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Contextual Factors of Compensation and Benefits Management to Expatriate Workforce

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Abstract

The future of foreign organizations' competitiveness in the global market is contingent on those organizations' ability to change and adapt their resources strategically to the nuances of the broadening global playing field. Based on secondary data, it argues that maintaining a domestic compensation program that supports the strategic goals of the organization and meets the needs of employee is a difficult challenge. This challenge is intensified when a similar program must be designed to operate in multiple countries with different cultures. Therefore, this conceptual paper aims to examine the right mix of factors which directly impact expatriate compensation with the most important approaches an organization should contemplate. These contextual factors include cost of living, healthcare, accommodation allowance, expatriate taxes and children's education. Most factors often integrated as an element of the distinct strategic contingency approaches to discussions: balance-sheet approach and the going rate approach. In order to survive in a competitive world, organizations should consider the concept of 'wholeness' within the perspective of compensation packages. In general, this paper was proposed to augment our perceptive to expatriate compensation and using the following recommendations will help the organizations to prepare strategies for the expatriate.

Keywords: Compensation, Expatriate

Introduction

With the rapid development of globalization, organizations particularly larger multinational corporations have improved their activities associated with the traditional human resource management to utilize its human resources effectively. These individuals who conduct global business outside their country for a period of time are referred to offshore (expatriate) workforce. In a recent report, estimates suggest that over two million American expatriate are working abroad for US organizations at any given time (McCallum and Olson, 2004). These expatriate employees are placed in various international offices and have international responsibilities (Haile & Williams, 2011) in order to provide lucrative opportunity for expansion and differentiate themselves in a world that is shrinking and becoming more homogenized. Untapped markets, resources, technology, customers and partners could potentially boost an organization's competitive advantage and profitability. However, managing globally requires

monitoring numerous political, social, legal, and cultural differences among countries, which could trigger events that would adversely affect the long run profitability or value of the organization (Deresky, 2011).

A continued utilization of expatriate employees by organizations in their foreign subsidiaries represents a substantial investment with costs of expatriate failure reaching exorbitant levels (Baruch, 2004), and thus there are pressures to decrease such cost (McEvoy, 2011). Expatriate failure is usually defined as a posting that either ends prematurely or is considered ineffective by expatriate managers. Most research into this matter has come to the conclusion that failure rates are usually very high (Scullion, 2005; Harzing & Christensen, 2004) and can vary between 20% and 50%. For instance, studies conducted by Black and Gregerson (2007) confirm that nearly one-third of the expatriates who complete their overseas assignments did not perform up to the expectations of their superiors. Expatriate failure can cause an international organization thousands of dollars. One source indicates that each expatriate failure, a premature return, can cost an organization to US\$250,000 to US\$1 million approximately (Vogel et al., 2008). A more recent source suggests that expatriate failure costs a US organizations approximately \$2 and \$2.5 billion (Reish, 2011), depending on the employee's salary, the location, and whether a family transfer was involved. When an expatriate fails, the organization suffers a major economic loss. After returning home, a failing repatriate may choose to leave the organization.

As result in a given statistics, organizations need to more closely manage and control expatriate assignment costs, an objective that can be achieved through an understanding of the compensation and benefits management in general. From an operational perspective, many organizations have adjusted or entirely revamped expatriate compensation (Phillips & Fox, 2003) coupled with the organization's global strategic objectives. Various organizations rapidly viewed compensation program as an effective component a potential expatriate think deeply when accepting an international assignments. In today's intensely competitive labor market, attracting and retaining the best international candidates are requisite of any successful organization in global level (Minter, 2008). When organizations decide to operate internationally, the human resources compensation program supports the way the business is structured, organized, and operated both globally and locally (Mondy & Mondy, 2012). Haile and Williams (2011) argue that compensation is a significant link between strategy and its successful implementation. There must be a fit between compensation and the goals for which an organization wants expatriate employees to achieve. In a recent survey of employers with global operations, 85% said they have a global compensation strategy to guide compensation decisions for employees at all levels and in all countries where they operate (Noe et al., 2011). In line with the widespread perception of international assignments, experienced expatriates are extremely valuable asset in today's management.

A lack of professional expatriates who have the ability to administer the business and have management style to achieve objectives at the highest level could result in organizations not to make the necessary adjustments to compete in emerging global markets. Moreover, expatriate compensation is often regarded as indispensable factor of effective foreign assignment

management (Harvey & Moeller, 2009). This underlines why it is essential for organizations to effectively indemnify expatriate, regardless of international settings. In regard to compensation, average remuneration to expatriate can stretch depending on a variety of factors such as the cost of living, quality of life, hardship of relocation and even extra expenses such as secure living (gated communities) and international schooling. According to Press Release of ECA International, the world's leading provider of knowledge, information and technology for the management and assignment of employees around the world, as shown in Figure 1, illustrates that Japan has highest expatriate compensation packages in Asia which worth US \$374,000 per year (ECA International, 2012).

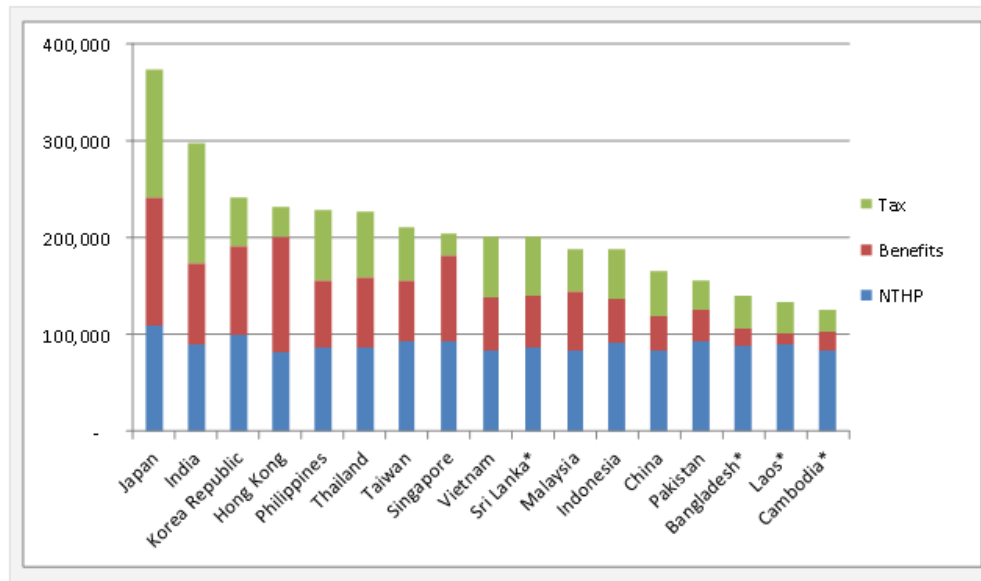


Fig. 1 - Gross expatriate salary packages in Asia (US Dollars)

Source: ECA International, 2012

To advance a superior understanding of related issues identified with expatriate compensation in a complex global market, organizations should uphold the management criteria impacting expatriate compensation. Although costly, it will view as an effective tool to motivate and retain top individuals, whether they are local staff or expatriate. Such factors will determine the appropriate levels of expatriate compensation. Research revealed that while general guidelines should lead to a fair and constructive system, situational factors will force organizations to be inventive and flexible in setting and managing the remuneration system across borders (Baruch, 2004), while enhancing their corporate's positive image (Wang, 2008). The primary purpose of this paper was to identify those factors that can help organizations to develop expatriate compensation and benefits management and fulfilling them successfully. Also, this paper examines expatriate workforce as central to the growth of multinational organizations and an assessment of their future use in global organizations.

Literature Review

Expatriate compensation has long been a center of dissent and trepidation for organizations (Nazir et al., 2012). Despite respond to the demands of a global economy, organizations simply unable to improve the return of investment as expected. As organizations start to grow and branch out overseas, often conflict of goals with related to expatriate compensation plans are always an issue. For instance, organizations must establish robust approaches to handle the escalating cost of expatriate compensation packages. However, on the other hand, the organization must be equitable to their current expatriates, while ensuring the organization offers a compensation package competitive enough to attract, retain, and motivate expatriates (Sims & Schraeder, 2005). Addressing this predicament, a very complex and complicated balancing act for organizations are often required. Nevertheless, in order to remain high qualified expatriates, organizations should pursue consistency in routine functioning in the face of ongoing change in their foreign operations as part of this coveted balance (Turner & Rindova, 2011).

This contention is supported by Geigle and Malhotra's (2009) research debating that without diversity of skills and expertise of high qualified expatriates no one country can compete in a global environment. According to Sengupta & Bhattacharya (2007) compensation is an internal rate of return that valued by employee's in accordance with their relative contributions to performance towards achieving the desired goal of an organization. For instance, Duvivier and Peeters (2011) examined the propensity of using expatriates as one type of international transfer assignees in the context of service offshoring operations. The results provide a framework for organizations to approach international transfer assignment decisions for service offshoring activities in a more systematic way. One source indicate that focuses on the importance of the selection process in maintaining the viability of an organization's foreign operations (Wentland, 2003) will positively affect the long run profitability or value of the organization.

In order to survive in a competitive world, organizations should also consider the concept of 'wholeness' within the perspective of compensation packages. The concept refers to the organization's desire to ensure that the expatriate does not experience an overt gain or loss when all elements of the compensation package are combined (Wentland, 2003). In Pearce's (2013) book titled "International Education and School" revealed that maintaining 'wholeness' is clearly a potential minefield where the host location has an infrastructure significantly less well developed than that of the sending country (facilities, healthcare, schools, and so on being limited in provision and/or quality). Yet, even in developed host countries, the ability for employers to keep assignees 'whole' can be severely defied. Hence, expatriates may take the concept of wholeness a step further by expecting some type of hardship or incentive pay for accepting the expatriate assignment (Oemig, 1999; Wentland, 2003). As a result, it is necessary for various organizations to focus attention on the right mix of expatriate employee compensation components to keep their sense of "wholeness". These include host-country cost of living, healthcare, housing, foreign taxes, children's education, and hardship allowances (Sims & Schraeder, 2005). These factors account for the excessively high packages earned by expatriates.

The Right Mix of Expatriate Compensation and Benefits

Cost of Living

Cost of living has been considered as one of the most important factors on expatriate compensation. Various studies indicate that cost of living in the host country have a strong upward effect on expatriate compensation. Majority of organizations use cost of living to determine the amount of payment needed for the international cost of living difference. Generally, employers use a “no loss, no gain” approach when developing compensation program for employees while working overseas. Within this framework, if the cost of living in the foreign country is higher than that at home, then the manager’s existing base pay along will result in a lower standard of living. On the other hand, if the cost of living at a foreign location is lower than that at home, no such allowance is needed (Denisi & Griffin, 2015). In early 90s, international assignments were less common than today, and most employers provided generous benefits for their expatriate workforce. Such as housing, an automobile, generous health benefits, frequent trips home and other incentives to ensure successful assignments (Puccino, 2007). An adjustment made to cost of living is generally equal to the percentage increase in the expatriate’s base pay.

No doubt when start working overseas, base pay for the expatriate in the host country may vary widely from organization to organization; they may even vary greatly among of the same employees’ organization. Adjusting expatriate’s base pay may typically range from 15-40 percent to be added. For instance, results of a survey of MNEs from a few years ago in the Middle East for the percentage of base pay added to expatriate compensation for assignments to the area: United Arab Emirates 12.5 percent, Bahrain 20 percent, Egypt 20 percent, Saudi Arabia 25 percent, and Israel 42.5 percent. Given recent events, these percentages are probably even higher today (Briscoe & Schuler, 2004). The cost of living adjustment for an expatriate located in a developing country, with a very low cost of living, may be substantially less than the estimates associated with prior examples (Solomon, 1995). In general, it’s imperative when an expatriate discusses their salary expectations with a prospective employer to try and negotiate some kind of allowances into their compensation package. Also, expatriates anticipate the organization to amend the package to reflect any additional cost of living, thereby keeping the expatriate “whole” or in some cases, more than whole (Oemig, 1999).

Healthcare

In terms of quality of life, healthcare is one of the most important trepidations of expatriates however fairly little seems to have been written in the management literature. The fact that healthcare provides benefits to expatriate, vary widely across countries makes their management extremely complex and their transportability very difficult to normalize (Dowling et al., 1994). For instance, only sixty five percent of international placements are engaged and satisfied with the healthcare service within the expatriate compensation benefits (Barker & Harris, 2014). Research indicates that eighty percent of organizations across sub-Saharan Africa provide some form of health care to employees and also provide medical care for spouses and dependents (Heerden, 2012). Whereas, in Saudi Arabia, health care have been given a high priority by the

government at all levels in terms of quality and quantity. This includes comprehensive products for travel, life, and income replacement. In fact their healthcare is ranked 26th among 190 of the world's health systems. It comes before many other international health care systems such as Canada (ranked 30), Australia (32), New Zealand (41), and other systems in the region such as the United Arab Emirates (27), Qatar (44) and (45) Kuwait (Almalki et al., 2011).

Ordinary methods to supplement expatriates with healthcare benefits are gradually fluctuating. Some organizations are contracting with international insurance organizations that offer comprehensive annual renewable health insurance tailored to the needs of expatriates, global nomads or international citizens, such as IMG Global Medical, Cigna International, and GeoBlue Xplorer. These global insurers can offer basic as well as more comprehensive plans with additional benefits and coverage options. Also, they have processes in place to handle language translation and even remove the risk of currency fluctuation (Sims & Schraeder, 2005). Expatriate claims may be handled internally or outsourced and be paid in ten to fifteen days. This type of healthcare insurance is generally expensive compare to home-based employees. Therefore, by planning carefully and obtaining an international health plan, expatriates and organizations can enjoy their times abroad with confidence instead of stressing about what might happen or an effort to keep their expatriates whole (Frazee, 1998).

Accommodation Allowance

A housing allowance represents one of the most costly elements of expatriate compensation package. Organizations tend to ensure that expatriates live as well as their foreign peers or that their housing and utilities are comparable to what they back home (Suutari & Tornikoski, 2000). Housing costs vary substantially by location. Tokyo and London, for instance, are notoriously expensive places to live. Rental rates in Tokyo fare exceed comparable housing costs in most US cities. In other international cities, such as Rio de Janeiro, may be less expensive than average US domestic rates. Although it is becoming increasingly uncommon, some employers pay the full housing expense on behalf of the expatriate employee. If housing rates are higher at the assignment location, an adjustment may be paid directly to expatriate employee and to seek reasonable accommodations. In some cases, it may be advantageous for the employer to directly pay the rent and thereby reduce the tax liability (Puccino, 2005).

In some less-developed countries, the housing available for expatriates and their families would have unreasonable expectations going in, which would leave them disappointed and often negatively impact their overall expatriate experience. Organizations should create a compensation package for an expatriate which included their base salary, a cost-of-living differential, and a monthly housing allowance. However, without proper insight into the local housing markets, employers would often establish housing allowances that were not reasonable or appropriate for a given location (Jelinek, 2014). Realizing that adequate housing is a crucial factor in successful expatriate adjustment, many organizations continue to assist the expatriate by both locating and subsidizing housing. Many organizations, as well as their expatriates, continue to view housing assistance as a key part of the expatriate compensation package (Oemig, 1999).

Expatriate Taxes

An expatriate tax is quite often subject for discussion in the presence of communication age. Issues about taxation, however, are particularly complex. Taxation in both home and host countries is not common, thus inflating the overall tax liability. Tax counseling as a benefit for expatriate employees is almost an imperative. Organization may decide to address taxation issues by implementing a tax protection, tax equalization or a localization strategy (Puccino, 2005). In the tax protection approach, the company figures the expatriate's hypothetical U.S. income tax and compares it with actual taxes paid. At the end of a year, the company reimburses any disparity. If the expatriate pays less in taxes than he or she would have paid in the United States, the expatriate keeps the difference. A disadvantage of this program is that it can create inequities between expatriates in low-tax-cost countries and those in high-tax-cost countries.

While, in a tax equalization program, the expatriate's tax situation is neither better nor worse than it would have been in the United States. A hypothetical U.S. income tax is withheld from each paycheck. Foreign taxes are either paid by the employer or reimbursed. Although this program ensures equity among expatriates, it requires more administrative resources than the other methods (SHRM, 2014). Localization is less common; under the localization approach, the expatriate employee is responsible for his or her own tax payments. Localization may result in significant additional tax burden on the employee (Puccino, 2005). In relation to this, employer should provide tax assistance to its employee, not only to respect that tax rules applicable in both countries but also to guarantee some tranquility to the employee on this topic.

Children's Education

Education is a form of learning in which the motivational and psychological factors of individuals are transferred from one generation to generation. In international context, good quality education for children is another significant factor for expatriate in deciding to accept an overseas operation. Thought school choices are always challenging, and even more where the traditional approaches are limited or non-existent. Families who succeed in dealing with these difficulties and successfully educated their children in limited local schools find the rewards to be noteworthy. A unique offer of societies in different country such as new languages, cultures and curricular subjects can provide some form of acceptance for the youngsters. As schools are a microcosm of the cultures they inhabit, children raised in local schools abroad can be our true ambassadors in the global world of the next generation (Perelstein, 2009).

Despite the fact that cost related to international school might be overwhelmed, parent organizations found that paying up in these situations is an essential requirement. In general, expatriates now a day are more flexible as parent organizations make every effort to lessen their expatriate costs. Nonetheless, some motivational factors of the expatriate assignment fall into certain non-negotiable standard package of benefits. Typically, children's education will part of education allowance of expatriate under the non-negotiable benefits. Ultimately, when the parent company covers the cost of adequate education for expatriate children, it makes it easier for the children to dissimilate into the home country school system once the expatriate

assignment is complete. As previously mentioned, the cost of children's education is often viewed by expatriates as a critical part of their compensation package (Allard, 1996).

Worldwide Approaches in Expatriate Compensation

There are a number of strategic contingency approaches that can be adopted for long-term international assignments and has its own advantages and disadvantages. But definitely it is not a "one size fits all" exercise. In today's environment, the global mobility landscape has changed and the expatriate population has become more diverse (Neijzen & De Bruyker, 2010), which can appear to be a daunting issue. It is therefore, that understanding of salient issues associated with expatriate compensation should not be limited, exclusively to these factors (Sims & Schraeder, 2005). These distinct factors are identified: the balance sheet and the destination going rate approach (Reiche et al., 2009).

Balance-sheet Approach

Every multinational organization has compensation programs that use the balance sheet approach. Recent research revealed that more than 85% of US organizations used this approach to meet their business and global mobility needs. Balance sheet approach explained as a compensation approach that links the base salary of an expatriate to the salary structure of their nominated home country with the intention of keeping them whole (McNulty, 2014). Thus, the expatriate neither gains nor loses from a financial perspective. Royle (2011) added that balance sheet approach is based on some key assumptions and is designed to protect expatriations from cost differences between their home and host countries. In general, the idea of this approach is to provide the expatriate with equivalent purchasing power abroad in order to maintain the standard of living in home country (Overman, 2000). Further various organizations often provide other allowances and perquisites to the expatriate employee. These cover the initial logistics of the international move such as hotel costs while settling in (Rahim, 2012).

This is also the common practice among 70% of European, and 65% of Asian-Pacific organizations use this approach (Schroeder, 2010). Moreover, the recent Worldwide Policy and Practices of over 930 organizations presents that in the year 2010, 80% of corporations in the USA and Japan and 70% in Europe preferred the balance sheet approach of paying expatriates (Friedman, 2010). The advantage of this approach is that, by keeping expatriates in line with conditions at home, they can readily fit back into their home country after their overseas posting. In addition, it enables a company to achieve worldwide consistency in its expatriate employment practices. However, it is not without drawbacks, which will arise when different nationalities work together in similar jobs. Yet there exist solutions to this problem too. For example, Endesa, an electrical company in Spain, gets around this by giving all peer-group expatriates the same host-country element, such as housing or goods and services allowance (Stahl et al., 2012). In management view, this factor can be expensive for an organization and must be carefully developed and managed particularly if they are subject to host country taxation.

Going Rate Approach

The second well known approach in international compensation that organizations can take in order to properly compensate, motivate, and retain employee expatriates is called the going rate approach, which is also known as the ‘localization’, ‘destination’ or ‘host country-based’ approach (Sims & Schraeder, 2005). A compensation approach that pays expatriates the prevailing rate for comparable positions in a host country (Peng, 2010). The multinational usually obtains information from local compensation surveys and must decide whether local nationals, expatriates of the same nationality or expatriates of all nationalities will be the reference point in terms of benchmarking. For instance, a Japanese bank operating in New York would need to decide whether its reference point would be local US salaries, other Japanese competitors in New York, or all foreign banks operating in New York (Dowling et al., 2008). Generally, base pay and benefits are supplemented by additional payments, particularly for expatriates operating in low-pay countries. Carbery and Cross (2013) summarized the benefits and negatives associated with such an approach in table 1.

Table 1: Benefits and Negatives associated with Going Rate Approach

Benefits	Negatives
It is simple to administer It encourages the individual to identify with the host location It ensures equality in terms of pay with local employees and employees of other nationalities (Dowling et al., 2008)	The variation in compensation between assignments for the same individual The variation between individuals of the same nationality in different countries The potential for re-entry problems (Dowling et al., 2008)

Apart from the above-mentioned differences in the two approaches and the related benefits and drawbacks, the going rate approach seems to be more cost-effective than the balance sheet approach. However, no matter which compensation approach is used, the certain basic needs of expatriates should be still met. Organizations should not forget about the daily life challenges faced by employees in a foreign country, and hence there is a need for extra attention to security and different types of allowances for undertaking the assignments (Reiche, 2011).

Conclusion

Today, it is obvious that issues related to expatriate compensation is far more complex. Some organizations are even trying to develop approaches or use a mixed strategy to accommodate employee being relocated on a wide variety of business assignment types. In order to achieve the best results out of the various compensation strategies, implementation and selection of the above-mentioned primary approaches could be a suitable part for organization. This paper was proposed to augment our perceptive to expatriate compensation and using the following recommendations will help the organizations to prepare strategies for the expatriate: (i) the managers should formulate the standard pay policies which will help them to prepare the attractive compensation packages for expatriates; (ii) mix of the two approaches will provide the

organization with the flexibility required to experiment and try different components with less challenges and fear of failure. Given the implications of these considerations, it is clear that this article need more research by the educational scholars, mainly with respect to methodological, empirical studies on the complexities of international compensation.

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