Down and out

By Liu Yifan | HK EDITION | Updated: 2023-09-29 12:29

Stock market pundits have warned that the number of Hong Kong brokerages putting up the shutters this year may exceed last year's as the market turnover continues to shrink. They say mergers and acquisitions, stamp duty cuts for stock trading, and seeking greener pastures up north or elsewhere may help to turn the tide. Liu Yifan reports from Hong Kong.

Hong Kong's small- and medium-sized brokerages are facing their sternest test in years.

Up to 30 local securities firms have called it a day since the beginning of 2023, aggravating a brutal downdraft last year that has already seen a series of closures, according to Hong Kong Exchanges and Clearing, which runs the city's bourse.

"It was a challenging year in 2022 for the global financial industry, as evidenced by the unprecedented collective price drops in equities, currencies, bonds and commodities," notes William Yeung, deputy chief executive officer of Everbright Securities International.

"This has resulted in risk-off investor appetite affecting the brokerage industry whose business is highly correlated with market sentiment and fluctuations."

For most small- and medium-sized securities firms, their revenue is mainly generated by trading commissions and margin businesses. According to a survey of local brokers by the Hong Kong Securities Association, more than 72 percent suffered losses last year, with 60 percent saying they don't plan to expand further, and more than one-fourth planning to scale down their operations this year.

Their pessimism is in line with the general trend of withering turnover in stock trading, as well as the tepid Initial Public Offering market in the special administrative region.

The benchmark Hang Seng Index has retreated by about 12 percent so far this year, while average daily turnover on the stock market shrank 16 percent year-on-year to HK$115.5 billion ($14.77 billion) in the first six months. The Hong Kong Stock Exchange saw 33 IPOs in the first half of 2023, raising a total of HK$17.9 billion — down from HK$19.7 billion in the same period a year earlier and a fall of more than 90 percent compared with the same period in 2021.

Yeung blames multiple factors, such as fierce competition, the rise of online trading platforms and deeper investor knowledge acquired in recent years, for the dwindling business of conventional brokerage companies.

Besides a shrinking market, the most notable knock-on effect is the widening gap between those who have more and those who have less in the sector. The market share of stock exchange participants in category A, which includes the top 14 brokerages in the city, rose to 66.04 percent in July from 64.3 percent in August last year. In contrast, exchange participants ranking below 65 and which are in category C, saw their share drop to 4.4 percent from 5.21 percent during the same period.

Tom Chan Pak-lam, a director of the Institute of Securities Dealers in Hong Kong, says the increasing market share of leading brokerage firms is detrimental to the development of the local financial market in the long run.

If small- and medium-sized brokerage houses were to be weeded out, it would be at the mercy of giant firms that would dictate the market in terms of trading and pricing, leaving investors to bear the consequences, he warns.

Chan predicts the wave of closures of local brokerages is likely to persist this year, and the number is not expected to be fewer than that of 2022.

Take the initiative

As concerns mount over the shrinking brokerage business that would hurt the SAR's status as a global financial hub, experts say the sector must proactively seek breakthroughs in cross-boundary programs, asset management and international expansion.

Lawmaker Robert Lee Wai-wang, who represents the financial services sector in the Legislative Council, says he believes mergers and acquisitions within the industry would be a solution that would strengthen compliance and operational cost efficiency, and the transformation toward asset management should gain pace.

He sees considerable revenue in the pipeline if the Wealth Management Connect program between the SAR and the Chinese mainland would allow brokers to participate.

Launched in September 2021, the Wealth Management Connect was tailor-made for cross-boundary trading of investment products in the Guangdong-Hong Kong-Macao Greater Bay Area.

"The growth drivers of Hong Kong's brokerage sector include continuing to expand cross-boundary connect programs, such as that in wealth management, and interest-rate swap products. All these will stimulate trading volume and capital flow," Yeung says.

The family office initiative promoted by the SAR government is expected to push asset agglomeration to benefit the city's financial industry, says Yeung, adding that the demand for a greater variety of wealth management products will be generated, creating more investment opportunities.

Meanwhile, some brokerages are moving to greener pastures in Southeast Asia to drive business growth in an emerging market that's supported by optimistic economic growth expectations, and is flagging a better and stable outlook for the next five years. The International Monetary Fund forecasts that emerging markets will see an average annual GDP growth of almost 4 percent from 2023 to 2028.

Among the early birds are Guotai Junan Securities and China Galaxy International Securities, which have seen rapid growth in their operations in Southeast Asia.

"The fact that the stock markets in emerging economies are falling behind their economic growth expectations could be beneficial to their valuation recovery," says Yeung. In addition, a potential pause in US interest-rate hikes is likely to drive capital into emerging markets. "Historically, data show that within six months after the US stopped raising interest rates each time, emerging market bonds often saw decent gains. This deserves investors' attention," he says.

A researcher at Zhongtai Financial International agrees that the key to brokerages' business stability is expanding their global footprints and strengthening synergies in operations across the globe. "Continuous expansion of geographical coverage contributes to the pursuit of risk diversification and the ability to sustain growth," he says.

Cut stamp duty

It's critical for brokerages to take the initiative, but their plight has sparked heated discussions about how the SAR government should act to help the city preserve its status as a financial hub.

Among the much-anticipated moves is whether the government will cut or even waive its stamp duty on stock trading, which has been long criticized by the local financial sector. Hong Kong raised the stamp duty on stock transactions from 0.1 percent to 0.13 percent in August 2021, making the city's exchange one of the most expensive among developed markets.

Thomas Ip Hon-tak, a council member of the Hong Kong Securities and Futures Professionals Association, says brokerages' razor-thin income from commissions has been directly eroded by the levy, and indirectly affected by the consequent lower trading volume.

He urged the government to cut stamp duty as soon as possible, saying the existing stamp duty level has caused an exodus of professionals, which will hurt the government's revenue from salaries tax, and create social burdens.

Describing the reduction of stamp duty as a global trend, Andy Kwan Cheuk-chiu, director of the ACE Centre for Business and Economic Research, says brokerages would see a turnaround after the levy is lowered as more people take to the market and invigorate the growth in commissions. He says a government should not see stamp duty as a major source of revenue, and reinvigorating the market may increase government income.

Hong Kong set up a 13-member task force last month to review the city's listing rules, market structure and trading mechanisms amid growing calls to bring down the stamp duty on stock transactions.

Carlson Tong Ka-shing, the task force's chairman and former chairman of the Securities and Futures Commission, says the team will discuss adjusting the stamp duty on stock trading after reviewing relevant data.

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