2022

INTERNAL PAY EQUITY REPORT

EXECUTIVE SUMMARY

In September of 2020, Acme Corporation (ACME) sought to conduct an internal pay equity study for its non-exempt workforce. Internal pay equity describes the extent to which an organization's compensation is related to the behavioral contributions of employees, meaning employees are paid equally for significantly similar work. Such analyses also ascertain the extent to which protected individual differences, such as age, gender, and ethnicity/race, impact performance evaluations and compensation.

Red Castle began the process with data engineering, cleaning and integrating company records into a single database that would enable the needed analyses. Following this process, regression analyses were conducted on the data to analyze the factors that were driving performance evaluation and compensation at ACME in 2019 and 2020. These analyses were conducted after controlling for other factors that influence compensation, such as tenure, job role, shift differentials, additional compensation for safety leaders, and disciplinary actions.

The results of these analyses suggest that there is no statistically significant variation in performance evaluations or total compensation based on age, gender, ethnicity/race in 2020. However, historical analyses from 2019 suggest pay differences based on ethnicity/race and gender, where non-Caucasian employees and females earned less than Caucasian and male employees, after controlling for relevant work-related differences.

These findings suggest that there is not a current inequity problem at ACME. However, they also represent a cautionary tale for the company's leadership. In particular, the historical findings of inequity suggest a need to closely monitor performance evaluation and compensation practices, potentially engage in training and development for supervisors regarding best practices for performance management, and to monitor selection/staffing practices in the placement of female and minority employees. We also recommend that ACME assess internal equity every 2-3 years to monitor performance evaluations and compensation.

THE PROCESS

1. Background and Context

ACME, America's largest and oldest manufacturer of anvils, is a Tennessee-based, fifth-generation, family-owned company committed to doing the right thing for its employees and community. As part of its commitment to being a socially responsible corporate citizen, ACME seeks to build an inclusive workplace, where employees are rewarded fairly — based on their performance, skills and other job requirements — and where pay inequity due to gender, race/ethnicity and other demographic factors does not exist. Beyond its corporate values and fairness reasons, the firm also sees pay equity as critical to talent acquisition and retention, employee engagement, and legal compliance.

ACME's compensation and people data for the 2019-2020 period was analyzed to determine the extent to which gender and race/ethnicity (i.e., unjustified factors) relate to employees' compensation. The team also examined the extent to which legitimate compensable factors (such as organizational tenure, business unit, disciplinary record, and performance) influenced employees' pay.

This report begins with an overview of the methods and data used in the Pay Equity assessment and is followed by a summary of the key findings. The report concludes with a set of key recommendations and best practices to advance pay equity, as well as broader measures to promote an equitable and inclusive workplace.

2. Methodological Process

The data cleaning and integration was accomplished using the software package R and Python Script over a period of four weeks. Once this was done, a Senior Consultant reviewed the data integration as a quality control check, and began running statistical tests on the data. The final dataset included:

- Employee performance evaluations
- Recommended Raises
- Total Compensation and Historical Compensation

- Race/Ethnicity
- Tenure
- Unit Pay Differentials
- Department Location
- Disciplinary Actions
- Job Code
- Shift Differentials
- Safety Differentials
- Age
- Gender

One Senior Consultant analyzed the data, tracking all manipulations and tests to enable replication. Following the completion of statistical analyses, and a second Senior Consultant was given the raw data, analytical methodology, and findings. This enabled independence of assessments and added extra rigor to ensure that the analyses were accurate.

3. Objectives

This Pay Equity assessment uses statistical analysis to investigate whether gender, race or another protected class accounts for differences in compensation at ACME. In conducting this exercise, we paid attention to three issues or steps:

- **Establish a definition of pay equity that is meaningful to ACME.**

The traditional definition of pay equity, based on federal laws and widely accepted standards is: 'equal pay for equal work'. However, several U.S. states are expanding equal pay protections, and forward-looking organizations are broadening their definition of pay equity to: 'equal pay for substantially similar work'. We recommend that ACME adopt this higher standard.

- **Utilize statistical models to conduct a pay equity analysis.**

Our statistical model includes legitimate non-discriminatory data — for example, basic employment status and historical employment information, job title, overtime exemption status (we focus on hourly employees only), tenure, business unit information, and performance ratings — and discriminatory variables, notably employee age, gender and race/ethnicity.

- **Conduct a regression analysis of ACME's compensation data.**

The goal of the regression analysis is to address the following key questions:

Does ACME have a gender pay gap?

Does ACME have a racial pay gap?

To what extent do justifiable factors (e.g., experience, job level, skills,

tenure, performance, etc.) impact ACME employees'

performance evaluations and earnings?

- **Provide evidence-based insights and recommendations on how to advance pay equity and foster an inclusive workplace culture.**

Based on the results, and our review of research evidence and best practices, we will recommend strategies and actions for advancing pay equity and workplace inclusion at ACME.

THE FINDINGS

In this study, we analyzed compensable factors such as: employee age, organizational tenure, unit pay rate, work shift, job title, verbal and written disciplinary warning, performance, and departmental description. These are all legitimate, non-discriminatory factors. The discriminatory factors investigated in the model are age, gender, and race/ethnicity.

Most of the legitimate factors included in the regression models using 2020 data were found to be statistically significant. Unit pay rate, work shift, job title, organizational tenure, performance, and department description of workers were all statistically significant. These factors account for differences in annual pay between workers at ACME.

However, from the cumulative analysis, the two most significant drivers of pay are *unit pay rate* and *work shift*. These two factors are statistically significant in all models analyzed. All other legitimate factors also become non-statistically significant with the inclusion of unit pay rate and work shift. However, in the analysis of 2019 data, only job title and organizational description remained statistically significant with the inclusion of unit pay rate and work shift.

4.1 Gender Pay Equity

There is currently no statistical significance in performance ratings or annual pay between male and female non-exempt employees at ACME.
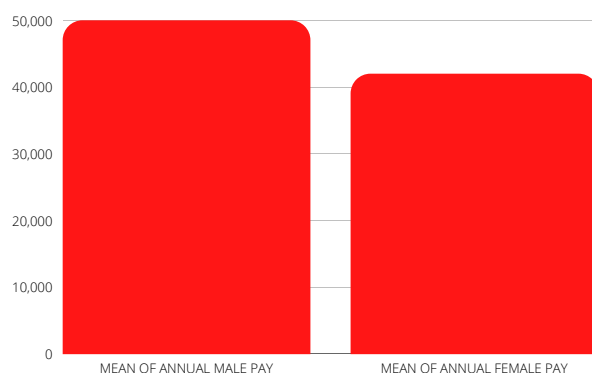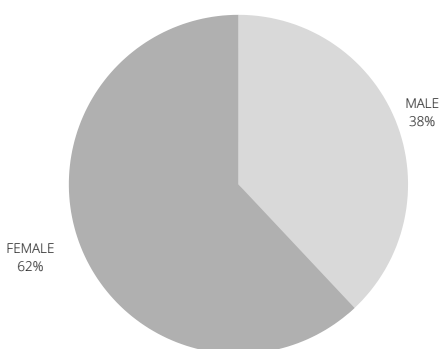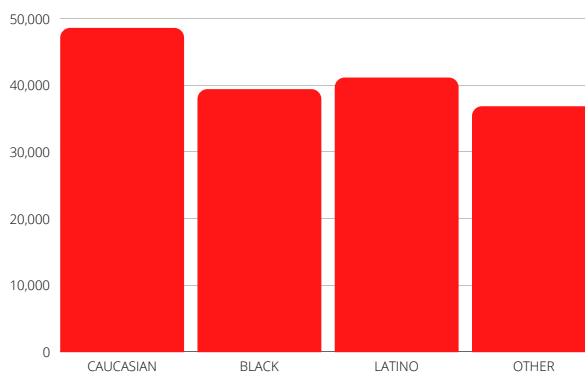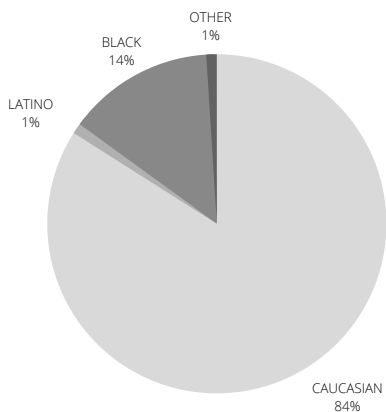
When annual pay for 2020 at ACME is analyzed solely based on gender, on the average, men earn $50,166.75 while women earn $42,160.03. However, after controlling for all legitimate non-discriminatory factors, the difference in pay between men and women was not statistically significant. In 2020, men earn $227.86 in annual pay less than women, after controlling for all necessary legitimate factors, this difference is not statistically significant.
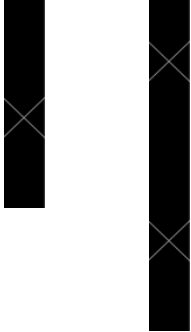
However, an analysis of 2019 data showed that gender was statistically significant, and on the average men earned $445.99 more than women after controlling for legitimate non-discriminatory factors. There are a number of changes in gender pay equity analysis between 2019 and 2020.

One, in 2020, there is a reduction in the average difference in annual pay between men and women. Two, the difference, though significant in 2019, became non-significant in 2020. The reason(s) for this change in the gender pay equity between 2019 and 2020 requires further investigation.

4.2 Racial/Ethnic Pay Equity

Race/ethnicity is not currently statistically significant in determining performance and annual pay at ACME.

In the analysis of 2020 data, race/ethnicity is not statistically significant. When annual pay for 2020 at ACME is analyzed solely based on race and ethnicity, Caucasians earn an average of $48,563.01 and Blacks earn an average of $39,385.60. On the average, Latinos earn $41,123.28 and other races earn an average of $36,821.09.

However, after controlling for all legitimate non-discriminatory factors, on average Caucasians earn $168.71 less than other races and ethnic groups. This difference is also not statistically significant. However, in 2019, race was statistically significant and Caucasians earned $406.86 more than other races and ethnic groups. However, this statistical significance was only marginal (significant level was 0.52 in comparison to a 0.50 cut off significance level). Similar to the changes in the gender pay equity between 2019 and 2020 above, the change in race and ethnic pay analysis between 2019 and 2020 may also be worthy of further investigation.

4.3 Pay Equity and Employee Age

There is no statistical significance in performance or annual pay in relation to employee age at ACME.

The data for 2020 shows that on the average older employees earn only $2.73 less than younger employees. This is a reduction from $10.78 from 2019. In both years, there is no statistical difference in the annual pay earned by older and younger employees. Employee age plays no substantial role in the determination of annual pay at ACME.

4.4 Pay Equity and Employee Performance

While performance evaluation has a statistical significance on annual pay, disciplinary measures have no statistical significance on annual pay at ACME.

In both 2020 and 2019, disciplinary measures such as verbal and written warnings had no statistical significance on workers' annual pay. Performance evaluation, on the other hand, was statistically significant in both years.

Despite being statistically significant, performance evaluation does not seem to have considerable consequences on workers' pay. It also appears that the use of negative reinforcement is more prevalent at ACME. Interestingly, the non-statistical significance of verbal and written warnings on workers' pay may mean that these forms of disciplinary measures may not be having the desired effect. This finding is however only preliminary, but the disciplinary and performance evaluation policies at ACME may require further exploration.

4.5 Justified Compensable Factors and Pay Equity

The two main legitimate non-discriminatory factors with statistical significance at ACME are unit pay rate and work shift differentials.

The statistical significance of unit pay rate and work shifts are pointers to some compensation policies at ACME. On the average, after accounting for other factors, unit pay rate accounts for $1,583.89 in annual pay in 2020. In 2019, this was $837.69, an increase of 89.06%. Between 2019 and 2020, ACME appears to have implemented some policies that have had a statistically significant increase in the effect of unit pay rate on workers' annual pay.

The average unit pay rate for hourly non-exempt workers at ACME is $18.74. From the output graph below, the unit pay rate of 54% of workers at ACME is between $15.01 and $20.
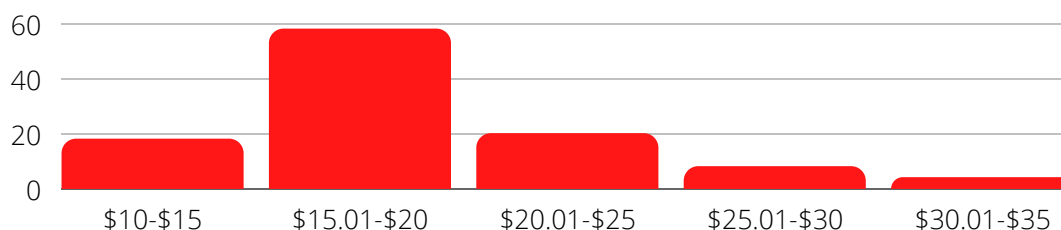
RECOMMENDATIONS AND BEST PRACTICES

Consistently use data and analytics to inform pay and talent decisions.

Pay equity is an ongoing commitment. While our analyses do not raise concerns about serious bias or discrimination at ACME, we caution against complacency. In reality, whenever an organization hires, fires, promotes (or demotes) an employee, that changes the pay data and affects the group comparisons. It is therefore important for managers to use data and analytics to inform pay decision-making; we recommend incorporating gender and racial equity audits into ongoing pay increase and promotion cycles (PayScale, 2019).

Perform strategic and compliance review of compensation philosophy and policies.

Our analysis shows that organizational variables such as unit pay rate, work shifts and employee performance influence pay at ACME. Further, our analyses show that there are no considerable racial and gender pay gaps. In some instances, it appeared the firm had made the necessary adjustments to address pay gaps, which suggests that ACME's compensation philosophy or strategy is shaping pay levels as designed.

However, we have not reviewed the organization's compensation philosophy, and we strongly recommend conducting a strategic review to ascertain how the organization's compensation philosophy drives business results. There is also a need to regularly conduct a legal review to ensure that pay practices comply with the following federal and state regulations and statutes that ban discrimination in pay: The Equal Pay Act of 1963 (EPA); Title VII of the 1964 Civil Rights Act; The Age Discrimination in Employment Act (ADEA); The Americans with Disabilities Act (ADA); The Tennessee Equal Pay Act. In particular, we recommend performing a thorough review of pay structures, starting pay policies, merit increase policies, promotional pay policies, and record keeping practices.

Conduct a firmwide total pay equity analysis.

Our pay equity analysis has focused narrowly on base compensation, and on hourly employees. However, the laws against pay discrimination cover all forms of rewards, including bonuses, profit sharing and bonus plans, life insurance, vacation and holiday pay, and other benefits.

In addition, recent surveys show that pay gaps often widen as women move up the ranks to managerial levels; for example, it starts at 98.3 cents to $1 for individual contributors and widens to 94.4 cents for executives (PayScale, 2019). We therefore recommend a review of other forms of rewards beyond base pay, and a firmwide equity analysis that covers exempt professionals and executives.

Institutionalize pay transparency.

Pay transparency can help to achieve pay equity. It promotes diversity, increases employee productivity, and generates value for businesses (Russell, 2020). We therefore recommend that ACME implement pay transparency practices that may be suitable for its context.

NEXT STEPS FOR ACME

Although pay equity is the focus of this engagement, we think it is important to highlight the need for a coherent diversity, equity and inclusion strategy — given the increasing attention to racial, gender, disability, LGBTQ+ and other dimensions of difference in society. Moreover, the business and moral case for diversity, equity and inclusion is strong and growing stronger. Below, we outline four best practices for advancing pay equity and institutionalizing equity and inclusion.

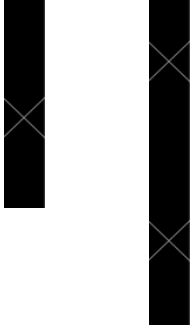### Incorporate Pay Equity into Corporate Diversity & Inclusion Strategy

Pay equity should be seen as just one (important) element of an organization's overall diversity, equity and inclusion strategy. To build a truly inclusive workplace, attention needs to be paid to integrating equity and inclusion into all HR practices and processes: recruitment, selection and onboarding; total rewards; and learning and talent development. This should go beyond compliance ("What we have to do to stay out of trouble?") towards integrated ("How can we create business value from our diversity of employees?") (Deloitte, 2018).

Make Performance Management Inclusive

Our analysis showed that performance management is an important tool at ACME. As such, it is important to continuously seek ways to identify and fix any biases in the performance appraisal and management processes and practices. Some practical tips for making performance management more inclusive include rating inclusive behaviors, training managers to overcome common biases, and providing a performance discussion toolkit to guide valid assessments of employee contributions (Mackenzie, Wehner and Correll, 2019).

Promote Inclusive Leadership

To build an inclusive workplace culture, the executive team and managers must take diversity and inclusion as a personal priority, role model inclusive behavior, and be held accountable for actions/outcomes.

Training and organizational support can help them develop their inclusive leadership competencies, including commitment, courage, cognizance of bias, curiosity, cultural intelligence, and collaboration (Bourke and Dillon (2016).

Appoint Diversity Manager or Task Force

Finally, building an inclusive workplace requires sustained and coordinated efforts. Diversity managers and task forces can help advance equity and inclusion by leading people to think more about their actions and motivating them to take deliberate steps to avoid the occurrence and appearance of bias (Dobbin & Kalev, 2014). Since hiring a full-time diversity manager may not be feasible for small and medium-sized organizations, they can designate a senior (HR) executive to take responsibility for this function and/or establish a diversity task force or council.

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