Subjective and Objective Performance Assessment

Performance Pay at Trelleborg Forsheda AB

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Abstract

The purpose of this thesis is to understand the opinions and potential effects of objective and subjective assessments of performance as a basis for performance pay for blue-collar workers.

The study takes a qualitative approach to find out how and why four companies - Trelleborg Forsheda, Finnveden Powertrain, Isaberg Rapid and Parker Hannifin - work with salaries, incentive system and performance assessment the way they do.

The concept of individual salary is central in this thesis, and individual salary is based on four criteria; capabilities, performance, work demand and formal competence. These can be divided in subjective or objective criteria. Individual salaries also contribute to salary divergence, which in many studies have indicated higher performance. Important to remember is that it has to exist a purpose to salary divergence and how salary is diverged in the company is related to the goals and strategy of the company. If the company chooses to have performance based salaries - which is salary divergence - another question arise; what is good performance?

In organizations that have performance salaries, a group or an individual (often the middle manager) have to decide if a certain group of personnel performs good or bad. This can mainly be done in two different ways; objective performance assessment or subjective performance assessment. Objective performance assessment is based on numerical calculation of measures, which will form the basis for rewarding employees using a salary system that reward performance. Subjective performance measurements are based on judgment. Instead of relying on numerical calculations, one evaluates if the results reflect good or bad performance.

For both methods it is essential that the personnel feels that the salaries are fair, and that the salary system is clear and easy to understand. Something else that is important to understand is that employer and employee have different views in what is a fair salary.

Objective assessments are based on numerical calculations of measures, and one important property such measures have is that they don’t leave any room for excuses. Research indicate that performance pay has important motivation enhancing effects, but the profitability doesn’t always benefit from it. When monitoring costs are high, or product quality or long term thinking is required, hourly wages may be preferable. Tasks which are measured, will naturally be prioritized by the organization. This means that the choice of measures is very important. The amount of measures mustn’t be too high, and they have to be carefully considered. Subjective assessments are the opposite to objective ones. The advantages with subjective performance assessments are, among other things, that additional information which have surfaced during the period of measurements can be taken into consideration, errors in the measurement process can be corrected and unlucky circumstances can be dealt with. However, problems exist in unfair assessments, which are based on prejudice.

Findings in this report shows that profitable companies have large differences in their salary systems. This is also supported by other research. The company Isaberg Rapid AB only uses objective criteria, focused on simplicity and group rewards. Finnveden Powertrain on the other hand, has a system focused on individuals and subjective assessments. Some conclusions could be drawn; one of the most important being that connections between the type of activities and the salary system is positive, and that salary systems have to be updated and revised continuously.
Sammanfattning

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Disposition

1. **Introduction:** First in this thesis the problem areas and the direction of this work is presented and the reasons to why the thesis is interesting and important. The topics dealing with this are called introduction, background and purpose. Chapter 1 is recommended for readers who want to know why reward and salary systems are an interesting area.

2. **Methodology:** This chapter presents the methodology the thesis is built on, how the research process was designed and why this process was chosen. For the interested, a model have also been developed explaining how individual salaries can be determined, depending on four different aspects that are more or less subjective/objective.

3. **Theoretical Framework:** Articles and books constitute the foundation for a theoretical investigation of the field. It is presented in four parts; individual Salaries, Performance assessment, employer and employee and finally control and incentive systems. For the reader that wants to study the differences between subjective and objective performance assessment, chapter 3 is recommended. Some analytical parts are included here as well.

4. **Empirical Findings:** This chapter contains translated manuscripts of the interviews performed at the companies participating in the study.

5. **Analysis:** This part of the thesis connects the empirical findings from the interviews with the theoretical framework in order to see similarities, differences and interesting aspects of both.

6. **Conclusion:** Presents findings from both theory and empirical data, derived through the analysis.
Concepts and definitions

**Bonus system** – A system that rewards employees, depending on some predetermined factors.

**Individual salaries** – In this paper, salaries mean periodic payments of employees, decided by contracts. An individual salary makes it possible for the contract to differ from individual to individual within the same unit of the organization. This means that the salary spreading increases within an organization with individual salaries, and this has both pros and cons. The contract can be influenced by various aspects where performance is common.

**Incentive system** – A system which purpose is to motivate employees to perform better by rewarding or punishing them, depending on some predetermined factors. It can be either monetary or non-monetary rewards and/or punishments.

**Mechanisms of Market/ Bureaucratic/ Clan** – A system of categorizing the operations in three different ways. They are used in describing how control and evaluation of employees should be dealt with.

**Measurement** – Is an estimation of attributes of an object or process that can be used as input in a bonus, salary or other incentive system.

**Middle manager** – Employees in the company that have responsibility over other personnel or processes.

**Objective performance assessment /evaluation** – This means that assessment or evaluation of performance are done objectively, which refers to the absence of perspective, feelings, beliefs, or desires. The Objective performance assessment /evaluation are usually calculated by a formula with statistics and measurements as input. The term is usually connected to Subjective performance assessment /evaluation which is its opposite.

**Performance pay** – see Performance based salary.

**Performance assessment** – Performance is evaluated using a set of criteria or subjective comparisons.

**Performance based salary** - A salary contract that is affected by the performance of the individual, the team, the whole organization/company or all of them.

**Performance evaluation** – see performance assessment.

**Result control** – This is a process where organizations motivate employees in the direction of the organizational strategy to achieve good results.

**Salary responsible** – A person in a managerial position that has the main responsibility when it comes to representing the owner in salary negotiations, and who makes sure that the salary payments are done properly.

**Salary systems** – The system that handles the costs of acquiring human resources in the organization.

**Subjective performance assessment / evaluation** – This means that assessment or evaluation of performance is done subjectively, which refers to; perspectives, feelings, beliefs, or desires. The term is usually related to objective performance assessment /evaluation which is it’s opposite.

**Supervisor** – This is usually a middle manager that has the responsibility to control his subordinates, and influence them to do an as good job as possible by “rewarding” or “punishing” them.
1 Introduction

Salaries can be seen as the main mean used by employers to retain the employees, but it can also be a driving force in systematic improvements and it can reward and control the performance of people by increasing work motivation (Merchant & Stede, 2007). Salary systems consist of collective salaries or individual salaries, which in turn consist of four criteria; capability, performance, work requirements and formal competence. The two first are very hard to assess in an objective manner, but the two later, do not allow any subjectivity (Nilsson and Ryman, 2005). This leads to often debated subjects such as if performance and capability should be assessed using objective and non-disputable measures or softer, subjective measures, and if salaries should be decided on an individual level or group level. Salary systems constitute a source of frequent debate and conflict (Risher, 2002). On the other hand, driving performance through monetary rewards is proven to have a large impact (Stiffler, 2006). Can the negative effects be reduced while maintaining the positive?

This study addresses some of the issues using Swedish companies as examples. Swedish company leaders within the private sector were interviewed about individual salaries by Temo (2001), and 61% answered that they are using this form of salaries. Individual salaries seemed most popular (around 85%) in the knowledge-intensive service sector (consultancy, education, health, media), while the lowest proportion (around 40%), were from the capital dependent service producing sector (transportation, harbor, construction). With more than half of all employers using individual salary systems to some degree, it is clear that such systems have become the norm in setting salaries in Sweden.

The question of what a fair salary is like is frequently debated, where the organization represented by the middle manager faces the employee, often represented by the union. A fair salary might very well be different in the eyes of the employer compared to the employee, and the fact that it is all about money and status makes it even more difficult to deal with. The topic has long been debated among white collar workers, but are not mentioned as often among blue collar employees (Nilsson and Ryman 2005). This makes it interesting to look for tendencies in improvements of motivation and performance among the blue collar workers using such salary systems as well. The question if salaries, incentives and bonuses should be paid out individually or collectively is also a sensitive issue. If salaries, incentives and bonuses are dependent on assessment of performance - subjective or objective - should it be the performance of the individual, the department, or the organization as a whole?

Nilsson and Ryman (2005) argue that objective assessments are direct and give the opportunity to clearly see the problem, as well as simplifies the understanding of why a bonus, incentive or salary is accurate. With objective assessment of performance it’s easier to accept that a fellow employee receives a higher salary or bonus. Subjective performance assessment on the other hand, takes away the risk of rewarding employees by chance or by luck, or punishing them when they are unlucky (Merchant & Stede, 2007). According to Ouchi (1979), different companies utilizes different means of control depending on their respective appearance. Finding a balance between subjective and objective assessments suitable for a specific company can be a difficult task, and some parameters are investigated in this report.
1.1 Background
The research area of salaries and how to determine salaries, incentives or bonuses is interesting since it can be a driving force behind organizational change, rewards and control efforts through motivation enhancing effects (Merchant & Stede, 2007). It is also an area with a lot of conflicts because of the complexity and different opinions present.

On one hand, managers close to the personnel that will be affected by the decisions on salaries, incentives or bonuses, want a system that is fair and easy to understand. Managers often do not want to be forced to explain why salaries differ to his/her subordinates. On the other hand, most managers also want the liberty to bypass rules and routines in order to reward an employee that performs better than average. The question is then what the best way is; should performance assessment be done objectively or should the managers have a more subjective way of determining the performance?

The company Trelleborg Forsheda experienced exactly this when this thesis was initiated. From their point of view, the present salary system weren’t driving change or motivating employees to perform better. To get an understanding of why the salary system didn’t work, several interviews were performed at Trelleborg, and additional interviews were performed at the other companies to discover how a functional salary system is designed. From the start, the goals set by Trelleborg Forsheda were used and a company specific report written. The report was then used as a basis for this master thesis. The focus was then shifted from the company's perspective to a holistic view where the main idea was to depict and understand the entirety of the problem.

1.2 Problem discussion
The organization has to find a balance in subjective and objective performance assessment done by the supervisor of the employees, or as often is the case; the middle managers. The middle managers have limited time and resources to observe, control and measure all of an employee’s performance. Is the time the middle manager spend observing, controlling and assessing employees enough in order to make a fair judgment of the performance, or should the middle managers rely on predetermined measurements and outcomes in order to set fair salaries, incentives and bonuses?

These are issues relevant both in objective and subjective measurements. The balance between the two is the second large subject of study. How should an organization decide on this, and which variables are key aspects when trying to create an effective system?

Thirdly, white collar workers have traditionally had individual, subjective salaries. Companies such as Finnveden Powertrain have, however, moved toward the same system for blue collar workers as well. Why is subjective systems common in certain environments while objective seem popular in others?

1.3 Purpose
The purpose of this thesis is to understand the opinions and potential effects of objective and subjective assessments of performance as a basis for performance pay for blue-collar workers.
1.4 Delimitations

The study does not include salary systems at other departments than production, and only blue collar workers. The focus will be middle managers perspectives and only at medium and large manufacturing companies. At Trelleborg Forsheda AB, only the sections "PA Materials & Mixing" and "PA Resonance Damping & Shaft Seals" will be examined. Interviews will only be performed with middle managers.
2 Methodology

This chapter describes the realization of the work, methods used and the direction of the thesis.

2.1 Scientific method

This thesis is based on a case study using a qualitative approach. According to Patel and Davidson (2003) a case study is a restricted case in which processes and changes are inquired. Darke & Shanks (2002) argues that a case study is functional in order to understand the context, particularly when terminology, language and definitions are not clear. Since clear definitions of individual salaries, objective and subjective measures and so on don't exist, these are some of the reasons for choosing a case study method in this thesis.

The data needed has portrayal characteristics in terms of images and expressions. Jacobsen (2002) describes data from a qualitative approach in a way that strengthens this choice. Both types of data were required since the purpose was to get a wide, holistic view of salary systems and their uses, although the theory collection provides the higher validity in this case. The reason to why theory has a higher validity is that the consultancy report data is based on opinions and feelings about the different systems. The middle managers have their own experience to base their answers on, but no experiment or any research have been performed in order to get to their conclusions. The focus of the analysis was therefore on theory within the salary, incentive, bonuses and motivation literature, while the focus of the empirical studies was to achieve high relevance of gathered material, and to be able to relate empirical data with the theoretical. Furthermore, the ability to generalize outside of the given cases wasn't prioritized in this work. This choice is also strengthened by Jacobsen (2002), who upholds that issues like these a best investigated using an intense and describing case study.

2.2 Data collection

The collection of data was done in several ways, and both primary and secondary data was used as foundation for analysis and conclusion.

2.2.1 Consultancy report

A consultancy report was first written as an aid for Trelleborg Forsheda in their development of a new salary system. That report later formed the basis for this master thesis.

The primary consultancy report data was gathered from four companies, and this data can be described as data collected directly through interviews and observation (Williams 2002). The goal was to summarize information about the current situation at Trelleborg Forsheda's salary system, and to investigate how three other companies use their systems to control and reward their employee’s. In order to do the observations, appointments were scheduled with managers at Trelleborg Forsheda that could walk through the production and explain the processes and the routines. While observing the production stations and production lines, interviews with blue collar workers were also performed.

The main method of getting the interview data from the companies was open-ended interviews based on a questionnaire. The questionnaire was in turn based on the scientific literature used in the work (appendix 1). The questionnaire was a help in the interviews, in order to get the discussions going. The interviews developed themselves in the directions of the
interviewees. The main questions were always asked but the focus varied. The purpose of the interviews performed at Trelleborg was primarily to gather information about why the salary system doesn't work today, how a new system could be designed and what the opinions are regarding this. All interviews were shaped in such a way that they encouraged discussions about why the company had chosen a certain salary system approach and strategy. The reason for this was to get a clear picture of the underlying reasons for the strategic choices of the company. The interviews performed in the companies were done with middle managers -working both with salary aspect and developing the salary, incentive and bonus programs of the company- and production managers that performed assessment of employees.

Out of all interviews conducted, seven were selected for this thesis. The criteria to use a particular interview in this work were partly its length and depth, and partly if it would contribute new ideas and other information not present in the other interviews already. Since the consultancy report was written with slightly different goals in mind than this thesis, it may have steered the research in certain directions. However, the core ideas remained the same as both studies aimed at finding out what constitutes a good salary system in a certain environment/company using the objective and subjective measurement notions. This is further discussed in 2.5 Criticism.

2.2.2 Theoretical framework data

The theoretical framework data is, in this report, data already collected by somebody else. This can be scientific studies and literature, scientific articles and books (Williams 2002). Emphasis in this thesis was put on the field corporation measurements or accounting and control, but fields of motivational theory and psychology within organizations were also used. One of the frequent reoccurring problems was that the scientific reports often contradicted each other. This might be the result of different scientists projecting their views onto their work which can lead to different conclusions. The phenomenon is also mentioned by Saunders et al. (2003), who argue that secondary data may represent interpretations rather than an objective image of the reality. The reason for this can be the complexity of the reality and the difficulty of generalizing one case onto other cases. This thesis has the focus of its analysis on secondary data and theory. This means that the thesis is mainly a theoretical work, and that the theoretical data is very important for the validity.

2.3 Validity

The validity can either be internal validity or external validity, where the first one is if the investigation measure what it should be measuring. The external validity is if the result of the research can be generalized onto other cases (Williams 2002). The internal validity was strengthened by discussion and feedback from the three supervisors of the project. This includes supervisors from school, but also from the company that helped us develop goals with the project. The external validity was not critical in this thesis; this is because focus was on the situation in one company and the fact that it can vary a great deal between what’s good for one company and the other.

The internal validity of the thesis has also been strengthened by the structure of the interviews; where the interviewees was able to freely explain how their salary system was developed, as well as explain how they consider an effective salary system to be constructed. This meant that it was questions with open characteristics, and that follow up questions only was asked when something needed to be clarified. The personnel that got interviewed were also familiar with the subject and where working daily with the questions. This should
lower the risk of misunderstandings arising. The internal validity was strengthened by having open questions because the purpose was to understand the opinions and potential effects of subjective and objective assessments of performance. With open questions, accidentally guiding the interviewees in certain directions can be avoided (Williams 2002).

2.4 Reliability

Reliability is in a way the ability of getting the same result of an investigation, with different input. One of the difficulties with qualitative case studies can actually be to determine the degree of reliability (Williams 2002). During the investigations in this thesis it was apparent that there exist different views among the people that were interviewed and literature that was examined. The views on salary systems were often determined by own experience, and are connected to a lot of sensitive issues. This situation might have affected the result in the way that the interviewees were either very strong-minded on their standpoint or overly careful about discussing and agreeing about the issues. Deliberate decision of interviewees and companies to interview where made, this with help from supervisors at the company of Trelleborg Forsheda. The need of investigating different opinions about the subjects in this thesis were apparent. Consequently, different companies that had different experience and success had to be found. Indications on which companies and which persons that had a certain opinion was also taken into consideration when interviewees were selected.

The collected data presented in the empirical findings chapter, has some weaknesses. The most apparent one is the varying lengths and depths of the interviews. Other problematic aspects are the tendency of the subject to be controversial to discuss, and the relatively low amount of data gathered. However, the data covers a wide spectrum of opinions and ideas. It is also strengthened by the theoretical analysis which acts as a foundation to the conclusions in the final chapter.

2.5 Criticism

Criticism of sources was the major method selected in this work, accompanied by discussions of validity and reliability.

2.5.1 Source criticism

The secondary data primarily used in this thesis is based on literature within the field corporation measurements or accounting and control. However, there is a large amount of research available from the neighboring fields of motivational theory and psychology. Those fields of research aren't dealt with in great depth in this thesis, apart from certain scientific results. This can be seen as criticism, but the choice was well founded taking time and lack of experience within the fields into account. The focus of this study was mainly on a few selected sources, where other interesting references were discovered and consequently looked up.

With a relatively large proportion of the theory referenced from the same books and articles, one should pay attention to the possible effect of some researchers getting a larger influence on the results than others. However, many of the articles present contradicting views and a too simple view was consequently not probable. Additional articles were found through the use of databases, which further increases the credibility of the theoretical findings.

The consultancy report data has it's own set of weaknesses. The interviews were performed in an open ended fashion, with some basic questions as guideline. This might have made
some interviews deeper and distorted the overall impression and conclusions. Furthermore, interviewees and participating companies were picked by following recommendations from Trelleborg Forsheda. A random pick would probably have rendered slightly different data.

Even though the interviewees were allowed to be anonymous, they might not have been fully free in what they said. The field of salaries and control very often provokes strong feelings and opinions (Risher, 2002). This is a problem since people might feel they have to be loyal to their employer and coworkers.

2.5.2 Methodology criticism

One possible disadvantage with using an intensive case study is that it is difficult to generalize, because of the fact that only a small sample of the whole population was selected. This was considered less important because it was a specific task. The task of the thesis is focused on theoretical aspects of salary systems, the interviews are mainly compliments giving a higher validity of the thesis. Because of that the interviewees was selected due to their expertise, and this could have had an influence on the result. Most interviewees where working in the production department, which mainly promoted objective assessment.

When a qualitative approach is used, the project usually demands vast amount of resources in form of data collection and analysis of the data. It also exists a risk in open interviews in that these get off topic and that important information is lost (Williams 2002).

Before work on the thesis had begun, a consultancy report was written in Swedish. The report was made to help Trelleborg Forsheda in their work of developing a new salary system. Some specific priorities, such as avoiding old scientific articles and using the company’s circumstances when choosing which aspects of the subject to put focus on was made. Since the consultancy report was later used as a starting point and major source of scientific articles when writing the master thesis, this might have steered the work in certain directions.

Since the starting point of the work was Trelleborg Forsheda, most of the interviews were done there. Additional companies were selected from a pool of by Trelleborg Forsheda recommended companies. The order of the companies could've had an impact on the end result, since prioritizing was largely done by following the advice from Trelleborg Forsheda. However, other aspects such as distance to travel to reach the companies and difficulties getting appointments came into play as well.

An effect of the consultancy report might be that the final results of this thesis may lean more towards practical implications when developing a salary system than the theoretical causes and effects. This is one of the reasons for putting much effort into the theoretical framework, thus getting a wider view of the investigated problems.

Furthermore, individual salaries have been generally thought of as being a more efficient mean than others when trying to motivate and control employees. Another common belief is that differentiation of salaries creates competition which enhances productivity (Nilsson and Ryman, 2005). Beliefs such as these can be an influence to what and how the topic is studied and presented in general in scientific literature.
3 Theoretical framework

The theoretical framework is divided into four different parts, with the focus on monetary rewards of performance, and is introduced by background information on individual wages. The condition for performance pay is that the organization have accepted individual wages, and embrace the notion that good performance should result in higher payment than bad performance.

3.1 Concepts

A big obstacle when investigating salary systems is that the entire field is exposed to lots of strong opinions and emotionally charged words. Subjective assessments are more often perceived in a negative manner than are objective ones, and this most likely has an impact on the scientific studies and results available. Some confusion of ideas exists as well. Subjective criteria often mean how something is done, while an objective criterion describes what is done. Consequently, objective criteria may have several subjective elements and vice versa (Strandås, 2003). Assessments done either objectively or subjectively will be described later in this report.

Individual salaries is a wide concept, that includes everything from blue-collar worker contracts with negotiations between unions and employers at local levels, to individual discussions between workers and their closest manager. There is, however, no unambiguous definition of what individual salaries mean (Nilsson and Ryman, 2005). In this report, the expressions individual salary, performance pay and result oriented pay will be used, and the similarities often overshadows the differences.

Different concepts related to individual salaries will be introduced. To make the relationships easier to grasp, the model below can be used. The salary can be based on subjective assessments, objective assessments or a mix of the two. Individual salaries are normally based on four criteria; capabilities (independence in work, ability to cooperate, initiative, creativity, empathy), performance (amount of work, results and quality), work demands (number of tasks, difficulties of work) and formal competence (education etc.) (Nilsson and Ryman, 2005).

![Figure 3.1, Salary components](image-url)
The model above shows that individual salaries are based on subjective and objective assessments that in turn are based on four different individual criteria. For example, capabilities are hard to quantify and measure in an objective manner, and because of this it is one of the hardest criteria to convert to something solid and understandable. Furthermore, when performances are hard to measure, they have to be assessed (Nilsson and Ryman, 2005). Since capabilities have to be assessed, they are closer to subjectivity than objectivity. Performance, work demand and formal competences are increasingly easier to measure and quantify, and are therefore seen as more objective.

3.2 Individual salaries

*Individual wages, which can reward employees in a number of ways both individually or in a group, are described in this chapter. Introducing individual salaries can have different purposes, and will result in a spreading of the salaries. The results of the introduction can have various effects.*

3.2.1 History and spreading in Sweden

One could easily get the idea that individual salaries are something new, when reading material from trade unions or Svenskt Näringsliv (Swedish industry organization). However, it has been around for a long time. In the 1930's, it was developed and later in the 1950's, it was utilized for most privately employed white-collar workers. Within the public state sector, around 40% of the employees have contracts without exact agreements in cash or percent. In the private sector, the development toward individual salaries is slower, and this far only around 10% have contracts without exact numbers (Nilsson and Ryman, 2005).

When company leaders within the private sector were interviewed about individual salaries by Temo (2001), 61% answered that they are using this form of salaries. The highest proportion (around 85%) of those who upheld that they were using individual salaries, came from the knowledge-intensive service sector (consultancy, education, health, media), while the lowest proportion (around 40%), came from the capital dependent service producing sector (transportation, harbor, construction).

3.2.2 Conditions for individual salaries

Norén (1998) upholds that there isn't any reason to have differences in salary levels merely for the sake of having differences, but there need to be a clear objective connected to the differences. Companies should design their salary processes so that it is easily understood by everyone, what is required in order to acquire a higher salary level. The system also has to be consequent and systematic. An organization that successfully implements and keeps a salary system that has well balanced structures and a well thought through spread of salaries often gets a positive image that attracts new, qualified personnel, helps the company to retain the old, competent workers and increases motivation to exert effort in daily work (Norén, 1998).

Several leading companies have developed their salary systems in different directions even though some commonalities are present, and they all work for the respective company (Risher, 2002). From this, one could assume that there are a multitude of possible solutions to the problem of developing successful salary systems. However, some common grounds seem to exist. Lately, market oriented pay systems have gained in popularity over employee retention focused ones. This trend probably depends on a shift in expectations on career and number of employers from the employee's. Furthermore, the company should use its strategy, its philosophy of relations with its employees and the expectations on the system from the managers as starting points when developing the salary system. A salary system is
just one of several means of control, but one that often is brought into light and criticized. Both managers and employees need to agree on that the system fulfills the needs of the company, and just like every single company has different demands, the salary system should look different, depending on the circumstances (Risher, 2002).

Large variations exist in between different industries, companies and even between different departments in the same company in how individual salaries are applied. Some of the basic conditions for individual salaries to have beneficial results are, according to Nilsson and Ryman (2005):

1) A good leadership, with managers that frequently talk to their subordinates about the goals of the organization, individual goals and development of the processes. This requires resources to be put in leadership development in a lot of companies.

2) Criteria for salary levels should be well known, clear and accepted. This is especially valid for individual criterions such as performance and capabilities. To make the system legitimate, all workers have to be able to participate in the development of the criterions.

3) The system should be developed with the organizations capabilities in mind. If a new salary system is just adopted without adaption to the current situation of the company, it might end up being contra productive.

4) The talks between managers and employees have to have an effect on salaries. That is, managers who conduct such talks have to be able to set the salaries of those participating in the discussions.

5) Discussions and reflection between managers and workers about the salary systems strengths and weaknesses have to be given time. The system should be open for continuous change through small and large improvements.

The core of the individual salary systems today, is the conversation between managers and their subordinates (Nilsson and Ryman, 2005). Sometimes the conversation regarding the salary has been preceded by another conversation, where the subordinate has been given goals in relation to the goals of the organization as a whole. Such a conversation should make clear what he/she must perform in order to get a raise in salary. If that condition is met, the following conversation about salary level will be less dramatic, since the manager can motivate the new salary level using what was decided in the preceding conversation as criteria (Nilsson and Ryman, 2005; Strandås, 2003).

Sometimes the salary conversation is called a salary deciding conversation. This is to underline the importance of that managers who conduct such conversations need to be able to actually decide salaries, not just talk about them (Nilsson and Ryman, 2005).

### 3.2.3 Individual salaries and company results

A company may enhance its financial results by transferring for instance salary expenses from fixed costs to variable costs. According to a study of two organizations performed by Burke and Terry (2004), an organization can decrease its breakeven point through such a transfer. This means that a company can achieve better profitability, if it allows result based variations in parts of its salary expenses. In addition, companies have searched for methods to motivate and reward their employees for a long time, and systems using compensations as main method of achieving this have become the dominant approach (Burke & Hsieh, 2005).
Furthermore, individual salaries have mainly been advocated by the employers. This has been done as a way of rewarding good performances. A common belief has been that differentiation of salaries creates competition that will function as an incentive to exert effort (Nilsson and Ryman, 2005).

The hypothesis that companies that use performance based salary systems are more attractive to high performing workers has received considerable attention in economic theory as well as management and organization literature. This has been hard to find empirical evidence for, since the motivation creating effect of such a system is hard to separate from the company image enhancement and thereby high performing worker attracting force (Moen & Rosén, 2005). One exception to this is Lazear (2000), who investigates a manufacturing company that makes a switch from hourly wages to performance based wages. The results from the study suggest that the effect of higher performing workforce attraction from the company accounts for roughly half of the productivity increase. Furthermore, the average salary in the company increased for a given performance, and the productivity increase and workforce attraction could therefore be explained by the high average salary rather than performance based pay (Moen & Rosén, 2005).

Systems, in which the employees do their own judgments of their performances, have been tested in lots of companies. A frequently occurring problem with such systems is that employees tend to value their own performances as slightly above average, which of course isn't possible in all cases. Most people can't accept their performance as being worse than average (Vest et al. 1994).

For performance based salaries to have positive effects on company results, employee performance has to be monitored and measured in a way that matches the business. In a production facility where the performance of every single employee is easily measured in number of produced products, large enhancements in performance may be achieved by basing the salaries on that specific variable. If, on the contrary, the tasks have a more complex nature, as is the case with most office based work etc., a connection between salary and simple measurable performance measures is no guarantee for better performance at all (Belfield & Marsden, 2003). Often, hourly salaries should be preferred, especially in businesses where monitoring costs are high, or product quality is more important than production speed (Lazear, 2000).

Piekkola (2005) made a study among Finnish companies, where the connections between company result and performance based pay was investigated. One connection seemed to be that the performance based part of the salaries had to be larger than 3.6% in order for it to have a significant effect on overall company result. If this condition was met, the effect seemed to be an increase in company productivity and profitability of approximately 6%.

3.2.4 The effects of spreading salaries

Competition within companies can have positive effects on the productivity and result of the company according to the tournament theory (Lazear and Rosen, 1981). Several studies in different companies based on the tournament theory have been conducted, and they indicate that the theory is most likely right (Nilsson and Ryman, 2005). According to a study made in Sweden, some workers perform worse when they are dissatisfied with their salaries. Furthermore, the opinions on performance based salaries vary depending on the size of the company. Large companies tend to have a more positive view on large variations in salaries than small. This might be an effect of the importance of a good social spirit in small businesses in contrast to the large businesses need for performance enhancing competition (Agell, 2003).
Pfeffer and Sutton (2000) uphold that the opinion of high competition as a way to increase effectiveness is a result of confusion between what competition is and what motivation is. Internal competition within companies where single performances are measured and individual rewards handed out, the system might be flat out contra productive, as it increases conflict occurrence and internal opposition.

The individual salaries effect for individuals is debated. Nilsson and Ryman (2005) uphold that the salaries increases very little or nothing at all. There are some studies from the health sector, where the salaries of nurses have increased dramatically after introduction of individual salaries. This could, however, be an effect of increased demand and more competing employers in the industry. The same tendency can't be observed for other hospital personnel, such as doctors etc. (Nilsson and Ryman, 2005).

A common view is that companies can easily improve performance by simply introducing performance pay. According to Moen and Rosén (2005) this is often true, but they also write that too much use of high rewards can make the most productive workers exert too much effort, and prioritize their tasks in the wrong way. Furthermore, performance pay often makes the average salary in a company to increase. Solely an increase of average salary can often explain the performance improvements in the company, and effects of performance based salaries are therefore uncertain (Moen & Rosén, 2005). In order to introduce performance pay, some kind of control and assessment of performance have to be done. This can be done in different ways and are explained in following chapter of the theory.

3.3 Performance assessment

Performance assessment or evaluating performance can be used to differentiate individual salaries to reward good performance and discipline bad. The assessments or evaluations of performance can be done in different ways, and the common starting points are presented below.

3.3.1 Objective performance assessment

Objective performance assessment is based on numerical calculation of measures, which will form the basis for rewarding employees using a salary system that reward performance (Merchant & Stede, 2007). How this numerical calculation is done depends on the decisions made by the senior management and is discussed in the section about control and incentive systems. One of the characteristics of clearly objective performance assessment is that it doesn't provide any opportunities to throw the blame on something else. Such assessments are not based on any subjective parameters but only on measurable results that can be derived from processes related to the work. For example, one could reward employees in the end of a certain project, when the profitability is known (Prendergast, 1993).

One study performed by Lazear (2000), is based on data from the company Safelite Glass Corporation during the years 1994 and 1995. During those years, the company went through major changes in their salary processes, when changing from hourly wages to piece rates. Time based pay means that the salary is decided entirely from the amount of hours worked, while piece rates are based on productivity (performance based pay). By studying such large changes, from one point of extremism to another, some tendencies could be observed. The following four conclusions were drawn by the author:

1. The change from time based pay to piece rates had a significant effect on average productivity per worker, with a close to 44% large improvement.
2. The improvement can be divided into two components. Roughly half can be derived from increased productivity due to the motivation enhancing effects. Another large factor is that the company succeeded in hiring more productive workers, and the most productive employees tended to stay with their employer to a larger extent.

3. The company shared parts of its profits with the employees, which could be seen by the 10 percent increase in average salary when moving from time based pay to piece rates.

4. The change led to higher productivity variances. The most ambitious workers are easier to notice when a piece rate system is used.

Performance based pay have important motivational effects, but an increase in profitability isn’t always the case. Often hourly wages should be preferred, especially in work where production monitoring costs are high, or product quality is more important than production speed (Lazear, 2000).

Processes that are measured will be prioritized by the organization. This means that the choice of what to measure is very important. If too many measures are chosen, or simply the wrong measures, the result may be counterproductive (Simons, 2000). Furthermore, one risk also exists in that when problems occur, attention is drawn to the measurements instead of how to solve the real problem. The incentives to work in a certain direction exist without measurements as well. The sure cost of introducing and using performance measurement may exceed the potential benefits that may not even materialize (Halachmi, 2005).

3.3.2 Subjective performance assessment

Subjective performance measurements are based on judgment. Instead of relying on numerical calculations, one evaluates if the results reflect good or bad performance. There are both pro’s and con’s in using subjective measurements, which are reinforced in different situations and industries (Gibbs et al 2004). Studies have shown that subjective measures are more frequently used in complex work situations, where the work involve many tasks and individual decision making (Nisar, 2006).

The pros in subjective performance measurements include the possibility to take additional information that is revealed during the measurement period into account when doing the evaluation. Further, some argue that subjective measures can remedy shortcomings in measurements and account for unpredicted events during the process (Gibbs et al 2004). Merchant and Stede (2007) explain this as if a firm connection between performance measurement and performance assessment exist, it will probably have the effect that the employer punishes employees when they have bad luck and reward them when they are lucky.

One of the main purposes of subjective measurement is to reduce risks in performance assessments by eliminating unpredictable events and results of bad luck or luck. However, this can in turn lead to assessments that are unfair, inconsistent and based on prejudice from biased employee policies, the organizations financial status and the personal views of the person in charge of making the judgments. Furthermore, a subjective performance assessment often provide to little or no information on how the assessment was made. This lack of feedback reduces the ability to learn from earlier assessment processes and decreases the motivation among employees to enhance performance in periods to come (Merchant & Stede, 2007).
Even when an assessment is done in line with company recommendations, the problem still exists with employees that don't understand the judgments or trust them. Only a small fraction of prejudice – true or not – will lead to problems with moral and motivation. This is the same as the result of the performance judgment responsible breaking an outspoken but not documented promise of reward (Baker et al 1994).

One prerequisite for a salary system to function properly is that the employee feels that the system is fair (Risher, 2002). This is closely connected to the debate of salary differences related to gender, since the same work should result in equal pay. Investigations performed by Kommunal (the union for community employees) presented by Strandås (2003) have shown that individual salaries, based on subjective measurements and salary discussions, won't result in any relevant differences between sexes. This result contradicts the prediction that the introduction of subjective measurements would favor the men, since they are regarded as having an easier time describing themselves in a positive way. An equally large part of the men and women think that differences in performance should result in differences in pay. Furthermore, the gender and power perspective is hard to investigate since women often have female managers and men often have male managers (Strandås, 2003).

Subjective performance judgments often result in a "throw the blame"-culture within the organization. This is a consequence of the human characteristic to blame bad performance on outside causes, like bad luck and task difficulties, while good performance is related to own effort, knowledge, traits and competences (Prendergast & Topel, 1996).

Additionally, subjective performance assessment is costly in time. People in charge of passing judgments often have to spend considerable time to gather information on every employee. If the performance is bad, the responsible also has to look for and find legitimate reasons for the bad result and explain them to the employee. The same is true the other way around, since good performance may have been due to lucky circumstances (Merchant & Stede, 2007).

3.3.3 Complexities and contradictions

The assessment of performance can be done as previously discussed objectively and subjectively, but the choice of the two is not always clear. The author Nisar (2006) argues that problems and questions concerning the design of a bonus system vary from industry to industry and unit to unit and should be resolved by considering the organizational and technological capabilities of the organization. Bonus Systems are used within many companies as means to follow strategies and achieve goals. A consequence is that companies often have to use subjective assessments of how the bonuses are affecting the implementation of its strategies. Even if only objective measures are used, the final assessment of how good the performance really is will be subjective (Nisar, 2006).

In order for a bonus system to function in a positive way, it must be integrated into the human resource management system of the company. Additionally, connections between individual preferences and company goals have to be present. The system also has to be able to resist abuse, such as when workers focus all attention on quantity and ignore quality to achieve higher bonuses, or getting free rides from other workers performances. Another important aspect is that one has to understand the conditions and circumstances of the organization before choosing which measures to focus on. Subjective bonuses have certain advantages when the organization prioritizes long term perspectives from managers, human resources, less complex measures and organizational change and development (Nisar, 2006).
Ouchi (1979), also argues that there are different approaches to successful reward systems, depending on the present work situation. In some situations, letting the market decide what a good performance is like would be to prefer, while other situations wouldn't allow such an approach.

3.4 Employer and employee

The understanding of both the employer and the employee perspective is important, since both sides have their views on how to develop a fair salary system. One of the important aspects to have in mind is the perceived salary fairness. That is, the salaries are only fair if they are perceived as such by the workers. Another is the employers need to raise productivity by differentiating pay and reward good performance. After all, the most important aspect might be to find common grounds, to achieve both comfort and long term profitability.

3.4.1 Different views

Individual salaries have traditionally foremost been advocated by the employers. The reason for this is to increase productivity in the organization by differentiating salaries and pay more for high performances than low (Nilsson and Ryman, 2005). There also exists a belief that salaries are one of the best ways of motivating and controlling employees to strive for high performances and achieving company goals. Another belief is that highly differentiated salaries create competition that function as a strong incentive to perform better for workers (Nilsson and Ryman, 2005).

3.4.2 Salary fairness

There are multiple perspectives on what distinguishes a fair salary. Both employer and employee usually have their own opinions on the subject. Nilsson and Ryman (2005) list the 9 most common starting points when discussing fair salaries as:

1. Need related salaries. This perspective is based on that everyone should get at least a large enough share of the company's profit, so that they can cover their own basic costs.

2. Task related salaries. Based on that the complexity of the work should decide the salary level.

3. Productivity based salaries. Mirrors the opinion that the most efficient workers should have the highest salaries.

4. Behavior related salaries. Based on that the employees who behave according to predefined company rules should have higher salaries than others.

5. Market related pay. Means that people who are competent and are in demand from many businesses should have higher salaries than others.

6. Education based salaries. A long education should result in higher salary than a short one.

7. Time of employment related pay. Those who have been employed for a long time should have higher salaries than the newly employed.
8. Non discriminating salaries. Salaries shouldn't be influenced at all by individual properties of employees that isn't related to the work.

9. Perceived fair salaries. The only thing that matters is if the workers perceive salaries as fair themselves.

Apart from the large number of different perspectives on salary fairness, the complexity increases even more since many perspectives can coexist while some are in direct conflict with each other. Risher (2002) upholds that the most important part of the salary process is that the workers understand why they get the salary they get. This is the same as in 9) above. If that condition isn't met, using the system as a way to increase work motivation fails totally.

The different perspectives often reflect who is being represented. As example, the unions that represent their members’ needs mainly take their starting point in the need related salary perspective. There are, however, many other starting points depending on who is being represented (Nilsson and Ryman, 2005). Recently many unions have started highlighting high productivity and efficiency, to try to increase the Swedish companies’ international competitiveness and thereby create more job opportunities in Sweden (Huzzard and Nilsson, 2004).

Employers more consistently advocate productivity related, behavior related and market related salaries. To try to find common views is an important part in achieving mutual understanding and compromises (Nilsson and Ryman, 2005).

3.5 Control and incentive systems

This chapter presents a process of how result control can be used practically in order to develop an incentive system that rewards employees for good performance, as well as how organizational characteristics are related to the success rate of different systems.

3.5.1 Organization characteristics and control

In order to cope with the difficulties of controlling and evaluating performance- in order to say, set bonuses or salaries- the author Ouchi (1979) argues that there exist three different mechanisms for the organization. These mechanisms are markets, bureaucracies and clans, and they can help explain which characteristics of an organization should be used when designing incentive systems. An example of a department that could beneficially use a market mechanism for controlling and evaluating the employees is a purchase department where the purchase agents work is simplified by the fact of that he does not need to determine, for each part purchased, that it is the best and most efficient possible. Instead he lets the market bid and define a fair price for each interesting part. The work of a supervisor in a purchase department is also simplified because of the fact that he only needs to control the purchase agent’s decision against the criterion of cost minimization. This leads to a simplified control and evaluation process for the supervisor and he will not need to go through every step of the employees work, thus spending less time and costs on administrating control (Ouchi 1979).

The mechanism opposite to market is called bureaucratic and fits according to the author Ouchi (1979), well in a warehouse with a lot of employees where the work process is full of
routines. The supervisor in the bureaucratic mechanism has to use monitoring and surveillance in order to control and evaluate the employees. Because of this it takes a lot more time to control than the market mechanism and the supervisor has to create an atmosphere where the employees feel comfortable with the monitoring and surveillance. The market mechanism is far more efficient in terms of administrative overhead costs, but it is rare that only prices can determine if a person performs a good job. Consequently, in these situations the bureaucratic mechanism is to prefer.

The third mechanism is called clan and can be described as a middle form of bureaucratic and market. Control and evaluation are not performed as with bureaucratic by strict surveillance and are neither done as easily as market. In the case of a warehouse the supervisor not only has pickers to control and evaluate but also the foreman. The tasks of the foreman are by definition harder to evaluate and analyze if it was a good performance, thus bureaucratic can be hard to perform. The supervisor then has the option to select his own foreman that show spirit and commitment for the organization’s objectives. This would lead to that the supervisor can trust that the foreman is trying his hardest to achieve the right objectives, and a lot of costly and time consuming auditing and surveillance can be eliminated. An important aspect of this mechanism is that it has been preceded by a period of socialization, where not only skilled training has been performed but also training in the common values. An example of where clan mechanism is usual is in a hospital where nurses go in school together, and when they depart to different organization, they will keep the values they have been taught (Ouchi 1979).

3.5.2 Result control

Organizations should offer the rewards to their employees that instill the most motivation, are viewed as most fair, and can be provided as cost efficiently as possible. The compensation to the employees is based on what is reasonable according to both the employer and the employees. The purpose of result control is to steer the workers in the direction of the organizational strategy and achieve good results (Nisar, 2006). Paying employees according to how they work and perform is a typical example of result control, since it involves rewarding employees when good results are achieved (Merchant & Stede, 2007).

Four different parts make up the basis for result control; (1) defining dimensions, (2) measuring performance, (3) deciding performance targets, and (4) developing rewards that promote behavior in line with wanted results (Merchant & Stede, 2007). These parts will be discussed in depth below.

Defining dimensions means that one has to decide what kind of performance and which tasks to measure. This is extremely important since employees tend to improve in processes being measured, irrespective of if the dimensions are correctly defined or not. If the dimensions aren’t correctly defined, that is, they do not in line with the organization’s goal and strategies, the result control will reward employees for doing the wrong tasks (Merchant & Stede, 2007).

The second part involves to measure performance, which can later constitute the foundation for a reward system. In this context, financial measures like net income, profit per share, profitability etc. are primarily used in the top part of organizations. There are also non financial measures, like market share, quality and customer satisfaction, that on the contrary primarily are used further down in the organization hierarchy. A third classification of measures can be described as subjective measures with subjective assessments, and
an example of this can be the tendency of an employee to be team oriented. If many performance measures have been identified as important to an employee or group of employees, some kind of balancing must be performed in order to aggregate the measures to one, useful, performance measure. This weighting can be a simple addition, in which for example the aggregated measure is 40% dependent on an increase in sales, and 60% dependent on return on capital employed. Though multiplication, other factors can be put into the equation as well. At the company Browning-Ferris Industries, the return on capital employed is multiplied with a figure dependent on environmental responsibility. If the environment variable is less than 70%, the multiple is automatically set to 0, and no bonus is payed out at all (Merchant & Stede, 2007).

Defining performance goals is another important element within result control. Performance goals steer behavior in two different ways. The first is to stimulate action (increase motivation) by offering goals for the employees. Most people also need very basic, down-to-earth goals in order to get better motivated. Vague goals such as ”do the best you can” or ”work at an acceptable pace” mostly don't raise motivation at all. The other way is by introducing a tool for employees to monitor their own performances. People don't respond to feedback if they don't understand it, and comparing individual performance to company performance is one way of making this easier to understand (Merchant & Stede, 2007).

The final part is to define what rewards the employees will receive for a certain performance. This reward can be anything that the employee’s attaches value to, like financial rewards, additional task flexibility, possibilities, status etc. By linking rewards to aspects that employees can influence and control, the organization will increase the efforts and motivation of its employees (Merchant & Stede, 2007).

### 3.5.3 Determining characteristics

With the knowledge of market, bureaucratic and clan mechanisms, Ouchi (1979) design tables in order to see the type of control, what social requirements and information the organization required, as well as form of commitment and how people were treated (see table 3.2).
The table 3.2 tells us that it exists a controlling mode that heavily depends upon monitoring, evaluating and correcting work patterns, which will likely lead to unenthusiastic compliant employees (Bureaucracy). This will by itself lead to the need of more supervision and thus higher controlling costs. Furthermore, measuring control is not possible to do without affecting the employees and in general the more noticeable and precise measurement, the more noxious it will be for the employees and consequently cost of administrating the control system will rise. Another controlling mode is to choose people when hiring that perfectly fit the organization’s values and needs. Furthermore, the essence of both market and bureaucratic forms of control is that performance has to be measured with reasonable precision. The two forms of performance that can be measured are behavior and output, and they are essential for the market and bureaucratic mechanisms (Ouchi 1979).

Merchant and Stede (2007) have the step called deciding dimensions in their model, which corresponds to this. However, they put more emphasis to what tasks to measure than which measure to use. It requires a little more work on the company’s side, but will lead to higher accuracy in improvements and control. The approach that best fits the situation vary between organizations, units and departments and are dependent on cost of search and acquisition, access to needed skills, cost of skill and value training and cost of developing and running a supervisory system in order to monitor, evaluate, and correct behavior (Ouchi, 1979).

To give some examples of what organizations that are affected by which cost, and if behavior or output measurements are preferred, Ouchi (1979) designed a table that have the parameters Ability to Measure Output and Knowledge of The Transformation Process. This is presented by table 3.3 and is explained below.

<table>
<thead>
<tr>
<th>Controlling Type</th>
<th>Social requirements</th>
<th>Informational requirements</th>
<th>Form of Commitment</th>
<th>People Treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market</td>
<td>Norm of Reciprocity</td>
<td>Prices</td>
<td>Internalization</td>
<td>Totally Unselective; take anyone, no further treatment</td>
</tr>
<tr>
<td>Bureaucracy</td>
<td>Norm of Reciprocity</td>
<td>Rules</td>
<td>Compliance</td>
<td>Monitoring behavior/ output</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Skill/ Value Training</td>
</tr>
<tr>
<td>clan</td>
<td>Norm of Reciprocity</td>
<td>Traditions</td>
<td>Identification</td>
<td>Selection/ Screening</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Internalization</td>
<td>Skill/ Value Training</td>
</tr>
</tbody>
</table>

Table 3.2 (source Ouchi, 1979, pp. 838)
In the case where Knowledge of the transformation Process is perfect and the Ability to Measure Outputs is low, Ouchi (1979) argues that a factory producing Tin Cans would be a good example. Here, a supervisor can look at how the employee performs his/her tasks and observe the machine in order to know that the products are coming out fine. The opposite of the Tin Can plant is a Women’s Boutique where the important is not how the cloth was sold but that they were. A case where behavior and output measurement can be used is Knowledge of the transformation Process is perfect and Ability to Measure Outputs is high is a space shuttle program, where personnel can either monitor every tiny aspect of the program or only if the shuttle succeeds in coming back again with everyone surviving. If both Knowledge of the transformation Process is imperfect and Ability to Measure Outputs is low none of the behavioral or the output measurement can be effectively used. What happens in these situations is that organizations rely heavily on ritualized, ceremonial form of control, what we earlier have called the clan mechanism. Examples of clan control can be a Research laboratory, Schools, Universities, Hospital etc. The organizations that evaluate people for their values and motivations can tolerate wide differences in performance and that encourages experimentation and variety which usually is demanded in organizations with clan control. Moreover, if the situation is ambiguous or uncertain, measuring performance is not possible in an exact manner. If measurement is performed during these situations, it will lead to that the organization reward contra productive behavior (Ouchi 1979).

To make measures more reliable, several aspects can be measured and then aggregated to a single value. By having such a structure, subjective measures used on low levels in the organizational hierarchy (like in a hospital, women’s boutique etc) can translate into financial measures on a higher level (Merchant & Stede, 2007).

Many stable organizations in the field of manufacturing can both use behavior and output control, and thus choose either market or bureaucratic mechanisms for control. If the organization works in the public sector, in service industries, or with fast-growing technology, behavior and output control may not fit and clan could be a better choice (Ouchi 1979).
3.5.4 Salaries and control

Some general rules of successful control seem to exist. One frequently mentioned (Nilsson and Ryman, 2005; Risher, 2002; Nisar, 2006) is that a salary has to be perceived as fair by the employee in order to create positive motivation. Individual salaries have a tendency to increase productivity (Piekkola, 2005), and the benefits seem to be largest for big companies since social spirit is more important than competition in small (Agell, 2003). Most of the control mechanisms defined by Ouchi (1979) require some kind of measurements to be made, and the result control theory developed by Merchant and Stede (2007) is dependent on measurements. In certain cases, such as when one manager has a large number of employee's to control, measurements might be more complex and resource demanding than the actual production increase is worth (Halachmi, 2005). In such cases, Ouchi's (1979) “clan control” is an option, and just using simple monthly salaries.

If salaries are to work as means of control, clear and easily understandable goals have to be in place. A thorough analysis of how the company want to use the salary system and what it’s characteristics are is necessary (Merchant & Stede, 2007). Different companies have different prerequisites, thus no standardized salary system will be as efficient as developing a tailored one (Risher, 2002).

Gibbs et al. (2004) argue that subjective measures can remedy shortcomings in measurements and account for unpredicted events during the process. Workers might be punished when they perform worse due to bad luck, and rewarded when they are lucky. To prevent this, the connection between performance measurement and assessments shouldn’t be too strong, and critical review is necessary (Merchant and Stede, 2007).

3.5.5 Other means of control

There are a large number of tools and methods used to control performance. The area includes tools such as the balanced scorecard (Kaplan and Norton, 1996), financial reporting, data analysis, organizational intelligence, performance rewards, competence development, incentive control, and many more (Stiffler, 2006). However, not a single one of the tools mentioned will provide a systematic, integrated solution to the problem of controlling performance. Every part is just like a piece in a puzzle, which controls and improves a very specific part of the organization. In order to achieve a general improvement in the entire organization, several methods should be considered simultaneously (Stiffler, 2006).

3.6 Summary of theory

Individual salaries are widely used in most sectors, but have received the highest popularity in knowledge-intensive service oriented fields. This is also where subjective measurements are most popular.

Subjective measures are usually described as focusing on how something is done, while objective measures focus what is done. There are, however, no clear and commonly agreed upon definitions of what the different classifications mean. In reality, most measurements consist of a mix of subjective and objective criteria.

If individual salaries are to work well, requirements regarding leadership, communication and openness have to be met. From the companies point of view, advantages such as high-
er profitability and an ability to attract higher quality workers can be achieved. However, some negative side effects such as workers prioritizing their tasks in a bad way or exerting too much effort exist as well.

Both subjective and objective measurements bring new costs to the company. In certain cases, monitoring costs may exceed the potential benefits of measurements. When problems occur, attention may be directed toward the measures instead of the real problem.

Objective measurements are usually motivated by the tendency to decrease disputes and conflicts, provide easily understandable measures, and increase productivity. Subjective measurements on the other hand, have advantages such as minimizing the effects of unforeseen production disturbances, taking long term goals into consideration and providing more freedom to managers when they decide how to work.

For a performance evaluation system to work, it has to be accepted by those it affects. To become accepted, salary fairness is one of the most important aspects to take into consideration. It isn’t always what the company management or the general public perceive as fair, which will be accepted. Instead, it is the workers own, perceived salary fairness that is important.

The last chapter of the theoretical framework stressed the importance of considering the organization’s characteristics when designing a control system in order to evaluate performance. Small companies don’t benefit as much from performance assessments as large do. It also described different theories in how the evaluation could be done in form of subjective, objective, behavior, output or value (clan) control and evaluation of performance.
4 Empirical findings

This chapter consists of interviews performed at Isaberg Rapid AB, Parker Hannifin AB, Finnveden Powertrain AB and Trelleborg Forsbeda AB. All interviews were done with people middle manager positions, knowledgeable in the companies’ respective salary systems.

4.1 Isaberg Rapid

4.1.1 Company introduction

Isaberg Rapid AB manufactures, develops and markets staplers, pliers, hole punches and other similar tools. A factory in Germany that manufactured such products was bombed in 1942, and this was the starting point of the factory in Hestra. The Hestra factory started production of its first pliers; Rapid 1, already in 1943. From there on, the products have grown in numbers, but the Rapid 1 is still manufactured and sold in large quantities (900 000 yearly). There are subsidiaries in Denmark, Great Britain, the Netherlands, Germany, France, Spain, Italy and China. Branch factories exist in France and China. The main factory and office lie in Hestra, 65 kilometers south-west of Jönköping in Sweden. In 2007, the turnover was close to one billion sek, and the company group had around 1100 employees (Isaberg-rapid.se, 2008).

4.1.2 Interview

The middle manager has a large organization to administrate. The primary tasks in his/her work is to conduct talks with union representatives and managers, and monitor payrolls. He/she has a background on the production floor, but now have primarily administrative tasks (Informant 1, personal communication, 2007-10-31).

Several revisions of the salary system are made each year. Discussions are held between managers, employees and union representatives. It is important that all parties get involved in the process. A monthly salary constitutes the basis of the salary system, and it is based on several salary levels. Usually there are 4 levels, but more exist for certain groups in the company. It is the managers, together with controllers, who decide the definitions of each salary level. Every group that has 4 levels in their basic system has the same levels of pay for each level (Informant 1, personal communication, 2007-10-31).

On top of the basic system there is a bonus system, which is based on delivery accuracy, quality and efficiency. The bonus system works on a group level, to strengthen solidarity and increase motivation to help each other (Informant 1, personal communication, 2007-10-31).

- Delivery accuracy is inspected every week. Judgments are passed as a simple "yes/no" criterion, since the goal is to always achieve 100%.
- Quality is checked a few times each month by taking random samples. Also daily inspections are made by controllers. The goal is 100% in this area as well, and a simple "yes/no" criterion is consequently used here too.
- Efficiency is measured by using timing. Each operation has a standard time. The standard time and a so called distribution time constitute the time granted for a specific operation. Every percent of time gained from the granted time will give every worker in the group 40 öre in bonus. Newly employed in the group may lead...
Some groups have managed to gain more than others in bonus. Because of this, a special bonus (200 kr) has been introduced to those who change group to a group with lower bonus. This will spread the competences between the groups and departments. The bonus system constitutes a fairly small part of the total salary. The motivational effect seems to be present anyhow, and they constantly strive to achieve the maximum bonus. Each year the standard times are lowered in order to avoid the case where everyone receive maximum bonus. In 11 years, the times have been reduced by approximately 15% (Informant 1, personal communication, 2007-10-31).

For the salary system to work, the definitions have to be maintained. At revisions, standard times shouldn't be the only factor to look at. Usually, the times have to be lowered by another percent or so in order to account for generic improvements. The salary system can also be used to guide behaviors. Bonus payments have been made for completed courses and education, and to workers that have been employed for a long time (to increase personnel retention). Individual rewards for higher education and previous knowledge might be a good thing, but one should always try to avoid disputes in the group (Informant 1, personal communication, 2007-10-31).

One potential improvement of the current system could be to introduce special rewards, paid out for primarily doing the work one is trained to do. As an example, machine engineers should have a basic salary level for doing the tasks they are trained to do, in order to make them spend as much time as possible on those specific tasks. Remaining time can be filled by less qualified work. When changes are carried out in the salary system, the responsible should always have the question “how do you want to work?” in the back of their heads. Otherwise, adjustments might be made that aren’t thought through properly, just to increase salaries a little (Informant 1, personal communication, 2007-10-31).

### 4.2 Parker Hannifin

#### 4.2.1 Company introduction

Parker Hannifin is one of the largest companies in the world in the field of motion and control systems. The branch in Sweden has been running for almost 40 years, and provides products and services foremost to its Swedish customers. A wide range of areas is covered within the company’s field of business; fluid and gas control, filtering, climate control, flight industry, sealing, shielding and more (Parker.com, 2008).

#### 4.2.2 Interview

The middle manager is primarily responsible for making the salary system work technically. He/she inputs data into the computer system deciding salaries and bonuses. The influence over the key measures and the design of the system seemed to be low (Informant 2, personal communication, 2008-01-24).

The IT system used to manage salaries is called AGDA and is in addition to salaries also responsible for employee management; time, travel, pay etc. The evaluation system of employees is based on a stair system, with steps or levels that have definitions of position, flexibility; how many tasks the employee can do, education and the time the employee has
been employed. In addition to this, Parker Hannifin finds it important that the flexibility, education and experience are relevant for the work the employee has been set to do. Follow-up of the development and salaries is made through yearly conversations between managers and employees. These conversations don't provide any opportunity for the personnel to negotiate higher salaries, since all salaries are performance based and the assessments are strictly objective (Informant 2, personal communication, 2008-01-24).

Apart from the stairways system, the company also has a bonus system. The bonuses are paid out collectively, and they are based on the results of the division. The system used to calculate the bonus is called RONA. It comes directly from Parker Hannifins department in the USA, and is used directly on the financial result of the division. If a division performs well, it may receive a financial reward. The money is transferred to a bank account belonging to the division, and it can be used to finance collective entertainment (Informant 2, personal communication, 2008-01-24).

### 4.3 Finnveden Powertrain

#### 4.3.1 Company introduction

The company is a supplier to the car industry, is owned by an Italian company, and has production facilities in England, Poland, China, Germany, and Swedish cities Trollhättan, Alvesta, Torpsbruk and Moheda. It has 850 employees and a turnover of approximately 1.3 billion kronor. The factory in Moheda is based on line production and foremost lathe operation. The company produces only what is ordered by customers, and thereby has no own, real, products (Finnveden.com, 2008).

#### 4.3.2 Interview

The middle manager doesn't primarily work with setting salaries, but rather decide on criteria and support other middle managers. Some important tasks include participating in talks with company management at different sites, and attend meetings with management. Since many salary administrators exist in the organization, informing and providing support is important (Informant 3, personal communication, 2008-01-31).

The salary system is different in Sweden compared to England. Trollhättan introduced the same system as Moheda has in 2006, since Volvo previously owned the Trollhättan factory and had their own salary system. Because of the Volvo's earlier presence in Trollhättan, Finnvedens salary system has met resistance there. The salary system used for the blue collar workers in Moheda is very similar to the salary systems commonly used for white-collar workers, since the assessment of the individuals’ performances and salary levels are done by the middle managers. In addition to the assessments, each individual has a situation or position in the organization. On the production side of the organization, there are three different situations; operator, machine operator and machine technician. These positions define steps in a stairway describing different salary levels. Apart from the stairway, the salary is decided by a library of competences, where the individuals’ competences are matched against what is needed in the company. To understand what competences are lacking and needed in the organization, a so called GAP-analysis is carried out. The rarer a competence is the higher salary it will bring to those who have it. To actually get a higher salary, the employees also have to do the tasks they know; knowledge alone isn't enough to motivate a raise. The middle managers have to constantly question if they have the right personnel and
right competences to produce efficiently (Informant 3, personal communication, 2008-01-31).

In other words, the middle manager has the position of the employee and the library of competences as support when he/she decides the salary for the individual. The first step in the process is to perform individual performance management discussions with each employee, where he/she should discuss the development of the individual. What does he or she want to do in the future, and is he or she fit to do the tasks he or she does today? In the conversation, questions on salary and such aren’t discussed at all. Such questions are left for the salary discussions (Informant 3, personal communication, 2008-01-31).

The salary discussions are the follow-up of the preceding individual performance management talks. It is important that these two kinds of discussions are kept separate, and consequently some time should pass in between the talks. The reason for this is that the personal development discussions should be about how to develop, not about how to get a higher salary (even if that often is the consequence). Between these parts in the salary process, the salary revisions should take place. In the revision, the middle managers evaluate the performances of their subordinate with support of a condition matrix, and then defend his/her decisions in front of a committee. The committee consists of the senior factory manager, the senior work manager, the middle manager and the salary responsible (the interviewee), and it is supposed to monitor salary statistics, both internal and external, and see how the division is doing in comparison. Additionally, they should work with union representatives to monitor individual dissatisfaction and why certain people have received more money than others (Informant 3, personal communication, 2008-01-31).

The assessment matrix used to evaluate employee performance, is a very central tool in the process. The matrix consists of five different criteria; performance, responsibility, initiative, flexibility and cooperation. These five criteria are evaluated and marked with not satisfying, less than expected, as expected, more than expected or much more than expected for every subordinate by the middle manager. As mentioned above, internal and external salary statistics is used by the committee. This information is also available to the union representatives, and thereby indirectly to the workers. The statistics also shows how large amounts of money each middle manager gets to spend on higher salaries to their subordinates every year. Important issues to attend to during revisions of the system are if any positions or competences should be rewarded, and if differences between for example men and women exist that are not fair. The revisions should also educate the middle managers in how to handle salaries and the discussions around (Informant 3, personal communication, 2008-01-31).

The middle managers judge their subordinates performance through observation, and have to take own responsibility for collecting sufficient information about each individual. Communication regarding the performance of the employees, and what they are required to do in order to develop and get a higher salary, is done entirely by the middle managers and it is up to them to take responsibility for doing this. Weekly meetings for instance, are good opportunities for middle managers to communicate positive and negative aspects of the group’s performance. Individual performance measurements are not done in the company, since the production is designed the way it is. Consequently, performance measurements are only done on group levels, and only to a small extent (amount of produced goods is measured) (Informant 3, personal communication, 2008-01-31).

One of the most important aspects in the system is that the middle managers are committed and engaged in their work, and thereby continuously monitor and document the per-
formance of their subordinates. The system must be kept up to date, and much work is needed from the middle managers. Problems will always arise when there are differences in salaries that can’t be properly explained. The system functions very well as long as the middle managers keep a holistic view of the group members and manages to conduct discussions. The discussions must be frequent and shed light on not only if the performance in certain tasks is high or low but also why it is so. The complexity of the salary system is often thought of as a problem, since much money and time is spent to administer it. Position criterions need to be updated continuously, and communication within the committee, between the workers, middle managers and senior managers has to work. The system sure is resource demanding, but it has its advantages in that it is flexible in a world that is constantly changing. Sometimes differences can be observed between middle managers and their judgments of employee performance. This is of course problematic, because it starts conflicts. Differences in salaries that are hard to explain sometimes have to be resolved on a higher level, by the salary system committee for instance. Further, it is important to remember that the amount the salaries can be raised with is decided on a group level. Individuals from different groups are thereby hard to compare, salary-wise. However, generally the differences within groups more often are debated than differences between groups (Informant 3, personal communication, 2008-01-31).

The middle managers have to be competent. The groups can consist of somewhere between 5 to 30 workers, but 10 to 15 is the most common. Since the assessments done by the middle managers are performed solely by observation, they will have to try to spend time with everyone in their group. This can sometimes be hard, because the work is split into shifts, both daily and nightly. Sometimes individuals are attempting to get a free ride by only exerting effort when their manager is looking. These cases will eventually be discovered, when other workers explain what is going on to the manager. The tasks of the middle managers should in an optimal case only be about managing personnel. The right worker has to be in the right place at the right time (Informant 3, personal communication, 2008-01-31).

The future salary system at Finnveden Powertrain will probably be different in many ways from that of today. For example, the new owner of the company wants to introduce result oriented pay, where the result of the business is partially shared with the employees. The changes needed for this are currently discussed in the company. Another example of changes might be that social benefits are introduced to employees, like dental insurance, instead of just raising the salaries. This would lead to more cost efficient pay and positive effects among the employees (Informant 3, personal communication, 2008-01-31).

4.4 Trelleborg Forsheda AB

4.4.1 Company introduction

Trelleborg AB manufactures and develops damping solutions, seals and other protection products aimed at demanding industrial usage. The Trelleborg group has annual sales of about 31 billion SEK, and has around 25 000 employees in 40 countries. It was founded over 100 years ago, in 1905. The products are primarily based on polymer technology, and are developed to fit each customer’s needs (Trelleborg.com, 2008).

The factory in Forsheda was founded in 1946, and has developed and manufactured products using polymer technology since the start. In October 2003, the factory was acquired by
the Trelleborg group, and became a unit within the business area “Engineering systems”. The factory has around 30 employee's, and manufactures seals and damping solutions for the car and air industries and for industrial use. One of the most produced types of products are the different so called “O-rings”, which are round seals in polymer materials used in pipes (Trelleborg.com, 2008).

4.4.2 Interview 1

The middle manager handles scheduling and production planning. He/she also has some influence over the design and implementation of the salary system and important criteria (Informant 4, personal communication, 2007-09-06).

Trelleborg Forsheda AB has a salary system that consists of a basic pay and a frozen bonus pay system. The basic pay system is consists of evaluation of qualifications, and a stairway system. One of the major disadvantages with the system today, is that it contains a lot of subjective criterions. This has the effect that it is very complicated for middle managers to decide salaries, and the salaries are often thought of as unfair. Blue collar workers have a bonus of between 0 and 800 sek (Informant 4, personal communication, 2007-09-06).

The bonus system was, from the start, meant to increase productivity, quality and delivery. Since the maintenance of the system was bad, the bonuses bolted to high levels. In other words, too many workers reached the maximum bonus pay, and the system consequently stopped working as a motivation increasing factor. Another problem was that productivity, quality and delivery often was prioritized differently, depending on what was the most profitable to prioritize. The goal was actually to have an even level of engagement in all fields (Informant 4, personal communication, 2007-09-06).

4.4.3 Interview 2

The middle manager (human resources manager) is responsible for acquiring new employees and managing primarily white-collar workers. Daily tasks include managing valuable contacts and building relationships (Informant 5, personal communication, 2007-10-10).

The goal of the organization should be the main concern when developing a new salary system. For example, salaries shouldn't be based on history; it should be a reward for what is performed today. That is, an upper secondary school education shouldn't be rewarded by default. The main problem today is the lack of a clear salary policy and goal of the salary system (Informant 5, personal communication, 2007-10-10).

The salary system should primarily work as a mean of control and should be designed by the management. Subjective criteria are good, if the middle managers and the organization have matured enough to handle it. Objective criteria, as for example boxes in a staircase, are old fashioned and will have the tendency that the majority of all salaries in time gets to the upper end of the salary interval because of salary inflation. A system consisting of boxes filled with objective criteria is no good alternative at Trelleborg Forsheda AB (Informant 5, personal communication, 2007-10-10).

One should have individual salaries based on subjective assessments in the production side, just like among the white-collar employees. The middle managers then do individual assessments and conduct individual performance management discussions for example in the autumn, and then conduct individual salary discussions in the spring. The system has to be easily understandable to anyone; otherwise it may lead to suspiciousness. The middle man-
agers have to be mature enough, to do individual subjective assessments, in an objective way. That is, no discrimination should occur. Salary discussions should work as a red thread in the process (Informant 5, personal communication, 2007-10-10).

Another problem in the organization of today is the decentralization of everything. Every department functions as a small company, and a forum for cooperative efforts, such as higher management, is lacking. Because of this, no shared and clear salary policy exists. Generally, middle managers have too many subordinates, which in turn make individual assessments hard to handle. The salary system should be a uniting force for the organization. Changing the organization first would be a step in the right direction (Informant 5, personal communication, 2007-10-10).

4.4.4 Interview 3

The middle manager (production supervisor) works close to the blue-collar workers, and is responsible for getting the right people in place in the right time. He/she is also responsible for communicating and discussing salaries with the employees below (Informant 6, personal communication, 2007-10-17).

Every salary system has problems that are discovered sooner or later, and are exploited by workers. Therefore, the system has to be redesigned to a large extent once every three years or so, and be maintained in between. When salaries are to be decided, two union representatives make a qualification assessment together with a production manager. The qualification assessment doesn't last long, but is problematic since it only shows what the person has done, and not what he/she is capable of today. Furthermore, most of the workers succeed in getting higher and higher rankings quickly (Informant 6, personal communication, 2007-10-17).

The bonus system had problems with all exceptions built in due to conflicts. Exceptions could be caused by circumstances such as workers not wanting to get a lower bonus, if for example a machine stopped working. Individual performance management discussions are held each year, and take an enormous amount of time. Daily communication should be enough if a good salary system is used (Informant 6, personal communication, 2007-10-17).

4.4.5 Interview 4

The middle manager is responsible for conducting salary talks with employees and managers (Informant 7, personal communication, 2007-10-31).

Salaries are decided once a year. Shift leaders and salary responsibles do the work. The hardest problem is that everybody reaches the highest salary possible sooner or later, and when that happens, no further development opportunities exist. A bonus system should be based on productivity, cassation and development. It should be hands-on, that is, if a worker performs a task today, he/she should easily be able to see what consequence it will have, salary wise. Bonus systems can be a good thing, but they mustn't control the work in detail. Instead, the holistic view is important. Individual assessments might be problematic in various ways as well, an group based systems avoid this. Generally speaking, the basic salary system shouldn't control much, while the bonus system should control work and help prioritize certain processes (Informant 7, personal communication, 2007-10-31).
5 Analysis

This chapter has three major parts, all using data gathered from interviews and theory. The first and second deal with views and theory concerning objective and subjective assessments, and the problems and benefits of using such approaches. The third part analyzes the connections between measurements and certain organizational characteristics.

5.1 Objective assessments

Objective performance assessment is based on numerical calculation of measures, which will form the basis for rewarding employees using a salary system that reward performance (Merchant & Stede, 2007). The companies in this investigation that used objective performance assessment all had different experiences using it. Trelleborg Forsheda had difficulties in getting objective performance assessment to work, while Isaberg Rapid as well as Parker Hannifin that based their performance assessments on objectivity were pleased with it.

Isaberg Rapid argued, in line with Prendergast's and Topel's (1996) view, that objective performance assessment doesn't provide any opportunities to throw the blame on something else. Such assessments are not based on any subjective parameters but only on measurable results that can be derived from processes related to the work (Prendergast, 1993). Isaberg Rapid also argues that they should use the salary system in order to keep and retain qualified personnel and make it as simple and fair as possible. The arguments by Isaberg Rapid are also valid in light of Noréns (1998) thoughts that companies should design their salary process so that it is easily understood by everyone, attract new and qualified personnel, help the company to retain the old, competent workers and increase motivation to exert effort in daily work.

This was also one of the reasons Isaberg Rapid was working like they did, and it was the main argument among personnel connected to the production department in Trelleborg Forsheda why they wanted to revise and improve the objective performance assessment system. The reason to why personnel linked to production are more fond of objective performance assessment can be explained with that the responsibility of achieving the results are among the personnel and cannot be excused. The middle managers at the production line, working close to the personnel who are affected by the performance assessment do not want to end up in conflicts, and they don’t want to be forced to explain their decisions when personnel argues they are wrong.

Isaberg Rapid argues that when the employees see that good performance is rewarded they change their behavior and try their best, even if it is a little harder compared to only doing what they absolutely have to do. These rewards do not need to be great either, but have to promote good characteristics and action from the employee. The author Lazear (2000) also argues that rewarding hard work gives a better result. He investigated this, and as mentioned earlier in the theoretical framework, proved that a change from time based pay to piece rates had a significant effect on average productivity per worker, with a close to 44% large improvement. The reason to why the productivity goes up is due to the motivation enhancing effects. Another aspect argued by Lazear (2000) is that the most productive employees tended to stay with their employer to a larger extent. This is an important issue also for Isaberg Rapid that says that it's really important today to keep the employees and see
them as resources. The workers that are the most valuable to the firm is also easily noticed by objective performance assessment where a piece rate system is used (Lazear 2000).

However, there also exist disadvantages with objective performance assessment. The literature argues that it should not be used where production monitoring costs are high, or product quality is more important than production speed. The arguments against objective performance assessment both at Finnveden and Trelleborg Forsheda were mainly these issues, but also flexibility in how to do things. Having objective performance assessment can also be very complex and choosing the right measurements can be difficult. Research indicates that if too many measures are chosen, or simply the wrong measures, the result may be contra productive (Simons, 2000). Another risk with this kind of performance assessment is when problems occur, attention is drawn to the measurements instead of how to solve the real problem (Halachmi, 2005).

### 5.2 Subjective assessments

Both subjective and objective assessments seem to have the problem of results depending on circumstances that can’t be affected by the workers. Merchant and Stede (2007) uphold that this can be accounted for, if subjective assessments are used. However, this will be costly in terms of time for the middlemanagers. They will then have to look for and find legitimate reasons for the performance being better or worse than expected, and explain those reasons to the workers. At Finnveden Powertrain, where subjective measures are used in form of middlemanager observations and judgments, the picture of a time consuming process seems to be true. The interviewee maintains that this is acceptable, since the middlemanagers should focus all their time to personnel management.

Subjective assessments have some advantages when the organization prioritizes long term perspectives from managers, human resources, less complex measures and organizational change and development (Nisar, 2006). At Finnveden Powertrain, flexibility and fast adaption to the company's environment are two strong reasons for using subjective assessments. This is essentially the same aspects as organizational change and development. At Trelleborg, one opinion (interview 2, Trelleborg) was that subjective performance assessment was better in presenting the present while objective performance assessment is historical. That opinion does also fit well with what Nisar (2006) argues, and how Finnveden Powertrain explains how they work.

It is also important in a salary system that is based on subjective performance assessment that the system is easily understandable by everyone; otherwise it may lead to suspiciousness (interview 2, Trelleborg). This is usually an argument for an objective system, and an important aspect according to Norén (1998). In order to get an understandable salary system based on subjective performance assessment, the middle managers have to be mature enough, to do individual subjective assessments, in an “objective” way. That is, no discrimination should occur. Salary discussions should work as a red thread in the process (interview 2, Trelleborg).

Prejudice among middle managers will lead to problems with moral and motivation. This is the same as the result of the middle manager breaking an outspoken but not documented promise of reward (Baker et al 1994). The salary responsible at Finnveden upholds that this issue is dealt with by having a high competence level among the middle managers. Another common problem described by Prendergast and Topel (1996), is that subjective perfor-
mance judgments often results in a "throw the blame"-culture within the organization. This is a consequence of the human characteristic to blame bad performance on outside causes, like bad luck and task difficulties, while good performance is related to own effort, knowledge, traits and competences (Prendergast & Topel, 1996). Finnveden doesn't seem to have a plan to deal with such issues, instead they rely on openness of the workers and that the truth will eventually surface.

5.3 Performance assessment and organization characteristics

The two different ways of doing performance assessment fit differently well in different organizations and with different processes. This is argued both by Ouchi (1979) and Merchant & Stede (2007), and they give indications on how to develop the functions of control and performance assessment. It can also be argued that while having a fully subjective assessment system is possible, the objective counterpart isn't really achievable. There will always be parts of the performance assessment chain, which are subjective. One example can be the process of determining what a certain performance should give as reward.

The four companies don't fully comply with the definitions of the criteria specified in figure 3.1. Just like the figure indicates, the criteria “performance” and “work demands” are close to being subjective and objective respectively. This makes those criteria hard to make totally objective or the opposite, since they tend to lie somewhere in between. The consequence is companies like Isaberg Rapid having to take large measures to eliminate subjectivity in their performance measures (interview, Isaberg Rapid).

It is important that both managers and employees agrees on that the system serves it’s purpose, and just like every single company has different demands, the salary system should look different, depending on the circumstances (Risher, 2002). In order to determine bonuses or salaries three different mechanisms described by Ouchi (1979) can be used by the organization. These mechanisms are markets, bureaucracies and clans. The task of a worker that has its main goal to produce quantity is easy to control and do assessment upon, and here the bureaucratic mechanism is clearly to prefer. The tasks of the worker with focus on quality are by definition harder to evaluate and analyze if it was a good performance, thus bureaucratic can be hard to perform (Ouchi, 1979). Therefore it is important to analyze the focus of the tasks and then choose a method to assess the performance, should it be objective or subjective.

The bureaucratic mechanisms seem to have been the most important in departments related to production, and it can also be related to objective performance assessment which in turn leads to that objective performance assessment have been historically the most used one in producing departments. This has changed slightly as we can see in Finnveden Powertrains arguments of why they use subjective performance assessment, and in what Nilsson and Ryman (2005) write on the development of salary systems in Sweden. Finnveden Powertrain has a similar organization as Trelleborg Forsheda, Isaberg and Parker Hannifin, but they have chosen to develop a different salary system. This can be due to differences in focus among the middle managers in the companies. While Finnveden Powertrain focuses on how the workers perform their tasks- which is related to the process – and the quality of the products, the other companies concentrate on that the salaries are fair and that the workers are efficient. This has been seen in the interviews that were performed in the companies. An example of this is that Isaberg Rapid who use objective performance assessment stresses that it is very important that all parties get involved in the process, while
Finnveden allows their middle managers to determine most of how their processes should look like.

One could say that Finnveden Powertrain has gone from using bureaucratic mechanisms to clan mechanisms if using the definitions by Ouchi (1979). Thus, they have gone from using objective performance assessment to subjective performance assessment. The reason for this can be as mentioned before that they want to put their focus on processes of the employees and the quality of the products.

5.4 The companies and their solutions

Isaberg Rapid who has the most objective system of the participating companies in our view, has done many corrections and updates to their system over the years. New problems seems to occur all the time, so small corrections have to be made. Finnveden Powertrain who has the most subjective system on the other hand have their own share of weaknesses in their system. For instance, feelings of unfairness might exist among the employees which might prevent them from performing at their best, but this is hard to find out.

Still, both Isaberg Rapid's and Finnveden Powertrain's systems seem to have worked better than the system of Trelleborg Forsheda, who had a system which was somewhere in between objective and subjective. Why did the extreme point systems do well but the middle way fail?

Of course the number of investigated companies is too small to draw any conclusions from this, but it may strengthen the importance of having a clear strategy and values when developing a salary system. The basic concepts have to be easy to explain. If one doesn't believe in the system and the strategy it represents, it will not work. Risher (2002) writes that “The focus on staff understanding cannot be overemphasized ... That is a central issue in the psychological contract with employees. Managers play the lead role in managing that contract, but they should not be put in a position where they have trouble understanding or explaining the salary system”.

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6 Discussion

The design of a performance assessment system, and in particular salary systems, should be developed with the company’s strategy and operation in mind. Subjective measures create conditions for long-term planning and individual decision making. On the other hand, objective measures have been thoroughly studied and proven to generally have beneficial effects on results and productivity (Lazear and Rosén, 1981; Lazear, 2000).

However, one should keep in mind that all performance assessments don’t have to be done in the same way in a company. Certain tasks are by nature easier to measure in a subjective manner, and vice versa. Work that requires less individual decision making and have clearly defined tasks favor objective assessment. Examples of such work is within manufacturing departments, transportation and tasks targeted at quantity.

Subjective assessments are on the other hand better suited for work within IT, health and care, education etc., where differentiation of salaries based on objective performance measures is very difficult to achieve. Generally, subjective assessments are efficient to use in complex work where objective measures are either too time consuming or too expensive to perform.

Figure 6.1, Complexity and measures.

Example of how task complexity through resource demands in measurements usually distribute objective and subjective measures. The position/group parameter has a large influence because the performance based part of a salary doesn’t have to be large for the system to have significant effects. The figures are for illustration only and are not based on any quantitative studies.

The trend in the industrialized nations seems to be more and more complex work. However, objective measures are still common, and they definitely have a place in these countries as well. In Sweden, it is only the service oriented fields which have adopted the subjective measurements fully (apart from white collar workers, who have had such criteria for a long
time). Especially in the public sector, subjective measurements are common (Nilsson and Ryman, 2005).

The same criticism concerning time consumption and costs is directed towards both subjective and objective measurements. It is, however, possible to reduce these problems by using criteria which are easy to quantify. An example is measuring product quality by using simple achieved/failed criteria, and only pay bonuses if all criteria are assessed as achieved (interview, Isaberg).

One should remember that differentiated salaries have both positive and negative effects. The positive effects, which are shown in higher productivity and better results, can’t be proven to come from higher motivation depending on increased competition. Perhaps the same effect can be reached by other means (Pfeffer and Sutton, 2000). Furthermore increased spreading of salaries might reduce unity and cooperation within the company. People have a hard time accepting their performance as worse than average (Vest et al. 1994). To not display the rankings is a common way to deal with this problem, but the company has to put effort into making the salaries fair anyways. Fairness problems have a tendency to surface sooner or later if they are not being dealt with (interview, Finnveden).

The differentiation of the salaries doesn’t have to be very large to achieve distinct effects. However, the variable part of the salary should be larger than 3.6% (Piekkola, 2005). To resist negative effects like reduced cooperation and more conflicts within the company, rewards can be collective rather than individual (interview, Isaberg; interview, Parker Hannifin). Criteria have to be revised continuously to prevent exploitation and salaries hitting the roof top. When the maximum salary is reached, the systems effect of getting the employees to try to constantly improve disappears (interview, Isaberg). This seemed to be one of the main obstacles in getting Trelleborg Forsheda's salary system to work satisfactory (interview 1, Trelleborg). One should remember that the salary system is just one of many means of control, but one which often provokes strong feelings and opinions (Risher, 2002).

The main purpose of salary systems seems to be to communicate to workers which tasks are important, not the rewards. Using balanced rewards which are small enough to not provoke too much jealousy from others but still large enough to provide some feelings of importance and reward is very important.

Feelings and conflicts are something middle managers have to deal with frequently. Still, some middle managers uphold that their freedom to choose how they and their subordinates work is more important for both the company and themselves than the support of a rigid, objective salary system (interview 2, Trelleborg; interview, Finnveden).

We believe that the importance of a salary system varies depending on the company's strong and weak sides. Salary systems seems to have strong motivational effects when it comes to parameters such as quantity (Lazear, 2000) and controlling priorities (Simons, 2000), but it seems difficult to make people more team oriented or innovative by using individual performance based pay. Isaberg Rapid even introduced small team bonuses for teams taking in new employees and training them, to prevent disputes over unfair salary levels (interview, Isaberg). Consequently, if a company's success or failure is directly dependent upon the amount of produced units, a performance driven salary system has a clear role to play. In a software manufacturing firm, on the other hand, such a system would be more questionable.

Also, figure 3.1 suggests that different components (formal competence, performance, work demands etc) of a salary are more or less appropriate to measure in a subjective or an
objective way. In reality, the position/group fields in figure 6.1 are often determined by the most objective criterion (formal competence), and is also the largest component of salaries. How a company should design their salary system from our point of view is explored further in the conclusion.
7 Conclusion

Salary systems is an area where much tension and conflicts exist. Opinions vary greatly, and so do the actual salary systems in use. However, even though the systems have large differences, they might work well. This is true as long as the organizational characteristics matches the salary system. Looking at the investigated companies, having a clear strategy and values when developing the salary system seems at least equally important. Trying to find a middle way between subjectivity and objectivity might not always be the most successful route, since it might make the system more complicated.

Middle managers often have to both gather performance related information about their subordinates and set salaries. If objective criteria are used for deciding the salaries, some discussions and tension can be avoided since all workers understand that no personal opinions influenced the decisions in the process. However, objective criteria might be hard to apply in certain situations, such as when measuring quality or innovation. Also, it might hinder long term thinking and decision making since objective criteria tend to focus on short term gains.

Subjective criteria comes with its own set of advantages and problems. The resource demands of objective criteria is often mentioned as a serious problem using subjective criteria as well. A middle manager responsible for a large group of workers will have difficulties gathering data on everyone’s performances.

It is important to remember that salary systems should, if possible, make all groups satisfied: from the machinists to the performance evaluators to the company management. Employers and employees often have different views on how a good salary system looks like. There is a wide agreement that the system should reward good performance, but to what extent and by which criteria is a subject in frequent debate. One could consider the following important aspects as a starting point:

1) What type of tasks should the system assess? If the work demands decision making, responsibility and long term thinking, a larger portion of subjective measures is preferable.

2) Salary fairness is important, and especially perceived fairness. A dissatisfied worker performs worse.

3) Differentiation of salaries will increase productivity and results, but may create internal conflicts. Taking measures to preserve cooperation and friendliness is possible.

4) Assessments are time and resource demanding. Keeping the number of measures low and streamlining the processes will reduce the costs.

5) The guidelines for what to measure play a critical role in where the effects of the system will be largest. The company’s goals and strategy have to be at the core of the system.

The different aspects suggest that the organization’s strategy and characteristics are important when developing a salary system that fits well. The mechanisms of Market, Bureaucratic and Clan which are systems of categorizing the operations, are controlling and evaluating the employees in three different ways.

Small firms surely have less clearly divided roles for their employee's, but since measurements have the largest impact and are most common in large firms, viewing the employee's as either white or blue collar workers serves our purpose. The mechanisms that traditional-
ly are connected to blue collar workers in producing companies are the bureaucratic ones as described by Ouchi (1979), which are used when a lot of employees are involved and the work process is full of routines. The supervisor in the bureaucratic mechanism has to use monitoring and surveillance in order to control and evaluate the employees. This mechanism is, however, difficult to use when the focus is on quality, and some manufacturing companies that have this focus have moved away from bureaucratic and adopted clan or market which traditionally is used in white collar environments. In businesses today, steps are often taken to alleviate the shortcomings of the selected control mechanisms. Quality is used as an important measure in objective assessments, groups are used instead of individuals as measurable units and in subjective assessments the supervisors are encouraged to spend most of their time administrating and monitoring workers to be able to make fair judgments.
8 References

Agell, J., 2003. Why are small firms different? Managers views, research paper nr 2003:9, Nationalekonomiska institutionen, Stockholms universitet


9 Appendix 1 – Questions for interviews

- How is your salary system structured? – components (base/ premium/ bonus)?
- Which are the key criteria in your bonus system? What do you want to reward? Why?
- Who is responsible for doing the assessments (influencing the salaries), and how are they done?
- Can an employee affect his/her salary? How?
- Is it easy for an employee to see the connections between his/her actions and the salary bonus?
- How often are the bonuses paid out?
- How often are the salaries negotiated, and how?
- What does an objective and subjective criterion mean to you?
- What are your thoughts regarding objective and subjective criteria?