

Six-year Comparison of Business Activities Surveys on Commodity Dealers

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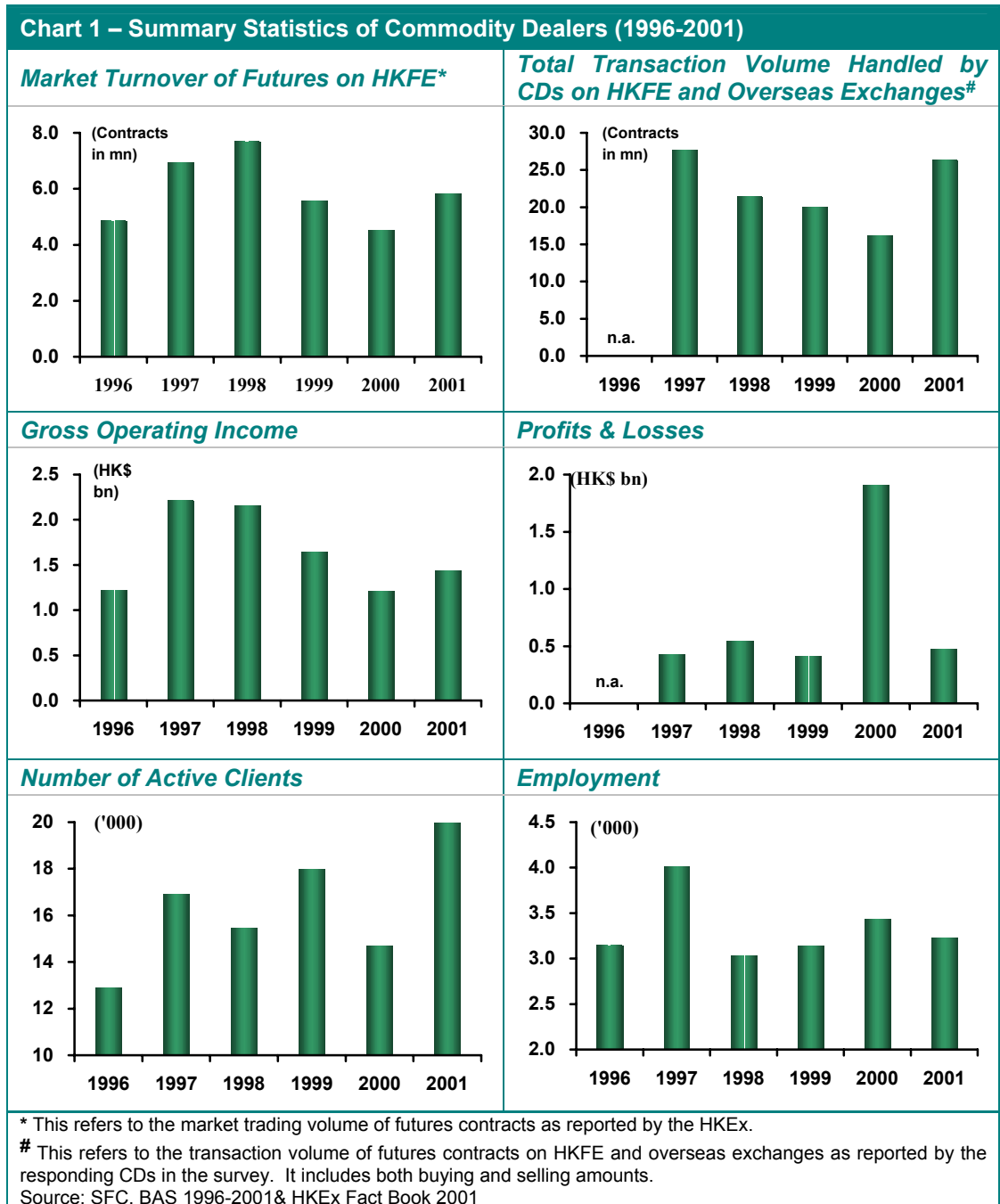
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Executive Summary

- Broking of derivatives constituted the majority of the gross operating income (GOI) of commodity dealers (CDs). GOI peaked in 1997, but declined during 1998-2000 (Chart 1). In 2001, CDs reported better performance, a rise of 19% in their GOI, due to the growth of broking activities on overseas exchanges.
- There had been a decreasing concentration of income among the big players, but such trend reverted in 2001. The top 10 brokers accounted for 52% of the total turnover in 1996. The proportion fell continuously to 43% in 2000. However, in 2001, it rebounded to 58%.
- The aggregate profits and losses of the responding CDs dropped from the peak level of HK\$1.9 billion in 2000 to HK\$0.5 billion in 2001, which was more in line with the levels reported during 1997-1999. The high profits in 2000 were mainly contributed by the top five gainers, which reported a total profit of HK\$0.7 billion with two of them not responding to the surveys before 2000. Meanwhile, some CDs were also involved in the dealing of equity securities. Their profits in 2000 were partly boosted by the tech fever in the cash market in the year. As a result, the total number of loss-reporting firms dropped from 44 in 1999 to 19 in 2000. In 2001, 25% of the responding CDs reported losses, compared to 13% in 2000. Nevertheless, this was still comparable to the levels of 20%-29% during 1997-1999. Besides, the majority (77%) of these CDs reported losses of less than HK\$5 million in 2001.
- CDs had increases in the number of active clients in 1997, 1999 and 2001. This was mainly due to the increase in local investors. Institutional clients contributed about 50% to GOI in 2001, despite being out-numbered by retail clients. The proportion of overseas clients decreased from the peak level of 10% in 1998 to 5% in 2001. The income derived from overseas clients also decreased.
- The number of persons working for CDs declined from the peak level in 1997. This was because a number of Japanese and US firms underwent worldwide restructuring and consolidation after the Asian financial crisis. Despite this, the number of persons working in the “Sales and Marketing” group continued to

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expand. The “Information Technology” group also recorded consecutive growths over the period.



Background

Established in 1976, the Hong Kong Futures Exchange Limited (HKFE) is one of the major derivatives exchanges in the Asia-Pacific region. Below is a brief description of the developments of derivatives products launched in Hong Kong:

- The first equity index derivatives product, the HSI Futures, was introduced by the HKFE in May 1986.
- The HSI Options were launched in May 1993.
- The Stock Futures and Stock Options were launched in Mar 1995 and Sep 1995 respectively².
- The International Stock Futures and Options were launched in Oct 2001. These contracts were issued on individual stocks selected from markets in Asia and the US.
- To facilitate the participation of retail investors, Mini-HSI Futures were brought into the market in Oct 2000. The Mini-HSI is a small-sized HSI contract, with its size equivalent to one-fifth of that of a standard HSI contract.
- A few equity index futures based on overseas indexes have been launched in recent years. These included MSCI China Free Index Futures in May 2001 and DJIA Index Futures in May 2002.

Apart from product development, enhancements in systems and financial infrastructure also took place over the period. To increase capacity and functionality, the trading system was upgraded to a new electronic screen-based trading system, namely the HKFE Automated Trading System (HKATS) in 2000. With HKATS, market participants have direct access to the marketplace and conduct trading through HKATS workstations.

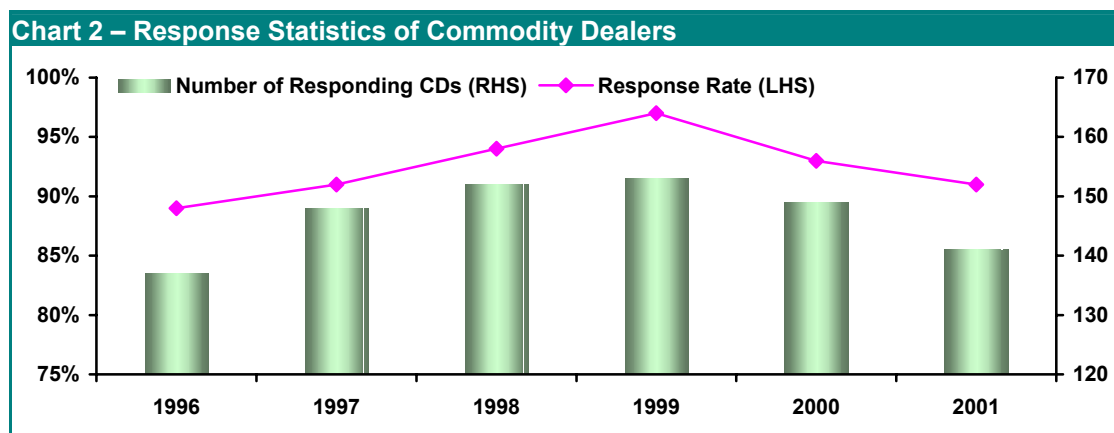
Major statistics of the derivative market during 1996-2001 are found in the Appendix.

² Stock Options are the products of the SEHK but the trading has been migrated to the Automated Trading System (HKATS) of the HKFE. Trading activities are not reflected in the business performance of CDs.

Introduction

With a view to enhancing the understanding of the developments in the securities and futures 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 securities dealers, CDs, investment advisers, commodity trading advisers, exempt dealers and exempt investment advisers. A 6-year comparison of securities dealers has been published in the previous Quarterly Bulletin (Issue No. 51). This paper will focus on CDs.

The number of responding CDs was 141 in 2001, compared with 137 in 1996 (Chart 2). The response rates of CDs to the BAS have been high, with an average level of about 90%. Due to the differences in response rates in different years, figures reported in later sections may not be strictly comparable.



Primary Business Activity

The majority of the responding CDs in 2001 (76%) considered broking of futures products on the HKFE to be their primary business activity (Table 1). Other lines of business include broking of futures products on overseas exchanges, market making of futures products, proprietary trading and arbitrage trading, etc.

Table 1 - Primary Business Reported by Commodity Dealers

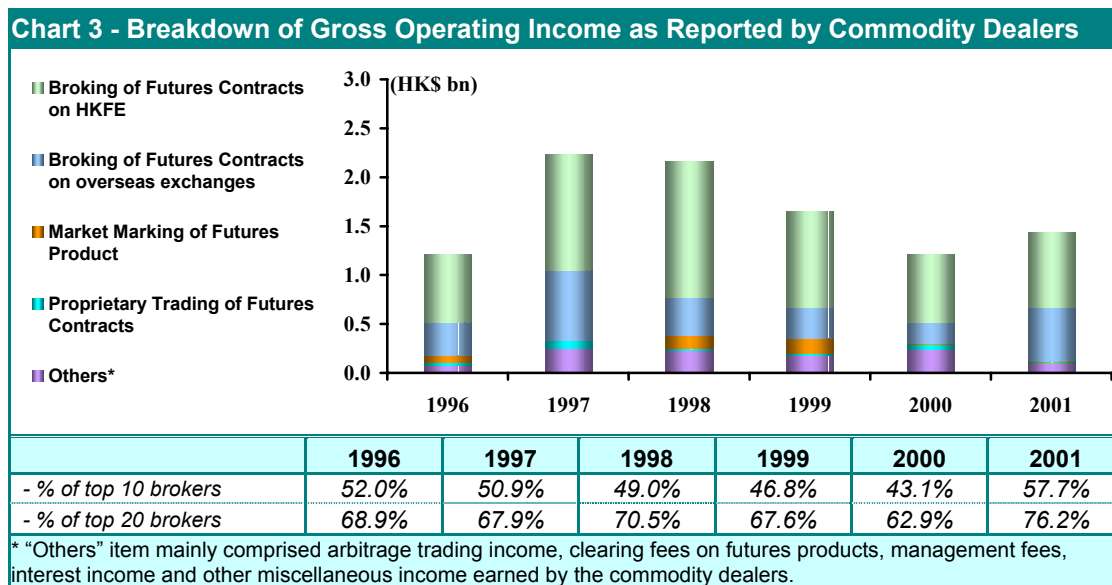
	1996	1997	1998	1999	2000	2001
Broking of Futures Product on HKFE	80%	76%	77%	78%	76%	76%
Broking of Futures Product on Overseas Exchange	12%	10%	11%	8%	9%	10%
Market Making of Futures Product	3%	1%	3%	2%	1%	0%
Proprietary Trading	2%	1%	3%	2%	1%	2%
Others*	4%	11%	7%	10%	13%	12%

* "Others" item mainly comprised arbitrage trading, interest income, and other activities carried out by the commodity dealers.

Gross Operating Income

Trading activities on the HKFE were most active during 1997-1998. The growth was in part attributable to the active trading of futures products due to worries over the Hong Kong Dollar peg amidst the Asian financial crisis, and in part attributable to the launch of new derivatives products (i.e. HIBOR Futures, HKFE Taiwan Index Futures and Options, and Hang Seng 100 Futures and Options) during the period.

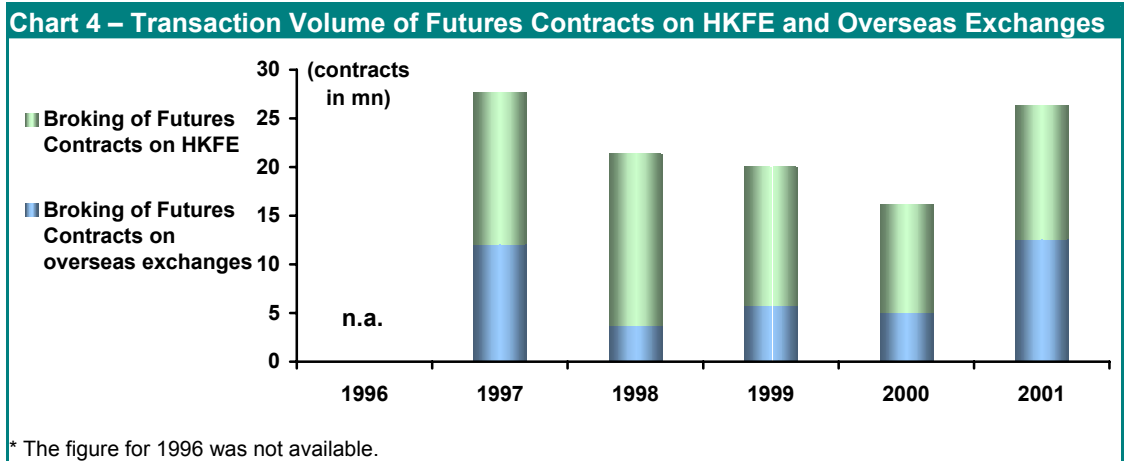
Broking of futures contracts constituted the majority of GOI of CDs. Its proportion climbed to the peak level of 92% in 2001 (Chart 3). Of this, the share of futures broking on the HKFE lost 11 percentage points from the peak level of 64% in 1998 to 53% in 2001. In contrast, the share of futures broking on overseas exchanges gained 20 percentage points from 18% to 38% over the same period.



There had been a decreasing concentration of income among the big players, but such trend reverted in 2001. The top 10 brokers accounted for 52% of the total turnover in 1996. The proportion fell continuously to 43% in 2000. However, in 2001, it rebounded to 58%.

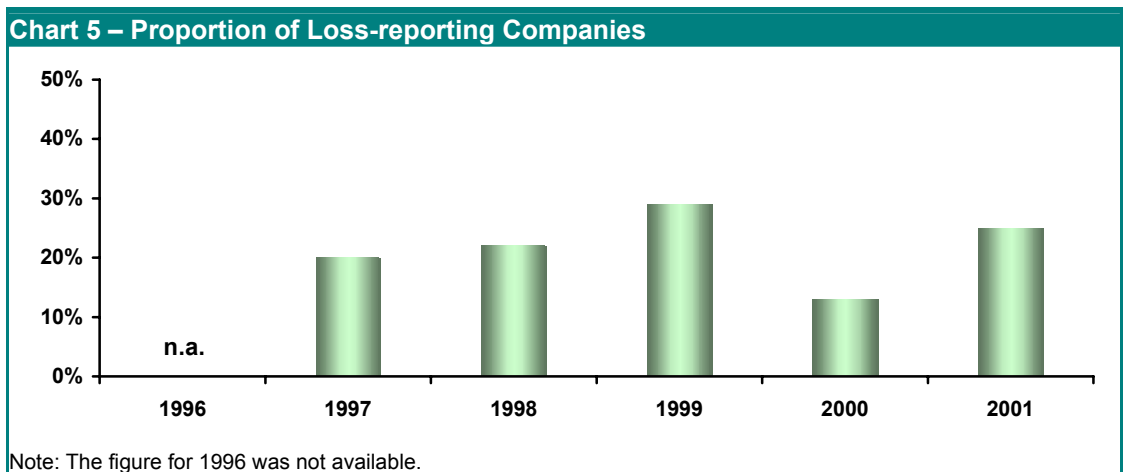
Transaction volume of futures contracts on the HKFE had been falling during 1999-2000. However, transaction volume rebounded in 2001 (Chart 4).

The reported number of futures contracts on overseas exchanges in 2001 showed an increase of 150% over 2000. This was mainly accounted for by the growth of 2 large firms, which contributed 79% to the total transaction volume for the trading of futures contracts on overseas exchanges in 2001. Of the overseas countries, the US, Japan and Singapore have been the most popular markets for futures trading.



Profits and Losses

The aggregate profits and losses of the responding CDs dropped from the peak level of HK\$1.9 billion in 2000 to HK\$0.5 billion in 2001, which was more in line with the levels reported during 1997-1999 (Chart 1). The high profits in 2000 were mainly contributed by the top five gainers, which reported a total profit of HK \$0.7 billion with two of them not responding to the surveys before 2000. Meanwhile, some CDs were also involved in the dealing of equity securities, their profits in 2000 were partly boosted by the tech fever in cash market in the year. As a result, the total number of loss-reporting firms dropped from 44 in 1999 to 19 in 2000. In 2001, 25% of the responding CDs reported losses, compared to 13% in 2000. Nevertheless, this was still comparable to the levels of 20%-29% during 1997-1999. Besides, the majority (77%) of these CDs reported losses of less than HK\$5 million in 2001.



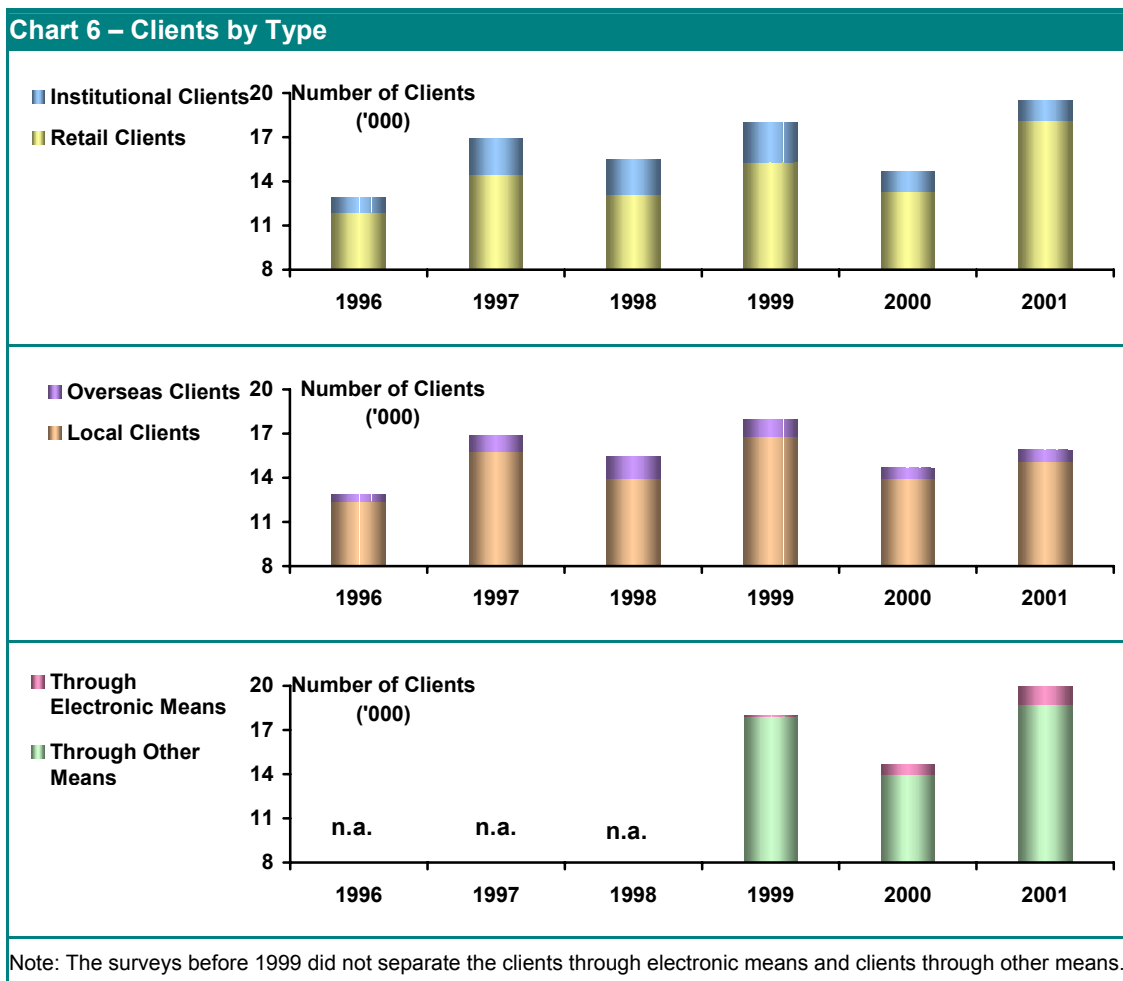
Clientele

Clients by Type

CDs had increases in the number of active clients³ in 1997, 1999 and 2001 (Chart 6). This was mainly due to the increase in local investors.

The percentages of retail clients to institutional clients were 93% to 7% in 2001, compared to 85% to 15% in 1996. This was mainly due to an increase in the number of retail clients in 2001.

The proportion of clients trading through electronic means increased to 6% in 2001. This compared to 5% in 2000 and 1% in 1999.



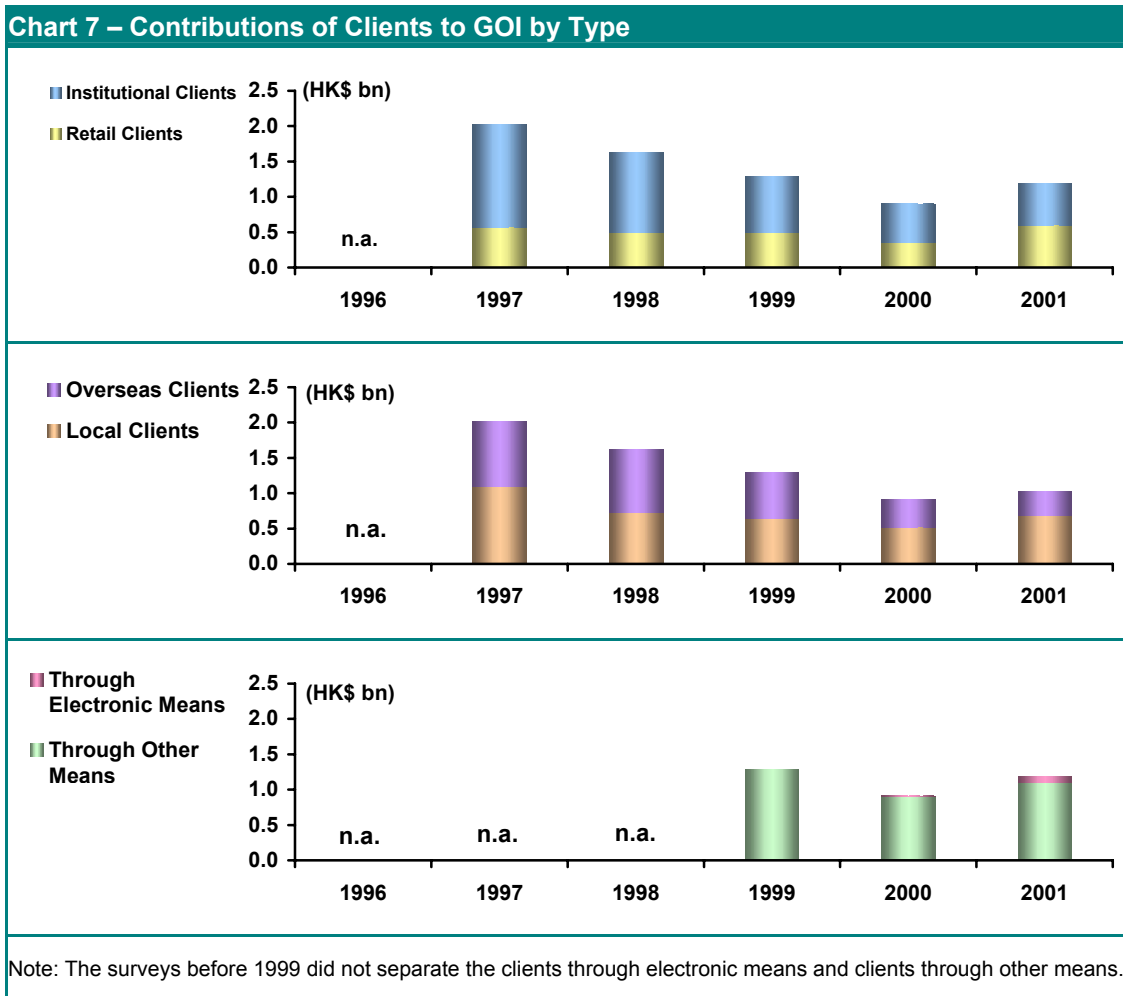
³ The total number of clients recorded in the surveys may not be the actual number of clients in the futures market. This is because some of the clients may have several brokerage accounts with different registered firms. Besides, some of the accounts reported as institutional clients are in fact omnibus accounts, which absorb dealing orders directly from the general public.

Contributions of Clients to GOI by Type

Institutional clients contributed about 50% to GOI in 2001, despite being outnumbered by retail clients⁴ (Chart 7). The share of institutional clients was 72% in 1997.

The proportion of overseas clients decreased from the peak level of 10% in 1998 to 5% in 2001. The income derived from overseas clients also decreased from 55% in 1998 to 44% in 2001.

Although the proportion of clients trading through electronic means grew by one percentage point from 5% in 2000 to 6% in 2001, the contribution of these clients to GOI increased by seven percentage points from 1% to 8%.



⁴ Retail clients refer to those who trade on their personal accounts with average balances not exceeding US\$1 million during the year.

Employment

In line with the general economic downturn, the number of persons⁵ working for CDs declined from the peak level in 1997 (Chart 1). This was because a number of Japanese and US firms underwent worldwide restructuring and consolidation after the Asian financial crisis.

- The number of persons working in the “Dealing / Execution” group has been declining since 1997 (Table 2).
- The number of persons working in some functional groups like “Settlement” and “Accounting” declined in 2001, to a level lower than that of 1996.
- However, the number of persons working in the “Sales and Marketing” group continued to expand. This could possibly be attributable to the commission-based and bonus-based remuneration structure for the majority of “Sales and Marketing” group.
- The “Information Technology” group also recorded consecutive growths over the period.

The proportion of manpower in the front office rose from 55% in 1996 to 69% in 2001, whilst that of the back office dropped from 45% to 31%. This reflects a more dynamic sales force.

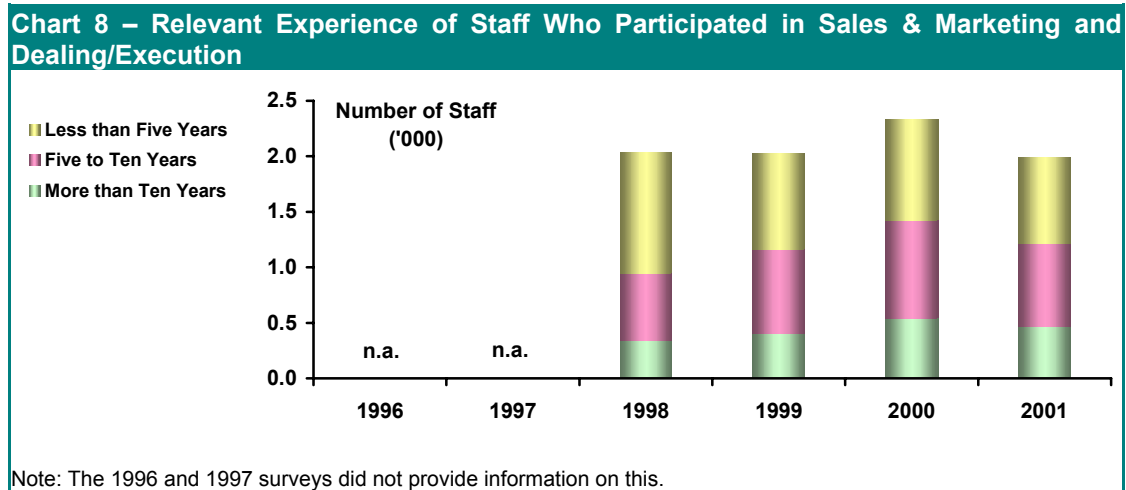
Around 20% of the staff who participated in sales and marketing and dealing/execution activities in 2001 had more than ten years of relevant experience (Chart 8). Another 40% or so had five to ten years of relevant experience, whilst the remaining had less than five years of experience.

⁵ 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.

Table 2 - Reported Number of Persons Working in Futures Industry by Functional Group

	1996		1997		1998		1999		2000		2001	
		% to total		% to total		% to total		% to total		% to total		% to total
Total Number of Staff	3,145		4,014		3,032		3,143		3,436		3,229	
Front Office	1,728	55%	2,429	61%	2,007	66%	2,194	70%	2,319	67%	2,216	69%
Sales and Marketing	1,158	37%	1,638	41%	1,249	41%	1,529	49%	1,759	51%	1,749	54%
Dealing / Execution	570	18%	791	20%	731	24%	591	19%	546	16%	423	13%
Fund / Portfolio Management	n.a.	n.a.	n.a.	n.a.	2	0%	4	0%	5	0%	0	0%
Research	n.a.	n.a.	n.a.	n.a.	25	1%	70	2%	9	0%	10	0%
Others	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	34	1%
Back Office	1,417	45%	1,585	39%	1,025	34%	949	30%	1,117	33%	1,013	31%
Settlement	331	11%	424	11%	310	10%	282	9%	311	9%	249	8%
Credit Control	n.a.	n.a.	n.a.	n.a.	85	3%	69	2%	69	2%	65	2%
Risk Management	n.a.	n.a.	n.a.	n.a.	55	2%	52	2%	64	2%	53	2%
Accounting	335	11%	347	9%	202	7%	213	7%	250	7%	206	6%
Legal and Compliance	138	4%	182	5%	110	4%	85	3%	91	3%	86	3%
Information Technology	n.a.	n.a.	n.a.	n.a.	132	4%	141	4%	179	5%	210	7%
Others	613	19%	632	16%	132	4%	107	3%	153	4%	144	4%

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



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

Table A1 - Turnover of Futures and Options (Contracts in thousands)										
For the period	Total Futures	HSI Future:	Mini HSI Futures	MSCI China Free Index Future:	3-Mont HIBOF Future:	Others*	Total Option	HSI Option	Stock Options	Others#
1996	4,851	4,656	n.a.	n.a.	n.a.	195	2,364	1,094	1,270	n.a.
1997	6,934	6,447	n.a.	n.a.	88	399	2,797	1,147	1,649	1.2
1998	7,684	6,970	n.a.	n.a.	503	212	2,443	799	1,637	6.7
1999	5,563	5,132	n.a.	n.a.	309	122	2,966	714	2,198	54
2000	4,522	4,023	120	n.a.	325	53	4,739	544	4,189	5.9
2001	5,831	4,400	770	3.1	629	28	4,719	716	4,001	1.8

* Including Hang Seng 100 Futures, Hang Seng Properties Sub-Index Futures, Red-Chip Futures, Stock Futures, International Stock Futures, Rolling Forex, One- Month HIBOR Futures and Three-Year Exchange Fund Note Futures

Including Hang Seng 100 Options, Hang Seng Properties Sub-Index Options, Red-Chip Options and International Stock Options

Remarks: Figures may not add up to totals due to rounding
Trading in Mini-Hang Seng Index Futures commenced on 9 Oct 2000
Trading in MSCI China Free Index Futures commenced on 7 May 2001
Trading in Hang Seng 100 Futures, Hang Seng Properties Sub-Index Futures, Hang Seng 100 Options, Hang Seng Properties Sub-Index Options and Red-Chip Options suspended with effect from 31 Jul 2001
Trading in Red-Chip Futures suspended with effect from 31 Aug 2001
Trading in International Stock Futures and International Stock Options commenced on 4 Oct 2001, and suspended with effect from 30 May 2003
Trading in Three-Year Exchange Fund Note Futures commenced on 19 Nov 2001
Trading in Rolling Forex delisted with effect from 21 May 2002

Source: HKEx