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# **Cultures' Impact on Incentive Programs**

-a Comparison between Swedish and American  
Companies

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# Abstract

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**Title:** Cultures' Impact on Incentive Programs – a Comparison between Swedish and American Companies

**Background and problem:** Many multinational companies have experienced a significant growth during the last few decades, which has resulted in more heterogeneous and geographically widespread organisations. This has led to a more complex decision-making for the senior executives, especially when new cultures enter into the company. People's cultural belonging and values affect their preferences, even work-related ones. Since the individual preferences differ between cultures one would expect to find that work related factors, such as incentive programs, differ.

**Purpose:** The main purpose of this thesis is to analyse in what way the incentive programs for senior executives differ between Swedish and American public companies. The secondary purpose is to analyse to what degree these differences are the result of cultural differences between the two countries.

**Method:** Sixteen Swedish and sixteen American companies were selected for review. The selection of companies in this survey was made so that the comparison between Swedish and American companies would be as little affected as possible by factors such as company size, industry, ownership and employee occupation. The basis of the survey consists of the annual reports of the selected Swedish companies and the proxy statements of the selected American companies.

**Analysis and conclusions:** The empirical results have shown similarities but also significant differences between Swedish and American incentive programs. The largest differences between the two countries can be traced to the characteristics of the dimension masculinity. The results in this thesis suggest that the variation in the design of incentive programs to a certain degree can find support in cultural differences between the two countries.

**Suggestion for further studies:** To be able to determine contingent trends concerning the design of the incentive programs in the two countries, a longitudinal study over several years would be of interest.

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# 1 Introduction

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*This chapter begins with a background, where the subject of this thesis is presented. Thereafter a problem discussion follows, which intends to give the reader a deeper understanding of the subject and aim of the thesis. Finally, under the last heading of this chapter, the purpose is formulated.*

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## 1.1 Background

Employees are becoming increasingly important for companies' efficiency and long term survival. They are, with their knowledge and competence, the main resource for a great number of companies. Hence, the ability of companies to attract and keep competent co-workers and to motivate them is crucial. Rewards and appreciation are two important factors in attracting and motivating employees and remaining competitive on the labour market.

For a company to be successful it is also necessary for the employees to work in a way that is congruent with the company's policy. First, employees need to be aware of which actions are desirable and, second, they need to be motivated to act in the desired way. Using incentive programs within organisations helps employees decide how to direct their efforts and motivates them to perform well<sup>1</sup>, as the rewards signal which performance areas are important<sup>2</sup>.

An organisation without incentive programs risks being inefficient due to the lack of concrete guidelines. The ability to attract and keep competent co-workers decreases and the co-workers that the organisation does attract might not know what is expected of them. It is well acknowledged that an organisations' total compensation system must be competitive to attract and keep qualified employees<sup>3</sup>. Hence, the use of incentive programs helps companies to stay competitive, given that the incentive programs are constructed to fit the companies' needs.

Despite the benefits of incentive programs, they have been subject to many debates during the last few years. Newspapers and other media have frequently discussed the design of incentive programs and the size of rewards, especially for managers in listed companies. The discussion escalated at the beginning of the 21<sup>st</sup> century when several serious scandals occurred in the US, for instance in the cases of Enron and Worldcom.

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<sup>1</sup> Arvidsson (2004)

<sup>2</sup> Merchant & Van der Stede (2007)

<sup>3</sup> *ibid*

Incentive programs have not only been subject of debates internationally - also in Sweden the size of rewards to senior executives has been questioned. One strongly criticised incident regarding incentive programs in Swedish industrial life is the scandal at Skandia, which was revealed in 2003. The main reason for the criticism was how the incentive programs for the senior executives were designed. Over a few years around the turn of the century the senior executives in Skandia received in total approximately 5 billion SEK, which is the largest reward ever recorded in Sweden<sup>4</sup>. One of the reasons that the amount was so large was that the upper cut-off of the rewards in the incentive programs had been removed and public opinion was that the senior executives at Skandia had been greedy and had acted immorally<sup>5</sup>.

Some critics argue that the difference between rewards for senior executives and for the rest of the employees is not reasonable. A couple of hundred managers in Volvo in the course of a few years received 750 million SEK worth of stocks and options, which can be compared to the 450 million SEK the 83,000 employees shared from 2006's profits<sup>6</sup>. This large difference in the size of the financial rewards has been criticised and is just one of many examples of the gaps in rewards between positions within one and the same organisation.

The criticism concerning incentive programs has to a great extent been centered round senior executives due to the large sums of money they receive as rewards. People have questioned whether the senior executives' contributions to the companies' performances actually are worth as much as they get paid. However, since many of the world's already large companies have experienced significant growth during the last few decades, the organisations have become more heterogeneous, geographically widespread and complex<sup>7</sup>. This growth has partly come about through mergers and acquisitions, which have aggravated the ability to create a uniform organisational culture. The process of achieving a homogenous business culture becomes even more complicated the more the traditions within the previous companies differ.<sup>8</sup> Due to the complexity and the different cultures within international firms operating in more than one country, managerial decisions become more complicated.

Decision-makers of different cultural origins are becoming increasingly more common among multinational companies and their individual personal values influence their decisions. Since managers from different organisations are routinely required to interact with both colleagues and customers from around the world, and since they are influenced by the new cultures they meet, an understanding of cultural differences often makes the difference between success and failure – both for careers and entire organisations.<sup>9</sup>

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<sup>4</sup> Dagens Nyheter (2006-02-16)

<sup>5</sup> Granskningsrapport, Försäkringsbolaget Skandia (2003)

<sup>6</sup> Dagens Nyheter (2007-02-07)

<sup>7</sup> Sjöstrand & Petrelius (2002)

<sup>8</sup> Styhre et al. (2006)

<sup>9</sup> Porter et al. (2003)

Some researchers even claim culture to be one of the most significant influences on global operations, while others, based on the convergence perspective, suggest that globalisation is reducing the influence of culture by imposing greater conformity on management practices<sup>10</sup>. Even though different opinions concerning culture's impact on multinational organisations exist, many studies have shown that culture does, in some respects, influence managerial decisions and organisational practises.

## 1.2 Problem Discussion

There are differences in structure and values due to organisational culture but also due to the many cultures in the world. It is therefore not possible to classify all organisations as one homogenous group. People within organisations have different values, traditions and behaviours depending on which group they belong to and in which part of the world they originate.<sup>11</sup> The cultural differences between nations are however not consistent; they vary in size and importance. Countries with geographical proximity and common language roots and religion tend to be more alike than countries from different regions of the world<sup>12</sup>.

People's cultural belonging and values affect their preferences. In some cases, work related factors that are highly valued by one person can, in fact, be considered not important to someone else in another part of the world. Factors that may have different importance to different people are, for instance, the importance of a good working environment, grade of responsibility, recognition and fringe benefits.<sup>13</sup> Since individual preferences differ between cultures one would expect to find that also other work related factors, such as incentive programs, differ.<sup>14</sup> It is of great importance that incentive programs are designed as a motivator to good performances and to be so, consideration must be taken of the recipients' individual values and preferences. In some countries one performance measure or reward type may be preferred, while it is nearly inappropriate in other countries.

Prior studies<sup>15</sup> with the purpose of examining the relationship between national culture and different types of incentive programs have however noted the existence of other important factors besides culture that might explain the variance of reward preferences and the use of different types of incentive programs in organisations with different countries of origin. These factors include organisational features such as size, industry, ownership and employee occupation<sup>16</sup>. Some surveys have, however, found that cultural determinants in the country in which firms are operating are more influential than determinants arising from a firm's organisational features<sup>17</sup>.

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<sup>10</sup> Chiang & Birtch (2005)

<sup>11</sup> Hofstede & Hofstede (2005)

<sup>12</sup> Segalla et al. (2006)

<sup>13</sup> Rehu et al. (2005)

<sup>14</sup> ibid

<sup>15</sup> Schuler & Rogovsky (1998), Chiang & Birtch (2006)

<sup>16</sup> Chiang & Birtch (2006)

<sup>17</sup> Gooderham et al. (1999)

As mentioned earlier, the number of large multinational companies around the world is growing. Hence, managers of today's multinational companies need to be aware of the different national cultures that are represented within their companies and the responsibilities of the senior executives increase the larger and more complex the companies get. The influence of new cultures within a company can modify its organisational features and globalisation has shown signs of cultural convergence between organisations with different countries of origin<sup>18</sup>. This modification can, however, only be done gradually, which means that the business culture of a company cannot be altered too fast<sup>19</sup>.

Some countries have had more impact than others concerning cultural influence of organisations and their management practices. The US has during the 20<sup>th</sup> century had a strong business culture, and has in many respects been a role model for other countries. Many western economies are influenced by the American business culture and companies tend to adopt various management practices from the US<sup>20</sup>.

Even though Swedish business culture, like many others, has been affected by that of the US, there have traditionally been differences between Swedish and American work life that affect their management practices. Sweden has had informal and non-hierarchical organisations, whereas American organisations tend to favour competition and formal procedures<sup>21</sup>. Moreover the Swedish labour market has traditionally been characterised by solidarity and "equal pay for an equal amount of work"<sup>22</sup>. Labour unions and collective agreements with fixed wages have historically also had a significant impact<sup>23</sup>.

The implementation and use of incentive programs are, as previously mentioned, important managerial tools to make a company competitive and successful. People's values and preferences have great effect on the design and function of the incentive programs, which makes culture an important factor when designing a company's incentive programs. The impact of national culture on organisations can thus be substantial and it would therefore be interesting to study whether the differences in national culture between Sweden and the US affect their management decisions, more specifically their incentive programs.

### 1.3 Purpose

The main purpose of this thesis is to analyse in what way the incentive programs for senior executives differ between Swedish and American public companies. The secondary purpose is to analyse to what degree these differences are rooted in cultural differences between the two countries.

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<sup>18</sup> Harzing & Sorge (2003)

<sup>19</sup> Gooderham et al. (1999)

<sup>20</sup> Styhre et al. (2006)

<sup>21</sup> *ibid*

<sup>22</sup> Persson (1994)

<sup>23</sup> Arvidsson (2004)

## 2 Frame of Reference

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*The first part of the frame of reference includes theoretical information about compensation systems, incentive programs and the decisions that have to be made when designing them. The second part gives theoretical information about national cultural differences and the dimensions of which they consist.*

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Many organisations meet the salary requirements of their employees by offering flexible salary systems, which are formulated to motivate and reward the employees. The purpose of these salary systems is to connect the compensation to the employees' work effort and to the economic result of the company.<sup>24</sup> The typical salary system consists of a base salary, benefits, short-term incentives, long-term incentives and a pension, but also insurance and severance pay can supervene. The latter items should however not be considered rewards but security against inferior protection of employment.<sup>25</sup> The fixed part of the salary is usually referred to as the base salary and, as the name suggests, it makes up the base of the compensation. The other parts of the total financial compensation are usually based on a percentage of the base salary.

Both Swedish and American studies show a positive relation between the base salary and the size of the company. In a study conducted at Uppsala University in 2002, however, it appears as if the correlation between the two components, size of the base salary and company size, is not perfect, but there are still more indications that there exists some relation than there are indications that there exists no relation at all. When comparing the level of the base salary in Swedish companies and that of foreign companies, the same study indicated a higher base salary in the foreign companies. Thus, the foreign senior executives received a higher compensation than their Swedish counterparts, but they also administrated a larger stock market value per SEK of the salary. The stock market value alone is, however, not the single indicator of the CEO's responsibility.<sup>26</sup> One can also measure the size of the company, and thereby the responsibility of the CEO, through the number of employees or size of turnover.

Connecting the size of the base salary too closely to the size of the company could, however, cause an increased incentive for mergers at the expense of the company's profitability. American and Swedish studies show that the base salary varies not only with the company size or number of employees, as mentioned above, but also between different lines of business.<sup>27</sup>

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<sup>24</sup> Smitt et al. (2002)

<sup>25</sup> Smitt et al. (2004)

<sup>26</sup> ibid

<sup>27</sup> ibid



The use of base salaries solely within compensation systems makes the size of the payouts fixed and the employees certain of what they will receive. The base salary can, of course, increase when the employee performs well, but the amount by which it increases often has only a small impact<sup>28</sup>. Since the base salary can rarely be decreased, i.e. it is not reversible; the increase in base salary due to good performance is usually moderate<sup>29</sup>. It is instead the fluctuation of the variable part of the salary that has the most impact on the fluctuation of the salary in total. By the introduction of an incentive program the employees can affect their variable salary or receive other rewards when they perform well or make extraordinary efforts.

## 2.1 Incentive programs

Incentive programs have different designs depending on the purpose one wants to achieve and the employees for whom the incentive programs are intended. The introduction and application of a well excogitated and conformed incentive program can certainly have many positive effects for the company. The Swedish organisation Aktiespararna (The Share Investors) is one of many who have pointed out the importance of well excogitated incentive programs. Their belief is that a well functioning incentive system, especially one which carries over a period longer than one year, gives incentives to the managers to make and carry out decisions which coincide with the shareholders' interests.<sup>30</sup>

One must however be aware of the cost the implementation of an incentive program causes and if the cost exceeds the increased performance generated by the program, the system is ineffective<sup>31</sup>. Thus, incentive programs in organisations should be designed from a cost-benefit perspective.

Incentive programs for managers and senior executives have been widely discussed and in many aspects criticized over the last decade mainly due to the size of the rewards. If shareholders, co-workers or media find the rewards given to senior executives unreasonably large, it is possible that a negative image of the company and of the board of directors will emerge. Hence, the board of directors must take this into consideration when designing the incentive programs for the senior executives.<sup>32</sup> This is important especially in public companies, since they receive more media attention than other firms and possible criticism from the media causes badwill towards the company<sup>33</sup>. There are no direct rules or guidelines on how large the compensation to the senior executives should be, since every company has its own unique situation. It could, however, be relevant for the board of directors to compare themselves with other companies of the same size and within the same line of business, when designing the compensation plans<sup>34</sup>.

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<sup>28</sup> Merchant & Van der Stede (2007)

<sup>29</sup> *ibid*

<sup>30</sup> Arvidsson (2004)

<sup>31</sup> Merchant & Van der Stede (2007)

<sup>32</sup> Smitt et al. (2002)

<sup>33</sup> Smitt et al. (2004)

<sup>34</sup> *ibid*

When determining the total compensation to managers and senior executives, it is also of great advantage if the company has a well excogitated and business oriented policy, which is accepted by shareholders as well as by co-workers and labour unions. Well formulated processes that show how the decisions concerning reward system and type are made should exist. In addition, one should try to attain total transparency, i.e. clearness in the information concerning the policy, processes and the results of the compensations given to the CEO and the other senior executives in all listed companies.<sup>35</sup> A business policy accepted by shareholders and distinct information concerning the compensations to senior executives help the company to avoid badwill.

Incentive programs can take different forms, and one has to consider many factors when designing them. Several definitions are used regarding the design of the programs and rewards, and there are no unequivocal terms. According to Chiang and Birtch (2006) there are three dimensions of incentive programs: reward system, reward criterion and reward type. For the incentive program to be effective, it is of great importance that all dimensions of the incentive program are congruent<sup>36</sup>.

### **2.1.1 Reward System**

When introducing an incentive program it is crucial that the recipients of the rewards know why they receive them or how they can improve their work to be able to obtain them. By the use of incentive programs within an organisation, one must decide on what basis the rewards should be set and communicate this decision to the potential recipients of the rewards.

The reward system is the method by which organisations determine employee rewards, which can be performance or non-performance based<sup>37</sup>. The major non-performance method is to tie the rewards to seniority, where the period of time for which an employee has been working for the company is the basis for the compensation<sup>38</sup>. If the rewards are performance-based, it is important that they are linked to the company's business strategy and objectives, since the desirable actions should be in line with the business strategy. Lack of a well defined business concept and strategy must be solved before decisions regarding reward systems can be made<sup>39</sup>.

The basis of the rewards does not have to be linked to predefined targets within the company; relative objectives, e.g. comparison with competitors, can also be used. Relative objectives remove the impact of exogenous uncontrollable factors, which makes the congruence between the recipient's performance and the outcome stronger. On the other hand, relative objectives might result in payments of variable salary even though the company is running at a loss, which has been debated in media and has caused badwill towards the concerned companies. Many companies tend to abandon the relative

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<sup>35</sup> Smitt et al. (2004)

<sup>36</sup> Porter et al. (2003)

<sup>37</sup> Chiang & Birtch (2006)

<sup>38</sup> Porter et al. (2003)

<sup>39</sup> Svensson (2001)

bonus systems, and use systems where the variable salary is based on objectives within the company itself.<sup>40</sup>

Whether objectives within the company or relative objectives are used, the basis on which the performance is measured must be chosen. Traditionally, financial measures, e.g. turnover and net profits, have been used, but the introduction of the balanced scorecard has in some respects served as a stimulator in the discussion concerning the use of non-financial measures, e.g. customer service/satisfaction and product/service quality<sup>41</sup>. Financial measures are often easy to understand and to measure, but a use of solely financial variables can result in excessively short term thinking. If the non-financial measures such as customer satisfaction are neglected, long-term profitability can become a secondary priority<sup>42</sup>.

### **2.1.2 Reward Criterion**

When designing an incentive program one needs not only to consider the reward system, but also the reward criterion, which refers to the allocation used to determine the reward<sup>43</sup>. The performance measured can be based on actions performed by individuals, groups or the entire organisation.

There are both positive and negative effects related to the use of these three criteria. Individual based systems require measures that are linked to the performance of one person, which is often the case for e.g. salespersons<sup>44</sup>. If only individual performances are measured, there is a risk that the individual will prioritise his or her own work at the expense of cooperation. The competition among the employees within the organisation might then increase, especially if the reward is a scarce resource<sup>45</sup>. On the other hand individual incentive programs do provide a stronger and more direct incentive effect than those that are group based and no free rider problem emerges<sup>46</sup>.

In some cases, when the performance measured is based on actions performed by groups or by the entire organisation, the rewards might be distributed differently among the employees. Sometimes only one or a few people get rewarded for the performance of the entire organisation. The CEO and other senior executives can, for instance, be the only ones who get rewarded with high bonuses if the organisation has had a high profitability, even though all of the employees in the company have contributed to the performance<sup>47</sup>.

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<sup>40</sup> Smitt et al. (2004)

<sup>41</sup> Arvidsson (2004), Merchant & Van der Stede (2007)

<sup>42</sup> Smitt et al. (2004)

<sup>43</sup> Chiang & Birtch (2006)

<sup>44</sup> Svensson (2001)

<sup>45</sup> Jacobsen & Thorsvik (2002)

<sup>46</sup> Merchant & Van der Stede (2007)

<sup>47</sup> Arvidsson (2004)

### 2.1.3 Reward Type

Reward type refers to what type of reward the employees receive if they perform according to the predefined targets within the incentive programs. The reward types must be chosen so that they encourage the appropriate performance for different individuals or groups. One way to systematise the rewards is to divide them into two groups: extrinsic, i.e. they are provided to the individual by someone else, and intrinsic, i.e. rewards that the individual provides him- or herself, such as feelings of accomplishment<sup>48</sup>. The environment cannot give or take away the intrinsic rewards directly, but can only make them possible.

The rewards do not have to be material; they can also be immaterial rewards, such as praise, promotion or greater responsibility. Some rewards might have both material and immaterial effects. Promotions, for instance, do not only signify higher compensation, but also result in higher status and more responsibility<sup>49</sup>. Material rewards are for natural reasons always extrinsic, whereas immaterial rewards can be both extrinsic as well as intrinsic. The issue regarding whether actions can include both extrinsic and intrinsic motivation is widely debated. Some argue that they are not additive, and that the use of extrinsic rewards reduces the employees' intrinsic motivation<sup>50</sup>.

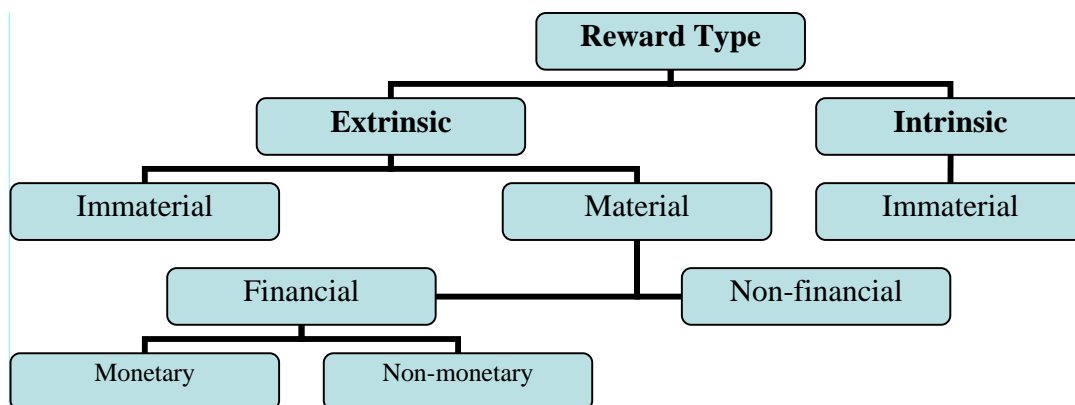


Figure 1. Types of rewards (Model designed by the authors)

The material rewards can be classified into financial and non-financial, and incentive programs normally include both types. Financial rewards within an incentive program include both monetary, e.g. bonuses and commissions, and non-monetary rewards, e.g. option programs and stocks. Fringe benefits, such as access to a company car and training opportunities, are on the other hand classified as non-financial rewards and are also used within organisations, but they are less flexible and as a general rule not usually tied to performance to the same degree as the financial ones are<sup>51</sup>.

<sup>48</sup> Porter et al. (2003)

<sup>49</sup> Jacobsen & Thorvik (2002)

<sup>50</sup> Björklund (2001)

<sup>51</sup> Porter et al. (2003)

Depending on the period during which the performance is measured, the monetary rewards can be divided into short-term incentives and long-term incentives. They have different effects and most managerial incentive programs include both incentives.

#### *2.1.3.1 Short-term incentives*

Performances measured over a period of one year or less are covered by the short-term incentive programs, which normally include bonuses, commissions and piece-rate-payments.<sup>52</sup> Short-term incentives are common and play an important role in motivating senior executives to extraordinary performances.<sup>53</sup> The size of the bonus to senior executives is normally linked to the effort of the recipient and the corporate performance.

The bonus for a particular year can be paid either as a lump sum or be spread over a period of time. The reasons for paying the bonus over several years are to counteract too much short-term thinking and to extend the planning horizon of the senior executives<sup>54</sup>.

When designing the short-term incentive programs for senior executives, the board chooses one or several reward systems, e.g. financial objectives often in combination with personal objectives. The better the target achievement, the greater reward, but short-term incentives are often designed with a lower and an upper cut-off that limit the size of the rewards. The lower cut-off must be reached for a minimum compensation to be eventuated. Thereafter, the payment increases until a preset upper cut-off is reached. The reason for the upper cut-off is to avoid extreme or non-anticipated outcomes that otherwise might occur<sup>55</sup>. Especially when introducing a new incentive program, it might be difficult to estimate all its possible effects, and an upper cut-off will lower the risk of the misjudgements becoming too expensive for the company. An upper cut-off also lowers the risk of managers taking actions to increase current period performance at the expense of long-term performance and insures that upper-level managers are paid more than lower-level managers<sup>56</sup>.

#### *2.1.3.2 Long-term incentives*

In recent years the long-term incentives have become more important in Sweden. There has been a shift in the relation between the different parts that the total financial compensation consists of. The share of the total compensation consisting of the base salary has decreased, whereas the long-term incentive programs, such as option programs, make up a substantially greater part of the total compensation than before. A mapping of the a-listed companies in Sweden between 1997 and 2001 conducted at Uppsala University showed that the long-term incentives' significance as a part of the total financial compensation had gone from almost non-existent to representing more than one fifth.<sup>57</sup>

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<sup>52</sup> Merchant & Van der Stede (2007)

<sup>53</sup> Arvidsson (2004)

<sup>54</sup> Smitt et al. (2002)

<sup>55</sup> Smitt et al. (2004)

<sup>56</sup> Merchant & Van der Stede (2007)

<sup>57</sup> Smitt et al. (2004)

One reason for the increase in the significance of the long-term incentives might be that they tie the employees closer to the company<sup>58</sup>. The fact that, during the last decades, it has become more common that workers stay a shorter period of time at one and the same workplace has made it even more important to design programs that link competent co-workers to the company<sup>59</sup>. It is no coincidence that long-term incentives, such as option programs, have been frequently used in companies as Swedish Framfab and other firms with younger, well-educated and mobile co-workers.<sup>60</sup>

The purpose is, however, not only to keep competent co-workers, but also, in contrast to short-term incentives, to reward employees for their role in maximizing the company's long-term value<sup>61</sup>. Since the long-term success of the company is more attributable to higher levels of management, the long-term incentives are usually restricted to these levels<sup>62</sup>.

When long-term incentives are used, the performances are measured over periods longer than one year, and the most common base for the rewards is a change in value of the company's stock, so called equity-based rewards<sup>63</sup>.

Long-term incentives come in multiple forms, but the most common types are convertible bills of debt, stocks and different option programs<sup>64</sup>. Convertible bills of debt include a right to purchase shares according to conditions set beforehand. Option programs give the employees the right to purchase a set number of shares of company stock at a prearranged date. At the prearranged date, the employee can decide whether to buy the shares or not.

Since the employees only benefit if the stock price goes up, the use of stock-based incentives serve as a motivator to increase their company's stock price. These types of long-term incentives create interest congruence between the company's senior executives and its shareholders, so called bonding<sup>65</sup>. This is a strong motive for using incentives that include ownership, such as stocks and some types of option programs, rather than using incentives that only result in direct economic compensation.

Despite the strong motive for using option programs, there are several disadvantages. Option programs might for instance motivate the managers to undertake riskier business strategies and, thus, increase stock price volatility, which is not favourable for the other shareholders. The employees receiving the options might also be rewarded due to a general stock exchange rise, even if the company itself does not perform extraordinarily well. The rewards are in that case not solely linked to the performance of the managers, but are also affected by exogenous uncontrollable factors.<sup>66</sup>

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<sup>58</sup> Svensson (2001)

<sup>59</sup> Smitt et al. (2002)

<sup>60</sup> Svensson (2001)

<sup>61</sup> Merchant & Van der Stede (2007)

<sup>62</sup> *ibid*

<sup>63</sup> *ibid*

<sup>64</sup> Smitt et al. (2004)

<sup>65</sup> *ibid*

<sup>66</sup> Merchant & Van der Stede (2007)

## 2.2 Cultural differences

Culture is not an easy variable to define and can be described in many different ways. Not one definition or description is exactly the same. This can be confusing when trying to explain culture and its impact on people and societies, but the difference in definitions is not the only problem. Another problem occurs if nations are equated with societies. From a historical point of view, societies are organically developed forms of social organisation. Strictly speaking, one could state that societies have a common culture, while nations have not. Nevertheless many nations do make up entireties which have been developed through history and where groups that usually differ have found common ground in for example a national political system, a national defence and normally one dominant national language. One must be aware that nationality should be used carefully in research on cultural differences. However, nationality is often the only criterion for classification and it is practical, as it is much easier to get hold of data from nations than from organically homogeneous societies.<sup>67</sup> Therefore, when talking of culture in this thesis, we will henceforth refer to national culture, if not otherwise mentioned.

National culture is usually characterised by the values and beliefs of the people belonging to that culture. Most of these values and beliefs have been acquired in early childhood within the family, at school and in other surroundings. Earlier studies have ascertained that there exist cross-cultural differences in values and beliefs<sup>68</sup>, but in many cases, researchers still ignore elementary differences between cultures when studying organisations. Researchers such as Sanchez-Runde and Steers and, perhaps primarily, Hofstede have, however, reviewed the topic of organisational preferences in motivation and performance due to cultural differences.<sup>69</sup>

Even though cross-cultural differences play an important role in comparisons of organisations across countries, it is far from the only aspect that has to be considered. There are also cultural differences between organisations within the same country. Business culture is something one adopts from a workplace and it consists of the organisation's practices<sup>70</sup>. Recently, it has been well documented that business culture can have a strongly motivating effect on the employees. However, due to national cultural differences, substantial differences can exist between employees' preferences, which one must consider when designing a work situation that promotes the motivation of the individual.<sup>71</sup> Several authors have suggested that both national and organisational culture should be taken into account and that one should not underestimate the influence of national culture<sup>72</sup>.

Since values and preferences vary between people from different cultures, management of organisations is likely to differ as well. There are studies supporting the relationship

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<sup>67</sup> Hofstede & Hofstede (2005)

<sup>68</sup> Schuler & Rogovsky (1998)

<sup>69</sup> Porter et al.(2003)

<sup>70</sup> Hofstede & Hofstede (2005)

<sup>71</sup> Jacobsen & Thorsvik (2002)

<sup>72</sup> Styhre et al. (2006)

between congruency in a firm's management practices with national culture<sup>73</sup>. Several studies have also indicated that norms in the society affect the design of the incentive programs and people's opinions of what are fair rewards for performance. American incentive programs, for example, are characterised by fast promotion and large increases in salary.<sup>74</sup>

Demographic characteristics are also thought to affect the shape of reward preferences. People who live within the same culture but who possess unequal demographic characteristics may have different reward preferences.<sup>75</sup> Furthermore, organisations are often bound to agreements, set outside the company by parties on the labour market<sup>76</sup>, which may affect how incentive programs and rewards are formed.

As discussed earlier, Sanchez-Runde and Steers are two researchers who have contributed more knowledge on the subject with their studies and discussions regarding how culture affects employee behaviour<sup>77</sup>. From their studies, they could ascertain that cultural differences influence work behaviour, motivation, and job attitudes in a variety of significant ways.<sup>78</sup>

The results of the study also show that cultural variations influence employee preferences for financial incentives, e.g. salary, versus non-financial incentives, such as additional time off. Similarly, cultural differences in uncertainty, risk and control may affect employee preferences for fixed or variable compensation.<sup>79</sup>

Culturally-based influences on work motivation and values are, however, in no way universal. Sanchez-Runde and Steers emphasise that self-efficient beliefs and rewards, incentives and disincentives derived from performance all affect work norms and employee performance goals.<sup>80</sup>

### **2.2.1 Hofstede's IBM studies**

One of the most pre-eminent researchers on the topic concerning cultural differences and organisational preferences in motivation and performance due to these differences is Hofstede. By virtue of comprehensive research during the past four decades, Hofstede has become famous for his theories of management and motivation. By using a model in which worldwide differences in national culture are classified according to four independent dimensions, Hofstede has aimed to explain differences in management.<sup>81</sup> After finishing the original survey a fifth dimension, virtue, was added, but since this was not part of the original survey, it will not be further discussed in this thesis.

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<sup>73</sup> Schuler & Rogovsky (1998), Chiang & Birtch (2005)

<sup>74</sup> Jacobsen & Thorsvik (2002)

<sup>75</sup> Chiang & Birtch (2006)

<sup>76</sup> Jacobsen & Thorsvik (2002)

<sup>77</sup> Porter et al. (2003)

<sup>78</sup> Sanchez-Runde & Steers (2002)

<sup>79</sup> *ibid*

<sup>80</sup> *ibid*

<sup>81</sup> Porter et al. (2003)



Hofstede's most groundbreaking studies were those conducted on people working in subsidiaries of the multinational company IBM in the early 70's. Hofstede collected and reviewed data from questionnaire studies, which had been answered by employees in fifty countries and three regions all over the world. The employees constituted an almost perfect selection, since they were similar in all respects but nationality, which resulted in an unusually apparent nation-related effect on their answers.<sup>82</sup>

In connection with the IBM studies, Hofstede set up a model in which cultures consist of four dimensions. A dimension is an aspect of a culture which can be measured relative to other cultures. The dimensions were given the denominations masculinity versus femininity, uncertainty avoidance, individualism versus collectivism, and power distance.<sup>83</sup>

Together, the four dimensions compose a four dimensional model of the differences between national cultures. Each country is described by a value for each of the four dimensions. The calculated values of the dimensions are relative, i.e. they are only a measure of the differences between the countries/regions.<sup>84</sup>

#### *2.2.1.1 Masculinity*

Masculinity as a dimension refers to how equal the role distribution between the genders is in a culture. Cultures where gender roles are clearly separated are masculine, and the ones with equal gender roles are feminine.<sup>85</sup>

For individuals within masculine cultures aspects such as assertiveness, achievement and material success are important. They favour material gain, money and other financial arrangements<sup>86</sup>. Cultures with predominantly feminine values are, on the contrary, characterised by concern for others, modesty and preference of human relationships and quality of life<sup>87</sup>.

The degree of masculinity differs greatly even among countries in the same part of the world, with the same economic development<sup>88</sup>. The Scandinavian countries are, for instance, very feminine, whereas Great Britain, Germany and the US are rather masculine. Sweden was ranked as the most feminine of all the countries included in the survey, whereas the US was ranked as the 15<sup>th</sup> most masculine country. See appendix I for a Masculinity index (MAS) for all countries.

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<sup>82</sup> Hofstede & Hofstede (2005)

<sup>83</sup> *ibid*

<sup>84</sup> *ibid*

<sup>85</sup> *ibid*

<sup>86</sup> Hofstede (1997)

<sup>87</sup> Chiang, & Birtch (2006)

<sup>88</sup> Hofstede & Hofstede (2005)

	Score rank	MAS score
USA	15	62
Sweden	53	5

### 2.2.1.2 Uncertainty avoidance

In every organisation there are situations that are ambiguous or uncertain. Uncertainty avoidance (UA), as a dimension of culture, is defined as the degree to which uncertainty and ambiguity are tolerated in a society or organisation. Individuals from low UA countries are far more tolerant of uncertainty than their high UA counterparts, who feel uncomfortable in unstructured situations with an uncertain future<sup>89</sup>. Thus, in countries with high UA, rules, guidelines and direction are more necessary than in low UA countries, where risk taking and flexibility in work conditions are more prevalent.

The uncertainty avoidance index (UAI) shows the attitude towards uncertainty in different countries/regions, where a low score rank indicates a high tolerance for uncertainty. Both Sweden and the US have a low score rank among the 53 examined countries/regions. For an uncertainty avoidance index for all countries/regions see appendix II.

	Score rank	UAI score
USA	43	46
Sweden	49/50	29

### 2.2.1.3 Individualism

Individualism is a dimension that has collectivism as its counterpart. People within individualistic countries put their individual interests and the interests of their immediate family above those of others and the ties between individuals are loose.<sup>90</sup> Countries with a low individualism index (IDV) score are collectivistic. These countries are characterised by strongly cohesive so called in-groups, which serve as a protection for the individuals in exchange for unquestioning loyalty.<sup>91</sup> Due to the characteristics of individualistic and collectivistic countries, the former are more likely to accept individual responsibility for results, whereas the latter prefer group-based actions and responsibility<sup>92</sup>.

The IDV shows that there is a strong relationship between national wealth and the degree of individualism: nearly all wealthy countries score high on IDV while nearly all poor countries score low. The USA is the country ranked as the most individualistic and Sweden is, together with France, ranked as the 10/11 most individualistic country among the examined. See appendix III for an individualism index for all countries.

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<sup>89</sup> Schuler & Rogovsky (1998)

<sup>90</sup> Hofstede & Hofstede (2005)

<sup>91</sup> *ibid*

<sup>92</sup> Schuler & Rogovsky (1998)

	Score rank	IDV score
USA	1	91
Sweden	10/11	71

#### 2.2.1.4 Power distance

People within countries and organisations are different and have unequal amounts of power. The emotional distance between superiors and subordinates within a culture and to what extent they accept the unequal distribution of power is defined as the power distance. Subordinates within cultures with small power distance can quite easily approach and contradict their superiors, and the emotional distance between them is small.<sup>93</sup> This can for instance manifest itself by employees taking part in the decision making<sup>94</sup>.

There is a common belief that there should be a certain degree of inequality in cultures with large power distance and that the subordinates are quite dependent on their superiors. Both superiors and subordinates within cultures with high power distance accept their respective positions and compensations associated with the position, such as promotion, job title and salary<sup>95</sup>.

Researchers have found that not only the degree of individualism but also the degree of power distance is related to wealth; as a country gets wealthier, power distance decreases in many cases<sup>96</sup>. Both the US and Sweden have a relatively low power distance, even if the US is ranked higher than Sweden. For a power distance index (PDI) for all countries/regions see appendix IV.

	Score rank	PDI score
USA	38	40
Sweden	47/48	31

### 2.3 Chapter discussion

Studies made by both Hofstede and Sanchez-Runde and Steers have shown that cultural variations influence organisations and managerial decisions made within them. As incentive programs are part of the managerial decisions and definitely linked to the preferences of the decision-makers and recipients it is likely that incentive programs differ between countries.

There are many decisions to be made when designing incentive programs and cultural differences around the world influence the three dimensions; reward system, reward criterion and reward type. Financial rewards are important to most individuals, but the allocation of financial and non-financial rewards is likely to differ between countries.

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<sup>93</sup> Hofstede & Hofstede (2005)

<sup>94</sup> Schuler & Rogovsky (1998)

<sup>95</sup> Chiang & Birtch (2006)

<sup>96</sup> Hofstede et al. (2002)

Due to the characteristics of masculine cultures the importance of financial rewards is likely to be greater in these cultures than in the feminine ones<sup>97</sup>, where non-financial rewards such as taking time off are considered more valuable than additional income<sup>98</sup>.

Also, the share of fixed salary and variable compensations might vary. Variable compensations, especially those based on performance, are uncertain and place future income in jeopardy and are therefore more likely to be accepted in countries with low uncertainty avoidance<sup>99</sup>. Non-performance-based rewards, such as seniority, are more predictable than performance-based and are thus presumably more valued in countries with high uncertainty avoidance<sup>100</sup>. Seniority-based rewards are also more likely to be found in countries with high power distance, due to their respect for authority and loyalty<sup>101</sup>.

One could also expect to find variations within the dimension reward criterion, which refers to whether individual or group performance should be measured. Acceptance of individual responsibility for results differs depending on the degree of individualism within the country. Individualistic countries are more likely to accept individual responsibility for results and individual rewards, whereas collectivistic countries should prefer non-competitive rewards based on group performance<sup>102</sup>.

Incentive programs are primarily made up of variable salaries, share- and option programs, but the type of rewards used might vary between countries due to cultural differences. According to some studies, rewards tied to ownership are more prevalent in countries with higher levels of individualism and lower levels of uncertainty avoidance and power distance<sup>103</sup>.

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<sup>97</sup> Chiang, & Birtch (2005)

<sup>98</sup> Porter et al. (2003)

<sup>99</sup> Chiang & Birtch (2006)

<sup>100</sup> Schuler & Rogovsky (1998)

<sup>101</sup> Chiang & Birtch (2006)

<sup>102</sup> Schuler & Rogovsky (1998)

<sup>103</sup> *ibid*

## 3 Method

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*This chapter contains information on choice of method, selection of companies and what the survey is based on to fulfil the purpose of this thesis. It also covers a description of the theory used, limitations and criticism of the sources.*

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### 3.1 Collection of data

A deductive approach is, as opposed to an inductive approach, a method in which the researcher starts out with a theory and studies how it is practiced in reality<sup>104</sup>. In this thesis, we approach the empirics based on the theory in chapter two, which helps us to form an idea of how the incentive programs in Sweden and the US are designed. Hence, we use a deductive approach throughout this thesis.

This study has both a descriptive and a causal dimension. Since the primary purpose of this thesis is to describe how the incentive programs for senior executives differ in Swedish and American companies, the survey will be descriptive. We chose only to compare the design of the incentive programs as it appears at the present. Thus, we will use a cross-sectional research method. Using cross-sectional research as approach, one studies the current situation without considering the change over time. This kind of study is suitable when one wants to describe a situation at a given time or when one wants to discover which phenomena interoperate at a given time.<sup>105</sup>

For the study to have a causal dimension it has to meet three conditions. First, there has to be a covariance between what we assume is the cause and what we assume is the effect. Second, the cause must also precede the effect and the two have to be close in time to each other. To meet this criterion, data which runs over a period of time is preferable. Thus, cross-sectional research does not completely fulfil the second condition. The third criterion states that one must have knowledge of and control over all other relevant situations, which in fact is impossible in practice.<sup>106</sup>

The secondary purpose of this thesis is to seek an answer to why the incentive systems for senior executives differ between Swedish and American companies. With a good theory it is to a certain extent possible to make statements of cause and effect by using a cross-sectional research method<sup>107</sup>.

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<sup>104</sup> Andersen (1994)

<sup>105</sup> Jacobsen (2002)

<sup>106</sup> *ibid*

<sup>107</sup> *ibid*

### **3.1.1 Document survey**

Collection and processing of data has been done through a document survey. Information has been collected on the basis of the purpose of this thesis and the material, annual reports and proxy statements, has been found through the databases on the library web page and on the selected companies' web pages.

### **3.1.2 Basis of the survey**

The basis of the survey consists of the annual reports of the chosen Swedish companies. Since the companies, according to Swedish law (see appendix V), have to provide information concerning incentive programs and rewards to senior executives in their annual reports we found it suitable to use the annual reports as basis of the survey.

According to American law (see appendix V), the information on the incentive programs to senior executives must be stated in each company's proxy statement. The basis of the survey regarding the American companies is therefore the proxy statements.

Swedish and American law have also determined the delimitation of this thesis concerning the recipients of the incentive programs. According to the regulations, the annual reports and proxy statements only need to include incentive programs for senior executives and information concerning incentive programs for other employees is more difficult to find. Therefore, this thesis only focuses on the design of incentive programs for senior executives.

## **3.2 Selection**

### **3.2.1 Selection of companies**

The selection of companies in this study has been made so that the comparison between Swedish and American companies will be affected as little as possible by factors such as company size, industry, ownership and employee occupation, which were mentioned in part 1.2. The one factor we concentrate on is national culture. Therefore the selected companies in both countries are in the same lines of business and with turnovers that are roughly equal. As mentioned in part 3.1.2 we focus only on the design of incentive programs for senior executives, which also eliminates the impact of differences in employee occupation. Since all companies are listed on either the Stockholm stock exchange or on one or several of the American stock exchanges, the ownership factor does not affect the comparison between the companies either.

Since the basis of our thesis is Swedish companies, the selection was first made by choosing Swedish companies listed on the Stockholm stock exchange. As individual reward preferences are partly influenced by culture and the objective of this thesis is to determine what differences exist between the Swedish and American incentive programs, the survey only includes companies with predominantly Swedish senior executives. Thus companies with predominantly foreign senior executives were excluded. In total, the

sixteen companies with the largest turnover listed on the Stockholm stock exchange were selected.

On basis of the selection of the Swedish companies, sixteen American listed companies within corresponding lines of business and turnovers equal to those of the Swedish companies were selected. When choosing American companies, only companies with predominantly American senior executives were included, for the reason cited in our selection of Swedish companies. The turnovers of the American companies have been transformed into SEK with the exchange rate that prevailed at the time this thesis was written<sup>108</sup>.

Based upon the above criteria, the following companies have been selected, ordered by size of turnover (for more details see appendix no VI):

<b>Line of business</b>	<b>Swedish company</b>	<b>American company</b>
Construction & Farm Machinery & Heavy Truc	Volvo	Paccar
Communications Equipment	Ericsson	Motorola
Paper Products	SCA	Kimberly-Clark
Household Appliances	Electrolux	Whirlpool
Integrated Telecomm. Services	TeliaSonera	Qwest
Industrial Machinery	Sandvik	Kennametal
Apparel Retail	H&M	GAP
Diversified Banks	Swedbank	Wells Fargo
Industrial Machinery	Atlas Copco	Ingersoll Rand
Industrial Machinery	SKF	Timken
Steel	SSAB	Commercial Metals Company
Integrated Telecomm. Services	Tele2	Alltel
Diversified Banks	SEB	PNC
Auto parts & equipment	Autoliv	TRW Automotive
Building products	ASSA ABLOY	Stanley Works
Household Appliances	Husqvarna	Toro

*Figure II. Survey Companies*

### **3.2.2 Selection of components**

When comparing the design of incentive programs for senior executives in Swedish and American companies, a large amount of information on the subject can be collected from the annual reports and proxy statements. Not all aspects of the incentive programs and the differences which exist between the two countries are of relevance for this thesis, which

<sup>108</sup> Exchange rate April 2008: 1 USD = 6.16 SEK.

is why, from here on, only some of them will be considered and discussed. The components we have singled out to focus on are:

- Base salary and value of incentive programs specified for CEO and other senior executives
  - Information on base salary and variable salary
  - Value of incentive programs divided by total financial compensation (base salary + value of incentive programs)
- The size of the total financial compensation (base salary + value of incentive program) for the CEO in comparison to the size of the turnover
- Reward system
  - Objectives within the company and/or relative objectives
  - Performance-based and/or seniority-based
  - Basis for predefined targets
- Reward type and comparison of which type, short-term or long-term, is the most common
  - Types of short- and long-term rewards
  - Short-term rewards divided by total rewards (short-term incentives + long-term incentives)
- Whether an upper cut-off for the variable salary exists and how it is formulated

In the calculations the CEO has been separated from the other senior executives. This has been done due to the fact that the CEO has a unique position within the company and the ultimate responsibility. His or her compensation might therefore differ in size and design from the other senior executives. For more information regarding the questions formulated see appendix VII.

### **3.2.3 Limitations**

The aim of this thesis was to select and review the twenty largest Swedish companies on the Stockholm stock exchange in terms of turnover and to compare them with twenty American companies within corresponding lines of business and with turnovers equal to those of the Swedish companies. It was, however, quite difficult to find American companies that corresponded to the Swedish ones according to the above mentioned criteria, especially in terms of size of turnover. As we are aware of the imperfect correspondence between the turnover size of the Swedish and the American companies, quotas have been used in the calculations, which reduce the impact of the turnover size.

In the end, we had to settle for sixteen American companies instead of twenty and, consequently, we have only reviewed sixteen Swedish companies as well. The four Swedish companies, out of the twenty that were first selected, which have not been reviewed, are Skanska, Securitas, NCC and Boliden.



In section 2.2 we discussed Hofstede's IBM studies and the four cultural dimensions deriving from them. From the individualism index one could deduce that the US traditionally has been more individualistic than Sweden. It would therefore have been interesting to examine whether there are any differences in the design of the Swedish and the American incentive programs that can be derived from this type of cultural difference. However, since annual reports and proxy statements have been used as the basis of the survey, it is not possible to distinguish differences directly related to the degree of individualism, as the information does not provide any indication of how great a part of the rewards is based on individual- and group-based performance respectively. Hence, we have not been able to study any components that are directly related to the dimension of reward criterion.

### **3.3 Criticism of the sources**

It is important to have a critical attitude towards the sources one uses since it facilitates the judgement of the sources' authenticity and relevance<sup>109</sup>. Most of the information that forms the basis of our survey has been collected by reviewing annual reports and proxy statements. Hence, the accuracy of our survey depends to a large extent on the accuracy of the annual reports and the proxy statements. Since the information in these sources is strictly regulated by Swedish and American law, we consider the information in the annual reports and proxy statements correct and truthful.

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<sup>109</sup> Patel & Davidsson (1994)

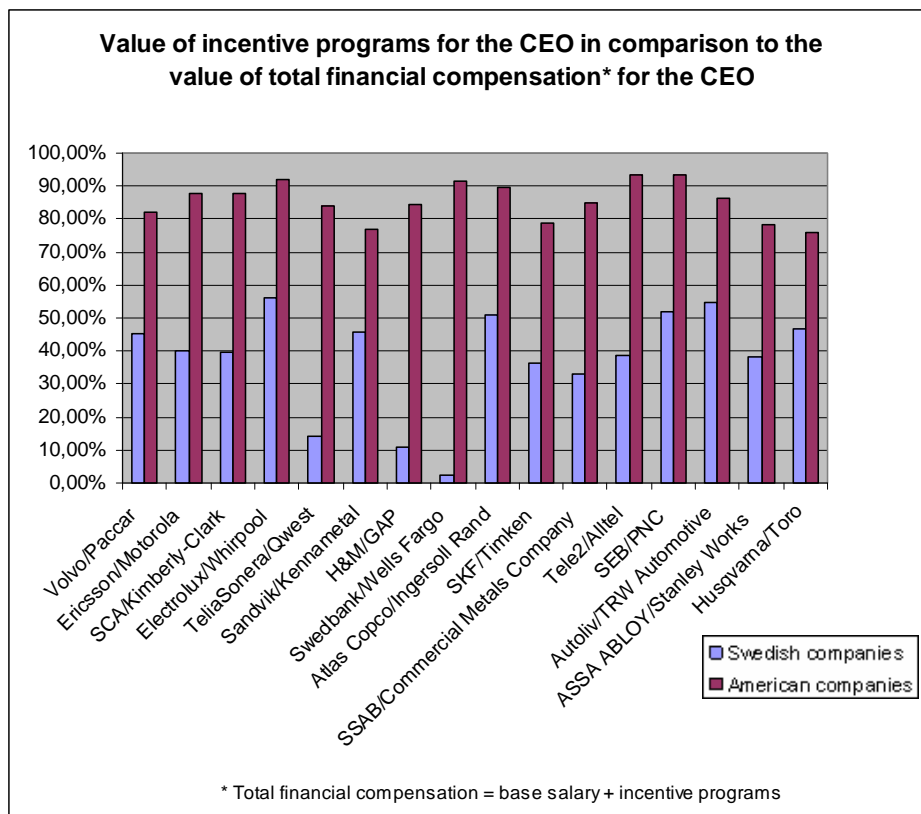
## 4 Empirical Results

*This chapter contains a collocation of the empirical results that were found when reviewing the annual reports of the Swedish companies and the proxy statements of the American companies.*

The empirical results as a whole can be found in appendix VII-XII.

### 4.1 Value of incentive programs

The base salary, short-term incentives and long-term incentives make up the total financial compensation for the senior executives<sup>110</sup>. The variable salary is the monetary part of the financial compensation, and can be both short- and long-term. A comparison between the value of the incentive programs and the total financial compensation for the CEO as well as the other senior executives has been made.

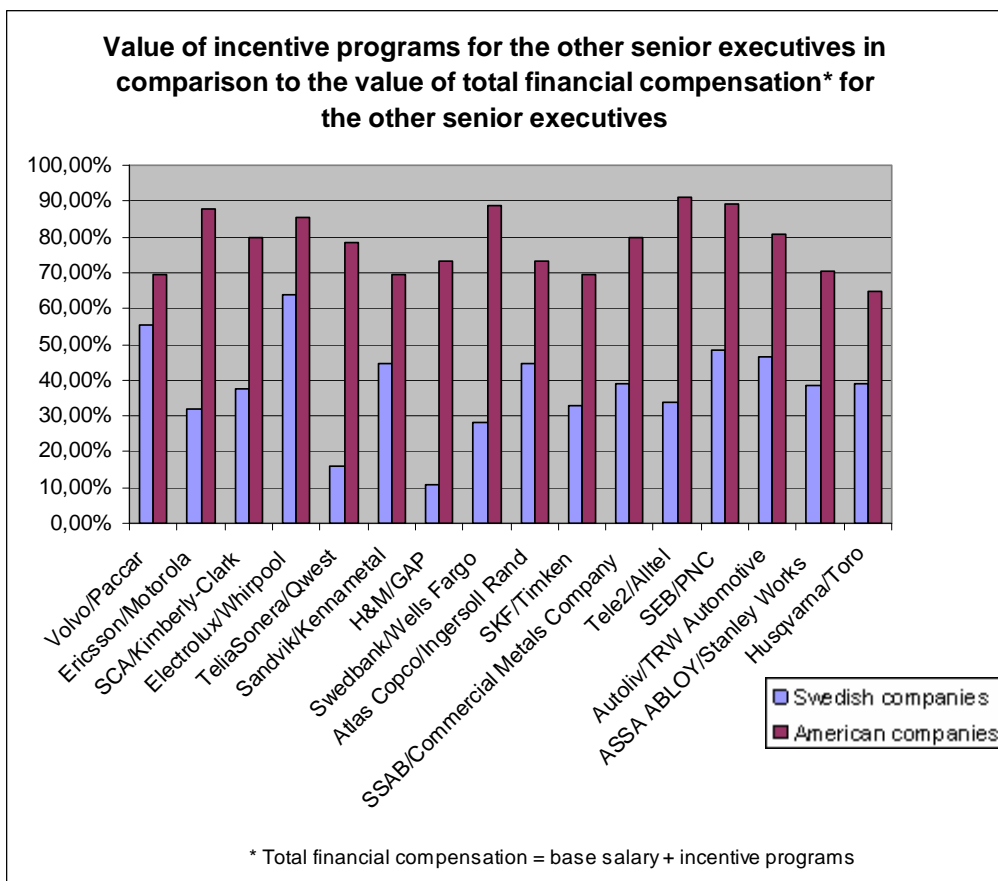


*Chart I. Value of incentive programs for the CEO in comparison to the value of total financial compensation for the CEO*

<sup>110</sup> Other compensations like fringe benefits and pension benefits are usually also part of the total compensation, but as this thesis focuses on incentive programs, no consideration will be taken to other compensations than the ones mentioned in part 4.1.

As the chart shows, the values of the incentive programs for the CEOs in most of the Swedish companies constitute about 40-50 % of the total financial compensation. However, the incentive programs in three of the companies are significantly lower in comparison to the total compensation – 2 % (Swedbank), 11 % (H&M) and 14 % (TeliaSonera), which results in an average of 38 %. The remaining 62 % are consequently fixed salary. In the company with the highest quota (Electrolux), the CEO receives rewards from the incentive programs that constitute 56 % of the total financial compensation.

In the American companies, the size of the incentive programs in comparison to the size of the total financial compensations for the CEOs is significantly greater than in the Swedish companies. No American company has an incentive program with a value of less than 76 % of the total financial compensation, whereas the incentive programs within all of the Swedish companies constitute 56 % or less. The highest quota found is 93 % (Alltel), while the lowest is, as mentioned above, 76 % (Toro). The average value of the incentive programs in comparison to the total financial compensation is 85 %.



*Chart II. Value of incentive programs for the other senior executives in comparison to the value of the total financial compensation for the other senior executives*

For the other senior executives in the Swedish companies the average value of the incentive programs is 38 % of the total financial compensation, with a top rate of 64 % (Electrolux). No company has a quota lower than 10 %, even though H&M and TeliaSonera are quite close with 11 % and 16 % respectively.

The other senior executives in the American companies have fairly high quotas between the incentive programs and the total financial compensation in comparison to the Swedish companies – the average value is 78 % and a top rate at 91 % (Alltel). In the company with the lowest quota (Toro) the other senior executives receive rewards that constitute 65 % of the total financial compensation. This figure is, however, still higher than the highest quota found among the Swedish companies, which is 64 %, as mentioned above.

#### 4.2 Total financial compensation in comparison to turnover

This question focuses on the responsibility of the CEO, which in this case is represented by size of the annual turnover, and how large the compensation is compared to this responsibility. The total financial compensations for the CEOs in comparison to the companies' turnovers for the Swedish and American companies are presented in the chart below.

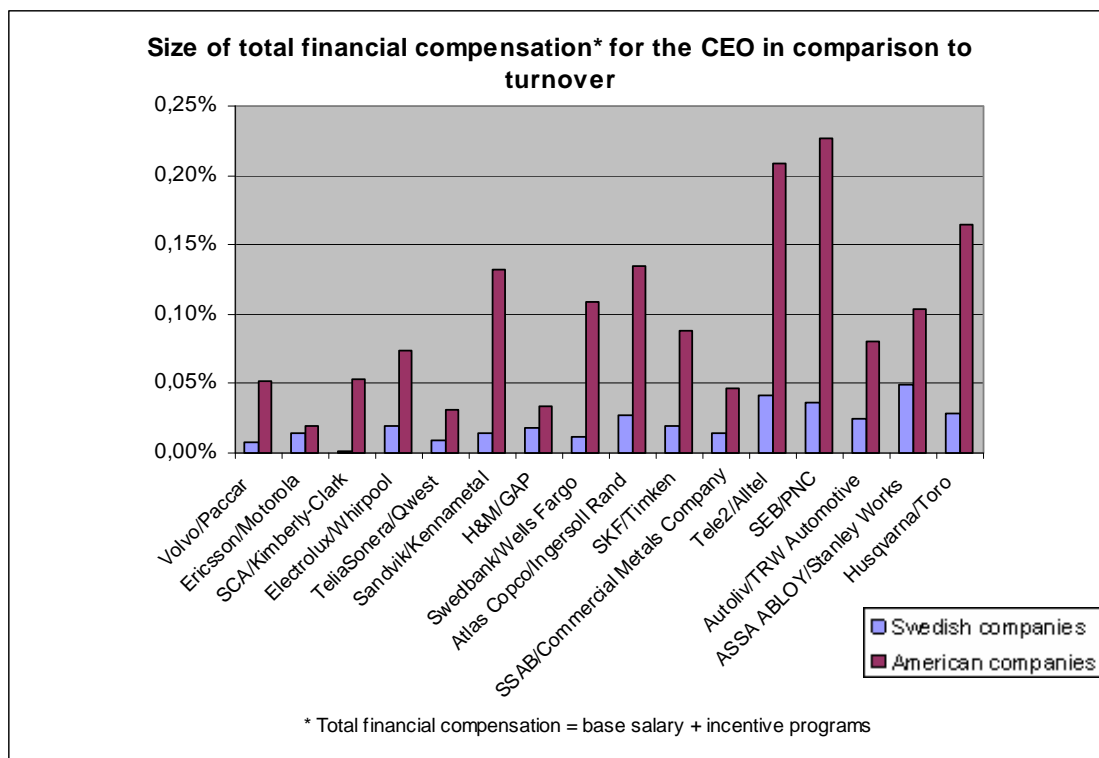


Chart III. Size of total financial compensation for the CEO in comparison to turnover

All of the Swedish companies give their CEOs a total financial compensation of somewhere between slightly less than 0.01 % (SCA) and 0.05 % (ASSA ABLOY) of their turnover in 2007. Ten out of the sixteen companies compensate their CEOs with

0.01-0.02 % of their annual turnovers and the average among the Swedish companies is 0.02 %.

The CEOs in the American companies receive total financial compensation of between 0.02 % (Motorola) and 0.23 % (PNC) of their turnover 2007. Only six of the sixteen companies compensate their CEOs with 0.05% or less, which results in an average of 0.10 %.

### 4.3 Reward system

The third question looks into reward systems, i.e. what the rewards are based on. Incentive programs are often performance-based, and all 32 companies, both Swedish and American, included in this survey use some kind of performance-based reward for their senior executives. The major non-performance method, the one tied to seniority, is not as commonly used. None of the Swedish companies report that they use seniority-based rewards and only four of the American companies (Kimberly-Clark, GAP, Alltel and Stanley Works) use seniority as a basis in some respects.

The objectives that are set within performance-based incentive programs can be defined differently and focus solely on performance within the company or on its performance compared to competitors, i.e. relative performance. All of the sixteen Swedish companies have objectives within the company, whereas only three (SCA, Tele2 and SEB) state that they are using relative objectives.

Among the American companies, all sixteen use objectives within the company and seven companies (Paccar, Motorola, Kimberly-Clark, Wells Fargo, Alltel, PNC and Stanley Works) have relative objectives.

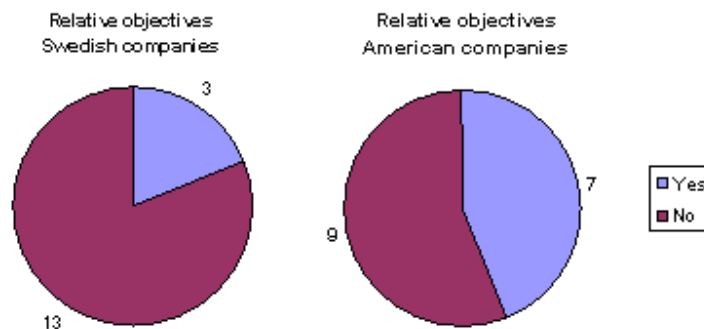


Chart IV. Relative objectives

The rewards that senior executives receive are based on predefined targets that the board of directors must approve and most of the companies report these targets in their annual reports or proxy statements. Out of the 32 companies, 28 have defined their targets for short-term incentives and all of them use some kind of financial target, whereas only three Swedish companies (Ericsson, Atlas Copco and SEB) and six American (Motorola,

Whirlpool, Qwest, Kennametal, Wells Fargo and TRW Automotive) report a use of non-financial targets. The non-financial targets used by the Swedish companies are co-worker motivation and customer satisfaction, while those defined by the American companies are, among others, quality, brand equity progress, engagement of employees, effective management, customer satisfaction and customer retention.

Four of the Swedish companies have not defined their short-term financial targets, but of those targets specified in the annual reports, profitability related ones, such as earnings before interest and tax (EBIT), are most common (Volvo, SCA, SKF, SSAB, SEB and Autoliv), but also cash flow related (Volvo, SCA) and market-based ones (SCA) are used. The information given in the proxy statements is more detailed and all sixteen American companies have defined their financial targets. All of them, except one (Qwest), report the use of profitability related targets, such as earnings per share (EPS) and return on invested capital (ROIC), whereas six (Motorola, Whirlpool, Qwest, Ingersoll Rand, TRW Automotive and Stanley Works) also use cash flow related targets, two (Motorola and Qwest) use turnover defined targets, and one (Wells Fargo) uses market-based targets.

The companies with long-term incentives set predefined targets for these incentives as well, and companies with reported targets all use financial ones, whereas only one (Alltel) reports the use of non-financial targets. Six of the Swedish companies have defined which targets they use; five (Sandvik, SSAB, Tele2, SEB and ASSA ABLOY) use profitability related targets, where return on capital employed (ROCE) and EPS are the most common ones, and two (Ericsson and SSAB) use market-based targets, such as stock price development.

Among the American companies, fourteen have specified their predefined targets for long-term incentives. Ten (Paccar, Motorola, Whirlpool, Kennametal, GAP, Ingersoll Rand, Commercial Metals Company, Alltel, PNC and Stanley Works) report the use of profitability related targets, where the most common ones are EPS and ROCE, eight (Paccar, Motorola, Kimberly-Clark, Qwest, GAP, Wells Fargo, Alltel and PNC) use market-based targets, such as total shareholder return (TSR), two (Motorola and Toro) use turnover related targets, and one (Whirlpool) uses cash flow related predefined targets.

#### **4.4 Reward type**

The reward type used as a short-term incentive within all the Swedish companies is the variable salary, which is expressed either as an annual bonus or a cash incentive. Also, the American companies use variable salary as a short-term incentive, even though the denomination in the proxy statements is non-equity incentive plan compensation.

The reviewed Swedish companies tend to use different denominations for the long-term incentives in their annual reports. Four of the Swedish companies (SCA, TeliaSonera, H&M and Swedbank) do not report any long-term incentives. For those that do, the most common long-term incentives are non-monetary, such as stock options and restricted stocks, also called equity-based incentives. One company (ASSA ABLOY) instead uses

variable salary as a long-term incentive and another company (SSAB) also reports the use of variable salary, but the payouts will not start until 2008.

All of the sixteen American companies have at least one kind of long-term incentive. The equity-based incentives are used within all of the American companies, while nine companies (Paccar, Motorola, Whirlpool, Kennametal, Timken, Commercial Metals Company, Alltel, PNC and Stanley Works) also use variable salaries, even though they usually make up smaller parts of the total long-term incentives than the non-monetary ones do.

From the annual reports and proxy statements one can deduce that the stock options and the restricted stocks are given to the CEOs and the other senior executives based on the companies' performances rather than on their individual performances. Non-monetary incentives that are based on individual performance to a higher degree are defined as performance shares and two Swedish companies (SEB and Electrolux) and four American (Kimberly-Clark, GAP, Ingersoll Rand and Toro) report the use of this kind of reward.

#### 4.4.1 Size of short-term rewards

The size of the short-term rewards in comparison to total rewards for the Swedish and the American companies is illustrated in the charts below.

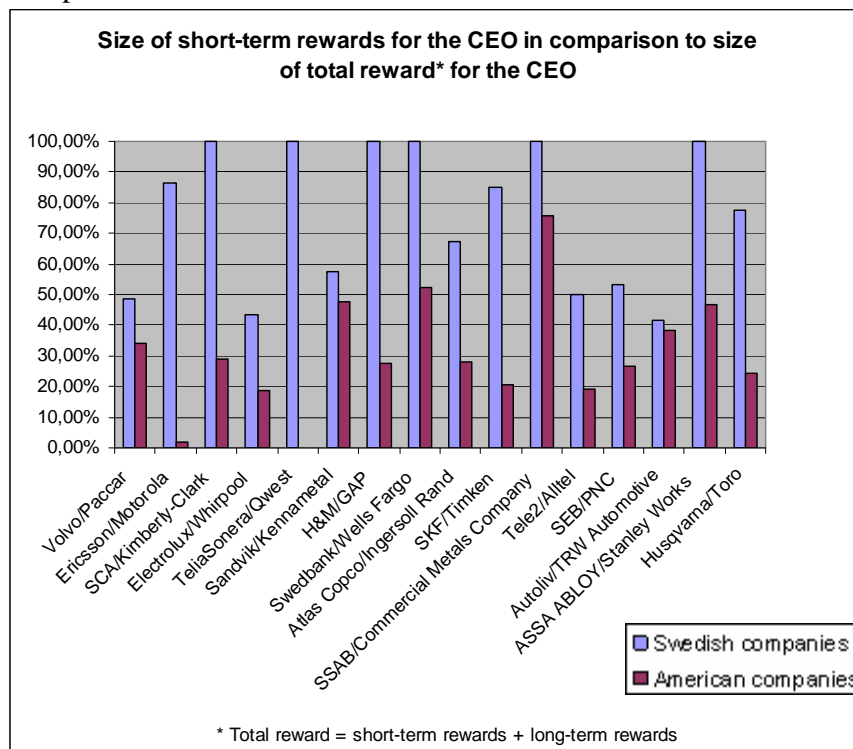


Chart V. Size of short-term rewards for the CEO in comparison to size of total reward for the CEO

Six of the sixteen Swedish companies do not report any payouts of long-term rewards in 2007, even though two of them (ASSA ABLOY and SSAB) both use long-term incentives. Hence, the short-term rewards are equal to the total rewards in these six companies, as illustrated above. A median, instead of an average value, has therefore been calculated, both for the Swedish and for the American companies. For the Swedish companies that report payouts of long-term rewards, the short-term rewards make up between 42 % and 86 % of the CEOs total rewards with a median of 81 %. The two companies with the highest quotas (Ericsson and SKF) have short-term rewards that are equal to more than 80 % of the total rewards, whereas the companies with the lowest quotas (Electrolux and Autoliv) have short-term rewards that are only equal to around 40 % of the total rewards.

All of the American companies report payouts of long-term rewards. The short-term rewards in the American companies generally make up a smaller part of the total rewards than those in their Swedish counterparts and only one company (Commercial Metals Company) reports a quota above 66 %. The median quota is 28 %, with four companies (Whirlpool, Timken, Alltel and Toro) at just around 20 % and another four (Kennametal, Wells Fargo, TRW Automotive and Stanley Works) well over or close to 40 %. Two companies (Motorola and Qwest), who reported losses in 2007, differ substantially from the others – the short-term rewards are only equal to 2 % respectively 0 % of the total rewards.

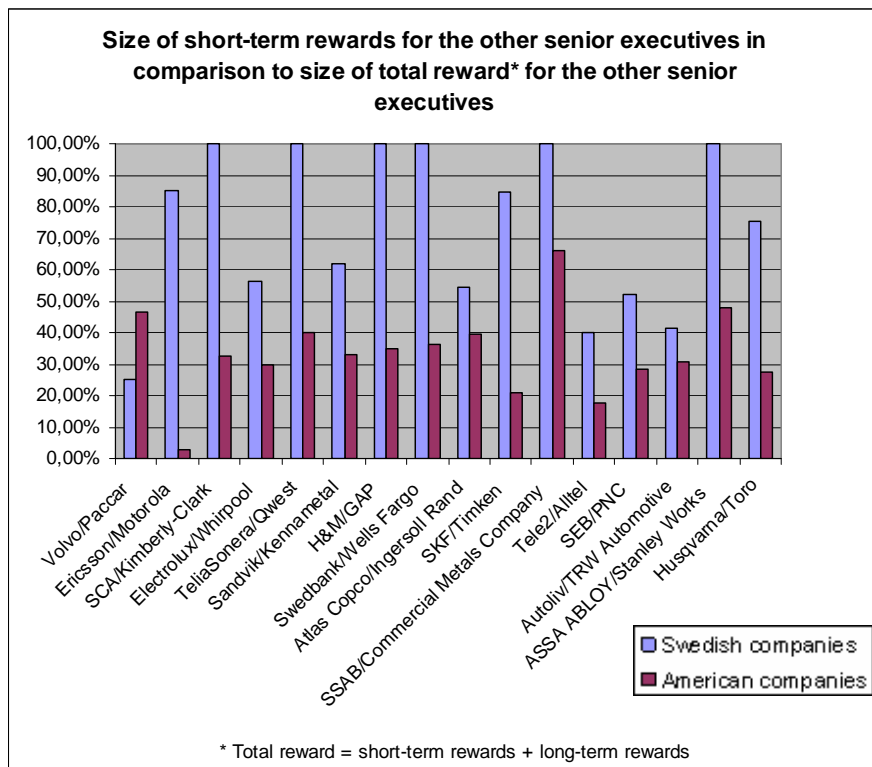


Chart VI. Size of short-term rewards for the other senior executives in comparison to size of the total reward for the other senior executives



The short-term incentives for the other senior executives in the Swedish companies make up, as a median, 80 % of the total rewards, which is a little lower than for the CEOs. For the companies that report payouts of long-term rewards, the lowest quota is 25 % (Volvo) and the highest is 85 % (Ericsson).

For the other senior executives in the American companies, the average quota is almost of the same size as for the CEOs (33 % respectively 28 %) and Commercial Metals Company is yet again the one with the largest share of short-term rewards, 66 %. Motorola has the lowest quota of less than 3 %, while Qwest, who does not report any payouts of short-term rewards at all to the CEO, pays short-term rewards to the other senior executives that are equal to 40 % of the total rewards.

#### **4.5 Upper cut-off**

This question speaks to whether or not the companies have an upper cut-off for the variable salary paid to senior executives, and how these possible upper cut-offs are formulated. From the information given in the annual reports and proxy statements, one finds that almost all examined companies, Swedish as well as American, have upper cut-offs for their variable salaries. In many cases, the upper cut-offs for the CEOs differ from those for other senior executives.

All sixteen Swedish companies report that they have an upper cut-off, even though not all of them formulate the cut-off in the annual reports. Regardless whether or not the companies define them, one can deduce that the size of the variable salary is usually based on a percentage of the base salary. The average cut-off for the Swedish companies is around 70% of the base salary, ranging from 35 % (Atlas Copco) of the base salary for the senior executives to 110 % (H&M) of the base salary for the CEO. However, some of the companies report an absolute upper cut-off, with the highest one set at 900 KSEK after tax (SEB) for the CEO. One company out of sixteen (SSAB) reports that the senior executive situated in the US has a higher upper cut-off than those situated in Sweden.

Fourteen of the selected American companies report in their proxy statements that they have an upper cut-off for the CEO and the other senior executives. Only two companies, Kennametal and Motorola, do not state a cut-off in their proxy statements. Another two companies state that they have upper cut-offs for the variable salary, but do not formulate them. Eight of the sixteen companies base the cut-offs on a percentage of the base salary. The average cut-off is around 240 % of the base salary, but two companies (Whirlpool and Commercial Metals Company) report cut-offs as high as 400 % and 300 % of the base salaries. Six of the American companies use an absolute upper cut-off, where the highest is over 33, 000 KSEK (Qwest). One company (GAP) reports that the cut-off is calculated as a percentage of the 2006 actual fiscal earnings.

## 5 Analysis and Conclusions

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*In this chapter the empirical results will be analysed based on the theoretical information presented in chapter two. The cultural differences and the use of incentive programs in the two countries will be compared. Thereafter, a concluding discussion, which ends with suggestions for further studies, is presented.*

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More or less every compensation system includes a base salary and some kind of incentive program. The base salary is fixed and the recipient knows what he or she will receive every month. The compensation in the form of incentive programs varies in size and is therefore uncertain from the company point of view as well as for the recipient. Individuals with different backgrounds and values respond to this uncertainty in different ways, and when designing compensation systems one therefore has to take these individual preferences into consideration.

The empirical results regarding the share of fixed salary versus incentive programs show a significant difference between Swedish and American companies. The CEOs in the US receive a substantially greater part of uncertain compensation, whereas the Swedish CEOs have more secure compensation systems, which do not vary to the same degree as their American counterparts. The American company with the lowest percentage of incentive programs relative to the total financial compensation for the CEOs even has a larger share (76 %) of incentive programs than the Swedish company with the highest share (56 %), which indicates a great difference between the two countries.

The other senior executives in the American companies have on average a lower share of incentive programs than the CEOs, but the figures for other senior executives follow the same pattern as those for the CEOs, i.e they are much greater than their Swedish counterparts, and therefore strengthen this analysis.

When incentive programs are widely used, a great part of future income is placed in jeopardy. This uncertainty is likely to be preferred in countries with a low ranking on Hofstede's uncertainty avoidance index. Since both Sweden and the US have low uncertainty avoidance, the major difference between the compensation systems discussed above is not likely to be referred in this dimension. However, the design of incentive programs in organisations can be affected by external factors such as collective agreements. The lower financial value derived from the incentive programs within the Swedish companies could be explained by the fact that the Swedish labour market traditionally has been characterised by solidarity and "equal pay for an equal amount of work".

Even though the results clearly show that the American companies use incentive programs to a greater extent than the Swedish ones, one should be aware of the

delimitation of this conclusion. The payout of variable salary depends on how well the targets within the company or the relative targets are achieved, i.e. how well the company or business unit performs. The share of incentive programs is therefore dependent upon the company's profitability, market value, or how well other predefined targets are reached. It is, however, difficult to make a perfect match concerning these factors, since there is a great difference in reward systems between the companies; some use profitability related, cash flow related and/or market-based targets. The impact of the companies' success is however reduced in this study since the compared companies are in the same lines of business and operate on the same markets, and they are therefore subject to the same economic trends.

Also, the total compensation for the CEO in comparison to the company's turnover is substantially higher in the American companies than in the Swedish ones. All sixteen American companies have a larger percentage of total financial compensation in comparison to their responsibility, expressed as the turnover, than their Swedish counterparts. The average percentage is also significantly higher in the US (0.10 %) than in Sweden (0.02 %). These empirical results indicate that the American companies use financial compensation to a greater extent than the Swedish companies.

Also the comparison regarding the upper cut-offs indicates a preference for financial rewards. All of the Swedish companies report an upper cut-off for the variable salary paid to the CEO and the senior executives, while fourteen of the American companies report an upper cut-off. The American companies have in general substantially higher upper cut-offs than the Swedish ones, regardless of whether they use a variable or an absolute upper cut-off. The fact that one Swedish company reports a higher upper cut-off for the senior executive situated abroad, more specifically in the US, than for the senior executives situated in Sweden also indicates that this difference exists. As discussed above, the variable salaries are higher in the American companies than in the Swedish ones. One might expect the level of the upper cut-offs to follow the same pattern as the variable salaries and the findings regarding the upper cut-offs are therefore not surprising.

Large financial rewards as well as high upper cut-offs for the variable salaries, indicate a preference for financial rewards. According to Hofstede's studies, preference for material gain and money varies with the degree of masculinity and it is within this dimension Sweden and the US differ the most. As the US is far more masculine than Sweden, which in Hofstede's studies is the most feminine country, the larger financial compensation and higher upper cut-offs used in the US are likely to relate to the country's higher degree of masculinity.

In feminine countries like Sweden, individuals value non-financial compensation to a greater extent than in masculine countries like the US. This suggests that the lower financial compensations and upper cut-offs within the Swedish companies might be offset by other types of rewards that cannot be measured in monetary terms, e.g. additional time-off.

When studying the bases for the rewards one can deduce that all of the companies studied, both Swedish and American, use performance-based incentive programs. Since the use of performance-based incentive programs is extremely common among multinational companies around the world, these empirical results are not surprising. Moreover, the dimensions uncertainty avoidance and power distance do affect the preferences for performance-based rewards negatively and since both Sweden and the US have low uncertainty avoidance and low power distance, one would expect both of them to use performance-based incentive programs. Consequently, national culture could give some explanation as to why both the Swedish and the American companies have performance-based incentive programs.

Seniority-based incentive programs are not as prevalent as performance-based ones. None of the Swedish companies report a payout of seniority-based rewards, whereas one fourth of the American companies use incentive programs based on seniority. Among the companies in which the use of seniority-based incentive programs is reported, all report the rewards to be long-term and equity-based. The empirical results suggest that performance-based incentive programs in general are preferred over seniority-based ones. The use of seniority-based incentive programs is, however, a bit more prevalent in the US than in Sweden. The reason that seniority-based incentive programs are more common among the American companies than among the Swedish ones cannot be found in Hofstede's theories. The use of seniority-based incentive programs can, like the use of performance-based ones, be connected to the dimensions power distance and uncertainty avoidance. As Sweden and the US have quite similar values for these dimensions, no variation relating to cultural differences should appear.

Objectives within the company are used by all the companies reviewed, whilst relative objectives are more prevalent among the American companies. Noteworthy is that among the seven American companies using relative objectives, one can find their counterparts in the three Swedish companies that use the same objectives. The lines of business of the three matching pairs are paper products, diversified banks and integrated telecom services. The empirical results show a difference between the Swedish and the American companies regarding the use of relative objectives, but this difference cannot be explained by national culture.

The short-term rewards given to CEOs and other senior executives, in all of the companies reviewed, consist of a variable salary, whereas the long-term incentive programs include both equity-based rewards and variable salaries. In the American companies, the use of variable salaries as long-term rewards is more prevalent than in the Swedish companies, even though non-monetary, i.e. equity-based, incentive programs are more dominant than monetary ones.

The findings further suggest that equity-based rewards based on seniority are more common among the American companies. The empirical results also show that performance-based shares are a more prevalent form of reward in the American companies. However, some companies state that not only individual performance but also corporate performance affects the payout of the reward. Moreover, the difference in the

use of the performance-based shares is not that substantial, which makes it risky to draw any conclusions on the subject.

Among the American companies, the long-term incentives constitute a greater value than the short-term ones do, while the opposite is true among the Swedish companies. For all the companies studied, the Swedish ones have higher quotas when the value of short-term incentives is compared to the value of the total incentive programs, except in the comparison of Volvo and Paccar. The senior executives in Motorola receive very low payouts of short-term rewards and the CEO in Qwest has no variable salary at all based on short-term incentives programs. This is most likely to be the result of the losses they showed in 2007. However, as explained earlier, the impact of the profit size on payouts of rewards differs greatly between companies. Moreover, our study shows that if the low payouts of short-term rewards due to losses are disregarded, the value of the short-term rewards in the American companies is still lower than the value of the short-term rewards for the Swedish companies. The findings suggest that equity-based long-term incentive programs, such as stock options and restricted stocks, are more prevalent in the US than in Sweden.

The preference for ownership-related rewards is higher in countries with low power distance, low uncertainty avoidance and high individualism. Since the dimensions power distance and uncertainty avoidance do not differ substantially between the two countries, the difference in the use of equity-based incentive programs can to some degree be explained by the higher level of individualism in the US. This indicates that differences in national culture do affect the preference for this type of reward.

The rewards that the CEOs and the other senior executives receive can have targets of a financial or non-financial nature. The use of non-financial targets is more common and the number of different types of targets is greater within the American companies. The non-financial targets are however mostly used within short-term incentive programs.

Financial targets are reported by all companies who have defined their targets and are used in both the short-term and the long-term incentive programs. The differences between the companies concerning targets for the short- and long-term incentive programs are noticeable, but still not huge. In all the companies reviewed, profitability related targets are mainly used within short-term incentive programs.

Within the long-term incentive programs, targets that are market-based are more prevalent in the American companies than in the Swedish ones. This is, however, not surprising, since the American companies use equity-based incentive programs to a greater extent. As the rewards within these types of incentive programs only create a value for their recipients if the stock price increases, targets such as total shareholder return (TSR) are important and, as shown in part 4.3, many American companies do report the use of TSR as a target for long-term incentive programs.

## 5.1 Final conclusions

The purpose of this thesis was to analyse in what way the incentive programs for senior executives differ between Swedish and American public companies and to what degree these differences are the result of cultural differences between the two countries. This analysis has been implemented by making a comparison between the incentive programs of sixteen Swedish and sixteen American public companies.

The empirical results in this thesis have shown similarities but also significant differences between Swedish and American incentive programs. The major differences found are as follows:

- the total financial compensation is substantially higher in the US than in Sweden;
- the value of incentive programs in comparison to the total financial compensation as well as the level of the upper cut-offs are higher in the US than in Sweden;
- the use of seniority-based incentive programs is more prevalent in the US than in Sweden;
- the value of the short-term rewards in comparison to the long-term rewards is significantly higher in Sweden than in the US;
- the use of equity-based long-term incentive programs is more prevalent in the US than in Sweden;
- the use of non-financial targets is more common in the US than in Sweden; and
- market-based targets are used more frequently in the US than in Sweden.

Some of the differences can be related to each other, such as the use of equity-based, long-term incentive programs and market-based targets.

Great similarities have been found between theory and the empirical results. A substantial part of the differences that were found can to some extent be explained by differences in national culture, as shown in the analysis. Our findings suggest that the four cultural dimensions defined by Hofstede affect the design of the incentive programs. The largest differences between the incentive programs within the two countries can be explained by the characteristics of the dimension masculinity. It is also within this dimension that Sweden and the US differ the most. The higher total financial compensation as well as the higher upper cut-offs within the American companies can to a large degree be explained by the great preference for material gain and money in the US, in its capacity as a masculine country.

The second largest cultural difference between Sweden and the US is related to the dimension individualism. This dimension has also to some degree affected the design of the incentive programs, more specifically the use of equity-based rewards, which is more frequent in the US.

The results of this thesis thus suggest that the variation in the design of incentive programs to a certain degree can be a product of cultural differences between Sweden and the US.

## **5.2 Suggestions for further studies**

As this study only reviews information from one year, it is difficult to draw conclusions about contingent trends concerning the design of the incentive programs in Sweden compared to in the US. Nor can one tell if the design of the incentive programs in Sweden is starting to resemble their design in the US due to globalisation. A longitudinal study over several years would therefore be of interest.

It might also be interesting to study the design of the incentive programs for employees other than the senior executives and to study the differences between countries other than Sweden and the US.

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## **Appendix**

- Appendix I : Masculinity index (MAS) values for 50 countries and regions
- Appendix II : Uncertainty avoidance index (UAI) values for 50 countries and 3 regions
- Appendix III : Individualism index (IDV) values for 50 countries and 3 regions
- Appendix IV : Power distance index (PDI) values for 50 countries and 3 regions
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## Appendix I: Masculinity index (MAS) values for 50 countries and regions

Score rank	Country or region	MAS score	Score rank	Country or region	MAS score
1	Japan	95	28	Singapore	48
2	Austria	79	29	Israel	47
3	Venezuela	73	30/31	Indonesia	46
4/5	Italy	70	30/31	West Africa	46
4/5	Switzerland	70	32/33	Turkey	45
6	Mexico	69	32/33	Taiwan	45
7/8	Ireland (Rep.)	68	34	Panama	44
7/8	Jamaica	68	35/36	Iran	43
9/10	Great Britain	66	35/36	France	43
9/10	Germany FR	66	37/38	Spain	42
11/12	Philippines	64	37/38	Peru	42
11/12	Colombia	64	39	East Africa	41
13/14	South Africa	63	40	Salvador	40
13/14	Ecuador	63	41	South Korea	39
15	USA	62	42	Uruguay	38
16	Australia	61	43	Guatemala	37
17	New Zealand	58	44	Thailand	34
18/19	Greece	57	45	Portugal	31
18/19	Hong Kong	57	46	Chile	28
20/21	Argentina	56	47	Finland	26
20/21	India	56	48/49	Yugoslavia	21
22	Belgium	54	48/49	Costa Rica	21
23	Arab countries	53	50	Denmark	16
24	Canada	52	51	Netherlands	14
25/26	Malaysia	50	52	Norway	8
25/26	Pakistan	50	53	Sweden	5
27	Brazil	49			

Source: Hofstede (1997)

## Appendix II: Uncertainty avoidance index (UAI) values for 50 countries and 3 regions

Score rank	Country or region	UAI score	Score rank	Country or region	UAI score
1	Greece	112	28	Ecuador	67
2	Portugal	104	29	Germany FR	65
3	Guatemala	101	30	Thailand	64
4	Uruguay	100	31/32	Iran	59
5/6	Belgium	94	31/32	Finland	59
5/6	Salvador	94	33	Switzerland	58
7	Japan	92	34	West Africa	54
8	Yugoslavia	88	35	Netherlands	53
9	Peru	87	36	East Africa	52
10/15	France	86	37	Australia	51
10/15	Chile	86	38	Norway	50
10/15	Spain	86	39/40	South Africa	49
10/15	Costa Rica	86	39/40	New Zealand	49
10/15	Panama	86	41/42	Indonesia	48
10/15	Argentina	86	41/42	Canada	48
16/17	Turkey	85	43	USA	46
16/17	South Korea	85	44	Philippines	44
18	Mexico	82	45	India	40
19	Israel	81	46	Malaysia	36
20	Colombia	80	47/48	Great Britain	35
21/22	Venezuela	76	47/48	Ireland (Rep.)	35
21/22	Brazil	76	49/50	Hong Kong	29
23	Italy	75	49/50	Sweden	29
24/25	Pakistan	70	51	Denmark	23
24/25	Austria	70	52	Jamaica	13
26	Taiwan	69	53	Singapore	8
27	Arab countries	68			

Source: Hofstede (1997)

### Appendix III: Individualism index (IDV) values for 50 countries and 3 regions

Score rank	Country or region	IDV score	Score rank	Country or region	IDV score
1	USA	91	28	Turkey	37
2	Australia	90	29	Uruguay	36
3	Great Britain	89	30	Greece	35
4/5	Canada	80	31	Philippines	32
4/5	Netherlands	80	32	Mexico	30
6	New Zealand	79	33/35	East Africa	27
7	Italy	76	33/35	Yugoslavia	27
8	Belgium	75	33/35	Portugal	27
9	Denmark	74	36	Malaysia	26
10/11	Sweden	71	37	Hong Kong	25
10/11	France	71	38	Chile	23
12	Ireland (Rep.)	70	39/41	West Africa	20
13	Norway	69	39/41	Singapore	20
14	Switzerland	68	39/41	Thailand	20
15	Germany FR	67	42	Salvador	19
16	South Africa	65	43	South Korea	18
17	Finland	63	44	Taiwan	17
18	Austria	55	45	Peru	16
19	Israel	54	46	Costa Rica	15
20	Spain	51	47/48	Pakistan	14
21	India	48	47/48	Indonesia	14
22/23	Japan	46	49	Colombia	13
22/23	Argentina	46	50	Venezuela	12
24	Iran	41	51	Panama	11
25	Jamaica	39	52	Equador	8
26/27	Brazil	38	53	Guatemala	6
26/27	Arab countries	38			

Source: Hofstede (1997)

## Appendix IV: Power distance index (PDI) values for 50 countries and 3 regions

Score rank	Country or region	PDI score	Score rank	Country or region	PDI score
1	Malaysia	104	27/28	South Korea	60
2/3	Guatemala	95	29/30	Iran	58
2/3	Panama	95	29/30	Taiwan	58
4	Philippines	94	31	Spain	57
5/6	Mexico	81	32	Pakistan	55
5/6	Venezuela	81	33	Japan	54
7	Arab countries	80	34	Italy	50
8/9	Ecuador	78	35/36	Argentina	49
8/9	Indonesia	78	35/36	South Africa	49
10/11	India	77	37	Jamaica	45
10/11	West Africa	77	38	USA	40
12	Yugoslavia	76	39	Canada	39
13	Singapore	74	40	Netherlands	38
14	Brazil	69	41	Australia	36
15/16	France	68	42/44	Costa Rica	35
15/16	Hong Kong	68	42/44	Germany FR	35
17	Colombia	67	42/44	Great Britain	35
18/19	Salvador	66	45	Switzerland	34
18/19	Turkey	66	46	Finland	33
20	Belgium	65	47/48	Norway	31
21/23	East Africa	64	47/48	Sweden	31
21/23	Peru	64	48	Ireland (Rep.)	28
21/23	Thailand	64	50	New Zealand	22
24/25	Chile	63	51	Denmark	18
24/25	Portugal	63	52	Israel	13
26	Uruguay	61	53	Austria	11
27/28	Greece	60			

Source: Hofstede (1997)

## Appendix V: Laws and regulations

Due to many scandals concerning frauds and inaccuracies in American firms' financial reports in the 90's, revisions in the American legislation were made. More focus was put on Corporate Governance and regulations of how companies should give information on compensations to managers and senior executives in the financial reports were developed. The adoption of the U.S. Securities Exchange Commission's proxy reform rule amendments in October 1992 was one of the most significant amendments to the already existing legislations<sup>111</sup>. In part 240, section 14a in the Securities Exchange Act of 1934, one can find information about the proxy statement the shareholders of a company receive prior to a shareholder meeting, annual or special<sup>112</sup>. The regulations have enhanced the demands of clearness and transparency in the financial reports concerning compensations to senior executives, which have resulted in better insight for shareholders. The regulations have also made it possible for shareholders to measure the company's performance against other companies and to decide if the compensations paid to the CEO and other senior executives are justified.<sup>113</sup>

The legislations have continued to be revised and the regulations have come to also affect other parts of the world, including Sweden, mainly due to scandals resembling the American ones but also because the companies are operating in many different countries and have to follow the legislations in each country. In 2002, new legislations came into effect in both the US, with the Sarbanes-Oxley legislation<sup>114</sup>, and in Sweden, with NBK's rules concerning information of benefits to senior executives. The regulations stated that the financial reports of listed companies must contain specific information on what senior executives have received from incentive programs and what they have received as base salary<sup>115</sup>. Since 2002, more regulations concerning how to give information on compensations to senior executives have followed, where the legislations in the US in general are more detailed and specific than the Swedish ones.

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<sup>111</sup> Monks & Minow (2004)

<sup>112</sup> [www.sec.gov/answers/proxy.htm](http://www.sec.gov/answers/proxy.htm) (2008-05-02)

<sup>113</sup> Monks & Minow (2004)

<sup>114</sup> *ibid*

<sup>115</sup> Näringslivets Börskommittés (2002) *Regler angående information om ledande befattningshavares förmåner.*



## Appendix VI: Selected companies

Line of business	Swedish company	Turnover MSEK	American company	Turnover MSEK
Construction & Farm Machinery & Heavy Truck	Volvo	258 835	Paccar	86 487
Communications Equipment	Ericsson	187 780	Motorola	225 756
Construction & Engineering	Skanska	138 781		
Paper Products	SCA	105 913	Kimberly-Clark	112 600
Household Appliances	Electrolux	104 732	Whirlpool	119 641
Integrated Telecomm. Services	TeliaSonera	96 344	Qwest	84 872
Industrial Machinery	Sandvik	86 338	Kennametal	14 702
Apparel Retail	H&M	78 346	GAP	97171
Diversified Banks	Swedbank	67 087	Wells Fargo	49 667
Industrial Machinery	Atlas Copco	63 355	Ingersoll Rand	54 020
Diversified Commercial & Prof. Services	Securitas	62 907		
Industrial Machinery	SKF	58 559	Timken	32 277
Construction & Engineering	NCC	58 397		
Steel	SSAB	47 651	Commercial Metals Company	51344
Integrated Telecomm. Services	Tele2	43 420	Alltel	54 227
Diversified Banks	SEB	40 440	PNC	38 010
Auto parts & equipment	Autoliv	39 802	TRW Automotive	90 630
Building products	ASSA ABLOY	33 550	Stanley Works	27 642
Household Appliances	Husqvarna	33 284	Toro	11 571
Div. Metals & Mining	Boliden	33 204		

## **Appendix VII: Formulated questions**

Salaries and rewards are measured in KSEK.

### **1) Size of the incentive programs in comparison to the size of the total financial compensation**

- a.** Base salary CEO
- aa.** Variable salary CEO
- aaa.** Value of incentive programs CEO / total compensation (base salary + value of incentive programs) per senior executive (excl. CEO)
- b.** Base salary per senior executive (excl. CEO)
- bb.** Variable salary per senior executive (excl. CEO)
- bbb.** Value of incentive programs per senior executives (excl. CEO) / total compensation (base salary + value of incentive programs) per senior executive (excl. CEO)

### **2) Size of total financial compensation for the CEO in comparison to turnover**

- a.** total compensation (base salary + value of incentive programs) CEO / turnover

### **3) Reward system**

- a.** Performance-based rewards
- aa.** Seniority-based rewards
- b.** Objectives within the company
- bb.** Relative objectives
- c.** Bases for predefined targets for short-term incentives
- cc.** Bases for predefined targets for long-term incentives

### **4) Reward type**

- a.** Types of short-term rewards (ordered by value)
- aa.** Amount short-term rewards CEO
- aaa.** Amount short-term rewards per senior executive (excl. CEO)
- b.** Types of long-term rewards (ordered by value)
- bb.** Amount long-term rewards CEO
- bbb.** Amount long-term rewards per senior executive (excl. CEO)
- c.** Short-term rewards CEO/ Total rewards (short-term rewards + long-term rewards) CEO
- cc.** Short-term rewards senior executives (excl. CEO) / total rewards (short-term rewards + long-term rewards) senior executives (excl. CEO)

### **5) Upper cut-off for the variable salary**

- a.** Does an upper cut-off exist?
- b.** Formulation of upper cut-off

### **6) Other information**

## Appendix VIII: Definitions for predefined targets

<b>CF:</b>	Cash flow
<b>CF-multiple:</b>	Operating CF less capital expenditures divided by net earnings
<b>CPC:</b>	Controllable profit contribution, i.e. divisional operating earnings excl. other income or expense
<b>EBIT:</b>	Earnings before interest and taxes
<b>EBITDA:</b>	Earnings before interest (incl. accounts receivable, securitization program expense), taxes, depreciation, amortization and accrual for long-term cash incentives, i.e operating revenue – operating expenses + other revenue
<b>EPS:</b>	Earnings per share
<b>EVA:</b>	Economic value added
<b>OI:</b>	Operating income
<b>ROCA:</b>	Return on controllable assets
<b>ROCE:</b>	Return on capital employed
<b>ROE:</b>	Return on equity
<b>ROIC:</b>	Return on invested capital
<b>RONA:</b>	Return on net assets
<b>TSR:</b>	Total shareholder return
<b>TVA:</b>	Total value added (simplified model of EVA)

## Appendix IX: Empirical results for Swedish companies

### Questions 1-3

Company	1a	1aa	1aaa	1b	1bb	1bbb	2a	3a	3aa	3b	3bb	3c	3cc
Volvo	11 840	4 800	45,39%	3 194	992	55,42%	0,01%	Yes	No	Yes	No	Targets relating to OI and CF, on company and group level.	Certain financial goals.
Ericsson	15 473	8 940	40,06%	4 104	1 633	31,85%	0,01%	Yes	No	Yes	No	Financial objectives on corporate group basis or individual basis, operative objectives, co-worker motivation and customer satisfaction.	Long term financial objectives and stock price development.
SCA	1 171	772	39,73%	3 402	2 065	37,77%	0,00%	Yes	No	Yes	Yes	CF, profit before tax, increase in share value.	-
Electrolux	8 863	4 892	56,02%	3 850	2 595	64,02%	0,02%	Yes	No	Yes	No	Value creation on group level and of the sector for which the executive is responsible as well as other financial measures. Non-financial targets: focus on elements in line with the company's strategic plans.	Value creation targets for the group.
TeliaSonera	8 000	1 308	14,05%	2 969	568	16,06%	0,01%	Yes	No	Yes	No	The company's and business units' financial results, individual goals.	-
Sandvik	6 871	3 333	45,86%	3 522	1 747	44,54%	0,01%	Yes	No	Yes	No	Company financial results and targets within each individual's area of responsibility.	Company growth, profitability and capital efficiency, ROCE.
H&M	12 500	1 500	10,71%	2 364	291	10,96%	0,02%	Yes	No	Yes	No	Performance based but otherwise not specified.	-

Company	1a	1aa	1aaa	1b	1bb	1bbb	2a	3a	3aa	3b	3bb	3c	3cc
Swedbank	8 000	194	2,37%	2 571	1000	28,00%	0,01%	Yes	No	Yes	No	Performance goals connected to the business area of each senior executive. Objectives which promote the interest of the bank and its shareholders.	-
Atlas Copco	8 652	6 056	50,95%	2 693	1 185	44,77%	0,03%	Yes	No	Yes	No	Qualitative and quantitative objectives.	Not specified.
SKF	7 382	3 600	36,41%	2 885	1 184	32,67%	0,02%	Yes	No	Yes	No	TVA.	Not specified.
SSAB	4 500	2 200	32,84%	1 400	900	39,13%	0,01%	Yes	No	Yes	No	ROE.	Stock price value and integration of IPSCO. Senior executive situated abroad: ROCE.
Tele2	11 200	3 500	38,46%	2 867	583	33,83%	0,04%	Yes	No	Yes	Yes	Established objectives connected to company result and mainly individual performance.	ROCE, TSR.
SEB	7 000	4 000	51,72%	3 475	1 688	48,18%	0,04%	Yes	No	Yes	Yes	Key objectives, collectivistic and individual, qualitative and quantitative objectives, such as results, costs and customer satisfaction.	Relative EPS and ROE.
Autoliv	4 318	2 181	54,75%	2 880	1 033	46,43%	0,02%	Yes	No	Yes	No	EBIT.	Individual performance, industry conditions, other criteria.
ASSA ABLOY	10 200	6 300	38,18%	2 723	1 690	38,30%	0,05%	Yes	No	Yes	No	Predefined result targets and other key objectives within the individual sphere of responsibility.	Variable salary based on increase in EPS, organic growth. An agreement made before 2007, only for a few senior executives (excl. CEO).
Husqvarna	5 125	3 483	46,72%	2 797	1 352	39,08%	0,03%	Yes	No	Yes	No	Value creation.	Not specified.

## Appendix VIII: Empirical results for Swedish companies

### Questions 4-6

Company	4a	4aa	4aaa	4b	4bb	4bbb	4c	4cc	5a	5b	6
Volvo	Variable salary	4 800	992	Shares, stock options	5 042	2 979	48,77%	24,98%	Yes	CEO and other senior executives: 50% of base salary.	
Ericsson	Variable salary	8 940	1 633	Stocks, option plans	1 399	285	86,47%	85,14%	Yes	Not specified, but what the board believes is reasonable and market praxis	
SCA	Variable salary	772	2 065	-	0	0	100,00%	100,00%	Yes	CEO and executive vice president: 75% of base salary, other senior executives: 65% of base salary	
Electrolux	Variable salary	4 892	3 850	Performance shares	6 397	2 999	43,33%	56,21%	Yes	CEO: 110% of base salary, other senior executives: 100% of base salary	
TeliaSonera	Variable salary	1 308	568	-	0	0	100,00%	100,00%	Yes	CEO and other senior executives: 50% resp. 35% of base salary.	New CEO 1st August 2007, with annual base salary of 8 000 KSEK.
Sandvik	Variable salary	3 333	1 747	Shares	2 486	1 082	57,28%	61,75%	Yes	Usually 50-70% of base salary, but no specified maximum limit.	
H&M	Variable salary	1 500	291	-	0	0	100,00%	100,00%	Yes	CEO: 900 KSEK after tax, other senior executives: 300 KSEK after tax.	The bonus paid must be invested entirely in shares in the company which must be held for at least five years.

Company	4a	4aa	4aaa	4b	4bb	4bbb	4c	4cc	5a	5b	6
Swedbank	Variable salary	194	1 000	-	0	0	100,00%	100,00%	Yes	Total benefits: CEO and other senior executives 400 resp. 350 income base amounts.	The variable salary to the CEO also includes other benefits.
Atlas Copco	Variable salary	6 056	1 185	Options/Synthetical options	2 932	998	67,38%	54,28%	Yes	CEO: 70% of the base salary. Other senior executives: 40-50% of the base salary	
SKF	Variable salary	3 600	1 184	Options (2001-2003)	627	216	85,17%	84,57%	Yes	CEO and other senior executives: 60-90% of base salary, depending on position	
SSAB	Variable salary	2 200	900	Variable salary, but not payable before 2008	0	0	100,00%	100,00%	Yes	CEO and other senior executives: 45%-50% of the base salary. Senior executive situated abroad: 70% of the base salary, but up to as much as 400%.	
Tele2	Variable salary	3 500	583	Options	3 500	883	50,00%	39,77%	Yes	CEO and other senior executives: 100% of base salary. Additional bonus: 20% of base salary.	The CEO has received 5 300 KSEK, which is a compensation for negative tax consequences related to incentive programs 1997-2006.
SEB	Variable salary	4 000	1 688	Performance shares	3 500	1 543	53,33%	52,24%	Yes	A percentage of the base salary, but otherwise not specified.	

Company	4a	4aa	4aaa	4b	4bb	4bbb	4c	4cc	5a	5b	6
Autoliv	Variable salary	2 181	1 033	Stock options, restricted stock units	3 043	1 463	41,75%	41,39%	Yes	CEO: 100% of base salary, other senior executives: 52-80%.	New CEO 1 april 2007. Information found in proxy statement.
ASSA ABLOY	Variable salary	6 300	1 690	Variable salary	0	0	100,00%	100,00%	Yes	70% of the base salary	No information if long-term rewards actually has been paid to senior executives 2007.
Husqvarna	Variable salary	3 483	1 352	Shares, stock options	1 011	442	77,50%	75,36%	Yes	80-100% of base salary	



## Appendix XI: Empirical results for American companies

### Questions 1-3

Company	1a	1aa	1aaa	1b	1bb	1bb	2a	3a	3aa	3b	3bb	3c	3cc
Paccar	8 008	12 683	82,28%	3 827	4 004	69,25%	0,05%	Yes	No	Yes	Yes	Net profit. Company profit goals, business leadership, business unit profit, business growth.	Growth in stockholder value, growth in net income, return on sales, return on capital.
Motorola	5 285	2 994	87,79%	4 096	2 742	87,85%	0,02%	Yes	No	Yes	Yes	Operating earnings, operating CF, revenue growth, quality-specific measures.	Financial targets: economic profit (net operating profit-capital share), growth in sales, TSR.
Kimberly-Clark	7 466	15 394	87,63%	3 511	4 540	79,91%	0,05%	Yes	Yes	Yes	Yes	Corporate key financial goals such as adjusted EPS, net sales and adjusted ROIC, other corporate financial & strategic performance goals, performance of the business unit or function of the individual.	Achievement of long-term objectives, the specific responsibility & performance of the executive, business performance, stock price performance and other market factors.
Whirlpool	7 287	42 892	91,80%	3 998	13 840	85,32%	0,07%	Yes	No	Yes	No	Financial measures: ROE, earnings, EPS, free CF and EVA. Customer measures: market share, quality, brand equity progress. Employee measures: engagement of employees, diversity, effective management.	Strategic objectives: innovation, total cost productivity, price margin realisation, total cost of quality, ratio of operating profit to earnings from continuing operations. ROE target, EPS and cumulative free CF.
Qwest	4 250	0	84,08%	3 208	4 586	78,21%	0,03%	Yes	No	Yes	No	Corporate performance: total CF, total revenue, total net income, total imperative. Group/business unit performance: group revenue, group channel margin, group imperatives. Customer satisfaction, customer retention, productivity and efficiency.	Market value of common stock.

Company	1a	1aa	1aaa	1b	1bb	1bb	2a	3a	3aa	3b	3bb	3c	3cc
Kennametal	4 466	9 524	77,00%	1 990	2 437	69,60%	0,13%	Yes	No	Yes	No	Corporate performance: sales growth, EPS, ROIC. Business unit performance: sales growth, EBIT, ROCA. Individual performance: technology development and positioning, global expansion & growth in emerging markets, free operating CF, etc.	Company performance: EPS, ROIC.
GAP	4 657	7 004	84,60%	4 543	4 338	73,12%	0,03%	Yes	Yes	Yes	No	Financial performance, such as earnings goals, of the company or a division of the company and subjective operating objectives.	Earnings performance, TSR.
Wells Fargo	4 620	25 872	91,44%	3 534	10 010	88,67%	0,11%	Yes	No	Yes	Yes	Company performances: revenue growth, diluted EPS growth, price/earnings growth, loan growth, etc. Business line performances: earnings growth, sustainable profitable growth, etc. Individual qualitative objectives: delivering on compliance & risk initiatives, developing leadership talent, expanding community involvement ,etc.	Contributions to growth in stockholder value over the long term, e.g. consistent stock price growth and high stock holder returns.
Ingersoll Rand	7 583	18 480	89,62%	2 409	2 586	73,09%	0,14%	Yes	No	Yes	No	EPS, available CF, ROIC, OI.	EPS, other financial and strategic objectives.
Timken	6 049	11 199	78,63%	3 131	3 741	69,63%	0,09%	Yes	No	Yes	No	Earnings before interest and taxes as a percentage of beginning invested capital, excl. the effects of restructuring and impairment charges and accounting change charges (EBIT/BIC), working capital as a percentage of sales.	Specified multi-year corporate performance goals, if shareholders receive additional value after the date of grant, TSR performance of the company or price of common stock.

Company	1a	1aa	1aaa	1b	1bb	1bb	2a	3a	3aa	3b	3bb	3c	3cc
Commercial Metals Company	3 696	15 523	84,71%	2 295	5 988	79,78%	0,05%	Yes	No	Yes	No	ROIC, net earnings, RONA, operating profit.	LTI-EBITDA
Alltel	7 571	46 132	93,29%	3 178	16 914	91,22%	0,21%	Yes	Yes	Yes	Yes	Company performance: EPS and net subscriber additions.	EPS growth, growth in customer base and TSR.
PNC	5 852	16 170	93,22%	3 319	5 661	89,26%	0,23%	Yes	No	Yes	Yes	EPS, ROCE.	Rise in stock price, relative TSR, EPS and ROCE .
TRW Automotive	9 819	24 049	86,48%	3 551	4 598	80,85%	0,08%	Yes	No	Yes	No	EBITDA, CF, additional factors: integration of an acquisition, the launch of a new product line, new business awards, etc.	Recent performance, overall contribution and value to the company.
Stanley Works	6 160	10 472	78,37%	2 954	3 350	70,22%	0,10%	Yes	Yes	Yes	Yes	Sales growth, EPS, CF-multiple.	EPS, ROCE.
Toro	4 620	3 511	75,80%	1 990	1 001	64,58%	0,16%	Yes	No	Yes	No	Corporate financial goals: EPS, corporate average net asset turns. Divisional goals: CPC, divisional current net asset turns.	Cumulative net income plus after-tax interest, cumulative corporate average net assets turns.

## Appendix IV: Empirical results for American companies

### Questions 4-6

Company	4a	4aa	4aaa	4b	4bb	4bbb	4c	4cc	5a	5b	6
Paccar	Variable salary	12 683	4 004	Restricted stock units, stock options, variable salary.	24 513	4 615	34,10%	46,46%	Yes	CEO: 24 460 KSEK (annual) + 36 960 KSEK (long-term cash).	Long-term cash awards for 2005-2007 not determinable as of the date of the proxy statement.
Motorola	Variable salary	770	810	Stock options, restricted stock units, variable salary	37 219	28 803	2,03%	2,74%	Yes	Not specified.	Loss 2007.
Kimberly-Clark	Variable salary	15 394	4 540	Stock options, restricted stock units, performance shares.	37 496	9 425	29,11%	32,51%	Yes	CEO and other senior executives: 0-240% of target payment amount, which is 120% resp. 80% of base salary.	
Whirlpool	Variable salary	15 400	6 932	Stock options, restricted stock units, variable salary.	66 140	16 301	18,89%	29,84%	Yes	CEO: 18 MSEK or 400% of the base salary. Other senior executives: 330% of base salary.	
Qwest	Variable salary	0	4 586	Stock options, restricted stock units.	22 447	6 925	0,00%	39,84%	Yes	CEO: 33 264 KSEK, Other senior executives: 6 838-13 201 KSEK.	Loss 2007. The CEO numbers used are for the former CEO (new CEO from 10 August 2007).

Company	4a	4aa	4aaa	4b	4bb	4bbb	4c	4cc	5a	5b	6
Kennametal	Variable salary	7 146	1 498	Restricted stock units, variable salary, stock options.	7 805	3 058	47,80%	32,88%	No	Not specified.	
GAP	Variable salary	7 004	4 338	Stock units, performance shares.	18 579	8 018	27,38%	35,11%	Yes	Other senior executives: 103%-114% of fiscal 2006 actual earnings.	Another long-term reward: stock options, but no stock options were given to other senior executives 2007.
Wells Fargo	Variable salary	25 872	10 010	Stock options, restricted stock units.	23 476	17 645	52,43%	36,20%	Yes	A percentage of the base salary, but not otherwise specified.	
Ingersoll Rand	Variable salary	18 480	2 586	Stock options, performance shares.	46 970	3 958	28,24%	39,52%	Yes	A percentage of the base salary. CEO: 20 618 KSEK. Other senior executives: not specified.	
Timken	Variable salary	4 626	1 517	Variable salary, restricted shares, stock options.	17 637	5 662	20,78%	21,13%	Yes	A percentage of the base salary, but not otherwise specified.	CEO: 20% base salary, 20% annual cash bonus, 20% long-term cash bonus, 40% stock options & restricted shares. Other senior executives: 50% annual compensation, 50% long-term compensation.

Company	4a	4aa	4aaa	4b	4bb	4bbb			5a	5b	6
Commercial Metals Company	Variable salary	15 523	5 988	Variable salary, stock options, restricted stock units.	4 956	3 068	75,80%	66,12%	Yes	Bonus: CEO: 300% of base salary, other senior executives: 205%, Long-term: CEO: 90-120% of base salary, other senior executives: 67,5-90% of base salary.	
Alltel	Variable salary	20 020	5 771	Restricted stock units and stock options, variable salary.	85 303	27 255	19,01%	17,47%	Yes	Short-term: CEO: 260% of base salary, other senior executives: 120%-200% of base salary. Long-term: CEO: 195% of base salary, other senior executives: 122,5%-150% of base salary.	
PNC	Variable salary	21 560	7 816	Stock options, restricted stock units, variable salary.	58 921	19 757	26,79%	28,35%	Yes	CEO and other senior executives: 29 198 (0,2% of "Incentive Income").	
TRW Automotive	Variable salary	24 049	4 598	Stock options, restricted stocks.	38 740	10 393	38,30%	30,67%	Yes	CEO: 24 640 KSEK, other senior executives: 2 692-9 573 KSEK.	
Stanley Works	Variable salary	10 472	3 350	Restricted stock units and stock options, variable salary.	11 846	3 615	46,92%	48,10%	Yes	Short-term: a fixed percentage of the base salary, as high as 200% of the target amount when exceeding the performance maximum. Long-term: as high as 200% of the target number of shares when exceeding the performance maximum.	
Toro	Variable salary	3 511	1 001	Stock options, performance shares.	10 959	2 627	24,26%	27,59%	Yes	CEO: 7 392 KSEK, other senior executives: 1 552-2 846 KSEK.	