6 OPERATIONAL AND STRUCTURAL ISSUES

6

KEY FINDINGS

REVENUE AND COSTS

- Total average net revenue after commission was £25.8 billion in 2021, equivalent to 27 basis points (bps) of total assets under management. This is up from £22.9 billion reported in 2020.
- In 2021, total operating costs were £18.3, equivalent to 19bps of total AUM (up from £16.4 billion the previous year).
- Profitability stood at 28.9% at the end of the year, which is one percentage point up from the previous year.

INDUSTRY EMPLOYMENT

- As of December 2021, the UK's investment management industry employs an estimated 122,000 people, of which 45,000 are directly employed by investment management firms.
- Distribution of staff by activity sees little change year on year, but over the past five years we have seen an increase in the number of jobs in back office and operations (especially in IT systems).
- There has been little change in the regional distribution of those directly employed by the UK investment management industry, with three quarters of people (76%) working in London, 19% in Scotland and the rest (5%) elsewhere in the UK.

INDUSTRY CONCENTRATION

- The industry remains relatively unconcentrated. IA membership continues to consist of a small number of large firms and a long tail of medium and small-sized organisations.
- As of December 2021, the proportion of assets managed by the top five and ten firms account for 44% and 60% of total AUM, respectively, which is a slight (1%) increase on the previous year.
- However, concentration has increased steadily (albeit slowly) over the past ten years. In 2021, the number of boutique investment management firms in the IA membership has dropped down to 12 (down from 15 the previous year).

INVESTMENT MANAGER OWNERSHIP

- The majority (48%) of IA member firms belong to companies headquartered in the US. Over the past ten years the share of UK-headquartered parent companies has dropped to 40%. Meanwhile, the share of companies headquartered in Europe, Asia and elsewhere remains the same.
- There has been little year on year change in the type of parent companies to IA member firms. Standout long-term trends recorded over the past ten years include: a drop in retail banks, an increase in investment fund managers and a decrease in insurance companies.

This chapter looks at the operational and structural dimension of the investment management industry by taking a closer look at the firms that constitute the IA's membership. As a complement to the analysis of trends in asset allocation and client type, this chapter focuses on the following three themes: industry profitability, employment and concentration.

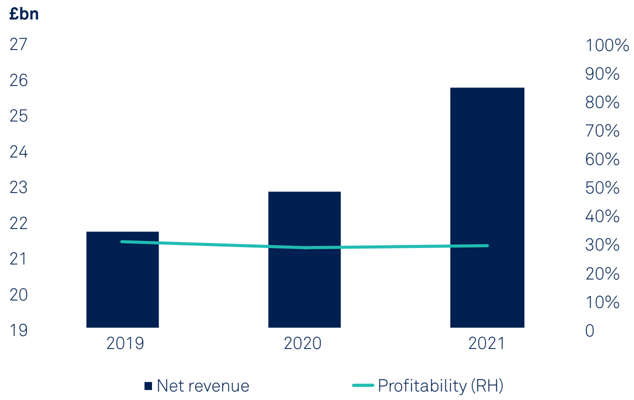
REVENUE AND COSTS

Each year, the IA reports the aggregate revenue and cost figures for the industry, covering both in-house and third-party business.[27] Chart 76 looks at industry net revenue over the last three years. We observe the following:

- In 2021, total average industry revenue stood at £25.8 billion after commission, equivalent to 27 basis points (bps) of total assets under management. This is up from £22.9 billion reported in 2020 (and 26 bps).
- Total operating costs were £18.3 billion, equivalent to 19bps of total AUM, up from £16.4 billion the previous year (and 18 bps).
- Operating margins increased very slightly between 2020 and 2021, from 28.2% to 28.9%.

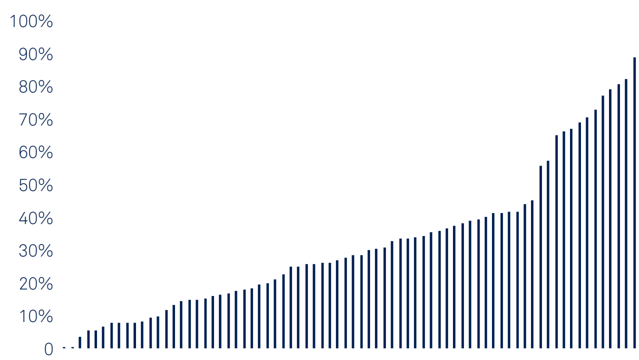
Average profitability in 2021 slightly increased (by less than 1%) on the previous year, reaching 28.9%. Revenue growth outpaced growth in costs, increasing 13% year on year compared with a 12% rise in costs. All IA member firms who participated in this year's Survey recorded profits, whereas some member firms experienced losses in 2020.

CHART 76: INDUSTRY NET REVENUE AND PROFITABILITY (2019-2021)



Average profitability across the industry in any given year can mask great underlying variation in individual firm experience. Chart 77 illustrates the range of profitability across IA member firms in 2021, which ranged from just over 0% to 89%. Our data also show that lower quartile was 15%, meaning that 25% of respondents had operating margins less than 15%. The upper quartile of firms had operating margins above 41%.

CHART 77: DISTRIBUTION OF INVESTMENT MANAGER PROFITABILITY IN 2021



[27] 2021 figures are comparable to figures published for 2020 and 2019, but not to figures of previous years due to a change in methodology. 2019's change in methodology consisted of supporting returns from members with publicly available data obtained from submissions to Companies House (where available).

Revenue has increased year on year for the past ten years, as have operating costs. Meanwhile, profitability has fluctuated between 28% and 38%.

Strong market performance has been a driver of revenue growth over the past ten years. At the same time, however, the scale of regulatory activity and the cost of compliance has been driving up operating costs. As the economic environment becomes more stressed due to market pressures associated with rising inflation and geopolitical turbulence, AUM growth is likely to weaken and early indications for 2022 is that AUM has fallen. As most investment managers charge fees on a percentage of assets basis, revenue growth could slow and we may find a very different picture of industry profitability in coming years.

EMPLOYMENT IN THE INVESTMENT MANAGEMENT INDUSTRY

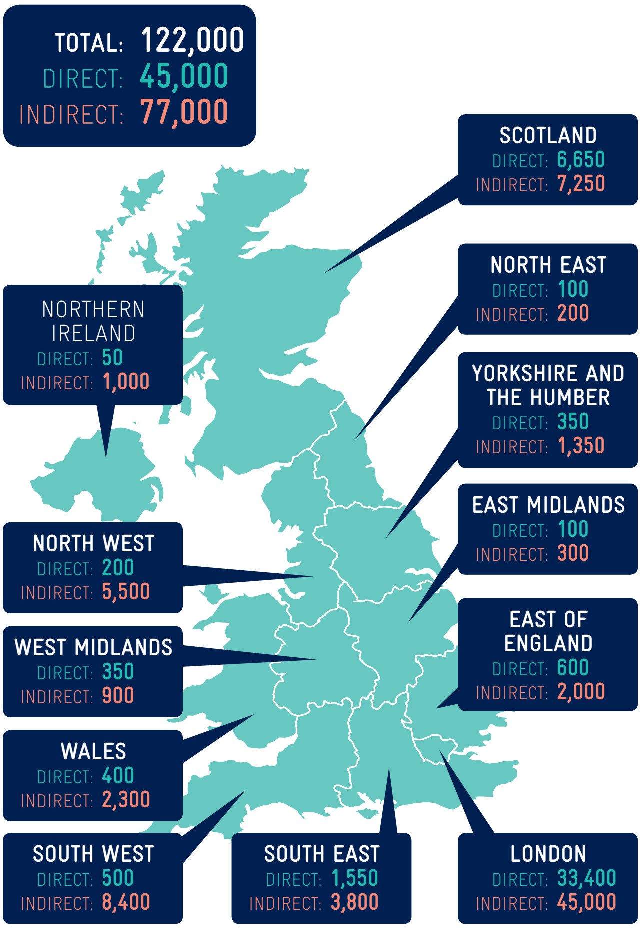
For the past fifteen years, the IA has been tracking direct employment numbers in the investment management industry. In 2006, an "indirect employment" category was introduced to assess the value of the investment management industry more accurately as a source of employment in the UK. Indirect employment includes an estimate of the level of employment in supporting industries such as custodian banks, transfer agents and wealth managers, as well as employment by IA affiliate members – notably legal firms providing services to the industry.

As of December 2021, the UK investment management industry supports approximately 122,000 jobs, of which 45,000 are directly employed by investment management firms and the remainder (77,000) are employed either by affiliate IA members or wider administration services, or in securities and commodities dealing activities.[28]

London continues to be a major centre for the industry in the UK. Followed by the South West and Scotland.

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.[29] In addition, a number of firms have offices in other parts of the British Isles, notably the Channel Islands.

FIGURE 14: MAP OF DIRECTLY AND INDIRECTLY EMPLOYED STAFF ACROSS THE UK IN 2021



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.

[28] 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).

[29] 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.

DIRECT EMPLOYMENT

IA estimates find that just under 45,000 people are directly employed by investment management firms in the UK. This is up on the previous year, when we estimated 42,200 people were employed by the industry. This is equivalent to a 7% increase, a strong year for hiring in the industry. By comparison Since 2014, year on year growth in employment has fluctuated between 1% and 5%. The longer-term trend in industry employment has been one of slow – albeit steady – growth.

Chart 78 illustrates the growth of direct employment alongside total AUM growth for the past fifteen years. Overall, growth in AUM has outpaced the rise in headcount. Between 2008 and 2021, the average year on year growth rate for AUM was 8%, whereas industry headcount grew by 3% on average.

There are a number of reasons why growth in industry employment has been slow over the past fifteen years:

- The Global Financial Crisis (GFC) brought about a severe drop in industry employment, with industry headcount falling by more than 10% between 2007 and 2009. This was followed by a long period of recovery, with near stagnant growth in industry headcount between 2009 and 2013.

- A rise in industry assets does not necessarily lead to a rise in industry headcount. This is particularly true in the indexing strategy space. In order to keep fees low for investors and to maintain a profitable business, indexing firms focus on growing AUM to increase scale but try to keep headcount lean.

- Though a rise in AUM is not necessarily followed by a rise in industry headcount, when AUM falls or stalls it does affect employee growth. In Chart 78 we see that in years where AUM growth is weaker, this often followed by slowing growth in direct employment. This is because profitability is put under strain when AUM growth stalls and firms become increasingly cautious around adding headcount. We see this in the following instances:

  – The 11% drop in AUM between 2007 and 2008 caused by the GFC was followed by a 3% fall in industry headcount between 2007 and 2008, and a further 7% drop between 2008 and 2009.

  – Between 2014-15, AUM grew by just 1% and over the next couple of years industry headcount experienced little growth (increasing by 2% between 2015-16 and by 1% between 2016-17).

  – When growth in AUM stalled between 2017-18, this was followed by a slow down in growth in employment numbers, with industry headcount increasing by a modest 2% between 2018-19 and by 4% between 2019-20.

As AUM looks set to fall in 2022, we expect to see some impact on our employment data..

CHART 78: INDUSTRY HEADCOUNT ESTIMATE VS. UK ASSETS UNDER MANAGEMENT (2007-2021)

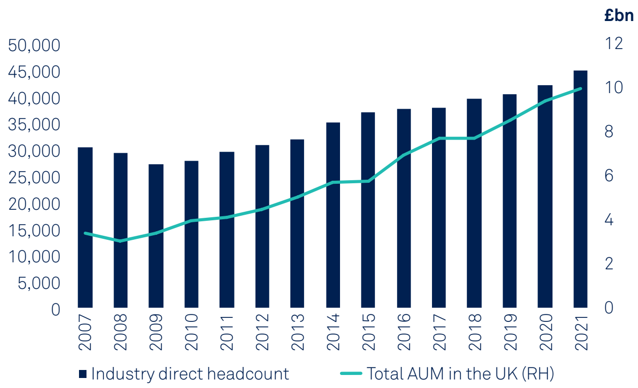


Table 4 provides a breakdown of staff by activity. The largest share (25%) of those directly employed by investment management firms work in investment management, for example as portfolio/fund managers or on product teams. The other three quarters work across the back office in support roles, mainly in operations and fund administration, business development and client services.

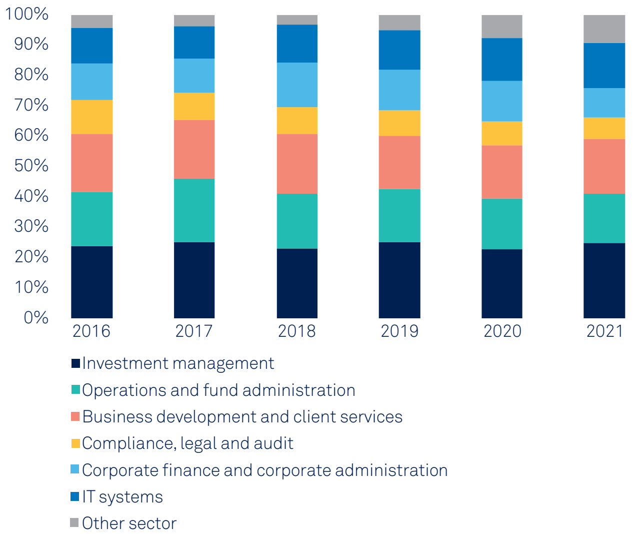
TABLE 4: DISTRIBUTION OF STAFF BY ACTIVITY IN 2021

Activity	Percentage of total headcount
Investment management	26%
Operations and fund administration	16%
Business development and client services	18%
Compliance, legal and audit	7%
Corporate finance and corporate administration	10%
IT systems	15%
Other sector	8%

The distribution of staff by activity sees little change year on year, but looking at Table 4 alongside Chart 79, which illustrates the medium-term trends in employment by activity, it is possible to identify some of the long-term trends in industry staffing.

- Employment in investment management roles has remained stable over the past five years, fluctuating between 23% and 24%. Between 2020 and 2021, staffing levels in investment management roles remained stable at 23%.
- Employment in Operations and Fund Administration has fluctuated between 16% and 21% since 2016. In 2021, 16% of directly employed staff in the industry were working in administration, which is down one percentage point on the previous year.
- The share of staff working in Business Development and Client Services has fluctuated between 17% and 19% over the past five years. In 2021, staffing levels in Business Development and Client Services increased by one percentage point on the previous year, reaching 19%.
- Employment in Compliance, Legal and Audit has generally been decreasing over the past five years, falling from 11% in 2016 to 7% in 2021. This drop is in part due to a slight decrease of staff in these roles in nominal terms, but mainly due to growth in other sectors outpacing growth in compliance, legal and audit roles.
- The share of staff working in Corporate Finance and Administration has fluctuated between 10% and 14% over the past five years. Between 2020 and 2021, there was a step drop from 13% to 10%.
- One of the most notable trends in industry staffing levels has been the rise in employment in IT systems. The share of roles in IT systems has increased from 13% in 2016 to 15% in 2021 as the industry increasingly prioritises embracing technological change (see discussion in chapter 2). We expect headcount in IT systems to continue to rise as some firms will look to develop their tech capacities in-house to boost their competitive edge.
- Staff working in Other sectors have also been on the rise over the past five years, increasing from 4% in 2016 to 10% in 2021. According to our members, a large proportion of these roles are in risk management because of increased regulatory scrutiny. Firms are also increasing headcount in executive and administrative positions. Other sectors also include staff working on stewardship, which has long been an important function for investment management, and sustainability-related activities. Sustainable investing has gained significant traction in recent years as investor appetite has increased and the pace of regulatory change has accelerated. We expect headcount in stewardship and S&RI related roles to continue to rise.

CHART 79: DIRECT EMPLOYMENT STAFF SEGMENT (2016-2021)



Employment in the industry varies by location as well as by staff segment. Between 2020 and 2021, headline employment by region has changed very little. Table 5 provides a breakdown of direct industry employment by location, which also sees little change year on year. A few things to note:

- **London** continues to be the UK's centre for the investment management industry, employing three quarters of people working in the industry (76%) and with the highest concentration of those working as investment managers (27%). Over the past five years, the most important change in the distribution of staff in London has been a decrease in staff working in back-office roles (including operation and fund administration, business development and client services, compliance, legal and audit) from 47% to 39%. By comparison, nearly half of people employed by the industry in Scotland work in these back-office roles (49%).
- **Scotland** continues as the leading centre for operations and fund administration in the UK, with more than a quarter of people directly employed by the industry in Scotland working in operations and fund administration (24%). Many IA members with offices across the UK will locate portfolio management teams in London and support roles in their Scotland offices.
- **Regional** employment (i.e. staff working in investment management outside London and Scotland) varies year on year. For the past five years, the largest increase in regional jobs has fluctuated between investment management and operations and fund administration. We also see a relatively high proportion of regional business development and client services roles, which are likely to cater to financial advisers and discretionary wealth management firms that have a significant presence outside London.

TABLE 5: DISTRIBUTION OF INVESTMENT MANAGEMENT JOBS BY REGION IN 2021

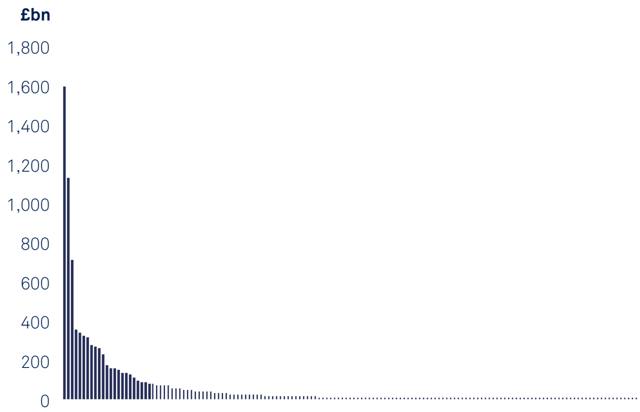
	London	Scotland	Elsewhere in the UK
Investment management	27%	19%	29%
Operations and fund administration	13%	24%	24%
Business development and client services	19%	15%	14%
Compliance, legal and audit	7%	7%	5%
Corporate finance and corporate administration	10%	11%	11%
IT systems	15%	18%	11%
Other sector	9%	6%	7%

6

INDUSTRY CONCENTRATION

Each year, the IA analyses trends in industry concentration, looking at the distribution of investment management firms by AUM. The ranking of IA member firms by total UK-managed assets under management in Chart 80 shows us that, aside from a few large firms, the industry is mainly made up of medium- and small-sized organisations, confirming that the UK investment management industry is still highly competitive.

CHART 80: IA MEMBER FIRMS RANKED BY UK ASSETS UNDER MANAGEMENT (JUNE 2021)



The median value of IA member firms' assets under management stands at £10 billion but the mean value is much higher at £59 billion, which confirms what we see in Chart 80, that there is a relatively small number of members managing large volumes of assets under management. In 2020, the mean value stood at £55 billion and the median value at £11 billion. Between 2020 and 2021, the mean value rose more than the median, which suggests that the largest firms grew assets at a faster rate.

The distribution of firms by size sees little change year-on-year. The general trend between 2020 and 2021 was an increase in the share of large firms and small firms, and a narrowing in the share of medium-sized firms. This is in large part due to M&A activity which brought a number of firms up from medium to large-sized. Furthermore, as the industry grows and the value of assets under management continue to appreciate, it is expected that more firms will move up the scale. It is conceivable that in coming years, a firm managing between £15 billion and £25 billion will be considered small, for example.

Table 6 offers a breakdown of IA member firms by size. In the analysis, we have grouped firms into small firms managing less than £15 billion; medium-sized firms managing between £15 - £50 billion and large firms managing over £50 billion. Year on year changes have been small. Over the past five years, we observe that:

- Smaller firms, managing £15 billion or less, continue to constitute the highest share of the IA's membership (at 57%). This is up from 56% in 2020,

TABLE 6: ASSETS MANAGED IN THE UK BY IA MEMBERS BY FIRM SIZE (2016-2021)

AUM	% of firms (June 2016)	% of firms (June 2017)	% of firms (June 2018)	% of firms (June 2019)	% of firms (June 2020)	% of firms (June 2021)
>£100bn	11%	12%	12%	11%	12%	13%
£50-100bn	9%	9%	8%	7%	9%	9%
£25-50bn	11%	10%	14%	11%	9%	9%
£15-25bn	8%	10%	8%	12%	14%	12%
£1-15bn	51%	47%	49%	45%	48%	47%
<£1bn	10%	13%	10%	13%	8%	10%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

which constitutes the first year on year increase in the proportion of small firms, which had been slightly decreasing year on year since 2016, in large part due to M&A activity.

- Medium-sized firms continue to constitute close to a quarter of firms in the industry, fluctuating between 19% and 23%. Generally, there has been an increase in firms managing between £15 billion and £25 billion and a decrease in firms managing between £25 billion and £59 billion.
- In 2021, the proportion of large firms has grown to account for 22% of firms which is up from 20% in 2016.

Between 2020 and 2021, the share of assets managed by the top five firms remained unchanged on the previous year at 44%. Meanwhile, the share of assets managed by the top ten firms increased by one percentage point, reaching 60%. The growth of the share of assets under management of the top ten firms outpaced the growth in assets under management of the top five firms, which means that firms ranking fifth through tenth experienced the most growth. This further confirms the lack of concentration in the industry.

AVERAGE ASSETS UNDER MANAGEMENT IN JUNE 2021

MEAN: £59 BILLION

MEDIAN: £10 BILLION

BOX 5: BOUTIQUES

The IA membership contains a number of boutique management firms. The definition of a boutique firm is based on four broad criteria:

- Being independently owned
- Managing assets of less than £5.0 billion
- Providing a degree of investment specialisation
- Self-definition

While the IA definition of boutique asset managers places a £5 billion cap on AUM, there are many boutique firms both within and outside of the IA's membership that are much smaller, and so the size dispersion of boutique firms can be quite broad. According to these criteria, there are 13 IA members that qualify as boutique investment management firms. This is down from 15 boutique firms recorded last year. This is in part due to high levels of merger and acquisition (M&A) activity in the sector over recent years (see Appendix 3). As regulatory and compliance requirements continue to rise, and investing in technology becomes increasingly important to staying competitive, firms with scale could be better able to manage the cost burden and to maintain investment in innovation.

Many members we spoke to expect to see increased consolidation in the industry. However, boutiques are also well placed to capitalise on their investment specialisation as the ability to deliver superior returns in more challenging markets becomes a significant competitive advantage. Specialisation in growth areas such as private markets and impact investing could also lead to business gains.

"Some firms are very good at just focusing on alpha generation and this will be critical to competing in more challenging markets."

Chart 81 looks at the concentration level of the industry using the Herfindahl-Hirschmann Index (HHI), which is a commonly used measure of market concentration. HHI increased to 596 in 2021, the highest level of concentration recorded in the past ten years. However, an HHI of between 1000 and 2000 indicates moderate concentration, and anything below that indicates low concentration. This puts the industry well below the threshold of moderate concentration.

CHART 81: MARKET SHARE OF LARGEST FIRMS BY UK ASSETS UNDER MANAGEMENT VS. HHI (JUNE 2011 – JUNE 2021)

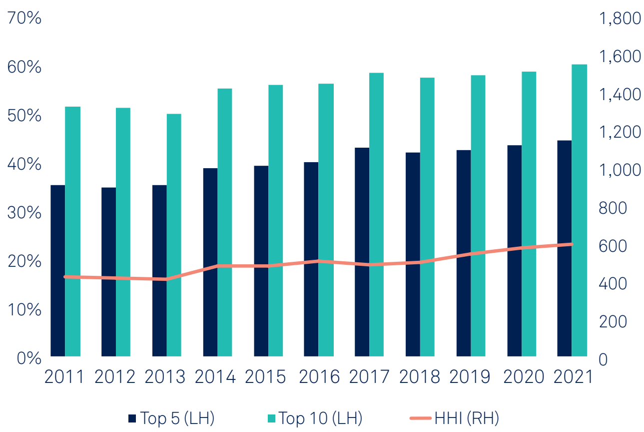


Chart 82 presents the top ten firms in terms of UK and Global assets under management. The top ten UK firms are a diverse group ranging from independent investment managers to bank and insurance owned managers. Both active managers and managers offering indexing strategies are represented in the top ten firms.

Most firms in the top ten have a large global footprint, most notably BlackRock, Vanguard and State Street with the largest value of globally managed assets. However, for most top ten firms, UK assets under management account for the majority of their global assets. Of the top three managers, Legal and General Investment Management is the only firm headquartered in the UK.

Over the past ten years, there has been movement between the top firms, including new entrants to the list. Some of the changes in the composition of the top ten firms have been the result of merger and acquisition activity. In the next section on investment manager ownership, we further discuss the impact of mergers, acquisitions and de-mergers on the industry (see Appendix 3 for more on M&A activity).

CHART 82: TOP TEN FIRMS BY UK-MANAGED AND GLOBAL ASSETS UNDER MANAGEMENT[30]

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

INVESTMENT MANAGER OWNERSHIP

In this last section we take a closer look at IA members ownership structures. Chart 83 illustrates total assets under management in the UK broken down by location of parent company headquarters. The share of assets managed by firms with a parent company headquartered in Europe, Asia-Pacific and elsewhere has seen little to no change over the past ten years (12% together). Meanwhile, there has been an increase in the assets managed by IA member firms whose parent company's global headquarters are in the US. As of December 2021, nearly half (48%) of total UK AUM is managed by a firm with a US-headquartered parent company, which is up from 42% in 2011. The proportion of assets managed by domestically headquartered companies is 40% in 2021, down from 47% ten years ago.

CHART 83: BREAKDOWN OF UK AUM BY REGION OF PARENT GROUP HQ (2011-2021)

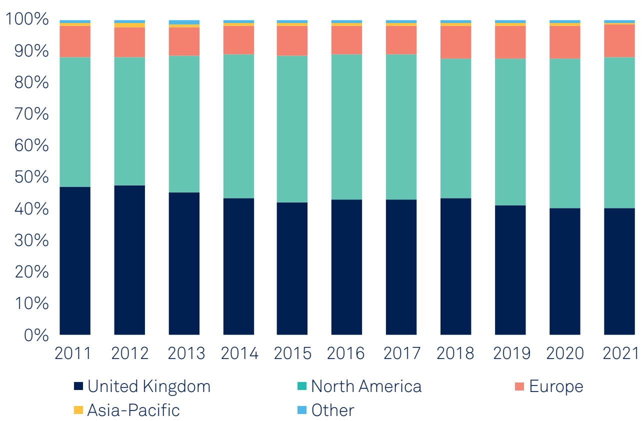


Chart 84, looks at a breakdown of member assets by type of parent company. One of the most notable trends of the past ten years has been an increase in the share of standalone investment management firms, which has increased from 37% to 45%. Over the same period, the share of assets managed by companies owned by insurers has decreased from 28% to 24%. This is mainly due to de-mergers, where we have seen a few large insurers demerge from their investment management arms.

Retail banks made up between 5% to 6% of the asset base between 2010 and 2013, but this has fallen to 2% since 2013. This coincides with the introduction of the FCA's Retail Distribution Review (RDR), which particularly impacted the parts of the market that offer investment advice. While retail banks retain their investment platform capabilities, serving a direct investor base, there is significant competition for direct investor share of wallet. Many retail banks exited the advice market or reduced headcount in 2013 as a result of increased regulatory and compliance costs. The loss of bank investment advisers has constrained the distribution of their investment products post-RDR and this has contributed to slower growth in AUM.

The share of pension fund manager companies has remained stable between 2% and 3% over the past ten years. Over the same period, the share of investment banks has fluctuated between 11% and 13%.

CHART 84: BREAKDOWN OF UK AUM BY PARENT TYPE (2011-2021)