continues to strengthen, the country's ability to compete in the international marketplace deteriorates. This trend is especially significant since many of Canada's industries are export related. When the Canadian economy does slow down in the coming years there will be increased pressure to compete for existing market share.

HSBC is unable to compete on price because of its size. The larger Canadian banks all have competitive advantages associated with economies of scale. This poses a real danger to HSBC. No longer will the strong Canadian economy protect the bank. In order to compete in the future, HSBC must find ways to differentiate itself from the competition. Many long-time employees of the bank are familiar with the concept of offering excellent customer service. It would seem logical to consider incorporating a re-focus on improved customer service into the bank's future strategic direction.

HSBC's current shortage of highly skilled employees is another area of immediate and future concern. The bank needs to acquire several new commercial relationship managers to keep up with current and future demands from its customers. The bank's poor internal systems and lack of adequate spending on technology also need to be properly addressed. HSBC has already dedicated increased funding towards its technology budget, but the results have yet to be determined.

The financial analysis demonstrated in the previous section reveal that HSBC's operating efficiencies are better than industry averages. These improved efficiencies are a competitive advantage unto themselves which can be better leveraged. The bank has room to increase its compensation to attract highly skilled employees and still be as efficient as or better than the other larger banks.

As shown in Figure 5, HSBC is currently in a state of uncertainty. The Canadian banking industry continues to grow as banks are able to compete with many new services. As business continues to expand, the industry is becoming more global in nature. At present, HSBC has a very nominal market share of the Canadian sector. However, it is important to note that HSBC's market share continues to increase year over year; HSBC's commercial operation is one area of particular strong growth for the bank.

Figure 5 Present and Future Direction for HSBC

	Relative Market Share High	**Relative Market Share Low**
Market Growth High	STAR **X**	??? ***HSBC***
Market Growth Low	CASH COW	DOG

Boston Consulting Group Growth-Share Matrix, 1970.

Going forward, HSBC must look at building its core strengths in order to move it into the Star quadrant of the Boston Consulting Group Growth-Share Matrix (see Figure 5 above). In particular, HSBC should be investing heavily into three strategic assets: employees, technology and the company brand.

HSBC should continue identifying niche markets and developing expertise in these fields. In particular, the bank should target customers that operate internationally. HSBC must be able to offer specialized services in niche markets, but must also be able to provide a full spectrum of financial services. These efforts solidify the bank's customer relationships and discourage customers from splitting their banking needs with other institutions.

The competition continues to pose a credible threat to HSBC. With greater resources and substantially better internal processes, these larger banks are already closing the gap on customer service. Most of HSBC's competitors have already invested heavily into technology and are now able to offer improved service as a result. The larger Canadian banks continue to look at ways to reduce costs, which also makes their ability to compete on price even greater. In order to survive in this increasingly competitive market, HSBC must now seriously look for ways to differentiate itself from its larger competitors.

There is considerable bureaucracy in banking. As such, HSBC must start making investments and strategic moves now before it loses too much ground to the competition. The situation is becoming increasingly urgent. Fortunately, HSBC's smaller size allows it to respond more quickly to new initiates than an institution such as RBC or TDCT.

5 STRATEGIC OPPORTUNITIES IN COMMERCIAL BANKING

Canadian banks are forced to evolve because of the ongoing changes in banking, both domestically and internationally. Banks continue to adopt new services and become larger and more global. We are witnessing these changes with the increase of foreign banks operating in Canada and with the big five Canadian banks expanding around the world.

Currently, HSBC maintains a strategy that is similar to its larger competitors, which is largely focussed on reducing costs. However, HSBC's branch distribution network and smaller market share dominance prevent it from achieving the same economies of scale enjoyed by the larger Canadian banks. However, HSBC does have a number of strategic alternatives to chose from at this time.

5.1 Strategic Alternatives

5.1.1 Strategy Number One: Maintain Status Quo

HSBC is currently growing its total assets at a rate that is substantially better than the industry average. It is very successful: its profitability is comparable to that of the other major Canadian banks and it has very strong financial efficiencies that are greater than the industry averages.

The overall financial performance of this bank has been very strong over the past five years. It is arguable that nothing should be changed since everything appears to be operating quite well. However, the competition appears to be closing the gap; the larger Canadian banks have increased their returns on equity and on assets. For the fiscal year 2006, the three largest banks in Canada, RBC, TDCT and BNS, all had returns on equity that were superior to HSBC's. Two of these same banks, TDCT and BNS, also had superior returns on assets, while RBC's was very close. These banks have also improved their total asset growth rates and operating efficiencies over the past several years.

5.1.2 Strategy Number Two: Expand & Develop Niche Markets

HSBC has built a strong reputation over the past three decades by appealing to many niche markets. Some of these niche markets include businesses that have international banking needs, business that require leasing facilities, and the Asian business community. HSBC also appeals to businesses that are headquartered on the West coast of Canada and prefer to deal with a locally headquartered institution.

The larger institutions typically design services that appeal to the mass markets. This is done to take advantage of their lower economies of scale. Therefore, HSBC could exploit the situation and develop new niche markets that are currently being ignored by the larger Canadian banks by concentrating on many of the untapped business communities. For example, the demographics of the Canadian population are such that the average age and the average life expectancy are steadily rising. The bank already has strong expertise with real estate development. By investing in development projects designed for seniors commercial banking would complement HSBC's personal banking efforts. Financing of the construction of such projects provides HSBC with an automatic foot-in-the door to provide personal banking services for the prospective occupants.

HSBC should also consider deepening customer relationships within the existing niche markets. Being a full-service bank is useful in this regard. Solidifying the relationship would lead to greater profitability as the customers use more services. This practice also discourages other banks from targeting these niches.

5.1.3 Strategy Number Three: Expansion by way of Acquisition and / or Merger

It is arguable that some banking services are starting to take on commodity-like characteristics. Services, such as residential mortgages, are very price sensitive and offer little differentiation. Commercial banking, however, is more relationship driven. While price remains an issue for many commercial customers, it is not their sole basis for choosing with which bank to deal. However, price will increase in significance as some commercial services are also taking on commodity-like characteristics, such as term loans and operating credits, unless HSBC can find a way to substantially differentiate itself from the other banks.

The ongoing compression of the interest rate spread provides further indication that price is a key success factor. There is considerable pressure on banks to reduce loan interest rates and pay higher deposit interest rates, which indicates that customers are concerned with price. The banks are forced to look at fee-based income, such as application fees, renewal fees and higher service charges, to compensate for reduced interest revenues. HSBC would be better positioned to compete on price if it had a greater distribution network, allowing it to spread many of its fixed costs over a greater number of locations. As such, one way for HSBC to increase its distribution network would be through a merger or acquisition with a larger Canadian bank. A larger distribution network would enable the bank to enjoy superior economies of scale.

A merger or acquisition of the proposed magnitude would require some serious lobbying with the Canadian federal government; not an easy or cheap process. HSBC would have to convince the government that any proposed merger or acquisition would not reduce competition or harm the Canadian population in any form. HSBC is a small player in the Canadian banking industry and has a reputation for acquiring other small entities. Its status may work in its favour should the merger / acquisition strategy be pursued. There would be less disruption to the level of service provided to the Canadian public if HSBC were to merge with a larger Canadian bank than if there was a merger between two of the big five banks.

A key consideration in implementing this strategy would be the affects it would have on HSBC's existing culture. Its commercial banking operation historically has been a strong provider of customer service. A merger could result in HSBC losing some of this focus. If the bank were to merge with any of the big five Canadian banks or National Bank (the sixth largest) then there is little doubt one of these larger institutions would exert a significant influence on the bank. The flexibility of the HSBC organization is an area that would be constrained under a merger scenario.

5.1.4 Strategy Number Four: Refocus on Resources

HSBC must report to the shareholders. Maximizing profitability in the short run is always a concern for the bank's stakeholders. The refocus on resources strategy (#4) suggests that HSBC forego some degree of its immediate profits to invest in its primary assets: people, brand and technology. Hiring many highly competent and service-oriented employees would be expensive. Investing heavily into state-of-the-art internal and external systems and the HSBC brand would also be costly.

Having more relationship managers and support employees would enable the bank to provide better service to its commercial customers. Improved technology would enable customers to access the bank's services with greater ease, decreasing some of the ever-increasing workload of its employees. Improved technology would also enable relationship managers to be more efficient and respond to customer credit requests in a timelier manner.

The goal of this strategy is to work towards long-term payoffs by investing today. The bank would be able to differentiate itself with superior customer service and brand identity. This strategy would assist in minimizing the significance of price as a key success factor. The bank should be able to charge a premium for the superior customer service. The goal is to have these premiums provide sustained, long-term profits.

5.2 Possible Future Scenarios

5.2.1 Best-Case Scenario

Perhaps the best-case scenario for HSBC is if the six larger Canadian banks begin to merge with each other. Such newly merged entities would be challenged with serious upheavals to their operations. It is fair to assume that mergers of such magnitude are very difficult to streamline in short periods of time. There would be significant clashes to such factors as culture, systems and management.

HSBC would then emerge as a reliable alternative. Even without actually making any improvements to the bank's level of customer service or types of services offered, it would appear to be a stable option to the newly developed financial institutions. HSBC is already significantly differentiated from the larger Canadian banks. The greater level of customer service allows it to charge a premium for its services, thus creating greater value for the shareholders.

However, the present nature of the industry makes this scenario fairly unlikely. The Canadian government has made it quite clear these mergers are not permitted unless it can be clearly demonstrated that such moves would benefit the Canadian public. If, for whatever reason, the federal government believes the level of service would drop or prices would increase, then the mergers would be prevented. However, there continues to be considerable media attention given to the possibility of mergers between several major Canadian banks. This attention reinforces the notion that such a possibility could occur.

5.2.2 Worst-Case Scenario

The worst-case scenario is that the commercial banking segment in Canada becomes completely price driven. The commercial banking segment would closely resemble the residential banking segment in such a case. Ultimately, price would become the most important

KSF and the larger banks would maximize their economies of scale pushing HSBC out of the market, unless it made some serious investments to expand its distribution networks.

Some facets of commercial banking are becoming more automated. For example, most banks now offer accessible, online, small business loans. Customers are able to apply for loans with minimal interaction between themselves and a relationship manager. The qualification process is largely based on the customers' personal net worth and their credit scores. Customers are able to open commercial accounts (non-borrowing) without having to meet a bank representative.

Most businesses, however, are unique in one way or another, making it difficult to standardize commercial banking. The human element may be minimized with the more basic commercial services, but remains essential with more complex commercial arrangements.

5.2.3 Most-Likely Case Scenario

The most-likely scenario for HSBC involves the eventual slowing of the Canadian economy. Fortunately, HSBC typically outperforms its larger competitors in slower markets. The larger banks would have greater difficulty meeting the demands of its employees: some employees would be let go while others become frustrated with the lack of upward mobility. Under these circumstances, HSBC would be presented with an opportunity to entice talented employees from the competition without having to pay sizeable signing bonuses. And, with recently-hired employees, comes a better understanding of the competition, as well as new service knowledge.

HSBC usually performs quite well in slowing economies and has typically been able to grow at the expense of its larger competitors. Another by-product of a slowing economy is the devaluation of the Canadian dollar. When the Canadian dollar decreases in value it becomes cheaper for businesses in other countries to buy from Canada. This activity translates into increased trade finance business for HSBC, one of its areas of expertise.

In slower economies, interest rates usually start to drop. Banks tend to make more money when this happens as they are usually slower to pass on the lower rates to borrowing customers. Again, a slower economy may actually prove advantageous for HSBC. The opposite is true when the government increases rates; in such cases, the banks have greater difficulty increasing their rates out of fear that customers will leave to bank with other institutions.

5.3 Evaluation Criteria Based on HSBC's Goals

The strategic alternatives identified in Sub-Section 5.1 are evaluated in this section using criteria derived from HSBC's stated goals. These goals, also known as the seven pillars, within HSBC, are mentioned and explained as follows:

- Culture: Be recognized as one of the world's most respected and customer-driven financial services employers
- Customers: Improve customer service
- Our Brand: Be the world's best financial services provider
- Global Distribution: Improve the global distribution channels, as this is the bank's key industry advantage
- Business: Continue to be a growth company, with a focus on deposits and quality risk-weighted assets
- Technology & Process: Make it easier for customers to do business with HSBC; then focus on head office functions and support services
- Organization: Hire staff to reflect international nature and diversity of HSBC

Source: HSBC 2007.

The seven pillars are all expected to contribute to overall profitability and shareholder value. For this reason, profitability is not included as a goal.

Table 16 below reflects the overall importance, or relative weight, of each goal. The goals are weighted, based on two criteria: 1) how closely they relate to the KSFs previously identified and 2) conversations held with executive vice presidents, senior vice presidents and vice presidents within HSBC. The same criteria is used to determine the short-term and long-term importance of each goal. For the sake of simplicity, an average is taken of the both goals.

Table 16 HSBC's Weighted Goals

GOALS	**Short Term**	**Long Term**	**Average Weight**
Culture	5%	5%	5%
Customer	10%	15%	12.5%
Brand	20%	20%	20%
Global Distribution	20%	20%	20%
Business	20%	20%	20%
Tech. & Process	20%	10%	15%
Organization	5%	10%	7.5%
TOTALS	***100%***	***100%***	***100%***

Source: HSBC 2007.

It is apparent that HSBC's three most important goals are business growth, brand and global distribution. The significance of the business goal is not surprising since upper management has been very vocal in making this the number-one theme for the next five years. What is interesting to note are the values associated with global distribution and brand. It seems that these two tools have been identified as primary differentiators for HSBC over its Canadian competitors.

Improvements in technology and processes and customer service are also worthy of mention. Improvements to customer service and technology and processes also have the ability to act as key differentiators.

All seven goals are essential to making HSBC a successful and financially strong company. As such, each strategy analyzed below assesses the bank's ability to meet all of its goals.

5.4 Analysis of HSBC's Strategic Alternatives

5.4.1 Analysis of Strategy #1 – Maintain Status Quo

HSBC is capable of working towards many of its goals by maintaining the status quo. The bank is already spending considerable advertising dollars promoting the HSBC brand. The bank also continues to improve cross-border banking arrangements, which increases the strength of the HSBC global distribution network.

The two greatest deficiencies associated with the current strategy are seen in customer service and improvements to technology and processes. Although both are often discussed in various internal publications, there are no clearly defined benchmarks in place that pertain to these two issues. Furthermore, it appears that HSBC's culture may be slipping somewhat evidenced by the considerable number of vacant, commercial banking positions. The current strategy does not seem to be addressing this goal either adequately.

The bank's business growth goal has been made very clear by setting highly aggressive targets for 2007, but little has been done to provide additional support to its relationship managers to reach these targets. HSBC is having a strong year, as per second quarter results. Net income attributable to common shares was $274 million CDN for the half-year ended June 30, 2007, an increase of 18.6 per cent over the same period in 2006 (HSBC Bank Canada, 2007). However, one could argue that these results are a direct reflection of Canada's economic strength. As indicated in the most likely scenario, the Canadian economy will likely slow down in the next few years. When the economy slows, HSBC has a more difficult time attaining its growth targets unless it attracts more experienced relationship managers.

HSBC's current strategy appears to be meeting the organization goal. Diversity continues to be encouraged and sharing of best practices from country to country continues to be facilitated. HSBC's culturally diverse workforce demonstrates the bank's commitment towards multiculturalism. The bank's secondment program, international officer positions and various international workshops are examples of HSBC's commitment towards being an international company in its own right.[35]

5.4.2 Analysis of Strategy #2 – Expand and Develop Niche Markets

The niche market strategy involves HSBC developing new niche markets and deepening relationships in its existing ones. Opening up new markets certainly leads to business growth, but there is a certain degree of risk with this approach. If the bank cannot find ways to increase its commercial banking capacity, by either acquiring more employees or improving its processes, then this strategy will backfire. Attracting new clientele is futile if the desired services cannot be delivered in a satisfactory and timely manner. Rather, this strategy could prove very damaging to HSBC's reputation. Therefore, the niche market strategy would likely force HSBC to concentrate its efforts on improving its technology and process and customer service goals. Without such advances, this strategy does not work.

Developing new niche markets and expanding existing niche markets further differentiates HSBC from its competition. An increasing trend in Canada is to have cheaper

[35] HSBC encourages its more mobile senior staff to take secondments, which are essentially 2 or 3-year job postings in other countries. On return, the employee is guaranteed a position equal to or greater than the one held prior to leaving the home country.

international labour brought into the country for temporary work. Examples of this trend can be seen in such diverse fields as seasonal farming and bridge construction. This foreign labour is both skilled and unskilled, depending on the work needed. Leveraging HSBC's global network, the bank is able to facilitate electronic fund transfers all over the world, which allows Canadian employers to transfer payments to bank accounts in the employees' home countries. By actively pursuing this business, HSBC is able to act on its global distribution advantage.

To facilitate these payments, HSBC must continue advancing its technology and processes. For example, each country uses a slightly different payment clearing. HSBC must develop its network to function within each system to effectively capture this international market.

Pursuing the niche market strategy also allows HSBC to concentrate on building its brand image. HSBC needs to target its advertising and promotional efforts towards the designated markets. Each new market reached results in an improved image as a premier, international financial-service provider.

Developing new niche markets as well forces the commercial relationship managers to learn and experience different industries, which further strengthens the employees' skill sets while providing new and challenging opportunities. The excitement and challenge helps improve HSBC's culture goal. One key characteristic of the bank's commercial banking culture is the desire to be a deal maker. Overcoming challenges and finding new and interesting ways to put deals together is a significant part of the bank's tradition.

5.4.3 Analysis of Strategy #3 - Expansion by way of Acquisition and / or Merger

An acquisition or merger would have serious impacts on almost every one of HSBC's goals. The loss of control would be much greater if HSBC were to merge or be acquired by one of Canada's six larger banks. It would, however, retain considerable control if it were to acquire one of the several smaller banks, as it has done many times in the past. For the purposes of this strategy, we are only considering an acquisition and / or merger with a larger institution.

HSBC would not lose its global network connections. Rather, this goal would likely be further leveraged. Any new entity would surely want to make use of these connections for its existing client base. Therefore, there would be instant justification for HSBC to pursue this goal to an even greater degree.

HSBC Holdings plc, however, would most likely not give up its brand control over HSBC Bank Canada. Thus, the merged entity would have to bear some combined form of the HSBC name and logo as well as that of its merged partner; this partner would certainly have brand value associated with its name as well. Assuming that the HSBC brand is incorporated into the new entity's name and logo there would be an instant increase in brand exposure. All of the larger Canadian banks have substantially greater branch networks that would be would allow HSBC to take on a greater presence.

Business growth would also be achieved in an instantaneous manner through an acquisition or merger. No matter which bank was selected, all of the larger Canadian banks have relatively low-credit risk associated with their customer bases. It is fair to assume that any such merger would result in quality growth, not growth fraught with problem accounts.

HSBC would also benefit from the superior technological and process expertise if it were to merge with one of the big five Canadian banks. It would be much easier for HSBC to adopt existing systems and processes than to try building new ones from scratch. One concern here would be whether or not the adopted systems were compatible with systems used by HSBC Holdings plc and its other subsidiaries. There would also be a transition period whereby it would take some time to merge HSBC's systems with the new entity's systems. Therefore, technology and process goals could not be met in the immediate future.

One area of concern with the acquisition and /or merger strategy is the affects on HSBC's culture. Although the bank's culture is currently not at its strongest, a merger or acquisition could have a demoralizing effect on its employees. Many of them have ridden out the numerous changes over the past years. However, an acquisition or merger would be an unprecedented challenge changing the face of the bank. It is difficult to predict the full impact of such a move on HSBC's culture. It stands to reason that joining up with a larger institution would result in the larger entity having a greater influence on the smaller entity. Therefore, it seems quite probable that target of an acquisition or merger would impose its culture on HSBC. Therefore, the bank must ensure that its partner is driven to be a premier, customer-service provider if HSBC is to achieve its culture goal. It is also difficult to gauge whether or not customer service would improve with this strategy. It stands to reason that it may falter at least in the initial stages of the acquisition and / or merger as employees adapt to new processes and systems.

HSBC's organization goal to improve diversity and foster an international management approach is another area of concern with the acquisition and / or merger strategy. Of the six larger banks, there is a real discrepancy as to which banks have an international focus. It appears BNS is the leader in this regard.[36] It is therefore essential that the right partner must be selected in order for HSBC to achieve its organization goal.

5.4.4 Analysis of Strategy #4 - Refocus on Resources

The refocus on resources strategy involves a substantial investment into three of HSBC's primary resources: people, brand and technology which should lead to considerable improvements to these goals. The purpose of this strategy is to focus on a few key areas that have

[36] BNS' international banking business line operates in more than 40 countries and includes operations in three geographic regions: the Caribbean and Central America, Latin America and Asia Pacific.

traditionally served as key differentiators for the bank and / or will continue to do so in the future. For instance, HSBC has long had a strong reputation for its commercial banking operation. However, in more recent times there has been considerable strain on this resource and the continuous changes have resulted in a deterioration of customer service. To what extent the deterioration has fallen or where it compares to the competition is difficult to measure with any certainty. However, it is an area that must be addressed if HSBC wants to continue using customer service as a key differentiator.

Present technology and processes are also a detriment to the bank. The competition seems to have developed systems and processes that are much more user friendly and automated. The refocus on resources strategy calls for considerable improvements to both HSBC's internal and external systems and processes. Much of these improvements will come with advances in technology.

Lastly, this strategy calls for an increased focus on the HSBC brand. The bank wants to promote the global nature of HSBC as a key differentiator. Although the bank intends to invest two per cent of its net non-treasury revenues towards branding and marketing in the next few years, it must be in a position to deliver on the promises it makes. As such, investments into people, technology and processes go hand in hand with investments into the HSBC brand.

The disadvantage of this strategy is reduced profitability. HSBC must make the investment into the three resources before to seeing a payoff. It is also fair to assume that business growth may level off during the period of transition as new processes and systems are implemented. Regardless, HSBC's commercial banking has persevered through numerous changes while still managing to generate strong asset growth.

As the bank invests in its people, there will be opportunities to hire a diverse group of employees who complement or improve the existing culture. It is fair to say that the refocus on resources strategy should have a positive effect on the bank's culture and organization goals.

The refocus on resources strategy would indirectly improve HSBC's global distribution network. Improvements in technology should facilitate the bank's ability to improve the integration of systems used by HSBC subsidiaries around the world, indirectly improving the bank's global network. Furthermore, the investment in people would also incorporate training initiatives. These initiatives would educate HSBC's commercial relationship managers to effectively use the bank's global distribution network to solicit new business.

The refocus on key resources strategy suggests positive results for all of HSBC's desired goals. Some of these positive outcomes are a direct result of the strategy while others appear to be more indirect.

5.5 HSBC's Goals and Valuation

Table 17 identifies the likelihood of HSBC reaching each of its goals by pursuing each strategy identified in section 5.1. Vining and Meredith (2000) developed this type of matrix. It is designed to demonstrate a better understanding of the probabilities associated with each strategy as they relate to the company's goals. The table uses a Low, Medium, and High rating to measure the expected outcomes.

A refocus on resource and the niche market strategies would allow HSBC to achieve the majority of its goals. The status quo strategy also has some benefits as it is the only one that seems to meet the bank's two most important goals at a High level. The acquisition and / or merger strategy seems to offer the least potential for HSBC to meet its objectives.

Table 17 Weighted-Goal Forecast for HSBC

		Strategic Alternatives			
		Status Quo	Niche Markets	Merger / Acquisition	Refocus on Resources
Goals	Culture	Medium	Medium/High	Low	High
	Customer	Low	Medium	Low	High
	Brand	High	Medium	High	High
	Global Distribution	High	Medium	Medium	Medium
	Business	Low/Medium	High	High	Medium
	Technology and Process	Low	High	Medium	High
	Organization	High	Medium	Low	Medium/High

Based upon Vining and Meredith (2000).

The above matrix in Table 17 does not take into consideration the values attributed to each goal. As such, it cannot be used solely to assess which strategy HSBC should pursue. In order to provide a better indication as to which strategy the bank should select, the weighted values from Table 16 are incorporated into a new matrix, Table 18 below, also based on Vining and Meredith (2000). It was designed to highlight the best strategy selection, given the company's objectives.

A refocus on resources appears to be the best possible strategy for HSBC to pursue. Although not perfect, it would seem to meet HSBC goals to a degree of 86.5 per cent. The second best alternative is the niche market strategy, which meets the bank's needs by 79 per cent.

Table 18 Valuation Prediction for HSBC's Goals

		Strategic Alternatives								
		Status Quo		Niche Markets		Merger / Acquisition		Refocus on Resources		Weight
Goals	Culture	Med	3%	Med/ High	4%	Low	1%	High	5%	5%
	Customer	Low	5%	Med	8%	Low	5%	High	12.5%	12.5%
	Brand	Med	20%	Med	14%	High	20%	High	20%	20%
	Global Distribution	High	20%	Med	14%	Med	14%	Med	14%	20%
	Business	Low/ Med	10%	High	20%	High	20%	Med	14%	20%
	Technology and Process	Low	5%	High	15%	Med	10%	High	15%	15%
	Organization	High	7.5%	Med	4%	Low	2%	Med/ High	6%	7.5%
	TOTAL		*70.5%*		*79%*		*72%*		*86.5%*	*100%*

Based upon Vining and Meredith (2000).

This above analysis makes it clear that achieving long-term profitability and maximizing shareholder value is important enough for HSBC to forgo short-term profitability and growth. By maintaining the status quo it is likely that HSBC would continue to grow its asset base, but would eventually succumb to inefficiencies and poor service. Conversely, a merger and / or acquisition would result in immediate growth and improvements to economies of scale over time. However, the merging of two cultures would likely prove time consuming and difficult. Without a smooth transition, the level of customer service would surely deteriorate.

One consideration is that HSBC should look initially at the refocus on resources strategy and then perhaps to the niche market strategy. The niche market strategy offers many of the same benefits as the resources one and would help the bank achieve its highly valued business growth goal. However, the refocus on resource strategy would enable HSBC to set the foundation to pursue the niche market strategy effectively. Thus, HSBC should first implement the refocus on resource strategy.

5.6 Scenario Analysis for HSBC's Strategy Selection

5.6.1 Best-Case Scenario Analysis

The best-case scenario involves the Canadian banking industry undergoing substantial change through several major mergers. Under this scenario, HSBC would be able to significantly differentiate itself from the competition by appearing as the most reliable alternative. A status quo strategy is probably the best alternative under this best case scenario. Minimal investment would be required and the bank would be able to pick up substantial market share. HSBC would also be able to charge a premium for its more reliable level of customer service, thereby increasing the bank's profitability.

Under this scenario, HSBC's brand name would strengthen. HSBC could maximize its brand value with minimal investments in advertising and promotion. As the mergers began to sort themselves out, HSBC would have already positioned itself well with a stronger brand identity and it would not have to invest heavily in developing niche markets. The bank would still have to consider investments in its overall capacity in order to accommodate the anticipated increase in business.

At present the likelihood of a major Canadian bank merger is remote. The federal government has not provided any indication that it would reverse its previous position against such an action.

5.6.2 Worst-Case Scenario Analysis

Under the worst-case scenario, the commercial banking segment of the Canadian banking industry would become much more price-driven. As such, the larger Canadian banks would use their greater economies of scale to force out the smaller players such as HSBC. In this circumstance, the acquisition and / or merger strategy would seem the most appropriate action for HSBC to pursue. By taking a "if you can't beat them, then you might as well join them" approach, the bank would be able to join a major Canadian bank and benefit from the combined, greater economies of scale. Furthermore, HSBC would be able to bring its international distribution network advantages to the table which would further leverage the improved economies of scale.

Alternately, the niche market strategy may also be appropriate. By operating in markets not yet exploited by the larger Canadian banks, HSBC is not forced to compete on price. However, customers would be less willing to pay for higher-priced generic services offered by HSBC and the bank would be left with several, split banking arrangements which would reduce overall profitability.

6 CONCLUSIONS AND RECOMMENDATIONS: REFOCUS ON RESOURCES

6.1 Conclusion

HSBC continues to enjoy strong asset growth and profitability. The bank's financial performance has historically been strong year after year. It is now at a point where it must address a number of issues. The capacity to maintain and improve commercial banking capacities is one concern for HSBC, which is a direct result of the growth enjoyed by the bank. Another result of HSBC's continued growth is that it now appears on the radar screens of many of its competitors; more specifically, the competition is starting to watch HSBC a little more closely.

It is also important to note that the commercial banking segment within the Canadian industry is becoming increasingly competitive. There are now a greater number of foreign banks operating within Canada. More commercial services are being offered by credit unions, and the virtual banks are offering cheaper alternatives for basic services. The biggest threat, the big five Canadian banks, are becoming much more efficient; they are controlling costs by centralizing many activities and they are growing revenues with greater expansion into the United States and elsewhere. To add to these changes, there is a general compression of interest-rate spreads. With all of the transformations mentioned above, HSBC cannot afford to remain static and hope to enjoy continued success.

HSBC's smaller size means that it must differentiate itself by means other than price. Its commercial banking operation has traditionally distinguished itself with superior customer service, which is a strong part of the HSBC culture. Continuous change, manual processes and insufficient human resources, however, are straining HSBC's ability to deliver high-level customer service.

This analysis concludes that HSBC should look seriously at re-investing in three core assets: people, brand and technology. Looking forward, these three elements form the basis on which HSBC is able to best differentiate itself from the competition. The people and technology components provide a return to superior customer service. The brand component highlights HSBC's international distribution strengths. As more Canadian businesses begin to operate internationally, HSBC's brand identity will become increasingly important.

Under the refocus on resource strategy, HSBC is able to build a platform that enables both one-stop shopping for all domestic and international commercial banking needs. From this platform, it is able to continue targeting niche markets, which is another differentiation method that has worked well for HSBC over time. But, the investment into HSBC's three core resources must come first.

6.2 Suggested Implementation Plan

If HSBC chooses to pursue the suggested refocus on resources strategy, it must develop a comprehensive implementation plan. In order to facilitate the change process, senior management must take several key steps to prepare the organization for what is to come. Following Kotter's 'Eight Change Phases Model' (1990), it is recommended that HSBC consider implementing the following steps:

1. **Establish a sense of urgency**: all personnel within HSBC should be made aware that change is critical to HSBC's survival and that time is of the essence.

2. **Create a coalition**: HSBC must elect a team of 'champions' that understand the need for change and are enthusiastic about making it happen. Ideally, this group should be

selected from various functions within the company to ensure a buy-in from all departments. This group should also be formed by people from different levels of management and must include at least one or two very senior employees.

3. **Develop a clear vision**: HSBC must develop and communicate a very clear vision. The vision should highlight HSBC's desire to be a top provider of customer service. The bank must address how it will achieve this ultimate goal: A.) attract and retain highly skilled employees, B.) make sizeable investments to technological and process improvements, and C.) continue to promote the HSBC brand and the global implications that stand behind the brand.

4. **Share the vision**: the strategy team must effectively communicate the vision to all personnel within the bank.

5. **Empower people to clear obstacles**: HSBC must empower people and groups to achieve clearly defined objectives. Everyone impacted by the changes should have a voice in how the changes are to be implemented. These individuals must also be able to see the benefits associated with the changes in order for them to buy into the process.

6. **Secure short-term wins**: the strategy team must implement incremental and measurable changes. As these goals are attained, the bank must celebrate them in order to create a sense of accomplishment and excitement.

7. **Consolidate and keep moving**: the strategy team must actively integrate each short-term accomplishment into the overall change process. A sense of momentum must be fostered and maintained. Short-term triumphs must drive each subsequent change initiative. One very important aspect of this step is to resist being satisfied until the entire process is complete.

8. **Anchor the change**: the strategy team must find a way to cement the new practises into the company's culture. This goal can be accomplished with proper performance incentives, both monetary and non-monetary.

6.3 Recommendations

6.3.1 Improvements to Customer Service

As HSBC implements the suggested strategy it must consider several key points. Providing superior customer service involves attracting and retaining highly skilled employees. Although HSBC appears to adequately compensate its commercial relationship managers; there appears to be room for improving the work-life balance for these individuals. As well, HSBC commercial relationship managers will note their primary obstacle to providing better customer service is being overburdened with administrative duties.

The bank should also continue to look at the centralization of highly administrative duties, such as security file management and margining of inventory and receivables. The overriding consideration here is that the outsourcing should not be approved if there is a potential for deterioration in the level of customer service.

The bank should consider hiring a major consulting company, such as SAP or IBM, which have industry experience providing technological solutions. HSBC must develop internal software applications that eliminate many of the bank's manual processes; a fully integrated system is needed to eliminate repetitive entry processing.

6.3.2 Leveraging the HSBC Brand

HSBC must continue its branding efforts. The big five Canadian banks all have a strong identity in Canada, which HSBC does not enjoy. As HSBC's parent company, HSBC Holdings plc, has a very well recognized brand on an international scale, HSBC made the right move in

1999 when it changed its name form HongKong Bank of Canada to HSBC Bank Canada. This switch was part of Holding's international re-branding strategy. It allowed all of the subsidiary companies operating in various countries around the world to leverage off of the recognition associated with the parent company. Since the re-branding move, HSBC has spent considerable funds on advertising and promotions. These efforts have helped substantially to raise awareness to the HSBC name. As the world becomes more global, businesses continue to expand their operations into different countries. Seeing the HSBC logo in these various countries creates further brand identity for HSBC in Canada.

Worldwide branding will become a necessity over time. During the past couple of decades, the world has seen numerous bank acquisitions and consolidations. This trend will likely persist. For example, the future of ABM Amro, a large Dutch bank, is currently being pursued by a consortium led by the Royal Bank of Scotland and Barclays. HSBC Holdings plc is well positioned to become one of these few large players in the international banking industry.

6.4 Caveats

HSBC must not consider the suggested strategy to be the ultimate strategy. It is merely a recommendation based on the bank's current goals. The recommended strategy is also a reflection of the bank's core competencies. As these goals and competencies change over time, HSBC must continue to monitor its strategy and change accordingly.

HSBC should continue to take appropriate steps to prevent its strategy from becoming obsolete or stale. Such steps include establishing a means of monitoring the external market, both domestically and internationally. The bank should monitor which of its activities provide the greatest return. Prior to eliminating any activities that are deemed unprofitable, the bank should assess whether or not they complement activities that are highly profitable. Finally, HSBC should continually monitor its goals and the relative weights assigned to each. As the goals change over time, the present strategy should be re-evaluated. These steps allow HSBC to gather the information necessary to decide if the current strategy remains appropriate and effective.

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