



FINANCIAL MANAGEMENT

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Introduction

Financial statements for banks are a little bit different from other industries analysed by investors. It is necessary a solid understanding of how banks earn revenue and how to analyse what is driving that revenue.

The first section of the report will present a brief history of HSBC. Then, by using different financial ratios, the financial performance of the bank will be analysed. In this section, it will be made a comparison with the major competitors of the bank including Lloyds Banking Group and Royal Bank of Scotland. Then, the impact of contemporary issues on the operations of the bank will be evaluated.

Limitation of the Study

While conducting the research, there have been faced several limitations. There is a limitation in collecting primary data from the bank and as this is the largest bank in UK, it was not possible to access to the bank and collect its primary data. So, the research was based on the secondary data collected from the annual reports of HSBC and several publications. As a result, some of the collected data from web sources may lead to wrong calculations, analysis and conclusion. In addition, while conducting the research I was faced limitation in data analysis. As there are no reports on banking industry in UK that is available for free, I could not collect data of the banking industry in the country. If industry data could be collected, the comparison can be made with the whole industry and better conclusion can be drawn. In addition, I also faced problems while collecting competitors' data as I could not collect primary data of the competitors for the same reason. In addition, the secondary data collected for the report was not fully reliable. If I could collect primary data, I would be able to make better conclusion based on the analysis.

Part A

A brief history of "HSBC Holdings."

"HSBC Holdings" also known as Hongkong and Shanghai Banking Corporation is a UK based multinational public limited company registered under London Stock Exchange. This is seventh largest banking corporation of the world with total assets of US \$2.558 trillion was established by Sir Thomas Sutherland on 3 March 1865. Now Mark Tucker is the group chairman of this banking corporation, and John Flint is the chief executive officer of this bank. During 2018, the

bank was able to earn a net income of US\$15.025 billion when these total bank assets were US\$2.558 trillion around the world.

MandA

In August 2015 this corporation their Brazilian business unit to Banco Bradesco for \$5.2 billion as the performance of that unit was not good. In 2016 this banking corporation shut 24 of its 50 branches in India.

Change of directors

On 1 October 2017, Mark Tucker was announced as the chairman of this banking corporation he succeeded Douglas Flint. In the same year, chief executive of retail banking activates also changed where John Flint was announced for this important post, he succeeds Stuart Gulliver.

Litigation cases/financial penalties

On 20 March 2017 was accused of laundering KGB-related funds out of Russia and this blamed was proved by Global Laundromat investigation for which this banking corporation was faced on financial penalties. In 2016 we saw the name of this bank several time with Panama Papers investigation which reduced the reputation of this banking corporation. Moreover, this bank has a bad reputation of doing business with corrupt politicians, arms dealers, dictators, tax evaders and many other criminals. In 2015 this banking corporation was fined by the Geneva authorities by 40 million Swiss Francs for money laundering.

Increases/decreases of earnings

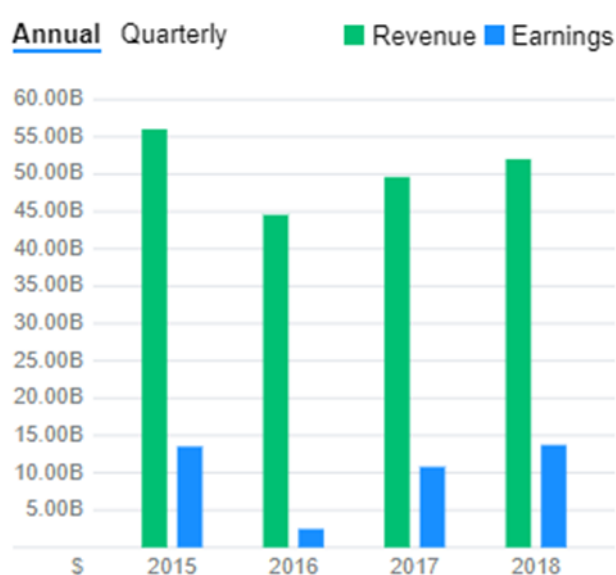


Figure- Revenue and earnings of “HSBC Holdings.”

From this data set we saw in 2015 this banking corporation had earnings of the 14b bun in next year this earning greatly fall. However, in 2017 the net earnings of this banking corporation were around 11.5b which increase in 2018 by US\$15.025 billion (<https://www.hsbc.co.uk>.)

Part B

Key performance ratios of HSBC

To determine the performance of a bank the capitalisation, asset quality and liquidity need to be calculated. In the following section the key performance ratios of HSBC are calculated to determine the level of liquidity, capitalism and quality of assets of the bank for the last five years. In addition, the ratios will be compared with the two closest competitors of the bank including Lloyds Banking Group and Royal Bank of Scotland. HSBC is the number one banking institutions in UK followed by Lloyds Banking Group and Royal Bank of Scotland Group. HSBC holds 24.82% of the market share of the UK's Banking industry while Lloyds Banking Group holds 10.3% and Royal Bank of Scotland holds 9.36% market share of the same industry (Jurgilas and Zikes, 2014).

Capitalisation ratios are calculated to determine the amount and portion of debt in the capital structure of the company. Using these ratios, the financial managers can determine how the assets of the company are financed; whether they are financed by debt or by equity (Koch and MacDonald, 2016). Thus, capitalisation ratios also indicate the risk of a company especially credit risk and default risk.

In this report all data for the calculations Macrotrends – The Premier research platform for long term investors (<https://www.macrotrends.net>).

- **Leverage Ratios**

- a. Debt equity ratio**

Debt equity ratio shows the portion of long-term and short-term debt in the capital structure of a company comparing to the shareholders' equity. By calculating the debt equity ratio, the management can determine whether the company has used optimum amount of debt (Putri, Nasution, et al. 2018). Having debt-equity ratio less than the optimum level cause loss of profitability of the company as debt is less costly than equity. On the other hand, using debt more than the optimum level increases the level of risk, especially credit risk of the company as the company may fail to meet the debt obligations on time.

The debt equity ratio of HSBC is calculated as follows. The results for the last 5 years within those for the competitors (Lloyds Banking Group and Royal Bank of Scotland) are shown in table 1.

$$\text{Debt Equity Ratio} = \frac{\text{Total Debt}}{\text{Shareholders' equity}}$$

HSBC					
Year	2014	2015	2016	2017	2018
Debt*	472,308.6	382,573.8	400,048.8	433,770	486,120.3
Shareholders' equity*	190,447	188,460	175,460	190,250	186,253
Debt-equity ratio	2.48	2.03	2.28	2.28	2.61
Lloyds Banking Group					
Year	2014	2015	2016	2017	2018
Debt-equity ratio	3.29	3.34	3.10	2.87	2.78
Royal Bank of Scotland					
Year	2014	2015	2016	2017	2018
Debt-equity ratio	1.60	1.33	1.39	1.46	2.64

Table 1. Debt to Equity Ratio calculation

*All the amounts are in billion dollars

The debt to equity ratio of HSBC is more than 1 in most of the years. That means more than 50% of the assets of the company are financed by long term debt. Thus, the company may face risk in paying the interest and principal amount of the debt, as a result, it may face bankruptcy. However, due to the hugeness of the company, the credit risk is lower for HSBC. That's why taking debt instead of using equity financing is much cheaper for the company and the company injected more debt in the capital structure.

In the following graphic it is represented the ratio in comparison with that of Lloyds Banking Group and Royal Bank of Scotland:

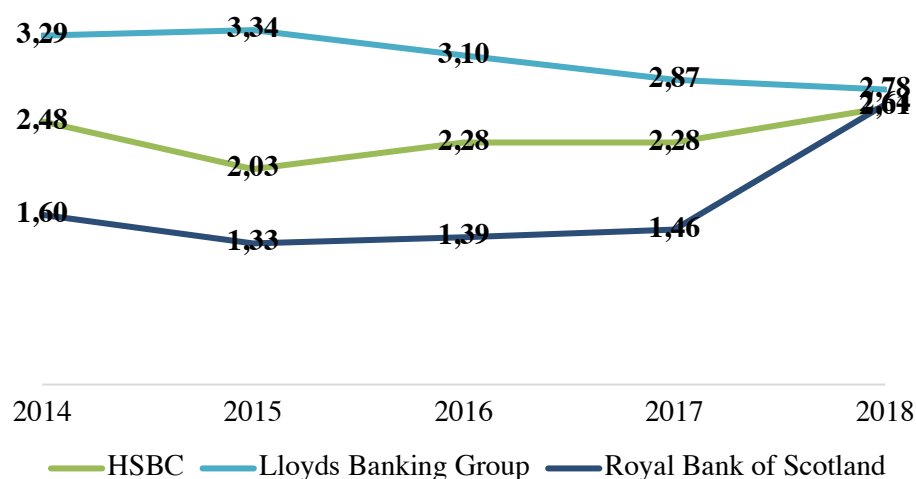


Figure 1. Comparison of Debt-equity ratio

From the figure 1 it can be observed that HSBC has higher debt equity ratio than Royal Bank of Scotland and lower than Lloyd's Banking group. That means that the capital structure of the company is riskier than that of Royal Bank of Scotland but less risky than the capital structure of Lloyds Banking Group.

b. Total long-term debt to capital ratio

Total debt to capital ratio is calculated to determine the financial leverage of the company. For banking companies, calculating this ratio is of great importance to determine the capitalisation. Calculations for the last 5 years are made by the following formula and represented in table 2. Ratios for Lloyds Bank and Royal Bank are represented as well.

$$\text{Long term Debt to Capitalisation} = \frac{\text{Total long term debt}}{(\text{Total long term debt} + \text{Shareholders' equity})}$$

The total interest-bearing debt refers to the sum of the debt on which the company needs to pay interest to the debt holders. Using this ratio, the investors can determine whether the company is a risky investment or not. If the debt to capital ratio is higher than the benchmark, then the company is considered as a risky investment opportunity for the investors.

HSBC					
Year	2014	2015	2016	2017	2018
Long term debt*	122,611	111,651	86,899	92,397	107,779
Shareholders' equity*	190,447	188,460	175,460	190,250	186,253
Debt to capital ratio	0.38	0.36	0.32	0.32	0.36
Lloyds Banking Group					
Year	2014	2015	2016	2017	2018
Debt to capital ratio	0.67	0.69	0.67	0.65	0.68
Royal Bank of Scotland					
Year	2014	2015	2016	2017	2018
Debt to capital ratio	0.55	0.49	0.49	0.47	0.18

Table 2. Long term debt to capital ratio calculation

*All the amounts are in billion dollars.

The long-term debt to capital ratio of HSBC is less than 1 in all the years. That means the company has less long-term debt in the capital structure. So, the risk of making investment in the company based on this ratio is low.

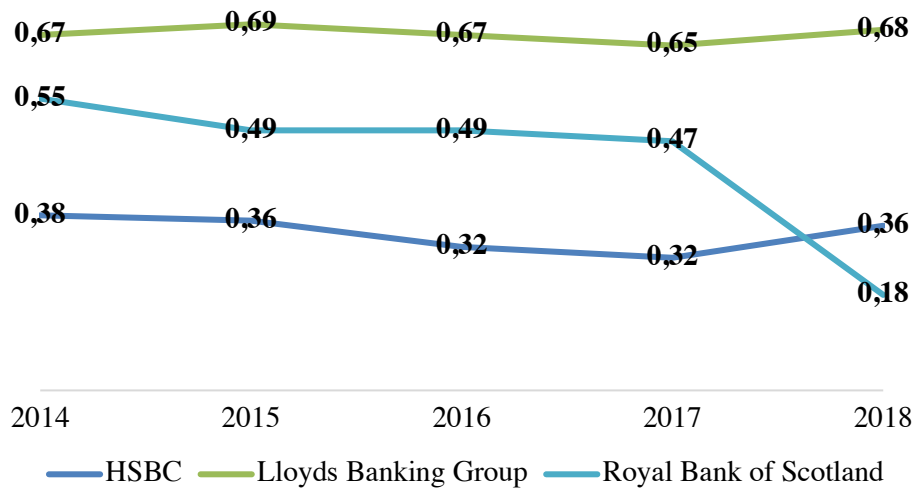


Figure 2. Long term debt to capital ratio comparison

After analysing figure 2, HSBC seems safer comparing to Lloyds and Royal Bank of Scotland as the bank has the lowest long-term debt to capital ratio except in 2018. So, HSBC has higher solvency comparing to its major competitors.

▪ Liquidity ratios

The liquidity ratios of a company are calculated to determine the level of liquid assets of the organisation. Liquid assets are those assets that can be converted into cash without significant loss of its value within short period (Nataraja, Chilale, et al., 2018). If a bank has optimum liquid assets it can meet the urgent demand of cash such as honouring the cheques of the depositors and maintain optimum profitability. But if a bank has low liquidity it will face liquidity crisis which may lead of non-payment of short-term debt and dishonouring of the depositors' cheques. Thus, the confidence of the depositors on the bank will go down and the bank may even face bankruptcy.

On the other hand, liquidity has negative relationship with profitability. That means, if the bank has excess liquidity it will have lower profitability as liquid assets can generate lower return comparing to illiquid or less liquid assets. So, considering both risk and profitability the banks need to set their optimum liquidity ratios. To analyse the liquidity condition here, it will be calculated the current ratio and cash ratio.

a. Current ratio

Current ratio is calculated to show the portion of current assets comparing to the current liabilities of the company (Easton & Sommers, 2018). By analysing the ratio, the ability of a company to repay its short-term obligation can be determined. A company having a lower current ratio such as current ratio of less than 2 or less than the industry average, indicates that the company may not be able to meet its short-term debt obligation and may face liquidity crisis. Due to liquidity crisis, the bank needs to take emergency loans at high interest rate and thus increase the cost of the bank. A severe liquidity crisis can lead the bank to bankruptcy.

This ratio is calculated for HSBC for the last five years in the following table 3. Ratios for Lloyds Bank and Royal Bank are represented as well.

$$\text{Current ratio} = \frac{\text{Current assets}}{\text{Current liabilities}}$$

HSBC					
Year	2014	2015	2016	2017	2018
Current assets*	1,884	1665.4	1606.63	1745.59	1737.38
Current liabilities*	1,985.08	1,739.37	1,770.41	1,852.14	1,809.84
Current ratio	0.95	0.96	0.91	0.94	0.96
Lloyds Banking Group					
Year	2014	2015	2016	2017	2018
Current ratio	1.37	1.40	1.41	1.39	1.44
Royal Bank of Scotland					
Year	2014	2015	2016	2017	2018
Current ratio	1.00	1.20	1.17	0.98	0.99

Table 3. Current ratio calculation

*All the amounts are in billion dollars.

Generally, current ratio values vary from industry to industry. Analysing calculations, it is indicated that HSBC has current ratio of less than 1. That means the current liabilities of the bank is more than the current assets of the bank. So, the risk is a little bit high for the bank. But as this is a financial institution, this level of current ratio is acceptable for the depositors, investors, shareholders.

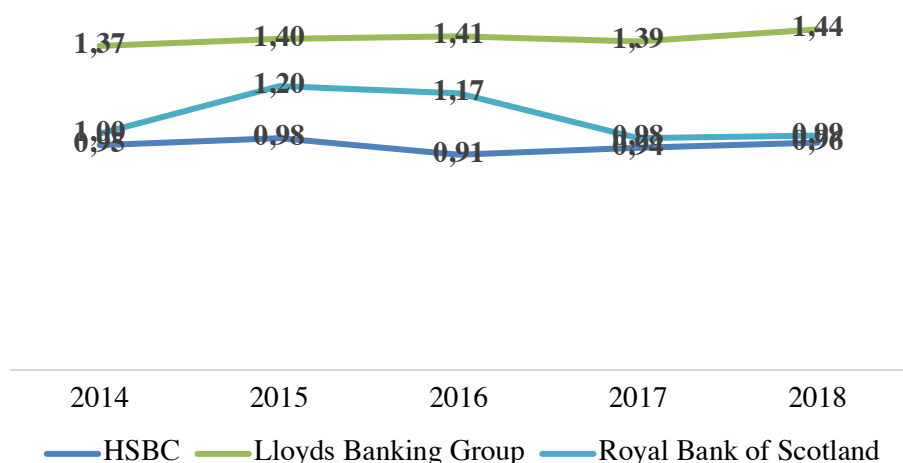


Figure 3. Current ratio comparison

In comparison with its two major competitors in UK, the current ratio of HSBC is lower, as seen in figure 3. So, the company has higher short-term risk comparing to the competitors. The

chance of facing short term liquidity crisis is higher for the company. HSBC should add more current assets comparing to current liabilities.

b. Cash ratio

Cash ratio shows the ability of a company to instantly pay its short-term liabilities. Having sufficient cash ratio is a good indication for the bank as it will be able to pay its short-term liabilities immediately in case of any emergency (Easton & Sommers, 2018). Thus, the bank can avoid emergency loans and as a result it can avoid severe liquidity crisis. The cash ratio of HSBC is calculated in the following table. Ratios for Lloyds Bank and Royal Bank are represented as well.

$$\text{Cash ratio} = \frac{\text{Cash and Cash equivalents}}{\text{Current liabilities}}$$

HSBC					
Year	2014	2015	2016	2017	2018
Cash and cash equivalents*	129.95	98.93	128	180.62	162.84
Current liabilities*	1,985.08	1,739.37	1,770.41	1,852.14	1,809.84
Cash ratio	0.07	0.06	0.07	0.10	0.09
Lloyds Banking Group					
Year	2014	2015	2016	2017	2018
Cash ratio	0.03	0.04	0.03	0.05	0.05
Royal Bank of Scotland					
Year	2014	2015	2016	2017	2018
Cash ratio	0.09	0.08	0.06	0.09	0.09

Table 4. Cash ratio calculation

*All the amounts are in billion dollars.

The cash ratio of HSBC bank indicates that it can meet less than 10% of its current liabilities using the cash and cash equivalents. That means the bank can immediately meet 10% of its current liabilities. This ratio seems good for financial industry.

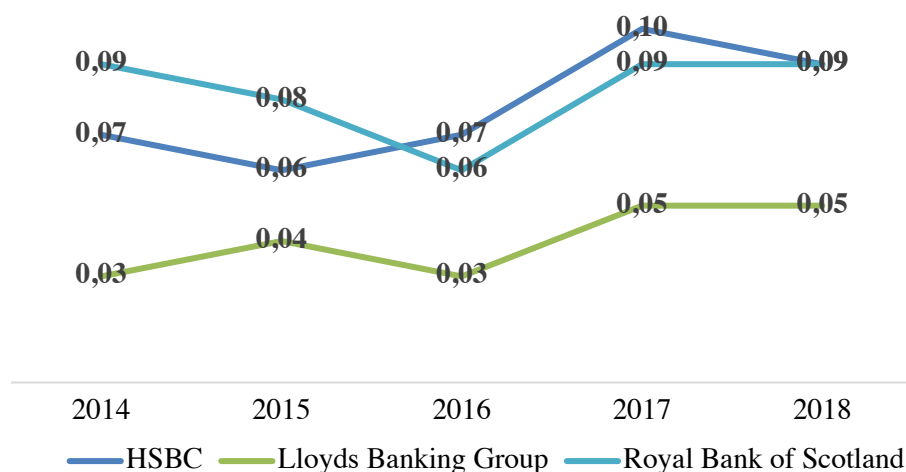


Figure 4. Cash ratio comparison

In view of the graphic representation in figure 4, the cash ratio of HSBC is higher than those of the two competitors during the last two years. The company has better capability than Lloyds to pay its current liabilities using cash and cash equivalents immediately.

▪ Profitability ratios

Profitability ratios or performance ratios are related to the firm's ability to earn profits on sales, assets and equity. Mainly, operating profit margin, net profit margin, return on assets and return on equity are widely used by investors in order to determine if investing in a company shares is profitable. Calculation of these ratios for HSBC bank re made as follows and compared to the competitors.

a. Operating Profit Margin

Operating Margin also known as return on sales, measures the profit an organisation makes on a dollar of sales. Thus, dividing the operating profit by its net sales, operating profit margin ratio is obtained.

$$\text{Operating Profit Margin} = \frac{\text{Operating Income}}{\text{Revenue}} \times 100$$

Year	2014	2015	2016	2017	2018
Operating Income*	60.84	61.57	48.59	45.03	41.19
Revenue*	64.58	64.90	53.17	46.75	42.32
Operating Profit Margin	94.20%	94.86%	91.38%	96.32%	97.32%
Lloyds Banking Group					
Year	2014	2015	2016	2017	2018
Operating Income*	54.65	32.77	14.66	8.50	1.93
Revenue*	64.32	59.49	17.52	21.64	15.07
Operating Profit Margin	84.96%	55.08%	83.67%	39.27%	12.80%
Royal Bank of Scotland					
Year	2014	2015	2016	2017	2018
Operating Income*	-17.15	1.99	-1.60	3.75	4.73
Revenue*	23.13	27.59	21.16	19.90	15.74
Operating Profit Margin	-74.15%	7.21%	-7.56%	18.84%	30.05%

Table 5. Operating Profit Margin calculation

*All the amounts are in billion dollars.

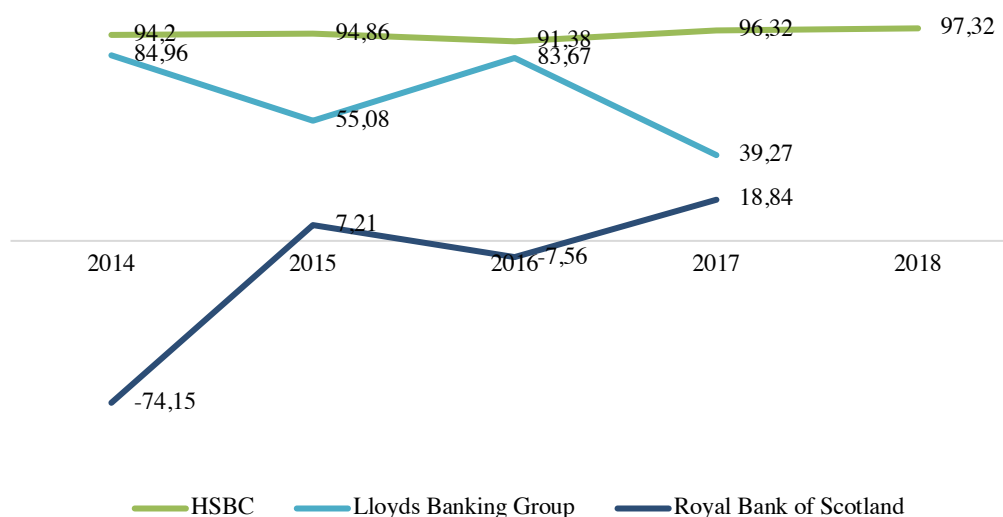


Figure 5. Operating Profit Margin comparison

It is observed that almost a 100% of operating profit margin is obtained for the last year by HSBC in comparison with the much lower percentages of the other two banks. It is also seen the improvement in earnings over the years by HSBC. There are not observed highly variable operating margins which usually indicate a business risk. What is impresses from Table 5 - we

can see for Royal Bank of Scotland for 2015 and 2016 they have negative profit margin but for the last two years they return their positive values. To keep positive and to strive higher operating profit margin Royal bank of Scotland can reduce operating expenses. The same can be done by the HSBC and Lloyd Banking Groups to keep the level or improve.

b. Net Profit Margin

Net profit margin represents the generated income as a percentage of revenue. It is one of the most important indicators for a company to know about whether current practices are working and estimate the profits based on revenue. For shareholders net profit margin is very important because it shows how good a company is at converting revenue into profit for shareholders.

$$\text{Net Profit Margin} = \frac{\text{Net Income}}{\text{Revenue}} \times 100$$

HSBC					
Year	2014	2015	2016	2017	2018
Net Income*	15.90	14.79	4.56	0.89	9.94
Revenue*	64.58	64.90	53.17	46.75	42.32
Net Profit Margin	24.62%	22.78%	8.57%	1.90%	23.48%
Lloyds Banking Group					
Year	2014	2015	2016	2017	2018
Net Income*	-1.94	1.99	0.74	2.18	1.11
Revenue*	58.12	69.39	17.52	21.64	15.07
Net Profit Margin	-3.34%	2.86%	4.22%	10.07%	7.29%
Royal Bank of Scotland					
Year	2014	2015	2016	2017	2018
Net Income*	-9.68	-7.44	-4.79	-1.17	2.20
Revenue*	23.14	27.59	21.16	19.90	15.74
Net Profit Margin	-41.83	-26.97	-22.64%	-5.87%	13.97%

Table 6. Net Profit Margin calculation

*All the amounts are in billion dollars.

If company's net profit margin is declining over time the problem could be poor customer experience or inadequate expense management or ranging from decreasing sales. From this tables we can see for these three banks which of them are most effective at converting sales (revenue) into profit.

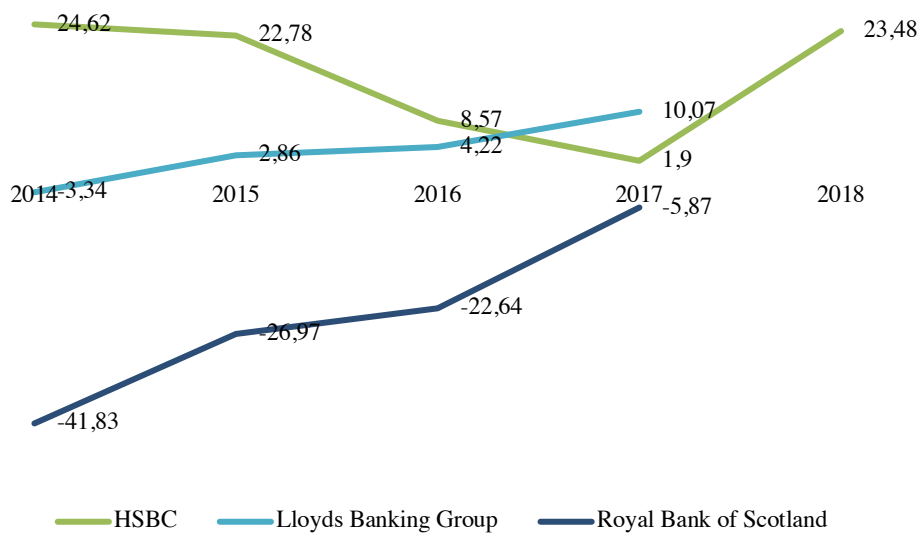


Figure 6. Net Profit Margin comparison

Viewing the net profit margin ratios (in percentage) for all three banks, it is clearly visible that HSBC generates more profit than the competitors. However, there is an expanding margin ratio over time by Lloyds and Royal Bank in contrast of the irregularities of HSBC bank.

As a recommendation, the managers of the banks could concentrate on the long-term expenses, equipment maintenance, research and development and marketing in order to increase the net profit margin. Definitely, they should cut back on the expenses that impair the ability of the business.

▪ Efficiency ratios

The ability to generate revenue or performing a task by using assets. Different ratios can be calculated in order to determine asset efficiency.

a. Total Asset Turnover Ratio

The asset turnover ratio is useful to indicate whether the organisation uses its assets efficiently to generate revenues, taking into account that the total assets are those at the beginning and the ending balance sheet of the year.

$$\text{Total Asset Turnover} = \frac{\text{Revenue}}{\text{Total Assets}}$$

HSBC					
Year Date 09/30	2014	2015	2016	2017	2018
Total Assets*	2634139	2409656	2374986	2518430	2558124
Revenue*	63780	62356	50320	66639	75436
Total Asset Turnover	0.024	0.025	0.021	0.026	0.029
Lloyds Banking Group					
Year Date 09/30	2014	2015	2016	2017	2018
Total Assets*	1408954	895746.4	1108355	1046646	1064634
Revenue*	63358	32698	63642	50690	33,429
Total Asset Turnover	0.044	0.036	0.057	0.048	0.031
Royal Bank of Scotland					
Year Date 09/30	2014	2015	2016	2017	2018
Total Assets*	1731763	1246759	1082419	951206.6	929664
Revenue*	24588	20519	19564	21083	21083
Total Asset Turnover	0.014	0.016	0.015	0.022	0.022

Table 7. Asset Turnover calculation

*All the amounts are in billion dollars.

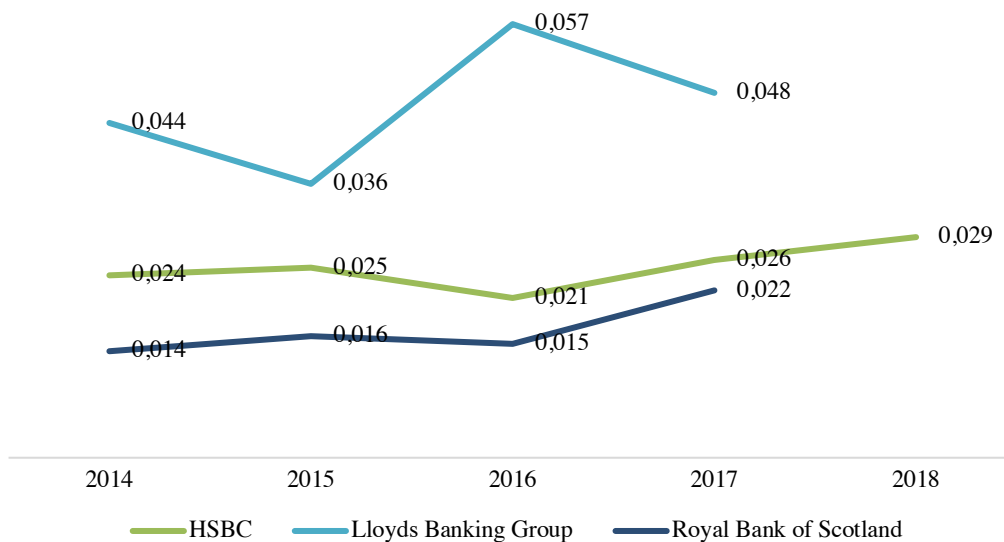


Figure 7. Asset Turnover comparison

By comparing the asset turnover ratios for HSBC, Lloyds Banking Group and Royals Bank of Scotland, a better estimate of which company uses assets more efficiently can be provided. Observing the asset turnover ratios of the three banks for the last year, it can be concluded that Lloyds bank is performing better than the Royal or HSBC, even though ratio of HSBC is very closer. Thus, Lloyds and HSBC generate almost the same revenue per dollar of assets since

ratios are similar. Low turnover on Royal Bank of Scotland may also mean that the company has weak collection methods.

Generally, a low asset turnover ratio, indicates poor inventory management or lax collection methods. However, an increase in the ratio over the last year in case of the HSBC bank explains that the capacity of the organisation is growing in. As a recommendation or how to improve this ratio, banks may liquidate obsolete or unused assets. They may improve their efficiency, for example analysing how they are used. Additionally, they can check its inventory managements.

Part C

Calculation of PBP, ARR, IRR and NPV

By calculating the payback period, accounting rate of return, internal rate of return and net present value, the finance managers can evaluate the projects available to them and select the best project for the organisation which will add the optimum value to them. The following paragraphs will show the calculation and evaluation of the two projects using these tools:

a. Payback period

Payback period is used to determine the number of years that a project will take to recover the money invested in the initial year (Johnson, et al., 2017). The project which has the lowest payback period will be selected. The payback period is calculated by determining the number of years in which the cash inflow of the project is equal to the cash outflow of the project. If the cash inflow of the project becomes equal at the middle of the period, then the period is considered as the payback period

The payback periods for the two projects are calculated below:

Year	Project A	Project B
0	-85	-90
1	10	25
2	20	30
3	40	35
4	55	40
Payback Period	3.27 years	3 years

Table: Payback Period Calculation

The payback period of the first project is 3.27 years whereas for the second project is 3 years. So, the second project will take less time for recovering the initial amount. Based on the calculation of payback period, the second project should be selected as the manager can recover the investment in less time from this project.

Accounting rate of return: The accounting rate of return calculates the rate of return considering the average net income and the average investment of the project (Penman & Zhang, 2018). The average net income of a project is calculated by dividing the total income of the project by the number of years. The average investment is calculated by dividing the sum of initial and end book value of the project by 2. Then the rate is calculated by dividing the average income by the average investment. If the ARR is higher than the cost of the project, then the project is selected otherwise not as the project will add negative value to the company.

Year	Project A	Project B
0	-85	-90
1	10	25
2	20	30
3	40	35
4	55	40
Average cash flow	31.25	32.5
Depreciation	-21.25	-22.5
Average income	10	10
Average Investment	42.5	45
Accounting rate of return	24%	22%

Table: Accounting rate of return

The accounting rate of return of both of the projects is more than the cost of the projects which is 10.5%. But as the projects are mutually exclusive, the project with higher return will be taken. Based on ARR, the project A should be taken as the return is more in this project comparing to the project B.

Internal rate of return: The rate that makes the net present value of a project zero is called the internal rate of return or IRR. The calculation of IRR is very crucial while selecting projects especially when the projects are mutually exclusive (Miao, et al., 2018). By calculating the IRR,

the finance manager can determine how much rate of return the project will generate during the investment period. If the IRR of a project is more than the cost of the project, then the finance manager can select the project as the project will add value to the company because it will generate more return than the cost of the project. If the IRR of a project is less than the cost of capital, then the manager rejects the project. When evaluating the mutually exclusive projects, the finance manager selects the project that has the highest IRR among the projects because it will add the highest value to the company.

Year	Project A	Project B
0	-85	-90
1	10	25
2	20	30
3	40	35
4	55	40
IRR	13%	15%

Table: Internal rate of return

The internal rate of return of both of the project is more than the cost of capital of the two projects which is 10.5%. So, both of the projects will add value to the company. But as the projects are mutually exclusive the finance manager should take the project B. The finance manager should take the project because this project has higher IRR that means it will add more value to the company comparing to the project A. So, project B will generate more return over the cost of capital for the company.

Net Present Value: The net present value of a project refers to the value calculated by deducting the initial investment from the discounted cash flow of the project. Exactly how much value will be added in amount terms can be determined by calculating the net present value of the project (Rich, et al., 2018). If the NPV of a project is positive, then the finance managers take the project as it will add positive value to the company. But if the NPV is negative, it indicates negative value addition and that's why the finance managers should not take the project. When evaluating two or more alternative mutually exclusive projects, the finance managers take the project with highest NPV as it will make the highest value addition to the company.

Year	Cash flow	Discounted cash flow	Cash flow	Discounted cash flow
1	10	9.05	25.00	22.62
2	20	16.38	30.00	24.57
3	40	29.65	35.00	25.94
4	55	36.89	40.00	26.83
Total		91.97		99.96
Initial investment		-85		-90
NPV		6.97		9.96

Table: Net present value

The net present values of both of the projects are positive. As the projects are mutually exclusive the manager should take project B as the NPV of project A is more than the NPV of project A. So, project B will add more value to the company in terms of amount. For this reason, the manager should take project B based on the calculation of NPV of the projects.

Final selection

Based on PBP, ARR, IRR and NPV, the finance manager should take project B as this project will add more value to the company, except in case of ARR. Moreover, as NPV and IRR are more reliable than ARR the manager should select project B.

Advantages and disadvantages of NPV, PBP and IRR

The tools used for selecting capital investment projects including NPV, PBP and IRR have some benefits and drawbacks which the finance managers should consider while using the tools. The benefits and drawbacks are discussed below:

Payback period:

Advantages

- This tool is easy to use that means the manager can evaluate the project easily.
- The payback period method gives more preference to liquidity that means recovering money quickly. The managers who need to recover the investment from the project quickly can use the method to select projects.

- The method is also useful for evaluating the uncertain projects. If the managers have high uncertainty regarding the future cash flow, the managers can use this method to select and evaluate projects.

Disadvantages

- The payback period method does not consider the time value of money and thus may provide wrong outcome.
- The method does not consider the cash flow after the payback period. If a project has high cash inflow or outflow after the payback period, the managers will take wrong decisions while selecting the projects.
- The method does not consider the project profitability while evaluating the projects. Having a lower payback period does not mean that the profitability of the project will be more as cash inflow can stop after the period.

Net present value:

Advantages

- The biggest advantage of the method is that it helps the managers exactly determine how much value will be added to the company after taking the project. For example, if a project has NPV of £2000, it will create £2000 amount of value for the company.
- The method considers the time value of money that means it considers the opportunity cost of the investors.
- It considers the conventional cash flow that means it considers more than one negative cash flow during the project period.
- The method considers all cash flow of the projects and it is a good measure of profitability.

Disadvantages

- The net present value method does not consider the sunk cost of the project which has already been spent before starting the project.
- It is very difficult to determine the cost of capital of the project.
- The method does not consider the initial fund requirement of the project. For example, a project having an NPV of £20000 required initial investment of £50000 should be more preferred than the project having an NPV of £30000 but needs initial investment of £200000. NPV does not consider it.

Internal Rate of Return:

Advantages

- For calculating the internal rate of return, the finance managers do not need the required rate of return which is very difficult to estimate.
- The managers can determine the percentage rate of return of the projects which can be directly compared with the cost of capital.
- It considers the time value of money as well.

Disadvantages

- The method considers that the cash flow will be reinvested at the rate of return of the project which may not be possible.
- If the projects have conventional cash flows, there will be more than one IRR for the projects and thus the project cannot be evaluated properly.
- The method does not consider the difference in maturity of the projects.

Among the three methods, NPV is the best as it gives a clear amount of value that will be added to the company after taking the project.

Conclusion

It is important to analyse the history of the bank in order to understand whether it is performing well from its establishment or not. A brief history was analysed in order to know the culture of the bank and the morale of the management of HSBC. To analyse the financial performance of the bank, different ratios have been determined. Analysing the debt-equity ratio, long term debt to capital ratio helped to understand that the bank has sufficient capital to pay the debt and face the risks. To assess the liquidity of a bank the current ratio and the cash rate were useful. In comparison with the Lloyds Banking Group and Royal Bank of Scotland, it was observed that HBSC has more equilibrate and already well-established financial health.

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