Managing the Costs of EXPATRIATION

They may be greater than you think.

By William Maurice Baker, CMA, and F. Douglas Roberts, CPA

Fletcher Core, the world-renowned manufacturer of snowboards and snowboard equipment, is considering global expansion. The Colorado-based company's products have become quite popular in Europe. Fletcher analyzed this popularity by combining the art of geography with the science of information systems within a geographic information system (GIS).

Using analyses of GIS templates and output, Fletcher decided to expand operations into Europe by building a distribution center in Garmisch-Partenkirchen, Germany. This location gives Fletcher easy and complete access to the snow resorts of the Alps (an environment similar to Colorado), a strong employee base that understands Alpine conditions, and close proximity to the Munich airport.

THE "RIGHT" EMPLOYEES

Fletcher knows that most center employees will be hired in Germany, but company leaders are convinced that the manager of the center (and perhaps certain other employees) should come from the United States. Fletcher wants to instill its corporate values in the European market and establish a "home-based" presence in Germany. These desires necessitate the expatriation of management.

Expatriation has other advantages, too: Fletcher's managers can truly become "global" in a cultural sense, and the company needn't worry about trying to hire and train a manager in Germany.

When Fletcher's management accountants begin to analyze the costs of expatriation, a number of questions evolve. Should Fletcher send several in-house employees, one employee, or consultants? Can its strategies and corporate philosophies remain intact with a German workforce? Will the dedication to short cycle times and on-time delivery, of which Fletcher is so proud, stay intact in Europe?

Fletcher realizes (as most companies do) that the most important step is hiring the best person to manage the foreign facility.

Finding the best person is difficult and can be quite expensive. The costs of expatriation aren't all direct, and they start accruing long before the new manager arrives in Germany. Experts conservatively suggest that the overall (direct and indirect) costs will be at least three to five times the expatriate's base salary, and some estimates place the costs at more than $1 million per person per assignment (see Table 1).

The best person—indeed, several of the best people—may not even want to go to Germany. The only hope of convincing someone to go is to demonstrate that the assignment will be both a positive professional development and part of a beneficial career path. This isn't a simple task. Seventy percent of companies in Fletcher's position have to go outside to hire such a person. It becomes easier if Fletcher seeks advice and benchmarking ideas from a best-practices group such as the Global Mobility Forum (see Table 2).

Groups such as the Global Mobility Forum are excellent sources for input from experts on expatriation and other global practitioners. Further, because concerns about family are big stumbling blocks, Fletcher can assume that the person chosen for the assignment will want to bring family to Europe, too.

If Fletcher can't accept and manage these concerns, a virtual assignment (i.e., occasional travel to Germany with an overabundance of e-mail and teleconference communication) will be the only option. But a virtual assignment is almost always less effective than expatriation because virtual assignees usually possess (or glean) insufficient global experience.

Table 1: THE COSTS OF EXPATRIATION

UPSTREAM COSTS
- Selection
- Training

DIRECT (CASH-OUTLAY) COSTS
- Housing
- Transportation/Travel
- Salary/Benefits (including Taxation)
- For the Family

INDIRECT (BEHAVIORAL) COSTS
- Feelings of Isolation
- Culture Shock

DOWNSTREAM COSTS
- Repatriation
- Knowledge Management

CROSS TRAINING

Once the manager is chosen, training begins. Fletcher will want to be sure that the manager of the distribution center is as fluent in German as possible. Corporate leaders should also plan to train the manager's family to understand and speak German. This cost varies from a few hundred dollars (for a correspondence course, books, or CDs) to $5,000 or more per person for a 10-day immersion program.

Cultural training is even more important. Poor cultural adjustment is a major cause of expatriation failures.

There are many concerns here. Does the manager understand the business norms of Bavarian Germany? Can he or she relate to German social values? Does the manager realize that topics such as salaries, religion, and politics are extremely taboo throughout Europe? Are work-related and living-related differences explained and understood? Can the manager adjust to German work teams, and is cultural knowledge embedded well enough to enable the manager to display compelling leadership skills?

Fletcher must also be careful not to make the common mistake of focusing on only one culture. Core products will be distributed in shops throughout Austria and Switzerland and even into the Alpine areas of France and Italy. The manager will undoubtedly have business con-

Table 2: HELPFUL ORGANIZATIONS FOR GLOBAL MOBILITY

Several organizations exist to help companies manage globally mobile situations and employees. The best known is the **Global Mobility Forum** (www.globalmobilityforum.org), which is composed of:

- CREME—The Centre for Research into the Management of Expatriation at Cranfield School of Management at Cranfield University in the U.K.;
- The Center for Human Resource Strategy at Rutgers University in the U.S.;
- The Strategic Global Mobility Research and Consulting Centre at Monash University in Australia;
- Associate members, who are professors from all around the world; and
- Input from hundreds of global practitioners.

Other groups also have evolved to help with the global mobility issue. They offer advice, seminars, and links to several websites. One is the **Institute for Global Mobility**, which is sponsored by Ernst & Young in Great Britain. Information about it and links to other global mobility websites can be found at www.ey.com/global/content.nsf/UK/IGM_-_Web_links.

tacts in all of those countries and cultures.

Fletcher might be fortunate enough to find the perfect person who already understands all the financial, operational, and technical details of the business *and* is fluent in German *and* wants to move to Germany. This is unlikely, though, so financial, operational, or technical training may also be necessary. Further, it's unclear whether the training would be accomplished best in an Internet-based environment or face-to-face in the U.S. or Germany.

Fletcher should analyze the costs of each of these approaches and then train one or more managers who can then, in turn, train employees. Failure to train properly and fully can lead to customer ill will, lost market share, increased sick time, poor work performance, and no benefits to show for all the costs.

"TO-AND-IN" COSTS

When Fletcher's management accountants began analyzing the assignment of an expatriate to Germany, they focused first on direct cash-payment costs—what they called "to-and-in-Germany" costs. They originally overlooked the important costs of selecting and training the right person for the job. They also initially overlooked the costs and concerns of repatriation. Beginning their focus on direct costs was valuable, however, because the sheer financial outlays can be quite cumbersome and must be considered.

Housing

When the manager arrives in Germany, he or she needs temporary living quarters designed for relatively short stays. After a while, the manager will likely identify a neighborhood or home that's the "best" place to live and move there.

Once the manager becomes somewhat accustomed to life in Garmisch-Partenkirchen, he/she can seek a more permanent home. This is especially important if family has accompanied the manager overseas. Finding a place to live tends to speed up the process of adjusting to expatriation. The big decision will be whether to rent a home or buy one.

Depending on financial, legal, and tax considerations, buying a home may be a good idea. One mistake companies often make is that they budget a time frame for overseas managers to accomplish their goals, then rent a home consistent with that time frame. But adjustment to expatriation is very difficult to predict. Some people adjust quickly, and others don't. Some adjust quickly in one culture but slowly in others. Until they've adjusted, managers can't possibly achieve company goals, so the anticipated time frame is rarely accurate.

In addition, other costs of housing must be considered. The house must be furnished. Will the family's belongings be shipped to Germany, or will the family buy new furnishings? Further, "unfurnished" has a different meaning throughout Europe, and it always differs from the American concept of unfurnished. In Europe, unfurnished may mean that light fixtures, light bulbs, toilets, and even the kitchen sink are *not* included.

While dealing with these differences, the family must also decide how to manage and maintain its home in the United States (see Table 3).

Transportation/Travel

Travel costs will likely be high even before the manager's assignment begins. Several trips to Germany will be necessary, and, indeed, many job candidates may visit before Fletcher finds the right person. Travel costs probably won't end with one expatriation flight and one repatriation flight, either. The company should allow ample vacation time (and additional flights) so the manager can maintain social and cultural ties to home base.

Also, though public transportation is common in Europe, Fletcher may opt to provide a family car and will

Table 3: ESTIMATING DIRECT COSTS

HOUSING*

Temporary (short-term) Housing	$2,000 – $3,000 per month
Rent	$1,500 – $2,000 per month for a three-bedroom apartment (slightly more for a house)
Buying a House	Comparable houses would be at least 10% to 20% more expensive than in the U.S., with real estate commissions of up to 12%
Transporting Goods Overseas	$10,000 – $15,000 (plus $2,000 or more to transport an automobile)
Furnishing a House	About 15% more expensive than in the U.S.; unfurnished might not even have a kitchen sink
Selling or Maintaining U.S. Home	Typical charge for property management is about 30% of monthly rental income

**Housing costs will be far greater in Asian locations such as Hong Kong or Tokyo.*

TRANSPORTATION

Preassignment Trips, Moves, Vacations	$1,000 – $2,000 per person (economy class) $4,000 – $8,000 (business class)
Vehicle	Vehicles are slightly more expensive in Europe
Gasoline	Prices are often more than $6 per gallon
Public Transportation	Public transportation is commonly used and reliable throughout most of Europe. Most expatriates don't use cars unless their companies purchase them.

SALARIES AND BENEFITS

Salary Premium	10% – 25% of base salary
Cost-of-Living Adjustment	Goods and Services cost 10% – 15% more than in the U.S.
Salary Reductions	Healthcare—14% (employer portion varies); Unemployment—6.5%; Retirement—19%, half paid by employee—if employee leaves in less than five years, his or her 9.5% can be "transferred" to U.S. Social Security System from some countries).
Medical	Co-pays are typically about $10 with National Health Insurance plans, which are "low overhead" (Spartan surroundings, one receptionist, doctor completes all paperwork). Most expatriates opt for some private health insurance until National plan is in place.

COST CONCERNS FOR THE FAMILY

Spousal Assistance	$10,000 for job searches and to get spouse/family situated
Visas, Permits, Immunizations	Minimal costs while still in the U.S., but costs and requirements can be frustrating upon arrival in Europe. (It helps to bring along a "local" bilingual friend to the various government offices.)
Medical	National Healthcare plans are much stronger than in the U.S., but bureaucracy can seem overwhelming.
Private school	At least $20,000 per year per child
Social Benefits	Most European governments pay child support to families each year (regardless of income or nationality).
Transportation to School	There are no "school buses"; children use public transportation.
Communication with U.S.	Minimal (thanks to e-mail), but usually more costly than companies expect

Table 4: THE U.S. FOREIGN EARNED INCOME EXCLUSION

REQUIREMENTS

- Must be a U.S. citizen or resident alien of the U.S., and
- Meet the Tax Home Test, and
  - Meet the Bona Fide Residence Test, or
  - Meet the Physical Presence Test

CONSTRAINTS AND ISSUES

- Maximum foreign earned income exclusion is $80,000
- Business and moving expenses may be income
- The foreign housing exclusion/deduction, if claimed, may be income
- Allowances, reimbursements, or expenses paid may be income, including (but not limited to)
  - Cost-of-living allowances
  - Family expenses
  - Education costs
  - Home leave

have to allow for extremely high fuel prices. High fuel prices may also have exorbitant effects on the transportation costs that will be incurred for freight to ship family belongings to and from Germany.

Salary/Benefits

Fletcher correctly anticipated that convincing someone to go to Germany would require a pay increase. Not only should there be a salary premium for going, but the company should ensure that the manager's take-home buying power isn't overwhelmed by currency concerns, exchange rates, cost-of-living differences, or taxes.

Tax planning is an important element of any expatriation assignment. For example, income may be taxable in both Germany and the U.S. If Fletcher is careful, however, it can avoid double taxation through the Foreign Earned Income Exclusion available to U.S. citizens and resident aliens. The maximum amount of total foreign earned income that can be excluded is $80,000, but certain conditions must be met (see Table 4). The employee must either be a bona fide resident of a foreign country or countries for an entire tax year or be physically present in a foreign country or countries for at least 330 days during the year, or any other period of 12 months in a row starting or ending in the tax year. Further, the employee's tax home must be in a foreign country or countries throughout the period of bona fide residence or physical presence.

Self-employment income, business or moving expenses, or claiming the foreign housing exclusion or deduction may reduce the amount of the exclusion. Any cost-of-living allowances, family expenses, education costs, and other services that Fletcher might pay on the employee's behalf may have the same effect.

Other benefits should also be considered and planned carefully. The most notable is insurance. In addition to medical insurance, other insurance may be necessary, such as increased coverage on personal property for the expatriated employee or increased (at high cost) life insurance coverage.

Since the healthcare systems in other countries are different from those in the U.S., the process of obtaining healthcare will be different. The company may want to contact medical specialists (such as orthopedic surgeons or orthodontists) in Garmisch-Partenkirchen if the manager needs specialized care. Fletcher must also assure that all necessary work permits and visas exist and remain current.

Fletcher can minimize the burden of cultural adjustment for the expatriated employee by completing as many tasks and details as possible.

For the Family

Other direct costs may arise from the presence of the manager's family. Additional food or clothing allowances may be necessary. When children are involved, the choice and cost of good schools may be a concern, especially if the family isn't prepared to immerse the children in a German-speaking environment right away.

Expatriates overwhelmingly indicate that the most important cost in this area is spousal job assistance. If the spouse doesn't work for Fletcher, the company must go to all lengths to find a job for him or her. This might necessitate extra trips to Germany before the distribution center opens.

Behavioral Costs

Invariably, the manager who accepts an expatriation assignment feels, to some degree, banished to a deserted island. There's an inevitable feeling of isolation, which some people overcome more quickly than others. A sort of culture shock may set in, creating tension between the manager and family and/or employees.

Productivity may suffer at this point. Expatriation assignments often fail because of these issues. Although behavioral costs are difficult to quantify, they are definitely real. Research is ongoing regarding this issue, but there are few strong conclusions that can help. In fact, the most productive suggestion harkens back to the selection process. Research shows conclusively that people who are extroverts, agreeable, and emotionally stable are more likely to see an expatriate assignment through to completion and adjust more quickly to isolation and culture shock.

Once the manager is in Germany, Fletcher must do everything it can to be sure that the expatriated manager "stays connected" with the United States—with the Colorado headquarters and with family and friends. This means unlimited e-mail, fax, and phone costs. Travel and vacation allowances should also be plentiful.

Formal communication channels should exist between the U.S. and German offices, and routine performance evaluations should continue. This communication should also include a "sponsor"—a person or department in the U.S. who's responsible for keeping the expatriated manager up-to-date on company and social events. These practices will be helpful in reducing behavioral costs and in easing the adjustment of returning home.

Repatriation

Fletcher must be careful to realize that after the manager has completed the assignment in Germany, he or she will be more important than ever before. Nevertheless, expatriate managers are far more likely than other managers to leave a company. Twenty-five percent leave within one year, and 40%-50% leave within three. Worse, these expatriate managers often leave to join forces with a competitor.

The process of returning to the U.S. may be as difficult as (and often more difficult than) the original expatriation. The company should outline a clear set of career plans that utilize the "new skills" the manager has acquired in the expatriation assignment. The inability to use such skills often drives managers to competitors. Fletcher should also provide strong assurance that the manager will remain on the main career-advancement track in the company.

If the manager and/or his/her family have become so accustomed to life overseas that they don't want to come home, Fletcher should plan to offer a salary premium to entice the manager to return home and continue to work for the company.

Fletcher also should anticipate that the isolation problem facing the manager and the family upon arrival in Germany will exist again when they return home. Time and distance create gaps and isolation from employees, friends, and other family members. And Fletcher simply must not forget about the spouse, who lacks fellow employees to ease the transition and probably needs help finding a job. If the spouse has trouble repatriating, the manager may relocate and join forces with a competitor.

A Learning Experience

Above all else, Fletcher should view the manager's expatriation as a knowledge-transfer mechanism. Fletcher will gain knowledge!

In today's economy, where knowledge and human capital are premium assets, the repatriated manager represents a gold mine. If he/she leaves for a competitor, then the competitor has obtained a highly trained and extremely capable asset—at Fletcher's expense.

To keep the manager from leaving, Fletcher might consider a job-rotation scheme to ease the manager's feelings of isolation and to glean knowledge. Before forcing him/her back into a management position, Fletcher could assign the manager to various jobs—at varying skill levels.

For example, the manager could spend two weeks in distribution, a week in manufacturing, a few weeks in sales, and a week in quality control. This offers two advantages:

- The rotation, perhaps combined with additional training, gives the manager the opportunity to become reacquainted with the Fletcher-U.S. approach to business.
- It allows Fletcher and its employees the opportunity to glean knowledge from the manager about the techniques, strategies, and controls used and refined in Germany.

Fletcher must do everything possible to keep the manager and then continue to build the corporation by growing global advantages. The repatriated manager will possess unsurpassed knowledge about the European view of Fletcher's products, distribution channels in Europe, and simply doing business in Germany, Austria, Switzerland, France, and Italy. Fletcher's biggest gain will be a knowledge-transfer mechanism for the global economy—but only if the company retains the repatriated manager. ■

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