INTERNATIONAL HUMAN RESOURCE MANAGEMENT

UNIT V

INTERNATIONAL COMPENSATION

INTERNATIONAL COMPENSATION

Components of international compensation- Approaches to international compensation – Challenges and choices -International Labor Standards – emerging Issues

- 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
- International compensation can be defined as the provision of monetary and non-monetary rewards, including base salary, benefits, perquisites, long- and short-term incentives, valued by employees in accordance with their relative contributions to MNC performance.
- International compensation and benefits are overseas compensation packages. The idea is to offer various perks and benefits for international employees to keep them engaged and productive.
- Compensation is a key economic issue, which continues to assume an increasingly large share of its operating expenses. HR executives in global firms spend a great deal of time and make a lot of effort in designing and

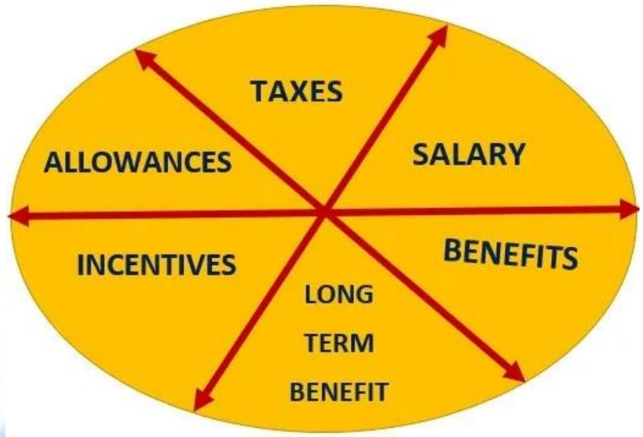
managing compensation programmes, because of their high cost and impact on corporate performance, employees commitment and also their retention

IMPORTANCE OF INTERNATIONAL COMPENSATION

- For Satisfying the Employees
- Encouraging the Employees
- Understand the needs of the Employees

OBJECTIVES OF INTERNATIONAL COMPENSATION

- Attract employees who are qualified, experienced and interested in international assignments
- Facilitate the movement of expatriate's from one subsidiary to another, from home to subsidiary, and back from subsidiary to home
- Provide a consistent and reasonable relationship between the pay levels of employees at headquarters, domestic affiliates and foreign subsidiaries
- Be cost effective by reducing unnecessary expenses
- Should be easily understood and easy to administer



ELEMENTS OF INTERNATIONAL COMPENSATION

The main elements are discussed as follows:

- **Base pay**
- **Incentives**
- **Retention and Referral Bonuses**
- **Allowances**
- **Benefits**
- **Taxes**
- **Long-term Benefits**
- **Base pay**

- Base pay is the primary component of a package of allowances and may be paid in-home or local-country currency. The base salary is the foundation block for international compensation whether the employee is a Parent Country or from any other country.
- It is the main element in the compensation structure that decides the status, rank or grade. This is the basic element upon which all the other components are built and retirement benefits calculated both in domestic and international compensations.
- Incentives
- Incentives are used to motivate employees for higher performance and to undertake foreign assignments. Latest trends in total compensation package has seen a rise in monetary benefits.
- Retention and Referral Bonuses
- Almost every organization faces the issue of turnover of employees at some point or the other. Referral bonus is paid to employees who bring qualified new employees who meet the selection criterion.
- This reduces recruitment cost and time of the organisation and hence referral bonus is paid. There are many factors leading to retention of employees

apart from money such as quality of work-life, flexibility at work timings, challenging assignments, transport and other benefits and rise in career graph.

- Allowances
- Foreign service premiums: most common for employees on long-term assignments (over one year). More often paid to parent country nationals (PCNs) than to third country nationals (TCNs).
- Hardship: in consideration of isolation, crime, natural hazards, political violence, based on government data upon which rates can be provided by consulting organizations such as International SOS, a global medical and security assistance company.
- Relocation: compensation for costs such as transport, storage, temporary accommodation, purchases of appliances and vehicles, associated with moving to the host country.
- Education: for assignees' children. This may involve compensation for language classes, books, and school fees. Home country boarding school fees may also be involved for assignees who opt not to take their children to isolated and or politically violent locations.

- Home leave: provision for the assignee and family to return home periodically during the length of the assignment. (Dowling et al., 1999; Stanley, 2001)
- Benefits
- These are also known to be indirect compensation and their purpose is to minimise the payments and enhance quality of life. Benefits could include use of health clubs, medical treatment to family, upkeep of house, servants etc.
- Taxes
- These take a substantial part of the salary to governments of both host and home countries. Hence, MNCs follow tax equalisation policy, according to which the expatriates pay only the taxes required to be paid in the home country and what is required to be paid to the host country is paid by the country. Expatriates are required to obtain tax clearance certificate from the host country before they are allowed to leave the country.
- Long-term Benefits
- Employee Stock Option Plan (ESOP)- a certain nos. of shares are reserved for purchase and issuance to key employees

- Restricted Stock Unit (RSU) –Units of stocks are provided with restrictions on when they can be exercised. It is usually issued as partial compensation for employees
- Employee Stock Purchase Plan (ESPP) –Company sells shares to its employees at a discount. Company deducts the purchase price of these shares every month from the employee's salary

APPROACHES TO INTERNATIONAL COMPENSATION

There are two main approaches of international compensation, such as follows:

- **Going Rate Approach**
- **Balance-Sheet Approach**
- Going Rate Approach

The key characteristics of this approach are summarised:

- Based on local market trends and rates
- Relies on survey comparisons
- Local nationals (HCNs)
- Expatriates of same nationality
- Expatriates of all nationalities
- Compensation based on the selected survey

- Base pay and benefits may be supplemented by additional payments for low-pay countries
- In this approach, the base salary for international transfer is linked to the salary structure in the host country. The multinational usually obtain information from local compensation surveys and must decide whether local nationals (HCNs), expatriates of the same nationality or expatriates of all nationalities will be reference points in terms of benchmarking.
- For example, an Indian bank operating in London would need to decide whether its reference point would be local U.K. salaries, other Indian competitors in London, or all foreign banks operating in London. With the Going Rate Approach, if the location is in a low-pay country, the multinational usually supplement base pay with additional benefits and payments.
- Balance-Sheet Approach
- Many multinational companies commonly apply the balance-sheet method for determining expatriate compensation. The balance-sheet method provides a compensation package that attempts to equate or balance an expatriate's purchasing power in his or her home country.
- To balance the compensation received for the international assignment with compensation received in the home country, multinational companies usually provide an additional salary. This increased salary includes adjustments for differences in taxes, housing cost, and the cost of basic goods and services.
- Goods and services include items such as food, recreation, personal care, clothing, education, home furnishing, transportation, and Medicare (Dowling and Schuler, 1990).
- There are four Balance Sheet approach categories:
- Goods and services –home-country outlays for items such as food, personal care, clothing, household furnishings, recreation, transportation and medical care.

- Housing –the major costs associated with housing in the host country.
- Income taxes –parent-country and host-country income taxes.
- Reserve –contributions to savings, payments for benefits, pension contributions, investments, education expenses, social security taxes, etc.
- Besides matching the expatriate's purchasing power, companies often provide other allowances and perquisites to the expatriate manager. These cover the initial logistics of the international move (such as hotel costs while settling in), provide compensation for lifestyle differences between the home and host country, and provide incentives to take the assignment.
- Some of these additional allowances and perquisites include the following (Black, Gregerseen and Mendenhall, 1992):
- Foreign Service Premiums: Multinational compensations often provide 10 percent to 20 percent of base pay for accepting the individual and family difficulties associated with an overseas assignment.
- Hardship Allowance: This is extra money paid for particularly difficult posting due to issues such as high risk or poor living conditions.
- Relocation allowance: Along with the basic costs of moving a family to an international assignment, many companies pay a flat sum equal to one month's salary at the beginning and end of the assignment to cover miscellaneous costs of relocating.
- Home-Leave Allowances: These provide transportation costs for expatriates and their families to return to their parent country once or twice **a year.**

CHALLENGES OF INTERNATIONAL COMPENSATION

- Three common challenges facing compensation managers today are:
- Finding the perfect compensation balance, recruitment and retention of qualified employees, and the limited talent pool of those with high-demand skill sets and the market competition for those job candidates.
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- **Compensation challenges**
- You can read through the challenges in more detail below.
- **Regulations**
- Compensation is facing constant application of regulatory rules, with variations from country to country. Organizations will spend much more time dealing with the intricacies of these regulations, which are subject to constant change, along with the administrative burden that accompanies them.
- **Administration**
- The administration that is associated with the constant regulatory changes means that a solution must be in place that can cope with the requirements for recording, testing, and calculating the correct payouts at each particular point.
- Organizations have realized tremendous bottom-line savings from a reduction in the total cost of ownership over existing on-premise solutions. The elimination of errors is one of the easiest ways

to gain control of escalating costs with the most common reason for compensation processes going wrong often relating to a simple administrative error.

- **Market practice in each country**
- When it comes to compensating a globally dispersed workforce, organizations need to manage the market practice in each country.
- Finding a balance between a global view and local execution is always a challenge. Bonus plans, merit increase policies and benefits need to be consistent throughout your global organization. On the other hand, local labor contracts and compensation practices may require some flexibility and adaptability.
- Centralized systems offer greater budgetary control, increased visibility into compensation and performance review processes. An audit trail will be apparent to demonstrate compliance.
- **Governance**
- Scrutiny of executive compensation is more intense than ever, and large corporations have to question who decides the pay levels, who controls the payments, and how does it cascade through the organization? At the senior pay level, there is a tendency to become more centralized, with salary levels, incentives, and other pay elements needing to be aligned with company compensation strategies.
- **Reporting requirements**
- Much like regulations, reporting requirements vary by country and need to be taken account of. Organizations have to provide accurate models and what-if scenarios to properly design revenue-based compensation plans during the forecasting cycles and simulate changes throughout the year to continually align compensation to business goals and revenue recognition requirements.

- **Shareholders**
- What do your shareholders think? Unlike the private sector, a publicly listed organization will have proxy advisors on senior pay, with shareholders who are generally much more involved, and much more interested in how companies are paying senior management. Transparency and proper communication are key to maintain a dialogue regarding compensation strategy and practices.
- **Taxation**
- If your organization is delivering rewards via LTIPs or other deferred compensation plans, there are a vast array of taxation issues that are all country dependent. You need to understand what the tax consequences are of the LTIP, and the administrative effort required to implement and maintain.
- All of these challenges come together, forming a complex subject that has to be taken care of. With beqom, you will have the features allowing you to balance the required global consistency with the adaptability to manage country-specific needs, defining a global process and then adapting it by region or organization.
- Contact beqom today to speak to one of our compensation experts about your needs for managing global compensation.

Taxation

- **Tax Equalization**
- Firms withhold an amount equal to the home country tax obligation of the expatriate, and pay all taxes in the host country

- The employee pays no more and no less tax while on assignment than they would have paid had they remained in their home country
- The company bears all the actual home and host country tax due
- The most common approach to tax management, used by 80% of companies
- **Tax Protection**
- Employee pays up to the amount of taxes would pay on remuneration in the home country, but could end up paying less if the host country tax burden is lower than in the home country
- The company will reimburse the employee for any excess tax resulting from higher tax rates in the host country