Systemic Compensation Analysis: An Investigatory Approach

by Joseph DuBray

I. Overview

During the first 25 years after the signing of Executive Order # 11246, as amended, the Office of Federal Contract Compliance Programs (OFCCP) focused its investigative efforts on recruitment and placement systems. The reason for this emphasis was to ensure that applicants were provided an equal opportunity to both get into the workforce and to enter that workforce in areas that could lead to greater economic rewards.

As a result of these emphases, the decades of the '70's and '80's produced significant improvements in the workforce profiles of federal contractors as compared to all other kinds of companies. Minorities and women were brought into federal contractor workforces at rates that easily exceeded what had been occurring in earlier decades.

After 25 years, the agency acquired a great deal of expertise in identifying where systemic discrimination or lack of affirmative action had taken place at the entry points to workforces. This emphasis was mirrored in the numerous decisions on systemic discrimination which have emanated from the courts over the last 25 years. The vast majority of these decisions focused on applicants for entry-level, blue-collar or clerical positions. The reasons for this were:

1. Generally, there was a greater amount of hiring activity that occurred at the lower end of the pyramid as opposed to the upper levels.

2. Most entry-level blue-collar or clerical positions had qualifications standards which required skill sets common to most of the job seekers. As a result, hiring outcomes for a variety of jobs could be easily aggregated for a more meaningful analysis.

3. The qualifications an applicant brought to the door of a company were clearly untainted by any potentially biased decisions of the employer subsequent to hire.

4. The qualifications necessary for these types of entry level positions were easily understood and comprehended by the lay person. As a result, both lawyers and judges were more willing to substitute their judgments for the company's judgments concerning who was "best qualified."

   In 1990, 61% of the bias charges filed with the E.E.O.C. involved advancement and dis- charge, while only about 8% involved hiring. The U.S. Census Bureau reported in its Current Population Survey that in 1994, the average of the median earnings of minorities and white women was $10,000 less than the median earnings for white men. Minorities and white women had lower median earnings than white men at each level of educational attainment from high school graduate through more than 4 years of college.

   These facts suggest that, while discrimination in hiring has by no means disappeared, there is today a great concern for what happens to people after they are employed. Current compensation can be viewed as the outcome of numerous decisions by employers which affect the economic well-being of their employees. Such decisions begin at the entry point to the workforce and are often ameliorated or exacerbated by decisions on transfer, promotion, demotion or merit increases during each worker's tenure with a particular employer.

> Romona L. Paetzold and Rafael Gely, two Professors in Management from Texas A & M recently published an article in the Houston Law Review entitled "Through the Looking Glass: Can Title VII Help Women and Minorities Shatter the Glass Ceiling." They concluded that Title VII has been a rather ineffective tool for combating discrimination in promotion and advancement.

This statement can be best understood if we look at the other side of the previously mentioned reasons for ease of identifying systemic hiring discrimination:

1. Generally, there are fewer promotion and advancement transactions in a workforce than there are new hires and placements. This is not always true, particularly in a downsizing environment, but it has been the experience for OFCCP at most companies.

2. Data cannot be easily aggregated since the qualifications standards for each promotion and/or advancement decision are usually distinct and unique.

3. The skill sets possessed by employee candidates for promotion or advancement may reflect previous decisions of the employer which were tainted by discrimination e.g. performance appraisals.

4. The qualifications necessary to be promoted to many positions is often subjective and esoteric causing courts to defer to the judgments of the business organization in cases involving individual promotion and advancement decisions.

In other words, all of the criteria which works to the advantage of the plaintiff in pursuing a case of systemic discrimination in entry level hiring, work to the plaintiff's disadvantage when the issue is promotion or advancement. Despite these difficulties, it is possible to analyze the fairness of promotion and advancement decisions in the aggregate if current compensation is perceived as a "proxy" for the cumulative outcomes of all such decisions.

II. Common Methods of Compensation Analysis

There are as many different ways to analyze compensation as there are plaintiffs and investigators who have tried. Within OFCCP, the most common form of compensation analysis has been a cohort analysis of people in nearly identical job titles. Typically, if a problem arises, it is treated as one, or more, individual disparate treatment issue.

The courts have recognized regression analysis as a way to examine compensation from a systemic, or pattern and practice, perspective. The underlying premise for looking at compensation from a broader perspective is that each individual decision on each person's advancement within a company may, or may not, be an instance of legally provable discrimination. When the cumulative effects of such decisions on a number of employees are arrayed, a problematic picture may emerge. Decisions on advancement are often influenced by unconscious and subconscious habits and the routine and unquestioned policies and practices of bureaucratic life. The aggregate effect of these myriad decisions is of far greater consequence than the result of any one decision.

Regression analysis, often called multiple regression, is a way of looking at the cumulative effects of an employer's decisions on the salaries of groups of individuals. In a sense, it is method of aggregating data on decisions in a way that otherwise would not be possible. The advantage of multiple regression is that it can isolate the effect of any one variable on salary while controlling for all the other variables that are objectively relevant to compensation. The dis- advantages to the approach are that there is more than one formula that can be used to calculate the outcomes, although all are essentially similar, and there is often a dispute concerning which variables are objectively relevant to determining compensation. As a result, both plaintiffs and defendants must bear the burden of employing someone with a Ph.D. in statistics to nullify each others' arguments.

OFCCP has neither the computer capabilities, nor the in-house expertise nor the monetary resources to contract for the services of a statistician for every single compliance review. Due to these mitigating factors, the agency is moving in the direction of an alternative model for indicating the likelihood of serious systemic compensation issues.

III. Alternative Systemic Compensation Methodology

Title VII suggests that evidence of intentional dis- crimination can be inferred where employers have conducted job evaluations or wage surveys and then deviated from them to the disadvantage of one race or sex. When a contractor actually has a current market survey for every job title, actual salaries can be compared against such surveys and then analyzed on a group comparison basis e.g. the median compa-ratio for minorities as compared to the median compa-ratio for nonminorities. The compa-ratio indicates how persons are paid against the market value for their jobs as determined by the employer.

More often employers have a salary grade system which groups together jobs titles which have similar, or identical, market values. By the very act of creating a grade level system, where each employee has approximately the same potential to move from the minimum to the maximum of his/her grade range dependent upon performance, the employer has recognized that certain jobs are essentially similar in terms of skill, effort and responsibility. All relevant variables affecting pay being equal, we would expect to see no particular pattern of pay disparities.

The question becomes how does one conclude that a set of salary data constitute a pattern. The appropriate dictionary definition of a "pattern" is a definite direction or tendency of certain characteristics. In employment discrimination the direction or tendency of a series of personnel decisions is generally indicated by statistics. Since 1977, most systemic discrimina- tion cases have included, as an integral part, a "statistically significant" pattern of employment decisions adverse to one race or sex.

In 1977, the U.S. Supreme Court decided in <u>Hazelwood School District v. United States</u> that, as a general rule for large samples, if the difference between the percentage of any group you would be expected to hire based on their availability and the percentage you actually hired is greater than two or three standard deviations then the hypothesis that the hires occurred without regard to a prohibited factor would be suspect.

This formula began to be used again and again, almost exclusively in applicant to hire cases, over the years. In certain circles, it has come to be believed that you cannot have a systemic discrimination case unless you have at least a two standard deviations difference between the expected outcome and the actual outcome of certain events. However, pattern and practice cases were brought prior to 1977 without the use of a test of statistical significance and have been successfully brought by plaintiffs since 1977 without the use of statistical significance.

Statistical significance assumes much greater impor- tance in the context of a hiring case than it does in a compensation case. The reason statistical significance is crucial in a hiring case rests not so much on its measuring the importance of selection rate differences as it does on authenticating the validity of the results of the sample that was drawn. In hiring cases, actual applicants are always a sample of the total population of potential applicants for jobs at a certain facility. Statistical significance is critical in the context of sampling and inferential statistics i.e. we want to draw an inference that the outcome of this employer's selection process would have been the same even if an entirely different sample of the popu- lation applied for these jobs.

In a compensation case, we are not sampling to deter- mine a pattern we are looking at an entire population e.g. all persons employed in Exempt Level Grade 10. Any difference in salaries is an <u>actual</u> difference, the importance of which is a policy decision more than a statistical one.

In summary, OFCCP's alternative form of analysis focuses on within grade differences, does not rely on statistical significance but does rely on the existence of an observable pattern of groups pay disparities.

The initial step in this approach is a comparison of the median salaries of men to women and minorities to non-minorities <u>within</u> the same salary grades and, generally within the same E.E.O.-1 category. The median is the middle salary in a rank-ordered series of salaries. If there is only one male and one female incumbent, each one's salary is the median. If there is an even number of minority or nonminority incumbents of a grade, the median is the average of the two salaries in the middle of the rank order. If the company has a broad-band system, such a system is usually created by collapsing a previous grade level system. In such cases the bands should be subdivided into previously existing grades, before beginning the median salary comparison.

Experience has shown that, generally, time-in-grade correlates very closely with actual compensation. Therefore, an average, or median, time-in-grade should be computed for the groups being compared.

Patterns can be revealed in many different ways. The key is to determine, for the group with lower median pay, does the group difference in time-in-grade appear to explain both the existence of the difference and the extent of the difference in median salaries. The analysis is very fact specific. Some of the questions which might be asked in determining whether a pattern exists are:

1. Does the group with greater median time in grade always receive greater median com- pensation?

2. Does the dollar difference in median com- pensation appear to correlate to the degree of median time-in-grade difference?

3. If there are exceptions to #1 or #2, are the exceptions random or do they predominantly affect one race or sex?

There are no hard and fast rules for determining whether or not a pattern exists. Accordingly, it is difficult to establish any "bright line" test differentiating a pattern from a random series of events. A pattern of compensation difference certainly means that a group difference in pay and time-in-grade is happening more often to one race(s) or sex than to another. Patterns may be stronger, or weaker depending upon the data array and analysis. Generally speaking, the greater the number of observations adverse to one group, the stronger the pattern. Oftentimes different patterns emerge within different contexts. No two compensation systems are, in all respects, identical. Therefore, broad generalizations concerning the exact statistical parameters of any such patterns are impossible to make.

When a pattern emerges, the agency compliance officer (CO) must conduct detailed in-depth interviews with whoever is responsible for creating and/or maintaining the compensation system as well as the line managers responsible for making pay decisions at the grade levels under analysis. The CO will be attempting to determine the criteria used to establish pay upon initial hire or upon entering a grade through transfer or promotion; and what criteria are used to determine the rate of pay escalation within a grade.

Generally, education and prior related experience are the key variables determining pay upon initial hire. Almost all organizations assert that they pay for performance. Therefore, performance evaluations should be the critical variables affecting promotion and advancement pay decisions.

To the extent market surveys, job evaluation studies or other related "neutral factors" have been used to determine pay for <u>all</u> the jobs under consideration, they will be reviewed and analyzed. If only some jobs have been surveyed, or evaluated, these factors will have less probative value concerning compensation differences.

The second phase of this investigative approach is to determine whether the contractor's stated criteria for determining pay consistently and uniformly explain the pay decisions that have led to the compensation patterns which emerged in phase I. Typically the CO will analyze cohorts of individuals currently in the same grade who were hired into the establishment in the same year. Depending upon the numbers, the cohorts may be further subdivided by education. Since total numbers of employees in upper level grades may be small, finding pairs of men and women or minorities and nonminorities employed in the same year may not be feasible. In the alternative, salary histories may be traced to determine if, when people were hired or, for whatever reason upgraded in pay, the same criteria were uniformly applied and resulted in compensation decisions which could be objectively determined to be fair.

Most white-collar pay systems, though composed of objective criteria, do not have objective methodologies for combining the criteria to arrive at an appropriate compensation decision. It is this subjective aspect of determining pay that can most often lead to pay disparities that are difficult to detect at the micro-level but are obvious in the aggregate.

It is generally not possible to thoroughly analyze the employment and salary histories of an entire workforce. Therefore, the agency will try to focus its resources in those areas with the most glaring aggregate salary disparities and look at a sample of the individuals employed in those areas in order to detect the primary cause of the problem. This last phase is not an analysis that is undertaken to prove or disprove the validity of the observed cumulative salary differences. At this point, the agency should have examined the job-related variables e.g. education, prior experience, performance, most often used to determine salaries, and concluded that they do not appear to explain the differences. It is important to note that the U.S. Supreme Court has said that omission of <u>possible</u> explanatory factors from a plaintiffs study is not fatal to any inference of discrimination. In most cases, a defendant cannot rebut statistical evidence by mere conjecture or assertions. The defendant must demonstrate how any omitted variables are both job-related and clearly explain not individual but <u>group</u> differences in compensation.

The "samples" are reviewed to detect the precise point(s) in the personnel process that pay decision anomalies are occurring. It is important that companies understand that, in a pattern and practice investigation, these anomalies are being identified to illustrate the impact of subjective decision-making throughout the system. When such anomalies are identified, they call into question the integrity of the entire compensation system.

Often, but not always, there is a pattern in the anom- alies that are identified. In other words, the initial pattern of pay disparity has been traced to a pattern of certain kinds of decisions. This allows the company not just the opportunity to correct the results of its pay deciding systems but to eliminate the primary cause of those outcomes so that the patterns of pay disparities, once corrected, do not re-emerge.

There have been three key cause patterns that have been identified to date in one, or more, pay disparity cases. All of them have a common element of subjectivity.

None of what follows is meant to be a generalization of the characteristics of any group, but rather reflects the experience of the agency in selected compliance reviews.

The author has not researched to determine whether empirical evidence exists to suggest that certain groups are more mobile than others, particularly in the same labor market. However, there have been several studies conducted outside OFCCP which indicate that an individual's bargaining power is affected by his/her race and sex. Mobility and bargaining power are two factors which can greatly influence the outcomes of salary determinations.

Our review experience has shown that, if you are currently employed, you generally receive a raise in salary when you are hired by another company. Often this means being placed within a grade level at a salary in excess of that received by one, or more, current incumbents of the same grade. Since most companies pay for performance the company makes a business decision that the background and experience of the new employee should result in job performance exceeding that of some of the current employees in the grade. Though seldom reduced to writing, this is clearly the underlying assumption of most profit-oriented employers. If, however, over time, the new employee does not outperform the lesser paid employees within the same grade, questions of fairness should dictate that those employees salaries be raised for the sake of internal equity. Performance, not credentials, should be the barometer of actual salaries.

Bargaining often enters the salary equation at the time of hire and at the time of subsequent promotions. To the extent that bargaining is allowed to influence the outcomes of salary decisions, minorities and women may be at a disadvantage. Several recent studies have revealed that both new and used car dealerships' margin of profit on sales is greatly affected depending upon the race and sex of the car buyer. It is possible that those in power presume that minorities and women do not have the leverage in a bargaining situation and treat them in accordance with this stereotype. This is not to say that any individual minority and/or woman cannot be an outstanding negotiator. It merely means the market does not treat all people fairly and treats certain groups less fairly than others.

The final type of cause pattern we have seen to date is the "discretionary" range of either promotion or merit increase. Typically supervisors have a degree of latitude concerning the percentage of merit increase an individual can receive for a certain level of performance and the percentage of increase over previous salary that can accrue due to promotion. Very minor differences in yearly individual decisions can accumulate to large salary differentials between certain groups over time. Companies need to either standardize the percentage of increase which attaches to performance or promotion, or ensure greater oversight of the cumulative effects of a wide variety of discretionary salary decisions.

In fact, either greater uniformity and less discretion, or greater oversight of the EEO outcomes of salary decisions, is necessary to ensure that all compensation systems function fairly and provide true equal opportunity for economic rewards.

