Performance Appraisal and Compensation

Performance Appraisal in International Business

Here are few tips for performance appraisal in international business-

1. The importance of goal setting cannot be overestimated within the context of planning, yearly objectives and targets. It is a widely acknowledged that people who have goals do achieve more. A useful template to follow when setting goals is the SMART goal framework. SMART goals are Specific, Measurable, Assignable, Relevant and Timely. They provide you with a benchmark that will help lead you to success in a clear, purposeful and stress-free manner.

2. Make a plan. In line with the need to set goals for the coming year, it is equally important to make a plan for the next year in terms of a review cycle. Managers and reports need to have a conversation to set objectives for the future, and also set dates for the various parts of the review process. Making a plan will ensure all parties know what is expected of them; and what they should have accomplished at each stage of the process. This plan should not be rigid; it should be fluid and open to change as necessary.

3. Continuity. Performance management is so much more than just the end of year performance review. True performance management is an ongoing process. Peer monitoring, as well as regular feedback and coaching sessions form an integral part of the performance management process. This continuous nature opens the process up for adjustments to performance planning as conditions dictate.

4. Improve productivity. Through this continuous performance management and regular revaluation of goals and objectives, productivity can be improved as time is not wasted on endeavors that produce less than satisfactory results. If something is not working; evaluate the failure, then move on.

5. Multiple source feedback. When carrying out performance review process it is important to consider multiple sources. 360 feedbacks is perhaps the best kind of multi-source feedback as it takes input from peers, as well as from reports and managers alike. 360 feedback provides the most complete picture of any employee's performance and consequently is the most objective.

6. Keep track. This may seem like a moot point however, it is nevertheless an important one. It is all very well to make plans, set targets and objectives for the upcoming quarter (or whatever the period) but they need to be documented. This is important for both parties, not only so the manager can go back at review time to assess if goals have been met, or targets exceeded, but also for his/her reports. A written record should be kept for ease of reference and to prevent confusion.

7. Train your managers. Reviewing your employees' performance is a big job, but not a task that necessarily comes easily to everyone. Therefore, as an employee is elevated to the position of manager it is important that they receive some sort of training so that they are prepared for the task of performance management.

International Incentives

Designing and developing a better compensation package for HR professionals for the international assignments requires knowledge of taxation, employment laws, and foreign currency fluctuation by the HR professionals. Moreover, the socio-economic conditions of the country have to be taken into consideration while developing a compensation package. It is easy to develop the compensation package for the parent country national but difficult to manage the host and third country nationals. When a firm develops international compensation policies, it tries to fulfill some broad objectives:

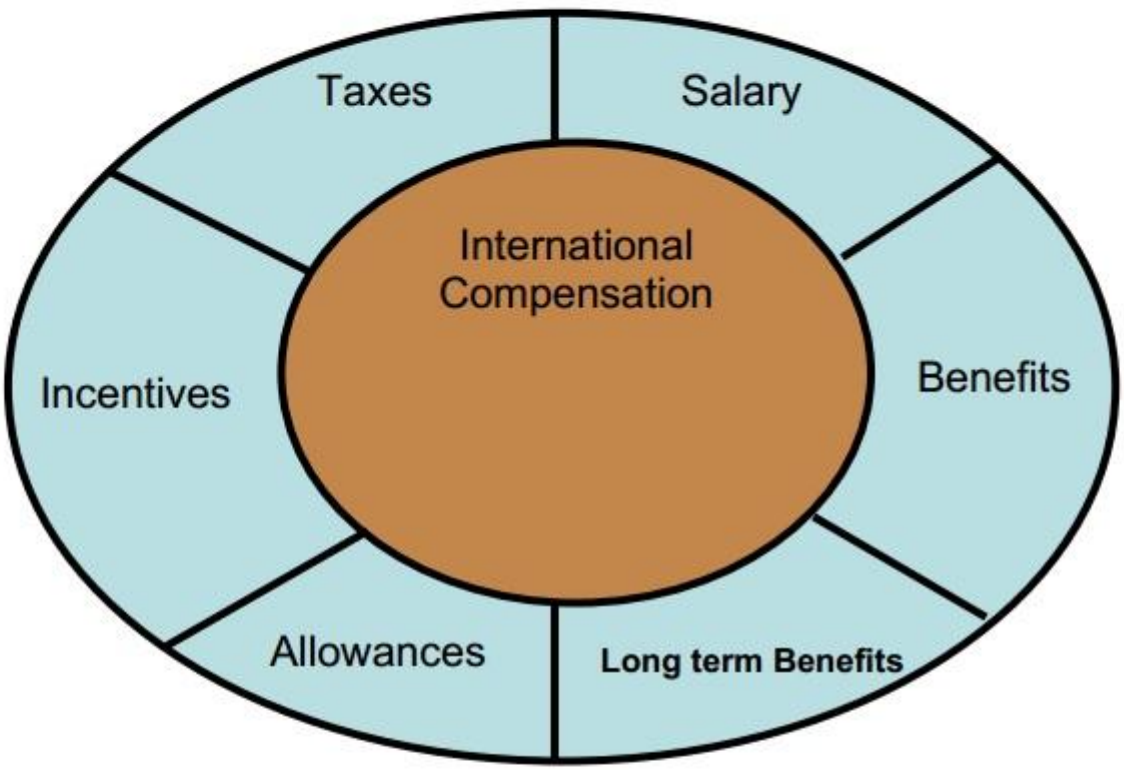
1. The compensation policy should be in line with the structure, business needs and overall strategy of the organization.
2. The policy should aim at attracting and retaining the best talent.
3. It should enhance employee satisfaction.
4. It should be clear in terms of understanding of the employees and also convenient to administer.

The employee also has a number of objectives that he wishes to achieve from the compensation policy of the firm

- He expects proper compensation against his competency and performance level.
- He expects substantial financial gain for his own comfort and for his family also.
- He expects his present and future needs to be taken care of including children's education, medical protection and housing facilities.
- The policy should be progressive in nature.

Major Components in an International Compensation Package

International Compensation is an internal rate of return (monetary or non monetary rewards / package) including base salary, benefits, perquisites and long term & short term incentives that valued by employee's in accordance with their relative contributions to performance towards achieving the desired goal of an organization.



The following are the major components of an international compensation package.

1. Base Salary

This term has a slightly different meaning in an international context than in a domestic one. In the latter case, it denotes the amount of cash compensation that serves as a benchmark for other compensation elements like bonus, social benefits. For the expatriate, it denotes the main component of a package of allowances directly related to the base salary and the basis for in-service benefits and pension contributions. Base salary actually forms the foundation block of the international compensation.

Companies take one of the following approaches to establish base salaries for expatriates:

- **The home-country-based approach.** The objective of a home-based compensation program is to equalize the employee to a standard of living enjoyed in his or her home country. The 2016 Cartus Global Mobility Policy & Practices Survey found that 76 percent of long-term assignments and 75 percent of short-term assignments use a home country pay structure.[1] Under this system, the employee's base salary is broken down into four general categories: taxes, housing, goods and services, and discretionary income.

- **The host-country-based approach.** With this approach, the expatriate employee's compensation is based on local national rates. Many companies continue to cover the employee in its defined contribution or defined benefit pension schemes and provide housing allowances. Only 14 percent of long-term assignments and 5 percent of short-term assignments base pay on local rates, according to the Cartus survey.[2]

- **The headquarters-based approach.** This approach assumes that all assignees, regardless of location, are in one country (i.e., a U.S. company pays all assignees a U.S.-based salary, regardless of geography). Cartus found that a small percentage of companies use headquarters-based approaches for long-term assignments (4 percent) and short-term assignments (5 percent).[3]

- **Balance sheet approach.** In this scenario, the compensation is calculated using the home-country-based approach with all allowances, deductions and reimbursements. After the net salary has been determined, it is then converted to the host country's currency. Since one of the primary goals of an international compensation management program is to maintain the expatriate's current standard of living, developing an equitable and functional compensation plan that combines balance and flexibility is extremely challenging for multinational companies. To this end, many companies adopt a balance sheet approach. This approach guarantees that employees in international assignments maintain the same standard of living they enjoyed in their home country. A worksheet lists the costs of major expenses in the home and host countries, and any differences are used to increase or decrease the compensation to keep it in balance.

Some companies also allow expatriates to split payment of their salaries between the host countries and the home country's currencies. The expatriate receives money in the host country's currency for expenses but keeps a percentage of it in the home country currency to safeguard against wild currency fluctuations in either country.

2. Long Term Benefits or Stock Benefits

The most common long term benefits offered to employees of MNCs are Employee Stock Option Schemes (ESOS). Traditionally ESOS were used as means to reward top management or key people of the MNCs. Some of the commonly used stock option schemes are:

- **Employee Stock Option Plan (ESOP)-** a certain nos. of shares are reserved for purchase and issuance to key employees. Such shares serve as incentive for employees to build long term value for the company.

- **Restricted Stock Unit (RSU) —** This is a plan established by a company, wherein units of stocks are provided with restrictions on when they can be exercised. It is usually issued as partial compensation for employees. The restrictions generally lifts in 3-5 years when the stock vests.

- **Employee Stock Purchase Plan (ESPP) —** This is a plan wherein the company sells shares to its employees usually, at a discount. Importantly, the company deducts the purchase price of these shares every month from the employee’s salary.

Hence, the primary objective for providing stock options is to reward and improve employee's performance and /or attract / retain critical talent in the Organization.

3. Foreign Service Inducement Premium

This is a component of the total compensation package given to employees to encourage them to take up foreign assignments. This is with the aim to compensate them for the possible hardships they may face while being overseas. In this context, the definition of hardship, the eligibility criteria for premium and the amount and timing of this payment are to be carefully considered. Such payments are normally made in the form of a percentage of the salary and they vary depending upon the tenure and content of the assignment. In addition, sometimes other differentials may be considered. For instance: if a host country's work week is longer that of the home country, a differential payment may be made in lieu of overtime.

4. Allowances

One of the most common kinds of allowance internationally is the Cost of Living Allowance (COLA). It typically involves a payment to compensate for the differences in the cost of living between the two countries resulting in an eventual difference in the expenditure made. A typical example is to compensate for the inflation differential. COLA also includes payments for housing and other utilities, and also personal income tax. Some types of premiums and allowances are as follows:

- **Hardship and hazard/danger pay.** Employers sometimes need to send employees on assignments to host countries where conditions are difficult or hazardous (i.e., remote locations or countries with high rates of violence). As a result, a hardship allowance may be granted as an additional incentive to compensate employees for accepting assignments in less-than-desirable countries. Premiums typically range from 10 percent to 50 percent of base pay, depending on the severity of the hardship. For assignments in developing countries that have a history of violence or are experiencing political unrest, expatriates often receive some form of hazard pay, such as an additional 25 percent of their base salary.

- **Cost-of-living adjustments.** A cost-of-living adjustment is an increase or decrease of an expatriate employee's pay in response to fluctuations in the economy, such as inflation or deflation. To prevent attrition of the global employee's purchasing power, companies often raise the employee's base salary to keep up with inflation. When price levels drop, companies may also decrease the base salary accordingly.

- **Educational assistance.** Educational assistance for dependents of expatriate employees varies based on conditions in the host country. Assistance is usually not provided if local educational institutions are deemed adequate. When the educational system of the host country is substandard, employers may use a variety of benefits, such as employers operating a school in the foreign country; paying for dependents' educational expenses, including room and board, to attend schools in the United States; or providing an allowance for attendance at private schools in either the United States or the host country. Other employers may simply choose to pay employees a specified amount (stipend) considered necessary for schooling at the nearest adequate school, and the employees make up any difference to send their dependents to an institution of their choice.

- **Housing assistance.** Assistance for housing is usually provided either in the form of free company-owned housing or via a housing allowance that is typically equal to the difference in housing costs between the home and host countries or based on a specified percentage of an employee's base salary. Housing allowance rates are usually calculated based on either a single person or a two-person household. For employees with larger families living with them, employers may provide an additional supplement, typically ranging from 10 percent to 30 percent of the two-person allowance.

- **Home leave.** The objective of home leave policies is to give the assignee and his or her family the opportunity to maintain personal and business relationships and remain abreast of any economic, political, social or cultural changes in the home country. Although home leave policies vary among multinational corporations, most policies grant leave based on the employee's level within the organizational structure. Executives, managers and more senior-level professionals are most often granted home leave once a year, or once every other year for a duration of up to four weeks, and lower-level employees may be allowed only a single visit during the course of their assignment. Companies that provide home leave allowances generally purchase or reimburse the employee for any travel-related expenses, such as airline tickets for the employee, spouse or partner and any dependent children younger than college age.

5. Benefits

The aspect of benefits is often very complicated to deal with. For instance, pension plans normally differ from country to country due to difference in national practices. Thus all these and other benefits (medical coverage, social security) are difficult to imitate across countries.

Thus, firms need to address a number of issues when considering what benefits to give and how to give them. However, the crucial issue that remains to be dealt with is whether the expatriates should be covered under the home country benefit programmes or the ones of the host country. As a matter of fact, most US officials are covered by their home country benefit programmes. Other kinds of benefits that are offered are:

- Vacation and special leaves
- Rest and rehabilitation leaves
- Emergency provisions like death or illness in the family

These benefits, however, depend on the host country regulations.

6. Incentives

In recent years some MNC have been designing special incentives programmes for keeping expatriate motivated. In the process a growing number of firms have dropped the ongoing premium for overseas assignment and replaced it with on time lump-sum premium. The lump-sum payment has at least three advantages. First expatriates realize that they are paid this only once and that too when they accept an overseas assignment. So the payment tends to retain its motivational value. Second, costs to the company are less because there is only one payment and no future financial commitment. This is so because incentive is separate payment, distinguishable for a regular pay and it is more readily for saving or spending.

There are two types of incentives:

- **Short-term incentive plans** are usually annual plans that link awards based on meeting individual or group performance criteria and objectives. Unlike long-term plans, these incentive pay plans provide for the payout to be awarded yearly.

- **Long-term incentive plans**, on the other hand, can vary in length from three to five years. These plans typically include equity-based incentives, such as stock options, restricted share grants and other types of equity-based plans like phantom stocks or stock appreciation rights. Awards are closely linked to the achievement of company goals and objectives over the three- to five-year period.

Participation and eligibility for each type of plan, as well as the level of incentives and average payouts, vary greatly among different companies, industries and countries around the world.

7. Taxes

The final component of the expatriate's compensation relates to taxes. MNCs generally select one of the following approaches to handle international taxation.

1. **Tax equalization: –** Firm withhold an amount equal to the home country tax obligation of the expatriate and pay all taxes in the host country.

2. **Tax Protection:-** The employee pays up to the amount of taxes he or she would pay on remuneration in the home country. In such a situation, the employee is entitled to any windfall received if total taxes are less in the foreign country then in the home country.