INCREASING INVESTOR PARTICIPATION: INSIGHTS FROM HKEx SURVEYS[1]

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Active participation by investors is essential to a vibrant securities market. The Hong Kong market's global profile can also benefit from more investor activity. Findings from a number of HKEx surveys reveal key factors for increasing investor participation — improved market quality, improved products and services, and greater and sustained efforts in promotion and education. Any strategy to secure more investor participation in Hong Kong's securities markets will need a long term perspective and will require support from all parties in the market.

Introduction

The Hong Kong stock market has been among the top ten member exchanges of the World Federation of Exchanges (WFE) by market value[3]. However, its ranking in terms of turnover value is not as high. In the first three months of 2002, Hong Kong's cash market turnover ranking was 6th in the region and 21st in the world[4]; and derivatives market contract turnover ranking 9th in the region and 32nd in the world.[5] The (lower) turnover rankings compared with the (higher) capitalisation rankings may already indicate the potential to increase investor activity in the Hong Kong market. Securing more active investor participation would be of high strategic importance and would raise Hong Kong's global profile.

A number of surveys conducted by Hong Kong Exchanges and Clearing (HKEx)[6], addressing the level of investor participation, investors' investment behaviour, attitudes and opinions, provide useful insights for an investor retention and development strategy. The findings in fact constitute a strategic agenda for market development. These are presented in the sections below.

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[2] *This paper represents only the personal views of the author and not necessarily the views of HKEx.*

[3] *Hong Kong, with a market value of US$503 billion as at the end of March 2002, ranked 10th; New York Stock Exchange (US$11,328 billion) ranked 1st.*

[4] *The rankings include the Mainland exchanges, which are not members of the WFE. Hong Kong, with a turnover of US$51 billion of share trading during January to March 2002, ranked 21st while New York Stock Exchange (US$2,591 billion) and Nasdaq (US$2,228 billion) ranked 1st and 2nd respectively. Tokyo Stock Exchange (US$375 billion) and Taiwan Stock Exchange (US$210 billion) from the Asian-Pacific region, ranked 5th and 7th respectively. Shanghai and Shenzhen Stock Exchanges, with turnovers of US$58 billion and US$37 billion respectively during January to March 2002, ranked 20th and 23rd respectively.*

[5] *Hong Kong, with a trading volume of 2.4 million contracts during January to March 2002, ranked 32nd; Korea Stock Exchange, with 345 million contracts, ranked 1st, followed by EUREX and Chicago Mercantile Exchange.*

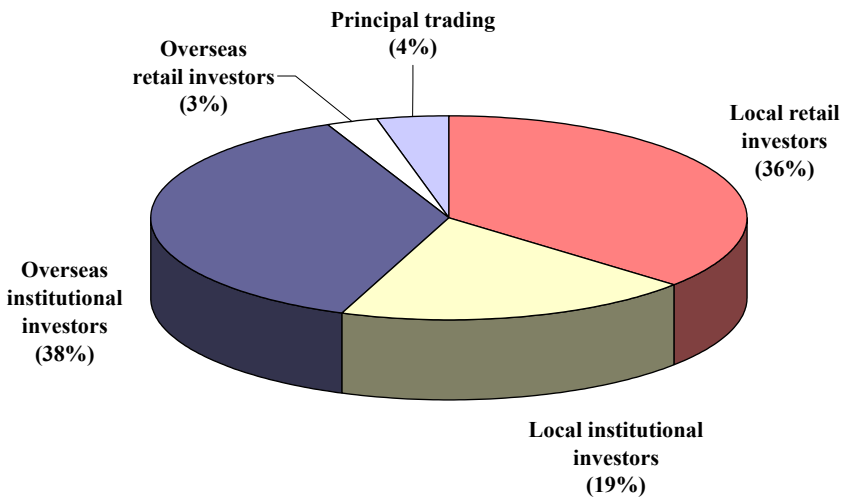
[6] *See Annex for the list of HKEx surveys.*

Investor Composition in the Cash Market

The HKEx cash market products include shares, warrants, debt securities, Exchange Traded Funds (ETFs) and unit trusts. Trading concentrates very much on shares (93% of market trading value in 2001). Warrant trading came second (6%).

In HKEx cash market trading, local retail investors, local and overseas institutional investors are all major contributors. During October 2000 to September 2001, local retail investors contributed 36% of the cash market trading in value terms; local and overseas institutions contributed 19% and 38% respectively. *(Figure 1)*

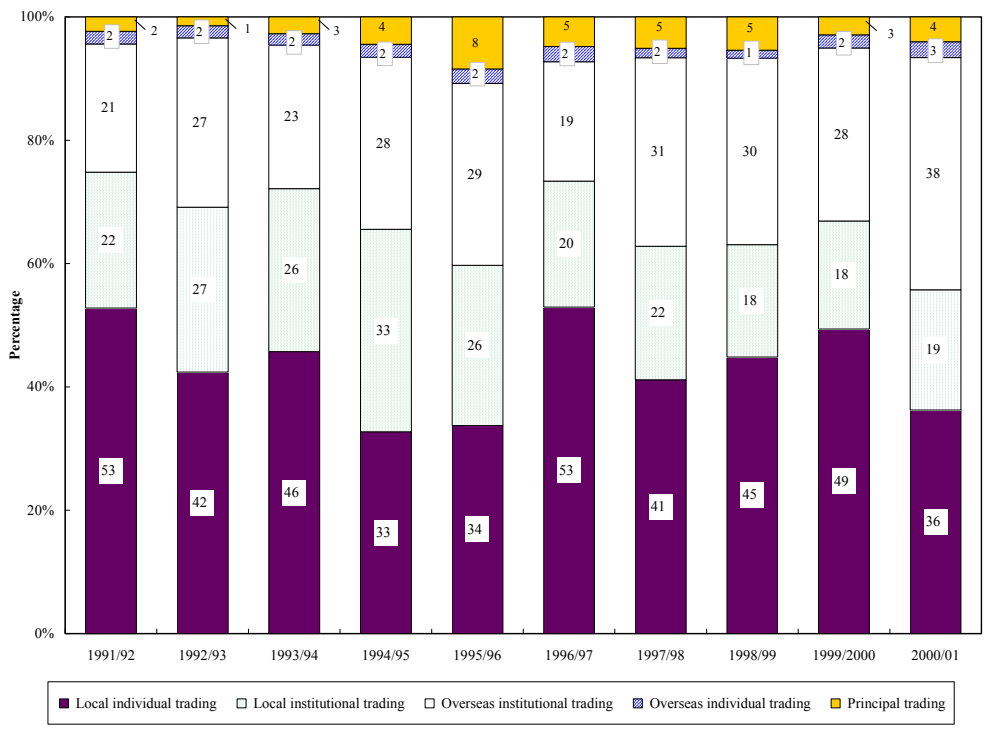
Figure 1. Distribution of cash market trading value by investor type (October 2000 – September 2001)



Source: CMTS 2000/01

Over the past decade, local retail trading has had a dominant market share of one-third to over 50% in value terms. However, retail trading has the characteristic that it expands and contracts to a greater extent than institutional trading in accordance with changes in market sentiment. In bullish times, as in 1996/97, retail trading value increased to a much greater extent than institutional trading, contributing 53% of trading value during 1996/97. In bearish times, as in 1994/95, retail trading contracted much more than institutional trading, resulting in only a 33% contribution during 1994/95. In other words, institutional investors have been a more stable source of market trading. *(Figure 2)*

Figure 2. Distribution of cash market trading over time (1991/2 – 2000/01)

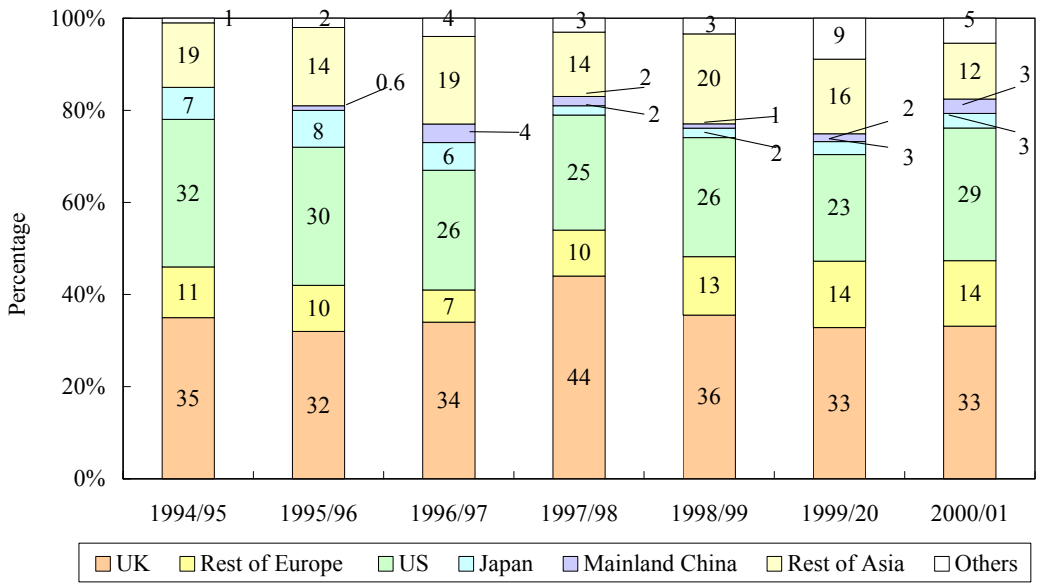


Compared to overseas institutional investors, local institutional investors' percentage contribution has not been as substantial, albeit quite steady over the past few years.

Among overseas investors, which are predominantly institutions, UK and the US investors are the major customers, contributing about one-third and 30% of overseas agency trading, or about 14% and 12% of total market trading respectively during 2000/01. Japan, given its economic size, has a lower than expected level of participation. Its contribution declined from 8% in 1995/96 to 3% of overseas agency trading in 2000/01 (the latter figure representing 1% of total market trading). Mainland China, a perceived major potential source of customers, has had very low level of contribution. This probably reflects the current very restrictive government policy on overseas investment by Mainland individuals and institutions[7]. *(Figure 3)*

[7] *Money of Mainland origin transferred to Hong Kong and then invested in the market would be counted in these surveys as constituting Hong Kong order flow.*

Figure 3. Distribution of overseas agency trading by origin over time



Notes: Mainland China was included in the rest of Asia in the 1993/94 and 1994/95 Surveys.

Source: CMTS 1994/95 – 2000/01

Principal trading by brokers (or the Exchange Participants) has been around 5% over the past few years. This is understandable under the existing order-driven trading mechanism.

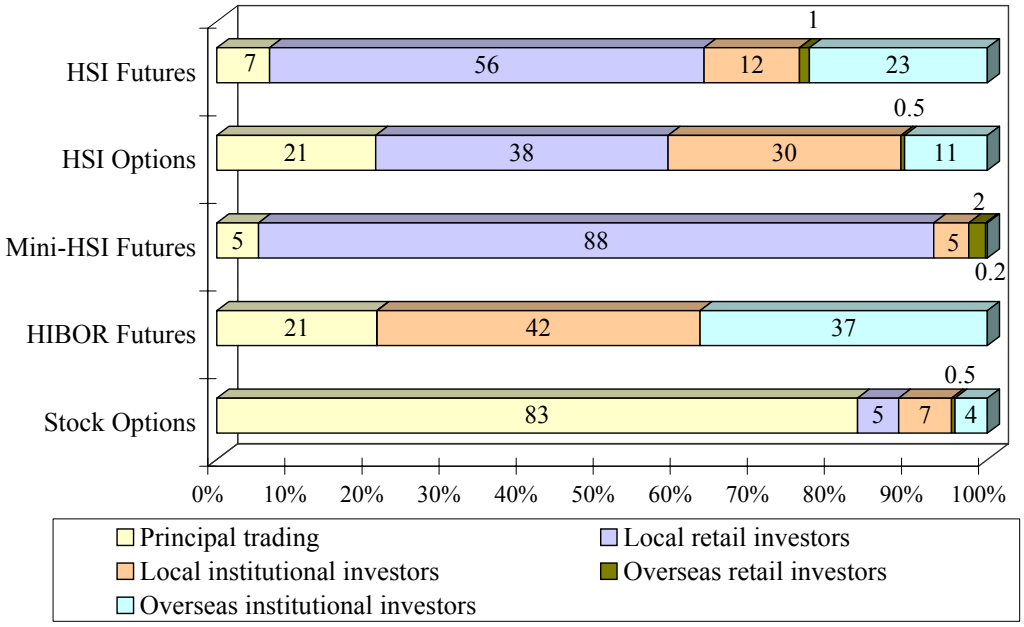
The findings indicate that (1) factors that can sustain retail investors' investment in the cash market at also bearish times — when it may actually be more rational to invest for long term saving — would be beneficial; and (2) there is untapped potential in certain overseas markets. In addition, changes in the contribution of local institutional investors as a result of the development of the Mandatory Provident Fund (MPF) industry should be monitored.

Investor Composition in the Derivatives Market

The HKEx derivatives market consists of the stock options market and the market in other futures and options products — index futures and options (mainly the Hang Seng Index products), stock futures, and interest rate futures (including HIBOR futures and Exchange Fund Notes futures). In terms of trading volume, the major products are HSI futures and stock options, contributing 42% and 38% of market trading respectively in 2001.

In the derivatives market, the investor composition varies greatly across products. For stock options where there is market making, principal trading by brokers constituted 83% of total market volume during July 2000 to June 2001. For the regular HSI futures and especially the Mini-HSI futures, local retail trading dominated — constituting 56% and 88% of market volume of the respective product in 2000/01. *(Figure 4)*

Figure 4. Distribution of contract volume in each derivative product by investor type



Note: Products with negligible contribution in terms of contract volume (less than 0.5% in aggregate) are excluded.
Source: DMTS 2000/01

Similar to the case in the cash market, UK and US investors were the major overseas customers in the derivatives market, contributing 39% and 27% of overseas agency trading volume in 2000/01.

The findings indicate that (1) there is plenty of room for increasing retail and institutional participation in the stock options market; and (2) among all products offered, HSI products are the most appealing to retail investors. The success factors of the latter are worth consideration.

Retail Investors

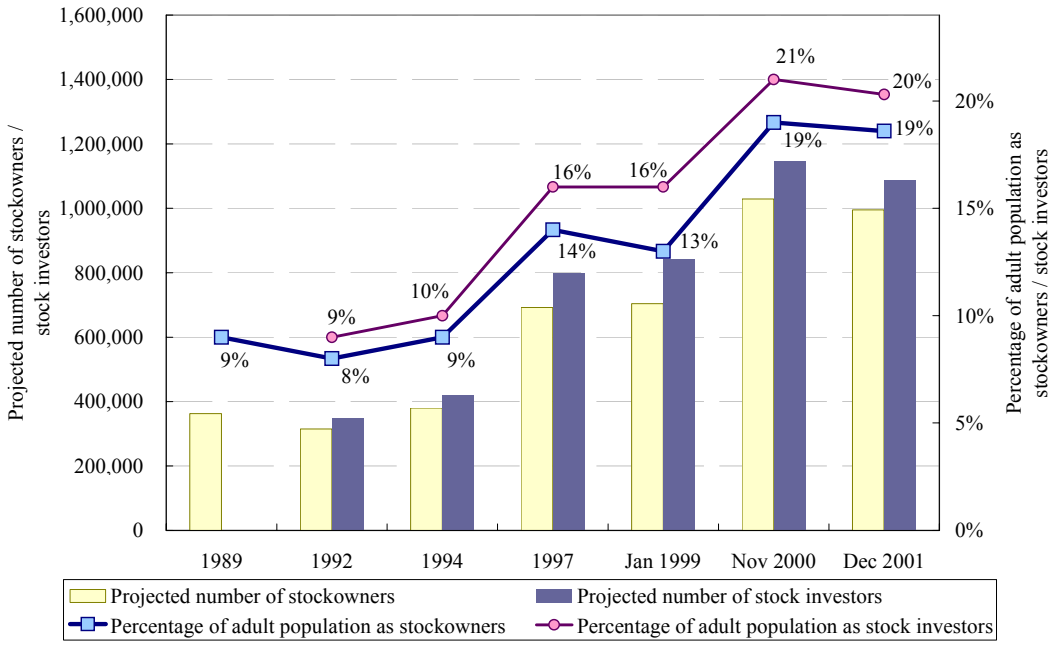
As the major customers in both the stock and the derivatives markets, local retail investors deserve a closer look.

Level of stock investment

It is projected that retail investors[8] in the Hong Kong stock and derivatives markets numbered to 1.1 million in 2001, or 20.6% of the Hong Kong adult population. Retail investors are predominantly stock investors, i.e. individuals investing in the HKEx cash market, who represented 20.3% of the adult population. This is more than double the 9% obtained in 1992. *(Figure 5)*

[8] *An individual who is either a **stock investor** — currently holding or had traded stocks (shares, warrants and ETFs) on HKEx in the past 12 months at the time of the survey interview in December 2001; or a **derivatives investor** — currently holding or had traded derivative products on HKEx in the past 12 months at the time of the survey interview.*

Figure 5. Trend of stock ownership and stock investment among Hong Kong adult population



Source: RIS 1989 – 2001

The proportion of derivatives investors was found to be 5.2% of the adult population in 2001, a significant increase from the 1.5% in 2000.[9] Among these derivatives investors, the majority (95%) were also stock investors (hereinafter referred to as stock-and-derivatives investors).

Among the stock investors, 19% were new stock investors who entered the Hong Kong stock market in the recent two years. Over half of these investors entered the market through subscribing shares of large-scale initial public offerings, such as MTR Corporation.

Among the individuals who did not invest in stocks or derivatives, the major reasons were "no spare money" (chosen by 59% and 49% for stock and derivatives investment respectively) and "insufficient knowledge" (chosen by 39% and 45% for stock and derivatives investment respectively) (multiple answers allowed).

Investor profile

A typical Hong Kong retail stock investor is a 42-year-old professional or manager, with upper-secondary or above education, and with a monthly personal income of about HK$18,750.

Compared to the overall adult population, stock investors comprise more males, with higher education, higher work status, and higher income. Derivatives investors tend to be younger and have higher income than stock investors. *(Figure 6)*

[9] *Since the derivatives participation is low, the statistics obtained from the survey (especially the 2000 survey where the sample of derivatives investors identified was small) would be subject to large possible error.*

Figure 6. Stock and derivatives investor profile

	Adult population	Stock investors	Derivatives investors
Sex: Male/Female	48%/52%	56%/44%	58%/42%
Median age	42	42	37
Education: % upper secondary or above	53%	71%	74%
Occupation: % managers/administrators/ professionals	11%	25%	28%
Median monthly personal income (HK$)	11,250	18,750	22,500

Source: RIS 2001.

Investment behavior

Stock-and-derivatives investors were found to be more active stock traders than a general stock investor. They had shorter stockholding period and higher trading frequency, and were more aggressive in taking risk for higher return. *(Figure 7)*

Figure 7. Stock investment behaviour

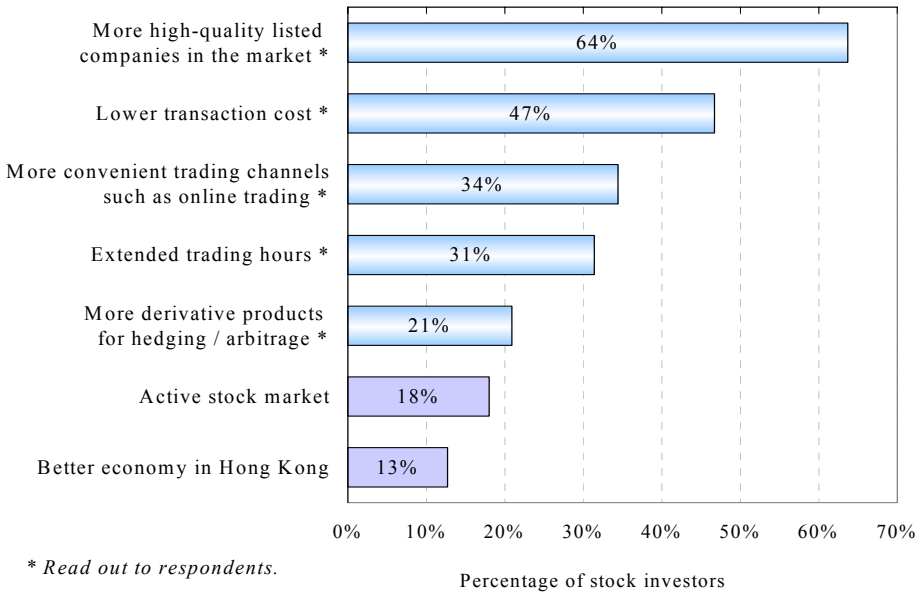
(Median)	Stock investors	Stock-and-derivatives investors
Number of years in stock trading	6	6
Number of listed company shares held*	3	3
Stockholding value* (HK$)	95,000	95,000
Ratio of stockholding value to monthly income*	4.5	5.1
Duration of stockholding (months)	18	9
Number of transactions in past 12 months	3	6
Usual transaction value (HK$)	30,000	30,000
Willingness to take risk for higher return (Mean score on a scale of 0-10: 0 = very conservative, 10 = very aggressive)	4.8	5.3

* *Among stockowners who were holding stocks at the time of the survey.*

Source: RIS 2001.

When asked about what factors would stimulate them to trade more in the HKEx cash market, most stock investors chose "more high-quality listed companies" (64%) which was followed by "lower transaction costs" (47%) and "more convenient trading channels such as online trading" (34%). *(Figure 8)*

Figure 8. Major stimuli for more retail trading in cash market

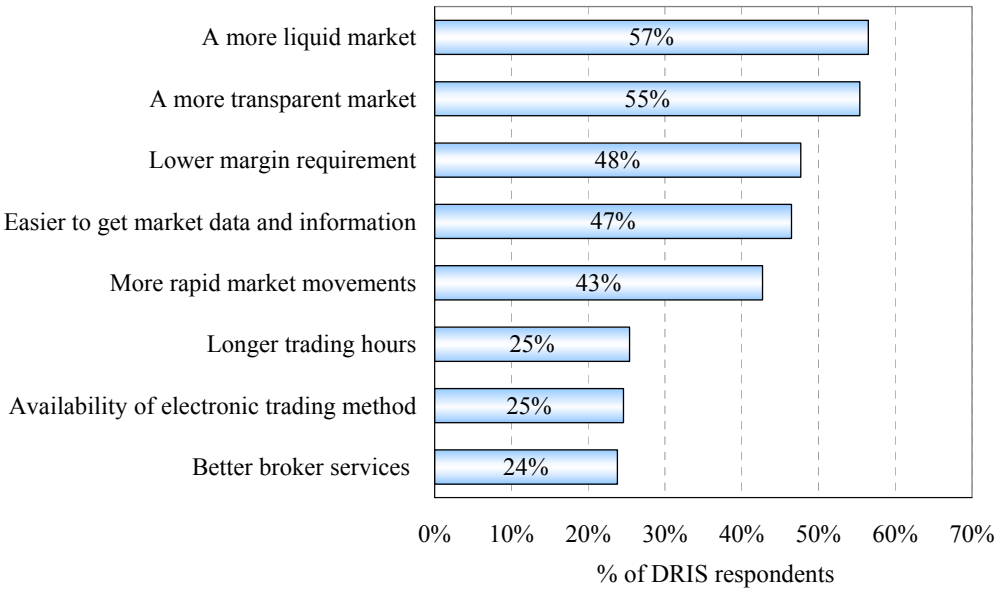


** Read out to respondents.*

Source: RIS 2001

For the derivatives retail investors, the majority (54%) were motivated by their stock investment experience to start trading derivatives. When asked about the stimuli for more derivatives trading, "a more liquid market" and "a more transparent market" were most frequently chosen (57% and 55% respectively). These were followed by "lower margin requirement" (48%), "easier to obtain market data and information" (47%) and "more rapid market movements" (43%). "Availability of electronic trading method" was also frequently chosen, though to a lesser degree (25%). *(Figure 9)*

Figure 9. Major stimuli for more retail trading in derivatives market



Source: DRIS 2000/01

Online trading

As indicated from the above findings, the availability of online trading is one possible stimulus for more stock or derivatives trading. However, the current level of online trading in Hong Kong is still low — 6% of retail stock trading[10] as compared to over 50% of all trading in Korea.

About 18% of retail stock investors and derivatives investors were online traders. Compared to overall stock investors, the online stock traders comprise more males, younger persons, with higher education, higher working status and higher income. They were also more active traders with shorter stockholding period and higher trading frequency, and were more aggressive in taking risk for return. Over one-third of the online stock traders were stock-and-derivatives investors — the proportion is higher than the 24% among all stock investors.

The findings indicate that: (1) higher educated and more affluent individuals are more likely to become investors; (2) efforts to educate potential investors and increase their market knowledge would help to increase investor participation; (3) promotion of derivatives investment might help increase stock trading and vice versa; (4) market quality, including quality of listed companies, liquidity and transparency are important stimuli for investor participation; and (5) the lowering of transaction costs and the promotion of online trading might help increase trading from retail investors.

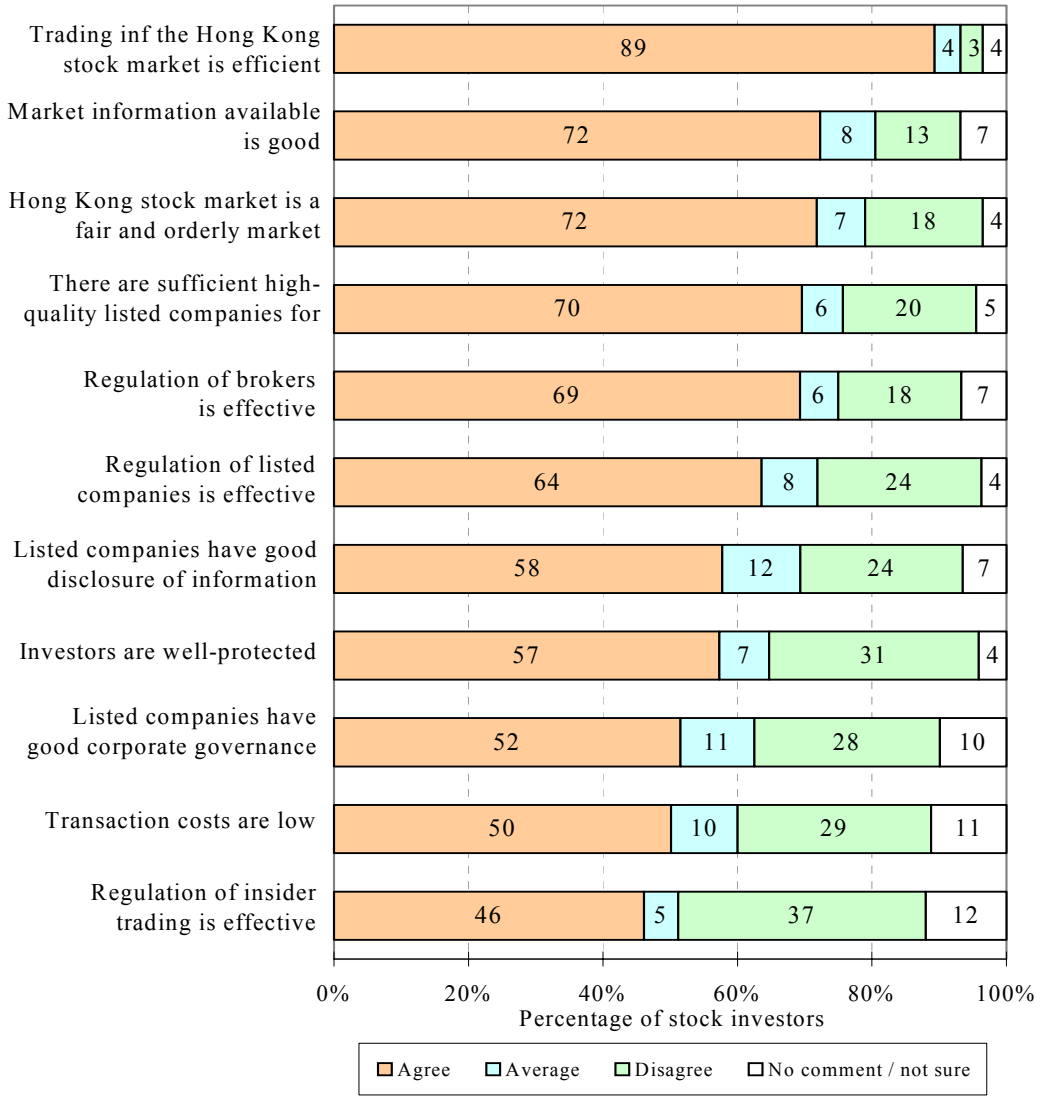
[10] *Source: HKEx Cash Market Transaction Survey 2000/01, covering the period from October 2000 to November 2001.*

Investors' opinions

Retail stock investors

Retail stock investors were very satisfied with the efficiency of stock trading. They were also content with the quality of available market information, and the fairness and orderliness of the stock market. However, there are certain potential areas for increasing investor satisfaction, for example, the regulation of insider trading, corporate governance of listed companies, adequacy of investor protection, and regulation and information disclosure of listed companies. *(Figure 10)*

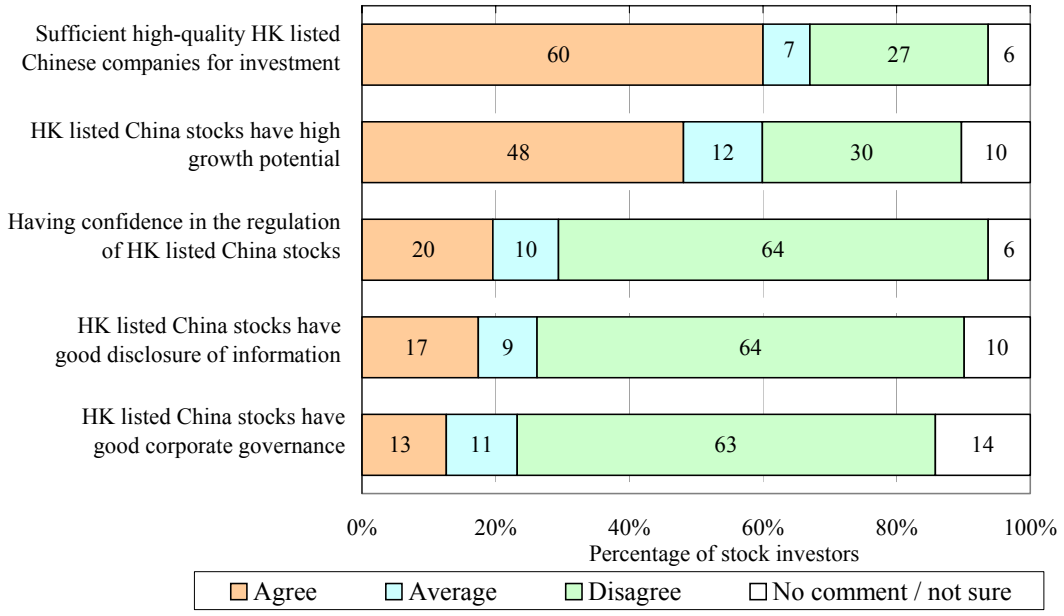
Figure 10. Views of retail stock investors on Hong Kong stock market



Source: RIS 2001

In respect of Hong Kong's major strategic development area of China stocks, the majority of retail stock investors agreed that there are sufficient high-quality Chinese companies listed in Hong Kong for investment and these companies have high growth potential, albeit some had reservation. However, not many of them showed confidence in the regulation of Hong Kong-listed China stocks, their information disclosure and corporate governance. *(Figure 11)* Nevertheless, China stocks listed in Hong Kong, which had a market share of 21% by market capitalisation at the end of May 2002 and contributed over 30% of market turnover in value terms for the first 5 months of 2002, have established considerable investor interest.

Figure 11. Views of retail stock investors on Hong Kong-listed China stocks

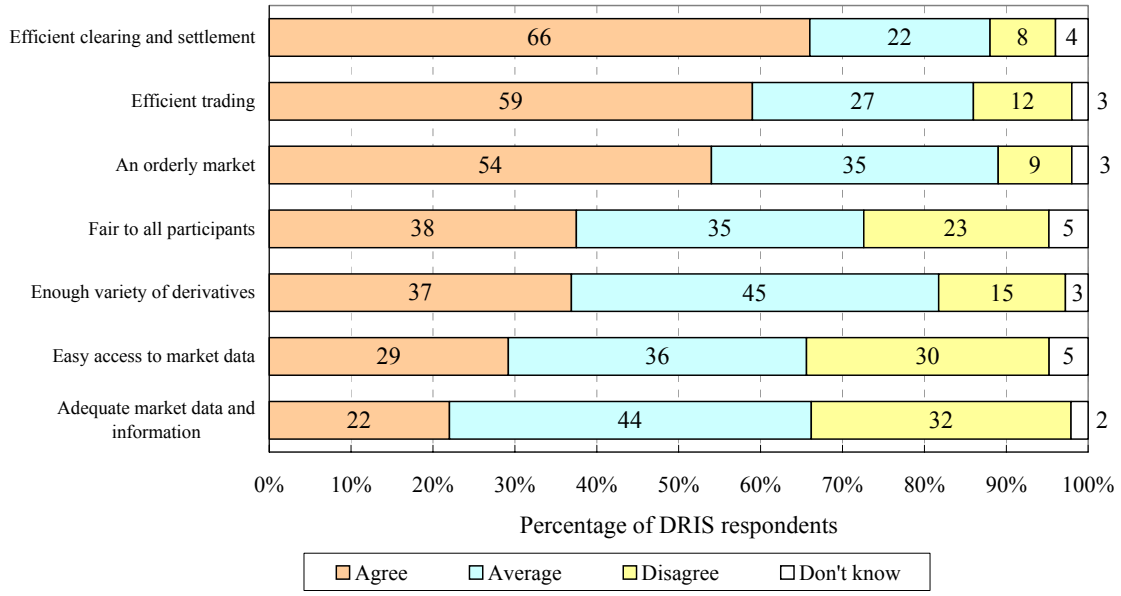


Source: RIS 2001

Retail derivatives investors

Retail derivatives investors were satisfied with the operational efficiency of the HKEx derivatives market and largely perceived that it was an orderly market. However, a certain degree of dissatisfaction was shown in the areas of the adequacy of market data and information and their accessibility. *(Figure 12)*

Figure 12. Views of retail derivatives investors on the derivatives market



Source: DRIS 2000/01

Fund managers

The fund managers were most concerned about the regulatory issues and information disclosure of listed companies. These include effective regulation of insider trading and listed companies on Growth Enterprise Market (GEM) and the Hong Kong-listed Mainland companies, and their information disclosure.

The findings indicate that: (1) effective market regulation is important to raise investor confidence and to increase their participation; (2) improvement in the quality of listed companies — including their corporate governance and information disclosure — will attract investors; (3) improvement in investor confidence in the Hong Kong stock market's China dimension — its major strategic focus — might contribute much more to trading potential.

Implied factors for increasing investor participation

Drawing on the findings of the HKEx surveys, the possible factors that could increase investor participation are analysed in the dimensions of retail and institutional participation in the cash and derivatives markets. These are summarised in Figure 13.

Market conditions

Favourable market sentiment is fundamental to trading activities. This effect is rather strong on retail trading. Market liquidity and volatility are the results of trading activities and are also their drivers. In the derivatives market, for example, investors may see volatility as potential profit opportunity.

Market liquidity could be enhanced by suitable changes to the market structure or systems.

Enhancements such as appropriate short selling regulations and facilitating day trading can be considered.

Costs and services

Institutional investors did not show much concern over transaction costs. Cost is a factor mainly for retail investors whose transaction amount is relatively low and who have little negotiating power. Lower transaction costs might not be able to attract new investors but may be a strong stimulus for investors to trade more — e.g. doing more day trading. Lower cost is also known to be a major attraction of online trading.

The tangible components of the transaction costs — commission and stamp duty — would have room for reduction. A certain degree of positive impact is expected in the market if commission becomes negotiable in 2003. The effect of spread — an intangible component of the transaction cost — on trading activities in Hong Kong would be an interesting area of study.

The promotion of online trading is expected to stimulate more trading activities. Although the survey findings do not indicate the direction of causality, i.e. whether heavy traders tend to become online traders or whether online trading will stimulate investors to trade more, both appear likely. With the convenience and efficiency offered by online trading, there is shorter turnaround time for stock trading. Investors feel more empowered by the information and functions at their disposal, and so may be more willing to trade frequently. The experience in Korea was that online trading stimulated more day-trading and speculative trading, thereby boosting market turnover. However, online trading may be more appealing to the younger generation who are more receptive to, and familiar with, computer technology but who may not currently be the dominant group of retail investors in the Hong Kong market. Possible regulatory concerns over excessive speculation and price volatility should not be overlooked and may require consideration as activity expands.

Online trading is essentially a broker service to retail investors. Other associated broker services will also help attract and retain investors, e.g. product promotion, investment advice, and entertaining investors' inquiries.

Development of investor base

Given the fact that a large proportion of retail non-investors did not enter the market because of lack of knowledge, general market promotion and education appear to be important. Marketing is also important to tap potential overseas institutional markets with currently low participation. The Mainland market, in particular, is a high potential source of both retail and institutional investors. It is likely that institutional investors in the Mainland will be allowed sooner than retail investors to invest in Hong Kong, and that investment in overseas cash markets is more likely to be allowed sooner than investment in overseas financial derivatives markets.

Promotion of retail trading in derivative products other than HSI-related products will also have great potential benefits. In particular, the growth potential of retail participation in the stock options market is expected to be high, given the US experience.[11] Motivation of retail

[11] *Retail investors constituted 44% of the total options contract volume in the US (including Chicago Board Options Exchange, American Stock Exchange, Philadelphia Stock Exchange, Pacific Exchange and International Securities Exchange) in November 2001.*

participation in derivatives is also expected to benefit the stock market as derivatives investors were found to be more active stock traders. Conversely, promotion of stock trading is expected to stimulate derivatives trading as stock investment experience was found to be the major motivation factor for derivatives trading.

Product development

Apart from product quality and variety, the right product for the right people is also important. In the cash market, the listing of large companies with which local people are familiar and high quality companies may attract many new retail investors. In the derivatives market where the products may have greater customer segmentation by nature, careful product design will be needed.

Market quality

Market quality is an essential factor for sustaining investor participation. The major areas with improvement opportunities that are highlighted by the survey findings include: market regulation and protection of investors — regulation of insider trading, listed companies, and primary and secondary market intermediaries; corporate governance and information disclosure of listed companies; and investor confidence in Hong Kong listed China stocks — their regulation, corporate governance and information disclosure.

Figure 13. Implied factors for increasing investor participation

	Retail	Institutional	Cash	Derivatives
Market conditions				
1. Favourable market sentiment	✓✓	✓	✓	✓
2. Liquidity and volatility	✓	✓	✓	✓✓
Costs and services				
3. Lower transaction costs	✓		✓	✓
4. Promotion of online trading	✓		✓	✓
5. Improve broker services	✓		✓	✓
Investor base development				
6. General market promotion & education	✓✓	✓	✓	✓
7. Promotion & education on products other than HSI	✓			✓
8. Cross-motivation of stock and derivatives investment	✓		✓	✓
9. Mainland investors	✓	✓✓	✓✓	✓
Product development				
10. Sufficient good-quality listed companies	✓	✓	✓	
11. Large IPOs of well-known companies	✓		✓	
12. Product diversification to suit investor interest	✓	✓		✓✓
Market quality				
13. Improve market regulation	✓	✓	✓	✓
14. Improve corporate governance and information disclosure of listed companies	✓	✓	✓	
15. Increase investor confidence in China stocks	✓	✓	✓	

Notes:

✓ *Positive impact expected.*

✓✓ *Relatively more positive impact expected than on other market dimensions.*

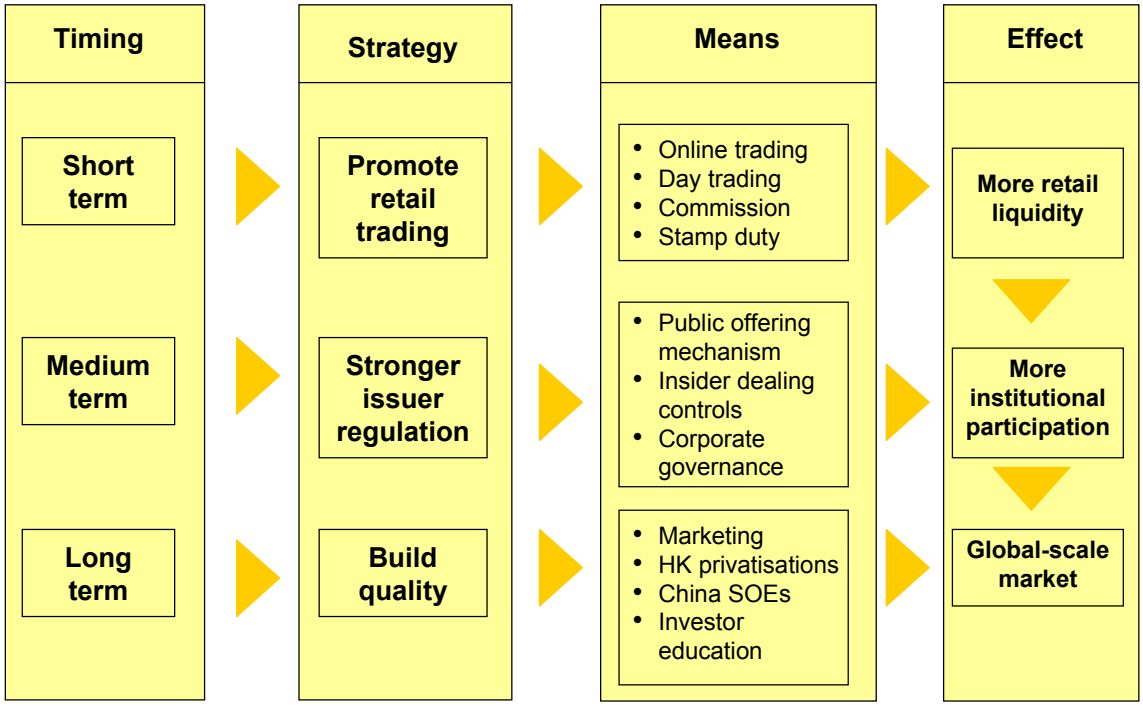
Towards a Possible Strategy

In respect of the market factors controllable by the market operator, HKEx, and the market regulator, the SFC, suitable strategic initiatives can be formulated. These strategic initiatives would have impacts over different time frames and on different market users. Figure 14 depicts a possible strategy for increasing investor participation in the short and long term, thereby bringing the Hong Kong market to a higher world status.

Under this strategy, the lead is taken at the retail level. More retail participation is promoted by initiatives such as online trading, facilities for day trading and lowering transaction costs. This is expected to have a quick result in the short term. Increasing institutional participation would require more fundamental changes in the institutional setup of the market, especially the

regulation of the issuers and their corporate governance. An improved regulatory environment in the medium term will attract more institutional participation. In the long run, market quality in all dimensions — issuers, regulation, market systems, investor base, intermediaries — will have to be improved in order to build up a global-scale market with world reputation.

Figure 14. Towards a possible strategy



Conclusion

Growing investor participation in the Hong Kong market is a long term process in which the HKEx and the SFC, and even the Government, will have significant roles. Strategic initiatives formulated will have to be implemented with the support of all market participants, including the issuers, investors, brokers, investment banks and other market intermediaries, before fruitful results could be obtained.

ANNEX. THE HKEx SURVEYS

1. **Cash Market Transaction Survey (CMTS)** — An annual survey since 1991 to obtain the distribution of Stock Exchange Participants' trading in the HKEx cash market (formerly the cash market of the Stock Exchange of Hong Kong) in value terms by type of investors.

2. **Derivatives Market Transaction Survey (DMTS)** — An annual survey to obtain the distribution of Futures and Stock Options Exchange Participants' trading in the HKEx derivatives market in volume terms by type of investors. It was formerly carried out since 1994 by the Hong Kong Futures Exchange on its market.

3. **Retail Investor Survey (RIS)** — A survey carried out roughly triennially since 1989 to ascertain retail participation in the Hong Kong securities market, to study their characteristics and investment behaviour, and to obtain retail investors' opinions in the stock market. In the interim period since 1999, an annual omnibus survey is carried out to obtain basic statistics on retail participation.

4. **Derivatives Retail Investor Survey (DRIS)** — A survey conducted for the first time in late 2001 and early 2002 to study the investment behavior and opinions of the retail investors in the Hong Kong derivatives market.

5. **Primary Market Survey (PMS)** — A survey carried out roughly triennially to obtain opinions of listed companies, investment banks and fund managers on the primary market issues in Hong Kong. The first of this kind was conducted in 1991 on listed companies and investment banks.

Latest reports on all of the above surveys are available on HKEx website (http://www.hkex.com.hk/research/cmsurvey.htm).