

DEVELOPING AND OPTIMIZING THE DESIGN OF INTERNATIONAL REMUNERATION

Dr. R.C. Sharma¹ and Idhant Sharma²

ABSTRACT

Today, in the arena of human resource management, understanding how to develop and optimize the design of international remuneration is a much sought after skill. How much should an expatriate or a third country national or a local (host) country national engaged in international organization whether it is an international organization or a multinational corporation or global corporation or a transnational corporation, be paid is a critical issue. In the present paper, an attempt has been made to suggest how to develop and optimize the design of international remuneration. It has been suggested that while developing and optimizing the design of international remuneration, first of all, the objectives of international remuneration, like attracting and retaining the desired talent, reducing grievances, enabling the employees to adapt themselves to the new environment, aligning remuneration with the strategy of the organization, etc., be kept in view. Besides, the various factors like statutory obligations, state of technology being used, socio-cultural factors, regional practices, labour policy, economic trends, etc., should also be taken care of. In addition to above, a perfect choice should be made with regard to adoption of international remuneration approaches like traditional or home country-based approach, host country-based approach, global market approach, balance sheet approach, contemporary approach, etc.

It has been pointed out that it is indeed a tough job to develop and design the remuneration of expatriate, which consists of base pay, variable pay, bonus(es), various allowances including hardship allowances and risk allowances, besides payment of taxes, fringe benefits, and some of the less common benefits like servants and position benefits. It is so because of vast differences in the nature of foreign subsidiaries, nature and duration of foreign assignment, socio-economic-cultural environment, etc. Hence, a foreign subsidiary has to be very conscious when it comes to choosing an approach to determine expatriates pay. The approaches available in this regard include: balance sheet approach, flexible compensation approach, negotiation approach, localization approach and lump summing approach. In the same way, developing and designing third country nationals remuneration is also very demanding as it requires "equalization of compensation" with some countries. In this regard, options available are host country equalization, headquarters equalization home country equalization etc and so on.

Similarly, there are several issues involved in developing and designing the local country nationals' remuneration like the practice of collaborative bargaining, statutory obligations, wage boards, bonus and other practices, etc., prevalent in the country concerned. Thus it is observed that developing and designing remuneration of employees engaged in international organizations, which mostly comprise expatriates, third country nationals and local country nationals, is not an easy task as the nature of foreign subsidiaries, talent and experience required, typical conditions under which a particular job is to be performed, duration of the employment contract, socio-economic environment of the country where the foreign subsidiary is operating, etc., also come into fray.

Keywords: International, Multi National, Remuneration Design, International Remuneration

INTRODUCTION

Understanding how to develop and optimize the design of total reward programmes within global organisations is

a much sought after skill in the arena of human resource management. International/ global remuneration is a complicated issue as it has many dimensions to be taken care of. Globalisation is the outcome of two major trends, viz. (i) internationalization of marketing which has been possible because of revolution in communication which has enabled demand for goods and services go

¹ Professor Emeritus, Amity Business School, Amity University Haryana, (AUH), Founder Vice Chancellor, AUH, Manesar, Gurugram-122413.

² UG Student, Ashoka University, Sonapat

upward all the world over due to ever increasing standard of living. Consequently, a good number of companies now see their market place as not only their own country or continent but the whole world, and (ii) endeavour to reduce the costs of production which is due to locating the production facilities where labour is available at cheaper rates. These two trends have caused the companies to have their plants and office in different countries.

Types of International Organizations

Before jumping into the fray, it will be in the fitness of things to have an idea about various types of international organizations and how they staff themselves. Coming to the main types of international organizations we come across the globe, they may include *international corporations* (e.g. P&G, General Electric Co., etc.), *multinational corporations (MNCs)* (e.g. Xerox, Philips, etc.), *global corporations (GCs)* (e.g. McDonald's, Coca-Cola, Nestle etc.) and *transnational cooperation (TNCs)* (a transnational corporation is a fine blend of local responsiveness of an MNC and the efficiency of a global corporation).

However, irrespective of any of the forms discussed above, an organisation that conducts business overseas is usually known as an international organisation. Since the matter of international remuneration is to be discussed in the context of people whose remuneration is to be developed and optimally designed, it is desirable to know the sources from where such people are procured and the issues related thereto. Usually, international organizations operating overseas may use any one or more than one of the sources, namely, (i) *home country or parent country nationals (PCNs)*. i.e. the citizens of the country in which the multi-national company has its headquarters. (ii) *host country nationals (HCNs)*, and (iii) *third country nationals (TCNs)*

Developing and Designing International Remuneration

While developing and designing international remuneration, the main objectives of international remuneration

should be kept in view. Such objectives comprise: attracting the desired and talented people, retaining the talented employees on their current international assignments, reducing grievances, enabling the employees and their families to adapt themselves to the socio-cultural environment of the host country, enabling the employees to move from one subsidiary to another subsidiary, improving and maintaining employee motivation, maintaining internal and external equities, maintaining balance between employees pay and their performance, perception of fairness, aligning compensation with the strategy of the organization. Besides, there are certain factors which should be looked into and provided for. For example, there may be *statutory obligations, state of technology, socio-cultural factors* which play an important role while developing and designing international remuneration. Other factors may include regional practices, government controls, labour policy of the host country, employee unions' approach, economic trends prevalent in the host country and so on.

While developing and designing international remuneration, we have to choose as to which approach (es) would suit the organization most in this regard. The main approaches to international remuneration include: *traditional approach* which is also known as *home country based approach, host country based, headquarter based approach, global market approach* and *balance sheet approach*, etc. As per *traditional approach*, base pay for international assignments may be determined on the basis of how it is worked out in the home country i.e. it is home country based. It may be considered fair. As per *host country-based approach*, the base pay should be as per rates applicable for the similar assignments in the host country because internal and external equities should not be disturbed. However, this may not sound fair if the expatriate is from a developed country where the base pay is usually more than the host country of the expatriate. Then, there is another approach known as *global market approach* as per which, base pay for

international assignments should be global market-based. It may appeal to all concerned though it may be burdensome if the expatriate is from a developing country where base pay rates are relatively much less as compared to the global market-based rates of base pay. Of late, *balance-sheet approach* is also getting popular. There is also *contemporary approach* which includes

package should also include the cost of any other expenditure which expatriates may have to incur in the host country because of its typical environment there. Besides, the expatriates have to visit their home country periodically, say, quarterly, half-yearly or annually for which they need to be granted paid home leave and many other things (see Exhibit 1).

Exhibit 1

What Expats Demand to Locate to Remote Locations

A review visit before signing up. This is a must

Gym and Club facility
(Some say tennis courts in particular)

Shopping malls, recreation, international schooling for children

In many cases they want to opt for boarding schools for their kids in locations like Singapore for which they need separate compensation

If spouse joins, they need adequate safety in township, spouse clubs, foreign-language training.

Contract-break protection, ease of forex conversion, tax filing help from Big4

Medical and accidents insurance and air ambulance.

Source -The Economic Times, 8 January, 2019

premium and allowances and takes care of typical nature and requirements of international assignments. As per the contemporary approach, international remuneration should take care of typical aspects of international assignments. For example, the pay package of the people taking up international assignments should include hardship pay as they usually confront more hardships. They may also be subject to more risk and hazards, hence their pay package should include risk/hazard pay. Another way out is that they should be paid for the cost of living adjustments so that there is no grudge an account of difference in cost of living of the host and home countries. In case housing facilities are costly in the host country, their pay package should include housing assistance. Similarly, their pay package should include educational assistance which may cover up the education of their children in the host country. Their pay

Then, there is also a *variable/incentives compensation approach* which has provisions for short-term or long-term incentives usually based on their performance. There should also be a provision for variable pay which is directly dependant on their contribution towards the goals and objectives of the organisation. Since, as stated above also, the nature of international assignments is typical and usually demands higher skills, experience, expertise and qualifications etc and further that they involve greater risk, physical discomfort, etc., the expectations of people who are entrusted with international assignments, are greater. Thus, appointing expatriates in foreign subsidiaries is a costly proposition as they expect a lot of things.

Which of the aforesaid approaches is better is difficult to decide. It should be chosen based on the typical nature/circumstances of the international assignment concerned.

DISCUSSION

Determination of Remuneration of Employees of International Organisations

It is primarily the expatriates, third-country nationals, and local (host) country nationals who dominate the workforce in foreign subsidiaries. A brief discussion with regard to the determination of their remuneration and some of the practices followed are as follows:

Expatriates' Remuneration

As mentioned earlier also, expatriates are the present employees or new hires from the home country of the company posted in the host country. Normally expatriates are sent to host country for a temporary assignment i.e. a short term assignment, say for a period less than one year, though some countries like the US prefer to post expatriate in new foreign countries for a period of 2-3 years whereas some countries do so for a still longer period, say 5 years or so. Japan is one such example. Since temporary assignments are for a period of about one year or so, pay and benefits remain almost the same as they were getting earlier plus some additional pay or benefit to cover living cost. However, in order to attract and retain expatriates, the companies make the package a little bit tempting. Because of the typical nature of expatriates' jobs, their pay is also determined in a different way. As a matter of fact, an international assignment compensation plan has to appropriately balance rewarding and motivating expatriates while keeping costs under control for corporate headquarters at home country.

Hiring expat professionals has never been more difficult for corporate India as it is now. Apart from hefty paycheques, prospective 'foreign hands' expect companies to specifically look into their personal safety, comforts and superfluity.

As an increasing number of companies in India, both domestic as well as global multinationals, have their businesses in small cities and towns, hiring an expat is becoming a tough negotiation. India, once

reckoned to be one of the much sought-after destinations that added to the repertoire of experience of an international talent, may be losing its charm or is becoming pricier for the companies. For those who are willing to risk a few years in India often ask for the moon - from air ambulance to personal bodyguards, gym and foreign-language training institute for spouses, tennis courts and club facilities - even at remote plant sites. Here, the example of a senior Japanese engineer can be cited, who before taking up the assignment in India not only wanted to visit the site but also sought to meet local administrators such as the district collector, NGOs, suppliers and water contractors to understand the ease of functioning at the location. "Such kind of demand would never be made when one is going to Europe or even South America. It arises from the concerns about bottlenecks in functioning smoothly in the country".

Among the demands, expats make to move into industrial regions are international schooling or boarding schools for their kids in locations like Singapore for which they need 'separate compensation'. A review visit to the local area before signing up is a must. If the spouse joins, they need adequate safety in the township, gym, spouse clubs and foreign - language training as spouses can use this time to learn new languages and vocations. Medical and accidents insurance are a must with protection against environment and safety incidents.

For example, when foreign subsidiaries in India do not have expertise in a particular field locally, they look forward to talent from abroad but expats ask a lot more questions than a local hire. Things become still difficult in hiring expats if they have to be appointed in a second-rung town as today in India many of industrial activities are moving to second-rung cities like Nashik, Udaipur, Vadodra, Aurangabad, etc. where finding many of the facilities asked for by the expats are difficult to be arranged (See Exhibit 2)

Exhibit 2

To Work in India, Expats Ask for the Moon

“..... Not every company can afford to have such infrastructure in remote locations and for them, it is tough task to hire expats for niche roles for which homegrown talent is not available”.

-The Economic Times, 8 January, 2019

India's financial, commercial and entertainment capital, Mumbai, tops global rankings for expat salaries, according to a survey conducted by HSBS Bank International. Foreigners moving to the Indian subcontinent's most populous city reported average annual earnings of \$217,165. That's more than double the global expat average of \$99,903 (See Exhibit 3). Expat's salary is more because Mumbai is more expensive for expats than many other global cities (see Exhibit 4).

Exhibit 3

Expat Salary: Mumbai No.1

(Average Mumbai expat salary more than twice the global average

Top 10 & select European cities)

(The HSBS Expat Explorer survey was completed by 27,587 expats from 159 countries and territories. With a minimum sample of 90 expat respondents required, 52 cities were included in the analysis.)

	Rank	(\$,000s)
Mumbai	1	217.2
San Francisco	2	207.2
Zurich	3	206.9
Shanghai	4	202.2
Geneva	5	184.9
New York City	6	182.2
Los Angeles	7	161.1
Jakarta	8	152.6
Hongkong	9	148.4
Paris	10	139.6
London	26	107.9
Global Average		99.9
Dublin	37	91.4
Berlin	42	84.2
Prague	46	68.7
Birmingham	50	62

-The Economic times, 27 February, 2019

Exhibit 4

Mumbai More Expensive for Expats

CITIES	COST OF LIVING RANKING
Mumbai	55
Melbourne	58
Frankfurt	68
Buenos Aires	76
Stockholm	89
Atlanta	95

- **Reasons for jump in Mumbai's ranking** are continued surge in prices of food, alcohol and domestic supplies
- **Hongkong** is ranked as the world's costliest city to live for expatriates
- **Inflation**, among the highest in INDIAN cities surveyed remained at 5.57%
- **93% of companies** compensate through a cost of living allowance for their expatriate assignee

This increase in prices of goods in our cities, viewed along with exchange rate, has a direct impact on the Indian assignee compensation when using a balance sheet approach, making overseas assignment costs sometimes greater and smaller. -
The Economic Times, 25 June, 2018.

Constituents of Remuneration of Expatriate

The package of expatriates is usually tempting. It may consist of: base pay, variable pay, bonus(es), allowances [cost of living allowance, automobile allowance, education allowance, hardship allowances. (according to Armstrong and Murlis, hardship allowances may be for an excessively hot or cold climate; health hazards; poor communications; isolation; language difficulties; daily possibility of burglary, kidnap, mugging, etc; scarcities of food; poor amenities; political risk; *Force majeure*, floods, typhoons, earthquakes, etc.), risk allowance, club membership allowance, uniform allowance, picnic allowance, etc. Other allowances, according to Armstrong Murlis⁷, may include separation allowances, clothing allowance, added responsibility allowance (position

allowance), and relocation allowance], payment of taxes, adjustment of purchasing power of money, fringe benefits, discretionary benefits, not very common benefits [which according to Armstrong and Murlis, may include: servants which represent affluence, power and status though the practice has been given up in many countries, club subscription, rest and recuperation].

Approaches to Determine Expatriate Remuneration

How to determine an expatriate pay depends on which approach the home country organisation adopts for the purpose. It can follow any one or a combination of more than one of the following approaches for determining an expatriate's pay:

- **The Balance Sheet Approach**

It is a very common and popular way of determining an expatriate's pay. Of the two-fold purposes of balance sheet approach is keeping the 'expatriates whole' i.e. how is his standard of living in the host country, and the second purpose is controlling the costs involved in the whole exercise. Milkovich, Newmann and Ratnam have pointed out the following three objectives (i) Ensure mobility of people to global assignments as cost-effectively as possible. (ii) Ensure that expatriates neither gain nor lose financially, and (iii) Minimize adjustments required of expatriates and their dependents.

It is worth monitoring here that none of the above objectives is related to performance. Thus, it is a costly proposition to send an employee, and his family, overseas on an international assignment. The first step in the balance sheet approach is to determine the base rate for the job which can be done through the job evaluation process being used by the home country organisation. The other option is to make a decision keeping in view the market rate for the job. Though not essential but the base rate for the job so arrived at may be divided into certain categories like taxes, goods and services, housing and utilities, and discretionary income, and so on. The aforesaid categories

reflect living costs in the home country of the expatriate. The second step involves estimating the costs the expatriate is likely to incur on the above categories in the host country. In case the costs so worked out for the host country are more than such cost incurred in the home country, the difference is the allowance that should be paid to the expatriate. As per the balance sheet approach, the following format can be used to calculate the above:

Category of expenditure	Costs incurred in the home country	Costs incurred in the host country	Differentials

The differential amount should be paid to the expatriate otherwise he/she may decline the offer of appointment. Though this is a good approach at the same time, it is mechanical in nature and leaves no scope for the expatriate to go further for any negotiation which he would have otherwise preferred.

Armstrong and Murlis, have pointed out the following three components of the balance sheet system: (i) Notional home salary (ii) Spendable income, and (iii) Allowances.

- **Flexible compensation approach** - It is another approach for determining an expatriate's pay. Also known as cafeteria approach, flexibility is the main feature of this approach. It takes care of the needs and desires of an expatriate as there is a scope for adjustment. For example, if an expatriate prefers a spacious house with good furniture and fittings and, therefore more money for meeting out the expenditure on the count of housing, but since he does not yet have any child, he may not need any money for the schooling of children.
- **Negotiation approach** - It is a simple approach as per which the two, viz. the management of the home country organisation and the would-be expatriate, negotiate and reach a

decision with regard to compensation which is acceptable to both. The main shortcoming of this approach is that if a good number of employees are sent overseas for international assignments, it will be difficult to negotiate with each of them individually as it is a time-consuming process to work out mutually agreed compensation for every expatriate.

- **Localisation approach** - It is another approach to determine compensation and is usually used in the case of determining the compensation of new employees. As per this approach, the compensation for overseas assignments should be as it is in the host country, though some adjustments can be made if the costs on a particular category are substantially higher than in the home country. This plan is getting popular by and by.
- **Lump summing approach** - It is yet another approach whereby a lump sum amount is given to the expatriate which he can spend as he likes. According to Armstrong and Murlis, there are three main expatriate remuneration systems that are now prevalent as described under:
 - i. Balance sheet or build-up (home-based).
 - ii. Local market rate (host-based)
 - iii. Hybrid (usually a combination of home-based and host-based pay systems).

Third Country Nationals' Remuneration

Besides expatriate compensation discussed above, there is another section of international employees whose compensation is as important to be discussed as that of expatriates. This section of international employees comprises the employees that the home country organisation transfers from one host country to another host country, who are known as third-country nationals (TCNs). For example, an Indian international

organisation transfers its employee presently posted at a foreign subsidiary located in Hong Kong to its another subsidiary located in London. Though the process of working out a compensation package for TCNs is the same yet some differences are there which should be taken care of as follows:

The first question that arises in this direction is "equalization of compensation to which country?" In this regard, it may be said that if an employee is working in a particular host country and if he is transferred to another host country, then he should be paid the same amount that of a local country national (i.e. of another host country to which the employee stands transferred from his previous host country). This is also known as *host country equalization*. However, his salary will not be reduced from his present status. Another possibility may be that of *headquarters equalization* as per which all third-country nationals are treated as if they all are citizens of the headquarters country and, therefore, all employees working in a country are paid the same compensation package. This system helps in maintaining internal consistency. Of course, as different countries follow different taxation policies, which may disturb internal consistency because the compensation package due to different rates of taxes, may be below or above the third-country national's current one. The other possibility may be of *home country equalisation* in which the third-country nationals are paid their regular home country compensation. However, if the housing accommodation is costly in the host country, a housing allowance is added to the pay package so that the cost of living could be maintained. The fourth possibility may be that of modified *home country equalization* under which for calculating the cost of living the home country approach discussed above is followed but for calculating base pay, the headquarters approach, also discussed above, is used. In case the organisation makes use of split pay system, the home country equalization approach is perhaps the best approach. However, according to Milkovich, et al.,

equalizing pay, may not motivate an employee to move to another country, particularly if the new location has less personal appeal. Hence, in order to encourage the employees to move to the host country, many home country organisations also offer some form of financial incentive or bonus too. For example, the home country organisation may give relocation bonuses to tempt people to take up expatriate assignments in the host country. However, if an expatriate himself is keen to get international experience, relocation allowance can be ignored or, at least, the amount of it can be reduced.

Constituents of Third Country Nationals' Remuneration

The third country nationals' remuneration may include: base pay, variable pay, various types of allowances, payment for taxes, benefits, etc.

Local (Host) Country Nationals' Remuneration

There is a great variation in the wage level of different countries due to the state of their country's economy, its culture and laws. There are several practices of determining the wage levels being followed across the world and many of them differ widely from country to country. For example, collective bargaining has been playing an important role in determining local country national's compensation. Some countries exercise control over wages through their income policy and enacting laws. Some others constitute wage boards to set wage rates. Culture too affects pay practices in a number of ways, and so on.

In view of above, there is a great variation in different countries in the base pay which is considerably affected by the differences in countries prosperity, internal business factors, social factors, and purchasing power of money. For example, prosperous countries usually pay more as compared to poor countries. In some countries, government policies and laws and union influence play an important role in the determination of base pay. Availability of wage data and cultural norms also exercise

a great influence on determination of base pay. Similarly, with regard to bonuses also, in some countries, it is viewed as an *ex-gratia* payment. In some countries, it is called 'deferred wage', while in some countries it has to be determined and paid as per legal provisions, e.g. in India it is determined and paid as per provisions of the Payment of Bonus Act, 1965. Hence, there is a great variation in the determination of bonus also in the case of local country nationals.

So far as variable pay in the case of local country nationals is concerned, in some countries like the US, it is very popular while in some other countries it is not so where profit sharing may be popular, and so on. So is the case with stock options. Similarly, pay-for-performance is very popular in countries like the US but may not be so in many other countries, the reason being that performance is usually evaluated by managers depending on their whims instead of measuring it scientifically or mechanically.

Then comes the allowances, the meaning of which differs what it is in the case of local country nationals (LCNs) than in the case of expatriates. In most countries, allowances are paid as additions to base pay and given for a number of reasons. In some countries, they constitute a significant part of their base pay and may go up to 25% or even more. Allowances differ widely from country to country. For example, there are 56 separate allowances which can be claimed by an employee, subject to conditions laid down for the purpose in the Metal Trades Association Agreement in Australia. However, allowances paid are categorised under certain heads based on position of the employees, behaviour and person.

Benefits too differ a great deal from country to country. Some benefits may be very popular in one country but be totally missing in another country because benefits are extended to meet the local requirements and to provide psychic comfort to the employee which may differ from country to country. Statutory benefits also vary from

country to country though a few are common in all countries. For example, in India, there are legal provisions for extending certain benefits as per Employees' Compensation Act, 1923, Employees' State Insurance Act, 1948, Employees' Provident Funds and Miscellaneous Provisions Act, 1952, Payment of Bonus Act, 1965, Payment of Gratuity Act, 1972, Industrial Dispute Act, 1947, Industrial Employment (Standing Orders) Act, 1946, Maternity Benefit Act, 1961 etc. Again, how much financial burden for implementing the required benefits will be borne by whom, i.e. the government, employer, employees or a combination of two or more of above. Time off is another benefit which may be available to the employees in the form of holidays and vacations. The number of national holidays may also differ from country to country. Working hours, though usually 8 hours per day or 40 hours per week, is a common phenomenon, in certain countries, it is up to 48 hours a week also. For example, in India, it is 48 hours per week. Similarly, in some countries, it is 5 days a week, in some countries, it is 6 days a week and so on. The rates of overtime also differ from country to country. In some countries, it is one and a half time more than the rate of standard hours, it is twice of the standard hourly rate in some other countries. Again, while severance pay is common in most countries, it is not paid at all in some other countries. The base amount of severance also differs from country to country. Occupation and age are the other factors that play their own role in the case of severance pay.

Discretionary benefits, as the name suggests, vary from country to country because they are based on needs, customs and culture of the respective country. Transport allowance or a vehicle in lieu thereof, meals, loans and taxes too differ from country to country. Executive perks also differ in variety, quality, and frequency from country to country. Thus, it is noticed that there is great variation in the local country nationals' compensation. It has to be decided keeping in view a number of factors stated above.

REFERENCES

- Armstrong, M. & Murlis, H. (2004). *Reward Management*. London, U.K: Kogan Page Limited
- Cherrington, D.J., Middleton, L.Z. (1995, June). An Introduction to Global Business Issues. *HR Magazine*, 124-130.
- Ivancevich, J.M (2011). *Compensation*. New Delhi, India: Tata McGraw Hill Education Pvt Ltd
- Milkovich, G.T., Newmann, J.M., & VenkataRatnam, C.S.(2011). *Compensation*. New Delhi, India: Tata McGraw Hill Education Pvt Ltd
- Sharma, R.C. (2016). *Industrial Relations and Labour Legislation*. Delhi, India: PHI Learning Pvt Ltd
- Sharma, R.C., Sharma, N.(2018). *Human Resource Management: Theory and Practice*. New Delhi, India: Sage Publications India Pvt Ltd
