

Learning Objectives

- Understand various complexities in managing international compensation and benefits.
- Analyze the objectives of international compensation and benefits.
- Study the impact of various internal and external factors on international compensation management.
- Understand different components or structure of international compensation and benefits structure.
- Analyze the executive compensation of MNCs in different countries.
- Analyze various approaches to international compensation management.

Structure

1. Introduction.
2. Complexities in International Compensation Management.
3. Objectives of International Compensation Management.
4. Factors that affect International Compensation – Internal and External factors.
5. Components / Structure of International Compensation Package.
6. Executive Compensation.
7. Approaches to International Compensation Management.
8. Summary.

9.1 Introduction

Rewards can be intrinsic or extrinsic.

Intrinsic reward is a feeling of pride of a job well done and achievement.

Extrinsic rewards include praise from superiors, salary, employee benefits, career progression etc. Compensation is key extrinsic reward and a key issue in international human resource management.

Expatriates take risk, bear inconveniences and discomforts in foreign assignment mostly based on the expected compensation package. They leave their current comfortable jobs, family life, friends, relatives, society to earn more finance and for better future prospects.

As such international HR managers prioritize compensation function over others.

9.2 Complexities in international compensation management.

The factors causing complexities are

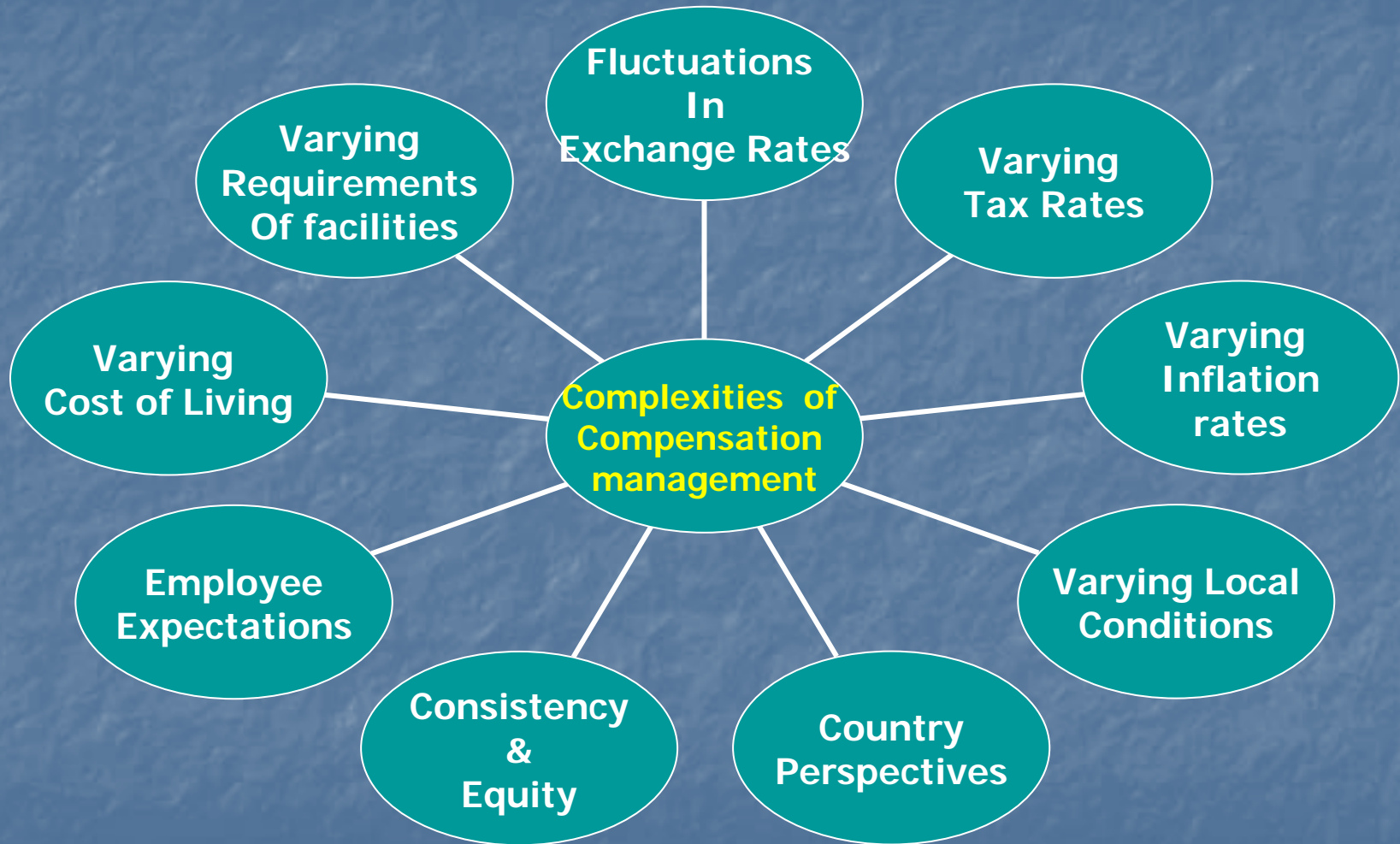
- The salary & benefit levels vary from country to country.
- Cost of living varies widely among countries.
- Requirements for provision of housing, medical, transport and education facilities also vary with each country.
- Varying salary levels of expatriates in their respective home countries.
- Fluctuations in foreign exchange rates.
- Varying tax rates on incomes.
- Varying rates of inflation in economies of different countries.

9.2 Complexities in international compensation management.

The factors causing complexities are

- Varying local conditions in host countries in terms of cost of living, availability of housing and medical facilities, school facilities and security situations that demand the MNCs to design individual pay packages for different countries.
- MNCs consider country perspectives in terms of tax rates, percentage of repatriation of expatriates' incomes.
- MNCs look for consistency and equity in the compensation scheme but face problems when expatriate moves from one subsidiary to another in different country.

9.2 Complexities in international compensation management.



9.3 Objectives of international compensation management.

MNCs design and practice compensation and benefits to

- Recruit and retain most suitable employees in terms of efficiency & cultural adaptability.
- Secure consistency between pay and performance & equity among employees of different nationalities and categories.
- Facilitate mobility from parent company to subsidiaries & from one subsidiary to another.
- Assist the employee and family adapt to the host country culture.
- Suit MNC's ability to pay which ultimately determine quality of employees and MNC's overall employee costs.

9.3 Objectives of international compensation management.

MNCs design and practice compensation and benefits to

- Reduce employee grievances and simplify collective bargaining procedures.
- Motivate employees and enhance their job performance, learning latest skills that contribute to enhancement of organizational performance.
- To ensure that the package is both competitive and comparable. It must always be better than the package available to the expatriate in his home country so that he is attracted to foreign assignments.

9.3 Objectives of international compensation management.

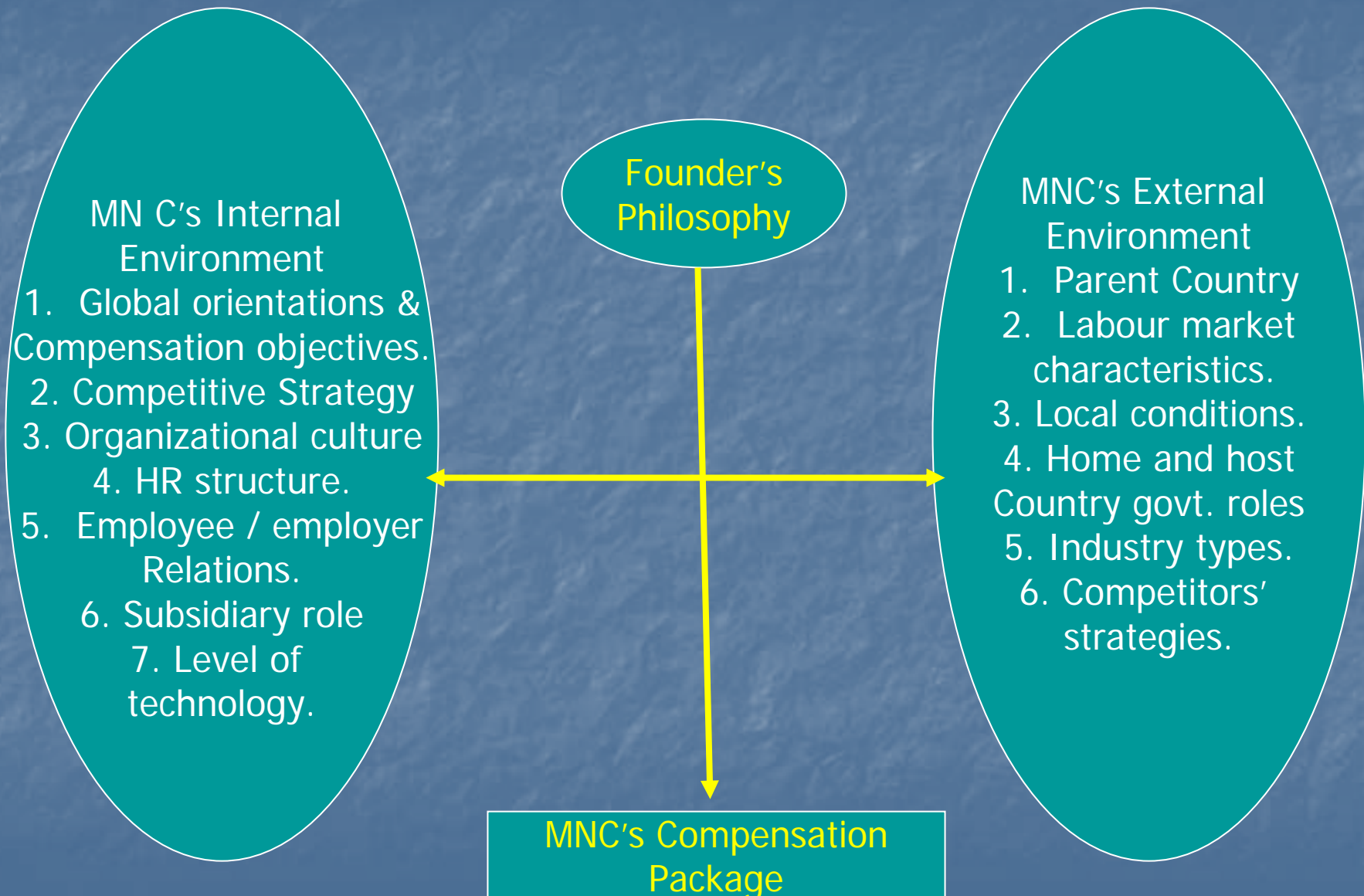


9.4 Factors that affect international compensation – internal and external factors.

The contingency theory of international compensation suggests that there are a number of variables that affect international compensation. This theory attempts balance sheet approach and identifies factors like host country preferences in designing international compensation package. Resource based theory recognizes the factors of competitive advantage through human resources which are valuable, rare and difficult to process / imitate and replace.

Such employers contribute to MNC's sustainable competitive advantage. Competitive advantage of MNCs resides in competent, knowledgeable and skilled human resources. According to resource based theory, MNCs design pay package in order to maintain & retain such competent employees for sustainable advantages.

9.4 Factors that affect international compensation



9.4 Factors that affect international compensation

MNC's Internal Environmental Factors

These factors are related to the company's strategic management and functional areas of management. They are

- (i) Objectives and goals of MNCs and their compensation management. They could be increase profits, expand markets, increase market share, and the like.
- (ii) Capacity to pay is based on MNC's long term profitability. MNC cannot pay more than they earn, except for a short period to attain short run survival.
- (iii) Competitive Strategy of the MNC requires its compensation strategies to be competitive and aggressive.

MNC's Internal Environmental Factors

- (iv) Organizational Culture is embodied by the quality of work life. This in turn is influenced by facilities and benefits provided in its compensation package.
- (v) Human resource structure includes age, gender, educational qualifications, skill level and attitudes of employees and influences the compensation package.
- (vi) Employee employer relations are determined by their attitude towards each other and trade unions. Trade unions often resort to strikes to force MNCs to pay higher salaries than what MNC can afford to pay.

MNC's Internal Environmental Factors

- (vii) Role of Subsidiaries has vital effect on designing compensation package in view of their specific requirements in terms of job skills, organizational requirements, cultures, stake holder demands and the system.
- (viii) Level of technology determines the level of skills and expertise and the level of difficulty of adjusting to new technology influence the structure and level of compensation & benefits.

Now let us study the external factors.

MNC's External Environmental Factors

- (i) MNC's parent country, its culture, cost of living, values and attitudes towards compensation influence the initial compensation structure. Local conditions are considered at the final stage.
- (ii) Labor market characteristics that influence compensation include demand for and supply of different categories of employees and their skills and knowledge. Further availability of training facilities, proximity of competitors, attitudes and tolerance levels towards compensation inequities between national and expatriates.

MNC's External Environmental Factors

- (iii) Local conditions of the country where MNC or subsidiary is located include the security conditions, availability of housing, medical, educational, communication, hospitality facilities, transportation and recreational facilities and their cost.

- (iv) Host & home country government roles play an important influence on compensation through labour policies, enactment of compensation laws and guidelines. For example host country's Maternity Benefit act determines maternity leave and amount that has to be paid to female employees by the MNC.

MNC's External Environmental Factors

- (v) Industry type determines wage levels. Compared to wage levels of traditional industries like steel, auto or chemicals, the levels of newer industries like software, health services, biotechnology are higher.
- (vi) Competitors' strategies in business, human resource management, as well as in compensation package influence the compensation package of the MNC. MNCs with strategy of market leadership also prefer to be leader in compensation package.

In general MNCs follow the compensation packages of comparable MNCs in terms of industry, region, closeness in competition and size.

9.5 Structure of international compensation package.

MNCs design the compensation structure for their employees in such way that it meets the financial needs of employees for various facilities, compensates the current and future inconveniences and insures a variety of risks.

The components of international compensation include:

Pay or base salary; Cost of living allowance; Tax equalization allowance, International market allowance, Housing allowance; Educational allowance; Relocation allowance; Setting in and setting out allowance; Medical allowance; Hardship and danger allowance; Exchange rate protection allowance; Insurance allowance; Stock option; Bonus; Gratuity; Pension; Social security benefits etc.

9.5 Structure of international compensation package.

Base Salary or Pay: This is the amount payable for employee skill, knowledge and other requirements of the job. Compensation for other factors and inconveniences is covered by allowances.

Cost of living allowance [COLA] : is paid essentially to [fully or partially] neutralize adverse effect of inflation on earnings of the employee and protect their purchasing power at a level comparable to that of employee's home city or earlier cities of employment.

COLA is based on cost of living index calculated by taking into account house rent cost, educational and medical costs, various services and other living expenditures and comparing them to a base year.

9.5 Structure of international compensation package.

Housing allowance: House rents in some cities like Sydney, Tokyo, London etc. would be exorbitant and sometimes more than employee's after tax salary. MNCs, therefore, pay house rent allowance to enable expatriate to live in type of housing he/she is accustomed to. Else the MNC provides comparable accommodation in the host country.

Educational allowance : Cost of school and university fee is exorbitant in some countries like US, UK and Australia. Hence educational allowance is paid to expatriates that includes cost of language training for employee and family, training and educational cost for employee's continuous learning and development and educational expenses of school / university going children of the employee.

9.5 Structure of international compensation package.

Relocation allowance: Movement of employee with family from home country to a foreign country involves a variety of expenses like temporarily closing up the family activities and professional activities at the home, transferring the children from home to foreign school / university, payment of advance taxes, rents and fee at the home country, visa, travel to foreign country , freight and loss of a few items including baggage. In addition employee incurs additional costs in settling in the new country.

MNCs provide relocation allowance in order to relieve the employee from meeting these additional financial commitments.

9.5 Structure of international compensation package.

Settling-in and Settling-out allowances: These allowances are similar to relocation allowances. MNCs provide settling-in allowance in order to reduce employee's financial burden from buying various goods /services when they arrive in a foreign country. Settling out allowance is provided to meet the costs of leaving for home country or any other host country.

Hardship premium : Foreign jobs in certain countries like Afghanistan or Iraq are highly critical and dangerous. There are other countries in undeveloped regions where medical assistance , security etc are of very low levels. Sometimes the nature of job offered, like negotiating in multi cultural environment, makes it hard to perform. To attract candidates for such jobs this allowance is added to basic pay.

9.5 Structure of international compensation package.

Exchange rate protection allowance: Foreign exchange rate fluctuations directly affect the repatriation amount to home country of foreign employees. Adverse fluctuations reduce this repatriation amount and discourage the expatriates from continuing employment in the host country.

Some MNCs pay a certain % of base salary as exchange rate stabilization allowance to offset the reduction in earnings due to fluctuations in exchange rates.

Insurance allowances : MNCs buy different policies for employees' health, travel, vehicles, house and other such emergencies and pay premiums in the form of insurance allowance to expatriate.

9.5 Structure of international compensation package.

Stock option: Stock options are common in most of the MNCs in many countries. This benefit allows employees to purchase the shares of the company at fixed and / or reduced price. The stock options are viewed as performance based incentives to attract and retain competent employees and create a sense of belongingness and ownership among them.

Bonus : MNCs provide individual or group bonus to expatriates based on their performance in the form of output, sales, productivity, savings and cost minimizations. This benefit provides mutual advantage to the employees and the MNCs.

9.5 Structure of international compensation package.

Gratuity: Gratuity is the retirement benefit and / or contract termination benefit. This benefit encourages the employees to continue their employment with the same employer MNC until the completion of the contract and for the long run.

Pension: Some MNCs pay pension to the expatriates and the host country national who served the company for a relatively long period. However, MNCs face complexities in pension payment with regard to calculation, country of origin, varying legal requirements of different countries and fluctuations in exchange rates. Therefore, they limit pension facility to restricted categories of employees only.

9.5 Structure of international compensation package.

Other benefits: MNCs provide a variety of other benefits to employees, in addition to allowances above. These benefits include Cafeteria, travel fares, Recreational allowances, facilities for physical and mental fitness, socialization programmes, maternity & paternity benefits and leave, legal aid, credit cards and other loan facilities, family support facilities etc.

Social security measures: MNCs provide various security measures to their employees like employment security {unemployment measures, technological adjustment pay, health insurance}, health protection {accident or disability insurance, sick leave}, provision for old age and retirement and for personal identification, participation and stimulation { beauty parlour services, counselling, stress counselling & safety measures etc}.

9.6 Executive Compensation.

MNCs across the world pay attractive compensation for executives to attract and retain the best talent in order to enable them to craft and implement most appropriate strategies .

They, however, pay different levels of compensation for executives in different countries based on the compensation levels in comparable firms and cost of living in respective countries.

Review of compensation paid to finance, marketing and HR executives in various countries in the year 2007, indicates that MNCs paid highest compensation to expatriates from the US and lowest to those from India.

9.7 Approaches to International Compensation Management.

Different MNCs follow different approaches to compensation determination, revision and adjustment. We shall study nine of them in this session.

Salary Level in host country approach: This approach is also known as 'localization' approach. International compensation under this approach is based on salary levels for similar jobs in comparable organization in the host country.

Under this approach HSBC in India pays salaries to Indians [host country nationals], Chinese [parent company nationals] and Americans [third country nationals] based on i] salary levels of Indian banks like ICICI or HDFC bank, ii] salary level of foreign banks operating in India like Citi or of other Chinese financial institutes in India.

9.7 Approaches to International Compensation Management.

This approach is appreciated by host country nationals in most countries except very advanced countries. Expatriates also appreciate this approach when they are transferred to advanced countries. However, this approach cannot attract and retain expatriates in developing countries. Therefore, MNCs pay international allowance or overseas assignment allowance in addition to base salary that is based on host country levels.

- Advantages :**
- HCN feel a sense of equity with expatriates.
 - Sense of equality among HCN and expatriates from different countries.
 - Cost of HR is low in developing countries.

9.7 Approaches to International Compensation Management.

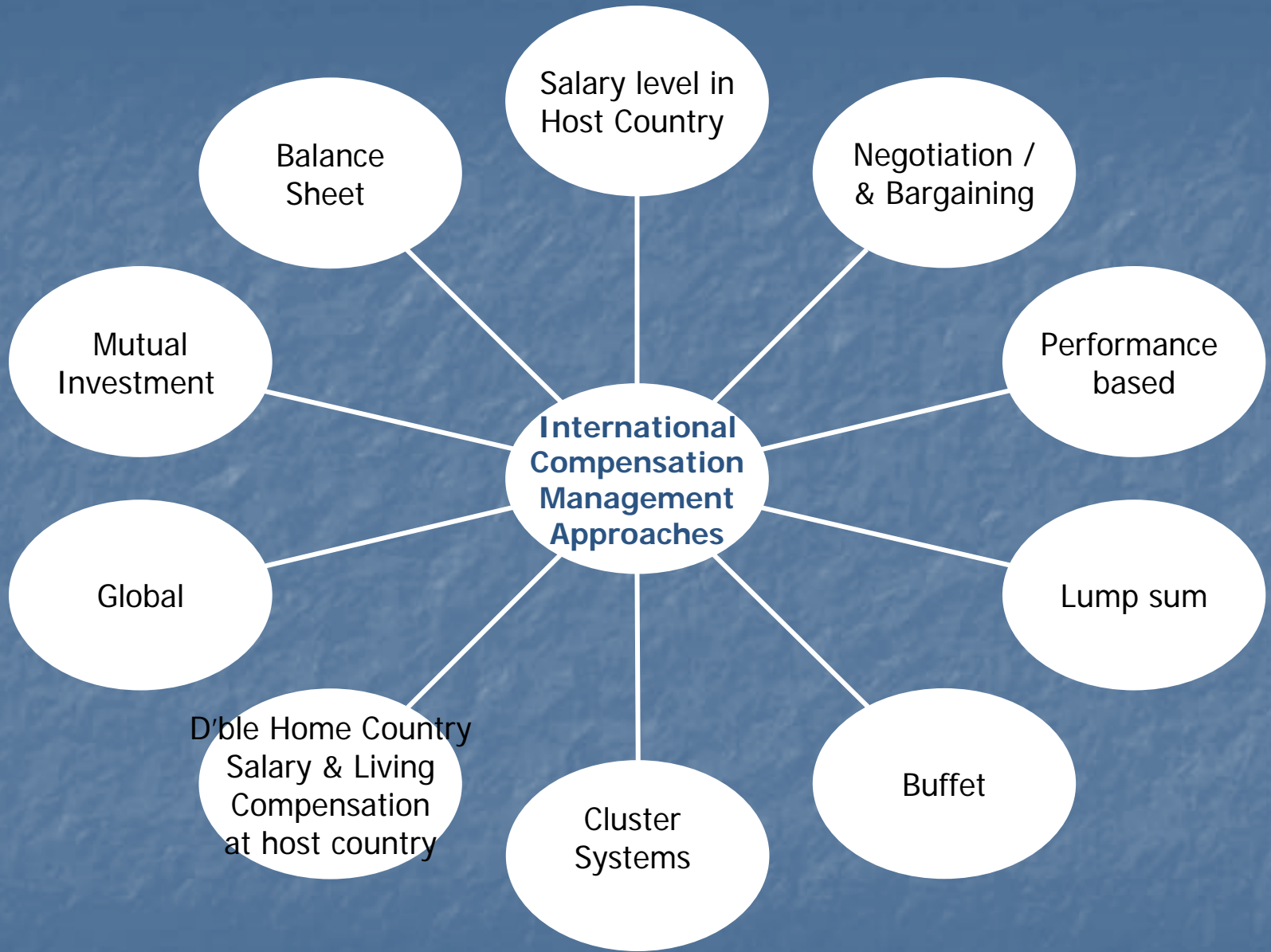
- Disadvantages :**
- Feeling of discrimination among HCN as expatriates earn higher salary.
 - Feeling of discrimination among expatriates of different countries.
 - Problem of retention of employees.
 - Problem of recruitment of competent employees.

Negotiation and Bargaining approach: Some employees as well as MNCs prefer to determine the compensation package through mutual negotiations. This approach would be practical when number of expatriates is small, MNC and the employees are well aware of ongoing salary and benefits levels, and skills of prospective employees are in short supply.

9.7 Approaches to International Compensation Management.

- Advantages :**
- Mutual satisfaction of employee & employer.
 - Compensation is determined based on MNC's ability to pay.
 - Sense of belonging to expatriates towards the MNC.
 - Employees get their doubts cleared.

- Disadvantages :**
- Dissatisfaction when ground realities in the host country are different.
 - Feeling of inequality among host country nationals.



9.7 Approaches to International Compensation Management.

Lumpsum approach:

Under this approach, MNC determines the total package in money value that covers the base salary, all kinds of allowances and benefits. The employee is provided with the freedom of allocating the money and deciding up on the type & quality of housing, medical, conveyance, education for self and family, air travel, recreational facilities, taxation, repatriation of savings, settling in , settling out, exchange rate protection etc

A number of MNCs and Aus Aid follow this approach.

9.7 Approaches to International Compensation Management.

Advantages : ➤ Employees have option to allocate the money for various items of expenditure.

➤ Employee has a little scope for grievance over quality, convenience and comfort of benefits.

➤ MNCs can reduce cost and inconveniences of benefits and salary calculation administration.

Disadvantages : ➤ HCN have a feel of inequity in compensation package.

➤ Possibility of tax avoidance.

➤ Employee may not go for qualitative housing and other benefits with adverse effects on performance.

9.7 Approaches to International Compensation Management.

Buffet approach:

MNCs design the approach of paying less cash & providing more benefits in the compensation package as expatriates prefer to reduce tax burden and save as much as possible in order to repatriate savings to the home or other country of their choice.

Under this approach the total salary level is determined by the organization and the employee is given an option to decide the cash component and benefits component in the total compensation package.

This method involves high cost of salary administration, but helps the individual needs of the employees.

9.7 Approaches to International Compensation Management.

- Advantages :**
- Provides wider choice to expatriates.
 - Reduces tax burden of expatriates and thus increases their savings and repatriation amounts.
 - MNCs can attract and retain best talent without increase in compensation levels.

- Disadvantages :**
- High cost of administration.
 - HCN have a feel of inequity.
 - HCN develop a discriminatory attitude against expatriates.
 - Reduces the tax income of the host country.

9.7 Approaches to International Compensation Management.

Cluster systems approach:

MNCs segment the countries and / or cities based on the cost of living and other factors like hardships and danger issues that affect the compensation package. They determine more or less same package for each job within the same cluster of cities.

Under this approach the cost of complexities in the compensation administration is reduced. Further it enhances the feeling of equity among expatriates of different countries.

Employees would be offered additional allowances if a factor like medical attention or parental care is distinctively applicable to them.

9.7 Approaches to International Compensation Management.

- Advantages :**
- Simplifies the administration of compensation.
 - Reduces ambiguity of salary comparison among expatriates.
 - Feeling of equity among expatriates.
 - Flexibility, provides for adjustment of special issues / cases.

- Disadvantages :**
- Feel of dissatisfaction among expatriates whose skills are in demand & who command higher pay at home country.
 - HCN have a feel of dissatisfaction.
 - Absence of relief from tax burden to expatriates

9.7 Approaches to International Compensation Management.

Global approach:

Skills knowledge, talents and competency requirements of certain jobs are uniform throughout the globe. Employees fit for such jobs are globally mobile. MNCs under global approach determine the uniform pay scales for such jobs throughout the countries where they operate.

These pay scales are applicable uniformly for all categories of employees including host country nationals. The approach is based on the concept of country's national pay scales with bad climate allowance [in tribal areas in Andhra Pradesh] & danger allowance [in Kashmir] or war allowance [in Iraq].

9.7 Approaches to International Compensation Management.

- Advantages :**
- Reduces cost of administration of compensation.
 - Reduces complexities of compensation administration.
 - Feeling of equity among expatriates.
 - Greatest advantage is a feel of equity among HCN.

- Disadvantages :**
- Increases the cost of compensation and thereby cost of HR.
 - Increases tax burden and thus reduces net salary of employees.
 - Employees lose benefit of other systems.

9.7 Approaches to International Compensation Management.

Performance based compensation approach:

Globalization and enhanced competitive environment place heavy emphasis on employee performance and value creation and addition to the job as well as the organization.

As such, the established practice is that MNCs design compensation package with a part of performance based compensation. This part is assuming major portion.

The approach provides a minimum guaranteed base salary irrespective of performance that would be enough to meet the basic needs of employees. This approach is organization friendly as it enhances organization performance & increases value & productivity.

9.7 Approaches to International Compensation Management.

- Advantages :**
- Enhances employee performance.
 - Increases organizational productivity.
 - Enhances value to the organization.
 - Increases equity between compensation and employee's contribution.
 - Reduces cost & complexities of compensation administration.

- Disadvantages :**
- Difficult to measure individual employee performance for all jobs.
 - Ignores cultural issues that affect performance.
 - Creates a feel of insecurity in less dynamic or old employees and lacks human approach.

9.7 Approaches to International Compensation Management.

Double home country salary and living compensation at the host country approach:

Under this approach , MNCs determine the package in such a way that the expatriates get compensation of best domestic salary plus living host country compensation.

Home country salary , which is paid in home country currency, is double of what the best candidate get in the home country and which, therefore, expatriate cannot expect unless he opts for foreign assignment.

Host country living compensation is paid in cash in host country currency and takes care of expenses to live a comfortable and decent life there .

9.7 Approaches to International Compensation Management.

Advantages :

- Guaranteed repatriation amount to the home country of the expatriate.
- Reduction in tax burden.
- Enhances value to the organization.
- Decent living in host country.
- Expatriates feel secured and satisfied.

Disadvantages :

- Feel of inequity among HCN
- Complexity in compensation administration..
- Cost of exchange rate fluctuations

9.7 Approaches to International Compensation Management.

Balance Sheet approach:

Various compensation approaches described so far have their own limitations. MNCs observed that expatriates initially accept the pay packet under anyone of the approaches, but in later stages of their career express their dissatisfaction with the same.

MNCs, therefore, determine a package that balances the sacrifices by the expatriate in the home country and inconveniences experienced in host country under this approach.

This approach of determining the compensation through balancing opportunity costs with salary, allowance and benefits is called balance sheet approach.

9.7 Approaches to International Compensation Management.

Compensation approach in various countries.

International compensation packages vary from country to country based on the economic system, cost of living, political system of the country, level of country's political, economic, social development, safety and security conditions, availability of quality housing, educational & medical facilities and compensation levels prevailing in the country.

However, MNCs prefer to have a global compensation approach. International compensation, though it has global approach, MNCs of various countries follow different approaches in managing international compensation.

9.7 Approaches to International Compensation Management.

Compensation approach in various countries.

USA

Base pay forms a small part of US executive's total package. Significant part of the package is in the form of performance based pay and stock options which is a long term source for creating wealth for the executive.

The package is determined by the company size, annual revenue level, job duties and job level of the executive and the city where the MNC operates.

Women executives are holding more and more responsible positions and gap between men / women package is narrowing..

9.7 Approaches to International Compensation Management.

Compensation approach in various countries.

Europe

The compensation received by European executives is less than that of US executives , but with rapid globalization the gap is narrowing. The part of performance pay and stock options is relatively smaller but is gradually being increased.

Their package includes tax free fringe benefits and perks like company car, housing, club memberships, augmented pensions etc.

The trend is moving towards the package that is offered in the US.

9.7 Approaches to International Compensation Management.

Compensation approach in various countries.

Japan

The compensation received by Japanese executives is less than that of US & European executives. The package is based on the seniority of the employee and employment is considered as long term assignment. Group incentives are paid in addition to life time income programs, retirement benefits and the like.

Russia

Russia is transforming from communistic pattern to capital economic system. Their pay package includes base salary, incentive pay and various non-monetary benefits. Individual bonuses, small group incentives , long and short term incentives are now being added to the package.

9.7 Approaches to International Compensation Management.

Compensation approach in various countries.

South and Southeast Asia

The culture of these countries includes collective living environment and strong family relationships. It is reflected in fewer gaps between the salary of lower and higher level employees.

The package typically includes base pay, COLA, house rent allowance, social and security allowances and vacation pay. Usually there is a maximum limit fixed for the compensation payable.

HCN

It is still a fact that HCN and the expatriate carrying the same job in the same company in the same city receive varied package. MNCs should carefully design compensation to reduce level of dissatisfaction of HCN.

9.8 Summary.

- ✚ Managing compensation in MNCs and Domestic companies employing foreigners is more critical and complex due to varying factors from country to country.
- ✚ International compensation management aims at maintenance of equity, attraction and retention of competent candidates.
- ✚ MNCs capacity to pay is based on its long term profitability.
- ✚ MNCs adapting aggressive and offensive business strategies would like to be competitive and craft competitive compensation strategies.

9.8 Summary.

- ❖ Country of the MNC's headquarters, its culture, cost of living, values and attitudes towards compensation influence the initial compensation structure.
- ❖ Labour market characteristics that influence compensation include demand for and supply of different categories of employees and their skills and knowledge.
- ❖ MNCs follow the compensation packages of other comparable MNCs in terms of industry, region, closeness in competition and size.
- ❖ Employees with distinctive skills and skills in short supply are demanded by many MNCs across the world.

9.8 Summary.

- ✚ Settling-in and settling-out allowances are similar to relocation allowances.
- ✚ Hardship allowances are for taking risks by employees like war, terrorism, natural calamities etc.
- ✚ Stock option benefit allows employee to purchase the shares of the MNC at fixed and /or reduced prices.
- ✚ International compensation under salary level in host country approach is based on salary levels for similar jobs in comparable organizations in the host country.
- ✚ MNC determines the total package in money value that covers the base salary, all kinds of allowances and benefits.

9.8 Summary.

- ✚ MNC design the approach of paying less cash and providing more benefits under buffet approach.
- ✚ MNCs balance the home salary and sacrifices and hardships of expatriates by the host country salary and benefits.
- ✚ Double home country salary would be the double of the best salary that a best candidate gets in the home country for a similar job.
- ✚ Compensation package of American executives include salary, bonus, long term incentives and other benefits and perks.

9.8 Summary.

- ✚ Generally European executives are paid less compensation than that of American executives.
- ✚ The social and cultural environment in Japan is quite different from that of industrialized countries of North America & Europe.
- ✚ Though the higher salary for an expatriate is essential to attract skills in short supply in host country, host country nationals feel compensation discrimination and experience dissatisfaction and frustration.

Well students

this brings us to the end of our
session 09!

Next we move to session 10
On "International Industrial Relations"
Chapter ten .

Good Luck!