

6 OPERATIONAL AND STRUCTURAL ISSUES

KEY FINDINGS

REVENUE AND COSTS

- » Total average industry revenue after commission stood at £21 billion in 2018, a 2% increase in nominal terms. This equates to 27 basis points (bps), from 28bps in 2017.
- » Total operating costs in 2018 increased 4% to £15 billion. In basis point this is almost unchanged from last year at 19bps.
- » Consistent with findings in recent years, costs increased at a higher rate than revenue during 2018. As a consequence profitability stood at 29%, down one percentage point on 2017.

INDUSTRY EMPLOYMENT

- » Around 115,000 jobs are supported by the UK investment management industry, either directly or indirectly.
- » The UK investment management industry directly employed an estimated 40,000 people at the end of 2018, up 4% on the 2017 figure.
- » Jobs in the investment 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.

INDUSTRY CONCENTRATION

- » The UK investment management industry remains relatively unconcentrated. Assets managed by the top five and the top ten firms stood at 42% and 57% of total assets respectively. Both were one percentage point lower than 2017.
- » The industry continues to comprise a small number of very large firms but a long tail of medium- and small-sized organisations. The median figure for assets managed by IA member firms was similar to 2017, at £12 billion, compared to a mean figure of £52 billion.

INVESTMENT MANAGER OWNERSHIP

- » Over the past decade the proportion of assets managed by firms owned by a parent headquartered in the US has increased from 27% to 44%.
- » The proportion of assets managed by independent investment managers now stands at 44%, more than double the level in 2008 (21%). This is in large part a reflection of high levels of M&A activity seen in the industry over that period.

This Chapter focuses on investment managers as firms. It covers three broad themes: industry revenue and profitability, employment and broader corporate issues, including changing patterns of ownership and industry concentration levels.

REVENUE AND COSTS

Chart 74 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 £21 billion in 2018, an increase of 2% on the 2017 figure. This represented 27bps of total assets, down 1bp.⁴⁷
- Total operating costs in 2018 rose by 4% to £15 billion. In basis point terms this was almost unchanged from 2017, representing 19bps of total average assets under management.⁴⁸
- Consistent with findings in recent years, costs increased at a higher rate than revenue during 2018. As a consequence, profitability fell to 29%, down from 30% in 2017.
- Viewed over a longer time horizon, average profitability has declined from 35% in 2008.

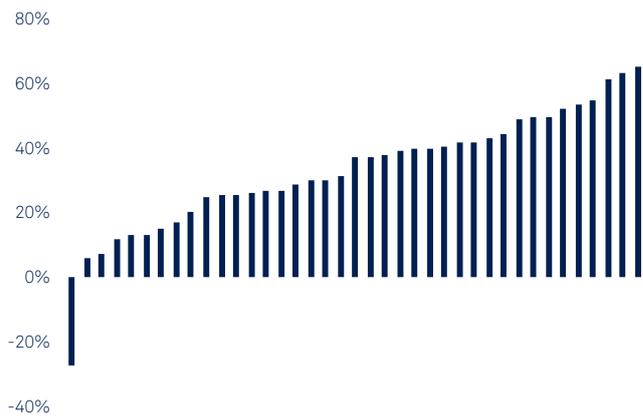
CHART 74: INDUSTRY NET REVENUE VS. REVENUE AND COSTS AS A PERCENTAGE OF AVERAGE ASSETS UNDER MANAGEMENT (2008-2018)⁴⁸



The average profitability figure is a useful measure for monitoring year on year changes in the overall industry. However, investment managers operate in a very diverse environment and profitability varies significantly by individual firm. Chart 75 shows the distribution of profitability of respondent firms in 2018.

Profitability ranged from -28% to 66%, with almost one quarter of firms having profit margins of 20% or lower and one quarter above 46%.

CHART 75: DISTRIBUTION OF INVESTMENT MANAGER PROFITABILITY



Performance-based fees remain a relatively small part of the industry’s fee generation. In 2018 around 9% of assets under management were subject to performance-based fees.

⁴⁷ Calculated as net revenue less costs divided by net revenue.

⁴⁸ Average assets under management are calculated using AUM figures at the beginning and end of each year, reflecting the practice that charges are billed throughout the calendar year.

EMPLOYMENT IN THE INVESTMENT MANAGEMENT INDUSTRY

The IA has been monitoring direct employment numbers in the investment management industry since 2006. In recent years this has been extended to estimate employment in supporting industries such as custodian banks, transfer agents and wealth managers. For the first time this year data also includes those employed in a broader range of the IA's affiliate members, notably legal firms providing services to the investment management industry.

The IA estimates that UK investment management industry supports just over 115,000 jobs in the UK. 40,000 are employed directly by investment management firms. 76,000 are employed in IA affiliate members and in fund and wider administration services, and securities and commodities dealing activities⁴⁹. Given that we have included a broader range of affiliate employment in the indirect category this year, no year on year comparison of total employment can be made.⁵⁰

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, Guildford, Harrogate, Henley, Leeds, Manchester, Norwich, Oxford, Peterborough, Southampton, Swindon and York. In addition a number of firms have offices in other parts of the British Isles, notably the Channel Islands.

Not yet included in the above data, an increasing number of people are employed in Fintech companies providing services to the investment management industry. In October 2018 the IA launched Velocity (www.iavelocity.com), a FinTech Innovation Hub and Accelerator for investment management and capital markets. With an Advisory Panel consisting of 25 industry practitioners and experts Velocity has been created to accelerate the identification and adoption

of new emergent technology across the sector. Over 110 firms are now active within the Velocity ecosystem, operating in over 35 countries and technology-related jobs are likely to become increasingly important in the coming years.

FIGURE 13: DIRECT AND INDIRECT EMPLOYMENT IN INVESTMENT 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

⁴⁹ It is difficult to identify jobs associated with investment management among firms that have a remit that extends wider than their investment 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 investment management related roles.

⁵⁰ Our figures do not include the estimated 26,000 financial advisers in the UK, who provide a distribution point for a wider variety of financial services alongside funds and/or discretionary wealth management (e.g. insurance).

DIRECT EMPLOYMENT

An estimated 40,000 are directly employed by investment managers in the UK. This figure has increased by 4% since the end of 2017.

CHART 76: INDUSTRY HEADCOUNT ESTIMATE VS. UK ASSETS UNDER MANAGEMENT (2008-2018)



The investment management industry involves significant levels of outsourcing, notably in IT. These figures are likely to understate the numbers working to directly support investment management activity.

DISTRIBUTION OF STAFF BY ACTIVITY

Table 10 provides more detail on the number of employees directly employed by investment managers in the UK by function. The breakdown of staff activity was similar to 2017. The proportion of staff in Operations and Business Development fell slightly and those employed in Corporate Finance increased.

TABLE 10: DISTRIBUTION OF STAFF BY ACTIVITY (DIRECT EMPLOYMENT)

Activity	Percentage of total headcount
Investment Management of which	26%
Investment management (asset allocation and stock selection)	63%
Research, analysis	30%
Dealing	7%
Operations and Fund Administration of which	17%
Investment transaction processing, settlement, asset servicing	36%
Investment accounting, performance measurement, client reporting	39%
Other fund administration (incl. CIS transfer agency, ISA administration etc.)	25%
Business Development and Client Services of which	20%
Marketing, sales, business development	68%
Client services	32%
Compliance, Legal and Audit of which	8%
Compliance	37%
Risk	36%
Legal	22%
Internal audit	6%
Corporate Finance and Corporate Administration of which	13%
Corporate finance	37%
HR, training	23%
Other corporate administration	40%
IT Systems	12%
Other Sector	4%

Over the longer term some trends in staffing levels do emerge. Over the last five years, Chart 77 shows the following changes:

- The proportion of people employed in investment management has fluctuated slightly year on year but stands at 26%, down from 28% in 2013.
- Operations and fund administration roles have also fallen slightly over the same period (from 18% to 17%).
- The levels of staffing in Compliance, Legal and Audit and in Corporate Finance and Administration have seen increases of two and three percentage points respectively.

CHART 77: DIRECT EMPLOYMENT BY STAFF SEGMENT (2013-2018)

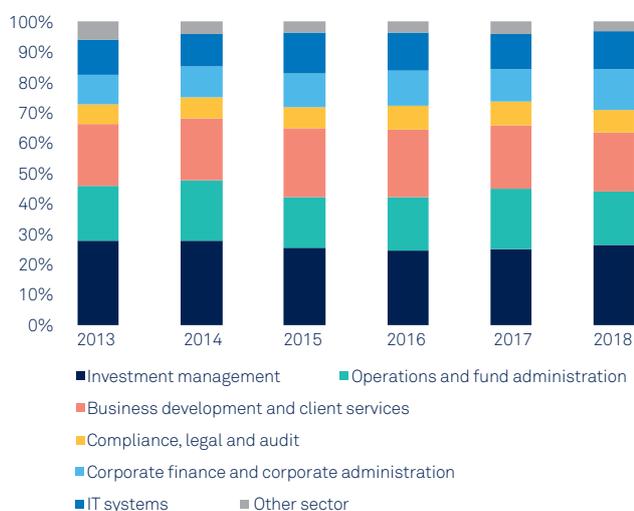


Table 11 shows that the type of activity undertaken in different locations differs widely:

- London is the main centre of investment 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 11: DISTRIBUTION OF INVESTMENT MANAGEMENT JOBS BY REGION

	London	Scotland	Elsewhere in the UK
Investment Management of which	28%	18%	30%
Investment management (asset allocation and stock selection)	64%	57%	65%
Research, analysis	30%	35%	27%
Dealing	7%	8%	8%
Operations and Fund Administration of which	14%	26%	24%
Investment transaction processing, settlement, asset servicing	43%	28%	16%
Investment accounting, performance measurement, client reporting	37%	53%	27%
Other fund administration (incl. CIS transfer agency, ISA administration etc.)	19%	19%	57%
Business Development and Client Services of which	21%	15%	17%
Marketing, sales, business development	72%	46%	81%
Client services	28%	54%	19%
Compliance, Legal and Audit of which	8%	6%	8%
Compliance	35%	43%	35%
Risk	37%	31%	35%
Legal	22%	20%	25%
Internal audit	6%	6%	5%
Corporate Finance and Corporate Administration of which	13%	15%	10%
Corporate finance	35%	38%	52%
HR, training	24%	26%	12%
Other corporate administration	41%	36%	36%
IT Systems	12%	17%	9%
Other	4%	3%	1%

INDUSTRY CONCENTRATION

Chart 78 illustrates that the investment 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 is evidenced by the difference between the mean value of assets under management by an IA member firm and the median. The median value of assets under management stands at £12 billion of assets but the mean value is much higher because of the relatively small number of members with large volumes of assets under management.

AVERAGE ASSETS UNDER MANAGEMENT AT JUNE 2018

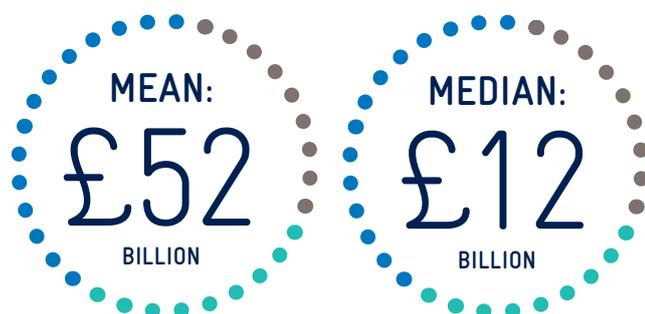
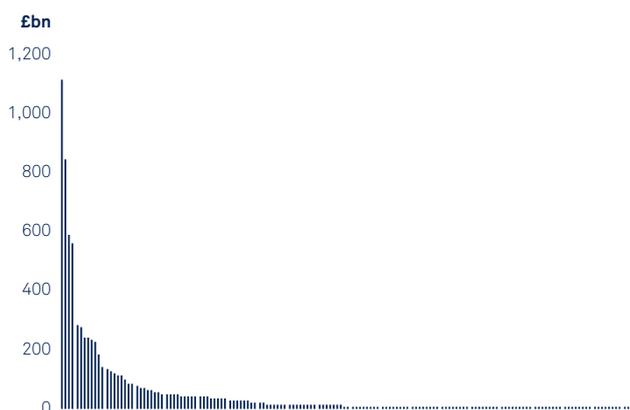


CHART 78: IA MEMBER FIRMS RANKED BY UK ASSETS UNDER MANAGEMENT (JUNE 2018)



Looking at how the distribution of assets under management has changed over time there has been a steady increase in the number of the largest firms with more than £100 billion under management (see Table 12). This is consistent with level of merger and acquisition activity that has been seen in the industry in recent times (see Appendix 4).

2018 saw a decrease in the proportion of firms with less than £1 billion under management. However, at the same time there was a larger increase in firms with between £1 billion and £15 billion and £25-50 billion under management, indicating there is still significant competition and demand for smaller firms, which might be more likely to offer specialist investment services.

TABLE 12: ASSETS MANAGED IN THE UK BY IA MEMBERS BY FIRM SIZE

AUM	Members (June 2013)	Members (June 2014)	No. of firms (June 2015)	No. of firms (June 2016)	No. of firms (June 2017)	No. of firms (June 2018)
>£100bn	9%	8%	10%	11%	12%	12%
£50-100bn	11%	10%	10%	9%	9%	8%
£25-50bn	9%	10%	10%	11%	10%	14%
£15-25bn	10%	10%	10%	8%	10%	8%
£1-15bn	49%	48%	50%	51%	47%	49%
<£1bn	13%	15%	11%	10%	13%	10%
Total	100%	100%	100%	100%	100%	100%

The UK investment management industry remains relatively unconcentrated. The five largest firms represented 42% of assets, down one percentage point from 2017. The ten largest firms represent 57% of industry assets. A figure of less than 1,000 on the Herfindahl-Hirschmann Index, a standard measure of competition, represents low concentration. The value for the investment management industry stands at just 500 (see Chart 79).

CHART 79: MARKET SHARE OF LARGEST FIRMS BY UK ASSETS UNDER MANAGEMENT VS. HHI (JUNE 2008-2018)

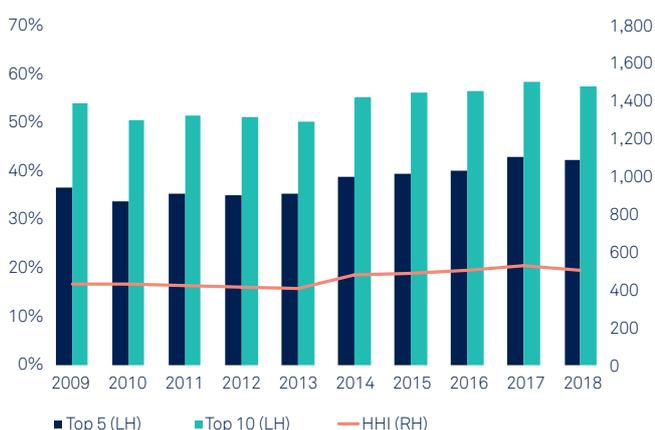
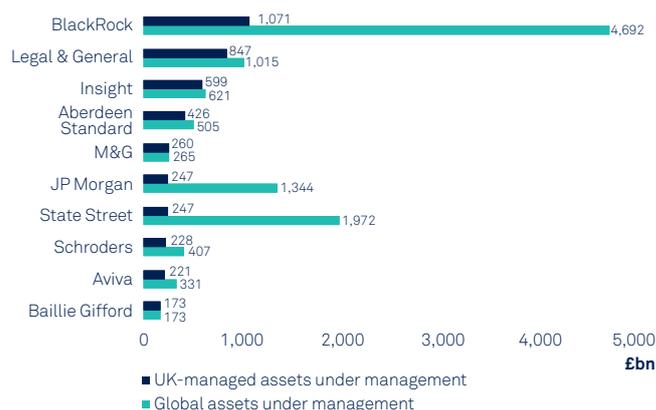


Chart 80 shows the ten largest firms in the UK, measured by UK assets under management supplied to the IA in response to the Survey questionnaire.⁵¹ The top ten includes a mix of active and passive managers. There is also a wide variety of group types in the top ten, including independent investment managers, as well as managers that are part of a larger insurance group, or bank. Unsurprisingly, with institutional clients representing 80% of assets under management the assets of the top ten managers are dominated by institutional assets.

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

CHART 80: TOP TEN FIRMS BY UK-MANAGED AND GLOBAL ASSETS UNDER MANAGEMENT⁵²



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 billion⁵³
- Providing a degree of investment specialisation
- Self definition

According to these criteria the number of boutiques within the IA membership increased from 22 in 2017 to 25 in 2018.

⁵¹ Based on headline data supplied to the IA in response to the Survey questionnaire.

⁵² Assets under management figures may reflect the value of wider economic exposure managed for clients in addition to securities within segregated or pooled portfolios.

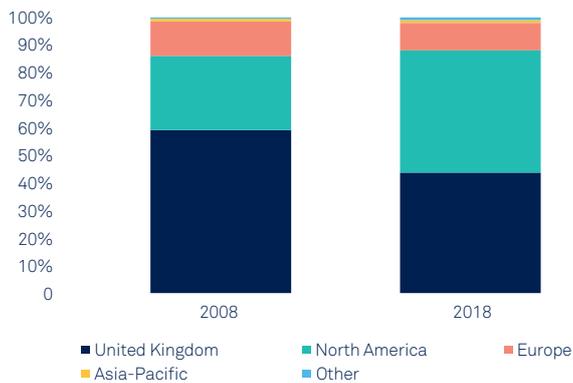
⁵³ Our original definition in 2013 used £5 billion in assets under management. We have increased this threshold in line with overall asset growth.

INVESTMENT MANAGER OWNERSHIP

Over the past decade the biggest shift in ownership of UK investment managers has been the large increase in the proportion of assets managed in the UK by organisations with a headquarters in the US. This proportion has increased from 27% in 2008 to 44% in 2018. However, much of the shift occurred early in the decade and the proportion of US owned firms has remained relatively stable in the past five years.

- UK-owned investment managers now account for 43% of assets managed in the UK, down from 59% in 2008.
- Assets managed by European-owned firms remain at a relatively low proportion of total assets managed in the UK at around 10%. This is down from 13% in 2008.

CHART 81: ASSETS UNDER MANAGEMENT BY REGION OF PARENT GROUP HEADQUARTERS – TEN YEAR COMPARISON



Over the same period, there has been a fundamental shift in the ownership of investment management companies. Chart 82 illustrates the proportion of assets managed by independent investment managers now stands at 44%, more than double the level in 2008 (21%). This is in large part a reflection of high levels of M&A activity seen in the industry (see Appendix 4). Retail banks are now the smallest parent group, representing just 2% of assets.

CHART 82: BREAKDOWN OF UK ASSETS UNDER MANAGEMENT BY PARENT TYPE – TEN YEAR COMPARISON

