



## What Is A Proactive Compensation Analysis?

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Increased regulatory and enforcement activity by the Equal Employment Opportunity Commission (EEOC) and the Office of Federal Contract Compliance Programs (OFCCP) has prompted employers to consider undertaking proactive compensation analyses. Such analyses are for the purpose of detecting and measuring demographic group differences in pay. Many organizations are interested in a statistical examination of compensation to determine whether the outcomes of the pay-setting process are, in fact, aligned with equal opportunity pay policies and philosophy. However, before embarking upon a proactive compensation review, stakeholders need clear insight into what such projects entail.

### *What are the benefits of a proactive compensation analysis?*

A proactive compensation analysis provides decision-makers and stakeholders with the information to critically assess whether their data reveal demographic group differences in compensation. With this knowledge, they are able to make informed pay-setting decisions in the context of regulatory investigations, internal equity programs, or potential lawsuits.

Further, a proactive compensation analysis alerts stakeholders to potential misalignments between the organization's compensation decision-making process and its pay policies and philosophy. When potential pay gaps are identified as a result of the proactive audit, the organization can further investigate the observed disparities to determine whether the differences are explained by non-discriminatory factors that were not available for the analysis. If not, then management is in a position to design a remedy outside of a regulatory audit or investigation or a private lawsuit.

### *What are the data requirements?*

In addition to the salaries and hourly rates paid to employees, the information required to prepare a compensation analysis includes the demographic status of each employee (race/ethnicity, gender and/or age) and data regarding his/her relevant characteristics. These factors often include job title, grade/band, department, function, various measures of the amount of work experience with the organization (e.g., years in current job, years in current grade/band, other years of service) and location, as well as any other relevant factors that influence compensation levels (e.g., performance ratings).

If incentive compensation such as bonuses or long-term incentive pay is to be examined as part of the audit, then these data would also need to be provided for each employee. Similarly, if commission compensation is to be analyzed, then commissions paid and measurable factors that impact commission earnings would also need to be produced (e.g., product line or sales targets).

Initial rates of pay are often found to be a source of demographic group differences in pay disparities because of the varying backgrounds that employees have upon entry into an organization. If an analysis of the initial rate of pay is conducted as part of the audit, then information about employees at the time of hire would also be collected for those who were hired during a pre-determined period.

### *What can organizations do to prepare for a proactive compensation audit?*

First, the organization can identify the groups of employees who are to be included in the compensation analyses (e.g., hourly, management, upper management, sales, etc.). Second, the organization can identify the elements of compensation to be examined – base pay, incentive compensation, commissions, etc. The organization can also outline the factors that impact the establishment of pay rates for each of the employee groups to be analyzed and, in conjunction with HRIS personnel, identify the best sources from which to extract the relevant data. Once these sources are identified, the organization may wish to determine whether the data fields are consistent across the employee group(s) to be included in the analyses. In our experience, performance rating scales and/or other criteria that may affect compensation levels for employees may vary by level or location. The analyst will need to understand these differences in order to prepare useful analyses of the compensation decisions.

Finally, before the project commences, the sponsor of the proactive compensation audit is encouraged to establish an internal team to participate in the project that includes legal counsel and relevant executives. The establishment of a team is important to address potential disparities that are identified through the audit process and to maintain the confidentiality of the study.

### *What statistical technique will be used to analyze compensation?*

Generally, to quantify compensation differences between similarly situated demographic groups, multiple regression analysis is used. This statistical method measures the difference between the average compensation for two or more groups after “filtering out” pay differences that are attributable to group differences in legitimate factors that impact pay (e.g., grade/band and amount and type of work experience). When pay differences are uncovered, multiple regression analysis produces statistics that are used to determine whether or not the observed disparities are “small enough” to be consistent with the outcome of a pay-setting system that is neutral with respect to demographic group status.

### *What information will we receive?*

You will receive information at various times throughout the project. Early on, you will be advised of data anomalies that need correction.

After the initial compensation model has been specified and discussed with the internal team, you will receive tables and/or charts that summarize and illustrate the results of the refined analyses. If desired, a narrative executive summary or more detailed report will be provided.

Once an ERS Group economist reviews the results of the analyses with your internal team, he/she will make recommendations regarding additional analyses that are generally helpful in understanding why the data reveal the patterns uncovered. For example, analyses can be conducted to identify the particular employees whose pay rates have the greatest impact on the results obtained. Most organizations find this information most valuable in understanding the particular aspects of the pay-setting system that may be generating pay disparities.