The contribution of asset management to the UK economy: executive summary

Prepared for
The Investment Association

July 2016

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Executive summary

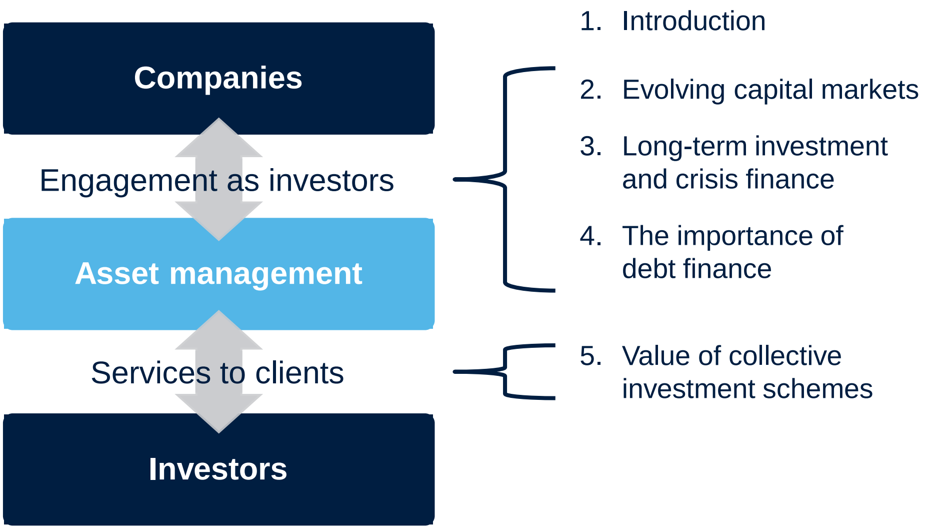
Asset managers are responsible for managing assets for pensions, insurance and other long-term savings products. With over £5trn of assets under management in the UK, asset management makes up a large part of the capital markets.[1] Asset managers also generate significant net exports for the UK, as some £2.2trn of these assets are managed for overseas investors.[2]

Much of the academic and public debate about asset management has focused on the size of the industry, in terms of gross value added or number of employees, or its performance relative to the market average.[3] There has been less focus on the role that asset management plays in channelling new capital to public and private companies. It is the connection between this underlying investment and the services to clients that makes the asset management industry an important intermediary in the financial system, with implications for both growth within the economy and returns to millions of savers and investors. There is therefore a need for a better understanding of the role that asset management plays in primary markets.

The Investment Association (IA) commissioned Oxera to assess the contribution of asset management services to the UK economy. In particular, Oxera was asked to consider how the activities of professional asset managers contribute both to the efficient allocation of capital and to the efficient pooling of savings on behalf of savers and investors.

Supported by quantitative and qualitative findings, this study explores the role of asset managers through the savings and investment value chain, as summarised in the figure below.

Structure of the report in terms of the relationships between companies, asset managers and investors



Source: Oxera.

[1] Total assets under management in the UK grew from just over £2trn in 2003 to some £5.5trn at the end of 2014, which is over three times UK GDP. See The Investment Association (2015), 'Asset Management in the UK 2014-2015: The Investment Association Annual Survey', September.
[2] The asset management sector contributes a net £5.2bn to the UK's trade balance.
[3] For example, compared with a market index, which represents a frictionless benchmark without any transaction costs.

Asset managers and funding of the UK economy

The report contains the following five **key messages** about asset managers and economic funding.

1. **Capital allocation**. The capital allocation function of asset management firms is a significant facilitator of UK company funding, and thereby contributes to long-term productivity growth. This capability is broad, extends across multiple asset classes and funding structures, and supplies funds over the economic cycle.

   The study finds that asset managers are responsible for purchasing the majority of new corporate bond issues in the UK (around 60–70% of total issuance in recent years), and are a significant source of equity capital for IPOs (around 40% of total issuance), rights issues and placings (representing around half of the total capital). This funding contribution in equity markets is in excess of overall ownership, which stands at around a third of domestic market capitalisation.

2. **Long-term holding periods**. Successful capital allocation is facilitated by the potential for long-term holdings, which allows for long-term engagement with companies.

   Asset managers (including those using both active and passive investment strategies) hold UK equities for around six years on average, which is longer than their own clients hold investments in pooled funds (around five years on average).

3. **Stewardship and role in crisis finance**. Research in this area has focused increasingly on the role of asset managers in stewardship and engagement. This study adds another perspective, by showing how long-term relationships can facilitate the supply of new finance. It reviews one period in particular: the significant issuance of shares in the form of rights issues in 2009 in response to the financial crisis (and, in particular, the contraction in bank lending).

   In 2009, around £80bn was raised through rights issues and share placings, most of which was used to reduce leverage. The case studies described in this report illustrate the role that asset managers played in response to the challenging market conditions.

4. **Shift to debt finance**. The role of asset managers is frequently seen through the lens of the equity-dominated cycle of the 1980s to 1990s, whereas in recent years the role of asset managers as debt investors has become more important in the context of the changing landscape of capital markets. This has helped companies to maintain access to new capital and to reduce their cost of capital by switching from bank lending to cheaper bond financing.

From 2009 to 2013, total net bond issuance was £64bn, which is approximately equal to the contraction in net bank lending over roughly the same period. As bond yields fell relative to bank lending rates, the shift was estimated to be worth approximately £1bn annually for the companies that switched to bond finance from 2009 to 2013. Such a reduction in the cost of debt is estimated to have reduced the overall weighted average cost of capital (WACC) by approximately 30 basis points.

5. **Diverse financing channels**. This investment in debt extends beyond public corporate debt markets to alternative forms of debt finance and through a variety of infrastructure projects, including social housing.

Private placements of debt by UK companies grew significantly over the five years to 2014, to £7bn. There has also been significant growth in infrastructure investment and, in 2014–15, capital markets accounted for approximately 60% of the £6.8bn of new funding secured by housing associations.

Benefits for investors

The report contains three **key messages** about asset managers and their benefits for investors.

1. **Widespread exposure to asset management**. The majority of UK households draw on asset management services in some form or another, which includes their provision of investment vehicles, portfolio diversification, and access to a wide range of asset classes and investment strategies. While much of the debate on the benefits of asset management has focused on the financial performance of funds relative to a set of standard benchmarks, this study explores the economic value of the fundamental functions of asset management services.

Approximately 75% of households have occupational or personal pension wealth (which will typically involve asset management), and around 14% of gross household financial wealth is held in retail investment funds, compared with only 9% of wealth held directly in UK shares (without the involvement of an asset manager).

2. **Access to asset classes and diversification of risk**. Investment vehicles run by asset managers, pooled and segregated, provide portfolio diversification. However, for individuals investing directly in capital markets without the use of asset management services, this is often not the case. Asset managers also provide access to a broad range of asset classes, including overseas equities, fixed income, property, and commodity-based investments, where it would be costly or not feasible for an individual investor to build a diversified portfolio.

   Diversification across asset classes is estimated to reduce portfolio volatility by between 11% and 23% compared with a portfolio confined to one asset class. Diversification within asset classes also delivers benefits to investors, as many individuals investing directly in shares fail to diversify their portfolios. Patterns of individual share ownership observed in the USA suggest that the average portfolio exhibits volatility some 32% higher than a well-diversified portfolio.

3. **Economies of scale**. The core aggregation function provided by asset management products—whether index-tracking or more actively managed—delivers economies of scale to UK savers and investors even before the costs of the time and skill required to build a diversified portfolio are considered.

   Based on an illustration of building a domestic large cap equity portfolio, a one-off investment of greater than £50,000 is required before an individual retail investor can efficiently construct their own portfolio without asset management services. Such an investment is greater than most would invest in a single asset class, and this estimate takes no account of the time and skill required to construct a diversified portfolio, nor the accessibility of other asset classes.

These significant benefits partly explain the wide use of collective schemes administered by asset managers, along with more traditional institutions such as occupational pension schemes.

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