

LECTURE 2: INTERNATIONAL COMPENSATION

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For Students of 1 Master,
HRM

Course: Wages and incentives
Management 2

OBJECTIVES

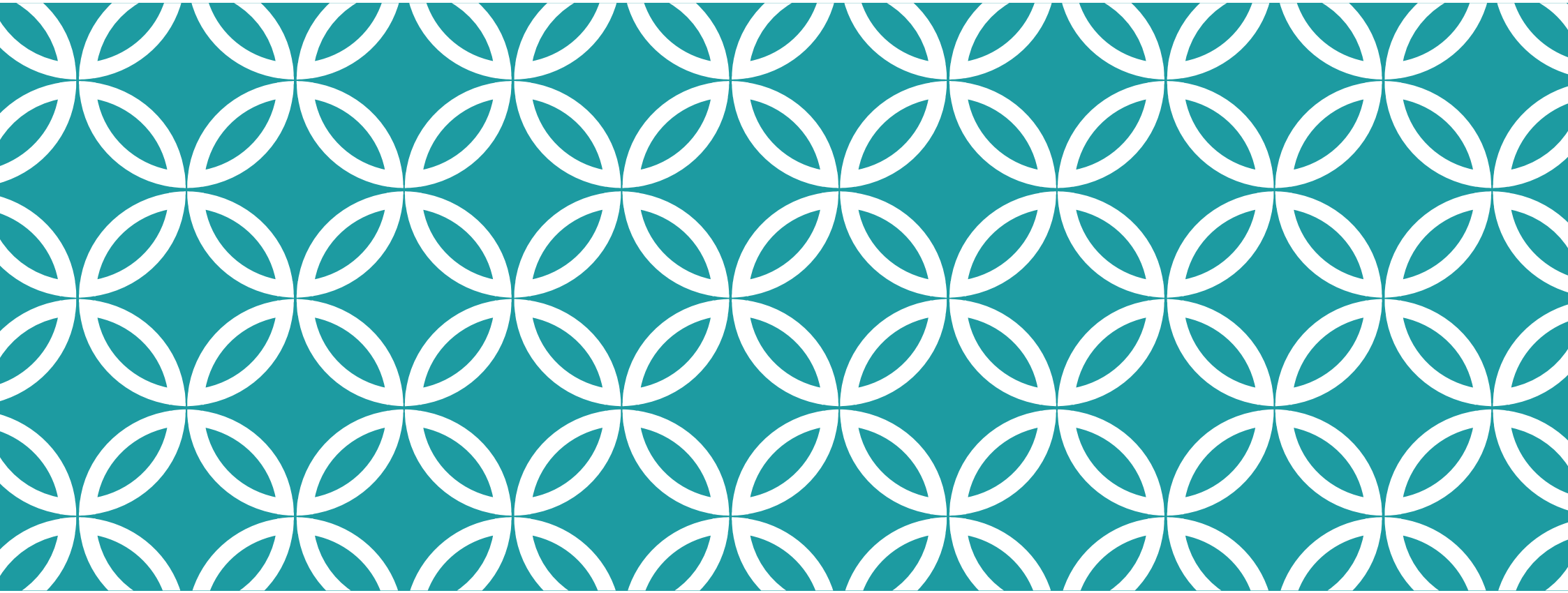
- 1.Examine the complexities caused by moving compensation from a domestic to an international context
- 2.Detail components of a international compensation program
- 3.Outline the main approaches to international compensation & the advantages/disadvantages of each
- 4.Examine the special problem areas of taxation, valid international living cost data, & the problem of managingTCN compensation
- 5.Outline Theories of International Compensation
- 6.Examine recent developments & issues

INTRODUCTION

Compensation is the remuneration received by an employee in return for their contribution to the organization.

International compensation refers to all forms of financial returns and tangible benefits that employees of an international organization receive from their employer in exchange for providing their labor and commitment.

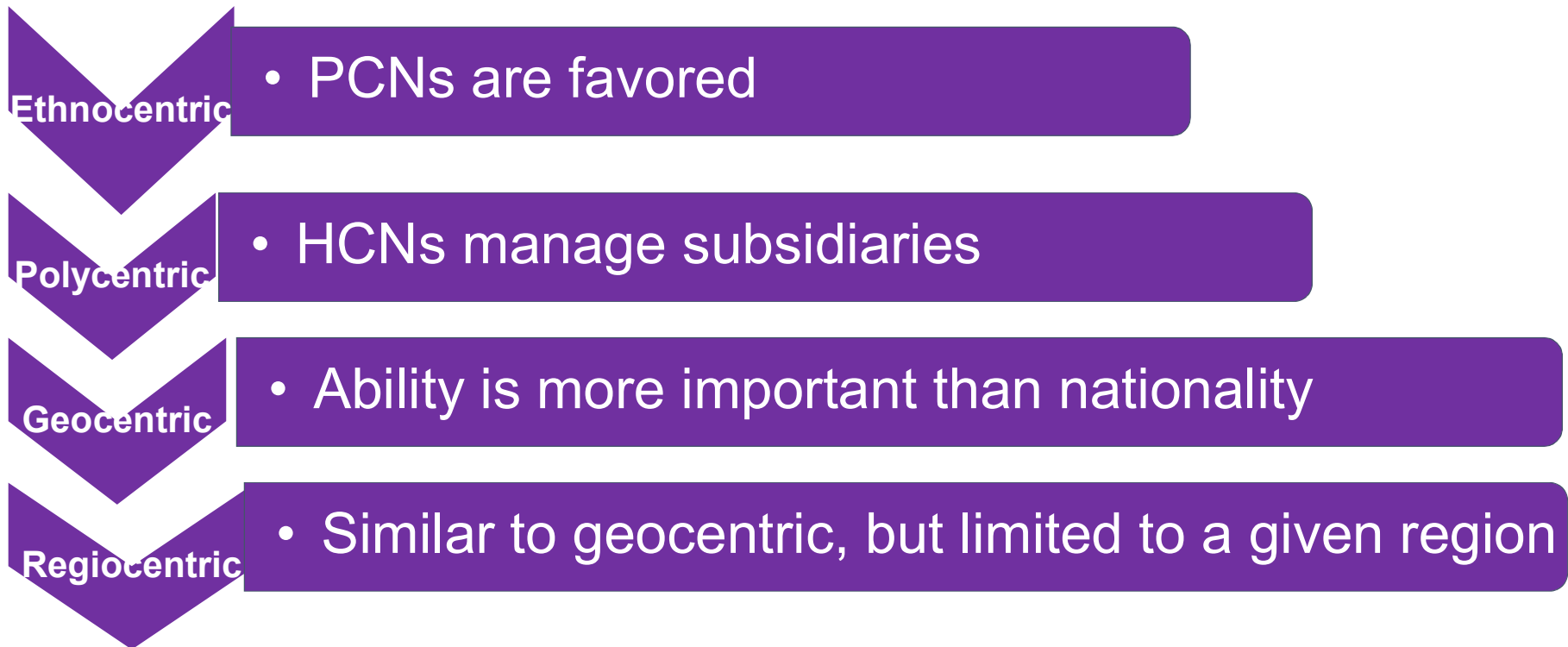
Almost all the employees accept jobs in MNC's take-up assignments in various countries, & take-up the risk, bear inconveniences & discomforts in foreign assignments mostly based on the compensation package



APPROACHES TO STAFFING



STAFFING ATTITUDES OF INTERNATIONALIZING FIRMS



TYPES OF INTERNATIONAL ASSIGNMENTS

- Short term** up to 3 months
- Extended** up to 1 year
- Long term** 1 to 5 years (traditional expatriate assignment)

Some non-standard assignments:

- Commuter:** go home every one to two weeks
- Rotational:** commute for set period followed by break in home country
- Contractual:** specific skills employees hired for 6-12 months on specific projects
- Virtual employee:** manages international responsibilities from base in home country *

DEFINITION OF INTERNATIONAL COMPENSATION STRATEGY

It is a framework companies use to design and manage employees pay & benefits across different countries

OBJECTIVES OF INTERNATIONAL COMPENSATION

Consistent with overall strategy, structure, & business needs of the MNE

Recruit & Retain Competent Employees/ Boosting employer brand

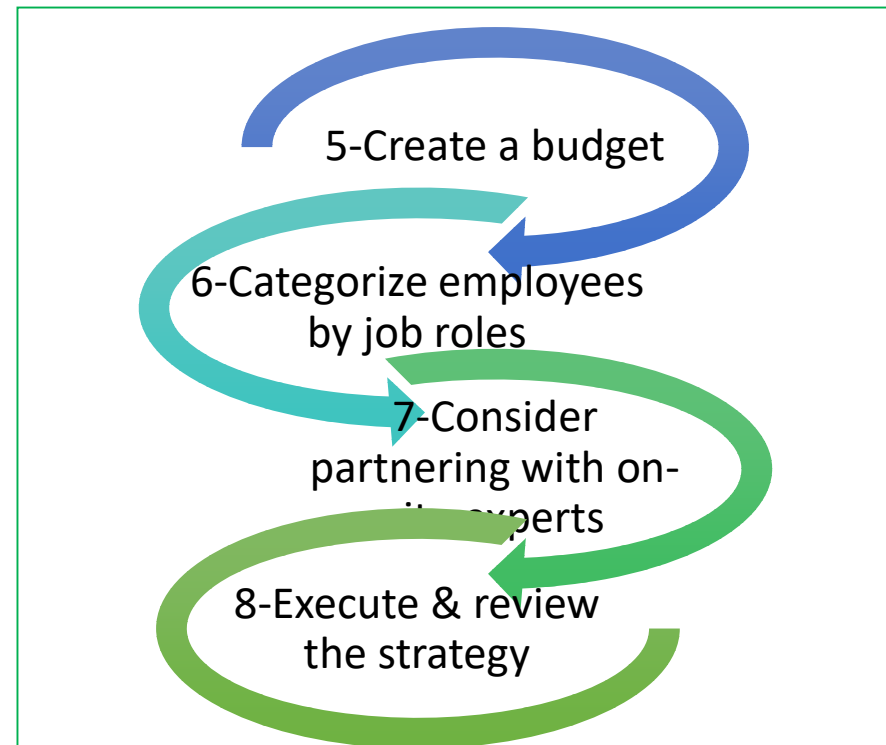
Employability in a Cost Effective

Consistency & Equity in Pay

Cultural alignment and global mindset

Compliance with diverse legal and cultural requirements globally

HOW TO CREATE AN INTERNATIONAL COMPENTATION STRATEGY



KEY CONSIDERATIONS FOR INTERNATIONAL COMPENSATION STRATEGY

Market Competitiveness

Cost of Living Adjustments

Currency fluctuations

Pay Transparency & Equity

Technology & Data Analysis

Sustainability and Long-Term Planning

TECHNOLOGIES USED FOR INTERNATIONAL COMPENSATION STRATEGY

Data Analytics
and Business
Intelligence Tools

Human Resource
Information
Systems (HRIS)

Cloud-Based
Payroll Systems

Compensation
Management
Software

CHALLENGES IN IMPLEMENTING AN INTERNATIONAL COMPENSATION STRATEGY

**Talent Mobility
and Expatriate
Compensation**

**Compliance With
Local Labor Laws**

**Cost of Living
Variations**

**Currency Exchange
and Economic
Fluctuations**

Taxation Issues

FACTORS AFFECTING INTERNATIONAL COMPENSATION

MNC's Internal Environment

- Goal Orientation
- Capacity to pay
- Competitive strategy
- Organization culture
- Workforce characteristics

MNC's External Environment

- Parent country
- Labor market characteristics
- Role of Home and host country government
- Industry type
- Competitive strategy

INTERNAL FACTORS AFFECTING INTERNATIONAL COMPENSATION

Goal orientation - UK-based foam manufacturer Zotefoam, where equality is a key aspect of HRM in the company's mission, the only perks that differentiate executives from other workers are private health insurance and a car allowance – MD of the firm sees the internationalizing firm as one with minimal status differences between levels in the org. hierarchy.

Capacity to pay - Cost constraints on the enterprise

Competitive strategy - If for eg., as part of the MNC competitive strategy, the IHRM strategy is to be a market leader in employee compensation in order to compete for the most competent candidates, then the levels of compensation might well be higher than if the competitive strategy is based on, say, the provision of secure employment.

INTERNAL FACTORS AFFECTING INTERNATIONAL COMPENSATION

Organization culture- It also influences the degree to which employees are compensated on the basis of seniority, in contrast to personal connections or performance.

Workforce characteristics -Age, education level, qualifications and experience, along with workforce tastes and preferences, and labor relations factors such as nature of employment relationship will result in different international compensation approaches

EXTERNAL FACTORS AFFECTING INTERNATIONAL COMPENSATION

Nationality of the parent country - In terms of culturally determined values and attitudes towards compensation policy and practices – local culture influences international compensation strategy through the dominant societal values, norms, attitudes and beliefs concerning for eg. bases for compensation differences (performance, family connections, gender), degrees of compensation differences between managerial and non- managerial employees, and the propensity for using particular types of compensation (pay incentives and benefits).

Labor market characteristics of supply and demand - Education and skill levels, ages and experiences of those in the labor market.

Role of home and host country government in labor relations Affect the level of govt. regulation of the labor market and employment relationship, including compensation of the workforce

EXTERNAL FACTORS AFFECTING INTERNATIONAL COMPENSATION

Industry type

- Evidence from two global industries, scientific measuring and medical instruments suggest that MNCs competing in a global industry may be more likely to allocate rewards based on corporate and regional performance rather than on subsidiary performance, as favored by MNCs competing in a multi-domestic industry .
- Different industry sectors also have different norms and practices for international compensation (eg. service-sector and high technology MNCs have been more likely than manufacturers to incorporate equity- based options in their international compensation strategies)

Competitors' strategies

- Even if the MNC is not seeking to be a market leader in international compensation, it generally cannot afford to fall behind market rates across its locations, as it will risk losing valuable employees to competitors

KEY COMPONENTS FOR EXPATRIATES

1 Base salary

2. Foreign service inducement & hardship premium

3. Allowances: COLA, housing, home leave, education, relocation, spouse assistance

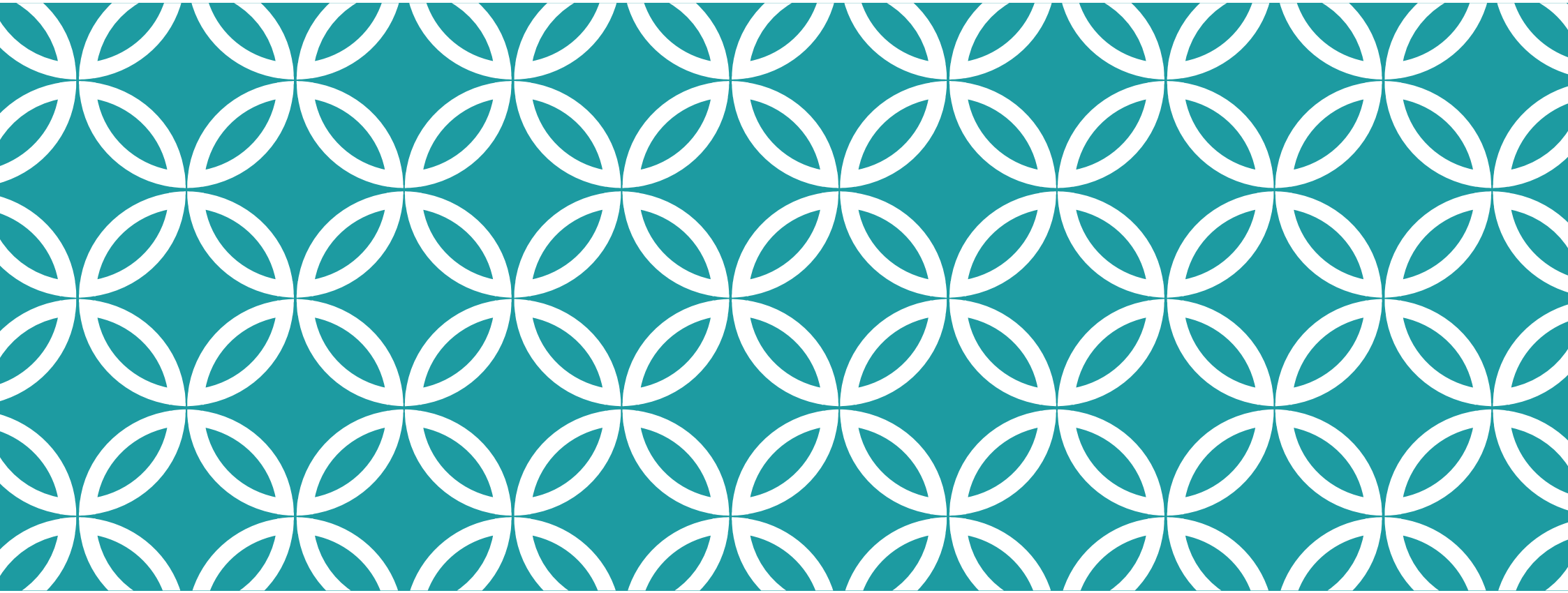
4. Benefits

1- BASE SALARY

- Expatriate salaries typically are set according to the base pay of the home countries.
- Therefore, a German Manager working for a US MNC and assigned to Spain would have a base salary that reflects the salary structure in Germany.
- The salaries usually are paid in Home currency, local currency, or a combination of the two.
- The base pay also serves as the benchmarks against which bonuses and benefits are calculated.

2- FOREIGN SERVICE/HARDSHIP PREMIUM

- This is often perceived as an inducement in the form of a salary premium to accept an overseas assignment.
- Generally, salary premiums vary from 5—40% of the base salary. Actual salaries depend upon the assignment, actual hardship, tax consequences and length of assignment.
- In addition, if the work – week in the host country is longer than in the home country , the assignee will be paid for the extra hours worked.
- Certain countries are highly hostile to foreigners staying and working. Expatriates in such environments are paid 2-3 times more than their domestic salaries.



3- ALLOWANCES



3-1- COST OF LIVING

Various studies indicate that cost of living in the host country have a strong upward effect on expatriate compensation.

Majority of organizations use cost of living to determine the amount of payment needed for the international cost of living difference.

Generally, employers use a “no loss, no gain” approach when developing compensation program for employees while working overseas.

Within this framework, if the cost of living in the foreign country is higher than that at home, then the manager's existing base pay along will result in a lower standard of living.

An adjustment made to cost of living is generally equal to the percentage increase in the expatriate's base pay.

3-2- HEALTHCARE

The fact that healthcare provides benefits to expatriate, vary widely across countries makes their management extremely complex and their transportability very difficult to normalize.

For instance, only 65% of international placements are engaged and satisfied with the healthcare service within the expatriate compensation benefits.

Research indicates that 80% of organizations across sub-Saharan Africa provide some form of health care to employees and also provide medical care for spouses and dependents.

Whereas, in Saudi Arabia, health care have been given a high priority by the government at all levels in terms of quality and quantity. This includes comprehensive products for travel, life, and income replacement. In fact there healthcare is ranked 26th among 190 of the world's health systems. It comes before many other international health care systems such as Canada (ranked 30), Australia (32), New Zealand (41), and other systems in the region such as the United Arab Emirates (27), Qatar (44) and (45) Kuwait.

3-3- ACCOMMODATION ALLOWANCE

Organizations tend to ensure that expatriates live as well as their foreign peers or that their housing and utilities are comparable to what they back home.

Housing costs vary substantially by location. Tokyo and London, for instance, are notoriously expensive places to live. Rental rates in Tokyo fare exceed comparable housing costs in most US cities. In other international cities, such as Rio de Janeiro, may be less expensive than average US domestic rates.

Although it is becoming increasingly uncommon, some employers pay the full housing expense on behalf of the expatriate employee.

If housing rates are higher at the assignment location, an adjustment may be paid directly to expatriate employee and to seek reasonable accommodations.

3-3- ACCOMMODATION ALLOWANCE

In some cases, it may be advantageous for the employer to directly pay the rent and thereby reduce the tax liability.

In some less-developed countries, the housing available for expatriates and their families would have unreasonable expectations going in, which would leave them disappointed and often negatively impact their overall expatriate experience.

Without proper insight into the local housing markets, employers would often establish housing allowances that were not reasonable or appropriate for a given location.

3-4- CHILDREN'S EDUCATION

Thought school choices are always challenging, and even more where the traditional approaches are limited or non-existent. Families who succeed in dealing with these difficulties and successfully educated their children in limited local schools find the rewards to be noteworthy.

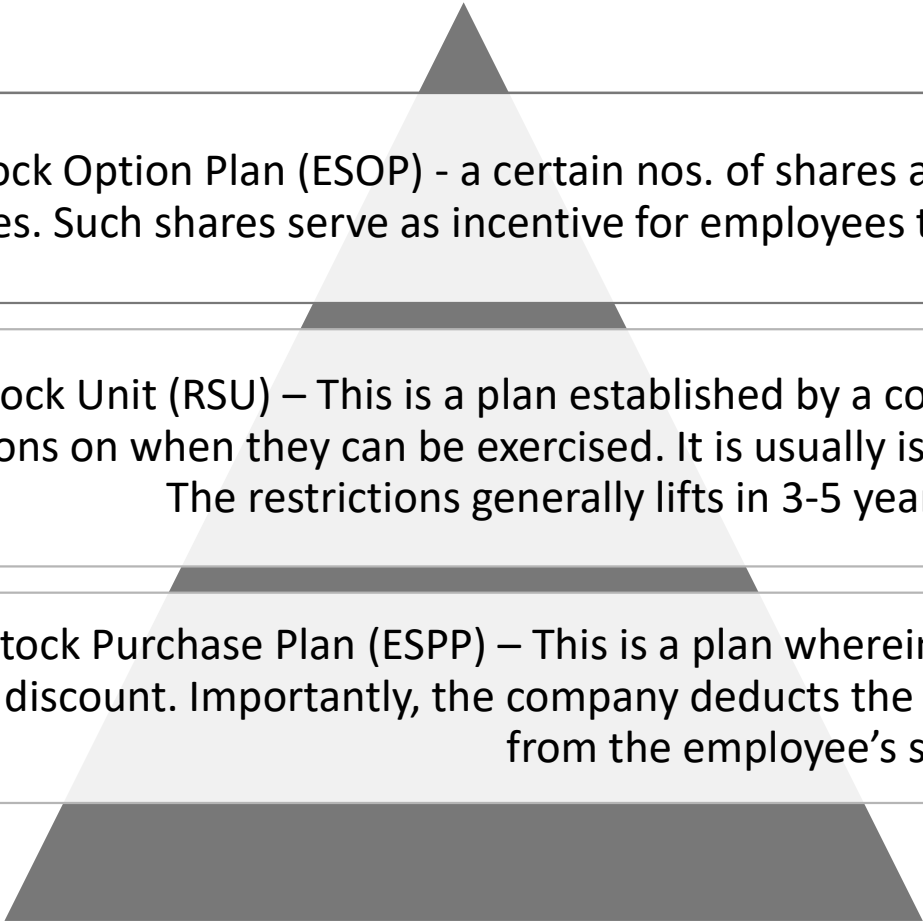
A unique offer of societies in different country such as new languages, cultures and curricular subjects can provide some form of acceptance for the youngsters.

Despite the fact that cost related to international school might be overwhelmed, parent organizations found that paying up in these situations is an essential requirement.

4- BENEFITS

- Alternatively known as indirect compensation.
- One third of compensation for regular employees is benefits).
- Benefits include a suit of programmes such as: – Entertainment, Festival celebrations, Gifts, Use of club facilities, provision of hospitality including food and beverage, employee welfare, use of health club, Conveyance tour and travel, Hotel Board and Lodging, vehicles, telephone and other telecommunication facilities, Sponsorship of children.
- Basically an employee tends to join and stay with an organization which guarantees an attractive benefits programme.

4- LONG TERM BENEFITS



Employee Stock Option Plan (ESOP) - a certain nos. of shares are reserved for purchase and issuance to key employees. Such shares serve as incentive for employees to build long term value for the company.

Restricted Stock Unit (RSU) – This is a plan established by a company, wherein units of stocks are provided with restrictions on when they can be exercised. It is usually issued as partial compensation for employees. The restrictions generally lifts in 3-5 years when the stock vests

Employee Stock Purchase Plan (ESPP) – This is a plan wherein the company sells shares to its employees usually, at a discount. Importantly, the company deducts the purchase price of these shares every month from the employee's salary

MNE APPROACHES TO INTERNATIONAL TAXATION

Tax equalization

A hypothetical home country income tax is withheld from each paycheck. Foreign taxes are either paid by the employer or reimbursed. Although this program ensures equity among expatriates, it requires more administrative resources than the other methods

Tax protection

Tax protection: The employee pays up to the amount of taxes he or she would pay on remuneration in the home country. In such a situation, the employee is entitled to any windfall received if total taxes are less in the foreign country than in the home country.

A disadvantage of this program is that it can create inequities between expatriates in low-tax-cost countries and those in high-tax-cost countries.

MNE APPROACHES TO INTERNATIONAL TAXATION

Localization

The expatriate employee is responsible for his or her own tax payments. Localization may result in significant additional tax burden on the employee

- Ad hoc** – each expatriate handled differently
- Laissez-faire** –each is on their own

APPROACHES TO INTERNATIONAL COMPENSATION



1- BALANCE SHEET APPROACH

Balance Sheet Approach

It is considered as an all encompassing method in compensating the expatriates

This approach integrates the base salary for PCNs and TCNs to the salary structure of the home country.

the main target of the balance sheet approach is to endow with an equivalent purchasing capacity abroad in order to maintain home life style.

1- BALANCE SHEET APPROACH

Balance Sheet Approach

It mainly deals with two factors of compensation i.e., “base compensation” and “incentive and equalization adjustment”,

The former discusses the salary, performance based incentives, and indirect remuneration while the later includes the benefits (house allowance, displacement allowance, etc.) employees enjoy when transferred to unusual or bumpy environments

1- BALANCE SHEET APPROACH

ADVANTAGES

- Provides equity between assignments and between expatriates of the same nationality.
- Ease of Communication.
- Due to the consistency between the compensation system and the compensation system in the parent country, the repatriation process for expatriates is facilitated.

DISADVANTAGES

- it can result in significant disparities between expatriates from different nationalities and between expatriates and locals doing the same work.
- It is also complex to administer.

2- GOING RATE APPROACH

Going rate approach

It is also known as the 'localization', 'destination' or 'host country-based' approach

The core of this approach lies in linking the expatriate compensation to the salary structure of the host country, taking into account local market and compensation level in local employees

The multinational usually obtains information from local compensation surveys and must decide whether local nationals, expatriates of the same nationality or expatriates of all nationalities will be the reference point in terms of benchmarking. For instance, a Japanese bank operating in New York would need to decide whether its reference point would be local US salaries, other Japanese competitors in New York, or all foreign banks operating in New York

2- GOING RATE APPROACH

Going rate approach

Generally, base pay and benefits are supplemented by additional payments, particularly for expatriates operating in lowpay countries.

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2- GOING RATE APPROACH

ADVANTAGES

- pay equality with local nationals is facilitated
- It also promotes equity amongst different nationalities doing the same work.
- The approach is simple and easy for expatriates to understand
- It provides greater identification with the host nation

DISADVANTAGES

- Variations in pay between assignments for the same expatriate and pay discrepancies between expatriates from the same nationality doing similar work in different nations.
- This approach also causes potential re-entry challenges, particularly when expatriates have been receiving significantly more pay while on assignment as compared to their home nation.

3-LOCAL PLUS APPROACH

Basis: Host-country salary scale.

"Plus" Factor: Adds allowances like relocation, housing, and school fees not given to locals

Usage: Often used for long-term assignments, permanent moves, or "localizing" expats

Goal: Balance local competitiveness with some expatriate-specific support

4-INTERNATIONAL CITIZENS APPROACH

Base on internationally set standards

An international basket of goods is used for all expatriates, regardless of country of origin

The basket of goods includes food, clothing, housing, and so forth

However, expatriates are not provided salary adjustments that would allow them to purchase exactly the same items in the host country as in the home country

Expatriates receive adjustments that would allow them to purchase a comparable local product of the same nature; e.g, rather than a Mercedes (which they had in the home country), they would buy a local luxa

Global salary systems seek to provide worldwide equity in rewards and allow managers to move between countries with minimal effects on lifestyle

5-LUMP-SUM APPROACH APPROACH

It is a pre established compensation approach

A one-time or fixed-amount payment, often used for relocation, housing, or goods and services, rather than itemized reimbursements.

Flexibility: Employees decide how to spend the funds, allowing them to prioritize their own needs (e.g., choosing cheaper housing to spend more on travel).

Administrative Simplicity: Reduces the complexity of tracking and auditing individual expense reports.

Use Cases: Often used for allowances rather than the entire base salary, such as for relocation or special, one-time premiums.

Drawbacks: It may not cover actual, unforeseen costs, potentially leaving the employee with out-of-pocket expenses if they mismanage the funds.

6- CAFETERIA APPROACH

Cafeteria approach is mostly used for senior level or upper- income expatriates.

In cafeteria plan employees have to choose between two or more incentives (flexible benefits) comprised of qualified and cash benefits, similar to the ability of a customer to choose among available items in a 'Cafeteria.

This approach let the expatriates to enjoy benefits like club membership, insurance, company car, free education, etc. with no amplified charges of taxation.

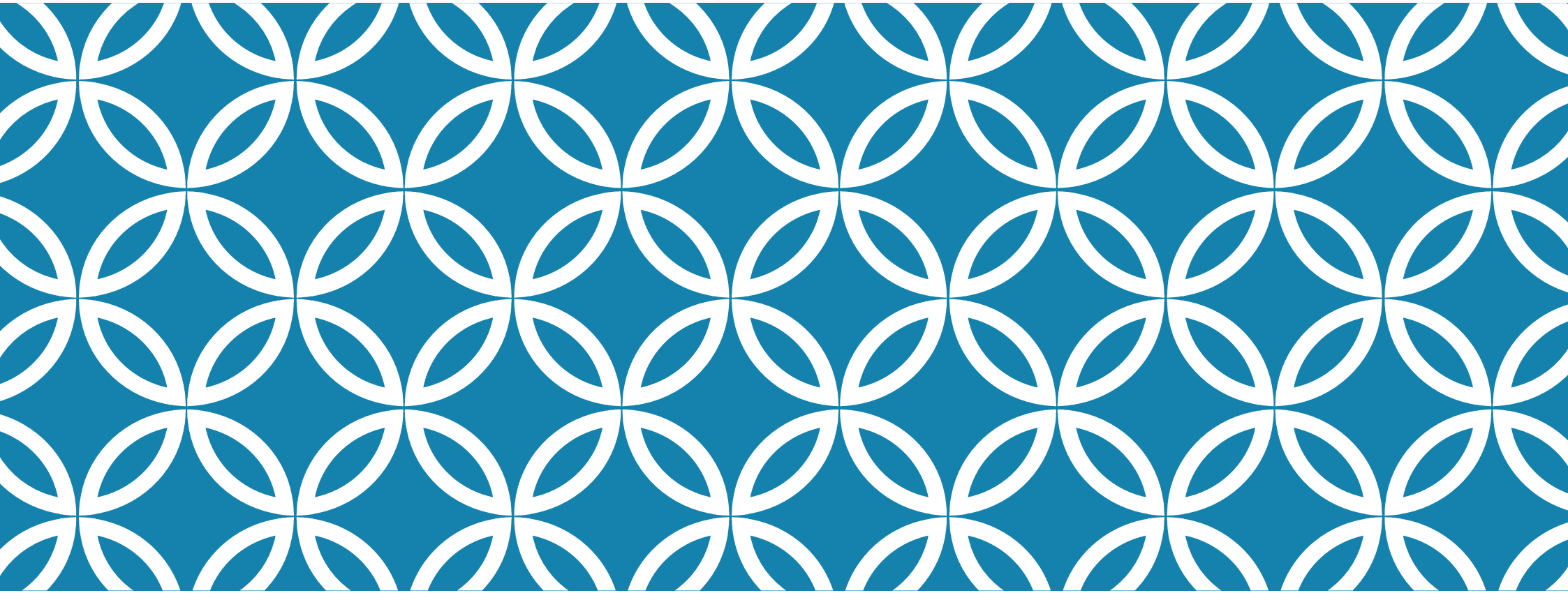
These plans are useful when there is considerable diversity within workforce. For example, the benefits needed by a family of four will be different from those required by a 'single' expatriate

7- NEGOTIATION

Negotiation is also considered the most commonly used, an ad-hoc scheme favored by higher ranked HR managers, and it mitigates the black and white set of laws while dealing with International payment contracts.

It involves customizing pay packages for individual expatriates through direct dialogue, rather than applying a standardized, company-wide policy.

It risks creating inequities among expatriates.



THEORIES OF INTERNATIONAL COMPENSATION



1-CONTINGENCY THEORY

Contingency theory is most popularly followed in international compensation.


According to this theory, expatriate compensation should be based on particular contingencies or situations prevailing in the host country.

Typically, therefore, these organizations believe that the same compensation rule cannot apply to expatriates across the globe.


The compensation philosophy in such organizations is normally de-centralized and allows units to localize the compensation structure.

2- RESOURCE BASED THEORY


This theory suggests that an MNC should pay well to attract and train competent people who contribute to its competitive advantage.



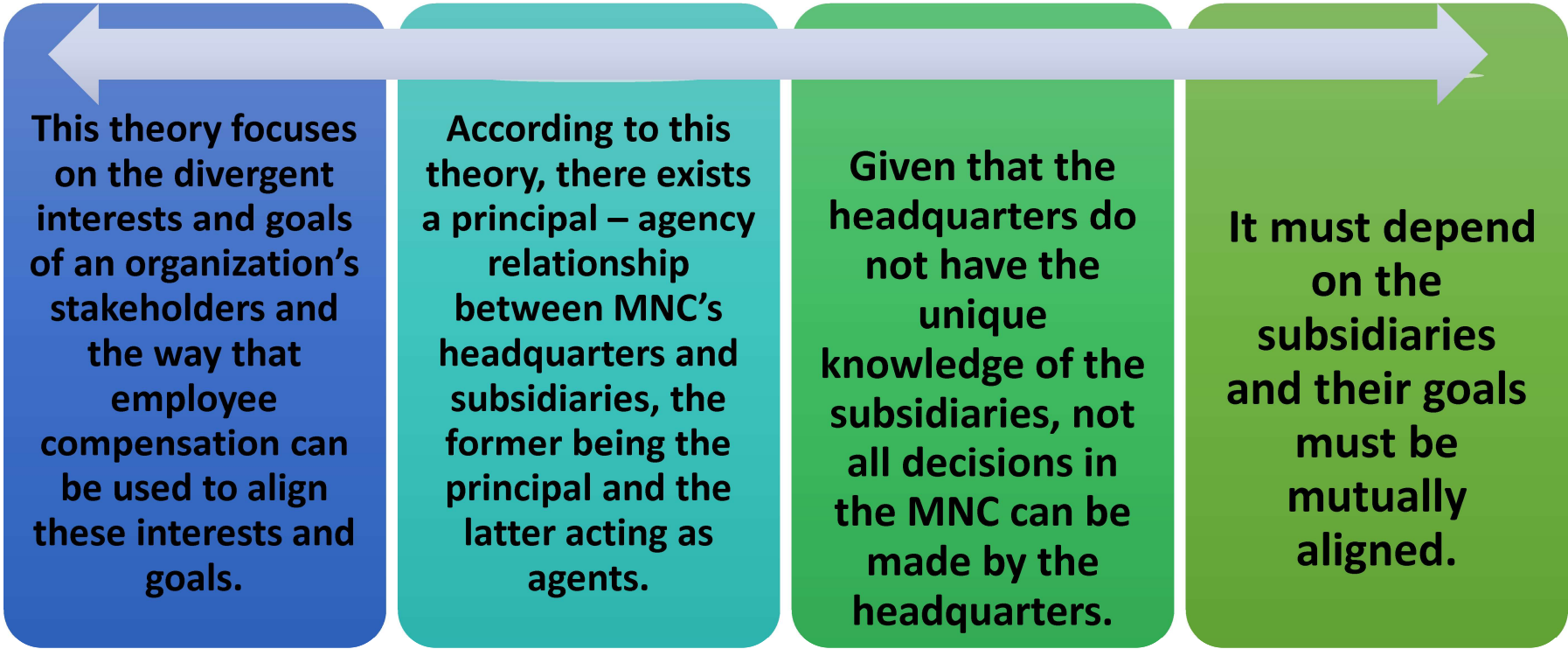
Human resource consists as the greatest asset of MNC and the firm should do anything to acquire, retain and use it for organizational effectiveness. It is a challenge in such organizations to ensure a fixed structure and stay within clearly defined salary bands.



Such organizations remain market sensitive and are constantly reviewing compensation to retain their position in hiring and retaining of talent.



3-THE AGENCY THEORY



This theory focuses on the divergent interests and goals of an organization's stakeholders and the way that employee compensation can be used to align these interests and goals.

According to this theory, there exists a principal – agency relationship between MNC's headquarters and subsidiaries, the former being the principal and the latter acting as agents.

Given that the headquarters do not have the unique knowledge of the subsidiaries, not all decisions in the MNC can be made by the headquarters.

It must depend on the subsidiaries and their goals must be mutually aligned.

4- EQUITY THEORY

Equity theory believes that there should be an equal balance between what the expatriate contributes and what he receives as compensation. Inequity between the two will result in low performance.

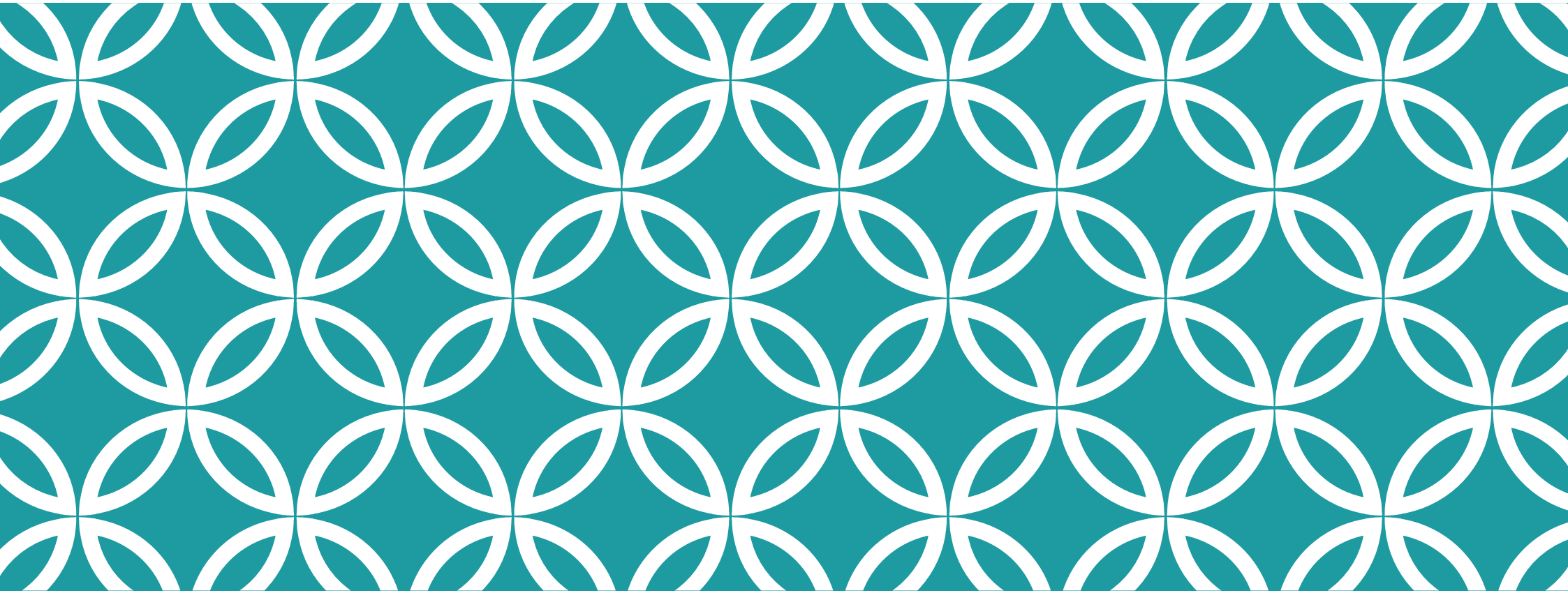


Establishing the equity principle in a domestic business may be relatively easy but in international compensation, this is a daunting task.



Relativities are much more difficult to establish in an MNC due to its geographic and cultural spread and its workforce mix of home, host and third country nationals.





**COMPENSATION STRATEGY &
CULTURE**



1- NATION AND REGION BASED

Nation and Region Based

There is considerable difference in compensation and rewards not only across nations but also within nations.

Recent studies done in China, for example, show that pay packages provided in state owned enterprises emphasize benefits like housing, food, healthcare, childcare, etc and relatively lower cash.

- Joint ventures and wholly foreign owned subsidiaries use widely divergent approaches, some emphasizing highly risky variable pay while others emphasizing training, career development and moderate cash.

2- NATIONAL CULTURE BASED

National Culture Based

Sociologists proposed that each nation has a culture – for example Geert Hofstede (Power Distance, Individualism-Collectivism, Uncertainty Avoidance, and Masculinity-Femininity) and some others as well.

Following this view, some argue that compensation strategies differ with the national cultures - compensation systems in countries where the culture emphasizes respect for status and hierarchy and thus produces higher power distance scores (Malaysia and Mexico) should exhibit more hierarchical pay structures, while those manifesting low power distance (Australia and the Netherlands) would choose more egalitarian systems.

In nations identified as individualistic (U.S., U.K., Canada), compensation and rewards would support employability and individual and performance-based pay.

2- NATIONAL CULTURE BASED

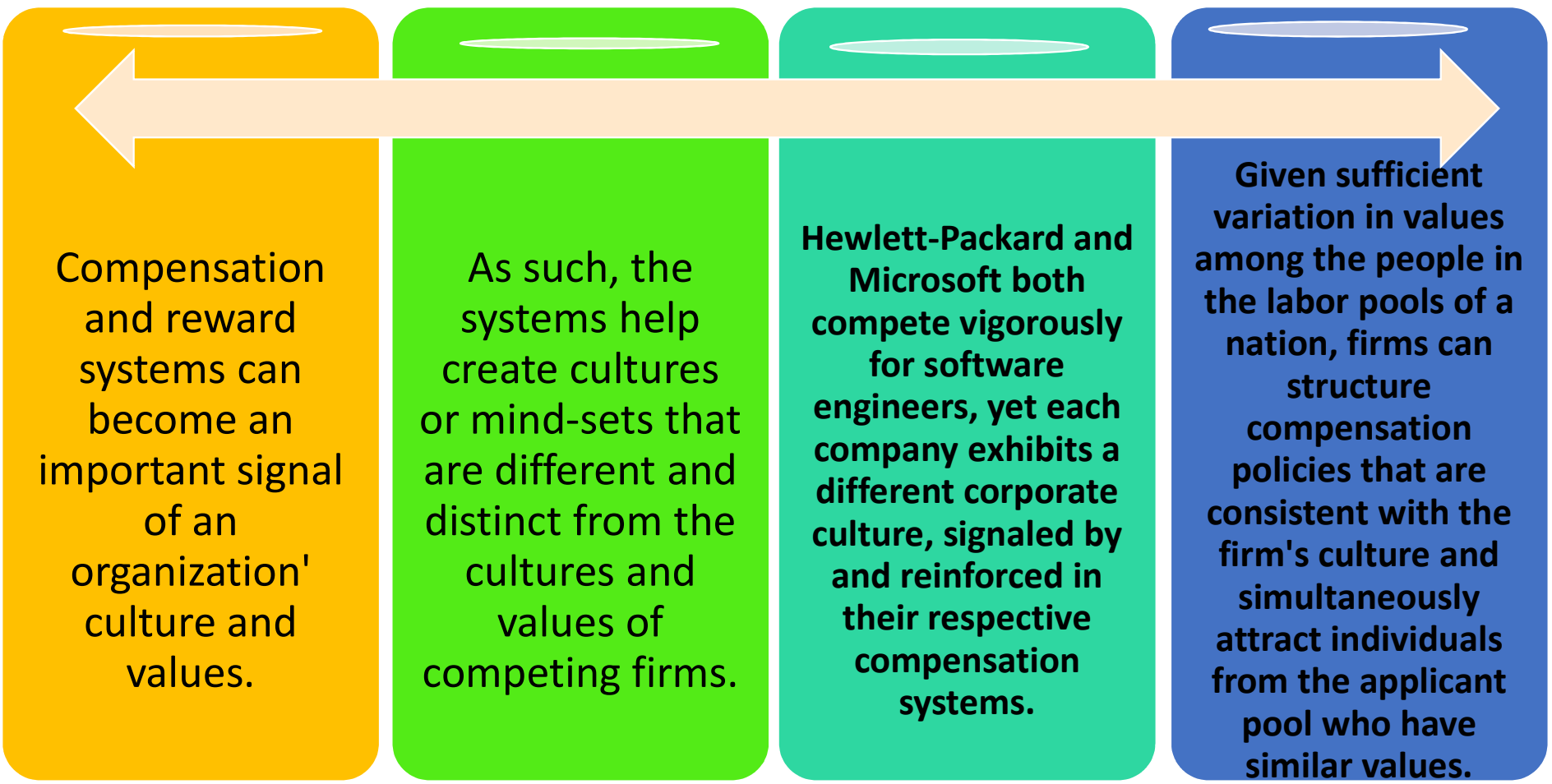
National Culture Based

This national culture approach prescribes that compensation and reward policies must be aligned with and reinforce attributes of national culture.

It has long been recognized that compensation and reward systems, because of their social as well as economic significance, exemplify and reinforce cultural norms.

Closer analysis reveals that political, economic, institutional, and other forces (rather than national culture) explain a significant amount of variation in the expressed desires of employees from different countries.

3-ORGANIZATION CULTURE BASED



Compensation and reward systems can become an important signal of an organization's culture and values.

As such, the systems help create cultures or mind-sets that are different and distinct from the cultures and values of competing firms.

Hewlett-Packard and Microsoft both compete vigorously for software engineers, yet each company exhibits a different corporate culture, signaled by and reinforced in their respective compensation systems.

Given sufficient variation in values among the people in the labor pools of a nation, firms can structure compensation policies that are consistent with the firm's culture and simultaneously attract individuals from the applicant pool who have similar values.

4- STRATEGIC FLEXIBILITY

There is a growing realization that focusing only on the financial forms of total compensation creates transactional relationships that can be easily copied or purchased by competitors.

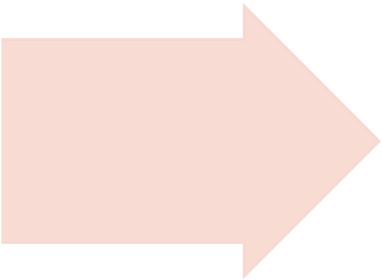
Strategic flexibility also includes a broader thinking that includes both financial and Relational returns.

Relational returns may bind individuals more strongly to the organization because they can answer those special individual needs that cannot be met as effectively with economic returns


- For example : providing for childcare via the noneconomic return of flexible work schedules, versus the financial return of salary to pay for childcare. The flexible schedule puts a parent, not a caregiver, at home.

4- STRATEGIC FLEXIBILITY

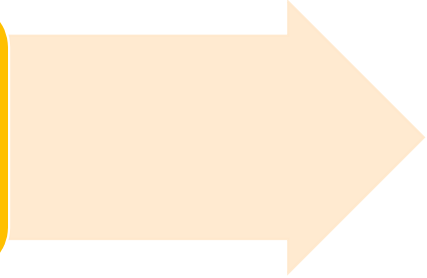
Flexibility is based on the premise that understanding and managing total compensation in a global business shifts thinking away from using a balance sheet to keep expatriates economically whole or relying on stereotypical notions of differences among nations.



The focus, rather, is on understanding and leveraging differences within and between nations.




Strategic flexibility means that companies achieve advantage by customizing multiple compensation and reward systems.




4- STRATEGIC FLEXIBILITY

Flexibility, choice, and managing risk form the essence of this thinking. It begins by viewing the employment relationship as an exchange.



Under this view, both the employer and employee make contributions and extract returns from the relationship.



A critical principle is that the returns offered by the employer are the primary determinants of the contributions provided by employees.

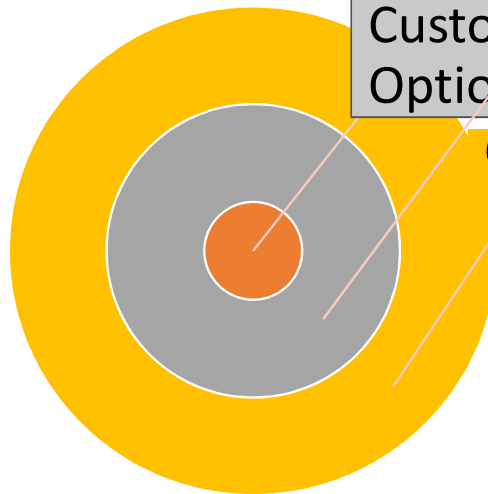
4- STRATEGIC FLEXIBILITY

- The model below groups different forms of total compensation into three sets: core, crafted, and choice.

Choice (Assignments, Stock purchase, Base/Bouns Mix, Benifits Choices, Tax Deferral)


Customise (Base/Bouns Mix, Stock Options, Flexible schedules, Training)

Core (Competitve Cash, Basic Benefits, Performance Based 5%, Employability, Work Chalanges)




4- STRATEGIC FLEXIBILITY

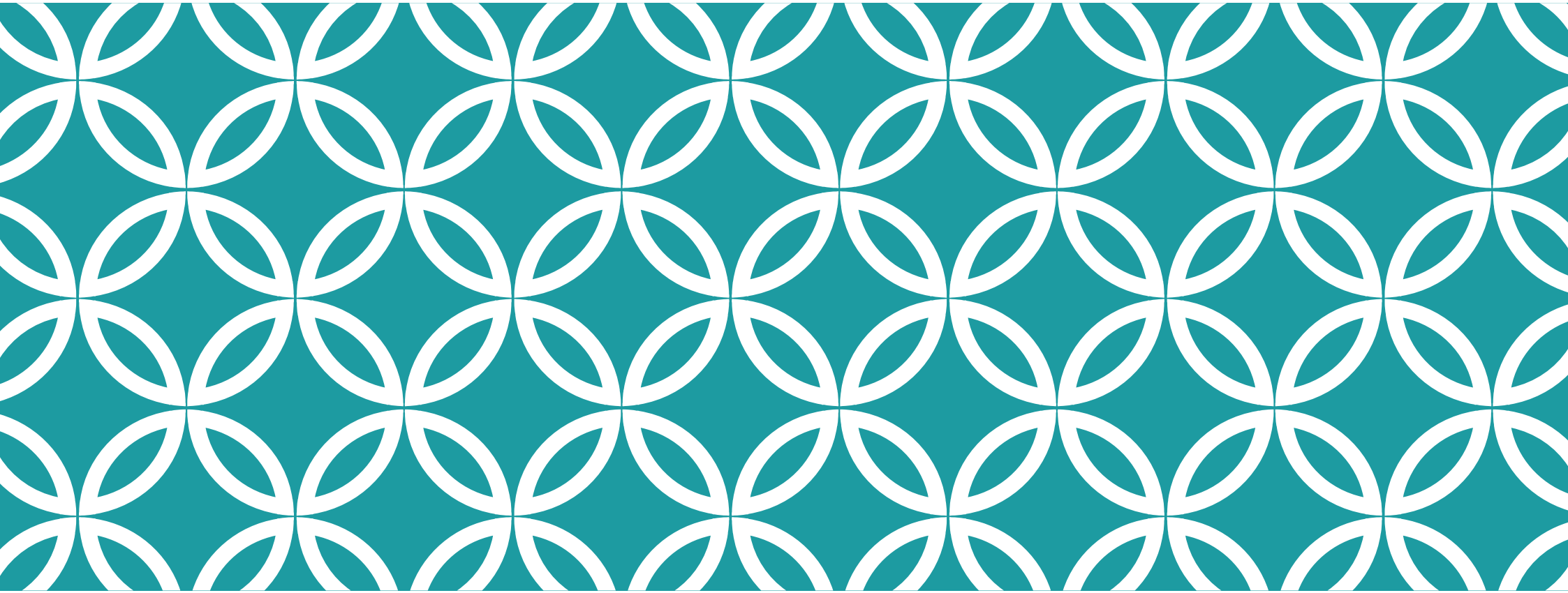
The core section of the model includes compensation and reward forms that signal the corporate global mind-set (example: creating a customer service culture).



The crafted set of compensation elements in the figure assumes that business unit or regional leaders have discretion to choose among a menu of total compensation forms that may be important to gain and sustain advantage in the markets in which they operate. For example, some form of housing assistance may make sense in Shanghai, whereas in London or Tokyo, transportation assistance may make more sense.



The alternatives in **the choice** set offer flexibility for employees to select among various forms of total compensation. Example here might include opportunities to take educational leaves to become eligible for regional or global assignments.



THANKS FOR YOUR ATTENTION.

