The pay equity challenge

How and why companies should act now

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Pay equity is clearly on the corporate agenda, although there is still much work to be done. Although companies understand the importance of addressing pay inequities, many are reluctant to be transparent, unless compelled by regulations to do so.

In this paper we recognize drivers of the need to address pay equity now, examine the current state of pay equity initiatives at US corporations, and offer an overview of a detailed pay equity solution.

Defining pay equity

"Pay equity" means that employees, regardless of protected class, receive the same pay for the same work. However, it is not always the case that any two employees are exactly comparable in terms of assigned tasks or productivity. Therefore, in practice, pay equity is a measure of the systemic differences in pay across protected group status for workers who perform the same or substantially similar work depending on various federal or state laws.[1]

[1] Chris Wilkinson and Cary Elliott, The Pay Equity Landscape: Top Trends for Employers, Bloomberg Law, June 16, 2022.

Why address pay equity now?

While federal protections have existed for decades through the Equal Pay Act and other legislation, there are emerging trends that are increasingly important for companies to address with a comprehensive pay equity solution. The trends driving the need for pay equity action include:

The race for talent: More than half (55%) of workers say they value fair pay above all other workplace attributes.[i] At a time when companies across industries are struggling to attract talent, failing to be transparent about compensation can dissuade potential employees from joining an organization. By contrast, those organizations that offer a fair and equitable compensation program will have a leg up on the competition.

The same goes for retaining current employees. Companies that don't align employee salaries with performance, as well as with published ranges, open themselves to attrition and potential litigation. Fifty-nine percent of employees are apt to look for a new job after learning they earn less than a colleague.[ii] And, when an individual finds out they are being paid less than someone of a different gender or race, 27 percent start looking for a new job, according to a survey by the Society for Human Resource Management (SHRM).[iii]

Pay transparency: Pay transparency refers to a communications approach in which a company provides pay-related information to employees or candidates about the pay opportunities at their level and/or into the future as they grow with the company. It is important to acknowledge that there is a difference between pay equity and pay transparency. There are numerous reasons explored in this paper for addressing pay equity, but it is important to bear in mind that pay transparency can reduce an employee's intent to quit by 30 percent, according to a survey by Payscale.[iv]

The average cost to correct pay equity gaps is expected to increase by $439,000 each year.

—"Addressing Pay Equity," Gartner

Companies that practice pay transparency can realize myriad benefits including:

- Demonstrating to employees and external stakeholders that all employees are valued equally and that the company is an employer of the future
- Lessening the burden of salary negotiations and merit processes
- Fostering greater trust between company management and employees
- Enhancing the employee experience and understanding of linkages across pay, performance, career progression, and culture
- Educating employees about how compensation decisions are made, why, and what that may look like for them in the future.

IPOs may further emphasize pay equity and transparency pain points

While the regulatory environment for IPOs is equivalent across privately held and publicly traded organizations, companies pursuing IPOs will be under additional scrutiny. As SEC disclosures around human capital management become more robust for publicly traded companies, there is more risk of exposure of how companies handle pay equity and pay transparency. Therefore, a public offering is an opportune time to remedy any prior missteps and enter the public marketplace with a strong foundation.

[i] Brett Christie, "Organizations are taking more action on pay equity, "World at Work, January 20, 2023.

[ii] Brett Christie, "Organizations are taking more action on pay equity, "World at Work, January 20, 2023.

[iii] "Bridging the Pay Gap: Why Pay Equity Pays Off," SHRM, 2021.

[iv] "Strategies to improve employee retention in the age of pay transparency," Payscale, 2023.

Regulatory mandates: On the federal level, the Equal Pay Act and Fair Labor Standards Act are putting additional pressure on employers to compensate and manage the workforce in a fair and equitable way. At the same time, pay transparency laws that require employers to include salary ranges in job listings have been passed in California, Colorado, New York, and Washington, and are expected to pass in other states in the near future. Employers in Illinois, for example, will face complex obligations in 2024 requiring them to certify their compliance with all state and federal pay equity statutes or face a fine of one percent of gross profits.

> **Don't forget**: Some state pay transparency laws require employers with a minimum number of employees to list salary ranges for all posted job ads, promotions, and transfer opportunities. In other states, employers are only obligated to reveal this data when a candidate requests the information.

In early 2023, a fifth of all US workers were covered under pay transparency laws, a trend that experts predict will continue to grow.[v] In anticipation of new laws in their geographies, 32 percent of human resources professionals surveyed by SHRM in 2023 say they started including pay ranges in their job postings this year.[vi] Further, if companies have official operations in one state and workers who live in other states, they may be subject to the pay equity laws where the workforce resides.

Ethics/Culture: As part of their environmental, social, and governance (ESG) programs and human capital management (HCM) efforts, many companies are including adjusted and nonadjusted pay gaps across gender and BIPOC populations in their sustainability reports. Organizations that have been surveyed on pay equity programs cite the following three reasons for doing so: "to build a culture of trust," "to remove bias against protected classes," and "because it's the right thing to do." Further, many publicly traded organizations are driven to institute pay equity programs through pressure from investors, who are increasingly pushing for increased access and disclosures.

Additional considerations during mergers and acquisitions (M&A)

Companies undergoing M&A deals need to ensure they aren't inheriting pay inequities and related litigation risks. Conducting detailed due diligence can uncover any legacy discrepancies and support a smoother and compliant transition to a common compensation and benefits structure for the acquired employee population. By contrast, intentionally pursuing acquisitions of companies that focus on providing opportunities to underrepresented groups and compensating them equitably can be an added benefit of a deal.

[v] Roberta Matuson, "Managers, Are You Prepared to Answer Questions About Pay Equity?" *Harvard Business Review,* November 28, 2022.

[vi] "Equal Pay Day 2023: Pay Transparency," SHRM, 2023.

The pay equity gap

Despite almost half a century since the Equal Pay Act was passed, the pay gap between men and women persists. And it doesn't stop there. Unequal pay for the same jobs is rampant across such factors as race, ethnicity, sexuality, disabilities, parenting status, and more.

Consider the following:

Women: Some pay inequities can be attributed to women having more proscribed opportunities than men. Viewed through this lens, there is an overarching gender pay equity gap of 27 percent. When you look at pay through the lens of men and women holding comparable roles, there is still a pay gap of 7.4 percent.[vii]

People of color: Black workers earn 76 cents and Latinx workers earn 73 cents for every dollar earned by white workers.[viii] The Latinx wage gap, in particular, has failed to narrow substantively over the past two decades.[ix]

LGBTQI+: College-educated workers who identify as LGBTQI+ earn 22 percent less than their heterosexual, cisgender counterparts.[x] Transgender men and women working full time are typically paid 70 cents and 60 cents, respectively, for every dollar that all workers are paid.[xi]

People with disabilities: Individuals with disabilities earn 64 cents to every dollar their colleagues make,[xii] which comes to around 26 percent less.[xiii] The largest pay gap can be seen between individuals on the spectrum and their neurotypical counterparts,[xiv] despite the fact that studies show that professionals on the autism spectrum can be up to 140 percent more productive than neuro typical employees when properly matched to jobs.[xv]

[vii] "Addressing Pay Equity," Gartner, 2016–17.

[viii] Earnings Disparities by Race and Ethnicity. (Using 2017–2019 Current Population Survey data), US Department of Labor.

[ix] Marie T. Mora and Alberto Dávila, "The Hispanic–white wage gap has remained wide and relatively steady," Economic Policy Institute, July 2, 2018.

[x] Megan Carnegie, "The big LGBTQ+ wage gap problem", BBC, June 9, 2022.

[xi] "Trans, Queer & Underpaid: Emerging LGBTQI+ Pay Gap Data", National Women's Law Center, June 15, 2023.

[xii] "Closing the Pay Gap for Workers with Disabilities", American Institutes for Research (AIR), January 22, 2015.

[xiii] Rebecca Vallas, Kimberly Knackstedt, Hayley Brown, Julie Cai, Shawn Fremstad, and Andrew Stettner, "Economic justice is disability justice", Century Foundation and Center for Economic Policy Research, April 21, 2022.

[xiv] Ryan Golden, "Why do pay gaps persist for US workers with disabilities?" *HR Dive,* July 16, 2020.

[xv] Ludmila N. Praslova, "Autism Doesn't Hold People Back at Work. Discrimination Does," *Harvard Business Review*, December 13, 2021.

Current state of pay equity initiatives

At present, 70 percent of companies are taking action on pay equity, which reflects an increase of 10 percent from 2019 and 4 percent from 2021, according to WorldatWork's recent Pay Equity Study.[xvi] Some actions leading companies are taking include developing statistical analyses to identify individuals with potential pay gaps across such demographics as gender, race, ethnicity, and other protected statuses; creating a consistent job-leveling structure to enable clear career paths, structured compensation, and other talent management activities; monitoring external marketplace pay levels and practices as guiderails to drive competitive compensation; communicating with employees about pay equity strategies; and taking steps to mitigate biases in performance reviews. It is worth noting that companies that report are typically required to do so by regulations under human capital disclosure rules.

Although companies understand the importance of addressing pay inequities, many are reluctant to be transparent, unless compelled by regulations to do so. Just over 1 in 10 organizations share the high-level results of pay equity analyses publicly, only a quarter share the high-level results with their employees, and only a third even share the fact that they are conducting a pay equity analysis with their employees.[xvii]

One of the key factors that has made addressing pay equity particularly difficult is the impact of the pandemic on workforce participation and wages. For example, the wage gap between men and women had reached the point where women were earning 84.3 percent as much as men in the fourth quarter of 2021; however, job loss due to childcare challenges has increased the amount of time it will take to correct the gender pay gap to 136 years from 99.5 years just before the pandemic.[xxvii] In addition, Morningstar recently reported that, during the pandemic, female C-suite executive pay fell to a nine-year low compared to male counterparts, which, at the current rate of progress, will take until 2060 to correct.[xxviii] Working mothers who have been able to remain in the workforce still suffer what Payscale refers to as the "motherhood penalty,"[xxix] or a perception that women with children have a lower level of commitment to their jobs and their own advancement.

[xvi] Brett Christie, Organizations are taking more action on pay equity, World at Work, January 20, 2023.

[xvii] Brett Christie, "Organizations are taking more action on pay equity", World at Work, January 20, 2023.

[xxvii] World Economic Forum's (WEF) Global Gender Gap Report, 2023.

[xxviii] Chris Wilkinson and Cary Elliott, The Pay Equity Landscape: Top Trends for Employers, *Bloomberg Law,* June 16, 2022.

[xxix] "Strategies to improve employee retention in the age of pay transparency", Payscale, 2023.

How to establish a comprehensive pay equity program

Start with peer benchmarking: Use external marketplace pay levels and practices as benchmarks or guardrails to drive competitive compensation and exclude practices that could create significant negative scrutiny from key stakeholders. Assess relevant industry and peer comparator sets, summarize competitive pay levels and mixes across positions, and leverage these findings to inform how you set compensation for existing and future positions. These analyses will form the basis of job architectures, salary ranges, and incentive plan structures, including target opportunities, performance metrics, timing, and vehicles (cash versus equity).

Conduct advanced analytics: To understand if your company has pay equity issues to address, build an analytics model that assesses existing practices around hiring, promotions, and performance management.

Cross-analyze multiple quantitative and qualitative variables across the employee lifecycle to determine the root causes of inequity. To assess if there are statistically significant compensation differences, use a multiple regression analysis that incorporates all relevant factors, including protected classes of employees and factors that might contribute to variation in compensation (e.g., level, education, experience, and geographic location) and tease out how much each factor contributes to the variation.

Define outcomes: The above data analysis will serve as the guide to remediating pay equity findings. Remediation may include addressing gender-based or ethnicity-based pay gaps (as well as gaps across other protected class), utilizing new methods of employee communication, and instituting changes to compensation policies and programs. It is not sufficient to address historic pay inequities. The most successful companies will also put plans in place to prevent issues going forward. Some methods to ensure your company remains focused on pay equity include: collecting robust data from performance reviews; conducting regular pay equity assessments, both internally and externally; and monitoring for gaps in your reporting structure.

> **Best practice**: Pay equity analytics should be conducted by a cross-functional team comprising statisticians, compensation specialists, and human resources leaders, under the guidance of a company's legal counsel.

Prevent issues going forward: Programs that can help prevent future pay gaps may include a clearly defined job architecture; a market-informed compensation structure with salary ranges and incentive plan target opportunities; an internal compensation administration manual; training for managers, human resources, recruiters, and other key stakeholders on go-forward processes and policies; and a communications campaign to educate employees on the total rewards programs at the organization.

Case study:

Merging financial services firms have opposing rewards philosophies

Challenges. A midsized financial services company was acquiring a company with an opposing rewards philosophy. The acquirer had a balanced and competitive compensation and benefit package (including long-term incentives), while the acquiree, a foreign bank, had a below-market annual cash compensation program supplemented by a generous, above-market benefit program. Further, the inconsistency between the acquiree's compensation program and its benefits programs had caused employee engagement challenges.

KPMG methodology. Our team coordinated with benefits brokers on key health and welfare refined plans and separately managed the cost modeling of vacation and 401(k) policy changes. Before adjustments to compensation were made as part of the harmonization, a formal pay equity analysis was performed. The analysis involved mapping all jobs at both legacy companies, creating a common job architecture framework, and identifying potential compensation outliers under the framework that needed to be addressed to avoid exacerbating issues during the integration. Employee communications were drafted to educate the workforce on the go-forward job architecture, compensation, and benefits programs. Finally, benchmarking of go-forward positions informed the future salary structure and incentive plan.

Outcomes. The client realized a new job architecture framework for both legacy companies, which clarified career paths, reporting relationships, and "VP" titling methodologies. The employee value proposition was elevated through a new salary structure, as well as annual and long-term incentive plan designs with revised eligibility, performance metrics, award opportunities, and payout provisions. Ultimately, the company was able to continue compliance under California pay equity regulations in a timely manner and set up the combined organization for equitable hiring and compensation practices within the first year post-close.

Conclusion

Taking a comprehensive approach to pay equity is more important than ever. States are enacting laws introducing pay transparency and greater rigor around supporting pay equity. Companies are facing increased scrutiny from employees, investors, and regulators. Therefore, organizations should commit to wide-ranging pay equity programs comprising industry job leveling, compensation and benefits benchmarking, plan design, ongoing compensation management, and more. Pay equity hygiene may take a significant up-front lift at certain organizations, while all companies will require ongoing monitoring and management as the market evolves, new regulatory requirements are introduced, and employee populations continue to scale.

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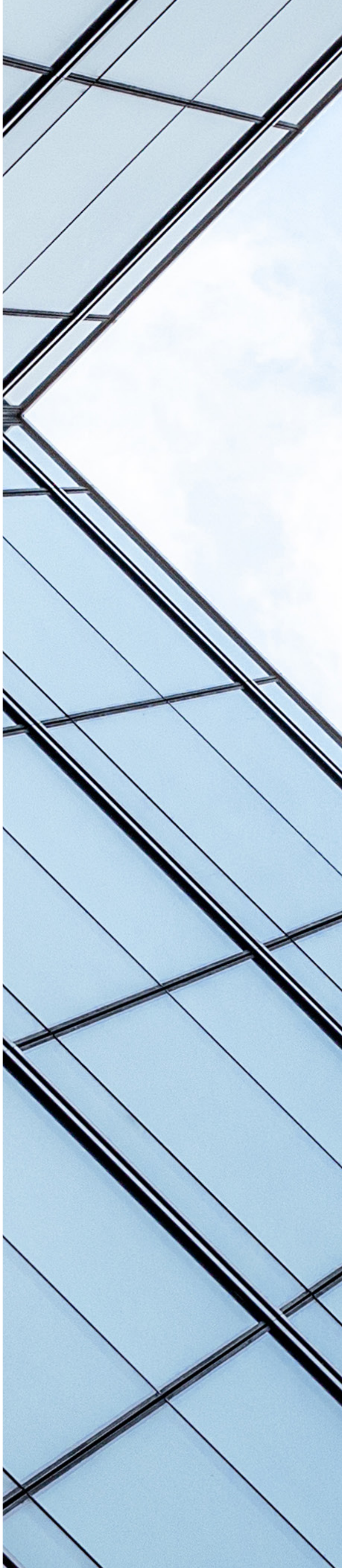

The authors would like to thank their KPMG colleague, Donna Ceparano, who assisted in the writing and production of this paper.

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