Ethical Dilemmas in International Compensation

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Abstract

The main thrust of the paper is to unravel the various ethical dilemmas in international compensation that shroud and therefore make the job of Multinational Corporations' (MNCs') HR managers daunting. The paper draws substantially on research conducted over the last twenty years to see if any progress has been made towards restructuring compensation and reward systems among the three types of MNCs' employees (PCNs, TCNs and HCNs). We are also interested in how international compensation is practiced among the three types of labor pools of managers regardless of nationality in an MNC. The paper concludes that MNCs have three options of recruiting staff from PCNs, HCNs or TCNs. These options often result in significant difficulties and differences like BSA, HBA and GMA. Also, variations in culture, economic development, laws and regulations, labor unions and living standards are some of the worst culprits responsible for these difficulties. The paper therefore recommends that MNCs should be cost effective in selecting technically competent people by balancing business objectives, goals and budgets with the compensation programs; narrow the gap by developing a balanced pay and reward systems that consider cultural, socio-economic and legal variations.

Keywords: International compensation, ethical dilemmas, Multinational corporations, parent country nationals, host country nationals, third country nationals, balance sheet approach, host-country approach, global market approach.

Introduction

The growth of the global economy has increasingly pushed Multinational Corporations (MNCs) into all corners of the world. This internationalization of business and employment is reaching a dramatic dimension in the 21st century. Overseas investments by American MNCs for example, have increased tenfold during the past decade. During the same period, the number of foreign-owned domestic firms has increased by 300 percent (Gomez-Mejia and Balkin, 1991).

Colgate – Palm Olive has operations in 194 countries, AT & T has 52,000 employees overseas working in 105 countries, and McDonald's International is operating 22,000 restaurants in 106 countries. In China alone, McDonald's International increased its operations from a single location to more than 130 restaurants in Beijing, China in just three years; it has 3 restaurants in Moscow, with the Pushkin Square having the distinction of being the busiest McDonald's in the world. The vast majority of McDonald's workforces are host – country nationals (French, 1998 & Fisher et al, 1999). Nike and Reebok also manufacture all their shoes overseas in plants owned and operated by foreign companies. Because of these factors, the total number of international workforces directly employed by U.S companies may understate the extent to which manufacturing capacity and the employment base has shifted abroad (McFarlin & Sweeney, 1998). Other companies with such investments include Procter and Gamble (P&G), International Business Machine (IBM) and Citibank.

Ford motor company has had successful businesses in Europe for many years and today the company employs less than half of its total workforce on U.S. soil. General Motors – Europe has also had strong sales in Europe since 1985 (Moorhead & Griffin, 1998). More than 75 percent of the employees of Gillette work outside the United States and more than 70 percent of profits come from overseas sales. Mobil, Citicorp, Motorola, Coca-Cola and Pepsi are also dramatically increasing their international investment and revenues, with Coca-Cola and Pepsi receiving more than half their revenues from operations outside the United States (Bernadin & Russell, 1998; Robbins, 1997).

Mobil, Texaco and Exxon had to increase their international market share to keep pace with foreign competitors such as British Petroleum and Royal Dutch Shell (Moorhead & Griffin, 1998). Overall, it is estimated that more than 60 million workers are employed in more than 100,000 U.S. companies now doing business overseas (Bernadin & Russell, 1998).

On the other hand, many foreign – owned firms are entering the U.S. market place. For example, General Tire, Pillsbury, CBS Records are actually foreign – owned. Japanese and German automobile firms such as Toyota, Nissan, BMW and Mercedes are selecting and training American labor force to fit the standards and procedures preferred by the foreign parent company (Moorhead & Griffin, 1998). These foreign firms employ more than three million Americans or approximately 10 percent of the manufacturing workforce in the U.S. In all, there are more than 37,000 MNCs doing business around the world and they employ a total of 73 million people (French, 1998).

Included in this growing number of workforce are three types of MNC employees: (i) recruited expatriates – called Parent Country Nationals (NCNs) – from the regular organizations, (ii) the creation of an international cadre of managers, professional and workers of very diverse cultural backgrounds from (amongst) Host Country Nationals (HCNs) and (iii)Third Country Nationals (TCNs) (Haile, 2002:1-3).

As already observed, these three types of employee groups have very different cultural backgrounds. Therefore, MNC's HR managers must coordinate policies and procedures to manage from the firm's home country as well as in subsidiaries around the world in shaping international compensation and reward systems. It is expected that these policies and practices will effectively balance the needs and desires of HCNs, PCNs and TCNs as well (Fisher et al, 1999). Failure to recognize these differences in managing the compensation systems of human resources in the international environment results in major difficulties and controversies in international operations (Desatnick & Bennett, 1978).

Statement of the Problem

MNCs employing HCNs, PCNs and TCNs often face challenges and risks when it comes to decision making on how to compensate and reward in each of their operating countries. As a result, international compensation systems are becoming more and more challenging issues for MNCs' HR managers. Do they "do as the Romans do" by applying local practices of compensation or do they seek to create a "standardized global framework" in an effort to standardize pay practices? Further compounding the problem is the diversity in political systems, laws, and customs. The MNCs' HR managers are confronted with diverse cultures, levels of economic development, laws and regulations, roles of labor unions and standards of living. Even fluctuations in the value of the U.S. dollar must be tracked and adjustments made as the dollar rises or falls in relation to currency rates in other countries. In addition to the aforementioned concerns is the need to compensate employees for the costs of housing, schooling of children and yearly transportation home for themselves and their family members. These different factors within the international community affect international compensation systems. As a result, finding the right method for MNCs to determine a compensation package in an international market is simply becoming a nightmare (Wetlaufer, 1996; Cullen, 1999). What then should be the position of the MNCs' HR managers? The main thrust of this paper therefore is to critically examine the ethical dilemmas MNCs' HR managers face in applying various methods of international compensation. A theoretical approach based on review of existing literature and research evidences are hereunder carried out to highlight the salient issues inherent in international compensation.

Extant Literature

As MNCs expand internationally, whether through growth, acquisition or cross-national alliance, the autonomy of their international operations can result in significant differences in the levels and types of compensation and benefits programs provided by each country or region. MNCs are doing business in all locations with diverse culture, economic development, laws and regulations, the role of labor unions, and standards of living. For example, union influences may play an important role in determining wage policies in some countries such as Australia where the Australian government and unions negotiate pay rates for workers that apply nationwide. Also, in Hong Kong, by contrast, labor unions are extremely weak and wage rates are determined by the free market (Fisher et al, 1999). All these different factors within the international community affect international compensation systems. Therefore, finding the right method for MNCs to determine a compensation package in an international market is simply becoming a nightmare (Wetlaufer, 1996, Cullen 1999).

Expatriate Compensation Approaches

There are a few methods commonly used to determine global compensation and they include but not limited to the following (Royle, 2011:1):

The Balance Sheet Approach

The Balance Sheet Approach (BSA) or the home – based approach is the most popular approach and it is used by more than 85% of U.S. multinational companies (Sherman, 1998). The BSA is also by far, the most commonly used method by European, and increasingly, Japanese global organizations to compensate expatriates (Haile, 2002:16). This approach provides international employees with a compensation package that equalizes cost differences between the international assignment in the home country of the individual or the organization. In other words, the BSA is based on some key assumptions and is designed to protect expatriates from cost differences between their home and host countries. (Royle, 2011:1).

The primary objective of the BSA is to ensure that expatriates neither gain nor lose financially compared with their home – country peers. The balance sheet facilitates mobility among the expatriate staff in the most cost – effective way possible (Reynolds, 1995). It starts with a home – country salary (wherever that home base is) and builds upon that foundation (Reynolds, 1977). Non monetary differences in the attractiveness of individual assignments (if they are not already reflected in base pay) may be compensated with separate allowances (premiums) and incentives. For example, expatriates often receive ‘hardship’ allowances if they are sent to culturally deprived locations, those with health or safety problems, or other unusual conditions (Bensimon, 1998:20-24).

Cascio (2003:642-649) observes that two philosophies characterize the balance-sheet approach viz: protection (paying expatriates the supplements in home – country currencies) and equalization or “split pay” where the employer pays the reserve in home – country currency after deducting home-country norms from the expatriate’s salary for income taxes, housing, and goods and services. The company pays all income taxes through the expatriate while making payments to the expatriate in local currency to provide housing and purchasing power for goods and services comparable to the purchasing power of a home-country peer. Cascio goes further to observe that the most important advantages of the BSA are the preservation of the purchasing power of expatriates in a cost-effective manner and the facilitation of mobility among expatriates.

Host-Based Approach

The Host-Based Approach (HBA) means the assignee transfers (or revert) to the host country payroll and receives based and incentive pay based on host country compensation practices and regulations. There are limited, if any, assignment related allowances (Royle, 2011). HBA implies paying a Saudi a British salary and benefits in London, and an American an Argentine package in Buenos Aires. Salary and benefits may be supplemented with one-time or temporary transition payments. HBA works well under certain conditions, for example when transferring an employee with very limited home-country experience, such as a recent college graduate to a developed country. It also works well in the case of permanent, indefinite, or extremely long (for example, 10 years) transfers to another country (Cascio, 2003:640).

Global Market Approach

Under the Global Market Approach (GMA), all assignees are on the equivalent compensation scale, regardless of their home country. This approach is much more inclusive. Regardless of which country the assignee is assigned, the main benefits are provided. Unlike the BSA, a global market approach to compensation requires the international assignment be viewed as continuous, even though the assignment may be for various periods of time and the employee may be in various countries (Royle, 2011:1).

Higher – of – Home – or – host compensation

This approach according to Cascio (2003:640), localizes expatriates in the host – country salary program, but establishes a compensation floor based on home – country compensation so that expatriates never receive less than they would be paid at home for a comparable position. Cascio goes further to explain that this approach is frequently used for transfers within regions – notably in Latin America and in the European Union – and for assignments of unlimited duration. It is less appropriate for an expatriate on a series of assignments of 2 – 3 years.

Intricacies in International Compensation and Benefits Systems

As MNCs expand internationally, whether through growth, acquisition or cross – national alliance the autonomy of their international operations can result in significant differences in the levels and types of compensation and benefits programs provided by each country or region. Managing such compensation practices in MNCs has therefore became challenging as HR and compensation professionals find themselves faced with the daunting task of managing compensation practices across multiple jurisdictions on a regular basis (Haile, 2002:9; Eandi, 2013:1).

As already observed, MNCs are doing business in all locations with diverse culture, economic development, laws and regulations, the role of labor unions and standards of living. For example, union influences may play serious conflicting roles in determining wage policies in some countries such as Australia where the Australian government and unions negotiate pay rates for workers that apply nationwide. Also, in Hongkong by contrast, labor unions are extremely weak, and wage rates are solely determined by the free market (Fisher et al, 1999). All such diversities within the international community affect international compensation systems and have made the discovery of the right method for MNCs to determine a compensation package in an international market a nightmare (Wetlauter, 1996).

As a result of the aforementioned diversity, the traditional function of pay to attract, retain and motivate has shifted from the attraction and retention functions to the motivation function. For the Americans, money is likely to be the driving force even though no financial incentives such as prestige, independence and influence may be motivators. Other cultures are more likely to emphasize respect, family, job security, a satisfying personal life, social acceptance, advancement or power. Since there are many alternatives to money, the role is to match the reward with values of the culture (Sherman et al, 1998).

Another complexity is the need to create a linkage between International Human Resource Management (IHRM) and MNC strategy (Welch, 1994). A successful compensation strategy is expected to keep expatriates motivated while meeting MNC goals and budgets. It is expected that MNCs' HR managers should build an expatriate pay package by: (1) meeting corporate goals at home and abroad, (2) keeping expatriates motivated, and (3) complying with company budgets (Latta, 1998). This strategic perspective on the linkage between IHRM and strategy is so critical for an MNC's success but socio-economic and political diversities hardly allow this HR linkage to create the much needed synergy among business objectives, staffing and compensation.

It has also become very clear that with increased globalization of businesses, the compensation of international managers and conditions of employment differ significantly among various labor pools of nationality categories of employees and also varies among MNCs (Sherman, 1998). These differences produce intense internal conflicts within MNCs at any stage of globalization. Compensation includes wages and salaries, incentives such as bonuses, and benefits such as retirement contributions. There are wide variations both between countries and among organizations within countries concerning how to compensate workers. The principal problem is salary level for the same job and the jobs are different between countries in which an MNC operates (Haile as cited in Cascio, 1998).

Gomez – Mejia (1998) observes that the cost of labor (both direct and indirect compensation) is one of the biggest motivators for international business expansion and MNC's HR managers can use compensation packages to enhance the effectiveness of expatriate assignments. However, such compensation policies can create conflict if local nationals compare their pay a package to the expatriate's and conclude that they are being treated unfairly. In most (if not all) cases the compensation package structured for an expatriate (of a PCN or TCN) is more complex and expensive than that of the HCN. Expatriate pay systems are often very different from those used for host country employees within a subsidiary. In some cases, expatriate employees make more money than HCNs who have jobs of equal or greater importance and complexity. These differences often result in host country employees feeling that they are being treated unfairly (Fisher et al 1999). This situation, in the words of Wederpabn (1991) can "create resentment and envy on the part of HCN managers and lower their morale and productivity". Yet, the mind boggling question that readily comes to mind is: should MNCs' HR managers pay the three types of employee groups who do the same work the same pay regardless of the host – country compensation environment?

Why doesn't one size fit all? Why not treat all employees in the same fashion, no matter where they are working; after all, they all belong to the same company?

Csizmar (2013:2) is quick to answer these 2 – why questions by advancing variations in economy, culture, competition and representations (by Unions or Work Councils) as reasons. In Csizmar's words, if you force international operating units to convert their practices to a common format and methodology, the result could be more than just confusion and local administrative difficulties. It could also mean the greater likelihood of over payments in some quarters while paying less in others – all for the sake of sameness and common report generation. This would offer a combination of hurting employees and a hurting business.

On the other hand, how can a company profess to have global operations while clinging to its country-centric mode of dealing with its overseas employees? Every country is a separate and unique entity with differences in HR policy practices, taxation, local competitiveness and statutory requirements, each of which must be acknowledged and addressed in order to develop and maintain a successful operation. In addition to these are the vagaries of the market place, where the same job is paid differently from Rome to Oslo to Buenos Aires – and typically coupled with differing social charges and benefit coverage. Csizmar (2013b:1) observes that choosing to operate under the guidance of the U.S employment law and US – based corporate practices ("what we do at home") is a failed strategy. According to Csizmar, maintaining such a US focus (usually for ease of administration) will bring you grief; grief from your employees, from those you hope to hire, and most worrisome of all from local governments whose laws you may have ignored or bypassed.

Csizmar (2013a:1) asserts that the MNCs' HR managers are often faced with a dearth of information when pricing international jobs. Information is often lacking as there is limited industry segmentation, hardship in segmenting information based on revenue size, absence of clear distinction between national, regional and global responsibilities and regional variations. The challenge is to balance an understanding of the subject position, the industry and the vagaries of limited data points. As Csizmar observes, "the correct answer will no longer jump off the page at you…and compensation has become an art not a science".

In IHRM, HR managers of small companies often send employees overseas with little more than a verbal agreement and a series of vague assurances. In doing so, these organizations try to avoid bureaucracy and move quickly. However, in most cases such casual and hurried arrangements have proven painful and expensive experiences for all concerned as they manifest in the following ways (Csizmar, 2013c:2):

- The shock employees and their families faced when they came to grips with actually living in a foreign country as against simply visiting.
- The constancy of unforeseen and confusing localized situations (medical claims, driving licenses, bank accounts, schooling, language, etc) proved such a frustrating distraction for the employee that they lost focus on the job.
- Relationships with headquarters suffered as the employee asked for more and more consideration to redress what they considered coverage gaps in their terms and conditions.

Assessing the inherent risks that accompany an undocumented assignment, MNCs that send employees overseas without international assignment letters should be prepared for unplanned additional costs, constant re-negotiations with the expatriate, disgruntled employees and affected family members, and greater risk of assignment failure.

Designing programs to recognize and reward an employee's extraordinary achievement is also becoming a daunting task for MNCs' HR managers. This is so because of the cultural implications of these programs and because not everyone thinks the same way. Companies with a truly global operating mindset will take into account national and cultural differences that distinguish their widespread employee populations. On the other hand, domestic – oriented organizations with international operations often struggle with their view point, preferring a standardized strategy. One size rarely fits all. One size rarely pleases everyone. It is possible to assume that the positive aspects of employee recognition programs are a universally accepted principle, but that may only be partially correct. Critical distinctions do exist (Csizmar, 2013d:1).

In some cultures or national identities, the role of the team is such a core element of employment identification that seeking out an individual contributor for recognition would not be a welcome practice. Some employees may be reluctant to step forward, not wanting to be pushed into the spotlight. In other countries it has been discovered that the perceived value of cash as a recognition award varies a great deal (Csizmar, 2013d:1).

While MNCs continue to try new strategies for employing talent overseas (shorter assignments, use of third country nationals, extended business trips, shared responsibilities, etc) one premise remains: the cost of those assignments will continue to be a" big pill to swallow". If a MNC accepts the premise that an employee sent overseas should be kept "whole" (expensive – wise) with their home country situation (maintaining their income and expense exposure as if they had never left their home country) then certain liabilities naturally fall to the company. For example the US is one of the few countries in the world where – no matter where you work – you continue to incur a tax liability on your earnings – while also being liable for earned income taxes in the host country as well. It is usually tough to note that such additional tax liability would ultimately be paid by the company (Csizmar, 2013e:1).

Also, when establishing the terms and condition that will govern an international assignment, the company provides the employee beyond what they would have received had they remained in their home country. These extras are also taxable income. For example, such taxable items would include, but not limited to: Home leave transportation, Cost of Living Allowances (COLA) housing allowances, utility payments and supplementary benefits (for example, national Health Service) (Csizmar, 2013e).

To compound the aforementioned internal challenge, Csizmir (2013e:2) observes that "too many managers know too little about the true costs of assignments. This ignorance leads to misconceptions, misleading comments to employees and in some cases a too casual consideration of costs like:

- "They speak English, so just get on the plane". It is a common refrain, as if we all have the same legal system, healthcare, work attitudes, etc., and any minor differences could be solved by a short conversation.
- "The money has been budgeted". A classic excuse, as if that in any way justifies an expense.
- "Let us go around company policy to save money". Short term thinking (and shortcuts) that more often results in a failed assignment. And how expensive is that going to be? Asked Csizmar (2013e:2).

Conclusion

MNCs' HR managers face three basic options for recruiting staff to manage their international operations: (i) send someone from the PCNs, (ii) hire someone from the HNCs, or (iii) hire someone from TCNs. These options result in significant differences in the levels and types of compensation and benefit programs provided by each country or region namely: BSA, HBA and GMA. The worst culprits responsible for variations in the levels and types of compensation programs are diversity in culture, economic development, laws and regulations, the role of labor unions and standard of living. The other is the variations in motivational factors from one country to the other. Such variations in international compensations are the cause of intense internal conflicts when local nationals compare their pay packages with expatriate's and conclude that they are treated unfairly. This creates resentment and envy on the part of the HCN managers and lowers their morale and productivity.

On the other hand, when international operating units are forced to convert their practices to a common format and methodology, the result could be more than just confusion and local administrative difficulties resulting to greater likelihood of over payments and underpayments in some quarters. This offers a combination of hurting employees while also hurting the business.

The dearth of information faced by MNCs' HR managers in pricing international jobs had made international compensation an art rather than a science. Also, failure by some MNCs (especially, small ones) to issue international assignment letters to employees can lead to unplanned additional costs for employers, constant shock for employees and their families, frustrating distractions as employees face unforeseen and confused localized situations (medical claims, driving licenses, bank accounts, schooling, language, etc). Finally, certain liabilities naturally fall to the MNCs who insist that employees sent overseas be kept whole (expensive – wise) by maintaining their income as if they had never left their home country.

Recommendations

1. MNC's HR managers should staff their international business operations with personnel who are technically competent, culturally proficient and cost – effective regardless of whether the people are PCNs, HCNs, or TCNs.
2. MNCs should balance business objectives, goals and budgets with their compensation programs (linkage between IHRM and Business strategy). MNC's HR managers should build an expatriate pay package by (i) Meeting corporate goals at home and abroad, (ii) keeping expatriates motivated, and (iii) complying with company budgets.
3. Since different countries have different norms for employee compensation, MNCs' HR managers should carefully consider the motivational use of incentives and reward among employees of different countries. In countries where money is the driving force, such rewards should be given while other means be awarded in countries with cultures that emphasize respect, family, job security, a satisfying personal life, social acceptance, advancement or power.
4. MNCs' HR managers should narrow the gap by developing a balanced pay system for the three types of employee groups who do the same work by standardizing the value of jobs irrespective of locale; pay mix (of base salary and incentives like 80/20, 70/30, 60/40, etc); universal date of pay increases (everyone's performance be reviewed on the same date); average pay increase percentages, regardless of local conditions; and pay-for-performance versus general adjustment increases.
5. MNCs' HR managers – when handling the problem of dearth of information for pricing international jobs should utilize subjectivity and professional judgment to consider the available data and gauge which figures best reflect the job under review.
6. Since every country is a separate and unique entity with differences in HR policies, practices, taxation, local competitiveness and statutory requirements, MNCs' HR managers should acknowledge and address such issues when pricing international jobs.
7. MNC HR managers should provide international assignment letters to employees for confirmation and clarification of assignment terms and conditions and the definition of company – paid expenses.

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