GLOBAL COMPENSATION

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The term compensation is often used interchangeably with wage and salary. However, the term compensation actually is a broader concept. Compensation refers not only to extrinsic rewards such as salary and benefits but also to intrinsic rewards such as achieving personal goals, autonomy, and more challenging job opportunities (Carrell, Elbert & Hatfield, 1995). The term wage and salary administration usually refers strictly to the monetary rewards given to employees (Carrell, Elbert & Hatfield, 1995).

Compensation comprises a wide range of components. A first distinction can be made between intrinsic and extrinsic compensation. Intrinsic compensation concerns the non-pecuniary compensation which is related directly to the nature of the work (Logger, Vinke & Kluytmans, 1995). Some examples of intrinsic compensation are job satisfaction, scope for development and promotion prospects. Extrinsic compensation basically is compensation of financial nature or whose values can be expressed in money (Logger, Vinke & Kluytmans, 1995). Extrinsic compensation can be divided into two: direct and indirect (and that is the second distinction of compensation). Direct compensation is employees' fixed and variable annual income while indirect compensation consists of all kinds of deferred income (Logger, Vinke & Kluytmans, 1995). The examples of direct compensation are wages, premiums and incentives, and the examples of indirect compensation are pension, insurance and benefits.

Multinational companies (MNCs) have many objectives in designing their compensation system. Primarily, the objectives of any MNC in designing a compensation system are to:
1. Attract good applicants.
2. Retain good employees.
3. Motivate employees.
4. Create environments that lead to employee cooperation and information exchange.
5. Optimize total wage and salary level.
6. Comply with the law.
7. Facilitate transfer between foreign subsidiaries, and between headquarters and foreign subsidiaries.

Alternative Compensation Methods

Not all objectives listed above are willing to be achieved in a short period of time. The companies have to decide which objectives are at the top priorities (relatively more urgent to achieve) and which ones are at the next priorities. That decision will determine which compensation method(s) are going to be used. However, the company needs to be very careful in selecting which method(s) to be used since the inappropriate selection may lead to the failure to achieve certain objectives.

So far, there are four alternative compensation methods available. The details are as follows:
1. Time-based method or compensation based on the time employees have already spent on their jobs. Thus, gross pay is calculated by multiplying the rate (the amount of money per time standard) by the units of time worked. The commonly used time standards are hour, day, week, two week (semi-month), month and year (annual). Employees prefer this method because it is clear and fixed (predictable). However, time-based method has one main disadvantage: it does not take the output yielded into account. So, productive employees may be harmed by this method.
2. Competency-based method or compensation based on the competency(ies) the employees have. With this method, the gross pay the employees received depends on how competent, in overall, they are. The more competent they are, the higher gross pay they receive. What does competency itself mean? In general, competency is defined as any underlying characteristic of an individual or team that can be shown to predict effective or superior performance in a job or situation (Tucker & Cofsky, 1994). Based on the type of characteristic demonstrated, competencies can be grouped into two categories (Tucker & Cofsky, 1994).
   a. Essential competencies which include skills (expertise) and knowledge. These competencies often can be acquired through training and development.
   b. Differentiating competencies which include self-concepts (attitudes, values and self-image), traits

(a general disposition to behave in certain ways), and motives (recurrent thoughts that drive behaviors). These competencies distinguish superior performance from average performance, and, although they are more difficult to develop, they can provide the basis for long-term success.

Available survey data indicate a rapid increase in the number of companies adopting this method (O'Neill & Lander, 1993/1994). I believe the main reason behind that is because adopting skill-based method can encourage every individual in the company to have new, desired competencies, and having competent employees is one important factor for the company being success in global competition.

3. Performance-based method or compensation based on employees' performance. The purpose of this method is to relate employees' gross pay directly to their performance. Performance-based method is quite popular among companies because it can motivate employees to increase their performance. Historically, performance-based method has meant only for individual performance but, since encouraging individual performance destroys cooperation among employees, most companies have modified it to include team (group and company-wide) performance. Today, when teamwork plays more important role in the success of the company, many companies place more emphasis on team performance than on individual performance. It means that employees will get higher pay if their teams perform well rather than if they individually perform well. The most popular form of pay-for-individual performance is merit pay system. According to Heneman (1992), merit pay system is a system where individual pay increases based on the rated performance of individual employee in a previous time period. This system was developed based on the Reinforcement Theory which assumes that any behavior, including performance, is determined by its consequences. Hence, by giving positive consequences to employees' individual past performance, they are motivated to increase their individual future performance. One form of pay-for-team performance that have been used for many years and in many varieties is gain-sharing system. In this system, pay increases are related directly to the company's performance. The better the company's performance, the higher the pay increases. However, the effectiveness of the system depends largely on a climate of participation (Beer & Walton, 1984). In a company with a good climate of participation (which means most structures, systems and procedures were created to involve employees in improvement process, and employees themselves are enthusiastic to participate in the process), the adoption of gain-sharing system will be effective because it can encourage people to participate in improvement process.

4. Seniority-based method or compensation based on employees' length of service. The company that applies this method, will pay more to employees who have longer length of service within the company regardless of any other factors. The logical reasons of applying seniority-based method are:
   a. It avoids biases in rewarding employees. With this method, it is obvious that senior employees deserve higher rewards than junior ones.
   b. It is quick and easy to apply.
   c. There is often a relationship between seniority and performance (employees usually become more competent at their jobs as they gain experience).
   d. It builds loyalty among employees which then may create people cohesiveness.

Global Compensation Policy

The area of global compensation is complex and this makes designing a global compensation policy not an easy task to do. The global compensation policy has to be formulated not only to meet the compensation multiple objectives mentioned in the previous section but also to cater to parent country nationals (PCNs), third country nationals (TCNs) and home country nationals (HCNs). Whether to establish an overall policy for all employees or to distinguish among them is the first issue facing MNCs when designing global compensation policies. The following are three approaches to address such issue (Dowling, Schuler & Welch, 1994):

1. Home-based approach. This approach links the base salary for PCNs and TCNs to the salary structure of the relevant home country. For example, a U.S. executive transferred to Indonesia will have his/her compensation built upon the U.S. base salary level rather than that applicable to the host country, Indonesia. One advantage of home-based approach is that international employees are treated equitably in relation to their home countries, which assist repatriation. However, international employees can be paid different amounts for performing the same function in the host country, according to the difference in home base salary level. That means, for instance, an American and a Philippino executive can have different compensation in Indonesia although they are doing exactly the same jobs. Home-

based approach can also become expensive as the number of PCNs and TCNs increases.

2. Host-based approach. With this approach, the base salary for international transfers is linked to the salary structure in the host country (e.g. a U.S. executive transfered to Indonesia will have his/her base salary built upon the Indonesia base salary level), but such significant international supplements as cost-of-living adjustments, housing, schooling, and other premiums, are usually connected to home country salary structure. The host-based approach is effective in attracting PCNs or TCNs to a location that pays higher salaries than those received in the home country, yet it poses problems upon repatriation when the person's salary reverts to home country levels. Inequity between PCNs and TCNs can still result as the foreign service premiums and benefits tend to still be linked to home country levels.

3. Region-based approach. This approach some MNCs have found attractive is to compensate PCNs working in their home regions at somewhat lower levels (an American works in Mexico) than those who are working in regions far from home (an American works in Indonesia). Some MNCs may realize significant cost savings by switching from home compensation system to regionally based one.

In addition to approaches, there are systems to compensate international employees. The bottom line for these systems is that the assigned employees must be compensated for what they miss out on. Economic factors play a role, but also the quality of the employee's social life. Up to now, most MNCs adopt one of the three systems below (Logger & Vinke, 1995):

1. Budget system. This system takes in all costs incurred by the employees in both home country and host country. These costs, and the effects of the local tax system, form the basis on which the employees' income is calculated. Budget system is extremely expensive to keep up because of the many adjustments which need to be made, notably in high-inflation countries. Also, such system is often seen as paternalistic by PCNs and TCNs since the employer in fact determines what items will and will not be included in the budget. But, on the other hand, if PCNs and TCNs are involved in budget arrangement, they always try to get as many as possible items getting on the list. The other drawback of budget system is the possibility of stirring up ill-feeling among HCNs when such imported, luxury goods as cheese and whisky are considered as basic essentials for PCNs and TCNs.

2. Balance sheet or home-net system. The premise underlying this system is that the same net sum must be available in both home and host countries. In this context, "net" does not mean net salary after taxes and social security contributions. In means the freely disposable income (the original, home gross income minus all premiums and costs). This disposable income, then, must be converted to local currency and adjusted by a factor called spending-power parity (the factor that equates spending power between home and host countries). Finally, such allowances as cost of living, housing and generally accepted spending patterns is added to the converted and adjusted disposable income. The benefit of balance system is that the PCNs are guaranteed their home country spending power. Moreover, it results in transparent and explainable differences between the salaries of PCNs who hold equivalent positions in different countries. A major drawback of this system is that it may cause large salary gaps within one and the same subsidiary, particularly between PCNs and HCNs.

3. Local going-rate system. Under this system, PCNs and TCNs are paid according to standards in the host country. That prevents the situation where junior employees are paid substantially higher salaries than PCNs who are compensated in conformity with the standards of income in their home country. The disadvantage of local going-rate system is that PCNs will not like the prospect of being assigned to a less prosperous country because they will certainly have lower salaries. MNCs that adopt this system are generally willing to compensate PCNs' lower salaries by giving various allowances such as extra housing costs, international schools and family visits.

Designing an Effective Compensation Program

A compensation program is a management method, and should be an integral part of the company's human resources management programs. Human resources management, in turn, is a subsystem, a part of the management of the company. The compensation program is, therefore, an important and integral component of the overall system of managing a company. The effectiveness of such compensation program will influence the effectiveness of overall company's management system. The effective compensation program should base on the following principles:

Principle 1: Serve all participants. It means that the compensation program should be consistent with the

interests of all participants in the company. The participants are the company's owners, managers and employees. From the owners' point of view, the compensation program should help them control the costs and contribute to greater employees productivity in return for each amount of money of compensation cost. From the managers' point of view, the compensation program should help them do the management job more effectively. That means the amount of compensation they receive should be equivalent with their responsibilities as the representatives of the owners. From employees' point of view, the compensation program should represent their values (competencies and contributions) to the business. It is almost impossible satisfying all participants' interests which are in conflict each other. The best thing that can be done is balancing those interests.

Principle 2: Simple. The best compensation program is certainly not the most elaborate nor is it the most complicated, but it should be as simple as possible. Why should it be simple? It is because it can be more understandable, and, hence, it can be implemented easily.

Principle 3: Fair. It means that the compensation program should be equitable internally and externally. Internal equity requires the company to set the amount of compensation that corresponds to the job worth and to pay compensation that allows distinctions to be made among individuals reflecting valued job inputs. External equity requires the company to pay compensation determined by workforce demand and supply (labor market).

Principle 4: Consistent with company's mission, objectives/goals and strategies. As mentioned in the beginning of this section, the compensation program is an integral part of the whole company's systems. That means the compensation program should be harmonious with other subsystems within the company, and they altogether have to focus on the same single point.

Principle 5: Fit with the company's culture. Company's culture means the ways individuals within a company do things. Company's culture is unique (there are no two or more companies which have exactly the same culture), and it directs the ways the people behave. Meanwhile, the compensation program basically is designed to encourage people to behave in certain ways. However, it can be very difficult and certainly takes time to encourage people to behave in unusual ways. How they can be encouraged if they are not familiar with such ways of behavior. So, the compensation program should encourage people to behave in usual ways, the ways that the culture directs them.

Principle 6: Flexible. Research indicates that employees differ widely in the preferences that they have for the compensation program (Lawler III, 1990). These differences are quite sensible and indeed predictable, given the differences in people's life-styles and personal situations. Considering those facts, it is necessary for the company to give little choice to individuals with respect to the compensation program, the choice that allows them to pick from among an array of compensations based on a budget which reflects the company's willingness to spend money on each of them. From individuals' side, this flexibility will be more attractive and can generate a perception that the company values them personally. From company's side, it will not increase the total compensation cost. Therefore, it will be a win-win situation.

Designing the compensation program itself is not a one-step process. It is a quite long process, and consists of sixteen steps as follows:

1. Form a cross-functional task force. The recommended members of this task force are top managers, compensation professionals and representatives of users (from both headquarters and subsidiaries).
2. Review the company's mission, objectives/goals and strategies, identify the company's culture, and identify the key success factors of the business.
3. Based on that review, then identify the company's needs in terms of its human resources (critical competencies, behaviors and performances of human resources). Long-term needs are more preferable than short-term ones because compensation program will not be designed for only short period of time.
4. Determine the compensation objectives that can satisfy those needs.
5. Select one of four methods or combination of any of those methods of compensation through which compensation objectives can be achieved.
6. Choose which global compensation approach and which global compensation system will be used. Consider compensation objectives, compensation method(s), and company's host countries' and third countries' (the countries where TCNs come from) cultures when choosing the approach and system.
7. Determine, and specifically and clearly defined the compensation criteria. These criteria depend on what compensation method(s) are going to be used:
    a. For time-based method, determine, and specifically and clearly defined what time standard(s) is/are going to be the compensation criterion/criteria.
    b. For competency-based method, determine, and specifically and clearly defined what kinds of competencies are going to be the compensation criteria.
    c. For performance-based method, determine, and

specifically and clearly defined what kinds of performances are going to be the compensation criteria, and what level of measurement(s) (individual, team, facility, department or company) is/are going to be used.

d. For seniority-based method, the compensation criterion has already been determined by the method itself.

This step is important to ensure the internal equity of the compensation program.

8. Conduct a market survey to get information about the "market price" of employees. This step is necessary for establishing the competitiveness (external equity) of the company's compensation program.

9. Build an internal structure of compensation which includes the number of levels in each criteria and the range of money amount assigned in each level.

10. Calculate the approximate compensation costs. This calculation will be one considerable input for annual budget preparation.

11. Fix the written rules and manuals. These rules and manuals should use common words and should not be complicated so they can be easily understood by all people in the company.

12. Communicate the draft of compensation program to all individuals within the company, and then open a discussion. The objective of the discussion is to extent participation of all individuals in the design process which is very important in order to get commitment to support the implementation of compensation program.

13. Experimentation or trial-and-error implementation in sample departments at the headquarters and in sample subsidiaries. This experimentation should be carefully monitored.

14. Get both positive and negative feedbacks from experimentation and then evaluate them.

15. Make adjustments as needed.

16. The improved compensation program is ready to be implemented throughout the company.

Global Compensation Practices in Nordson Corporation

Nordson Corporation engineers, manufactures and market systems that apply adhesives, sealants and coatings to a broad range of consumer and industrial products during manufacturing operations. Working closely with material supplier, Nordson Corporation develops dispensing technology that helps customers improve product quality and manufacturing efficiency. Nordson Corporation's products are used around the world in the appliance, automotive, bookbinding, construction, container, converting, electronics, food and beverage, furniture, metal finishing, non-wovens, packaging, and pharmaceuticals industries. The principal manufacturing, sales and service facilities of Nordson Corporation are in Amherst, Ohio, Atlanta, Georgia, and Lunenburg, Germany. Reaching out from corporate headquarters in Westlake, Ohio, Nordson Corporation markets its products through four international sales divisions: North America, Europe, Japan, and Pacific South. These sales organization are supported by a network of 32 direct operations, each managed by local personnel who understand their markets and cultures. Consistent with this strategy, nearly 60 percent of the company's revenues are generated outside the United States.

At present, Nordson Corporation has more than 3,200 employees worldwide. For Nordson Corporation, employees are very important and valuable assets, and it is reflected in the company's purpose of creating balanced, long-term benefits for all of its constituencies: customers, employees, shareholders and communities. One strategy that Nordson Corporation pursues is providing an equitable compensation for employees. Equitable compensation means:

1. Competitive externally or employees are paid competitive with companies in the outside.

2. Fair internally or employees are paid according to their jobs worth and reflecting their contributions.

In order to have an equitable compensation system, Nordson Corporation mostly adopts the performance-based method (compensation based on employees' performance). The other methods that the company also adopts in very limited circumstances are time-based method (compensation based on the time employees have already spent for their jobs) and seniority-based method (compensation based on employees' length of service). The time-based method is applied only for hourly-factory workers while the seniority-based method is applied only for workers who belong to union (union requires companies to pay its members according to the seniority).

In addition, Nordson Corporation adopts host-based approach and local going-rate system for its PCNs and TCNs. The host-based approach links the base salary for PCNs and TCNs to the salary structure of the relevant host country while the local going-rate system requires Nordson Corporation to pay its PCNs and TCNs according to standards in the relevant host country. The main reason for adopting that approach and system is because

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the company does not want to differentiate the compensation of its employees based on their nationalities. In Nordson Corporation's perspective, such differentiation is discriminatory and it can lead to internal inequity (inconsistent with the equitable compensation strategy).

Generally, the compensation package (or the total employee reward package) in Nordson Corporation consists of two components. The first component is called economic component which includes cash (salary, overtime, bonus and expenses), stock (employee stock ownership program and dividend reinvestment program), pension, risk/insurance program, vacation (holidays, personal days, family illness days and leaves), working facilities and medical. The second componenet is called non-economic component which includes environment (living and working environment), career potential/prospects, training professional development, image (external status and recognition) and management style (participative, communicative and contribution recognition).

Nordson Corporation designs its compensation program based on the following principles:
1. Pay for performance.
2. External competitiveness.
3. Internal equity.
4. Long-term capital accumulation (building a capital/ an equity, saving for the future).

The design of compensation program composes of four steps as follows:
1. Thoroughly understand the current compensation information for all employees which includes base pays, bonuses, salaries, special compensation plans, stock plans, allowances and benefits.
2. Identify high impact players and performance levels which includes develop the list of current key contributors and current high potentials, reconcile new lists with the existing succession plan materials, and categorize all employees within three performance levels (high, medium and low).
3. Develop total compensation strategy for the next three years which includes retain high impact players and attract future high potentials through individual-specific compensation, integrate all stock plans, accelerate pay for performance (individual employee), and recognize the company's ability to pay and protection of annual financial goals.
4. Develop detailed compensation program and projected costs which include translate macro data into specific micro program, cost out planned compensation program, use the basis of salaries, bonuses, allowances and benefits, include stock plans as compensation and

cost to the company, recognize the true value and cost of stock plans, and develop individual-specific fiscal year salary plans.

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