

## Six-year Comparison of Business Activities Surveys on Securities Dealers

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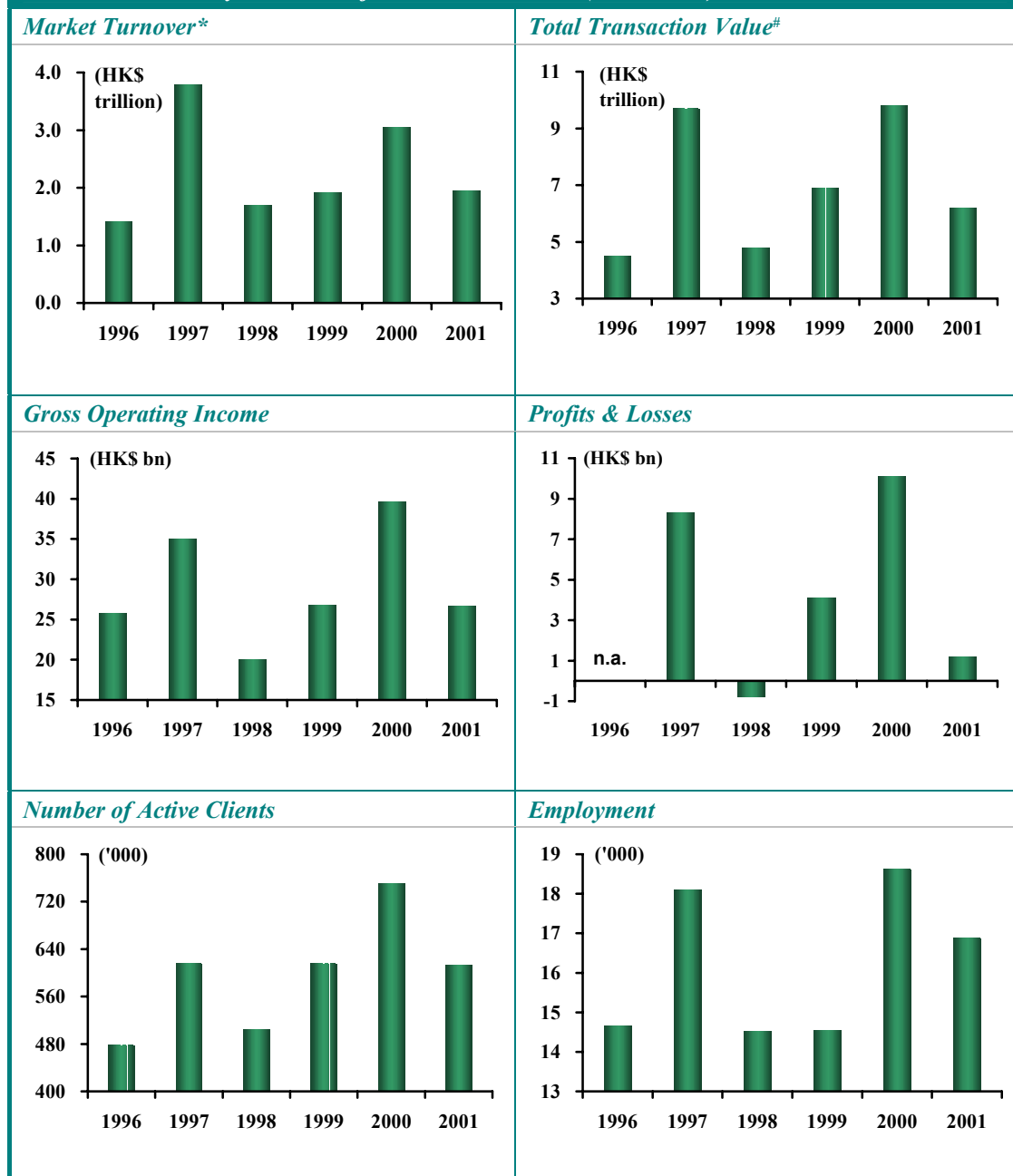
### Executive Summary

- Stock broking constituted the majority of a broker's gross operating income (GOI), which was highly correlated with the trading activities of the stock market, though its proportion was decreasing. GOI experienced sharp jumps in 1997 and 2000, but declined in 1999 and 2001, together with the slow down of the world's markets.
- The aggregate profits and losses (P&L) of responding securities dealers (SDs) dropped to HK\$1.2 billion in 2001, from the peak level of HK\$10.1 billion in 2000 (Chart 1). But this was still higher than the level of 1998, when an aggregate loss was reported.
- Institutional clients were the major contributors to GOI despite the fact that they were out-numbered by individual clients. A relative small number of overseas clients generated a significant proportion of the total income. The number of active clients increased in 1999 and 2000, but dropped in 2001 to the levels of 1997 and 1999. This was mainly attributable to the changes in market activity and the participation of local retail clients.
- In line with the trading activities of the stock market, the number of persons working in the securities industry peaked in 2000. Although the number of persons working in the industry declined only slightly in 2001, the relative shares of different functional groups have changed. For instance, the number of persons working in "Sales and Marketing" group and "Information Technology" group continued to expand in 2001. This could possibly be attributable to the commission-based and bonus-based remuneration structure for the majority of "Sales and Marketing" group. Such an incentive-based structure can help to keep the fixed overhead low and flexible. Therefore, although manpower increased by number, the related expenses followed the general pattern of market turnover. Besides, the higher the market turnover, the more account executives will be attracted to this business. When the turnover shrinks, securities firms still need to hire more account executives to pinch clients from their competitors. Regarding the "Information Technology" group, the increase in manpower reflected the need to invest in technology and financial infrastructure in order to keep up with the latest development.

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<sup>1</sup> Mr Joseph Lee is the Senior Manager and Miss Yan Yuhong is the Assistant Manager of the Research Department of the Supervision of Markets Division, SFC. Views expressed in this paper are the authors' and do not represent those of the SFC. The authors would like to thank the Licensing Department and the Intermediaries Supervision Department for providing raw data and helpful comments. Information contained in this paper is obtained from websites, annual reports and fact books of stock & futures exchanges and regulatory bodies, information vendors, research institutes and other organizations. While information from these sources is believed to be reliable, it is not guaranteed as being accurate and the most current. Readers are free to use the information contained in this paper, but any usage should not be attributed to the SFC. Please note some statistic figures shown in this paper might be different from those which appeared in the Business Activities Surveys Reports published before. This is because some re-classifications have been made to allow for more meaningful comparison of the survey results over time.

**Chart 1 – Summary Statistics of Securities Dealers (1996-2001)**



\*: This refers to the stock market turnover as reported by the HKEx.

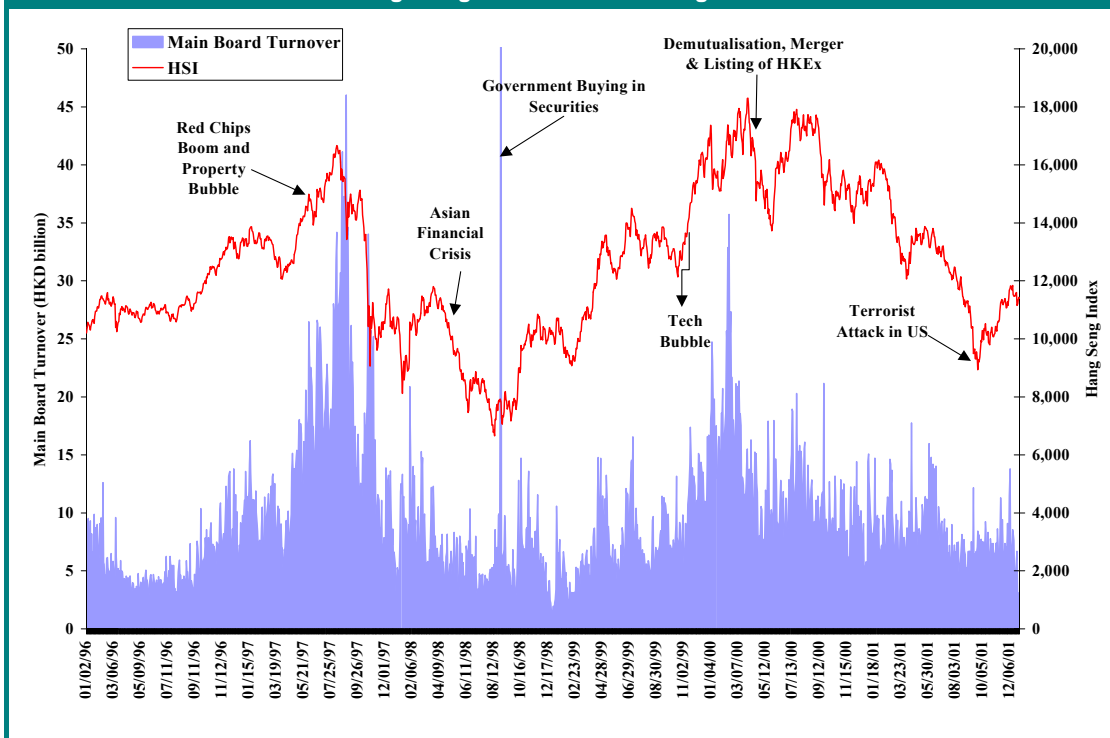
#: This refers to the value of stock broking on HKEx and overseas exchanges as reported by the responding SDs in the survey. It includes both buying and selling amounts.

Source: SFC, BAS 1996-2001 & HKEx Fact Book 2001

## Background

- As an international financial centre and an open economy, the performance of the Hong Kong stock market has been sensitive to external factors (Chart 2).
  - Both stock prices and trading volume were boosted by the red-chips boom in 1997.
  - The index and turnover dropped in 1998 when the Asian financial crisis took place and the property bubble burst.
  - The government stepped into the stock market in Aug 1998. The government bought in some HK\$120 billion worth of shares, and the majority of them were sold back to the market in the form of TraHK.
  - The stock market recovered after the government's action. The tech fever gave further boost to the market in late 1999 and 2000.
  - Due to the recession of global economy and the burst of tech bubble, the market experienced a bearish year in 2001.
  - The 9.11 incident dampened market sentiment further, with the HSI once retreating to a level below 9,000.
  - Major market statistics during 1996-2001 are found in the Appendix.

**Chart 2 – Performance of the Hong Kong Stock Market during 1996-2001**



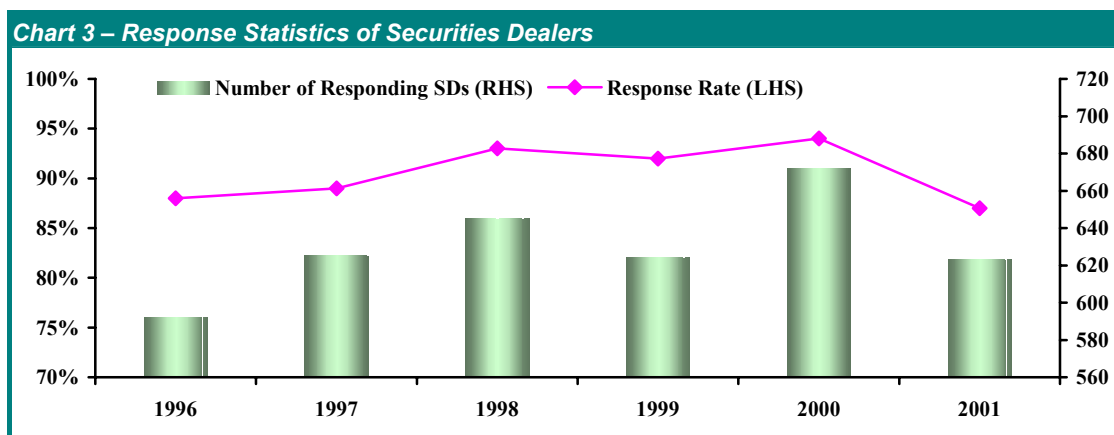
Source: Bloomberg

### The Three-pronged Reforms

- After the Asian financial crisis, the Financial Secretary announced in his Budget Speech in 1999 a three-pronged package of structural reforms:
  - Demutualization of the stock and futures exchanges and their merger with related clearing houses, followed by the listing of the new holding company;
  - Enhancement of the financial technology infrastructure of the securities and futures industry; and
  - Modernization of the securities legislation through a new Securities and Futures Bill.
- The merger of the Stock Exchange of Hong Kong with the Hong Kong Futures Exchange took place in March 2000, when Hong Kong Exchanges and Clearing Limited (HKEx) was formally established. HKEx itself got listed in June 2000.
- Further to the report of the Steering Committee on the Enhancement of the Financial Infrastructure (SCEFI) in Sep 1999, the SCFEI II report was released in Dec 2002. Key recommendations on improving the market infrastructure include:
  - Scripless market model
  - Clearing participant-ship structure
  - Cross-market linkages
  - Integration of payment and securities settlement systems to facilitate same-day payment finality.
- To bring Hong Kong's regulatory framework to the best international standards, the Securities and Futures Ordinance (SFO) was enacted in March 2002 and became effective in April 2003. This new framework consolidates the existing 10 ordinances and represents significant improvements in many areas of securities and futures regulation.

## Introduction

- With a view to enhancing the understanding of the developments in the securities dealing industry in Hong Kong, the SFC conducted six Business Activities Surveys (BAS) during 1996-2001. The surveys covered all firms registered under the Securities Ordinance and Commodities Trading Ordinance, which can be categorised into SDs, commodity dealers, investment advisers, commodity trading advisers, exempt dealers and exempt investment advisers. This paper will focus on SDs, whereas commodity dealers will be discussed in the Quarterly Bulletin.
- The number of responding SDs was 623 in 2001, compared with 592 in 1996 (Chart 3). The response rates to the BAS have been high, with an average level of about 90%. Due to the differences in response rates, figures reported in later sections may not be strictly comparable.



## Primary Business Activity

- The majority of the responding SDs (80%) considered stock broking to be their primary business activity (Table 1). Other lines of business include securities underwriting, distribution of unit trusts and mutual funds, fund management, proprietary trading, trading of derivatives and debt securities, market making, arbitrage trading and stock borrowing & lending, etc.

**Table 1 - Primary Business Reported by Securities Dealers**

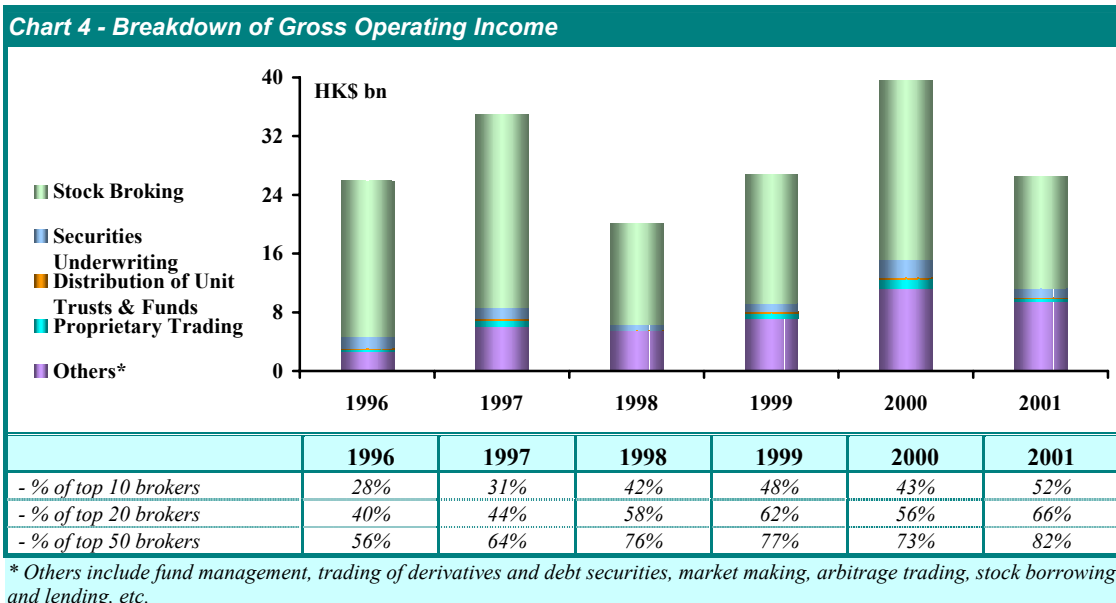
	1996	1997	1998	1999	2000	2001
<b>Stock Broking</b>	85%	84%	81%	80%	79%	80%
<b>Securities Underwriting</b>	3%	3%	3%	2%	2%	2%
<b>Distribution of Unit Trusts &amp; Funds</b>	3%	3%	3%	3%	3%	3%
<b>Proprietary Trading</b>	2%	1%	2%	1%	1%	1%
<b>Others*</b>	7%	9%	13%	14%	16%	14%

\* Others include fund management, trading of derivatives and debt securities, market making, arbitrage trading, stock borrowing and lending, etc.

- Overall speaking, the proportion of SDs who reported stock broking as their primary business dropped five percentage points between 1996 and 2001, while other lines of business picked up notably.

### Gross Operation Income

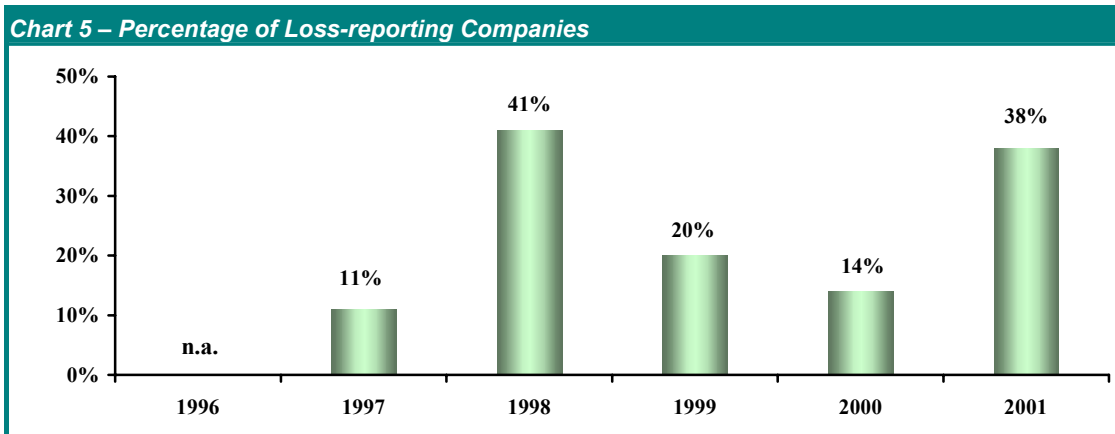
- In line with the trading activities of the stock market, GOI experienced a jump in 2000 (Chart 1). GOI then declined in 2001 with the slow down of trading activities in the stock market.
- Stock broking constituted the majority of GOI, though its proportion has declined from around 82% in 1996 to 57% in 2001 (Chart 4). In contrast, GOI from other activities like asset management, bonds/fixed income transactions and share margin financing has increased during the period.
- The GOI from stock broking on the SEHK increased steadily in 1999 and 2000. The growth was attributable to the gradual recovery of the Asian markets and the increasing popularity of tech stocks.
- In 2001, the stock market lost momentum due to the bursting of the tech bubble. The 9.11 incident dampened investor confidence further. GOI from stock broking activities on the SEHK recorded a decrease of over 40% during 2001, but was still higher than the 1998 level when the financial crisis took place.



- In 2001, market activities slowed down together with the world's markets. GOI from stock broking activities on overseas exchanges recorded a decrease of 20%.
- In respect of GOI, the share of stock broking on the SEHK lost 21 percentage points from 59% in 1997 to 38% in 2001 (figure in 1996 is not available). In contrast, the share of stock broking on overseas exchanges gained 3 percentage points from 16% to 19% over the same period.

## Profits and Losses

- In line with stock market activities, the total profits of the SDs retreated to an aggregate loss of HK\$0.8 billion in 1998 from a profit of HK\$8.3 billion in 1997. Similarly, the total profits of SDs dropped to HK\$1.2 billion in 2001, from the peak level of HK\$10.1 billion in 2000 (Chart 1).
- When the Asian financial crisis took place in 1998, 41% of SDs reported losses, while the relevant figures for 1997 was 11%. In 2001, 38% of SDs reported losses, compared to 14% in 2000 (Chart 5). Nevertheless, the majority (71%) of these loss-reporting SDs had losses less than HK\$5 million in 2001.



Note: The figure for 1996 was not available.

## Clientele

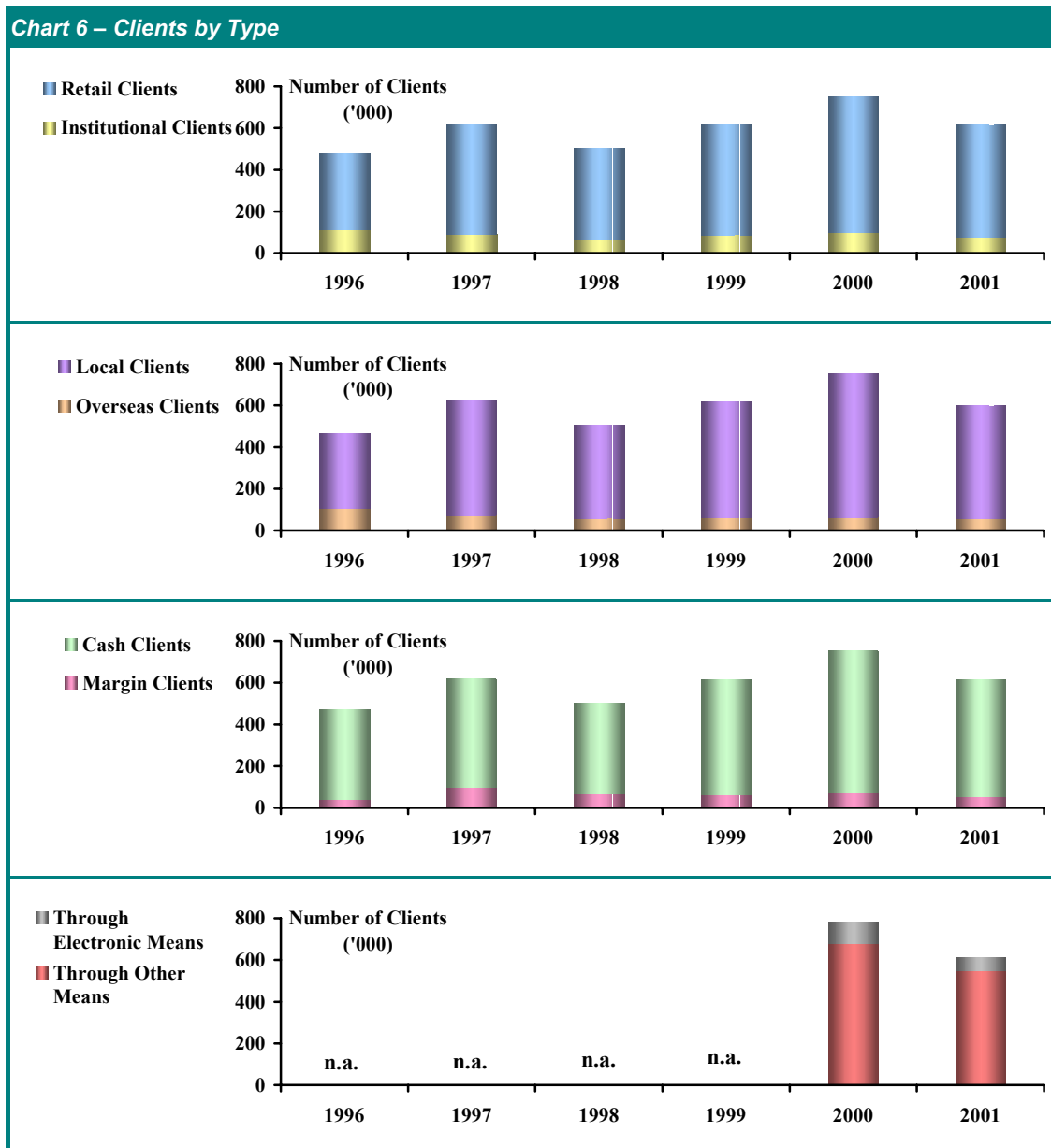
### Clients by Type

- The number of active clients<sup>2</sup> increased significantly during peak periods such as 1997 and 2000, but dropped in 2001 (Chart 6). This was mainly attributable to the changes in market activity and the participation of local retail clients<sup>3</sup>.
- The percentages of retail clients to institutional clients were 87% to 13% in 2001, compared to 77% to 23% in 1996. This was mainly due to a sharp surge of retail clients but a retreat of institutional clients since 1997. There was also a significant retreat of overseas clients (from 23% in 1996 to 12% in 2001), which seemingly implied that most institutional clients were overseas clients.
- The majority of the clients were local clients, accounting for almost 90%, compared to less than 80% in 1996.

<sup>2</sup> The total number of clients recorded in the surveys may not be the actual number of clients in the securities market. This is because some of the clients may have opened several brokerage accounts with different registered firms. And some of the accounts reported as institutional clients are in fact omnibus accounts, which absorb dealing orders directly from the general public.

<sup>3</sup> Retail clients refer to those who trade on their personal accounts with average balances not exceeding US\$1 million during the year.

- The share of margin clients was below 10%. Between 1996 and 1997, the percentage of margin clients doubled from 8% to 16%, but dropped to 13% in 1998 and further declined to 9% in 2001.
- The proportion of clients trading through electronic means was 11% in 2001, compared with 13% in 2000.



Note: The surveys before 2000 did not separate the clients through electronic means and clients through other means.

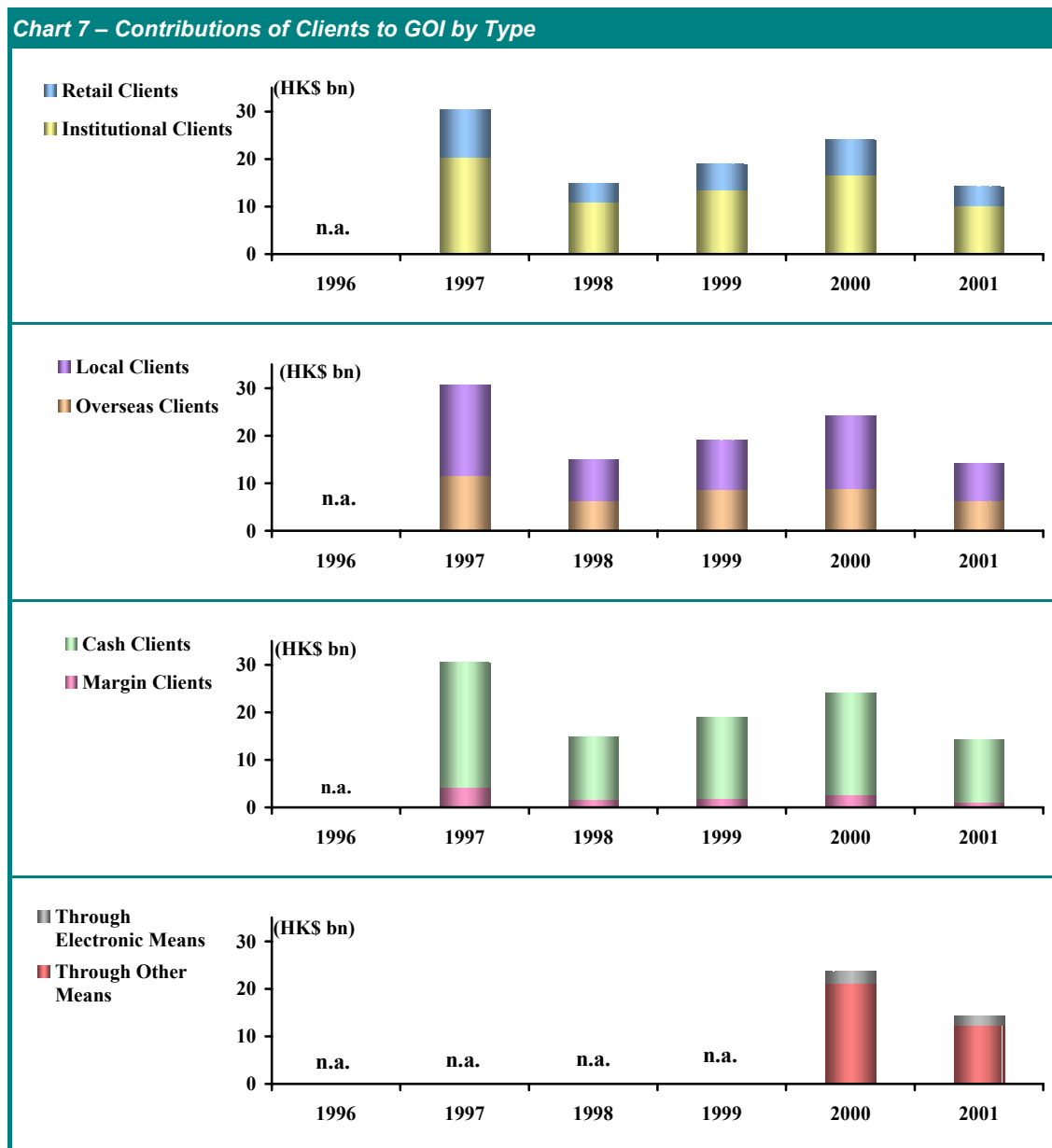
#### Contributions of Clients to GOI by Type

- Institutional clients were the major contributors to GOI, despite the fact that they were out-numbered by retail clients (Chart 7).
- Individual trading increased by a greater magnitude during bullish periods and decreased more during bearish periods. Institutional clients were seen to be



relatively more stable in their trading activities during difficult times and were contributing a relatively steady source of income to the SDs.

- A relative small number of overseas clients generated a significant proportion of the industry income. The number of overseas clients only accounted for less than 10% of the total, but they contributed to almost half of the GOI.
- In line with the sharp fall in number of margin clients, the contribution of margin clients to GOI decreased from 14% in 1997 to 7% in 2001.
- In 2001, the proportion of clients trading through electronic means decreased to 11%, but that through other means rose to 89%. However, the contribution of clients trading through electronic means increased from 11% in 2000 to 14% in 2001. This implies that clients using electronic means either traded more frequently or traded in larger size.



Note: Figures for 1996 were not reported. The surveys before 2000 did not separate the clients through electronic means and clients through other means.

## Employment

### *Employment by Functional Group*

- In line with the pattern of trading activities of the stock market, the number of persons<sup>4</sup> working in the securities industry experienced a sharp jump in 1997 and 2000 (Chart 1). Although the number of persons working in the industry declined only slightly in 2001, the relative shares of different functional groups have changed (Table 2).
- The number of persons working in “Sales and Marketing” group and “Information Technology” group continued to expand in 2001.
  - The “Sales & Marketing” group – the single largest group of 40% of the total at the end of 2001 – recorded consecutive growths over the period. This could possibly be attributable to the commission-based and bonus-based remuneration structure for the majority of “Sales and Marketing” group. Such an incentive-based structure can help to keep the fixed overhead low and flexible. Therefore, although manpower increased by number, the related expenses would follow the general pattern of market turnover. Besides, the higher the market turnover, the more account executives will be attracted to this business. When the turnover shrinks, securities firms still need to hire more account executives to pinch clients from their competitors.
  - The “Information Technology” group also kept a steady growth. This largely reflected the rapid changes and the need to keep up with the latest developments in this area, especially development of financial infrastructure and expansion of on-line trading.
- The number of persons working in some functional groups of the industry declined in 2001, but was still higher than that in 1999.
  - The number of persons working in “Accounting” group and “Research” group dropped to almost the same levels as those in 1999.
  - The number of persons working in “Others” group, which includes administrative staff, supporting staff, etc., fell, but remained higher than the 1999 figure.
  - These three groups together accounted for another 20% of the total number in 2001 (22% in 1998, 1999 and 2000).
- The number of persons working in several major functional groups of the industry has declined to below the 1998 and 1999 levels, or even lower than the 1996 level.
  - For instance, the number of persons working in the “Dealing / Execution” group dropped to a level which was less than the corresponding figures in 1998 and 1999.
  - A similar phenomenon was observed for the “Settlement” group.
  - As these groups are trade-related, the drop in manpower in these groups could be in part accounted for by the shrinkage of trading activities in the stock market and in part by the investment in financial infrastructure which assisted automation and restrained manpower growth.

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<sup>4</sup> In the surveys, a value of less than 1 is assigned to a person who performs more than one function or serves more than one company simultaneously. For example, if a person who spends 30% of his time on research and 70% on sales and marketing, the headcount for this person should be reported as 0.3 for research and 0.7 for sales and marketing.

- These two groups together accounted for 26% of the total in 2001 (28% for 2000 and 32% for both 1999 and 1998).
- The proportion of manpower in front office rose from 47% in 1996 to 54% in 1998, and further to 59% in 2001. That of back office dropped from 53% in 1996 to 46% in 1998, and further to 41% in 2001.

**Table 2 – Reported Number of Persons Working in Securities Industry by Functional Group**

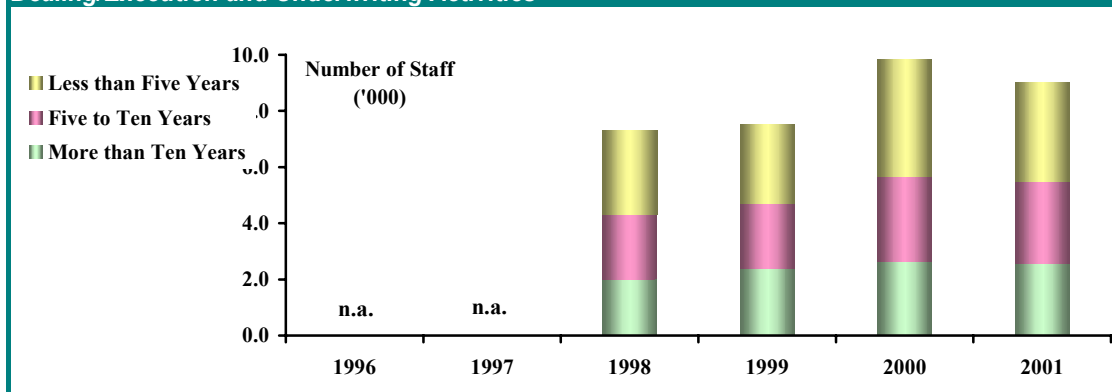
	1996		1997		1998		1999		2000		2001	
		% to total		% to total		% to total		% to total		% to total		% to total
<b>Total Number of Staff</b>	<b>14,669</b>		<b>18,104</b>		<b>14,527</b>		<b>14,540</b>		<b>18,618</b>		<b>16,868</b>	
<b>Front Office</b>	6,918	47%	9,762	53%	7,796	54%	7,968	55%	10,500	56%	9,882	59%
Sales and Marketing	4,410	30%	4,503	25%	4,608	32%	4,869	33%	6,765	36%	6,569	39%
Dealing / Execution	2,508	17%	3,709	20%	2,567	18%	2,435	17%	2,857	15%	2,397	14%
Underwriting	n.a.	n.a.	n.a.	n.a.	88	1%	162	1%	220	1%	202	1%
Fund / Portfolio Management	n.a.	n.a.	195	1%	63	0%	30	0%	57	0%	45	0%
Research	n.a.	n.a.	1,355	7%	470	3%	472	3%	603	3%	465	3%
Others	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	204	1%
<b>Back Office</b>	7,752	53%	8,339	46%	6,731	46%	6,572	45%	8,118	44%	6,986	41%
Settlement	2,751	19%	2,751	15%	2,234	15%	2,268	16%	2,461	13%	2,150	13%
Credit Control	n.a.	n.a.	n.a.	n.a.	390	3%	321	2%	363	2%	332	2%
Risk Management	n.a.	n.a.	n.a.	n.a.	270	2%	228	2%	292	2%	249	1%
Accounting	1,612	11%	1,957	11%	1,329	9%	1,388	10%	1,617	9%	1,342	8%
Legal and Compliance	474	3%	621	3%	477	3%	415	3%	504	3%	465	3%
Information Technology	n.a.	n.a.	n.a.	n.a.	744	5%	717	5%	1,138	6%	1,167	7%
Others	2,915	20%	3,010	17%	1,287	9%	1,235	8%	1,744	9%	1,281	8%

Note: The classification of functional group in the questionnaires of 1996 and 1997 was different from those after 1998.

*Employment by Working Experience*

- Around 30% of the staff who participated in sales and marketing, dealing/execution and underwriting activities had more than ten years of relevant experience in the industry (Table 8). Another 30% or so had five to ten years of relevant experience, while the remaining had less than five years of experience.
- The shares of people with relevant years of experience were stable during 1998-2001.

**Chart 8 – Relevant Experience of Staff Who Participated in Sales and Marketing, Dealing/Execution and Underwriting Activities**



Note: The 1996 and 1997 surveys did not provide information on this.

## Appendix – Highlights of the Hong Kong Stock Market during 1996-2001

As at end	Main Board				GEM			
	Number of Listed Companies	Market Cap (HK\$ bn)	Average Daily Turnover (HK\$ mn)	Equity Funds Raised (HK\$ mn)	Number of Listed Companies	Market Cap (HK\$ bn)	Average Daily Turnover (HK\$ mn)	Equity Funds Raised (HK\$ mn)
<b>1996</b>	583	3,476.0	5,672	100,018	n.a.	n.a.	n.a.	n.a.
<b>1997</b>	658	3,202.3	15,465	247,577	n.a.	n.a.	n.a.	n.a.
<b>1998</b>	680	2,661.7	6,887	38,257	n.a.	n.a.	n.a.	n.a.
<b>1999</b>	701	4,727.5	7,757	148,120	7	7.2	144	1,583
<b>2000</b>	736	4,795.2	12,338	451,281	54	67.3	341	16,056
<b>2001</b>	756	3,885.3	8,025	58,593	111	61.0	162	5,836

Sources: SFC Quarterly Bulletin, HKEx