

MERCER

Cost-of-Living Differentials

Choosing the Right Methodology to Match Your Needs

Cost-of-Living Differentials: Choosing the Right Methodology to Match Your Needs

When employees go on an international assignment, they are likely to find the prices of goods and services in their host location to be different (often higher) than in their home location. A prime task for expatriate administrators is to be able to take into consideration cost-of-living differences in diverse locations and integrate them into a workable and fair compensation package that also complies with basic principles of transparency and cost-efficiency.

The Benefit of Two Approaches

Finding the best way to address the cost-of-living issue is a challenge when managing a modern global workforce that originates in, and is assigned to, a diverse array of locations. To help you find the optimal solution, Mercer offers two distinct methodologies and several index types:

- **Mercer Multinational Cost-of-Living Approach.** This approach develops cost-of-living indexes and differentials that are based on a blended international spending pattern. The methodology assumes a convergence of spending patterns among expatriates of companies potentially employing a variety of expatriates with complex assignment patterns and from many different nationalities. With weighting of goods and services the same for all locations, this approach compares prices of similar brands and from similar retail outlets in both the home city and host city. Indices may be “reversible”.
 - **Mercer ORC Home/Host Cost-of-Living Approach.** This approach develops cost-of-living indexes and differentials that are based on the unique spending patterns in a base (usually home or headquarters) country. By using different weights for each home country, it ensures that expatriates can retain their expenditure pattern in the host location. The methodology compares prices in the home country from a local-national perspective to prices in the host city from an expatriate perspective. Indices are not “reversible”.
- In practice, what does this mean?**
- The Multinational approach assumes that any difference in spending patterns between an American and a German expatriate, for instance, is not relevant to the calculation of a differential, while the Home/Host approach assumes these differences are relevant. In addition, the Multinational approach will produce different goods and services differentials for expatriates coming from multiple locations within the same country (e.g., the United States) assigned to the same host location since the basis for comparison is different (home country for the Home/Host approach vs. home city for the Multinational approach). Finally, the Home/Host approach will tend to produce higher indices and differentials than the Multinational approach.
- The way in which the resulting data is delivered is also different:
- **Mercer Multinational:** Clients subscribe to data and pay a fee for on-line access to data, reports, and calculators, according to their country/city entitlement. Standard data updates are automatic for release of new survey data, but clients must access their locations and update index calculations on a self-serve basis. No historical home/host data is stored for the client. Clients may produce cost of living indices and differentials between any city within their entitlement, whether as a home or as a host city, using calculators available to them in Mercer’s Global HR Monitor.
 - **Mercer ORC Home/Host:** Clients subscribe to specific combinations of home and host location data and pay an annual fee for web access, quarterly publications, calculators, and regular automatic updates to all of their combinations. Clients may access their specific data (including a history of data produced specifically for them) via the Mercer ORC client website whenever they wish. Client-specific home/host data is updated automatically, at least four times a year, with more frequent updates when exchange rate movement thresholds are exceeded or on a custom schedule. Clients may also update data for a single home/host combination, update batches of data, or update all of their data whenever they wish.

Which Approach Fits Your Needs?

When deciding what works best for your organization, consider these questions:

- **Methodology.** What is your typical assignee profile (do they move largely within their region, do they move from one assignment to another, or are they out-and-back assignments)? How important is a pure home-based vs. an international approach? How many home and host locations do you have and how varied are your home/host location combinations? Is index reversibility important?
- **Service Delivery.** Do you want data updated automatically on a regular or custom basis, or do you prefer to access and update data autonomously? How important is access to your specific historical data? How large and knowledgeable is your administrative staff? Do they have the expertise (and willingness) to administer expatriate pay on a self-serve basis? Is service, including data explanation for expatriates, important?

The overall factors for selecting a specific approach focus on these decision points:

- If you believe that the use of a blended international purchasing pattern is appropriate for your population, you are comfortable with a self-service delivery model of data and data updates, you have many intra-regional transfers and/or highly mobile employees, and index reversibility is important, you may be best served by the Mercer Multinational Cost of Living Approach.
- If you believe that the expatriate's home-country purchasing pattern should be maintained, you prefer automatic data updates for any or all location combinations, you want global access to a repository of specific historical data, you require a high level of service, you may be best served by the Mercer ORC Home/Host Cost of Living Approach.

Before you make your final choice, discuss the issue with your Mercer consultant to find the optimal solution for both your organization and your expatriates.



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