

NHH



Effects of Discontinuing Performance Pay

A qualitative analysis in three branches of SpareBank 1 SMN

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Abstract

SpareBank 1 SMN, a regional bank consisting of 50 branches, recently decided to change their compensation policy. That meant for the bank to discontinue its performance pay scheme, and replace it with a new fixed pay scheme, namely a career model. The change happened due to a general dissatisfaction amongst the management with the consequences of using performance pay as a part of the compensation system, and it was in 2013 decided to discontinue further use of it and instead implement a career model based on fixed pay.

This research was done using a qualitative method. In total, 17 interviews with employees working at 3 different branches (Stjørdal, Malvik, and Meråker) were conducted. The aims of the research was to find the employees' perceptions and opinions concerning being deprived performance pay, in addition to reveal possible multitask problems that could have occurred due to the bank's performance pay schemes.

The findings revealed that the perceptions of the most recent performance pay schemes varied to a great extent. Performance pay seems to have motivated the majority of the interviewees, but the thesis also proposes that employee loyalty, and the level of effort put in, did not change significantly because of its discontinuation. However, the discontinuation seems to have led to a reduction of several multitask problems that previously occurred.

Preface

In this master thesis, I have chosen to write about incentives and pay. This is a field of study I found interest in when I was studying for my bachelor's degree at Trondheim Business School, and that was reinforced when I took the course "BUS400N – Styring av større foretak (Management Control)" at the Norwegian School of Economics in the fall of 2012.

I have written this thesis in cooperation with SpareBank 1 SMN, first and foremost with the three branches Stjørdal, Malvik, and Meråker. SpareBank 1 SMN have recently discontinued their performance pay schemes, and replaced performance pay with a new career model that is based on fixed pay. The purpose of this thesis has been to examine how this transition has been received among the employees, i.e. their perceptions of being deprived performance pay. Additionally, I have sought to examine whether the discontinuation of performance pay have reduced or eliminated several of the typical multitask problems that tends to occur due to it. In order to examine this, I conducted a total of 17 interviews with several of the employees working at these branches.

I would like to thank SpareBank 1 SMN for letting me write about and do research on their recent compensation systems. Especially, I would like to thank HR Manager Irmelin Andersen, Manager Inge Grøntvedt, and his staff. Finally, I would like to thank my supervisor, Iver Bragelien, for constructive input and feedback.

Bergen, June 2014

Kristoffer Næss Skjerve

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1. Introduction

Incentives can have both a direct and an indirect effect for how employees behave and work (Bragelien, 2012b). The direct effect refers to the connection between rewards and behavior, i.e. the connectivity. That means that if there is a change in what is rewarded, a change in behavior and performance can also be expected. Rewards are influenced by behavior, and behavior is influenced by the rewards that are offered. The indirect effect includes environment, i.e. the norms and values that are present at the workplace. It can be expected that compensation systems have influence on what values and expectations each employee has to one another. This, in turn, is likely to affect the behavior of each employee, as it is commonly acknowledged that most people want to “fit in” (see Maslow’s hierarchy of needs, which is addressed later).

1.1 Why performance pay?

In recent decades, performance pay as a reward system has become a very popular compensation strategy for many organizations. It is believed to help motivate employees, and to contribute to improved individual and organizational results. The purpose of performance pay is to give employees financial incentives for increasing their own productivity, to increase the quality of what they do, and/or to increase their efficiency (Rynes et al., 2005). There are several reasons for how and why performance pay has gained as much popularity as it has in recent decades, and the theory behind it will be presented in chapter 2.

Bragelien (2012c) claims that by using pay as a way to control and “guide” employees in their work, great benefits for organizations can occur. The following 5 points describe how Bragelien (2005) says how the success of a compensation system can be measured. One or more of these points should be fulfilled in order for organizations to be able to claim that their compensation system is successful:

- The compensation system makes the employees work harder
- The compensation system makes the employees work smarter
- The compensation system makes the employees make better decisions
- The compensation system attracts talent

- The compensation system attracts talent

Design can be essential for the success or failure of the system (Balkin and Gomez-Mejia, 1987). The first three points (harder, smarter, and better decisions) can be addressed as a part of the problem with moral hazard, and the latter two points can be addressed under the problem of adverse selection, both of which is to be addressed in following chapters.

1.2 Can we see signs that organizations are returning to fixed pay?

In recent years, especially since the financial crisis that occurred towards the end of the 2000s, a lot of attention has been given to financial institutions and the way compensate their employees. Before the crisis, many employees were rewarded in ways that encouraged them to undertake high risk, at times even irresponsibly high, in the pursuit of higher profits (Norwegian Ministry of Finance, 2013). Banks and other financial institutions were by many (especially older generations) to a large extent blamed for the crisis, and many were criticized for undertaking too high risk, and gambling with third parties' money, e.g. customer's (Coombes, 2013).

As the world started to recover from the crisis, governments all over the world, especially in the regions that were most affected, started working on bills and regulations in order to ensure that a crisis of such magnitude would not happen again. Even though Norway was one of the western countries that endured the crisis best, the Norwegian Ministry of Finance determined a regulation that would be effective as of January 1st 2011. The regulation was intended for the financial sector, and one of its goals was to ensure that financial institutions would not undertake irresponsibly high risk. The regulation introduced stricter rules for how compensation systems could be designed; including how bonus programs and performance pay could be used. The regulation's purpose was to establish remuneration policies that promoted healthy risk management, that would counteract excessive risk-taking, and that would reduce conflicts of interests (PwC, 2011). In other words, the idea behind the regulation was to reduce the incentives for short-term thinking and excessive risk-taking, and rather promote long-term thinking, i.e. for institutions to undertake a more healthy risk level. Even though the regulation first and foremost might have been intended for management and key employees, who earlier might have had huge bonuses, it has also had an impact for how lower level employees are rewarded.

CEBS (Committee of European Banking Supervisors) determined their “Guidelines on Remuneration Policies and Practices” on December 10th 2010, and to a large extent, these guidelines correspond with the regulation determined by the Norwegian Ministry of Finance (PwC, 2011).

Since 2010-2011, every now and then newspaper articles describe how some managers and organizations have eliminated bonuses and performance pay. Among these, SpareBank 1 SMN, who discontinued their performance pay scheme in 2013 (Laugen and Trumpy, 2014).

The high bonuses that occurred, and still do, in the financial sector received a lot of criticism from outsiders, and many believed that employees of financial institutions were paid for undertaking unnecessary high risk, thus their trust in banks and financial institutions were weakened. Krishnan (2012) supports these accusations, arguing that excessive risk-taking by financial institution employees are likely to happen because of what he calls asymmetries in compensation for lenders, traders, investment bankers and investors. He argues that potential losses have a limit (the money invested), but that there exists no such limit for how high the gains can be if the investment turns out to be successful. Further, he argues that typical compensation programs include both a part fixed pay and a part variable part, and that there is an imbalance between how employees, and institutions and customers think in relation to long-term and short-term gains. As employees can have a more shorter-term perspective than the customers typically have, employees may be tempted to undertake high risk by investing in projects that are likely to have high short-term returns, thus increasing the employees’ income (due to increased performance pay), while they in the same time have little incentives for being concerned about any possible downsides to the investment in the longer run.

This has been brief introduction to some of the reasons for why bonuses and performance pay in the financial sector, for many, have gotten a bad omen. Because financial institutions and organizations are dependent on the trust of their customers, discontinuing bonuses and performance pay may be a way to regain their trust.

1.3 SpareBank 1 SMN¹

As my thesis evolves around the compensation systems used at SpareBank 1 SMN in recent years, I will in this subchapter present the bank in general, and give the reader an insight to the bank's history, vision, and structure. Additionally, I will give a short presentation of the three branches I focus on: Stjørdal, Malvik, and Meråker.

Vision

SpareBank 1 SMN's vision is to be considered as "*the recommended bank*" ("*den anbefalte banken*"). This is reflected in the bank's ambition of being an independent regional bank that is rated higher than any other bank in the region, by both private customers and corporations. "Our customers are to find us *skilled and nearby*".

History

SpareBank 1 SMN is one of the oldest banks in Norway. It was established in 1823 as "Trondhjems Sparebank", and is today the leading bank in its region (Nord-Trøndelag, Sør-Trøndelag and Romsdal). As of September 2013, Sparebank 1 SMN had 50 branches spread across the region, from the town of Terråk in the north to the towns of Førde and Øvre Årdal in the south (in Sogn og Fjordane). Approximately 1,200 employees are working at the bank's headquarter, which is located in the city of Trondheim.

In September 2013, SpareBank 1 SMN had 200,000 private customers and 15,000 corporate clients. They own the subsidiaries SpareBank 1 Finans Midt-Norge, EiendomsMegler 1 Midt-Norge, Allegro Finans, and SpareBank 1 Regnskapshuset SMN.

In 1996, SpareBank 1 SMN became a founding member of the SpareBank 1 Alliance. Today, the main parties of the alliance are SpareBank 1 SMN, SpareBank 1 SR-Bank, SpareBank 1 Nord-Norge, Sparebanken Hedmark, Samarbeidende Sparebanker AS, and Sparebank 1 Oslo Akershus, together with the Norwegian Confederation of Trade Unions (LO). The SpareBank1 Alliance is the second largest financial group in Norway, composing of approximately 5,500 employees and 350 branches altogether. The broad cooperation secured through the SpareBank 1 Alliance helps the parties maintain a strong brand, make

¹ Information found on SpareBank 1 SMN's homepage (www.sparebank1.no/smn) and from a personal presentation of the bank given to me by Branch Manager Inge Grøntvedt in early January 2014

great competence and technology easily available for every branch, and secures economies of scale. This makes it possible for the regional branches to provide skilled advisors and a wide variety of products, in addition to ensure possibilities for having strong and solid long-term strategies, while still being able to focus on the regional and smaller markets.

Organizational structure

The financial advisors working at SpareBank 1 SMN are divided into two divisions; PM, which handles private customers, and CO², which handles corporate clients. Recently, for a short period of time, the divisional boundaries between the two divisions were removed in an attempt to provoke cooperation and higher utilization of the bank's human capital. However, the boundaries are now being restored, and PM and CO operates more as two separate divisions again.

The employees at SpareBank 1 SMN are bound to follow a set of guidelines, as is shown in figure 1, in order for the bank to reach its goals and vision. As the figure implies, there are 4 main areas that should be given extra attention: initiative, service, cooperation, and entrepreneurial spirit.

² CO is a self-made abbreviation for Corporate. In Norwegian, the term NÆ (Næring), previously BM (bedriftsmarked), is used for this division

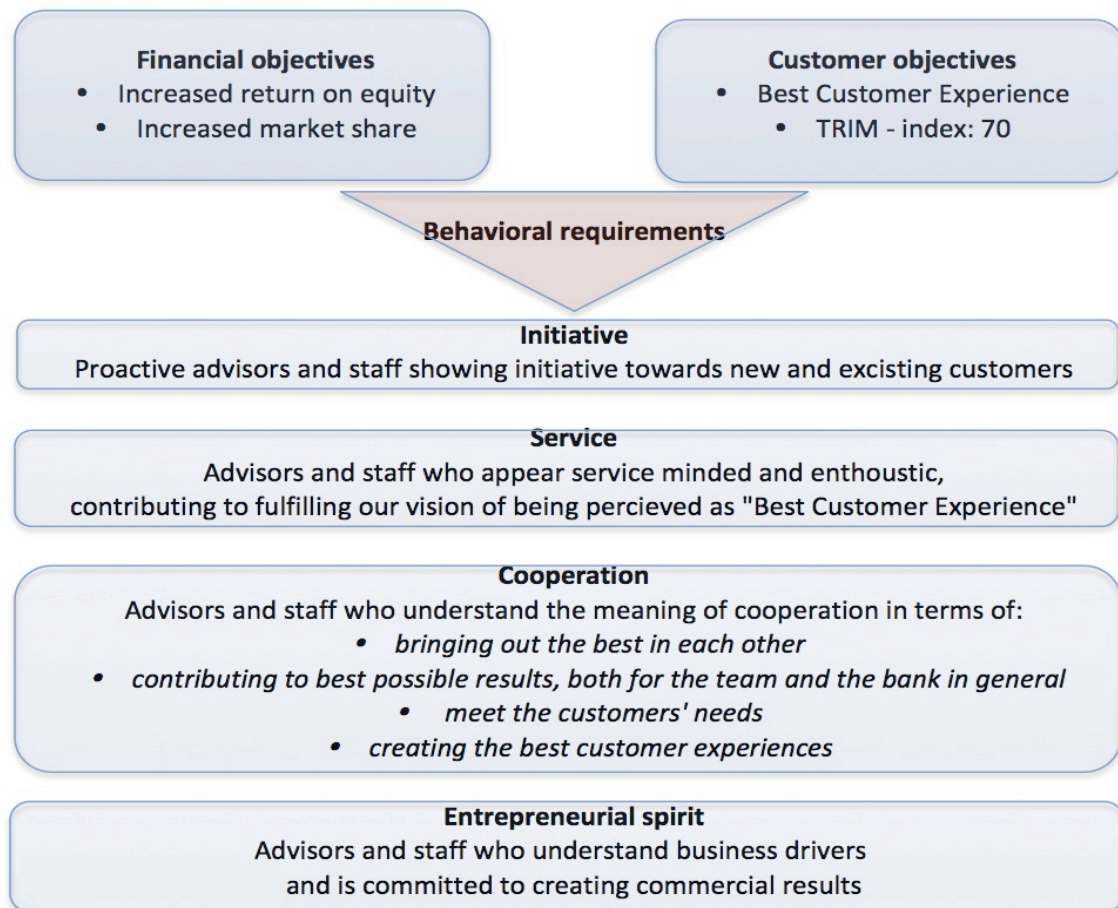


Figure 1 – SpareBank 1 SMN's behavioral guidelines

The Stjørdal, Malvik, and Meråker branches

The Værnes region is composed of the three branches Stjørdal, Malvik, and Meråker. Of these three branches, Stjørdal is the biggest with a total of 18 employees (15 advisors), including the market area's manager Inge Grøntvedt. The Malvik branch is composed of 6 employees, while the Meråker branch is composed of 3 employees. Because the Meråker branch only is open for customers on Wednesdays and Fridays, its employees spend many of their working days at the Stjørdal branch. All advisors located at the Malvik and Meråker branches are working in the PM division, while both divisions are represented at the Stjørdal branch (however, CO representatives help out at the other two branches when needed).

Stjørdal is one of the biggest cities in Nord-Trøndelag County with an approximate population of 22,667³. Malvik's population is approximately 13,380, while Meråker has a population of approximately 2,500.

The three branches are now operating as one designated market area. Previously, each branch had its own manager, but now Mr. Grøntvedt acts as manager for the entire region.

1.4 Research question

The purpose of this thesis is to analyze and discuss SpareBank 1 SMN's compensation systems in recent years, i.e. the years 2012 until today. SpareBank 1 SMN did over several years use compensation systems that included performance pay in one way or the other. However, in the summer of 2013, SpareBank 1 SMN's management recommended to discontinue further use of performance pay, and instead work towards implementing a career model based on fixed pay.

This thesis will examine how the employees received the transition, and their perceptions of being deprived performance pay. Thus, the two last performance pay schemes should be a reasonable limitation. Additionally, I seek to answer whether performance pay had any behavioral effects on the way the employees conducted their work. In order to examine this, I raise a threefold research question:

- Sub-question 1: Did performance pay motivate the employees?
- Sub-question 2: How did performance pay affect important focus areas for SpareBank 1 SMN?
- Sub-question 3: How can the findings of this research be useful for SpareBank 1 SMN in the future?

Ideally, this research would also have addressed the implementation of the career model, and whether it has any effects on the employees' motivation and the way they perform their work. However, the career model was not yet fully implemented and adapted, and so by the

³ Population in mid May 2014, obtained from the municipalities' homepages

time this thesis was written, it was impossible for the employees to point at any change in behavior that had happened due to it. Thus, the implementation of the career model will be given little attention in this thesis.

1.4.1 Thesis structure

The thesis is structured as follows: Chapter 2 is the theory chapter, where relevant theory will be presented. The chapter is divided into 5 subchapters, where the first, principal-agent theory, forms the foundation for the four following subchapters. Chapter 3 is the methodology chapter. First, general methodology theory is presented, before a thorough review of how the data for this research was collected and processed. In chapter 4, a thorough presentation of SpareBank 1 SMN's compensation systems in recent years are presented, that is from 2012 until today. The analysis chapter is divided into three separate chapters, 5 to 7. Chapter 5 summarizes and concludes the theory chapter, thus forming several expectations or hypotheses for which results we could expect to find when processing the data. Chapter 6 presents an overall review of the responses given by the interviewees. Chapter 7 analyzes the responses on a deeper level, and compares them to relevant theory. The chapter is divided into three main sections, namely the three sub questions noted above. In the eight and final chapter my conclusions are presented, and this is where I will attempt to answer my research questions.

2. Theory

In this chapter, I will present relevant theory for this thesis. My discussions in the chapters 5 to 7 are based on the theories presented here.

The chapter is divided into 5 subchapters. First, I present principal – agent theory. This is presented first because a lot of the incentive and pay theory uses it as a premise. Next, I present theory concerning motivation. Motivation is an important part of any compensation system, and in the subchapter I first present four motivational directions, before I thoroughly address intrinsic and extrinsic motivation, and the interaction between them. Further, I present design-related issues of compensation systems, before I address various methods for how to evaluate employees. Finally, I present theory concerning careers.

2.1 Principal – agent theory

One of the most significant theories of incentive and pay theory is the principal – agent theory, and so this chapter will begin with a review of it. To a large extent, principal-agent theory forms the premise for the following subchapters.

A principal (the employer) offers an agent (the employee) a contract and compensation for doing a job. The agent is free to accept or reject the offer. If the agent agrees to accept the offer and signs the contract, he or she can decide what level of effort they choose to put into the job. Given rational behavior, the principal would want the agent to put in the level of effort that maximizes his (the organization's) profit. The principal's problem however, is that he has limited possibilities for conducting surveillance on the agent or for doing micro managing (at least at a price within reason), thus he will not know for sure what level of effort the agent actually ends up putting in, because the agent decides the level of effort *after* he or she has accepted the contract. In other words, the agent is by himself or herself responsible for how he or she handles the everyday activities of the job, and these decisions can directly affect the principal's profit. As long as we can assume that every party (the agent and the principal) behave rationally, we can expect that the agent will put in the level of effort that maximizes his or her own wealth, i.e. their personal trade-off between pay and leisure time (Mirrlees and Raimondo, 2013).

This information asymmetry can cause problems for the principal, because he cannot be sure that the agent will put in the desired level of effort. Additionally, the principal will have to offer the agent a contract he or she finds interesting and attractive. If the contract is not good enough, i.e. the pay that is offered is too low, the agent will likely reject the offer and the principal will not have someone to do the job. These possible conflicts of interest are called agent costs, and they can be divided into two groups (Bragelien, 2009):

- *Deviational costs.* Costs that occur because the agent acts to the contrary of the principal's interests, i.e. their interests do not coincide.
- *System costs.* Costs that occur as the principal attempts to reduce the deviational costs. For instance, this can be costs associated with surveillance, higher salary, etc.

There are two significant issues that should be addressed when discussing principal-agent theory. These are *moral hazard* and *adverse selection*, and they will be addressed below:

2.1.1 Moral Hazard

Moral hazard refers to the problem where the principal doesn't know for sure what level of effort the agent will put in, or which decisions he will make.

“Moral hazard problems arise when there is the possibility of post-contract opportunism” (Demski, 1997)

As the agent acts rationally, we can assume that if he is aware of any eventual monitoring conducted by the principal, he will likely put in the effort he knows is expected. But if the monitoring disappears, and the agent believes that the principal won't notice a slightly reduction in effort, it might be in his best interest to reduce it.

“The source of this moral hazard or incentive problem is an asymmetry of information among individuals that results because individual actions cannot be observed and hence contracted upon. A natural remedy to the problem is to invest resources into monitoring of actions and use this information in the contract...Generally however, full observation of actions is either impossible or prohibitively costly” (Hölmstrom, 1979)

Often, it can be assumed that the principal only can observe the final output of the agent's work. This is why it often is easiest to design a contract where the agent's salary is directly linked to the output. By doing that, the principal can reduce the agent's incentive for behaving in his own best interest (if that is slacking) and instead increase his incentives for

behaving in the organization's best interests (if that is high productivity, etc.). In other words, the principal wants to align his own and the agent's interests (Jensen and Murphy, 2010). However, the agent might perceive this as unfair because the final output is often a result of more than just the agent's effort. It is also affected by external factors, which often are beyond the agent's control. For instance, unforeseen changes in markets that can lead to a sudden drop in demands is one example of how output might end up different from what was expected by the time the contract was agreed upon.

Performance pay can help the principal avoid problems associated with moral hazard, given that he offers the agent a contract that gives him incentives to work and make decisions that are in the principal's best interests. The principal can use pay and rewards as guidance in terms of directing the agent's behavior in the ways he finds optimal. This topic has been thoroughly researched, and it is often proposed that performance pay can induce higher effort and productivity compared to fixed pay schemes (Cadsby et al., 2007).

2.1.2 Adverse selection

Adverse selection refers to the problem where the principal doesn't know 100% for sure who the agent is, i.e. the agent's characteristics. Based on job interviews and general experience, the principal can obtain some knowledge of who he is, but it's more or less impossible to get to know everything there is to know about another person's skills and preferences in this kind of settings. Often during job interviews, agents tend brag a little extra, or claim to be a better candidate for the job than they objectively are. Demski (1997) notes that "*adverse selection refers to pre-contract opportunism*", i.e. agents will exaggerate their own abilities in order to be offered a job.

It is possible to reduce the problem of adverse selection so that the principal can make better decisions on whom to hire. The contract he offers can be designed in ways so it disqualifies undesirable candidates, or in ways where it doesn't attract the "wrong" candidates. If they are optimally designed, performance pay contracts can act as a sorting device where unwanted agents either won't apply or they will quit because they realize that the principal's interests does not align with their owns, and agents who have aligning interests with the principal will either apply or stay (Lazear, 2000a, Lazear, 2000b). In other words, performance pay can help attract and retain preferred agents and talents.

2.1.3 A simple linear model

In order to explain principal-agent theory, I will present a simple model and explain the basic assumptions of it. The model seeks to reduce the previously mentioned moral hazard problems.

A reasonable economical assumption is that agents (employees) are risk averse, and that they initially value leisure time higher than time spent at work. The principals (employers) however, are risk neutral, and their purpose is to maximize their own profits and value⁴.

Two superior constraints need to be overcome in order for the contract to appear acceptable for the agents. The principal should offer a contract that satisfies the following (Bragelien, 2009):

- Participation constraint: The contract must be as attractive as other possible contracts the agent in question can be offered at other organization, or as attractive as he finds being unemployed (unemployment benefits).
- Incentive constraint: The contract must motivate the agent in question to put in the desired level of effort.

The linear model can be written as:

$$w = \alpha + \beta z,$$

where w is total pay, α is the portion of base pay, and βz is the portion of variable or performance pay. βz can be divided into $e + x$. e stands for the agent's effort, and x for the exogenous effects on the outcome. β is the incentive element.

The model can be further explained by deriving the principles the model is built on: the incentive-intensity principle, the informativeness principle, the monitoring intensity principle, and the equal compensation principle. Although not mentioned by these exact terms, they will be addressed to some extent onwards in this chapter.

⁴ Profit = income – labor costs

If the principal offers the agent a strict base pay contract with no performance pay possibilities ($w = \alpha + 0$), it can, due to the previously mentioned assumptions, be expected that the agent will put in low effort into his job⁵. Thus, the contract's only purpose will be to overcome the participation constraint. It is overcome when the α (base pay) is set high enough for the agent to value it as the better option (after having subtracted his personal costs of putting in low effort) compared to being unemployed or accepting an alternate contract somewhere else. In mathematical terms, it can be written:

$$U(w - C_L) > U(M),$$

U stands for utility, w for pay, C_L for costs by putting in low effort, and M for what the market offers.

When the contract composes a portion performance pay ($w = \alpha + \beta z$), the contract has to overcome both constraints. It is often assumed that the principal wants the agent to put in high effort in a setting like this. From the principal's point of view, the relation between the agent's input and output is given by the figure below (2). I.e. $x_1 < x_2$, and input H > input L (Demski, 1997). The outcome is uncertain, but for simplicity, with input L, output will be x_1 . With input H however, the probability of output x_2 is p .

| | Output | |
|---------|--------|-------|
| | x_1 | x_2 |
| Input H | $1-p$ | p |
| Input L | 1 | 0 |

Figure 2 – Simple model, relation between input (effort) and output (Demski, 1997)

For overcoming the participation constraint, the mathematical expression will be like this:

$$(1-p)U(w_1 - C_H) + pU(w_2 - C_H) > U(M),$$

⁵ As a simplification, a normal economical assumption is that the agent can choose either high or low effort

w_1 stands for pay when output is bad, w_2 for pay when output is good, and C_H for the agent's personal costs of putting in high effort. All other symbols have the same meaning as earlier. The expression indicates that in order for getting the agent to accept the contract, his expected utility of putting in high effort must be bigger than the expected utility of other possibilities he has in the market.

In order to overcome the incentive constraint, the mathematical expression will look like this:

$$(1-p)U(w_1-C_H) + pU(w_2-C_H) > U(w_1-C_L),$$

and the expression indicates that the agent's expected utility of putting in high effort is bigger than the expected utility of putting in low effort.

2.2 Motivation

“Motivation is a factor that activates and directs human behavior” (Bruno, 2013)

One of the more important tasks for organizations is to make sure that their employees are motivated to do the work they are required to do and that is expected of them. Motivation is often essential in terms of how well employees will perform on a daily basis, thus how well the organizations' overall performance will be.

Studies on motivation have been conducted for many years, and several motivational theories form the basis for many of them. Kaufmann and Kaufmann (2009) divides motivational theories into four groups; needs theories, cognitive theories, social theories, and job characteristics theories. Rynes et al. (2005) emphasize Maslow's need hierarchy and Herzberg's motivation-hygiene theory as the most influential psychological theories used when discussing motivation and pay, in addition to Deci and Ryan's cognitive evaluation theory (CET).

Typically, motivation is divided into two groups; intrinsic and extrinsic motivation. Intrinsic motivation is motivation coming from “inside” the individual, while extrinsic motivation stems from external factors (for instance pay). In this subchapter, I will first describe the theories mentioned above, before thoroughly address intrinsic and extrinsic motivation, the differences between them, and how they affect each other.

2.2.1 Needs theories

Needs theories are based on individuals' needs, and they imply that the way people behave is due to the needs they seek to fulfill. Likely, the most influential theory in this category is Maslow's hierarchy of needs.

Maslow's hierarchy of needs

The theory presents an individual's needs in a hierarchical order from most to least important needs (Maslow, 1954, cited in Kaufmann and Kaufmann, 2009, p. 94). The lowest (and most essential) level is the physiological level, and the four following levels build on from there. The five levels can be divided into basic needs (the three lower levels) and growth needs (top two levels) (Kaufmann and Kaufmann, 2009).

The five levels:



Figure 3 – Maslow's hierarchy of needs

- Physiological needs. The first and lowest level of the hierarchy is the basic requirements needed for a person in order for him to survive. These are the needs a person has to fulfill if he even is to remotely function as a human being, for instance food, water, sleep, etc.
- Safety needs. The second lowest level of the hierarchy is safety needs. These are needs related to for instance health, economical, or personal safety/security. This level represents for instance job security.

- Social needs. The third level is the need to belong to somewhere and/or someone. These needs are important because they enable the ability to connect and interact with other human beings.
- Esteem. Esteem and self-esteem, is important for a person's ability to perform tasks or jobs, and to believe that they can be done. According to (Kaufmann and Kaufmann, 2009), Kaufmann and Kaufmann (2009) this level is of great importance for organizations, because giving recognition to their employees can be an effective motivational strategy.
- Self-actualization. The fifth and final level of the hierarchy is a person's possibility for realizing his or her full potential as a human being. This means being able to pursue dreams, and personal and professional goals.

The lower levels (physiological and safety) can be satisfied by only having access to money. If being paid (receiving money), one will be able to buy food, provide shelter, and i.e. generally buy the things needed to survive. The logic of the hierarchy is that once a person is satisfied on one level, he will move one level up and pursue satisfaction there. For instance, once access to food, water, and air to breathe in is secured, the safety needs will be pursued. And as these needs are fulfilled, one will move on to fulfilling the social needs, and so on. However, social needs are not necessarily met just by earning money. The hierarchy implies that as one moves up, the attention will shift more and more towards the needs that not necessarily are directly related to money. In other words, Maslow suggested that the higher levels of the hierarchy only will be met if the feeling of doing something meaningful and important is present, and that pay is less and less important as higher up in the hierarchy one gets (Rynes et al., 2005).

2.2.2 Job characteristics theories

These theories propose that motivation is something that is generated by the job itself and the characteristics of it. Maybe the most influential theory of this group is Herzberg's two-factor theory, which is presented below.

Herzberg's two-factor theory

In the 1950's and 60's, Frederick Herzberg conducted extensive research on employees and how they were motivated, and which factors that could possibly have a negative impact on their motivation. His research resulted in what is now known as the two-factor theory.

The theory differs between “motivators/intrinsic motivators”; that is the factors that affect motivation in the workspace, and “hygiene-factors”; that is the factors that can lead to dissatisfaction if not present (Herzberg, Mausner, & Snyderman, 1959, cited in Kaufmann and Kaufmann, 2009, p. 108). What is interesting about these is that the motivators create motivation just by being present, but they won't demotivate if they are not. In comparison, the hygiene factors will create an environment of mistrust if they are not present, but they won't create motivation by themselves if present. They are just expected to “be there”, and are often first noticed when they removed.

The intrinsic motivators are:

- Achievement (satisfaction by the work done)
- Recognition (for the job that is done/being done)
- The work itself (interesting, varied, etc.)
- Responsibility (flexibility, control over work)
- Advancement (possibilities for such)
- Growth (potential for personal growth)

The hygiene-factors are:

- Company policy and administration
- Supervision
- Relationship with supervisor, peers, and subordinates
- Work conditions
- Salary and benefits

- Personal life
- Status
- Security

2.2.3 Social theories

Social theories are based on individuals' relations, primarily the relationships arising between colleagues. The relationships that arise at the workplace can either have a negative effect or a positive effect on individuals' motivation. For instance, perceived fairness (which is addressed later) is one of these factors that can affect motivation.

2.2.4 Cognitive theories

Cognitive motivational theories propose that the way individuals behave is due to their expectations of how a certain behavior can lead to achievements of specific goals or targets. Among cognitive theories, we find Deci and Ryan's Cognitive Evaluation Theory and Vroom's Expectancy Theory.

Expectancy Theory

Expectancy theory describes how employees perceive the relationship between rewards, skills, and expectations.

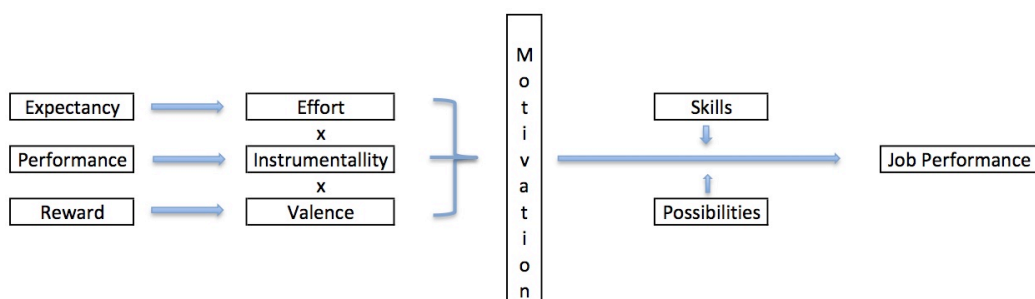


Figure 4 – Expectancy Theory (Kaufmann and Kaufmann, 2009)

According to the theory, motivation is a product of expectations, instrumentality and valence. This implies that in order for employees to be motivated, they need to have some expectations of that the effort they put in will cause good performances, that the good performances will cause the expected or desired outcome, and that the reward caused by the performance and outcome is something they value. As is shown in the figure, if one of the three factors is either very low or missing, the employees will probably not be motivated (Kaufmann and Kaufmann, 2009).

Cognitive Evaluation Theory

Cognitive Evaluation Theory (CET) is a psychological theory developed by E. L. Deci and R. M. Ryan that focuses on the effects external influences, for instance pay, can have on intrinsic motivation. The theory implies that employees need to feel competent and self-determined, at least to a certain degree, in their work in order to be able to perform well. Competence and autonomy are said to be the determinant factors of how motivated employees are, and thus how well they will perform.

External factors can have both a negative and a positive influence on intrinsic motivation. Monetary rewards can in some situations be perceived as controlling, and it is implied that once rewards are perceived as such, they can reduce intrinsic motivation because employees will feel less self-determinant (Frey and Jegen, 2001). If monetary rewards end up reducing intrinsic motivation, the net effect can turn out to be negative for the organization in question as a whole (Rynes et al., 2005). It can risk paying its employees more, but end up with less motivated employees.

“Deci and Ryan argue that when effort is exerted in exchange for pay, pay takes on a controlling aspect that threatens the individual’s need for self-determination” (Deci and Ryan, 1985, cited in Rynes et al., 2005, p. 575)

Rynes et al. (2005) also argues that monetary rewards can have a positive effect on intrinsic motivation, and thus give a positive net effect for the organization. If the reward system is designed so that it gives the employees a sense of being in charge of how they can perform their tasks, their perceived self-competence will most likely be high, thus they might feel that their employer rewards them for who they are, and not just for what they do.

2.2.5 Extrinsic motivation

Extrinsic motivation is motivation inflicted by external factors. Pay is usually defined as an external factor because it is given to employees as a way of motivating them to do a job, and to reward them for doing it. When employees know they will be paid for doing a certain job, they will do it as long as they value the reward high enough to weigh up for the “sacrifice” they make by giving up their leisure time or other alternative activities they could have filled their time with.

Motivation inflicted by external factors can often be considered as a more unstable form of motivation than intrinsic motivation (Frey and Jegen, 2001). One of the reasons for this is that external factors easily can be removed or inflicted by someone or somewhere else. This can make employees less committed to any specific organization or job, i.e. they will possess little organizational commitment.

2.2.6 Intrinsic motivation

Intrinsic motivation comes from the internal forces within people. Employees possess intrinsic motivation if they have a sincere interest for their work, or experience satisfaction from doing it, and possibly even experience a sense of responsibility for their work’s outcome (Bragelien, 2011). In other words, intrinsic motivation is motivation that is present even though no external motivational factors are influencing the employees in question, thus intrinsic motivation cannot be it “bought”.

*“Any motivation that is endogenous to the individual and/or to his behavior is intrinsic. When motivation is not provided by someone else, is formalized into a feeling, and/or is strictly linked to the activity performed, it is intrinsic”
(Bruno, 2013)*

If employees possess high levels of intrinsic motivation, they will likely put in higher levels of effort and precision in their job. When internal forces, rather than external, are driving employees, it is likely that they will do a more thorough job, especially if the job requires creativity and innovation (Ederer and Manso, 2013). A study conducted by Cinar et al. (2011) found that both intrinsic and extrinsic factors affects employees, but that intrinsic factors are more motivating than extrinsic factors. The study itself cannot be used for generalization purposes because of its limited data collection, but it supports the assertion that intrinsic motivation often is “better” than extrinsic motivation.

2.2.7 The interaction between intrinsic and extrinsic motivation

Individuals' actions and behavior can be said to be a result of a combination of their intrinsic and extrinsic motivation. As earlier noted, extrinsic motivation can often have an influence on intrinsic motivation, and this can have both positive and negative consequences. Several researches have concluded that in some occasions, adding extrinsic elements (for instance performance pay) to increase motivation can in fact reduce intrinsic motivation (e.g. Pfeffer, 1998). A known example is Titmuss' assertion that when blood donors were compensated monetarily for their blood, their will to donate fell because they started considering giving blood as not only a goodhearted favor anymore (Titmuss, 1970, cited in Gneezy and Rustichini, 2000, p. 792). Thus, employers should seek to find an optimal balance between intrinsic and extrinsic motivational factors for its employees.

According to Kuvaas (2008), intrinsic motivation is more effective than extrinsic motivation in jobs where quality, learning, development, understanding and creativity are considered as important elements, while extrinsic motivation is well suited for jobs characterized by standardization and where the tasks are of a more trivial and simple nature. He notes that intrinsic motivation is strongly related to work performance and organizational commitment, including extraordinary behavior (for instance mentoring and cooperation) and low turnover intention. Thus, intrinsic motivated employees should imply that the workplace in question is stable, and composed by employees possessing high organizational commitment. In addition, intrinsic motivation reduces job-related stress and absence due to sickness (Kuvaas, 2008).

Adding elements to increase extrinsic motivation, for instance give the employees a raise or other benefits, is often considered to be "the easy" solution. However, this may often have negative consequences. A better solution may be to attempt increasing their intrinsic motivation, as a higher intrinsic motivation correlates to higher effectiveness, at least for certain jobs (Kuvaas, 2008). Finding ways for the employee to be more self-actualized in the workplace (cf. Maslow's hierarchy of needs), or create a better balance between the employees' skills/knowledge and the challenges they face at work (Skretting and Solvang, 2007), are both ways of how an employer can increase intrinsic motivation among its employees.

2.3 Purpose/Design

In this subchapter, I will present how compensation systems composing performance pay can be designed. First, I address basic features of performance pay scheme design. Following, I address a few typical pitfalls and success criteria for performance pay schemes. Towards the end, I describe incentive intensity.

2.3.1 Compensation⁶

Compensation systems can be designed in several ways. Often, compensation systems can consist of a portion base pay and a portion performance pay, together forming the total pay. Base pay is often known as fixed pay, while performance pay typically represents a portion of the total pay that is put in place in order to motivate and to inspire to extra effort. There is no definite to how huge the two portions should be in relation to each other. People tend to be motivated differently (Kanfer and Ackerman, 2000), meaning that employees' perception of their compensation system, their risk aversion, and so on, are all factors determining how motivating they will find the system. However, some research on this matter has been conducted, and it is believed that a potential bonus or portion of performance pay should be equal to 5 to 10 per cent of the base pay in order to appear motivational (Heneman, Ledford, and Grisham, 2000, cited in Kuvaas, 2006, p. 376-377).

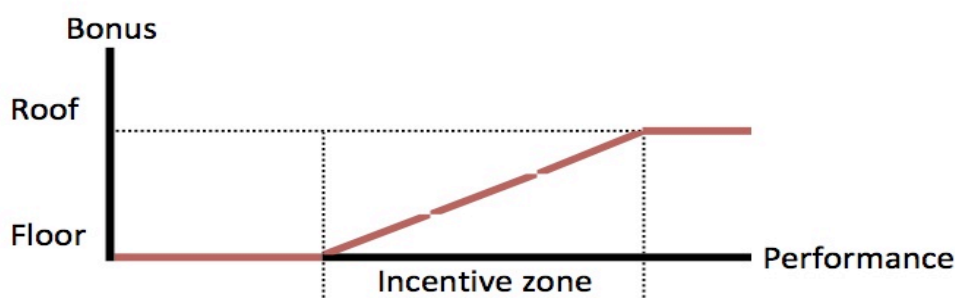


Figure 5 – Linear incentives (Bragelien, 2009)

⁶ Based on BRAGELIEN, I. 2009. Incentiver. In: HOFF, K. G. (ed.) *Strategisk økonomistyring*. Oslo: Universitetsforlaget.

A traditional performance pay scheme can be designed by using a floor and a roof, as can be seen in figure 5. The floor represents base pay, i.e. minimum pay, even if performance has been unsatisfying. The roof represents maximum salary, i.e. when full performance pay is rewarded. Under normal circumstances, the floor (base pay) should be set at a level where employees still will be able to maintain a minimum lifestyle. This is due to the general assumption of risk aversion, i.e. employees are not willing to accept contracts where they consider the risk of not being paid enough to cover essential expenses (the participation constraint must be overcome). The roof is usually functioning as a security mechanism for the employer so he won't risk having to pay unreasonably huge bonuses or performance pay if unforeseen events were to happen. If there is no roof for the performance pay, the employer will risk providing his employees with incentives for continuously working on certain tasks, even if they after a certain point no longer is profitable for the organization (Bragelien, 2009). When the roof, or the maximum performance pay, is met, there will no longer be any strong external incentives to focus on that particular task anymore, and the attention of the employees can be shifted to other assignments. The area between the floor and the roof is called the incentive zone.

Figure 5 presents a linear incentive system, showing that marginal higher pay compensates marginal performance improvement. However, performance pay systems can have various designs, and figure 6 presents an example of a system where performance and pay is stepwise related, meaning that performance has to improve to a certain level before it is reflected in the pay.

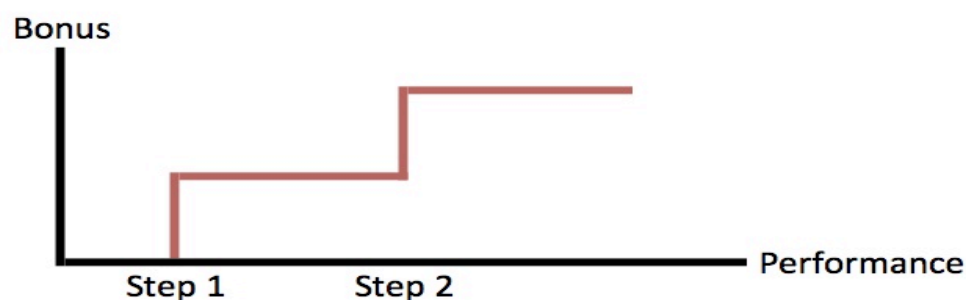


Figure 6 – Step-by-step incentives (Bragelien, 2009)

2.3.2 Design

A compensation system that includes a performance pay scheme can be designed in many different ways, and there is no one-fit-all solution that applicable for any kind of organization (Bragelien, 2003). For it to function as intended, the design should be tailored for each organization in order to fit its goals, purpose, and environment (Balkin and Gomez-Mejia, 1987). However, it generally seems to be a criterion for success that a compensation system includes a couple of key features. First, there should be a clear link between performance and effort, and second, pay should be linked with performance.

“Intelligent design must accompany effective implementation over time in order for pay systems to run effectively. In particular, two significant barriers must be overcome: barriers associated with linking performance to effort, and with linking pay to performance. In addition, these must be overcome in a way that is perceived as fair and equitable by management and employees alike” (Beer and Cannon, 2004)

According to Nordhaug (2002), there are 4 important criteria that should be fulfilled in order for a compensation system to promote efficiency and incentives for the employees it is intended for. These are:

- It should be perceived as fair by most employees,
- It should be understandable,
- It should contain factors that are within the employees control,
- It should be designed in a way that gives the employees a certain security for future income.

The first criteria, being perceived as fair, can further be divided into internal fairness and external fairness (Nordhaug, 2002). Internal fairness concerns relations within the organization in question. Roughly, it means that equal work should be rewarded equally. However, factors like education, experience, seniority, etc., should be considered, i.e. internal fairness must not be understood as equal pay for all employees working on the same hierarchical level. In a research, Garbers and Konradt (2014) found that equity distributed rewards lead to higher performance than equally distributed rewards, implying that those who performs well should be rewarded higher than those who don't, in order for the compensation system to motivate the high-performing employees.

External fairness concerns relations outside the organizations. Organizations should be able to relate to similar organizations operating in the same sector and geographical areas. In order for the compensation system to be perceived as fair, rewards and pay should be equivalent to the standard pay levels of the organizations' counterparts. Employees should, and will, expect to be paid accordingly to their "market value", and if competing organizations pay their employees more, the best employees might be tempted to transfer, and go work for them instead, thus the organization in question might lose its best employees. On the other hand, if an organization pay much more than its competitors, it will likely lose competitiveness (Nordhaug, 2002). Thus, it will be important for organizations to keep track of their competitors' pay and reward levels.

Measurement problems

There are several factors that can reduce the quality of performance pay schemes. For performance pay to be effective and profitable for an organization, it should have a clear perception of what needs to be measured, and how it can be done in fairly and efficient. In order for measuring performance correctly, one should make sure factors that can interfere with the quality of the results are minimalized, i.e. consider that what is measured is what actually creates value. There is little or no value for organizations in giving performance pay to their employees, if what the employees actually do does not create any particular value.

Complicated design

That employees understand the compensation system can be crucial in terms its success. The features of it should be clear, and they should easily be able to see and comprehend what level of performance and effort is expected in order to receive any performance pay. If they are not able to do so, the incentive effect will likely be low or non-existent (Nordhaug, 2002).

Below is presented a few of the reasons for why a compensation system can be unsuccessful because of its design:

- Combined individual and collective performance criteria

Compensation systems can be based a combination of individual and collective criteria. If, for performance pay to be rewarded, all of them need to be fulfilled, the system might easily become complex. The link between individual performance and pay may seem unclear, thus the incentive effect can be reduced. Typically, this can

be a problem for organizations that are characterized by employees who don't trust each other. When an employee doesn't fully trust that his colleagues will perform at the desired level in order for the group to meet the collective criteria, he may feel that putting in any extra effort himself is useless.

- Too detailed

When there are only a few performance criteria determining whether performance pay will be rewarded, the link between pay and performance are likely to seem clear for most employees. However, narrowing down all the important considerations an organization has to take into a few simple criteria might be difficult. Easily, the design can be too detailed, because one hopes that the compensation system will manage to cover all the considerations. The problem arises when the criteria the employees are measured by becomes too complicated, i.e. when they contain too much information for them to handle. Thus, employees may spend too much time trying to figure out how to optimize their effort in order to maximize their pay, typically time that could have been spent on actually working. A too detailed design will likely reduce the direct incentive effects severely, thus making the system worthless (Bragelien, 2009).

2.3.3 Intensity

The incentive strength, or incentive intensity, is something that should be considered when using performance pay schemes. What is optimal strength in one situation or in one organization is not necessarily the optimal strength in another. Typical factors that should be considered when attempting to find optimal incentive intensity are: value of employee effort, importance of sorting, measurement error, risk aversion, trust and subjectivity, distortion and multitask incentives, and potential manipulation (Lazear and Gibbs, 2009). Below is presented a thorough discussion of risk, and how different perspectives might affect the optimal incentive strength.

Risk

One differs between controllable and uncontrollable risk (Lazear and Gibbs, 2009). Controllable risk is risk within an employee's control, while uncontrollable risk refers to the risk that is beyond the employee's control. It is usually accepted that employees expect to be compensated for the uncontrollable risk, also known as the controllability principle (Giraud

et al., 2008). However, controllable risk is usually not specifically compensated because employees themselves should be expected to be aware of it. Employees can normally be expected to have specific knowledge and understanding of the business they operate in, thus they should be able to foresee many of the uncertain aspects of their job and take their precautions accordingly.

Perspective

For any organization, the different stakeholders' risk perspective varies depending on their relative position. Typically, owners tend to have a more long-term perspective, thus they will make decisions in regards to what will most likely be the best possibility in order for the value of their organization to be as high as possible, i.e. maximize net present value. Employees and lower level management however, may tend to think more short-term as they might not see themselves spending their whole career with one particular organization. This means that employees on lower levels can have incentives for maximizing their employer's short-term value, and thus not act in order to maximize its long-term value, as it will not have any consequences for them personally.

When measuring employees' performance, most performance indicators measure only the most recent happenings (Lazear and Gibbs, 2009). In other words, they rarely measure the long-term consequences of the actions and decisions made today. This means that employees will have stronger incentives for making decisions that generate income today rather than in the future. As Lazear and Gibbs (2009) notes, postponing rewards to see whether the actions and the behavior generates long-term value for an organization is risky, because there are no guarantees that their employees will be staying with the organization for that long, and thus making it riskier for the employees. In other words, if the time gap between performance and reward becomes too long, the incentive effect of the rewards may be weakened. Additionally, when the time gap becomes too long, employees may experience problems linking pay to effort and performance, thus violating the two previously mentioned critical barriers stressed by (Beer and Cannon, 2004).

2.4 Evaluation

In this subchapter, I will address how employees and their performances can be evaluated. First, I will address three levels on which evaluations can be conducted; organizational,

team/group, and individual. Secondly, I will address subjective and objective evaluations, and finally, objective and relative evaluations will be addressed.

2.4.1 Level

When evaluating its employees, organizations have to decide on which level it will be done. Typically, this is done on one or more of these three levels; an organizational level, a team- or group level, or an individual level.

Organizational

Evaluating and rewarding employees on an organizational level means that the whole organization's results are used as a basis for the rewards. Based on the organization's profit and/or other measures and metrics, an executive bonus can be rewarded and shared between all employees. Typical performance indicators can be financial metrics like EBIT or EVA (Economic Value Added)⁷.

The incentive effect of evaluating on an organizational level is debated, and whether such evaluations are successful or not depend on the organization itself, and the environment and company culture (Bragelien, 2012a). Yet, it is believed that when organizations are huge, the direct incentive effect of executive bonuses is little, because the link between effort, performance, and rewards will likely be weak. And as is addressed in the previous subchapter, if a compensation system is to have strong incentive effects on individual employees, the rewards should be directly linked to their effort (Bragelien, 2009). However, because an organization's annual profit is a result of a lot of many factors, the employees might find it difficult to observe the relation between their effort and performance, and the organization's total performance and results.

However, organizational level evaluations can incite team spirit amongst the employees and give them a sense of working together as a unit towards a mutual goal. Additionally, broad cooperation and knowledge sharing is more likely to happen in organizations that evaluate on an organizational level (Van Alstyne, 2005).

⁷ EVA™ by Stern Stewart

Group/team

A team within an organization can be defined as a group of employees working towards a mutual goal over a certain period of time, where the employees have differentiated roles and tasks, and a mutual responsibility of achieving the goal (Hjertø, 2008). Hollensbe and Guthrie (2000) define a group performance pay plan as a plan where compensation varies as a function of performance achieved by a group of employees.

By rewarding their employees on a team-based level, organizations may put themselves in a position where they are better prepared to solve complex and widespread tasks than what they would be if every employee were working on their own, because the employees will have incentives to help each other. Being organized in teams might help break down barriers between employees, as cooperation usually is a key factor when determining a team's success. Success should not only be considered in terms of revenue, but also in terms of the learning and the development that occurs as the team-members work together (Hjertø, 2008). Thus, organizing in teams should preferably incite cooperation and knowledge sharing.

When organizing in teams, the teams' sizes should be considered. There is no definitive, but the general assumption seems to be that smaller teams are to be preferred to bigger teams. Hollensbe and Guthrie (2000) finds that when teams are small and thus easier to monitor, team-members tend to show more commitment to the goals set for the team than what is the case in bigger teams. Additionally, a lot of research has been done in relation to how well team-based evaluations and rewards work in regard to performance. Garbers and Konradt (2014) concludes that the effect on performance of team-based rewards is stronger in smaller teams. They found that as the number of team-members increased, the effect of team-based rewards decreased. Generally, the reason for why team-based rewards will likely be more effective in smaller teams is that the team-members will have a greater influence on the performance. Naturally, the effort put in by a member of a team of 5 has a greater impact and influence on the performance than that of a member of a team of 20.

Free rider

Free riding is a problem that can occur when a group of employees, *a team*, is evaluated only by their collective performance. As the team-members won't be evaluated on an individual level, they might find it tempting to shirk. This is due to the fact that even those who perform poorly, i.e. who do not put in the desired level of effort, in the end will receive the same rewards as those who do. Often, this means that the other team-members will have to

compensate for the shirkers' lack of effort and performance. According to Zenger and Marshall (1995), employees organized in smaller groups have the possibility of monitoring the other team-members' effort. Thus, if they find it to be unsatisfactory, the underperforming colleagues can be sanctioned or punished.

Free riding problems are also a great concern for organizations as a whole. When team-members shirk, or act as free riders, the organization in question will not get full utilization of its employees. Several studies point to the fact that the problems of free riding increases as the groups get bigger. The bigger the group, the bigger the problem (Hollensbe and Guthrie, 2000). If a group is doubled in size, the estimated reduction in gain per employee is as much as 25 % (Zenger and Marshall, 1995), thus indicating that organizing employees in big groups or teams may dramatically reduce the utilization of their knowledge and skills. Thus in order to exploit every employee's skills and knowledge, they should be organized in smaller groups. Hoon and Tan (2008) finds that the perceived responsibility of a task is strongly related to social loafing. In smaller groups or teams, every member's effort tends to be more evident and transparent. Thus, team-members in small groups will likely be more aware of their responsibility in terms of not letting the other team-members down, and they will consider themselves as more responsible for the performance than what would be the case if they were a part of a bigger team.

Individual

An individual evaluation offers organizations the opportunity of rewarding their employees based on personal performance and their contribution to the organization. By being evaluated individually, employees are given feedback on how their effort and performance is directly affecting their organization's performance. Free riding will not occur because shirk and reduced effort will be reflected in the evaluation of the employees, and in the rewards they are given. Thus, individual evaluation may appear motivational for employees in terms of having them put in the desired level of effort.

Scorecards are one way of evaluating employees on an individual level. A scorecard can clearly identify and specify individual performance indicators, and it should guide the employees in their daily work. Scorecards can be designed in several ways, but one usual way is to use a "traffic-light"-system. A traffic-light system gives an indication to where the employees stand in relation to achieving the targets set for them. When grading the level of achievement by the colors of a traffic light, the employees will know in which areas they

have performed well, and in which they have not performed as well as anticipated. The red zone usually indicates that the target is yet to be met, the yellow zone indicates that target is met or within reach, and the green zone indicates that the target is met or even surpassed.

Individual evaluations may in some occasions have a negative side effect. Cooperation and cohesion may suffer, as the employees will focus their attention to manner of self, thus individual performance evaluations may promote competition between employees (Rothenberg, 2011). This means that employees will keep valuable information and knowledge to themselves instead of sharing it with their colleagues, in order to increase their own performance. This is an especially valid point if the employees are evaluated relative to each other (this issue will be further addressed later).

2.4.2 Objective and subjective evaluations

In this section, I will address different criteria employers can use in order to evaluate their employees. When using performance pay, employers have to decide how to evaluate their employees, and it is often difficult to find the optimal measures (Baker, 1992). Normally, one differs between subjective and objective criteria and evaluations.

Objective

An evaluation of employees can be conducted by only using objective criteria. This means that employees are evaluated based on predefined target indicators, and to what extent these criteria are fulfilled by the end of the evaluation period. If they are fulfilled, the employees are likely to get a good evaluation, whereas if they are not, they may get a negative evaluation.

Objective criteria are usually characterized by being easily observable. Objective criteria can be simple economic figures and financial metrics, or other non-economic figures like for instance number of sales or customers acquired. These numbers are not just easily observable; they may also represent a major part of the value creation in organizations.

There are several positive aspects of using objective criteria in evaluations, and one of the most important is how employees usually perceive them as fair (Bhattacharjee, 2005). For motivational purposes, it can be crucial that the compensation system is perceived as fair, as it assures employees that they will be evaluated based on their actual work and work-related performance, and that the evaluations are not influenced by personal relationships. But as

Bragelien (2005) notes, when an organization is composed of more than one team or division, a perception of unfairness can easily arise if they are rewarded unequally, or if one of them receives benefits while the others don't. This was further addressed in the *Purpose/Design* subchapter.

Because objective criteria often are perceived as fair, many employers tend to prefer using them when evaluating their employees (Baker et al., 1988). However, identifying the correct and optimal criteria and individual goals can often be difficult. Baker et al. (1988) argues that even though the employer has a clear perception of what he wants the employee to deliver in terms of performance, the range of possible actions the employee can take, and the range of possible outcomes the actions can lead to, is enormous, thus making it difficult for the employer to decide what to measure, and not at least how.

Subjective

Adding the element of subjectivity to evaluations enables employers to evaluate their employees not only by measurable and quantifiable indicators, but also by factors like for instance quality. As organizations attempt to adapt to the continuously changing environment of which they operate in, flexibility can be a key factor. Rigid compensation systems, where employees are evaluated strictly by objective criteria, may be destructive in terms of flexibility because employees may have little short-term incentives for "thinking outside the box".

By using subjective evaluation criteria, in addition to objective criteria, it is easier to reward employees for thinking ahead of time and for being innovative. According to Lazear and Gibbs (2009), employers should hold employees responsible for events that are, or at least should be, partially within their control. Thus, paying attention to what the competitors are doing and to the changing environment, are activities employers can expect their employees to do, at least to a certain degree. These are typical tasks that are hard to measure; therefore subjective evaluations might incite proactive thinking and explorative behavior, thus helping the organization avoid falling behind compared to its competitors. Ederer and Manso (2013) conducted a research that, amongst others, compared employees working under a fixed pay contract and employees working under a pay-for-performance contract. They found that those working under the pay-for-performance contract were less explorative in their work compared to the others, and explained this partially by the fact that the risk of failing are more critical when working under a pay-for-performance contract. Thus, if employees are

evaluated subjectively, employers are able to reward them for their effort, even though the effort sometimes leads to non-successful performances.

In addition to letting employers' reward innovative and forward-thinking behavior, subjective evaluations give them the possibility of rewarding employees for their contribution to the small, everyday tasks like cooperation, encouraging colleagues, and sharing knowledge, all of which are tasks that might be important for the organizations' success, even though they by themselves cannot be directly converted into income.

The drawback of subjective evaluations is that they, in order to be successful, should be based on trust between employees and their employer. Often, employees tend to overestimate their own performance and importance - known as self-enhancement bias (Pfeffer et al., 1998), and this might easily lead to mistrust among employees.

“The more subjective the measure, the higher the degree of trust needed, because without high trust there is little chance that the subordinate will believe that his pay is really fairly based on performance” (Lawler III, 1971, cited in Baker et al., 1988, p. 598)

Multitask problems

Multitask problems, or distortional effects, are something that can, and often will, occur when using a compensation systems that include performance pay. With a performance pay contract, employers can precisely decide what their employees should focus their attention to. The employees will, due to the performance criteria in their contracts, know how to maximize their own pay and given that they act rationally, they will attempt to do so. Other tasks may be neglected, typically the tasks that are not directly measured (Holmstrom and Milgrom, 1991). In turn, this can be destructive for their organization, especially in a long-term perspective. A performance pay contract should be designed so that employees' interests and goals coincide with those of their organization. However, this is difficult due to several reasons (Baker, 1992), and thus negative distortional effects will often occur.

It can be assumed that most employers would find it easy to measure their employees based on short-term objective criteria, for instance if they have sold as much as expected, or if they have acquired as many new customers as expected. However, as earlier noted, measuring the quality of these sales, or the profitability of these new customers, requires more effort. These are factors that can be important in the long run, as high-quality sales likely will lead to fewer complaints and more satisfied customers. Satisfied customers are naturally more likely

to be returning customers, and maybe they even will boast about the organization to their friends and relatives, thus generate a larger potential customer base. There are several reasons for why loyal customers may be considered more valuable to employers than employees, (among others their different perspectives) implying that employees who are evaluated based on short-term objective criteria are likely to have incentives to focus less on quality and more on quantity.

By using subjective evaluation criteria in addition to objective criteria, employers will most likely manage to reduce some of the negative distortional effects. Lazear and Gibbs (2009) notes that using subjective evaluations, either alone or in combination with objective criteria, can improve the quantitative measures, in addition to giving employees incentives to act appropriately in terms of risk-taking, improving internal decision making amongst employees, giving compensation systems more flexibility, helping expand communication at the workplace, and helping improve training and learning processes that takes place in organizations. In other words, it can influence employees to focus their attention to all aspects of their organization, and not just those that directly generates income.

2.4.3 Absolute versus relative evaluations

Employers can evaluate their employees by absolute standards/measures, or by relative standards (two extremes). When using relative evaluations, every employee is evaluated in comparison to their colleagues. Relative evaluations give employers the possibility of predefining a set number of employees to be rewarded by for instance a raise or a promotion. But this gives employers limited control over the quality of the performances, as there are no lower limits of what will be considered minimum performances. A worst-case scenario will be if no one performs well enough for their organization to make a profit; yet still those who perform best will be rewarded.

However, a situation like the one described above may seem a little unrealistic. Relative evaluations can be preferred if, for instance, the organization in question has a set number of positions to be filled, and it wants to fill them through inside recruitment, or that it has a bonus pool that is to be divided between a set number of employees. A potential drawback of relative evaluations is that it might give employees incentives for sabotaging each other's performances. Relative evaluations can have a negative effect on co-workers willingness to cooperate, and share information and experiences (Mookherjee, 1984).

By using absolute standards, several of the problems that are associated with relative evaluations can be avoided. Absolute standards ensure that every employee that is rewarded actually has performed well, or at the desired level. Therefore, organizations can be sure that those who are rewarded actually have performed well enough for them to earn. The problem of absolute standard evaluations are that if the measures are set too low, i.e. that too many employees reach them, or if they are set too high, i.e. that none or too few reach them. The former can be a problem because employers might have to give rewards to everyone, thus the incentive effect of the rewards likely will be reduced. The latter can be a problem because the average employees will find the targets to appear unreachable, and the rewards will have little incentive effects because they might feel a sense of hopelessness and not even bothering trying to reach it. However, by using absolute standards, the chances of experiencing unhealthy internal competition between employees are likely to be reduced. As long as the employees reach the measures or targets, there should be no need for them to sabotaging for their colleagues (Lazear and Gibbs, 2009).

2.5 Career/fixed pay

Even though a lot of theory emphasizes the advantages of performance pay, certain jobs and organizations can, and most likely will, be better off by using fixed pay schemes. As earlier noted, several scholars have found arguments for why performance pay can work on the contrary of its intentions, especially if it is not optimally designed. It can often be difficult to design a performance pay scheme that is simple enough for every employee to fully understand and for them to see how their effort correlates with the rewards they are given, and that in the same time is precise enough to avoid multitask problems.

According to Lazear and Gibbs (2009), internal promotions can have two important roles: the role of sorting, and the role of providing incentives. In a career perspective, promotions can work as a sorting device because good performers will be rewarded for their performances and maybe promoted to higher hierarchical levels. That implies that good employees, if they are promoted, will gain more and more influence, and can participate in strategic decision-making. In addition, the possibility for employees to achieve a “better” title or a higher-level position can motivate them to perform better, thus providing them with incentives for doing a better job.

2.5.1 Why careers?

What kind of compensation system that will be optimal for a particular organization will depend on the level of value commitment its employees feels towards their workspace (Deckop et al., 1999). Organizations can use careers and career paths as a way of rewarding their employees. Career paths may have a motivational effect on employees because they will feel that they can have a possible future at their organization, and it increases their possibility of planning their professional future. Lawler III and Finegold (2000) describe the concept of individualizing the organization. By that, they mean how employees can feel like their jobs are customized in order to match their expertise and skills (see review of three career systems below). In turn, this might lead to stronger organizational commitment, as employees may think of their employer as someone who actually trusts them and consider them to be a part of the future of the organization.

Further, this section will address some of the most interesting aspects of careers, and why employees might be interested in having a career at one particular organization.

Motivation

The possibilities of having a career can be a great motivational factor for employees. When organizations operate with defined career plans and systems, employees will be able to see the requirements for which levels of performance, knowledge, and effort that are needed in order to get promoted. Many will consider this as highly motivational (Nordhaug, 2002).

When deciding on filling an open position either by promoting an internal candidate or by hiring externally, organizations should consider the possible upsides and downsides of both options. According to Chan (1996), opening up a position for external candidates reduces in-house employees' possibilities of climbing the organizational ladder, and therefore reduces their incentives for working harder. Thus, opening up available positions to the public can lead to less motivated employees on lower levels.

Attract and retain employees

The possibilities for having a career and a possible future at an organization are factors that graduates and other candidates consider when applying for jobs. According to Nordhaug (2002) and Lazear and Gibbs (2009), the possibilities of having a career can function as a sorting device because many well-qualified workers will find it attractive and thus apply, while in-house employees will see that they have possibilities for both personal and

professional development within their organization, thus they will be more attracted to stay with at organization instead of seeking out to other employers. Predefined career ladders can increase the visibility of various possibilities that exist in-house, and they can reduce intended labor turnover (Nordhaug, 2002).

Experience and firm-specific knowledge

Maybe one of the most sensible reasons for why organizations should promote in-house employees is that they possess firm specific knowledge (Chan, 1996). When employees spend years at the lower levels at their organization, they will gain experience and become an integrated part of the organizational culture. Given that the culture is positive, and that the employers in question wish to maintain it, promoting in-house employees can make the integration of new employees smoother.

“Accumulation of firm-specific human capital usually involves joint investments by both the employer and the employee, so that both parties have the incentive to maintain a long-term relationship” (Chan, 1996)

Many jobs involve training of employees. Often, employees will learn about their job and their organization as they work, and it is not uncommon that new employees go through a training period in their first months or years after being hired, especially if they have little or no professional experience from previous jobs. Giving employees career possibilities can reduce the risk of investing a lot of money in employees who will leave once they are fully “educated”. It is often inferred that employees are profitable first after they have worked for a few years, thus it might be very valuable to organizations to keep trained employees after their learning period is over.

2.5.2 Structure

Career paths

When using career as an incentive mechanism, it is important to define how to decide whom to promote. According to Lazear and Gibbs (2009), this can be done in one of two ways: tournaments or absolute standards (addressed earlier, see absolute versus relative evaluations). Tournaments are used when a set number of employees are to be promoted, and who is promoted is decided on the basis of the employees performances compared to that of their colleagues. If, for instance, two positions have opened up on a higher level, the organization in question will offer their two best performers on the lower level a promotion. On the contrary, if organizations decide to use absolute standards, they predefine a goal or a

target, and every employee who either reaches it or surpasses it will be offered a promotion. Sometimes, this means more employees will “earn” a promotion than what is available on the higher level. Thus, new positions might have to be created. Other solutions can be to delegate more responsibility or to give more advanced tasks to those who perform well.

However, a problem that may arise when promotions are used as incentive mechanisms is that there are few guarantees that good performers on lower levels will be good performers also on higher levels. Thus, this should be given some consideration before deciding to solely use careers for incentive purposes. Chances are that organizations can risk promoting good lower level employees who turn out to be poor on higher levels, thus organizations can risk reducing the quality on their lower levels without gaining that same quality on their higher levels. According to Lazear and Gibbs (2009), it can not be taken for granted that the best performer at lower levels will be the best performers on the higher levels as well.

Career phases

Nordhaug (2002) has divided careers into three phases. First, employees choose a career, e.g. they decide which area they will focus on, and adapt to the needs and requirements of the organization they work for. Secondly, they decide whether they should specialize on a certain field or at an organizational position, or if they should just stay at a more general level. Finally, when their careers are approaching their ends, they will likely focus their attention to guidance of younger employees, and prepare for their retirement. All of these phases represent different stages of individuals’ careers, and organizations will have to adapt to the different stages in order to get full utilization of their employees, and for keeping their employees motivated. At the different stages, organizations will have to relate to their employees differently in terms of guidance, freedom, etc.

Career systems – vertical or horizontal

Nordhaug (2002) describes three ways of how a career system can be designed. These are monolithic, monolithic and lateral, and network systems.

A monolithic system is when the career paths follow a direct ladder. Thus, this design is used when employees are moving from one level to the next, all in the same area or division. For instance, promotions across divisions and organizational areas are likely not to happen, the employees move strictly up the ladder of the division they are already working at.

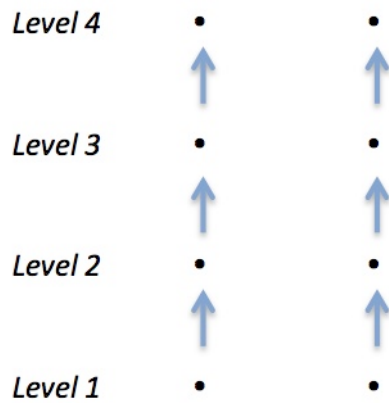


Figure 7 – Monolithic system (Nordhaug, 2002)

A monolithic and lateral system is a mix, where promotions are given vertically within the same division, but horizontally across divisions. This means that employees can be promoted to the next level at their division, or they can be “promoted” to the same level at a different division.

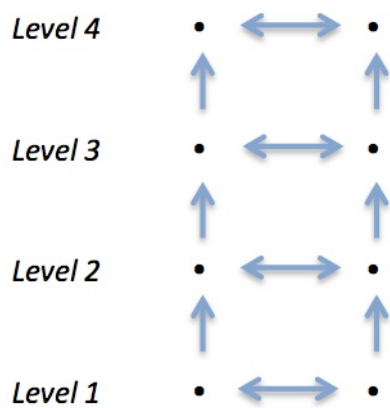


Figure 8 – Monolithic and lateral system (Nordhaug, 2002)

A network system refers to the design where employees can be promoted vertically within their division, horizontally across divisions, and diagonally across divisions and levels.

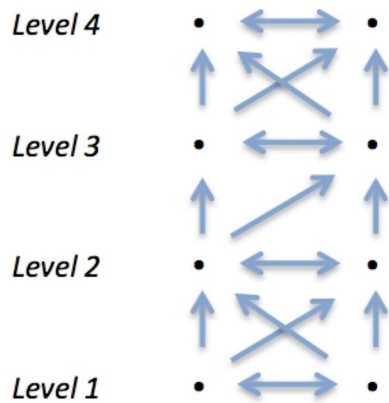


Figure 9 – Network system (Nordhaug, 2002)

2.6 Summary

Finally, I will present a brief summary of the theory chapter, where I see the different subchapters and theories in context to each other.

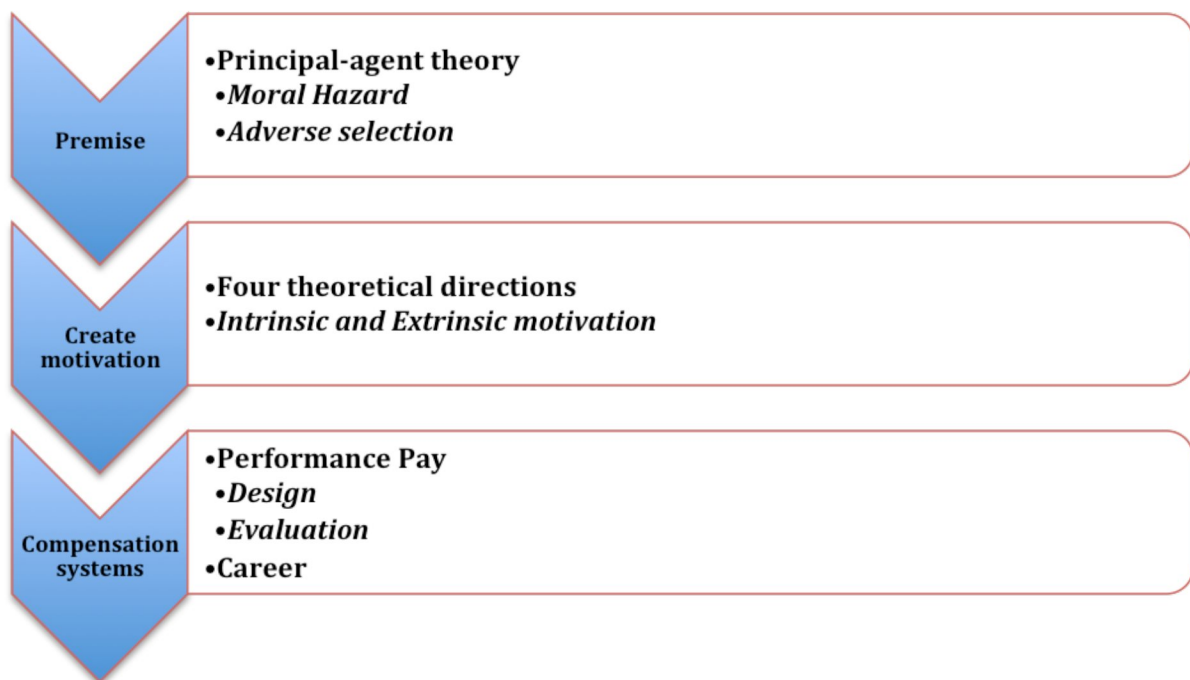


Figure 10 – Summary of chapter 2

The figure above shows that the chapter started by giving a review of the premise for incentive and pay theory, namely principal-agent theory. As noted, it concerns problems

related to moral hazard and to adverse selection. Further, I addressed theories concerning motivation. Motivation is an important topic because properly motivated employees can increase the chances of avoiding several of the problems related to principal-agent theory, maybe especially moral hazard. I addressed four groups of motivational theory; needs theories, cognitive theories, social theories, and job characteristics theories, in addition to addressing the differences between intrinsic and extrinsic motivation. Further, I reviewed various topics of how compensation systems can be formed in order to avoid several of the principal-agent problems. Mainly, I focused on performance pay, and how such schemes could be formed, both in terms of design and evaluation methods. Finally, I addressed theory concerning careers, and how compensation systems based on it can be formed.

3. Methodology⁸

Generally, a research is conducted for one or two purposes, either to describe a defined situation, or to measure the effects of a certain initiative.

Methodology refers to how the research is conducted. It explains how the data is collected, how it is processed, how it is analyzed, and how it is interpreted. By following a set methodology it should be easy for third parties to verify the results.

According to Jacobsen (2005), a research process consists of 8 steps:

1. Develop a research question
2. Choose research design
3. Choose methodology – qualitative or quantitative
4. Gather data
5. Choose units
6. Analyze the data gathered
7. Critically question the conclusions made
8. Interpret the results

When a research is conducted, the researcher should make sure the data found are both valid and reliable (Jacobsen, 2005). This applies no matter which design is used or type of data that is gathered. Validity refers to whether the research measures what it is supposed to measure, and reliability refers to whether the findings can be trusted. If the same research was to be conducted over again, the researcher should be able expect results that are very much alike those already found.

3.1 Research question

Jacobsen (2005) names three necessities for defining a good research question. It should be interesting, it should be simple and easy to understand, and it should be possible to answer, in addition to provide new knowledge.

⁸ Based on JACOBSEN, D. I. 2005. *Hvordan gjennomføre undersøkelser?*, Kristiansand, Høyskoleforlaget.

3.2 Design

There are three basic types of research design. The design used for a specified research should depend on which type of research that is conducted, what the researcher expects to find, and other characteristics of the research.

3.2.1 Explorative

Explorative design should be chosen if the researcher don't know much about the topic or research question in general, and the purpose of the research is to achieve new knowledge and a better understanding of the topic. Generally, this design is preferred when a new research is started because it gives the researcher valuable information about the topic of the research.

When explorative design is used, the researcher usually gathers primary data by conducting in-depth interviews and group discussions, in addition to collecting secondary data in order to gain more knowledge.

3.2.2 Descriptive

Descriptive design is used when the researcher has a general knowledge about the topic and research question to begin with. The primary objective is to describe a specific topic or phenomenon. Descriptive design requires defined specifications for how, when, and why the research is conducted. Jacobsen (2005) names 4 different types of descriptive designs.

- Cross section studies (the situation at a given time)
- Time series studies (the development of a set of units over time)
- Cohort studies (the development of a defined group over time)
- Panel studies (the development of individuals over time)

Descriptive research is usually carried out by handing out a survey to a representative sample, or by doing frequent observations of the sample in question over time.

3.2.3 Casual

Causal design is used when the researcher seeks to find causal relationships. It is typically used when the researcher finds an interesting observation, and wants to explore whether the observation is caused by a previous situation or condition. The researcher predicts that the observation he made was a direct consequence of a specific incident, and he wants to see whether this assumption is correct.

There are strict rules for how to design a causal research. First, there needs to be a covariance between what is expected to be the cause and what is expected to be the effect. Further, the cause needs to occur before the effect in time, and there should be a timely closeness between the cause and the effect. Finally, one should control for other possible causes that could be of relevance to the effect (Jacobsen, 2005).

3.3 Types of data

Generally, one differs between two types of data. These are primary and secondary data. Primary data is data that is not already discovered, hence it must be found first hand. Secondary data is data that is already found, but that usually needs to be processed and adapted to fit the analysis.

3.3.1 Primary data

Primary data is generally divided into two groups. According to (Jacobsen, 2005), these groups should not be seen as counterparts but rather as two extremes on a scale.

- Qualitative data

Qualitative data is preferred when the researcher has limited knowledge about the question he seeks to address (Jacobsen, 2005). There are usually uncertainties of which variables that could be expected to explain a phenomenon. When using qualitative data, the researcher wants the units' (interviewees') opinions and perceptions of the topic, and not necessarily measurable data.

- Quantitative data

Generally, the researcher knows precisely what he wants to know when using quantitative data, i.e. he is experienced in the field and has knowledge about the topic in question. One of the benefits of using quantitative data is that the results often can be measured and used for generalization purposes, given that they are statistically significant.

3.3.2 Secondary data

As already noted, secondary data is data that already exists somewhere, and that needs to be reprocessed before used in a new research. Secondary data is generally divided into internal and external sources. Internal sources refers to the data the organizations or the particular groups in question have collected themselves, and external data refers to data that outside sources have collected. Internal sources can for instance be annual reports and other internal documentation, and external data can be statistics or reports published by public agencies.

3.4 Chosen methodology

As the topic of this thesis is the effects of discontinuing performance pay, the design was first and foremost explorative. Before conducting this research, I had minimal knowledge and information about how performance pay “worked” at SpareBank 1 SMN in terms of motivating the employees, and how they took it when it was discontinued, thus an explorative design was the optimal design.

As coincides with theory on explorative design, qualitative data was the main source of data. I sought to acquire information about the perceived effects of the performance pay scheme, to what extent it was motivational, and what effects followed due to its discontinuation. I conducted in-depth interviews with 17 employees in order to acquire this information.

The interviews were conducted with a combination of open-ended questions and more specific questions with predefined response options (see attachment 1). This was done in order to generate a few measurable responses, in addition to letting the interviewees explain their views and opinions in detail. I should stress the fact that the interviews were in general addressing the most recent performance pay systems, i.e. from 2012 until today. The terms bonus and performance pay were used interchangeably during the interviews, but unless otherwise is noted, the questions and answers concerns these systems (see chapter 4 for a

detailed review). The first section of the interviews was an introductory section, where the interviewees could explain their views and opinions of bonuses and performance pay, in addition to their general perception of the compensation systems that have been used at SpareBank 1 SMN in recent years. The main section of the interviews was more specific. The interviewees were asked questions in order to reveal their attitude towards work, and how the changes to the compensation systems affected their motivation and how they conducted their work on an everyday basis. The structure of the main section was based on the five key questions set forth by Bragelien (2005); did it make the employees work harder, did it make them work smarter, did it make them take better decisions, and did it attract and retain talent.

An important notion is that the interviews were conducted over a time span of two weeks. During those two weeks, the market area's manager held individual meetings with the employees, informing them about the details of the new career model. This implies that the knowledge about the career model and what it entails varied among the interviewees because some of them were interviewed before they had the meeting, while some were interviewed after. The positive sides to this, is that the sample could be divided into two groups. One that had a clear insight to the new career model, and another that by the time of the interviews knew very little about it. As the Værnes-region consists of three branches (Stjørdal, Malvik, and Meråker), it was easy to differ among those who had information about the new career model and those who didn't. All interviewees from the Stjørdal and Meråker branch had very limited knowledge, as they had yet to have their personal meeting. At the Malvik branch, however, all 6 interviewees had already had their meetings by the time of the interviews, meaning that they had more knowledge and information about it.

In total, 17 interviewees were interviewed. They all work in the Værnes-region market area of SpareBank 1 SMN, and they represent a broad diversity when comes to age, sex, experience, education, and seniority. This gave me the possibility of investigating whether these factors were of importance to the data collected, and if there could be observed differences between the branches in this market area. However, due to a small sample of interviewees, the external validity of the findings will be limited.

The interviews were taped and transcribed in order to get the qualitative data correct, and to get the possibility of using quotes in the following chapters. In addition, because the interviews were taped and transcribed, they can support the reliability of this research

because the risk of miscommunication and misconceptions is minimalized. The interviews were done in Norwegian, thus the quotes rendered in chapter 7 are translated.

Prior to the interviews, I had several meetings with the market area's manager, Inge Grøntvedt, and two meetings with SpareBank 1 SMN's head of Human Resources, Irmelin Andersen. These meetings were held in order to discuss the thesis in general and for me to learn and obtain essential information about the bank, and the different compensation systems used in recent years, including the new career model. Additionally, I learned about how the bank's management perceived the performance pay schemes, and how they believed the discontinuation was received by the employees.

4. Presentation of SpareBank 1 SMN

As a thorough presentation of the bank itself was given in chapter 1, it will not be repeated here. However, this chapter will present the bank's compensation systems in recent years. Mainly, this thesis addresses the two years prior to the elimination of performance pay and bonuses at SpareBank 1 SMN, and the most recent year, where the employees only have received fixed pay.

4.1 SpareBank 1 SMN compensation systems

SpareBank 1 SMN has over time had various compensation systems. From early on, they operated with executive bonus for all employees. This compensation system was later revised, and SpareBank 1 SMN started implementing different performance pay schemes depending on which division the employees worked at. The data I was given access to (the compensation systems from 2012 and later) shows that in 2012, PM (Private Market) and CO (Corporate) had different compensation systems, and the employees were evaluated differently. For PM, the performance pay was rewarded based on a mix of team-based and individual evaluations, using scorecards to determine how well the employees had performed. For CO, they solely relied on team-based evaluations. In 2013, the compensation system was revised again. From 2013, also PM was to be evaluated based on team performance. However, the revised scheme of 2013 was recommended eliminated in the summer of 2013, meaning that the effects of this scheme could be hard to measure due to the schemes short timespan. A short period of time followed, where no definite compensation system was applied (meaning that the employees were only paid fixed pay), until the new compensation system, the career model, was developed and implemented in 2014, see Figure 11.

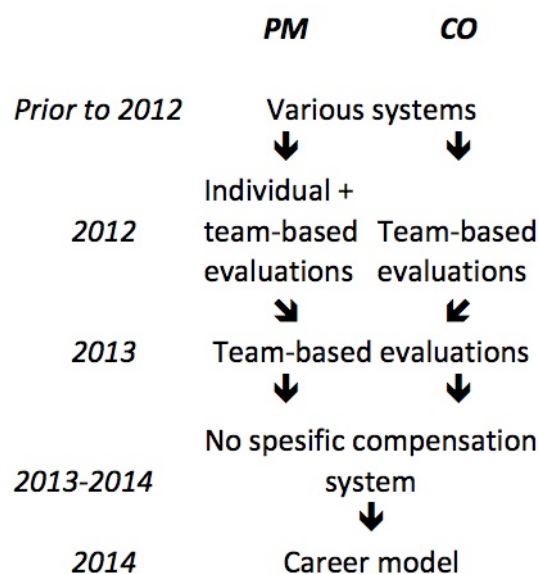


Figure 11 – SpareBank 1 SMN’s compensation systems

According to SpareBank 1 SMN’s remuneration policy of 2012, a performance-enhancing remuneration scheme was an important strategic instrument⁹. As the competition for recruiting and retaining skilled workers were continuously increasing, the remuneration were to help strengthen the competitiveness of SpareBank 1 SMN. All rewards that were given by SpareBank 1 SMN should have contributed to, and encouraged, desired behavior and goal achievement.

4.1.1 Compensation system 2012¹⁰

Principles of the compensation system

First of all, the system was meant to motivate employees to act accordingly in relation to SpareBank 1 SMN’s core values. It was to be competitive, and by that contribute to successful recruitment of new employees and to retain valued in-house employees. The system was designed so that it would help the bank fulfill the main objectives of its risk management profile. Those three objectives were; to reduce the chances of undesirable risk-taking, to stimulate to efficient capital employment, and to reduce the risk of failures in internal controls.

⁹ All information about the different compensation systems is obtained from internal pamphlets and documents, in addition to personal meetings with SpareBank 1 SMN’s head of HR, Irmelin Andersen

¹⁰ The compensation systems of the PM and the CO division were very similar. Eventual differences will be noted specifically

Additionally, the system was supposed to be simple enough for the employees to comprehend and for them to know exactly how their total pay was composed. Strategic priorities, market trends, characteristics, requirements, and work force, were all factors that were to play a role in how the system was customized for each division. Hence, PM and CO were operating with non-identical systems.

For PM, the evaluation criteria were related to both individual and team performance, and it was a mix of financial and non-financial performance indicators. For CO however, there were only team-based performance criteria. For both divisions, the behavioral guidelines was to be described, and made known amongst the employees, meaning that everyone should know when and how outstanding performance pay could be reduced or withdrawn. Finally, minimum performance standards were to be made clear for every employee.

Framework

Performance pay was to be considered as a supplement to fixed pay, and it was to be based on scorecards. The performance pay was computed by using the employee in question's fixed pay as a basis. In the PM division, maximum performance pay as of 2012 was NOK 80 000, or approximately 25 % of fixed pay (some variations were to be expected). For the CO division however, the performance pay was divided equally amongst everyone on the team. Depending on the team's performance, the performance pay would be somewhere between NOK 0 and NOK 96 000. For both divisions, the basis for performance pay was related to the bank's risk-adjusted returns, and it was to be computed over a timespan of minimum one year.

The scorecards

In PM, each employee had their own individual scorecard that composed of individual and team-based evaluation criteria. Performance pay was to be rewarded if these criteria were fulfilled to a certain extent. CO operated with a scorecard for each team, where the weighting of the different criteria were customized depending on the teams' characteristics and work environment. The scorecards were to be updated monthly, i.e. the employees would be able to monitor how their own performances on a monthly basis.

The scorecards were composed of four perspectives: an economical perspective, a customer perspective, a quality perspective, and an organizational perspective. Under each of these perspectives, several control parameters were defined in order to reward both qualitative and

quantitative performances. The perspectives were weighted differently, but in total the four perspectives amounted to 100 % of possible performance pay. Within each perspective, the employees could achieve 100 % fulfillment if all performance indicators were fulfilled. The ulterior motive behind the four perspectives was to promote the bank's key strategic areas.

Performance was evaluated quarterly, and the evaluation was to form a preliminary basis for the total performance pay. They were based on a color-coding system, where an overall achievement between 90 to 99 % was to be rewarded with 50 % of total performance pay, and an overall achievement of 100 %, or more, was to be rewarded with 100 % of total performance pay.

Outstanding performance pay withdrawal policy

SpareBank 1 SMN had a policy, or a set of behavioral guidelines, meant to secure the quality of the employees' performances, and that the employees behaved in accordance with the bank's guidelines. If these were violated, if the employees went above their authorization levels, or if they continuously failed to live up to the quality and behavioral standards expected of them, outstanding performance pay could be withdrawn.

The policy was divided into five levels. Level 1 and 2 qualified for up to 50 % reduction of performance pay, and the levels 3-5 qualified for up to 100 % withdrawal. Withdrawals were only to be used if the employees obviously should have understood that their actions were a violation of the bank's standards and policy.

Frequency

Performance pay was to be paid out in the following year of the vesting year, and it was to be paid out on a monthly basis. If termination of employment were to happen, the outstanding performance pay by the time of termination was not to be compensated for.

4.1.2 Compensation system 2013

Fundamental principles

The framework was to be perceived as predictable, and the performance pay scheme was to be as equal as possible for both divisions (PM and CO). As of this revised compensation system, rewards and evaluations were to be based on team performance, thus the individual performance pay found in the PM division earlier was eliminated. The share of performance pay was not to represent a huge amount of total pay, and management and support positions

were not to be considered in relation to performance pay at all. The allocation of rewards between market segments was based on the scorecards, and divisions that had red lights on their scorecard were not to be rewarded.

An important goal of the compensation system was to stimulate to intrinsic motivation, and to stimulate to improved cooperation both within and between divisions. In addition, cooperation between branches and market areas was to be improved, but still healthy competition between the market areas was encouraged.

Significant changes from the previous system (2012)

Performance pay was as of the revised compensation system based on team performance, both for PM and CO. Further, maximum average disbursement per division was reduced from NOK 100 000 (CO) and NOK 50 000 (PM) to NOK 50 000, and for the entire organization overall, the total amount of performance pay disbursed was to be reduced from NOK 24,1'' in 2011 and NOK 25'' in 2012 to a maximum of NOK 9,5''.

A final significant change was that 25 % of the total bonus pool now could be allocated individually (by local managers), based on individual performance and behavior.

4.1.3 Transition from performance pay schemes to a career model

In the summer of 2013, it was decided that SpareBank 1 SMN was to discontinue its performance pay scheme, and instead develop and implement a career model based on fixed pay sometime in 2014. There were several reasons for why the bank saw the recent performance pay scheme as dissatisfying, and below is presented the most important ones¹¹:

- The scheme did not motivate as well as expected
- The scheme was poorly communicated
- The expectations for increased pay got unrealistic, and thus they couldn't be met
- Continuous changes to the performance pay schemes caused an undesirable attention to pay among the employees

¹¹ Info was given in a presentation to managers and employees on June 24th 2013

- The new [career] model should improve the status and image of customer advisors

Because the career model is not the focus of this thesis, I will not present its features in detail here. However, I will present a short summary of the basics:

The career model is supposed to be implemented over a certain timespan, and each advisor is to be placed on a step on the career ladder that is fitting to their present “profile”. The profile is determined by historical performance, competence, behavior, and experience, and within each of the four perspectives there are several criteria that should be fulfilled in order to rise in the ranks. The two divisions, PM and CO, have different criteria within the perspectives, but many of them are to some extent aligned.

The career model aims to influence the advisors to have a long-term perspective of their work. As they are promoted to higher levels, the more long-term performance is valued.

4.1.4 Summary

In order to give a more orderly presentation of the two performance pay schemes (2012 and 2013), I present a figure below where the two schemes are put up against each other.

| Compensation systems | | | | |
|-----------------------------|-----------------|--|------------------------|---|
| | | 2012 | | 2013 |
| | | <i>PM</i> | <i>CO</i> | <i>PM & CO</i> |
| Evaluation | <i>Criteria</i> | Objective | Objective + subjective | Objective + subjective |
| | <i>Level</i> | Individual + team | Team | Team |
| Framework | <i>Pay</i> | Max NOK 80' (25%) | Max NOK 96' | Max NOK 50' |
| Scorecard | | Individual (including team criteria) 4 perspectives | Team 4 perspectives | Team (for pay) Individual (for individual development) 4 perspectives |
| Frequency | | Computed over 1 year | Computed over 1 year | Computed over 1 year |

Figure 12 – Performance pay schemes of 2012 & 2013 compared

5. Expectations – what can I expect to find?

In this chapter, I will present some of the expectations I had prior to the review of the interviews. Based on the theory presented in chapter 2, and the features of the SpareBank 1 SMN's compensation systems in recent years (which were presented in chapter 4), I was able to make a few hypotheses in regards to how the interviewees perceived the compensation systems, and to what extent they were motivated by them. Additionally, because theory implies that performance pay quite easily can lead to multitask problems (Holmstrom and Milgrom, 1991), I reviewed the compensation systems in terms of revealing aspects by them that could indicate whether I could expect to find any such occurrences.

Roughly, the theory chapter was divided into five general sections. These were principal-agent theory, motivation theory, compensation system design, evaluation methods, and career. The principal-agent theory section formed the basis of the four following sections, which were more specified towards particular topics. When reviewed in context, they contributed to the following hypotheses:

Motivation

My first sub-question was concerning whether performance pay did motivate the employees or not. Initially, I expected that the discontinuation of bonuses and performance pay had an effect to the employees' motivation in one way or the other. As people tend to be motivated differently (Kanfer and Ackerman, 2000), there was reason to believe that performance pay had a stronger motivational effect on some more than others. In addition, the motivation crowding effect (Frey and Jegen, 2001) suggests that external factors, for instance money, may have either undermined or strengthened intrinsic motivation.

The four theoretical directions addressed (needs theories, job characteristics theories, social theories, and cognitive theories) gave leads in relation to what to expect as well. For instance, Maslow's hierarchy of needs implies that what individuals consider as motivating can depend on which level of the hierarchy they find themselves to be on. Here, a factor like age might be of relevance. It can be imagined that younger employees tend to find themselves on lower levels, e.g. they might have mortgages etc. that makes them more concerned about money related issues, while older employees might be more focused on the higher levels as for instance self-actualization. Older employees are more likely to be in a position where they no longer have to provide for children etc., thus money may be a lesser

concern for them. From Herzberg's two-factor theory we can see that factors like the relationship with one's supervisor, one's personal life, and one's perception of the company policy, are all of importance in regards to job satisfaction. The expectancy theory implies that motivation is a product of expectations, instrumentality, and valence.

All of these factors mentioned above are factors that varied among the interviewees due to their different characteristics. Additionally, I expected that the level of intrinsic motivation varied amongst the interviewees. For instance, interviewees with long seniority might find the work itself highly motivating, thus performance pay might not have had a positive motivational effect (Frey and Jegen, 2001).

Other issues that were addressed in chapter 2 were matters concerning design and evaluation. Among others were several pitfalls (for instance combined individual and collective criteria and too many details) and success criteria discussed. Especially in the 2012 scheme, where the PM division was evaluated based on both individual and team-based criteria, it is thinkable that the scheme might have been too complex. When I additionally consider the fact that the time gap between performance and pay (performance pay had to be earned over a timespan of one year before being paid out in portions in the following), I suspect that the motivational effect of the whole scheme may have been little. I believe it was difficult for the employees of SpareBank 1 SMN to observe the link between effort, performance, and pay, thus violating the two significant barriers of intelligent design noted by Beer and Cannon (2004).

To conclude, my first non-directional hypothesis is that the interviewees were motivated to various degrees by the performance pay (due to both intrinsic and extrinsic motivational differences, and the schemes complexity), and that we can observe changes to their motivation now that performance pay is discontinued.

Design and evaluation

My second sub-question concerned how the performance pay schemes affected important focus areas for SpareBank 1 SMN. As was thoroughly addressed in the chapter 2, multitask problems, or distortional effects, can occur when performance pay is used in compensation systems. People tend to focus on the tasks that are measured and rewarded, and belittle the tasks that are not (due to measurement problems or other circumstances) (Holmstrom and

Milgrom, 1991). As was noted in the theory chapter, many tasks and areas of the job can be tasks of great importance even though they are hard to measure, for instance cooperation.

However, both divisions were evaluated based on team-based criteria. Thus, cooperation should, to some extent, be expected to already be a focus among the employees. Nevertheless, for the PM division, in the 2012 scheme, several individual criteria were also weighted relatively high.

Also, other important tasks, for instance proactivity and risk assessment, might have been affected by performance pay. If the performance schemes were designed in ways where they for instance made the employees focus heavily on customer recruitment, they might have been tempted to taking upon higher risk than they were comfortable with in order to recruit more customers, i.e. lowered their standards. As will be addressed in chapter 7, certain criteria, especially of the 2012 scheme, could lead to such behavior, meaning that negative distortional effects likely could have occurred. Thus, it is reasonable to expect findings of changes in employees' priorities, and that they under a fixed pay scheme (as they work under now) tend to work more with the "full picture", i.e. that some of the distortional effects have disappeared since the discontinuation.

In chapter 2, another problem that can easily arise was discussed, namely the problem of free riding and social loafing. It is noted that the problem tends to be smaller when groups or teams are small (Hollensbe and Guthrie, 2000). Additionally, individual influence is bigger in small teams (Garbers and Konradt, 2014). As the employees at SpareBank 1 SMN were evaluated on a team level, and the fact that the market area was relatively huge in terms of employees, problems associated with free riding could have appeared (maybe especially in the scheme of 2013, where there were no individual evaluations).

Thus, my second hypothesis is that several multitask problems occurred at SpareBank 1 SMN due to performance pay, and the way the schemes were designed. It can be reasonable to assume that several of the interviewees paid more attention to the individual criteria they were evaluated by in the 2012 scheme compared to the team-based criteria, because they were easier to directly influence. Additionally, it is interesting to find whether any problems associated with free riding occurred at any point. However, we can expect that the discontinuation of performance pay reduced some multitask problems, given that they did appear in the first place.

Motivation and career

My third sub-question concerns how this thesis can be useful for SpareBank 1 SMN in the future. By that, I mean how the results and answers I have found can come to use when the bank will design future compensation systems.

As already noted several times, there were two groups of interviewees, those working at the Stjørdal and Meråker branch, and those working at the Malvik branch. And because those who work at the Malvik branch by the time of the interviews already were informed in detail about the new career model (see chapter 3) it was interesting to see whether there was a differences in observed motivation between the two groups. Even though none of the groups had significant experience working under the career model, the level of knowledge they possessed in terms of its features might have been decisive for how motivated they were in relation to the future at SpareBank 1 SMN. As noted in chapter 2, to implement a career model as an incentive mechanism can be considered as very motivational by in-house employees (Nordhaug, 2002). In addition, by using career ladders as incentives can be seen as a sign that the bank seeks to promote in-house employees rather than opening up available positions to external candidates, thus, according to (Chan, 1996), the employees should not be demotivated due to the risk of finding that external candidates will be considered for open positions before them. Finally, theory also implies that information and knowledge about the compensation system is important in terms of generating motivation (Nordhaug, 2002), thus we might expect to find differences in terms of future motivation between the two groups.

My third hypothesis is therefore that the group who had more knowledge about the career model (Malvik) was more motivated in terms of the future (assuming that the career model at SpareBank 1 SMN by itself is motivating).

6. General approach – what have I found? A presentation of the results

In this chapter, I will present the general findings from the interviews. The interviews allowed the interviewees to present and explain their opinions, perceptions, and views. An overview of them will be provided in the following pages, and differences and similarities between the responses will be highlighted. However, I will not address many in-depth details here, as that will be done in chapter 7.

Before addressing the detailed questions of how the different compensation systems influenced their behavior and effort, the interviewees were asked several general questions concerning the characteristics of their workplace and their general perception of bonus and performance pay, in addition to their perceptions of the new career model. As earlier noted, just a few interviewees had enough actual knowledge about the features of the career model to give valid answers to the questions concerning it by the time of the interviews.

As this is only a summary of the in total 17 interviews, the results found cannot be used for generalization purposes. However, it is interesting to summarize the responses quantitatively in order to see if any patterns or trends can be observed.

Table 1 – Question 3 (of the interview guide)

| | Yes | No | Don't know |
|--|-----|----|------------|
| <i>Do you believe discontinuing bonuses and performance pay was the right thing to do?</i> | 7 | 5 | 5 |

As can be seen from the table, the interviewees did not agree to whether or not performance pay or bonus is a positive reward mechanism. 7 interviewees believed that SpareBank 1 SMN did the right thing when performance pay was discontinued, while 5 believed it should have been continued. 5 interviewees were unsure or did not have an opinion on the matter.

Theory stresses the importance of knowledge and communication of compensation schemes if they are to be successful (Nordhaug, 2002). The interviewees were asked whether they believed that the bank's management in that relation had done a good job, i.e. whether they had a fair understanding and knowledge of how to behave in order to receive performance pay.

Table 2 - Question 5

| | Easy | Hard | Didn't familiarize myself with the criteria/Can't answer |
|--|------|------|--|
| <i>Did you find it easy to know which activities and what behavior was expected in order to receive performance pay?</i> | 11 | 2 | 2 |

The responses indicate that knowing what to do and how to behave in order to receive performance pay was perceived as relatively easy in the most recent performance pay schemes (2012 and 2013). Even though this question alone gives little basis for being conclusive, the responses indicate that the management did a good job when came to communicating important focus areas and what was considered as desired behavior and effort.

In order to get a better understanding of their perceptions of the performance pay schemes, the interviewees were asked another question concerning this topic. It was difficult to measure the answers quantitatively, but the general majority seemed to believe that they had somewhat of an impact in relation to whether or not they would receive bonus/performance pay. A sample of the quotes is rendered in the table below:

Table 3 - Question 6

| | | |
|--|---|---|
| <p><i>Did it ever happen that a bonus came as a surprise to you? Did you believe you had a lot of influence to whether or not bonus or performance pay would be given?</i></p> | <ul style="list-style-type: none"> - “I feel we had pretty clear targets for what was expected of us” - “We had individual budgets, and it was how well you performed in relation to your budget that decided whether there would be a bonus or not” - “I feel like the continuous feedback was good, and so you knew what you were missing in order for getting the bonus” - “You had to achieve your budget. If you didn’t, you wouldn’t get a bonus” | <ul style="list-style-type: none"> - “It wasn’t easy to know whether you were in position of getting a bonus or not. Cases of lookism did occur” - “Sometimes we expected to get a bonus, but we had no idea what criteria we were measured by was” - “There were problems with the continuous feedback. The reports we were given contained errors” - “The scorecards were updated too rarely and too late. Especially the team-based part was updated late, and we wouldn’t know the total” |
|--|---|---|

This table (3) does not give any conclusive evidence to whether or not the interviewees knew how to behave in order to get bonus or receive performance pay. But it reveals that the opinions and perceptions varied. Some found it easier to know whether they could expect performance pay or not, while others believed they only had limited influence to whether they would receive it. It is maybe especially interesting that a few interviewees criticized the continuous feedback systems, while one interviewee had a positive view of them. Continuous feedback and updates to whether current behavior and performances are good enough is important for the performance pay scheme’s incentive effects and employee motivation (Spreitzer, 1995).

The interviewees were asked a few questions concerning the new career model in an attempt to reveal their knowledge and perceptions of it. It should be noted that even though most interviewees had yet to have informative meetings with their local manager, a few of them had been able to obtain information about it on their own initiative.

Table 4 - Question 1

| | Very good | Somewhat good | Know very little about it | Somewhat bad | Very bad |
|---|-----------|---------------|---------------------------|--------------|----------|
| <i>What is your tentative perception of the new career model?</i> | 1 | 5 | 10 | - | 1 |

As can be seen in the table above, the majority knew very little about the new career model by the time of the interviews. Although, it is interesting that those who claimed to have knowledge about it mostly considered it to be a good model. Only one interviewee responded that he or she had a very negative perception of it.

Table 5 - Question 4¹²

| | Much worse | A little worse | Neither or | A little better | Much better |
|---|------------|----------------|------------|-----------------|-------------|
| <i>Compare the new career model to the recent performance pay schemes</i> | 1 | 3 | - | 5 | 2 |

When asked to compare the career model to the previous performance pay schemes, the responses varied. And even though some of the interviewees who previously had noted that they knew very little about it believed they knew enough to be able to compare it to the previous schemes.

As is previously noted, in order for compensation systems to be successfully adapted by the employees they are intended for, it is important that the employees in question are aware of the different aspects of them, and that they know how they will be rewarded and compensated (Nordhaug, 2002). In this context, the interviewees were asked whether they believed that the management had communicated the features of the new career model well.

¹² Due to limited knowledge, 6 interviewees refrained from answering this question

Table 6 - Question 2

| | Well | OK | Poorly |
|--|------|----|--------|
| <i>How well is the new career model communicated to you employees?</i> | 2 | 3 | 12 |

It seems reasonable to imply that the majority was not satisfied with the communication provided concerning the new compensation system. This observation can support further explanation of the answers given to the two previous questions as well. Most interviewees informed that they were aware of the fact that a new compensation system was about to be implemented, but that they did not know much of the details of it.

As a final question of the introductory section of the interviews, the interviewees were asked whether they believed that the general focus on and attention to pay was high at SpareBank 1 SMN.

Table 7 - Question 7

| | High | Moderate | Low |
|--|------|----------|-----|
| <i>Is the focus on and attention to pay high at SpareBank 1 SMN?</i> | 6 | 3 | 8 |

Even though the responses that were given to this question were as they are rendered in the table above, the answers and following discussions implied that several interviewees may have misunderstood the question, thus many interviewees may have had similar opinions, but yet have answered differently.

During the discussions that followed, the majority of the interviewees informed that pay was something they were concerned about. 13 of 17 interviewees mentioned that the general base pay given at SpareBank 1 SMN was low, and that they did worry about an alleged wage gap between the advisors. That opinion was often repeated, and many perceived it as damaging in terms of motivation due to the lack of internal fairness. Although many informed that there was a lot of secrecy when comes to pay, i.e. that employees tended to not talk a lot about it with each other, they believed that some advisors were paid improperly much, and that the link between wage and work-related knowledge and experience was weak or even non-existent in some occasions.

During the main section of the interviews, the interviewees were asked questions in order to reveal whether the changes of compensation systems have changed their way of working, in terms of what kind of work they do, whether their motivation has changed, and whether they consider SpareBank 1 SMN to be a more attractive employer now compared to earlier. Because the general majority knew very little about the new career model, the main focus of the questions was the transition from performance pay schemes to a compensation system solely based on fixed pay.

As is noted in chapter 3, the interviews were divided into sections based on Bragelien's (2005) 5 dimensions for measuring the success of compensation systems.

Did performance pay make you work harder?

Initially, a small majority claimed that performance pay motivated them to put in extra effort in their daily work, and that they do not see the same value of working extra anymore. However, the majority also asserted that their effort has not changed since performance pay was discontinued.

Table 8 - Question 8

| Did you work harder? | Yes | No |
|---|------------|-----------|
| <i>Were you more motivated to put in higher effort when knowing that you could receive a bonus or performance pay if you did?</i> | 10 | 6 |
| <i>Do you still see the same value of working extra?</i> | 7 | 9 |
| <i>Have your effort changed in any way since performance pay was discontinued?</i> | 6 | 10 |

As can be seen in table 8, the majority (10 of 16) replied that they were motivated by the potential bonus or performance pay, and that only 7 still saw the same value of putting in extra effort.

The three questions in table 8 were all basically seeking to reveal the same thing, i.e. how much pay meant for the interviewees' motivation for working. However, we can see that the interviewees were not consistent in their answers. Scholars have found results indicating that pay in fact is more important for motivation and effort than people tend to say, and that they often tend to answer politically correct when they rate the importance of pay (Rynes et al.,

2004). Thus, this might help explain why even though most said that they were motivated by performance pay, they have not changed their effort since it was discontinued. This will be addressed further in the following chapter.

Do you work smarter now that performance pay is discontinued?

The first question of this dimension sought to reveal whether the interviewees have changed the way they work since they worked under a performance pay scheme.

Table 9 - Question 9.1

| | Yes | No |
|---|-----|----|
| <i>Are you focusing more on some tasks compared to earlier?</i> | 5 | 11 |

As table 9 illustrates, the majority were generally focusing on the same tasks as they used to when they were working under performance pay schemes. This implies that most reported that pay was not of significant importance in relation to which tasks they chose to prioritize.

The interviewees were then asked two follow-up questions related to this topic. The purpose was to obtain a better understanding of the way they conducted their work, and how it might have changed in recent years, seen in the context of important focus areas for SpareBank 1 SMN.

Table 10 - Question 9.1.2

| | Much more | More | No change | Less | Much less |
|--|-----------|------|-----------|------|-----------|
| <i>Are you focusing more on being proactive towards customers now?</i> | 5 | 5 | 5 | 1 | - |

Table 11 - Question 9.1.3

| | Much better | Better | No change | Worse | Much worse |
|--|-------------|--------|-----------|-------|------------|
| <i>How is cooperation between the employees now compared to earlier?</i> | 3 | 5 | 6 | 2 | - |

An isolated view on these two tables (10 and 11) can imply that important focus areas like cooperation and proactivity towards customers have improved since performance pay was discontinued. Maybe the most significant improvement can be seen in the first table (10). It seems reasonable to say that most interviewees believed they were being more proactive after the discontinuation, as 10 of 16 indicated that they in fact paid less attention to it a few years ago, and that only 1 indicated that he or she had more attention to it before. Naturally, the tables give no indication to whether the discontinuation of performance pay was the main factor behind the behavioral changes; they only indicate that many of the interviewees behave differently in relation to these areas now compared to only a few years ago.

Table 12 - Question 9.2

| | Much more | More | No change | Less | Much less |
|---|------------------|-------------|------------------|-------------|------------------|
| <i>Do you get to focus more on the tasks that you personally believe is more important for the bank now compared to before?</i> | 2 | 5 | 8 | - | - |

Table 12 shows that 7 of 15 interviewees believed that they were freer to focus on the tasks they themselves believed was important for the bank after performance pay was discontinued. This can imply that performance pay influenced several employees to act on the contrary of what they believed was important to do, and that they rather focused on the tasks that would improve their chances of receiving performance pay. This is interesting because when asked whether they focus more on certain tasks now compared to earlier (table 9), only 5 of 16 answered that they did. Does this mean that even though they became freer to focus on what they believed was important when performance pay was discontinued; some still chose not to do so? Or can it be that they believed that they always have worked with the important tasks, but that the discontinuation of performance pay gave them the opportunity to pay even more attention to those tasks?

As a follow-up question, the interviewees were asked whether they tended to have a more short-term perspective when they worked under performance pay schemes. As theory implies, performance pay can often, either intentionally or unintentionally, provoke short-term thinking because employees will seek to maximize the short-term profits in order to

fulfill the criteria they are measured by in time for their evaluations. Employees will often have a different perspective than their employers (Lazear and Gibbs, 2009).

Table 13 - Question 9.2.2

| | Yes | No |
|---|-----|----|
| <i>Do you have a more long-term perspective now? In terms of sales, customer advisory, etc.</i> | 7 | 10 |

Table 13 shows that 7 of 17 interviewees believed they had a shorter perspective earlier. Thus, it is possible that performance pay may have had an impact on many of the employees and the way they made decisions because they had incentives for making short-term decisions.

Are you making better decisions?

Further, in the interest of revealing whether the employees were making better decisions (from the banks perspective) compared to earlier, the interviewees were asked a few questions concerning this topic. The three main questions of this dimension are rendered in table 14. The results indicate that even though the majority mainly gave many of the same advice as they would have done earlier, they tended to have a more long-term perspective when meeting with their customers and clients now. This can be seen in relation with the third question of table 14 (question 10.3), which shows that 9 of 16 advisors believed they were tougher now in their evaluations of new and existing customers and which products they would offer or suggest (typically what interest rate the customers should be offered).

Table 14 - Question 10

| Are you making better decisions? | Yes | No |
|---|-----|----|
| <i>Are you giving any different advice to the customers now compared to earlier?</i> | 5 | 11 |
| <i>Do you believe that there is a greater focus of risk and risk assessment at SpareBank 1 SMN now?</i> | 12 | 5 |
| <i>Are you "tougher" when evaluating customers and their profitability?</i> | 9 | 7 |

Seeking further details to question 10.3, the interviewees were asked whether they had recently experienced having to say no to customers (for instance if customers asked for lower interest rates or specific products) that they would most likely have said yes to under the performance pay schemes.

Table 15 - Question 10.3.1

| | Yes - many | Yes – a few | No |
|---|------------|-------------|----|
| <i>Are there customers you would have accepted earlier that you now choose to reject?</i> | 2 | 5 | 9 |

Table 15 indicates that 7 of 16 interviewees rejected more customers now than they used to. Table 13 indicates that the same number of interviewees (7) behaved and planned more long-term now, thus it is interesting to see whether these were the same interviewees as those who claimed to reject more customers. The two who replied that they rejected many more also stated that their perspective shifted from short-term to long-term when performance pay was discontinued. However, only two of those who claimed to have rejected a few more also claimed to have a more long-term focus now. This is interesting because it means that there are three interviewees left who said that they were not thinking more long-term now, yet they still have rejected a few more customers. What can be the reason for this? According to their responses, they claimed to always have been focusing on the long-term. But due to the bank's recent and stricter risk assessment profile, they were "forced" to reject a few customers. Two of them perceived this a risky strategy because it devalued the value of local knowledge. That opinion was found in several other interviews as well, and my perception was that many of the interviewees were dissatisfied by not being allowed to fully utilize their local knowledge.

Attract/retain talent

The two last dimensions address whether the compensation system attracts and retains talent, and so the interviewees were asked a few questions concerning this topic. The first question was asked in order to reveal whether the employees considered SpareBank 1 SMN to be a more attractive employer now compared to earlier.

Table 16 - Question 11.1

| Attract/retain talent | More attractive | No difference | Less attractive |
|---|-----------------|---------------|-----------------|
| <i>Is SpareBank 1 SMN more attractive as an employer now?</i> | 3 | 11 | 2 |

As can be seen in table 16, the general majority did not believe SpareBank 1 SMN was neither a worse nor a better place to work now compared to when they operated with performance pay. The fact that only 2 of 16 answered ‘less attractive’ makes it doubtful whether the compensation systems even were to blame at all for their perceptions of SpareBank 1 SMN as an employer. To get a better understanding of whether the compensation systems were of importance for how they evaluated SpareBank 1 SMN as a workplace, they were asked a follow-up question.

Table 17 - Question 11.1.1

| | Great importance | Some importance | No importance |
|--|------------------|-----------------|---------------|
| <i>Are the discontinuation of bonus and performance pay, and the implementation of the career model, of any importance for your perception of SpareBank 1 SMN's attractiveness as an employer?</i> | - | 6 | 10 |

As table 17 shows, none of the interviewees found the compensation systems to be of great importance, while 6 answered that it was of some importance. The fact that the majority did not seem to think that the compensation systems was of any importance at all to whether they considered SpareBank 1 SMN to be a good place to work or not might imply that many interviewees considered other factors to be of much greater significance for their job satisfaction. Again, the responses to this question should be seen in the context of the previously mentioned problem concerning how employees tend to downplay the importance of pay (Rynes et al., 2004).

A final question, in the interest of examining whether the interviewees found performance pay more attractive than they found the current situation, they were asked whether they were more motivated to stay at SpareBank 1 SMN now than what they used to be when they were working under performance pay.

Table 18 – Question 11.2

| | Yes | No |
|---|------------|-----------|
| <i>Are you more motivated to stay at SpareBank 1 SMN now?</i> | 1 | 14 |

As these numbers indicate, the majority were not more motivated to stay at SpareBank 1 SMN now. However, it should be stressed again that many of the interviewees had yet to have informative meetings concerning the new career model. What they could relate to at the time of their interviews was that they had been deprived performance pay, and that the deprived incentives had yet to be replaced by others.

Summary

At first glance, it was hard to find any significant trends or patterns that stood out from the interviews. The responses given by the interviewees were fairly diverse, and even though the majority indicated that pay was a motivational factor, many of them tended to think of it as an inferior source of motivation. However, for various reasons, a few more interviewees (7) agreed to the decision of discontinuing performance pay compared to the 5 who opposed it (question 3). The latest performance pay schemes seem to have been quite easily understandable for most, and the majority had a fairly good perception of how to behave and perform in order for receiving performance pay.

On another note, it seems reasonable to assume that performance pay could be associated with several multitask problems. For instance, the majority reported that cooperation did improve after it was discontinued, and that risk assessment changed, both important focus areas for the bank. Most interviewees also reported that proactivity towards customers improved.

What I believe stood out the most from the interviewees, was that there seemed to be an overall dissatisfaction with the general base pay levels at SpareBank 1 SMN. 13 interviewees addressed this as a problem, many of them even before I had the chance to direct them onto the topic. Additionally, many interviewees noted that they believed an alleged wage gap was present among the employees.

7. Discussion

This chapter will address and clarify the topics and responses that came up during the interviews, and they will be seen in the context of my threefold research question. In the first section of the chapter, I will discuss whether performance pay actually did motivate the interviewees, and what about the performance pay schemes SpareBank 1 SMN used that either motivated or didn't motivate. In the second section, I examine the effects performance pay had in relation to the way the interviewees conducted their daily work. This will be put in relation to their focus, or lack thereof, on important focus areas for SpareBank 1 SMN. The third and final section will address how the findings of this thesis can be useful for SpareBank 1 SMN, especially in relation to their compensation policies.

Aims:

As was presented in chapter 1, my threefold research question reads:

- Did performance pay motivate?
- How did performance pay affect important focus areas for SpareBank 1 SMN?
- How can the findings of this research be useful for SpareBank 1 SMN in the future?

Findings:

Of 16 interviewees, 10 responded that they were more motivated to put in higher effort when they were working under performance pay schemes, and 6 replied that performance pay did not matter in terms the level of effort they put in (see table 8, p. 72). It may initially seem that for the majority, performance pay was an important motivational factor. However, most interviewees have not experienced any significant changes to their effort since the performance pay schemes were discontinued. As was briefly addressed in chapter 6, this might imply that even though performance pay motivated, it might have been an inferior motivational factor. Another possibility, which was also briefly discussed in chapter 6, is that the interviewees answered more politically correct when they responded to whether their effort has changed (Rynes et al., 2004) than when they were asked whether performance pay motivated them. Out of the 10 who answered that they were more motivated by performance pay, only 3 replied that their effort has changed since it was discontinued. This means that

out of the 6 who replied that performance pay was not a significant motivational factor, 3 said that their effort in fact has changed after the discontinuation. How can it be that of the interviewees who actually claimed to be motivated to put in extra effort due to performance pay, only 30 % reported to have changed their effort, while of those who answered that performance pay was not an important motivational factor, as many as 50 % reported that their effort has changed? Before examining this further, it might be reasonable to assume that changes in effort would have been most significant amongst those who actually perceived performance pay as a huge motivational factor, and not the other way around.

In addition, an interesting note is that out of the 10 interviewees who claimed to be extra motivated by performance pay, 5 replied that they paid more attention to the tasks they perceived to be more important for the bank after the performance pay schemes were discontinued. That implies that among those who reported to be motivated by performance pay, as many as 50 % actually experienced that the performance pay schemes misguided their motivation onto tasks they believed were of lesser importance. 2 out of those 5 again replied that they changed the way they work, and that they now focused more on the tasks they believed were important. This observation can either imply that the performance pay schemes did not fully succeed in aligning the owners' and the interviewees' interests, i.e. that they motivated wrongly (moral hazard), or that the interviewees and the management had different opinions of what was the bank's best interests and goals.

Based on the interviews alone, it was difficult to conclude whether performance pay made the interviewees work harder or not. In the following section, I will examine the details and statements that were put forth during the interviews, and I will try to explain how and why the interviewees were more or less motivated because of performance pay, and further if it made them work harder. I will present views and opinions that can help describe how the performance pay schemes were perceived, and elements about them that were perceived as either motivating or demotivating, and further compare them to relevant theory. The 17 interviewees were randomly given a number from 1 to 17, and during the discussions I will compare their answers, illustrated by tables¹³, to whether or not they claimed to have been motivated by performance pay.

¹³ "Was motivated by performance pay" refers to my personal perception, based on the interviewees' responses, of whether or not the interviewees actually were motivated by performance pay

7.1 Performance pay – did it motivate?

This first section addresses various topics the interviewees stated as essential for their perceptions and opinions of the performance pay schemes.

Achievable criteria

Theory emphasizes that among the requirements for successful performance pay schemes are employee influence and clear links between effort and rewards (Nordhaug, 2002). This was also stressed by a few of the interviewees. As 10 of 16 interviewees found the performance pay schemes to be motivating, it was reasonable to believe that the criteria were both understandable and perceived as achievable by the majority.

Table 19 - Motivated by performance pay / Question 5

| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 |
|--|-----|-----|-----|-----|---|-----|----|-----|----|----|-----|-----|-----|-----|----|-----|-----|
| Was motivated by performance pay | Yes | Yes | No | Yes | | Yes | No | No | No | No | Yes | Yes | Yes | Yes | No | Yes | Yes |
| Had knowledge of criteria and expectations | Yes | Yes | Yes | Yes | | Yes | No | Yes | No | No | Yes | Yes | | Yes | No | Yes | Yes |

Table 19 indicates the link between the interviewees' responses to whether they claimed to be motivated by performance pay and whether they had knowledge of the criteria of the schemes. As it shows, there seems to have been a link between those who claimed to have been motivated by performance pay, and whether or not they had knowledge of the criteria for receiving performance pay, and the management's expectations. Four of the six who claimed to not have been motivated by performance pay said that they did not have adequate knowledge of the criteria.

However, in the final year of performance pay at SpareBank 1 SMN, only 11 advisors of the entire organization received maximum performance pay. In total, nearly half of the advisors got partial performance pay, though not full¹⁴. This means that as many as nearly 50 % of all advisors at SpareBank 1 SMN did not receive any performance pay at all. It is interesting that even though 50 % did not get anything beyond their regular salary, a few advisors still

¹⁴ Information obtained from a letter sent out to all employees at SpareBank 1 SMN by Department Manager Svein Tore Samdal, dated March 29th 2014

claimed to be motivated by performance pay. However, due to the quarterly evaluation systems, the employees started “on scratch” every third month. Thus, if the performances during one particular month were below desired levels, they knew that they had another opportunity for earning performance pay in the following quarters. That might have ensured that employees who fell behind early on had something to reach for even when the year was coming to an end. One of the interviewees noted that in order to get maximum performance pay, they had to stay on their toes through the entire year because they could not obtain maximum pay by just working hard in periods, thus their effort had to be spread out over the entire year. Therefore, we can assume that the performance pay schemes were designed in a way where they, although employees underperformed in one particular period, they would still be able to find motivation for putting in extra effort later.

Nevertheless, it is noteworthy that out of 426¹⁵ advisors, only 11 received maximum performance pay, but the majority of the interviewees still found the criteria to be achievable. The fact that only 11 of 426, or less than 2,6 %, received maximum performance pay could be an indication that the criteria, or at least some of them, were hard to achieve. It should be mentioned that I did not examine whether those who claimed to have been motivated by performance pay actually received any.

Influence

In a section of chapter 2, *Purpose/Design*, I addressed several success criteria proposed by Nordhaug (2002). Amongst these were the importance of employee influence, and how compensation systems should contain factors that employees can control to a certain extent. This was also stressed by Beer and Cannon (2004), who noted that one of the two barriers that should be overcome in any performance pay system is that pay should be linked to performance.

Of the 10 interviewees who indicated that they were more motivated to put in extra effort when working under performance pay schemes; six noted that they believed they had direct influence in terms of whether or not their performances and effort would lead to them receiving any performance pay. Those six also considered the measures to have been clear and fairly well communicated, in addition to having been provided reasonably in advance.

¹⁵ Advisors in the PM and CO divisions in total

However, the general perception seemed to be that even though the measures were perceived as achievable, they could sometimes have been difficult to keep track of.

“It could be a little complicated at times [to see whether we performed well enough to get performance pay], but we were usually able to figure it out if we put a little effort into it” and “it wasn’t very difficult [to observe how one’s own performances were in relation to the measures], but the scorecards were sometimes updated too late”

Maybe even more interesting is the fact that four of the interviewees who noted that they perceived performance pay as motivating, also informed that they only had a general idea of the criteria, i.e. they did not know the exact parameters, but they had a fair perception of whether they were in a position where they would get performance pay or not.

“Bonus wasn’t an extremely motivating factor for me, but if I knew I was close on some parameters, I would put in a little extra effort to make sure that I reached them”

Team size

As was noted in chapter 4 the performance pay scheme of 2012 was (for the PM division) designed so that it contained both individual and team-based evaluations. In the introduction, I presented the three branches in the Værnes-region, and how they were merged together to one designated market area. The six employees at the Malvik branch, who previously had been defined as their own market area, experienced that their market area increased from 6 to over 20 advisors when they were merged together. One interviewee, who worked at the Malvik branch, noted that this meant dramatically reduced influence in terms of the market area’s performance.

“The Værnes-region is now consisting of [approximately] 25 advisors, and we are a little powerless in terms of influencing the whole area. It was different when Malvik operated as its own team of 6”

This coincides with theory as it is acknowledged that when teams get bigger, individual’s influence to the team’s performance is reduced. When performance pay is directly linked to the team’s performance, it is crucial that the team-members feel that they are in a position where their effort and performance actually matters. As Garbers and Konradt (2014) noted, as the number of team-members increases, the effect of team-based reward decreases.

Table 20 - Motivated by performance pay / Branch

| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 |
|------------------------------------|-----|-----|----|-----|-----|----|----|----|----|-----|-----|-----|-----|----|-----|-----|----|
| Was motivated by performance pay | Yes | Yes | No | Yes | Yes | No | No | No | No | Yes | Yes | Yes | Yes | No | Yes | Yes | |
| Malvik(M) or Stjørdal / Meråker(S) | S | S | M | S | M | S | S | S | S | M | S | M | S | M | M | S | |

It is interesting that none of the interviewees from the Stjørdal branch mentioned market area size as a problem. That could imply that the Stjørdal branch already by the time of the merger was so large it did not matter all that much for those who worked there that the market area increased. As was noted in chapter 2, it is believed that in smaller groups, team members can actively monitor and punish employees who don't perform as expected or who put in too little effort (Zenger and Marshall, 1995). Thus, because the Stjørdal branch (if the Meråker branch is included) already consisted of a little less than 20 advisors, they were not affected much by the fact that 6 new advisors were added to their group. But for the 6 from the Malvik branch, the playing field changed entirely because their effort went from practically being worth 1/6 to about 1/25. Bragelien (2003) noted that the incentive effect can be marginal when a team or groups consist of 20+ members.

However, as table 20 shows, there was no definite link between motivation due to performance pay and branch affiliation. 6 of 10, or 60 %, of the interviewees from the Stjørdal/Meråker branch claimed to be motivated by performance pay, while 4 of 6, or 66,7 %, of the interviewees from the Malvik branch claimed to be. This means that there actually were more interviewees who were motivated by performance pay at the Malvik branch than the Stjørdal/Meråker branch. Thus, these findings cannot be used to support theories concerning that when team size increase, the motivational effects of performance pay decrease. But an important notion is that the market areas were merged together prior to 2012. Thus the market area's size was unchanged during the time period that was relevant for this research. The results did however give no indication to that those who previously worked in smaller teams (Malvik) were less motivated by performance pay in the years prior to its discontinuation.

Perceived fairness

Another topic that came up during a few of the interviews was that the criteria of evaluation were unfair. To the interviewees' knowledge, the criteria were too general, i.e. they did not

take into account the severe geographical differences that exist in the Trøndelag region. The employees who worked at the smaller regional branches could sometimes experience difficulties when came to achieving as many sales and as large volumes to them as those who worked in the bigger cities, e.g. Trondheim.

“Mortgages in say Meråker are usually significantly smaller than equivalent mortgages in the bigger cities, meaning that it is more difficult to achieve the sale targets”.

This was a reasonable argument, as the criteria did not give every employee across the organization the same possibilities and opportunities. The employees who worked at the smaller regional branches started off with what could almost be considered a handicap compared to those who worked in Trondheim. By early May 2014, the average price per square meter for a home was NOK 34 539 in Trondheim, while the price per square meter in the rest of the region was NOK 22 634 (NEF, 2014). Naturally, that meant that in order to achieve the same level of mortgage sales in the regional areas as in Trondheim, one would have to sell nearly 1,5 times as many mortgages, just in order be able to attain the same amount of income. This was a violation of an important principle, namely the principle of internal fairness (Nordhaug, 2002). But Nordhaug (2002) also noted that to design compensation systems that are 100 % internally fair is extremely difficult, and often even impossible. Yet, it wouldn't be unreasonable to believe that a few employees at the regional branches were slightly demotivated by the fact that they did not start off at the same point as those who worked in the bigger cities.

However, a counterargument could be that the average house in regional areas probably are bigger in terms of square meters than they are in bigger cities, thus the size of the mortgage per home could be equally big. But when the numbers of employees in the PM division at the Meråker branch and at the Stjørdal branch were compared, we could see that for each advisor in Stjørdal, there were about 1500 potential customers, while there were only 833 potential customers per advisor in Meråker¹⁶. This could be an indication of that there was something to the argument put forth by a few of the interviewees; there might actually have been harder to achieve the criteria in the regional areas. It should be mentioned that the regional areas and villages of Trøndelag often are typical cabin areas, thus this could have

¹⁶ Numbers found by dividing the population of Stjørdal and on PM advisors at each branch. It is unrealistic that every citizen use SpareBank 1 SMN, but the example was made for illustrative purposes

generated additional mortgages sold to people who were not actual residents of the village in question. However, despite having little data to support this argument, many people will have one primary bank connection, and we can assume that they most likely would have applied for their cabin mortgages at the bank where they already were customers. Thus, the regional branches might not have acquired much more business due to mortgages of this kind.

Time gap between performance and reward

Previous versions of the performance pay schemes used at SpareBank 1 SMN included more frequent payments. Through the years, the bank shifted from monthly or quarterly payments (as was used in schemes prior to 2012, thus falling outside the appraisal area of this thesis) to the most recent schemes where performance pay was accumulated over an entire year before being paid out periodically in the following year. At one point, as was mentioned by some interviewees, SpareBank 1 SMN operated with a compensation system where the employees got NOK 1 000 per new customer they acquired (again, this was prior to 2012).

Theory implies that for the intended motivational effects of performance pay to occur, the pay should be linked directly to the performance (Beer and Cannon, 2004). As was noted in chapter 1, the Norwegian Ministry of Finance introduced a regulation in 2011 that had consequences for the way performance pay schemes could be designed, including that performance pay had to be accumulated over an entire year¹⁷. The interviewees were asked whether the increased time gap in the recent performance pay schemes was demotivating, and whether it affected their willingness to put in extra effort. 11 interviewees were asked directly, and of those, 8 stated that they found the time gap to be less motivating. The remaining three stated that their motivation stayed the same despite the change.

By removing monetary incentives, the possibility that employees will turn their attention to the tasks they are comfortable doing, thus they will do less of the tasks they dislike because they no longer are directly measured (Holmstrom and Milgrom, 1991). This is often referred to as the opposite of the multitask problems of performance pay, namely the positive distortional effects. They ensures that employees will pay attention to tasks they otherwise

¹⁷ There were several exceptions

would have given less priority, for instance “uncomfortable” tasks like calling customers trying to sell them various products.

In this research I did however not find much evidence to support this theory. A few interviewees replied they did not call customers as often anymore, but the majority (10) informed that they in fact were more proactive towards customers after the discontinuation of performance pay.

“[When working under performance pay,] if there were criteria I easily could improve, I made them my priority. But now, speaking for myself, I focus more on the entirety”

As this thesis only addressed the performance pay schemes of 2012 and 2013, these findings could imply that the most recent performance pay schemes, designed in the way it was at SpareBank 1 SMN at the time, did not motivate the majority of the interviewees very much in terms of proactivity towards customers. Of the 10 who replied that they were more proactive towards customers after performance pay was discontinued, a small majority also informed that their focus got more long-term, and by that paid more attention to portfolio profitability. What was interesting about this was that some of those who claimed to be more proactive also claimed that they did not “push” sales to the same extent as they used to.

“I think we have become better in seeing the customers now. I think the customers get a better experience when they talk to us now because we are less product driven”

Following the discussions in these interviews, the perception seemed to be that the direct incentives for selling were stronger before, but that many claimed to have taken advantage of the reduced incentives by giving customers more attention, and to have been promoting products they actually needed instead of focusing on favored products.

However, campaigns and promotions were still used, even after the performance pay was discontinued, in order to motivate employees to sell specific products. An interviewee informed that the best performing market areas were rewarded, though not by direct cash-in-pocket. Rather, they were rewarded with activities and gifts that were meant to strengthen the organizational commitment and the sense of community amongst the employees, like for instance concerts, trips, or other experiences. Thus, this could be an indication to that SpareBank 1 SMN was trying to find the right balance between sale intensity and positive customer experience.

The overall answers implied, as is coinciding with theory, that rewards had a stronger motivational effect when they were easy to link to performance and effort.

“It took too long [to receive the pay], and you barely noticed it. You didn’t see the rewards in relation to the performance anymore. And when it changed from quarterly payments to periodically, next year payments, it wasn’t quite the same as the big payment every three months. Because when it was so [payments every three months], you really had something to work for”

Evaluate on which level?

As was addressed in chapter 4, SpareBank 1 SMN operated with a combination of team-based and individual evaluation criteria for the PM division, and strict team-based evaluation criteria for the CO division, in the compensation system of 2012. During the short period of time where the revised version of 2013 was applied, only team-based evaluation criteria were used for both divisions.

Based on the interviews, I was not able to find any significant signs of which level the interviewees preferred to be evaluated on. As was addressed earlier, the majority found performance pay in general to be motivating, and they had a fair perception of which activities and what behavior that was expected in order to receive performance pay. However, because the aim of this thesis was not supposed to address compensation systems prior to 2012, it was difficult to compare the interviewees’ perceptions of the different levels. In the relevant years, the interviewees who worked at the PM division experienced to be evaluated both on a team level and on an individual level. Yet no distinct opinions on which level was preferred were given.

What was interesting was that several interviewees mentioned that during earlier compensation systems, they were rewarded on an organizational level, meaning that every employee received a yearly bonus based on the bank’s overall performance. That was perceived as highly motivational amongst many. However, because this falls outside the thesis appraisal area, it is only mentioned briefly. Being evaluated on an organizational level seemed to be connected with a collective drive, and an eager towards fulfilling the criteria.

“From the customers’ point of view, I think discontinuing individual performance pay was a good idea. But I don’t think the annual bonus we had a few years ago caused any downsides for the customers. And it was really motivating when we, at the end of the year, got that little honor”

As was addressed earlier, individual evaluations may have provoked employees to behave selfishly and been destructive in terms of cooperation.

“I don’t think the recent performance pay schemes, with individual evaluations, were any good for the bank as a whole. It led to dissatisfaction amongst the employees. There was fighting between the employees for the most profitable customers, and nobody wanted those who didn’t generate that much profit”

This opinion was found in several of the interviews, and it was, by many of those who responded positively to the discontinuation of the performance pay (question 3), mentioned as a reason for why they welcomed the change.

7.1.2 The importance of pay

In this subsection I examine whether there was a connection between what the interviewees said regarding how important they perceived performance pay and pay in general, and how much effort they were willing to put into their job.

Table 21 - Motivated by performance pay / Question 8.3

| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 |
|--|-----|-----|----|-----|---|-----|----|-----|-----|-----|-----|-----|-----|-----|----|-----|-----|
| Was motivated by performance pay | Yes | Yes | No | Yes | | Yes | No | No | No | No | Yes | Yes | Yes | Yes | No | Yes | Yes |
| Effort has changed since discontinuation | No | No | No | No | | Yes | No | Yes | Yes | Yes | No | Yes | Yes | No | No | No | No |

Table 22 - Question 5 / Question 8.3

| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 |
|--|-----|-----|-----|-----|---|-----|----|-----|-----|-----|-----|-----|-----|-----|----|-----|-----|
| Had knowledge of criteria and expectations | Yes | Yes | Yes | Yes | | Yes | No | Yes | No | No | Yes | Yes | | Yes | No | Yes | Yes |
| Effort has changed since discontinuation | No | No | No | No | | Yes | No | Yes | Yes | Yes | No | Yes | Yes | No | No | No | No |

As can be seen in table 21, only 3 of the 10 who claimed to have been motivated to put in extra effort because of performance pay (interviewee 6, 12, and 13) changed their effort after

its discontinuation. Seven interviewees who claimed to have been motivated by performance pay did however not change their effort after it was discontinued. And from table 22, we can see that even though many knew the evaluation criteria, they had not changed their effort since it was discontinued. Does this imply that the compensation systems were less important in terms of what effort the interviewees put in?

In table 22, I examined whether or not the interviewees in fact reported that they believed the compensation systems were of importance in terms of their motivation and willingness for staying at the bank in the future.

Table 23 - Motivated by performance pay / Question 11.1.1

| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 |
|--------------------------------------|-----|-----|----|-----|-----|-----|----|-----|----|-----|-----|-----|-----|----|-----|-----|----|
| Was motivated by performance pay | Yes | Yes | No | Yes | Yes | No | No | No | No | Yes | Yes | Yes | Yes | No | Yes | Yes | |
| Compensation system is of importance | No | Yes | No | No | Yes | Yes | No | Yes | No | Yes | No | No | Yes | No | No | No | No |

Table 23 shows that many of the interviewees replied that compensation system was of lesser importance when it came to measuring their job satisfaction and motivation for staying at SpareBank 1 SMN. Six of the interviewees who claimed to have been motivated by performance pay said that they considered pay and compensation systems to be subordinate when considering own motivation for the future. It was thus interesting that as many as 13 interviewees mentioned a general dissatisfaction concerning the base pay levels at SpareBank 1 SMN (discussed further in section 3 of this chapter).

These findings implied that when they were asked directly whether pay was something they considered to be important for motivation and the level of effort they were willing to put in, many claimed that it was not. But when the topic came up more in a more natural setting later on during the interviews, many of the same interviewees reported that they considered low pay levels as demotivating. This supports the theory concerning an inconsistency in what people tend to say and how they actually feel (Rynes et al., 2004).

7.2 Multitasking – what multitask problems occurred?

This subchapter addresses whether any multitask problems occurred due to performance pay at SpareBank 1 SMN. As was thoroughly described in chapter 2, performance pay tend to inflict several distortional effects, or multitask problems, because employees will, either intentionally or unintentionally, focus on the tasks that are directly rewarded, and the tasks that are harder to measure can often be ignored or overlooked.

As can be seen in table 9 on page 73, 5 of 16 interviewees replied that they paid more attention to certain tasks after performance pay was discontinued. This was interesting because it implied that for some, performance pay affected the way they conducted their work. However, the majority informed that they did not let themselves be guided by the performance pay criteria, and that they did not change their focus after it was discontinued.

Two important focus areas for SpareBank 1 SMN in recent years have been to improve cooperation both between employees and divisions, and for the employees to be more focused on taking proactivity toward customers. During the interviews, the interviewees were asked whether they had experienced any changes to these (cooperation and proactivity) lately. In addition, I examined whether they had turned their attention and focus due to the discontinuation of performance pay. It was interesting to observe if multitask problems had occurred, and eventually whether they were more negative than positive, and how dominant they were.

Cooperation

As table 11 (p. 73) indicated, 8, or 50% of the interviewees replied that they considered cooperation between employees to be improved during the last few years. 6 replied that they had not noticed any significant change, while 2 replied that they believed that cooperation actually had worsened since the discontinuation of the performance pay.

As was described in chapter 1 and 4, the advisors were divided into divisions and teams. One of the main features of the revised performance pay scheme of 2013 was to stimulate to increased cooperation bot in between employees and the divisions. As it was only applied for a very short period of time, it was hard to measure the direct effects it had on cooperation. However, the majority of the interviewees informed that cooperation had been improving

“over the last few years”, i.e. that indicated that cooperation in fact had started to improve while the bank still operated with performance pay schemes.

“We don’t see the customer as either ‘mine or yours’ anymore, at least we do to a lesser degree than before. Now, we are more open to the idea of letting other colleagues participate in our customer meetings. We’re often two advisors taking part in the communication with the customer now, and that never happened before”

That statement was given by one of the interviewees who believed that cooperation had improved a lot during the last few years, and it was a very typical statement for those of that opinion. It seemed to be a trend that most employees were more willing to ‘share’ their customers after performance pay had been discontinued, i.e. more willing to help customers that were in other colleagues’ portfolios. However, a few of the interviewees mentioned that some employees still tended to think a little ‘mine and yours’, but that they were more and more the exception.

One of the typical multitask problems that can occur due to individual performance evaluations, is reduced motivation for cooperation with one’s colleagues (Rothenberg, 2011). As was mentioned in the review of the performance pay scheme of 2013, individual performance pay evaluations got eliminated, and the focus shifted to team and market area performance. According to Nordhaug (2002), we can expect that using team-based evaluations will have a positive effect on cooperation between employees. This seemed to be the case also at SpareBank 1 SMN, as most interviewees linked individual evaluations directly to a ‘mine and yours’-customer attitude.

Risk

The interviews indicated that the majority demonstrated a greater awareness when came to undertaking after the performance pay was discontinued. Table 14 (p. 75) indicated that 12 of 17 interviewees perceived the focus and attention given to risk and risk assessment as increased in the recent years. In addition, it indicated that the majority was tougher when they considered what types of products, and at what price (interest rate), they would offer the customer. This could imply that the latest performance pay schemes had elements to them that made several of the interviewees undertake greater risk in order to increase sales and acquire customers, i.e. performance pay might have made them compromise with their own beliefs of what they considered as acceptable risk.

Table 15 (p. 76) indicated whether the interviewees became stricter, and to what degree, when came to accepting and acquiring new customers. As table 24 indicates, the majority would still have accepted the same kind of customers as they did earlier, including those who represented a greater risk. However, 7 of 16 interviewees would more likely say no to high-risk customers after performance pay was discontinued, even though these were customers who probably would have been accepted earlier. For two of the interviewees, this applied to many customers, thus it indicated that they became a lot stricter after performance pay was discontinued compared to what they used to be. It should be noted that the question the table was based on table only considered whether the interviewees were more reluctant to accept new risky customers, and not whether they treated already existing high-risk customers any different.

Table 24 - Motivated by performance pay / Question 10.3

| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 |
|---|-----|-----|----|-----|---|-----|-----|-----|----|-----|-----|-----|-----|-----|-----|-----|-----|
| Was motivated by performance pay | Yes | Yes | No | Yes | | Yes | No | No | No | No | Yes | Yes | Yes | Yes | No | Yes | Yes |
| More strict in terms of risky customers | No | No | No | Yes | | Yes | Yes | Yes | No | Yes | No | Yes | Yes | Yes | Yes | No | No |

The findings indicated no particular correlation between the motivational effects of performance pay and the attitude towards risky customers. It showed that 5 interviewees who were motivated by performance pay changed their attitude towards risk and risk assessment, equally many as the last 5 who were motivated by performance pay but still did not change their attitude.

As was noted in chapter 4, the latest performance pay schemes had a maximal bonus of NOK 80 000, or 25 % of base pay. The scorecards (PM) indicated that the market area's performance as a whole was weighted heaviest in all four perspectives, and in total 49 % (see attachment 2). However, when I examined the parameters of the finance perspective, I found that individual performance represented 60 %. As of the entire scorecard, that amounted 22 % in total. Of all individual parameters, those (customer recruitment and new loan contributions) were the ones weighted the highest. That implied that if the employees sought to maximize their performance pay, their main priority would have been customer recruitment and selling new loans. All other individual parameters varied from 3 % to 8 %,

and though they might have had a certain motivational effect, some might have found it harder to direct their effort onto those tasks. For performance pay to be motivating, it should represent a certain amount of the total pay (Gneezy and Rustichini, 2000), and even though the maximum performance pay in total could be large enough to motivate, it seemed reasonable that the employees would have prioritized the tasks that had the least direct effect on performance pay first *after* the criteria for the more rewarding tasks were fulfilled.

As these two parameters were the most influential ones directly affected by individual performance, it was not surprising that some employees relaxed their standards in order to sell new loans or acquire new customers when they were rewarded with performance pay. However, it was interesting that from another question (question 6 of the interview guide, see attachment 1), the answers varied to a great extent to whether the interviewees believed they had direct influence on the performance pay or not. This might partially explain why 12 interviewees replied that their attention towards risk increased after performance pay was discontinued (question 10.2), yet that it in the same time does not necessarily mean they changed their behavior accordingly.

On a side note, an interesting topic that came up during several interviews was that many interviewees believed that SpareBank 1 SMN's recent risk assessment profile was too defensive. Multiple interviewees commented that it was difficult to exploit their local knowledge to a satisfying, and profit maximizing, degree. The topic was of great concern for several:

"We are so afraid of losing money now that we have to let potential good sales go",

and

"We know most of our customers, and sometimes we can almost personally guarantee that they won't be defaulting on a single installment...but no, the system is too strict. They [the management] don't trust us as advisors when it comes to risk assessment"

These remarks could imply that though some advisors became stricter in terms of risk assessment after performance pay was discontinued, and changed their behavior accordingly, they did not necessarily agree with the policy because they believed that the way they assessed risk earlier was completely safe and justifiable. In their opinion, SpareBank 1 SMN

was losing business and potential good customers due to the recent cautious risk assessment profile.

Proactivity

Further, I sought to examine whether the interviewees were more proactive towards customers after performance pay was discontinued. By that, whether they were more actively reaching out to existing and potential customers. In addition, I examined whether the way they behaved in relation to this changed after performance pay was discontinued. Were they giving less priority to the tasks they found “boring” or uncomfortable, typically tasks that maybe were directly measured when they worked under the performance pay schemes? As could be seen in table 10 (p. 73), 10 of 16 claimed to be more proactive after performance pay was discontinued, and half of them even much more. Only one of the interviewees informed that he or she was less proactive than before.

Some of those who reported that they were less motivated to acquire new customers after performance pay was discontinued saw this in connection to their reduced motivation for supplying extra effort. That was a reasonable connection due to the fact that in order to acquire new customers, advisors often will have to call potential customers and persuade them into changing their bank connection. When motivation for working extra hours in the nights (typically the time of the day when potential customers have time to discuss their bank connections) was reduced, a correlation with lesser recruitment might be expected.

“I tend to call fewer customers now. You don’t endeavor as much when you’re not getting anything back... When it comes to acquiring new customers we could have done more. If we had been rewarded with overtime payment and a little extra for working that extra hour, of course I would have done that”

Table 25 - Motivated by performance pay / Question 9.1.2

| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 |
|----------------------------------|-----|-----|----|-----|---|-----|----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| Was motivated by performance pay | Yes | Yes | No | Yes | | Yes | No | No | No | No | Yes | Yes | Yes | Yes | No | Yes | Yes |
| Are taking more initiative now | No | No | No | No | | No | No | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes |

As the citation above indicated, calling customers in the interest of selling might for some have been perceived as a rather boring task, and sometimes an even uncomfortable one.

When a task of that nature was not rewarded directly, they might easily have been given low priority, thus lead to reduced customer recruitment for the bank. Table 25 indicates that of those who claimed to have been proactive to the same or to a lesser degree (interviewee 1, 2, 3, 4, 6, and 7), four (or 67 %) reported to be motivated by performance pay. But what the table also indicates is that 6 interviewees who were motivated by performance pay (or 60 %) were less proactive when they were working under performance pay. Thus, there were no clear indications to whether performance pay had a positive effect on proactivity.

Additionally, the majority believed proactivity, and changes to it, was due to more focus and attention to it from their local manager, and that it was not directly a matter of the compensational systems. Many of the interviewees stressed that they were unaffected by the compensation systems in this relation, and that they have always had the customers' best interests in mind. A few however, reported that they did lose some of the motivation for acquiring new customers, and thus were more focused on maintaining their existing portfolio than calling out to new ones. But some of the younger interviewees, who tended to be more actively working to acquire new customers, informed that they felt freer to try new ways for to acquire customers after the performance pay schemes were discontinued.

"I try to think a little more outside the box now in relation to being more visible [to customers]... For instance by putting up stands at malls and at the local town squares. Just be more visible!"

As will be addressed further below, the majority of the interviewees had long experience and seniority at the bank. Naturally, this meant that many of them already had huge customer bases, thus the desire for acquiring new customers might have been slightly less at these branches compared to what we could expect at branches with younger and more inexperienced employees. One of the more experienced interviewees said:

"...I'm in a position where I already have a large portfolio, thus I don't have to be very proactive in relation to new customers because my hours are already filled up by the ones I have. I rarely recruit new customers actively. I accept those who come to me unsolicited, but I don't work actively to acquire more, because my portfolio already is too big"

Long-term perspective

Due to performance pay, short-term thinking could be a multitask problem. This problem was thoroughly addressed in chapter 2, and one of the main reasons is that employees often tend to plan for staying with the organization they work for only for a limited time before

they maybe will seek new jobs. While owners however, typically tend to focus on building the organization for the future and maximize its NPV. According to a survey conducted by Opinion Perduco on behalf of ManpowerGroup, only 5 % of the young employees (<30) who participated in the survey believed they would stay at the same position for longer than 10 years (Opinion Perduco, 2013). This demonstrated that employees, especially younger, often would have a short-term perspective when it came to the length they would stay at the same job. Employees might thus be more focused on the current state of their organization, and less focused on what happens to it after they have left.

As table 13 (p. 75) indicated, 10 of 17 replied that they did not think more long-term after the performance pay was discontinued. That could mean that they always have had a long-term focus, or it could imply that their perspective was unaffected by performance pay.

Table 26 - Seniority / Question 9.2.2

| | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 | 13 | 14 | 15 | 16 | 17 |
|---------------------------------|----|----|-----|-----|---|-----|-----|----|----|----|----|-----|-----|-----|-----|-----|-----|
| Seniority 15+ years | No | No | Yes | Yes | | Yes | Yes | No | No | No | No | Yes | Yes | No | No | Yes | Yes |
| Have a more long-term focus now | No | No | Yes | No | | No | No | No | No | No | No | Yes | Yes | Yes | Yes | Yes | No |

The majority of the 10 who replied that they did not have a more distinct long-term focus after performance pay was discontinued informed that they had always acted in a long-term manner. Initially, it might have been reasonable to assume that those were the ones who had long experience and high seniority. But as can be seen in table 26, of the 8 who had over 15 years of experience at the bank, 50 % informed that they actually changed to a more long-term perspective after performance pay was discontinued.

As SpareBank 1 SMN over time have operated with various performance pay schemes, the incentives for short-term thinking have varied in strength. Several interviewees mentioned a period where employees were paid NOK 1 000 per new customer acquired, and characterized it as a very shortsighted policy. One said,

“Earlier, you could acquire two new customers and get either a reward or praise. But nobody cared if you in the same time lost the same amount of your existing customers”

This policy implied that the bank, at that time, did not worry much about who their customers were, just as long as they steadily recruited new ones. However, this scheme falls outside this thesis' appraisal area, thus it will not be discussed any further.

Taking care of existing customers can often be perceived as easier, and more profitable, than obtaining new ones. An interviewee put it:

“Acquiring a new customer takes three times as much work as selling to existing ones”

Although that statement maybe should not be understood literally, it implied that it was a common perception that acquiring new customers were less lucrative than maintaining the existing customer portfolio. Another interviewee discussed how selling to existing customers often meant that they could sell to prices where they made a profit, but that when they were competing with other banks for new customers, they usually had to offer the lowest possible interest rate, thus affecting their profit.

7.3 Valuable information for the future

Differences between the Stjørdal/Meråker branches and the Malvik branch

As noted in chapter 3, the employees at the Malvik branch had deeper knowledge of the new career model compared to those who worked at the Stjørdal/Meråker branches at the time of the interviews, thus they could be expected to have a more thorough understanding and perception of it. It was interesting to examine whether they were more optimistic about the future compared to those who worked at the Stjørdal and the Meråker branches, and whether or not compensation system were of importance for their motivation and optimism.

If the new compensation system was to be motivating, it was important that it had been communicated well, and that the employees fully understood its features (Nordhaug, 2002). Thus, it could not be expected that by the time of the interviews, the employees from the Stjørdal and Meråker branches felt strong motivation due to the new system. Also, even though those from the Malvik branch were informed of the new model's features, they had yet to work under it over time, and so it was only possible to measure and discuss their first impressions.

3 of 6, or 50 %, of the employees at the Malvik branch agreed to the discontinuation of performance pay, and only 1 opposed it. Yet, even though some of those who agreed to the discontinuation found performance pay to be motivating, they remained positive to it because, as one said:

“Bonuses are unfortunate in banks”

Because three interviewees were positive to the discontinuation, 2 were unsure about it, and only 1 opposed it, it could have been expected that the majority would receive the new career model with an open mindset.

Three interviewees at the Malvik branch replied that they, after they had received thorough information about the new career model, were left with a fairly good impression of it. 2 had yet to make up a reasonable impression of it (which was understandable since they had been given little time to let its features sink in). One interviewee however, was left with a very bad general impression of it. When they were asked to compare the new career model to the previous performance pay schemes (question 4 of the interview guide), 3 rated it as a little better, 1 rated it as much better, and 1 rated it as much worse. The sixth and final interviewee refrained to rate it due to the fact that he or she had yet to make up an impression of it.

This very brief review did not give any conclusive evidence to whether the new career model was perceived as motivational or not. Even though 3 interviewees at the Malvik branch rated it as a little better, only one interview informed that he or she found it to be more motivating. At the Stjørdal and Meråker branches, only 5 interviewees rated the new career model and compared it to the previous performance pay schemes. 3 rated it as worse than the performance pay scheme, while 2 rated it as better. Even though the numbers showed that a slight majority was leaning towards worse, it was far from enough answers to conclude on anything based on it. But the majority at the Malvik branch was leaning towards the other direction. This could very likely just have been a coincidence, or it could imply that overall attitude towards the career model improved when information about it was given. However, the interviewees at the Malvik branch were not asked whether their impression of the career model improved when they were given proper information about it, thus it could not be concluded whether it was perceived as more motivating than first expected.

Base pay

This topic was intensely discussed by several interviewees, and as many as 13 interviewees mentioned that they considered this to have been a problem and something that caused great distress. The general perception amongst the interviewees was that the fixed pay levels at SpareBank 1 SMN were way too low, compared both to other business sectors and to colleagues who worked at other banks and financial institutions.

In chapter 2, the concept of external fairness was addressed. According to Nordhaug (2002), a compensation system should, in order to be perceived as fair, compensate the employees at the same levels as their colleagues at competing organizations.

“We have a thorough insight to the general pay levels out there, and we feel that some people, even many who have just started their professional careers, make a lot more money than us who have been with the bank for 20-30 years”

This opinion was expressed in the majority of the interviews, and it described pretty accurate that the criteria for external fairness was not fulfilled.

“...if I go back 15 years, I made a lot more money compared to those who came to me applying for mortgages. Now, most customers make more money than me, the change is significant”

An interviewee described how they, due to the nature of their work, knew the average pay levels across business sectors, including of other banks and financial institutions. And (although I did not conduct any research on this myself) the interviewee informed that the average SpareBank 1 SMN employee were paid between NOK 50 000 and NOK 100 000 less than their counterparts at other organizations. These numbers could vary due to education, seniority, etc., but when the perception was that financial advisors at other financial institutions made that much more money, SpareBank 1 SMN employees were left with a feeling of not being valued very high by their employer. Fehr and Falk (2002) notes that pay levels can affect employees' perceived social approval. If it is at a non-satisfying level, it can affect motivation and organizational commitment, and again lead to dissatisfaction with the job in general. Social approval can further be linked to basic motivational theories like Herzberg's two-factor theory, where we find 'recognition' as an intrinsic motivator¹⁸. In addition, it should be noted that Kuvaas (2008) in a study found that

¹⁸ Intrinsic motivation was one of the key targets of the performance pay scheme of 2013

base pay level was positively related to intrinsic motivation, because employees would be intrinsically motivated when they experienced being trusted by their employer.

“It has been said that in order to get a raise, you had to apply to other banks, and then come back to the management to present the offer you were given, in order for them to consider whether it could be matched”

This showed a questionable approach to this issue. In order to get a raise, loyal employees would have to get job offers elsewhere, and then go back to their employer with proofs of their market value. It could be questioned whether this was the best way to approach loyal employees, as research indicate that loyal employees traditionally are highly profitable for their organization (Brooks, 2000). Of the 17 interviewees, 13 had worked at SpareBank 1 SMN for longer than 10 years, and many of them for about 30-40 years, thus it indicated that amongst the sample for this research, a high percentage was what could be considered as loyal employees.

“...we, who have been loyal to the bank, are underpaid. And that goes for the most of us who works here, we are extremely loyal”

This thesis can not be used to support arguments saying that low base pay will result in low organizational commitment, at least when it comes to loyalty (Fehr and Falk, 2002). An interesting notion is however, that people have a tendency to

“see themselves in a self-enhancement fashion” (Pfeffer et al., 1998)

That means they tend to perceive themselves as better employees than they actually are, and also better than the average person. Self-enhancement bias is a fairly acknowledged phenomenon, and so we can only expect employees everywhere to believe they are underpaid when they themselves considers their value to their job. Because loyalty seemed to be fairly high amongst the interviewees in this research, but still most said that they were dissatisfied with the pay levels, self-enhancement bias might have occurred on some level in these three branches. And as long as the interviewees continued to stay loyal to their employer, SpareBank 1 SMN would in fact be saving money by not increasing their pay levels.

7.4 Summary

In the first section of the discussion, I sought to address whether the interviewees perceived performance pay, mainly the schemes used in 2012 and 2013, as motivating. I described what I considered to be the most significant and interesting topics that came up during several of the interviews, and compared them to relevant theory. The topics that were discussed were: criteria achievability, employee influence on pay, team- and market area size, perceived fairness, time gap between performance and rewards, and on which levels evaluations were made. There were relative significant individual differences amongst the interviewees. A brief summary of the discussions to each criterion is rendered in figure 13.

After having reviewed and examined the responses in terms of answering my first sub-question, I found that even though the majority claimed to be motivated by performance pay, their effort had only marginally changed after it was discontinued. This was especially addressed in table 22 (p. 89), where we could see that as many as 8 of those who had knowledge of the criteria also reported to not have changed their effort since its discontinuation. Thus, it is interesting that the bank informed that a part of the reason for why performance pay was discontinued was that the schemes did not motivate as intended.

In the second section of the discussion, I addressed whether any multitask problems occurred due to the performance pay schemes. First and foremost, I addressed cooperation, risk taking, proactivity, and different perspectives.

The discussions showed that the opinions varied in terms of whether multitask problems actually occurred. We saw that 50 % of the interviewees reported that cooperation improved after performance pay was discontinued, while only 12,5 % found it to have been worsened. Also, it was interesting that the majority did consider themselves to be stricter in terms of risk and risk assessment, in addition to being more proactive, after performance pay was discontinued. However, several interviewees noted that the some of the changes occurred due to not only the discontinuation of performance pay, but also due to managerial influences that guided them in particular directions (especially in relation to proactivity and risk taking).

The final sub-question I sought to answer was whether any information obtained from these interviews could be useful in terms of future compensation systems at SpareBank 1 SMN. In

that relation, I examined whether any significant differences in terms of future motivation could be observed. In addition, the topic of base pay was thoroughly addressed.

The discussions revealed that there, at the time of the interviews, were few indications to whether the career model would be motivational, although a small majority at the Malvik branch rated it as a little better than the performance pay schemes, while the majority leaned the other way at the other branches. Additionally, a solid majority of the interviewees reported a general dissatisfaction with base pay levels at SpareBank 1 SMN.

| Section 1: Performance pay - did it motivate? | |
|--|--|
| Achievable criteria | Seemed to be strongly correlated with motivation |
| Influence | Seemed to be correlated with motivation |
| Team size | No significant findings in relation to importance |
| Percieved fairness | A few noted that they did not find the schemes fair |
| Time gap between performance and rewards | Seemed to be correlated with motivation |
| Level of evaluation | Individual evaluations might have provoked selfishness |

| Section 2: Multitasking - what multitask problems occurred? | |
|--|----------------------------|
| Cooperation | Improved |
| Risk Assessment | Stricter |
| Proactivity | Improved |
| Perspective | No significant differences |

| Section 3: Valuable information for the future | |
|---|----------------------------|
| Differences between the branches | No significant differences |
| Base Pay | Percieved as low |

Figure 13 - Summary of discussion

8. Conclusion

Performance pay seems to have motivated to some degree. The majority reported that they were motivated by performance pay, yet still many at the same time reported that their effort did not change when it was discontinued. This might indicate that pay was not the only factor that was significant in terms of employee motivation and effort. As noted, SpareBank 1 SMN named unintended motivational effects as one of the reasons for why performance pay was discontinued. If they by that meant that they were dissatisfied with the levels of effort put in by the employees, the discontinuation seems not to have been successful in terms of leading to the desired change. If they on the other hand in general were satisfied with the levels of effort put in, the bank was most likely to have saved money on not continue performance pay. Nevertheless, for some interviewees, their responses showed low correlation to each other, thus the lack of consistency could indicate that some implied that pay is less important than what they actually believe, in addition to them tending to answer “politically correct”. Thus, the responses should be carefully considered in regards to that.

Several multitask problems occurred due to performance pay. There seems to be a perception amongst many of the interviewees that cooperation improved after performance pay was discontinued, both in between employees and in between divisions. Additionally, risk assessment seems to be stricter, and proactivity seems to have improved. The most significant change appears to be that the interviewees perceived themselves as freer to approach new and existing customers in ways they believed were more efficient than was the case when they were working under performance pay schemes.

Some of the employees at the Malvik branch tended to be a bit more optimistic about the future and the new career model, but because the differences between the branches were so marginal, it will not be reasonable to draw any conclusions based on it. However, the average base pay levels appear to be something of great concern for most interviewees. The career model might be a solution, as it entails changes to base pay rather than a yearly portion of performance pay that is likely to change every year, thus giving little stability for the employees.

The overall findings tend to imply that the discontinuation of performance pay was not of vital importance for the level of effort put in by the majority of the interviewees. It also

seems to have reduced several multitask problems, thus the decision to discontinue performance pay appears to have been reasonable.

As this research was done prior to the adaption of the career model, it would have been interesting to examine whether the results have changed in a few years, when the interviewees have worked under the career model for a few years. How does it work in terms of motivation and everyday work related matters, and does age and seniority matter for how motivated employees will be by a career model of this kind? Additionally, it would have been interesting to examine other branches of SpareBank 1 SMN in order to compare the results found in this one. As this thesis used qualitative interviews to collect data, the findings should not be used for generalization purposes. Thus, similar research conducted in other branches might have made this possible.

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Appendix

Attachment 1:

Interview guide

Name:
Age:
Seniority:
Education:

Introduction:

| Question 1 | Very good | Somewhat good | Know very little about it | Somewhat bad | Very bad |
|---|-----------|---------------|---------------------------|--------------|----------|
| <i>What is your tentative perception of the new career model?</i> | | | | | |

| Question 2 | Well | OK | Poorly |
|--|------|----|--------|
| <i>How well is the new career model communicated to you employees?</i> | | | |

| Question 3 | Yes | No | Don't know |
|--|-----|----|------------|
| <i>Do you believe discontinuing bonuses and performance pay was the right thing to do?</i> | | | |

| Question 4 | Much worse | A little worse | Neither or | A little better | Much better |
|---|------------|----------------|------------|-----------------|-------------|
| <i>Compare the new career model to the recent performance pay schemes</i> | | | | | |

| Question 5 | Easy | Hard | Didn't familiarize myself with the criteria/Can't answer |
|--|------|------|--|
| <i>Did you find it easy to know which activities and what behavior was expected in order to receive performance pay?</i> | | | |

Question 6
Did it ever happen that a bonus came as a surprise to you? Did you believe you had a lot of influence to whether or not bonus or performance pay would be given?

Main section:

| Question 7 | High | Moderate | Low |
|--|------|----------|-----|
| <i>Is the focus on and attention to pay high at SpareBank 1 SMN?</i> | | | |

Question 8
Did you work harder?

| Question 8.1 | Yes | No |
|---|-----|----|
| <i>Were you more motivated to put in higher effort when knowing that you could receive a bonus or performance pay if you did?</i> | | |

| Question 8.2 | Yes | No |
|--|-----|----|
| <i>Do you still see the same value of working extra?</i> | | |

| Question 8.3 | Yes | No |
|--|-----|----|
| <i>Have your effort changed in any way since performance pay was discontinued?</i> | | |

Question 9
Are you working smarter?

Question 9.1
Are you working more with some tasks now compared to earlier? (Sell more/less, are more proactive, etc.)

Question 9.1.1
Which tasks are you focusing more/less on now?

| Question 9.1.2 | Much more | More | No change | Less | Much less |
|--|-----------|------|-----------|------|-----------|
| <i>Are you focusing more on being proactive towards customers now?</i> | | | | | |

| Question 9.1.3 | Much better | Better | No change | Worse | Much worse |
|--|-------------|--------|-----------|-------|------------|
| <i>How is cooperation between the employees now compared to earlier?</i> | | | | | |

| Question 9.2 | Much more | More | No change | Less | Much less |
|---|-----------|------|-----------|------|-----------|
| <i>Do you get to focus more on the tasks that you personally believe is more important for the bank now compared to before?</i> | | | | | |

Question 9.2.1
Have the bank communicated what is important focus areas, and are these correlating with your personal perception?

| Question 9.2.2 | Yes | No |
|---|-----|----|
| <i>Do you have a more long-term perspective now? In terms of sales, customer advisory, etc.</i> | | |

Question 10
Are you making better decisions?

| | | |
|--|------------|-----------|
| Question 10.1 | Yes | No |
| <i>Are you giving any different advice to the customers now compared to earlier?</i> | | |

| | | |
|---|------------|-----------|
| Question 10.2 | Yes | No |
| <i>Do you believe that there is a greater focus of risk and risk assessment at SpareBank 1 SMN now?</i> | | |

| | | |
|---|------------|-----------|
| Question 10.3 | Yes | No |
| <i>Are you "tougher" when evaluating customers and their profitability?</i> | | |

| | | | |
|---|-------------------|--------------------|-----------|
| Question 10.3.1 | Yes - many | Yes - a few | No |
| <i>Are there customers you would have accepted earlier that you now choose to reject?</i> | | | |

Question 11
Attract/retain talent

| | | | |
|---|------------------------|----------------------|------------------------|
| Question 11.1 | More attractive | No difference | Less attractive |
| <i>Is SpareBank 1 SMN more attractive as an employer now?</i> | | | |

| | | | |
|--|-------------------------|------------------------|----------------------|
| Question 11.1.1 | Great importance | Some importance | No importance |
| <i>Are the discontinuation of bonus and performance pay, and the implementation of the career model, of any importance for your perception of SpareBank 1 SMN's attractiveness as an employer?</i> | | | |

| | | |
|---|------------|-----------|
| Question 11.2 | Yes | No |
| <i>Are you more motivated to stay at SpareBank 1 SMN now?</i> | | |

Question 11.3
Do you feel you have possibilities for personal and professional development at SpareBank 1 SMN? Have these changed (e.g. more courses, etc.)

Question 12
Are there any other topics you would like to address?

Attachment 2:

| Perspektiv, styringsparameter | | | | | |
|--------------------------------------|---------------------|---|-------------|----------------|------|
| | Definisjon | Mål | Vekt | Faktisk | |
| | Økonomi | | 35 % | | |
| 1 | Økonomi MO | Resultat fra markedsområdets prestasjoner innenfor hovedkategorien Økonomi | 6 | 40 % | 14 % |
| 2 | Utlånsbidrag | Årlig bidrag fra nye lån: Netto utbetalte lån med pant i fast eiendom multiplisert med margin på lån. Diskontert saldo multipliseres med kunderente med fradrag for bankens mellomregningsrente | 100 % | 30 % | 11 % |
| 3 | Kunderekuttering | Antall nye boliglånskunder i henhold til definisjon på ny kunde | 100 % | 30 % | 11 % |
| | Kunde | | | 55 % | |
| 4 | Kunde MO | Resultat fra markedsområdets prestasjoner innenfor hovedkategorien Kunde | 6 | 45 % | 25 % |
| 5 | Finansiering | Netto utbetalte boliglån og billån og benyttet beløp av innvilget ramme på rammelån hittil i år i forhold til målet | 100 % | 5 % | 3 % |
| 6 | Spareavtaler | Solgt volum av spareavtaler i kroner i aksjefond | 100 % | 10 % | 6 % |
| 7 | Engangstegning | Solgt volum av engangstegninger i aksjefond i ODIN utenom spareavtaler | 100 % | 10 % | 6 % |
| 8 | Skadeforsikring | Solgt volum av skadeforsikring | 100 % | 15 % | 8 % |
| 9 | Personforsikring | Solgt volum av personforsikring | 100 % | 15 % | 8 % |
| | Kvalitet | | | 5,0 % | |
| 10 | Kvalitet MO | Resultat fra markedsområdets prestasjoner innenfor hovedkategorien Kvalitet | 6 | 100 % | 5 % |
| | Organisasjon | | | 5,0 % | |
| 11 | Organisasjon MO | Resultat fra markedsområdets prestasjoner innenfor hovedkategorien Organisasjon | 6 | 100 % | 5 % |

100 % 100 %