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Key Words and Phrases
International strategy, incentives, expatriate managers.

* Bonache,J. Departamento de Organización de Empresas. Universidad Complutense de Madrid.
Fernández,Z. Departamento de Economía de la Empresa de la Universidad Carlos III de Madrid.
ABSTRACT

This paper focuses on the strategic design of expatriates' salaries. Unlike standard expatriation literature that assumes a lack of connection between strategy and international managers' compensation, we use the theoretical concepts from the international strategic management research to discuss how different international strategies affect the way expatriates are compensated. In this respect, the paper proposes a series of hypotheses on how expatriate compensation systems take shape according to the role that the expatriates may play in the internationalization process. The hypotheses refer to the type of incentives offered to encourage acceptance of the assignment, the type of criteria used to evaluate their performance, and the reference unit used to establish variable compensation.

1. INTRODUCTION

One of the implications of growing firm's internationalization is the increasing number of transfers of technical and management personnel between different countries. This increase can even be observed in companies from countries that traditionally have dealt very little in foreign trade. For example, the Spanish companies with the most significant international presence such as the Banco Santander (banking), Telefónica (communications) or Repsol (oil industry), which ten years ago had a merely symbolic number of international managers, now have more than 100 expatriates each.

The literature on international human resource management has not ignored these transfers. In fact, there is a large number of studies that analyze the role they play in
multinational companies (MNCs) and how these firms select, train, compensate and design the professional careers of these employees (Edstrom and Galbraith, 1977; Tung, 1981; Kobrin, 1988; Brewster, 1989; Boyaciliger, 1990; Naumann, 1992; Ghoshal, et al., Welch, 1994).

The aspect of expatriate management that has received the least amount of attention is compensation. By way of example, we should mention that of 174 references selected from "The International Journal of HRM" (May 1994) on issues specifically related to international human resource management, only one of them dealt with compensation systems in MNC's (the article by Reynolds, 1986). This contrasts with the abundant references that exists on managerial compensation in domestic human resource management; in this field, according to a recent study by Gómez Mejia (1994), we can find more than 300 empirical studies on the determining factors of managers' salaries.

The differences between the literature on domestic and international managerial compensation are not limited to the amount of published work but also refer to the orientation of this work. In the domestic arena, the strategic vision characteristic of human resource management since the early 80's has prevailed, showing how the design of a manager's salary package has a fundamental influence on the organization's strategic decisions (for a review of this literature, see Gómez Mejia and Balkin, 1992). On the other hand, international human resource management has not seemed to grant a strategic interest to the compensation system of international managers. In one of the first and most influential contributions in this area, Edstrom and Galbraith (1977, 253) justify the omission of the compensation system from the strategic dimensions involved in international transfers as follows: "Compensation packages ... do not differ with reasons for transfers; that is, all companies use compensation to maintain the expatriate's standard of living or slightly better it". Subsequent research has followed this same line of thought, as the scarce number of published works in this area (Reynolds, 1986; Phatak et al., 1987; Harvey, 1993) adopt a predominantly operational perspective.
Expatriate compensation is the responsibility of a functional department whose mission is limited to designing payment systems that, through the use of different technical tools (cost of living and housing differentials, tax treatment, monetary incentives, etc.), guarantee equity and help to encourage acceptance of international assignments. However, the connection between these systems and the company's international strategy is not accounted for.

This article intends to fill this gap in the literature by analyzing how different international strategies affect the way expatriates are compensated. In this respect, the article has one basic objective: build a theoretical framework to guide future empirical research on the strategic compensation system of senior expatriates.

The paper is divided into three main parts. In the first part, we explain how the transfer and accumulation of intangible assets (in particular knowledge) is the basic element that defines corporate internationalization. This allows us, based on Gupta and Govindarajan's work (1991), to classify subsidiaries into four main types: implementor, local innovator, global innovator, and integrated player. We then determine the role of expatriates in each of these subsidiaries. Finally, we propose a series of hypotheses on how expatriate compensation systems take shape according to the role that the expatriates play in each of the subsidiaries to which they may be assigned. The hypotheses refer to the type of incentives offered to encourage acceptance of the assignment (intrinsic or extrinsic), the type of criteria used to evaluate their performance (by results or by behavior), and the reference unit used to establish variable compensation (the subsidiary, a set of subsidiaries or the corporation as a whole).

The main conclusion reached in our study is that if MNC's use compensation systems as a mechanism to guide behavior, it may be reasonably predicted that the lack of connection between strategy and expatriate compensation does not reflect actual practices within MNCs.
2. INTERNATIONALIZATION PROCESS AND DIMENSIONS

Each enterprise can be viewed as a bundle of both tangible and intangible resources (Wernerfelt, 1984; Barney, 1991; Grant, 1991; Mahoney and Pandian, 1992). Within intangible resources, some may be considered as the company’s property, such as the intellectual property rights of patents and trademarks, copyrights and registered designs, contracts, trade secrets and databases (Hall, 1993). On the other hand, other intangible resources such as the corporate culture, the technological, commercial and organizational skills and knowledge of company personnel, and the supplier and customer networks, are not of a proprietary nature.

Within this set of resources, these more or less complex forms of knowledge are an essential element in corporate internationalization. Thus, several authors (Penrose, 1959; Hymer, 1976; Caves, 1982; Teece, 1986) maintain that foreign direct investment occurs when a company exploits in other markets valuable knowledge that it finds difficult to sell. In other words, possession of a body of valuable, scarce, imperfectly imitable and unreplaceable knowledge that provides the company with a competitive advantage in the domestic arena is also a basic factor in explaining the company’s expansion process toward new countries.

Now, internationalization also provides learning opportunities through exposure of the company to new cultures, ideas, experiences, etc., which may be used to create new expertise that complements and leverages its current knowledge. From this standpoint, the simultaneous efforts to earn income from existing resources and knowledge and to seek new knowledge to generate future income define the two basic dimensions of multinational expansion (Tallman and Fladmoe-Lindquist, 1994).

In this exploitation and accumulation of knowledge, not all subsidiaries perform the same function. On the contrary, the most recent literature on corporate internationalization has also pointed out the internal differentiation between subsidiaries
making up an MNC (Ghoshal and Nohria, 1989; Bartlett and Ghoshal, 1989; Martínez and Jarillo, 1991; Roth and Morrison, 1992). In this respect, Gupta and Govindarajan (1991) classify MNC subsidiaries in accordance with the magnitude (quantity and importance) and direction (inflow or outflow) of knowledge in which they are involved. Thus, they distinguish four categories: implementors, local innovators, global innovators and integrated players (see Chart 1).

Chart 1: Subsidiary Strategic Roles

<table>
<thead>
<tr>
<th></th>
<th>High Outflow of knowledge from the focal subsidiary to the rest of the corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global Innovator</td>
<td></td>
</tr>
<tr>
<td>Integrated Player</td>
<td></td>
</tr>
<tr>
<td>Low Inflow of knowledge from the rest of the corporation to the focal subsidiary</td>
<td></td>
</tr>
<tr>
<td>Local Innovator</td>
<td></td>
</tr>
<tr>
<td>Implementor</td>
<td></td>
</tr>
</tbody>
</table>

Source: Gupta and Govindarajan (1991)

Implementor subsidiaries apply the knowledge developed in the headquarters or other units of the organization in a specific geographic area. For example, the Spanish electric firm Unión Fenosa, began its international expansion eight years ago and is now present on four continents and in a total of 21 countries. The firm's international strategy is based on exploiting the experience it acquired in Spain by providing consulting to foreign electric utilities.

The global innovator learns and develops new knowledge that may later be
exported to other parts of the organization. This is the case of the merchant bank branches in Miami and Switzerland owned by the Spanish bank with the most extensive international operations: Banco Santander. The reason for these locations is the headquarters' interest in owning assets in the most competitive markets in order to transfer learning from these locations to other units of the organization (including Spain).

The integrated player is a subsidiary that develops new expertise but also uses the knowledge generated in other subsidiaries or the headquarters. Therefore, it is in these subsidiaries where the two above mentioned internationalization dimensions (exploitation and accumulation) are verified. The subsidiaries of the Spanish textile firm, Zara, belong to this category. The company's strategy is based on developing fashion products for the global market (Bonache and Cerviño, 1997). This requires close coordination between the different units in order to ensure that the products can be sold in all the markets in which the company operates. The different units have inherited the work systems from the headquarters (in particular, inventory management and the sales force incentive policy), which were successfully established in Spain. However, periodic meetings are also held between personnel from the different units, and there is also an information and incentive system to facilitate the transfer of innovations and ideas (fundamentally in marketing) between the different corporate units.

Finally, local innovators are subsidiaries that are much less dependent on the knowledge existing in the rest of the company's international network. In this case, internationalization is based more on the transfer of products or capital than on intangible assets (Gupta and Govindarajan, 1991). The reason for this is that the environment is considered to be so idiosyncratic that the subsidiary has to develop expertise internally and that this developed knowledge cannot then be transferred to other subsidiaries. Examples of this type would be the Chinese subsidiary of the Spanish transportation company "Alsa", or the subsidiary that the "Banco Exterior de España" has in Cuba.
On the other hand, this body of knowledge that is transferred between subsidiaries has a series of characteristics in; these include the following:

1. A lot of knowledge has a strong tacit component (Polanyi, 1967). As a result, it can only be acquired and transmitted by doing ("learning by doing"). On the contrary, other knowledge is coded, which makes it easy to imitate and transmit. This distinction has a series of consequences that are set forth in Table 1.

<table>
<thead>
<tr>
<th>TYPE OF KNOWLEDGE</th>
<th>TACIT</th>
<th>CODIFIED</th>
</tr>
</thead>
<tbody>
<tr>
<td>Location of Knowledge</td>
<td>People's head</td>
<td>Formulae, databases,…</td>
</tr>
<tr>
<td>Nature of learning</td>
<td>Experience based</td>
<td>Formal education</td>
</tr>
<tr>
<td>Method of learning</td>
<td>Apprenticeship, coaching</td>
<td>Classroom</td>
</tr>
<tr>
<td>Easy of transfer</td>
<td>Low</td>
<td>High</td>
</tr>
</tbody>
</table>

Source: Adapted from Jaikumar (1988)

2. Knowledge is organized according to a hierarchical structure (Grant, 1995). Some knowledge is very specific and involves performing a certain task, whereas other knowledge is the integration of different types of expertise of a more specific nature. For example, a hospital's knowledge that allows it to treat heart patients depends on the integration of different lower-level expertise such as diagnosis, cardiovascular surgery, postoperative care and other support know-how.

3. Knowledge can be generic or specific. The former is knowledge that can be applied in any company without losing value (for example, accounting expertise). The latter is knowledge that can be applied in the company proper but that loses value
in another organization. Since, to be a source of competitive advantage, knowledge must be valuable, scarce, imperfectly imitable and unreplaceable (Barney, 1991; Dierickx and Cool, 1989; Peteraf, 1993), it holds that specific knowledge is more crucial than generic knowledge to explain the company's competitiveness and internationalization.

4. The process of obtaining and generating knowledge is gradual, i.e. a minimum amount of time is required to generate and assimilate new knowledge - what Dierickx and Cool (1989) call "time-compression deseconomies". This occurs even to acquire coded (and thus easily interpreted and transmitted) knowledge. In addition, acquisition of knowledge is "path dependent", which means that the way in which the knowledge is gained affects the results that are eventually obtained.

5. Finally, just as any other intangible asset, Itami (1987) pointed out that knowledge is characterized by the fact that its raw material is information possessed by the individuals and groups both in the organization and outside it (for example, brand image and reputation is information possessed by the company's customers and suppliers).

Thus information and people are two essential elements of intangible assets in general and of knowledge in particular. People are the ones with the experience, information and knowledge that it is applied in the activities developed by the company. From this perspective, we can discuss the role that human resources play within the corporate internationalization process.
3. SUBSIDIARY STRATEGIES AND REASONS FOR USING EXPATRIATES

In the international arena there are two types of human resources: local and expatriate, and the latter may be from the headquarters or from a third country. The literature has indicated that expatriate personnel can play different roles in corporate internationalization such as starting up operations, control, coordination, organizational development and supplementing the lack of local talent (Edstrom and Galbraith, 1977; Brewster, 1989).

All these roles are related either to the exploitation, acquisition or accumulation of the company's knowledge. Moreover, taking into account the hierarchical nature of knowledge, there are three types of expatriates: subsidiary managers who possess the highest level of expertise; functional expatriates with specialized know-how in one of the areas of corporate management (e.g., human resource or marketing managers); and technical experts who deal with aspects of an operational nature (e.g., process and product technologies).

In this paper, our interest is focused exclusively on the first group of expatriates; subsidiary managers. We must not assume that these expatriates must perform all the above mentioned roles. On the contrary, there are roles that may be justifiable in some subsidiaries and not in others (e.g., coordination between different units), or others that may be justifiable in more than one type of subsidiary (e.g., operations control). Our goal is to relate the traditional reasons for using expatriates to the types of subsidiary.

Impplementor subsidiaries exploit many skills and knowledge from other units. If we look at some of the characteristics of knowledge indicated above, we can explain why it is necessary to use expatriates to start up the subsidiary's operations, as well as the basic source of recruitment. Thus, the tacit nature of skills and knowledge means that in order to exploit them in the subsidiary, it is necessary to transfer employees (Pucik, 1992). Their specific nature explains the empirical datum provided by
Naumann (1992) indicating that the source of expatriate recruitment is located in the company itself and not in the market. This is the case of Union Fenosa. Its implementor subsidiaries always develop the same procedure: personnel from Spain assume responsibility for the subsidiary, along with young local professionals who are gradually trained.

Once the knowledge that defines how things are done in the company is transferred, the implementor subsidiary may continue to use expatriates for purposes of control. In fact, as it becomes more mature and independent with regard to the headquarters' resources and capabilities, there will be increasing centrifugal trends in the subsidiary. This is because the subsidiary's success depends more on its ability to adapt to local conditions than on the support received from the headquarters (Nohria and Ghoshal, 1994). In this case, it is essential that the headquarters ensure that this adaptation and local development of its expertise do not contradict the organization's basic image. In the case of Union Fenosa, since communication is easier between managers who share not only the same corporate culture but also the same Spanish nationality, and since the expatriates are more loyal to the interests of the headquarters than to those of the subsidiary, the headquarters continues to use expatriates to maintain good communication links with the subsidiary and to guarantee close compliance with the central guidelines.

In local innovators, there is no relevant transfer of knowledge from the headquarters to the subsidiary or vice versa. Therefore, there is little basis for using expatriates to set up operations or transfer know-how in this type of subsidiary. Moreover, the fact that the expatriates' expertise is not well suited to the subsidiary environment, together with factors such as expatriates costs (Kobrin, 1988), the motivation and aspirations of local employees (Harris and Moran, 1987) or local governmental pressures (Groose and Kujawa, 1988), will make international assignments seems less attractive to the multinational firm. On this basis, it could be argued that these subsidiaries will tend to be directed not by expatriates but rather by local
managers. The latter speak the language, understand the country's culture and political system and generally belong to a social elite that permits the company to more easily penetrate the market (Hamil, 1989). In addition, using local managers increases company acceptance by the governments and trade unions in the host country (Groose and Kujawa, 1988).

In spite of these considerations, a lack of local talent often forces companies to use expatriates. This is usually the case when the company is setting up in developing countries (Brewster, 1989; Gómez Mejia et al., 1995). Likewise, circumstances may exist (which can also be found in other types of subsidiaries) that force the company to opt for expatriate instead of local managers in order to ensure control of the subsidiary. For example, in situations of political risk (in which a political event is likely to occur that will change the profitability prospects of a specific investment; Haendel et al., 1975) or cultural risk (when there is a large cultural distance between head office and subsidiary; Hofstede, 1980), the headquarters needs to process a lot of information. This may lead it to assign "trustworthy" managers whose function will be to increase the channels of communication between the head office and subsidiary and guarantee that the headquarters' interests are well represented in the subsidiary (Boyaciliger, 1990). Thus, a lack of available local talent and maintaining control are reasons why the management of Banco Exterior de España assigned a Spanish expatriate to its subsidiary in Cuba.

The above mentioned reasons for using expatriates to start up operations also apply in the case of "integrated players", as there is a considerable input of know-how into these subsidiaries. The close interdependence between these subsidiaries and other units in the organization also makes it necessary to coordinate their activities (Porter, 1986; Grant, 1988). This coordination does not take place spontaneously since each unit will tend to be particularly concerned with performing its own tasks, will pursue its own functional goals and will confront its own environmental pressures (Cray, 1984). Moreover, managers of interdependent units may lack information on the overall impact
of their decisions, and thus it is likely that they will not make the most effective decisions for the organization as a whole (Edstrom and Galbraith, 1977). Under these circumstances, the headquarters has several coordination mechanisms at its disposal, such as centralized decision-making (Jones and Hill, 1988; Roth et al., 1991) or increased lateral links between subsidiaries (Galbraith, 1977). The latter include shorter assignments of managers between subsidiaries and between subsidiaries and the headquarters (Galbraith, 1977; Edstrom and Galbraith, 1977; Bartlett and Ghoshal, 1989). For example, in its first phase of internationalization, Zara wanted to ensure that its activities were coordinated in order to exploit the economies of scale that result from selling standardized products to the same global market segment (the firm only produces articles that can be sold in the 9 countries in which it does business; Bonache and Cerviño, 1997). To do so, the headquarters chose to assign expatriates to start up operations and transfer them to different units in order to increase their knowledge of the network, to be aware of the impact of their decisions and to develop multiple contacts, which would allow them to act as links between interdependent units.

Finally, "global innovators" transfer know-how from their unit to other units. Due to the tacit nature of this expertise, it can only be transferred through the international assignment of key personnel. Therefore, organizational learning is the other fundamental reason for using expatriates in this type of subsidiary. For example, in the Banco Santander's merchant banking subsidiary in Miami, expatriates are transferred both to Spain and to other units (e.g., Chile) in order to apply there the know-how acquired in the North American branch.

Table 2 shows a summary of the expatriate's different roles in each of these subsidiaries. It should be noted that the lack of available local talent is not included either in the case of implementors or integrated players. In this respect, Boyaciliger (1990) found no correlation between availability of a professional workforce and use of expatriates. In other words, even when local talent was available, companies continued to use expatriates. This datum is also corroborated in the Ernst and Young survey on
international assignments (1994). However, these empirical results can be easily construed in the case of the two above mentioned subsidiaries. They both have very little knowledge inflow. It must be remembered that such a knowledge can be generic or specific. Only the latter is grounds for using expatriates in these subsidiaries, since it is this knowledge the basis of the company's competitive advantage. Thus, even when there is sufficient human capital in the host country with a high level of generic skill and expertise, the use of expatriates will continue to be necessary either to start up, control, coordinate or transfer knowledge in foreign operations.

Table 2: Subsidiary Strategies and Expatriation

<table>
<thead>
<tr>
<th>TYPE OF SUBSIDIARY</th>
<th>Implementer</th>
<th>Local Innovator</th>
<th>Integrated Player</th>
<th>Global Innovator</th>
</tr>
</thead>
<tbody>
<tr>
<td>Knowledge Flow</td>
<td>High Inflow</td>
<td>Low Inflow</td>
<td>High Inflow</td>
<td>Low Inflow</td>
</tr>
<tr>
<td></td>
<td>Low Outflow</td>
<td>Low Outflow</td>
<td>High Outflow</td>
<td>High Outflow</td>
</tr>
<tr>
<td>Main expatriates roles</td>
<td>* Initiate operations</td>
<td>* Coverage of the lack of local talent</td>
<td>* Initiate operations</td>
<td>* Coverage of the lack of local talent</td>
</tr>
<tr>
<td></td>
<td>* Transfer of know how to the subsidiary</td>
<td>* Control</td>
<td>* Coordination</td>
<td>* Organizational learning</td>
</tr>
</tbody>
</table>

13
4. DESIGN OF EXPATRIATE COMPENSATION SYSTEMS

Wright et al. (1994) claimed that the existence of a pool of human capital is a necessary but not the only condition required for human resources to act as a source of competitive advantage: "The potential of the human resource capital is realized only to the extent that the possessors of the human capital (i.e., individual employees) choose to allow the firm to benefit from the capital through their behavior" (pg. 320). In other words, once the firm has personnel for assignment to foreign locations, it is also required that the expatriates perform the role (i.e., exhibit the type of behavior) that makes it possible to implement the subsidiary strategy. For example, the headquarters must ensure that an expatriate assigned to an implementor subsidiary to start up operations is effectively disseminating headquarters' culture and expertise, or that an expatriate of an integrated player to which he/she has been assigned for purposes of coordination is actually acting as a link between interdependent subsidiaries.

A mechanism to encourage expatriates to act in the company's interest and to display the type of behavior required in the subsidiary is the compensation and incentive system. This can be defined as "a pivotal control and incentive mechanism that can be flexibly used by management to achieve business objectives" (Gomez Mejia and Balkin, 1992; pp. 18).

This concept of the compensation and incentive system goes against the prevailing line of thought in the field of expatriate compensation. Such a prevailing view is reflected in the most widely prevalent salary approach in the multinational arena: the balance sheet (Reynolds, 1986; Phatak et al., 1987; Dowling and Schuler, 1990). The purpose of this approach is to maintain the expatriate's purchasing power in different locations and to offer monetary incentives to make assignments appealing. The vision of compensation in this and other similar systems (the global compensation system, the host country system, etc.) is based on two fundamental elements:
1. Their objective is to achieve internal consistency. These systems try to introduce a series of rules and procedures to standardize salary decisions and apply them uniformly throughout the organization.

2. They are guided by considerations of a technical and operating nature. The different proposed systems focus on the design of differentials (cost of living, taxes, housing, etc.) and monetary incentives that assure equity and make assignments appealing.

Obviously, such systems can be very useful for solving the multiple technical problems posed by assignments, such as double taxing problems or differences in living conditions and wage levels of the different countries. However, these systems have two major limitations. In the first place, they do not account for the internal differentiation between subsidiaries. In effect, the use of a standard compensation system is easier to control from an administrative point of view, and at the same time it provides a greater sense of equity. However, when the expatriate's role varies depending on the different subsidiaries, a specific compensation package for each type of subsidiary makes much more sense. Secondly, these systems do not provide an answer to the different questions posed by the strategic design of a compensation system, such as: How should expatriate performance be evaluated?, How does the system help to attain our strategic goals?. Consequently, they are merely a support tool and not the target on which an strategic compensation system should be focused.

As opposed to this traditional vision, our interest lies primarily in analyzing how the design of expatriate compensation systems can help to implement the subsidiary's international strategy. Figure 1 shows the standpoint adopted in this article. Compensation is not restricted to solving the multiple monetary problems posed by assignments, but rather is also an instrument to guide behavior. As all human resource policies, it should not be conceived in isolation, but rather should be externally and internally integrated (Dyer, 1984; Lengnick-Hall and Lengnick-Hall, 1988; Wright and
McMaham, 1992). Externally, it should be related to the subsidiary’s strategic goal and consequently to the reason for assignment. Internally, the system must be integrated with all other expatriation policies (selection, training and professional development). The purpose of this dual integration is to achieve a higher performance. As a result, instead of a single compensation system applicable to all assignments, expatriate compensation must be conceived in a flexible way.

Focusing on integration or fit between compensation and type of subsidiary, and assuming that the firm conceives compensation as a mechanism for guiding behavior, the rest of this article intends to answer the following question: What shape will the compensation system predictably take on in each type of subsidiary?

As elements of compensation systems, we will merely focus on three options that implicitly or explicitly play a determining role in types of managerial behavior; the type of incentives offered to accept the international assignment, the criterion used to evaluate performance, and the reference unit for calculating variable compensation.

a) Type of Reward

This element refers to the type of incentive offered by the organization to accept an international assignment. Such incentives can be extrinsic or intrinsic. The former refer to the type of tangible or money reward, while the latter are intangible rewards such as the opportunity for professional development, security or recognition.

A situational factor that determines the emphasis of one type of reward or the other is repatriation (Adler and Ghadar, 1991). In many organizations, employees believe that their return to the country of origin after one or more assignments will be accompanied by readaptation problems, loss of status (Harvey, 1982; Törbiorn, 1982)
and lack of recognition of the experience gained abroad (Howard, 1973; Harvey, 1989). This problem is very obvious to the rest of the organization's employees, which can influence the multinational firm's ability to recruit new employees for future assignments (Tung, 1988).

The repatriation problem is minimized if expatriates are assured that international experience will positively affect their professional development. However this is not a normal practice, as the purpose for providing personnel for international assignments seems more to cover immediate human resource needs than to create a career development strategy for future corporate managers (Mendenhall, et al., 1987).

Taking into account the degree of applicability and the value of expertise acquired abroad, not all assignments generate the same repatriation problems, nor do all of them have the same impact on professional careers (see Figure 2). If the human capital gained abroad represents a type of knowledge that cannot be applied once the assignment has concluded (e.g., because it is linked to a specific location), repatriation problems will arise. This would explain the results of several investigations (Howard, 1973; Harvey, 1989) that demonstrate that skills developed by expatriates during foreign service are barely exploited. On the other hand, if this human capital can be profited from once the assignment has concluded, repatriation will be easier. Also, the company's long-term competitive advantage depends on constant updating of the knowledge on which it is based (Tallman and Fadmoe-Linquish, 1994). Consequently, the value of human capital acquired abroad will rise as it increasingly incorporates knowledge to the one already exists in the country of origin. If this value is high, it will have a positive impact on professional development. Otherwise, the impact will be more uncertain.

Figure 2 shows how repatriation problems and the impact on professional career assignments determine the type of reward offered by the organization.

[Insert Figure 2]
Expatriates of local innovators develop expertise that is totally heterogeneous with regard to that existing in any other unit. Therefore, these assignments result in more serious repatriation problems. In view of this uncertainty associated with repatriation, monetary incentives are strongly emphasized to attract human resources to the expatriation service (Adler and Ghadar, 1991).

In the other three kinds of subsidiaries, knowledge is shared between units. This fact facilitates repatriation. However, the value of the human capital acquired abroad varies between them. Thus, integrated players and global innovators contribute heavily to the generation of new expertise in the home country. Under these conditions, the incentives offered by the firm to accept international assignments could be less of a monetary type and related more to the intrinsic value involved in the opportunity to undertake a brilliant career within the organization. Thus, in strongly integrated companies such as Zara, the condition for accessing executive posts in the head office is to have had at least one international assignment.

Finally, expatriates in implementor subsidiaries contribute very little to new know-how, and therefore an international assignment will have a more indecisive impact on the professional career. As a result, the headquarters will also have to emphasize extrinsic rewards to motivate acceptance of the assignment. Based on these observations, it can be assumed that:

Hypothesis 1: To accept international assignments, the emphasis will be on extrinsic rewards for expatriates in local innovators (very high emphasis) and implementor subsidiaries (medium emphasis), whereas in global innovators and integrated players the emphasis will be on intrinsic compensations.
b) **Type of criterion used to evaluate performance.**

The literature has discussed two fundamental criteria to evaluate performance: by results or by behavior (Eisenhardt, 1989; Rajagopalan and Finkelstein, 1992). The former method uses quantitative criteria based on objective results such as the economic or financial returns of the unit, providing incentives to individuals to obtain these outputs. The latter method uses subjective evaluation criteria of a qualitative nature in order to motivate individuals to display certain types of behavior.

The following three basic factors have been indicated as determinant of the type of criterion used:

1. **Information asymmetries (Eisenhardt, 1989).** When headquarters lacks information regarding the tasks to be performed, it will not be able to issue judgments on the quality of the examinee's performance. Consequently, the evaluation will be by results. Otherwise, the evaluation will be by behavior.

2. **The level of autonomy that the headquarters wishes to encourage.** When the organization wants to promote a climate of autonomy and entrepreneurship, a result-based evaluation is usually used (Berg, 1973; Williamson, 1975). On the contrary, when the type of actions carried out by managers is relevant and the organization wants to strengthen dependence on superiors, a behavior-based evaluation is more rational.

3. **The existence of shared resources (Lorch and Allen, 1973; Hill and Pickering, 1986; Hill, 1988; Gold and Campbell, 1987).** The existence of shared resources leads to a high involvement of headquarters in the subsidiary strategic decisions. Under these circumstances, it is difficult to determine who is responsible for the subsidiary's results. This leads to evaluate managers performance by behavior. If there are not shared resources, performance evaluation will be by results.
In the first stage, the expatriate of an implementor subsidiary requires a high level of initiative and entrepreneurship to adapt the organization's products and policies to the subsidiary's environment (Bartlett and Rangan, 1986). This leads to the creation of a system of evaluation by results that promotes the expatriate's autonomy. However, penetration of a foreign market that leads to the creation of an established reputation, the mastery of technological skills and abilities by local personnel and the establishment of a stable network of suppliers in a foreign market is a slow, costly process that does not translate immediately into financial results. Furthermore, the headquarters' managers understand the business and know the activities that these expatriates must perform, which allows them to issue judgments and establish expectations regarding the quality of the expatriate's actions. These opposing forces will lead to a combination of results and behavior when evaluating expatriate behavior, with a greater emphasis on the former as the subsidiary matures.

In the first stage, expatriates of global innovators share very little know-how with the headquarters, which leads to evaluation of performance in terms of results. However, the headquarters will be interested in limiting their autonomy once their actions and objectives strongly influence other parts of the organization. Consequently, a combination of results and behavior will also be used. The emphasis on the latter will increase as the headquarters becomes more familiarized with the know-how transferred from the subsidiary to other units.

The close interdependence that integrated players maintain with other units of the organization leads to a heavy involvement of the headquarters in making operating and strategic decisions, i.e. to a restriction of the expatriate's autonomy. If to this we add the know-how shared between the head office and these subsidiaries, we can conclude that behavior will be the criterion used to evaluate the performance of these expatriates.

Finally, the headquarters and local innovators share very little expertise. As a result, the Headquarters' managers will not be highly involved in formulating the
subsidiary's strategy, which is the responsibility of the subsidiary's expatriates. The main influence of the head office on the subsidiary will be through budgetary control (Dundas and Richardson, 1982; Williamson, 1975), which will lead to expatriate evaluation in terms of easy-to-measure quantitative results. From this analysis we hypothesized that:

Hypothesis 2: Performance evaluation will be by behavior for expatriates of integrated players, and by results for expatriates of local innovators. A combination of behavior and results will be applied to expatriates of implementor subsidiaries (with an ever greater emphasis on results as the subsidiary matures) and of global innovators (with an ever greater emphasis on behavior as the subsidiary matures).

c) Reference Unit

The headquarters has two basic reference units to which it can link the variable part of the expatriate's salary: the corporation or the subsidiary. Selection of the reference unit will have a strong influence on the degree of the expatriates' cooperation with other units and on the unit to which they will be most committed. As regards cooperation, if expatriates are paid exclusively in terms of their units' performance, they will not be motivated to diffuse knowledge to other units (Pucik, 1992). As regards commitment, Ouchi (1979) pointed out that linking variable compensation to organizational performance increases the employees' commitment to and identification with the organization. Consequently, although these two units can be mixed, their relative weight must vary in terms of the degree of cooperation that the expatriate must maintain with other units, and also of whether the organization wishes to leverage the expatriate's commitment to the corporation or to the subsidiary.
Expatriates in local innovators perform their functions with a high degree of independence from the headquarters. Under these conditions, the unit is the best indicator of the contribution of a subsidiary manager to the organization as a whole. Expatriates of implementor must coordinate with other units, but only to implement and adapt knowledge in a subsidiary to which they will be attached for a limited period of time. If a large proportion of their variable salary is related to the subsidiary proper, they will be provided with a clear incentive to disseminate information and teach local employees what they themselves have learned, as well as to supervise the effective implementation of organizational expertise.

Expatriates of global innovators must have an incentive to disseminate their expertise because of the close coordination required with other units. Consequently, the corporation (or set of interrelated units) will also weigh heavily on their variable compensation. Finally, if to the need for coordination of expatriates in integrated players we add the fact that their role is to act as "organizational glue" (Bartlett and Ghoshal, 1989), we can conclude that the fundamental reference unit will be the one that promotes greater commitment to the corporation. Given these arguments we hypothesized that:

Hypothesis 3: The reference unit for calculating variable compensation of expatriates will be the subsidiary itself for local innovators, and the subsidiary and the corporation for the other three kinds of subsidiaries. In implementors, the subsidiary will have a higher weight, in integrated players the corporation will have a higher weight, and in global innovators the corporation and the subsidiary will have an equivalent weight.
Table 3: Summary of Hypothesis

<table>
<thead>
<tr>
<th>TYPE OF SUBSIDIARY</th>
<th>Local innovator</th>
<th>Implementer</th>
<th>Global Innovator</th>
<th>Integrated Player</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Type of Reward</strong></td>
<td>High emphasis on extrinsic rewards</td>
<td>Medium emphasis on extrinsic and intrinsic rewards</td>
<td>High emphasis on intrinsic rewards</td>
<td>High emphasis on intrinsic rewards</td>
</tr>
<tr>
<td><strong>Performance evaluation criteria</strong></td>
<td>Outputs</td>
<td>Outputs and behavior (higher emphasis on outputs as the subsidiary matures)</td>
<td>Outputs and behavior (higher emphasis on behavior as the subsidiary matures)</td>
<td>Behavior</td>
</tr>
<tr>
<td><strong>Unit of reference</strong></td>
<td>Subsidiary</td>
<td>More weight on the subsidiary</td>
<td>The subsidiary and the corporation</td>
<td>More weight on the corporation</td>
</tr>
</tbody>
</table>
5.- CONCLUSION

The traditional perspective for analyzing expatriate compensation has been based on analyzing the multiple problems that international assignments pose for individuals (differences between countries in cost of living, housing, taxes, etc.). According to this view, compensation is primarily a mechanism to calculate differentials and bonuses aimed at promoting international mobility and guaranteeing equity. With this understanding, Edstrom and Galbraith (1977) stated that the way in which multinational firms compensate expatriates is independent of the reasons for assignment. Subsequent empirical research has been developed along the same lines. For example, Welch (1994), in her analysis of four Australian multinational firms, shows that in spite of their differences in strategy, all four develop a standardized focus on expatriate compensation (the balance sheet). In short, from this individual point of view, corporate reality seems to indicate a lack of connection between compensation and international strategy.

In this article, we have extended the prevailing strategic orientation of domestic compensation policy to the multinational arena. According to this view, compensation is an instrument that must guide behavior in order to achieve corporate objectives. This means that the system design, in addition to solving the multiple individual problems involved in accepting an international assignment, must address additional questions (how to evaluate expatriate performance, what the reference unit to establish variable compensation is, etc.). From this new perspective, expatriate compensation does not correspond to the traditional standardized vision. On the contrary, assuming that the multinational firm uses compensation as a tool to attain the strategic goals of the subsidiary, it can be predicted that there is an internal differentiation in the way that multinational firms compensate their expatriates.

The interest of this strategic vision is obvious if we bear in mind that, in accordance with the principles of the contingency theory, the integration of human resource policies with corporate strategy results in improved corporate performance.
(Snell and Dean, 1992; Lengnick-Hall and Lengnick-Hall, 1988; Wright and McMahan, 1992). Therefore, it can be expected that empirical research will demonstrate how companies that compensate their expatriates in connection with the subsidiary's strategic objectives will obtain better performance than those that develop a merely individual, operative vision.

In any event, the compensation policy is only one element of expatriation policies. Consequently, if it is not integrated with the rest (e.g., with expatriate selection or training), it is likely that it will produce only modest results. The lack of indications regarding the way in which this integration with other expatriation policies is achieved is precisely one limitation of this study.

Our analysis also suffers from other limitations. We have not considered compensation of junior expatriates or of those international managers with short-term assignments who are not responsible for the subsidiary (Welch and Welch, 1994). We have also not examined the types of expatriate compensation in organizational forms other than direct investment (e.g., Strategic Alliances). Finally, we have also omitted from our analysis other elements of strategic compensation design such as percentage of variable salary over total compensation, the frequency of rewards, or the time frame of incentives (short term / long term).

In conclusion, both these empirical and theoretical questions open up an entire new field of research about a policy that, to date, has received very little attention from the strategic literature on international human resource management.
FIGURE 1: THE STRATEGIC ROLE OF EXPATRIATE COMPENSATION

- **Type of Subsidiary**
  - Implementor
  - Integrated player
  - Local innovator
  - Global innovator

- **Expatriate Compensation System**
  - External fit
  - Internal fit

- **Other expatriate policies**
  - Selection
  - Training
  - Career development

- **Solve problems**
  - Associated to international transfers
  - Guide behaviour

- **Improved performance**
FIGURE 2: KNOWLEDGE ACQUIRED ABROAD, REPATRIATION AND TYPE OF REWARD

<table>
<thead>
<tr>
<th>Knowledge acquired abroad</th>
<th>Degree of applicability</th>
<th>Value of knowledge</th>
<th>Impact on professional career</th>
<th>Incentive offered to accept an international assignment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Low</td>
<td>Repatriation problems</td>
<td>High</td>
<td>Emphasis on extrinsic rewards Low</td>
</tr>
<tr>
<td></td>
<td>High</td>
<td>Uncertain impact</td>
<td>Medium</td>
<td>Emphasis on intrinsic rewards Medium</td>
</tr>
<tr>
<td></td>
<td>High</td>
<td>Positive impact</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Uncertain</td>
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<tr>
<td>Medium</td>
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<td>High</td>
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<td>Medium</td>
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<tr>
<td>Low</td>
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</table>

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NOTES

1. When an attempt is made to exploit know-how or other resources in new businesses instead of other countries, the company is said to be diversifying (Teece, 1982; Montgomery and Wernefelt, 1984, Markides and Williamson, 1994). Unlike internationalization, which usually consists of selling (and producing) in foreign markets the same products sold on the local market, diversification consists of penetrating new markets with new products.

2. Kogut and Zander (1992) indicated the paradox of tacit knowledge: while the fact that it is difficult to imitate makes it more valuable, it also results in transmission problems within the company.

3. Grant (1995) does not speak of knowledge but rather capabilities. However, these are no more than the knowledge the company possesses regarding the way to combine resources to perform a productive activity.

4. Starting up an operation involves transferring the way the corporation's characteristic activities are done to foreign operations. Control would be a mechanism intended to secure the headquarters' interests in the subsidiary (to ensure that the subsidiary applies expertise properly). Coordination is possible to the extent that information and knowledge are shared between different units. Organizational development involves disseminating and accumulating knowledge. Finally, the lack of local talent refers to the impossibility of finding managers in the subsidiary's country with the skills and knowledge required to assume responsibility for foreign operations.

5. There are other types of assignments that primarily affect junior staff: expatriations for managerial development. As our interest is limited to the compensation system of senior expatriates, we will not discuss this type of expatriation.

6. When knowledge is coded, it can be easily transmitted to other persons or groups, provided that a suitable code is provided. On the contrary, if it is tacit, the individual cannot be separated from the knowledge that he/she possesses and that has been acquired through a learning-by-doing process.

7. The Ernst & Young survey included 427 companies from a sampling of 6000 multinational firms from around the world. With regard to the question on how important the "lack of available local talent" is when assigning expatriates to Western Europe (where a priori there is a well-trained professional workforce), the average answer provided was 3.5 on a scale of 1 (not important) to 5 (very important).
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