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GLOBAL TALENT MANAGEMENT AND STAFFING IN MNES

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Chapter 6

Why Expatriate Compensation Will Change How We Think about Global Talent Management

Yvonne McNulty

Abstract

Purpose – I build on a strong foundation of prior studies about expatriate compensation in general to provide an overview of changes in expatriate compensation, from home- to host-based approaches, during the past 10 years.

Methodology/approach – Underpinned by findings from academic and practitioner literature, I review and integrate studies of expatriate compensation and global talent management to outline the challenges and opportunities home- and host-based compensation approaches present to MNEs.

Findings – Home-based compensation is becoming an outdated and overly expensive model that is often ineffective in moving MNEs' global competitive advantage to where it needs to be, leaving host-based approaches as the only alternative. But the use of host-based “cheaper” compensation approaches can also lead to unintended outcomes for MNEs in terms of unforeseen opportunity costs (such as the loss of critical talent) arising from shortsighted compensation decisions.

Practical implications – I argue that expatriate compensation works best when it is not based on an employees' home-country status but instead on the role that he or she performs *locally*. I suggest a host-based compensation approach — global compensation — that is based on the worth of the position

rather than where the individual has come from. Such an approach is more equitable because it is performance-based thereby eliminating overpaying and perceived unfairness. It is much simpler to administer than home-based compensation because it represents an extension of most MNEs already existing domestic (home country) pay-for-performance model.

Originality/value – Despite more than 10 years of new compensation practices being implemented and reported by global mobility practitioners, very little has been studied or written by scholars about some of the recent changes in expatriate compensation over the past decade. The chapter addresses this gap in academic literature.

Keywords: Expatriate; compensation; balance-sheet; local-plus; localization; permanent transfers

6.1. Introduction

Attracting global talent in the form of expatriates is a competitive advantage for multinational enterprises (MNEs) as is developing, managing, and retaining them (Collings & Mellahi, 2009; De Cieri & Dowling, 2006; Vaiman & Collings, 2014). Expatriates are defined as,

legally working individuals who reside temporarily in a country of which they are not a citizen in order to accomplish a career-related goal, being relocated abroad either by an organization, by self-initiation, or directly employed within the host country, some of whom are paid on enhanced terms and conditions to recognize their being foreigners in that country.

One area of importance in global talent management (GTM) is how expatriates are compensated (McNulty, De Cieri, & Hutchings, 2013; Warneke & Schneider, 2011). GTM is defined as the strategic integration of high-performing and high-potential employees on a global scale that includes their proactive identification, development, deployment, and retention. (Collings & Scullion, 2008; Farndale, Scullion, & Sparrow, 2010).

Studies show that compensation is a source of frustration for many MNEs (Chen, Choi, & Chi, 2002; Dowling, Festing, & Engle, 2013; Foote, 1977; Harvey, 1993a; Suutari & Tornikoski, 2001) regardless as to whether it is remunerating an organization-assigned expatriate (OE) or employing a locally hired foreigner already in the host-country location (see McNulty & Vance, 2016 for an overview of differences). While expatriate compensation has a long publication history dating back hundreds of years (Lay, 1925; Reynolds, 1997), and in the management literature

dating back to the 1960s (Bader, 2014; Bonache & Fernandez, 1997; Foote, 1977; Gomez-Mejia & Welbourne, 1991; Harvey, 1993a; Hodgetts & Luthans, 1993; Lowe, Milliman, De Cieri, & Dowling, 2002; Phillips & Fox, 2003; Schollhammer, 1969; Stone, 1986, 1995; Suutari & Tornikoski, 2001), scholarly articles about changes in expatriate compensation over the past decade are lacking across most management disciplines (e.g., international human resource management, IHRM; international management, IM; and international business, IB). This is despite extensive coverage of changes in compensation approaches in the practitioner literature (e.g., AIR Inc., 2010, 2011, 2016; Brookfield Global Relocation Services, 2009a, 2015; Ernst & Young, 2010; Herod, 2009; KPMG, 2011; McNulty & Aldred, 2013; Mercer, 2006, 2010, 2014; ORC Worldwide, 2004a, 2008, 2009a; Reloc8 Asia Pacific Group, 2007; Stanley, 2009) and significant implications arising from these changes for GTM and global staffing practices that have emerged in recent extant literature (McNulty et al., 2013; Tait, De Cieri, & McNulty, 2014; Yanadori, 2014).

The most significant change in expatriate compensation over the past decade is the move from home- to host-based approaches resulting in large-scale reductions in the costs associated with expatriate remuneration more broadly (AIR Inc., 2011; Ernst & Young, 2010; ORC Worldwide, 2009a). The introduction of host-based approaches, such as local-plus, localization, and permanent transfers (AIR Inc., 2016; ORC Worldwide, 2004a; Stanley, 2009), has been shown to result in high strategic value for organizations by maximizing short-term talent management and cost containment (Brookfield Global Relocation Services, 2015; Herod, 2009). New evidence nonetheless suggests that short-term cost savings can also jeopardize MNEs' ability to achieve their *long-term* goals regarding talent management and knowledge sharing (McNulty et al., 2013; Reynolds, 2000). Whereas generous home-based compensation tends to bind expatriates to the MNE and increases their loyalty, host-based compensation has the opposite effect: it provides fewer ties that bind expatriates to the MNE financially (e.g., fewer allowances and benefits and often no pension or retirement plans) meaning that job movement in and out of the organization is facilitated with greater ease. There is, therefore, an inherent "opportunity cost" arising from host-based compensation that is often overlooked by MNEs and which remains virtually untouched as a research topic among expatriate compensation scholars, despite the prevalence with which it is being utilized in practice (Mercer, 2014; Stanley, 2009; Tait et al., 2014) and its likely impact on GTM. What we do know is that host-based compensation creates many problems for companies because, while short-term financial gains can become easier to attain for the MNE (via less expensive remuneration), it can be undermined by long-term strategic losses in talent (Ernst & Young, 2010).

In this chapter, I build on a strong foundation of prior studies about expatriate compensation in general (e.g., Bonache & Fernandez, 1997; Roth & O'Donnell, 1996; Sims & Schraeder, 2005; Tornikoski, 2011a), including solid evidence for the success of global rewards (Bonache & Stirpe, 2012; Fay, 2008; Festing & Perkins, 2008; Gomez-Mejia & Welbourne, 1991; Tornikoski, 2011b; Tornikoski,

Suutari, & Festing, 2014) and pay for performance (Lowe et al., 2002; Salimaki & Heneman, 2008), as well as global pay systems (Bloom & Milkovich, 1999; Dwyer, 1999; Festing, Eidems, & Royer, 2007; Stone, 1995; Suutari & Tornikoski, 2000; Warneke & Schneider, 2011; Watson & Singh, 2005) to provide, specifically, an overview of changes in expatriate compensation, from home- to host-based approaches, during the past 10 years. I outline the challenges and opportunities these changes present to MNEs in relation to GTM and in doing so suggest ideas for future scholarly inquiry.

The chapter contains five sections. The section that follows establishes a strong rationale for more scholarly studies about expatriate compensation. I then outline established terminology about expatriate compensation and clarify some new terminology and concepts that are used in practice but which has not yet been adopted in scholarly studies. This naturally provides an overview of the research base that has examined and informed expatriate compensation research to date by combining studies from within the scholarly domain with literature from practitioners. Next, the challenges that expatriate compensation presents to MNEs are canvassed, focusing on issues that pertain to GTM and how they can potentially be overcome. Concluding thoughts follow in which I outline a future research agenda.

6.2. Rationale: Why Expatriate Compensation Is Still Relevant

Despite more than 10 years of new compensation practices being implemented and reported by global mobility practitioners, very little has been studied or written by scholars about some of the recent changes in expatriate compensation over the past decade (cf. McNulty et al., 2013; Reynolds, 2000; Tait et al., 2014; Yanadori, 2014) which are outlined in Figure 6.1. My motivation for writing this chapter is based on this obvious gap and stems from two personal experiences. The first is my own journey as a corporate/academic expatriate (I am married to a corporate CEO). Our first international assignment in February 2000 was with *Oracle Corporation*, a US-headquartered company with subsidiary offices in all corners of the globe; the company asked my husband and I to relocate from our home country (Australia) to Chicago. We accepted the role on a fully localized basis meaning that, unlike our peers in other companies, we did not relocate with any of the typical benefits that expatriates could expect at the time — housing and car allowance, annual home leave, club membership, tax equalization, relocation bonus, cost of living allowance, school fees, and so on. My husband and I were unusual in that he did not relocate to the United States as a transferee of the Australian office but as a new employee of the US headquarters (on a H1B visa, having resigned his position in Australia). Thus, we were “localized” expatriates compensated entirely via salary and performance bonuses — and nothing else. While this was rare 17 years ago, today it is quite the norm.

Home-based	Balance Sheet	\$\$\$\$
	Balance-Sheet Lite	\$\$\$
Host-based	Local-Plus	\$\$
	Localization	\$
	Permanent Transfer	\$

Figure 6.1: Overview of expatriate compensation approaches.

The second personal experience is based on an unsuccessful special issue on “expatriate compensation” in 2014 for which I acted as special issue editor (McNulty & Harvey, 2014). Despite the long-held view that there is much we still do not know about expatriate compensation, the special issue was (in all respects) a flop: the 12-month call for papers garnered only two useable submissions. In reflecting on this outcome, the general view held by senior scholars contacted at the time is that everything that has needed to be said about expatriate compensation has been said over the past 100 years and there is nothing more to add. Respectfully, I disagree, and so (it seems) do others. Bonache and Fernandez (1997, p. 457) observed nearly 20 years ago that,

the aspect of expatriate management that has received the least amount of attention is compensation,

while Phillips and Fox (2003, p. 466) argued just over a decade ago that,

this area is particularly worthy of attention.

Sims and Schraeder (2005, p. 107) similarly proffered that,

it is apparent that the topic of expatriate compensation will be the focus of more research by the academic community, particularly with respect to systematic, empirical studies.

Yet personal experience shows that these long-standing calls within academia remain unheeded in spite of empirical evidence showing that new compensation approaches over the past decade are emerging that will dramatically change the expatriate management landscape (McNulty & Inkson, 2013; Reynolds, 2000). For example, AIR Inc. (2011, p. 1), a workforce globalization consultancy, in a recent commentary stated that,

Local plus ... pay packages are not new to mobility, having been leveraged successfully in the financial and professional services industries for over a decade. Recently there has been a lot of interest in the local plus approach as a possible low-cost alternative to the traditional balance sheet. When used in the proper context, the host plus approach can be an effective and successful scheme for compensating expatriates. Knowing when and how best to use this method is the key to its successful implementation.

Dowling et al. (2013, p. 216) further argue that,

Th[e] complexities, challenges and choices facing managers involved in global compensation decisions do not change two primary areas of focus. These individuals must manage highly complex and turbulent local details while concurrently building and maintaining a unified, strategic pattern of compensation policies, practices and values.

As my own family situation shows, there is irrefutable *practical* evidence that expatriate compensation is changing. Moreover, for a field such as IHRM which is so heavily tied to practice, it seems important not to ignore industry reports altogether when it shows there is an abundance of literature and issues demanding scholarly attention about this topic in particular (Bitten, 2001; Dwyer, 1999). If one were to ask, for instance, any global mobility practitioner 20 years ago about their compensation challenges, nearly all would have said the key issue is “fewer benefits” (Aschkenasy, 1997; Gould, 1999; Graham & Trevor, 2000; Kates & Spielman, 1995; Oemig, 1999; Reynolds, 2000); today, the biggest challenge is retaining global talent in an overwhelmingly cost-driven global mobility environment pushing to implement “localization” policies (Brookfield Global Relocation Services, 2012; Cartus, 2010; KPMG, 2003; Mercer, 2010; ORC Worldwide, 2004a) — an issue that has barely been looked at academically. The question then arises (among others), what does this mean in scholarly terms and how might it impact upon theories about expatriation? Undoubtedly, as the fierce competition for foreign talent increases, compensating expatriates is likely to become (if not already) more and more complex, with localization just the tip of the iceberg. A survey by Ernst and Young (2010), for example, found that 67 percent of mobility managers report “compensation packages” as the biggest area where expatriates’ expectations are not met. This may in part be due to fluctuating exchange rates, inflation, challenging locations in emerging markets, variable income tax rates, and a range of new compensation practices — such as localization — being introduced (Dwyer, 1999; Phillips & Fox, 2003). Yet scholarly research suggests that expatriates do not seek or accept international assignments purely for financial reasons (Borstorff, Harris, Feild, & Giles, 1997; Dickmann, Doherty, Mills, & Brewster, 2008; McNulty, 2013). Indeed, there is compelling evidence that expatriates have many non-financial reasons for engaging in global mobility, with career enhancement and progression, seeking a personal or family adventure, and fulfilling a lifelong dream among them (Hippler, 2009). Why, then, is expatriate compensation such a challenging topic? And what is *localization* anyway? How could an understanding of this, and other, new compensation approaches impact positively on GTM and global staffing practices theoretically and strategically?

6.3. Overview of Expatriate Compensation Research and Approaches

6.3.1. Existing Terminology and Concepts

Expatriate compensation has a long history of well-established and accepted terms and concepts.

6.3.1.1. Balance-Sheet

The most commonly understood and longest-standing conceptualization is the home-based or balance-sheet approach defined as,

providing an employee with the same standard of living in the host location as in the home location with no loss or gain (“no win, no loss”). The basic procedure involves covering for cost-of-living and housing cost differences to ensure maintenance of home country purchasing power. (Mercer, 2010, p. 4)

This approach is intended to keep an expatriate “whole” in relation to their home-country peers (Wentland, 2003) and to minimize changes in their standard of living resulting from an international assignment (Phillips & Fox, 2003; Sims & Schraeder, 2005; Tornikoski et al., 2014). For this reason, it is usually applied only to OEs on long-term assignments (Tornikoski et al., 2014), and particularly those who least want to be relocated abroad and thus need to be incentivized financially to go (Sims & Schraeder, 2005). In the 1980s and 1990s, research showed that a large majority of US companies employing OEs used the balance-sheet approach to compensate their expatriates (GMAC, NFTC, & SHRM Global Forum, 2004; Wentland, 2003).

The balance-sheet approach is conceived of four components: (1) *tax equalization* to alleviate an expatriate’s assessed “tax burden,” which guarantees that the expatriate pays neither more nor less in taxes than he or she would if they were to remain in their home country; (2) *housing allowance* which is calculated according to costs above or below those represented by an expatriate’s home-country housing norm; (3) *goods and services* in relation to an expatriate’s “purchasing power” in the host location for groceries, transportation, and medical care (among other items) compared to cost of living expenditure in the home country; and, (4) *reserve elements*, including pension contributions, savings, and investments all of which remain untouched (Mercer, 2010; ORC Worldwide, 2009b). The balance-sheet approach has also been referred to as the *net-to-net*, *home country*, *build-up* and *destination-based* approach (Dowling et al., 2013; Mercer, 2010; Sims & Schraeder, 2005).

The balance-sheet approach has many benefits including that, because compensation remains tied to the compensation system in the home country, it provides expatriates with lavish allowances and benefits (Stone, 1986) and MNEs with the ability to control who is sent to a particular host location with a reasonable assurance of their repatriation and/or re-assignment elsewhere (Dowling et al., 2013). It can be a useful retention tool, especially for high-potential employees that sit within

MNEs' global talent and succession planning initiatives. Nonetheless, it is not a "one size fits all approach" being costly and expensive to administer. Consider, for example, that in relative terms only a very small proportion of a company's overall *total* employee workforce (e.g., perhaps 5% of employees worldwide) could be incurring 60% or 70% of total salary costs. Arguments against using the balance-sheet approach are based largely upon those also made about executive compensation in general, that is, that top managers tend to be over-paid in comparison to the work they actually do (see Hope, 2004).

6.3.1.2. Balance-Sheet Lite

The expense of the balance-sheet approach, along with limited empirical evidence showing that higher pay results in better performance outcomes (see Hope, 2004; Locke, 2004), has resulted in a number of *hybrid* forms of home-based compensation such as the *cafeteria*, *mix-n-match* and *flexible plan* approaches (Sims & Schraeder, 2005; Wentland, 2003). These typically involve the higher of the home and host-country approaches being applied depending on the home/host location combination, or a home approach being used but with international (non-home-related) elements integrated, such as an international spendable income (Mercer, 2010). An *international headquarters* (or *regional*) approach can also be used where expatriates are compensated as if all originated from the same geographic headquarters and are being paid on the same balance-sheet program. Sims and Schraeder (2005) describe this approach as promoting perceptions of equity among expatriates from different nationalities working together in the same host location to ensure that each is not paid any more or less than expatriates already working in that location.

The balance-sheet approach has been shown to create considerable compensation disparity between the pay levels of OEs and host-country nationals (HCNs) who can be paid different amounts for performing the same or a similar role (Dowling et al., 2013). This has been identified as a key determinant of dissatisfaction and lower morale among local employees that work directly with expatriates resulting in feelings of resentment, inequity and unfairness (Bonache, Sanchez, & Zarraga-Oberty, 2009; Chen et al., 2002; Festing et al., 2007; Leung, Wang, & Hon, 2011; Leung, Zhu, & Ge, 2009).

6.3.2. New Terminology and Concepts

In contrast to home-based compensation, host-based compensation, in general, can be summarized according to two approaches — *local-plus* and *localization* — both of which are intended to integrate an employee into the local market structure of the host location by paying him or her a base salary according to the local market rate (Mercer, 2010; Yanadori, 2014). Host-based approaches are typically used as a cost containment measure and utilized when an assignment has a combination of: (a) a permanent position in the host country; (b) the assignment location is in the

same region as an employee's home country; (c) there is not likely to be a suitable role in the home country for an employee to return to; and (d) cost reduction is a priority (Tait et al., 2014). Host-based approaches result in ties back to an expatriate's nominated home country being scaled back (for local-plus) or severed altogether (for localization) with he or she becoming a local (for the purposes of payroll) in the host country.

6.3.2.1. Local-Plus

Local-plus is an approach where 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 dependents' education. (Stanley, 2009, p. 2)

Expatriates compensated on local-plus,

are usually responsible for paying all actual income taxes ... companies commonly keep assignees, where possible, on the home country pension or social security system, since local plus packages tend to be used for temporary assignments that can result in a return to the home country. (AIR Inc., 2011, p. 2)

Local-plus has also been described as *mutual benefit* (a reduced package of benefits) and *core plus* (a core of required benefits such as immigration and relocation costs to host country which can be added as needed depending on circumstances or as an incentive; Brookfield Global Relocation Services, 2009b).

Not all expatriates on local-plus receive the full range of additional benefits as these are at the discretion of the MNE and determined by a range of factors including the location of the assignment (e.g., hardship, emerging economy), position status and seniority, assignment type, and family size (Brookfield Global Relocation Services, 2009b). Stanley (2009) notes a steady rise in local-plus compensation in Asia as an alternative to the traditional balance-sheet approach, with AIR Inc. (2011) reporting that, of the companies that offer local-plus policies, approximately one-third of expatriates are compensated in this way. McNulty et al. (2013), in their study of 31 OEs in Asia found that, consistent with other surveys (e.g., Brookfield Global Relocation Services, 2016; ORC Worldwide, 2004b, 2009a), local-plus compensation was the most common form of remuneration.

An important benefit for firms when using local-plus is the inherent flexibility to tailor each "plus" component (i.e., to add or remove a benefit) according to a variety of MNE objectives (Burns, 2003). These "top ups" or "uplifts" can be delivered either as cash directly to the expatriate (in the host-country currency) or as in-kind benefits directly to a supplier (e.g., a landlord, airline, or school; AIR Inc., 2011). Local-plus is particularly beneficial for OEs being sent from and to developed economies where home and host-country locations are comparable in terms of wages and standard of living, but less appropriate for OEs that are sent into low wage, developing, or hardship countries where lower levels of affinity between the

home and host country exist. In contrast, local-plus can be particularly suited to locally hired foreigners employed by MNEs in low wage and emerging economies directly from local labor markets who may already be adjusted to lower levels of affinity and for whom “keeping them whole” is not a requirement (AIR Inc., 2011).

6.3.2.2. Localization

Localization is similar to local-plus with the exception that it involves the removal or absence of an OEs “expatriate” status but only from a policy and payroll standpoint in terms of benefits and allowances (ORC Worldwide, 2004a). Mercer (2010, p. 5) defines localization as,

the process of transferring an employee who used to be under expatriate terms and conditions to local conditions.

Localization almost always involves replacing a salary package (e.g., base salary, incentives, allowances, perquisites, social security, and retirement plans) with compensation comparable to that offered to local citizens of the host country and/or in accordance with minimum salary levels required by law for locally hired foreigners employed on work visa. Localization has also been described as the *going rate* and *market rate* approach (Dowling et al., 2013).

It is important to note that there has been some confusion in academic literature about the exact meaning of the term “localization” in reference to expatriation. Some articles refer to localization as the,

extent to which jobs originally held by expatriates are filled by local employees who are competent to perform the job (Selmer, 2003, p. 43),

or,

displacing expatriate managers with local talent. (Fryxell, Butler, & Choi, 2004, p. 269)

These definitions assume that “local employees” are nationals of the host country, where localization is linked to their career development (i.e., they are offered a job that an expatriate used to do). Technically, this is not correct given that localization as defined and practiced among mobility consulting firms determines that “local employees” are *both* nationals of the host country *and* localized expatriates (i.e., locally hired foreigners). Localization is not, therefore, the replacing of expatriates with nationals of the host country, but the transitioning of OEs that are originally deployed on home-based compensation onto host-based local terms and conditions, who then join the local workforce as locally employed foreigners.

Local-plus and localization is offered in one of two ways. It can be *delayed* where an expatriate commences an international assignment on a balance-sheet (or lite) approach and, after a period of between three to five years, then transitions to local-plus or is fully localized directed by either the employer or employee (ORC Worldwide, 2004a). Some expatriates relocate, for example, with full knowledge that local-plus will be offered or localization will occur after two years in the host

country as pre-determined in their contract whereas other expatriates will be transitioned onto host-based compensation on completion of an initial assignment but with little prior warning. Transitioning to a reduced compensation package usually involves a phasing out period where expatriate benefits (such as transportation, housing, health care, and school fees) are reduced over a wind-back period (e.g., 50% phased out in Y1, and 50% in Y2). For fully localized expatriates, it is essential for them to resign from his/her home country office for payroll and tax purposes and to be formally hired by the host country office of the same company. This is also a typical requirement for local-plus expatriates, but not always enacted.

6.3.2.3. Permanent Transfers

Localization and local-plus which is offered *immediately* at the onset of an assignment is typically in the form of a permanent (or one-way) transfer. In this scenario, employees know from the outset that they will be on local-plus or fully localized once they arrive in a host location and will be required to operate as a “local” whilst there (Mercer, 2010; Tait et al., 2014). A permanent transfer is one in which an employee resigns from their home country office and is hired by the host country office of the same company, but for which there is no return (repatriation) to the home country and no guarantee of company-sponsored re-assignment elsewhere (Mercer, 2010; Tait et al., 2014; Yates, 2011). When a permanent transfer is used, host-country compensation and benefits are applied with relatively few, if any, typical expatriate package benefits made available over the long term (ORC Worldwide, 2004a). In some instances, a local-plus compensation package may be offered to a permanent transferee during an initial transfer period of up to two years to facilitate their transition. Importantly, and excepting only on the payroll, employees undertaking a permanent transfer are still expatriates in every sense of the literal meaning of the word because of their non-immigrant status and lack of citizenship of the host country (see McNulty & Brewster, 2016).

The prevalence of permanent transfer opportunities among companies is on the rise. Reports by EY (2016), KPMG (2003) and ORC Worldwide (2004a) show, for example, that more than three-quarters of companies have some form of permanent transfer and localization policy in place. Brookfield Global Relocation Services (2012) found that more than one-third of the 123 participating firms in their survey used permanent transfers as a cost effective alternative to the balance-sheet approach. Indeed, it (along with others, e.g., EY, 2016) found that half of the firms in their survey were switching employees to localized conditions, with a marked increase in permanent transfer and localization activity overall. A survey by Cartus (2010) identified skills shortages in host-country locations as an additional reason for using permanent transfers.

The upside of host-based approaches for MNEs is that it reduces global mobility costs, widens talent pool and sourcing opportunities, and provides employees with more job opportunities in international labor markets. In other words, it offers an alternative, less expensive solution to global staffing, buoyed by the availability of

more employees willing to accept partial or full host terms and conditions in exchange for valuable international experience. A further key advantage for MNEs, especially in relation to localization, is that it can facilitate a strategy of local responsiveness particularly when there is a need to demonstrate long-term commitment to a particular host country or region. It is worth noting, however, that companies do not always drive host-based compensation practices. Employees are increasingly seeking out permanent transfers as a step toward fulfilling their own career development abroad (Collings, Scullion, & Morley, 2007), even though doing so may not increase the financial rewards they receive as substantially as their balance-sheet colleagues.

6.4. Expatriate Compensation and Global Talent Management

The transitioning by many MNEs from home- to host-based compensation approaches illustrates that expatriate compensation is undergoing significant, and some would argue necessary, evolution. The subsequent impact on GTM is undeniable, largely because GTM is predominantly a *human* activity and compensation is an inherently *personal* hygiene factor in the MNE-expatriate employment relationship. Moreover, while MNEs will never stop using monetary rewards as the primary solution to motivate and reward their employees (Pfeffer, 1997), including expatriates, what remains critical is *how* it is used to ensure the success of GTM and global staffing practices. MNEs face three challenges when compensating expatriates: issues arising from the normalization of global mobility, balancing extrinsic versus intrinsic rewards, and managing the increasing irrelevance of repatriation.

6.4.1. Normalization of Global Mobility

The “normalization” of global mobility as a typical, rather routine, and even expected part of one’s career progression is a major challenge for GTM due to an increasing availability of more employees willing to relocate abroad in order to gain valuable international experience (Cerdin & Brewster, 2014), particularly younger employees, which has been a key reason for the steady decline in home-based compensation approaches in regions such as Asia, where host-based packages are in the majority (Diez & Vierra, 2013; ORC Worldwide, 2008). In certain regions and across particular industries, the heightened competition for global talent has not driven expatriate salaries up as one would logically expect but has actually driven salaries down. This means that it is increasingly more difficult for MNEs to attract, and then retain, global talent via the compensation it offers them. While on the one hand this can be seen as a legitimate reason for MNEs to utilize cost-reducing host-based compensation approaches in lieu of more expensive home-based approaches (because it is not necessary to pay more for some segments of the talent pool), it also means that MNEs have fewer tools at their disposal to find the *right* talent at

precisely the time it is required. This challenge has been shown to feed into a “buy” versus “build” dilemma for MNEs (McNulty, 2013; Minbaeva & Collings, 2013; Stahl et al., 2012), where the building of a global talent pool through developmental and career enhancement activities is likely to be a far more successful long-term GTM strategy, than the short-term focus of poaching talent from competitors with expensive and over-inflated salaries.

6.4.2. *Intrinsic versus Extrinsic Rewards*

Another major challenge facing MNEs is that, while decades of research about expatriates has assumed that the fundamental driver for them to undertake an international assignment is for financial (extrinsic) gains, recent studies show a strong bias toward intrinsic rewards as a key motivator (Cappellen & Janssens, 2010a; Dickmann et al., 2008; Dickmann & Harris, 2005; Hippler, 2009). Warneke and Schneider (2011), for example, found that the five top criteria for relocating includes base salary (71%) and a location bonus (to incentivize the move; 32%), as well as accompanying partner support to assist in adjustment and the dual-career issue (finding employment; 60%), re-integration guarantees for an expatriate’s career (58%), and the quality of schooling for children (41%). This suggests that financial rewards as the primary motivator to relocate are waning (Crowley-Henry & Collins, 2016; McNulty & Inkson, 2013), particularly when competitor organizations can match or exceed an expatriate’s host-based remuneration package as a means of poaching them. Instead, non-monetary factors such as job guarantees and family support seem to play an increasingly important role, with the potential to impact on intent to leave and turnover (McNulty et al., 2013).

The shift in motivators has come at an important time in expatriate management. Decades of conventional wisdom aside, studies have recently shown that higher pay does not guarantee improved performance, instead being linked to a number of unintended and negative consequences such as manipulating performance measures (e.g., revenues) and excessive risk taking (e.g., Enron immediately comes to mind; Pfeffer, 1998; Pierce & Aguinis, 2013; Sanders & Hambrick, 2007). In other words, to fully link global mobility to GTM, MNEs need to deploy an appropriate compensation approach in combination with other non-monetary rewards that engages and motivates their expatriates *intrinsically* and which is aligned, rather than in conflict, with its broader GTM objectives. Recent research (e.g., Haslberger & Brewster, 2009; McNulty & Inkson, 2013) suggests this can be achieved using the psychological contract — an individual’s subjective belief about the terms of his or her exchange agreement with an employer, usually in an indirect, unwritten form of communication between them (Inkson & King, 2011; Rousseau, 2004). This involves moving away from a transactional approach to compensation and rewards (i.e., motivating an OE to undertake an assignment using financial incentives) to instead adopting a relational approach that fosters harmonious and committed relationships through mutual respect and understanding (e.g., family and career support). Studies

show that transitioning from transactional to relational psychological contracts can positively impact on expatriate retention and the success of MNEs' GTM programs (McNulty & De Cieri, 2016; McNulty et al., 2013). Whether this is achieved via home- or host-based compensation is dependent on the MNEs short- and long-term GTM objectives (e.g., where host-based compensation is more likely to facilitate short-term talent management objectives and home-based compensation much longer term goals).

For host-based compensation, it requires that MNEs carefully manage expatriates to ensure they are not treated like HCNs or domestic employees. It means acknowledging that *all* expatriates, regardless of the compensation approach used to employ them, incur more substantial expenses and greater disruption to their lives than employees who choose not to work abroad. As such, they need to be rewarded accordingly and subjected to a different set of policies, but only insofar as the compensation approach remains appropriate to the job that the expatriate actually does, rather than the status he or she holds because of their home-country ties. In addition to formal policy elements, attention must be paid as to how expatriates are adjusting to their new status of being semi- or permanently integrated among a local workforce. It includes issues related to an "organizational hierarchy" or "pecking order" that typically arises when MNEs treat employees differently on the basis of those considered "true expatriates" versus those who are "locals" from a policy and payroll standpoint (Tait et al., 2014; see also Mellahi & Collings, 2010). Expatriates on home-based compensation, for example, typically represent the elite class of foreign employees being of higher strategic value, while expatriates on host-based compensation are often viewed as lower-order foreign employees stuck beneath a type of expatriate glass ceiling — a limbo status of being neither a "true expatriate" nor a "true" local employee. This glass ceiling frequently results in strategic and operational restrictions for localised expatriates in terms of frustration with their career advancement that has recently been shown as a predictor of turnover (McNulty et al., 2013).

6.4.3. Repatriation Is Increasingly Irrelevant

A third challenge for MNEs is that home-based compensation is based on a repatriation model that insists on maintaining a link to expatriates' nominated home country or headquarters, despite increasing evidence that a growing number of expatriates may never return there (Cappellen & Janssens, 2010b; Stahl, Miller, & Tung, 2002). Thus, the increasing irrelevance of repatriation is a factor that must be considered when deciding on a compensation approach. If home-based compensation, for example, is strategically geared toward an expatriate who will one day return to their home country but who never does, or who does so infrequently and intermittently, this compensation approach is likely to be unnecessarily expensive, and potentially cost-prohibitive over the long-term, nor is it likely to effectively support a GTM program that is reliant on the continual movement of expatriates

across borders — often over decades — to help build the MNEs competitive advantage. Host-based compensation then becomes the only viable alternative, and along with it various opportunity costs as outlined above that MNEs might be unprepared for. What is needed is a strategic level of GTM in the MNE (see [Collings & Mellahi, 2009](#)), to determine the most effective global staffing “mix” that combines the different types of expatriates (see [McNulty & Brewster, 2016](#); [McNulty & Vance, 2016](#)) with appropriately aligned home- or host-based compensation approaches, that can then effectively support the MNEs broader objectives as appropriate to the demands of its global operation (see [Hartman, Feisel, & Schober, 2010](#)). Clearly, this is easier said than done given that it requires a level of strategic GTM planning that many MNEs struggle to implement in practice ([Collings, 2014](#); [Minbaeva & Collings, 2013](#); [Scullion, Collings, & Gunnigle, 2007](#); [Stahl et al., 2012](#)).

6.5. Future Research Agenda: Expatriate Compensation

The study of expatriate compensation has the potential to extend and build on prior research about expatriate management in general, including changes to reward and benefits structures applicable to international employees. Although this chapter has provided an overview of recent changes in expatriate remuneration, more systematic and empirical research is needed to increase our understanding of the specific challenges MNEs face when compensating expatriates and how they can be overcome. I propose a number of research questions that will help advance conceptual and empirical development related to these challenges.

One of the major issues facing MNEs is how to link global mobility to GTM and how compensation acts as a moderator or predictor variable for the success of global mobility and GTM in general. In their insightful article about the seven myths of global talent management, [Minbaeva and Collings \(2013\)](#) show that the connection between global mobility activities (including expatriate compensation) and talent pool acquisition remains weak: many MNEs seem to engage in global mobility without linking it to developing future global leaders or to meeting expatriates’ career development expectations (see [Collings, 2014](#); [Cerdin & Brewster, 2014](#)). Yet GTM is often the program through which many individuals hope to realize their international career aspirations and goals. [McNulty and De Cieri \(2016, p. 4\)](#) define the link between global mobility and GTM as one that is,

focused on international mobility as a planned and deliberate career move for expatriates that has clear long-term benefits for the individual ... as well as for the employer, i.e., successful GTM outcomes.

These “outcomes” are undeniably linked to expatriates’ performance which prior research suggests can be impacted by the MNEs compensation and reward structure ([Evans, Pucik, & Bjorkman, 2011](#); [Locke, 2004](#); [Malhotra, Budhwar, & Prowse, 2007](#)). The importance of GTM success lies not just in getting the mobility piece

right but also in overall global strategic success across all aspects of the MNEs business operation (Boudreau & Dowling, 2003; Cui, 2006). Research on GTM has nonetheless paid very little attention to the mobility and/or relocation of individuals as part of the MNEs overall GTM initiative (see Collings & Mellahi, 2009 for a review), with virtually no research linking GTM and expatriate compensation. Given the many problems MNEs face in compensating expatriates (Ernst & Young, 2010; McNulty et al., 2013), there is an urgent need to rethink international compensation (see Milkovich & Bloom, 1998 for an early call) and to address the challenges it presents in relation to GTM. Important topics worthy of further examination are thus:

RQ1. To what extent do MNEs link global mobility and GTM? What are the barriers and how can they be overcome?

RQ2. Which compensation models encourage, and conversely discourage, expatriate performance?

RQ3. To what extent, and by how much, does expatriate compensation impact on GTM outcomes? Which compensation models are more or less effective in helping MNEs achieve GTM success?

In light of recent changes to expatriate compensation as outlined earlier in the chapter, there is still little empirical data to explain why, and how, MNEs adopt home- versus host-based compensation beyond the simplistic reasoning of “cost considerations.” Moreover, do MNEs apply strategic decision-making when deciding on a compensation approach for expatriates or do operational considerations take precedence? Engle and Mendenhall (2004) suggest that pay for expatriates should be based on strategic choices related to type of job (skill-based, developmental, knowledge transfer, governance and control, oversight) and seniority, while Gomez-Mejia and Welbourne (1991) argue that the unit of aggregation is an important consideration (e.g., individuals, groups, business units, pay/skill grade). An over-riding concern in the literature relates to pay equity and fairness (hierarchical vs. egalitarian; Engle & Mendenhall, 2004), especially in comparison to HCNs (Bonache et al., 2009; Festing et al., 2007; Leung et al., 2011). Yet practitioner literature suggests that practical choices related to ease of administration and standardization of pay practices (by avoiding a complicated number of home-host combinations for the balance-sheet, or having to deal with numerous “local” systems for host-based approaches) can over-ride the desire to engage in strategic decision-making (Brookfield Global Relocation Services, 2015; Ernst & Young, 2010). When deciding on an expatriate compensation approach, tension often exists between MNEs strategic necessity and the contextual requirements of the host location: while pay standardization is expensive (e.g., balance-sheet), host-based compensation is complex (with many versions across geographies) but more flexible and responsive to diverse business conditions (Dowling et al., 2013). Related to the diversity MNEs face are differences in the types of expatriate employed

(see McNulty & Brewster, 2016; McNulty & Vance, 2016 for an overview of different types), given that how newer types of expatriates are attracted to work for, and compensated by, the MNE differs significantly from approaches used in the past (Shaffer, Kraimer, Chen, & Bolino, 2012). These new types of expatriates constitute a broad array of different types, e.g., employed self-initiated expatriates (SIEs) that are characterized as taking control of their career outside of the confines of the organization thereby abandoning corporate intervention and its relative security in favor of autonomy and flexibility (Doherty, Richardson, & Thorn, 2013). Scholars suggest that employed SIEs may be ideally suited to host-based compensation (Froese & Peltokorpi, 2013; McNulty, 2013), hence the link between global mobility, GTM and compensation is clearly evident but remains under-researched. Thus:

RQ4. How do MNEs decide on a home- versus host-based compensation approach for expatriates? Which criteria are used (strategic, operational, administrative, financial) to determine a compensation approach for expatriates?

RQ5. What are the MNE drivers (strategic, operational, administrative, financial) for changing compensation approach (e.g., from home- to host-based and vice versa)?

RQ6. Which types of expatriates are more or less suited to home- versus host-based compensation, and why?

A further challenge for MNEs is addressing the opportunity costs that arise when changes in expatriate compensation occur. Virtually nothing is known about the opportunity costs arising from these changes, especially from home- to host-based compensation, to both MNEs and the expatriates they employ, despite recent commentaries suggesting that these costs can be high (McNulty et al., 2013; McNulty & Inkson, 2013). When, exactly, should host-based compensation be introduced and implemented? Expatriates who are compensated on host-based approaches from the start or transitioned at some point during an assignment but who know to expect it have been found to adjust better in the host location (Tait et al., 2014) than those who do not undertake an international assignment with a host-based approach in mind but who inevitably find themselves with less remuneration than they originally intended (McNulty, 2013). In the latter case, expatriates will no longer have access to allowances and incentives resulting in unplanned lost income and financial disadvantages. A recent study found that this then impacts on perceived fulfillment of the psychological contract, leading to resentment, thoughts of leaving, and decreases in engagement (McNulty & De Cieri, 2016; McNulty et al., 2013).

Prior research (e.g., Festing & Müller, 2008; Haslberger & Brewster, 2009; McNulty & Inkson, 2013; Pate & Scullion, 2010) suggests that the psychological contract “currency” for expatriates generally falls into two categories: (1) *economic* currency in benefits like tax equalization, bonuses, paid home leave, housing and education costs, and medical insurance; and, (2) *development* currency in the form of, for example, increased levels of job autonomy and challenge, and mobility opportunities (including re-assignment) that can help them to build an international

or global career. When companies reduce expatriate compensation they are shrinking the psychological contract “pie” by asking (or forcing) expatriates to re-define their value to the MNE, possibly their lifestyle, and probably their commitment to the organization. While some expatriates welcome the opportunity to engage in international work experience irrespective of the compensation approach applied (Crowley-Henry & Collins, 2016; Doherty et al., 2013), research has shown that there are many who accept host-based compensation because they perceive there is no alternative (McNulty, 2013; McNulty et al., 2013). Here, the temporal dimension becomes critical in terms of when, and how, host-based compensation is introduced. A recent study found, for example, that expatriates are not necessarily dissatisfied with their need to transition to local-plus or localization but with the *process* by which it is implemented (McNulty et al., 2013). The most significant issue is transitioning during an assignment rather than waiting until the end of the contract to allow better personal budgeting and financial planning to take place. Others were found to resent that once they were established as “career” expatriates, the compensation “goal posts” were then moved at the point of re-assignment or assignment extension by the MNE in the full knowledge that expatriates have few alternative employment opportunities in their home country. These practices create a heightened sense of unjustified loss among expatriates. Issues of job embeddedness (Feldman & Ng, 2007) as a predictor of employee retention (Holtom & O’Neill, 2004), and job mobility preparedness activities (e.g., obtaining information about job opportunities, developing networks of contacts about job information, keeping an updated resume, benchmarking compensation with other employers, and considering the next position that is desired; Kossek, Roberts, Fisher, & Demarr, 1998) are likely to emerge. McNulty (2013) recommends that the best way to alleviate tension relating to the implementation of host-based compensation is to engage in a much closer dialogue with expatriates and to ensure absolute transparency about the process. Thus:

RQ7. What is the opportunity cost(s) to (a) MNEs, and (b) expatriates when changes in compensation approach occur (e.g., from home- to host-based)?

RQ8. How do changes in expatriate compensation (e.g., from home- to host-based) impact on expatriates’ perceptions of psychological contract fulfillment?

RQ9. To what extent do changes in expatriate compensation (e.g., from home- to host-based) impact on outcomes related to (a) expatriate performance and (b) GTM.

Recent commentaries suggest that a global compensation model (Bloom & Milkovich, 1999; Phillips & Fox, 2003; also referred to as “global pay” and “universal pay,” Dowling et al., 2013) could help MNEs achieve global strategic success. A global compensation model is based on remunerating expatriates as related to the role that he or she performs as opposed to their home-country status (Harvey, 1993b). This is because it is the *worth of the position* that needs to be aligned to GTM, not whether an employee has expatriate status or where the individual has

come from. The shift in focus from “expatriate” to “global” compensation reflects a shift in mindset (see [Milkovich & Bloom, 1998](#)); while expatriates clearly perform in an international context, many are nonetheless employed in jobs similar to those of HCNs, or in jobs that HCNs can also do at some point in the future. The distinction, then, is to focus less on “expatriate status” as the defining criteria for compensation and more on the international nature of the job ([Freeman & Kane, 1995](#)). In this way, a global compensation approach enables MNEs to find the most appropriate candidate and then compensate them accordingly, not because of who they are but according to what they are expected to achieve for the MNE in relation to their performance and other GTM expectations. A global compensation approach, then, is more equitable because it is performance-based, thereby eliminating overpaying and perceived unfairness ([Engle & Mendenhall, 2004](#); [Hope, 2004](#)). Global compensation is much simpler to administer than a balance-sheet approach because it represents an extension of most MNEs already existing domestic (home country) pay-for-performance model ([Dowling et al., 2013](#); [Salimaki & Heneman, 2008](#)).

While a global compensation approach will, in some instances, also reduce expatriates’ compensation when host-based approaches are used, one advantage is that it allows MNEs to expand their global talent pool by targeting candidates’ eager to pursue international and global careers; that is, candidates who are willing to expatriate not just because of the compensation being offered, but often in spite of it. This includes career expatriates and other locally hired foreigners for whom many 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 ([Froese & Peltokorpi, 2013](#); [Thomas & Inkson, 2009](#)). A further advantage is that it is inherently more flexible than that of the balance-sheet because, being based on pay-for-performance, it can continue even after an employee decides to relinquish their expatriate status: global compensation is not necessarily location or status-specific to the MNE but can be leveraged over the long term to facilitate the retention of expatriates as a means of ensuring a better return on investment from global mobility and GTM programs. Systematic field studies about global compensation are lacking, but sorely needed. Thus:

RQ10. How common is the global compensation model in practice? What are the drivers for MNEs to implement a global compensation model?

RQ11. Is a global compensation model more or less (a) expensive and (b) effective than other home- and host-based compensation approaches (e.g., balance-sheet, balance-sheet lite, local-plus, localization and permanent transfer)?

6.6. Conclusion

My goal in this chapter has been to build on a strong foundation of prior studies about expatriate compensation by providing a detailed overview of changes in

expatriate compensation during the past 10 years and the implications arising from these changes for global mobility and GTM in practice. One such implication is that the move to host-based compensation approaches is both increasing and undoubtedly permanent. This means that the situation is likely to get worse before it gets better for MNEs struggling to find the right global talent. In other words, the balance-sheet approach is likely to be proven as an outdated and overly expensive model that is ineffective in moving MNEs' global competitive advantage to where it needs to be, leaving host-based approaches as the only alternative. But the use of host-based "cheaper" compensation approaches that seem appealing to many MNEs can also lead to unintended outcomes in terms of unforeseen opportunity costs (such as the loss of critical talent) arising from "shortsighted decisions" about home- versus host-based expatriate compensation strategies (Tait et al., 2014). While I have outlined these and other challenges and opportunities that recent compensation changes present to MNEs in relation to GTM, my hope is that by identifying significant gaps in our understanding of these new compensation trends over the past decade, future researchers have the opportunity to contribute to studies that will help MNEs across a wide range of communities and industries to address the complex issues associated with remunerating an increasingly diverse and inclusive expatriate workforce.

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