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Compensation Tips for Global Expansion

This article, first published in WorldatWork's Workspan magazine, tackles the complexities of global pay practices and policies to help companies when considering international expansion.

As companies continue to expand internationally, increasing market share, growing profits and developing low-cost production centers have become leading corporate goals. The need for a long-term vision on a global strategy has never been more important — and developing a smart compensation plan to support that strategy is a central component of corporate success.

Companies looking to expand their global footprint must wrap their arms around the complexity and multifaceted nature of compensation and incentive design. All too often, however, we see companies merely replicate their headquartered company policies as they expand. Over time, these policies can create concerns with internal pay equity, adverse performance achievement, retention and, ultimately, profitability.

In this article, we'll tackle some of the complexities of global pay practices and policies to help you make more informed decisions as you consider international expansion.

Compensation Decisions Companies Are Grappling With

Let's start with one of the foremost decisions multinational companies face: how to staff local subsidiaries. There are different ways to do so, including:

- Send headquartered executives to the subsidiary. However, a key question is how long the executives should reside there, as this may create additional income tax liabilities and a need for expatriate policies, which can become quite expensive.
- Transfer an executive team with the goal of starting and staffing a subsidiary within a few months.
- Hire a new, local executive team.

Depending on the pathway that a company takes to staff their subsidiary, they are then faced with decisions around compensation design. Some considerations include:

- If the headquartered staff is transferred temporarily, should they continue to be paid (and incentivized) as if they stayed with the headquartered company?

- If the transfer is temporary and the duration is defined, should their compensation be dependent on the achievements of the assignment?

- If executives are hired locally (which can create a more stable executive team), should they be paid similarly to headquartered executives or benchmarked to their local peers?

Part of the solution should be addressed early in the staffing/hiring process. Companies generally spend years developing and designing local pay practices and philosophies. Before going global, the compensation strategy should be tested against the multinational business strategy. What are its strengths and weaknesses? Where should additional guidance be developed and how will the global variables impact the future philosophy? Although this article focuses on cash components and long-term incentives ("LTIs"), this philosophy should address all elements of rewards including benefits and pension.

Designing compensation plans, including short- and long-term incentives, requires special consideration since they are influenced by various financial and operational factors. Let's dig into the common factors that influence the design and implementation of global pay.

Key Factors Informing Global Pay Strategies

The dollar is the strongest it has been in almost a decade. This affects United States-based companies' ability to penetrate markets overseas — and in return, affects the ability of non-U.S. headquartered companies to export goods to the U.S. Beyond the impact on the cost of goods, it also affects the cost of labor.

For U.S. companies paying executives overseas, the strong dollar reduces compensation costs.

LTIs, which are generally tied back to the U.S., are a windfall for global executives as their awards are worth considerably more after currency conversion. Today, this is especially true for United Kingdomand European Union-based executives who have seen the pound and euro devalued with the ongoing uncertainty surrounding Brexit.

Even as companies recognize that currency fluctuation is affecting employees across the globe, most companies are not addressing the issue annually. According to Aon's "2017 Global Pay Practices Survey," 67% did not expect to adjust pay in the near future.

The impact of currency fluctuations should be reviewed when designing pay programs. Some questions to ponder include:

- Should current global reward opportunities be adjusted to reflect the strong dollar?

- If so, how often should they be reviewed?

- If the currency fluctuation reverses, should the compensation targets be reduced?

- If companies decide to maintain the status quo, how is this communicated to their executives?

The answers to these questions have to be balanced against a company's goal of simple administration, the ongoing compensation strategy, and employee engagement.

Local inflation can also play a role in influencing global compensation design, with Latin America, Asia Pacific and Europe representing the most affected regions currently. Despite this, two-thirds (66%) of the companies we surveyed did not expect inflation to affect pay design. Many of the surveyed companies cited Latin America as a concern.

When companies expand and design local compensation packages, they need to plan for possible inflation impact by answering the following questions:

- Should we pay in our headquartered currency?
- If we choose to pay in local currency, does our compensation have to be consistently adjusted? If so, how often?
- If annual compensation reviews are customary, is there concern about retention over a 12-month period?
- Should salary compensation be paid in local currency, but incentive opportunities paid in another currency?

Again, companies balance plan administration versus employee engagement. Most companies adopt a philosophy that base pay and annual incentives are local designed, benchmarked to local peers, and should be paid with local currency. In general, only LTIs are denominated in the headquartered company currency.

Single Compensation Tier for Global Executives

A trending approach to designing pay programs for multinational executives is to create a group of "global executives." These executives share similar responsibilities, such as implementing key strategic business initiatives and supervising a multinational workforce that resides in numerous countries and typically reports directly to a named executive officer.

A unique aspect of their compensation package design is that they are paid and incentivized within a single band. Their base salary is not tied to their current global locale, but instead to their "global executive" peers. Annual incentive metrics are designed to align with the central goals of the company, but have regional influence. Performance based LTIs are also aligned with the headquartered company goals, which are generally determined or influenced by the board of directors.

These global executives are expected to be future leaders, and their success or failure plays a role in company earnings and future growth. In addition, these executives will be expected to relocate several times during their careers and lead regional operations across the globe before returning to the company headquarters.

As companies continue to look for growth globally and supply chains across continents, we expect this band of single-tier executives to expand. Future leaders are expected to understand and engage their global population while the home country wants to continue to exercise oversight and judge performance.

Benchmarking Pay — Global vs. Local

Companies often struggle with benchmarking pay for their global subsidiaries because the design is largely influenced by local and regional pay practices.

Many times, companies begin trying to align compensation across the globe by maintaining internal pay equity. For example, a goal may be to have all country leaders paid within 10% of each other. However, this can have the opposite effect, as country by- country purchasing power will result in pay inequality. A country leader living in a locale with a lower cost of living will be enriched by such a program. The pay inequity is only exacerbated by annual and long-term incentives that are generally allocated as a percentage of base pay.

Rather than try to create equality within a pay band, companies should try to develop equality within a subsidiary's geographic location. As noted above, local benchmarking for base salary, cash compensation and total direct compensation creates a more harmonized approach to pay by aligning executives' pay to the local market. This also will filter down to all local employees, creating a competitive compensation arrangement that will aid in retention and align with a company's business strategy. This type of approach is also preferred when the local labor market is undergoing dramatic change and adjustments are needed in real time.

Other Influences on Pay Design

Many countries offer an "enhanced" base salary or "guaranteed cash compensation" that includes allowances for things like housing, conveyance, education or even a 13th month of pay, which is sometimes referred to as a Christmas bonus. Balancing a global pay strategy to remain compliant with local laws and be locally competitive can prove more complex and costly than expected.

But companies often struggle when determining which markets require allowances as well as how much they should allot. As both annual and long-term incentives are typically tied to base salaries, should the opportunities be calculated using straight pay or straight pay plus allowances? These are small nuances that illustrate the difficulty of developing global pay programs and the hidden expenses.

Another area to review when determining global compensation levels are acquired rights. Often, a company may provide special, ad hoc payments to global employees in multiple years that in many jurisdictions, if deemed an acquired right, will become a part of an employee's regular remuneration. As such, these rights could affect target base salary and incentive design opportunities and are more frequently addressed in LTI design.

In addition, global executive pay is moving toward a U.S. model where incentives are tied more directly to performance goals, and base salaries are a smaller portion of total compensation. However, there is still a big gap in pay practices in some markets. In India and China, for example, the ratio of fixed pay versus variable pay is generally 40:60 or 50:50, whereas for executives in the U.S., it can be closer to 20:80. Synchronizing this for executives across the globe is yet another challenge.

Adding an additional challenge in the local versus global pay practices is the granting of LTIs. As noted, cash compensation is generally locally driven and LTIs are delivered and administered from the home country. Metrics are designed globally, awards are denominated and paid in one currency. However, adjustments to award sizes are made locally to balance award opportunities and prevent unjust enrichment. Often, LTIs can be used to balance the shortcoming of a deficient local compensation design for key talent.

Lastly, historical practices can also affect global pay programs. In Japan, for example, market practice results in executive pay levels that are generally less than their global peers. When executives in Japan take international assignments, they appear to be underpaid, which in turn causes internal pay equity issues. Companies that find themselves in this situation may ask themselves questions such as:

- Should pay adjustments be made?
- When should the adjustments be made — right away or over time?
- What should be adjusted — salary, incentive opportunities?
- What happens when the executive returns to the home country? Does the reverse occur?

Expatriate pay design and repatriation issues should be addressed when developing a global compensation philosophy — these topics are beyond the scope of this article.

Keeping Pace with Trends

The role of rewards professionals has become more crucial than ever as they are expected to navigate complexities associated with current and future trends in the marketplace — including U.S. multinational companies determining: whether they should differentiate LTI globally for people in hot jobs such as IT or engineering; the need for ongoing benchmarking as concerns to retain top talent grow; how the strength of the U.S. dollar is affecting pay, especially from an LTI perspective; the prevalence of performance-based long-term plans increasing outside the U.S.; and so much more.

As companies continue to expand internationally, the need for a comprehensive global strategy — which includes a review of LTI practices, taking into account the factors we've outlined in this article — becomes paramount. LTI awards are typically the largest component of executive pay and can therefore have the greatest impact on decision-making for global management. Developing competitive LTI policies and practices can be complex and challenging. To help drive business success, increase employment engagement and retention, and maintain long-term performance, companies need to design LTI plans that are local-market competitive.

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