

6 OPERATIONAL AND STRUCTURAL ISSUES

KEY FINDINGS

REVENUE AND COSTS

- » Total average industry revenue after commission stood at £20.6 billion in 2017, a 17% increase in nominal terms, likely reflecting the strong asset growth experienced in the second half of 2016. This equates to 28bps of total assets, same as in 2016.
- » Total operating costs in 2017 increased to £14.4 billion. In basis point terms this represents an increase from 19bps to 20bps.
- » Once again costs increased at a higher rate than revenue during 2017, meaning that profitability for the year averaged 30%, down 2 percentage points from 2016.

EMPLOYMENT IN THE ASSET MANAGEMENT INDUSTRY

- » We estimate that the UK asset management industry directly employed 38,000 people at the end of 2017, up by around 1% on the 2016 figure.
- » Jobs in the asset management industry vary by location, with the largest proportion in London being employed in investment management and operations and fund administration being of greater importance in Scotland.
- » Staff in Compliance, Legal and Audit have grown most significantly over the past five years with the proportion of staff employed in these roles more than doubling within this time.

INDUSTRY CONCENTRATION

- » The UK asset management industry remains relatively unconcentrated. Assets managed by the top five and the top ten firms increased slightly from 2016, to 43% and 58% of total assets respectively.
- » The number of small firms, with assets below £15 billion, increased from 84 to 88 in 2017. This is likely to reflect a change in IA membership rather than any industry trend.
- » The median figure for assets managed by IA member firms was similar to 2016, at £10 billion, compared to a mean figure of £50 billion.

ASSET MANAGER OWNERSHIP

- » The proportion of assets run by independent asset managers was at 40%, slightly up from 2016 but almost double the proportion in 2008 (21%).
- » Asset managers that are owned by a UK parent represent 43% of assets under management, down from 58% in 2008. US owned managers represent 46% of assets under management, up from 27% in 2008.

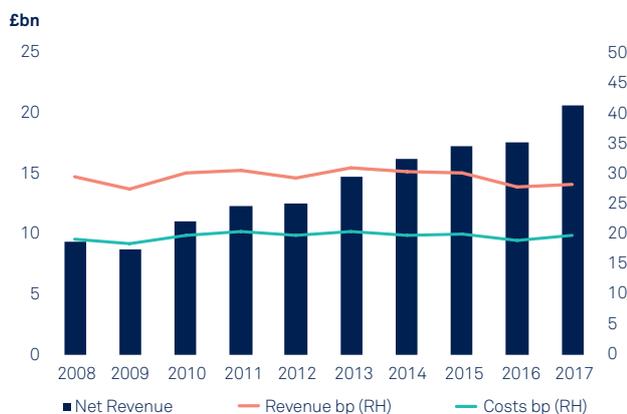
This Chapter focuses on asset managers as firms. It covers three broad themes: industry revenue and profitability, employment and M&A activity.

REVENUE AND COSTS

Chart 78 reports aggregate revenue and cost figures for the industry, covering both in-house and third party business.

- Total average industry revenue after commission stood at £20.6 billion in 2017, a 17% increase in nominal terms, likely reflecting the strong asset growth experienced in the second half of 2016. This equates to 28bps of total assets, equal to 2016.⁶¹
- Total operating costs in 2017 increased to £14.4 billion. In basis point terms this represents an increase from 19bps to 20bps.
- Once again costs increased at a higher rate than revenue during 2017, meaning that profitability for the year averaged 30%, down 2 percentage points from 2016.³
- Viewed over a longer time horizon, average profitability has declined from 35% in 2008.

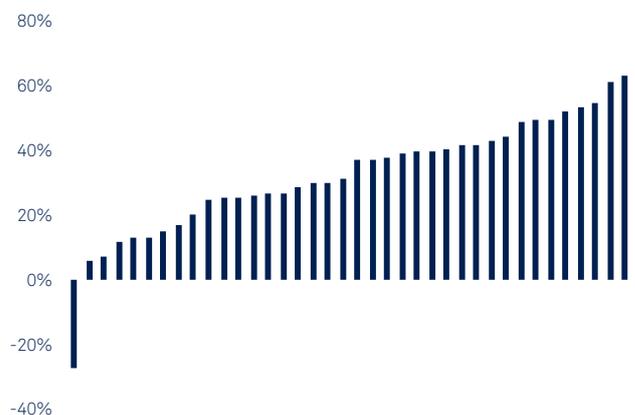
CHART 78: INDUSTRY NET REVENUE VS. REVENUE AND COSTS AS PERCENTAGE OF AVERAGE ASSETS UNDER MANAGEMENT (2008-2017)



The average profitability in any one year does not fully reflect a very diverse operating environment. Chart 79 shows the distribution of profitability of respondent firms in 2017.

Profitability ranged from -27% to 65%, with one quarter of firms having profit margins below 25% and one quarter above 43%.

CHART 79: DISTRIBUTION OF ASSET MANAGER PROFITABILITY



⁶¹ Calculated as net revenue less costs divided by net revenue.

EMPLOYMENT IN THE ASSET MANAGEMENT INDUSTRY

IA data indicates that the UK asset management industry supports just under 100,000 jobs in the UK both directly (38,000) and indirectly (61,200) in fund and wider administration services and securities and commodities dealing activities. The bulk of this resource is concentrated in London and South East England, with a broader regional footprint, particularly seen in a strong Scottish industry.

Figure 13 shows this in more detail. Specifically, IA members have offices across the UK. Locations include: Bristol, Birmingham, Bournemouth, Cardiff, Chester, Chelmsford, Harrogate, Henley, Leeds, Manchester, Norwich, Oxford, Peterborough, Southampton, Swindon and York.⁶²

Beyond this immediate employment base, there are further associated professional groups:

- An estimated 26,000 independent financial advisers in the UK, a proportion of whom are involved in the distribution of asset management services.
- An estimated 61,000 people are employed by FinTech companies in the UK. Only a small proportion of these are likely to be working directly in support of asset management but this is an area of employment that is likely to grow in significance in the coming years.⁶³

FIGURE 13: DIRECT AND INDIRECT EMPLOYMENT IN ASSET MANAGEMENT IN THE UK



Source: IA estimates from information provided by members and publicly sourced information. All regional numbers have been rounded to the nearest 50 and therefore may not add to exact total

⁶² It is difficult to identify jobs associated with asset management among firms that have a remit that extends wider than their asset management support, such as consultants, lawyers and accountants. In addition, a substantial number of roles in areas such as IT are outsourced to third party organisations and cannot be discretely measured. The figures provided below should therefore be viewed as a conservative estimate of those employed in asset management related roles.

⁶³ UK FinTech On the cutting edge An evaluation of the international FinTech sector, EY, 2016

DIRECT EMPLOYMENT

The number of people directly employed in the asset management industry in the UK increased by 1% during 2017, albeit at a slower rate than that seen in recent years. The total reached 38,000 (see Chart 80), representing an overall increase of 29% since 2008

CHART 80: INDUSTRY HEADCOUNT ESTIMATE VS UK ASSETS UNDER MANAGEMENT (2008-2017)



Around three quarters of asset management firms outsource at least some of their staffing to external organisations and so these figures are likely to understate the numbers working to directly support asset management activity.

“THE INVESTMENT MANAGEMENT INDUSTRY IS A SIGNIFICANT EMPLOYER AND A SIGNIFICANT PART OF THE UK FINANCIAL ECOSYSTEM AND THE ECONOMY.”

DISTRIBUTION OF STAFF BY ACTIVITY

Table 5 provides more detail on the number of employees directly employed by asset managers in the UK by function. The breakdown of staff activity was little changed from 2015. The proportion of staff in frontline investment management was up slightly at 25%, but still down from the high of 28% in 2014.

TABLE 5: DISTRIBUTION OF STAFF BY ACTIVITY (DIRECT EMPLOYMENT)

Activity	Percentage of total headcount
Investment Management of which	25%
Investment management (asset allocation and stock selection)	69%
Research, analysis	24%
Dealing	7%
Operations and Fund Administration of which	20%
Investment transaction processing, settlement, asset servicing	35%
Investment accounting, performance measurement, client reporting	40%
Other fund administration (incl. CIS transfer agency, ISA administration etc.)	25%
Business Development and Client Services of which	21%
Marketing, sales, business development	69%
Client services	31%
Compliance, Legal and Audit of which	8%
Compliance	34%
Risk	36%
Legal	22%
Internal audit	7%
Corporate Finance and Corporate Administration of which	11%
Corporate finance	40%
HR, training	25%
Other corporate administration	35%
IT Systems	12%
Other Sector	4%

Over the longer term some trends in staffing levels do emerge. On a like-for-like basis over the last five years, Chart 81 and Table 6 show the following changes:

- Investment management accounts for a slightly smaller proportion of total employment (25% from 27% in 2012), although overall numbers have risen.
- Operations and fund administration roles have also seen a two percentage point fall (18%). Again, overall numbers have grown.
- In stark contrast, the levels of staffing in compliance, legal and audit have increased by three percentage points. In absolute terms, the number of people employed have more than doubled since 2012. (see Table 6).

CHART 81: DIRECT EMPLOYMENT BY STAFF SEGMENT (2012-2017)

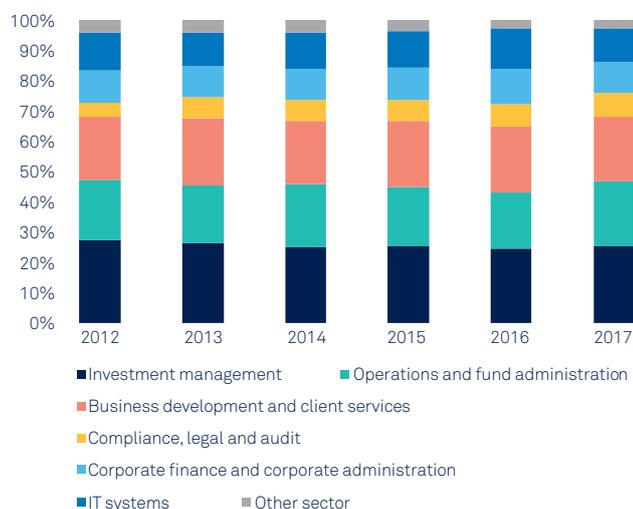


TABLE 6: ESTIMATED NUMBERS OF STAFF EMPLOYED BY ACTIVITY (DIRECT EMPLOYMENT)

	2012	2013	2014	2015	2016	2017
Investment management	8,300	8,300	8,700	9,300	9,300	9,600
Operations and fund administration	6,200	6,000	7,400	7,300	7,000	8,200
Business development and client services	6,400	7,200	7,400	8,000	8,200	8,100
Compliance, legal and audit	1,400	2,100	2,400	2,600	2,700	2,900
Corporate finance and corporate administration	3,300	3,300	3,500	4,000	800	3,800
IT systems	3,900	3,600	4,200	4,500	4,500	4,300
Other sector	1,400	1,400	1,600	1,300	5,200	1,000

Table 7 shows that the type of activity undertaken in different locations differs widely:

- London is the main centre of asset management activity and business development.
- Operations activities and finance are more important outside of London. There is a marked contrast with Scotland in this regard, also seen in IT roles.

TABLE 7: DISTRIBUTION OF ASSET MANAGEMENT JOBS BY REGION

	London	Scotland	Elsewhere in the UK
Investment Management of which	28%	20%	12%
Investment management (asset allocation and stock selection)	67%	75%	86%
Research, analysis	26%	18%	13%
Dealing	7%	7%	1%
Operations and Fund Administration of which	16%	29%	34%
Investment transaction processing, settlement, asset servicing	44%	17%	22%
Investment accounting, performance measurement, client reporting	39%	53%	21%
Other fund administration (incl. CIS transfer agency, ISA administration etc.)	17%	29%	57%
Business Development and Client Services of which	22%	15%	19%
Marketing, sales, business development	72%	56%	79%
Client services	28%	44%	21%
Compliance, Legal and Audit of which	9%	6%	9%
Compliance	35%	31%	42%
Risk	34%	45%	40%
Legal	25%	16%	12%
Internal audit	7%	8%	5%
Corporate Finance and Corporate Administration of which	10%	12%	13%
Corporate finance	37%	47%	50%
HR, training	26%	26%	11%
Other corporate administration	37%	27%	39%
IT Systems	10%	16%	11%
Other	5%	2%	2%

INDUSTRY CONCENTRATION

Chart 82 illustrates that the asset management industry in the UK continues to comprise a small number of very large firms but a long tail of medium- and small-sized organisations.

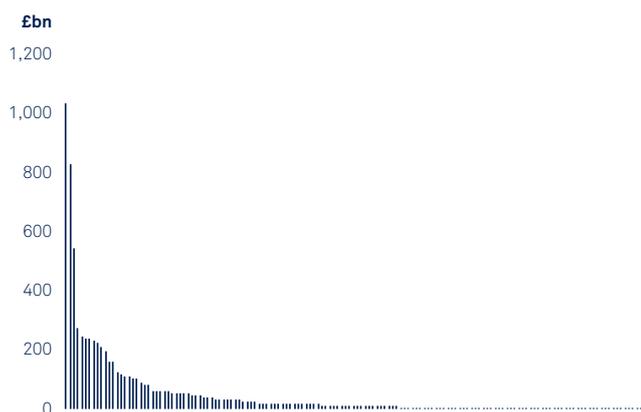
This has historically been the pattern within an industry that has been characterised by a diversity of operating models and comparatively low barriers to entry. As discussed in Chapter 2, there is an expectation that in the future the industry may well see greater focus on larger managers. These would be able to use scale to their advantage and offer a full suite of investment products and perhaps even operate via a more vertically integrated business model, alongside a range of boutique managers offering specialist expertise (see page 92).

“THE MARKET WILL CONTINUE TO BECOME POLARISED. YOU ARE STILL GOING TO HAVE ALL THE SMALL BOUTIQUES AT ONE END, BUT IT’S THE MIDDLE GROUND WHERE YOU ARE GOING TO SEE FEWER AND FEWER PLAYERS AS THEY JUST WON’T BE ABLE TO COMPETE.”

AVERAGE ASSETS UNDER MANAGEMENT AT JUNE 2017



CHART 82: IA MEMBER FIRMS RANKED BY UK ASSETS UNDER MANAGEMENT (JUNE 2017)



This expectation seems to be confirmed by what we observe in the distribution of member firms by the level of assets they have under management. Looking at the data for the last five years there has been a steady increase in the number of large firms with more than £100 billion under management (see Table 8).

Continuing M&A activity among asset management firms is entirely consistent with the increase in the number of larger firms that is evident from IA data (see Table 8).

At the same time, the number of firms with under £1 billion under management has also increased quite significantly. Although there have been anecdotal concerns around barriers to entry in recent years, some amongst those interviewed pointed out the continued activity in this space.

“THERE IS STILL ROOM FOR SMALL BOUTIQUE FIRMS, PROVIDED THEY ARE NIMBLE AND HAVE A LOW COST BASE.”



There was no particular concern that the hurdles for entering the market would restrict the setup of new boutiques as the process for boutique creation was seen to be a natural product of the talent-based focus of the investment management industry. Successful portfolio managers building a reputation with larger firms but then desiring more control over their own investment strategies was expected to continue.

TABLE 8: ASSETS MANAGED IN THE UK BY IA MEMBERS BY FIRM SIZE

AUM	No. of firms (June 2017)	No. of firms (June 2016)	No. of firms (June 2015)	No. of firms (June 2014)	No. of firms (June 2013)
>£100bn	18	15	13	11	12
£50-100bn	13	13	14	14	15
£25-50bn	14	15	13	14	13
£15-25bn	14	11	13	14	14
£1-15bn	69	70	68	70	69
<£1bn	19	14	15	22	18
Total	147	138	136	145	141

“THE REGULATORY ENVIRONMENT IS TOUGHER BUT WHERE SOMEBODY CREATES SOMETHING INTERESTING, DIFFERENTIATED AND INNOVATIVE, AND THEY HAVE PERFORMANCE, THEY’LL FIND BACKING TO BE ABLE TO BUILD THE BUSINESS.”



Another explanation for the growth in smaller firms could be that it partly reflects an expansion of IA membership among small firms. This category accounts for 50% of the increase in IA members between June 2016 and June 2017.

Nevertheless the UK asset management industry remains relatively unconcentrated. The five largest firms represent 43% of assets, up three percentage points from 2016, and the ten largest firms represent 58% of industry assets, slightly up from 2016, largely as a result of merger and acquisition activity. A figure of less than 1,000 on the Herfindahl-Hirschmann Index, a standard measure of competition, represents low concentration. The value for the asset management industry stands at just above 500 (see Chart 83)

CHART 83: MARKET SHARE OF LARGEST FIRMS BY UK ASSETS UNDER MANAGEMENT VS. HHI (JUNE 2008-2017)



Chart 84 shows the ten largest firms in the UK, measured by UK assets under management supplied to the IA in response to the Survey questionnaire. The top ten includes a mix of active and passive managers. There is also a wide variety of group types in the top ten, including independent asset managers, as well as managers that are part of a larger insurance group, or bank. Unsurprisingly, with institutional clients representing around 80% of assets under management in the UK, the assets of the top ten managers are dominated by institutional client assets.

As the difference between UK and global assets shows, a number of the largest asset managers are primarily UK focused, whereas others have a much wider global footprint

CHART 84: TOP TEN FIRMS BY UK-MANAGED AND GLOBAL ASSETS UNDER MANAGEMENT⁶⁴



⁶⁴ Assets under management figures may reflect the value of wider economic exposure managed for clients in addition to securities within segregated or pooled portfolios.

ASSET MANAGER OWNERSHIP

Compared to a decade ago, significantly more assets are managed in the UK by organisations headquartered overseas, especially in the US. This has changed from 41% in 2008 to 57% in 2017. Despite the ongoing high levels of merger and acquisition activity, Chart 85 shows there has been little change on the geographic breakdown of ownership in the last three years:

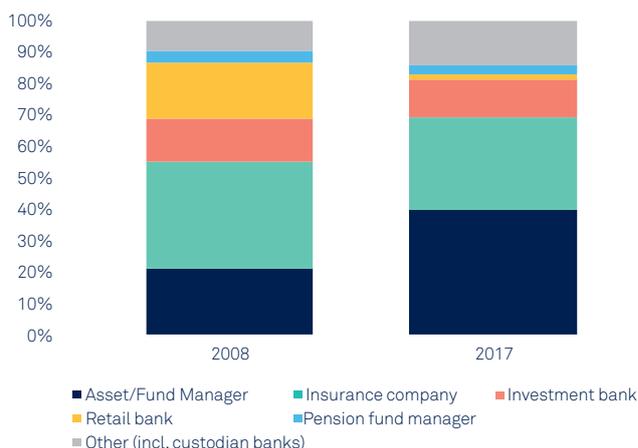
- UK-owned asset managers now account for 43% of assets managed in the UK.
- The proportion of assets managed in the UK for US-owned asset managers stands at 46%.
- Assets managed by European-owned firms remain at a relatively low proportion of total assets managed in the UK, at around 9%.

CHART 85: ASSETS UNDER MANAGEMENT BY REGION OF PARENT GROUP HEADQUARTERS (2008-2017)



At the same time, a structural shift has occurred in the ownership of asset management companies. Chart 86 illustrates the number of independent asset managers now stands at 40%, which is similar to 2015 but markedly up from 18% ten years ago. This relates to the M&A activity discussed in more detail in Chapter Two

CHART 86: BREAKDOWN OF UK ASSETS UNDER MANAGEMENT BY PARENT TYPE (2008-2017)



BOUTIQUES

The IA membership contains a number of boutique managers. The definition of a boutique firm is not based purely on the size of the firm. There are four broad criteria:

- Being independently owned
- Managing assets of less than £5.5 billion⁶⁵
- Providing a degree of investment specialisation
- Self definition.

According to these criteria the number of boutiques within the IA membership increased from 21 in 2016 to 22 in 2017. Although the number of firms remained almost unchanged the individual firms categorised as boutique changed due to two main influencing factors:

- Some boutique firms increased in size such that they no longer classified.
- The membership of the IA increased during 2017 and a number of new IA members fell into the boutique category.

⁶⁵ Increased after 2013 from £5bn in line with overall asset growth.