What Are the Pay Equity Implications of Expatriate Compensation?

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Abstract

Identification of effective and cost-efficient compensation practices for recruiting and retaining expatriate employees is becoming increasingly important in today’s global labor market. This paper proposes a study to investigate perceptions of fair compensation for expatriate employment using the tenets of equity theory. Participants will specify an “equitable” monetary bonus for hypothetical overseas assignments of different lengths and locations. Relying on Konopaske’s and Werner’s (2002) propositions, the author predicts the following: 1) Short-term overseas assignments will require a larger “foreign service premium” (monetary bonus) than domestic relocation, 2) Long-term expatriate assignments will require a larger premium than short-term or domestic relocation, and 3) Relocation to a developing country will require a larger premium than relocation to an advanced industrialized nation or to a domestic location. A methodology and data analysis strategy are described.

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Introduction

Over the last half century, globalization has profoundly affected the dynamics of national economies and labor markets. Free-trade agreements among nations and efficient transportation systems allow for an exchange of goods and services across borders impossible only a century ago. This global economy has also produced an international workforce, allowing the skills and knowledge of human capital to be strategically employed where they are most needed. A loosening of restrictions on foreign investment and the growing influence of multinational corporations are increasing the employment of expatriates, defined as a national of the company’s base-country assigned to work in a foreign host-country (Milkovich, Newman, & Cole, 2005).

Reynolds (1997) has specified three reasons why a company may choose to employ an expatriate rather than a local national. First, overseas assignments provide high-potential employees a chance to develop an international perspective. Alternatively, a company may only trust a proven domestic employee for a sensitive and/or confidential position. In other situations, specialized skills and knowledge may not be available in the local labor market requiring the exportation of home-country personnel.

Although the need for qualified expatriates and other types of global employees is increasing (Gomez-Mejia & Wilbourne, 1991), the demand for such individuals is greater than the available supply (Quelch & Bloom, 1999). Therefore, the identification of effective compensation strategies for recruiting and retaining qualified expatriate employees is of vital importance to the success of global enterprises. As the acceptance of an overseas assignment involves significant added expenses for an employee, employers have traditionally provided expatriates with a variety of financial adjustments and incentives. Components of expatriate compensation have included the following: tax equalization payments, housing allowances, child education allowances, transportation expense reimbursement, currency protection, family support programs (such as spousal employment assistance), and social adjustment programs (such as emergency leave, rest and relaxation leave, career development, repatriation planning, and language/culture training) (Milkovich, Newman, & Cole, 2005). In addition, employers generally pay expatriates a foreign service premium to compensate for the psychological stress and inconvenience of moving to and residing outside their home-country. Therefore, the cost of a total expatriate compensation package is often high. Puccino (2005) estimates that the cost to a company of keeping an employee and his family overseas for a typical three year assignment can run as high as $1.4 million or three to four times the employee’s annual base salary.

Willingness to Accept Expatriate Employment

Despite such financial benefits, many companies have found managers reluctant to relocate internationally (Feldman & Thomas, 1992). A manager’s family situation is often a determinate of expatriate employment acceptance. Several researchers have documented the influence of spousal attitudes on an employee’s willingness to accept an international assignment (Konopaske, Robie, & Ivancevich, 2005, Brett & Stroh, 1995) and the decision to return before
the assignment has been completed (Tung, 1997). Black & Gregersen (1999) found that spouses most willing to accept international relocation were older, well-educated, predisposed towards moving, willing to relocate domestically, and had no children living at home. In addition, the researchers report that spouses who believe a company has a favorable reputation for providing relocation services were more likely to be supportive of their spouse’s expatriate employment. However, spouses who are highly engaged in their current job were the least willing to support global relocation (Brett & Stroh, 1988) especially for short-term assignments (Konopaske et al., 2005).

Other employees are unwilling to accept expatriate employment for career-related reasons. For example, many managers report fears that accepting overseas employment will sidetrack their careers by removing them from their local labor market (Milkovich, Newman, Cole, 2005). This is particularly worrisome as prior research documents that 25% of expatriates leave their company within three years upon returning to their home country (Black, 1989). Many expatriates feel that they were not provided with adequate information about local costs, standards of living, and expenses (Suutari, 2001) and many are dissatisfied with their company’s internal communication (Bonache, 2006).

Some researchers have posited that individual differences in personality may be a significant factor in an employee’s willingness to accept an international assignment. Personality is defined as those stable factors that predispose individuals to behavior in certain ways (Costa & McCrae, 1992). Konopaske and Werner (2002) suggest that personality traits of “adventurousness” and “excitement-seeking” are positively related to the acceptance of expatriate employment. In addition, Konopaske, et al., (2005) found that spouses high in “adventurousness” are more willing to support their spouse’s global relocation. Overall, males are more willing to accept assignments or to follow their spouses overseas than women are (van der Velde, Bossink, & Jansen, 2005).

The length of an overseas assignment may affect an employee’s willingness to accept expatriate employment. Although such assignments traditionally last three to five years (Flynn 1999), more companies are offering short-term (less than one year) assignments to attract candidates who would not be willing to accept a longer-term relocation (McErlain, 1999 cited in Konopaske, et al., 2005). Consequently, Konopase et al. (2005) found that spouses are more willing to support short-term rather than long-term assignments.

Employees may also consider the location of an assignment when making a decision. Moving from an advanced industrialized nation (AIN) such as Canada or the U.S.A. to another AIN would seem to require less psychosocial adjustment then moving to a developing country (e.g., Brazil or Indonesia). This assumption is based on Oberg’s (1958 in Konopaske & Werner, 2002) concept of “culture-shock,” defined as a generalized trauma that results from entering a new culture and having to learn and cope with different cultural cues and expectations. Oberg (1960 in Ericson, 1999) further proposed a four stage process of acculturation including a honeymoon, crisis, adjustment, and complete adjustment that occurs when relocating to a different cultural environment. Adler (1997) has suggested that the acculturation process may last six months before expatriates can completely overcome the culture shock experience. Therefore, a move from an advanced industrialized nation to a developing nation can be
reasonably expected to produce a greater culture shock and longer acculturation period than relocation to another AIN.

A primary consideration in the decision to relocate overseas is the perception that the relocation will be fairly and equitably compensated. However, 80% of expatriates report that their salaries are unfairly low when compared with their colleagues (Harvey, 1993). This finding is surprising considering the substantial expatriate allowances and foreign service premiums typically provided and suggests a complex relationship between compensation and perceptions of pay fairness. Fortunately, equity theory provides a tool for unraveling the complexity of expatriate compensation perceptions.

**Equity Theory**

Equity theory (Adams 1963) is a derivation of Festinger's (1957) theory of cognitive dissonance. According to Festinger, an individual experiences dissonance when he detects a discrepancy between his beliefs and his behaviors. The experience of dissonance motivates the individual to either change his beliefs or alter his behaviors. Adams's (1963) equity theory applies the concept of cognitive dissonance to an individual’s perceptions of the employment relationship and assumes that an employee compares his/her work-related inputs, such as effort, performance, and time, with the outcomes he/she receives. This ratio of inputs to outcomes is compared with specific "referent" individuals. Inequity exists when the output-input ratio between an individual and a comparative referent are unequal. For example, if an individual believes that a comparable referent receives more pay for the same amount of work, the individual will likely experience a payment inequity.

Inequity is assumed to create tension, motivating the individual to restore an equitable state. The individual may accomplish this restoration by one or a combination of the following strategies: altering his personal inputs and/or outcomes, changing the comparison referent’s inputs and/or outcomes, using cognitive distortion to change perceptions, changing the referent used for comparison, or removing himself from the situation (Mowday, 1983). Empirical research has supported the predictions of equity theory in a variety of contexts (Mowday, 1983).

Three types of equity have been considered in relation to employee compensation (Konopaske & Werner, 2002). The first type, external equity, concerns employee’s perceptions of pay in comparison to employees in the same position but in a different organization. External equity occurs when positions with similar job titles and responsibilities across companies are paid comparably and is normally achieved when companies set wages at market levels. Organizational size, type of industry, firm’s ability to pay, geographic location, and the capital-intensiveness of firms are key factors affecting pay differences across firms and, therefore, influences external equity (Milkovich et al. 2005).

Internal equity involves the perceptions of pay fairness across different jobs within the same organization. The factors affecting internal equity, also referred to as internal alignment (Milkovich, et al., 2005), are job-based relating to the input component of the individual’s input to outcome ratio. Organizations attempt to maintain perceptions of internal pay equity through the use of job evaluation procedures that compare the job requirements (e.g., education and
experience), the nature of the work (task, behaviors, working conditions), and the output value of different jobs within the organization.

Employee equity relates to comparisons of individuals in the same job within the same organization. Individual performance, effort, and seniority are primary inputs for perceptions of this type of equity. Consistent with equity predictions, research demonstrates that employees desire pay raises and overall pay levels that are based on individual merit or job performance (Sherer, Schwab & Heneman, 1987) and seniority (Werner & Ones, 2000). Some research has suggested that gender may be perceived as a job input (Adams, 1963) due to the traditional discrepancies of pay between men and women. Other researchers have suggested that organizational citizenship behaviors (behaviors that benefit the organization but are not specified in an employee’s job description) may also serve as an employee input (Organ, 1988 as cited in Konopaske & Werner, 2002) influencing equity perceptions.

The Proposed Study

Although the prediction of equity theory have been consistently supported (Summers & DeNisi, 1990; Mowday, 1983 ), little research has explored how equity theory explains expatriates’ perceptions of pay fairness. This paper proposes a study utilizing equity theory to predict employees’ perceptions of fair compensation for overseas assignments of different lengths and in various locations.

Konopaske and Werner (2002) have put for a series of propositions based on the assumption that expatriates use other home-country expatriates and non-expatriates as their comparison referents. First, they predict that employees will perceive an expatriate assignment to increase employee inputs due to the reduction in supervision typical of expatriate positions, the inconvenience of a physical relocation, and the need to adjust to a new location. Second, relocation from an advanced industrialized country (AIN) to a developing country (DC) will increase perceived employee inputs as relocation to a DC will require a greater cultural adjustment due to differences in living standards than would occur with relocation to another AIN. Lastly, as the length of an overseas assignment increases, the physical and psychological adjustment required to adapt to an expatriate relocation will increase (particularly for those employees with a spouse and children) leading to an increase in perceived employee inputs. Each prediction assumes that increased compensation (or other payment) will be required to restore an equitable balance of employee inputs to outcomes.

The proposed study will test each prediction by presenting participants with fourteen vignettes describing hypothetical long-term and short-term expatriate assignments in either an AIN or DC. Each assignment is based on a project management position and includes standard expatriate housing, transportation, moving, and childcare allowances. Participants will be asked to specify a foreign service premium that they believe to be fair compensation for accepting the assignment and relocation. The foreign service premium specified for the various expatriate scenarios will serve as the dependent variable of the study. Based on Konopaske and Werner’s proposition, we proffer the following hypotheses:
H1: In order to achieve an equitable payment condition, participants will specify a higher foreign service premium for a short-term expatriate assignment than a short-term non-expatriate assignment.

H2: In order to achieve an equitable payment condition, participants will specify a higher foreign service premium for a long-term expatriate assignment than a short-term expatriate assignment.

H3: In order to achieve an equitable payment condition, participants will specify a higher foreign service premium for an expatriate assignment requiring relocation from an AIN to a DC than an expatriate assignment requiring relocation from an AIN to another AIN.

Method

Participants

Fifty students enrolled in an MBA program at a university in southern Ontario will be recruited through class announcements as participants. Due to the demographics of the university’s MBA program, we expect a balance of males and females of various ages, work experience levels, and ethnicities. Participants will receive a coupon for a free beverage at a popular chain as compensation for their participation.

Procedure

Students who agree to participate will immediately be given the five-minute questionnaire to complete. The first page will briefly explain the purpose of the study and provide assurances of confidentiality. The first page will also ask subjects to indicate their age, gender, profession (if currently working full-time), intended profession after graduation, years of full-time work experience, and country of permanent residence (as the university’s MBA program contains a significant number of international students).

The fourteen vignettes will begin on the second page of the questionnaire. For each, participants will be told to assume the position described involves a single (unmarried and without children) project manager currently working from the Toronto office of a Fortune 500 financial services company. Two vignettes will describe an internal transfer requiring relocation to Ottawa, Ontario. Six of the scenarios will require the employee to relocate to one of three advanced industrialized nations (Japan, Germany, Portugal). The remaining six vignettes describe an assignment requiring relocation to a developing country (Philippines, Slovakia, Brazil). One vignette for each country will indicate a short term (length of 1 year assignment) while the other will be a long-term (length of 3 years) assignment. All vignettes will describe the assignment as including paid moving expenses, tax equalization adjustments, increases for any cost-of-living differences between the Toronto and the relocation country, cross-cultural and language training, international medical and life insurance, and reimbursement for travel. In order to reduce the effects of ordering, the experimenter will employ a Latin-squares rotation method of the vignettes, creating fourteen versions of the questionnaire. Participants will be randomly assigned to each of the fourteen versions.
Dependent Variable

After reading each of the fourteen vignettes, participants will answer the following question: “What annual, lump-sum amount (above your current base salary and in addition to the expatriate expense allowances) would you feel is fair compensation for accepting this assignment in the corresponding relocation?” All responses will be rounded to the nearest thousand. Participants will be informed that the base salary of the position is $100,000. The participant’s answer to this question will serve as the equitable “foreign service premium” for the specific scenario.

Data Analysis Strategy

Manipulation Checks

Manipulation of developing country and advanced industrialized nations assumes that no differences exist among nations within each category (i.e., Thailand = Brazil = Slovakia, Portugal = Japan = Germany). A repeated measures ANOVA will be performed to test for differences among the “foreign service premiums” of the three developing countries and the three advanced industrialized nations.

Primary Analysis

Repeated Measures ANOVAS are the appropriate statistical tool for this study’s data analysis. The first hypothesis will be evaluated by comparing the “foreign service premium” assigned to the domestic (Ottawa, ON), short-term assignment with the participant’s average premium for the three foreign, short-term relocations. Similarly, Hypothesis Two will require a comparison of participants’ average premium across the three foreign, long-term assignments with the average premium for foreign, short-term assignments and with the average premium for domestic, long-term assignments. In order to evaluate the third hypothesis, the average premium across the six developing countries scenarios (including long-term and short-term assignments) will be compared with the six advanced industrialized nations scenarios and with the two domestic relocation scenarios.

Potential Contribution

The results of the proposed study will provide a unique investigation of the pay equity implications of two aspects of expatriate employment – assignment length and duration. The choice of an experimental methodology allows for tight control and manipulation of the individual variables. However, a vignette-based approach will necessary limit the generalizability and ecological validity of the study’s findings. Therefore, the author envisions this as the first of a series of related studies that will expand to include more realistic methods using samples with real expatriate employees. Future research will also consider the source of an expatriate’s comparison “referents,” as differences between expatriates and local employees may serve as a unique source of pay inequity.
References


