# International Compensation

UNIT 3 (Part III)

Course Code: MGMT4044

Course Title: International Human Resource Management

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# International Compensation

- "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." (Fenwick, 2003)
- Components: Base salary, incentives, allowances & benefits

# Objectives

- 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

# Base Salary

- Amount of money that an expatriate normally receives in his/her home country
- In a domestic context, base salary denotes the amount of cash compensation serving as a benchmark for other compensation elements (such as bonuses and benefits).
- Used to establish expatriate pay
- Paid in home currency, local currency or combination
- Serves as benchmark against which bonuses & benefits are calculated

# Benefits

- constitute a substantial portion - approx. one third of compensation
- Transportability of pension plans, medical coverage & social security coverage are very difficult to deal as national practices varies.
- issues surround the amount & nature of the benefit package for expatriates
  - Whether MNC's should maintain expatriates in home country benefit programs particularly if firm does not receive tax deduction for it
  - Whether MNC has option of enrolling expatriates in host country benefit programs
  - Whether home or host country is responsible for the expatriates social security benefits
  - Whether benefits should be subject to the requirements of home or host 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

# Allowances

Some Common International 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)

# Approaches to Expatriate Compensation

1. **Home-based policy** (the balance sheet approach)
2. **Host-based policy** (going rate approach)
3. **Local Plus approach**

# Home-based policy (the balance sheet approach)

- Home country's salary structure, Financial inducements to home package- Foreign hardship allowance
  - Goods and services– home-country outlays for items food, personal care, clothing, household furnishings, recreation, transportation, medical care
  - Housing – the major costs associated
  - Income taxes – parent-country and host-country income taxes
  - Reserve – contributions to savings, payments for benefits, pension contributions, investments, education expenses, social security taxes
- The Balance Sheet approach preserves equity between international assignees of the same nationality and between assignments
- However, it can create disparities and inequities between PCNs, TCNs and HCNs

# **Host-based policy** (going rate approach)

- Assignee transfers to the host country payroll and receives base and incentive pay based on host country compensation practices and regulations.
- Adopting the same compensation for all countries within a particular region.
- The host-based approach may be a cost-effective option to the traditional home-based approach, including local plus policy components.
- Difficulties can occur in repatriating assignees, if applying this approach, because it integrates employees into the local host salary structure. It can make it very difficult to move the assignees to another destination or back to their home country.
- Another challenge with this approach can be that of defining a region.

# Local Plus approach

- Paid according to the prevailing salary levels of host location plus 'expatriate type' benefits such as assistance with transportation, housing, and dependents' education
  - Benefits may be paid in-kind (directly by the MNE)
  - does not typically include tax equalization, COLA, mobility premiums, hardship allowances, familiarization visits, home leave, cross-cultural training and other pre-departure programs, or spouse assistance
  - Pension benefits are optional depending on the nature of the assignment
- Localization involves integrating the assignee into regional or host country compensation levels and systems to the extent that the law allows.

# 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

1. ad hoc (each expatriate is handled differently)
2. laissez-faire (employees are 'on their own' in conforming to host-country and home-country taxation laws and practices)

# References


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