

## **Review of Literature on Expatriate Compensation and its Implication for Offshore Workforce**

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### **Abstract**

Offshore employees (expatriates) working abroad are an important part of any organisational workforce, working and competing globally. The specific requirements of expatriates are quite different as compared to the local workforce of that particular company. These requirements range from base salary to the educational needs of their families, children, and spouses. The employers especially working in multi-national companies (MNCs) face challenges of satisfying and rewarding such diversified work force keeping in view of their wide-ranging requirements. No single reward package is identified as a part of HR Compensation Practices fulfilling these diversified needs. A combination of Cafeteria and Localised Approach is suitable for addressing this problem. Factors that affect the Expatriate Compensation in motivating and retaining their offshore employees have been identified and their implication is discussed. Repatriation is also a challenge for the MNCs regarding their employees coming back to the home country. This study is valuable for both policy makers and industrialist for making strategies.

### **Keywords:**

Expatriate compensation, Global rewards, Motivation, Repatriation, Reward packages.

## **Introduction**

Compensation is a very important aspect of workforce motivation, whether they are local staff or Expatriates, and international compensation discloses the abundant different versions of employee benefits. There are varieties of different reward packages the employers offer to their employees other than money, each of which has its own effectiveness and varies from organization to organization. It is imperative for the organizations to understand the impact of their reward strategies and the success of such reward packages depend greatly upon the best fit of their packages to the employee's preferences.

Instead of local staff, expatriates are the professionals who perform their job duties outside the country where they have been brought up. Therefore, the reward considerations for such employees by their employer are different compared to the locally hired employees. With the growing trend of expatriates, it is an important aspect of compensations practices by various organizations. Global reward practices are equally important for the organizations especially the MNCs, and expatriate compensation is the most important part of such practices. In this paper, the focus is on identifying those factors that can help organizations in understanding the specific requirements of expatriates and fulfilling them successfully. Furthermore, the research would help organizations in improving their expatriate treatment to the offshore employees.

## **Literature Review**

### **Expatriate Compensation**

Expatriate compensation has always been considered a matter of dissent and trepidation (Fish and Wood, 1996; Nazir *et al.*, 2012). Phatak's (1989) observation is considered more valuable in this regard as he stated that the main obscure part of multinational workforce policy is the "compensation" as it more often creates intraorganizational offence rather to present a straightforward solution. Consequently in order to meet the crucial strategic issues which crop up from expatriate assignments, it is indispensable to fascinate the expatriates. (Reynolds, 1997) Therefore, in order to come

out of this predicament, organizations tend to offer a compensation package economical enough to “attract”, “motivate”, and “retain” the expatriates (Cryne, 2004; Gould, 1999; Nazir *et al.*, 2012).

Lowe *et al.* (2002) mentioned that in the effectiveness of worldwide maneuver “expatriate compensation” is considered the main and key element, and it always underpins why it is essential for organizations to successfully compensate “expatriates” despite the location (Dwyer, 1999; Freedman and Vardy, 1998). Bilodeau (2010) determined that workplace health plays a role in expatriate teacher sustainability in international schools from the perspectives of expatriate teachers, and in doing so, the study provide a new way to think about the role of international school environments in supporting expatriate teacher sustainability. Duvivier and Peeters (2011) examined the propensity of using expatriates as one type of international transfer assignees in the context of service offshoring operations. The results provide a framework for companies and researchers to approach international transfer assignment decisions for service offshoring activities in a more systematic way.

Reynolds (1997) stated that the history of offshore compensation is taken from U.S. government far back in 1792, when they set off to remunerate their expatriates, while soon after World War II (1946) U.S legislation further fortified the rules and presented a paradigm for forthcoming expatriate programs. In the present scenario, Dickover’s concept of balance sheet (1964) and tax equalization proved to be the stride in a new compensation arena (Reynolds, 1997).

### **Strategies/Types of Expatriate Compensation**

To compete against global business environment, it is very significant to analyze the organizational ability which can be achieved by reducing the gap between compensation costs by increasing the probability of winning expatriate assignment (Wentland, 2003). Toh and DeNishi (2005) argued that many MNCs tend to amplify the incentives to seize and stay on the assignment until the desired goal is accomplished. Wentland (2003) and Nazir *et al.* (2012) contended that in a number of compensation strategies, choosing the best fit is a real challenge for multinational enterprises.

### **The Balance Sheet Approach**

Balance sheet approach is considered as an all encompassing method in compensating the expatriates (Sims and Schraeder, 2005; Shelton, 2008; Solomon, 1995; Watson and Singh, 2005; Wentland, 2003). Commonly, the main target of the balance sheet approach is to endow with an equivalent purchasing capacity abroad in order to maintain home life style. Overman (2000) commented that balance sheet approach is mainly employed for senior and midlevel's "expatriates" transferred to foreign subsidiary that lasts from one year to five years (Wentland, 2003). Balance sheet approach mainly deals with two factors of compensation i.e., "base compensation" and "incentive and equalization adjustment" (Sims and Schraeder, 2005); the former discusses the salary, performance based incentives, and indirect remuneration while the later includes the benefits (house allowance, displacement allowance, etc.) employees enjoy when transferred to unusual or bumpy environments. Dickover's Balance sheet approach aims to even out the purchasing power amid the home-country officials and expatriates (Shelton, 2008). Solomon (1995) postulated that "balance sheet" method is widely used in the United States and 85% American organizations actually exercise this practice according to the "1994 worldwide comparison of international policies and practices". However, it generally becomes challenging especially in upholding an internal equity between local staff and expatriates in host unit environment (Volkmar, 2003). in order to tackle the changing dynamics of business environment, different approaches are required.

### **The Destination – Based Approach**

The determinant of this approach to expatriate set apart the variations of compensation that weigh against the compensation packages of local employees in similar jobs (Chen *et al.*, 2002; Wentland, 2003). In destination-based approach, conventional allowances (housing, premiums, children's education or other incentives) are gruffly mitigated (Molnar, 2005) and these curtailed incentives become problematic to the perceived significance of performance – based pay to "expatriates" (Low *et al.*, 2002). This approach treats the "expatriate" as a host country national, cheering a "when in Rome do as the Romans do" mind set where expatriates are anticipated to grasp

the host country life style instead of their own community (Myers, 1995); however, this approach is also not without drawbacks as it discourages the global mobility of expatriates (Compensation and Benefits Report, 2002).

### **Lump-sum Approach**

Lump-sum approach intermingles all the benefits with base pay and expatriates have liberty to spend the transportation, housing, travel, etc. by their own choice (Wentland, 2003).

### **Cafeteria Approach**

According to Wentland (2003), cafeteria approach is mostly used for senior level or upper- income expatriates. Tropman (2000) remarks that in cafeteria plan employees have to choose between two or more incentives (flexible benefits) comprised of qualified and cash benefits. Nazir *et al.* (2012) explained that this approach let the expatriates to enjoy benefits like club membership, insurance, company car, free education, etc. with no amplified charges of taxation.

### **International Headquarter Approach (Regional system)**

This approach is considered in about three out of every 10 cases observed. It presumes that all the expatriates are from the regional location. It is mainly functional when assignees have no intention to return straight to their home country (Wentland, 2003).

### **Negotiation**

Negotiation is also considered the most commonly used, an ad-hoc scheme favored by higher ranked HR managers, and it mitigates the black and white set of laws while dealing with International payment contracts (Wentland, 2003).

### **Factors Affecting Expatriate Compensation**

Frazer (1998) stated that no other variable effects the expatriate compensation as severely as the host country's cost of living. Sims and Schraeder (2005) commented that mostly employees exercise a "no loss" approach while extending compensation packages and within this structure, compensation is adjusted upward in order to get the higher cost of living but the cycle is not overturned in case of low cost of living as compared to the home country. Solomon (1995) presented an analysis that expatriate in multiple countries could be

assessed through consulting firms to resolve the issue of the increased percentage (about cost of living) added on the base salary of expatriates (Sims and Shraeder, 2005).

Wentland (2003) and Nazir *et al.* (2012) indicated that expatriates have the expectations from employer, that he would consider the local market and the trends of goods and services while developing expatriate packages in the host country. Moreover, offshore employees expect from their parent company to adjust the supplementary cost of living in order to keep the expatriates “whole” or more than “whole” (Oemig, 1999). Frazee’s (1998) research designated that 65% of global assignments are assured with the health care service provided to them under the expatriate remuneration package. Solomon (1995) stated that housing allowance smooth the progress of expatriate in maintaining life style up to the level at home and this compensation part, including taxes, constitutes the greatest disbursement. Another important type of premium is “cost of living allowance; COLA”. It facilitates the expats to keep up the same standard of living they experience in the home country. Organizations tend to collect the information of COLA by archetypal customer spending prototype in a “market basket of goods and services” and by scheming prices in the host country. If a substantial difference of prices between the home country of expats and the destination country is observed, companies review their allowances pay period or semi-annually.

Wentland’s (2003) study suggests that providing “housing facility” to expats is reckoned a key factor in expatriate compensation package. Issue of “dual taxation” is another significant component that mostly affects the expats compensation (Wentland, 2003). Solomon (1995) introduced two widely used methods of taxation: tax protection or tax equalization. In tax protection, employees do not pay taxes that are lower than those of the home country, while in tax equalization expatriates pay more nor less than the home country based taxes (Sims and Schraeder, 2005). Inclusion of an education allowance is also considered an integral part of expatriate compensation, and providing quality education is becoming the “first worry” of expatriates (Solomon, 1995; Nazir *et al.*, 2012). Organizations always reimburse the educational expenses at primary and secondary school level by

covering the tuition fee or miscellaneous for international and private schools (Allard, 1996). Organizations mostly provide “transportation allowances” to compensate the expatriates. It mostly consists of company car or lump-sum allowances along with round-trip coach provided by firm for the whole family (Solomon, 1995).

Kwon *et al.* (2008) reckoned the gain sharing an exclusive tool that stresses upon the performance, coordination, and employee involvement. These attributes enhance the employees’ perception of “organizational justice” and accelerate the desirable employee attitudes. ERC (Employee Relocation council) advocates that financial incentives (Konopaske and Werner, 2005; Zhou and Martocchio, 2001), cultural similarity (Black and Mendenhall, 1990; Nazir *et al.*, 2012; Selmer *et al.*, 1998), and “destination safety” persuade the employees to relocate willingly, since the organizations tend to offer elevated compensation packages to employees going to less desirable and adverse locations, that is called “hardship premium” (Zhou and Martocchio, 2001).

Harvey (1993) identified that “family life cycle” has greatest impact on one’s life with regard to compensation. The two most distinct cost issues for offshore managers were: bachelor stage. In “tax equalization” and “hardship” allowances, while married (but without children), emphasis was on salary and COLAS. Married (with children) COLAS and hardship allowance and the older executives at their “empty nest” stage again attracted by salary and COLAs that maintains the life pattern of seniors in a juncture (Dunbar and Bird, 1992; Bird and Dunbar, 1991; Harvey, 1993).

### **Repatriation**

Expatriate assignments inexorably come to an end; often organizations inadequately handle repatriation planning (Brown, 1995; Nazir *et al.*, 2012). Howard (1973) classified the failure of expatriate into five categories in the framework of an overall line of business structure, i.e., no job upon return, failure in maintaining authority and professional independence, bearing bitterness from colleagues, contingency upon the overseas stay, and loss in promotional prospects. However, Forster (1992) squabbled upon the argument and said that in order to compete globally, it is imperative for the managers to have an

overseas experience and it could be achieved by adding such activities like staff interchange amid home country and host country locations and letting full admittance to the firms career structure on behalf of host country and TCN (third country nationals). Foreign experience matters a lot if employees wish to move forwards.

Harvey (1993) found in his study that in order to shun the severity of repatriation, it must be addressed properly before allocating the foreign assignment, because MNCs do not assure the job and support the repatriates upon their return (Toh and DeNishi, 2005). Baruch (2004) mentioned that expatriates in their foreign subsidiaries are considered as an exorbitant investment with the cost of “expatriate failure” attaining excessive level. Insch and Daniels (2002) and Wentland (2003) mentioned that every premature departure of expatriate could cost to a firm a surfeit of \$1 million. Baruch (2004) remarked that compensation plays a significant role in the expatriate dynamics while addressing the failure of offshore employees.

Puccino (2005) has suggested in his research that the failure of expatriate assignments results in a drastic lost not only in recruitment and expatriate cost but also puts the overall success of the project at a stake; therefore, it is imperative to have an arrangement that deals with the pre-assignment groundwork, expatriate logistics, family support, evaluation of project, repatriation, etc. (Brown, 1995; Nazir *et al.*, 2012). Puccino (2005) further catered the idea to dispirit the repatriates by launching formal in-house repatriate programs so that they could manage their career prospects upon their return.

### **Designing Successful Global Reward Program**

Baruch (2004) contends that compensation has an extensive part in designing a thriving global reward program; however, a number of dreadful elements are still there in coping up with the breakdown of expatriate that still ranges between 16% and 40%(for American expatriates) ,although calculate approximately over \$ 1 million for every untimely exit (Sims and Schraeder, 2005).

A careful selection of the candidates and assessing the difficulty of expatriate’s assignment can help in developing a suiTable compensation model that involves the willingness of the expatriate assignment including the risk factors, market attractiveness, and the



competitive advantage of the organizations of that particular country (Kotler, 1997). Organizations continue to deploy their employees abroad in order to fill a skill gap, (transfer knowledge through training and development) skill development, and setting up the corporate venture (Csizmar, 2008; Nazir *et al.*, 2012).

Sterdwick (2000) confirmed that the reward program is required to align with the business strategy of the company and they (rewards) must be elasticize and dependent upon the international and home situation. He stressed upon the variable pay (performance-based) and “broad banding” (base pay) as an integral part of International compensation structure which knock down the conventional many-graded compensation system into a fragile pay bands, that only aid the performance of employees to endorse the internal equity (White, 2005).

Fish and Wood (1996) found that in designing global compensation structure, a variety of dynamic issues i.e. GDP as per investment, taxation, unemployment, economic uncertainty, inflation, etc. can maneuver and enhance the expatriate practices (Wentland, 2003). Centralized (but integrated) approach is reckoned paramount in sprouting and aligning the organizational reward program with corporate objectives, and offer requisite tools, skills, and directions for an international remuneration management system (White, 2005). Only integrated reward structure can support and magnify the considerable shareholder value and “one size fits all” structure can never be successful (Nazir *et al.*, 2012; White, 2005). A survey by Worldatwork & Watson Wyatt illustrated that 60% companies preferred centralized approach, whereas only 36% favored the decentralized system (White, 2005).

### **Disparity**

It generally becomes challenging in upholding an internal equity between local staff and expatriates in the host unit environment (Volkmar, 2003). Consequently according to Li and Klainer (2001) it is observed in host countries like china that the disparity ( in compensation) in terms of benefits and developmental prospects craft a serene antipathy in local staff towards expatriates - mostly for those who are less incompetent than the locals .

Toh and DeNishi (2005) commented that capable local managers over an expatriate are considered an asset to a MNC because of the continuous restiveness of expatriates in an unfamiliar terrain. According to Fish and Wood (1996), local competent and qualified staff is not taken into account and the primacy of expatriate over locals' leads to dwindle the host national's commitment. Reynolds (1997) has found that the home nationals most often be paid lesser than the foreign nationals and sometimes this disparity reaches up to 20% difference even in the similar tasks and it can be trimmed down only by selecting the commendable expatriates and the transparency of pay and compensation can craft a linkage amid the work inputs and rewards more clearly.

Leung *et al.* (2009) has taken it as the upshot of the norms found in conventional ethnocentric reward strategies, cultural distinctiveness and more often due to the narrow appeal of polycentric tendency towards foreign nationals (Bonache *et al.*, 2009). By providing improved compensation schemes to local staff compared with the foreign nationals in the same workplace may possibly mitigate the effects of disparity (Leung *et al.*, 2009). The reward strategies for the workforce consisting of locals and expatriates should be devised such that it satisfies both types of the employees eliminating the disparity (Nazir *et al.*, 2012). The gap between expatriates and local staff is increasingly reduced in most countries by training the locals on level of foreigner employees. So, now they are working with expatriates as co-workers, instead of simply being subordinates of offshore employees (Toh and DeNisi, 2005).

Nazir *et al.* (2012) concluded that it is not possible to guarantee one possible way of making any reward effective. Rather its effectiveness depends upon various different circumstantial factors. Moreover, combination of two or more different reward packages or reward mix can generate the desired level of motivation for the productivity and performance.

## **Discussion**

It is evident that issues associated with expatriate compensation are highly complex and complicated due to a lot of factors such as

taxation, the stage in one's family life-cycle, financial incentives, housing, culture, repatriation, concerns, etc. The desirability of a foreign assignment is largely governed by these factors, and thus it becomes difficult for the organizations to garner benefits or obtain "return on investments" from such assignments without ensuring a guaranteed, fair and competitive compensation package/remuneration for the expatriate's expectations. Thus, the need for survival in such a competitive corporate world is to undertake the challenge of balancing these factors; thereby, generating a sense of 'wholeness' within the perspective of expatriate compensation.

Researchers argue that global compensation has focused more on expatriates than the local nationals. For them, local nationals or Host Country Nationals (HCNs) are more important than the expatriates in that they possess those key skills which are crucial in winning a local market. Expatriates, on the other hand, may be more competent technically but lack those key local-market-winning skills, and hence fail to generate the desired result in a number of instances. Moreover, expatriates are in minority comparing the larger global workforce; therefore, it is imperative to shift attention towards others as well rather than focusing on expatriates only.

MNCs, however, have their own reasons to use expatriates. For them, technical competency and industry knowledge are the top most reasons crucial for conquering a local market. Although previously it was considered that MNCs prefer expatriates only in case of the unavailability of local talent, contemporary research shows that MNCs use expatriates even in the presence of suitable host country nationals. This is evident by the number of overseas assignments that are increasing day by day with a faster pace. Both PCNs and TCNs are being used by MNCs and the trend seems to be multiplied in the upcoming years. Nevertheless, the use of expatriates is not without problems. Compensation disparity, inevitable in most of the cases when expatriates are used, is the primary issue which is detrimental for the workforce peace and harmony. Organizations use compensation approaches that focus on compensating expatriates with local terms and conditions but have not yet reached the optimum solution. The other issue is the repatriation concerns which arises when the expatriate returns to his/her home country after the

completion of an assignment and finds a number of things shocking. Literature testifies that employees hesitate to undertake an overseas assignment just because of the expected repatriation problems. Repatriation programs are set-up by organizations to overcome this issue. Another strategy used by the organizations is to make expatriate assignments attractive through generous compensation and market it as a wise move in one's career ladder.

Employers should offer both monetary and non-monetary rewards to their offshore employees to enhance the level of their job satisfaction and improve their interest towards job. The compensation strategies must include the training opportunities and career development for increasing their skills in order to improve their efficiency and effectiveness. Few more considerations are also important while devising and implementing the reward strategies for expatriates. Such strategies start from performance-based evaluations to the seniority based compensations. Negotiation can be effective sometimes and eliminate the need of accessing and offering different reward incentives.

Compensation packages should include supplementary salary packages for expatriates for their additional duties besides offering base salary equivalent to the headquarters' pay scales. Other incentives like bonuses and group incentives can be given while offering the direct compensation to expatriates. The education of the family and children is the main and prime objective of any expatriate and compensation for covering such costs partially or fully will help him/her. The employers and MNCs can offer some job opportunities to the spouses and family members in their organization on part time basis or flexible working hours and provide them with other club activities (trips and recreation etc.), besides availing the opportunities for their education. Security, insurance, education, transport, accommodation, relocation, and displacements can be offered to cover the cost of living adjustments of expatriates. The reimbursement on these heads should be on a higher side to attract and motivate the expatriates compared to locally hired employees. Similarly, encashment of leaves, leaves, medical facilities, and elderly and child care are also attractive motivators for the offshore employees. Honorariums and hardship allowances can be offered to employees

working abroad and on tough duties. Culture plays an important role in the settlement of offshore employees and adverse effect of the misfit/unacceptable cultural environment can lead to quitting that company. Awareness and adaptability to the new culture can overcome such situation and help the companies in retaining their employees over a longer period of time. In order to familiarize the expatriates with the culture, language, and work environment of the host country, cross-cultural training is an effective and necessary part of the expatriate compensation. Like monetary rewards, non-monetary rewards are also equally important for the motivation of workforce and are an important part of the HR Reward Practices.

Regardless of the fact that several expatriate compensation approaches have been developed, they still seem less effective and are not helpful in achieving the desired results and objectives. Therefore, companies are experimenting using various techniques and approaches for adopting some better options. In short, firms should have compensation packages that are compelling for expatriates that can make them accept an international assignment. Adjustments to new setups and failures can be managed by sending expatriates who are willing to travel abroad and are showing consents in this regard. At the same time to overcome the professional jealousy and discouragement because of differences in rewards of expatriates and locals need to be addressed, and good practices should be used in rewards for locals in comparison with the other companies in the same area.. Locals should be trained to perform at par with their expatriate counterparts and should be paid accordingly to remove disparity. In cases that offshore employees return to their home country, Repatriation Training Programs should be devised for the expatriates and their families for the adjustment with the local conditions. Expatriates should be assigned more tough and challenging assignments because of their acquaintance with the similar work experience of the past. Considering these issues is very important for retaining the expatriates and taking full advantage of their expertise without losing their talent.

### **Conclusion and Recommendations**

Since the expatriates are the professionals working abroad with high qualifications and talent, high level of independence and flexibility is the key to successful execution of their job duties on international assignments. The lesser involvement of cost addition is the vital part of designing such reward strategies. To achieve this objective, amalgamation of both cafeteria and localization approaches are the most suitable part of expatriate reward strategies.

In order to achieve the best results out of the various compensation strategies, companies should select the approach that is a mix of localization and Cafeteria approaches which is termed LC Approach where L represents localization policy and C stands for cafeteria approach.

This approach is suggested because:

**Localization Approach:** This approach is relatively new and is used to address problems related to high costs and perceived inequality among staff in foreign subsidiaries. The expatriates can be paid comparably to locals; it will be simple for administration. Nevertheless, since expatriates belong to different living standards compared to the foreign country, special supplements can be used and negotiated for this concern; for example, expatriates forfeit compensation can be provided.

**Cafeteria Approach:** This approach is increasingly being used for expatriates to provide them a set of choices of benefits. This allows the expatriates to gain benefits like company car, insurance, and company-provided accommodation, which will not increase the expatriate's taxable income.

### **Potential Benefits from Recommended LC Approach**

Using the recommended approach will result in a structure that is both beneficent and feasible:

- In rewards mix, the local approach is recommended for making the direct compensation component of the compensation strategy and making it applicable across the board, whereas the cafeteria approach is recommended for providing the cost of living allowances (COLAs) that will be applied for the expatriates only.

- Mix of the two approaches is useful and will save the cost because local based approach takes the advantage of transferring from the developed to less developed region. At the same time, the cafeteria approach will be providing flexibility to the packages being adopted which in turn will lead to a win-win situation for both parties.
- At present, the firms are offering the expatriates excellent compensation packages in developed countries. Incorporating the local approach will ensure successful continuation of this package in lesser-developed countries. Adoption of cafeteria approach will be useful in cutting costs through negotiating COLAs benefits with the expatriates.
- This approach will make the global mobility easy and less challenging.
- Combination of local and cafeteria approach will provide the company with the flexibility required to experiment and try different components with less challenges and fear of failure.
- Showing employer concern would boost employee's morals.
- Localization is cost efficient.

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