Complexity in Global Pay: A Meta-Framework

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Abstract: This conceptual review paper is a preliminary step in creating a robust conceptual framework to further research in the complex and dynamic field of the management of global pay systems. The proposed “meta-framework” consists of three major elements. First, the competing research paradigms of universalist and contextualist HRM are presented as the horizontal foundation of the meta-framework. Second, three levels of pay – following Schein’s (1985) presentation of cultural assumptions, values and norms, and artefacts - make up the vertical basis of the meta-framework. Third, three perspectives, in the form of an internal context (built upon the universalist paradigm), an external context (built upon the contextualist paradigm) and an overarching or bridging pay context, provide the horizontal basis for the meta-framework. Examples of theoretical and empirical research related to various areas of the meta-framework are presented in order to clarify the major points of the presentation.

The paper concludes with a discussion of potential applications of this meta-framework for global pay practitioners and researchers. The shared use of the framework has the potential to coordinate progress in empirical research and share experiences and prescriptions amongst practitioners and researchers alike.
INTRODUCTION

Global pay systems involve an increasing complexity. However, there is no encompassing conceptual approach capturing developments in international pay practices and respective explanations. From a theoretical perspective the question arises: Which determinants could lead to those varying pay forms across international organizations (McWilliams, Van Fleet and Wright 2001; Pucik 1997; Schuler, Dowling and DeCieri 1999)? As international compensation practices differ widely across organizations, it is important not simply to notice these differences, but also to find explanations for this complexity in global reward designs. The purpose of this paper is to provide a meta-framework explaining pay differences among international companies. The suggested framework includes potential determinants of global pay decisions and outlines their interrelationships. Articulating a more sophisticated and encompassing framework of global pay issues will allow pay strategists and academics to move beyond domestically-embedded (and therefore domestically biased) pay systems characterized by host pay systems clumsily grafted upon a parent company framework (Dowling and Welch 2004: Chapter 6; Engle and Mendenhall 2004; Heneman, Fay and Wang 2002: 25-29; Milkovich and Newman 2005: 530-531). This meta-framework still very much represents a conceptual work in progress.

A META-FRAMEWORK FOR GLOBAL PAY

The paper presents a meta-level analysis of determinants influencing pay decisions in a global context. A new conceptual framework has been developed, which captures the complexity of pay decisions in this rapidly-evolving global context. The framework refers to the Schein-model and is extended by firm-internal and external perspectives. Additionally, research paradigms guiding international human resource research provide a foundation for this framework. Figure 1 summarizes the basic ideas outlined in this paper.
The column in the middle focuses the pay-specific elements, which may be influenced by factors from the different levels and contexts.

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Figure 1: Meta-Framework explaining complexity in global pay.

Note that our organization of the model into firm-internal and external perspectives has an analytical character, and may not fully reflect the purpose of the approaches and determinants. For example, theoretical perspectives such as new institutional economics, which are interpreted here as mainly firm-internal perspectives reflecting an universalist research paradigm, may also have the potential to incorporate firm-external issues. However, this does not seem to be the primary focus of these approaches (Festing 2005).
For the purpose of this paper, the question whether external context factors influence internal context factors and vice versa has no relevance because the suggested framework has a rather static orientation and does not assume the dynamic dimension of pay systems. Here, it is more important to provide a complete outline of the influences of both contexts on pay decisions. Furthermore, it has to be pointed out that the underlying assumption of this framework is that pay decisions makers in practice follow a bounded-rational approach trying to take into account as many influencing factors as possible. However, the assumption of limited information processing capacities may be responsible for the consideration of different influencing factors and thus, for complexity in global pay.

**Underlying Research Paradigms**

Brewster (1999) has suggested two basic paradigms guiding international human resource management research: the universalist and the contextual paradigm. These two positions may well be exclusive, so that the adoption of one position excludes the other. Both involve the choice of different theoretical perspectives on HR practices. Each of the two approaches has strengths and weaknesses. While the universalist approach neglects country-specific aspects and may lead to a non-realistic and thus, an ineffective degree of standardization in pay practices within a multinational firm, the contextual approach may not appropriately consider strategic issues such as strategic control on the corporate level and reward-performance implications (Sparrow 1999). Following this critique, and considering the complexity of global pay patterns, we suggest that research should involve some combination of universalist and contextualist ideas.

**Applying Schein’s Model**

This framework is based on Schein’s tri-level model consisting of artefacts, norms and values and basic assumptions (Schein 1985). Following the three-level model developed by Schein allows considering influencing factors of global pay decisions on different levels. The first
level includes basic explanations, underlying ideas and logics relevant to pay system decisions. These basic explanations influence respective values and norms, which finally are expressed in artefacts. This classification allows systemizing the multiple determinants for global pay on different levels and provides a structure for the complex issues associated with global pay patterns. Some factors, for example laws, can be observed as determinants of global pay decisions; other influencing factors (for example culture, norms or assumptions) are not as evident concerning their effect on global pay decisions.

Including Firm-Internal and -External Views

Influences on pay decisions arise not simply from different levels, but also from different frames of reference or contexts. Therefore, the proposed meta-framework is extended to incorporate both firm-internal and external perspectives. The underlying research paradigms (universalist or contextualist) provide a basis for choosing an internal or an external perspective. The conceptual framework developed in this paper integrates the two, often competing, internal and external perspectives because both provide valuable contributions to cope with complexity in global pay patterns.

We will first outline relevant issues and their influence on pay decisions on all three levels within the internal context and then focus on the external context. Finally, the pay context will be in the centre of consideration.

INTERNAL CONTEXT

The perspective of the firm-internal context can be best described as an organizational perspective. It is supposed that factors endogenous to organizations will have primary influence on the design of their compensation system.

Level One: Basic Explanations

This internal perspective includes a variety of theoretical approaches such as the resource-based view (Barney 1991), new institutional economics (e.g. Williamson 1984), resource-
dependence theory (Pfeffer and Salancik 1978), behavioral approaches (March and Simon 1958) etc. As it would go far beyond the scope of this paper to outline the theoretical reasoning of all approaches in detail, we will take the example of new institutional economics, more precisely transaction cost economics (Williamson 1984, 1991), to explain emerging norms and values. Transaction cost theory involves a contractual perspective on labour relations. The danger of opportunism, free riding and shirking (behavioural uncertainty) must be controlled through institutional arrangements, especially if investments in firm-specific human capital are to be protected and enhanced. From the two core variables “asset specificity” and “behavioural uncertainty” four types of internal labour markets can be derived, which involve different employment relationships (e.g., a high level of human asset specificity is efficiently organized in long-term relationship-oriented labour markets (relational teams) while a low level of human asset specificity would be organized in rather short-term relationships (internal spot market) (Williamson 1984)). The first type of employment relationship would lead to a long-term orientation within the pay system perhaps achieved through long-term incentives.

If transaction cost economic arguments are applied to the pay context the approach captures the tension between pay effectiveness as a consequence of free agent or outsourced pay as opposed to a consequence of a more complete and holistic “high commitment” pay system (Lawler 2000: 59-62; Milkovich and Newman 2005: 12-13). Firms valuing efficiency or market-driven “transactional” relationships deal with employees in a calculative-remunerative sense (Etzioni 1961) and avoid unnecessary long-term employment entanglements. Alternatively, firms valuing long-term effectiveness of “high commitment” relationships will seek for complex, often implicit “family like” relationships with employees, dealing with them in a “moral-normative” sense (Etzioni 1961), often provide long-term incentives and

A similar reasoning can be developed based on the resource-based view. This approach focuses firm-internal resources, which should lead to competitive advantages if they are valuable, rare, inimitable and non-substitutable (VRIN-criteria) (Barney 1991; Eisenhardt and Martin 2000). Human resources, characterized by different features such as the VRIN-criteria, could lead to different employment relations such as “high-performance” or “high commitment” work systems (Purcell 1999) in order to gain competitive advantages. However, this also means that different groups of employees, who would correspond to different resource groups, may be managed in a different way. Differentials may become so intense that differences in the strategic value and uniqueness inherent in the intellectual capital of various employee groups in a firm may result in radically different relational forms (contracts) between the firms and the various groups. Differences can result in a distinguishing “architecture” of human resource relationships, resulting in radically different pay systems across these groups and yet within one firm (Snell, Lepak and Youndt 1999).

From these examples it becomes clear that the choice of a dominant organizational perspective can have a strong influence on the values and norms. Choosing a behavioural approach would imply different norms and values on the second level and therefore lead to differing pay decisions.

Fundamental and unspoken differences in pay systems stem from the fact that decision makers may hold different assumptions. Mapping and making these differences more clearly defined is a critical first step in overcoming the significant potential for misunderstandings so inherent in global pay processes.
Level Two: Norms and Values

To illustrate the influence of norms and values on the pay context we will take the example of the corporate strategy because this is one of the main determinants of strategic HR decisions (Price Waterhouse Coopers 2002). Assuming that decision makers design compensation systems that are aligned with and support an organization’s strategy, companies using an adapter or localizer strategy would create compensation systems very close to the local host context (Bloom, Milkovich and Mitra 2003). Balkin and Gomez-Mejia pointed out that “management adjusts its pay strategies to fit with the organizational strategy” (1990: 163). For example, a shift in business strategy from growing to maintaining may cause adjustments concerning the pay mix, because incentive could become less important (Balkin and Gomez-Mejia 1990).

Level Three: Artefacts

The third level of Schein’s model involves artefacts. These observable features of an organization, which are supposed to have an influence on pay practices, are related to the norms and values. For example the observable structure of an organization can be influenced by norms and values. Companies aiming for flexibility and innovation have to provide associated structures and, in the context of this paper, corresponding pay forms. Therefore, companies that organize their work in teams and or networks have to match these organization forms with their pay design (Heneman, Tansky and Tomlinson 2002).

EXTERNAL CONTEXT

The emphasis here is on how pay decision can vary according to the organization’s cultural, social or political environment (Armstrong and Murlis 1991). Multinational companies can be forced by conditions in the external context to adapt certain pay elements (Bloom, Milkovich and Mitra 2003). There are a variety of factors in the external context, which may influence an organization’s decision about the design of its pay system.
Level One: Basic Explanations

The external environment consists of cultural and institutional assumptions, leading to institutional factors and cultural norms/values on the second level. The significance of national culture is based on Hofstede’s statement, that most inhabitants of a country share the same mental program (Milkovich and Bloom 1998). Following the national culture approach means, that “compensation and reward policies must be aligned with and reinforce attributes of national culture” (Milkovich and Bloom 1998: 18). Since Hofstede’s research many other researchers have recognized the importance of culture and its impacts on human resources or compensation issues (Rogovsky, Schuler and Reynolds 2000). The institutionalism perspective highlights the importance of exogenous factors and recognizes that contextual institutional pressures may be powerful influences on pay strategy (De Cieri and Dowling 1999). For legitimacy reasons it can make sense for some organizations to offer specific benefits even if they are very expensive.

Level Two: Norms and Values

On the second level institutional factors and cultural norms influence decisions about compensation practices. For example, performance-based pay structures rewarding individual outcomes may be more effective and appropriate in individualism cultures, such as the US. In countries with low tolerance of power distance, egalitarian pay structures are more likely to find (Gomez-Mejia and Welbourne 1991; Graham and Trevor 2000). Moreover according to Schuler and Rogovsky (1998), share options and stock-ownerships plans are more appropriate in countries with high individualism, low uncertainty avoidance level and power distance. This approach can be contrasted to firms that take a direct, Skinnerian approach to pay and focus on creating and communicating an explicit, objective menu of inducements. Cultures wherein work is based on more integrated personal social “relationships” may value a more complete balance of intrinsic and extrinsic rewards, while cultures characterized by personal
independence and isolation (“individualism”) and rapidly changing personal and social contexts may emphasize extrinsic rewards – given the absence of a strong and enduring social matrix that attributes meaning and power to intrinsic rewards (Frey 1999; Triandis 2002). The importance of labour unions, which belong to the group of institutional factors, can also have significant results on pay systems, e.g. group-level performance measures are more often implemented in unionized firms (Heneman, von Hippel, Eskew and Greenberger 2002).

**Level Three: Artefacts**

Factors on the third level may be a result of issues arising from level two. For example, labour and employment laws reflect dominant national values (Hofstede 1980). Laws are important determinants for designing a global pay system. For instance tax reforms affecting executive pay can result in a rearrangement of the pay mix for executives. The difference in the use of stock options in Germany versus United States may be related to different tax rates (Bloom and Milkovich 1990). In case of a minimum wage regulation, companies have no choice concerning the pay level for certain groups of employees. Additional relevant factors include local market conditions such as labour or product markets specificities. Firms operating in competitive labour markets are influenced by this market situation. In order to attract employees they have to offer above-market pay levels including specific incentives (Miceli and Heneman 2002).

**ACROSS LEVELS AND CONTEXTS: FIRM-INTERNAL AND EXTERNAL INFLUENCES ON PAY CONTEXT**

The purpose of the paper is to explain differences within global pay practices among firms based on firm-internal and firm-external factors located on different levels. As outlined before, this middle column can be seen as a dependent variable, because it is influenced by the internal and external context of an organization. By combining the universalist and contextualist paradigms, pay decisions are no longer explained independently from a firm-
internal or firm–external context. Rather, possible determinants from both sides (and on all three levels) become clearer. These influences can vary in their intensity. For example, the external factor law may have stronger influence than some cultural values. However, our present treatment represents a static framework, which cannot represent dynamic relationships evolving over time.

**Level One: Basic Explanations**

Because basic explanations for pay may arise from different sides (sources), the level is linked with the first level of basic explanations of the external and internal context. Following for example a new institutional economics perspective, more precisely agency-theory, would lead to the basic explanation that pay should be used as an incentive. Because it is impossible or too cost-prohibitive for organizations to observe and monitor employee performance, pay is an important instrument to control employees. Behavioural theory focuses on different functions of pay. In this context, pay is seen as important to motivate, gain and retain people. As March and Simon (1958) have outlined, people calculate whether their contributions for the organization match their rewards, i.e. different returns may effect the contributions employees are willing to provide or a too low pay level offered by the company can cause employees to leave the company (Bloom and Milkovich 1990).

**Level Two: Norms and Values**

The second level implies that organizations have specific values and norms about pay, which they follow when designing their pay strategy. Gomez-Mejia and Welbourne (1988) define a compensation strategy as a repertoire of pay choices. Analyzing 18 different studies they identified three criteria addressing different dimensions. We will mainly refer to the different basic choices for pay: job vs. skill, performance vs. seniority, individual vs. group performance, Short- vs. long-term orientation, risk aversion vs. risk taking, corporate vs. division performance, hierarchical vs. egalitarian, and qualitative vs. quantitative performance.
measures. Within this context, firm-internal and –external influences play an important role for the chosen design of the pay system. If employment relationships are characterized by certain norms and values, which are again influenced by the chosen theoretical approach, this may lead to certain basic pay decisions. Following transaction cost theory, pay decision-makers may conclude that due to measurement problems, performance-based pay may not be possible and due to asset specificity it is not the job specifications but rather the skills developed within the company which should guide pay decisions (Boudreau, Ramstad and Dowling 2003). Furthermore, the long-term perspective of a relational work team would probably require a bonus based on corporate performance-based system in an effort to link the individual more closely to the firm. Pension plans might also be created to complete this linkage.

However, firm-exogenous and institutional factors would also need to be considered in this type of global pay decision scenario. Enterprises may strive for global coordination and control of their HR activities including global pay systems and related information measures such as performance evaluation, yet they still may be forced to adapt to local conditions. Legal norms such as those included in the industrial relations systems cannot be neglected. Furthermore, as has been outlined above, culture may favour certain choices such as group-based pay in collectivist countries. Following an internal or external perspective may also influence a company’s decision about the importance of internal or external equity considerations when designing the pay system: Pursuing a more internal focus probably leads to emphasizing internal equity, meaning that comparisons with other jobs in the same company are relevant for pay decisions. Instead, emphasizing external equity could be a result of a more external orientation of companies and therefore comparisons with other potential employers. These companies rely on external market comparisons for compensation pricing and decide about where to position their organization relative to competitors. However, other
factors located within other contexts and levels can also influence this decision about internal or external equity of the pay system (e.g. local market conditions, industry, and the size or structure of an organization) (Gomez-Mejia and Welbourne 1988).

Level Three: Artefacts

The third level addresses the observable issues of global pay such as the pay mix, the pay level and the choice between global standardization and local adaptation of pay practices. Following the organizational perspective, a multinational enterprise may differentiate pay practices between certain groups of employees (e.g. due to resource characteristics or asset specificity etc.). The level of internationalization may also have an influence on how globally standardized a pay system is. Usually, this is the effect of many years of international experience. Considering external factors, labour market conditions can influence the pay level of a company. For example, the local labour market conditions can be characterized by a scarce of good personal. If this should be the case, firms operating in these countries would be expected to have higher pay levels than companies operating in countries where unemployed qualified people are available without any problems.

CONCLUSION

Even if neoclassical economic theory, being largely unchallenged until the 1940s and 1950s, at least with respect to pay level gives little room for employer differences in international reward practices, global pay systems vary extremely across companies (Gerhart and Milkovich 1990; Gerhart and Rynes 2003). These theories are neglecting several factors influencing pay decisions of international companies. Given the variety of differing contexts in which global companies are operating, a single pay system cannot be efficient. “Each firm has its own unique history and tradition, cultural norms, and sociotechnical and environmental forces that shape the framework within which the compensation system must operate. Most companies fall on a continuum along the multiple variables that could

As every company occupies a special position or perspective on this framework, it is only logical that different pay systems emerge, and effectiveness varies by context. The major dimensions and elements of the framework are not meant as an exclusive list of all determinants of global pay decisions, but rather as a heuristic for future research about (additional) influencing factors and their interrelationships in the complexity of global pay. This proposed meta-framework outlines ex post many factors that may be used to explain the prevalent variety in global pay systems we observe empirically. Due to the meta-level character of this paper it would be difficult to develop testable hypotheses or propositions at this stage. However, some interrelationships between firm-internal/external factors and an organization’s pay design are highlighted, which may be further developed and operationalized by future research.

For future research we suggest that it would be most valuable to go beyond the use of a single research paradigm such as the universalist or contextualist approach because this does not seem to be sufficient for explaining the differences in global pay practices - even though both paradigms are very valuable. Future research should rather focus on developing a new paradigm reflecting the global reality in which companies are operating at the beginning of the 21st century. This “new paradigm” could focus on the one hand on combining the strengths of the universalist and contextualist paradigm and on the other hand on establishing a link to firm performance from the mixture of both perspectives.
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