6 OPERATIONAL AND STRUCTURAL EVOLUTION

KEY FINDINGS

6

INDUSTRY PROFITABILITY

- Industry profitability fell sharply through 2022 as revenues fell and costs marginally increased. With revenues falling to an average 25 basis points (bps) and operating costs at 19 bps, operating profitability was 22% (down from 29%). This includes all operating models, including firms that are part of larger financial services groups.

INDUSTRY EMPLOYMENT

- The IA estimates that as of December 2022, the UK's investment management industry employs an estimated 126,400 people, of which 46,200 are directly employed by investment management firms.
- The distribution of staff by activity has remained relatively consistent over the past five years. Approximately a quarter (24%) of staff work in front office investment roles and the remaining three quarters work in a variety of back-office roles, including business development, operations, compliance and client services.
- The regional distribution of those directly employed by the UK investment management industry has equally experienced little change in recent years. London continues to be the centre of employment for the industry and hosts the largest concentration of people working in investment management roles (26%).

INDUSTRY CONCENTRATION

- The industry maintains a relatively low level of concentration. The IA's membership is comprised of a small number of large firms and a long tail of medium and small-sized organisations. As of December 2022, the top five and top ten firms collectively manage 43% and 58% of the total UK AUM, respectively, representing marginal falls of 1% and 2% respectively on the previous year.
- Despite the relatively low level of industry concentration, we have recorded a gradual (albeit modest) increase in concentration over the past five years. In 2022, the IA's membership saw a reduction in the number of boutique investment management firms from 13 to 10, and the industry's Herfindahl-Hirschmann Index (a common measure of market concentration) increased very marginally to 598.

INVESTMENT MANAGER OWNERSHIP

- Over the past decade, the share of assets managed by firms belonging to parent companies headquartered in the UK has decreased in favour of firms headquartered in North America. As of 2022, 39% of assets are managed by firms headquartered in the UK and half (50%) by North American headquartered firms. The remaining share of assets managed by firms headquartered in Europe, Asia-Pacific and elsewhere has remained relatively stable at 12% over the past decade.
- The largest share of industry assets (44%) is managed by independent investment and fund management firms, up from 37% in 2012. Over the past decade, the share of assets managed by retail bank has stabilised at 2% and the share of assets managed by insurance companies has decreased from 29% to a quarter, in large part due to de-mergers between insurance companies and their investment management arms.

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.

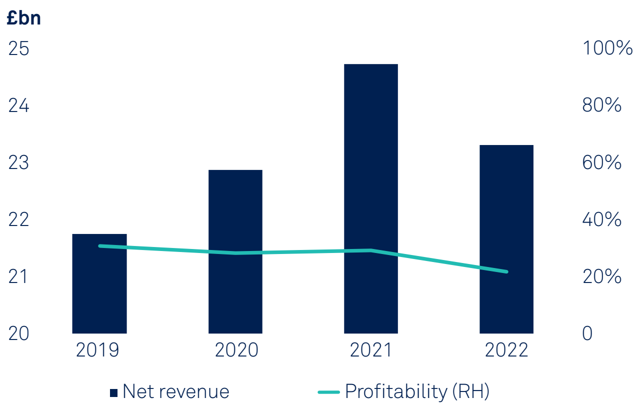
INDUSTRY PROFITABILITY – REVENUE AND COSTS

In this section, we look at the aggregate revenue and cost figures of the industry, covering both in-house and third-party business. Chart 62 illustrates the development of net revenue and profitability at an industry level over the past four years.

As of December 2022, industry revenue stood at £23.3 billion, equivalent to 25 basis points (bps) of total assets under management. Meanwhile, operating costs in 2022 totalled £18.3 billion, equivalent to 19 bps.

The industry's headline profitability fell significantly in 2022 to 22%, down from 29% in 2021. The matched sample of IA member data, suggests that this fall in profitability was driven by a combination of lower revenue (down 6% on a matched basis) and marginally higher levels of operational cost (up 1% on a matched basis).

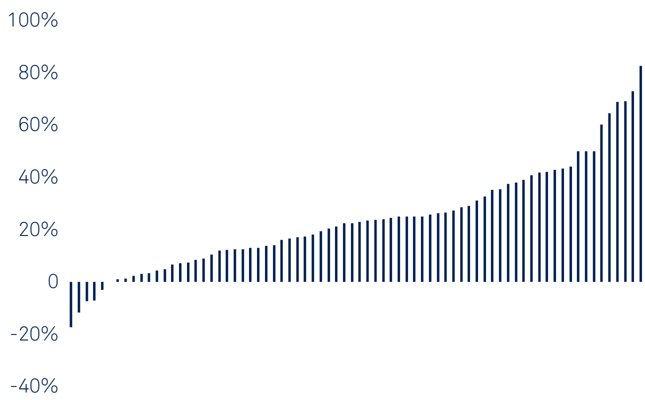
CHART 62: INDUSTRY NET REVENUE AND PROFITABILITY (2019 – 2022)



Source: The Investment Association

Industry-level statistics – such as average profitability – can mask underlying variation in individual firm experience. The range of profitability across the Investment Association's membership in 2022 is illustrated in Chart 63. The data suggests that while the majority of firms remained profitable throughout the year, there was a downward shift in the distribution between 2021 and 2022. In 2022, a quarter of firms had operating margins of 11% or lower, whereas the top quarter of firms had operating margins of 35% or above. This compares to a lower quartile of 15% and an upper quartile of 41% in 2021.

CHART 63: DISTRIBUTION OF INVESTMENT MANAGER PROFITABILITY IN 2022



Source: The Investment Association

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EMPLOYMENT IN THE INVESTMENT MANAGEMENT INDUSTRY

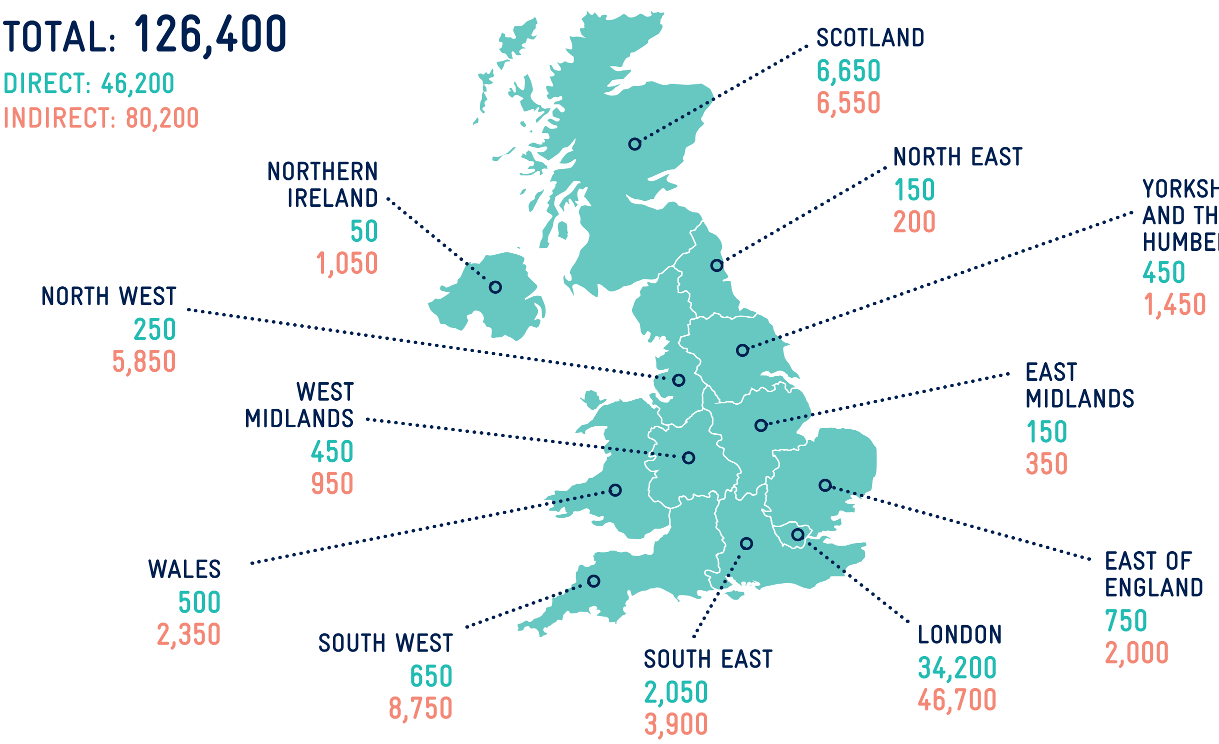
For the past fifteen years, the IA has been tracking direct employment numbers in the investment management industry. In 2016, an "indirect employment" category was introduced to assess the value of the investment management industry more accurately as a source of employment in the UK. Indirect employment 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 2022, the UK investment management industry supports approximately 126,400 jobs, of which 46,200 are directly employed by investment management firms and the remainder (80,200) are employed either by affiliate IA members or wider administration services, or in securities and commodities dealing activities.[37]

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

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

FIGURE 12: MAP OF DIRECTLY AND INDIRECTLY EMPLOYED STAFF ACROSS THE UK IN 2022



Sources: Investment Association estimates are from information provided directly by member firms and publicly sourced information. All regional numbers have been rounded to the nearest 50 and therefore may not add up to exact total.

[37] 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).

[38] 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.

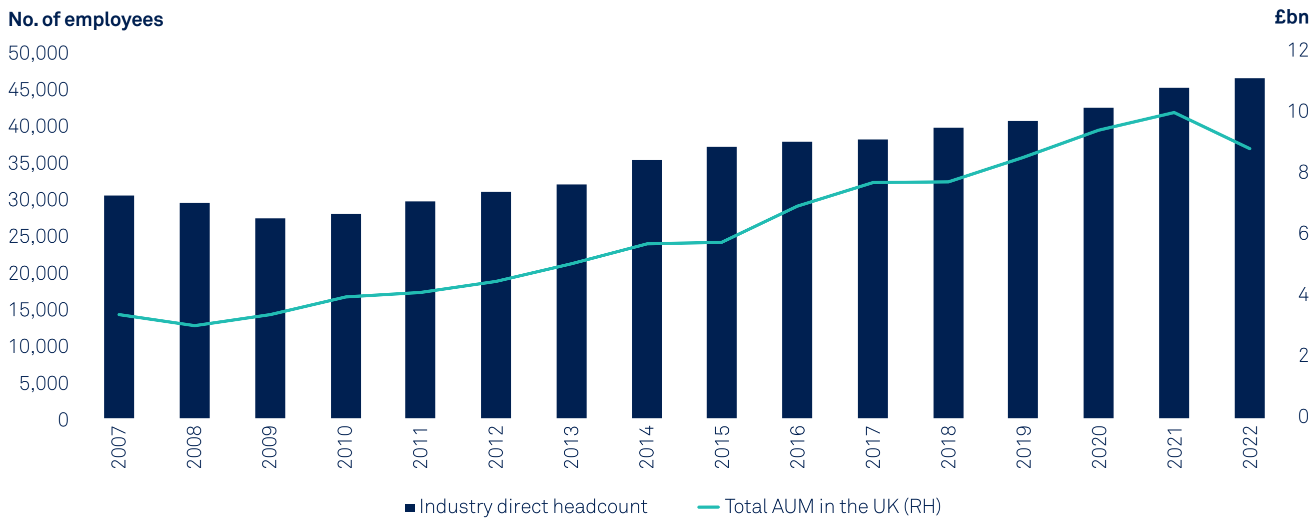
DIRECT EMPLOYMENT

The Investment Association estimates that an approximate 46,200 people are directly employed within the investment management industry in the UK. Chart 64 looks at the growth in direct employment alongside growth in AUM. We make the following observations:

- Despite the overall fall in assets under management in 2022, direct employment increased 3% year-on-year from an approximate 44,800 people in 2021 to 46,200 by the end of 2022.
- The last time industry AUM fell year-on-year was during the Global Financial Crisis. Between 2007 and 2008 we saw a fall in industry employment of 3%. Despite a recovery in assets the following year, profitability numbers were still declining until 2010 and as such we see a further 7% fall in headcount in 2009.
- The impact of falling profitability and industry AUM is not borne out in the 2022 employment figures, though a muted recovery in 2023 may see this reflected in 2023 headcount data.

In Table 3 we provide a breakdown of people directly employed in the industry by job function. The distribution of staff by activity experiences little change year-on-year. As has been the case since the IA began collecting direct employment data, approximately a quarter of people directly employed by the industry work in front office investment management roles, which includes portfolio/fund managers, product teams, traders, etc. The remaining three quarters of people directly employed by the industry work in back-office roles, which includes roles in operations, business development, compliance and client services.

CHART 64: INDUSTRY HEADCOUNT ESTIMATES VS. UK ASSETS UNDER MANAGEMENT (2007-2022)



Source: The Investment Association

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TABLE 3: DISTRIBUTION OF STAFF BY ACTIVITY IN 2022

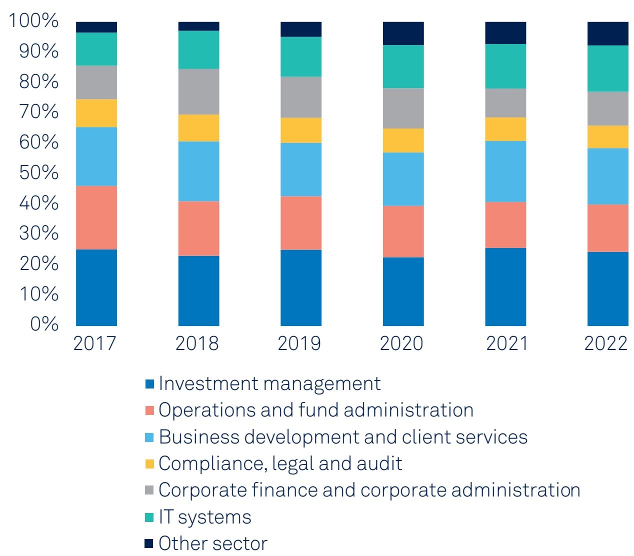
Activity	Share of total headcount
Investment management	24%
Operations and fund management	16%
Business development and client services	18%
Compliance, legal and audit	7%
Corporate finance and corporate administration	11%
IT systems	16%
Other sector	8%

Source: The Investment Association

Chart 65 illustrates the medium-term trends in employment by activity. We highlight the following trends in industry staffing:

- Employment in the front office, ie in **investment management**, has consistently accounted for about a quarter of industry employment, fluctuating between 23% and 26% for the past five years.
- The share of people working in **operations and fund administration** has slowly been decreasing, down from 21% in 2017 to 16% in 2022.
- People working in **business development and client** services decreased slightly between 2021 and 2022, prompting a drop in the share of those employed in this sector to 18%, very marginally down from the average 19% recorded over the previous four years.
- The share of staff employed in **IT systems** was slowly increasing between 2017 and 2020 (from 12% to 15%) but has since levelled off at 15%.

CHART 65: DIRECT EMPLOYMENT BY STAFF SEGMENT (2017-2022)



Source: The Investment Association

Alongside tracking industry employment by activity, IA data records employment by location. London and Edinburgh are the two largest centres in the UK for investment management activity, accounting for 88% of the direct headcount. Table 4 provides a breakdown of the jobs by function in London, Scotland and elsewhere:

- **London** continues to be the centre of employment for the industry in the UK, with three quarters of all directly employed people in the UK working in the London area. London also continues to host the highest concentration of people working in investment management across the UK (26%). The most notable trends within those working in London over the past five years is: 1) an increase in the share of those working in IT systems and other sectors, which combined has increased from 15% in 2017 to a quarter of staff in 2022; 2) a fall in staff employed in business development, down from nearly a quarter of staff in 2017 (24%) to 17% in 2022.
- The most significant trend in employment in **Scotland** has been a decrease in the share of staff working in front office roles and an increase of those working in the back office. On the one hand, employment in investment management roles has fallen from 20% to 16% over the past five years. On the other hand, between 2017 and 2022 there has been an increase in staff working in:
  - Business development, up from 15% to 17%,
  - Compliance, up from 6% to 8%,
  - IT systems, up from 16% to 20%,
  - And in other sectors from 2% to 7% over the same period.

TABLE 4: **DISTRIBUTION OF INVESTMENT MANAGEMENT JOBS BY REGION IN 2022**

Activity	London	Scotland	Elsewhere in the UK
Investment management	26%	16%	20%
Operations and fund management	14%	21%	21%
Business development and client services	17%	17%	23%
Compliance, legal and audit	8%	8%	6%
Corporate finance and corporate administration	11%	12%	10%
IT systems	16%	20%	15%
Other sector	8%	7%	6%

Source: The Investment Association

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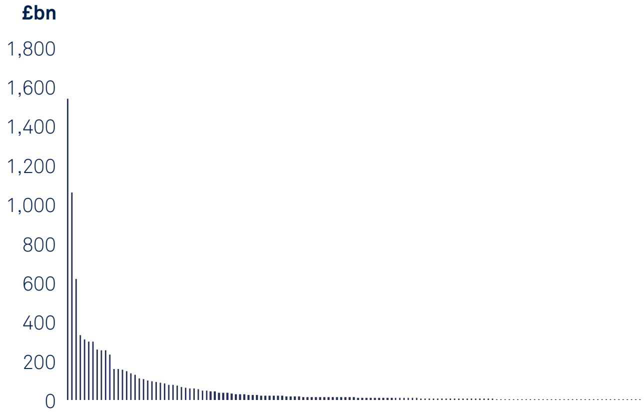
INDUSTRY FIRM SIZE

In this section we focus on the size of investment management firms as measured by assets under management.

Chart 66 ranks IA member firms by total UK-managed AUM. The chart shows a steep downwards curve from a small number of very large firms to a long tail of medium- and small-sized organisations – a strong indication of a competitive industry.

As of June 2022, the average value of assets managed by IA member firms stood at £59 billion and the median value of IA member firms' AUM stood at £11 billion. The large difference between mean and median indicates that there is a relatively small number of firms managing a high volume of assets.

CHART 66: MEMBERS OF THE INVESTMENT ASSOCIATION RANKED BY UK ASSETS UNDER MANAGEMENT (JUNE 2022)



Source: The Investment Association

AVERAGE ASSETS UNDER MANAGEMENT IN JUNE 2022

MEAN:
£59
BILLION

MEDIAN:
£11
BILLION

In Table 5, we offer a breakdown of IA member firms by size. Over the past five years, there has been little change in the distribution of assets by firm size.

- The largest share of the Investment Association's membership is made up of smaller firms (below £15 billion AUM), which has fluctuated between a 56% and 60% of total AUM since 2017.
- The share of assets managed by medium-sized firms (£15-50 billion AUM) decreased from 21% in 2021 to 19% in 2022 – the lowest point of the past five years.
- The proportion of assets managed by large firms (>£50 billion) has slowly been increasing towards a quarter of industry assets, unchanged from the previous year at 22% in 2022.

ROLE OF BOUTIQUES

Small firms within the IA membership will be a mixture of business models, including both smaller UK firms and UK offices of larger international companies. A specific category that we identify is investment management boutiques.

Various criteria are employed to characterise boutique investment management firms. In our analysis we use the following criteria to identify the boutique firms in the Investment Association's membership:

- Being independently owned
- Managing assets of less than £5 billion
- Providing a degree of investment specialisation
- Self-definition

TABLE 5: ASSETS MANAGED IN THE UK BY IA MEMBERS BY FIRM SIZE (2016-2021)

AUM	% of firms (June 2017)	% of firms (June 2018)	% of firms (June 2019)	% of firms (June 2020)	% of firms (June 2021)	% of firms (June 2022)
>£100bn	12%	12%	11%	12%	13%	13%
£50-100bn	9%	8%	7%	9%	9%	9%
£25-50bn	10%	14%	11%	9%	9%	10%
£15-25bn	10%	8%	12%	14%	12%	9%
£1-15bn	47%	49%	45%	48%	47%	50%
<£1bn	13%	10%	13%	8%	10%	9%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

According to these criteria, there are 10 IA members (compared with 13 in 2021) that qualify as boutique investment managers.[39] In recent years, we have reported decreasing number of boutique firms. This is in part due to high levels of merger and acquisition (M&A) activity in the sector over recent years, which in turn reflect a range of considerations, particularly rapidly rising regulatory and compliance requirements. As we note in Chapter One, an essential part of the UK's success as an investment management centre depends on innovation, which itself is a function of a diverse and vibrant industry ecosystem.

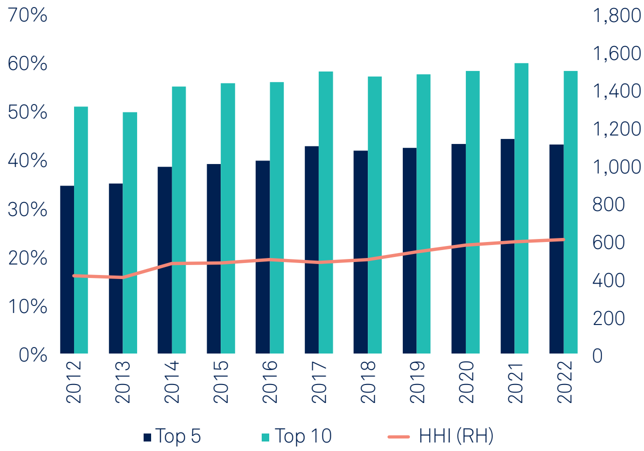
MARKET SHARE OF LARGER FIRMS

Chart 67 tracks the share of UK-managed assets managed by the five largest and ten largest firms in the industry:

- Although the share of assets managed by the top five investment management firms increased from 35% in 2012 to 43% in 2017, over the past five years, the growth has levelled off, standing at 43% on average.
- Over the last decade there has been a gradual increase in the proportion of assets managed by top ten firms from 51% in 2012 to 60% in 2021. In 2022 there was a two percentage point fall in assets managed by the top ten asset managers to 58%.

Chart 67 also includes an Herfindahl-Hirschmann Index (HHI) calculation, which is a commonly used measure of market concentration. The UK investment management industry's HHI shows a very marginal increase from 596 to 598 between 2021 and 2022, marking the fifth year in a row of increased industry concentration. However, the industry remains well below the threshold of moderate concentration which is set at an HHI of between 1000 and 2000.

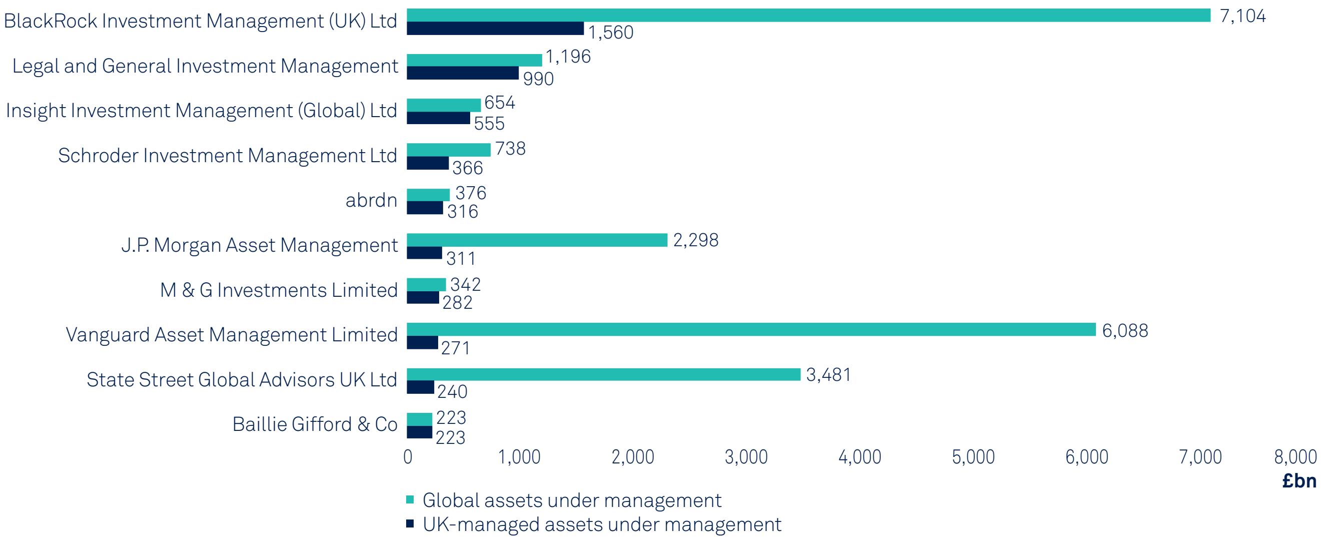
CHART 67: MARKET SHARE OF LARGEST FIRMS BY UK ASSETS UNDER MANAGEMENT VS. HHI (JUNE 2012-2022)



Source: The Investment Association

[39] There is a wide variety of firms within the boutique category. While the IA definition of boutique asset managers places a cap of around £5 billion on AUM, the size dispersion of boutique firms can be quite broad and there are many boutique firms both within and outside of the IA's membership that are much smaller.

CHART 68: TOP TEN FIRMS BY UK-MANAGED AND GLOBAL ASSETS UNDER MANAGEMENT IN 2022[39]



Source: The Investment Association

Chart 68 presents the top ten investment management firms in terms of UK-managed 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 primarily indexing strategies are represented in the top ten.

For most top ten firms, UK assets under management account for the majority of their global assets.

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 which we discuss in more detail in the next section (see Appendix 3 for more on M&A deals over the last few years).

THE TOP 10 LARGEST ASSET MANAGERS ACCOUNTED FOR

58%

OF AUM IN 2022

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

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BOX 11: M&A AND BROADER OPERATIONAL IMPLICATIONS

Consolidation has been a constant theme in the industry for many years. It is now almost two decades since Huw Van Steenis posited his barbell theory whereby there would be an increasing polarisation between scale providers, driven by commoditised indexing products, and smaller high alpha specialists especially in the alternative space. The consequences, he suggested, would be significant for the mid-sized active houses which could not effectively compete in either orbit.

Significant elements of this prediction have been proved correct at product level and are still playing out in 2022-23. Other drivers of scale, notably increasing regulatory costs in the UK, have also been increasingly apparent, placing pressure on smaller players in the market as well as mid-sized players. At the same time, despite signs of accelerating M&A activity in the UK market, the concentration data shown earlier in this chapter indicates that the industry still remains highly diverse as measured by firm size and type.

“If you're a mid-sized asset manager, with all the costs of a big asset manager, mergers are an inevitable conclusion to the inconsistency of the value proposition there. The smaller firm will innovate. I just see it bifurcating. You can have your boutique, that's going to innovate, speak to market and disrupt. And then you have the scale players who are trying to deliver broad solutions to clients, but if you're in the middle the economics are challenging.”

“There's a market for the scale providers and a market for multi-capability providers because of the benefits you get from diversification. Equally, assuming you could generate decent returns, given the accessibility of information you could set up a small business. As you start to scale up, that's when it gets a bit complicated. Being in the middle is difficult.”

At the same time, M&A activity has also been focused vertically through the distribution chain and not just horizontally across investment management capabilities. What had previously been a clearer distinction between a ‘manufacturing’ and ‘distribution’ community has become much less so as a number of players acquire adviser or direct to customer capability to evolve and diversify their operating model.

“There is value to being very close to your end client, so that the risk of disintermediation is less or eliminated in the case of direct business.”

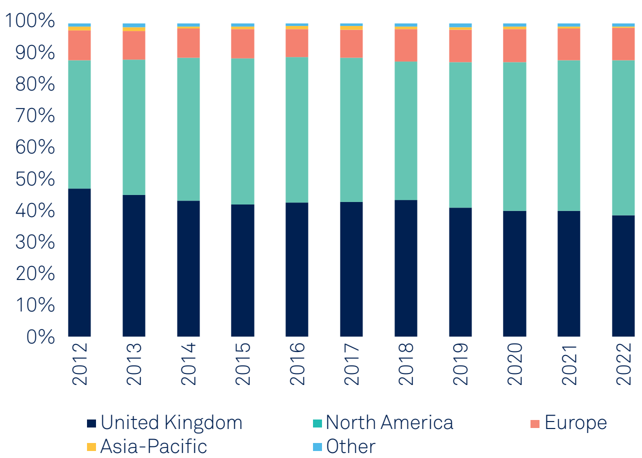
Industry data on profitability reflects the scale of the challenges, as revenue fell much faster than costs during 2022 for many firms, resulting in a marked fall in headline profitability.

INVESTMENT MANAGER OWNERSHIP

In this last section we take a closer look at the ownership structures of IA member firms. Chart 69 provides a breakdown of UK-managed assets by headquarter location of their parent company, and is one of the key metrics highlighting the increasing internationalisation of UK investment management. Some long-term trends have emerged:

- The share of assets managed by members belonging to parent companies headquartered in the UK has been slowly declining, and responsible for 39% of assets in 2022 which is down from 47% in 2012.
- The share of assets managed by firms headquartered in North America has been on the rise. As of December 2022, North America headquartered companies account for half (50%) of UK-managed assets, which is up from a recorded 41% in 2012.
- The share of assets managed by firms headquartered in Europe, Asia-Pacific and Elsewhere have remained relatively constant – European headquartered firms have been responsible for approximately a tenth of UK-managed assets over the past ten years. Assets managed by member firms belonging to parent companies headquartered in Asia-Pacific and elsewhere in the world continue to be responsible for 1% of UK-managed assets.

CHART 69: BREAKDOWN OF UK ASSETS UNDER MANAGEMENT BY REGION OF PARENT GROUP HQ (2012-2022)

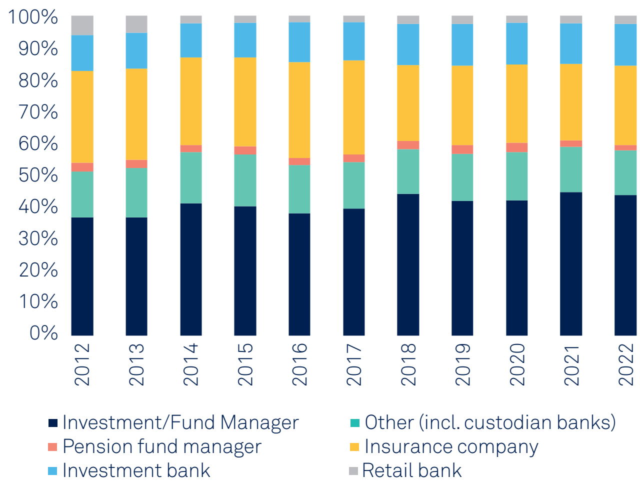


Source: The Investment Association

Chart 70 illustrates the breakdown of UK-managed assets by type of parent company, and provides a comparison of the size of assets managed by autonomous investment managers with investment managers that are subsidiaries of wider financial services groups. We make the following observations:

- The chart shows a more independent investment management industry as the proportion of assets managed by autonomous investment and fund management firms over the past ten years has grown from 37% to 44%.
- As a result of de-mergers of insurance companies from their investment management arms, there has been a decrease in the share of insurer-managed assets in the UK, from 29% to 25% over the past ten years.
- Since 2014, the share of assets managed by member firms belonging to retail banks has stabilised at 2% compared with 5-6% between 2010 and 2013. This has been driven by a variety of factors including divestment of investment management arms following the Global Financial Crisis (prior to which retail bank managed assets accounted for 18% of AUM) and changes in the retail distribution landscape, including the rise of fund platforms.

CHART 70: BREAKDOWN OF UK AUM BY PARENT TYPE (2012-2022)



Source: The Investment Association