The Lion Wakes

A modern history of HSBC

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Front endpaper: The Hong Kong waterfront around 1890. The head office of The
Hongkong and Shanghai Banking Corporation is the second building from the left.
Back endpaper: The Shanghai waterfront today.

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Preface

WE WERE DELIGHTED when in 2006, shortly before the end of his chairmanship, Sir John Bond invited us to write an independent and archivally based modern history of HSBC in order to mark its 150th anniversary in 2015. We knew it would be a fascinating if complex story, and so it has proved. The prologue briefly charts the bank's first 115 years, from 1865 to 1980; the postscript briefly covers the main developments between May 2011 and May 2014; but the heart of the book is our treatment of HSBC between 1980, when the bank seriously began a global journey from its Asian heartland, and May 2011, when the new top management team set out a distinctive strategy for the future. HSBC during those thirty-one years became such a large organisation with such an extensive footprint that it might have been an insuperable task if there had not been two of us on the case. We have (not the first time) enjoyed working closely together – while also engaged on our own individual projects and responsibilities – and we hope that this book's readers find enjoyable as well as illuminating the fruits of our joint efforts.

Richard Roberts & David Kynaston
June 2014

◆ CHAPTER 1 ◆

Unique place, unique bank

FOR MANY YEARS the fortunes of Hong Kong and its biggest, most celebrated financial institution were inextricably intertwined. To understand one of the most distinctive cities in the world is to go a long way towards understanding what has been special about HSBC. At the start of the 1980s – perhaps the most astonishing, transformative peacetime decade of the twentieth century – both city and bank were poised for great things.

'It is a place where flyovers leap skyward between skyscrapers, and frenetic streams of trains, trucks, buses and motor-cars race through tunnelled hills and under a glorious harbour, linking multi-storeyed offices with multi-storeyed factories,' rhapsodised a local journalist, Graham Jenkins. 'Where in the ubiquitous bustling street picture, even demure Chinese girls are forever in a determined hurry – just like everybody else bent upon the task at hand with few holds barred. And where neon signs shine in colourful profusion not just to proclaim their oriental message but to set a mood for an extraordinary pace in trade and commerce.'[1]

Hong Kong's population in 1980 was just over five million, of whom some 98 per cent were Chinese. In the 1950s and 1960s Hong Kong had been predominantly a community of refugees – mainly from Communist

A 1980s Hong Kong street scene.

China – and even though many of these Chinese were now 'belongers', enjoying a distinct identity as Hong Kongers, the desire to achieve a higher standard of life than they or their parents had enjoyed on the Chinese mainland still burned brightly.[2] 'The Hong Kong worker draws his dynamism from firmly believing the sky's the limit for him,' noted Jenkins. 'Self-reliance seems almost inborn. Parents certainly seem to develop it in their children from early childhood. From teenagers most are bent upon doing their own thing.'[3] This self-reliance had been exemplified during the global slump of the mid-1970s. 'The depth of the 1974–5 recession was great in the Colony,' recalled the magazine *Asian Finance* some years later, 'and the unemployment rate was thought to be as much as 20 per cent at times. Family income may have dived by appalling percentages over a number of months; and there was no unemployment pay, no rural "safety net" for out-of-work townspeople to return to – nothing but the grim determination to find some money somehow, even by hawking items at the street-gutter, and get by. This is what happened. No strikes, no protest marches, no appeals for protection (against whom?); just grit. Grit, shrewdness, the willingness to try anything once.'[4]

As Hong Kong prospered, despite the odd painful blip, there emerged by the end of the 1970s an increasingly strong Chinese middle class, studded with some phenomenally rich entrepreneurs. The two most frequently held up for admiration and emulation were Sir Yue-Kong Pao and Li Ka-shing. Pao had arrived from Shanghai shortly before that city's fall to the Communists in 1949 and had subsequently – much helped by HSBC's far-sighted financial backing from the 1960s – built up the world's largest private merchant shipping fleet. Li had come from southern China and, after making his first fortune selling plastic toys and flowers, was one of Hong Kong's largest property owners, third only to the government and Hongkong Land. Together they exemplified what *The Economist* described as 'a new breed of local Chinese millionaires', having achieved 'a size and turnover to rival the power of the giant, European-run trading houses, the "hongs", which have dominated the colony's commercial life for the past century'.[5]

A key ingredient in the mix was the generally good quality of governance in Hong Kong, which provided a day-to-day administration that was predictable, rigorous, honest and paternalistic. The Governorship of Sir Murray MacLehose in the 1970s was especially important: in addition to cracking down effectively on corruption, particularly in the police, he pursued a policy of well-directed welfare provision (above all in housing) that went a long way to erasing local images of British colonial rule as aloof and uncaring.[6] What was not on the agenda, though, was any meaningful form of democracy or representative government. A reform movement was afoot towards the end of MacLehose's tenure in 1982; but the *South China Morning Post* was being no more than realistic when it commented in February 1980 about the prevailing mood that 'most are politically wise enough to realise that the present Hongkong system, in spite of all its many faults, has brought about higher real incomes and a better way of life for many'.[7]

Those rising incomes would not have been possible, moreover, without the Hong Kong government's almost unwaveringly low-tax, free-market approach towards economic policy – in stark contrast to the dominance of Keynesian demand management and state interventionism or even ownership in much of the post-war Western world. MacLehose found the perfect counterpart in Sir Philip Haddon-Cave, financial secretary through most of the 1970s and into the early 1980s. 'The total money flows into and out of Hong Kong are many times the GDP,' reflected Haddon-Cave in 1981. He added that it was 'futile and damaging to the growth rate of the economy for attempts to be made to plan the allocation of resources available to the private sector and to frustrate the operation of market forces which, in an open economy, are difficult enough to predict, let alone control'.[8] No tariffs (except for alcohol, tobacco and oil), no soft loans, no subsidies – it was a Gladstonian world that owed much to this somewhat Gladstonian figure, certainly in the gruelling length of his annual Budget speeches.

The economy over which Haddon-Cave presided was heavily export-oriented: Hong Kong's external trade tripled during the 1970s, and from early in that decade it was the world's largest exporter of clothing, toys and dolls.[9] Altogether, in 1980 some two-thirds of the total industrial workforce was employed in the textiles, clothing, electronics, plastic products, toys and watches and clocks industries, between them accounting for 72 per cent of Hong Kong's exports.[10] Moreover, whatever the manufacturing future held, Hong Kong had at least one trump card up its sleeve. 'The physical development of this city-state now dwarfs that of any mainland city in Asia,' the eminent journalist Dick Wilson had noted in 1978;[11] and two years later, not only did Hong Kong eclipse Osaka to become the third-largest container port in the world, but the enthusiastically greeted opening of the Mass Transit Railway signalled a new era in the territory's infrastructure.

An Asian financial centre

Even as early as the 1970s the shift was under way from manufacturing to provision of services – including, of course, financial services. The ultimate goal, increasingly in the minds of policy-makers like Haddon-Cave and bankers like Michael Sandberg (chairman of Hongkong Bank from September 1977), was for Hong Kong to become a world-class international financial centre. It was not an aspiration that everyone thought was realistic. 'Hong Kong has a tiny capital market, a tiny foreign exchange market, a tiny money pool and its money markets are undeveloped and unsophisticated,' a member of Hongkong Bank's investment banking arm Wardley told *Euromoney* in 1979;[12] but Bill Brown, chief manager of Standard Chartered, Hongkong Bank's traditional but friendly rival, was closer to the underlying trend when he ambitiously claimed in 1980 that 'Hong Kong now possibly ranks as the third-largest financial centre in the world, and certainly in foreign bank presence is second only to London'.[13] At this stage, with Tokyo seriously retarded as an international financial centre as a result of the Ministry of Finance's introverted focus, the key comparison was with Singapore. Despite being far more state-controlled than Hong Kong, it maintained its well-established lead in the money markets; but in the field of international lending, above all in the market for syndicated loans, Hong Kong roared ahead and was third only to London and New York by 1981 (115 loans totalling $5.5 billion), with Singapore lagging in eighteenth place.[14]

Journalist Kevin Rafferty, writing in 1989, recalled how in the space of only a few years – the late 1970s to the early 1980s – Hong Kong had arrived on the world financial map:

> Global financial markets were in their infancy in the 1970s. Banks active in New York, the biggest financial centre in the world, and London, the heart of the growing Euromarkets, needed an Asian centre to complete their round-the-clock operations. Hong Kong offered the ideal location. It was easy in every way to set up an office. Freedom from foreign exchange controls and an absence of the bothersome restrictions, rules, regulations and the mountains of paper that other countries demanded made it more attractive than virtually anywhere else.[15]

These were exciting times, played out against the background of a feverishly booming stock market and an almost grotesquely spectacular property bubble. But beneath the froth and the excitement, there were signs that the freewheeling days might be numbered. 'This entire episode reflects poorly on Hong Kong's reputation as a financial centre,' warned the *South China Morning Post* gravely in June 1980 after a sharp, high-profile battle for control of Hongkong and Kowloon Wharf had made a mockery of the colony's voluntary takeover code;[16] while when later that year the chairman of the Far East Exchange (largest of Hong Kong's four not-yet-unified stock exchanges) claimed that 'London and New York have their scandals' and that 'Hong Kong's record is not too bad in comparison', *The Economist* commented bleakly that 'overseas investors, wary of dipping in Hong Kong's speculative waters, might disagree'.[17]

Crucial to the territory's emergence as a regional financial centre was the Pacific Rim phenomenon. 'It is undoubtedly the region which now offers the greatest potential for international trade and investment by multinational corporations,' declared Hongkong Bank's Michael Sandberg, in an article for the *American Banker* in 1981. 'A global shift in development away from Western Europe to the Pacific is currently under way, and this shift is taking place amid the booming trade activities of Japan and the "Four Tigers", Hong Kong, Singapore, Taiwan and South Korea. In addition, the remarkable economic growth attained by the ASEAN states [Indonesia, Malaysia, the Philippines and Thailand as well as Singapore], around 7 per cent per annum in the last few years, has added greatly to the prosperity of the community.' Sandberg then spelled out how, in less than a dozen years, Hong Kong's predominantly domestically oriented banking system had been 'transformed into a financial entrepot that services the whole Asian-Pacific region', whether through the provision of bank credit or the arranging of syndicated loans, in addition to other financial services. What did the future hold for this part of the world that, in the context of the second oil shock and serious economic difficulties in the West, was now attracting huge attention? 'The Pacific Basin Community is still young and there will doubtless be many problems to be solved,' Sandberg concluded. 'But all its partners share the same mutual interests, and between themselves they can provide virtually all of the commodities, goods and services necessary to increase their prosperity and welfare.'[18]

The final piece in the jigsaw was China. How would Deng's 'open door' policy, launched in 1978, and its accompanying programme for radical reform of the Chinese economy, affect Hong Kong? By the start of the 1980s no one could possibly know for sure, not least because of the possibility of a strong internal reaction against Deng's modernising drive. A similar uncertainty pervaded speculation about the other great imponderable, namely 1997, the date that Hong Kong was expected to return to Chinese sovereignty, in consequence of the nineteenth-century leasing arrangements for the New Territories. Governor MacLehose had attempted to set the negotiating ball rolling with a visit to Beijing in the spring of 1979 – a visit that enabled him to return with Deng's comforting if vague message to Hong Kong to, in what became five much-quoted words, 'set your hearts at ease'.[19] Moreover, as some observed, the fact was that the fundamentals of the situation had shifted significantly since the 1960s. 'The philosophical gap between the pragmatic communists of China and the enterprising Chinese businessman of Hong Kong narrows daily,' David Hewson pointed out in *The Times* in August 1980. He quoted the redoubtable Sir Lawrence Kadoorie, chairman of China Light and Power, on the ever-increasing human and economic ties between Hong Kong and the mainland: 'For all intents and purposes, Hong Kong has become the free zone of China under British management.'[20] Given these underlying realities, it did not seem impossible that, as Sandberg had confidently forecast as early as 1978, 'something will be worked out'.[21]

'The Bank'

The Governor of Hong Kong, the chairman of The Hongkong and Shanghai Banking Corporation (locally known as Hongkong Bank or simply 'the Bank'), the chairman of Jardine Matheson, the chairman of the Jockey Club – traditionally these were the four rulers of Hong Kong, and not necessarily in that order.[22] In 1980 the bank's chairman, Sandberg, was one of nine 'unofficial' (i.e. non-government) nominated members of the executive council, an advisory body to the Governor; but it was traditionally through a mixture of financial muscle, extensive business and personal connections (including at the highest level), and a reputation for integrity, trustworthiness and reliability that the bank exercised such a pervasive influence on the life of Hong Kong.

Sandberg himself, a larger-than-life figure in the local community, was undoubtedly the driver of the bank by this time. Born in 1927, he left the army in 1948 (after serving with the First King's Dragoon Guards in the Middle East and the Sixth Lancers in India) and found himself, in austerity Britain, 'hankering to get back out East again'.[23] Told by an army friend about 'a rather good club called the Hongkong Bank', he joined and began a steady upwards progression.[24] Accountant in Singapore; chief accountant in Hong Kong; manager of the Hong Kong office; general manager, Hong Kong – these posts were Sandberg's main stepping-stones to becoming deputy chairman in 1974. 'He is likeable, he's a very good banker, and he's got a quick brain,' reflected Guy Sayer. 'He gets on well with the board, and he's decisive. Are there any more qualities you need?'[25] Once in the saddle, these qualities came through strongly. 'He is totally English, but quite free of snobbery,' observed a perceptive journalist in 1980. 'But for all his amiability, he is dedicated to success.'[26]

Ultimately, of course, Sandberg was answerable to his board. 'Nowhere is the colony's power structure – and the Hongkong Bank's role within it – more aptly demonstrated than in the boardroom,' an American magazine asserted in September 1980. 'Apart from the bank executives, there is the leader of the hongs, David Newbigging, chairman of Jardine Matheson and Hongkong Land. Representing other hongs are Swire's John Bremridge, Wheelock Marden's John Marden and Inchcape's John Holmes. Powerful Chinese interests are represented by shipping magnate Sir Y. K. Pao and property king Li Ka-shing.'[27] This was true, reflecting the bank's crucial importance in the colony, but a trio of other examples from earlier the same year gives a better flavour of its ubiquity. In January a bullish editorial ('All roads lead to Hongkong') in the *South China Morning Post* referred to 'the thousands who have queued daily for the Year of the Monkey gold coins outside the Hongkong and Shanghai Bank';[28] that spring at City Hall the annual general meeting for shareholders (now numbering some 112,000, predominantly British subjects resident in Hong Kong) was attended by about 700 and was the usual good-humoured bunfight, with the caterers managing to 'produce a magnificent buffet';[29] while soon afterwards the bank competed as usual in the annual Dragon Boat Races and won the Mixed Invitation Race at Tai Po (though otherwise proving 'no match for the competing teams which consisted mostly of strong and well-trained fishermen').[30]

'It could be said that we are a quasi-central bank,' Sandberg told *The Banker* in 1976. 'It is a question of acting responsibly – orderly money and exchange markets are a prerequisite for Hong Kong's survival and success as a commercial and industrial centre. Hong Kong's interests and well-being are very much in tune with ours.'[31] Sandberg might have added that Hongkong Bank's quasi-central bank functions also included running the clearing house for the banking system, acting as principal banker to the government, and implementing its monetary policy through interventions in the foreign exchange and money markets.[32]

Even so, it was still a somewhat uneasy part-public, part-private position that the bank occupied. 'We think what is good for Hong Kong is good for us in the bank,' John Boyer, the general manager, retorted when asked by a magazine in 1977 whether there was any conflict of interest between the bank's roles as a commercial bank responsible to its shareholders and as an 'unofficial' central bank.[33] However, shortly before this, another senior figure, Ian Macdonald, had reiterated to Guy Sayer his 'strongly held view that the Foreign Exchange exposure of this Bank is unacceptable, and during a period when currency instability is probably at its height then it is positively dangerous',[34] an exposure largely resulting from the bank's tacit obligation to make Hong Kong dollars available to the banking system, leaving it vulnerable if the currency was then to rise.[35] It was, moreover, a model almost unknown in other market economies. 'In Hong Kong, however, due to its peculiar historical circumstances and institutional structure, central banking and commercial banking are intermingled in a way that gives one private-sector bank a very special status,' the well-informed, generally well-disposed economist Y. C. Jao would observe in 1991 in words that could as easily have been written a decade or two earlier. 'Such arrangements,' he added, 'inevitably give rise to conflict of interest and favouritism.'[36]

There was certainly no shortage of banks in Hong Kong – a complement, according to *The Banker* in 1981, of 44 local banks and 71 foreign banks with full banking licences, another 107 foreign banks with representative offices, and 302 deposit-taking companies (DTCs).[37] There was equally no doubt about which bank was dominant. In the early 1980s all measures – whether of assets or profits, of deposits or loans and advances – put Hongkong Bank overwhelmingly first, followed a long way behind by its Hang Seng subsidiary, which itself was well ahead of everybody else.[38] Hongkong Bank held over half the colony's total deposits,[39] while it was estimated that together with Hang Seng it had five million accounts in Hong Kong, of which 80 per cent were interest-bearing passbook accounts.[40] It was not, on the face of it, a fiercely competitive banking environment, certainly relative to the rest of the local economy.

Naturally Sandberg disagreed. 'I would like to correct a view, which is still held in some quarters, that banking in Hong Kong is somehow a "closed shop" controlled by a powerful cartel,' he declared publicly in January 1978:

> There has never been any restriction on foreign banks wishing to enter the Hong Kong Market via the acquisition of equity interests in local banks or the establishment of wholly or partly owned merchant banks and finance companies. This is exactly what many international banks have been doing during the past decade. As a result of the rapid increase in the number of merchant banks and finance companies – all of which are now labelled as 'deposit-taking companies' under present regulations – there has been a profound change in our banking structure, leading to a very vigorous competition which belies the claim that Hong Kong banking is monopolistic.[41]

Over the next few years Hong Kong became ever more 'banked'. The Chinese banks that were sometimes known as the twelve 'sisters'[42] – all controlled from Beijing – continued to expand their Hong Kong businesses and branch networks, while the rise and rise of the dangerously unregulated DTCs, many of which were subsidiaries of foreign banks, seemed unstoppable.[43] 'The figures for November 1980 indicate that deposit-taking companies control roughly 30 per cent of the Colony's deposits, and that their deposits continue to grow while those of banks are declining in relative terms,' Tom Welsh, the bank's general manager Hong Kong, warned Haddon-Cave in early 1981. 'If the figures are extrapolated it seems probable that deposit-taking companies will in a few years control the bulk of the Colony's deposits.'[44]