

Chapter 5

International Compensation Management



IHRM

Welingkar Hybrid Program

Chapter Objectives

By the end of this chapter, you will understand:

- How to manage international compensation
- What are the challenges in international compensation



Chapter Structure

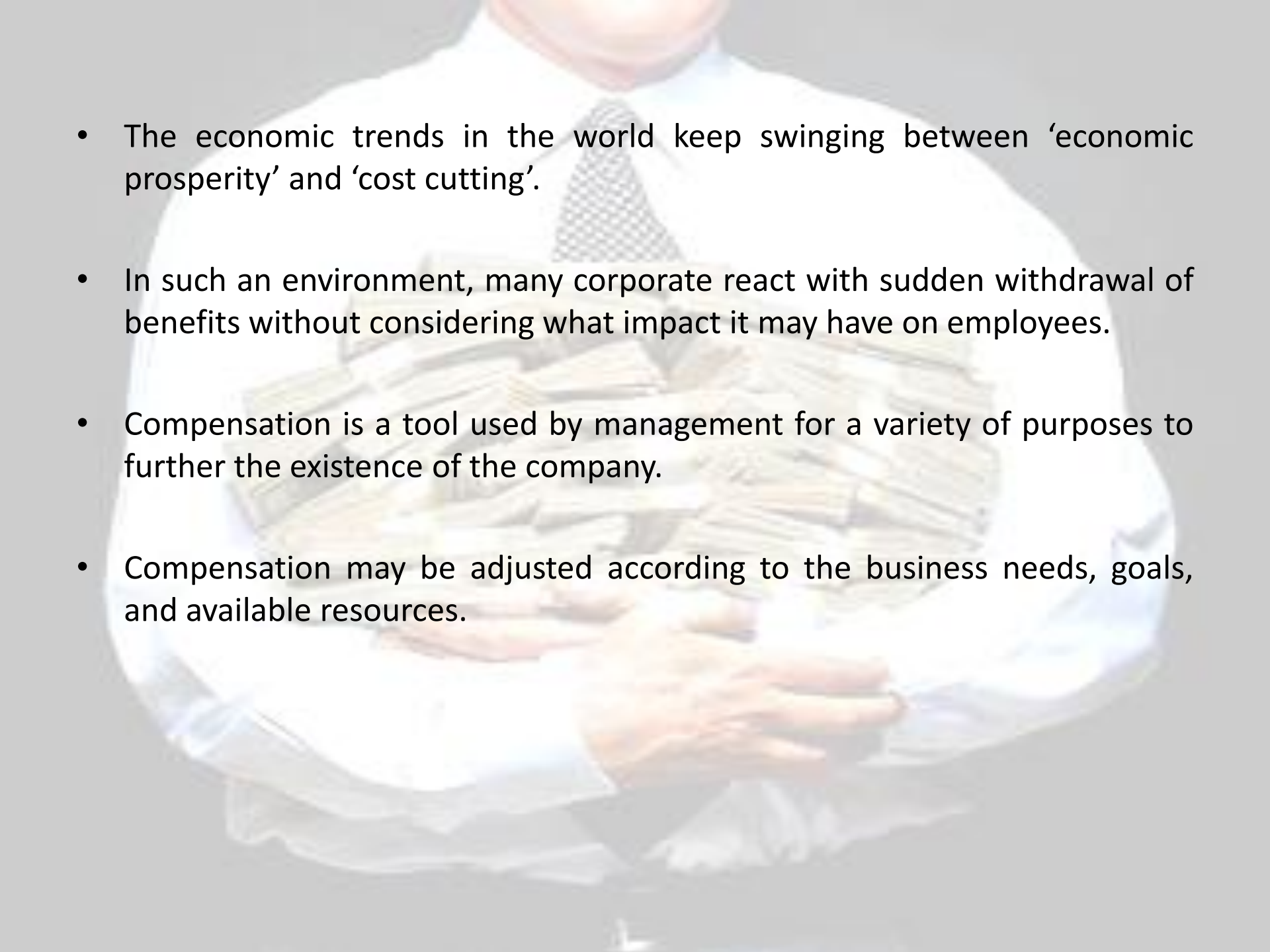
1. Managing international compensation
2. Challenges in international compensation
3. Conclusion: Is it just about the money?
4. Summary




1. Managing International Compensation



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- A person wearing a white dress shirt and a patterned tie is holding a large, thick stack of Japanese yen banknotes. The person's face is partially visible at the top, and their hands are visible at the bottom, gripping the stack. The background is a soft, out-of-focus grey.
- Managing compensation internationally is a tricky area.
 - International HR managers have to think beyond the set theories and be highly aware of the trends and conditions all over the world.
 - For Example: Japanese electronics giant Panasonic has announced plans to pay expat workers in China a wage premium to compensate for dangerous air pollution.
 - The employer is thinking beyond the traditional expat package and giving an allowance that shows a high amount of care and the employee is bound to feel valued.
 - The objective of managing compensation is to ensure that an organization has an edge in terms of having the right talent at the right place and the right time.
 - If compensation is not managed proactively, managing expatriates can prove to be a big challenge.


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- A person wearing a white dress shirt and a patterned tie is holding a large, thick stack of cash in their hands. The person's face is not visible, only their torso and hands. The background is a plain, light color.
- The economic trends in the world keep swinging between ‘economic prosperity’ and ‘cost cutting’.
 - In such an environment, many corporate react with sudden withdrawal of benefits without considering what impact it may have on employees.
 - Compensation is a tool used by management for a variety of purposes to further the existence of the company.
 - Compensation may be adjusted according to the business needs, goals, and available resources.

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- A person wearing a white dress shirt and a patterned tie is holding a large, thick stack of cash in their hands. The cash is piled high, filling most of the person's torso. The background is a plain, light gray color.
- Compensation may be used to:
 - Recruit and retain qualified employees.
 - Increase or maintain morale/satisfaction.
 - Reward and encourage peak performance.
 - Achieve internal and external equity.
 - Reduce turnover and encourage company loyalty

A person wearing a white dress shirt and a patterned tie is holding a large, thick stack of US dollar bills in front of their chest. The person's face is not visible, only their torso and hands. The background is a plain, light color.

- Compensation is based on:

- Market research about the worth of similar jobs in the marketplace,
- Employee contributions and accomplishments,
- The availability of employees with like skills in the marketplace,
- The desire of the employer to attract and retain a particular employee for the value they are perceived to add to the employment relationship, and
- The profitability of the company or the funds available in a non-profit or public sector setting, and thus, the ability of an employer to pay market-rate compensation.

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- A person wearing a white dress shirt and a patterned tie is holding a large stack of cash. The person's face is not visible, only their torso and hands. The background is a plain, light color.
- Compensation responsibilities of any HRM manager
 - International Compensation System is understood as provision of monetary and nonmonetary rewards including Base Salary, Benefits, Perquisites, long and short term incentives in accordance with their relative contribution to performance.
 - Attract Individuals who are competent and interested in foreign assignments.
 - Facilitate movements of Expatriates from one subsidiary to another, from one home country to subsidiaries, from subsidiaries back to home country
 - Consistent pay levels at Headquarters, Domestic affiliates, and foreign subsidiaries.
 - Be Cost effective by minimizing unnecessary expenses.
 - Be consistent with the overall strategy, structure and business needs.

Components of an International Compensation package

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.

Components of an International Compensation package

Benefits

- Alternatively known as indirect compensation,
- Benefits constitute a substantial portion of international compensation (approx. 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.
- Vacation along with holidays and rest breaks help employees mitigate fatigue and enhance productivity during the hours employees actually work.

Components of an International Compensation package

Allowance

- It is an inevitable feature of International compensation. The most common allowance relates to the cost of living – an adjustment for different in the cost of living between the home country and foreign country assignment. This allowance is designed to provide the expatriate with the same standard of living that he or she enjoyed in the home country.
- **Spouse assistance, housing allowance, home leave allowance, relocation allowance and educational allowance are the popular in expats compensation.**
- These allowances are often contingent upon tax – equalization policies and practices in both the home and the host countries.

Components of an International Compensation package

Incentives

- An additional payment (or other remuneration) to employees as a means of increasing output. Increasingly, MNCs these days are designing special incentive programmes for keeping expatriates motivated. In the process, a growing number of firms have dropped the ongoing premium for overseas assignments and replaced it with a one – time, lump-sum premium.
- The lump – sum payment has at least three advantages:
 - First, expatriates realize that they are paid this only once and that too when they accept an overseas assignment. So the payment tends to retain its motivational value.
 - Second: costs to the company are less because there is only one payment and no future financial commitment. This is so because incentive is a separate payment, distinguishable from a regular pay, and it is more rapidly for saving or spending.
 - Third, less chances for pre mature repatriation.

Components of an International Compensation package

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.
- Indians engaged in road construction work in Afghanistan, for example, face constant threat to their lives.

Components of an International Compensation package

Long Term Benefits

- The most common long term benefits offered to employees of MNCs are **Employee Stock Option Schemes (ESOS)**. Traditionally E-SOS were used as means to reward top management or key people of the MNCs. Some of the commonly used stock option schemes are:
 - 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

Components of an International Compensation package

Taxes

- The final component of the expatriate's remuneration relates to taxes. MNCs generally select one of the following approaches to handle international taxes:
 - Tax equalization: Firms withhold an amount equal to the home country tax obligation of the expatriate, and pay all taxes in the host country.
 - 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.

Compensation Philosophy

- The basis of deciding compensation for any expatriate is the Compensation Philosophy of the organization.
- Compensation philosophy is the set of values and beliefs an organization has with regard to monetary and non-monetary rewards payable to the employees.
- Differences in compensation philosophies are wide spread.
- Some MNCs, in order to attract the best talent, seek to pay at the top of the market. Some other MNCs are more generous to certain levels of super performers while others work to retain equity across all levels and employees.
- Therefore, the compensation philosophy of an organization plays a big role in the sort of remuneration an employee draws from there.

Theories of Compensation

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 decentralized and allows units to localize the compensation structure.

Theories of Compensation

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.

Theories of Compensation

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.

Theories of Compensation

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.