6 OPERATIONAL AND STRUCTURAL EVOLUTION

6

KEY FINDINGS

INDUSTRY PROFITABILITY

- Industry profitability decreased to 20% in 2023, down from 22% in 2022. Revenues rose by 2.6% and costs grew by 3% overall, outstripping revenues – a trend observed across firms of all sizes. Operating profit margins varied widely, ranging from -33% to 70%, with an average margin of 18%, a decline from 24% in 2022.

INDUSTRY EMPLOYMENT

- The UK investment management industry supports approximately 124,800 jobs with 45,800 people directly employed by investment management firms. The remainder are employed in industries such as custodian banks, transfer agents and wealth managers.
- Headcount has grown nearly 4% year on year from 2009 to reach 46,300 in 2022. In 2023 headcount fell by 1% to 45,800, the first annual fall since the Global Financial Crisis.
- Of the 45,800 people employed by investment managers, 23% of employees work in investment management roles, 18% work in business development and client services and 16% in operations and fund administration. The highest proportion of investment management roles (27%) are in London, whilst the highest number of operations and fund administration roles are located in Scotland (24%). A quarter of business development roles are located outside London and Scotland indicating that many firms continue to employ regional teams.

INDUSTRY FIRM SIZE

- As of June 2023, the mean AUM is £62bn and the median AUM is £11bn.
- Small firms (<£15bn AUM) make up 57% of IA membership and medium-sized firms (£15-£50bn AUM) are a fifth of IA members. Large firms (>£50bn AUM) account for 22% of IA member firms.

INDUSTRY CONCENTRATION

- The UK industry remains relatively unconcentrated. In 2023, the top five firms managed 42% of total assets, slightly down from 43% in 2022. The top ten firms managed 58% of assets, unchanged from the previous year.

INVESTMENT MANAGER OWNERSHIP

- Over the last decade, the share of assets managed by UK-headquartered firms has declined as the share of assets managed by North American headquartered firms has increased. In 2023, UK-headquartered firms managed 38% of assets and North American headquartered firms managed 51% of AUM.
- The share of assets managed by independent investment managers has steadily increased to 46% of assets in 2023, up from 21% in 2009. Assets managed by firms with an insurance company parent have declined from 34% to 23% over the same period. Retail bank owned AUM fell substantially from 18% in 2008 to 9% in 2009 and has been 2% of industry AUM since 2014.

This chapter looks at the operational and structural evolution 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 industry concentration.

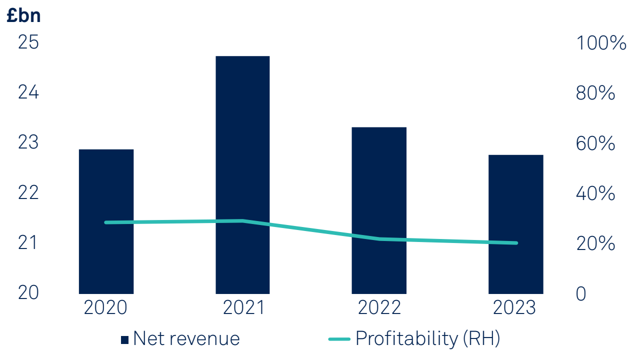
INDUSTRY PROFITABILITY

In this section, we look at the aggregate revenue and cost figures of the industry, covering both in-house and third-party business. Chart 61 illustrates the development of net revenue and profitability at an industry level over the past four years.

Industry revenue stood at £22.6 billion as of December 2023, equivalent to 29 basis points (bps) of total assets under management (AUM). Meanwhile operating costs stood at £18.1 billion, equivalent to 19 bps.

Overall, the industry's headline profitability declined slightly to 20% in 2023, down from 22% in 2022, marking a substantial drop from 29% in 2019. The matched sample of IA member data suggests that this fall was driven by a higher level of operating costs (up 3% on a matched basis). Revenues were higher in 2023 (up 2.6% on a matched basis) with the increase being marginally lower than that of operating costs. Industry profitability has fallen sharply over the last four years from 29% in 2019 to 20% in 2023. High net revenues in 2021 did not result in a significant improvement in average profitability (29%) and this suggests that operating costs need to fall further in order to support improved profitability.

CHART 61: INDUSTRY NET REVENUE AND PROFITABILITY (2020–2023)

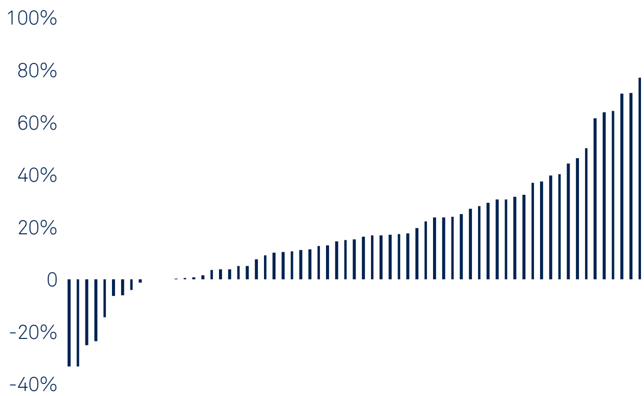


Source: The Investment Association

Whilst average profitability is a useful measure of overall industry profitability, it can mask the variation in profitability across investment managers who operate different business models in a diverse environment. Chart 62 illustrates the profitability distribution of IA member firms. We observe the following:

- Operating profit margins in 2023 ranged from -33% to 70% whilst in 2022 they were between -17% and 82%. Relative to 2022, investment managers were less profitable at both the higher and lower ends of the scale.
- The upper and lower quartile for operating profitability stood at 30% and 4% respectively, compared to 2022 when the upper and lower quartiles were 35% and 11%.
- Average operating margins came in at 18%, six percentage points lower than the 24% recorded in 2022. Operating profit margins have not returned to the levels they reached in 2021 (32%).

CHART 62: DISTRIBUTION OF INVESTMENT MANAGER PROFITABILITY (2023)



Source: The Investment Association

6

EMPLOYMENT IN THE INVESTMENT MANAGEMENT INDUSTRY

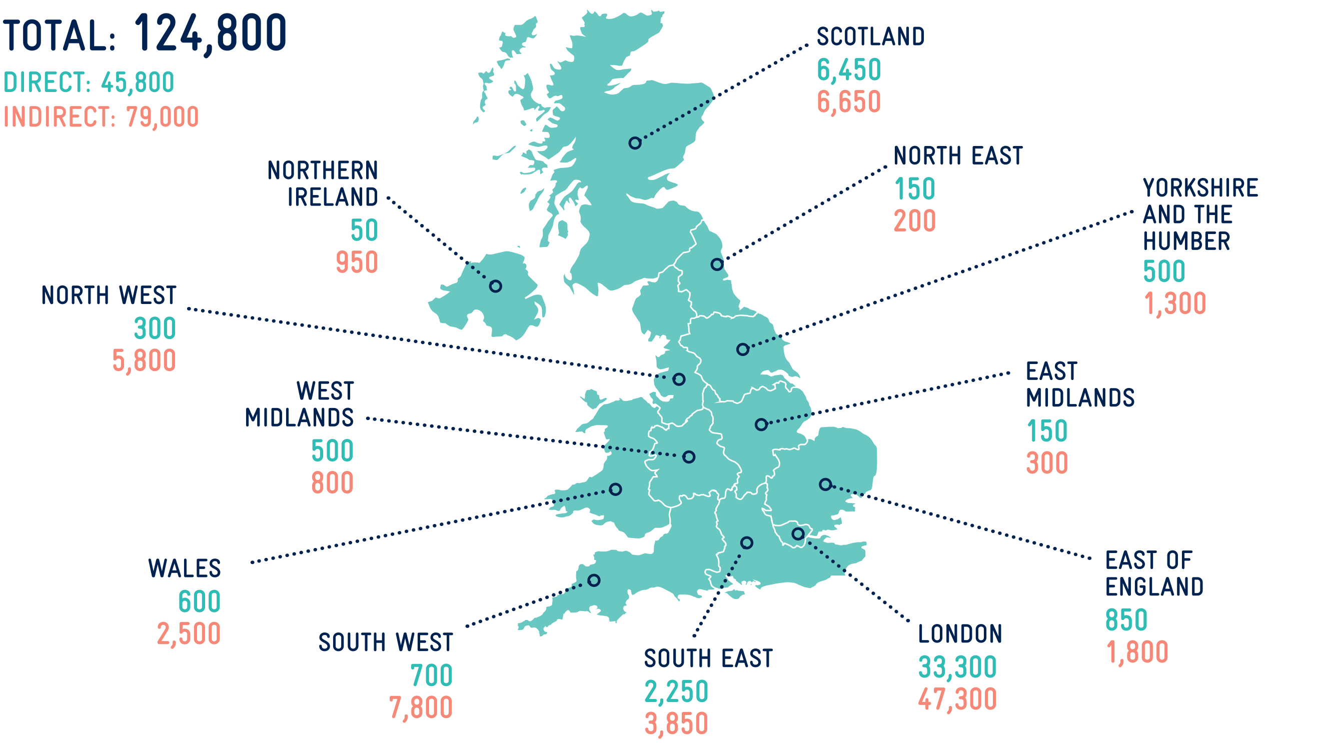
For the past fifteen years, the IA has been tracking direct employment numbers in the investment management industry. In 2006, an "indirect employment" category was introduced to assess the value of the investment management industry more accurately as a source of employment in the UK. Indirect employment 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 2023, the UK investment management industry supports approximately 124,800 jobs, of which 45,800 are directly employed by investment management firms and the remainder (79,000) are employed either by affiliate IA members, wider administration services, or in securities and commodities dealing activities.

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

FIGURE 11: MAP OF DIRECTLY AND INDIRECTLY EMPLOYED STAFF ACROSS THE UK (2023)



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.

BOX 10: ACCESS TO TALENT AND CREATING THE RIGHT CULTURE

Enabling access to the right talent is a critical success factor in maintaining the UK's position as the largest global centre of investment management and in all our interviews with industry leaders, they stressed the importance of attracting the best people from around the world to work in investment management in the UK.

Amid the rapid pace of industry change, organisations are closely monitoring their evolving talent needs as they adapt to technological advancements, revenue pressures and geopolitical shifts. Current talent shortages are partly due to the demand for new skill sets, with a strong emphasis on attracting globally experienced professionals to fulfil both skills and senior leadership requirements. With headcounts tightened, the need for greater efficiency has led to an intensified focus on reskilling the workforce in tech and AI skills to boost productivity.

A strong emphasis remains on creating a supportive work environment that nurtures growth, adaptability and wellbeing – not merely as a perk but as an essential strategy for maintaining talent engagement, productivity and retention. As such, most organisations have continued to offer hybrid working models.

Cultivating an inclusive workplace culture that promotes belonging and psychological safety is an industry priority given the direct link between healthy cultures and positive business outcomes. Moreover, the long-term success of efforts to enhance representation and build diverse teams is increasingly recognised as dependent on a healthy business culture, aligned policies and a shared commitment to accountability.

We are seeing a shift towards integrating equity, diversity and Inclusion (EDI) into organisational talent initiatives, evolving from isolated 'diversity' efforts to a more cohesive and embedded approach. Firms have become more intentional about measuring EDI progress, focussing on improving the integrity and quality of their diversity data to ensure it accurately represents their workforce. However, a significant challenge remains in encouraging higher employee response and disclosure rates, and there's still considerable work to be done in this area. While quantifying progress remains a challenge for many firms, there has been notable advancement in conversations and accountability.

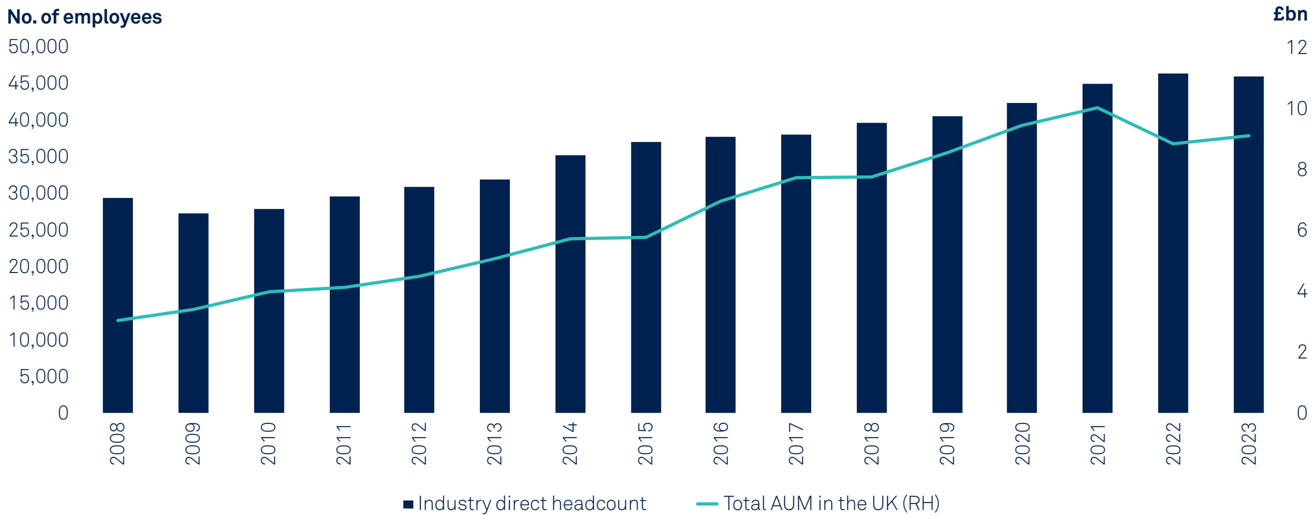
There has been significant interest from the UK regulators, the FCA and PRA, on diversity and inclusion, setting out proposals requiring firms to develop diversity and inclusion strategies and to collect, report, and disclose diversity demographic data, which helps to set targets to address under-representation. While many of these proposals were not new in themselves, their scale is unprecedented. Following significant consultation, the regulators need more time to evaluate the proposals due to the complexity of the issues they aim to address and the potential impact they could have. While there has been a pause on the diversity and inclusion proposals, they are pressing ahead with proposals relating to non-financial misconduct. Furthermore, the new Labour Government has introduced a series of EDI proposals likely to significantly reshape the current landscape. While we await details of the proposals, they include ethnicity and disability pay gap reporting for organisations.

DIRECT EMPLOYMENT

The Investment Association (IA) estimates that approximately 45,800 people are directly employed within the investment management industry in the UK. Chart 63 looks at the growth in direct employment alongside growth in AUM. We make the following observations:

- In 2023, employment in the UK investment management industry decreased slightly by 1%, with the headcount falling to 45,800, while AUM saw a modest recovery of 3%, reaching £9.1 trillion. The simultaneous slight recovery in AUM and a reduction in workforce suggest that investment management firms are leveraging technology to improve efficiency or have reduced headcount and implemented recruitment freezes as cost control measures in line with the decline in industry operating profitability over the period.
- Over the longer term, headcount in the UK investment management industry has been trending upward from 2009. Headcount has grown nearly 4% year on year to reach 46,300 in 2022, with only a slight 1% dip in 2023 to 45,800, although this is the first year that industry headcount has fallen since the Global Financial Crisis. The gradual increase in both employment and AUM reflects the asset management industry's recovery from the 2008 financial crisis and its expansion in the following decade.

CHART 63: INDUSTRY HEADCOUNT ESTIMATES VS. UK ASSETS UNDER MANAGEMENT (2008-2023)



Source: The Investment Association

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, investment analysts, product teams and traders. The remaining three quarters work in roles in operations, business development, compliance and client services.

TABLE 3: DISTRIBUTION OF STAFF BY ACTIVITY IN 2023

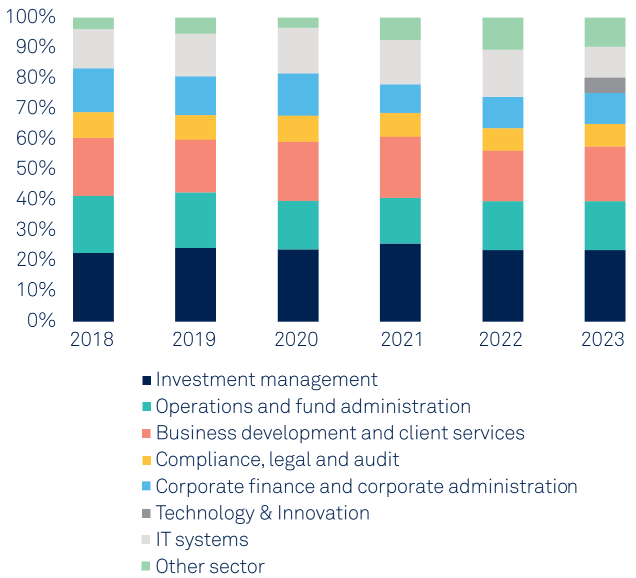
Activity	Share of total headcount
Investment management	23%
Operations and fund administration	16%
Business development and client services	18%
Compliance, legal and audit	7%
Corporate finance and corporate administration	10%
Technology and innovation	5%
IT systems	10%
Other sector	10%

Source: The Investment Association

The medium-term trends in employment activity are illustrated in Chart 64. Industry staffing trends include:

- Investment management roles remained steady at 23% in 2023, maintaining a stable range of 23% to 26% over the past five years.
- The proportion of employees in operations and fund administration roles fell from 19% in 2018 to 15% in 2021, stabilising at 16% over 2022 and 2023.
- The share of employees in business development and client services roles has fluctuated between 17% and 20% over the past five years, indicating variability in demand for these roles. The proportion has settled at 17% and 18% in 2022 and 2023 respectively.

CHART 64: DIRECT EMPLOYMENT BY STAFF SEGMENT (2018-2023)



Source: The Investment Association

The IA tracks industry employment by function but also by location. London is the largest hub for investment management in the UK, followed by Edinburgh as the second largest. Table 4 shows the distribution of roles across London, Scotland and other regions:

- The majority of investment management roles are located in London, with 27% of front office functions based in the capital. This has remained steady, ranging from 26% to 28% over the past five years. Other notable developments in the share of employment in London include:
  - The proportion of employees in operations and fund administration roles has gradually decreased from 14% in 2018 to 12% in 2023.
  - There has been a slight upward trend in business development and client services roles, rising from 17% in 2022 to 20% in 2023 as some firms have moved to centralise business development teams.
- The proportion of investment management roles in Scotland has fluctuated between 16% and 20% over the past five years, reaching 18% in 2023, the same as five years ago. While roles in business development and client services have remained at stable levels in Scotland, others like operations and fund administration have shown more variability:
  - Business development and client services has fluctuated between 15% and 17%, reaching 16% in 2023.
  - The share of operations and fund administration roles has moved between 21% and 29%, reaching 24% in 2023.
- The greatest proportion of roles outside London and Scotland were in business development and client services (24%) and operations and fund administration (23%), indicating that a number of firms continue to employ business development teams based in the regions. This reflects the regional dispersion of financial advisers and wealth managers across the UK. Institutional clients such as the LGPS are also located across the country.

TABLE 4: DISTRIBUTION OF INVESTMENT MANAGEMENT JOBS BY REGION (2023)

Activity	London	Scotland	Elsewhere in the UK
Investment Management	27%	18%	19%
Operations and fund administration	12%	24%	23%
Business development and client services	20%	16%	24%
Compliance, legal and audit	7%	7%	5%
Corporate finance and corporate administration	10%	11%	10%
IT systems	10%	17%	5%
Technology and innovation	7%	2%	5%
Other sector	8%	5%	8%

Source: The Investment Association

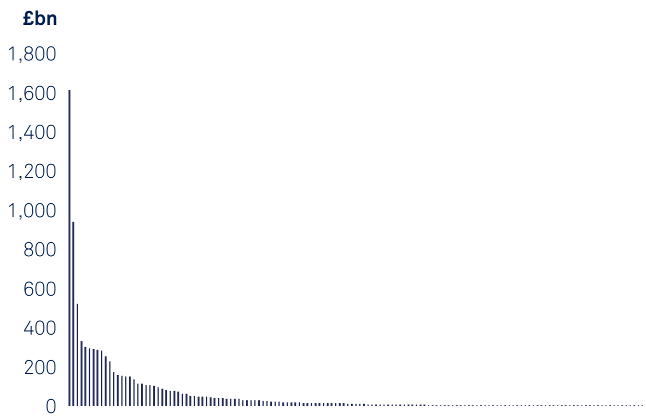
INDUSTRY FIRM SIZE

This section focuses on investment manager firm size as measured by assets under management.

Chart 65 ranks IA member firms by total UK assets under management. It 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 2023, the mean AUM was £62 billion while the median comes in at a much smaller £11 billion. This is consistent with Chart 65, showing that a high proportion of AUM is managed by a small number of large investment managers. In 2022, the mean was £59 billion while the median was unchanged at £11 billion, implying that larger firms grew assets at a faster rate.

CHART 65: MEMBERS OF THE INVESTMENT ASSOCIATION RANKED BY UK ASSETS UNDER MANAGEMENT (JUNE 2023)



Source: The Investment Association

Table 5 illustrates the distribution of assets under management for IA member firms over a five year period ending in June 2023. Our observations are:

- Small firms (<£15 billion AUM) continue to make up the largest proportion of firms in 2023 at 57%. This has dropped two percentage points since 2018 with little fluctuation over that period.
- Medium-sized firms (£15-£50 billion AUM) make up a fifth of IA member firms, the lowest recorded level over the past five years indicating that consolidation has been concentrated in mid-sized firms.
- Large firms (>£50 billion AUM) account for 22% of IA member firms, recording a one percentage point increase since June 2022.

“I think there’s going to be greater consolidation among mid-sized asset managers. Those boutiques that are strong will continue to be strong because they're subject matter experts. The cleanup will be in the part of the market where asset managers have insufficient scale or do not have a niche or expertise.”

AS OF JUNE 2023, THE MEAN AUM IS

£62BN

AND THE MEDIAN AUM IS £11BN

6

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

AUM	% of firms (June 2018)	% of firms (June 2019)	% of firms (June 2020)	% of firms (June 2021)	% of firms (June 2022)	% of firms (June 2023)
>£100bn	12%	11%	12%	13%	14%	15%
£50-100bn	8%	7%	9%	9%	9%	7%
£25-50bn	14%	11%	9%	9%	11%	11%
£15-25bn	8%	12%	14%	12%	9%	9%
£1-15bn	49%	45%	48%	47%	49%	48%
<£1bn	10%	10%	8%	10%	8%	9%
Total	**100%**	**100%**	**100%**	**100%**	**100%**	**100%**

ROLE OF BOUTIQUES

Small firms within the IA membership represent a range of businesses models. Our definition of a boutique firm is based on the following criteria:

- Independent ownership
- Managing under £5 billion in AUM
- Providing a degree of investment specialisation
- Self-define as a boutique

There are 10 IA members meeting the criteria to qualify as a boutique firm (this number is unchanged from 2022 but compares with 13 in 2021). In recent years, the number of boutiques in the IA membership has fallen. This has been driven by M&A activity but our interviews with senior industry representatives suggest that it is becoming increasingly hard for boutique firms to establish themselves in the UK, meaning that we are not seeing a pipeline of new boutiques coming through. The cost of regulation and the resource required to implement new regulation has been cited as a factor making it more difficult for boutiques to set up and operate in the UK. However, there was greater optimism that boutiques with a specialism, particularly in private assets, can thrive as growth in demand for private assets looks set to continue (See Chapter 3).

“There's still space for boutiques to capture market share but I would say mostly in the alternative space. I'm a little bit more sceptical about boutique asset managers in the traditional space because margins will continue to come down. Simultaneously, costs will continue to go up because regulation unfortunately is not always proportionate to the size of the business.”

“The level of investment in technology is going to make it very difficult to compete if you're a small boutique. There is going to be place for small firms that are in niches and good at what they do.”

BOX 11: M&A AND BROADER OPERATIONAL IMPLICATIONS

The data in this chapter shows a picture of falling revenue and lower operating margins as firms have not yet recovered from the impact of the sharp falls in AUM through 2022. To succeed in investment management, having scale or specialist expertise has proved to be an advantage, According to the prescient barbell theory put forward by Huw Van Steenis nearly two decades ago, the investment management firms that would take the largest market share would be scale players, who could offer more commoditised index strategies at very low cost. He also predicted that at the opposite end of the universe, smaller firms with the expertise to drive superior returns would remain competitive, particularly in the alternative investment space.

Mid-sized firms that do not have the scale to succeed in indexing, or in a proposition that aligns with industry growth areas, most notably private assets where firms can drive higher revenues, have been among the hardest hit by rising regulatory costs.

"Some firms have historically been asset gatherers because they've got a brand or because they've been able to sell solutions. The Consumer Duty obligation is going to force them to really look long and hard about whether they've really got the right resources on the pitch to be charging active fees for certain areas. Either they'll then go passive or they'll outsource aspects of their portfolio management to people that are doing it well."

Indeed, the most significant trend in M&A in recent years has come from larger firms buying boutiques with expertise in private markets, which has been a significant growth area and revenue opportunity for investment managers.

"Private markets are tricky for more standard asset managers to get into because it's cost intensive and very different in structure to more standard fund structures and therefore this part of the market is always going to be more niche. If you're successful in private assets, you can have lower AUM and still keep your overall income because margins are higher. Money is flowing from active to passive but not from private to passive."

However, M&A between traditional investment firms hasn't accelerated in the last two years despite challenging economic and market headwinds. The Herfindahl-Hirschmann Index (HHI) index, a measure of industry concentration, shows that the investment management industry remains diverse and relatively unconcentrated. Even in challenging market conditions, unlocking the value from mergers and acquisitions and exploiting synergies between merging companies can be complex and costly.

"Mergers themselves have a lot of elements related to merging two different cultures, two different groups of people. Two different ways of doing business results in high costs whilst the economies of scale resulting from a merger can be overestimated by investment bankers and consultants."

"Cultures often don't align and it's a real problem to integrate. There have been various examples of organisations combining for the benefits of scale only and they haven't been successful."

This view suggests that building scale is not enough to create a competitive merged entity. The most successful examples of M&A in the investment industry have either provided access to distribution through merging with firms that offer investment platforms, advice, wealth management capabilities or all of the above. Another area where acquisitions have proved successful is acquiring firms that enable investment managers to offer new products or services including ETFs or expertise in private assets.

"Good M&A deals have a distribution or a manufacturing enhancement."

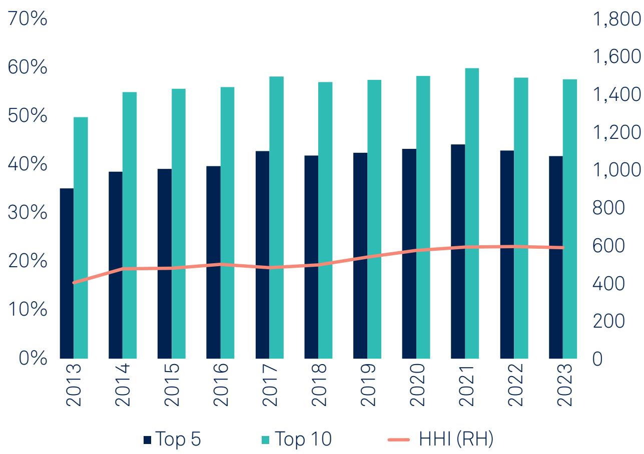
MARKET SHARE OF LARGER FIRMS

The evolution of UK-managed assets by the five and ten largest investment managers in the industry is illustrated in Chart 66:

- The top five investment managers managed 42% of AUM in 2023, a one percentage point decrease from 2022. Although there was a decrease, the share of AUM managed by the top five firms was still marginally higher in 2023 than over the last decade (41%).
- No change was recorded in the proportion of assets managed by the top ten firms in 2023 (58%). Over the past decade, the proportion of assets managed by the top ten firms increased by eight percentage points from 50% in 2013.

The Herfindahl-Hirschmann Index (HHI) calculation is also included in Chart 66, a commonly used measure of market concentration. The UK investment management industry's HHI saw a slight decrease from 598 in 2022 to 592 in 2023, marking the first decline since 2017. This represents a small reversal of the long-term trend of increasing market concentration, which has risen from an HHI of 406 in 2013 to 592 in 2023. However, the industry remains well below the threshold of moderate concentration which is set at an HHI of between 1000 and 2000.

CHART 66: MARKET SHARE OF LARGEST FIRMS BY UK ASSETS UNDER MANAGEMENT VS. HHI (JUNE 2014-JUNE 2023)



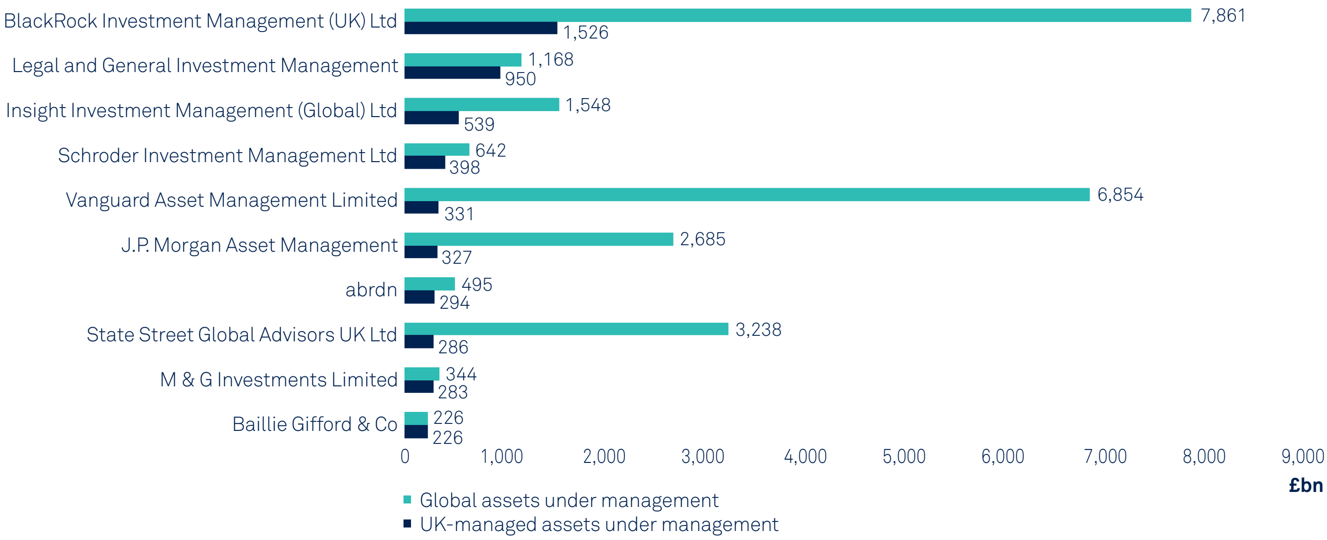
Source: The Investment Association

THE TOP FIVE INVESTMENT MANAGERS HAD A

42%

MARKET SHARE IN TERMS OF ASSETS UNDER MANAGEMENT IN 2023

CHART 67: TOP TEN FIRMS BY UK-MANAGED AND GLOBAL ASSETS UNDER MANAGEMENT (2023)



Source: The Investment Association

Chart 67 presents the top ten IA member firms ranked by UK-managed assets. 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. Four out of the top ten firms have a US headquartered parent company.

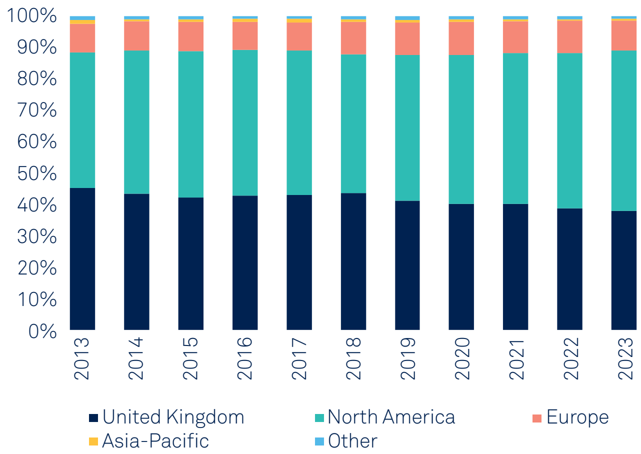
While some of these firms have a large global footprint, UK AUM accounts for the majority of assets for most of the top ten firms. There have been movements between the top ten firms but no new entrants over 2023. Over the past decade, there have been some new entrants to the top ten as mergers have resulted in firms building scale.

INVESTMENT MANAGER OWNERSHIP

In this last section, we examine the ownership structures of IA member firms. Chart 68 offers a breakdown of UK-managed assets by headquarter location of their parent company – a key metric illustrating the increasing globalisation of UK investment management. The following trends emerge:

- The proportion of assets managed by firms with parent companies headquartered in the UK was 38% in 2023, down one percentage point from the previous year. This is in line with the steady decline observed over the past decade with assets down from 45% in 2013.
- North American headquartered firms represent an increasing proportion of UK-managed assets, managing over half (51%) of assets for the first time in 2023. This is up from the 45% recorded in 2013.
- The share of assets managed by firms headquartered in Europe, Asia-Pacific and elsewhere has remained steady over the period. European headquartered firms have been responsible for managing around 10% of assets over the last decade and the proportion of assets managed by Asia Pacific firms has remained at circa 1%.

CHART 68: BREAKDOWN OF UK ASSETS UNDER MANAGEMENT BY REGION OF PARENT GROUP HQ (2013-2023)



Source: The Investment Association

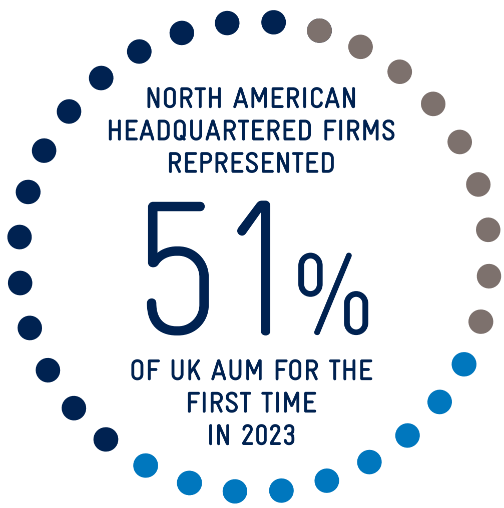


Chart 69 presents a breakdown of UK-managed assets by parent company type, providing a comparison of the size of assets managed by independent investment managers with investment managers that are subsidiaries of wider financial services groups. We observe the following:

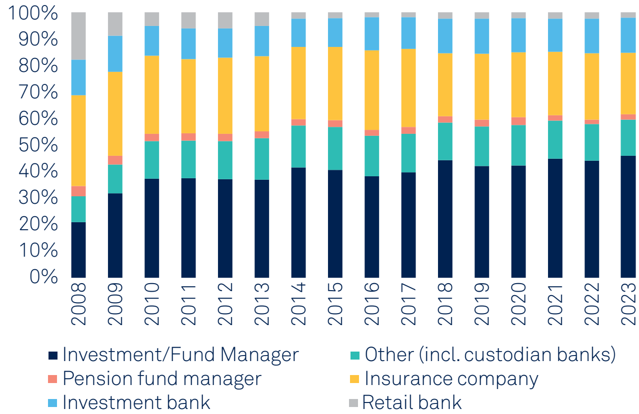
- The share of assets managed by independent investment managers has steadily increased to reach 46% of assets in 2023, up from 21% in 2009. Investment management is the only parent type which has increased share of AUM consistently over the period evidencing an increasingly independent industry.

  The success of overseas investment firms in building competitive investment management businesses in the UK has been a factor in this growth, as is the trend for asset management arms splitting from their insurance parent companies to become independent.

- The proportion of assets managed by firms with an insurance company parent has declined from 34% to 23% over the past fifteen years. This is as a result of demergers of insurance companies from their investment management arms.

- The proportion of assets managed by investment managers with retail bank parent companies fell substantially from 18% in 2008 to 9% in 2009 and has remained at 2% of industry AUM since 2014. This contrasts with the success of this model in Europe. The Global Financial Crisis forced retail banks to focus on core banking and the introduction of the Retail Distribution Review in the UK in 2013 meant that many banks exited the financial advice market and largely lost access to investment distribution.

CHART 69: BREAKDOWN OF UK AUM BY PARENT TYPE (2008-2023)



Source: The Investment Association