Brookfield Global Relocation Services

Strategic Advisor

Local Plus: Winning the Compensation Battle But Losing the Talent War

Brookfield Global Relocation Services (Brookfield GRS) has invited the respected expert, Dr. Yvonne McNulty, to examine this conundrum for our readers. Using data from her new book, Managing Expatriates: A Return on Investment Approach (Business Expert Press, 2013), McNulty provides an in-depth understanding of the issues corporate expatriates and their companies face in relation to compensation.

The Battle and the War
The retention of key talent is a critical issue for many companies. It would be logical to think that the desire to retain talent would drive compensation up but, in fact, research shows that failure to retain key talent is often linked to companies feeling pressure to cap compensation levels as well as overall assignment costs. Yet expatriates do not seek or accept international assignments purely for financial reasons and there are other important, non-financial considerations when making a decision to take an assignment. So why then is compensation such a big source of dissatisfaction? And what happens when companies win the battle, but lose the compensation ‘war’? This article gets to the bottom of this conundrum to show how expatriate compensation has changed over the past two decades, and why the rapid increase in local-plus and other hybrid host-based packages, can be both a useful tool but, if not properly understood, a disaster.

Expatriate compensation is complex; complicated in part by fluctuating exchange rates, inflation both at home and in the assignment location, challenging locations, and the recruitment of expatriates in, to and from new emerging markets. Many mobility managers report compensation packages as the biggest area where assignee expectations are not met, largely because the fierce competition for global talent has not driven expat packages up as one would logically expect, but has driven them down. One area where we see these changes is in the introduction of local-plus compensation.

Local-plus is a relatively new approach in which expatriate employees are paid according to the salary levels, structure and administration guidelines of the host location, as well as being provided, in recognition of the employee’s foreign status, with special expatriate benefits such as transportation, housing, and the costs of dependent children’s education. It is worth noting that not all expatriates on local-plus receive the full range of additional benefits, these being at the discretion of the employing organization and largely determined by the location of the assignment (e.g. hardship versus non-hardship location), among other factors.

The table below illustrates this trend, showing an overview of compensation strategies, some of which are well established. Our focus is the third category of package, “local-plus” which has emerged as a viable and popular alternative to the traditional balance sheet approach because costs associated with that traditional approach to global mobility are prohibitive for many companies. The typical response to managing these costs is to engage in cost-cutting, often in a non-strategic way, that may have unintended consequences as we shall see. So while the typical reasons for needing expatriates (e.g. knowledge and skills transfer, global control and culture, career development) remain valid, there are more localized and local-plus assignees that have a similar skill level to those on the balance sheet approach that often makes the need for “full package” expatriates redundant.

Incentives and Motivations
Consider also that expatriates have many non-financial reasons why they choose to engage in global mobility. Career enhancement and progression, seeking a personal or family adventure, and fulfilling a lifelong dream are all among the reasons that may drive the desire to accept a position abroad. This tells us a lot about modern expatriation, that we are witnessing a change in the drivers that motivate expatriates to go abroad, with corresponding changes in companies’ strategies to attract the right people into global employment. Gone is the need to provide fat compensation packages for every assignment to create a “home away from home” as an incentive to accept an international assignment. What does this mean?
Let's consider that for decades, many have believed that the fundamental driver for expatriates to accept international assignments has been financial gain, mostly as a result of the substantial benefits and allowances they receive over and above base salary. Included in these traditional packages were COLA, hardship premiums, relocation bonuses, lifestyle allowances (housing, schooling, car), and other perquisites (country club memberships, home leave, home-country storage costs, and home sale reimbursement). To be fair, for many years, this was a major reason why expatriates agreed to go: few people are willing to uproot their lives, families, established networks and familiarity of home to simply “break even” in terms of home-country salary.

Money clearly does matter to some extent – expatriates, like everyone else, need to earn their keep, pay their bills, and support their families. Expatriation is often a fast-track way to earn more money more quickly to meet this need, and sometimes to save money as well, making mobility attractive to many employees, at least in the short term. But still, money may not be everything. In fact, I found in my research that many expatriates were clear they would not compromise on things such as family support, security and safety (especially after 9/11), quality of life, and work/life balance, with job guarantees upon returning to the home country, partner support, and children’s schooling ranking as important incentives to accept an assignment. On these issues, expatriates expect companies to overcome their unbending view of money as a “means to an end”, to instead help them maintain some semblance of home-country (or equivalent) standards in areas such as housing for their family, medical care, and education for their children. One participant, a China-based expatriate from New Zealand, made this point clear when he explained a planned move to South Korea:

I talked about the move with my wife and daughter and we agreed it’s a good job and it pays more money. However, the American school there doesn’t have a good reputation. So I went to see the CEO and I said, “I’ll think about that job. However, in order for me to make a decision you need to break the rules a bit and I need you to agree to provide my wife and daughter with accommodation in China for one more year so she can finish her last year in high school there. I need you to agree to keep my daughter in the American school in China, and I will need a two-bedroom flat in Seoul as well, so that when they visit there’s somewhere for them to stay”. Effectively I asked for two apartments. And the answer was “yes.” I know that’s breaking the rules but that’s how I think things should be done – it should be based on circumstances.

Why Local-Plus Will Dominate Expatriate Compensation

To be absolutely sure, the trend to local-plus in expatriate compensation is here to stay. This is mostly because the balance sheet approach is becoming not only an outdated and overly expensive model, but is ineffective for moving companies’ global competitive advantage to where it should be. Think about it: the balance sheet approach is based on a repatriation model that insists on maintaining a link to expatriates’ home-country or headquarters, despite the fact that many expatriates may never return there. As a result, if compensation is strategically geared towards an expatriate who will one day return to their home-country, it is not then capable of effectively supporting the high demand for career expatriates whose continual movement across borders – often over decades – helps to facilitate true global staffing. A further disadvantage for the career expatriate is that the...
balance sheet approach also does not enable expatriates to fully acculturate to local norms and customs.

Let’s consider that one of the main problems associated with the balance sheet approach is the disparity between how traditional full-package expatriates and local foreign hires are compensated, often for doing the same job. Both are expatriates, neither are locals, yet the former are nearly always paid on the basis of the balance sheet approach, and the latter frequently on a local-plus package, predominantly because local foreign hires typically have few, if any, home-country links. But if local foreign hires can do the same job for half the cost, then a radical shake-up in expatriate compensation is overdue to ensure that a small link to the headquarters or home-country standard of living is maintained, but a larger emphasis is placed on the local market context which expatriates are sent to support. Put simply: expatriate compensation needs to move away from being based exclusively on assignee or home-country status, and instead on the role that expatriates perform. This is because it is the worth of the position that should be aligned to strategic objectives, not whether an employee has assignee status. Expatriates need to be compensated not because of who they are, but according to what they are expected to, and do, achieve.

While local-plus reduces expatriates’ overall compensation, one clear advantage in using it is that it allows organizations to expand their global talent pool. They do this by targeting candidates who are eager to pursue international and global careers and who are willing to expatriate not just because of the compensation being offered, but often in spite of it. This includes career and self-initiated expatriates, many of whom have already acquired the intercultural competencies, cultural intelligence, and language abilities necessary to succeed in an international role, and who also have the necessary desire, skills, and attitudes. This resembles less the ‘traditional’ approach that has been the mainstay of expatriation for decades, and moves instead towards a more innovative and strategic ‘global talent’ approach that is customized according to the demand, location, cost, and other strategic and operational concerns of the company.

From this perspective, local-plus compensation is clearly a more cost-effective means by which companies can manage various types of expatriate staff, while simultaneously attempting to meet their organizational objectives. But in advocating a local-plus approach, it is not suggested that expatriates should be treated like local host-country or domestic employees: clearly expatriates of all types incur more substantial expenses and greater disruption to their lives than employees who choose not to accept an international assignment. As such, they should be compensated accordingly and subjected to a different set of policies, but only insofar as the compensation approach remains appropriate to the jobs that expatriates actually do, rather than the status they hold because of their home-country.

The Opportunity Cost of Local-Plus

Despite the growing prevalence and many advantages of local-plus terms and conditions, it can also be a problematic compensation method that, from a return on investment (ROI) perspective, requires extremely careful management.

The reason for reaching this conclusion is that, in my research, expatriates expressed very negative views about having their compensation status altered to local-plus. The most significant issue they raised was that companies often change compensation contracts during an assignment (e.g. by withdrawing or reducing a housing allowance, school allowance, or home leave), leaving many expatriates feeling that they are backed into a corner because they are forced to accept changed conditions when an international assignment is already under way. Others resent that once they are established as career expatriates, companies ‘move the goal posts’ by reducing compensation packages at the point of re-assignment or assignment extension. Doing so creates a heightened sense of unjustified loss for those expatriates forced onto local-plus compensation, not necessarily because they are unhappy with the package, but because they are unhappy with the process. One participant summed it up by stating,

I know it’s easy to dwell on the negatives. I mean at the end of the day, it’s a pretty good deal. We send our kids to the best school, we get a company car. There are a lot of good things. What it boils down to really is ‘process untidiness’. The tension would be much less if there was a clearer dialogue between the company and me when changes in compensation are underway.

The advice then is that more transparency is clearly needed. We need to remember, too, that when expatriates perceive that an ‘unjustified loss’ has occurred in their compensation, there are ramifications. My research shows, for example, that when changes in expatriates’ compensation are made during an assignment, there is likely to be a clear and direct psychological shift in their loyalty and commitment to the company; local-plus compensation increases their willingness to change jobs because money is no longer the defining factor that binds them to their employers. Essentially, reduced compensation reduces loyalty thus leading to less job commitment; money can be found anywhere, even – and perhaps especially – on the international labor market.

The most important take-away, then, is that whereas generous packages bind expatriates to their firm, local-plus puts expatriates on a level playing field akin to their domestic counterparts, meaning that job movement in and out of the organization can be facilitated with greater ease. The opportunity cost of local-plus, therefore, is that because it provides fewer ties that bind expatriates to their employers financially, it facilitates higher levels of risk taking on their part; because there are fewer allowances and benefits, and virtually no pension or retirement plans, local-plus affords easier job mobility out of the organization.
The opportunity cost of local-plus becomes crystal clear when turnover among expatriates increases as an unintended consequence, particularly when an assignment is already under way, given that existing expatriate systems are not designed to cope with turnover other than during repatriation. So while local-plus compensation brings very direct benefits to firms via cost savings, among expatriates it often leads to increased tension and frustration, and reduced job satisfaction and commitment. Companies may save money by adopting local-plus practices but they also risk losing high potential global staff to competitors; hence short-term financial ROI gains can be undermined by long-term non-financial losses.

Rethinking the Future
The starting-point for this article was that compensation is a big issue in terms of the costs involved, the tendency for costs to balloon if not controlled, and the personal effect of compensation on expatriates themselves and their feelings about it. The use of local-plus packages certainly offers a viable alternative because it enhances global staffing options, facilitates greater mobility, and is far less costly to administer and sustain. But it also carries risks in terms of encouraging expatriates to move between organizations.

The real question for an organization then is whether the compensation approach that has been adopted for its expatriates has sufficient fit to produce organizationally relevant outcomes, i.e. the desired behavior among expatriates, including their retention to the end of an assignment, and beyond. If the compensation fit is poor, has the organization thought through how it might respond to, and deal with, the fallout and perhaps more importantly, has it even considered that there may be fallout?

Some Final Thoughts from Brookfield GRS
To some extent, local-plus has suffered from being another of the ‘next best things’ that global mobility grabs with both hands from time to time. In this case, as McNulty has demonstrated, the core value of this assignment type is sound. What perhaps is missing is a solid alignment with compensation and reward strategies that will ensure the ‘organizationally relevant outcomes’ that she describes.

Local-plus appeared out of necessity as a solution to a variety of challenges and has grown organically in a number of different directions. But McNulty’s research does more than acknowledge the ultimate relevance of local-plus packages. She shares from her material more than a hint of a disenchantment felt by some expatriates who feel that an unspoken ‘contract’ has been breached when their overall compensation is materially changed during an assignment or prior to an extension being agreed and she voices concern that this may have a pernicious effect on mobility. Yes mobility will continue to exist, but for some, that mobility may mean moving to take an opportunity with another company. Perhaps now is the time for a period of re-assessment and reflection so that the future of local-plus can be directed by a well planned strategy to define the objectives necessary to meet some very important goals.

Yvonne McNulty, PhD, holds a doctoral degree in international business from Monash University in Melbourne, Australia. An associate editor at the Journal of Global Mobility, she is also a leading authority on expatriate ROI, an expert in the field of expatriation, and co-author of the newly released Managing Expatriates: A Return on Investment Approach (www.expatROI.com). Her research has been featured in The New York Times, Economist Intelligence Unit, International Herald Tribune, The Financial Times, and China Daily, among others. She can be contacted at: ymcnulty@expatresearch.com.

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