



By Denver Investments

Return on Equality™, the Real ROE

The Shareholder Case for LGBT Workplace Equality

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Executive Summary

Workplace equality for lesbian, gay, bisexual and transgender (LGBT) workers in the United States has advanced at a rapid rate. While many studies have looked at the qualitative factors related to companies and their workplace policies toward their LGBT employees, very little research has been done around the effect on companies' financial performance as a result of adopting workplace policies that treat LGBT employees with equality, dignity and respect.

We analyzed stock performance for companies before and after their adoption of LGBT-inclusive workplace policies and compared that performance data to control groups comprised of S&P 500 Index GICS economic sectors. Although the data sets were limited due to the more recent nature of LGBT inclusiveness as a corporate value, we identified a long-term trend toward outperformance of companies relative to their respective sector peers after adopting LGBT-inclusive workplace policies. Specifically, both the percentage of companies outperforming their respective sector and the companies' absolute outperformance of the sector increased five to ten years after adopting LGBT-inclusive workplace policies. We will continue this research as the data sets become larger and a more comprehensive statistical analysis is possible.

Introduction

"The war for talent is over, and the talent won."¹ With businesses becoming more global and connected, talented job candidates have more employment options than ever. Companies must be able to attract and retain top talent if they wish to compete in today's global markets. Firms must not only attract and maintain top talent, but more importantly they should not discriminate against, nor exclude groups of highly qualified workers. By excluding prospective job applicants based on personal characteristics unrelated to the

workplace, firms lose out on talented individuals that otherwise could be productive employees for the firm. This is especially true for the LGBT community, which has very limited, albeit increasing, legal job protection within the United States.

Population estimates for lesbians, gay men and bisexuals range between 3.5% of adults to as much as 7%, while 0.3-1% of adults in the U.S. is self-described as transgenderⁱⁱ. With an estimated purchasing power of over \$800 billion in the U.S.ⁱⁱⁱ, the LGBT community represents an influential component both in the business and consumer landscapes. Many studies have researched various aspects of LGBT-inclusive workplace policies, but very little research has looked at the shareholder return, (i.e. stock price return) of companies that adopt inclusive workplace policies toward their LGBT employees^{iv}.

The purpose of this study was to understand the quantitative effects on companies that incorporate LGBT-inclusive workplace policies and provide support towards the LGBT community. As its main metric for over/under performance this study looked at the annualized total return (with dividends reinvested) both before and after (if applicable) companies qualified for inclusion in the Workplace Equality Index™. Annualized total return was used as the main metric because it provided a financial understanding of whether companies that incorporate workplace equality policies yielded better financial performance than their sector peers.

Selection

The Workplace Equality Index™ (EQLT), an index that tracks financial performance for companies with progressive, LGBT-inclusive workplace policies, was the source of data for this study. The creator of the Workplace Equality Index™, Denver Investments, has been screening publicly-traded companies for LGBT workplace policies since 1998. These companies have met a strict set of objectives around workplace equality for LGBT employees. The qualitative requirements include: (1) prohibition of discrimination in a company's equal employment opportunity statement, (2) providing benefits to same-sex spouses and partners that are on parity with those for opposite sex couples, and (3) including transgender-related health benefits. Companies must also support LGBT employee resource groups.

While many companies meet one or another of these requirements, meeting all of them shows an organizational commitment to workplace equality. For example, some companies may quickly embrace policies that offer parity for all sexual orientations, yet overlook transgender equality, particularly health care coverage for gender reassignment and other specialized medical services.

The Workplace Equality Index also has specific liquidity requirements for the inclusion of companies such as a minimum market capitalization of at least \$250 million and a minimum average daily trading volume of \$2 million in the prior three months. In order to fully capture performance for all publicly-traded companies this study ignored the liquidity requirements of the Workplace Equality Index. Using broader criteria also increased the number of companies in the study.

Data Collection

Annualized total return^v (ATR) performance of each stock was collected on a 1-, 3-, 5-, 7- and 10-year basis before and after implementing LGBT-inclusive workplace policies to provide both short- and long-term performance histories. Start and end dates were collected on a calendar year basis, January 1st to December 31st. The returns of each stock were then compared to the returns of each company's respective S&P 500 GICS Sector (Global Industry Classification Standards) during the same time periods^{vi}. S&P 500 GICS Sectors were the control groups used to represent companies that did not specifically incorporate LGBT-inclusive workplace policies. We acknowledge that these sectors do include some companies that had progressive workplace policies toward their LGBT employees, but we felt using industry standard classifications as a control group was superior to other alternatives. By comparing each stock to its respective sector, it provided an understanding of not only how its peers/competitors performed, but also eliminated any sector biases due to the heavy concentration of LGBT-inclusive companies in certain sectors.

Finally, the annualized total return averages of the selected companies versus their respective sectors were compared on a periodic basis^{vii}. A company's performance against its sector during each time span was calculated individually, then all over/under performance during the same time period was averaged. Many of the companies did not have performance figures for all time periods analyzed (either they weren't public or the data doesn't exist yet), and others had to have returns adjusted for corporate actions, mergers, or acquisitions^{viii}. If a stock did not have performance data during a certain time period, the time period for that stock against its sector was simply ignored and not included in the final calculation. The percentage of companies outperforming their sectors was calculated by dividing the number of companies with a performance greater than zero against their sectors, from the total number of companies in which over/under performance could be collected during that same time span.

To create 7-year and 10-year performance data sets, companies without performance 7 and 10 years forward from their start year were removed entirely. This provided a greater

focus on the performance of companies that have maintained a long-term commitment towards the LGBT community, rather than those that have only recently incorporated those policies.

Approximately two-thirds of the companies in the study fell within three GICS sectors: consumer discretionary, financials and information technology (see Table 1 in Appendix). A likely reason for why these sectors yield the highest percentage of LGBT-inclusive companies may be due to the high priority given to maintaining a skilled human capital workforce in these businesses. These firms logically appear to benefit most from incorporating LGBT-inclusive workplace policies.

This study had obvious limitations from a data standpoint. The number of publicly-traded companies that have adopted LGBT-inclusive workplace policies is not large.^{ix} However, there has been significant growth in the number of LGBT-inclusive companies over the past decade^x.

It is worth noting that this study is meant to understand directional trends with companies incorporating LGBT-inclusive workplace policies, rather than developing a statistically significant conclusion. As more companies incorporate and maintain inclusive workplace equality policies for the LGBT community, this will help develop better insights associated with the quantitative effects on a company's financial performance.

Findings

Performance for all of the time periods studied tended to show increasing out-performance by companies that adopted LGBT-inclusive workplace policies, particularly over the longer term and for companies that maintained a long-term commitment towards workplace equality.

Comparing each of the five pre- and post-inclusivity time periods we found general improvement in performance against the peer sectors. Of all 24 data sets of pre- and post-inclusivity time periods that we studied, both the ATR's out-performance and the percentage of companies out-performing their respective GICS sectors, 18 saw an increase in performance against their sector after adopting LGBT-inclusive policies. Five of the six decreasing pre- and post-inclusivity data sets occurred during the 1-year time period, which is assumed to be the year companies set in place full workplace equality policies. Ten of the twelve data sets measuring percentage of companies outperforming their respective GICS sectors also exhibited an increase after adopting inclusive workplace policies toward their LGBT employees. It should be noted that neither the total return performance nor the percentage of companies beating their sector saw a decline in

5-, 7- or 10-year performance after adopting LGBT-inclusive workplace policies. This may suggest that in order to fully reap better financial performance, companies must maintain equal workplace policies over longer periods.

For the averages of all companies in the study, the ATRs for the 5-, 7- and 10-year time periods saw an improvement; while the 3-, 5-, 7- and 10-year time periods saw an improvement in the number of companies beating their sector. The tendency to outperform peers also increased when looking at companies that maintained a long-term commitment towards equality. All data sets saw an increase in the percentage of companies out-performing their respective GICS sectors with 7-year performance data. Only the 1-year time period saw a decrease for companies with 10-year performance data.

Generally, the number of companies that outperformed their sector 10 years after implementing LGBT-inclusive policies saw a slight (4.5%) outperformance against their sector in the long-run. It is worth noting that the pool of companies' performance going 10 years back was nearly 4 times greater than the number of companies going 10 years forward. Companies with 7- and 10-year performance data, however, did show a general underperformance against their sectors before meeting the Workplace Equality Index™ inclusion criteria, both in ATRs and percentage of constituents beating their sector. After adopting LGBT-inclusive workplace policies, companies exhibited a clear out-performance trend over their respective GICS sectors. The greatest percentage changes were the 3, 5 and 7 year data sets for companies with 10-year performance numbers, which saw more than double the percentage of companies beating their sectors after adopting inclusive workplace policies than before adoption.

There were two major challenges that were encountered in the study. One was collecting information on the same companies during the same pre- and post-time periods. The second was collecting enough company data to have a complete analysis. The number of companies that had data pre- and post-index inclusion remained very small. Only 22 companies met this requirement for 10-year performance, while 58 companies met this requirement for the 7-year performance. The performance data still yielded a gradual upward trend over time with nearly all data sets showing an improvement. Of the 18 data sets we studied, ATRs and percentage of companies outperforming their respective GICS sectors, 15 either saw an improvement or similar performance.

Conclusion

The incidence of companies adopting LGBT-inclusive workplace policies is fairly new in the history of capital markets. The recent nature of these policies can only suggest or shape a trend rather than a statistically significant correlation. On a quantitative level, however, current performance results suggest that companies that adopt LGBT-inclusive workplace policies tend to provide better shareholder returns than do their broader economic sector peers over time. Maintaining a long-term commitment towards equality-minded workplace policies may lead to better stock returns. As more time passes and more data is available on equality-minded companies, there may indeed be a shareholder case for workplace equality.

About Denver Investments and the Workplace Equality Index™

For more than 15 years, Denver Investments has managed portfolios for clients seeking to invest in companies with progressive workplace policies toward their LGBT employees. Based on the screening criteria developed to facilitate identifying companies that meet our LGBT-inclusive criteria, the Workplace Equality Index™ was created as an investable index of equality-minded companies doing business in America. The screening criteria generally include mandatory language in a company's equal employment opportunity (EEO) statement prohibiting discrimination based on sexual orientation and gender identity, offering health benefits to same-sex partners or spouses of employees, along with other corporate benefits and privileges. Other screens are performed with the goal of eliminating companies that would detract from the Index such as companies in bankruptcy or reorganization. Stocks of the companies in the Index are equal-weighted, typically with a market capitalization larger than \$250 million. The Index is reconstituted with additions and deletions once a year, and rebalanced to equal weight at the end of every quarter.

Biographies of the Authors

John N. Roberts is a partner and portfolio manager with Denver Investments where he has managed portfolios screened for LGBT-inclusive workplace policies since 1998. He currently oversees the Workplace Equality Index™, which he envisioned in 1998 and has a track record back to 2001. He earned a Bachelor's degree in Business Administration from The George Washington University and a Juris Doctor from the University Of Denver College Of Law.

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APPENDIX

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Percent of All Companies in Study in Each GICS Sector

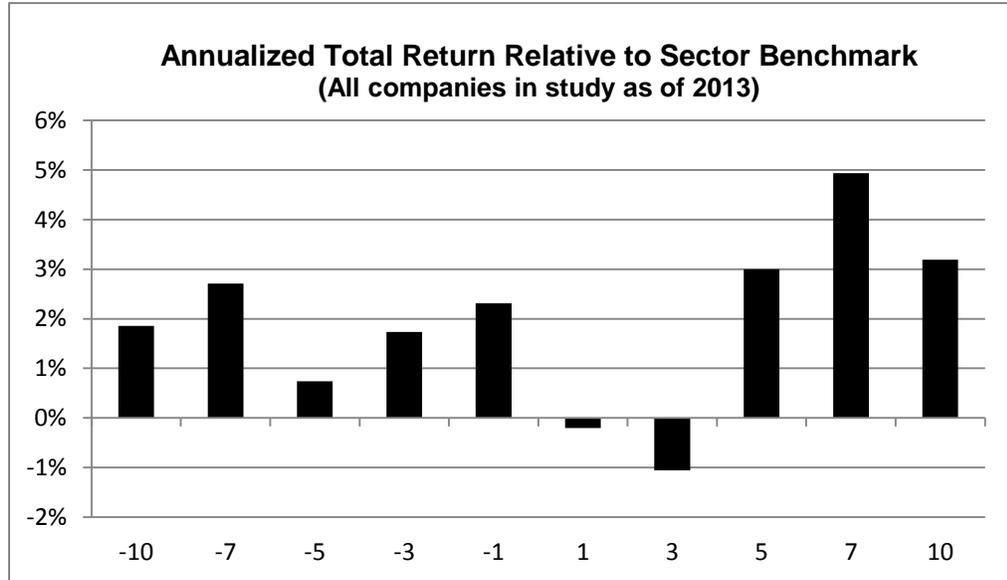
GICS Sector	% of Companies in Sector (all time periods)
Consumer Discretionary	24.7%
Consumer Staples	8.7%
Energy	1.3%
Financials	25.3%
Health Care	8.7%
Industrials	6.7%
Information Technology	17.3%
Materials	2.7%
Telecommunication Services	2.0%
Utilities	2.7%

Performance Data

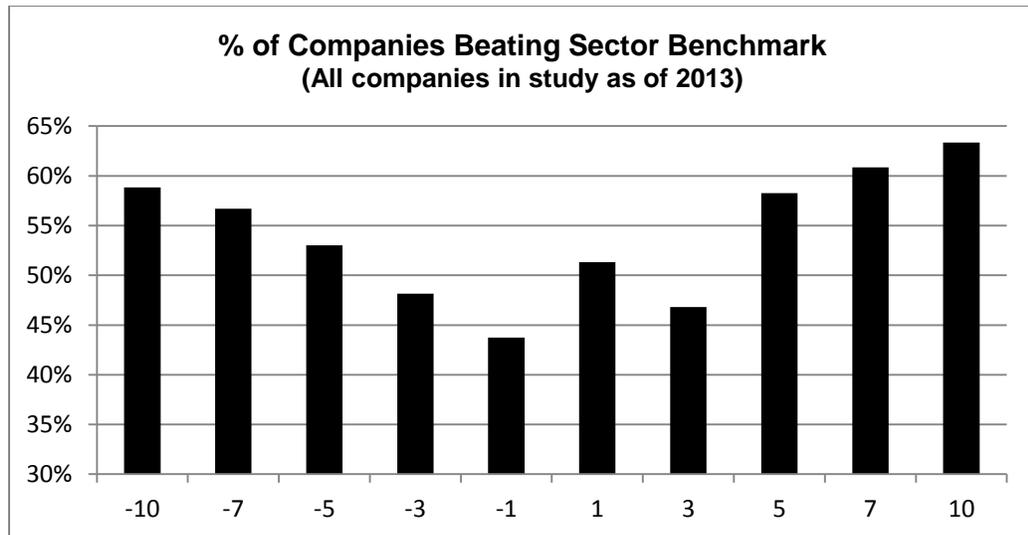
Both returns against benchmark and the percentage of companies beating their respective sector peers increased after companies' adoption of LGBT-inclusive workplace policies. This is shown graphically on the next page.

Workplace Equality Performance (All companies as of 2013)			
Years to/from Inclusion in Index	Number of Companies	Annualized Total Return Relative to Sector Benchmark	% of Companies Beating Sector Benchmark
-10	119	1.86%	58.82%
-7	127	2.71%	56.69%
-5	132	0.74%	53.03%
-3	135	1.73%	48.15%
-1	144	2.31%	43.75%
1	150	-0.20%	51.33%
3	126	-1.06%	46.83%
5	103	2.99%	58.25%
7	69	4.94%	60.87%
10	30	3.19%	63.33%

Three-year negative performance against benchmark notwithstanding, the long-term trend of increased outperformance looks encouraging.



An increasing percentage of companies outperformed their respective sector peers after adopting LGBT-inclusive policies.

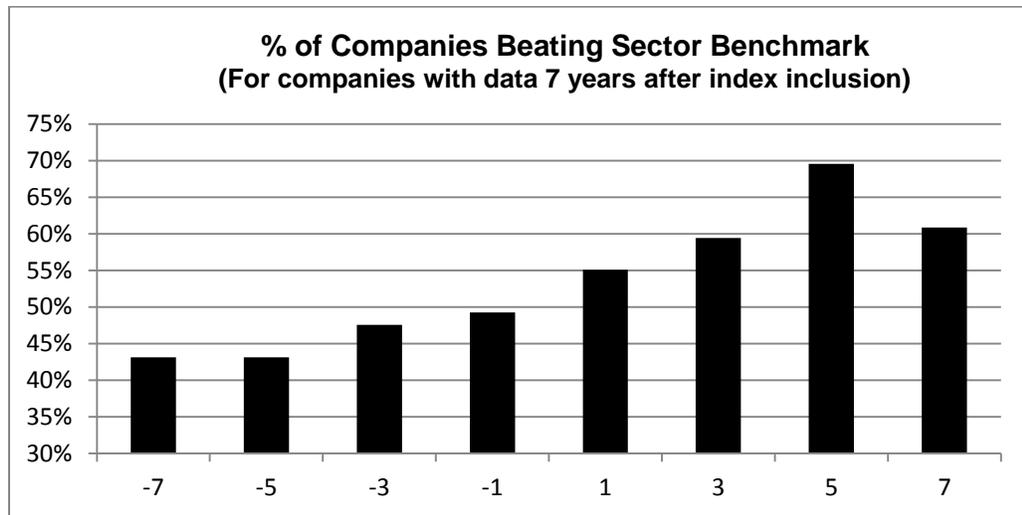
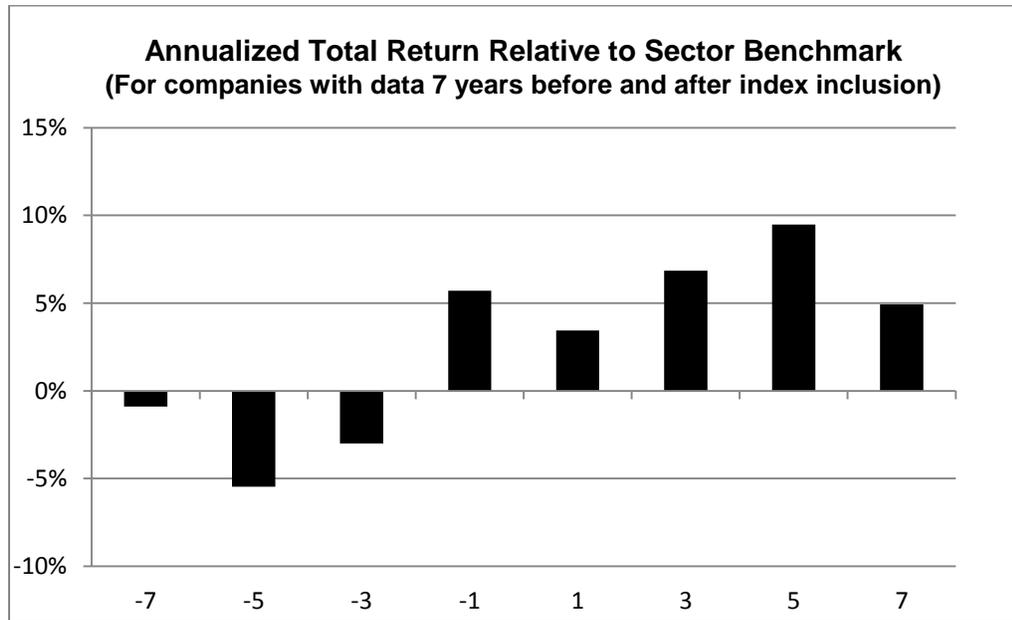


Return on Equality™, the Real ROE; the Shareholder Case for LGBT Workplace Equality

The same trends of increased outperformance and an increase in the percentage of companies outperforming is amplified in the data set with seven years of historical performance as compared to the entire data set. Both relative sector outperformance and the percentage of companies in the study outperforming increased.

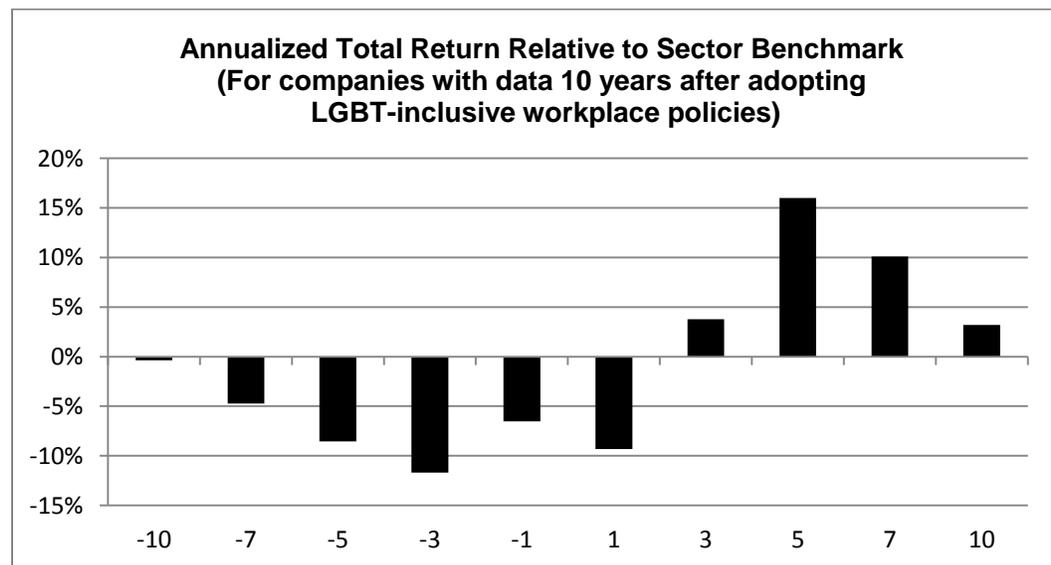
Workplace Equality Index Performance (For companies with data for 7 years before and after adopting LGBT-inclusive policies)			
Years to/from inclusion in index	Number of Companies	Annualized Total Return Against Sector Benchmark	% of Companies Beating Sector Benchmark
-10	54	-1.06%	42.59%
-7	58	-0.90%	43.10%
-5	58	-5.46%	43.10%
-3	61	-2.99%	47.54%
-1	67	5.70%	49.25%
1	69	3.44%	55.07%
3	69	6.86%	59.42%
5	69	9.47%	69.57%
7	69	4.94%	60.87%
10	30	3.19%	63.33%

More data is needed to parse out the seven-year number. The falloff in outperformance and percentage of companies outperforming could be due to the small data set.



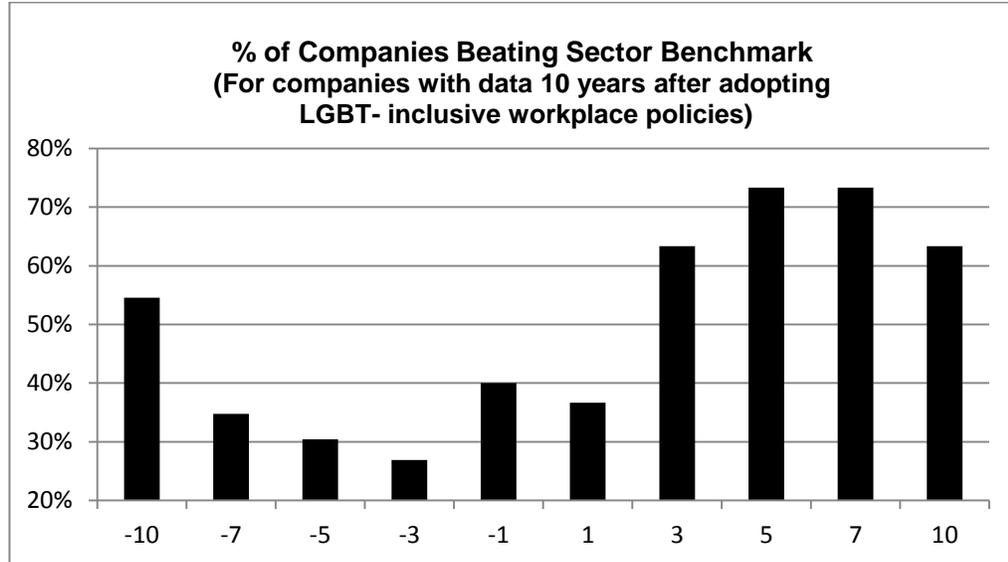
Workplace Equality Index Performance (For companies with data 10 years after index inclusion)			
Years to/from index inclusion	Number of Companies	Annualized Total Return Against Sector Benchmark	% of Companies Beating Sector Benchmark
-10	22	-0.37%	54.55%
-7	23	-4.72%	34.78%
-5	23	-8.56%	30.43%
-3	26	-11.71%	26.92%
-1	30	-6.54%	40.00%
1	30	-9.32%	36.67%
3	30	3.76%	63.33%
5	30	16.02%	73.33%
7	30	10.10%	73.33%
10	30	3.19%	63.33%

For companies with 10 years of data, the difference in performance versus sector benchmark is significant. The data shows companies move from underperforming to outperforming their sectors after adopting LGBT-inclusive workplace policies.



Return on Equality™, the Real ROE; the Shareholder Case for LGBT Workplace Equality

Here we see that the percentage of companies outperforming their respective sector increases from approximately 30% before adopting LGBT-inclusive workplace policies to well over 60% in the three to ten years after adoption.



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NOTES

ⁱ Bersin, Josh. "The Year of the Employee: Predictions for Talent, Leadership, and HR Technology in 2014." *Forbes* 19 Dec. 2013. Print.

ⁱⁱ Gates, Gary J. "How many people are lesbian, gay, bisexual, and transgender?" *The Williams Institute* April, 2011. <http://williamsinstitute.law.ucla.edu/wp-content/uploads/Gates-How-Many-People-LGBT-Apr-2011.pdf> Accessed August 18, 2014.

ⁱⁱⁱ Witeck Communications. "America's LGBT 2013 Buying Power Projected at \$830 Billion." Witeck Communications November 18, 2013 <http://www.witeck.com/pressreleases/lgbt-2013-buying-power/> Accessed August 18, 2014

^{iv} Schwarz, Joshua L. and Wang, Peng. "Stock Price Reactions to GLBT Nondiscrimination Policies." *Human Resource Management* 49.2 (2010) 195-216.

^v Annualized Total Return = $[\prod_{i=1}^n (1 + r_i)]^{\frac{1}{n}} - 1$

^{vi} (Annualized Total Return)_{Company} – (Annualized Total Return)_{GICS® Sector} = Company Out Performance

^{vii} $\frac{\sum \text{Sector Out Performance}(+/- n \text{ years from start})}{\text{Number of Companies with performance data}}$

^{viii} Due to changes in tickers or company reorganizations, some companies needed individual adjustments to provide ATR. American Airlines (AAL) was adjusted with its previous ticker, AAMRQ, to provide more historical performance. Kraft Foods (KRFT), which de-merged from Mondelez International (MDLZ) in 2012, was also adjusted; ATRs from Mondelez was used for Kraft with the exception of the 10 year performance, which adjusted for KRFT's 2013 performance (the first full calendar year Kraft Foods publicly traded).

^{ix} As of 12/31/2013, there were less than 200 publicly-traded (at some nominal volume) companies that met the qualitative criteria for the Workplace Equality Index™.

^x In 2002, the Workplace Equality Index™ consisted of nine companies. By 2008 that number had increased to 119, and by 2014 the Index contained 164 companies.