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Agenda

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UK asset management: a changing industry

UK asset management is undergoing considerable changes, not least as a result of the recent financial crisis. Jonathan Lipkin, Head of Research at the Investment Management Association, discusses some of the main trends and implications, focusing on ownership, market structure and product development

Members of the Investment Management Association (IMA) were managing a total of £3.4 trillion of assets in the UK at the end of December 2009. Taking into account the assets managed by the wider industry—eg, hedge funds and private equity companies—we estimate that around £3.9 trillion is currently managed in this country. This makes the UK the largest asset management centre in Europe. It is also one of the most diverse in terms of types of firm and types of activity, serving a wide range of UK and international clients. Just under a third of total assets (£1.1 trillion) managed in the UK by IMA members are for overseas clients.

The latest IMA asset management survey points to an industry that is undergoing considerable change.[1] The survey explores a wide range of issues, including the ongoing fall-out from the financial crisis. This article highlights some of the key trends and features, focusing on ownership, market structure and product development.

A more independent identity

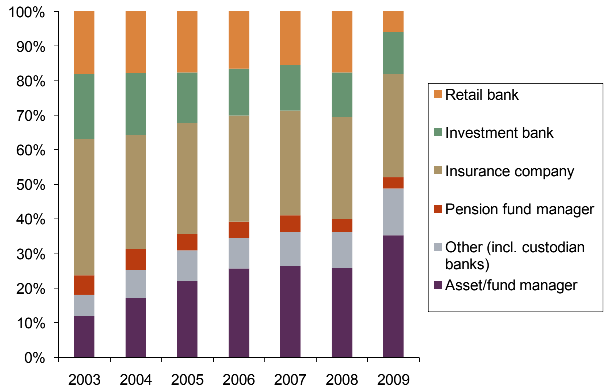
Areas of particular interest in this year's IMA survey were ownership and corporate identity. Historically, insurance companies and retail and investment banks have been the primary owners of asset management firms. Many developed asset management arms as a consequence of other activities they undertook. Indeed, in some parts of Europe asset management is still very closely associated with distribution through bancassurance groups.

In recent years, we have noticed three significant developments in the UK with respect to ownership structures.

- The share of total assets under management in the UK that is managed by stand-alone asset managers has been rising, while that of insurance companies and retail and investment banks has been falling—to below 50% by the end of 2009 (see Figure 1).
- A number of the asset management firms that developed within larger financial groups are increasingly defined by their third-party external assets rather than internal business.
- Third-party asset managers are able to win institutional business from financial groups where the in-house manager might in the past have been the natural manager of parent company assets.

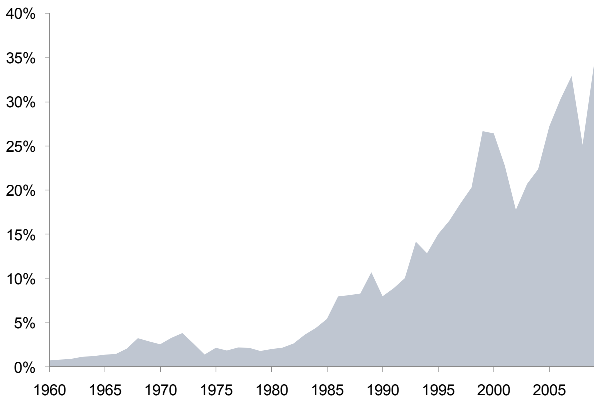
All of this points to an industry where asset management firms are acquiring a much more independent identity. In some respects, this is not surprising. Asset management is a comparatively young industry that has grown rapidly over the past couple of decades, both in institutional and retail client markets. For example, Figure 2 below illustrates the growth of investment funds (the heartland of the retail market) as a proportion of GDP since 1960.

Figure 1: Ownership of asset management firms by the proportion of UK assets under management (2003–09)



Source: IMA.

Figure 2 Investment funds under management—percentage of GDP (1960–2009)



Source: IMA.

The UK financial services industry has also seen the emergence of less vertically integrated operating structures. For the asset management industry, a key change has been that providers are now generally defining themselves as upstream manufacturers of investment fund products, dependent upon distribution networks of different kinds. The distribution process is increasingly characterised by fund platforms and supermarkets that sell investment products from a wide range of manufacturers. The products are also more likely to be unit-linked or life-wrapped investments than with-profits insurance, which broadens the competitive opportunities for external fund managers.

For asset management firms owned by financial groups such as insurers or banks, this can result in a complex set of relationships. The asset manager may be manufacturing fund products for its parent group, while at the same time selling its fund products on rival platforms. Equally, parent group platforms may be selling products from third-party managers. Third-party funds are sometimes sold under an external brand, sometimes as white-label products.

In terms of ownership, therefore, the logic of the connection between certain kinds of financial services provider and an asset management subsidiary has changed. There may of course be other reasons why it would still make sense for a provider to maintain asset management capabilities—for example, the diversification of earnings streams. However, the relationship then becomes rather different.

The most recent driver of the move towards greater asset manager independence came during the recent credit crisis, when the needs of capital-challenged banking groups led to considerable divestment. The largest transaction was the BlackRock/BGI deal, which transformed BlackRock into a pre-eminent global player in asset terms. There have also been other deals involving UK asset management firms.

Still comparatively unconcentrated and likely to remain so

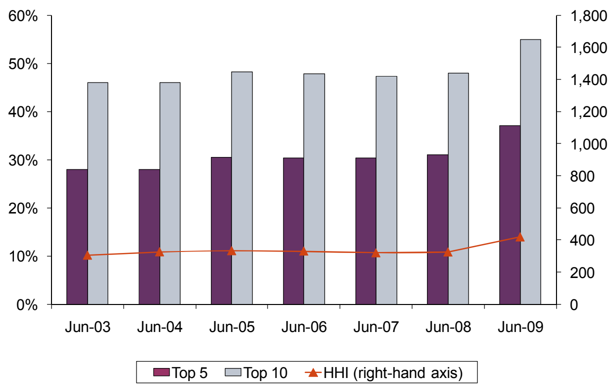
Despite the significant corporate changes over the past 12–18 months, it is interesting that asset management remains a comparatively unconsolidated industry. The top ten firms in the UK manage only just over half of total assets (see Figure 3). Measured according to the Herfindahl–Hirschman Index (HHI), a standard measure of market concentration, the industry currently has an HHI of just over 400, where a reading above 1,000 is generally taken to indicate that the market is moderately concentrated.

While senior figures in firms that we interviewed generally expect further corporate activity in the short to medium term, there is a widely held view that it can be difficult to add value through acquisitions. There are a number of reasons for the perceived difficulty.

- Asset management is an industry that is very much focused on human capital. Integrating different operating cultures and personalities can be far from straightforward. With fairly low barriers to entry, it has been comparatively easy for teams to depart and establish independent asset management boutiques.
- Depending on the strategy, asset class and region of investment, scale in asset terms can sometimes be difficult to achieve without compromising performance.
- There is no guarantee that client assets will follow the asset management business in the event of a merger or takeover.

To address some of these challenges, some firms have opted to go down a 'multi-boutique' route encompassing a number of separate asset management entities. However, this model attracts some strong views. For its proponents, it acknowledges the diversity of the industry and is a way of providing a

Figure 3 Market share of largest firms—UK assets under management (2003–09)



Source: IMA.

home to a number of distinct brands under a single corporate roof with supporting infrastructure. For its detractors, it militates against a coherent corporate structure or integrating culture.

One interesting question is whether the barriers to entry have risen in the aftermath of the recent credit crisis and how this will have an impact on the broad shape of the industry. Some medium-sized and large firms that we spoke to this year believe that size has become more important since the crisis. It remains unclear how widespread or permanent this phenomenon is.

Deploying capital differently

Alongside the move towards a more independent, manufacturing-focused industry, there is increasing suggestion that the intellectual capital of asset management firms could be deployed differently. A feature of the institutional market over the last decade has been a shift, whereby pension funds have moved to employ many more managers on the basis of comparative specialisation, for example, in emerging market equities or global bonds. The old balanced business has been replaced by a far more fragmented market, which has seen the entry of new players, particularly in the alternative investment management space (hedge funds, private equity, etc).

Now, however, there are signs of a further shift. Within the defined-benefit (DB) pensions market (both in the UK and internationally, notably the Netherlands), liability-driven investment (LDI) strategies are becoming more widespread. Under such strategies performance is evaluated against the potential to meet future liabilities rather than against a conventional market index. The IMA survey this year recorded an increase of around a third in assets managed in the UK under an LDI mandate. A number of firms are also seeking to move into the 'fiduciary' space, which sees asset managers take a much more prominent advisory role for pension fund clients in determining strategy and selecting managers.

At the defined-contribution (DC) end of the pensions market, asset managers are reflecting on how better to serve individuals providing for their retirement, through, for example, target date funds or other strategies that can deliver an approach focused on specific investment needs. With individuals in DC pension schemes showing a strong degree of inertia with respect to the selection of investment funds and/or strategies, this raises some interesting issues about the competitive landscape for the design and provision of a 'default fund' (ie, a fund for individuals who do not make their own investment choices and in which their pension savings accumulate by default).

Longer term, there is also likely to be greater demand for innovative products in the decumulation phase (ie, after retirement). With the UK government now consulting on a major reform to retirement income regulation that will see greater opportunities for more flexible deployment of retirement savings, asset management firms will have an opportunity to become involved across the entire pension saving cycle—ie, in the pension accumulation and decumulation phases.

Indeed, the shift to DC pensions is bringing asset managers 'out of the shadows' in the pensions environment and will do so far more in the future. In an environment characterised, until comparatively recently, by a focus on DB workplace pension provision (and which will remain characterised by DB in asset terms for some years to come), asset managers are relatively invisible to the beneficiaries of pension schemes. These employees and retirees see a promise from an employer rather than an investment arrangement. Under DC pensions, where investment risk shifts significantly towards individual employees, there is likely to be a far greater visibility for asset managers, even if most savers will buy units in default options (either single funds or collections of funds) rather than actively select their investments.

This greater visibility of asset managers creates both challenges and opportunities. Taking on a higher-profile role in the pensions environment, including direct provision of product solutions to individuals, gives asset managers a potential responsibility with respect to pension investment outcomes that not all firms are comfortable with. Many will instead be more inclined to remain manufacturing component suppliers, benefiting from comparative specialisation in certain asset classes, regions and/or strategies.

Conclusions: a changing industry

Taken together, these findings suggest that the UK asset management industry is undergoing a considerable transition. First, it is becoming far more independent and manufacturing-oriented. Second, as part of this transition, the industry is likely to become an increasingly visible part of the savings landscape, both in the UK and internationally, with more firms focused on specifically targeted investment solutions for their clients.

Jonathan Lipkin

[1] Now in its eighth year, the IMA asset management survey aims to offer an annual snapshot of the major themes and trends within the UK industry. With 90% of the UK market covered by assets under management, and following interviews with 24 senior figures in firms managing over £2.0 trillion, we believe it is the most comprehensive overview of the UK industry. The survey can be obtained from the IMA website (www.investmentuk.org).

If you have any questions regarding the issues raised in this article, please contact the editor, Dr Gunnar Niels: tel +44 (0) 1865 253 000 or email g_niels@oxera.com

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