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Pay Equity - Deriving Value from an Effective Pay Structure

Newsletter

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Background

It is increasingly more difficult to agree on a definition for pay equity considering that the concept of ***"equity"*** itself is ethical, intrinsic and varies across cultures, countries and continents.

In recent times, the issue of pay equity has generated more debate, with the Congress of the United States throwing out the Pay Check Fairness bill for the fourth time. This bill was reintroduced at the 114th Congress in 2015. According to Congress.gov, which is the official website for United States legislative information, this is ***"a bill to amend the Fair Labour Standards Act of 1938 to provide more effective remedies to victims of discrimination in the payment of wages on the basis of sex, and for other purposes."***

To reduce the back and forth of litigation and provide a legal framework for judging pay equity, countries and jurisdictions have set up laws to guide fair treatment in the workplace. The United Kingdom and United States of America have the Equal Pay Act of 1970 and 1963, respectively. These laws, and many others, examine pay equity from the perspective of eradicating unwarranted pay discrimination based on race, gender and other factors.

This article looks at pay equity from the perspective of utilising an effective pay structure to achieve an organisation's reward strategy.

What Is Pay Equity and the Importance of Remunerating Based on Reasonable Factors

Pay equity, refers to the concept that ***employees should receive proportionally fair treatment in terms of pay based on their contribution and investment in the employment relationship and on clearly-defined expectations as communicated to the employees from time to time.*** Reducing discrimination and unfairness based on favouritism and personal relationship is the key objective of pay equity.

If employees are to be compensated differently for doing similar or near-similar jobs, Reward Professionals should take care and ensure a fair basis for administering this differentiation. The fair basis for pay differentiating are referred to as ***Reasonable Factors.*** In essence, any differentiation in pay should be based on factors that are permissible by law, ethical and defensible by the employer. Such factors may include educational qualification, critical or scarce talent, and higher productivity. Some of the benefits of remunerating based on only reasonable factors are:

- Reduces the risk of litigation from dissatisfied employees
- Assists employers to minimize the cost of unnecessary pay increases
- Provides properly-defined criteria that employees can strive to achieve and improve their performance.
- Allows for transparency in pay practices, improves employee value proposition and positions the organisation as the employer of choice.

Employees' and Employers' Perspectives to Pay Equity

When discussing pay equity, perception is the same as reality because employees' perception of their compensation directly impacts job satisfaction and engagement; both of which are critical to the achievement of business objectives.

There are two ways to perceive compensation as equitable. ***Perception based on objective and scientific evidence and perception based on emotions.*** Employers usually use objective and factual methods as the basis of determining pay equity. One common way of doing this is to obtain and compare compensation data from companies that have similar jobs usually through compensation surveys where these data are shared in a confidential manner. Also, organisations rely on secondary sources such as professional HR and Reward organisations for global and local information on recent happenings with regards to compensation.

On the other hand, most employees perceive pay equity in terms of how they "feel" about their pay in relation to other employees within and outside the organisation. Usually, employees find it difficult to understand why another employee with better skills and higher productivity should earn higher. In unionized environments, it becomes increasingly difficult to operate a merit pay system as negotiations are based on feeling of oneness and camaraderie.

Issues That Arise When Pay Is Not Equitable

When there is no fair and objective basis for administering pay and there is a high perception of inequity, organisations may have to deal with the following issues:

- Increased exposure to the risk of litigation
- Reduced employee engagement leading to lower effectiveness on the job especially for employees that consider compensation as their most important work value
- Union unrest
- Strain in the communication of compensation and benefits policies.
- High attrition rate and loss of critical talent
- Lack of trust in the leadership of the organisation.

Can Pay Really Be Equitable?

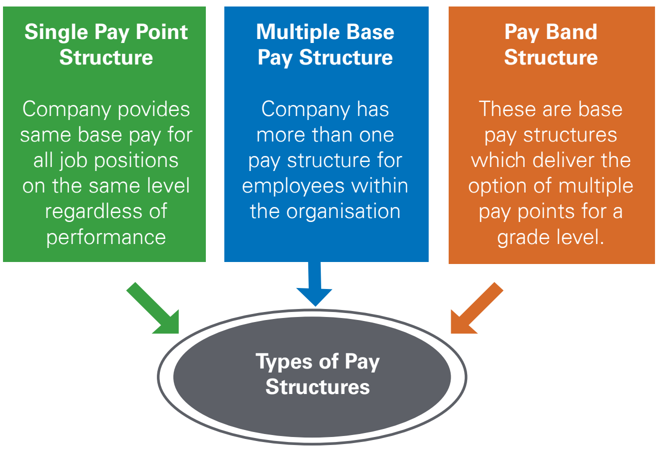
One hard truth employers and reward practitioners have to face is that there is no perfect pay system. At the point of hiring a new employee and negotiating pay, it appears that both parties have found common ground on compensation and are satisfied. Within a short time when the thrills of the new job begin to fade, combined with information that colleagues on "similar" roles earn more, the previously-excited employee begins to question the equity in pay levels.

The critical question to answer is whether compensation is ***internally fair*** and ***externally competitive.*** If compensation is internally fair, this means that jobs of similar worth within the organisation are paid equitably, and any differentiation in pay will be based on reasonable factors such as years of experience, educations, skills etc. To determine, external competitiveness, organisations compare pay and determine their market positioning in comparison to pay levels in comparable organisations operating in the business space.

In delivering equitable and competitive pay, organisations need an administrative tool that clearly defines pay levels and assists with pay adjustments such as pay increases, pay freezes etc.

Effective Pay Structure as a Means of Ensuring Pay Equity

An effective pay structure is a tool for administering a company's compensation program. The various types of pay structures are shown in the diagram below:



Organisations may choose any of the above types of pay structure depending on the business and what works best for them. Some organisations adopt different pay structures for different business units / divisions.

In practice, organisations have had to pay below or above competitive pay levels for various reasons such as ability to pay and need for a critical talent. However, having an effective pay structure provides a systematic method of moving employees within and across pay levels. It also provides a framework for merit pay as well as a tool for pay negotiations during recruitment and collective bargaining.

In designing pay structures, organisations emphasize external equity by creating pay bands around competitive anchor points in the pay market. Therefore, pay structures provide objective bases for equitable pay administration devoid of emotions and favouritism. This increases the hiring and retention power of the organisation.

A well-designed pay structure, in conjunction with a Performance Management System that aligns with the company's strategic objectives, encourages pay for performance. It also reduces the feeling of inequity and dissatisfaction amongst employees, since they are aware of the company's expectations and the reward for meeting these expectations.

Use of Pay Structure in Solving Some Pay Equity Related Challenges

- **A Proper Tool for Representing a Company's Pay Philosophy:** An organisation's pay structure is usually built around its pay philosophy and a desired anchor point within the pay market. A well designed pay structure incorporates this desired market positioning.
- **Providing a document for communicating pay:** A pay structure serves as a formal document for communicating and presenting the company's compensation strategy to management and stakeholders.
- **Negotiation:** In union negotiations, a pay structure provides a guide for management to know when you they are going overboard during bargaining. It also assists to, at a glance, assess the impact of proposed pay reviews.
  Also, in hiring new employees, pay structures assist the HR team to quickly decide on the pay level to offer the new hire.
- **Managing Expectations of Gross Versus Net Salary:** A clear pay structure allows reward practitioners to properly compute and communicate tax returns and net salary to employees ahead of any employment contract. This helps manage employee's expectation of Gross versus Net salary.
- **Managing Tax Returns:** A defined pay structure document can be presented to tax authorities during tax audits. It ensures compliance and transparency in making tax returns and reduces the risk of unwarranted tax liability.
- **Controls Pay compression:** A well designed and properly administered pay structure assist to reduce pay compression, a situation where employees earn close to their supervisors due to factors such as union negotiations, employees staying too long on a level and overtime payments. Pay structures assist to control