School of Business, Economics and Law
GÖTEBORG UNIVERSITY

Incentivising through EVA and other Short Term Performance Metrics -Exploring other neglected paradigms

Etumudon Ndidi Asien

Graduate Business School

International Accounting
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Supervisor: Gunnar Rimmel

Dedication

This thesis is posthumously dedicated to Janet Melekwue Asien,
of blessed memory, who went to eternal transition on August 3, 2003.

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No man (or woman) has even made it alone in life without the support of other people, one way or the other. Countless number of people has, in no small measure, contributed to making my studies at the Graduate Business School a memorable and an outstanding success. To them, I must place on record the invaluable support I received. They include faculty and administrative staff as well as fellow students. Words cannot adequately express how I relished and cherished the opportunity of meeting this people on my life's journey.

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Abstract:

The emphasis in theory and practice of using EVA and other short-term performance measures to incentivise senior management and management group alone arouses the inner curiosity for this thesis. If any thing else, it is the belief that all members of the organisation should be compensated for the good performance of organisation members. This research investigated whether incentive bonus systems linked to EVA and other short-term mimetic isomorphs have addressed the needs of the ordinary worker. That is, the thesis attempts to find out whether incentive bonus systems as being applied by companies can be considered fair and equitable, from the point of view of the rank-and-file employees. The term rank-and-file refers to the generality of workers on the shop floor. It does not in any way mean blue collar or white collar workers.

A graphical conceptual model was developed and tested in the study.

Theoretically, the research is anchored within the remit of behavioural accounting research.

Ensuing empirical results obtained from companies' annual reports through the use of content analysis method showed that the ways EVA and other mimetic variants are being selectively applied or used to incentivise organisation members are, in most cases, considered unfair to the rank-and-file or the generality of workers.

Keywords: Economic Value Added Short-term Incentives Long-term Incentive Programme Executive Compensation Performance Annual Reports Corporate Governance Distributive Justice Fairness Incentive Bonus Agency theory Content Analysis Disclosures

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Chapter 1

1.1 *Introduction*

As one was being exposed, through lectures and readings, to some performance metrics, such as Economic Value Added, Shareholder Value Added, Total Value Added, and a few mimetic others, which some companies use as the bases of incentive bonus schemes in organisations, one began to hear what one may call an inner voice pointing to certain aspects of using some of these short-term performance metrics as a basis to offering incentives to organisation members. The inner voice led to a beginning of pondering aloud about whose benefit the application of incentive bonus payments in the organisation is. What is observed from the various experiential readings is that there is no single performance metric that has not been praised by its *inventors*, and followers alike, as not offering the best of view as the basis of incentive compensation in organisations. But the various performance metrics used to reward organisational performance have always focused on the interest of senior management; and the bonus incentive offered as a result of meeting certain performance targets have always been reserved for the exclusive benefit of the same group of employees in an organisation.

There has always been a need or concern for industrial or work-place justice or fair-play. If any thing else, it is the belief that all members of the organisation should be compensated for the good performance (in terms of profitability) of organisation members. It is considered necessary that companies extend bonuses and other incentives to *all* members of the organisation, irrespective of their hierarchy in the organisation. To do otherwise would smack of discrimination and favouritism in favour of managers, and to the disfavour of the ordinary workforce, which we chose to call the rank-and-file employees, excuse the choice of terminology. The realisation has come to be that Economic Value Added and other mimetic isomorphs such as Total Value Added and others, in spite of being overly praised and eulogised, have not addressed this apparent neglect or concern of the ordinary workforce.

This observation brings us to the general propeller for the thesis, which is the concern to address the needs of workers other than senior managers in incentivising organisation members and the need to extend, anyhow somehow, some of the bonuses enjoyed by senior managers to other group of employees, especially those who have no *voice* or power in the organisation to distribute bonuses.

In the main, the thesis also has a specific underpinning that gave birth to it. In the course of the various lectures and readings at the Graduate Business School; School of Business, Economics, and Law of the Gothenburg University regarding performance-based incentive bonus systems, students (of whom this writer was one of them) got exposed to the so-called Economic Value Added (EVA) and other constructs like Shareholder Value Added (SVA), Total Value Added (TVA) and others. This constructionist quest has sort of captured the fancy of people who want to immortalise their names for an *invention* or breaking of new grounds, so to speak. Without exception, and in spite of the hype and hoopla accompanying them, almost, if not all, the various performance-based incentive systems fall short of what is thought should be a prevailing quest for workplace justice and fairness. Again, in spite of the highfalutin praise and encomium heaped on the various performance-based incentive bonus systems, what caught this researcher's spirit of enquiry has been the desire to know how the goodies resulting from a company's good performance (in terms of meeting or exceeding certain predefined profitability targets) has been spread to every member of the organisation. As mention, this has raised some inner curiosity as certain questions began to be asked. Some of these questions are the raison d'etre for this research. It is believed that since every member of the organisation has contributed in one positive way or the other towards meeting a desired target, every one should be rewarded somehow without regards to their position or level in the organisation.

The present research shall attempt to find out if this is the prevailing practice in companies and organisations that incentivise their members for good performance, i.e., for meeting or exceeding certain agreed performance or profitability targets.

The issues addressed in this introductory chapter of the thesis include the general framework, structure, organisation and presentation of the whole thesis. The chapter is approached by the way issues are sectionalised or calibrated in the following sequence, beginning with: a) problem recognition or formulation, b) purpose and motivation of study, c) formulation of propositions, and d) delimitation and scope of study.

1.2 *Problem Recognition*

Companies and their boards are continually finding ways of enhancing the performance of their employees and managers so as to further the interests of stakeholders (including managers) by way of increased shareholder-value and return on investment. Managers are being wooed or enticed by various means to make them perform their best in terms of improvements to the *bottom line*. However, researchers have posited that the notion of performance-related pay is based on some dubious psychological precepts. According to them the performance-related pay doctrine suggests that chief executives will not do their best in the long-term interests of their enterprises unless they are given special rewards, over and above an agreed salary. This implies that the commitment of a chief executive officer, or a manager generally, to optimise performance cannot be depended upon unless s/he is 'bribed' into it. (For more on this see for example, Morse 2003).

One of the ways managers are being benchmarked (and rewarded) is through what is now famously called Economic Value Added (EVA™) and other various models such as Shareholder Value Added (SVA), Total Value Added (TVA), and Market Value Added (MVA), to mention but a few. In simple terms all these models, especially EVA, are a financial incentive tool that is used to calculate the "true economic profit" of an enterprise. Specifically, EVA, in its theoretical construct, is a residual income that allows for the opportunity costs of capital invested in a business. EVA and the various performance metrics have been -and are being- eulogised by many pundits (for example, Adi Godrej (2004) and Lovata and Costigan (2002), as the best capture of a company's true economic profit. But it is noticed that the focus on EVA as a pay-for-performance incentive bonus system presupposes that the management of a company is solely responsible for the entire fortunes of the company. This is perhaps partly correct but it ignores other influences that are outside the control of management, and some of which are based on happenstance, or pure luck. The practice by some companies to use EVA and other short-term performance metrics to incentivise managers is also a presupposition that attributes the success of a company to the management alone. But this cannot be further from the truth or reality as the performance of an entire organisation is a connected web transcending one particular group of persons. The thinking is that it will be logical if it is argued that this practice does not appreciate the input of the generality of employees, including employees at the lower echelon. As this issue is thought over, it begins to be realised that it makes executive compensation based on EVA and other isomorphic performance metrics to be inequitable or unfair to some sections or groups of workers in the company. To reward only chief executive officers and senior managers by whatever incentive bonus system is rewarding the leadership cadre of a company alone. But it is a common-place truth that there would be no leadership without followership. It then stands to reason that the leader-subordinate dyadic relationship equation is unjustly skewed or tilted to one side of the workplace equation favouring managers as a consequence of recognising and rewarding only them for the performance of *all* organisation members. This, unfortunately, supports the propositional arguments of some CEOs (Adi Godrej (2004); for example) that the only way managers can make more money for *themselves* is by creating even greater value for shareholders; i.e., by meeting EVA targets. This is the prevailing paradigm with the various performance metrics, EVA not the least excluded. It stands to reason - and to question, "Why should the attention or focus be on managers making more money for themselves, and not for every organisation member? It is assumed that the greater the bonus for managers, the greater the shareholder value. This neglects the input of the rank-and-file employees, whom this thesis addresses and in honour of. Thus, this thesis is out to explore other neglected paradigms.

The focus on managers is not far-fetched, however; because a general pervasive concern and consensus for company owners according to the so-called Principal-Agency problem is how to make agents entrusted with the management of their principal's investments to perform better from one year to the other, on a consistent and continuous basis. One perspective of the Principal-Agency theory views incentivisation as an attempt by owners to motivate managers who control the owners' investments to conduct the enterprise in ways that enhance the welfare of owners or principals. This may therefore, explain the reason why some thoughtful owners think it wise to devise means to get their managers to behave in ways that would add value to the *next* "bottom-line" by enhancing the interests of principals, which in one way is the value they expect from their investment.

A second perspective regards managers (maybe owners as well) as risk-averse Gibbons (1998), Lovata and Costigan (2002), and Lynch and Perry (2003). Specifically, managers, as agents of the firm, are assumed to be risk-averse, with an interest in increasing their own wealth. As a result, the interests of managers are not always naturally aligned with those of shareholders or owners. It is believed that by linking pay with performance, compensation contracts can be used to help align the interests of managers with those of shareholders.

According to this latter perspective, incentivisation is needed to compensate managers for taking risks that go far and beyond the remit of agreed terms and conditions of their employment or engagement in the successful pursuit of the principals' interests. Thus, bonuses are seen as creating incentives for agents or managers to perform better than would normally be the case. Incentivising to assume or take additional risks also carries some risk (Gibbons, 1998). Several initiatives are devised, based on agreement between the owners and manager, as to how to motivate managers to enhance the value of shareholders in terms of the "bottom line" or what eventually goes to the owners accruing from their investments. Some of the devices that have been found in place for encouraging or motivating managers include stock grants, stock option grants, base annual salary, cash compensation, annual bonus, long-term incentive cash payout. This thesis will not dwell on these well-known compensation plans. Rather the emphasis is to deepen our understanding on how these, in conjunction with Economic Value Added (EVA), Shareholder Value Added (SVA), Market Value Added (MVA), and Total Value Added (TVA) and others, have not been able to take into account the interest of lower level workers in the organisation.

Up until now, emphasis has unduly solely been too much on short-term bonus incentive mechanisms *per se*: All of them are variants of the same paradigm—and they dwell on the quest of how to compensate managers for a job well done far in excess of expectation. This means that they all have the same basic aim, which is a way of giving managers a pat on the back for excellent performance in terms of the bottom line. As it is, this thesis has no quarrels with the various incentive programmes highlighted here. Its gross has to do with the question of why it is that only managers and top executives are recognised and thus given bonuses for the performance of all members of the organisation, including the managers themselves. Even though this behaviour is viewed as "short-termism" (a point that we shall be returning to later in Chapter 5), a case is beginning to be articulated by asking, why not extend the same bonus to the entire workforce instead of restricting it to the managers alone?

As a metric for compensation, EVA is a financial incentive tool that is used to calculate the "true economic profit" of an enterprise or a company. In its theoretical construct, it is a residual income which allows for the opportunity costs of capital invested in a business. "…*EVA is based on something we have known for a long time: what we generally call profits, the money left to service equity, is usually not profit at all. Until a business returns a profit that is greater than its cost of capital, it operates at a loss. Never mind that it pays taxes as if it had a genuine profit. The enterprise still returns less to the economy than it devours in resources. It does not cover its full costs unless the reported profit exceeds the cost of capital. Until then, it does not create wealth; it destroys it…*" "…*By measuring the value added over all costs, including the cost of capital, EVA measures, in effect, the productivity of all factors of production*…"—Drucker, (1995). For more on Drucker's view, see Chapter 2. Also, see Section 2.4 of the same Chapter on how to calculate Economic Value Added.

EVA is eulogised by many pundits, and castigated by critics alike. It is noted that the focus on EVA and other short-term performance metrics for that matter as a pay-for-performance incentive bonus system for top management presupposes that the top management of a company alone is solely responsible for the fortunes of the company. The practice by some companies to use EVA to incentivise managers is also a presupposition that attributes the success of a company to the management cadre alone. Going through this thinking process leads to the belief that this makes executive incentivisation based on EVA and others to be inequitable or unfair to some sections or groups in the company. To reward only top management by whatever incentive bonus system there is does not recognise the contribution of the generality of employees.

1.3 *Purpose and Motivation of Study*

Without an iota of doubt, academic theorising has a lot of bearing on this research. As mentioned above, having been exposed to EVA and other performance metrics for incentivising managers during the course of one's academic sojourn here at the Graduate Business School, some questions are beginning to be entertained regarding the adequacy (or otherwise) of using short-term performance metrics such as EVA and others to award performance bonus to the managers of an organisation. The way or manner EVA and other short-term performance metrics are portrayed in theory and in the literature make one to think that their application or practice is to the benefit of *every one* in the organisation without regards to their position or level in the organisation.

Generally, discussions about EVA and other incentive bonus systems as means of compensation make references to managers or group management members, without the slightest mention (implicit or explicit, remote or proximate) of the ordinary or average employee or worker on the shop-floor. There is, therefore, a concern to address the needs of the ordinary worker that have been neglected in the scheme of things in giving or awarding bonuses and other incentives as a result of their company meeting some performance targets as calculated by EVA, TVA and others: Hence the aptness of "*Incentivising through EVA and other short-term performance metrics: exploring other neglected paradigms*", which is the title of this thesis.

The proposition is held that one way or the other this group of neglected employees should also get a fair deal from the effort they expended in achieving the company's performance target. As was mentioned earlier, the focus so far on senior management and management group both in theory and in practice aroused an inner curiosity to try and find out if indeed these short-term performance metrics are as robust in addressing the needs of *all* organisation members as claimed or propagated by their promoters; from the perspectives of the ordinary worker though. In this thesis the concern is on the fairness and equity (if any) embedded in these performance metrics in addressing this neglected group of employees.

To date, no known researcher has taken the pain to examine who actually benefits from using EVA and other short-term incentives devices to motivate the rank-and-file workers of companies. Should the choice to be generous arise, this statement may be rephrased by saying that few researchers, if any, as far as one is aware, have thought it necessary to include every spectrum of workers of a company in their study of incentivising through EVA and other incentive systems for that matter. This is why this research is an important one. To the best of knowledge, no researcher researching on EVA has focused on the generality of workers as beneficiaries of whatever regime of incentive system that is in place in an organisation. Most or all the researches to date concerning EVA and others have tended to focus on the management cadre alone.

Researches so far have neglected to recognise the junior workers or average employee, whom we chose to refer to here as the rank-and-file employees in the equation.

Because compensation systems are such a dominant feature of modern businesses and organisations, a wider audience is expressing concerns about the fairness of pay. For the umpteenth time, we say that it is in realisation of this neglect of some sections of a company's workforce that the inspiration and motivation for this research emanated. And this is the point of departure for the thesis, as well as being its strength and contribution to the extant body of knowledge in the study of performance incentive regimes and incentive bonus systems. The study will therefore, probe how the growing body of performance metrics and incentivisation as seen in the applied finance/economic and behavioural accounting research literature, especially that of EVA, TVA and other mimetic measures, have helped the case for the ordinary workforce.

The study addresses this issue by exploring this neglected group of employees, hence again the justification for the caption '*neglected paradigm*'. EVA is made the focal referent of this study because of the way it has sort of successfully been publicly elevated above every other performance measurement and incentivisation system by its promoters and supporters (see for instance, Feltham *et al*. (2004); Stuart (2004), and Lovata and Costigan (2002).

First of all, the purpose of the research will be to further research the concept and theory of Economic Value Added (EVA) in relation to how it is used to incentivise organisation members, including especially, the rank-and-file. The intention is to look at the annual reports of selected companies that practice EVA, TVA and other variants and to conduct personal interviews with workers or their representatives in those companies so identified to determine whether and how the need of their members have been taken care of by using EVA or any other short-term performance measures that are being applied in their organisations.

Furthermore, the intended research will explore various implementation aspects of EVA as the following main research and ancillary questions that will be asked indicate.

1.4 *Research questions*

The following main research question is raised to help in pursuing and achieving the aim of the thesis. The main research question goes thus,

Does the way EVA and other incentive bonus systems are disclosed in annual reports provide sufficient information about how it benefits all organisation members?

This question has been raised to help find out whether the application of EVA and other short-term performance metrics have been to the benefit of all organisation members. This is very necessary because it seeks an answer in order to address the interests of a part of the members of an organisation that is generally neglected in the discussion concerning EVA and other variants of incentive bonus systems, and their fair representation in the administration of short-term compensation plans or bonuses. We shall try to answer this question by perusing some companies' annual reports. Effort will also be made, where possible, to conduct a face-to-face interview with workers or their representatives in the companies that will be chosen as samples for this thesis. If the question may be restated in another, yet similar form, *are all organisation members, including lower level employees, satisfied with the application or use of EVA and other performance metrics?* Given that the above main question serves as a prelude, a few further follow-up, ancillary questions can be asked thus,

1: For users of annual reports, is it possible to get enough information on a company's compensation system?

A second auxiliary question will look like this: For companies or organisations that practice EVA and other mimetic variants, as shown in their annual reports,

2: How have EVA and other short-term performance measures contributed to the focus on a company's short-term performance or profitability?

When managers are rewarded based on meeting and exceeding annual performance targets, there is the tendency to focus on the short-run while neglecting the long-term health of the company. A complimentary and complementary question to this will be to inquire if in the final analysis this adds value to shareholders in the long run? So, if one may ask, *how do EVA and other short term performance measures add to shareholder-value creation in the long run?*

3: Is the implementation or application of EVA, TVA, SVA and other short-term bonus incentive programmes perceived as fair or just to all organisation members?

The above four research questions prompt us to look at the EVA from four different but related perspectives. One challenge is to find out whether annual reports are able to provide readers information about whether *all* employees of a company benefit from the application of short-term incentive bonus systems, irrespective of their position in the company. A second task is to find out, through the annual reports, whether the implementation or application of EVA, TVA and other short-term incentive bonus systems in the companies is perceived as fair or just to all organisation members?

Thirdly, we shall investigate whether EVA and other mimetic variants as being applied or implemented have contributed to short-term focus by management and owners of the company. If so, is this in the long-term interest of the owners themselves?

Last but not the least; we shall investigate whether it is possible for the users of annual report to get enough information about a company's compensation system.

The above questions prompt one to make the following propositions to the effect that:

Proposition 1): The application of EVA does not treat all organisation members *fairly*.

Proposition 2): EVA may not enhance shareholder-value in the long-run because it can be subjected to manipulation by management.

Proposition 3): EVA allows the management of a company to focus on short-term profitability.

Proposition 4): EVA has contributed to the problem of excessive executive compensation.

The above propositions taken together will be posed so as to enable the study address the needs of the workers who are neglected in the calculus regarding incentive compensation for organisation members.

1.5 *Delimitation of Study*

It is appropriate at this juncture to state what this research can do, as well as what it cannot do. This delimitation of scope becomes necessary because the topic of EVA and other short-term performance mimetic isomorphic metrics is of particular interest. And more so, because the whole gamut of quantitative performance measurement has attracted a heightened attention of late, pundits and researchers are susceptible to approach it from quite different angles, as far as their inclination dictates. This personalised inclinational disposition of researchers and pundits makes it imperative to delimit the dimension from which the topic is being addressed in this thesis. Here, the concentration, scope and lens will focus on extending the benefit accruing from meeting performance targets as measured by Economic Value Added, EVA; Total Value Added, TVA; Skanska Value Added, SVA and others to every member of the organisation. In this case, one of the self-constraints or restrictions of the study is the inability to gauge and report workers' point of view regarding short-term incentive bonus system as a means of compensating organisational members. Secondly, the study focuses on the appropriateness of awarding yearly or annual bonus to only the senior managers of the organisation. Since managers are employed to add value to the organisation in the first place, we address this issue of compensating them alone with the argument that "what is good for the goose is good for the gender", according to one old adage. That means that what is good for senior managers *should* be good for all employees without regard to their position, power or level in the organisation.

The reader *ought* to have realised that this is a normative statement, if this point has been missing. Thirdly, the research takes the sample companies mentioned here, and others yet to be identified, as points of reference, not as case studies *per se*. There is no particular interest of studying these companies *per se*; it is just that by happenstance, they fall within the orbit or scope of inquiry. Therefore, we have not set out (nor have we attempted with the slightest intention) to concentrate on them as centre of gravity; but the allusion shall be made to them insofar as deriving information and making inferences for this thesis is concerned. Of course, the data for the thesis will be collected from the annual reports of these companies. Having thus said, it is to be stated here that there is no mutual exclusivity between not taking the companies as centre of gravity and collecting information about these companies, either directly by way of interviews or by proxy statements, by way of looking at their annual reports and financial statements in the area the research is interest in. The aim is to be able to offer a general commentary at the end of the exercise, not to dwell on the particulars of the companies *per se*.

Even though reference shall be made as to the size and magnitude of incentive compensation of some chief executive officers of companies, the intention is not to belabour the issue as to use it to make unnecessary remarks about the companies and their officers, whom the highest of regards and respect is accorded here. The figures or amount of incentive bonus payments of CEOs that shall be referred to in this thesis has been taken from the published annual reports of these companies. They are, therefore, information available in the public domain. As such they are not sacrosanct or classified information. And in this era of the talk about transparency, any company pretending to be transparent would readily oblige an innocuous academic researcher in the shoes of the present researcher.

Some might be expecting a complicated research. But it is prudent for the sake of clarity to mention from the outset that this endeavour have not set out to make a complicated research of what ought to be a simple one. Therefore, it is the intention to make the research as simple as possible because it is the belief that the quality of a research is not embedded in its difficulty, complication or complexity. It is realised that this thesis may lose some of its interested audience if it becomes unnecessarily overly complicated. That is why for the sake of the reader it has chosen to keep the thesis as simple and understandable as possible, both in language and style, although the grammar is unabashedly commensurate with a postgraduate research work. Again and as a caveat, the thesis is not out to question the computational and mechanical prowess of EVA and other residual income variants. Rather, it is about their adequacy in addressing other neglected paradigms; for example, addressing the fairness and distributive justice question as far as the rank-and-file employees, executive compensation, corporate governance, to name a few, are concerned.

It is realised also that this thesis can be looked at from the point of view of motivation. Some people, this researcher not excluded, may wonder whether rewards of any kind, not excluding cash bonuses, share-based payments and other share options have a motivational effect on the performance of workers. In some cultures, there are other things that motivate workers to perform apart from financial or monetary inducements. Unfortunately, this thesis has not taken the motivation route. It has not taken account of motivation. It is considered that to do so would be an aberration and obscure the essence of the thesis. The issue of motivation is better left to those researchers in the arena; for example, Maslow, Vroom, McClelland, and so on.

Finally, the thesis is not about performance measurement or how to measure performance. It does not seek to measure performance but rather seeks to know how the various performance measures have taken account of a neglected group of workers, who in all cases are in the majority in a work setting.

1.6 *Organisation of the thesis*

It is necessary at this stage to provide the organisational schema or structure of this thesis. The structure of the thesis is presented in a visual form as depicted in Figure 1 on the next page. The lines in the figure show how the themes in the different chapters are linked or woven. Following on from here is **Chapter 2**, which is devoted to the review of extant literature on the various themes of the study.

Chapter 3 addresses methodological issues, including the development of data collection method, choice of data collection method, choice and description of sample, coding scheme, amongst others. The chapter also showcased, for the first time, the graphic conceptual model that was developed and tested in the study.

Chapter 4 deals with the empirical data regarding the various themes of the study. In working with the data tables and charts shall be used to present information where necessary.

Chapter 5 deals with the analysis and finding of the whole research effort as dictated by the themes of the research. This will be based on the data collected in the previous chapter.

Chapter 6, being a wrap-up chapter, presents the study's conclusion, and suggest area for further future studies in the area of implementing and applying incentives to organisation members.

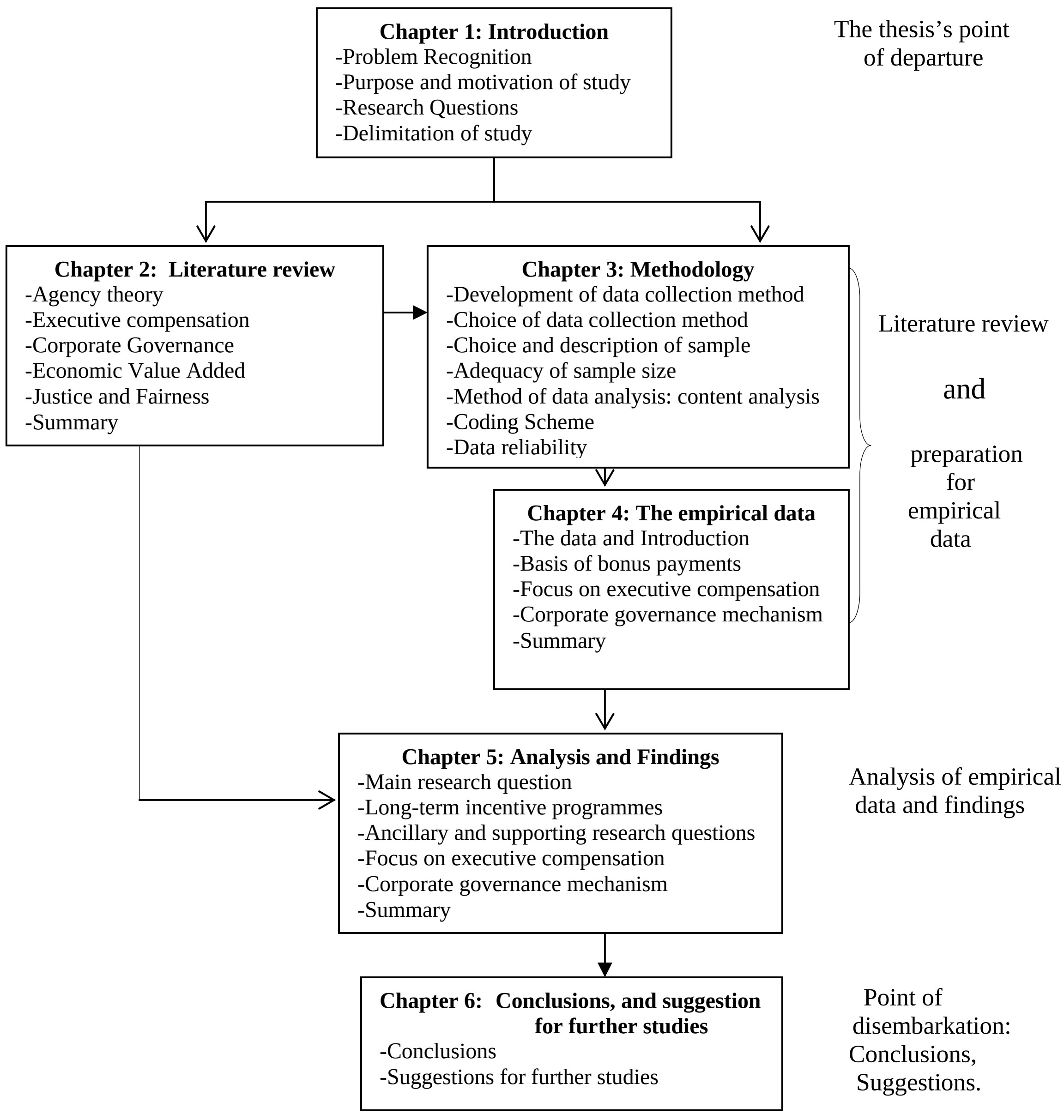

Figure 1: The structure of the thesis

Chapter 2: Literature Review

This chapter shall take a comprehensive review of the extant literature on the various aspects of the thesis including agency theory, executive compensation, economic value added, and a handful aspect of the ethics and fairness of paying attention to only senior management who are the occupiers of the top echelon of an organisation when incentivising organisation members.

2.1 *Agency Theory*

Why do the majority of organisations compensate managers or top management for doing what they are employed and paid to do in the first instance? Some writers, such as Gibbons (1998, p.3), and Gomez-Mejia and Wiseman (1997, p.29) have taken an agency theory perspective by arguing that "…a higher bonus rate ...creates stronger incentives for the agent, but also imposes more risk on the agent…" From Gibbons' (1998) point of departure, it is posited that incentives are meant to compensate agents for taking the risk to perform far above the agreed parameters with their principals. The argument goes that executives should be compensated for taking risks which their principals would not otherwise take on their own. Riley (2006) jibes that "an important side issue is whether the risk/reward balance is what shareholders really want…." The principal has opportunity to spread his risk by diversifying into various other business activities, related or unrelated, to the one the agent is managing. It is an implied assumption that if agents are not motivated through incentives their performance would just be to get the organisation going, at best.

Hence they need to be motivated by way of incentives. One interpretation of this is that, "…shareholders are no longer owners but merely participants in profit pools, alongside managers…" – Riley (2006). Executive risk aversion implies that managers require a higher expected value of compensation as a trade-off for increased compensation risk, as occurs with stock-based compensation (Matsumura and Shin, 2005) and (Gomez-Mejia and Wiseman, 1997).

There are observations at least, maybe fears in the extreme, that executives may base decisions on a shorter time horizon than shareholders wish. For example, in order to boost short-term accounting performance, and in turn, increase their compensation, short-sighted CEOs may reduce long-term investment, such as research and development spending that sustains firm organic growth, and thereby harm long-run firm value. Note that even if managers are part-shareholders of the firm, their interests will not necessarily be fully aligned with the general shareholders' interests because, for example, other shareholders will bear some of the cost of managers' excessive consumption of perquisites (*ibid*). This is, in spite of the plausibility of the so-called management/shareholder partnership arrangement propagated by Dial and Murphy (1995, p.273.) According to Riley (2006), because of the principal-agent problem owners are now thinking of how to hand over the running or administration of their companies to private equities to run on their behalf, stressing that as limited partners in the private equity pool the investors will get some benefit from successful corporate restructurings but only after conceding very generous rewards to general partners and highly incentivised executives. This point of view has necessitated Riley (2006) to comment that absentee landlords [that is, shareholders or owners who are distanced from the companies] have no choice but to hand (*sic*) day-to-day administration of assets to managers [agents]: They then have to worry about whether rents will be properly collected and handed over. It is known from the situation that gives rise to the principal-agent relationship that owners become principals when they contract with executives to manage their firms for them. As an agent of the principal, an executive is morally responsible to maximise shareholder utility; however, executives accept the status of agents because they perceive the opportunity to maximise their own utility. Thus, in the modern organisation, agents and principals are motivated by opportunities for their own personal gain or personal self-interest. Principals invest their wealth in companies and design governance mechanisms in ways that maximise their utility.

Agents accept the fiduciary responsibility (Dial and Murphy, 1995) of managing a principal's investment or wealth, because they perceive the possibility of gaining more utility with this opportunity than by accepting other opportunities. (The reader would note that this view is in contradistinction with the management/shareholder partnership arrangement propagated by Dial and Murphy referred to above.) If the utility functions of self-serving agents and principals coincide, there is no agency problem. Agency costs are incurred by the principals when the interest of principals and agents diverge, because given the opportunity, agents will rationally maximise their own utility at the expense of their principals; again this is inconsistent with the management/shareholder partnership, see above.

Lovata and Costigan (2002, p.216) posited that since EVA is designed to align managers' and shareholders' goals to relieve the moral hazard problem, it is expected that firms with more potential agency conflicts are more likely to employ this new model. Also, since EVA remains a financial measure of performance, the organisational strategy of the firm should impact its usage.

2.2 *Executive Compensation*

The topic of executive compensation has of late taken the front burner in corporate discourse in most parts of the world (especially in free market economies of the West), no thanks to some of the most recent ugly corporate sagas, and other high profile abusive cases. Gillan (2003) says

"…CEO pay became (indeed, has become) a hot topic in the business press. Front-page stories criticised the levels of pay, and went on to question both the link between pay and performance and the overall pay-setting process…" In his contribution Bloom (2004, p.1) observed that compensation systems are an integral part of the relationships organisations establish with their employees. It is viewed that pay systems are an efficient way to bring market-like labour exchanges inside organisations. This view suggests that only economic considerations matter for understanding how compensation systems affect organisations and their employees. Although the determinants of compensation go beyond economic consideration of firm size; performance in industry; pay levels in the industry concerned, and human capital variables, such as education, work experience, and tenure in the company, there is a postulated psychological factor – the so-called tournament model – that is used as a determinant of CEO pay (O'Reilly III *et al*., 1988, pp.261, 270; and Pukthuanthong *et al*., 2004, pp. 96, 100).

Gomez-Mejia and Wiseman (1997) have provided a topology of what they called executive compensation theory which was categorised into a) mechanism for compensation design, b) criteria for explaining compensation, and c) consequences of compensation design. Briefly, in the trichotomy embedded in the topology, mechanisms were used to refer to the processes used for linking compensation criteria (e.g., firm performance or size) to compensation consequences (e.g., pay at risk). Mechanisms can generally be categorised into two forms: those that centre on the contract and those that involve more direct monitoring of the executive.

Criteria may include outcomes of performance (generally involving measurable performance targets), behaviour (i.e., the quality of actions taken, possibly assessed against job requirements, or fulfilment of a prescribed role), the executive him/herself (the executive's experience, talent and skills), the role or position inhabited by the executive (pay is tied to the level of the hierarchy or to role requirements), peer compensation, or executive labour market considerations, and firm size. Finally, the major consequences of compensation design were stated as pay and employment.

Advances in organisational research, particularly those focusing on issues of justice and fairness (see below); suggest that the full understanding of the outcomes of compensation systems requires examining their psychological, social, and moral effects. For example, in the case of General Dynamics (GD) in the U.S.A., some critics noted that the high payments to GD executives negatively affected employee morale (Dial and Murphy, 1995, pp. 22, 24).

Noted here is the fact that the determination of management compensation has emerged as an academic, public as well as policy issues in corporate governance, both in theory and in practice. More than any thing else, it has attracted the attention of market regulators (such as the Securities and Exchange Commission, SEC, in the United States of America) and other regulatory authorities, and interested members of the public (including the media) and the government of some states, especially in the Western World since the eclipse of Enron and others. This has been the crux for the creation of SOX in 2002 in the United States of America, the Hampel Committee Report (1998), and the Cadbury Report (1992). Both the last two are in the UK.

Executive compensation has also been one of the preoccupations of the Business Roundtable[1], which issued what it called Principles of Executive Compensation. Item 1 of the six principles requires that:

1. *Executive compensation should be closely aligned with the long-term interests of stockholders and with corporate goals and strategies. It should include significant performance-based criteria related to long-term stockholder value and should reflect upside potential and downside risk.*

The alleged compensation excesses by CEOs and other top executives of companies have necessitated the need for a policy initiative or a mechanism to tackle the problem of board

[1] See http://www.businessroundtable.org/pdf/ExecutiveCompensationPrinciples.pdf

members determining their own pay. In the view of Matsumura and Shin (2005), recent scandals allegedly linked to CEO compensation have brought executive compensation and perquisites to the forefront of debate about constraining executive compensation and reforming the associated corporate governance structure.

Bloom (2004) notes that at some point in time employment relationships were viewed, for the most part, like market transactions for labour that had been brought inside the skin of a firm or organisation. According to this view, the key for managers and others who design pay systems is to ensure that pay accurately reflected the economic value contributed to the firm by a worker. The pervasive view at that time was that optimal compensation systems met the 'fair day's wage for a fair day's work' criteria. This view is supported by Dial and Murphy (1995, p.45) who argue that the decisions managers make are not easy, and that incentives had to be strong enough to attract and retain the right executives, ensure timely and comprehensive disclosure of critical information, and motivate the right decisions. Ultimately, the incentives had to be strong enough to make the executives willing to sacrifice their own jobs and positions.

As Bloom (2004) further pungently notes, the meaning of fairness for employees goes well beyond economic issues; it also incorporates issues related to trust, work relationships, and ethics.

To be sure, compensation systems can help create effective economic exchanges of labour (which is given by workers) for financial remuneration (which is given by the employing organisation). But, compensation systems also play important social and symbolic roles in organisations and through these roles pay systems affect a variety of important outcomes such as the nature of work relationships, employee commitment, and performance…" Going by Bloom's contribution, it is safe at this juncture to say that a word is enough for the wise.

As commonsensical opinion has it, and which is a disadvantage associated with any objective performance measurement (EVA not excluded) that is short-term focused, when managers' compensation is dependent on reported accounting numbers such as earnings, those managers have incentives to manage reported earnings to maximise their compensation, through discretionary accruals or through the selection of alternative accounting methods such as depreciation or inventory accounting methods. This is very apt for EVA and other *objective* performance measures that are hyped as being robust and free of fault.

2.3 *Corporate Governance*

The discussion of corporate governance is a way of getting around agency problem in an enlightened manner. "A corporate governance *system* is the set of institutions and processes, both inside and outside the firm, that help capital providers oversee and influence the behaviour of corporate managers." Stern (2004: p.97).

In their theorising on corporate governance Core *et al* (1999, p. 373) and Pukthuanthong *et al* (2004: p.94) note that "governance examines the efficacy of alternative ownership structures and alternative structures for the board of directors. They note that while there is mounting evidence of the failure of certain governance structures to motivate managers to increase firm performance, the empirical evidence to date is mixed and gives little coherent evidence for the shape of an optimal governance structure". This has become a problem as they further note that,

Board members may be unwilling to take positions adversarial to the CEO, especially concerning the CEO's compensation. Moreover, boards usually rely on the compensation consultants hired by the CEO, and this may lead to compensation contracts that have been optimised not for the firm, but for the CEO.

This is consistent with the view expressed by Pukthuanthong *et al* (2004: p.96) that from a corporate governance standpoint, the longer the CEOs serve in their positions, the more influence they may accumulate over the nomination of board members, thereby weakening the board independence.

In their contribution, Matsumura and Shin (2005) opine, "recent scandals allegedly linked to CEO compensation have brought executive compensation and perquisites to the forefront of debate about constraining executive compensation and reforming the associated corporate governance structure." In the domain of corporate governance, the board of directors has the responsibility to represent the interest of shareholders and tamper what may be conflict of interest between the managers and shareholders. It falls within the purview of the compensation committee, as for example, in line with SOX 2002, Cadbury Report (1992) and other various instruments, to engender good corporate governance to set the compensation levels of senior management. Stern (2004, p.91) notes that "corporate governance matters because it ends up affecting how current operations are managed and which strategic investments are made, and, if necessary, when they are harvested…" In this vein, one business writer, Riley (2006), writing in the FTfm observed, among other things, that "…the more general problem, however, is that shareholders are having to pay more to have their companies managed for them. Even so, they do not appear to be getting very consistent value for their extra money." Business Roundtable's remaining recommendations to the SEC bear on corporate governance as we can see from items 2 to 6 of the Principles of Executive Compensation, part of which has been discussed above. These recommendations include,

> 2. *Compensation of the CEO and other top executives should be determined by a compensation committee composed entirely of independent directors, either as a*

committee or together with the other independent directors based on the committee's recommendations.

3. *The compensation committee should understand all aspects of the compensation package and should review the maximum pay-out under that package, including all benefits. The compensation committee should understand the maximum pay-out under multiple scenarios, including retirement, termination with or without cause, and severance in connection with business combinations or sale of the business*.

4. *Compensation committees should require executives to build and maintain significant continuing equity investment in the corporation.*

5. *The compensation committee should have independent, experienced expertise available to provide advice on new executive compensation packages or significant changes in existing packages.*

6. *Corporations should provide complete, accurate, understandable, and timely disclosure to stockholders concerning all significant elements of executive compensation and executive compensation practices.*

In addition to the above, many of the guidelines for improving corporate governance that have been recently promulgated by various groups, such as the National Association of Corporate Directors (1996). In particular, calls for improving corporate governance by separating the Chairman and CEO, relying on smaller boards, imposing mandatory retirement ages or term limits, eliminating gray directors, limiting the number of other boards on which a board member may serve (Core *et al*, 1999: p. 404). This is by no means forgetting the SOX 2002 requirements of §.404 requiring CFOs to append their signatures to published financial statements, that different persons should occupy the office of chairman and that of chief executive officer, and that companies should appoint increasing numbers of their board membership from outside directors. These and various other measures are to create effective governance mechanism. As observed by Pukthuanthong *et al* (2004: p.97) corporate governance mechanisms, including an effective board of directors, the presence of large outside share blockholders, and institutional share ownership augment the compensation contract in mitigating agency problems. However, they note that the implementation of board governance is far from straight forward.

On their respective part, Conyon and Peck (1998), and Gillan (2003) of The Weinberg Centre for Corporate Governance examined the role of board control, and remuneration committees in determining management compensation. They discovered that board monitoring as measured by proportion of nonexecutive directors on a board and the presence of remuneration committees and CEO duality, had only a limited effect on the level of top management pay. They came to the conclusion that top management pay and corporate performance are more aligned in companies with outsider-dominated boards and remuneration committees.

2.4 *Economic Value Added*

Drucker (1995); and Lovata and Costigan (2002) have observed that the idea of having managers rewarded for carrying out projects that return more than the cost of capital is not a new phenomenon. In the words of Drucker (1995):

> *"EVA is based on something we have known for a long time: what we generally call profits, the money left to service equity, is usually not profit at all. Until a business returns a profit that is greater than its cost of capital, it operates at a loss. Never mind that it pays taxes as if it had a genuine profit. The enterprise still returns less to the economy than it devours in resources. It does not cover its full costs unless the reported profit exceeds the cost of capital. Until then, it does not create wealth; it destroys it."*

By measuring the value added over *all* costs, including the cost of capital, EVA measures, in effect, the productivity of *all* factors of production. It does not, by itself, tell why a certain product or a certain service does not add value or what to *do* about it. But it shows what is needed to find out and whether there is need to take remedial action. EVA should also be used to find out what works. It does show which product, service, operation, or activity has unusually high productivity and adds unusually high value. (See Chapter 1 for further discussion on this). In a similar complementary vein to that of Drucker (1995), Lovata and Costigan (2002) reveal that while the idea of rewarding managers for undertaking projects whose return is more than the cost of capital is not new, prior performance evaluation techniques have had difficulty integrating this philosophy into a corporate model. EVA claims to incorporate the complexity of maximising the net present value of the firm into a measure that can be used to evaluate current-year performance. That is, EVA is calculated as[2]:

EVA = **Net Operating Profit after Taxes — [Capital * the Cost of Capital]**

(NOPAT)

Where: NOPAT is the same as EBIT * (1-t),

t is the effective tax rate

IC = Invested Capital, and

WACC = Weighted Average Cost of Capital

Commenting on the popularity of (and by implication, praise for) EVA, Ehrbar and Stewart III (1999) opine that "EVA resonates with so many constituencies because it entails much more than a fleeting emphasis on a single aspect of corporate performance. Rather, EVA is a return to basics, a rediscovery of the most fundamental elements of business management that brings a lasting change in a company's priorities, systems, and culture. At heart, it is the practical application of both modern financial theory and classical economics to the problems of running a business, an application that turns out to provide the most effective framework for corporate decision making in a period of remarkable economic change."

As is common knowledge, in addition to EVA there is a variety of other known performance metrics that are used to incentivise organisational members. Some of these are Shareholder

[2] Restated from Chapter 1

Value Added, (SVA), Skanska Value Added (SVA), and Total Value Added (TVA), among others. A number of organisations apply one metric or the other among the list. But, to be sure, these performance metrics are nearly akin to each other; in actuality one is a modification of the other. It is not the intention of this thesis to go into any detailed treatment of each of the metrics. One common thread lacing all of these metrics together, and which this thesis is interested in, is their ability to address the need of every organisation member, whether those who occupy the upper echelon or those on the shop floor, the rank-and-file as the thesis chose to call them. There is no full assurance that EVA and other measurement metrics have a conceptual merit or property, but what is certain of is that the implementation of EVA and other metrics deserves a thorough rethink in order to relate them to the need of *all* organisation members, irrespective of level in the organisational hierarchy. There is a problem of implementation regarding the performance metrics that are used to incentivise organisation members. Some critics, such as McCormack and Gow (2001), who considered EVA a superior metric when they probed its adequacy in their study of Nuevo Energy, have faulted the implementation of EVA especially, following several questions they raised regarding the implementation of EVA in the upstream oil and gas industries. They observed that:

> "… *The challenge of operationalising this new metric remained. Many questions surrounded implementation. Even given a conceptually superior metric such as EVA, how could Nuevo Energy provide operating managers with "line of sight" between changes in shareholder wealth and day-to-day decisions regarding costs, volumes, and production? For example, how would an EVA financial management system deal with commodity price volatility? Crude oil prices can fluctuate wildly and, though managers have no control over prices, the effects on performance measures of commodity price swings often swamp the effects of most cost or production improvement efforts….*"

Questions such as these have led McCormac and Gow (2001, p.86) to recommend what they called a reserve-adjusted EVA in place of the *normal* EVA as they admitted that "…if EVA provides Nuevo with a logically coherent foundation for business planning, performance measurement, and incentive compensation, several EVA-related issues are still in need of more complete resolution. Although these are not the types of questions raised by this thesis, nevertheless they reinforce an aspect of implementation problems associated with EVA in spite of its acclaim.

Again, EVA as a managerial tool may be faultless in its conceptualisation, but it is suspected that the implementation aspect of it and that of other short-term incentive bonus systems is fraught with shortcomings; this is the focus of this thesis.

Some empirical workplace experience such as those of Ezzamel and Burns (2005, pp.766, 769) have found out that the problem with EVA lies in its implementation as a result of its bias in favour of senior management. In some cases EVA pitches one functional group against the other. For example, the professional competition and rivalry reported among the various functions of one company was well documented by Ezzamel and Burns (2005), who describe it as a failed change initiative. This amounted to what can be called here as organisational politicking.

It is in light of this implementation problem that this thesis explores how these metrics impact on the rank-and-file (again, excuse the choice of words) employees in the organisation. The expression rank-and-file is taken to mean low level employees in an organisation. It does not in any way mean blue choler or white choler workers. That is the purpose here. Do this group of workers feel fairly rewarded by the sweat they expended in the pursuit and achievement of their organisation's objective? In this case, do they feel equally recognised by the payouts from the improvement made by them? If senior executives, as argued by the various researchers reviewed above, deserve being *pushed* or enticed by incentives to excel, how about the generality of workers on the shop floor? O'Byrne and Young (2005) have found out that for most companies, the amount of incentive compensation paid or granted in a given year….has little correlation with the shareholder return in that year and so provided little incentive to increase value. But they argued instead that the change in the value of stock or options previously granted to the top managers of most companies is in fact highly correlated with shareholder return and provides strong incentives to increase shareholder wealth. Thus, the percentage of pay at risk appears to have turned the real story upside down: it exaggerates the typically modest incentives provided by current-year pay, while ignoring the considerable incentive power of prior stock and option grants. O'Byrne and Young (2005) have, by this line of reasoning, situated their support or argument in favour of incentives on a time continuum, with retroactive implication or effect.

The impression is that they do believe that incentive bonus payments influences behaviour. What this means is that present incentive payout will influence future performance, while past incentive payout will influence present behaviour.

O'Byrne and his colleague acknowledged the inadequacy of *short-termism* when they pointed out that whereas annual compensation includes salary, bonus, and the value of current-year stock and option grants, wealth includes the manager's *total* company stock and option holdings plus the total of the present value of the manager's expected *future* salary, bonus, stock compensation, and pension. In their considered view, taking such a comprehensive look at an executive's pay package is the only reliable way to assess its incentive power. EVA, as anchored on annual consideration, is circumspect in this regard.

In any case, how does EVA ensure organisational justice and fairness? It is recognised here that this question will not be an easy one to answer because the terms "justice" and "fairness" have no one universally accepted definition. They are subject to be interpreted in different ways depending on the personal, cultural and other contextual characteristics of the interpreter. But the terms are here situated within the realm of reasonableness as obtained in Western civilisation, thinking, and usage. The operationalisation provided by Jawahar (2002), see below, provides an handy referent on this.

Returning to EVA, Ehrbar and Stewart III (1999) have argued that EVA is much more than just a measure of performance. In their own words, "...it is the framework for a complete financial management and incentive compensation system that can guide every decision a company makes, from the boardroom to the *shop floor*, that can transform a corporate culture, that can improve the working lives of *everyone* in an organisation by making them more successful, and that can help them produce greater wealth for shareholders, customers, and themselves. (Italics inserted here for emphasis). Questions could be asked, such as does being a *successful* company lead to improvement in the work-life of everyone? And how is success measured in this case?

2.5 *Justice and Fairness*

The context for these analyses is organisational justice. It is assumed here and throughout the thesis that it can be taken-for-granted what is meant when we speak of an organisation.

In assuming a taken-for-granted position, it is realised that important information are glossed over because organisations consist of levels and subgroups and, for certain questions, understanding organisational subtlety can be significant. Nonetheless, viewing justice from an organisational perspective adds a degree of complexity that expands the purview of the work to other complex topics, such as authority and power as well as the varying perceptions and view points about such topics. From one perspective, all justice could be considered to be organisational and to contain procedural, interactional, and distributive elements. The reason for asserting this perspective is that justice involves a transaction between two or more individuals or entities, a presumed or explicit set of rules, expectations, and processes, as well as an outcome or result. Affect is often associated with justice-related activities: processes, interactions, and outcomes. The more complex the rules or policies and the more diverse the expectations, the more difficult it is to ascertain what justice is all about, and therefore, the more complicated it is to sort through the affect that surrounds it. Justice also implies power; some have the power to *distribute* justice and others have enough power to *defy* it. Often, individuals believe themselves to be powerless in the face of justice judgments that affect them but about which they have little or no say. Such questions could include: what is justice? Whose view is paramount in determining whether a process or an outcome is just? How does culture influence justice decisions? These and related questions are relevant if we remember, as in the words of Ehrbar and Stewart III (1999) that "…at heart, EVA isn't about finance or economics, it's about people. The most valuable resource in any company is the creativity and the will to succeed that all people possess, and usually to a much greater degree than they get credit for. EVA is a means to unlock the potential for achievement that exists throughout every organisation."

The questions of interest to this thesis encompass such issues as what one needs to know to be an arbitrator for justice. For instance, justice judgments are made daily not only in courts of law but in small and large corporations, academic classrooms, households, and elsewhere. Individuals and committees of individuals constantly are deciding about merit, rewards, sanctions, raises, promotions, disputes, and the like. They also include what kinds of persons or groups (e.g., how knowledgeable, disinterested, or involved) are best suited to make *just* decisions as in giving or awarding bonus incentives to all organisation members, and what styles of decision-making (e.g., how participatory or collaborative) best meet the multiple criteria for justice.

It must be remembered as well that each individual comes to an organisation with expectations (not to mention specific status, roles, and assignments) that significantly influence perceptions of justice. Finally, justice is always defined within a complicated, multifaceted context. Although there are “universal” or abstract definitions or notions of justice (see, for example, Jawahar, 2002), in the final analysis justice is always coloured by the particulars of a situation. Suffice it to say that at a minimum the type of organisation, its structures, goals, and purposes influence what is regarded as just.

For the most part in peoples’ professional, occupational, and social organisations, they are interested in distributive justice (which is concerned with the fairness of outcome, Jawahar (2002, p.3), the equal distribution of burdens and benefits. (The election to the use of the term distributive justice here implies or takes-for-granted the relational aspects of justice and the psychological need that accompanies them).

An important prior question to discussing organisational justice is what kind of person or organisation we want to make the fairness decisions that affect us or those close to us. Whether it is work assignments, recognition, tangible reward, or tax policy, people want to trust the person or group that is distributing these burdens and benefits.

Briefly, people must be able to trust one who judges them to tell them the truth about their performance and to have the judgment (or prudence) and competence to know what that truth is. It is also important that those who judge be humble enough to be open to error (i.e., their judgments are neither rash nor dogmatic). Further, supervisors need to be able to communicate empathy with respect to workers’ perspectives about workers’ efforts and provide feedback in a manner that is constructive and motivating for better work. Finally, if one wishes to create a climate of fairness, all of the interactions within the organisation must be accomplished with the utmost respectfulness (in particular, those interactions regarding, assignment, evaluation, or recognition).

Aside from employees, Meara (2001) opines that "the general public needs to know an organisation's standards and what they can expect from it. Companies also need to understand the mores, moral traditions, and virtues of those they employ and those they hope to serve or have as customers. A person's view of what is just in a particular situation as well as what is a fair climate within the organisation is also dependent on its goals. A non-profit service organisation has different demands and priorities than a corporation that cannot exist over an extended period of time without profits. Thus, justice questions are very different in the latter than in the former.

For example, in a non-profit organisation, support from the leader may be very important to the workers, but in a profit-oriented corporation financial reward from the leader may be most salient. That may or may not change the virtues needed by the evaluators, but it may well change the substantive issues of the evaluation and the workers' perceptions of their leaders. If those who have higher status and power can demonstrate consistently the virtues of veracity, prudence, humility, compassion, and respect, then the opportunities of producing an organisational climate or social entity reflective of those virtues is greatly enhanced. What seems important here is that determinations of organisational justice cannot be made apart from the goals of the organisation.

Designing research in this area or establishing organisational justice in practice could benefit from the articulation of clear connections between the goals or aspirations of the group, the virtues connected to these aspirations, and various members' perceptions of fairness.

It cannot be forgotten, however, either in research or practice that the view of the least powerful may in the end be the most important view in building just organisations and in doing research about how to build them. Those who do not have the power to distribute the burdens and benefits, and have probably had to bear more of the former and have enjoyed less of the latter, should never be far from our theorising, empirical inquiry, or practice. They look to the organisation to be virtuous and to honour their individual contributions and uniqueness, not just to compare them to others or evaluate their worth". We toe this line because reactions to perceived workplace injustice (as indeed, all forms of injustice) could be very dysfunctional and reactions to workplace injustice and unfair treatment include behaviours directed toward the organisation.

According to Jawahar (2002), if the distributive injustice involves substantive outcomes then the rank-and-file workers will seek to identify the individual or individuals (members of management) responsible for the unfair procedures and express their hostility toward those groups. Possible behaviours include, but not limited to, speaking ill of the organisation or individual(s) responsible for the injustice or unfair behaviour; acts of obstructionism which include actions that are designed to impede an individual's ability to perform his or her job or interfere with an organisation's ability to meet its objectives, engaging in protest behaviours, needlessly consuming resources, and intentional work slowdowns or "soldiering". An extreme overt aggression includes behaviours typically associated with workplace violence, such as physical assaults, stealing, and damaging company property. As a group workers are less likely to engage in extreme overt aggression. (Readers interested in a more robust discussion of organisational (in) justice and the attendant reactions or aggressive workplace behaviours should see Jawahar 2002.)

Being in accord with Meara (2001) we believe that justice is not a stand-alone virtue, that it is dependent on the goals of the organisation and that since the least powerful among us are often the most affected, it is important that those who judge (and are often the most powerful among us) are virtuous.

As the reader may have noticed, this thesis is concerned with the different dimensions of organisational justice at the workplace as typologised by Cropanzano *et al*. (2001), Jawahar (2002), and Tyler (1994), among others. These include distributive justice, procedural justice and interactional justice. Distributive justice as operationalised in the study is judgment regarding the fairness of outcomes or allocations [of rewards]: see Tyler (1994, p.858). Judgments regarding the fairness of process elements are termed "procedural justice", which is the fairness of processes. Theory and research has established that procedures are judged as fair if they are implemented consistently, without self-interest, on the basis of accurate information, with opportunities to correct the decision, with the interests of all concerned parties represented, and following moral and ethical standards—Jawahar (2002, p.3). And judgments regarding the fairness of interpersonal interactions are termed "interactional justice." The contention of the referred researchers is that individuals concern themselves with justice because (a) it is in their economic best interest (the instrumental model), and (b) it affirms their identity within valued groups (the relational model). This was why in the case of General Dynamics alluded to above, "many were outraged that the bonuses were being paid while thousands of the rank-and-file were being laid off. Others protested that the bonuses were much too concentrated among a tiny cadre of senior executives… while people who have worked in the trenches for many years are losing their jobs". Dial and Murphy (1995:21). Thus, there is a burden in explaining the fairness exhibited by the CEO of GD at that time, where at a time that management was laying off workers and downsizing the workforce, the same management was being showered with various mouth-watering incentives. Dial and Murphy (1995:22), and Jensen and Murphy (1990) have appropriately situated this phenomenon within the realm of politics as they found out that "…the outrage over GD's Gain/Sharing bonuses illustrates the important distinction between the politics and the economics of executive compensation. Providing incentives to create value under excess capacity virtually mandates paying bonuses during layoffs. In addition, concentrating incentive rewards at the top management level can be economically justified in GD's situation, since the decision to downsize is made and implemented exclusively by top management and can be accomplished without 'buy-in' and meaningful incentives for rank-and-file employees…"

In general, the relational model proposes that a procedure is seen as fair if it indicates a positive, full-status relationship with the authority figure (e.g., supervisor), and if it promotes within-group relationships. To the extent that a procedure indicates the relationship is negative or that the individual is a low-status member of the group, the procedure is perceived as unfair (Tyler & Lind, 1992).

2.6 *Summary*

In the foregoing pages, the endeavour has been made at reviewing some of the relevant extant literature on the various themes of this thesis; including agency theory, executive compensation, corporate governance, economic value added, and organisational justice and fairness, in that order. Try as one may, one has to admit that it is not possible to review all the existing literature on the various themes of this research; nevertheless, the review has been a comprehensive exercise. In any case, what is important is that one has a full grasp of the issues at stake and that the reader is led to appreciate the issues at play.

Next, we now turn to Chapter 3 of the thesis, which will introduce the methodology used for the research, research design, amongst others. A questionnaire (which was not administered for reasons the reader will see later) consisting of twelve items has been designed in order to help carry out the survey. This will be discussed further as we progress in the chapter.

Chapter 3: Methodology

3.1 *Introduction*

The reader would recall that EVA/TVA, incentive bonus systems, executive compensation, corporate governance, and agency theory are the themes of this thesis. Accordingly, and as was mentioned in Chapter 1, part of the concern that propelled the present thesis is to assess how these themes have addressed the need of organisation members, especially those of the rank-and-file employees. First encounter with these themes shows that the locus of focus has always been the senior management in most organisations. This raised the concern for work-place justice and fairness, where this concern is situated. It was then decided to investigate how the various performance metrics impacted on the ordinary worker. As was discussed in the introductory chapter of this thesis, i.e., Chapter 1, the practice by companies to lay emphasis on senior management as far as incentivisation of organisation members is concerned provoked some deep thought.

From this brief recap of the general background to the thesis, the reader is made to appreciate that the research takes both descriptive as well as exploratory "phenomenological methodology" (Hussey and Hussey, 1997, pp. 64-66), and which Ryan, *et al*. (2002: p.42) describe as interpretative accounting research methodology. The preceding chapter, Chapter 2, took the reader through the maize of extant literature in the area of principal-agency theory, executive compensation, corporate governance, economic value added, and organisational justice and fairness. The chapter was aimed at providing a thorough theoretical grounding of the themes discussed thereto. That is, to provide the reader with a deep understanding of the theoretical aspects of the thesis. The literature review was in-depth, insightful, comprehensive and thorough. The present chapter shall be dealing with methodological issues beginning with development of data collection methods, followed by choice of data collection methods, sample description, adequacy of sample size, method of data analysis, and data reliability and relevance; in that order. Methodology has been described as the process of doing research, while methods are the particular techniques used in the research (Ryan, *et al.* 2002). As the present chapter is devoted to methodology, it is about process and not result or outcome. It seeks to capture the process undertaken in carrying out the research, as outlined above.

3.2 *Development of data collection method*

The hands-on experiences encountered during the course of the study show that the topics of incentive bonus systems and executive compensation is a very secretive one because most of the companies approached for the empirical data collection aspect of the research were unwilling to discuss these topics.

Cognisance is taken of the fact that there are two main sources of data: Primary and secondary data sources. Amongst several of the data collection methods mentioned in section 3.3 below, questionnaire is associated with the former, whilst annual reports which are *ex post* documents are associated with the latter. Primary data is data pieced together by a researcher for the purpose of his/her present research. Secondary data are data which already exist, and which is meant for other purposes other than the present research. They include, for example, annual reports and accounts of companies. See Hussey and Hussey (1997, pp. 86 and 149) for a detailed discussion of types of data. As originally envisaged, a questionnaire was designed that would have been administered to respondents of a few selected companies. The questionnaire contained fourteen items calibrated along the lines of incentive bonus systems generally, demographics, fairness and justice. Figure 3.1 below is a specimen of the questionnaire.

1. Is your employment in this company or organisation a full-time or part-time one?
Full-time: ☐ Part-time: ☐

2. How would you describe your position or level in this company or organisation? For example, a manager, a clerk, an operator. You can add your title as appropriate)
………………………………………………………………………………………….

2. How much do you know or understand about Economic Value Added (EVA)?
……………………………………………………………………………………………
……………………………………………………………………………………………

3. Have you ever received a bonus in the name of EVA, TVA or any other such measure since you joined this company or organisation? Yes: ☐ No: ☐

4[3]**.** If you answer yes to Question 3, then when last were you incentivised based on EVA?
Less than one year ago: ……….
More than one year ago: …………
More than two years ago: …………….
More than five years ago: …………

5[4]* Did you receive more than you deserved, what you deserved, or less than you deserved?
More than I deserved ☐ what I deserved ☐ Less than I deserved ☐ not sure ☐

6*. Did the methods used by the management to allocate incentive favour one person or group of persons over another or were they equally fair to everyone involved?

7*. How fair were the procedures used to handle the incentive issue?
Very fair ☐ Fair ☐ No comment ☐ Very unfair ☐

8. Whose interest do you think EVA addresses most?

……………….	…………………………	……………………
Management	the ordinary worker	every one

9. Do you consider the present system of incentivising organisation members unfair or unjust?
Very unjust ☐ Not sure ☐ Very fair ☐

10*. How fair was the outcome you received?
Very unjust ☐ Not sure ☐ Very fair ☐

11. Does the promise by your company to incentivise members based on EVA motivate you to work towards achieving yearly performance targets set by management?

[3] Question 4 is a dummy question intended to reinforce and reconfirm the answer to question 3.

[4] Questions marked (*) were culled from **Tyler** (1994)," Psychological Models of the Justice Motive: Antecedents of Distributive and Procedural Justice", Journal of Personality and Social Psychology, Vol. 67, No. 5

Motivated: ☐ Can't tell: ☐ Not motivated: ☐

12. What are the other types of incentive bonus systems being operated by your company?
……………………………………………………………………………………….

13. How egalitarian or fair do you think the application of EVA has been in this company or organisation as far as you are concerned? Not fair at all: ☐ Somewhat fair: ☐
Can't tell: ☐ Very fair: ☐

14. What can you do on your part to increase EVA so that your bonus or incentive will increase? (*Ignore this question if you do not receive incentives*).

……………………………………………………………………………………………….
....

Figure 3.1: The Original Questionnaire

The questionnaire was to be personally administered to ten members of staff of each company, to be identified by the companies themselves for a face-to-face interaction with this researcher. The purpose of this face-to-face method was to be able to make clarifications for respondents should the need arise. But as events unfolded it became increasingly very clear that that was not to be. Most of the companies that were approached for access to administer the questionnaire either declined to cooperate or did not reply to the electronic mails sent to them requesting their assistance. Three companies were initially contacted regarding access to their employees. Apart from what has been discussed in Chapter 1 (see the section of Purpose and Motivation of study) regarding the choice of these companies to carry out the data collection phase of the research, other criteria that led to the choice of these three companies can be explained as **a**) the opportunity which students of the international accounting programme had when they interacted personally with officers of these companies. During the interactive sessions, the students were encouraged to approach the companies should they be desirous to enlist their assistance in carrying out their theses, **b**) this researcher happened to have met some of these companies who were on campus during a promotional event tagged "Gadden 2005" some time in 2005.

These and similar contacts served to reinforce the reasons why interest was kindled in these companies. However, only two of the companies replied negatively to the electronic mails sent to them. Of the two that replied one of them declined by invoking that the issues of interest to the research were an internal matter, which it would not like to discuss with any one outside the company, and in a thesis. Reference is made to Fig. 3.2 below, which are excerpts from the letters sent to the initial three companies that were intended to be used for the empirical data collection aspect of the study.

"Dear Sir/Madam,

….

I am conducting my Master's thesis titled '"Incentivising through EVA and other short-term performance metrics: exploring other neglected paradigms". It has to do with the implementation aspects of EVA, TVA and incentive bonus systems generally.

For the collection of the empirical data for my thesis I would like to conduct 10 interviews within your company. Therefore, I would kindly request your assistance to find suitable interviewees within Det Gör Inte AB (real name disguised). I would like to do face-to-face, personal interviews with about 10 of them: 5 on the management level and another 5 from the shop floor or junior level. An interview will take around 25 minutes. I am very flexible about the meeting schedule, but I would be very grateful if the interviews can be conducted during mid-September / beginning of October.

….

I therefore solicit your kind assistance and facilitation in enabling me gain access to whosoever you wish in your company for the purpose of carrying out this thesis.

I thank you for your cooperation.

Yours faithfully

Figure 3.2: Excerpts from the letters sent to the initial three companies

However, this initial request for access to the companies was denied. And upon receiving the reply declining the use of the company to administer the questionnaire, a second request was made; this time attaching a sample copy of the questionnaire which had already been prepared.. Again, this second request was also declined, in spite of the assurances given to them concerning confidentiality, and in spite of the fact that the questionnaire was sent along this time. The reason for sending the questionnaire was to allay the fears of the company.

3.3 *Choice of Data collection Method*

Research is a process of investigating and gathering information that will enable the researcher or policy-maker to arrive at a decision point. There are several methods of gathering data for a research (see section 3.2 above). Some of these include personal interview, by telephone or face-to-face contact; questionnaire, by post or face-to-face administration; observation, by participant observation or non-participant observation; and by *ex post facto*, where the researcher uses secondary or previously documented materials and records to conduct his/her research. For those in the physical or natural sciences, a laboratory experiment will be a uniquely or ideal method of data collection; whether by controlled group or treated group. However, it is to be borne in mind that each of these methods has their associated merit and demerits. In support of this assertion, Cooper and Schindler (1998, p.256) wrote that primary and secondary data sources each have strengths and weaknesses. This thesis would rather prefer to leave the elementary discussion of the merits and demerits of various data sources to basic texts on research methods such as those of Cooper and Schindler (1998, pp.257-258) and Hussey and Hussey (1997), amongst others. Using primary sources, researchers can collect precisely the information they wanted. Researchers can usually specify the operational definitions and can eliminate, or at least monitor and record, the extraneous influences on the data as they are gathered. However, as Cooper and Schindler (1998, p.256) posit secondary sources are indispensable in other ways. According to them, "there is nothing wrong with using primary data under any circumstances, or secondary data under difference circumstances, or rarely and prudently, substituting one for the other, when either might be suitable. But the basis for substitution has to be well understood and good judgment applied". This thesis holds this as a cogent defense for having recourse to annual reports as a source of data collection, and because proxy statements have been used by researchers, such as Zajac and Westphal (1995, p. 284, 293-294), Lovata and Costigan (2002, p. 221), O'Reilly III, *et al*. (1988, p.264) as a source of data collection. Ryan, *et al*. (2002:pp.ix, 1) posit that research [and research method] is uniquely about discovery and it entails disagreement, criticism, chance and error.

So, a researcher may have his/her preferences for using one research method or the other, aside from the probable factors of convenience, time, cost/economy, acceptability, and other such considerations too numerous to mention. This is one other reason for using annual reports as a source of data collection. See, for example, Cooper and Schindler (1998, p. 257) for additional reasons. In the case of the present research the following reasons informed the choice of data collection method, as originally articulated.

Firstly, is to have a specific reference or citation at any point in time. This is for reasons of corroborating the facts; and secondly, annual reports are an integral part of a listed company's mandatory disclosure requirement.

A scenario analysis was undertaken before the start of the data collection process. This involved a consideration of different "*what if*" situations and planning ahead for them. As a result of this the formulation of what was called Options A and B emerged. It took into account different possibilities, which considered different data collection methods and the likely difficulty to be encountered in the process, especially the one relating to accessibility to respondents or subjects at the companies. The empirical data collection method by way of a personally administered questionnaire was regarded as Option A, which was, predictably, the first option. The second, a contingent alternative, which would involve the use of annual reports to collect data, was reserved as Option B. However, Options A, and B could have been used conjointly, with one option supplementing the other, where there was a need. As events turned out, the unwillingness of the companies to cooperate for the empirical data gathering stage necessitated taking recourse to Option B. Because appropriate safeguard measures had been built-in in form of multiple scenarios into the calculation during the planning stage for the data collection exercise, this researcher was not disappointed nor surprised by the turn of events as a result of the refusal to conduct the empirical data collection exercise in the companies. The contingency plan, the so-called Option B, which was to use proxy statements, i.e., annual reports or financial statements as a source of data collection paid off handsomely. Cognisance of the fact is also taken that it is generally acceptable within accounting research to use annual reports as a source of data collection and analysis, see for example, Cooper and Schindler (1998, p.256) mentioned above.

3.4 Choice and *description of sample*

Because it was no longer necessary to have to administer about thirty questionnaires to employees of three companies (10 x 3), the sample size for the study was then increased from three companies to eleven companies. This means that we would be analysing eleven annual reports in Chapter 4 of this thesis. Apart from the original three case companies that were intended to be used, an additional eight companies were identified from the Financial Times' *Other International Stocks* pages of the Companies & Markets section. All the eleven companies are listed on the Stockholm Stock Exchange. They are all Swedish flagship companies of international renown, i.e., these companies are Swedish by birth. These companies include (in alphabetical order):

Atlas Copco	**Electrolux**	**Ericsson**	**Scania**
SEB	**Securitas**	**SKF**	**Skanska**
Swedish Match	**TeliaSoneria**	**Volvo AB**	

A check was run through some Internet search engines, notably Google™, to obtain the companies' website addresses. This effort was a success as Google™ made a redirection to the companies' websites. The websites were then visited, navigated and explored with particular reference to the aim of the visit, which was to get access to their annual reports. It was discovered that all the companies filed their annual reports in PDF format. These PDF files were then word-searched using the key-word search facility embedded in the PDF files. The annual reports were searched for such words as incentive, bonus, compensation, remuneration, economic value added, total value added, and according to the other themes of the research. All the companies identified were found to have reported, somehow, on the various themes of this thesis. Thus, their published annual reports or financial statements were searched with respect to disclosure of information regarding the application of incentive bonus systems, executive compensation, amongst others: Hence, they were finally chosen as sample companies for the thesis. A careful study of their disclosures on executive compensation, remuneration, incentive bonus system practices and policies was made. This exercise was carried out on the Internet, and it directed us to the relevant sections or pages of the annual reports. (The result of this shall be discussed in Chapter 4.) Hard copies of the relevant portions of the annual reports were then printed.

This *ex post facto* research method avails much when the possibility of a real-time empirical research is bleak. In the case of the present research, the *ex post facto* research method, which is a secondary data collection method through the Internet, has been chosen. It involves perusing the recorded data of the companies through their proxy statements. These are published annual reports and accounts of companies that are filed with the relevant regulatory authorities in their jurisdiction, Sweden; in the case of the companies being used in this thesis. The information that is of interests in the annual reports are those relating to companies' policy and practice on incentive bonus systems, executive compensation, etc.

It is instructive to note that being a record of past events that have taken place; annual reports cannot be manipulated or "sexed up" by a researcher to suit his/her whims or caprices. What the researcher using them needs to do is to interpret and analyse them the way they are. The researcher's personal opinion or judgment cannot be incorporated into them. The researcher has to take them as given. This is rather more of an advantage. Another serendipitous advantage that came to realisation by resorting to annual reports is the assurance of a constant and a readily available source of information whenever it was required. A further advantage of *ex post facto* research method is that when all else fail, it never fails. In our present case, the *ex post facto* method has come to be very handy. However, one draw back that ensues from using annual reports is the inability to have a real-time field experience with the rank-and-file employees. Nevertheless, this is because of the sensitive nature of the research. It is wondered to what extent the transparency of the data gathered on these sensitive topics through annual reports can be relied upon. Because of the invocation of *sensitive* or *internal affair* doctrine by the initial companies approached for the empirical aspect of the data collection, their disclosures on these issues as contained in their annual reports are held suspect. This position is borne out of the fact that one is susceptible to wonder if the reporting of incentive bonus systems and executive compensation is reported in a transparent and reliable way in annual reports since, as one company person puts it, it is a sensitive matter which will not be discussed with an outsider. Investigations conducted by this researcher have led to the discovery where researchers have been given access by companies to conduct the empirical data collection aspect of their study on issues of this nature, as in the case of Dulebohn and Martocchio (1998, p.475) in the US, for example. No doubt, the recourse to the Internet and annual reports has mediated the original plan of the thesis, albeit not in a negative way; one can say. For example, instead of reporting *live* (by having a face-to-face contact with respondents) on the implementation practices of incentive bonus systems including EVA and other isomorphic mimetics, annual reports will be content-analysed (see section 3.6 below) regarding these issues. This also has led to the modification of the main question of the research (see Chapter 1).

3.5 *Adequacy of sample size*

The reader may wonder whether the appropriate number of sample size has been selected. To a larger extent, yes! "One false belief is that a sample must be large or it is not representative. This is much less true than most people believe", write Cooper and Schindler (1998, p. 222). A researcher does not have to study the annual reports of all companies in the world before it can be said that he/she has carried out a satisfactory research. Basic statistics texts would describe a large sample size as one with number of observations greater than or equal to 30 ($\geqq 30$). However, it is argued here that a sample of eleven Swedish companies is enough to represent the population of companies in Sweden, insofar as they are found useful for the researcher's endeavour.

This position bears in mind that the result from these eleven companies can be generalised to the entire population of companies that use EVA, TVA and other variants to incentivise company members. Moreover, it must be stressed that the method used in selecting the eleven companies is judgmental or purposive. This is a convenient, non-probability method of sampling.

3.6 *Method of data analysis*

Content analysis has been chosen as the method to analyse the annual reports of the eleven companies. The method is a formal method of quantifying qualitative data. It represents a formal approach to qualitative data analysis and a way of systematically converting texts to numerical variables for quantitative data analysis (Hussey and Hussey, 1997, p.250). Cooper and Schindler (1998, p. 417) opine that content analysis measures the semantic content or the "*what*" aspects of a message. Its breadth makes it a flexible and wide-ranging tool that may be used as a methodology or as a problem-specific technique. More of content analysis as a method of analysing qualitative data shall be discussed in the next chapter, Chapter 4, which is dedicated to analysis of data. Suffice to say that some researchers, such as Zajac and Westphal (1995, pp. 293-294), Baldvinsdottir and Johansson (2006, pp.112, 114-115), Smith and Taffler (2000, p.638-639), amongst others, have used content analysis as a method to analyse the data obtained from proxy statements.

3.6.1 *Content analysis*

Content analysis is a formal method of quantifying qualitative data. It represents a formal approach to qualitative data analysis and a way of systematically converting texts to numerical variables for quantitative data analysis (Hussey and Hussey, 1997, p.250). Cooper and Schindler (1998, p. 417) opine that content analysis measures the semantic content or the '*what'* aspects of a message. Its breadth makes it a flexible and wide-ranging tool that may be used as a methodology or as a problem-specific technique.

Content analysis follows a systematic process starting with the selection of an unitisation scheme. The units may be syntactical, referential, propositional, or thematic. Thematic units are high-level abstractions inferred from their connection to a unique structure or pattern in the content. The method offers a number of advantages as a method of analysing qualitative data. It guards against selective perception of the content, has provision for the rigorous application of reliability and validity (see below) criteria, and is amenable to computerisation. The data to be analysed include materials of interest to a researcher. They include annual reports or financial statements, historical documents, interviews, paragraphs, and so on. Thus, content analysis may be used to analyse written data as well as secondary data studies, amongst others.

To the credit of the method, there is no problem with access as one is dealing with annual reports of companies. These reports are available on the internet, which is a public domain for mining all manner of information.

To a large extent published annual reports and accounts are permanent records which can be revisited and re-examined. Another merit of content analysis is that the pressure of time associated with interviews and observations are not an issue. One can choose to conduct one's analysis whenever one wishes. It is also a non-obstructive method which does not require observation, interview, or questionnaire. This, in effect, ensures that the subjects of one's study are normally unaware and unaffected by one's interests. It is also a relatively inexpensive method when compared with interviews, observations and questionnaires.

Finally, the systems and procedures for carrying out content analysis are very clear, so that a researcher who is concerned with the reliability and validity of their research will find the method highly acceptable.

In spite of this, unfortunately, there are also a number of criticisms and problems associated with content analysis. It has been argued (for instance, by Hussey and Hussey, 1997) that its theoretical basis is unclear and its conclusions can often be trite. Moreover, it involves a process of data reduction at the initial or early stage of the research. To record only the words or phrases a researcher considers of particular interest, may mean that the researcher discards large amounts of data which could help a person understand the phenomenon one is studying more thoroughly, and at a deeper level. There is also a problem that the documents may have been written for purposes other than those for which one is using them, or they may be worded for a public audience, especially annual reports in the case of this thesis. Even though a researcher can conduct the analysis when it best suits him/her, it is time consuming and it may be found tedious. But despite these reservations, content analysis can be useful to the researcher who has collected qualitative data and wishes to convert them into quantitative data. See Hussey and Hussey (1997, pp. 252-253), Smith and Taffler (2000, pp. 638-639), and Cooper and Schindler (1998, pp. 417-418) for a detailed explanation of content analysis.

3.7 *Coding scheme*

Coding is the process of assigning numbers, letters or other symbols to entities or respondents' answers. It is a short-hand way of identifying, classifying or categorising objects and subjects. Coding can be *alphabetical*, where letters are used to identify or represent things or objects.

It can also be *numerical*, where only numbers are assigned to entities. And it can be *alpha-numeric*, where a combination of letters and numbers are used to identify phenomena. The purpose of coding is to shorten what would ordinarily be a long sentence, phrase or name. It can also be done in order to mask the identities of respondents or samples in a study. This thesis has adopted alpha-numeric coding scheme, which is a combination of both letters and numbers. The codes have been pre-determined and written on each company's annual reports where they will associatively be used to identify the sample companies mentioned above. The codes adopted here are made up of three letters and two numbers. Arbitrarily, the letters have been made to precede the numbers. There are, therefore, eleven codes used to represent the eleven companies of the study. This means that one code represents one company. The numeric part of the code starts from 01 and ends at 11. Thus, the respective codes are ending with 01, 02, 03, 04, 05, 06, 07, 08, 09, 10, and 11 as the case may be. The alphabetical part does not purport to convey any logical pattern or sequence of arrangement or placement. It is a three-lettered word used as a prefix to identify the companies in this analysis.

As a point of departure, a mental schema or algorithm of the themes of the thesis has been produced below to enable the reader have a quick overview of the interlocking logicality of arriving at an opinion of whether the application of incentive bonus systems by companies can be considered fair or unfair. **Figure 3.3** provides a logic interwoven around the themes of the thesis. It is an attempt at detailing the step-by-step routines involved in the final determination of whether the application of incentives has been considered fair or unfair. In what has here been christened a "Black Box model" the first thing to decide is whether *value* has been added to the company or not. If value has not been added, that is the end of the step; no incentive. However, if value has been added, incentive programmes are then considered, depending on the company's policy and norm. This could be a bonus based on EVA; LTIPs (including Stock-based incentives such as Stock Options, Restricted Stocks or Stock Ownership); cash compensation; amongst others.

The crux of the matter is who is the beneficiary of the incentive programme? Is it solely for senior management/management group or it extends to every organisation member? This is where the cannel of this research is situated. A conception model has been developed and tested in **Figure 3.3** below. As can be seen in **Figure 3.3** several related words have been used to describe a situation whereby incentive programmes are meant for senior management alone. Such words range from unfair, unjust, inequitable and inegalitarian. On the other hand, where the incentive programme is meant to benefit all members of the organisation, the opinion will be that it is considered fair, just, equitable and egalitarian. This is considered the *ideal* situation that will reward every organisation member for the good performance of everyone.

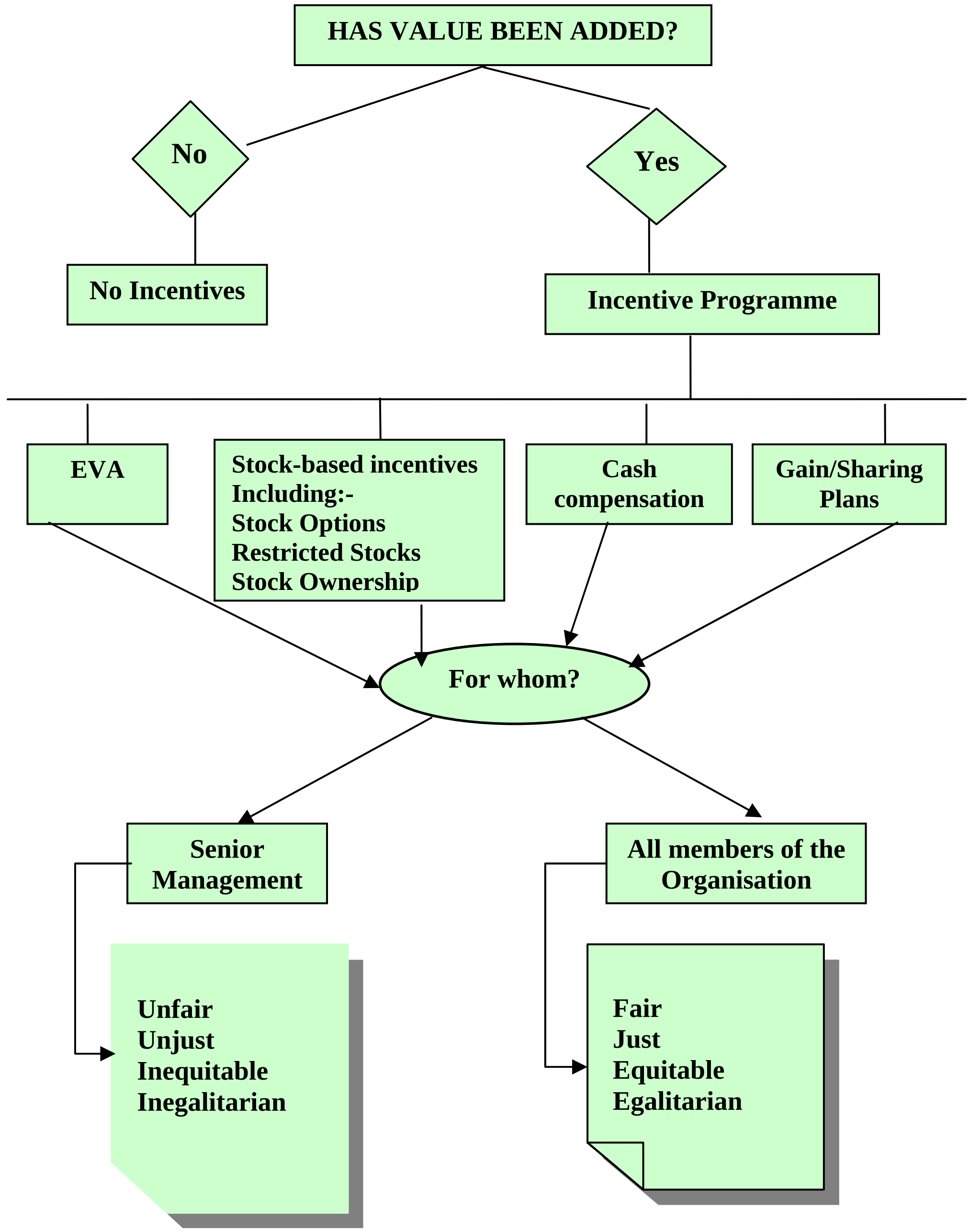

Figure 3.3: The *Black Box Model* of the research

3.7 *Data reliability*

This research has chosen annual reports as a source of data collection. The reliability in the use of annual reports as a source of data collection is assured here because they present consistency and repeatability of company information, especially in the area that this research has delved into. It is an assumption that there is internal consistency and reliability of the annual reports of the listed companies used as samples for this thesis. The annual reports are reliable as a method of data collection because they supply consistent information as long as they are published for public consumption. This is particularly so because of the need not to incur the wrath of market regulatory bodies should information contained in annual reports found to be inconsistent. In the words of Cooper and Schindler (1998, p. 171), a measure is reliable to the degree that it supplies consistent results. Reliability here is not been equated with the *accuracy* of the information contained in the annual reports of these companies. But it is a connotation that can be equated with consistency and replicability. This simply means that the same information will be found in the annual reports (of the same year) as any number of iterations is made upon being accessed. If a research finding can be replicated (using the same methods and measures), then it is reliable. In other words, if another person were to repeat the research, given similar circumstances as in the original, the same result should be obtained.

The method of data collection, using annual reports is reliable because it is believed that there is a high degree of replicability should any other researcher use the same method as is done in this thesis. And because annual reports are *stable* and consistent upon being published, they are considered very reliable for the purpose of conducting successive investigations.

Furthermore, almost all accounting researchers at one time or the other have had recourse to the use of annual reports as methods of data collection.

Chapter 4: *The Empirical Data*

Introduction

The thesis's methodology was discussed in the preceding chapter, including the research design, data collection method, and a brief introduction to the data analysis. The present chapter brings us to the point where the annual reports of companies that were identified will be analysed with particular reference to the themes of this research. As has been pointed out in Chapter 3 the annual reports of eleven companies will be analysed in order to find answers to the research questions outlined in Chapter 1.

For readers interested in corroborative endeavours, the annual reports used for this analysis were accessed from the following companies and their accompanying websites:

Atlas Copco:	http://www.atlascopco.com/
Electrolux:	http://www.electrolux.com/
Ericsson:	http://www.ericsson.com/
Scania:	http://www.scania.com/ir/Reports/annual.asp
SEB:	http://www.seb.se/pow/wcp/english.asp
Securitas:	http://www.securitas.com/
SKF:	http://www.skf.com/
Skanska:	http://www.skanska.com/
Swedish Match:	http://www.swedishmatch.com/Swe/Forstasida_fp.asp
Teliasoneria:	http://www.teliasonera.com/
Volvo AB:	http://www.volvo.com/

If one were to put a time badge on the data, the 2005 annual reports of the companies has been used throughout the analysis.

The annual reports of the sample companies have been analysed. What is conspicuously striking in the annual reports is the overly use of such words as “executive management members”, “members of group management”, “group management”, “senior executives”, "senior managers”, higher-level management”, “management incentives”, “senior executive team”, “executive officers”, “certain employees based on position”, amongst others.

4.1 Basis of bonus payments

As touching short-term bonus payment and variable compensation, among the companies studied only one, SEB or SSB07, extends short-term variable compensation to all of its employees as it says that “the vast majority of employees are also eligible for a variable salary component…”and “…In Sweden, all employees can receive a variable salary of maximum SEK18, 000 based on the financial result of the group…” In contradistinction to this picture, one company, Electrolux or SEX04, says “…Variable salary is paid according to performance... Variable salary for *sector heads* is determined by the achievement of both financial and non-financial targets. Value created is the most important financial indicator…. *Group staff heads* receive variable salary based on the value created for the Group as well as achievement of performance targets within their respective functions. ..” The same company says, “… variable compensation thus represents a significant proportion of total compensation for *higher-level management*” emphasising that “...a uniform programme for variable salary for *management and other key positions*” was introduced in 2003.

Three of the companies reported their modalities for arriving or calculating value added. Specifically, value added or creation as practiced by the companies falls within the conceptualisation of Economic Value Added, as discussed in Chapters 1 and 3. For example, taking a cue from the concept of EVA, one company, Scania or SSC11, p.78 of 2005 annual report, says its short-term incentive programme is based on "operating return, defined as the company's net income after subtracting the cost of equity, residual net income (RNI)". Another company, Skanska or SSK05, in a footnote disclosure on p. 115 of its 2005 annual report, refers to the variant of its value added as "operating income minus a capital cost for capital employed", hinting that "operating income includes financial income". Yet another company, Electrolux (SEX04), pp.83 and 95 of 2005 annual report, reveals that "value created is defined as operating income, excluding items affecting comparability, less the weighted average cost of capital (WACC) on average net assets, during a specific period".

With regards to Long-term Incentive Plans, again only one company, Ericsson or SER10, out of the eleven companies disclosed that "…the plan is designed to offer an incentive for *all employees* to participate in the company, which is consistent with our industry and with our ways of working".

Apart from these two cases, none of the remaining companies recognised or mentioned the rank-and-file employees. The expression rank-and-file is taken to mean low level employees in an organisation. It does not in any way mean blue collar or white collar workers. The term also refers to the generality of workers on the shop-floor.

. To show the extent of this neglect, for example, one company says, inter alia, "…The variable salary of a member of *Group Management* is according to a performance based programme. The purpose of the programme is to motivate and compensate value creating achievements in order to support operational and financial targets…The variable salary is determined primarily based on the short and long term financial performance of the … Group. The maximum variable salary is capped at a certain percentage of the fixed annual salary. The percentage is linked to the position of the individual and varies for *Group Management members* between 60 and 80%, including both the short term and the long term part." Yet, another company toeing the same line says "…For the other members of *Group Management*, the bonus is maximised at 60-100 per cent of their base salaries". Again, the emphasis has been on group management. And this type of disclosure focusing on executive or senior management is typical of most of the companies as revealed from their 2005 annual reports, which were analysed.

In order to bring out the complete picture as found in the annual reports of the companies, **Table 4.1** below has been produced to enable the reader have an informed understanding of the companies and how they fare in their application of various incentive bonus systems to their employees. Please note that the arrangement of the codes in the following table does not follow the alphabetical listing of companies as done in Chapter 3 above. In **Table 4.1**, the entry of ("1") in the various cells of the table indicates the allocation of various incentive bonuses to Senior Management or to all members of the organisation, as the case may be. Further discussion of the table shall be left until the next chapter, Chapter 5, where a thorough treatment shall be made.

4.2 *Focus on executive compensation*

When the focus is on executive compensation, the analysis of companies' annual reports reveals that most companies disclose information regarding the topic. As in the case of short-term bonus payment noted above, companies report spending a huge sum of money on executive compensation. For example, one company Securitas or SST06 reported that "during the 2005 financial year, one president and CEO received a salary equivalent to MSEK 11.5. A variable compensation of MSEK 6.4 for 2005 performance will be paid out to the same person in 2006…

There are six members of the Group Management in the company whose aggregate fixed salary amounted to MSEK 30.6 and other salary benefits to MSEK 2.1 in 2005.

Table 4.1 Showing Companies, types of incentive regimes, and to whom applied

(1)	Bonus based on Short term incentive criterion applied to (2)		Cash bonus applied to (3)		LTIPs applied to (4)		Fair/ Just? (5)	Unfair/ Unjust? (6)
	SM	ALL	SM	ALL	SM	ALL		
Teliasonera (STS03)	**1**							**1**
Swedish Match (SSM02)	**1**				**1**			**1**
Ericsson (SER10)	**1**		**1**			**1**	**1**	
Scania (SSC11)	**1**		**1**		**1**			**1**
Volvo (SVL01)	**1**		**1**		**1**			**1**
Securitas (SST06)	**1**				**1**			**1**
SKF (SSK09)	**1**				**1**			**1**
Skanska (SSK05)	**1**		**1**		**1**			**1**
Electrolux (SEX04)	**1**				**1**			**1**
Atlas Copco (SAS08)	**1**				**1**			**1**
SEB (SSB07)		**1**	**1**			**1**	**1**	

Legend: SM: Senior Management ALL: All members of the organisation
LTIPs: Long-Term Incentive Programmes

The aggregate variable compensation for 2005 performance amounted to MSEK 14.4, and will be paid out in 2006". Another company Electrolux (SEX04) reported that the compensation package for the President comprises fixed salary, variable salary based on annual targets, long-term incentive programmes and other benefits such as pensions and insurance…. The annualised base salary for 2005 was SEK 7,850,000, corresponding to an increase of 3.3% over 2005. Salary increased with 15.2% in 2004. The variable salary is based on an annual target for value created within the Group. The variable salary is 70% of the annual base salary at target level, and capped at 113.5%. Variable salary earned in 2005 was SEK 6,594,381. Like the President, other members of Group Management receive compensation package comprising fixed salary, variable salary based on annual targets, long-term incentive programmes and other benefits such as pensions and insurance. Base salary is revised annually per January 1. The average base salary increase in 2005 was 4.42%, and 6.10%, with promotions included. Variable salary for sector heads in 2005 is based on both financial and non-financial targets. The financial targets comprise the value created on sector and Group level. The non-financial targets are focused on product innovation, brand strength and succession planning. The target for variable salary for European-based sector heads is 50% of annual base salary. The stretch level is 100% and the payout is capped at 102–110%. Corresponding figures for the US-based sector head are 100%, 150% and 170%. Group staff heads receive variable salary based on value created for the Group and on performance objectives within their functions. The target variable salary is 35–40% of annual base salary. The stretch level is 64–80% and payout is capped at 66–82%. In addition, one of the members of Group Management is covered by a contract that entitles to a conditioned compensation based on achieved financial targets during the years 2005–2007. The compensation is paid provided the individual is employed until the end of 2007. The members of Group Management participate in the Group's long-term incentive programmes. These programmes comprise the new performance-based long-term share programme introduced in 2004 as well as previous option programmes. The determinants of executive compensation range from quantitative to non-quantitative criteria. While the base salary is determined by position, general performance and industry competitive standards, the variable package, which is capped in all of the companies, is determined by the achievement of certain financial performance of the group, financial performance of each officer's area of responsibility and individual performance objectives—Teliasonera (STS03) 2005 annual report, p.67).

In some companies, variable compensation is also influenced by achievement of predetermined earnings per share, operating margin, value added (or created), return on invested capital as well as increase in operating income of the individual divisions within the group — Swedish Match (SSM02) 2005 annual report, p.49, and SKF (SSK05) 2005 annual report, p.115). The non-financial targets are focused on product innovation, brand strength and succession plan, customer satisfaction, volume growth in the case of Electrolux, p.74, and SEB, p.50. Chapter 5 shall discuss whether these compensation packages can be regarded as excessive.

4.3 *Corporate Governance Mechanism*

Analysis of the companies' annual reports regarding corporate governance reporting was also carried out. In all of the companies analysed, compensation follows due process enshrined in the companies' corporate governance code. All the companies have established bodies responsible for the effective functioning of corporate governance, and they made a robust report about their corporate governance mechanism or structure. However, instructively, while some of the corporate governance reports were audited by external auditors others were not audited. For example, in the case of Volvo (SVOL01) as contained on p.72-75 of its 2005 annual report, there is a statutory annual general meeting of shareholders. There is also a Board of Directors; Remuneration Committee, which proposes the amount and type of compensation to the Board of Directors; Audit committee; Disclosure committee; Election committee; Group executive committee; provision for the appointment of independent external auditors, as well as internal control unit; amongst others. The Board of Directors on approval submits the recommendation to shareholders at Annual General Meetings of Volvo's shareholders.

The establishment of these corporate governance bodies are in furtherance of the requirements of the Swedish Code of Corporate Governance (effective July 1, 2005) for companies listed on the Stockholm Stock Exchange, and in compliance with the Sarbanes-Oxley Act (SOX) 2002; §.404; NASDAQ as well as London Stock Exchange requirements. The work of the various bodies is to ensure that the behaviour of all actors of listed (and unlisted) companies are regulated, controlled and monitored for the proper and healthy functioning of the companies.

Table 4.2 is constructed to show how the companies fare on the types of incentive regimes and disclosures on the two remaining themes of the thesis: As in **Table 4.1**, an ("1") entry in the second and third columns of the table is an indication that the company discloses information regarding the themes. Apart from one company (Teliasonera or STS03) whose corporate governance disclosure was very scanty, all remaining companies had a robust and adequate disclosure of corporate governance matters.

Table 4.2 Showing Companies, types of incentive regimes, and other disclosures

	Incentive Bonus system (1)			Disclosure on Corporate Governance (2)	Disclosure on Executive Compen-sation (3)
	Short-Term		LTIPs		
	EVA/TVA	CP			
Teliasonera (STS03)	1			1+	1
Swedish Match (SSM02)	1		1	1*	1
Ericsson (SER10)	1	1	1	1+	1
Scania (SSC11)	1	1	1	1*	1
Volvo (SVL01)	1	1	1	1*	1
Securitas (SST06)	1		1	1*	1
Skanska (SSK09)	1		1	1*	1
SKF (SSK05)	1	1	1	1+	1
Electrolux (SEX04)	1		1	1+	1
Atlas Copco (SAS08)	1		1	1+	1
SEB (SSB07)	1	1	1	1*	1

+ *represents companies whose corporate governance reports were not audited by the company's external auditors.*
* *represents companies whose corporate governance reports were audited by the company's external auditors.*

4.4 *Summary*

This chapter addressed analysis of data for the thesis, and it has carried out a conclusive and thorough analysis of the annual reports of the chosen companies for this thesis. The chapter also dealt with such issues as method used in analysing the data, coding scheme, the data itself, dealing with executive compensation, incentive bonus systems, and corporate governance. It also presented what was christened a black box model showing the steps involved in awarding incentive bonus to organisation members, which enabled an opinion to be reached as to whether the system was to be considered fair or unfair. Following on the heels of this chapter will be the presentation and discussion of the analysis's finding in the next chapter, Chapter 5.

Chapter 5: Analysis and Findings

5.1 *Introduction*

Data from annual reports of eleven Swedish companies were collected and analysed in Chapter 4 above. The data are presented and discussed in the present chapter. Recall from Chapters 1, 2 and other places that the emphasis of this thesis has been on extending short-term incentive bonus to all organisation members instead of the top or management group alone, a group that is seen as the elite of an organisation.

5.2 *Main Research Question*

This research has found out that incentivisation of senior executives or management group is based on EVA and other mimetic isomorphs such as TVA (in the case of SKF), SVA (in the case of Skanska), amongst others. Recall also from Chapter 1 that the main research question of this thesis is, "*Does the way EVA and other short-term incentive bonus systems are disclosed in annual reports provide sufficient information about how it benefits all organisation members*?" From the analysis of annual reports carried out in the preceding chapter, and presented in **Table 4.1** of that chapter, (repeated in **Table 5.1** below to avoid turning the pages of the thesis back and forth), only one company, SEB, reported extending bonuses based on short-term incentives to all organisation members, when it disclosed that "…in Sweden all employees *can* (italics added here for emphasis) receive a variable salary…" Even at this apparent wholesome disclosure, note is taken of the word "*can*". This means that there can also be situations or instances where all employees *cannot* receive a variable salary. There is, therefore, the possibility that all employees may not be receiving, at any one time, incentives based on short-term performance criteria. In any case and however the case may be SEB is the only company out of the eleven that can be said to be fair or just to its rank-and-file employees. This opinion is arrived at by looking at **Figure 3.3** in Chapter 3, called the Black Box Model. All remaining ten annual reports analysed did not make any reference whatsoever to the rank-and-file workers. As was mentioned earlier, the expression rank-and-file is taken to mean low level employees in an organisation. It does not in any way mean blue collar or white collar workers. The term also refers to the generality of workers on the shop-floor. Can it then be said that the main research question has been answered in the negative or affirmative? One cannot say for certain! It may be the case that companies have not seen the need or have not rather thought it necessary to disclose or report on such *minute* issue as touching the ordinary worker. They may have rather preferred to address the elites or senior members of their various organisations. Even among the elites, only a handful in the management group (between 5 and 10) was noted to have benefited from the short-term incentives considered. This is just a conjecture; and it begs the question.

Returning to the main research question, it was found that EVA was adequately reported in annual reports of companies analysed, although some of the companies had their own coinage to express the same concept or idea of EVA: For example, SKF calls it Total Value Added (see pages 26, 61-62 of 2005 annual report) while Skanska calls is Skanska Value Added (see page 115 of 2005 annual report). The data at the disposal of this researcher, and which is contained in **Table 4.1** (column 2) of Chapter 4, which is the same thing as **Table 5.1** (column 2) below, show that the application of short-term incentive bonus systems is, in the majority of cases, unfair or inegalitarian to the rank-and-file.

Table 5.1 Showing Companies, types of incentive regimes, and to whom applied

(1)	Bonus based on Short term incentive criterion applied to (2)		Cash bonus applied to (3)		LTIPs applied to (4)		Fair/ Just? (5)	Unfair/ Unjust? (6)
	SM	ALL	SM	ALL	SM	ALL		
Teliasonera (STS03)	**1**							**1**
Swedish Match (SSM02)	**1**				**1**			**1**
Ericsson (SER10)	**1**		**1**			**1**		**1**
Scania (SSC11)	**1**		**1**		**1**			**1**
Volvo (SVL01)	**1**		**1**		**1**			**1**
Securitas (SST06)	**1**				**1**			**1**
SKF (SSK09)	**1**				**1**			**1**
Skanska (SSK05)	**1**		**1**		**1**			**1**
Electrolux (SEX04)	**1**				**1**			**1**
Atlas Copco (SAS08)	**1**				**1**			**1**
SEB (SSB07)		**1**	**1**			**1**	**1**	

Legend: SM: Senior Management ALL: All members of the organisation
LTIPs: Long-Term Incentive Programmes

One is led to arrive at this opinion based on the model (**Figure 3.3** above) and as contained in the table under reference. There, it was shown that as incentive programmes are extended to senior or group management alone, it is considered unfair or unjust - in terms of distributive justice (see the operationalisation of this word in Section 2.5, Chapter 2, pp. 26 and 28). On the other hand, if short-term incentive programmes are extended to all organisation members, it is considered fair, just or egalitarian.

The reader would like to recall the operationalisation of distributive justice in the latter part of Chapter 2 as being based on judgment regarding the fairness of outcomes or allocation of reward;

which is borrowed from Tyler (1994: p.858). In the said latter part of Chapter 2, it was stated that "*judgment is fair if it is implemented consistently, without self-interest….and with the interests of all concerned parties represented…*" This, therefore, puts one in a comfortable position or stead to say that the application of short-term incentive bonus system is unfair insofar as it does not address the interest of all concerned in the majority of the companies whose annual reports were analysed in the preceding chapter. This point is also echoed with the help of **Figure 3.3** in Chapter 3 where short-term incentive programmes are considered to be fair or egalitarian if they are meant and applied to the benefit of all members of the organisation.

Confirmation of Proposition 1: This finding goes a long way in confirming Proposition 1 (see Chapter 1) that the application of EVA does not treat all organisation members fairly.

5.3 *Long term Incentive Programmes*

Although long-term incentive programmes, LTIPs, are not the focus of this thesis, nevertheless it is addressed briefly here. As with short-term incentive programmes, all the companies used for this study provide LTIPs to some of their employees. However, one out of the eleven companies made a categorical disclosure to the effect that it provides long-term incentives to all organisation members. The company, Ericsson, disclosed that "the stock purchase plan is designed to offer an incentive for all employees to participate in the company, which is consistent with our industry and our way of working."—page 81 of 2005 annual report. It is assumed in the case of SEB that it too extends long-term incentives to all employees since it has been found to extend short-term incentive bonus to all its employees; again see **Table 5.1** below. Now, since the remaining companies did not make a clear and categorical disclosure of the beneficiaries (senior management and/or rank-and-file) of their LTIPs, does it then mean that they are unfair in this regard? Well, to answer this question we take recourse again to **Table 5.1**. From the entries in column 4 of the table, this is unfair because LTIPs are meant, in the majority of the companies, for only senior management. The basis for this opinion hinges on **Figure 3.3** that enabled us to see the process involved in arriving at this opinion.

Furthermore, on this question, this research is not able to gauge workers' own opinion regarding whether *all* organisation members, including lower level employees, are satisfied with the application or use of EVA and other performance metrics. The reason for this is that it was not possible to sample the views of the rank-and-file, based on the absence of face-to-face contact with them which would have been possible by administering the questionnaire direct to them (on this, see suggestions for further studies in §.6.3 of Chapter 6).

5.4 *Ancillary or supporting research questions*

Tied to the main research question are three other ancillary questions. Beginning with the last ancillary question, it was thus asked:

Is the implementation or application of EVA, TVA, SVA and other short-term bonus incentive programmes fair or just on all organisation members?

In answering this question, the annual reports are used as a proxy. As was mentioned above, it is admitted here that gauging this view from the workers themselves through a face-to-face interview and administration of a questionnaire would have been most helpful. Nevertheless, on this the endeavour was made to improvise in the absence of no information at all. The answer to this question, however, is obvious when one considers column 6 of **Table 5.1**.

In that column, 10 out of the 11 (representing approx. 90.91%) companies were seen *not* to have extended short-term incentive bonus payments to the rank-and-file employees but applied them only to senior management or executive group. More worrying is that the executive group is composed of between five and ten persons!

In relation to the second ancillary question which was stated as:

"For the users of annual reports, is it possible for them to get enough information on a company's compensation system?

Without mincing words, the straight answer to this question is, no! Recall this researcher's encounter in Chapter 3 when the attempt that was made to collect information from one of the companies on this issue was rebuffed with the excuse that the company's compensation system is an internal matter which it would not like to discuss with outsiders. In the words of the company's contact person, "*Our TVA model is something we use internally and is, as you say (referring to this researcher), a kind of EVA model. How that is used for bonuses is nothing we would like to communicate externally and I also think such a wide interview group is nothing we would ever provide you with. I am sorry to reject your enquiry but this is something we consider confidential and internal*". What was noticed from the analysis of all the companies' annual reports is that the disclosure on executive compensation was always done in form of a summary. The details are not disclosed in most of the situations. That is not to say that there are no disclosures on compensation, but the system of arriving at compensation level is what is not clear. And only disclosures for a handful of senior executives (usually between 5 and 10 in most cases) are made. For example, in the case of Skanska the disclosure was made relating to the president and chief executive officer, CEO. The other disclosure was subsumed under "other members of the senior executive team."

By extrapolation or extension, it is noticed that the dearth of adequate information on executive compensation appears to be pervasive across most countries. This stretches to concerns even in the United Kingdom where a Financial Times' sponsored study revealed this trend. Shareholders are still interested in knowing what chief executives earn as compensation. The concern was express in the Financial Times of September 5, 2006, page 16, where the observation was made that "Long-term incentive plans, now estimated to make up more than a third of total compensation for top US and UK chief executives, are poorly reported, and their expected value difficult to calculate. Greater clarity on the topic might rekindle shareholders' ire." The third and final ancillary question is: *How have EVA and other short-term performance measures contributed to the focus on a company's short-term performance or profitability?*

EVA and other short-term performance measures have contributed to the focus on short-term performance and profitability. For example, Atlas Copco says, among other things, "…that variable compensation is for the achievement of specific results"—page 99 of its 2005 annual report. In the same vein, Teliasonera disclosed that "the objectives of the variable salary are established in a plan for each calendar year and are based on the Group's financial performance, the profit centre's financial performance and individual performance objectives…"—page 19 of 2005 annual report. Further on this same point, Securitas in its 2005 annual report, p.88, disclosed that "the variable compensation is based on performance relative to earnings improvements (and in certain cases other key ratios)…"

Other companies whose annual reports were analysed have the same thing to say regarding the focus on short-term performance or profitability. In the case of Scania, it says …"incentive programme…is based on operating return, defined as Scania Group net income after subtracting the cost of equity, residual net income."—page 78 of Scania 2005 annual report. Short- term consideration has also driven a company like Swedish Match to focus on performance and profitability. The company disclosed that the outcome of its short-term incentive programme is based on achieving an increase in earnings per share and increase in operating income of individual divisions. Continuing, it disclosed that "…maximum payment was dependent on an improvement in operating income compared to the preceding year and upon achievement of set targets." –Page 49 of Swedish Match 2005 annual report. The same pattern emerges from the analysis of SKF's 2005 annual report as it says that its TVA promotes improved operating profit, capital reduction, and profitable growth; page 19. On its part, Electrolux discloses that "…variable salary in the form of a short-term incentive based on annual performance targets…" This can be found on page 95 of Electrolux 2005 annual report.

Confirmation of Proposition 3: The above analysis confirms the third proposition of this thesis that EVA allows the management of a company to focus on short-term profitability.

Indirect confirmation of Proposition 2: Indirectly, via the confirmation of Proposition 3, Proposition 2 is confirmed or not rebutted, at least. In the life of human concocted systems like that of companies the demand of the future is also contending with that of the present or immediate. For example, humans face a natural dilemma or choice of whether to consume now or save for the future. They are faced with a choice of whether to forbear now or to sacrifice for the future.

Equity holders in most cases look forward to the long term survival, growth and profitability of their investment, while management may have a preference for the present, since their employment is not a life-long one. The latter may do all it could to scoop enough of what it can get from the company. Hence, it may likely focus on the short-term as manifested by its interest on profitability, share price, and income; amongst others. All of this may create an incentive or the enabling environment for managing earnings, or smoothing income. In outright cases, income may be manipulated in the direction management wishes. In the short-run companies may appear to be prospering and flourishing but in the long-run this may not enhance shareholder value creation. So, while management may crave to consume now, equity holders may be gunning for sacrificing in the long-term interest of their companies.

For example, where is Enron now as a going concern entity that its shareholders can be proud of? But during its short period of existence its management had a wonderful time as they had a field day to themselves, including holding the American corporate audience captivated or hypnotised.

The above relevant but experiential digression is meant to show or buttress that short-termism (see Chapter 1, under problem recognition) as occasioned by short-term performance criteria may not enhance shareholder-value in the long-run. This goes further to confirm the **proposition 2** of this thesis.

5.5 *Focus on executive compensation*

Although the rage over what has been called "fat cat" pay seems to have abetted as opposed to the past when it was under sharp watch by stakeholders, a glance at **Table 5.2**, which is actually the same as **Table 4.2,** reveals that all the companies made disclosures regarding executive compensation. But the adequacy of the information is held suspect. However, a Financial Times study shows that in the US chief executives pay is rising faster than earnings, although the same study shows that American chief executives are becoming more restrained in their pay demands. The pay package of an average chief executive comprises basic salary, bonuses, options exercised during a vesting period, other long term compensation, pension, insurance, amongst several other things.

The analysis shows that executive compensation is still increasing year-after-year. Does it then mean that executive compensation is becoming excessive? Well, it is not safe to say because excessiveness is a *relative* word. One way it is possible to judge whether executive compensation is excessive or not is to look at other factors such as the pay size or package of other members in the same organisation, the yearly profit of these companies, and the performance of the national economy, amongst others. As was seen in Chapter 4 when the annual report of TeliaSonera was analysed, "the determinants of executive compensation range from quantitative to non-quantitative criteria. While the base salary is determined by position, general performance and industry competitive standards, the variable package, which is capped in all of the companies, is determined by the achievement of certain financial performance of the group, financial performance of each officer's area of responsibility and individual performance objectives (Teliasonera (STS03) 2005 annual report, p.67).

In light of the above and regarding **proposition 4** of this thesis, we are not able to neither confirm nor refute it because it was not iterated for in the thesis. There is the constraint or difficulty of not being able to judge what it takes to call compensation "*excessive*".

5.6 *Corporate Governance Mechanism*

Analysis and findings presented in **Table 5.2** shows that all the companies reported putting in place corporate governance mechanisms, although there was no research question that specifically addressed this issue. Be that as it may it is heartening to note that all the companies whose annual reports were analysed are concerned about this theme. It is noted that while some companies' disclosures about corporate governance were audited by external auditors, others were not. As an example, some of the corporate bodies and mechanisms established, in the case of Volvo (SVL01), include Shareholders Annual General Meeting (AGM), Board of Directors; Remuneration Committee, Audit Committee; Disclosure committee; Election committee; Group

Executive Committee; provision for the appointment of independent external auditors, as well as internal control unit, amongst others (Volvo 2005 annual report, p. 72-75.) Corporate governance

Table 5.2 Showing Companies, types of incentive regimes, and other disclosures

	Incentive Bonus system (1)			Disclosure on Corporate Governance (2)	Disclosure on Executive Compen-sation (3)
	Short-Term		LTIPs		
	EVA/TVA	CP			
Teliasonera (STS03)	1			1+	1
Swedish Match (SSM02)	1		1	1*	1
Ericsson (SER10)	1	1	1	1+	1
Scania (SSC11)	1	1	1	1*	1
Volvo (SVL01)	1	1	1	1*	1
Securitas (SST06)	1		1	1*	1
Skanska (SSK09)	1		1	1*	1
SKF (SSK05)	1	1	1	1+	1
Electrolux (SEX04)	1		1	1+	1
Atlas Copco (SAS08)	1		1	1+	1
SEB (SSB07)	1	1	1	1*	1

+ represents companies whose corporate governance reports were not audited by the company's external auditors.
**** represents companies whose corporate governance reports were audited by the company's external auditors.***

is also strengthened by complying with the mandatory Swedish Code of Corporate Governance (effective July 1, 2005), other requirements for companies listed on the Stockholm Stock Exchange as well as the requirements of §.401 and the much controversial §.404 of Sarbanes-Oxley Act (SOX) 2002; amongst others (see §.4.4 of Chapter 4 on this).

5.7 Summary

The presentation and discussion of the research findings was carried out in this chapter. The main research question has been sufficiently addressed leading to an answer. Furthermore, we tackled the three ancillary or supporting research questions. The four propositions of the thesis were also addressed. Of the four propositions that were considered three were either directly or indirectly confirmed while one (proposition 4) was neither confirmed nor dismissed in anyway. We shall now turn to the next chapter, Chapter 6, of this thesis, which shall be dealing with the conclusions and recommendations of the entire work begun from Chapter 1 up to that point.

Chapter 6: *Conclusion, and Suggestions for further studies*

6.1 *Introduction*

***T**his research has come a long way. Whatever has a beginning must definitely have an ending, so the adage goes! This concluding chapter is meant to draw the curtain on what was begun in Chapter I up to the last chapter. It is pertinent to point out here that the present chapter shall not embark upon a repetitive discourse of what has been covered or treated in the preceding chapters.*

The general scene for the whole thesis was set in Chapter 1 where we dilated on the motivation behind the thesis. There, the problem was recognised as one where incentive bonus payment arrived at through the various short-term performance metrics such as EVA, TVA, SVA, and others, were noticeably used to incentivise senior management of the company to the neglect of the rank-and-workers. It was noted that EVA and others as they are discussed in the literature and in practice (in annual reports) lay emphasis only on senior management or executive management. It was remarked that the practice by some companies to use EVA and other short-term performance metrics to incentivise managers is also a presupposition that attributes the success of a company to the management alone. It was argued that this cannot be further from the truth or reality as the performance of an entire organisation is a connected web transcending one particular group of persons. As this issue is thought over, it begins to be realised that it makes executive compensation based on EVA and other performance metrics to be inequitable or unfair to some sections or groups of workers in the company. The whole research is anchored on the four stated research questions: One main research question and three other ancillary ones (see

Chapter 1, §1.4, for a recap of the questions). Following on from there, four propositions were also made in Chapter 1. These research questions and propositions were addressed earlier in Chapter 5.

In Chapter 2 extant literature on Agency theory, executive compensation, corporate governance, economic value added, the topic of justice and fairness, amongst others were reviewed. All of these were extensively treated as the position of various scholars, researchers, and professionals were reviewed. In Chapter 3 methodological issues were dwelt on, including the development of data collection method, where annual reports of companies were eventually used to gather data for the research; choice of data collection methods, where content analysis method was used to analyse the annual reports of the eleven companies identified. The choice and description of sample was done, which was influenced by the Financial Times' *Other International Stocks* pages of the Companies & Markets section and the subsequent use of the internet and Google™ search engine that pointed to the companies' websites; adequacy of sample size, leading to the argument that a sample of eleven Swedish companies is enough to represent the population of companies in Sweden, insofar as they are found useful for the researcher's endeavour; method of data analysis, where the election was made to use content analysis as a method of analysing the data collected from annual reports; and coding scheme, where the contraption of alpha-numeric coding method was made. The chapter also show-cased, for the first time, the step-by-step model of the research which enabled an opinion to be reached as to whether or not awarding short-term incentive bonus to a section of employees of a company can be regarded as fair or unfair. The model was called the Black Box Model. In Chapter 4 the data collected in Chapter 3 were analysed. The annual reports of companies were analysed in relation to basis of bonus payments, executive compensation, and corporate governance, amongst others.

The practices and policies of the eleven Swedish companies on these issues were seen from the disclosures made in their annual reports. Two tables that highlighted how the companies fared on various aspects were presented. **Table 4.1** showed the eleven companies, the types of incentive regimes operating in each company, and to whom they were applied.

The last table, **Table 4.2** also listed the companies, types of incentive regimes, and the disclosures they made regarding corporate governance and executive compensation. **Table 4.1** is most particularly relevant in answering the question of fairness espoused in this thesis (see Chapters 2, and 5 regarding the working definition of fairness as used in this thesis). It showed that only two companies (representing 18.18%) out of the eleven companies can be regarded as fair to all their employees, according to **Figure 3.3** in Chapter 3.

Recall our operationalisation of fairness as done in Chapters 2, 5 and elsewhere in this thesis. The penultimate chapter, Chapter 5, was all about presentation and discussion. Having concluded the analysis part of the thesis in Chapter 4, Chapter 5 had its point of departure from there. In the following few pages, the conclusion of the thesis will be drawn.

6.2 *Conclusion*

This research has been able to accomplish what it set out to achieve from the onset as most of the propositions (except one) received support. It has successfully investigated how companies use Economic Value Added, Total Value Added, and other mimetic isomorphs as a basis of incentivising organisation members. The thesis studied how companies apply or implement various short-term incentive programmes to their members. The reader is reminded of one of the research questions, which is: *Is the implementation or application of EVA, TVA, SVA and other short-term bonus incentive programmes perceived as fair or just on all organisation members?*

The conclusion to be drawn from this study is that the majority of companies in their efforts to reward or incentivise organisation members have neglected in their calculation to recognise the needs or concerns of the ordinary worker (who is described as the rank-and-file worker) as a group of employees who contributed in helping companies achieve their performance targets. What was conspicuously observed from the data collected and analysed for the study is that in their disclosure of short-term incentive bonus payments almost every emphasis has been laid on the senior management of the company. The research found that most of the rank-and-file workers were always neglected in companies' disclosure regarding incentivisation of organisation members. This research finding is consistent with that from literature, especially that of Ezzamel and Burns (2005, p.766) who also noted that "only the bonuses of senior managers … were linked to EVA because they are making big-spend strategic decisions" and described it as a "failed change initiative."—p.755. The present research has thus reached the inevitable conclusion that the payment of short-term incentive bonuses to only senior managers or executives among company employees is unfair or inequitable. The finding is also tangential to, but contradicts that of, Dulebohn and Martocchio (1998), who did an exploratory study of employees' perceptions of the fairness of work group incentive pay plans; although in their study they conducted personal interviews and surveys. In their study they surveyed senior management and plan administrators rather than the ordinary worker or the rank-and-file worker, which was the focus of the present research. So, while their study represented a top-down perspective, the present one represents a bottom-up perspective.

As for propositions, this finding also confirmed *Proposition 1* and the first ancillary question of the thesis (see Chapter 1) to the effect that the application of EVA does not treat all organisation members fairly. Why does one need to bother about this? The simple reason is that the rank-and-file workers are part of the "hen that lays the golden egg", if we may use this well known proverb. The truth of this proverb is reflected from, for example, the annual report of SEB that "in the opinion of the Board SEB's success is ultimately dependent on the commitment and competence of its employees. Thus, it is in the interest of the shareholders that SEB can attract and retain the most competent employees and create competitive compensation systems in order to achieve best possible return…" Thus, it stands to argue then that this group of employees deserves to be rewarded the same way that the top management is rewarded, even if not to the same extent. After all, senior management members have a basic salary from the contract of their employment. If they can be paid extra to be pushed to perform their tasks, then why not the ordinary worker also?

Specifically, and in addressing the main research questions of the thesis, the study found that only SEB disclosed adequate information regarding how it extends its bonus incentives to its employees. Other than SEB no other company made reference to paying short-term incentive bonus to *all* its employees.

Can it then be said that the main research question has been answered in the negative or affirmative? One cannot say for certain! But one can conjecture that it may be the case that companies have not seen the need, or have not rather thought it necessary to disclose or report on such *minute* issue as touching the ordinary worker. This leads to the inevitable conclusion that for users of annual reports it is not possible to get enough information on a company's compensation system as discussed in Chapter 5, and used in answering the second ancillary research question of this thesis. This conclusion is arrived at having regard to the excuse given by one authoritative company person that "*our TVA model is something we use internally and is, as you say, a kind of EVA model. How that is used for bonuses is nothing we would like to* *communicate externally and I also think such a wide interview group is nothing we would ever provide you with. I am sorry to reject your enquiry but this is something we consider confidential and internal.*" As the reader can see for him/herself the company says that its incentive bonus programme is an internal matter which it would not like to discuss with outside persons, especially to a researcher. This cloak of secrecy makes it somewhat difficult for readers of annual reports to get enough information about a company's compensation system, generally.

The research also found that it is even a handful of members of executive management that receive short-term incentive bonus; usually between 5 and 10 at the most. It was also found that EVA was adequately reported in annual reports of companies analysed, although some of the companies had their own coinage to express the same concept or idea of EVA.

It was also noted that EVA and other short-term performance measures have contributed to the focus on short-term performance or profitability. We noted that this may not be in the long-term interest of shareholders.

The executive who hasn't got a long term consideration for a company may do all he could to reap as much short-term windfall from the company as possible. This is irrespective of the long-term impact of this behaviour on the company. Thus, the *third proposition* of the thesis that EVA and others allow the management of a company to focus on short-term profitability was confirmed. The reader is urged to recall the allusion made to the case of Enron Corp in Chapter 5 as a means to buttress this point.

As to whether executive compensation is excessive, this could neither be confirmed nor rebuffed because of the difficulty we had in defining *excessiveness*. This difficulty will remain for a long time to come. In any case, the research did not iterate for excessive compensation.

On a cheerful note, it can be concluded without any equivocation that all the companies studied have in place adequate corporate governance mechanism.

This research has been unique in a way because to date, no known researcher has taken the pains to examine or study who actually benefits from using EVA and other short-term incentive programmes to motivate workers in order to put in their best for their companies.

It is hoped that the reader has enjoyed and found this thesis very interesting and informative as it was promised in Chapter 1 to make it devoid of unnecessary complications. And more importantly, as admonished by Dulebohn and Martocchio (1998: p.484) it is also hoped that "the results obtained can contribute to organisational efforts to design group incentive pay plans that will be perceived to be fair by employees, as well as suggest directions for future research."

6.3 *Suggestions for further studies*

This research has done its best insofar as its purpose is concern. No one research is able to cover every area or remit to the extent that it can say it has made a final contribution to a discourse. It is human to allow others to try their best when one feels one has done one's best. It is proper to give other researchers the opportunity to contribute their own quota to this topic. In giving this opportunity, areas for further studies are suggested for anyone interested in making their contribution. The suggestion here is only a guide as the future researcher can chose what they think is best, given the situation and circumstance they would find themselves.

Notably, the research was not able to conduct personal interviews with employees of companies. This handicap may be as a result of personal bias on the part of the company person that was contacted for access (we chose not to go into details). It is hereby suggested that another researcher (most probably a Swede for better cooperation from companies) should endeavour to replicate this study by administering a questionnaire.

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List of Abbreviations used in this thesis

AGM	Annual General Meeting
CEO	Chief Executive Officer
CVA	Cash Value Added
EBIT	Earnings before Interests and Taxes
EPS	Earnings per Share
EVA	Economic Value Added
GD	General Dynamics
IC	Invested Capital
LTIP	Long-Term Incentive Programme
M.Sc	Master of Science
MVA	Market Value Added
NOPAT	Net Operating Profit after Tax
Ph.D	Doctor of Philosophy
ROE	Return on Equity
SEC	Securities and Exchange Commission
SOX	Sarbanes-Oxley Act
SVA	Shareholder (Skanska) Value Added
TVA	Total Value Added
UK	United Kingdom
USA	United States of America
WACC	Weighted Average Cost of Capital

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