ClearBridge Investments

ESG Investment Program

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Key Takeaways

- Managing human capital through a pandemic and recovery is requiring approaches focused on the long-term success of both employees and the bottom line.
- ClearBridge holdings are proactively developing forward-thinking solutions that foster stronger hiring and retention cultures, helping to ensure the businesses remain competitive for years to come.
- The pandemic has accelerated the move to e-commerce and put forces into play that should result in higher wages both for workers in large retail supporting e-commerce and adjacent industries such as restaurants.

Cultivating Human Capital for Long-Term Success

Cost pressures in a reopening U.S. economy are coming from a variety of sources: shutdown-related supply shortages, a Suez Canal blockage rippling across global shipping, a semiconductor plant fire in Japan, and, not least, a tight labor market as demand for goods and services outpaces labor supply.

Managing human capital — a mixture of employee skills, wellness, productivity and innovative ability — through a pandemic and recovery is requiring approaches focused on the long-term success of both employees and the bottom line. Among these, wage inflation is conducive to reducing economic inequality in many industries.

As the pandemic wanes and the labor market tightens, ClearBridge holdings in essential retail, rideshare and logistics businesses are balancing labor and shareholder interests by proactively developing forward-thinking solutions that foster stronger hiring and retention cultures, helping to ensure the businesses remain competitive for years to come.

Essential Retailers Prioritize Retention

The pandemic has created challenges for businesses large and small; one major challenge for large essential retailers such as ClearBridge holdings Home Depot, Walmart and Costco has been ensuring adequate staffing to meet demand under trying conditions. All three instituted enhanced pay practices during the pandemic, with raises, unplanned bonuses and other benefits

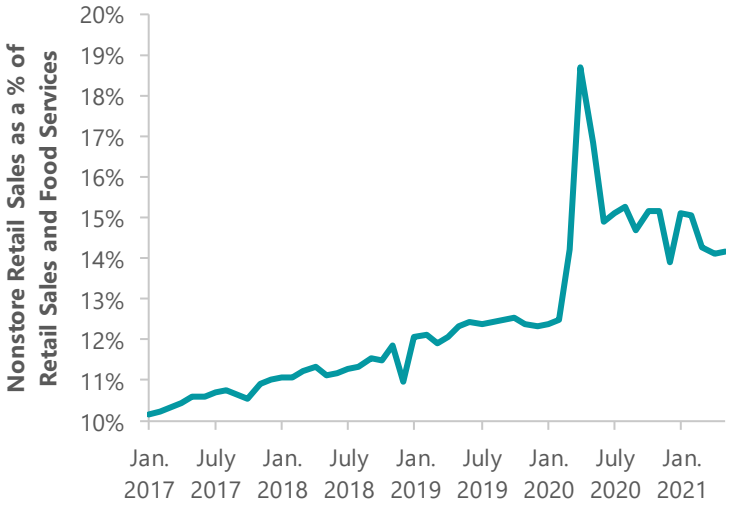
helping compensate employees for their efforts in a difficult environment. Over the course of the pandemic, for example, Home Depot has invested $2 billion in expanded benefits for employees. These have included extra weeks of paid time off that employees could use either as vacation time or supplementary pay, paid time off for employees contracting COVID-19 or requiring to be quarantined, and relaxed time off policies.

While some of the compensation measures are temporary, some have transitioned into permanent wage hikes. At Home Depot, expanded benefits include $1 billion a year in permanent raises for hourly workers. In September 2020 Walmart raised wages for 165,000 employees, including a number of entry positions to $15 an hour. It followed this in February with a raise for 425,000 workers that moved its average pay above $15 an hour. In February 2021 Costco, which we have long acknowledged as a leader in workplace practices, raised its starting wage to $16 an hour; its average wage at the time was $24 an hour.

The expanded benefits have meant a hit to margins for these companies, even while the essential services nature of their businesses has meant large influxes in sales that could offset these outlays, but we view the moves as forward-thinking human capital management.

There is a strategic benefit in raising wages and benefits to keep these businesses competitive. For one, being earlier rather than later in enhancing employee compensation also sends a strong positive message to workers that builds good will and trust. Proactively supporting employees through enhanced compensation measures also better positions these companies amid a scramble for talented workers in a new e-commerce-driven retail paradigm the pandemic has helped cement (Exhibit 1).

Exhibit 1: A New Plateau of E-commerce



As of May 31, 2021. Source: Census Bureau.

Wage inflation is conducive to reducing economic inequality in many industries.

One benefit of proactively raising worker compensation as these companies compete in a growing e-commerce paradigm is better employee retention, a key competitive advantage as higher retention saves costly onboarding and training efforts and keeps institutional knowledge strong. In terms of ensuring access to sufficient labor, Home Depot shared with ClearBridge that there has been no reduction in the number of applications for temporary workers it has been receiving, an indication its human capital policies are ensuring it is still able to attract talent even amid higher competition.

The pandemic has accelerated the move to e-commerce and put forces into play that should result in higher wages both for workers in large retail supporting e-commerce and adjacent industries such as restaurants. Anecdotally, we have seen some spillover effects from wage increases from large essential retail employers (Walmart employs 1.5 million; Home Depot 500,000; Costco 273,000) in that industries competing for this labor pool, such as restaurants, are now seeing worker scarcity as candidates prefer higher-paying distribution center jobs or jobs at grocery stores that are steadier and not reliant on tips.

There is some confirmation of this in the latest job data, which show average hourly wages for retail workers rose 8.6% in June from February 2020, while restaurant and hospitality workers' wages rose 7.9%, both above the overall wage growth of 6.6%. The average hourly wage in the hospitality sector was $18.23 an hour in June, and $21.92 in the retail sector.

While there are prices for the expanded compensation in terms of adjacent businesses, there is also potentially a modest downside for customers in the form of broader inflation as businesses pass on the expenses through price increases, ultimately weakening purchasing power for those enjoying higher wages. This does not seem to be the case at present, however. Companies may also be reducing sale promotions as a way to mitigate labor cost increases. At the same time, many companies will try to offset higher labor costs with technological innovation that will seek to boost efficiencies over the long term.

Culture Shift Coincides with Transport Boom

The recent acceleration of e-commerce has also meant workers are benefiting from upward wage pressure in freight and transportation. Wage inflation, however, is not enough for employee retention. United Parcel Service (UPS) is going a step further by shaping culture, and it is paying off.

Under the new CEO, Carol Tomé, UPS has increased its focus on ESG to retain and attract the next generation of workers. The goal is to move from being a "trusted but stodgy" shipper to a modern innovative company through greater attention to sustainability as

well as diversity and inclusion. Seeking to be a "people-led" company, UPS has been tracking the employee experience in order to understand and improve employee engagement. UPS measures its employee experience by asking how likely employees are to recommend others work there. That metric stood at 51% globally at the end of 2019 but has improved by six percentage points under Tomé's leadership as UPS drives diversity and inclusion efforts across the company, including investing in training, modernizing appearance standards, and adding a Chief Diversity, Equity, and Inclusion Officer on the executive leadership team. Ultimately, UPS hopes to get this "likely to recommend" metric up to 80%.

UPS is also driving environmental goals through its recent pledge to be carbon neutral in all of its operations by 2050. This aligns with the company's mission to attract next-generation talent. The carbon neutral pledge includes goals of 25% renewable electricity for facilities and 40% alternative fuel for ground vehicles by 2025; 50% reduction in CO2 per package delivered for its global small package operations; and powering 100% of its facilities with renewable electricity and running its air fleet with 30% sustainable aviation fuel by 2035.

Tomé's "people-led" approach builds on a long history of engaged workers at UPS; its employees and retirees own Class A stock, which entitles them to 10 votes per share versus Class B (public stock) at one vote per share, giving employees and retirees disproportionate say in voting matters.

Rideshare Moving Ahead of Peers on Labor

The pandemic has also brought attention to the question of gig worker employment status for companies, including ClearBridge holdings Uber and Lyft. In the U.K., Uber proactively classified its drivers as "workers" ahead of final rulings from the British court system. The worker status in the U.K. is a designation between self-employed and employed status that entitles drivers to minimum wage, holiday pay and in some cases a pension.

ClearBridge has engaged with Uber on labor issues since its IPO, and we have given feedback over that time to the CEO, CFO, Chief Legal Officer and Investor Relations on labor relations as well as strategy and communications. Uber's agreement on this designation is ahead of other competitors in the market and the legal mandate represents a step forward in the company's thinking about labor. The agreement represents a short-term hit to earnings, yet in some ways it places Uber ahead of the market in its ability to balance labor and shareholder interests. Workers benefit from improved conditions, with new contributions amounting to roughly 3% of a driver's earnings, while Uber

establishes more certainty on costs and visibility into its regulatory environment and operation conditions in the future.

Continuing to Engage on Important Social Issues

Human capital management is a frequent topic of engagement for ClearBridge with our portfolio companies as it touches on a number of related important social issues in our ESG framework, such as employee health and safety, recruitment and retention, health care affordability and access, union relations, and diversity and inclusion. Our belief is that strong human capital management practices, while they may entail costs that affect the bottom line, are ultimately a competitive advantage, especially when labor is in short supply. In the long run, having the right workforce in place also drives the top line.