PENSIONS FOR PURPOSE PODCAST TRANSCRIPT
FINANCIAL INCLUSION WITH STEWART INVESTORS – S2 EP17

Laasya Shekaran, Pensions for Purpose: Hello everyone, and welcome back to the Pensions for Purpose Podcast. I'm your host, Laasya Shekaran. On today's episode, we're going to be talking about financial inclusion, what it means and why investors should be thinking about this.

My guest for today's episode is Lorna Logan, Portfolio Manager at Stewart Investors. Welcome to the podcast, Lorna.

Lorna Logan: Hello there!

Laasya Shekaran, Pensions for Purpose: It's really great to have you here. Let's start by finding out a little bit more about you, and about how Stewart Investors thinks about sustainable investing.

Lorna Logan: Thanks, Laasya. I am Lorna Logan. I'm an Analyst and Portfolio Manager at Stewart Investors and I co-manage our worldwide strategies. Stewart Investors was formed in 1988, and has a long heritage of investing in Asian and emerging markets, and more recently global equities as well. We're very long-term focused investors. We aim to buy and hold companies for 10 years or longer, and have owned some companies in our portfolios for over 20 years.

Our philosophy is – it's a simple one, really – we aim to invest in very high-quality companies that are run by exceptional people, who are running businesses that are well-positioned for a sustainable future. We launched our first sustainability fund 20 years ago now, and we did that because we believed at that time, and still do very much so today, that sustainability is a key driver of investment returns, not a trade-off to returns. When your investment horizon is so long, it just makes sense to be thinking about the various long-term sustainability risks facing companies and also the opportunities that sustainability trends can present.

What does sustainability mean to us in practice? Well, we are general sustainability investors. We don't define ourselves as environmental, social and governance (ESG) investors, or thematic investors, or impact investors, even. We're simply looking for high-quality companies that either help us to reduce our ecological footprint, or advance human development, or ideally both. This might mean investing in an Indian bank, which is providing financial services to lower and middle-income populations, or it might mean investing in a company providing access to diagnostics tools to help patients' outcomes and also help save costs within the healthcare system. Or it might mean investing in a maker of energy-efficient electric motors. We believe all sustainability issues are important, not just environmental issues and not just human development issues, so we aim to invest in companies which are positively contributing to both.

Laasya Shekaran, Pensions for Purpose: Brilliant. It’s great to hear you talk about sustainability being a key driver of returns, rather than a trade-off. I think there are lots of misconceptions around that.

I want to dig into this idea of human development a little bit more. Often when we talk about sustainability, the focus is perhaps a little bit more on the environmental side of things. How do human development issues like financial inclusion fit into a broader approach to sustainability and sustainable investing?

Lorna Logan: So, within our process, we have two frameworks and we map all of our companies against these frameworks. One is on the environmental side, and that's called ‘project drawdown’. That's a framework that identifies 90 solutions today that if we scale up, will bring us to the point of drawdown, i.e. when emissions peak and start to come down. That's the environmental side. The second framework we use is a human development framework and that's been adapted from the United Nations (UN) and inspired by Amartya Sen's idea of ‘development as freedom’.

We map all of our companies to these 12 human development pillars, and they range from nutrition and healthcare to housing and financial services. So, financial inclusion sits squarely within the financial services pillar for us. It is an important topic for us, but it's also one of many sustainability issues that we're interested in.

Laasya Shekaran, Pensions for Purpose: One of those pillars that you talked about, financial services, financial inclusion falls into that. What does financial inclusion actually mean?

Lorna Logan: According to the World Bank, financial inclusion is defined as individuals and businesses having access to affordable products and services that meet their needs and are delivered in a responsible manner. In reality, it means having access to bank accounts and secure savings, having access to credit, or insurance products, or efficient payment services, all of which enables individuals to thrive, and small businesses to expand and create jobs and drive economic development. Financial inclusion has a huge role to play in reducing poverty, boosting prosperity, and supporting entrepreneurship and business growth. It also has a really important role to play in empowering women, particularly in emerging markets, to grow businesses, to manage household finances and really invest in their future.

Financial independence, of course, is incredibly important for everyone in society, but women in particular continue to be underbanked versus men in many parts of the world. There's been lots of studies proving the link between women's economic empowerment and subsequent improvements in their children's health, in nutrition and education, and children are then more likely to stay in school, delay early marriages, have a stronger voice in society, which then leads to a flywheel of improvements across communities.

The world has been making great progress in driving down poverty levels and income inequality, really up until the middle of the last decade, but the world economy has gone through various shocks, as we know, over recent years, including COVID, wars, the cost of living increases, which has actually hampered much of this progress. In fact, the World Bank now projects that 7% of the population, which is more than half a billion people, will remain in extreme poverty in 2030 and the World Economic Forum also predicts that the timeline to close the gender gap has increased from 100 years to 136 years, depressingly. So there's still a huge amount of work to be done on the financial inclusion front.

Laasya Shekaran, Pensions for Purpose: That is such a depressing stat that the gender gap has actually increased. You'd like to think that it's slowly closing over time, but actually, that's not the case. It’s also great to hear about the importance of economic empowerment for women in broader societal and economic impacts. You mentioned that, Stewart Investors is a global investor, so you're probably looking at this idea of financial inclusion across many different countries. How do the levels of financial inclusion vary across different countries, and what drives these differences?

Lorna Logan: They do. There's obvious differences between the developed markets and emerging markets, and financial inclusion levels vary significantly across countries, even within emerging markets as well.

The World Bank has a fantastic financial inclusion report, which they release every year, and was launched back in 2011. Overall, financial inclusion worldwide has improved over the last decade, so 79% of adults worldwide now have access to formal financial services, which was up from 51% in 2011, but 1.3 billion people still lack access to financial accounts. Nearly all of whom are in emerging markets, and there's still a gender gap, although it has actually been slowly improving in some emerging markets. Within emerging markets, the financial inclusion rates can vary quite dramatically. So, for example, India has made huge progress in this area, with 89% of adults having a bank account, whereas in countries like the Philippines and Indonesia, still only about one in every two people have a bank account. Even in Europe, in countries like Albania, account ownership is less than 50%.

We've really noticed that many Latin American countries have seen impressive improvements over recent years. So in Brazil and Chile, they've gone from being around 50% in 2011 to almost 90% of people having bank accounts last year. Much of that improvement is being driven by digitalisation, and people increasingly using accounts linked to their mobile phone.

It was really the telecoms companies in Sub-Saharan Africa, so the likes of M-Pesa, Viamo and Safaricom, which originally catalysed the mobile money revolution, allowing people in rural settings to access simple transaction accounts without needing to be near a physical branch. Some of the challenges or barriers still remain in some countries, so there's a lack of financial regulatory frameworks, a lack of infrastructure. For example, in the Philippines, there's a lack of a formal credit bureau system, and a lack of fully functioning national ID scheme, and a surprisingly low smartphone penetration level. So, as these things improve, financial inclusion should also improve.

Laasya Shekaran, Pensions for Purpose: Yeah, it's fascinating, and I think it's a really positive story in some of that, in that we have seen areas where there's been a lot of improvement over the last 10 years, and hopefully, if we can carry on those trends in other areas, we can continue to see more progress. So, most of the people listening to this podcast are investors, a part of the investment community and although financial independence is clearly an important topic from a moral perspective, from a how we want the world to be perspective, maybe it's less obvious why investors should care with their investor hat on. What's your take on why investors should care about, or at least be thinking about, financial inclusion?

Lorna Logan: You're right. Other than the moral imperative to care about the human benefits of financial inclusion, both from an individual perspective and also a societal perspective, there's also a number of financial and economic reasons to care about financial inclusion. There's many studies linking financial inclusion and economic growth. So, micro, small and medium-sized enterprises account for an incredible 90% of businesses worldwide, 70% of employment and 50% of gross domestic product (GDP). These businesses are even more prevalent in emerging markets, and as they formalise and grow, the flywheel effect on the economy can be quite significant.

So for us, we see real investment opportunities, particularly in the financial services space, and we invest in a number of banks, insurance and other non-banking financial services companies, which we expect to grow and expand as economies develop. Some of our best-performing investments over the decades have come from financial inclusions in emerging markets, that have benefitted from and contributed to this financial inclusion.

Laasya Shekaran, Pensions for Purpose: When you talk through those numbers in terms of the number of companies, the contribution to GDP, the contribution to jobs, it becomes really clear that it's a part of the economy that you shouldn't be ignoring, and that investors should at least be thinking about this as an opportunity. It would be good to dive a bit more into what that opportunity set looks like, especially given your experience looking at these companies in practice. Just to bring this to life a little bit, can you give us some examples of companies that are helping to address financial inclusion, and maybe tell us a bit about how that would fit into an investor's portfolio?

Lorna Logan: We invest in quite a few financial services companies across emerging markets, including in India, Indonesia, Brazil and the Philippines. In India, we've been invested in a company called HDFC Bank, which is one of the largest banks in India, and is also the leading mortgage provider. Now, they invest and have a big rural footprint, and half of the bank's branches are in rural or semi-urban areas, and that really increases the access to financing for many underserved regions. So, 64% of their loans by volume go to low and middle-income and economically weaker segments.

They're a leading lender to micro, small and medium-sized companies, which have been one of their fastest growing segments as well more recently. Their sustainable livelihood scheme is very impressive also, where they run financial literacy camps and vocational training for individuals and small businesses. They support female entrepreneurs with startup grants and help local communities through the creation of cooperatives and joint liability groups for smallholder farmers. They've created some really impressive innovations. For example, they have milk-to-money ATMs, where dairy farmers can receive instant payments at dairy societies within rural India.

In India, we see a huge runway for growth, with the mortgage rate to GDP ratio sitting at about 11%, and if you compare that to places like the US, it's more like 50%, or 70% in places like Norway, or higher, even, in Australia. Then, if we think about simple share price performance, we've held HDFC in our funds for more than 20 years now, and that's been one of our best long-term performers. It's gone up more than 100x in the decades that we've owned it, and around 80% just in the last five years. So, a really nice performer there.

Another interesting case study is a bank in the Philippines, where we believe financial institutions have a very long runway for growth, given 50% of the population still don't have access to a bank account. So, the Bank of the Philippine Islands is one of the oldest banks in southeast Asia, and has a leading deposit base and strong record for high-quality lending to corporates and consumers, but also micro, small and medium-sized companies as well.

They offer some interesting products, ranging from microloans and micro-insurance to social bonds as well. They work in partnership with the World Bank to help finance green projects, with a focus on small and micro companies, mostly related to sustainable agriculture.

Maybe a couple more. Aavas Financiers Ltd is another Indian company. That's a non-banking financial company that we invest in, so they provide home loans to low-income communities, many of whom are self-employed and don't have formal payslips, or are unable to access credit at other institutions.

Aavas have spent years and years building their underwriting process to really understand their customers' cashflows, and they've built out really deep relationships in local communities.

Although they're lending to customers who could be deemed as slightly higher risk, their loan default rates are actually very low.

We've also made some investments into some of the newer digital banks, such as Nu Holdings in Brazil. So, that was only founded in 2013, but already they've managed to scale that business incredibly quickly. They serve over 100 million customers already, and provide a range of accessible and affordable financial products. They benefit from the fact they don't have expensive legacy systems that the older banks have. They operate entirely online with no physical branches, so their overheads are a lot lower, meaning they can offer cheaper products than their peers. In 2023 alone, they say they've saved their customers an estimated $12bn in US dollars in fees and provided six million people with their first credit card or savings account.

There's lots of great opportunities to invest in really high-quality companies that are also helping to improve financial inclusion. There's obviously lots and lots of companies out there that might appear to be contributing to financial inclusion, but in reality are closer to loan sharks, charging too much or treating customers poorly.

Laasya Shekaran, Pensions for Purpose: How do you tell the difference between a loan shark and a somebody that's being positive and impactful?

Lorna Logan: The interest rates that they're charging is the first thing that we look at, but the companies that we're investing in, they tend to be very conservatively run, and they also tend to be run by a family or a founder steward at the helm, who we know and that we trust, and that they treat all of their customers and all of their stakeholders fairly. Our focus on people and cultures within organisations, and how they treat all of their stakeholders is a very important part of our process, and that really goes back to our heritage of investing in emerging markets since the 1980s. Back then, there wasn't great transparency in reporting, and so you really needed to find the people that you could trust to look after your client's capital; and so finding great people that have very long, good and positive track records is very, very important to us.

Laasya Shekaran, Pensions for Purpose: It sounds like transparency has improved, but do you still find when you're finding these companies – I imagine some of them might be quite small or new to the market when you find them, given in the HDFC example, how much that's grown over time? When you first went into it, it was probably fairly small. Do you find that you have to go to the countries and visit the companies and get to know the people there, or does the reporting provide you with what you need?

Lorna Logan: We do; we travel a lot to all over the world. Our offices are based in Edinburgh, London, Singapore and Sydney, so we don't have offices in India or the Philippines or Brazil, but we travel there regularly, so HDFC Bank, as a team, we will have met with over a hundred times.

Laasya Shekaran, Pensions for Purpose: Wow.

Lorna Logan: We know these companies very well. We travel to meet with them regularly. If we don't travel to meet with them, we will have calls like this, where we can talk over video conferencing. The team will be in India at least once a year, if not twice. It's a big part of our process to get the management teams to sit across the table from them, to understand how they think, whether they have a similar timeframe to us is very important. Given our timeframe is 10 years, we want to back people that have a similar decadal timeframe, rather than CEOs, management teams and boards that just care about next quarter's earnings or short-term profit maximisation.

Laasya Shekaran, Pensions for Purpose: That's a huge challenge for pension scheme investors generally, where they have such long-term time horizons, but often the time horizons of CEOs or quarterly cycles for returns and profits, just aren't really aligned with that, so I can see how important that would be.

I'd like to find out a little bit more about how you actually engage with the companies that you invest in, but also the broader system. What sort of role do you think you play in trying to improve financial inclusion?

Lorna Logan: Engagement is an incredibly important part of our investment process. It's a great way for us to get to know management teams more and to understand how they think about things, so we regularly talk to the management teams, as I mentioned.

The topic of financial inclusion for financial companies that we invest in is always top of mind when we're speaking with them, particularly in emerging markets. At the moment, it's very topical for us. We've been speaking with some of our Indian holdings recently, who have been doing some really interesting things, in regards to financial inclusion, and we've been linking them up with other financial institutions from other regions in Asia, so that they can share their lessons and knowledge that they have gained.

From that process, we're actually in the early stages of planning a bigger roundtable event, which we're thinking of holding in Singapore, whereby we're going to invite a number of the financial institutions that we invest in, and also others that we don't, to come together and share what they do, so that they can learn from each other.

This is something that we've done before on the topic of single-use plastics in India, where we brought together 12 of the largest consumer goods companies in India to talk about single-use plastics and what they can do to help solve the pretty dire situation that is single-use plastics more broadly, but also within India. That worked really well, and so we're hoping that experience is something that we can use to then do something similarly as useful within the financial inclusion space.

Laasya Shekaran, Pensions for Purpose: That sounds really exciting. I think we feel quite similarly at Pensions for Purpose, that using your convening power can be really impactful, and it's great to see you doing that across your portfolio with the companies you work with, bringing them together to share ideas and best practice.

It sounds like a really exciting time, for you and for your portfolio holdings. This has been a really interesting discussion. It's clear that there are some really great opportunities here to think about, impact and human development while also benefitting from a really fast-growing area in the market. If there's one thing you wanted listeners to take away from this discussion, what would it be?

Lorna Logan: I think that financial inclusion is an important topic. It's still an issue in many emerging markets, but it's getting better as digitalisation trends increase and that there are real investment opportunities in the space for all investors, not just sustainability investors like us.

Laasya Shekaran, Pensions for Purpose: Brilliant, absolutely. Thank you so much for joining us today. It's been a really interesting discussion, and hopefully it's getting the subject of financial inclusion on more people's radars.

Listeners, if you want to make sure that you never miss an episode, hit the follow button and remember that you can find us wherever you get your podcasts. Thanks for listening, and we'll see you on the next one. Lorna, thank you very much for joining us today.

Lorna Logan: Thank you.