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The Future of Expatriate Compensation



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Any major organization operating internationally could rely entirely on staff recruited locally. Most do so for the majority of positions. However, most companies also employ expatriates, those who work outside their country of origin, for a variety of reasons. In some cases, these workers fill skill gaps when local staff is unavailable; in other cases, they may be sent to train local staff or to install companywide systems in areas like IT and finance. Some may be sent on developmental assignments to gain skills and experience at an early stage of their careers. Increasingly, part of the motivation is to ensure that the company's future top-management cadre has some international experience.

Whatever the reason for using expatriates, this relatively small group of people takes a disproportionate amount of HR time. In setting pay for key local staff, employers must ensure that they are competitive with the local job market and that they offer challenging jobs within a country with the prospect of advancement within that country. However, this approach is insufficient for expatriates, whom employers must view by reference to different countries — where they originated, where they are currently working, where they will next move and where they will ultimately work. In terms of both pay and career, this perspective means taking into account conditions in at least two, but often more, countries.

Expatriates also cost a lot of money — cost-of-living and housing allowances, travel home at the company’s expense, additional premiums on top of their basic salary and children who must be educated. The overall cost of a typical expatriate assignment can approach \$1 million (Runnion 2005). In addition, the cost of an international assignment is three times that of a local hire, according to a PricewaterhouseCoopers study (*workspan* 2006).

Over the years, companies have struggled to reduce these costs. In general, the only effective means of doing so is to use fewer expatriates, but for a variety of reasons, the trend in most international companies is in the opposite direction. According to ORC’s *2004 Worldwide Survey of International Assignment Policies and Practices*, 44 percent of participants reported the increased use of expatriates, compared with 30 percent, who reported a decrease.

Even the effort to cut costs has started to grind to a halt. Employers already have performed the most obvious cost cutting, and they fear further cuts will exacerbate the difficulty in getting good people to go on assignment in the face of concerns about family and spousal issues, career prospects, security and overall dislocation. Expatriates often fill key roles and have political influence within their companies, so cost reduction is not always an easy sell. While not

typically considered in quite this manner, the relative generosity of expatriate pay packages is largely a question of supply and demand. If there were hordes of well-qualified candidates queuing up to apply for international assignments, the task of cutting costs would be far less challenging.

The practical effect is that we are becalmed. There has been little real innovation in the expatriate compensation field in years. This paper speculates on possible changes in the future and on the forces shaping the field in coming years.

What Factors Will Influence International Compensation?

At the macro level, several likely influences range from worldwide conditions to individual assignee circumstances (See Figure 1).

The World Economy

Organizations need expatriates because they operate on an international basis. The volume of necessary assignees increases with the overall level of global economic activity. More specifically, the particular locations where expatriates are required reflect the openness to inward investment of individual countries and the perceived return of operating in those countries. Many organizations have invested in China,

FIGURE 1 Major Influences on the Future of International Compensation	
▶	Growth and interdependence of the world economy
▶	Stability of the world political system
▶	Continued growth of economic and political integration at bloc level
▶	Need for assignees to fill skill gaps
▶	Degree of compensation and benefits convergence between countries
▶	Degree of convergence in purchasing power between countries
▶	Individual willingness or aversion to international relocation
▶	Cost of relocation in terms of whether it will increase or decrease overall and whether comparative costs by nationality or assignment location will change
▶	Degree that technical change reduces the need to physically relocate staff
▶	Changes in corporate structure and culture
▶	Company tolerance of cost

the United States and Western Europe; few bother to invest in Myanmar or Zimbabwe. Assignment location is a factor in the range of a company's pay options.

Thus, the geographic regions where "foreign direct investment," or FDI, increases most will impact program design. If most investment for the foreseeable future is in less-developed countries like India and China, the scope for innovative pay systems may be smaller than if the main focus is in developed countries. For example, the use of host-based expatriate pay systems is feasible if transfers are between developed countries; transfers on such a basis to countries like India or China are rarely possible.

In a more general sense, the degree that barriers to the flow of people and capital increase or decrease will affect program design. If organizing cross-border transfers is more onerous because of security issues or visa/work permit limitations, then those accepting such assignments will likely be conditioned (at least psychologically) to expect more generous pay packages.

The World Political System

Many foreign investment decisions depend on the expectation of political stability. In regions where such stability is in question, FDI tends to be limited to business areas where a strong reason compels a company to operate (for example, oil exploration). In a broader sense, the assumption that war or major political uncertainty will not disrupt operations encourages investment. On a personal level, too, assignees are more likely to move where the political environment is stable and are likely to demand less generous pay packages than in unstable situations.

Economic and Political Blocs

The removal of economic and trade barriers among groups of countries has led to a growth in employee mobility among those countries. The European Union, with its free movement of labor, is a clear case in point.

To the extent that such groups grow in number and to the degree that those that exist deepen their economic ties, it is likely that the extent of regional mobility will grow.

Skill Gaps

While a variety of reasons exist for companies to send employees abroad, one core motivation is to provide skills in short supply in the assignment location.

To the extent that less-developed countries cannot produce skills in sufficient depth and quantity to meet economic needs, companies must import such skills. As local supply expands, the need decreases; however, it remains likely that specialist skills will always be in international demand.

Converging Pay, Benefits, Purchasing Power

The specific structure of expatriate compensation systems is based fundamentally on the variations between countries in: (1) salary levels and structures and (2) real purchasing power. If there was substantial similarity in pay levels (both gross and net), and net pay purchased a similar standard of living in different countries, moving an employee from country to country would be no more complicated in terms of cash compensation than moving from one job to another within a country. Differences in benefits structures might still involve challenges, but the scope of adjustment to home pay would sharply narrow.

However, gross pay levels do vary between countries, and because tax systems also differ, net pay changes in a pattern that does not necessarily correlate with gross pay. Furthermore, the purchasing power of net pay that is delivered is inconsistent. Thus, employees moving from one country to another on a purely local pay basis are likely to experience their real standard of living rise or fall arbitrarily. Moreover, national salary systems often value job families differently, so an engineer moving between countries may experience a different shift

in purchasing power than a finance manager moving between the same locations.

Even within one country, there can be distortions:

- ▶ Often regional variations exist in pay levels (for example, London versus Yorkshire in England; California versus Arkansas in the United States).
- ▶ Certain countries have a local income tax structure impacting net pay (for example, U.S. state tax; Swiss cantonal tax).
- ▶ Living and housing costs vary in ways that may relate to salary levels but not always in a direct pattern.

If these national differences decrease, some complexities of existing international assignee pay systems disappear. Unfortunately, at best, this situation will only occur within more economically homogeneous regions such as Europe and even there, continuing substantial differences in tax structures and living standards are unlikely to disappear in the short term. Since the largest expansion of assignments is to less-developed countries, the practical situation is that the typical discrepancy between home and host pay levels for assignees is probably greater than 20 years ago.

Barriers to Mobility

Some literature on international relocation seems to assume that potential candidates will welcome the opportunity to advance their careers. In practice, most companies find that a degree of reluctance to move is normal. While some reasons for this hesitation have not changed significantly in recent years, family issues in general, and dual-career concerns in particular, are increasingly limiting mobility. There is evidence that the impact of moving abroad on children's education can be disruptive. The increasing need for many families to care for elderly parents or other relatives could affect willingness to relocate.

However, the specific problem of relocating individuals in a dual-career situation is the main issue, and two points are clear:

- ▶ The incidence of dual-career relationships is increasing in many industrialized countries.
- ▶ A company can provide no effective help if the spouse of a potential transferee has a high-earning job or is on a specific home-based career path. No company can afford to compensate for the highly paid spouse's loss of earnings.

In any case, if relocation's impact is to take a person off the career path, the potential future damage may be every bit as important as the cash loss. Although options such as single-status or shorter-term assignments may be possible, they are often neither practicable in terms of job responsibilities nor desirable for the individuals.

One potential result is that there may be a greater trend to schedule assignments during a career around the "easier" times for transfers. For example, a company may couple early career moves (before family constraints increase) with a trend to later career moves (when children are past school age). There is anecdotal evidence of this pattern, and greater flexibility in assignment timing is likely to be an increasing need.

Relocation Costs

The focus for 20 years often has been on reducing relocation costs, but there has been a recent subtle shift, as the need to attract qualified candidates becomes a more pressing problem. In the near term, costs are unlikely to decline. To the extent that costs increase, companies will no doubt focus on the value and need for an expatriate versus a local employee. Yet while there has been a heavy cost advantage to using local employees, expatriate numbers have remained stubbornly high.

A perceptible trend has become apparent in the use of assignees drawn from less-developed countries that may be intrinsically less costly than those from developed countries. Their starting salary base is lower, and personal expectations may be more modest.

On the other hand, in the next 20 years, as countries like China and India develop, their pay levels relative to the industrialized world likely will increase and sharply reduce this cost advantage.

Technical Change

There has been considerable discussion about “virtual” assignees who have a job in one place but are located elsewhere. Such assignees seem a lot more common in theoretical articles than they are “on the ground.” Functions such as IT may offer scope for such work, but in many jobs, physical presence remains a vital factor.

Corporate Structure and Culture

There are several aspects of this issue. The first is whether companies will continue to want a cadre of key staff with international experience. A driving force in the growth of international mobility has been the perceived need within many companies for future leaders to have worked outside their home countries. In an era of globalization, this preference unlikely will change.

However, a legitimate issue exists in terms of the balance companies wish to strike between having a global and local face. To the extent that reliance on expatriates interferes with the projection of a local leadership structure, some companies possibly will see a need to reduce assignees.

While labor market considerations in different countries largely drive compensation, one also should acknowledge that companies have a degree of control over the pay structure even when they must match a compensation level that is specific to an environment. For example, a company has some latitude in allocating the total compensation package between base pay and incentives and between cash compensation and benefits. Some companies have a strong worldwide pay philosophy, leading them to deviate from typical local practice in one or other of these regards in specific markets. To the extent that companies choose to have

their compensation practices in different countries converge more closely, this action impacts the ease of transferring employees.

Companies also differ in their internal structures and level of development in international business. Some companies are still a “uni-cultural” organization with some international operations. In such cases, a heavy use of outbound assignees from headquarters is common. At the opposite end of the spectrum are those few companies truly operating as global organizations, drawing talent from any geographic area where they operate. In such cases, the type of assignees and assignments are radically different — and more diverse — than in a company at an earlier phase of international activity.

Cost Tolerance

Up to now, while understanding the cost of expatriates, employers have typically accepted it as the price of achieving other necessary or desirable end results. Company tolerance of cost could alter; if cost considerations become a stronger limiting factor on the use of expatriates, it could obviously change the employment landscape.

Possible Scenarios

Given these issues, what are possible future scenarios for the international compensation area? One possibility is a broad continuation of current trends with no dramatic shifts. In this situation, some adjustments at the margin may occur in the way companies handle international compensation, but major innovations are unlikely. If more significant change does occur, it will likely arise as a result of the degree of change in either the supply or demand for expatriates.

The Supply Perspective

On the supply side, there could be a steadily increasing employee resistance to mobility that would reduce the potential candidate pool. The issue of dual-career

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families is creating significant barriers to the acceptance of international assignments. Most companies have tried to introduce policies to address this issue. According to ORC's *2005 Dual Careers and International Assignments Survey*, 65.5 percent of the respondents have a formal written policy in place; 9.1 percent use an informal policy. However, in most cases, it is impossible to ensure that the accompanying spouse with a career can continue to practice that career in the assignment location for two reasons:

- ▶ The likelihood that the career can continue to be pursued depends on having requisite language skills.
- ▶ Differing rules exist for the recognition of professional qualifications between countries; in some fields, such as law, experience in one legal system may not enable a person to practice in another.

Even if it is possible to practice the career in the assignment country, it is not a sufficient condition to ensure that the work experience contributes to furthering the spouse's career in the home location.

Dual-career issues are not the only barriers to mobility. Increasing concerns about the impact of mobility on children's education, particularly at certain points in their school life, can also come into play.

Other family and cultural issues, such as the need to care for elderly relatives or parents, could also be influential.

If the supply of qualified candidates does decrease, several probable consequences are likely:

- ▶ Companies will have to pay more generously to persuade assignees to accept international moves.
- ▶ There will be a stronger push to explore alternatives to conventional multiyear assignments (when the transferee is accompanied by family members). More single-status assignments could result, and shorter-term or commuter assignments also are likely to grow in popularity. However, these are not a solution for many assignee jobs.

It could be argued that there are factors pushing supply upwards. If companies can convince potential assignees of the long-term career value of international experience, that would be a major incentive to accept an assignment. If domestic employment in a company is at risk, working in an international position may seem a more-attractive option.

The Demand Perspective

On the demand side, one possible scenario is greater economic disruption worldwide or increased protectionism possibly reducing world economic activity and resulting in a decline in the potential need for deploying assignees. While this idea is inconsistent with current trends, stability in the world economy is by no means ensured. The rising economic importance of China, for example, could lead to a reaction when industrialized countries move in a more protectionist direction. Economic nationalism is never far below the surface. A possible takeover of a French company by an American company produces a political outcry in France; a possible takeover of an American company by a Chinese company produces an ironically similar outcry.

On the demand side, it is perhaps a more likely scenario that companies become more resistant to the high costs of expatriates. Since assignees in part

fill skill gaps, the increased focus of education and training in countries like India and China on needed technical and managerial skills could reduce the need to import expatriates.

Several scenarios can coexist at the same time. Overall, it is reasonable to think that the most likely scenario is that the supply of assignees becomes tighter while demand is maintained or increased. If so, what is the implication for expatriate management and compensation policy?

Possible Changes in Expatriate Compensation

The key considerations for any adjustment to international compensation methodology involve the use of host pay and/or multiple compensation systems within a company, pay-equity issues, global talent management and the growing complexity of assignment parameters.

Host Pay

A most debated aspect of international compensation involves the degree it is feasible to pay assignees on host packages rather than on a home-country basis, at least for selected markets. If pay structures converge and/or if companies simply become more willing to use such approaches, it would represent a potential major change in the expatriate compensation field. However, if the demand for assignees is increasing and the supply is restricted, the approach will only work in those limited circumstances when a sufficiently generous incentive to transfer results. In some companies, the impact of international experience in an early career may be sufficiently beneficial that the cash package can be more modest. For most skill transfers, however, this occurrence is probably unlikely.

Multiple Approaches

While some companies have been comfortable with multiple compensation approaches for different employee groups or geographies, others have felt that consistency across assignee groups was more important. In recent

years, the balance seems to have shifted, and a more noticeable trend evolved toward companies tailoring the assignee package to reflect different needs. While limitations exist on the supply side, the need to target expenditure in expatriate programs to produce the best return is likely to push compensation policies further in the direction of differentiation rather than a “one size fits all.”

Equity Considerations

An underlying problem in expatriate compensation is its extreme difficulty in meeting the various demands for “equity” among employee groups. For any assignee, a company can aim to achieve equity with any number of groups: the employee’s peers at home, local peers in the assignment location or other expatriates. The problem is that no single compensation system can achieve these objectives simultaneously. The biggest clash arises when a company’s desire to show a local face in a country conflicts with the need to attract assignees to move into the location. While each organization strives to find its own balance, it is reasonable to speculate that the equity-balancing act will exist for the foreseeable future.

Integration of Expatriate Management and Global Talent Management (GTM)

A major disconnect within most companies is between their expatriate and GTM programs. The level of “compensation” for an assignee (in the broadest sense) covers both immediate financial reward and the real (but less tangible) future career benefit. To the extent that companies can do a better job of ensuring that international assignments really do contribute to long-term career progression, they could reduce the level of direct cash compensation.

However, it will take time for companies to reap the benefits of improvements in this area. Essentially, potential assignees will want demonstrable examples of the career benefits before they are likely to believe promises. Thus, companies must not only deliver the career advantage but

also do a more effective job of communicating what they have achieved to others in the organization.


Assignment Patterns

One area of potential change that can be predicted involves assignment patterns in terms of length, frequency and other factors. There has been a steady trend toward the use of short-term assignments (typically three to 12 months). Even for the traditional longer-term assignment (two to five years), general movement has been toward a shorter duration. In policy and pay terms, most organizations treat short-term assignees somewhat differently from other expatriates and that will continue.

It is also possible that there will be an increased number of employees who are part of a highly mobile international cadre and are expected to have multiple assignments during their career. While such a group is likely to be a minority in the total expatriate population, an increase in their use could force companies to develop separate pay policies to reflect this group's particular needs.

Meeting the Challenge with Openness to Creative Solutions

Expatriate compensation is likely to remain a particularly difficult issue within the HR field. Few company officials are entirely satisfied with their current policies, but few see obvious alternatives. The underlying issues of assignee supply and demand will provide the basic parameters in determining how much freedom organizations have to change current practices.

The most probable development is in the direction of greater multiplicity of pay approaches within any organization. Although that constitutes a logical response to external developments, it also creates its own set of management challenges. While the desire for greater simplicity in pay systems is a constant theme, the future is likely to see quite the opposite. 

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