WHAT FACTORS INFLUENCE THE DIFFERENCE IN WAGE RANGES: A CROSS-COUNTRIES STUDY

THE SUMMARY

ABSTRACT
In this thesis, I will talk about multinational corporations and the consequences of their existence, such as technological advancement and market development, yet creating income inequality. Moreover, I will highlight the factors that influence the wage ranges difference across countries, the company and country environments as forces that shape the International Human Resources Management (IHRM) decisions in multinational corporations (MNCs) and what are their functions across countries. I will give an example about two countries and the difference in the wages between these countries for a particular job beside a comparison of some other countries and the difference in wages for similar jobs.

INTRODUCTION
Managers in international firms are bound by some forces in the host country. In order for them to have successful operations worldwide, Ghoshal and Bartlett identified some of these forces. The first is culture as MNCs operate in countries with different cultures, values and backgrounds. These differences in cultures are seen as ‘local differentiation’ which means that MNCs have standardized rules and policies in their home country, which need to be adapted to the host country’s rules and regulations. The second force is applicable in firms that provide consumer products, such as TVs, computers, etc. In order to succeed, these firms need to focus on achieving economies of scale to cope with the competition and gain competitiveness. In order to do so, some of these companies develop internationally integrated production processes. This results in the creation of the force of ‘global integration’. The third force is that MNCs are

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1 A Multinational Corporation (MNC) is a company that has operations in several countries but controlled from the home country.
expected to respond to evolving markets with products that have short life cycle. This is done by linking their international operations and transferring expertise across countries\textsuperscript{3}.

**CHAPTER 1: MULTINATIONAL CORPORATIONS AND PAY INEQUALITY**

**MULTINATIONAL CORPORATIONS (MNCs)**

With the openness of countries and the emergence of the term “borderless world”, foreign direct investment (FDI) took its wide spread. Companies started to look for opportunities outside their home country for many reasons, such as cost cutting, acquiring new technologies which are not available in the home country or are cheaper in other countries, expanding their business, achieving economies of scale, etc. MNCs existed many decades ago and their growth has been visible over the last 20 years. There are about 61,000 MNCs in the world controlling around 900,000 subsidiaries according to the United Nations Centre on Transnational Corporations estimates\textsuperscript{4}. The graph above shows how trade grew in the last 20 years outperforming real GDP.

MNCs enter other countries in different modes of entry/FDI:

a. **Greenfield**: the company construct a new plant/firm  
b. **Merger & Acquisition**: companies merge with or acquire another company  
c. **Joint Venture**: a foreign company have a shared ownership with a local company  
d. **Non-Equity**: through franchising or licensing

Depending on the scope of the firm, the suitable mode of entry is chosen.

There are some positive effects of MNCs entering a new market, some of these effects on the host country are creating job opportunities, establish healthy competition, increase trade between the two countries (import, export), and generally improve the economy of the host country due to the increased trade (exports). Moreover, in many cases the foreign companies/MNCs usually pay higher salaries to the employees compared to the local companies. This is to attract the local talents to work for them which is a reason for some governments to emphasize on education and provide scholarships for worthy students to study in the fields which are most required or are at scarce. Additionally, many MNCs seek to increase their economies of scale, and to do so, they need the skills and proficiency of the local people to help them achieve this target. So to attract the skilled and talented people, they need to pay them higher wages and attractive benefits which will be discussed in chapter 2. This is also dependent on the company’s policy.

As for the negative effects of MNCs, they are both on the home and the host countries. As for the home country, due to outsourcing, job opportunities in the home country are becoming limited and the percentage of unemployment increases. This is because MNCs usually go to developing countries, such as China and India where the wages are way less than what they are in their home country and they usually have the set of skills required by MNCs. Moreover, they create sort of trade deficiency as imports will exceed exports.

On the other hand, the MNCs affect negatively the host country by sourcing the skilled people and paying them higher wages, in which this action damages the business of the local companies and many of them eventually go out of business.

**PAY INEQUALITY**

As I mentioned in the previous part, MNCs are usually known for paying higher wages than the local companies when they start their operations abroad. This creates payment inequality among individuals who are working in MNCs and those who are working in local enterprises. Pay inequality has a positive correlation with performance. The higher the pay, the higher the performance and productivity and vice versa. This was evident in some American and Japanese manufacturing firms from the data analyzed by Levine (1993) in which the data was collected on more than 8,000 employees. Employees who received high wages worked harder than required
and had higher commitment. Inequality can be seen among individuals, between countries and within a country.

An example of income inequality within a country is shown in the following graph that illustrates income inequality for a particular job (Teller) between the different states in the United States. This is due to different states characteristics as country characteristics have an influence on wage dispersion which will be discussed in chapter 3.

### PAY INEQUALITY AND PERFORMANCE

Pay inequality or dispersion is concentrated on the contrast between the hierarchical and the compressed hypotheses. From one side, the hierarchical hypothesis looks at the pay dispersion as “networks of incentives … that attract talent and motivate individual performance … Hierarchical pay distributions are expected to induce higher employee performance because they create a meritocracy in which rewards for effort or human capital increase monotonically”. So under this hypothesis, employees who are placed in the minimum wage rage will try to increase their performance to reach the highest level of pay, while those who are in the highest end of pay will try to maintain their position or even increase their performance as they are rewarded according to their individual performance. This implies on the two different job classes (white-collar and blue-collar). White-collar employees tend to have higher wages due to their higher set of skills and they will try to increase their performance to maintain their salary premium. Blue-collar employees will try to obtain higher skills level in order to reach the level of white-collar employees salary.

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7 The hierarchical hypothesis has its theoretical foundation in the tournament theory (Lazear and Rosen, 1981).
8 Meritocracy: a system in which persons are rewarded and advanced.
From the other side, the compressed hypothesis “focuses on how pay distribution affect collaborative work and cooperation. From this perspective, hierarchical pay distribution create “disincentives” for cooperation, instill feelings of inequity, promote dissatisfaction, and diminish performance ... Conversely, following the compressed hypothesis, pay distribution are said to inculcate\textsuperscript{10} feelings of fairness, foster notions of common fate, and reduce interpersonal competition\textsuperscript{11}.

So to sum up the two hypotheses, the hierarchical one encourages and rewards individual performance in which people focus on increasing their productivity and performance, as a consequence it creates competition among individuals. While on the other hand, the compressed hypothesis promotes team work and cooperation and it reduces competition among individuals.

Income inequality has been analyzed by The Conference Board\textsuperscript{12} using three methods:

1. Calculate the income gap between rich and poor countries by calculating the average income of high-income countries and compares it with the average income of low-income countries. The difference between them is called the “income gap”.
2. Calculate the overall world income inequality using the Gini index\textsuperscript{13} measure, which calculates the extent to which the distribution of income deviates from a perfectly equal distribution. It ranges from 0 to 1 in which zero represents exact equality and one represents total inequality.
3. Calculate the income inequality of each country and compare them.

The increase in income inequality between countries can be explained by two major factors; market forces and institutional forces. Market forces are basically the technological advancement and the increase in globalization as mentioned earlier that openness of countries led to the increase of trade between countries and the existence of MNCs and this led to the demand of new technology and skilled people. Therefore, when MNCs move their operations to developing

\textsuperscript{10}\textsuperscript{10} Inculcate: to cause or influence someone to accept the idea or feeling.
\textsuperscript{11}\textsuperscript{11} Bloom 1999: 27, from the article "Show Me the Money! Pay Structure and Individual Performance in Golden Teams" by Edoardo Della, Torre, Antonio Giangreco and Johan Maes, 2014.
\textsuperscript{12}\textsuperscript{12} A tax-exempt non-profit business membership and research group organization that accounts for approximately 1,200 public and private corporations of 60 countries.
\textsuperscript{13}\textsuperscript{13} The Gini index is the most commonly used measure of income inequality named after the Italian statistician Corrado Gini.
countries with low-cost and high skilled people, equal jobs in the developed countries are lost due to their higher cost.

As for the institutional forces, it will be explained in more depth in the next chapter; however, they have a great influence on companies such as setting minimum wage rates, deregulation and national policies that favor the wealthy\textsuperscript{14}.

Inequality should be carefully looked at as inequality of what and between whom. This is because the factors mentioned in the previous parts are general factors, but when it comes to calculating the inequality properly, other specific factors arise, such as the population of the country, the number of hours worked (part-time vs full-time), and finally self-employed vs company employee.

**CHAPTER 2: COMPANY ANALYSIS – THE INTERNAL FORCES**

**COMPANY ENVIRONMENT**

Companies’ business is driven by revenues, but at the same time earnings are driven by many factors, for example the business model (local vs. multinational), ownership type (public/government vs private), etc. Based on the company type, some sort of skills are required such as technical, creative, analytical and innovative skills. According to the company type, the salary levels offered to employees differ from one company to the other even if the job level is similar. Therefore, each job salary may vary based on each employee according on his/her level of education, experience, skills and talent and according to the job class (white-collar vs blue-collar). That’s why for each position there is a wage range depending on the qualifications of each candidate for a given job, and this wage range for a particular job may differ from one country to another based on the characteristics of the country.

For instance, the position of a Teller in a bank in the United Arab Emirates (UAE) has a wage range the starts from approximately $817 up to $1,225. And for the same position in Hong Kong, the wage range is approximately starts from $1,290 up to $1,677. So the difference in the starting wage of a Teller in Hong Kong is 37% higher than the UAE’s, and the maximum wage of a

\textsuperscript{14} Paul Krugman; from the article “World Income Inequality”.

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Teller is 27% higher in Hong Kong as well. Other examples of the wage difference for similar jobs in different countries are listed in the table below.

<table>
<thead>
<tr>
<th>Job Title</th>
<th>Average Salary by Country in USD$</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>UAE</td>
</tr>
<tr>
<td>Office Manager</td>
<td>2,314</td>
</tr>
<tr>
<td>Accountant</td>
<td>1,572</td>
</tr>
<tr>
<td>HR Manager</td>
<td>4,463</td>
</tr>
<tr>
<td>Marketing Manager</td>
<td>4,612</td>
</tr>
</tbody>
</table>

The HRM is the most important unit within any organization. It is the unit which is responsible for recruitment, employee performance management, training and development. Companies’ rules, policies, standards and codes of ethics are initiated by the HRM unit. For international organizations, the HRM helps the company in standardizing globally and adapting locally their policies.

Setting the company’s strategy is one of the HRM responsibilities along with the Management of the organization. Companies can choose its strategy of managing and recruiting their manpower among three different approaches:

- **Ethnocentric**: the home country practices have a great influence in this approach. Key decisions are made from the headquarters in the home country and employees from the home country take key positions in the subsidiaries following the home country HR practices.
- **Polycentric**: the subsidiaries manage their practices based on the host country basis. Local people are employed in managerial positions and head the subsidiary as home country people are considered to lack knowledge about the host country. HR practices in the subsidiary are created locally.
- **Geocentric or Global**: companies applying this approach manage and staff employees on global basis. International managers from different countries are recruited. In this approach, the staff are usually mobile and are used in other subsidiaries as needs arise.

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15 The information in the table are gathered from the following web pages: [www.gulfalent.com](http://www.gulfalent.com), [www.payscale.com](http://www.payscale.com), [www.indeed.com](http://www.indeed.com)

Each of these approaches has its positive and negative aspects. For example, using local employees in international subsidiaries increase the acceptance of the corporation in the local community, but recruiting the right and qualified personnel may not be easy. On the other hand, using expatriate employees in international subsidiaries allow easier control and coordination of international subsidiaries, but at the same time it could create issues with regards to adaptability to the foreign environment and culture\textsuperscript{17}.

**RECRUITMENT AND SELECTION**

Companies have to be comparative in their organizational analysis, in which they should be able to explain the patterns of similarity and differences, of convergence and divergence\textsuperscript{18}. Based on the strategy of the company, the selection of the manpower can be according to the following classifications\textsuperscript{19}; **parent country national** which means that the employees of the subsidiary are of the home country nationality = ethnocentric, **host country nationality** by which employees of the host country are hired for various positions in the company, especially in the managerial positions = polycentric, and finally **third country nationality**, here the employees hired are neither of the home country nor of the host county = geocentric.

The IHRM should consider the home country practices and adapt them in accordance with the host country laws and regulations. As easy as it may sound, recruitment is not an easy process in international organizations. The local culture of the host country has a big influence on the recruitment and selection process.

**PAY BASES AND WAGE RANGES**

When it comes to wages, the pay range is set by the HRM, and there are three bases of pay\textsuperscript{20}. The FIRST type is the rate for the job of pay for the post which is for most employees and it is based on the job evaluation and a detailed description of the roles\textsuperscript{21}. This step of detailing the job specifications and requirements assist in setting the wage range for each position within the organization, and to some extend eliminates any discrimination and sets some kind of fairness in

\textsuperscript{17} Gomez-Meija, Balkin, Cardy 1995; from the article “Human Resources Management in International Organizations” by Sonja Treven, 2001.
\textsuperscript{19} Article “ Human Resources Management in International Organizations” by Sonja Treven, 2001.
pay among employees holding the same job. The SECOND type is the competence-based pay and it is assessed by the employees’ qualifications, the relevant experience he/she may have, the seniority level and age or tenure. The THIRD type is variable pay or pay for performance and it is usually used as a bonus, whether it is an individual, team, department or company performance.22

After the selection of the appropriate payment type that represents the company’s strategy, the set-up of wage ranges takes place.

WAGE RANGES
There are different pay systems for companies to choose from and there are specialized agents that can help the companies adopt the suitable pay system.23 Based on the type of business, the wage range may differ within a particular company from one position to the other. Some companies pay only the basic salary with no benefits, others pay the basic salary plus benefits (the benefits differ from one position to the other, and from one company to another) and sales driven companies pay either the basic salary plus bonus or just bonus.

Each position has a minimum and maximum pay based on the level of the job. In a study conducted by Martin Personick24 regarding the wage range distribution, he noticed that employees are placed in the lower side of the wage range. Referring back to the role that the working groups/ unions play and the influence they have on companies, David Belcher25 explained “Unions often favor the single-rate principle because it eliminates judgment-based differentials in individual pay”.

To establish the difference in wage ranges between jobs, we must understand the difference in the job classes. There are two job classes, white-collar and blue-collar.

JOB CLASSES
Job class is highly considered when setting a wage range within organizations. There are mainly two job classes: white-collar and blue collar. White-collar jobs refer to an office based official work that normally doesn’t require manual labor and are of people with high educational level.

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23 A financial system of transferring funds from payers to payees i.e. employers to employees.
25 Ibid.
such as bankers, brokers and agents. While blue-collar jobs are usually commenced by illiterate people and these jobs require manual labor and are usually field jobs, such as mechanics and electricians.

**IHRM AND EMPLOYEES’ PAY**

Multinational corporations have three approaches\(^{26}\) of employees’ pay that they can choose from. **Home-based policy** in which employees pay is equal to their home country payment scale. **Host-based policy**, the salaries in this approach are set according to the host country pay level, along with the benefits which are usually the same as the home country. And **Region-based policy**, in this approach, the region determines the pay. Employees’ wages working in subsidiaries reflect if they are working in subsidiaries within their home region or in another. Thus, employees working in subsidiaries that are closer to their home region receive wages lower than the ones who are working in regions further than their home region.

**EMPLOYEE BENEFITS**

Employee benefits are optional. Companies may choose to offer a wide range of employee benefits, limited employee benefits package or none, meaning just offering the basic salary. Some companies have different benefits for senior personnel, such as child education, accommodation and furniture allowance. This could be offered in a company in one country but not in the other counterpart. This is due to the country’s environment and what attractive benefits should be offered in order to attract high caliber people. Employees’ benefits may include health insurance, paid holidays, life insurance, retirement, etc.

**TRAINING AND DEVELOPMENT**

International Human Resources Management (IHRM) should have a well-established training and development plan for their international subsidiaries’ employees. The target must be that employees should be able to fulfil their duties in the subsidiaries to the maximum and achieve the company’s target of international expansion and growth. Even though salary is an important factor for employees, they now place higher weight on career development and training beside health insurance and bonuses\(^{27}\).

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\(^{27}\) Article “Salary and Employment Insights 2013” by Hudson leading global employee provider, 2013.
The IHRM responsibilities in terms of training and development programs are the training and development of employees who are working in the different subsidiaries around the world, create a special training that could help in preparing expatriate employees to work on different projects around the world and a special development program for globally minded managers.

**IHRM AND THE NATIONAL INSTITUTIONS**

The HRM of international organizations should recognize the constraints resulted from national institutions and working groups or unions in the targeted country. National institutions have a major role in shaping the international HRM practices and in some countries, their role is much influential than the others. The social and legal framework of a country have influence in many areas, such as recruitment and release, the formalization of educational qualifications, pay, the nature of employment contracts and others. As mentioned in the previous chapter, institutions have their role in income inequality as they have an effect on employment and wage distribution, thus institutions roles and effects differ from one country to the other, that’s why inequality exists and varies in its levels between one country to the other.

**CHAPTER 3: COUNTRY ANALYSIS – THE EXTERNAL FORCES**

**COUNTRY ENVIRONMENT**

It is important for companies to conduct a market research before entering a new market. This is an important step as it will point out the positive and negative aspects of this country and whether or not it is a suitable one to commence business in. As Sparrow and Hiltrop stated “the evidence suggests that our national culture is so deeply ingrained in us that it cannot easily be erased by any external forces [such as a company culture]” (1994:77).

To understand the impact of a country to MNCs, I will conduct a PEST analysis (Political, Economic, Social, Technology) in two different countries, Hong Kong and the United Arab Emirates (UAE).

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29 A group of people who are expert in their field and they come together to achieve specific goals and put some rule for companies to adhere to in order to guarantee employees’ rights and ensure that companies are working in accordance with the country’s regulations.
<table>
<thead>
<tr>
<th></th>
<th>Hong Kong</th>
<th>UAE</th>
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<tbody>
<tr>
<td>Political</td>
<td>The information is limited, but in terms of political parties, it has many of them.</td>
<td>It is considered to have an autocracy(^{32}) system and it has been ranked poorly in the freedom indices in terms of civil liberties and political rights. Political parties are not allowed in the country.</td>
</tr>
<tr>
<td>Economic</td>
<td>It has high international ranking in economic competitiveness and it is described as a laissez-faire(^{33}) capitalism. It has low taxation and free-trade systems. Although Hong Kong’s economy was affected by the global economic drawback, its economy prospect was expected to grow in 2013 due to the growing demand of Chinese middle-class consumers(^{34}).</td>
<td>It has the most diversified economy in the GCC(^{35}) and it possesses the second largest economy among the GCC countries and it had a GDP of $377 billion in 2012. The UAE is a tax free country and it has a free trade zone, which offers total foreign ownership. This attracts a lot of FDI, which as a result improves the economy of the country.</td>
</tr>
<tr>
<td>Social</td>
<td>Hong Kong’s culture is described to be “where east meets west” as a consequence of the culture mix of the neighboring country (China) and the influence of (Britain) for the period when it was a British colony. The standard of living in Hong Kong is very high compared to the UAE and other countries.</td>
<td>The UAE’s society is known for its openness and tolerance. It has a mixed culture due to the high number of immigrants and foreign employees. Indian, Filipinos, Pakistanis and other Arab countries nationals are the major nationalities living together in the UAE in a harmonious and peaceful way. It has an average standard of living compared to Hong Kong.</td>
</tr>
<tr>
<td>Technology</td>
<td>It has the most advanced information technology sector in the world. This is due to its advanced information and telecommunication infrastructure.</td>
<td>The UAE is increasing its annual spending on information technology and telecommunication as it aims to develop a knowledge-based economy.</td>
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After looking at the external forces of each country, we can conclude that there is a difference in the political system in each of the countries, they both have strong economic backgrounds, regardless of the shocks they encountered and they have attractive free-trade systems and low taxation. In terms of technology, Hong Kong is more advanced than the UAE, thus the UAE have a good enough technological advancement and it is spending huge amounts of money in the

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\(^{32}\) A form of government that is run by a single, self-appointed leader as opposed to a group of leaders or elected officials.

\(^{33}\) An economic system which is free from government intervention or moderation and driven only by market forces.

\(^{34}\) Article “Salary and Employment Insights 2013” by Hudson leading global employee provider, 2013.

\(^{35}\) GCC is the Gulf Cooperation Council which consists of six members; Bahrain, Qatar, Saudi Arabia, Oman, Kuwait and the UAE.
technology sector to be a knowledge-based economy. So with these similarities and differences in mind, we can understand how and why companies have different pay scales in different countries and the factors that influence this decision. Remember the example given earlier about the wage of a Teller both in Hong Kong and UAE and the big difference in the minimum and maximum wage range of this position between the two countries.

LABOR MARKET

The labor market within a particular country has an influence on employees’ salary. Companies have to obey the country’s work legislations in order to be able to operate legally in this country.

It is argued that countries with liberal market economies such as in the USA and UK, companies tend to reduce labor costs to have stable profitability. In the coordinated market economies, such as the ones in Germany and Japan, companies involve employees in corporate governance which means during shocks, the company will tolerate this shock by leaning towards profit reduction and returns to shareholders.36 Moreover, well established labor markets should show flexibility in wages and employment during shocks. Meaning, wages should be cut to offset the negative shock and employees should move from less productive sectors to more productive ones.

EXCHANGE RATES AND TAXES

Globalization is a term that is being used widely these days. Companies operate in different countries and there are some implications to the transactions that companies make, such as exchange rates and taxes.

In order to start a company or a branch of a company in any country, the management of the company would study the implications that they might face to operate in the targeted country. Such decisions also include the minimum and maximum salary to be offered to the people and the tax percentage they would have to pay. It is not an easy decision to take to operate in another country.

When it comes to wages, if the difference is highly noticeable between the home and the host country for similar positions, it might affect employees’ morals and motivation. Therefore, a careful study has to be conducted by the management in the HR unit in order to offer the best suitable and fair wage to each position and to have the right justification of the difference in wages between the countries. Additionally, Human Resources Management has to pay attention to taxation, as it may be applied on recruitment, retention, motivation and mobility of international staff which will have a considerable affect while setting the budget for the new operational country and how taxes play part in an employee’s salary\textsuperscript{37}.

**DISCUSSION AND CONCLUSION**

What we learnt from this thesis is that MNCs were born by the transformation of the economy into a global integrated economy. Multinational corporations face different cultures, political systems, national unions, etc. yet they need to face these challenges wisely and adapt to the new environment. This birth of MNCs caused income inequality among countries, which is a result of globalization, technological advancement and trade integration. Thus, the real reasons behind inequality among countries are questionable due to the shortage of specific definitions and concepts used in various studies\textsuperscript{38}.

By now, we must know that IHRM is the main organ in multinational corporations. They are responsible about establishing the appropriate company strategy, recruiting people based on the three employee classifications, preparing a suitable and attractive employee benefits package and finally creating promising training and development programs.

What managers should learn is that setting up a subsidiary in a new country requires a lot of time, attention and preparation. They must learn the different aspects that influence their business decisions, such as the national institutions, the local laws and regulations, the labor market in the new target country and the implications of exchange rates and tax.

\textsuperscript{37} "International Human Resources Management", 2nd edition 2011.
\textsuperscript{38} From the article “An Overview of Growing Income Inequality in OECD Countries: Main Findings".