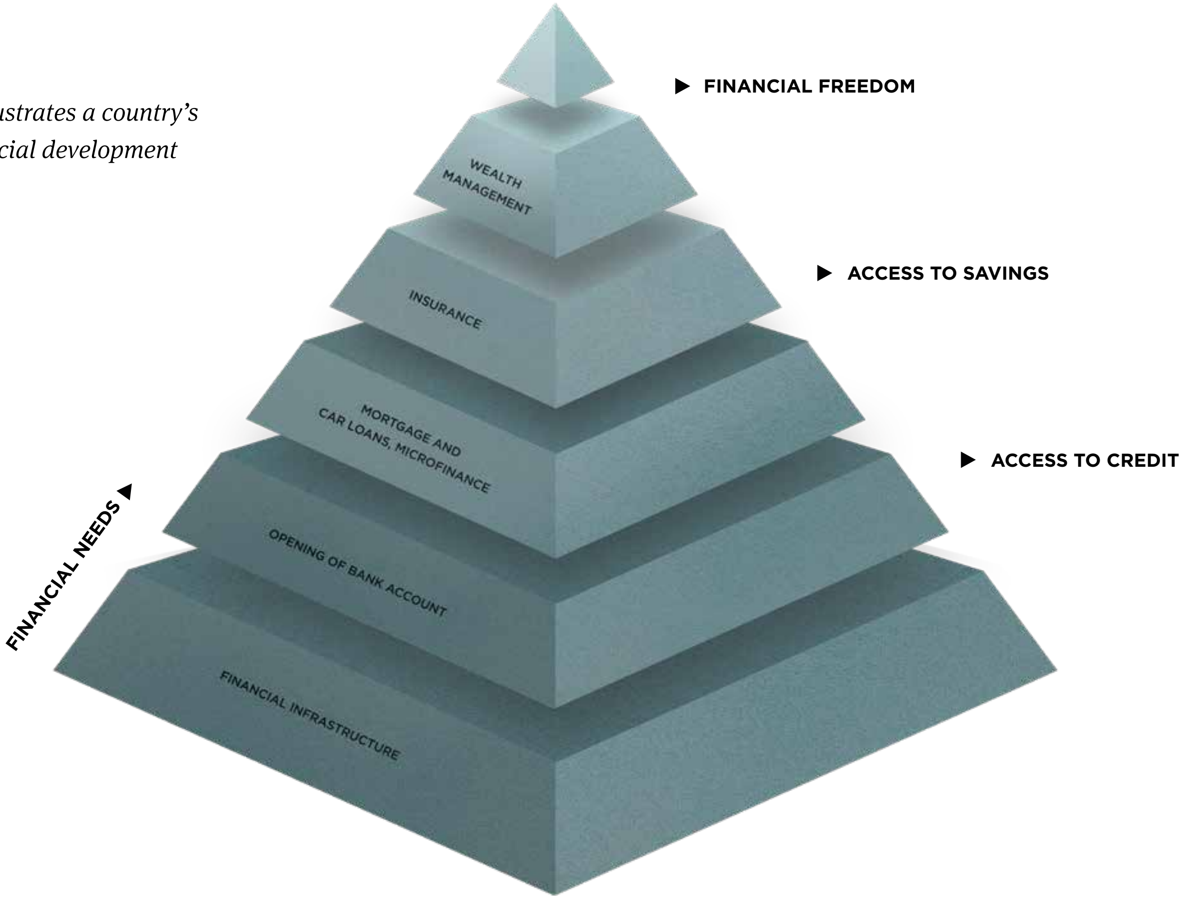
Growing Prosperity has Potential

We live in a world of constant change – a world where prosperity is growing and developing at different speeds. Long-term investors who understand the potential and dynamics of this development can take advantage of a host of exciting investment opportunities within the theme of financial inclusion.

The essential point is to understand the journey of development of a given country and what the citizens of the individual countries or regions will demand. The stage of development is a key parameter within financial inclusion when we seek out growth segments.

The concept of financial inclusion can help clarify a country's stage of financial development. Figure 1 illustrates consumers' financial needs like in Maslow's traditional hierarchy of needs. The precondition for satisfying basic needs is the presence of a financial infrastructure. That in place, opening a bank account is the first need stated at the bottom level of the hierarchy. When this need has been satisfied and the consumer has obtained greater financial leeway, the need for "mortgage and consumer loans" (microfinance) will grow. After this level, the need for safety and security will arise and thus – in financial terms – the need for insurance and savings products. Then follows a growing need for "insurance and wealth management" and, lastly, at the top of the hierarchy the consumer achieves so-called "financial freedom".

This figure illustrates a country's stage of financial development



Likewise, it is interesting to understand the underlying digital transformation that enables the development of financial services for a growing population group. Today, we see technology companies that have historically focused on e-commerce, for instance, make use of their technological infrastructure and data – including data about sales and customers' payment patterns, etc. – to increasingly offer financial services to companies and consumers who currently do not have satisfactory access to the services provided by traditional banks. One example is TCS Group.

Extraordinary growth in some emerging market economies

In the western world, the economies are typically located at the top level of the hierarchy, focused on financial security, wealth management and prosperity. In our global strategy, California-based First Republic Bank, which is focused on private banking and wealth clients, is one example of a bank that has successfully specialised in this segment as the bank's focus on individually tailored services generates high customer loyalty. In emerging markets, the growth stories within financial inclusion occur mainly at the three lowest levels. A large part of the population still does not have a bank account. For example, about 50% of the population in Latin America is outside the official banking sector, and in the Philippines, this share is 80%. Further, there is a huge need for credit among consumers as well as businesses – especially Micro-, Small and Medium-sized Enterprises (MSMEs), who have historically not been served satisfactorily by traditional banks.

These MSMEs represent an attractive growth opportunity as they make up a large part of the economy. In Indonesia, for example, MSMEs account for 60% of GDP and 97% of the labour force. As the financial resources of the Indonesian population grow, we can use our experience from comparable markets – India, for example, which, in our assessment, is some 10-15 years ahead of Indonesia. On that basis, we are focusing on the expansion and consolidation of the mortgage market, where we expect to see significant growth over the next 10-20 years. The ratio of mortgage loans to GDP in Indonesia is only 2% (the corresponding figure in India is 10%), and at the same time the country has a very young population, with 42% of its 261 million people aged below 25. In Indonesia, we have exposure to this theme through Bank Central Asia, which is the leading mortgage lender in Indonesia.

The most well-run and best positioned tech companies as well as banks that are focused on and capable of serving Indonesian consumers and businesses stand to benefit from this growth potential. Morgan Stanley estimates the growth potential of tech companies focused on financial inclusion in Latin America can be up to a staggering 100-fold increase in revenue over the next five years. According to a report by Google, Bain and Temasek from 2019, the market for digital services in Southeast Asia is expected to quadruple by 2025. This is why we focus on these areas as well when seeking out attractive investments. Some local fintech companies in emerging markets have been very successful in promoting the take-up of digital financial services. Our Emerging Markets strategy includes investments in the three Brazilian companies Pagseguro, Mercadolibre and Magazine Luiza.

As consumer wealth in the developing economies increases, households' need for insurance increases as well. Penetration rates in Asia remain very low, typically below 5%, but demand is on the rise, especially so in China where new insurance business is growing at a rate of some 15% a year. The two insurance companies Ping An and AIA, among others, profit from this trend. Both companies are part of our global strategy. Both are well-run companies with a conservative approach to insurance product sales, which has enabled them to increase their earnings over several economic cycles.

Western companies also benefit from financial inclusion

A number of western companies also benefit from the growing demand for financial services in developing economies. The payment service Visa (which has been part of our global strategy for more than ten years) is a good example. Visa's global payment network enables consumers across the world to trade and pay using debit and credit cards on Visa's infrastructure. As prosperity grows, so does tourism activity. This in turn increases the need for international payments. With its recognised brand and a global network of banks and retailers supporting the company, Visa enables this tourism. Growth in international payments is a key growth driver for Visa, and the company earns higher margins on these services.

Thematic investing, a road to compounding

Regardless of which of our strategies you invest in, we invest according to thematic principles. We seek out the most attractive growth segments across the globe. We identify growth phases in the different national economies and pick the best positioned companies, which – based on specific trends such as economic or demographic tailwinds – may be expected to be in a strong position with a viable business model and the ability to generate earnings growth over time. We call this compounding. You can obtain exposure to financial inclusion through all our strategies because we believe this is a structural investment opportunity the coming 10-20 years.

You can read more about our strategies at cworldwide.com.