

CROSS CULTURAL DIMENSION OF COMPENSATION MANAGEMENT: GLOBAL PERSPECTIVES

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Abstract With the advent of globalization, companies have realized the need to operate transnational and mark their footsteps across the world. The rise in frequent cross-nation transaction and operation has lead companies to focus on people centric approaches. Cross cultural issues have acted as hindrances in the performance of the organizations. Thus, there is a huge scope for companies to focus on HR approaches which act as a solution to numerous cross cultural issues. One such area which requires close attention of HR professionals is the 'Compensation Management'. While developing the global compensation and benefit composition, HR must deal with many factors that are not present in a domestic environment. In this paper, it is attempted to discuss about some of those factors that unswervingly impacts global compensation and benefits strategies. The paper identifies the factors affecting international compensation management and discusses the role of culture in developing compensation strategies.

Keywords: Expatriate Pay, Compensation Management, Cross-Culture, International Compensation.

1. INTRODUCTION

The focus of today's organizations is on Human Resource Management challenges that accompany the process of internationalization leading to raising issues on operation in an interconnected world where people are the source of sustainable competitive advantage. Local firms are competing with global corporations without venturing abroad. The metaphors of a 'Flat world' Friedman, (2005) or a 'Global village' Ger, (1999) are now fitting descriptions of the contemporary business world. Internationalization has a particular strong impact on understanding of Human Resource Management. Evans, Pucik and Barsoux, (2010) has elaborated that the issues that gave birth to international human resource management remain more important than other functional areas is expatriation and adaptation of practices to different cultures.

Rao, (2009) pointed out that international businesses normally employ the people from various countries. Therefore, the task of Human Resource Management is much complicated. Jing, (2010) has explained that some authors do not give a clear definition to Human Resource Management and thus emphasizes that it is policies that a company has, and activities that it takes which include job analysis and design, staff recruitment and selection, training

and development, performance management, employees safety and health management, compensation management, staff motivation, labour relations management, and labour relations management; we conclude those activities as the modern management methods of enterprise to obtain human resources (selection), development (education), keep and use (employment) etc, which carried out by planning, organizing, directing, coordinating, and controlling to achieve the goal of a enterprises development (de Kok, 2003). Price, (2004) has emphasized that human resource management is aimed at recruiting capable, flexible and committed people, managing and rewarding their performance and developing key competences.

Compensation Management is one of the crucial areas for HR professionals especially when operating globally. The objective of this paper is three folded.

- To identify the factors affecting international compensation management
- To explain the role of compensation management in managing across cultures.
- To discuss the role of culture in developing compensation strategies

The paper discusses the scholarly works of researchers in the areas of cross cultural studies and compensation management.

The paper is based on secondary data or past researches and intends to draw the attention of readers to the relation of cross cultural studies to compensation management strategies at organizations.

2. ROLE OF COMPENSATION MANAGEMENT IN MANAGING ACROSS CULTURES

International business people, who face the challenge of managing and motivating employees with different cultural backgrounds, need to understand what personality traits and need structures are?; and how they differ across culture? Organizations and Human Resource (HR) professionals are continually in search of ways to motivate and reward employees in order to increase their motivation and performance. One primary HR tool that is used to affect motivation and performance is compensation (Lawler, 1971). Recently, more emphasis has been on the use of variable compensation schemes, instead of fixed forms of pay (Greene, 2003; Marks, 2001). In order to increase employee productivity and thus firm performance. A distinct advantage is that variable pay costs “flex in sync” with revenues when the plan is well designed (Greene, 2003).

Variable pay schemes entail individual, group, and organizational level forms of Remuneration such as bonuses, incentives, on-the-spot bonuses, profit sharing, and Various other Pay-for-Performance schemes. They essentially are based on a principle that suggests an individual’s pay should vary based upon performance (of the individual, group, or organization). Fixed compensation tools, on the other hand, are preset, such as the traditional straight salary method of pay.

A number of propositions in support of merit pay may be drawn from theories put forward by scholars such as (Vroom, 1964 & Skinner, 1969). Vroom’s expectancy theory, briefly, indicates that the greater the belief that effort will lead to reward and the greater the value placed on that reward, the greater the motivation to work will be. Skinner’s proposition is that, behavior that is rewarded (in his terms, reinforced) will become more frequent. While very few controlled, empirical evaluations exist Pearce, et al., (1985), many believe that merit pay can bring efficiency, an enhanced competitive framework and improved results to public sector.

3. CULTURE BASED STRATEGIC COMPENSATION MANAGEMENT

Culture plays a central role in influencing various HR systems in the organization. The effectiveness of the performance management depends on the organizational culture. The consequences of impact of organizational culture on

performance management can be felt in compensation management. Culture based compensation management refers to a rules, culture of an organization that ingrains, reinforces, echoes and motivates those behaviors, values and actions that are positive, constructive and meaningful and tends to reward the same. Organizations with performance management driven compensation tends to comprise of an integrated performance management system, high performing work system and practices, mentorship, counseling and feedback systems, talent mapping and development system and strategic career and succession management system.

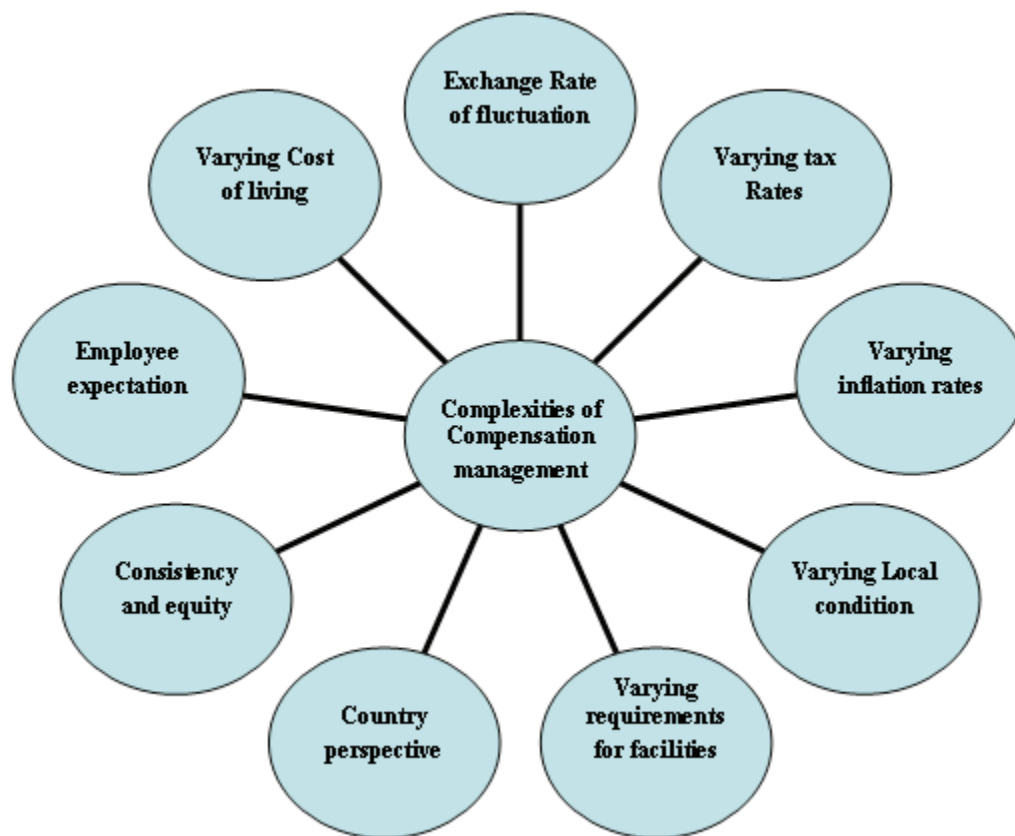
Depending on the type of culture, strategic compensation management will differ from one organization to another. McAdams (1996) recognizes the following types of cultures:

1. Apathetic Culture: There is no place for strategic compensation as there is no emphasis on people or performance improvement. Seniority rules, promotions are slow and automatic and performance management are rare.
2. Paternalistic Culture: In this culture, the focus is on people with less concern for performance. Most of these organizations meet employees’ need such as day care, flex-time etc. Compensation is important but strategic compensation carries least priority in such organizations.
3. Demanding Culture: Strategic culture is most valued. The focus is on efficiency, competition, individual performance and job position. Individual performance drives compensation of employees.
4. Involvement Culture: Core values are both people and performance. Both fixed and strategic compensation are important. In such, cultures, individual performance and team considerations carry equal weightage, and compensation strategy is oriented towards both fixed as well as incentives.

4. DETERMINANTS OF EXPATRIATES COMPENSATION

A more complex set of compensation issues apply to expatriate managers. Contemporary human resource management practice suggests that organizations should provide good compensation packages and training and development opportunities because organizations will benefit in the long run (McManis and Leibman, 1994). Compensation management function is more critical and complex over other functions. The salary and benefits levels vary from country to country. MNC’s face dichotomy with regard to maintenance of consistency of pay for those employees who move from one country to another within the service of the same MNC. Further maintaining a balance between expatriates’ pay and

Figure 1: Complexities of Compensation Management



Source: Rao, S. (2009) International Human Resource Management, Himalaya Publishing House, Mumbai. p- 330

nationals' pay. Most international business finds it necessary to provide these managers with differential compensation to make up for dramatic differences in currency valuation, standards of living, lifestyles norms and so on. Griffin and Pustay, (1999) has elucidated that compensation packages includes salary and non-salary items and determined by labor market forces such as supply and demand of managerial talent, occupational status, professional licensing required, standards of living, government regulations, tax codes and similar factor.

The various complexities of compensation management in organizations operating globally are as represented in Figure 1.

4.1. Complexities of Compensation Management

Armstrong, (2007) has explained the two basic approaches to devising expatriate pay packages: home-based and host-based pay.

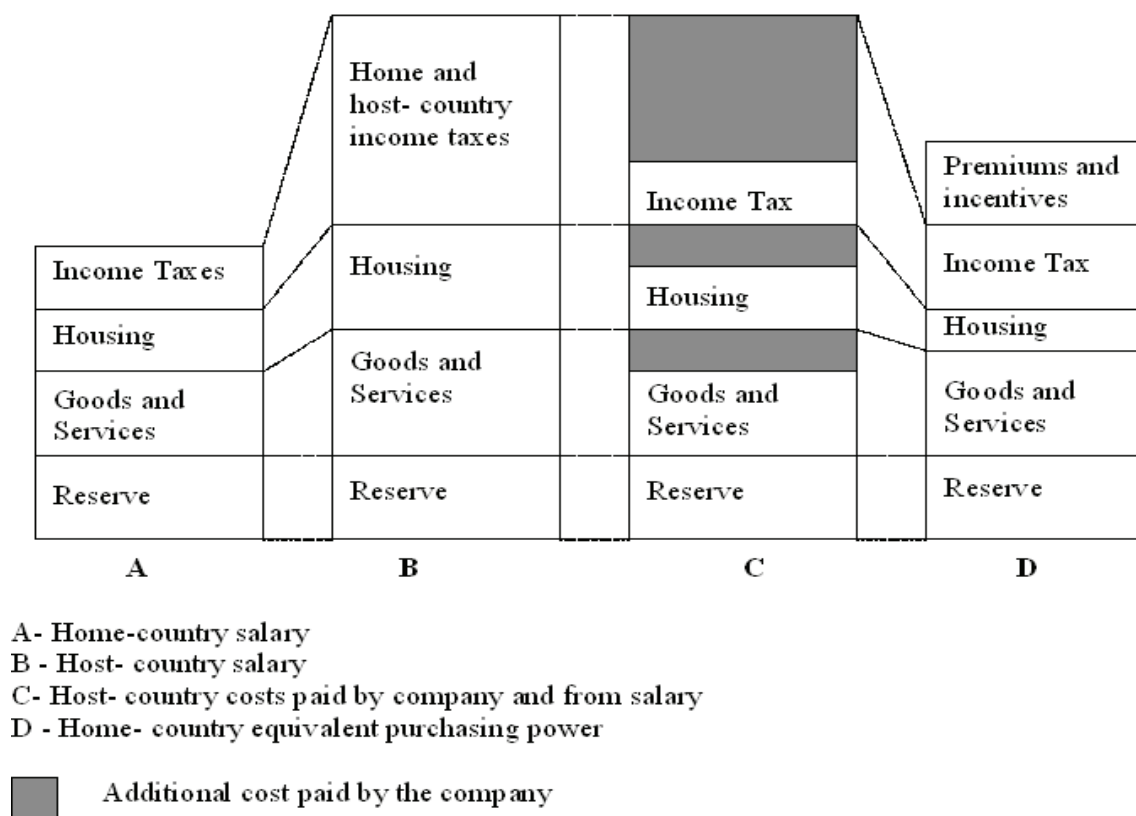
- a) Home-based pay: The home-based pay approach aims to ensure that the value of the expatriates, salary is the same as in the home salary. The home-base salary may be a notional one for long-term assignments and for

short term assignment it may be the actual salary of the individual. The notional or actual home-base salary is used as a foundation upon which the total remuneration package is built. This is sometimes called 'built-up' or 'balanced sheet' approach.

- b) Host-based Approach: The host based approach provides expatriates with salaries and benefits such as company cars and holidays which are in line with those given to the host country in similar jobs. The host based method ensures equity between expatriates and host country nationals. The host based method is certainly equitable from the viewpoint of the local nationals, and it can be less expensive than home-based pay. But it may be much less attractive as an inducement for employees to work abroad, especially in unpleasant locations, and it can be difficult to collect market rate data locally to provide a basis for setting pay levels.

Deresky, (2006) explained that to ensure that expatriates do not lose out through their overseas assignment, the balance sheet approach should be used to equalize the standard of living between the host country and to add some compensation for inconvenience or qualitative loss. The concept has been explained as in figure 2.

Figure 2: The Balance Sheet Approach.



Source: Reynolds, C. (1989) 2e. Compensation of overseas personnel, in Famularo, Handbook of Human Resource Administration, McGraw-Hill

5. THE BALANCE SHEET APPROACH

5.1. Factors Affecting International Compensation

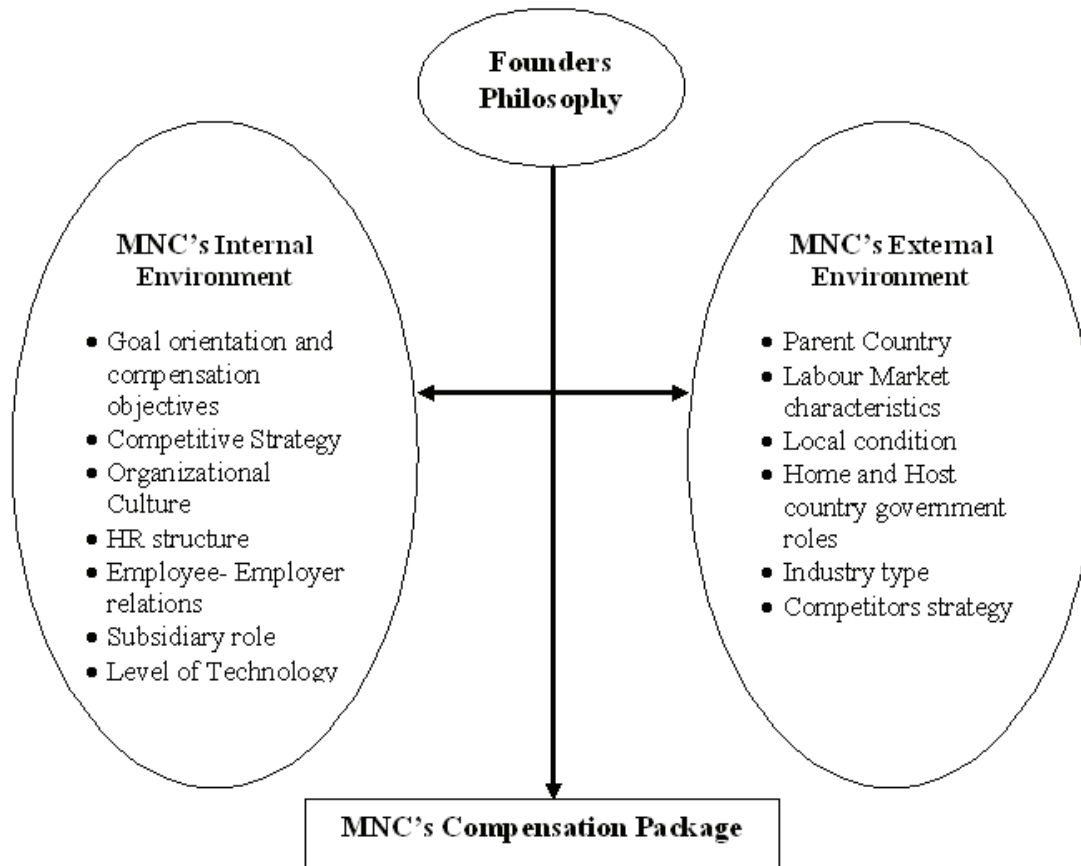
Most international businesses find it necessary to provide managers with differential compensation to make up for dramatic differentiation in currency valuation, standard of living, lifestyles norms, and so on. Figure 3. clarifies the factors associated with internal and external environment of MNC's for framing the international compensation.

5.2. Determinants of Executive Compensation

Company size is closely related to job complexity and employer's ability to pay in determining executive pay (Hijazi and Bhatti, 2007). Pay and Performance of top executives are strongly and positively related to each other. Level of pay affects the quality of managers an organization

can attract (Murphy & Jensen, 1990a). Studies in the area focused on documenting the relation between CEO pay and company performance was carried (Coughlan and Schmidt, 1985; Jensen and Murphy, 1990b; Abowd, 1990). Various studies on the poor performance and the CEOs termination were conducted. Studies clarified the issue of CEOs being rewarded for performance measures relative to the market or industry (Gibbons and Murphy, 1990).

In the Indian context there are studies conducted on CEOs compensation. Previous studies reported that CEOs of many Indian companies saw a 300 percent increase in salary in 2004. The studies also revealed that a huge part of CEO salary is in the form of variable pay. Ramaswamy et al, (2000) have studied the impact of human capital, firm performance and corporate governance on CEOs compensation using a sample of top 150 Indian firms. The study revealed a significant impact of firm's performance on CEOs compensation but firm size did not have a significant impact. Ghosh, (2003) studied the compensation of the board of directors along with CEO compensation to capture the effects of inefficient monitoring by the board. The study model included firm performance,

Figure 3: Factors affecting International Compensation

Source: Fenwick, M. (2006) 'International Compensation and Performance Management', in Anne Will, Harzing and Joris Van Ruysseveldt (eds), Sage Publication, London p-311

corporate governance and corporate diversification measures as determinants of CEO and Board compensation. The study revealed that board compensation depends on current and past year performance while CEO depends only on current year performance.

6. COMPENSATION FOR LOCAL MANAGERS

Localization is not a one-time only effort (Evans, Pucik and Barsoux, 2010). The challenge does not end with the appointment of a competent local management team. Once implemented localization efforts need to be sustained and carefully managed. The main challenge lies in balancing autonomy and support. Local cannot cope when the expatriates pull out thus it is to be taken as a campaign rather than an effort to harness and develop local capabilities. Compensation looms large among the mechanism to retain the local technicians and managers. Paying above market rates are typical measure. Pay is only one part of the compensation package and some companies propose more

binding facilities such as interest free loans, private health insurance or housing assistance programs. A number of variable apply including local market factors and pay scales, government involvement in benefits, unions, and the cost of living must all be considered. It is important to make clear what benefits, as well as salary, come with a position because of the way compensation is perceived and regulated around the world

6.1. Role of Culture in Developing Compensation Strategies: Research Across Countries

Hofstede's (1993) has defined 'Culture' as the collective programming of the mind that distinguishes one group or category of people from another. Understanding cultural differences is critical to the success of firms that intends to go global or is operating globally. A society's culture also reflects its value, beliefs, behaviors, customs and attitudes. Earley and Singh (1995) pointed out that the empirical literature in cross-cultural research is plagued with 'confusion concerning

the role of culture and national context'. Cavusgil and Das (1997) discussed methodological challenges in comparative cross-cultural research in management.

Earley and Gibson (1998) tracked the studies of individualism and collectivism over 100 years. Werner (2002) analyzed recent developments in international management research in 20 top management journals. Kirkman, Lowe, and Gibson (2006), reviewed 25 years of empirical research on Hofstede's cultural values framework.

A high difference exists cross culturally in the benefits provided. Ginnekan and Hoewan, (1989) Germany employers customarily reimburse their executives for car expenses. In Japan, the executive may actually get a car plus expenses. Japanese executives also receive generous entertainment allowances and allowance for business gifts. Similarly, British companies typically provide company cars to managers. In United States, firms offer managers health care benefits because such benefits are free from income taxes.

As Indian business expands globally, companies are now taking into account the cross culture implications of developing compensation strategies for managers from different countries.

7. CHINA

Managers are young and have experience working or studying abroad and have technical degrees. Managers are mostly benevolent authoritarians. Employees expect managers to lead by example. Managers who are hard-working and involved, gain respect and compliance from their employees. A survey by Elsevier declared that in the past, employers paid relatively low salaries but provided many benefits, such as housing, meals, transportation, clothing, etc. These practices still exist, especially in state-owned firms and in contract manufacturing sites where employees are housed on-site, but foreign firms tend to emphasize salary over benefits. In the transition to a market economy, high salaries and bonuses are becoming common for the most widely sought after managers, particularly English speakers.

8. INDIA

Indian managers generally focus on building strong emotional bonds with their subordinates, peers, and superiors. Managers are chosen on the basis of intellectual capability and knowledge. Managers are expected to know more than their subordinates, both in terms of expertise and company information. Indian organizations ensure that they have enough money to maintain a desired standard of living if they should become unemployed or encounter some other loss of income. Earlier the civil service jobs were some of

the highest-paying and therefore most desirable jobs in India. However, recently, high-ceilinged salaries and benefits of IT industries set a changed pattern of desirability for jobs in the private sector.

8.1. Influence of Culture on Compensation (Hofstede's Cultural Dimension Perspective)

Cultural differences have a major impact on compensation policy owing to differences in various cultural beliefs and norms. Hofstede (1991) gave five dimensions of culture which are discussed below to emphasize the impact of culture on compensation.

The Cultural dimensions are:

1. **Power Distance:** This refers to the extent to which inequalities among people are seen as normal. This dimension stretches from equal relations being seen as normal to wide inequalities being viewed as normal. In countries with higher power distance like France among the numerous such countries the power of organization is centralized, there is a huge difference between the top and the bottom echelons of the organization. Compensation rises given more for personal relationship than for performance or competencies. Employees are generally manual in nature and have less status than office work. However in countries with a low degree of power distance, compensation differential between different levels are comparatively lesser. Competence and performance is highly compensated and in fact, highly qualified employees command premium compensation.
2. **Individualism and collectivism:** This parameter describes whether individuals are used to acting as individuals or as part of cohesive group, which is based on the family (more the case with Chinese societies) or the corporation - as may be the case in Japan: Hui, (1990). Compensation in individualistic cultures is more oriented towards rewarding personal accomplishments and individual satisfaction is of prime goal of compensation management. Performance related pay is more successful in such cultures. In collectivist culture, compensation prime goal is satisfaction of group objectives. Employees closely related to the bosses get higher compensation.
3. **Masculinity and femininity:** Hofstede (1980) distinguishes hard values such as assertiveness and competition, and the soft or feminine values of personal relations, quality of life and caring about others, where in a masculine society gender role differentiation is emphasized. In masculine cultures, compensation differentials exist between men and

women based on gender discrimination. Women with similar qualification and performing similar work are paid less than their male counterparts. In femininity cultures, men and women are paid according to their qualification, ability and talents has no gender biasness.

4. **Uncertainty Avoidance:** This refers to a preference for structured situation versus unstructured situations. In countries with high uncertainty avoidance, feelings of safety and security is likely to be strong, therefore employees shall be highly motivated by compensation. In cultures with small degree of uncertainty avoidance like Sweden, employees will be motivated more by achievements, appreciation and sense of belongingness.
5. **Confucian Dynamics:** This parameter refers to the choice between long- term versus short- term focus in life. In culture which emphasizes on long- term focus, deferred compensation in the form of ESOP, retiral benefits are preferred. On the other hand, short-term focused culture is characterized by personal stability, to protect ones face, respect for traditions and reciprocity.

9. MANAGING COMPENSATION ACROSS CULTURES

Compensation provides the point at which organizational and individual priorities and goals meet, encouraging the contentment of both parties. It provides the driving force for talent acquisition and retention. It also acts as an encouragement for the talent to be persistent, enviable and performance oriented. Cultural differences necessitate understanding that the value of compensation and benefits programs is in “the eye of the beholder”. A benefit highly valued in one country may be comparatively worthless in another. Differences are often rooted in subconscious beliefs, attitudes and values (Himachali, 2010). Cultural differences often create ethical problems. Acceptable behavior in one culture may be viewed as immoral in another. In many poorer countries low- paid workers often expect small payment in return of small tasks other than regular work. Such behavior is inappropriate in richer countries where such payments may be considered as bribe.

Griffin and Pustay, (1999) explained a cultural cluster comprises countries that share many cultural similarities, although differences do remain. Ronen et al. (1985) has justified how clusters are based on language similarities, as is apparent in the Anglo, Germanic, Latin, American and Arab clusters and to a lesser extent, in the Nordic and Latin European clusters. Many international businesses instinctively utilize the country clustering approach in

formulating their international strategies. This acts as a base for the formulation of compensation management strategies.

Child, (1981) noted that the effects of culture are most evident as the interpersonal level, and that cultural effects are dissipated at the organizational level of analysis. Cheng (1987) also noted that although culture is an important aspect of national distinctiveness, it is only one of the differences between countries. A doubt was raised whether cultural affiliation has significant predictive utility in explaining macro-organizational phenomena although he conceded that it may have greater utility in predicting micro- organizational phenomena.

Townsend et al. (1990) studied 41 manufacturing industries in twenty eight countries across five different culture clusters. Cultural cluster model was applicable to the compensation practices. They studied the cultural groupings from cultural cluster model whose pay packages differed significantly from those of the other clusters. Although the level of pay shows some cultural influence, the greatest of culture is upon the ratio of other compensation to wages.

10. CONCLUSION

Compensation management is prone to cultural issues and norms. In some cultures, compensation is a matter of economics whereas in some other cultures, it is equated with the ‘total man reward’ concept that is, meeting the economic, social and psychological needs of the employees. Multinational companies manage their compensation by taking into account parent country and host country needs and norms.

Literatures support the statement that culture does act as a base for formulating compensation strategies when operating or is intended to operate internationally. Cultural study for both the host country and the home country acts a base for formulating the compensation system for expatriates, executives and local managers. The previous literatures proves that a strong correlation exists between the culture and pay system in different nations and a right or wrong do in the compensation of individuals influence the managing of the organization across cultures.

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