TRANSCRIPT

PENSIONS FOR PURPOSE PODCAST SERIES 1, EPISODE 10

HOW DIVERSITY, EQUITY AND INCLUSION HELPS ASSET OWNERS AND MANAGERS TO SELECT MORE PROFITABLE COMPANIES – WITH CHARLOTTE MOORE, KAREN SHACKLETON AND ABBIE LLEWELLYN-WATERS

Charlotte Moore: Hi, welcome to the latest edition of the Pensions for Purpose Podcast. I'm Charlotte Moore and your host. I'm delighted to welcome Karen Shackleton, Founder of Pensions for Purpose, back to the show. Hello, Karen!

Karen Shackleton: Well, Hello! It's really nice to be here again, Charlotte.

Charlotte Moore: We're both delighted to welcome Abbie Llewellyn-Waters, Lead Investment Manager of Jupiter's Global Sustainable Equity strategy to the show, welcome Abbie.

Abbie Llewellyn-Waters: Good morning, thanks for having me.

Charlotte Moore: Today, we're going to discuss a report that's recently been co-produced by Pensions for Purpose and Jupiter, which takes a deep dive into the importance of diversity, equity, and inclusion (DE&I). Abbie, can you tell us what motivated Jupiter to carry out this research? Why is DE&I an important issue for the investment chain?

Abbie Llewellyn-Waters: Yeah, there's several reasons why it was important for us to contribute to this initiative. Firstly, I think we have very strong philosophical alignment with Pensions for Purpose in the context of balance of stakeholder outcomes. So you mentioned in your introduction that I manage a Global Sustainable Equity strategy. The investment philosophy of that strategy is to invest in high-quality companies leading the transition to a more sustainable economy, and we define high-quality by those companies, who balance the need of three-core stakeholders being: planet, on which we all depend, people, with whom we all coexist, and the profit that we all require from our long-term savings.

On that basis, we felt it was a really important piece of research that covered across the value chain from asset owners, investment consultants, and investment managers, where we can come together and start to effect meaningful action on addressing some of the social inequality that we see across the global economy.

Charlotte Moore: Karen, can you summarise the key findings of the report for us?

Karen Shackleton: It was a fascinating piece of research, and we decided to look at DE&I with three different lenses. First of all, DE&I in an asset owner's own organisation. Second, was DE&I in their procurement of third-party providers. So, in other words, asset managers, investment consultants, and so on. The third lens, which is probably the one we'll want to explore most today, was looking at DE&I in the underlying investments. How did asset owners think about that? What were they doing to engage and challenge on DE&I?

To give you some headlines on the key findings in terms of their own organisations, what we found was that DE&I is actually an emerging theme. Most funds hadn't really started thinking about DE&I until the early 2020s. There were a few that had begun earlier, but most of them it's a fairly recent thing they've started to focus on. Those who had adopted it fairly early, what we found was they had good governance and sustainability policies in place, and those who were developing their process were focusing on age, gender, and background for their committees.

In terms of third-party procurement, they were mostly asking about DE&I when they went into a procurement exercise to find an asset manager, or a consultant, or a lawyer. However, a third emphasised the importance of policies, and that was something that they looked for in organisations. Something like 40% were including questions specifically on DE&I in their documents.

Finally, looking at the lens of investment, I think this is one of the more interesting findings of the research, because what we found was that most weren't really giving this a lot of thought. Around 40% did consider it in voting and engagement, particularly with, for example, women on boards. Sixty percent of asset owners did ask their asset managers how they integrated DE&I in their ESG policy, but we didn't have anybody who was consciously directing investments towards DE&I themes. Fascinating research!

Charlotte Moore: When you said at the beginning there you found most funds weren't really focusing on this until the 2020s. By funds, do you mean the pension funds, or do you mean the asset managers?

Karen Shackleton: No, I mean the pension funds.

Charlotte Moore: Do you think the asset managers have been looking at this issue for longer than the asset owners? Or is it both parties that only just started to look at these issues?

Karen Shackleton: I think some managers have been thinking about this for a long time, and Abbie is one of those managers, who I think has been very consciously focused on DE&I. For many, they are client-driven, and it's not until the asset owner starts pushing them to answer questions about a particular topic that they will be responsive.

Charlotte Moore: Abbie, if we can turn to you, can we take a deeper dive into why asset managers should be thinking about these issues when they're selecting investments?

Abbie Llewellyn-Waters: Yeah, for context I come to this narrative very much from a bottom-up, stock-picking perspective. I run a very concentrated portfolio of around 35 companies out of an investable universe of 8,000. That gives us a 95% active share. So, very high conviction, concentrated stock-picking approach. We spend weeks and months researching companies when we're looking into our long-term view, particularly because we have a 10-year investment horizon.

So, given the length of our investment horizon with which we anticipate to invest in an issuer, we really like to understand the business, we like to understand the economic sustainability, the planetary boundaries of the operational and product and service revenue of the company, but also to the point of this podcast: the social aspect of it, particularly on a DE&I basis. The reason that we do that is that we see a very strong correlation between leading human-capital policies at a company level, which support a more inclusive economic construct. We see a very strong correlation with those policies and what we would describe as operational excellence.

We've described it as a proxy for operational excellence when allocating capital. We think about it in the context of what a company sells and where it sells it, so sector and region, and that's a really important point. Maybe we can get further into that later on. I think some of these things come best alive when we talk about tangible examples. For instance, we have a financial services software provider. That's a US domestic equity, it's about a $14 billion market cap. This company has extraordinary customer retention. So 97% of its customers stay with it. Ninety percent of its revenue is recurring, and because it's a service business, we spent a huge amount of time on the correlation, looking at the strength of their human-capital policies, because employee loyalty and productivity leading to better customer retention, higher recurring revenue goes to the heart of the capital growth objective, the vast majority of public equity investors would be seeking to achieve.

You'll notice, I've chosen my words relatively carefully, because we can't talk about causation in that example. But we can talk about correlation: high employee satisfaction, high customer retention, high recurring revenue. So looking at these issues becomes a fundamental component of our capital growth objective in our view.

That is a view that we've held for a long time. I think from that perspective, that was one specific example relating to a services business, where employee training, employee loyalty, and low employee turnover is absolutely fundamental to customer satisfaction. There are other examples that we can dive into in terms of tools that we can consider in the context of products and services, and different alignments.

The last tool that I would suggest, which is perhaps one of the most important as we look forward to that point on better economic participation, would be the female representation within the workforce as a whole, not just at the levels of leadership, but also trying to understand the makeup of the workforce throughout the workforce. That would be the final tip I would give.

Charlotte Moore: I think that's a really fascinating point that you made about operational excellence and about being able to actually run your business to the best that it can possibly be. It touches on issues that we discussed in another podcast with the Maturity Institute, who does a whole lot of research and looks at whether companies are too focused on accounting measures alone, just seeing their workforce as a cost base and end up getting rid of a lot of people and then finding it hard to grow once the cycle has turned. I think it's fascinating the way you're echoing on a previous podcast that we've had.

Abbie Llewellyn-Waters: That is really interesting, because what I didn't mention in that preamble was that the specific company chose not to reduce headcount in times where you see financial servicing and capital expenditure being cut back. They chose not to cut headcount because their training cycle on their software service platform can be, depending on the software, between six weeks and 18 months for the more complex platforms, which perhaps some of the listeners will be familiar with in the context of trading platforms within financial services. That was fascinating. Because then, of course, when the capital expenditure budgets returned post-economic decline, they were ready to go. It meant that they took both market share and had pricing power. It's really interesting you raise that point because that's exactly what we saw in that specific stock example.

Charlotte Moore: I think that leads us nicely into a discussion about risk and return, and also how it fits with the asset managers' fiduciary duty. So, if you could maybe address that first part about risk and return, then we can move on to fiduciary duty? Why this consideration of DE&I factors feeds into that.

Abbie Llewellyn-Waters: Yeah, there is a big discussion on fiduciary duty and how it factors into it. We take a pragmatic approach on balance. Can we see a company being an attractive high-conviction investment opportunity based on the three pillars that we described at the beginning: planet, people, and profits? Depending on the company, service, sector, and region we are considering, we would look at that in the context of balance, because it's difficult to compare a Japanese company to a Swedish company, to a Brazilian company. There are different considerations you have to bring into your thinking on a conviction basis that allows those regions to be investable on a global basis, because it's challenging to apply an aggregated global standard to a global investment strategy, due to the regional nuance that we've just described.

I think from that perspective, you have to be careful about achieving your capital growth and your fiduciary duty to your clients. While balancing these outcomes, for us, our clients have an explicit desire to deliver positive environmental and social real-world outcomes. So for a strategy like ours, it's aligned and easy for us to achieve that in the context of our investment framework, because we aggregate that and actively bring it into our fiduciary duty. However, at a broader level, and Karen can speak on this in great detail and with great authority. The broader mix of defining fiduciary duty in the context of these considerations is something that's complex. Karen, I don't know if you want to expand on that?

Charlotte Moore: Let's talk about that and some of the challenges asset owners face when they want to start to integrate these DE&I factors.

Karen Shackleton: The way we work with pension funds when we're helping them to think about their investment beliefs is to encourage them to think about their preferences, their priorities, and what they want to focus on in their funds, but to have that underpinned by an investment thesis.

If you're going to go for gender diversity as one of your priorities, one of your beliefs, make sure you have a firm investment thesis underpinning that. Of course, for diversity, that would be around better governance, ultimately leading to better growth in a company. So I think it's a question about informing trustees of how to go about thinking about DE&I and always bringing it back to their fiduciary duty, saying this is part of your decision about getting the best value out of your investments.

Some of the challenges they faced were mainly around getting the data that they wanted. We asked them what lenses they were prioritizing, and nearly all of them said it was around gender and ethnicity. Some of them talked about social background, but mostly it was around gender and ethnicity. So we then said, what about things like neurodiversity? What about disability? And they said it was difficult to ask about those topics with their staff and managers, as the lack of available data meant that they weren't really able to push on this, although I think, in principle, they wanted to.

So to me, the main hurdle we need to overcome is just getting an openness about talking about things like disability, knowing which questions we should be asking, and making it an acceptable topic, so we can move the industry on and see organizations accommodating disability in their staff and workforce.

Charlotte Moore: I'm aware for the asset owners there's a lot that they need to be doing. It's about their own organizations and the intermediaries as well. It's about the consultants they work with. It's about the asset managers they select. So there is quite a lot of information and data that needs to be gone through, isn't there, Karen?

Karen Shackleton: There definitely is, and many of them were delegating responsibility for things like DE&I data to their investment consultants to ask from their manager, and their managers, of course, are being asked for that data on the underlying investments. Pension funds are often tightly resourced in terms of what they can do. So I think that's perfectly acceptable. But then you have to think, okay, how am I going to challenge my investment consultant? How am I going to challenge my manager to make sure they're keeping on top of this topic?

Charlotte Moore: That in itself requires more resources.

Karen Shackleton: Yes, it does, but I think you can, with careful targeted questioning, get the information that you need. I mean, I always want to see progress being made – not just taking a snapshot and saying yes, we've made sure these companies have policies in place. But okay, let's see the improvement year-on-year.

Charlotte Moore: Okay, and Abbie, for you, what are the challenges for asset managers? In a way, if you're running such a concentrated portfolio – does that make it easier or harder that you only have to focus on 35 companies? Of course, you have to screen the whole universe. If you were running a passive investment portfolio, it would be a different challenge.

Abbie Llewellyn-Waters: For sure on the latter point. Very different. Karen's already alluded to it's data, right? Data is the bottleneck here. We invest and we've bought data sets. We have stripped them out because what you typically find in the world of ESG data is the third-party providers typically lean to a scoring mechanism, which is a fairly blunt tool in our view. Because of the nuance, the regional aspect, etc, to just aggregate into a single score, we find that challenging from a conviction-enhancing perspective.

So, we buy these data sets and we work with our internal data engineering and data science teams to strip those back and get to the core understanding of some of the dynamics in these companies: things like remuneration linked to DE&I targets are absolutely critical. I think we talked about this in the report in the context of multiple social impact multipliers, but also economic outcomes. Half the world's population having better, enhanced economic participation is clearly a net positive for the global economy.

When we're thinking about these things and that impact multiplication, we're looking at things like remuneration-linked DE&I, we look at aspects like parental leave, particularly paternity leave, and paternity leave participation rates. Getting that data on a global basis is really challenging. Engagement is a key tool in the kit we leverage a lot when actually speaking to the companies, when trying to understand them. But as you pointed out, that is a time process. It's a stock knowledge process. But it's also a research outcome that's critical to the conviction enhancements of an investment opportunity on a 10-year forward basis. So time is well spent doing these things, but it's not without challenge.

Charlotte Moore: Yes, and I appreciate that there is a lot of data that needs to be gone through. Given the size of the challenge, could you, Abbie, maybe share your top tips for what asset managers could be doing if they want to embrace this process into their investment process and selection?

Abbie Llewellyn-Waters: Yeah, I think there are some really high-level commitments or baselines that managers could think about in the context of better integration of DE&I. So for us, the starting point would be a commitment to the UN Global Compact.

That is a baseline of 10 guiding principles largely focused on human capital and human outcomes, in the context of exploitation and corruption. Looking at that as a commitment would be a low bar that asset managers would do well to consider. We also have the UN Sustainable Development Goals, which have a target date of 2030 – that is just around the corner in investment terms. We need to accelerate the delivery of those goals.

From a capital markets perspective, there is a huge opportunity to consider the products and services of a company in the context of alignment to that framework, but also the behavioural aspects. We have several goals that sit within the focus of this podcast on a DE&I basis. We have gender equality and reduced inequalities that we could consider.

I was just going to have a quick look at the portal. I think we talked about the IMF study that looked at increased female participation in the global economy. I think it was the bottom-half countries in the sample in terms of gender inequality; if they had better economic participation, they could increase global GDP by an average of 35%.

Charlotte Moore: Wow! That's a big number!

Abbie Llewellyn-Waters: It's a big number! If we think about this in the context of putting that capital markets to work and committing to these goals, and thinking about the operational approach of human-capital policies within a corporate issuer's commitment, but also the products and services they sell.

The other two aspects I just wanted to highlight would be living wage commitments – consider those. We have a fast-moving consumer goods company in the portfolio, which is a global company, and they made a commitment to pay all of their tier-one suppliers a living wage. If you think about the social impact of that on rural communities working as a tier-one supplier to these companies, that has significant real-world outcomes in the context of capital allocation.

So, asking these questions, engaging on these questions of engagement, and working with companies to ensure they are achieving best practice. As investors, we can act as agents for positive change through stewardship, encouraging those companies to adopt better practices, but also to be regionally aware, having those conversations to achieve realistic and pragmatic outcomes in the context of those engagement targets.

Charlotte Moore: Karen, what about you from the asset owners' perspective? Are there some top tips you have for them? If they want to embrace the DE&I agenda and embed it into their process, not only within their own organization but also when they're selecting their intermediaries?

Karen Shackleton: Well, we've highlighted in the research some best practice examples of what other asset owners are doing. A starting point would be to go and have a read of those because there are some great suggestions. Think about the governance structure, make use of things like the Diversity Project’s Asset Owner Diversity Charter questionnaire for third-party providers as a good tool to use, and bring it onto trustee agendas. It doesn't need to be every quarter, but have it as a standing item, perhaps once a year, to really do a deep dive into DE&I on your own committees, DE&I in the third-party providers, and DE&I in the underlying investments.

Charlotte Moore: We've managed to cover a lot of material in a short amount of time, which I'm not surprised by given the calibre of my guests on this show. Just to conclude, I'd like to ask you both, what would your takeaway be? What do you want listeners to have embedded in the forefront of their mind, right there in their frontal cortex when they've finished listening to this podcast? Would you like to go first, Abbie?

Abbie Llewellyn-Waters: We have tools available to us – let's use them!

Charlotte Moore: That's nice and pithy. I love that! How about you, Karen?

Karen Shackleton: The thing that struck me as we were talking is how important this is in terms of the underlying investments. The research identified that perhaps this wasn't being given sufficient focus. So, let's think about DE&I and our underlying investments. What does that look like? What do we want it to look like? And how are we going to monitor and challenge it over time?

Charlotte Moore: I know that I don't really get a key takeaway, but I'm going to give one anyway. I was really struck, Abbie, by what you said about your case study of the software company, about how looking after their employees, nurturing that environment, helped them to nurture their clients and ultimately supported the bottom line. How that absolutely resonates with the earlier podcast we did with the Maturity Institute. It's about being emotionally intelligent in how you manage your human capital and not just having a treasury mindset driven solely by the bottom line. I think that's a really important takeaway for those who might view this as light and fluffy or overly progressive. It's crucial to recognize that this approach has a tangible impact on profits.

What a great podcast! Thank you both for all of your insights. It's been wonderful to talk to you.

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