Global Juggling Act:

Managing Employee Benefits for Smaller Foreign Subsidiaries

by | **Wil J. Gaitan**

benefits
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As the number and scale of their international operations increase, U.S. multinational enterprises (MNEs), particularly small and midsized companies, may struggle with managing benefits for staff spread throughout the world. The author provides strategies that can help MNEs address this challenge.

A vexing challenge for multinational companies of all sizes is managing the compensation and benefits of staff spread over many foreign locations. This can be particularly problematic for midsize and small companies that have a decentralized operating environment. These companies often have business managers or human resources (HR) generalists in small locations who may have little technical expertise or experience in benefits and must make critical benefits decisions on their own.

Experience shows that hasty, undisciplined and "expedient" benefit decisions/solutions often lead to serious long-term problems. For example, such decisions may ignore considerations such as "acquired rights" labor laws, long-term cost consequences and the effect on social program contributions as well as risk exposure to tax liabilities. Such decisions also may unwittingly generate long-term defined benefit pension obligations, affect severance and variable pay, and have a potential adverse impact on future merger and acquisition transactions.

This article will describe possible approaches to this challenge in addition to providing background on the global workforce of U.S. multinational enterprises (MNEs).

Background

The number and scale of international operations maintained by U.S. MNEs have increased steadily over the last century. Figure 1 shows the evolution of the employment figures of U.S. parents and majority-owned foreign affiliates (MOFAs) from 1999 to 2017.

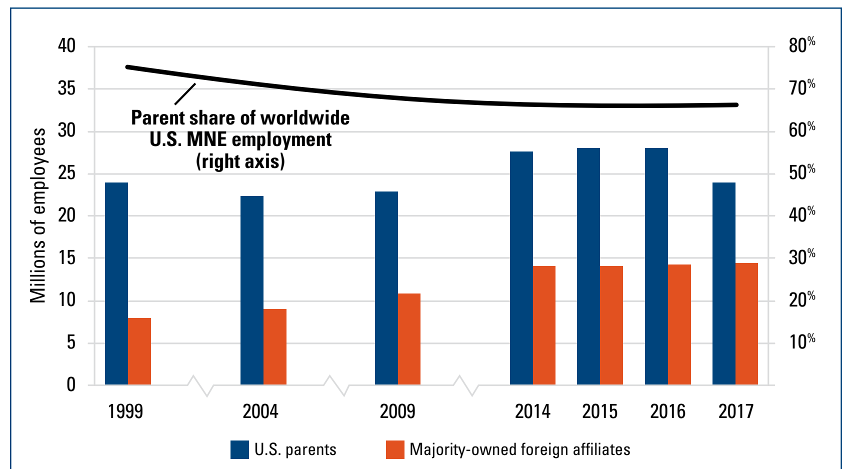
Much of this growth can be attributed to the following factors.

- **Offshoring to cut production costs**. Companies are moving production or commoditized activities—such as billing and collection, document scanning or translation services—to China, India, Mexico, Philippines, Vietnam, Poland and other locations with low manpower costs.
- **Expansion of trade and new markets for revenue growth**. MNEs have made considerable investment to develop or expand their presence in countries with large and fast-growing economies, particularly China, Brazil, Mexico, India and others.
- **Provision of regional management, technical, sales and administration support.** As firms grow, they hire highly specialized personnel in certain

countries to provide management oversight and support to their operations in each region. Some countries, including Singapore, Hong Kong, the United Kingdom (U.K.), Belgium, Switzerland, United Arab Emirates (UAE), Mexico and Brazil, provide a combination of convenient geographical location, large talent pools, stable legal environments, adequate support services, and often, tax and other incentives to host regional centers. The workforces devoted to these functions, at these locations, are generally small (five-100 employees) and often include globally mobile workers deployed from the head office or from the MNE's units in other countries.

FIGURE 1

Employment by U.S. MNEs



Source: U.S. Bureau of Economic Analysis.

Geographical Distribution and Economic Dimension of Workers in Foreign Locations

The latest Bureau of Economic Analysis (BEA) research shows that in 2014 a total of 15,594 U.S.-based MNEs had 14 million employees in foreign locations (Table I). BEA data shows that the distribution of head count and compensation costs by foreign entity and by country is highly skewed. Using the BEA data available, the distribution of MNEs based on foreign head count is estimated as follows:

- About 14% of all U.S.-based MNEs account for 89% of the total aggregate head count of foreign workers. This means that the remaining 86% of MNEs with at least one MOFA account for just 11% of the non-U.S. employee population of MNEs.
- The BEA figures suggest that smaller MNEs (those with fewer than 1,000 employees in foreign locations) maintain an average of only 20 employees per country.
- There is also a high degree of concentration of head count and employee compensation by country. In fact, 20 countries account for 80% of the total foreign workforce and more than 80% of the total compensation spend of MNEs. That means that the remaining countries in the world represent only 20% of the foreign workforce and less than 20% of benefit spend.

The size of MNEs is defined by the following head counts:

takeaways

- The number and scale of international operations maintained by U.S. multinational enterprises (MNEs) have increased steadily over the last century.
- Midsize and smaller MNEs often lack the critical mass of business required by the large global benefit providers to strike affordable and effective arrangements to provide employee benefits. They also tend to have fewer central resources, lack the skill sets or face budget restraints for engaging outside global consultants to help them deal with the complexities.
- Solutions that can be deployed in local markets include alternative employment models, making prepackaged insurance and retirement savings solutions available to employees, or negotiating individual compensation or cashout arrangements with workers.
- Central solutions include providing a corporate guide for benefit decisions and consolidating benefits purchasing through approaches such as multinational pooling, global underwriting or global or regional contracts, and outsourcing noncore technical activities in the corporate benefit management function.

- Small: One-1,000
- Midsize: 1,001-10,000
- Large: 10,000+.

A typical midsize company may have the bulk of its foreign staff concentrated in a few locations, with the small number of remaining workers scattered over a large number of countries. For small MNEs, small head counts is the typical distribution of their total non-U.S. footprint. The end result is a great deal of fragmentation of staff counts, even for the larger MNEs.

At the end of 2017, MNEs provided almost US$700 billion dollars in total compensation to employees in foreign subsidiaries.

Discretionary employer spending on benefits is estimated to cost MNEs between US$105-140 billion (15-20% of employee total compensation). This is a significant amount, especially from the perspective of foreign subsidiary entities and should merit the parent company's attention.

Global Benefits Management

MNEs focus on meeting the following objectives in their benefit programs for employees in foreign locations.

1. Implementing benefit plan designs that will attract, retain and motivate the workforce required for the success of the business in a highly competitive, multigenerational and culturally diverse global talent landscape
2. Deploying efficient benefit financing strategies that minimize costs and risks and are consistent with corporate financial objectives and constraints
3. Maintaining plan administration platforms that ensure flexible, equitable, and attractive benefit delivery and legal compliance and minimize administrative errors

According to a 2018-2019 survey of multinationals conducted by the American Benefits Council and Aon, 90% of the participating companies want to improve global benefit governance, and 74% aim to have best practices in this regard implemented by 2021.

Critical Issues Faced in Managing Small Head Counts

Table II provides a summary of the principal issues faced by foreign locations with small head counts.

At headquarter level, midsize and smaller multinationals often lack the critical mass of non-U.S. workers required by the large global benefit providers to strike affordable and effective arrangements. In addition, these MNEs tend to have fewer central resources or lack the skill sets and/or bandwidth, or may not have the budget to engage outside global consultants to help them deal with the complexities of managing the compensation and benefits for their workers in foreign locations.

To further complicate matters, corporate benefit managers are increasingly involved in benefits beyond the traditional retirement; capital accumulation; life, disability and accident insurance; and health care programs. Younger generations of workers expect employers to assist them in ensuring total personal well-being through programs delivered in a flexible approach that caters to individual needs and preferences. The broad scope, often scant regulatory guidance, administrative complexities and lack of cross-country scalability of these programs require a critical mass of employees in each foreign location to be viable.

TABLE I

Number and Employment of U.S. Parents and Foreign Affiliates

U.S. Aggregate Head Count Range	Number of MNEs	Percentage of Total MNEs	Total Foreign Head Count (000s)	Proportion of Aggregate Foreign Head Count
0 to 500	12,729	81.6%	1,155	8.2%
Between 501 and 1,000	702	4.5%	379	2.7%
Between 1,001 and 10,000	1,657	10.6%	3,547	25.2%
More than 10,000	506	3.2%	8,972	63.8%
Total	15,594	100.0%	14,053	100.0%

Source: U.S. Bureau of Economic Analysis (BEA), 2014.

TABLE II

Issues Faced in Managing Small Head Counts at Foreign Affiliates

Benefit Management Area	Issues	Illustrative Countries Affected
Plan Design	Minimum head count restrictions in many countries impede the formulation of plan designs that can be implemented only through group benefit vehicles.	South and Central America, Middle East, African and Southeast Asian countries
	Lack of critical mass in country hinders the provision of employee benefits through a flexible delivery platform.	Canada, Spain, Belgium, Brazil
	Inadequate competitive benchmarking data for small operations	Virtually all
Plan Financing	Inability to obtain group insurance results in adoption of expensive alternatives such as individual life, disability and health insurance; individual pension, cashout and alternative employment model solutions	All where head count restrictions for group benefits apply
	Inability to adopt tax-efficient financing vehicles available in country to large groups	U.K., Canada, Brazil, Mexico, Japan, India, Gulf Cooperation Council countries
	Disproportionate administrative costs for one-off solutions	All where individual insurance and cashout solutions are adopted
Plan Administration	Ineffective and labor-intensive recordkeeping for individualized solutions	All where individual insurance, cashout and alternative employment model solutions are adopted
	Difficulties establishing local legal compliance	
	Restrictions in reversing solutions once head counts have grown to a size that permits more standard approaches	

Source: Alta Actuaries & Consultants.

Following are the most common approaches that address these challenges when derived through proper due diligence analysis.

Local Solutions

The logical starting point for small and midsized MNEs is to simplify and standardize benefit programs in order to facilitate their placement in the local market. For example, these employers should avoid offering a traditional flex delivery or cafeteria model for life, disability, health care and retirement benefits due to lack of scale for the platform to be viable.

1. Alternative Employment Models

Rather than using a standard employment model, the company may use the following formats for contracting its staff:

- **Leased employees from a local labor provider.** These providers often make available to their client companies benefits that they have negotiated with carriers and other vendors for their entire pool of employees. They typically offer several tiers of benefits for leased employees chosen at the discretion of the client company. The feasibility analysis of this approach should factor in the cost of value-added or sales taxes that may apply to the engagement and the larger consequences and potential risks and/or restrictions to the business from using staff from a third party.
- **Independent contractor service agreements.** The MNE engages individuals through a mercantile agreement for provision of services rather than through a labor agreement. Under this approach, the MNE nego-

tiates an all-in fee that takes into account cash compensation, benefit loads, social insurance contributions and business expenses. Hence, the benefit decisions are left to the individual contractor. This model may appeal to senior-level or sales staff because it affords a lot of operating flexibility and, very often, better tax-efficiency for the individual. From a benefits viewpoint, the individual usually maintains or sets up life and medical insurance and retirement savings arrangements under his or her own name to fit personal goals. Like the employee leasing solution, there are broader factors to consider. Legal compliance is an especially important factor since independent contractor agreements tend to be heavily regulated from tax and labor law perspectives in most countries.

2. Prepackaged Insurance and Retirement Savings Solutions

Global consulting and brokerage firms and large local brokers have negotiated standardized benefits packages through proprietary pools designed for small groups. Often the groups have a minimum required number of employees, sometimes as few as two.

These packages can be readily implemented and, while there are restrictions on plan design, vendors offer products with various tiers (e.g., platinum, gold, silver and bronze) that can be tailored to fit the demographics and benefit levels of the individuals in the client's employee group.

The cost tends to be higher than arrangements for larger groups but definitely tends to be cheaper than individual arrangements. The premium basis is community rated with the underwriting experience of the pooled group of clients. These products usually offer better underwriting terms such as higher *free cover limits* (higher limits before the policy requires medical evidence of insurability).

3. Total Compensation and Cashout Approaches

With this approach, the company negotiates a total compensation package with individual employees. Unlike the individual contractor and the leased employee approaches, the individual remains an employee of the company. This approach can often provide the employee with optimal flexibility to configure the compensation delivery format to best fit personal preferences. The employee and the company may then focus on benefits that are not dependent on the size of workforce, such as paid time off, flexible work schedules, etc.

The employer and the employee share responsibility for organizing benefits. The employer may provide certain benefits that are readily available for employer placement in the local marketplace or that may not need an external vendor.

In many cases, the company and the employee may negotiate a cash allowance to finance an individual insurance policy to provide benefits. In determining the amount of the allowance, they should consider the cost of the individual insurance premium and how it may affect taxes for the employee, including personal income tax, social contributions and sales taxes.

In the case of life insurance, it is important to consider any capital accumulation element that may duplicate retirement or long-term savings programs that the company may provide through a separate benefit program.

The negotiated package or cash allowance should be properly documented, and the agreement should include a basis for periodic update in order to avoid annual renegotiation and facilitate reversal once the special arrangement is no longer needed or desired.

The challenges of adopting a cash-in-lieu-of-benefits approach are:

- Potential suboptimal tax efficiency (since cash tends to attract higher individual income taxes and social charges/costs to the company)
- Difficulty reversing the arrangements once the employee group is large enough to accommodate a more conventional benefit delivery
- Risk of creating real or apparent disparities in compensation delivered to various employees
- Exposure to local labor noncompliance and/or tax liabilities due to a number of reasons such as underreporting of taxable income by independent contractors, disputes from disgruntled independent

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bio

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contractors or leased employees claiming their agreement was a de facto employment agreement, and underpayment by the company of social taxes and income tax withholding
- Employee demands in the future for the traditional benefit programs that they originally relinquished as part of the original negotiations.

Employers should conduct a due diligence review before implementing this solution.

Central Solutions

Multinational companies should provide a robust framework for guiding local benefit decisions as well as organizing effective global/regional solutions for foreign locations with small head counts. Options include the following.

1. Corporate Guidance for Benefit Decisions

The best place to start is the development of a simplified governance model to guide benefit decisions across the global organization. The model should have the following key elements:

- Commonsense guiding principles for plan design, financing and administration of benefit programs. The development of these principles should include input from the larger non-U.S. subsidiaries in order to promote buy-in across the organization.
- Identification of corporate-sanctioned decision makers and individuals responsible for the various benefit management functions on the ground, regionally and at the headquarters
- Simplified processes for reporting, approvals of benefit initiatives, periodic competitive benchmarking, local legal compliance, insurance policy renewals, actuarial valuations of defined benefit programs, etc.

Developing corporate guidance for benefit decisions need not be a lengthy or overly complicated exercise and may be achievable by adapting any existing model designed for U.S. domestic benefits. However, senior corporate management must explicitly support and communicate this initiative.

2. Consolidation for Purchasing Benefits

A corporate headquarters has the ability to strike arrangements with global providers that will leverage the global, or at least the non-U.S., head counts. The most common of these approaches are:

- **Multinational pooling contracts.** Eight global pooling networks offer the ability to consolidate local policies for favorable pricing and underwriting of non-U.S. insurance policies. Better premium rates and free cover limits on the front end and the ability to obtain international dividends based on favorable underwriting results at the back end would be immediately available to the MNE. A key disadvantage to this approach is that MNEs may need to change carriers at the local level to the affiliates of the pooling network with which the company has contracted. Also, only contracts with group underwriting are eligible for inclusion, and the multinational pooling network will very rarely influence the minimum number of employees required at each location concerned for issuing a group contract.
- **Global underwriting transactions.** With this approach, the MNE negotiates up-front for a bulk of policy contracts for its non-U.S. units. The pricing will be based on the underwriting of all of the insurance contracts included in the transaction. Several pooling networks offer this feature. The savings would be up-front, and rates are usually guaranteed for two or three years. Like pooling, the key disad-

vantage is that the local contracts need to be moved away from incumbent carriers to the local insurer affiliates of the global carrier involved in the transaction, and the minimum number of employees required at each location concerned for issuing a group contract will not change.

- **Global or regional contracts.** The headquarters has the ability to leverage global contracts in order to cover employees of small locations. Usually, global medical policies and/or global pension trusts in offshore locations that are designed to cover expatriates can be used to cover limited numbers of local nationals. These programs typically include riders for life, accident and disability benefits. These expatriate policies and retirement plans tend to be the most effective for capturing very small head counts that do not meet local minimum requirements for group local contract issuance.

  The disadvantages are:
  - A minimum number of expats (or conversely, maximum number of foreign local nationals allowed for coverage) are required
  - Limited flexibility on plan design
  - Higher cost
  - Frequently, these policies are not *locally admitted* (i.e., are not supported by locally approved policy or pension contracts) and hence may be subject to adverse taxation and noncompliance risks.

Regional policies can also be written in certain jurisdictions such as the EU and Gulf Cooperation Council countries that effectively consolidate the small head counts under group insurance and pension arrangements in a locally compliant manner.

Non-U.S. Benefit Management Resources for Small Multinationals

To be truly effective and sustainable, corporate resources are needed in order to provide leadership, technical support and continuing oversight to the foreign units. Large multinationals have the size and scale to provide reasonable budgets and central resources to support the international benefits function. However, small and even many of the medium-size companies do not have this comfort. Following are some potential cost-effective and time-saving strategies that small and medium-size multinationals can use in order to procure a basic layer of resources to dedicate to the management of benefits of their foreign locations.

1. Enroll global vendors used by the MNE (carriers, brokers, actuaries, global benefit consultants) to support the benefit function for foreign locations.
2. Invest in training up-and-coming HR and domestic benefits staff of the MNE on global benefits. Several organizations provide formal training on these subjects at affordable costs and convenient time frames.
3. Leverage regional resources that may exist at the subsidiary level. It is not uncommon for HR and benefit professionals in certain locations such as Hong Kong and Singapore in Asia; the U.K., Netherlands and Belgium in Europe; UAE in the Middle East/Africa; and Mexico and Brazil in Latin America to have the skills and experience to assist with countries in their region.
4. Direct international dividends from multinational pooling and savings from global underwriting transactions toward budgets for the international benefit function.
5. Outsource noncore and/or technical functions of central international benefit management to specialized third parties. This will ensure cost-effective procurement of advanced skills and continuity of service over time. At the same time, the corporate HR/benefit team can devote their time to more productive activities.

For medium-size MNEs, a combination of the above suggestions should prove appealing.

Conclusion

Midsize and small multinationals face the critical challenge of how to deal with the provision of specialized internal resources to devote to benefit management in non-U.S. locations with small head counts.

The dilemma is the well-accepted notion that having the right benefits in the right places for the right people outside the U.S. is critical to the success of business growth objectives, yet the amount of benefit spend is relatively small.

Locations with small head counts usually host critical skills and resources and represent important sources of future revenue and profit to the MNE parent. Hence, however disproportionate the effort required, some basic level of oversight on benefit decisions should be exerted, regardless of small head count and financial magnitudes.

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