A LBV Perspective on Political Risk Management in a Multinational Bank During the First World War

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Introduction

This paper will use the Legitimacy-Based View (LBV) of political risk outlined by Steven et al. (2015) to understand how the Hongkong and Shanghai Banking Corporation (HSBC) responded to the First World War. The paper shows that the bank increased its legitimacy in the eyes of various British stakeholders by identifying itself with British patriotism and by minimizing, but not eliminating entirely, its contact with German firms. The paper examines how HSBC bolstered its legitimacy by changing the strategies it used in four of its most important markets: London, Hong Kong, mainland China, and Japan. The bank's response to the war in each jurisdiction was necessarily tailored to local circumstances: none of these jurisdictions outlawed all trade between British and German firms, but the degree of restriction varied considerably. This local variation created considerable challenges for HSBC's headquarters managers, for it meant that a banking practice considered legitimate in one part of the world might be perceived as highly illegitimate, even treasonous, in another. As a result, HSBC was attacked in Britain for its ongoing ties to the enemy. HSBC's managers were ultimately successful in defusing these attacks and re-establishing the perception that the bank's activities were legitimate. As a result, the bank was able to survive and even remain profitable during the First World War despite dramatic changes in its operating environment.

Jones and Kanna (2006) and Buckley (2009) have argued for the re-integration of historical research into the field of International Business (IB). Since war is a major research theme in history, the integration of IB and History would mean that IB scholars would need to consider how warfare affects MNEs. As Dai (2009) observes, the impact of war on MNEs is rarely considered by IB scholars. Dai also notes that the bulk of the literature in the field of strategic management "largely overlooks" (2009, 356) the impact of anticipated and actual interstate warfare on firm strategy. Dai's observation in 2009 is still true today: the research published in the leading IB and strategy journals says little about war. This oversight by IB and strategy scholars is highly unfortunate as many International Relations researchers see parallels between today's Great Power rivalries and those that led to the First World War (Mearsheimer, 2010; Shambaugh, 2012; Coker, 2014). Considering the impact of past wars on multinationals such as HSBC can help us to think about the likely impact of war on present-day multinationals.

The impact of political risk on multinational firms is an important theme in IB research. As Stevens et al. (2015) have pointed out, most of the existing IB literature on political risk applies either the bargaining power approach (BPA) or the political institutions approach (PIA). While they acknowledge that these approaches are often suitable for understanding how MNEs in certain industries (e.g., natural resources, infrastructure) manage risks in host countries, they argue persuasively that these approaches are less suitable for understanding political risk in the home country and in relatively "complex and interconnected" sectors of which finance is clearly one. They also critique the BPA and PIA lenses for being "undersocialized" and for downplaying the importance of cultural and intellectual factors that influence a firm's social licence to operate. The LBV of Stevens et al. deconstructs the term "the government" by recognizing that each national government is a decidedly non- monolithic entity: rather than being a single actor, the state is a collection of departments and individuals, some of whom may have very different ideas about the legitimacy of a given MNE.

The research presented below is consistent with the LBV's emphasis on home-country political risk, since it shows that HSBC's wartime managers became aware of the sheer importance of maintaining the goodwill of British officials and of refuting accusations of pro-German sentiment. This paper also supports the LBV by showing that individuals in different branches of the British state had very different attitudes to HSBC's wartime activities. As we shall see, while members of the British diplomatic corps were sympathetic to HSBC, decision-makers in some Whitehall departments were hostile. The lesson for present-day MNEs is that they must maintain legitimacy in the eyes of all of government departments.

While this paper is generally supportive of the LBV, it critiques the LBV for failing to acknowledge the importance of wars and other military conflicts for their capacity to rapidly change perceptions of what types of transnational business behaviour are legitimate. Stevens et al. (2015) are right to emphasize the importance of cultural context in influencing perceptions of corporate legitimacy. However, they ignore the fact that this cultural context is dynamic, linked to national and other large-group identities, and closely connected to war. Most scholars of nationalism regard national identities as invented cultural constructs. Much of the literature on the relationship between war and nationalism suggests that warfare generally intensifies the subjective importance of these constructed national identities (Saideman and Ayres, 2008; Cannadine, 2013). Indeed, some authors have speculated that since national identities are maintained largely in response to war, long periods of peace may cause national consciousness to diminish (Turner, 2001, 192-4). In such a world, individuals and firms would trade with each other without thinking about the nationality of potential exchange partners.

This research by scholars of nationalism has important implications for how we think about MNEs such as HSBC, since nationalism influences perceptions of the legitimacy of transactions between individuals that cross the imagined boundaries of the national community. During long periods of stability in the international system, the subjective importance of national identities to economic actors is likely to be low, which means that transactions between pairs of individuals who happen to be of different nationalities will be regarded as unproblematic. Moreover, MNEs may wish to represent themselves as cosmopolitan or trans-national institutions in such a context. During wars, hostility towards individuals and firms associated with enemy nation-states tends to increase dramatically. Such surges in nationalist sentiment will necessarily affect the strategies of firms with ties to foreigners now designated as 'enemies'. This paper will show that the outbreak of the First World War quickly and dramatically changed the thinking of many British people about the legitimacy of HSBC's actions, particularly those that involved individuals who were part of the socially-constructed category of 'German.'

This paper suggests that preserving legitimacy in the home country during major wars can sometimes require a MNE headquarters to increase its control over the activities of overseas managers. The existing research shows that the optimum trade-off between autonomy and centralization in MNEs will depend on the nature of the company's strategy (Birkinshaw et al., 1998; Young & Tavares, 2004, Table 1; Gammelgaard et al, 2012; Kawai, & Strange, 2014; Hoenen & Kostova, 2014; Samuels, 2014, 24, 81). To date, however, IB scholars have not looked at MNE organizational design through the lens of the LBV. As we shall see, British government officials repeatedly confronted HBSC's London manager with evidence of illegitimate and possibly illegal activity by the firm's managers in Asia. At the same time, the bank was attacked in the press for allegedly helping the German war effort. The potential loss of home-country legitimacy represented by these episodes could have been avoided had the firm reduced the autonomy of its overseas subsidiaries at the start of the conflict. This paper thus suggests that MNEs that face the serious risk of the loss of legitimacy in the home country should modify their organizational architecture in wartime to permit the more effective monitoring of overseas operations.

Background

HSBC's experience needs to be situated in the broader context of the history of globalisation. Among historians of globalisation, there is a consensus that the First World War, which saw the sudden appearance of exchange controls, submarine warfare, and the cessation of trade between belligerents, ended the pre-1914 golden age of globalization (Frieden, 2006, 303; James, 2011) The war initiated a long period of *deglobalization*, when nation-states that had previously been tightly integrated into the global economy reverted towards autarky. During the period after 1914, political risk was elevated, forcing multinational firms to develop a variety of strategies such as cloaking (Kobrak and Hansen, 2004; Jones and Lubinski, 2012; Donzé and Kurosawa, 2013; Casson and da Silva Lopes, 2013). The prevailing view is that globalization did not resume until the post-1945 period, when the United States began to provide many of the global public goods that the Pax Britannica had previously delivered (Kindleberger, 1986; Gilpin, 2011, 94-95). These broader changes in the structure of the world economy forced the MNEs of the era to manage political risk. The modern MNE emerged in the late nineteenth century. Some of the MNE founded in this era survived the period of deglobalization connected to the two world wars and still exist (Jones, 2000; Wilkins, 2001; Chandler and Mazlish, 2005).

HSBC was founded in 1865. During its first four decades, HSBC's strategy was based on the existence of a liberal international political system characterized by the relatively free movement of capital and labour and the cooperation of individuals of many nationalities. From the 1860s, the bank had many German clients. This business practice was regarded as entirely legitimate by most British people in the late Victorian period. It also made sense in view of the cosmopolitan nature of the European population of coastal China and the frequent cooperation in China of European governments (Kayaoglu, 2010; Cassel, 2012; Rowe, 2010, 236). Prior to 1914, the authorities welcomed migrants of every European nationality into Hong Kong (Mak, 2004). German and other foreign firms were placed on a level playing field in the Crown Colony, where neither the court system nor the executive branch of government displayed favouritism towards British firms. On the eve of the First World War, Hong Kong was home to "some 15 or 20 German" businesses "of varying importance, with some 150 German employees." Germans were "admitted readily to the clubs and the social life and sports of the colony." The German firms controlled a third of the trade of Hong Kong, "excluding the trade done by the Chinese themselves," and completely dominated particular branches of commerce. British cotton textile manufacturers seeking to reach consumers in the interior of China preferred to rely on the more efficient German distributors rather than on British trading companies such as Jardine Matheson (Manchester Guardian, 18 April 1916).

In addition to the purely German concerns in Hong Kong, there were a number of mixed companies that were jointly managed and owned by Germans and Britons (Liébert, 1906, 864). In other words, the lines between "British" and "German" business were blurred.Prior to August 1914, both British government officials and a large segment part of the British financial press had regarded such blurring as entirely legitimate. In April 1913, London's *Daily Telegraph* printed a letter from a reader who was clearly opposed to HSBC's dealings with the German armament manufacturer Krupp. This reader complained that HSBC's trading with nefarious German firms was regarded as legitimate both the civil servants of the Foreign Office, the leaders of two main political parties in Britain, and "the majority of the leading newspapers" (letter reprinted in South China Morning Post, 29 April 1913).

HSBC's core function was to provide =credit to European firms in China. The bank practiced insider lending, advancing credit to many of the trading houses that were represented on its "court" (i.e., board) of directors in Hong Kong. The trading houses then used this credit to finance the exchange of goods between China and overseas markets. In the decade following the bank's incorporation in the British Crown Colony of Hong Kong in 1865, the bank had been multinational in ownership, customer base, and senior management (King, 1988, 12, 172-5). While the bank's executive workforce in Asia became more purely British after 1880, the directors, client base, and shareholder roll remained internationalized despite the bank's shift to what would today be called an ethnocentric IHRM strategy (King, 1988, 18-21, 171, 192-3, 537-9, 594-5, 625). HSBC financed the operations of a number of German firms on the China Coast. Their needs resulted in the establishment of an agency, later branch, in Hamburg. Four German firms were particularly important to HSBC. They were Arnhold, Karberg and Co., Carlowitz and Co., Melchers and Co., and Siemssen and Co. All of these firms owed the bank substantial sums when war was declared (Inspector's Report on Tsingtao Branch, 24 July 1915). All four companies were represented on the HSBC's Hong Kong board in August 1914, as were the main British trading houses active in China (King, 1988, 527).

Throughout the period under consideration, HSBC's core business was the extension of short-term credit to companies. Since the 1870s, however, the bank had become gradually more involved in issuing and servicing Asian sovereign debt in European capital markets, including those of Germany. HSBC's connections to German financial institutions intensified in 1895, when military defeat by Japan forced China to find the funds needed for a large indemnity payment. In April 1895, China began negotiations with HSBC to arrange the issue of the loan. Since it appeared that London's capital market would be unable to supply the full £40 million that China urgently required, the involvement of other European bourses was necessary. At this point, HSBC began to work more closely with the Deutsch-Asiatische Bank (DAB), which was connected to Deutsche Bank, a major German universal bank (McLean, 1973; Deutsch-Asiatische Bank, 1916). HSBC and DAB again cooperated when they arranged for a loan to finance the indemnity that the Chinese government was required to pay the Western powers in compensation for the 1900 Boxer Rebellion (Ji, 2003, 69; Nishimura, 2012). Thereafter, HSBC and the German banks continued to cooperate in matters related to Chinese public finance.

Unfortunately for HSBC, anti-German sentiment in Britain intensified between 1904 and 1910, when Germany replaced France and Russia as the European nation perceived by most British people as posing the greatest military threat. This period saw the famous naval arms race between Britain and Germany associated with HMS *Dreadnought* (Hoerber, 2011). After late 1905, the idea that the German state was using underhand tactics to obtain control of the commerce of China was promoted in the pages of *The Times*, London's paper of record, and the *Financial Times* newspaper (Financial Times, 6 November 1905; Financial Times, 2 March 1914). At the same time, HSBC was attacked in Britain for its close ties to German firms. Valentine Chirol, the foreign editor of the *Times*, and G.E. Morrison, the newspaper's Beijing correspondent, demonized HSBC as a tool of German imperialism (Chirol to Morrison, 13 September 1909, 524-525, 534). In 1906, HSBC's board in Hong Kong elected a German, Armin Haupt of Melchers and Company, as the bank's chairman (King, 1988, 528). This decision suggests that the directors had concluded that Chirol's belief that it was illegitimate for a British bank to have German directors was not shared by the bank's most important stakeholders. These stakeholders included the British trading houses (e.g., hongs such as Jardine Matheson) as well as the firm's small shareholders, workers, and regulators.

Wartime Efforts to Bolster the Legitimacy of the Bank

Throughout the war, HSBC's senior managers worked to maintain the legitimacy of the bank in the eyes of various stakeholders, including government officials in London, the wider British public, British diplomats in Asia, clients in Asia, and its shareholders. These groups of stakeholders frequently had different ideas about what constituted legitimate banking activity in wartime. The challenges facing HSBC's managers were acute because the firm had effectively two home markets: Hong Kong, the British colony in which the firm had been incorporated, and Britain, the location of the senior HSBC managers who liaised with key British government departments. Soon after the outbreak of the war, British public opinion settled on the view that it would be illegitimate, indeed immoral, for a British company to continue trading with German firms as in pre-war days. As the British economy became fully mobilized for war through the introduction of conscription and rationing, the public became even more hostile to firms perceived as putting profit before patriotism by trading with individuals associated with Germany. In struggling to maintain the bank's legitimacy during the war, HSBC's managers had to take British public opinion into account. However, they also needed to be responsive to the prevailing notions of legitimacy in other markets, such as China, which was neutral until 1917. Chinese neutrality meant that HSBC's local managers operated in an environment in which it was legal for British and Germans to continue trading with each. Some of the bank's stakeholders in China thought that trading with Germans ought to continue as in the pre-war period. The bank was thus caught between two different, indeed contradictory notions of legitimacy.

In Hong Kong, which had a diverse expatriate population and an ethnic Chinese majority, HSBC was also confronted a situation in which various stakeholders had radically different ideas about what banking ethics in wartime. For instance, it is unlikely that many of the bank's ethnically Chinese shareholders would have approved a managerial decision to patriotically sacrifice bank profits so as to help the British war effort. HSBC's managers had to respect the opinions of such neutrality-minded stakeholders while simultaneously appeasing those stakeholders who were emotionally invested in Britain's war effort. The situation in Japan was particularly complex, for while Japan had opportunistically declared war on Germany in 1914, its government, which was divided between pro-British and pro-German factions, had declared that German citizens and companies were welcome to continue trading in the country. As the following sections will make clear, HSBC's various subsidiaries sometimes found it difficult to act in concert, which meant that the bank's emergent strategy in overseas markets conflicted with the goal of maintaining legitimacy in Britain.

HSBC in the United Kingdom

The outbreak of the war shocked HSBC's senior manager in London, whose diary indicates that he had not anticipated that Anglo-German tensions would result in actual war (Addis Diary, 4 August, 8 August). In its complete failure to prepare for a war with Germany, HSBC was similar to most London banks (Roberts, 2013, 39) and bond market participants (Ferguson, 2006). The declaration of war against Germany and Austria on 4 August 1914 surprised the managers of many banks in the City, even firms with ties to Germany that were greater than those of HSBC. For instance, the declaration created a legal crisis for J. Henry Schröder & Co., a London bank whose senior partner had carelessly failed to take the precaution of naturalization as a British subject despite decades of residency in Britain. The partner's German nationality meant the entire bank was liable to sequestration as an enemy alien asset, which would have devastated its many counterparties in the City. Arguing that £11 million in acceptances were at stake, the Governor of the Bank of England persuaded the Home Secretary to rush through the naturalization paperwork, which was promptly signed by the monarch. This speedy naturalization ended the legal threat of sequestration but the subsequent publication of the details of this episode reinforced the belief that the City was a nest of pro-German intrigues (Roberts, 1992, 152; McKenna, 16 November 1914). This belief further damaged the legitimacy of many international banks, including HSBC.

The outbreak of the war forced British civil servants to confront the question of whether it was going to permit commerce with Germany to continue. Whitehall mandarins had been passionately debating this issue, albeit in secret, since 1911, when contingency plans for a war with Germany were first mooted (Standing Sub-Committee, 1912). The Trading with the Enemy Act announced in September 1914 was part of the British government's pre-prepared strategy for economic warfare with Germany. The law criminalized most commercial transactions between German and British subjects was thus a corollary of the Royal Navy's blockade of the German coast (Lambert, 2012, 16). During the war, a variety of British SMEs were prosecuted for trading with the enemy. Their managers were frequently given custodial sentences, even when the goods forwarded to Germany were of an entirely non-military character, such as silk (Millar, 1915; Manchester Guardian, 22 February 1917). The British authorities arrested and interned most German males in the United Kingdom, with their property being entrusted to a Custodian of Enemy Property (Panayi, 2014). Trade with neutral countries such as the Netherlands was subject to controls designed to prevent the transhipment of goods to customers in Germany.

The Trading With The Enemy law of September 1914 contained a number of loopholes designed to minimize its impact on important British economic interests, particularly the cotton trade and the City. To satisfy the latter interest group, the London branches of five German banks were permitted to continue operating using German staff, albeit under the supervision of a partner of Deloitte, Sir William Plender. British public opinion towards Germany hardened over the course of the conflict, which made the continued presence of these German financial institutions seem illegitimate. The deliberate slowness with which branches of German banks were liquidated was controversial and Plender was attacked in the press as a symbol of pro-German sentiment in the City (Leaf and Vassar Smith, 1916, 2, Edwards, 2004). By 1916, the British public's intensifying hatred of Germany forced the Board of Trade to accelerate the liquidation of the London branches of the German banks (McKenna, 8 December 1916, Joynson-Hicks, 8 November 1916). However, as late as March 1918, British politicians were still complaining that the London branches of Deutsche Bank, the Dresdner Bank, and the Disconto-Gesellschaft were still operating in some fashion (Faber, 20 March 1918). In defending the policy, the Chancellor of the Exchequer explained that "these banks are kept going, not for the sake of the German shareholders, but for the sake of British and Allied creditors" (Bonar Law, 20 March 1918). In March 1918, the shareholders of the Deutsche Bank were informed that the bank's London premises had been seized and sold by the British government (Deutsche Bank, 1918, 11). Legislation to facilitate the termination of the London operations of these banks was finally passed in August 1918 (McDermott, 1997, 217).

The growth of anti-German sentiment in Britain had a major impact on the London operations of HSBC iafter the sinking of the Lusitania by a German submarine in 1915. This event caused a surge in hostility that did not discriminate between the German state and individuals of German background. In the aftermath of the sinking, German and Chinese businesses in Liverpool were destroyed by a xenophobic mob (Merseyside Maritime Museum, 2015). Given this context, it is not surprising that HSBC was subjected to repeated attacks about its patriotic *bona fides*. In 17 November 1915, the *Times* newspaper reported that German firms were still active in China and that “all the machinery of business is maintained for a resumption of full trade immediately the war ends.” It reported that the Deutsch-Asiatische Bank was sending large quantities of gold to the United States, with the money ultimately flowing into the coffers of Krupp and other German armament manufacturers. The paper concluded that the time had come for the British government to pressure the two main British banks in China, “the Chartered and the Hongkong and Shanghai Banks” to make a “combined effort” to suppress German banking and trade in China. The implication was that HSBC and the Chartered Bank were continuing to advance the interests of Germany.

Members of Parliament also attacked HSBC for both the presence of a naturalised British subject of German extraction in the bank’s London office (Addis Diary, 22 July 1915; Addis Diary, 2 November 1916; Gwynne, 14 November 1916) and its ongoing transactions with German banks. Although most payments between German and British firms had been banned at the start of the war, HSBC had been given a licence to receive remittances from Berlin for the purposes of paying coupon interest on Chinese government bonds held by UK residents (Gwynne, 9 November 1916). The British government defended this practice on the grounds that the “Chinese Government” were entitled “to fulfil their obligations, and the holders of bonds in this country” ought to be “able to receive the money due to them” (McKenna, 9 November 1916). Although these payments to and from German banks were entirely legal, “such intercourse had subjected” the bank to unpleasant insinuations about its patriotism (Stephen to Addis, 5 February 1917).

Sir John Jordan, the senior UK diplomat in China, appears to have thought that HSBC’s wartime conduct had been honourable (Wilton to Jordan, 19 December 1918). However, many British government officials in London questioned whether HSBC was acting in a legitimate fashion. As Lambert (2012, 162, 504) has noted, the various departments in the British government had conflicting views about the extent to which trading with enemy alien firms was legitimate in wartime. The Admiralty and the Board of Trade, two departments with radically different worldviews, clashed over this issue, which meant that the British state did not present the managers of British MNEs with a clear message about the legitimacy of various forms of trade with the enemy. HSBC’s internal correspondence among HSBC includes complaints about a “bewildering” lack of clarity on this point (Addis to Stabb, 15 January 1915).

HSBC's apparent unwillingness or inability to make a clean break with its enemy alien business partners in East Asia resulted in its London manager being summoned to the Foreign Office for an unpleasant interview (Addis Diary, 2 December 1915). It appears that the French intelligence agency had intercepted correspondence from German firms in Asia which indicated that HSBC had been "showing undue lenity" to German customers. The most incriminating of the intercepted letters were "those from German firms in the East to their correspondents at home in which the Hongkong Bank was lauded for its policy of nursing German firms so as to keep them in being and thus enable them to start again after the war" (Addis to Stabb, 7 December 1915). On 14 January 1916, the London manager recorded in his diary that he was again examined for "over an hour" by a secret committee interested in HSBC's relations with German firms (Addis Diary).

Sir Carl Meyer, who served on HSBC's London supervisory committee, became depressed by the increasingly xenophobic climate of opinion in Britain. Meyer, who was of German-Jewish origin, was subjected to abuse even though he was a naturalized British citizen with a son in uniform (Addis Diary, 22 July 1915). In November 1916, he was forced to resign from his position at the bank. When Meyer left the bank's premises for the last time, he was speechless, apparently with rage at the decision of bank's senior managers to sacrifice him (Addis Diary, 2 November 1916). In retrospect, however, it is clear that the decision to terminate HSBC's relationship with Meyer was important in preserving the legitimacy of the firm. Two weeks later, the issue of ongoing German involvement in HSBC was raised in parliament. One MP asked for assurances that in "the future no Germans, whether native-born or naturalised, shall be appointed directors" of HSBC or would serve on the bank's London advisory committee. The MP also asked whether any Germans were still involved in the management of the bank (Gwynne, 14 November 1916). The representative of the government replied that the last remaining individual of German extraction in the London office had resigned on 2 November (Prettyman, 14 November 1916).

In the final years of the conflict, the attacks on HSBC in Britain largely abated, thanks to the decision of HSBC's London managers to distance themselves from German firms and, in the case of Meyer, from a British citizen of German birth. In retrospect, it would have been better had HSBC's managers in London taken action earlier, for instance by firing Meyer at the outbreak of the conflict rather than waiting until 1916. It should, however, be stressed that the managers may not have foreseen that the conflict would have lasted as long as it did. Indeed, given the prognostications in the British press in August 1914, they might reasonably have concluded that the war with Germany would be over by Christmas and the situation would return to normal. The aforementioned inability of HSBC or any of the other London banks to foresee either the outbreak of the war or the fact it would last for four years suggests that these firms had an extremely limited capability for long-term forecasting. HSBC's managers in London also had a limited capacity to control the actions of subordinates in Asia. As we have seen, the head of HSBC's London operations was called in for unpleasant interviews and asked to account for the actions of overseas subordinates. The interaction between these HSBC branches and German firms is discussed below.

Hong Kong

In July 1914, Hong Kong's newspapers reported on the developing diplomatic crisis in Europe. On 4 August 1914, the four German members of HSBC's board attended an ordinary meeting. News that Britain was now at war with Germany, which reached Asia early on the morning of 5 August, prompted all four directors to resign. They were replaced by a single director of British nationality (South China Morning Post, 12 August 1914).

The first public statement about the war by an HSBC executive was made at the general meeting of the company in Hong Kong's City Hall on 22 August 1914. A.G. Stephen, who was then the Acting Chief Manager and thus the highest-ranking executive in Hong Kong, delivered a speech that was reported in the local press. This speech was strikingly devoid of any patriotic sentiments. In the previous three weeks, Hong Kong's English-language newspapers had declared that the British subjects in the colony would do their utmost to defend the interests of the Empire. Many British expatriates in Hong Kong had also declared that they were confident that Britain would, of course, emerge victorious in any military conflict. Stephen's speech was curiously bereft of such patriotic rhetoric. At no point did Stephen declare that the bank would use its resources to help either the war effort or any employees who enlisted in the armed forces. Instead, Stephen stressed that the bank had the financial reserves needed to survive the "widespread organization and distress" that the European war would cause in China. Rather than loyally predicting that England would win the war, Stephen declared that "it is useless at this present juncture to speculate as to how the nations will emerge from this terrific struggle." The key thing, in his view, was to impress on the Chinese population that "their persons and property" were safe in Hong Kong and they could leave their deposits in the bank without worry. He also alluded to the earlier panic by some Chinese depositors, which he suggested had been caused by "absurd rumours spread by interested parties" (South China Morning Post, 24 August 1914).

In his address to the shareholders, HSBC's Chairman, David Landale, declared that the other directors deeply regretted that the German directors had felt it necessary to resign after years of excellent service to the bank. The shareholders at meeting, who included individuals with Anglo-Saxon, Chinese, Portuguese, and Jewish surnames, applauded these remarks. It is likely that these shareholders had highly heterogeneous attitudes towards what sort of behaviour was legitimate for a British bank in wartime, since many of them were citizens of countries that either remained neutral throughout the conflict (e.g., Portugal) or which were neutral until 1917 (e.g., mainland China). One shareholder expressed his confidence that normal commercial conditions would soon return (South China Morning Post, 24 August 1914). The apparent belief that the war would be over quickly appears to have been informed by an earlier reports in the Hong Kong press that an association representing "nearly 1,000,000 businessmen" in Germany was pressuring the German government to declare a ceasefire and thus restore the global economy to normal (South China Morning Post, 8 August 1914). The implication of these reports was that a negotiated peace was imminent and that the German directors would return to the board. Such press coverage also distinguished between the sober-minded businessmen of Germany and the foolish actions of the German state.

As the war in Europe continued, perceptions of legitimacy among Hong Kong's white British population soon altered. Prior to the conflict, Germans had been the second-largest non-Chinese ethnic group in Hong Kong, immediately after the British. German firms had controlled important sectors of the economy, although determining which firms were actually German was difficult thanks to the pre-war blurring of the lines between German and British interests. By the autumn of 1914, however, local public opinion about the Germans had shifted, as did the policy of the Hong Kong government. In the autumn of 1914, all adult male Germans in Hong Kong were suddenly identified, registered, and interned. Their property was also seized by the authorities (Auswärtiges Amt to Embassy of the United States, 22 April 1915). This action signalled that all Germans, even apolitical businessmen, were now to be considered as enemies.

In 1916, Hong Kong government's changed the laws applying to locally incorporated companies to ensure the British subjects remained in control (Governor of Hong Kong to the Secretary of State for the Colonies, 29 March 1915). The law did not directly affect HSBC, which had already shed its four German directors, but the new rule was nevertheless significant because it signalled an emerging norm in Hong Kong corporate governance: in the future no foreigner, even a citizen of an allied nation, would be permitted to control a Hong Kong company. A contemporary British newspaper regarded the new companies law was a significant turning point because it marked a move away from the traditional policy of the Open Door (Manchester Guardian, 18 April 1916). These legal changes in Hong Kong signalled that attitudes in the colony, at least among the white British minority, were following British ones in becoming less liberal. In this context, any British company that traded with a German firm risked the loss of legitimacy in the eyes of the local British population. How the colony's ethnic Chinese minority viewed the issue of trading with the enemy is hard to determine. However, it is likely that many of HSBC's ethnic Chinese stakeholders in Hong Kong had attitudes towards the matter that were similar to those of people in mainland China, where indifference to Germany reigned supreme.

Mainland China

China was a neutral until August 1917, when it declared war on Germany in the hopes of enlisting British support in its ongoing struggle against imperial Japan (Scott, 2008, 202). The new Chinese republic was too preoccupied with the asserting control over the country's landmass and preventing the loss of additional territory to care much about the details of events in Europe. The outbreak of the First World War was nevertheless important to the Chinese because it undermined the notion that 'Europe' was a monolithic entity (Kirby, 1997, 442). HSBC in China served a variety of clients that included Western businesses, the Chinese government itself, and, via compradors, Chinese businesspeople. The bank's stakeholders thus included British subjects who were emotionally invested in the war against Germany, British subjects who were largely indifferent to their country's call to arms, German-speaking individuals who identified with the German state to varying degrees, and the Chinese, who were typically apathetic about European war and diplomacy.

In 1917, officials in the British government concluded that there was pro-Entente sentiment in Shanghai's Chinese business elite and that it might be used to sell British war bonds. HSBC's agreed to try to encourage wealthy Chinese individuals to invest in British war bonds, although the bank's manager in Shanghai was of the opinion that few if any Chinese merchants would actually purchase them, since they would view the possible purchase of these securities from a strictly commercial point of view (Stephen to Hillier, 3 March 1917). A section of the British expatriate population in China's cities appears to have adopted a similarly apolitical view of the war in Europe. One contemporary reported that the British community in Shanghai was divided between nationalist-minded people who patriotically wished to help their mother country and another group of individuals who wished to continue trading with Germans as far as the law would permit (Not a Lawyer, May 1916).

Two sources of law were particularly relevant to HSBC's operations in China. The laws of the Chinese state applied to Chinese citizens. Until China's entry into the war in 1917, the Chinese state treated German firms and individuals were treated like any other foreigners, which Chinese people had no legal reason to stop doing business with them. British citizens were subject to the jurisdiction of British consular courts and thus British law, which made it progressively more difficult to trade with enemy aliens. Under the 1914 Trading with the Enemy Act, Britons who resided in neutral nations outside of Europe were explicitly permitted to trade with enemy aliens in those nations. Firms in the United Kingdom were also allowed to deal with the extra-European branches of German-controlled firms, even though communication with a company in Germany was a criminal offence (Wileman's Brazilian Review, 7 September 1915). Textile manufacturing companies in the United Kingdom were thus free to continue shipping goods to German-owned firms in China (Manchester Guardian, 13 May 1915). The cotton manufacturers in Manchester who exported goods to China were divided as to legitimacy of continuing to use German distributors in the interior of China (Manchester Guardian, 15 March 1915).

In the summer 1915, the British government prohibited exporters in the United Kingdom from sending substantial consignments of goods to German firms in China. (Manchester Guardian, 16 November 1915). However, British subjects in China were still permitted to engage in a limited amount of trade with Germans, for instance by shopping in German-owned retail establishments or supplying Germans with water and electric current (General Licences Under King's Regulations, No 10 of 1915). This situation persisted until China's declaration of war with Germany in 1917. At that point, Chinese officials seized the assets of German firms, arrested German citizens, and made the issue of whether trade between HSBC and German citizens was permissible under British law a moot question (Hynd to Stabb, 17 August 1917; Deutsch-Asiatische Bank, 1927).

HSBC branches in mainland China continued to work with German clients after the August 1914. HSBC's branches in China continued to work with German firms with a view to helping the clients to repay overdrafts (Inspector's Report on Tsingtao branch, 24 July 1915; Inspector's Report on Shanghai, dated 22 October 1915, 28, 29). We also know from the HSBC Group Archive that as of October 1915, HSBC's Shanghai branch was still supplying overdraft credit to a number of companies that were unambiguously enemy alien firms, as well as an essentially Austrian company that had prudently reincorporated itself in Britain in 1911 (Inspector's Report on Shanghai, dated 22 October 1915, 54). HSBC appears to have remained on amicable terms with Arnhold, Karberg and Co. In July 1915, this German company was described by British diplomats as being "financially embarrassed." (German and Austrian Firms, 17 July 1915). In early 1917, the firm reconstituted itself as Arnhold Brothers, incorporating in China (Smith, 1994, 29).

Less than a month after the end of the fighting in Europe, HSBC assisted Arnhold Brothers to re-acquire a building in the former German concession in Hankow than had belonged to Arnhold, Karberg and Company before the war (Arnhold Brothers to Jordan, 4 December 1918, Wilton to Jordan, 19 December 1918). The fact HSBC's local managers reported this transaction to the most senior UK diplomat in China suggests that they were confident that both Sir John Jordan and his superiors in London would regard this action as entirely legitimate. In reality, while Jordan was friendly towards the bank, many officials in London believed that HSBC's branches in Asia were acting improperly. The result was a loss of legitimacy for HSBC London and its managers. As was noted above, the patriotism of HSBC was questioned in both private interrogations in Whitehall and in the British press.

Japan

HSBC's wartime relationship with German businesses in Japan was particularly ambiguous, for while Japan had opportunistically declared war on Germany in 1914, the country had chosen not to treat Germans living in the Japanese home islands as enemy aliens. Whereas the conflict was a total war for both Britain and Germany, Japan's participation was a very limited and aimed primarily at gaining German colonies in China (Nish, 2013). Although it was accompanied by only brief fighting, the Japanese seizure of the German concession in Tsingtao nevertheless badly damaged HSBC's business there. HSBC's agency in Tsingtao had closed on 15 August 1914 in consequence of the impending attack by Japan. Tsingtao fell to the Japanese on 8 November 1914, but it was not until 30 November that an HSBC manager was allowed to return to the town to assess the damage. He found that Japanese military rule had brought trade to a standstill and had depressed real-estate prices. Another HSBC manager noted in July 1915 the "the great majority of the good Chinese Firms left before hostilities commenced" and had not yet returned. The fact Tsingtao now lay outside China's customs frontier further reduced trade in the town. Most of HSBC's customers in Tsingtao, which had included Arnhold Karberg and Co. and Melchers and Co., either fled before the Japanese army arrived or were captured and sent to Japan. As a result, their accounts with HSBC were in arrears. HSBC had liens against an assortment of assets in Tsingtao, including real estate and foodstuffs, but as HSBC's travelling branch inspector noted in July 1915, under the "unsettled state of affairs property cannot be said to have any selling value" (Inspector's Report on Tsingtao branch. 24 July 1915).

In the Japanese home islands, the situation was very different, in part because a faction within the Japanese establishment supported Germany (Ikle, 1965). Moreover, Japan's rulers did not want to disrupt the wartime economic boom by interfering with trade with any nation. As a result, German firms were allowed to operate more or less freely, much to the chagrin of British diplomats in Tokyo, who pointed out that Japan was supposed to be a British ally (Hunter, 2007, 19). In 1914, the Japanese government positively encouraged German firms to continue operating in Japan, although German citizens were also told to avoid involvement in political matters. In fact, t Japanese Foreign Minister Katō Takaaki declared that German businessmen should remain in Japan, and "Japanese as individuals must not show any hostile feelings to Germans resident in Japan" (Japan Chronicle, 27 August 1914). It was not entirely clear to the bank's headquarters in Hong Kong whether Germans in Japan should be treated as enemy aliens. When R.T. Wright, the branch manager in Yokokoma, asked his superiors in Shanghai for additional guidance about how to apply a recent Royal Proclamation against trading with enemy citizens, they contacted the local

British Consul General for his opinion. Unfortunately, he was “without any information on the subject” of whether the rules applied to British subject in Japan. The Shanghai office informed Wright that “Germans, Austrians, Turks, and Bulgarians are now enemies in China, as we are not faced with the difficulty you apparently have in Japan” (Letter to Wright, Yokohama, 20 November 1916, p.73)

HSBC’s London office advised the Hong Kong headquarters that it should take “immediate steps” to dispel the impression the bank was pro-German “by advising all branches that it is incumbent on every officer of the Bank to act in such a way as to put beyond doubt the essentially British character of the institution.” In an urgent telegram on this issue, the London manager noted that some branches, particularly the one in the Japanese port of Kobe, had been corresponding directly with the Hamburg branch. “This must cease. Advices for Hamburg should be sent to London Office to be forwarded if permitted by H.M. Government” (Addis to Stabb, 4 December 1915). It appears that the staff of the Kobe branch were unaware that it was now a criminal offence for a UK resident to communicate with someone in Germany. The London manager said that an end to direct communication between the Kobe and Hamburg branches was needed to improve the bank’s reputation in the minds of those who mistakenly believed “that it is the part of true patriotism to harry the property of the enemy civilian” (Addis to Stabb, 7 December 1915). The managers of HSBC’s London office appear to have been more sensitive to the need to remain legitimate in the eyes of the British government state than were the bank’s managers in Asia, who were more willing to bend the rules about trading with the enemy. They nevertheless remained respectful of the property rights of German individuals.

Financial Performance of the Firm in Wartime

The First World War destroyed much of HSBC’s value (see Table 1). The fact HSBC survived the war and was even able to continue generating profits (see Jones, 1993, Appendix 5) suggests that its managers successfully responded to the erosion of the bank’s legitimacy in Britain. HSBC performed a number of important services for the British government. For instance, HSBC helped the British government to obtain guns from China to Europe (Addis Diary, 15 September 1915) and silver from India (Addis Diary, 2 March 1916). Although the bank’s motives for entering into these transactions was partly the pursuit of profit, such war-related activities helped to dispel lingering suggestions about its loyalty. Similarly, HSBC’s headquarters built up goodwill in Whitehall by promising to encourage wealthy Chinese individuals to invest in British war bonds. The bank’s managers suspected that few of these bonds would be sold and that commission income would thus be negligible (Stephen to Hillier, 3 March 1917). However, going through the motions of trying to market the bonds in China was politically expedient in view of the attacks on the bank in London. Judged by the metric of shareholder value, HSBC financial performance in wartime was superior to that of many other firms traded on the Shanghai exchange (see Table 3). The bank’s comparatively good performance stemmed, in part, from the actions it took to bolster its legitimacy in the eyes of key stakeholders.

TABLES 1 & 2 TO BE INSERTED HERE

Conclusions and Future Research

HSBC managed to survive the First World War despite dramatic changes in its operating environment. This survival of HSBC during the war was due, in part, to the ability of the firm to bolster its legitimacy in the eyes of various stakeholders in its home markets, Britain and the British colony of Hong Kong. As we have seen, HSBC was attacked in 1915 and 1916 for its ongoing dealings with German firms and for its continued employment of a British subject of German extraction. In retrospect, cutting these embarrassing ties the instant the war began would have likely been a superior strategy for preserving shareholder value. The lesson for present-day managers of MNEs is that conserving political capital in wartime may require the ruthless termination of relationships with firms and individuals who are associated with the enemy, at least insofar as the law permits.

Another lesson that wartime managers can derive from this paper is that preserving legitimacy in the home country requires the head office to exert more control over overseas managers, less they embarrass the MNE in the home country, than would be the case in peace. As we have seen, British government officials confronted HBSC's London manager with evidence of illegitimate and possibly illegal activity by the firm's servants in Asia. The London office responded to this threat to the firm by using letters and telegrams to try to control the Asian branches. Today's MNE managers would use different technologies to control overseas operations, but the underlying principle remains the same: maintaining legitimacy in the home country requires close oversight of overseas operations, especially during major wars. In wartime, MNEs should consider adopting an organizational architecture that temporarily reduces subsidiary autonomy.

For a period after the Cold War, MNEs operated in a unipolar world in which neoliberal values were ascendant. Ikenberry (2013) and Tyler and Thomas (2014) argue that we are witnessing a transition from an essentially unipolar world back to a multipolar international system. International Relations scholars are particularly interested in comparing the pre-1914 Anglo-German relationship with the current Sino-American one, since Britain and Germany were simultaneously economically interdependent and geopolitical rivals (Rosecrance & Miller, 2014). It remains to be seen whether the broadly classical-liberal norms and institutions that shaped the international business environment in the unipolar world of the 1990s and early 2000s will survive in the new multipolar international system (Ikenberry, 2011). Some observers predict a period of heightened political risk, increased nationalist sentiment, economic statism, and the risk of war (Bracken et al., 2008). In such a world, perceptions of what transnational business practices are legitimate for MNEs will likely be quite different. Others suggest that the world is now more peaceful than it has ever been and that this happy state of affairs is likely to continue (Pinker, 2011). In such a world, firms based in the United States, China, Russia and other great powers will be able to continue trading with each while remaining legitimate in the eyes of stakeholders in their home markets. Executives working in MNEs will likely have their own views about which of these two predictions is more plausible. The historical research presented in this paper suggests that present-day executives should increase their firm's capacity to maintain perceptions of legitimacy in their home market through improved control of overseas subsidiaries. Maintaining legitimacy in the home market is crucial to firm survival and profitability in both war and peace.

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Table 1: Market Value of HSBC Bank, Nominal and Inflation-Adjusted Values

Data Source: Yale School of Management, Center for International Finance, Shanghai Stock Exchange Project. Values have been adjusted for inflation using the Historical Opportunity Cost deflator from Measuring Worth (2014).

Year	Market Capitalisation (Nominal Terms)	Market Capitalisation (£1910)
1910	£10,320,000	£10,320,000
1911	£9,600,000	£9,511,000
1912	£10,140,000	£9,775,000
1913	£9,540,000	£9,196,000
1914	£9,600,000	£9,338,000
1915	£9,090,000	£7,781,000
1916	£9,120,000	£6,730,000
1917	£10,080,000	£6,385,000
1918	£11,880,000	£5,996,000
1919	£14,160,000	£6,109,000
1920	£12,540,000	£4,488,000

Table 2: Performance of Shares Traded on the Shanghai Stock Exchange, 1910-1920

Data Source: Shanghai Stock Exchange Project.

Equity	1910 Closing Quotation in US$	1920 Closing Quotation in US$	1920 Price in 1910 Dollars	Percentage of 1910 Share Value Retained in 1920
Hongkong & Shanghai Banking Corporation	464.14	423.40	206.20	44%
Russo-Asiatic Bank	96.24	0.00	0.00	0
Union Insurance Society of Canton Limited	419.76	112.50	54.79	13%
North-China Insurance Co., Ltd	90.33	110.93	54.02	60%
Yangtsze Insurance Association	95.11	11.64	5.67	6%
Canton Insurance Office	93.84	210.94	102.73	109%
Hongkong Fire Insurance Co., Limited	182.61	178.88	87.11	48%
China Fire Insurance Co., Limited	59.35	70.31	34.24	58%