



JÖNKÖPING INTERNATIONAL BUSINESS SCHOOL
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Remuneration Programs

- A Principal Agent Theory perspective of CEO Remuneration Programs -

Bachelor Thesis within Finance

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Bonusprogram

- Ett Principal Agent Teori perspektiv på VD Bonusprogram -

Filosofie kandidatuppsats inom Finans

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Bachelor's Thesis in Finance

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Abstract

In the media today, remuneration programs to CEO's are frequently discussed. Media are usually focusing on the large amounts paid out rather than why the companies use the programs. The purpose of this thesis is to examine whether the conflict of interest presented by the Principal Agent Theory is affected by a CEO remuneration program.

To reach the purpose, an inductive method has been used. Questionnaires have been sent out by e-mail and phone interviews have been carried out with two sample groups, one with remuneration programs, and one that do not use remuneration programs.

The main theoretical framework used is Principal Agent Theory. With the help of other supporting and complementing theories the authors have been able to analyze the empirical findings gathered, and come to a conclusion.

The authors were able to come to the conclusion that an effective remuneration program can to some extent steer a CEO's behavior in the short term, and thereby affect the conflict of interest going on between principals and agents according to Principal Agent Theory. At the same time the authors have come to the conclusion that it is more difficult to make any clear connections between remuneration programs and being able to steer CEO's behavior in the long run. However the long run reason for a remuneration program is to create a loyalty between the owners and managers.

It has also been seen that companies without a remuneration plan tend to apply a Stewardship relationship rather than a principal agent relationship, and are thereby managing to decrease the conflict of interest between the two parties.

Kandidatuppsats inom Finans

Titel:	Bonussystem - Ett Principal Agent Teori perspektiv på VD kom- pensationer
Författare:	Erixon, David Folkesson, Emil Hendeby, Elvira
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Sammanfattning

Bonusprogram är ofta diskuterade i media idag. Fokus ligger oftare på storleken på beloppen som betalas ut snarare än varför företagen väljer att använda sig av programmen. Syftet med den här uppsatsen är att undersöka huruvida intressekonflikten presenterad i Principal Agent Teori påverkas av ett bonusprogram till VD.

För att uppnå syftet har en induktiv metod används. Frågeformulär har skickats ut via e-post och telefonintervjuer har genomförts med två olika urvalsgrupper, en där företagen använder sig av bonusprogram till sin VD och en där företagen inte använder sig av bonusprogram till sin VD.

Den huvudsakliga teorin som använts är Principal Agent Teori. Med hjälp av andra stödjande samt kompletterande teorier har författarna kunnat analysera det empiriska materialet som samlats in och på så sätt lyckats komma fram till en slutsats.

Författarna kom fram till slutsatsen att ett effektivt bonusprogram kan till viss del styra en VD:s beteende på kortsikt, och på så sätt påverka den intressekonflikt som pågår mellan principal och agent enligt Principal Agent Teorin. Samtidigt har författarna kommit fram till slutsatsen att det är svårare att se något klart samband mellan bonusprogram och möjligheten att styra en VD:s beteende på långsikt. En annan anledning för att använda ett bonusprogram är att skapa en lojalitet mellan ägare och chefer på långsikt.

Det har även framkommit att företag som inte använder sig av ett bonussystem tenderar att ha en Stewardship relation snarare än en principal agent relation mellan ägaren och VD. På så sätt lyckas dessa företag minska intressekonflikten mellan de två parterna.

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1 Introduction

This chapter serves the purpose of introducing the reader to the thesis, its subject and why it is of importance today. To begin with, a general background is presented to the subject, followed by the problem discussion which takes the reader to the focus area of the thesis and ends up with the purpose of the thesis. Finally the disposition and delimitations of the thesis will be discussed.

1.1 Background

During the last years, several scandals concerning CEO remuneration programs have been brought to the surface, and one is frequently reminded by the media. Today remuneration programs are used in several of the listed companies on the Swedish stock exchange. The picture presented in media is that remuneration programs are unfair and unreasonable and have nothing to do with management performance (Näringsliv24, 2006, August 28). The people carrying on the debate usually have a predetermined opinion about how the wages of the CEO's ought to be constructed. At the same time voices are raised concerning the opinion that the CEO's wages in privately owned companies are increasing too fast and without reasonable motivations (Persson, 1995).

To further complicate the problem it is a fact that almost every citizen in Sweden does hold shares directly or indirectly in Swedish listed companies, since most of the people "own" their shares through investment in funds either for personal savings or through pension funds (7:e AP Fonden, 2006, November 15). This piece of information makes the whole story more interesting since this makes the whole Swedish population become owners of various listed companies.

The Swedish National Television (SVT) decided to alert this through a documentary that was broadcasted in the spring of 2006. The documentary offended lots of people when they highlighted the fact that the CEO's earned huge sums of money, and on top of that some interviewees claimed that these salaries and bonuses rather depended on luck than on their specific manager's skills. Further, SVT high-lighted that, results for many of the listed companies were mainly caused by the whole economy's performance.

One can also read on SvD Brännpunkt that there is little or no correlation between the company result and the bonuses retrieved by the CEO's and those companies without bonuses show stronger result. Further it is stressed that the owners of the companies have become invisible through indirect ownership by the large pension funds (Hässler, 2006, April 2).

The documentary gave the audience a perception that the management where greedy and drained the owners money into their own pockets. The frustration grew and the companies' remuneration programs were exposed, and still are, several times a month in media. One present example is Swedish Match who has suggested an 80 percent increase in remuneration for the board of directors. However, in this case some representatives from the investment funds have raised their voice against the increase. The company's defense is that they compare with foreign compensation levels, and that the increase will attract foreign representatives and knowledge to their board (Ekonominyheter.se, 2006, November 11).

From the perspective SVT present in the documentary, one can say that the remuneration programs rather increase the conflict between agents and principals within the company. This since SVT state that there is a great dissatisfaction among the Swedish population concerning the large remuneration programs. Since it was concluded above that almost all Swedish citizens in one way or another are shareholders in companies on the Swedish stock market, it implies that the remuneration programs rather increase the conflict of interest between agents and principals.

The above discussion illustrates the importance to please the passive owners, referring to the population that has not actively chosen to own shares in a company, of a public company. They have to be pleased by the agents' behavior and performance, how is this attention and diverse opinion tackled by the agents, and do the agent make any decisions in order to please this huge group of people?

The above mentioned discussions make the companies credibility decrease, both towards the customers but also towards other stakeholders. This ongoing discussion makes it a topic of current interest. Hence this thesis will focus on the Principal Agent Theory and remuneration programs as a mechanism to affect the on going conflict between the principal and agent according to the Principal Agent Theory. What is the purpose of remuneration programs for the principal-agent relation in Swedish listed companies? How are they constructed and is there a relationship between company results and remuneration? These are some questions that the authors will aim to investigate and try to answer in this thesis.

1.2 Problem Discussion

Managers of large corporations these days are often involved in remuneration programs that may appear to be too generous and offer the manager a lot of pecuniary benefits. Furthermore managers face pressure from various stakeholders of the company, e.g. shareholders, creditors, regulators, governments (Sunesson, 2006). Do managers produce output equivalent to their remuneration? Is the company's progress completely in the hands of the managers? Do the stakeholders agree with those generous remuneration programs?

These different kinds of stakeholders often have different intentions for the company and often pursue their group specific interests (Jensen & Meckling, 1986). The behavior results in a dispersed management team who cannot credible declare that they work in the interests of all of these stakeholders. This dilemma is known as the Principal Agent Theory (Jensen & Meckling, 1986). The problem is for the stakeholders to make incentives for the manager to act in their specific interest, and that is where the frictions between the managers and owners arise.

The authors have chosen to delimit the stakeholder group and to view this problem from the owners' perspective, i.e. shareholders. Since the measurements for shareholders are quite straight forward, namely, increase the value of their shares. This is true even if the shareholders have long term objectives with their shareholding, according to the Fisher separation theorem (Copeland, Weston & Shastri, 2005). What kind of incentives can the shareholders use? Are they making use of the available methods and do the used methods have any affect on the principle agent phenomenon? How do companies measure management performance?

The problem that arises from the basic Principal Agent Theory is how a company's principals shall give sufficient incentives to ensure that the agents decision maximize the firm value. The authors will examine this through the remuneration program's correspondence

and causation on the stock value, or market value, compared with an annual report analysis and variable wage collected by the agent (Eun & Resnick, 2004).

Based on the problem discussion, the authors have researched the following question;

Does the CEO's compensation and their remuneration programs affect the conflict between principals and agents?

To help the authors in their work, and to help the reader follow the theory, the main question has been taken apart into smaller questions.

When listening to the media, it is easy to get the impression that the only thing that motivates the executives in the company is monetary compensations given to the executives through generous remuneration programs. Is that really the case? Is monetary compensation the only thing that motivates executives to take the right decisions for the company? What is the companies' aim with the remuneration programs and why do they choose to make use of them?

According to the Principal Agent Theory, there is a conflict of interest going on between the principal and the agent. Do remuneration programs affect this conflict? In the same way, does the remuneration program reflect the result generated by the company?

1.3 Purpose

The purpose of this thesis is to examine whether the conflict of interest presented by the Principal Agent Theory is affected by a CEO remuneration program.

To sort out the purpose the authors will examine the interactions between the value of the company for the shareholders, and the compensation that the agent receives. The Principal Agent Theory will explain the main implications and the costs that occur from a principal agent relationship.

1.4 Delimitation

To be able to reach the purpose of the thesis within the limited time provided and to keep the focus of the thesis, some delimitation has to be done. In the paper the authors will assume there is a conflict of interest going on between principals and agents in companies according to Jensen and Meckling (1976). Therefore it will be outside the expectations of this thesis to prove that conflict. The authors will examine the remuneration programs from the shareholder perspective and what incentive they give the managers to act in their interest.

In this particular paper the authors will assume shareholders to be one homogeneous group, whose interest is to maximize their utility, i.e. wealth. In other words, the shareholders are satisfied when the stock price is high and they receive a reasonable dividend, and when the stock price is high the managers have earned their bonus, from the shareholder perspective. This is a short-term perspective and the authors will highlight the implications of the short-term perspective this approach may induce for the shareholders.

To delimit the search for principal agent implications the authors do not assume that there is an optimal remuneration package applicable for every firm, since the manager's decisions also depend upon their attitude to risk, the characteristic of the firm and the information

symmetry within the firm. Nevertheless the firms must strive for a balance between short-term and long-term incentives.

1.5 Definitions

Remuneration Program – a remuneration program is hereby defined as the package containing fixed salary, short term incentive, long term incentive and a pension scheme.

Principal Agent Theory – the background to the Principal Agent Theory is that management (agent), if not owner of the company, and shareholders (principal) have different incentives to run the company. Hence a conflict arises that incurs a cost for the company and suboptimal decisions may be taken. This does not maximize the value of the company.

Performance Valuation – the authors have chosen to evaluate the CEO's performance by analyzing Return On Equity (ROE) in relation to measurable goals and Total Shareholder's Return (TSR), since the authors has decided to limit themselves to evaluate the management performance from a shareholders perspective.

1.6 Disposition

The disposition of this thesis will be as follows:

Ch2 Method - here the authors will discuss the process of how they collected and processed the data. At the same time motivations for the choices made will be presented as well as the pros and cons of the method chosen.

Ch3 Theoretical Framework – is the foundation of the thesis. In this chapter the authors present the theories that will help them reach the purpose of the thesis. These theories will later on be applied to the empirical findings which in the end will result in the analysis and the conclusions.

Ch4 Empirical Findings - the empirical findings is what the authors have gathered from the research of the companies chosen when used the method described. This is a fundamental chapter for the analysis on these companies. This chapter will give the authors the base from where they will build their analysis, and finally reach some conclusions, if any.

Ch5 Analysis - in the analysis part the authors will mix and stir all the knowledge from the theoretical framework and the actual, empirical findings from the research. In this part the authors will, to their best ability, search for any connections between various inputs and to what extent the bonds are verifiable by their intuition.

Ch6 Conclusion - this is the essential part of any academic work. In the conclusion one may either find verification of the theories applied or falsification, here is where the reader will be informed of any new ideas or thoughts from the authors. The ideas and thoughts that may or may not be useful for further studies also is the answer to the “so what” question that a reader may ask in the beginning of a paper. This chapter will also indicate any recommended future research topics suggested by the authors.

Ch7 Discussion – in this chapter the authors will continue the discussion referring to the remuneration programs and the empirical findings. Finally some suggestions for further studies will be presented.

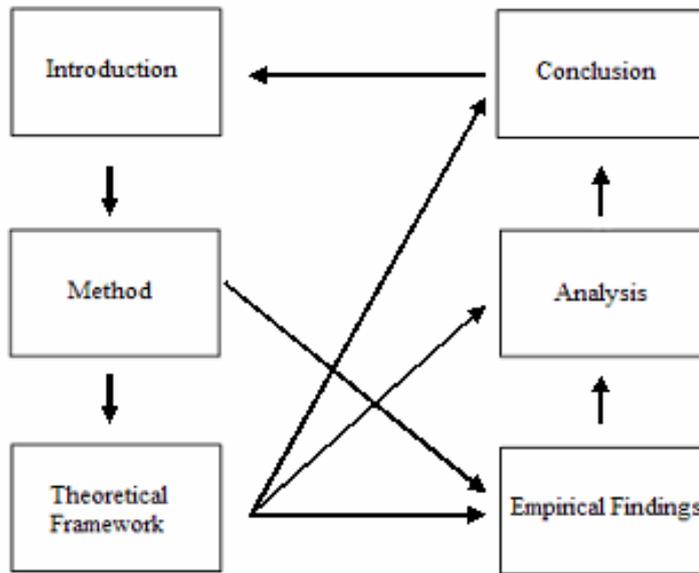


Figure 1-1 Disposition of the thesis

Figure 1-1 show how the sections are linked together and will provide the reader with a better understanding through out the reading and makes it easier following the authors' thoughts and conclusions drawn from the different sections.

2 Method

This chapter will describe the process of how the information of interest were gathered for this thesis.

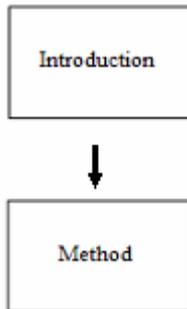


Figure 2-1 Method

2.1 Philosophy of Science

When writing a thesis it is important to consider what philosophy of science to use to support ones work. When talking about philosophy of science, there are usually two distinct approaches mentioned, positivists and hermeneutics. Positivists believe that the knowledge in the world is absolute knowledge and that there are only two ways to gain this knowledge, by observations and logic. Hermeneutics on the other hand believe one can gain knowledge by interpreting situations and thereby create understanding for the situation of interest (Thurén, 1996).

When considering the aim and purpose of this thesis, it becomes clear that the authors will use the hermeneutic philosophy of science to support its work and help them make choices throughout the process. Therefore it is important to be aware of the shortcomings that might come along with that philosophy. A research carried through in a hermeneutic manner is to a large extent based on the author's previous knowledge and experience. It is with this knowledge and experience that the author interprets the situation and thereafter makes conclusions. Therefore it is questionable if two different authors, at different times, with different backgrounds would interpret and conclude the same situation in a similar way (Thurén, 1996).

All authors are educated within in the school of business, and of course their way of reasoning is affected by their education. However, the three authors' writing this thesis complement one another with different backgrounds, with experience from finance, accounting, marketing and politics and that will, hopefully, help the authors to keep their perspective broad and analyze the problems from a number of different angles.

2.2 Qualitative vs. Quantitative

In order to reach the purpose of this thesis an empirical study has been conducted. The method most suitable for the purpose is a qualitative method where a small number of companies have been interviewed. The reason why a qualitative research method has been chosen instead of a quantitative one is that the study aim to create an understanding of the

behavior in a smaller sample group rather than making general conclusions from the larger mass (Trost, 2005). Therefore only five companies have been selected, and will be considered in depth. By understanding these five companies the authors will attempt to see if any general conclusions can be made concerning if a remuneration plan can affect the conflict going on in a company according to Jensen and Meckling (1976).

2.3 Collection of Primary and Secondary Data

To be able to fulfill the purpose, the authors have collected both primary and secondary data. Primary data are such data that does not yet include any interpretations and analysis from other people (Bell, 1995). In this thesis the primary data comes from the questionnaires sent out and the interviews conducted.

Secondary data on the other hand is data that is analyzed and includes someone's interpretation of the data (Bell, 1995). The secondary data needed and gathered in order to be able to fulfill the purpose of this essay are mainly annual reports, journal articles and textbooks. When searching for secondary data search engines such as Google Scholar, Emerald, Business Source Premier and Jstor have been used. Key words used on these search engines that have generated useful information are:

- Principal Agent Theory
- remuneration program
- stewardship
- motivation
- CEO compensation

2.4 Inductive vs. Deductive

Authors can either make conclusions by making use of an inductive or a deductive method. When making use of an inductive method, the authors make observations and try to generalize and contribute with new theories. If a deductive method is used instead, the authors test the existing theories, making use of hypothesis and test the hypothesis with the help of observations (Blaikie, 1993). When striving for fulfilling the purpose of this thesis, the authors will make use of an inductive method. The authors aim to create new knowledge rather than testing the already existing one.

One important risk to take into consideration when working with an inductive method is that the authors might already be biased in their way of thinking, and therefore unintentionally point and strive to take the research to a predetermined goal, consequently avoiding new and interesting inventions and thoughts within the subject (Patel & Davidson, 2003). Considering the biased thoughts that might interrupt the creation of this knowledge are unintentional and it is hard to work around it. After all, the authors are all business students, affected by their studies. There is a risk that the authors do believe that the ongoing debate about remuneration programs is an overstatement, and therefore has a slightly positive approach towards these programs and believes that they do affect the principal agent conflict. However, the authors are aware of the problem and have actively worked against it by having vivid discussions about the thesis, and its content.

2.5 Sample Selection

In order to be able to complete the study, a sample of companies had to be chosen. Since a qualitative method will be used the sample size has to be suitable for that method. To begin with an e-mail was sent out to eight companies with remuneration and three without to find out whether or not they were willing to participate in the study. The companies that the authors selected and contacted represent a cross-section of the companies on the Stockholm Stock Exchange. Hence meaning that both different industries such as banking, IT and forest were represented as well as companies with and without variable wage.

Several companies showed interest in the study but were unwilling to provide information about the sensitive topic. Hence we decided to reduce the sample group to three companies that make use of a remuneration program and two without, but at the same time keeping the cross-section of the Swedish Stock Exchange. These were all companies that were willing and able to provide relevant information. Eliminating companies less likely to provide the information needed, might cause a biased result, since there might be a reason why these firms do not want to participate. However, to be able to make any conclusions it is important for the authors to be able to work with people willing to help out and provide the information needed. Therefore the reader should be aware of the limitations caused by the selection process of the sample. At the same time it is important that the reader is aware of the fact that the majority of the companies on the Stockholm Stock Exchange A-list do make use of remuneration programs. Therefore it has been easier for the authors to find companies of interest making use of remuneration programs than companies that do not. The companies making use of remuneration program also tended to be more positive towards the study, since it is of their interest to give legitimacy to their programs, something which the companies' not making use of remuneration programs not had the need for.

At the same time the reader should be aware of the sensitive matter this subject might impose for some companies. Therefore it is important to consider what type of information the companies do not choose to share with the authors and why that is. Some of the companies have been willing to share more information than others. One also needs to carefully consider the answers given in order to understand why the person has said so. Is that because that is the way the company operates or is it just the "politically correct" answer that provides the picture of the company that it wants to provide? However, in the end, the authors have been well aware of the problem and even though all companies that were chosen to participate in the beginning said they were willing to participate and contribute with the information needed by the authors, some companies have been more successful than others to do so. Therefore a larger focus has been put on the companies providing valuable information for the study.

2.5.1 Companies with a Remuneration Plan

OMX

OMX is the owner of the Stockholm Stock Exchange (OMX, 2006). The authors found interest in the company since they recently opened a new stock market, the Nordic stock exchange and will be representing the global exchange industry in this thesis. The company uses a remuneration plan for their CEO, and will be one of three companies in the sample group of companies with a remuneration plan.

At OMX the authors has been in contact with Elin Sebö Malmström who is the Head of Compensation & Benefits at OMX.

Swedish Match

Swedish Match (SM) is a global tobacco manufacturing company with its range of market-leading brands in the product areas of snuff and chewing tobacco, cigars and pipes and will represent the manufacturing companies in this study (Swedish Match, 2005). SM uses a remuneration program for their CEO and will be part of that sample group.

At Swedish Match the authors have been in contact with Mats Rosenqvist, VP Compensation and Benefits. Rosenqvist reports to the group HR manager and is responsible for wages and remuneration programs within Swedish Match globally.

Ericsson

Ericsson is, as one of Sweden's largest companies, interesting in many aspects. Those that the authors will highlight here is: Ericsson is very exposed to the media's attention which also requires their actions to be very "politically correct" from the people's point of view. They also have a large and dispersed shareholding, which implies that the stakeholders, indeed, have different purposes for having a stake in the company.

At Ericsson Susanne Andersson who is the IR Manager at Investor Relations department with supported from the Human Resource Department has been the authors' link to the company by answering the authors' questions by e-mail.

2.5.2 Companies without a Remuneration Plan

Holmen

Holmen is a producing company that does not use a remuneration program for the executive management (Holmen, 2006). The company is of interest for this study since they do not use a remuneration programs and will take on the role as an antagonist compared to the companies that do use a remuneration programs for their executive management. The fact that the company is a producing company makes them even more valuable as antagonists since one would expect this company to have similar features with the other producing companies taking part in this study.

At Holmen the authors has been in touch with Anders Almgren who is the Executive Vice President CFO, Group Finance.

Svenska Handelsbanken

Svenska Handelsbanken (SHB) is a company that provides their customers with products within the whole range of bank related matters (Handelsbanken, 2006a). The company is important for this these since it just like Holmen do not make use of remuneration programs. Considering the company is not a producing company gives the thesis a width in the analysis, since this company might bring different thoughts to the lights considering why they do not make use of a remuneration program for their CEO. At SHB the authors have been in touch with Bengt Ragnå, who is the Head of investor relations at SHB

The two companies that do not use a remuneration program will work as antagonists and a control group in the thesis at the same time as they bring balance to the analysis.

2.6 Questionnaires and Interviews

To collect the empirical data needed, questionnaires have been sent out to the companies, allowing the authors to get a first knowledge about the companies' thoughts about the topic. The sample chosen consists of three companies that use a remuneration program (OMX, Swedish Match and Ericsson). However, just as important is the companies that not use a remuneration program (SHB and Holmen), this since the answers from these companies will help the authors create an interesting analysis, where conclusions from a broader perspective can be made. A thesis of this kind that focus upon whether or not remuneration programs do affect the conflict of interest that goes on between the principal and the agent in a company, will loose in credibility if not both parties are represented. It is expected to get biased information from the different parties regarding the effects and benefits of remuneration programs. Hence including companies with and without a variable salary, and comparing the information and benefits reported.

2.6.1 Questionnaires

One kind of questionnaire has been sent out to the companies that make use of remuneration programs (see, appendix 1). Another type of questionnaire has been sent out to the companies not making use of remuneration programs (see, appendix 2). The reason why different questionnaires have been sent out, is for the authors to be able to pin down the differences between the two groups and their chosen way of rewarding their CEO.

These questionnaires held the format of high standardization, with the same questions to all companies within the same group but with low degree of structure to allow questions with open answers. The purpose of the low structured questions was to avoid expected answers if those were not the ones the person interviewed first brought to mind. The companies participating were asked to return their answers by e-mail. Shortcomings with sending out questionnaires worth mentioning is that some people answering the questionnaires might do so without putting much thought in to the answers. On the other extremes one might also receive answers that are very well thought through, more representing the view the company want to present of themselves rather than the reality.

2.6.2 Phone-Interviews

At the same time, sending out a questionnaire creates an inability to follow up unclear or interesting answers with more questions to be able to create a deeper understanding of the matter. To avoid these both shortcomings, phone-interviews were conducted afterwards, bringing up unclear matters from the questionnaire complementing with more specific questions. The phone interviews enabled the authors to a quick replay and follow up questions making it harder for the companies to stick to the corrected version, as well as gaining a deeper understanding and discussion. During these phone interviews the companies were able to speak their minds. Two companies, Ericsson and SHB, were not able to offer a phone interview due to a lack of time from the company's side. Therefore complementary questions were sent by e-mail to Ericsson and answered by e-mail as well. SHB on the other hand provided the authors with well answered questions the first time and the authors felt that no further questions and answers were needed. At the same time Holmen did not have time to answer the questions by e-mail, but were happy to help the authors with a phone interview. Therefore the authors made sure to cover the questions from the questionnaire during the interview instead.

The advantages of making use of this method, with first sending out questionnaires by e-mail and then follow up with a phone-interview, outweigh the disadvantages. By sending out the questionnaires as a first part of the empirical gathering, the authors were able to get an overview of the different companies' individual view upon the subject. At the same time the authors were able to find out what questions, if any, that the companies avoided. When knowing what questions the companies preferred not to answer as detailed as preferred, the authors were able to construct new questions for the follow-up interview that approached the matter of interest from another angle in order to receive valuable empirical data. While putting together the answers, the authors were able to find interesting aspects where the companies agreed or disagreed. That allowed the follow-up interviews to be more focused on topics interesting for the matter and that took the thesis one step further. Gathering empirical data in two different steps also allowed the authors to specify their theoretical knowledge in order to be able to provide the companies with more specific questions during the follow up interviews.

The format of these follow-up interviews have been unstructured, to allow the interviewed person to fully explain their views and thoughts about the topic (Trost, 2005). Interviewing one person within a company might result in biased answers, or answers that are only true for the person being interviewed. However, the authors have been in touch with the people responsible for the remuneration within the respective company and one could expect that they present the company's point of view. In order to support the answers provided from the contact person at each company, the authors has also compared the answers with those available from the companies' annual reports to make sure they are in line with one another.

The information gained from the questionnaires and the phone interview that followed, will be found in chapter 4, Empirical findings.

2.7 Measurements of Management Performance

To analyze management's performance, the authors have decided to turn to both stock value and an annual report analysis. The annual report analysis will be focused on Return On Equity (ROE). ROE enables the authors to analyze whether the management has generated a decent growth in the company's value (McClure, 2005). At the same time, ROE is the rate at which the shareholders funds actually are returned. When calculating ROE the authors have chosen to make use of the companies' common stock when such figures were available as well as the average equity. All numbers used when calculating the ratios have been taken from the companies' annual report. In all the companies except OMX and Ericsson the figures taken into account comes from 2000 to 2005, hence six year. However, for OMX the numbers for 2000 were not representative, since their remuneration program has been changed severely and are therefore not presenting a fair view of the company. Therefore these figures have been eliminated. Ericsson on the other hand, had for 2000 and 2001 only presented the sum paid out as variable wage for the whole management group. Therefore the authors were not able to determine the actual incentive paid out to the CEO. The figures have only been presented for 2003-2005. This is a weakness in the measurements of management performance, but the authors feel that the three years represented still provide the authors with enough information to base the analysis upon.

In the analysis the authors will examine how well the ratio reflect the variable wage paid, the authors will, as McClure (2005), assume that a ROE about 15 percent is reasonable ROE.

Only measuring the company's performance by making use of ROE has its clear shortcomings, something which the authors are well aware of. However, the authors have made the judgment that it will be sufficient for the purpose it is used for in this thesis. The authors have limited their research to look at the problem from the shareholders perspective. Their main interest is to have as high return on their investment as possible. To evaluate the company's and the CEO's performance from that perspective, ROE are able to fulfill the authors need.

2.8 Validity and Reliability

When considering validity and reliability, it is important to take into account what type of a research one is conducting, since the criteria for a quantitative and qualitative research differ. This thesis is based upon qualitative research and therefore those are the criteria to take into consideration. When conducting a qualitative research it is the complete process that is of importance in order to create a high validity. What is of interest is to experience what is going on, and to be able to interpret the situation studied, consequently to be able to describe what is observed (Patel & Davidson, 2003). In order to keep the validity high for this thesis the authors will be careful in their research process by carefully evaluating the reliability of the resources before they are consulted. The questionnaires and the phone interviews have been carefully prepared as well as the empirical findings have been cautiously thought through, and the analysis of the results has been conducted with awareness.

2.9 Analysis Model

When all the empirical information was gathered the authors analyzed the material. To begin with each company was analyzed on its own in order to find out what specific findings were to be gathered from each company. From there on the authors moved on to find out what similarities and differences the different companies within the same group held. With that knowledge in mind, conclusions have been made.

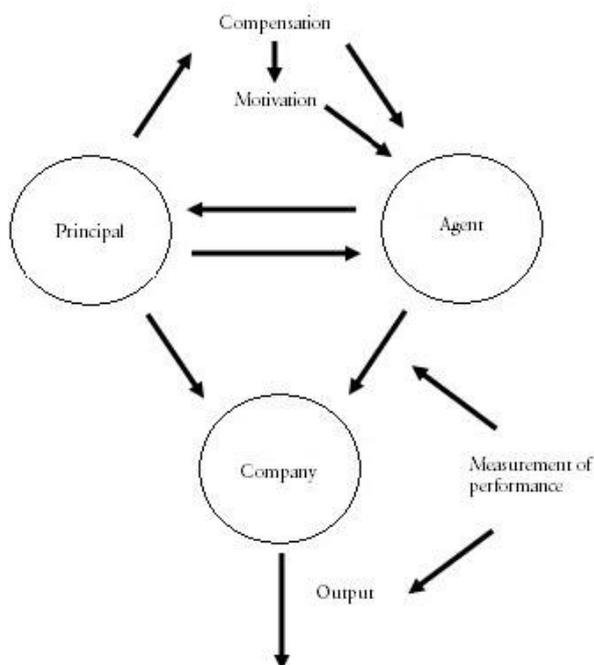


Figure 2-2 Analysis Model

In the figure above, one can see how the different theories interact with one another. As the base for the thesis we have the principals and the agent of the company. Between them there are a conflict of interest going on. This conflict of interest is according to the theories affected by what motivates the agent and what means of compensations the agent receives. The compensation is often dependent on the measurement of both the agent's individual performance as well as of the overall performance of the company. Depending on how the conflict between the principal and the agent appear, the compensation will look different. This model shows the corner stones of this thesis.

3 Theoretical Framework

In this chapter the authors aim to provide the reader with an understanding of the Principal Agent Theory and other supporting theories needed in order to be able to fulfill the purpose of the thesis.

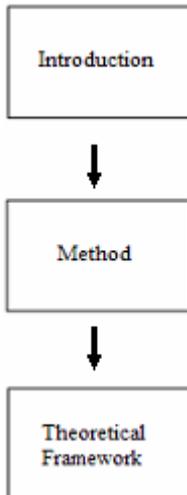


Figure 3-1 Theoretical Framework

When trying to reach the purpose, the authors will make use of different types of theories that seize the purpose from different angles. To begin with, theories that are dealing with the conflict that is going on between the principles and agents of a company will be dealt with. This will be the main part of the theory chapter. However, it is also important to understand what motivates a person and why. That is what the second part within the theory chapter will deal with. Having that knowledge, one is ready to move on to learn about compensation policies. In this final part of the theory chapter the authors will also explain what measurements they will make use of when analyzing the different companies.

3.1 Principal Agent Theory

A problem with employed managers is that the ownership is separated from the control of the firm. When the financing is constructed by equity or risky debt (Jensen & Meckling, 1976) the managers may face options whose outcome depend on their moral and ability to manage the business.

The moral hazard for the managers mainly consist of; work less and take more perks, managers may empire build or they may undertake projects that make them irreplaceable. Managers may pursue these, their own, actions of interest, instead of the shareholders interests, who actually appointed the manager to the position. These assumptions do not align with the basic theory of the firm, i.e. managers maximize the wealth of the shareholders.

Actually this phenomenon was noticed already by Adam Smith in his work *The Wealth of nations* (1776).

The directors of such [joint stock] companies, however, being managers rather of others people's money than their own, it cannot well be expected that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. /.../ Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.

(Smith, in Putterman & Kroszner, 1996, p.43)

The general assumption, raised by Jensen and Meckling in *Journal of Financial Economics* (1976), about employed managers, i.e. agents, is that they generally have different motives to run the business than the equity and debt holders, i.e. principals. Hence, a conflict of interest arises and as a result the company under-perform because the firm value is reduced due to various *agency costs*. This theory is generally known as *Principal Agent Theory*. Jensen and Meckling (1976) defined it as:

The problem of inducing an 'agent' to behave as if he were maximizing the 'principal's' welfare...

(Jensen and Meckling, 1976, p. 319)

Jensen and Meckling developed a fair attempt, on this difficult matter, to measure and label the cost that incurs from the different motives between the agent and the principals, *agency-cost*, that arises due to the conflict of interest. Jensen and Meckling's (1976) Agency-costs is composed of three different parts;

- i) the monitoring expenditures by the principal
- ii) the bonding expenditures by the agent
- iii) the residual loss

(Jensen & Meckling, 1976)

3.1.1 Monitoring Expenditures

The *monitoring expenditures* are costs induced by the principal to *monitor*, i.e. establishing appropriate incentives, the agent in order to limit the aberrant decisions and activities by the agent (Jensen & Meckling, 1976). By making use of information about the agent, the principles are able to create incentives that will induce the agent to put in as much effort as required in a matter. At the same time, the incentive will encourage the agent to make decisions that are beneficial for the company rather than for him or herself. In this discussion, remuneration programs are one input that will stimulate the agent behave and act in, from the principals point of view, correct manner (Demougin & Fluet, 2001).

3.1.2 Bonding Expenditures

The agent on the other hand will expend resources, *bonding expenditures*, to make credible promises to act in the principals' interest, and if the agent do not he or she ensures that the principal will be compensated for any such action (Jensen & Meckling, 1976).

In almost all principal agent relationships there will incur positive *monitoring-* and *bonding-costs*, both financial and non-financial. There will also be some deviation between the opti-

mal decision, the decision that maximizes the principals' wealth, and the actual decisions by the agent (Jensen & Meckling, 1976).

3.1.3 Residual Loss

The monetary equivalent, incurred by suboptimal actions, reduction of the principals' welfare is also a cost of agency, and labeled by Jensen and Meckling as the *residual loss* (Jensen & Meckling, 1976). Hence, the residual loss is the negative difference between the stochastic inflows and the promised payments to the agents (Fama & Jensen, 1983).

The total agency cost is defined, by Jensen & Meckling (1976), as the sum of *monitoring cost*, *bonding cost* and *residual loss* that are explained above.

The different costs are not connected and the principals' desire when monitoring an agent is to reduce the residual loss and as much as possible the bonding expenditures. The bonding expenditures, from the principals' point of view, may be almost eliminated, if the agent is confident that the principals' have faith in their ability to run the business when they are compensated through monitoring, i.e. incentive programs.

3.1.4 Free Cash Flow

Jensen and Meckling's (1976) principal agent problem tend to be more serious in companies that generate a lot of cash internally. The problem is to decide what to do with the cash; pay it out as dividend or invest the funds in, maybe not so profitable investments? Jensen (1986) named it as *Free Cash Flow*. Note that free cash flow in general is larger in mature businesses than in growth companies, since the cash in growth companies often are re-invested in the business.

Free cash flow is cash flow in excess of that required to fund all projects that have positive net present values when discounted at the relevant cost of capital.

(Jensen, 1986, p. 323)

This statement enriches the principal agent conflict presented by Jensen and Meckling (1976), since Jensen in *American Economic Review* argue that free cash flow to any given company may induce management to make, in terms of net present value, sub optimal investments. The cost to the shareholder in a situation as described above is identified as *Agency Cost of Free Cash Flow*, the cost of a management's bad fund management. They may also be tempted to give themselves some extra perquisites or even steal money of the Free Cash Flow (Jensen, 86).

To pay out the current cash to the shareholders in form of dividend or stock repurchase may seem to be the best solution; consequently no "bad" investments will be undertaken by the management. However, if this is a one off dividend increase or stock repurchase, it leaves the management in control of future free cash flow. Hence, the management cannot make credible promises to stick to the higher dividend policy forever since dividend may be lowered in the future. The agency cost of free cash flow is consistent with the phenomenon that the capital market punishes a reduction of dividend in terms of lower stock value (Jensen, 1986).

According to Jensen (1986), debt (risk-free) can overcome this problem. With debt, managers can credibly promise that they will pay out future free cash flows since the debt contracts are enforceable by debt holders.

3.2 The Fisher Separation Theorem

The Fisher Separation Theorem explains why the company does not have to worry about individual shareholders when deciding on which and what investment to carry out. Fisher Separation shows that the objective of the firm should be to maximize the present value of the company. This is true regardless of different preferences between the owners (principals), since, in a perfect and complete capital market the principals can borrow and lend money by him- or herself to the market rate of interest and seize market opportunities (Copeland, Weston & Shastri, 2005).

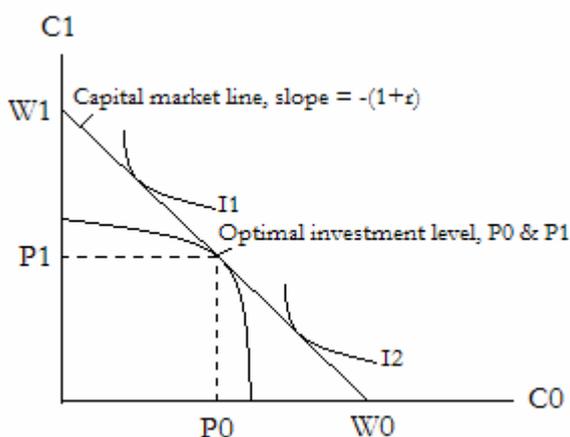


Figure 3-2 Fisher Separation (Copeland, Weston & Shastri p.19, 2005)

This is true since the shareholders, as the authors in this section assume perfect capital markets, may choose their own consumption level at any given time, by lending or borrowing money against future earnings.

The answer to the agents where to invest, is where marginal rate of return from an additional investment equals the slope of the capital market line. The capital market line, in the figure above, is a negative function of the interest rate $-(1+r)$. When the capital market line is tangent to the “investment opportunity set” the optimal investment level, for the company, is reached (Copeland, et al., 2005).

The investment opportunity set is the curved line underneath the capital market line. The investment opportunity set is the set of investments that the company faces, the first investment is the most profitable for the company and the second is the second best, so on and so forth. That is why the curve is bent (see, figure 3-1), intuitively the company should only invest to the point where the payoff for an additional investment is lower than the payoff on the market rate of interest (i.e. where the capital market line is tangent to the investment opportunity set. The point is marked as “optimal investment level” in the figure) (Copeland, et al., 2005).

The figure above describes the Fisher Separation Theorem where the line W_0-W_1 represents the “capital market line”. Anywhere along that line shareholders may place themselves, in terms of consumption, given the company’s investment P_0 and P_1 in year 0 and 1 respectively. The I_1 and I_2 represent two distinct individual’s utility curves and where along

the capital market line they wish to consume (C_0 for consumption in period 0 and C_1 for consumption in period 1). This is possible through borrowing or lending money in the capital market.

Consider a two period (for example years) interval, if an investor wishes to consume more next period the strategy is to lend money and consume less this period. I_1 , in figure 2-4, is an example of an investor's utility curve that lends money today and consumes more next period. Whereas, I_2 , in figure 3-2, is an example of an investor's utility curve who prefer to consume more today and less next period. Hence he or she will borrow funds against next period's income.

Wherever one individual wish to end up, between W_0 and W_1 , he or she strives to end up as far away from the origin as possible (Copeland, et al., 2005).

3.3 Motivation Theory

When looking in the dictionary, motivation is explained as:

The (conscious or unconscious) stimulus, incentive, motives, etc., for action towards a goal, esp. as resulting from psychological or social factors; the factors giving purpose or direction to behavior.

(Trumble, Stevenson, Bailey & Siefring, 2002, p. 1840)

When talking about remuneration programs, it is important not to forget that money is not the only incentive that makes humans motivated to perform. Svensson and Wilhelmsson (1988) claim that money is not the only thing that motivates humans since humans also have other needs, one of the strongest need is to be seen and recognized.

3.3.1 Maslow's Hierarchy of Needs

In a similar way, Maslow is discussing how humans have needs that affect their behavior. Maslow claims that humans at every moment have a number of needs that are competing with each other. These needs can be divided between physiological (primary) and social (secondary) needs. Since one of the needs will always be stronger than the other, the human will act in a manner that fulfils the strongest need. Maslow has created a model with different steps that takes a person to self-fulfillment and that is the goal that motivates humans (Maslow, 1943).

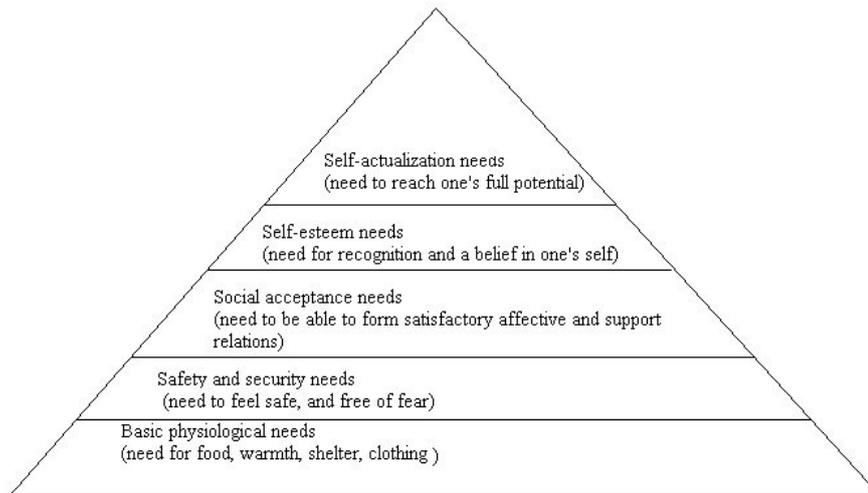


Figure 3-3 Maslow's Hierarchy of Needs (Adapted from Maslow, 1943, pp 370-96)

In the figure above, one can see the different basic needs a human have according to Maslow (1943). Self-actualization, which is found in the top of the hierarchy, according to Maslow the goal of humans is reaching the self-actualization step in the hierarchy of needs.

3.3.2 Herzberg Motivation-Hygiene Theory

In his motivation-hygiene theory, Herzberg (1993) also explains different needs a human need to fulfill in order to be motivated at what they are doing. Herzberg makes distinctions between hygiene factors and motivation factors. Hygiene factors which are circumstances and conditions in the working surrounding that needs to be fulfilled otherwise the person will be unhappy with his or her job. Example of this is wages, remuneration and working environment. The motivation factors on the other hand are related to the assignment. Not until both these two factors have been fulfilled, an agent can be fully motivated and perform at his or her best. Hence, it is not enough to only fulfill one of the two criteria's if the principal's want a motivated and a top performing agent.

3.4 Compensation Policy

The aim of a compensation program is to motivate the employees, the agents, within the company to perform at their best, to enable the company to make use of the full competence of its management team (Svensson & Wilhelmson, 1988). When discussing compensation policy, one has to be aware of the different parts it may consist of. Remuneration programs to the CEO are normally consistent of two parts, set wage whereas the other part is variable wage. The variable wage can further be divided into one part that consists of cash, one part includes options and the last part that includes a pension scheme (Svenskt Näringsliv, 2006).

The tool used by principals to encourage the agent is a remuneration package most often assembled by the board of directors, and voted upon at a general meeting. The remuneration package is often set up by various parts, the most common parts is described below.

3.4.1 Set Wage

A natural part of a CEO's compensation is the set wage or variable salary. This is a part of the compensation that is predetermined and does not depend on the performance of the CEO or the company's results. Instead it is determined depending on what is expected of the CEO, what responsibility that comes with it and other predetermined principles. In reality the set wage is determined on the size of the company and specific work tasks that are expected in the close future in a combination with the requirements that been asked for, for example education, experience and leadership skills (Svenskt Näringsliv, 2006). The set wage is also established to a level that is competitive on the market. With the help of a set wage that is competitive on the market the companies are able to attract and keep the staff or knowledge within the firm (Persson, 1995).

3.4.2 Variable Wage

The variable wage is the part of the wage that depends on the CEO's, as well as the company's performance and results. This is an attempt to motivate the CEO to perform at his or her best both concerning short term and long term goals. This part of the wage should be connected to predetermined goals that are measurable. When determining this part of the wage it is important that the company is aware of what it would like to achieve, since that will determine the preset goals that the variable wage is connected to. According to Svenskt Näringsliv, it is important not to call this part of the wage bonus, since that might be misinterpreted as something that was not negotiated prior to payment, which is not the case (Svenskt Näringsliv, 2006).

The variable wage can both consist of pure money, and partly of incentive schemes which are share price related. The share price related remuneration is usually long term incentives, rather than short term (Svenskt Näringsliv, 2006). When the authors make the analysis they will divide the variable wage as a pure monetary part, the cost of the option program and the pension scheme, which together makeup the whole variable wage that a CEO may earn.

If making use of remuneration programs where one part of the wage is set and the other part is variable, it is important to take into consideration that a variable wage, which to a large extent is depending upon the individual performance, might cause opposite effect of what was intended. In such a case the CEO might become too interested in his or her performance and act to achieve the goals required to get maximum reward, without the best of the company in mind. Therefore Smitt et al. (2002) argue that the companies should not only make the variable wage reflect the individual performance, but also partly on the overall performance of the company.

Options

The share price related part of the remuneration programs are most often related to options. Options are agreement in according to the civil law, and the value the option is determined by the relative value of the underlying asset. An option is a right for the owner to convert the option to a given asset at a predetermined price. In the case of call options, the options allow the owner to buy shares within their own company (Smitt et al., 2002). If the holder exercises the right of the options, he or she becomes a share holder of the company. Hence, he or she to some extent gets the same incentives as the other shareholders, principals, of the company, which often is the purpose of the incentive program. However, according to Andersson & Bratteberg (2000), it is more common that the purpose for the

holder of the options is to make money out of the program if the share price increases in the future.

Pension schemes

In most employment contracts, the question of pension schemes is an important part of the discussion between the board and the CEO to be (Smitt et al., 2002). It is important for the company to consider that the pension schemes are long term commitments (Svenskt Näringsliv, 2006). Occupational pension schemes are basically a deferred payment (Persson, 1995).

3.5 Stewardship

The Principal Agent Theory assumes that the interest from a manager and the owners diverge, but what if their interests are aligned? Davis, Shoorman & Donaldson (1997) saw the need for an alternative theory explaining such a case.

The theory of Stewardship is relatively, to Principal Agent Theory, new. The theory is a modified version of Principal Agent Theory and considers some psychological factors such as motivation and the need for a man to take the next step on Maslow's hierarchy of needs (Davis, et al. 1997).

Stewardship defines situations in which the managers are not motivated by individual incentives, rather the organizational goals that are set by the principals (Donaldson & Davis, 1991). To understand the situation it is essential to have a clear understanding of the characteristics of the manager as well as of the situational factors underpinning an owner-manager relationship (Davis et al. 1997). An assumption made in the stewardship theory is that the model of man is changed; a steward is rewarded higher utility with a pro-organizational behavior than self serving behavior.

Stewardship theory is in one sense combining the theories that the authors of this thesis have brought up so far. The theory relates to psychology, motivation the use of power and situational factors that a relationship between managers and owners may face.

The steward realizes the trade-off between personal needs and organizational objectives and believes that by working toward organizational, collective ends, personal needs are met. Hence, / ... / the utility gained from pro-organizational behavior is higher than the utility that can be gained through individualistic, self-serving behavior.

(Davis, et al. 1997, p.25)

Stewardship is not a theory that discards the Principal Agent Theory, it rather highlights that it is a choice for the principals and agents whether to have an agent or Steward Relationship towards the principals. The choice is depending on both the principals and the agents' perception of the situation and the manager's personal attributes (Davis, et al. 1997).

As Davis et al. (1997) argues, the suboptimal decisions that may arise from a principal agent relationship is diminished if they, the principal and agent, chose to have a steward relationship instead. With a stewardship relationship, or cooperation, the company and steward realize maximum return and reward.

		Principal's Choice	
		Agent	Steward
Agent	Minimize Potential Costs	1	Agent Acts Opportunistically
	Mutual Agency Relationship		Principal Is Angry Principal Is Betrayed
Manager's Choice		2	
Steward		3	4
	Principal Acts Opportunistically		Maximize Potential Performance
	Manager Is Frustrated Manager Is Betrayed		Mutual Stewardship Relationship

Figure 3-4 Stewardship, Davis et al (1997, p.39).

In the figure above the choices available for the manager and the principals and what the outcome is given different choices (Davis et al., 1997).

3.6 Measurements of Management Performance

To analyze management's performance, the authors have decided to turn to both stock value and an annual report analysis. The annual report analysis will mostly be focused on different return ratios. These tools are good measurements to determine the payoff for the company each year, according to McClure (2005). Return On Equity (ROE) tell us whether the management has generated a decent growth in the company's value (McClure, 2005).

Comparing the results among the different firms by the usage of financial ratios creates an opportunity to measure the relative performance among the companies and a way to measure how efficiently assets and equity is used. Furthermore it is important to stress that no conclusions is to be drawn from these stand alone values, but together they can create a descent overview if the managers are generating cash to their shareholders.

3.6.1 ROE

The ratio ROE is a measurement that provides the user with information about what return, in percentage terms, each equity invested crown gives. The intuition is; what rate of return an investor expects on every crown he or she puts in to the company at a yearly basis. Professional investors usually require a ROE of approximately 15 percent (McClure, 2005).

$$ROE = \frac{\text{Net Income}}{\text{Average Common Equity}}$$

There have been some discussions of which equity stake to use, the beginning or average over the total year. One group of investors argues that the beginning equity is the important one since it is on that equity base earnings are generated. The other says that the most meaningful analysis is made on an equity average, using the beginning and ending equity

divided by two (Pratt, Reilly & Schweih, 2000). The authors have chosen to use the average equity in our calculations. Hence the calculated ratio will be more significant and less affected by changes in the capital structure at the end of the year.

However there are some sources that claim that ROE is a poor measurement of performance. This due to the fact that it is possible for a company to, artificially raises the ROE by performing a leverage buy out, i.e. an acquisition that is 100% debt financed. The company that is acquired should earn less than its cost of capital but more than its cost of debt. This action increases the ROE but at the same time increases the risk of default; hence the share price decreases (Copeland & Weston, 2005).

3.7 Summary of the Theories used

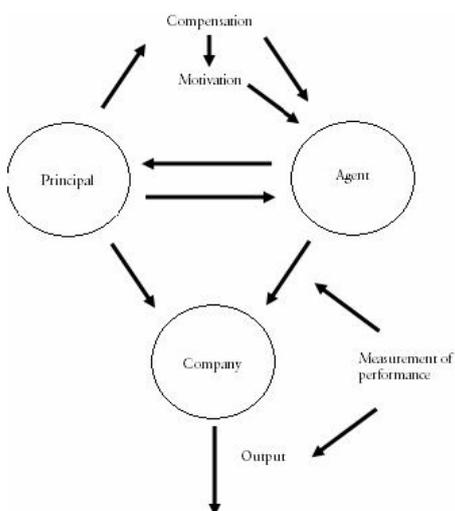


Figure 3-5 Analysis Model

The following section will guide the reader through the use of the theories and how the authors will apply them to the companies that are examined.

The Principal Agent Theory (see, Jensen & Meckling, 1976. See ch. 3.1), sets the problem by assuming that the relationship between owners and managers are expensive for various reasons. The cost incurred are monitoring expenses by the principals, bonding expenditures by the agent, and residual loss that occurs from the suboptimal decisions that may be made by the management. These costs are often difficult, or impossible, to find since they are quite intangible. However, the most evident example is the remuneration program as a monitoring cost, which most of the companies offer their CEO. This is the major agency cost the authors will consider in the analysis, since it is tangible and public.

An agent is often entitled to information that is not known to the principals, this information asymmetry may be vitally connected with the agents moral and motivation when performing his or her task. If an agent is privileged with information about for example investment opportunities he or she may make an active choice to, or not to, make the best available course of actions for the shareholders, i.e. principals.

The compensation package that is developed does differ between firms and for the authors purpose, the level of compensation is not vital. The interesting part of this thesis is the composition between the different parts of a compensation policy, i.e. Set Wage, Variable

Wage Options and Pension (see ch. 3.4) and if these are connected to measurable results and benefits to the shareholders.

The above discussion about whether an agent actively makes good or bad decisions is also connected with the amount of cash that are generated internally in the company, i.e. Free Cash Flow (see, Jensen, 1986. See ch. 3.1.4). The agent may take on “bad” investments or actions in order to not commit to any high payout to shareholders, either as dividends or as stock repurchase. However, this reduces the value of the company and ultimately reduces the wealth of the shareholders. The agent can, of course, chose to divide the cash among the shareholders as well, however this increase the value of the company which is positive for the shareholders.

From the shareholders perspective, their only interest is for the company to increase its value. This is true, since if the value of their shares increase they may increase their consumption in any given period, as explained in the Fisher Separation Theorem (see, Copeland et al., 2005. See ch. 3.2). Therefore such bad decisions, as described above, reduce the shareholders wealth. However, this is not completely true since there exist no perfect and complete capital markets, but the intuition is still valid and the basic assumption that an investor is only interested in high value of their shares is intuitively true.

Davis et al. (1997. See ch. 3.5) argues that the relationship between owners and managers do not have to be as costly as in a principal agent relationship, the principal agent relationship that per definition does incur costs to the principals. However the magnitude of theses costs is lower in this alternative relationship theory, Stewardship Theory. This theory is probably more applicable to companies without remuneration programs, or at least how they interpret the problem. To explain these companies behavior the authors have chosen to apply the Stewardship Theory framework.

To measure the agents' performance the authors have chosen to make use of some common ratios along with the return of the stock, including dividends, and the relative level of variable wage that the agent was rewarded for that same period of time (see ch. 3.6).

4 Empirical Findings

In this chapter, the empirical findings of the study are presented. A brief introduction of each company that participated in the study is included as well as the knowledge gained from the questionnaires, interviews and annual reports of the companies of interest.

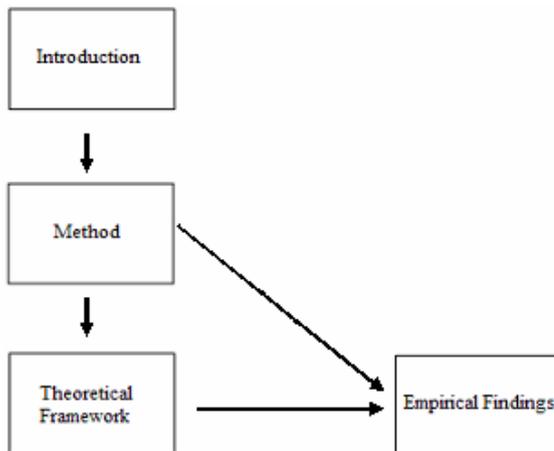


Figure 4-1 Emperical Findings

4.1 Companies with a Remuneration Plan

4.1.1 OMX

OMX is a company within the global exchange industry and do also develop and supply technology and services to marketplaces all over the world. The company is both the owner and operator of the Nordic Stock Exchange in Helsinki, Copenhagen, Stockholm, Tallinn, Riga and Vilnius. In 2005, the company made an operating income of 910 million SEK (OMX, 2005).

Benefits of a Remuneration Plan

According to the Head of Compensation & Benefits at OMX a remuneration program when it is at its best is a good incentive for the individual to perform at its best and in the interest of the company's shareholders, since the individual performance in a clear and direct manner is rewarded through the remuneration program. One cannot say that variable salary is the same thing as a reward. According to the Head of Compensation & Benefits point of view, a reward is so much more than just economical compensation. She includes everything from praise to economical compensation in the term reward (Head of Compensation & Benefits, OMX, personal communication, 2006-10-10).

The Head of Compensation & Benefits at OMX was asked to give the three most important reasons to have an incentive programs in their compensation package; first, it is due to the market today, to recruit good personnel they have to have a variable part of their salary to be competitive. Second, an effective compensation program does, according to the Head of Compensation & Benefits at OMX make it possible to steer manager to act on behalf of the owners. Third, it is, indeed, a good motivation for an employee (Head of Compensation & Benefits, OMX, personal communication, 2006-11-28).

The Remuneration Plan at OMX

OMX remuneration program is partly dependent on the company's overall performance and partly based on the individual's own performance. 60 percent of the program reflects the company's overall performance, and is used as a tool to distribute the earnings of OMX annual profit to its employees. The performance is measured through Return On Capital Employed and Earnings Before Interest and Tax. The remaining 40 percent is connected to the individual performance. By making such a large stake of the remuneration depending on the company's overall performance, OMX state that the remuneration program does, indeed, help to minimize suboptimal decisions (Head of Compensation & Benefits, OMX, personal communication, 2006-10-10).

The Head of Compensation & Benefits at OMX does point out that a short term versus long term incentive does fulfill different purpose for the company. Whereas the short term incentives work as a means of control, the long term incentive aim to create loyalty towards the company (Head of Compensation & Benefits, OMX, personal communication, 2006-11-28).

Up until 2002 the company made use of an option program that was beneficial for all OMX employees. However, since it was a general "bonus" not connected to individual results and performance, the option program was cancelled. During 2006 a new long term incentive program was introduced which only included the senior executives at the company. This new share matching program requires the participant to assent some risk and invest in the stock them selves in order to be entitled to the matching shares. Furthermore the employee must stay within the company for three years and perform to reach OMX pre-set goals. The programs have two roofs, the first state that a maximum of 5 matching shares can be rewarded for each invested share, secondly the participants are limited to invest a certain percentage of there annual salary (Head of Compensation & Benefits, OMX, personal communication, 2006-11-28).

The goals that need to be fulfilled are divided between Earnings Per Share (EPS) and Total Shareholder Return (TSR). The goal based upon EPS can give the participant up to 2.5 matching shares. For the program to generate anything the growth in EPS has to be at least 2 percent and 2.5 matching shares are given after three years if the growth has been 25 percent per year. The goal connected to TSR state that OMX need to perform better than the revised comparator group that comprises 9 exchanges and 9 technology companies with up to 10 percent per year and if these 10 percent annually is reached it will generate in 2.5 matching shares after three years (Head of Compensation & Benefits, OMX, personal communication, 2006-11-28).

The OMX personnel that are included in the remuneration program do have measurable goals, both at a personal level and on an overall performance of the company. The goals to be reached are decided by the next level of management, and the decisions are based on the nature of the challenges the individual will meet in the upcoming year. The predetermined goals are reachable and the individual must be able to affect the measurement that the incentives are based on, otherwise the incentive will not fulfill its purpose (Head of Compensation & Benefits, OMX, personal communication, 2006-11-28).

With these measurable goals in mind the size of the remuneration is decided depending on if the targets have been reached and to what extent, or if, the results are even better than the targeted results. It is the board that annually evaluates how well the CEO has managed to fulfill its individual goals (Head of Compensation & Benefits, OMX, personal communication, 2006-10-10).

Since OMX is the owner of the stock exchanges in the Nordic countries (Oslo is the exception) the company is under strict supervision of media. Therefore the company is careful to make sure their remuneration program and the performance targets are closely connected with the company's short- and long term incentive programs. At the same time the remuneration programs do include a maximum value as well as a minimum achievement in order to be worth anything. At the same time the Head of Compensation & Benefits at OMX points out that it is important with transparency in the remuneration programs since it increase the legitimacy of the programs (Head of Compensation & Benefits, OMX, personal communication, 2006-10-10).

The board of director in OMX is, according to the Head of Compensation & Benefits at OMX very interested in the remuneration program and how it is developed. The board continuously follows the market development of incentives (Head of Compensation & Benefits, OMX, personal communication, 2006-10-10).

In the board the shareholders have one representative, who is from the largest owner, Investor, who owns about 10% of the equity. The board of directors evaluates the incentive program on an annual basis (Head of Compensation & Benefits, OMX, personal communication, 2006-11-28).

OMX has not met any resistance towards their remuneration program. However, the board does show a great deal of interest in the programs. This is something the Head of Compensation & Benefits at OMX points out as positive (Head of Compensation & Benefits, OMX, personal communication, 2006-10-10).

Performance and Remuneration of OMX

Looking at OMX's share price, one realizes that the share has not been doing very well. The share price started out at 190 SEK and in 2001 it had its peak with a value of 233 SEK. In 2002 it reached its lowest value, 41.60 SEK. After that the share has managed to recover some, ending up in a value of 110.50 in the end of 2005 (OMX, 2000-2005).

If one turn to TSR instead, one can see that OMX have had some fluctuation in their TSR: In 2001 the TSR were negative 40.34 percent and in 2002 as low as negative 69.57 percent. In 2003 the TSR jumped and ended up at 98.01 percent to once again be as low as negative 6.08 percent. Finally the company's TSR ended at 36.44 percent in 2005 (OMX, 2000-2005).

Even when looking at the ratio ROE, one realizes that OMX have had some tuff years, resulting in a negative ratio. In 2000 OMX had a ROE of 25 percent. In 2003 this ratio was down to negative 16 percent before it once again recovered some to end at a value of 12 percent (OMX, 2000-2005).

If one instead takes a look at the remuneration paid out to the CEO one can see that in 2001, the CEO received a variable wage that were 54 percentage of the fixed wage. In 2002 that percentage was down to 32 percent and in 2003 the CEO received no variable wage at all. 2004 the CEO once again received a variable wage that corresponded to 14.28 percent of the fixed wage. Finally in 2005, the variable wage was 32.31 percent of the fixed wage (OMX, 2000-2005).

4.1.2 Swedish Match

Swedish Match is a global manufacturing company that offers products within snuff, cigars, pipe tobacco and chewing-tobacco. Within their range of products one can also find

matches and lighters. The company has its shares noted on the Stockholm Stock Exchange as well as on the New York Stock exchange (Swedish Match, 2005).

According to the VP Compensation and Benefits Swedish Match do not like to make use of the word bonus, since that is easily interpreted as something one receives without any predetermined goals. Instead the company talks about variable wage and incentive in their policy document. For Swedish Match variable salary is part of the compensation received for accomplished work which is dependent upon individual performance, the performance of the division, the own division's result and the group result (VP Compensation and Benefits, SM, personal communication, 2006-10-31).

What Swedish Match defines as variable wage or incentive is something one earns according to pre-set criteria and goals. A reward is something one receives for good performance that is not defined beforehand. Considering motivation, a reward can be even more motivating than an incentive of comparable size but since a reward is not based upon pre-set goals and criteria, it cannot direct the decision making (VP Compensation and Benefits, SM, personal communication, 2006-10-31).

Benefits of the Remuneration Plan

The purpose of the remuneration programs to the management team is to bring together the managements interests with those of the shareholders. This since the remuneration programs show the agents (management) which results are expected. With that knowledge, they can make decisions that are in line with the expected outcome. Apart from that, common remuneration programs among managers work as group uniting (VP Compensation and Benefits, SM, personal communication, 2006-10-31).

Swedish Match claim that the remuneration programs are positive for the company because these programs bring together the managements interests with the shareholders as previously mentioned. At the same time, if the company is generating a fine result, also the management's compensation will increase which strengthen the loyalty to the company and increase the motivation (VP Compensation and Benefits, SM, personal communication, 2006-10-31).

The variable payment is a part of the total remuneration which should be adapted to the market when it comes to size and structure. This helps the company to recruit and keep their co-workers that for each task holds the best competence and qualifications. These positive aspects are not only true for the company, but also for the shareholders according to the VP Compensation and Benefits. At the same time, the remuneration programs are important when it comes to being able to recruit and keep key-personnel within the company. The VP Compensation and Benefits claims that a tobacco company like Swedish Match does compete with the global companies on the tobacco market, and in that aspect Swedish Match are small. If a staff gets contacted by one of the larger global firms, of course it is of interest. Therefore Swedish Match must offer their staff competitive compensation. Maybe not on the level to be able to recruit on the global market, but to keep the key-staff they already possess (VP Compensation and Benefits, SM, personal communication, 2006-11-22).

The Remuneration Plan at Swedish Match

Swedish Match has a remuneration program, where its personnel receive financial benefits if the company or his or her division performs better than expected by the owners (VP Compensation and Benefits, SM, personal communication, 2006-10-31).

The remuneration program for the CEO today is based on the earnings per share (EPS). The increase in EPS should be corresponding to a 20 percentage over the last three years average to receive maximum financial benefit in variable wage. The maximum variable wage that could be collected, by the Swedish CEO, is 35 percent of the fixed salary. However it is possible for the Swedish CEO to receive 100 percent of the fixed wage if one considers the option program that is built in the remuneration scheme. The minimum requirements for the CEO to be rewarded, in monetary terms, are a five percentage increase in EPS over the same three year average (VP Compensation and Benefits, SM, personal communication, 2006-11-22).

For 2006 the Swedish shareholders, more precisely the Swedish institutions, required a change. This was because the Swedish shareholders were afraid that the managers too easily could manipulate the EPS figures, especially since the company has devoted themselves to a repurchase program of their shares. This means that the management easily could increase the EPS that the remuneration was based up on and receive a larger remuneration (VP Compensation and Benefits, SM, personal communication, 2006-11-22).

Hence the program was changed to be based upon the group's net income. The previous compensation scheme was based on the group's net income that should increase and in order for the CEO to attain the full potential of the incentive; the net income should be 10 percent better than previous year. The incentive was calculated from a linear basis from last year's net income to a maximum incentive at a 10 percent increase (VP Compensation and Benefits, SM, personal communication, 2006-11-22).

The driving force behind the change from Annual Net income to EPS was the international shareholders who now own about 80 percent of the company. Lately the international owners have grown to take upon a more active role within the company. They claim that it is important that the measurements that the remuneration programs are based upon are easily affected by the management. Therefore they have now demanded the company to change back to EPS for 2007 (VP Compensation and Benefits, SM, personal communication, 2006-11-22).

Swedish Match has not changed its remuneration programs because of the attention given to remuneration programs in media lately. However, their programs have been changed, as mentioned before, due to changed expectations and claims from the shareholders. Swedish Match does not have one single owner, the owners consists of a number of different shareholders with different interests, both within Sweden, but also from international investors. Lately it has become clear that investors from different part of the world have different philosophies of how a company should be governed. Therefore they do not have one single expectation of the company and accordingly have different opinions about how the remuneration programs ought to be formulated. The board continuously listens to the owners' demands and is doing their best to formulate the program in a way that can be accepted by all (VP Compensation and Benefits, SM, personal communication, 2006-10-31).

An overall objective for Swedish Match is to grow through acquisitions of companies. However, at the moment there are no such investment opportunities for Swedish Match. Therefore they have devoted themselves to a stock repurchase program. This has been done in order to get rid of some of the capital built up in the company (VP Compensation and Benefits, SM, personal communication, 2006-11-22).

The stock repurchase program is induced by the international investors that strongly believe that if the cash built up inside Swedish Match are not paid out to the shareholders the

funds may be used inappropriate, from the owners perspective. In the latest general meeting some of the investors argued for a change in the capital structure of the company and proposed a loan to finance a faster repurchase pace to increase the owners' rate of return (VP Compensation and Benefits, SM, personal communication, 2006-11-22).

An evident issue is recognized here between domestic and foreign shareholders where the international investors incentive to own shares differ from the Swedish. The Swedish investors have demanded a change of the parameters that are connected to the remuneration programs from earnings per share towards net income because of this repurchasing plan of shares, the international investors prefer the earnings per share parameter since that gives the managers an opportunity to directly affect their own remuneration (VP Compensation and Benefits, SM, personal communication, 2006-11-22).

With the help of economical measurements, Swedish Match cannot point out what parts of the remuneration programs that are generating positive or negative effects. However, the company has seen that the share and the company have developed in the right direction. At the same time, they are unable to comment on what the development would have looked like if they had not made use of the remuneration programs (VP Compensation and Benefits, SM, personal communication, 2006-10-31).

At Swedish Match the compensation committee is one instrument they make use of in order to guaranty a good quality of the programs. The committee consists of both people with history within the company but also of external investors. The compensation committee prepares, suggests and draws up the formulation of the programs and hand it to the board to take a decision on. The options program is also submitted as a proposal for the annual general meeting to decide upon. The compensation committee also settles the results before the payments of the incentives and does also decide upon the amount that is paid to the management team (VP Compensation and Benefits, SM, personal communication, 2006-11-22).

VP Compensation and Benefits claims that Swedish Match's remuneration programs hold a high degree of transparency; therefore increased transparency would not increase the legitimacy of them (VP Compensation and Benefits, SM, personal communication, 2006-10-31).

Performance and Remuneration of Swedish Match

An important part when it comes to address the efficiency of any remuneration program is to compare the company performance, remuneration and return to the shareholders. Hence, when shareholders receive a high return on their stocks in terms of relative increase and dividend, the CEO should receive a larger incentive. According to Swedish Match, the remuneration program and the monetary incentives is created to unite the shareholders and managements interest and in the long run create a trust between management and shareholders. The authors have collected data covering company performance and remuneration between the years 2000 and 2005 from the company's annual reports.

The value of Swedish Match's share has skyrocketed. In the beginning of January 2000 the share held a value of 29.9 SEK. By the end of December 2005 this value had doubled itself a number of times to in the end of December 2005 be 93.5 SEK. Just like the share value has increased during these year, so has the compensation to the CEO. During these years the set wage has increased with about 60 percent. At the same time the variable wage has increased with about 55 percent (Swedish Match, 2000-2005).

ROE started out with a value of 21.80 percent in 2000 and ended at 36.60 percent with a top in 2003 and then a slight decrease until 2005. However, the value for 2005 was still better than the value presented in 2000. Turning to TSR instead, one realizes that the value started out at 27.59 percent and had its top value in 2001 with 56.80 percent. Since then the value has been decreasing and reached its lowest value in 2004 with a value of 5.20 percent to once again increase to 22.96 percent in 2005. The variable wage received by the CEO as a percent of the fixed wage has not fluctuated much during the years, but have stayed within the range of 28 to 34 percent (Swedish Match, 2000-2005) (see, appendix 3).

4.1.3 Ericsson

Ericsson is a company that supply fixed network operators over the world with telecommunications equipment and services associated with these products (Ericsson, 2006). Ericsson's stock, both preferred and common, can be bought on the Stockholm Stock Exchange. At the same time common stock can be bought on the London Stock Exchange as well as on the American Stock Exchange NASDAQ (Ericsson, 2005).

Ericsson does not make use of the term bonus program since it can be misinterpreted as a compensation that has not previous been part of the agreement, hence, a gratuity. Therefore they state that the correct term to use is variable wage which is different from the set wage. The variable wage can consist of both an annual incentive and a long term incentive. The variable wage should be related to performance and connected to goals that are measurable. These goals should be predetermined and accepted by the proper manager (IR Manager at Investor Relations department, Ericsson, personal communication, 2006-10-11).

Benefits of the Remuneration Plan

Having a variable incentive in terms of options/shares as well as variable salary creates a clear connection between individual performance and company result. In the short and long run this will enhance the motivation of the CEO and establish a clear focus on the company goals. The board of directors represents the principals of the company and sets the goals of the company, reassuring that the interests of the owners are looked after (IR Manager at Investor Relations department, Ericsson, personal communication, 2006-11-21).

The Remuneration Plan at Ericsson

The remuneration program Ericsson makes use of consists both of a set wage, which is set to a level that is competitive on the market and a variable wage. The performance is especially reflected in the variable wage, both when it comes to the annual and the long term incentive plan. The variable wage accounts for approximately 60 percent of the CEO's total compensation. Whereas the other 40 percent is depending on how well the CEO manages to meet the predetermined goals, which to a large extent are the financial targets at corporate level. The annual incentive plan is based on cash whereas the long term incentive plan is based upon shares (IR Manager at Investor Relations department, Ericsson, personal communication, 2006-10-11).

Ericsson has chosen to make use of a remuneration system since it provides a clear connection to performance and the company's result both in short and long term. It also creates a motivation and a focus among employees to reach the pre-set goals (IR Manager at Investor Relations department, Ericsson, personal communication, 2006-10-11).

Quality of the Remuneration Program

Since the overall goals of Ericsson is determined by the board, which is representing the owners, the conflict of interest between the two groups is minimized, since both parts interest will be taken into account. At the same time it is the board that is in charge of deciding the variable and set wage. It is also their responsibility to judge the performance of the CEO. These set goals by the board are then transferred down to the different departments of the company to make sure they are fulfilled (IR Manager at Investor Relations department, Ericsson, personal communication, 2006-10-11).

It is the annual general meeting that takes the final decisions about what the remuneration programs should look like for the CEO and the rest of the board. At the same time the annual general meeting set all long-term incentive programs that are related to shares. Since the general meeting is representing the owners of the company, the owners do not have any objectives towards the company's remuneration program, since they are the ones deciding about it (IR Manager at Investor Relations department, Ericsson, personal communication, 2006-11-21).

According to the IR Manager at Investor Relations department, no changes have been made in Ericsson's remuneration program as a result of media's harsh coverage on the subject. However, the company is carefully following the development of wages and other compensations on the market. This since they want to be able to offer compensation packages that is competitive on the market. The company is also paying attention to the ongoing debate about managers' compensations in Sweden and abroad. The IR Manager at Investor Relations department does also state that an increase in transparency would not automatically increase the legitimacy of the remuneration programs (IR Manager at Investor Relations department, Ericsson, personal communication, 2006-10-11).

Performance and Remuneration of Ericsson

Ericsson makes use of both preferred and common stocks. Both shares have declined in value since 2000. Both shares reached its lowest value during 2003 and have since then slowly started to increase again. However, the drop in value are still major considering the value of the preferred share started out with 102.01 SEK in January 2000 and closing in 27.50 SEK in December 2005. A similar drop in value can be seen in the common share which started out being worth 100.21 SEK in the beginning of January and plummeting to 27.30 SEK in the end of December. Even though no variable wage has been mentioned in the annual reports for the CEO during 2000 and 2001 it is worth mentioning that no variable wage has been paid out 2002 and 2003. Pension has still been paid out for these years. 2004 and 2005 the CEO received a variable wage again for his performance (Ericsson, 2000-2005).

In 2003 Ericsson had a negative value of ROE, negative 16.20 percent. In 2004 the value was up to 27.60 and in 2005 it was 26.20 percent. During the same period of time, the company started out with a value of TSR at 91 percent. This value has decreased to 64 percent in 2004 and to 31 percent in 2005. If one instead consider the variable wage earned during the year and later paid out to the CEO the following year as a percentage of the fixed wage one can see that in 2003 the CEO received a variable wage that corresponded to 109.55 percent of the fixed wage. The variable wage decreased to 59.60 percentage in 2004 and 59.70 percentage in 2005 (Ericsson, 2000-2005) (see, appendix 3).

4.2 Companies without a Remuneration Plan

4.2.1 Holmen

Holmen is a manufacturing company within the forest industry. Among their main products are printing paper, cardboard, and timber. However, the group of companies Holmen is a part of, also own forest and energy resources. The company's shares are noted on the Stockholm Stock Exchange (Holmen, 2005).

Remuneration programs have never been a big matter at Holmen and have never resulted in any greater discussions. This has created a tradition for the company not to make use of any such programs. Holmen has had a high turnover on their CEO position during the last few years but this is something more connected with expected retirements. At the same time the company has not found it hard to recruit key personal to their company. If a potential job applicant has had a remuneration program as a top priority for a future employer the applicant has either chosen not to apply at all, declined the job offer or has fallen off elsewhere in the recruitment process (Executive Vice President CFO, Group Finance, Holmen, personal communication, 2006-12-07).

The fact that Holmen does not make use of any remuneration program today does not mean that the company will never do so, since the company has not carried through an analysis of the pros and cons of a potential remuneration program. But the Executive Vice President CFO, Group Finance (personal communication, 2006-12-07) does also state that it is difficult to draw any conclusions when it comes to if the CEO would behave differently if a remuneration program is in use or not.

Arguments against Remuneration Plans

At the same time as Holmen is arguing that the reason for not using a remuneration plan in terms of options nor variable salary is not based on any deeper discussions or analysis. They keep themselves posted on the current discussions and research on the matter. On the other hand the choice is actually based more on tradition than general opinions and industry standards. Hence this creates an open mind and states that they are not locked in to any position on the topic and might in the future change its policy if it would be beneficial to the company for various reasons (Executive Vice President CFO, Group Finance, Holmen, personal communication, 2006-12-07).

Performance and Monetary Compensation of Holmen

Holmen make use of both preferred and common shares. During the six years the authors has taken into account Holmen's share value has decreased. The preferred share has decreased from a value of 315 SEK in the beginning of January 2000 to 277 SEK in the end of December 2005. The common share show a similar trend, starting out with a value of 311.50 SEK in the beginning of January 2000 ending up in a value of 262.50 SEK in the end of December 2005. Even though the share value has decreased the CEO has received a slight increase in the wage. In 2000 the CEO received a wage worth about 5 million. This sum increased over the years and in 2004 the CEO received about 6.3 million. However, then a change of the trend occurred and the following year, in 2005 the CEO only received 5.4 million (Holmen, 2000-2005).

Holmen had a ROE of 22.40 percent in 2000. Since then the ratio has declined slightly every year and in 2005 the company had a ratio of 8 percent (Holmen, 2000-2005) (see, appendix 3).

4.2.2 SHB

SHB is a bank that offers their customers services within the whole banking area. The bank has offices in all Nordic countries as well as in Great Britain (Handelsbanken, 2006a). SHB is the oldest company that is still listed on the Stockholm Stock Exchange (Handelsbanken, 2006b).

At SHB the authors has been in contact with Bengt Ragnå, who is the Head of investor relations and since the bank do not make use of remuneration programs for the management team, the Head of investor relations does not have any definition of the term.

Arguments against Remuneration Plans

At the senior level, the question whether or not to make use of remuneration programs is also a philosophical matter. Anybody can sell credit agreements; the skill is to get the money back. Therefore business activities including credit agreements and remuneration is two matters that do not go well together at all (Head of investor relations, SHB, personal communication, 2006-11-23).

During a long time, more precisely 35 years, Handelsbanken has had a profit-sharing system where, given that the profitability of the bank exceed the average of comparable banks, a part of the higher earning capacity can be set aside to a foundation, Oktogonen, that is controlled by the staff. The incentive earned by all employees and placed in Oktogonen can be received when the employee reaches 60 years of age. If one would have been employed by SHB since 1973 the value of that incentive today would be approximately 7MSEK whether one is a janitor or manager (Adler, 2006, October 24). Since this system has its starting point in the bank's financial goals, the question about remuneration programs has not been current (Head of investor relations, SHB, personal communication, 2006-11-23).

Included in the tasks that are integrated in the board's assignment is to continuously value the CEO's performance. The Head of investor relations assume that this evaluation do not occur according to any diagrammatic model (Head of investor relations, SHB, personal communication, 2006-11-23).

In general, banks are not positively approached in the media, but since the company differ in this matter and do not make use of remuneration programs, they are at least not approached negatively because of that (Head of investor relations, SHB, personal communication, 2006-11-23).

The bank does have a variable wage based on the result in Handelsbanken Market in the areas where such a thing is the norm. However, in the other parts of the bank, the bank themselves do not believe that is appropriate. This because the office sell products to the customers that are most suitable for them, not what is most profitable for the bank's short term profitability. That is a security both for the customer and the staff. One of the bank's best arguments for sales is that the staff does not receive compensation what so ever that is connected to the sales they make or what products a sales person/adviser suggests. Therefore the choice of not making use of remuneration programs is also positive from the point of view that the customers' fear that a sales person suggests a solution, just because of his or her own advantage, can be minimized (Head of investor relations, SHB, personal communication, 2006-11-23).

In the long run, the Head of investor relations claim that all actors on the market need to pay a wage that is competitive on the market in order for the company to be able to attract

staff. It does not matter if one labels it as wage, bonus, pension or any other form of compensation (Head of investor relations, SHB, personal communication, 2006-11-23).

Performance and Monetary Compensation of SHB

SHB make use of both preferred and common stocks. Both shares show a good increase in value during the six years taken into account. The preferred share started out with a value of 108.00 SEK in the beginning of January 2000 and in the end of December 2005 the value had increased to 197.00 SEK, hence, an increase of 82%. The common share on hand increased in a similar way from a value of 103.00 SEK in the beginning of January 2000 and by the end of December 2005 the share was worth 196.50 SEK. That represents an increased value of 91%. During these years the share value has sky rocketed, the CEO's wage has not developed at the same rate. 2001 the CEO received a wage of about 4.5 million SEK. By 2005 the wage had increased to 7.5 million SEK which means that the CEO's wage has increased by 67 percent since 2001 (Handelsbanken, 2000-2005).

SHB started out with a ROE of almost 49 percent during 2000. Since then the ratio has decreased slightly every year until 2003 when the bottom was reached with 38.12 percent. Since then the value has increased, ending up with a value of 40.12 percent in 2005 (Handelsbanken, 2000-2005) (see, appendix 3).

5 Analysis

This chapter will analyze whether or not remuneration programs fulfill their purpose. A focus will be put upon the results of the questionnaires and interviews that have taken place in order to be able to fulfill the thesis purpose.

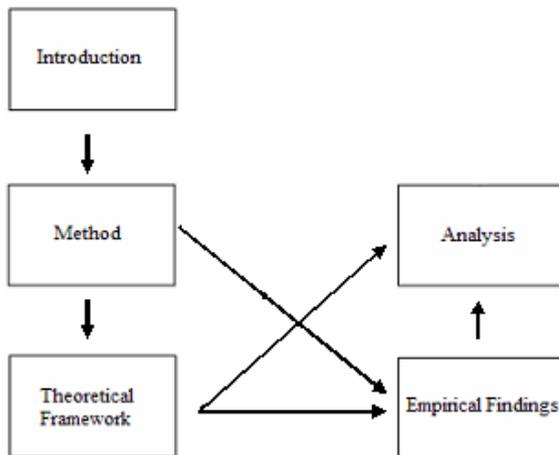


Figure 5-1 Analysis

5.1 Companies with a Remuneration Plan

In this section the three companies that use a remuneration program, OMX, SM and Ericsson, and are part of this study will be analyzed. First the authors will examine the companies separately and then compare them to each other

5.1.1 Principal Agent Theory

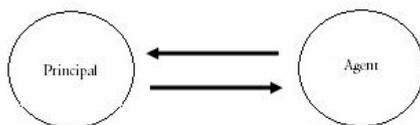


Figure 5-2 Principal Agent Theory

The Principal Agent Theory set the problem by assuming that the relationship between owners and managers may incur costs for the company for various reasons. The cost incurred are monitoring expenses by the principals, bonding expenditures by the agent, and residual loss that occurs from the suboptimal decisions that may be made by the manager. These costs are often difficult, or impossible, to locate since they may be intangible. However, the most evident cost that the authors found is the remuneration program as a monitoring cost that are induced by the principals, and offered to the manager in some companies.

OMX

The Head of Compensation & Benefits at OMX (see, personal communication, 2006-10-10. See ch. 4.1.1) points out that when a remuneration program is at its best it facilitates the

employee to perform at the top of his or her ability and in the interest of the company. In other words, the Head of Compensation & Benefits claim that a remuneration program does affect the conflict going on between principals and agents in accordance with the Principal Agent Theory (see, Jensen and Meckling, 1976. See ch. 3.1).

The reason why OMX make use of a remuneration plan is, according to the Head of Compensation & Benefits, that it is necessary to be able to recruit high-quality personnel, it enables the board to steer the managers on behalf of the owners and at the same time it is a good tool to motivate the management (see, personal communication, 2006-11-28. See ch. 4.1.1). Since the Head of Compensation & Benefits claim that the remuneration programs enable the board to steer the management, one can claim that the remuneration programs does decrease the conflict occurring according to the Principal Agent Theory (see, Jensen and Meckling, 1976. See ch. 3.1); since the manager acting on behalf of the owners.

The conflict is occurring since agents in general tend to behave in a way that is beneficial for him- or her-self, however if the board manages to steer the agent to take the decisions they prefer the conflict of interest is reduced. OMX's remuneration plan is composed of both short and long term incentives and this remuneration plan is a monitoring expenditure incurred by the principals (see, Jensen and Meckling, 1976. See ch. 3.1.1). Which means both the short term performance is encouraged as well as the long term loyalty towards the firm is strengthened. This implies that the company manages to affect the CEO's way of behaving both when it comes to the short term decisions as well as the long term strategy for the company.

At the same time OMX claim that it is important for the company to be able to offer a decent remuneration program in the recruitment process of new staff members (see, personal communication, 2006-10-10. See ch. 4.1.1). This can be connected with what Jensen and Meckling (1976. See ch. 3.1.2) labels bonding expenditures.

Swedish Match

SM argues that a variable wage is good for the company's short term results as well as in a long term perspective. Furthermore SM uses the monetary compensation as a tool to steer the management, in particular the CEO. An additional point that the VP Compensation and Benefits made was the fact that it is an advantage when it comes to keep, and recruit, key personnel, since SM competitors make use of remuneration programs (see, VP Compensation and Benefits, SM, personal communication, 2006-11-22. See ch. 4.1.2)

Since SM argues that it is possible for the owners to steer the agent with an incentive program. One may observe a pattern that the Principal Agent conflict is minimized since the owners, probably, are satisfied when they are able to steer the agent (see, Jensen and Meckling, 1976. See ch. 3.1). However the monitoring expenses, that an incentive program incurs, are a cost that the principals bear, which in turn increase the internal frictions between the principals and agent.

This resistance against an increase in the monitoring cost is apparent from the Swedish institutional shareholders, who did vote against the new remuneration scheme at the extraordinary general meeting in December 2006. Obviously the agency costs (see, Jensen & Meckling 1976. See ch. 3.1) are there, and there are probably disagreements of how the company should be run between different shareholders, in this case domestic and foreign.

From Jensen's article (1986. See ch. 3.1.4), the authors find a pattern that the funds internally generated by SM are Free Cash Flow, and are closely connected to the agency cost of free cash flow. To overcome the Free Cash Flow problem the international owners have

demanded a “textbook” action i.e. to distribute the funds to the shareholders instead of investing in low profit actions or accumulate cash within the company. Furthermore the international owners have argued that SM should borrow funds to be able to faster reach the goal of the stock repurchase, which is an internal ownership of 10 percent of the shares.

According to the VP Compensation and Benefits there are no good present investment opportunities for SM (see, VP Compensation and Benefits, SM, personal communication, 2006-11-22. See ch. 4.1.2). This is one argument in favor for the foreign owners demand to commit to the stock repurchase program that Swedish Match has devoted to. Hence, instead of accumulate cash internally, they should be paid out the shareholders (see, Jensen, 1986. See ch. 3.1.4)

An interesting fact that struck the authors is that SM does not, today, have any shareholder representatives at the board. Because with no board representatives the principals do not have any influence over the everyday activities. Nevertheless, the VP Compensation and Benefits is sure that at the next general meeting, in the beginning of 2007, there will be representatives from Wellington Management an American Fund who is the largest shareholder in SM (see, VP Compensation and Benefits, SM, personal communication, 2006-11-22. See ch. 4.1.2).

At the extra ordinary general meeting on 4th December 2006, the foreign owners steered the company in their best interest, even though they do not have any representatives at the board. This trend is not uncommon for companies, in which the previous major owners have been passive, for the new major owners to take on a more active part. This is an obvious act to try to achieve a lower the agency cost of Free Cash Flow from the shareholders. The monitoring actions from the investors are to clearly specify the course of action for the company to the management.

Ericsson

A remuneration plan helps the board steer the behavior of the CEO both in the short term decisions as well as create a loyalty for the company with the long term incentives (see, IR Manager at Investor Relations department, Ericsson, personal communication, 2006-10-11. See ch. 4.1.3). This reduces the conflict that arises according to the Principal Agent Theory (see, Jensen and Meckling, 1976. See ch. 3.1). The fact that the long term incentive plan includes stock options makes the CEO part owner of the company. That also reduces the conflict of interest since the CEO also becomes part of the group of owner whose interest is to increase the share value. The fact that it is the board, which is representing the owners that determine both the design of the program as well as the one that is evaluating the CEO’s performance and to what degree the remuneration will be paid out, the conflict will also be minimized.

5.1.2 Compensation Policy

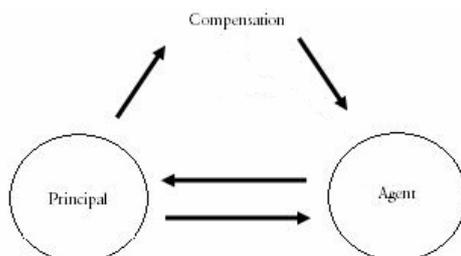


Figure 5-3 Compensation policy

OMX

Previously, more precisely until 2002, OMX did use an option program that all staff at OMX benefited from. However, it was cancelled since the company sensed that it did not fulfill the purpose they were expecting of a remuneration program. Since everybody benefited from it, the program did not manage to steer the behavior of the management (see, Head of Compensation & Benefits, OMX, personal communication personal communication, 2006-11-28. See ch. 4.1.1).

Swedish Match

SM remuneration plan was until the beginning of 2006 based on Earnings Per Share (EPS) but was changed to net income by request of the Swedish shareholder's. The Swedish institutions were afraid that the manager too easily could manipulate the EPS figures due to the fact that SM has devoted themselves to a stock repurchasing program (see, VP Compensation and Benefits, SM, personal communication, 2006-11-22. See ch. 4.1.2). The authors claim that this is an action of minimizing the conflict between principals and agent (see, Jensen and Meckling 1976. See ch3.1). An open attitude towards input from the shareholders is an important step and SM has been able to show transparency and willingness to change their remuneration program. The current remuneration plan that was agreed upon during the extra annual meeting of December 2006 once again changed the remuneration plan back to EPS but with a new goal that added a long run variable. In order to receive any variable salary the EPS must have an average increase of 5 percent during a three year period and the maximum is reached at an average increase of 20 percent. From the international shareholder's perspective, EPS is a better goal and is more impressionable for the management.

The transformation of the remuneration, presented at the extra ordinary general meeting 4th December 2006, is not due to any attention in media or any other publicity, the transformation was completely driven by changed expectations from the owners and their ability to steer the company (see, VP Compensation and Benefits, SM, personal communication, 2006-11-22. See ch. 4.1.2).

Based on the structure of the remuneration program within SM, the shareholders would also gain from when the company has made a strong result and hence the CEO has received remuneration in terms of variable salary and options (see, VP Compensation and Benefits, SM, personal communication, 2006-11-22. See ch. 4.1.2).

Although, Swedish Match has been able to keep key personal within the company and been able to show a strong growth and result during these last five years, which can be seen both in the CEO incentive plan as well as in the growth of the Swedish Match stock.

Ericsson

Ericsson's remuneration program consists of both a set and a variable wage. The plan is constructed in such a way that the short term incentives are based upon cash while the long term incentives are based upon shares. The remuneration program is a cost for the company that they pay in order to assure that the agent behaves in a way that is beneficial for the company (see, IR Manager at Investor Relations department, Ericsson, personal communication, 2006-10-11. See ch. 4.1.3). This cost Jensen and Meckling (1976. See ch. 3.1) call monitoring expenditures.

Together, the variable incentive component is set to a target of approximately 40 percent of the total remuneration (fixed salary, annual incentive and long term incentive), the remaining 60 percent for the annual fixed salary. Ericsson is comparing the remuneration

program to international wage trends in order to find performance driven remuneration programs. The annual short term incentive plan is derived from the annual business plan, and approved by the board of directors. The authors have not been able to obtain the exact targets for the CEO incentive plan but one major part is the financial targets at corporate level. The share based long term incentive plan is submitted every year for approval at the annual general meeting.

The combination of approval of the remuneration plan by the board of directors and the annual general meeting creates a foundation for legitimacy among the owners. The authors have found that during the heavy recession of 2001 and 2002 no variable salary was paid to the CEO, but the shifting result in 2003 which implied a large growth in Total Shareholder's Return (TSR) did also generate an increase in the variable salary of the CEO. The changes in TSR and variable salary are hard to compare in the long run but a short run trend that they are related can be seen in the figures concerning CEO compensation and the TSR. Which the authors claim is important in order to keep legitimacy of the remuneration program among the shareholders.

5.1.3 Measurement of Management Performance

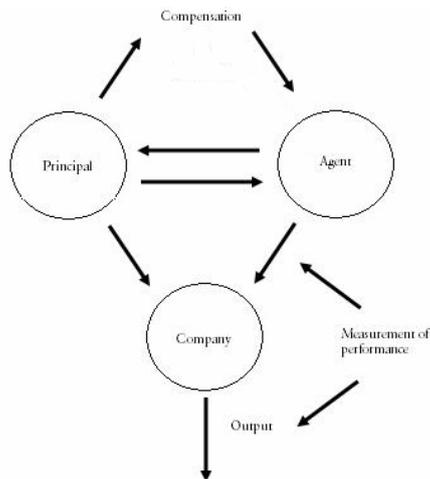


Figure 5-4 Measurement of management performance

OMX

Following the vast decrease on the Stockholm Stock Exchange after the burst of the IT-bubble, OMX was showing negative results between year 2001 and 2003. This logically implies that there was a large drop in the price of the OMX share. Between December 2000 and 2003 the OMX share decreased about 82 percent, hence the Total Shareholder's Return (TSR) also had a negative development. Based on OMX current remuneration program 60 percent of the variable salary or incentive is derived from the company's financial results and 40 percent from personal goals. Due to the negative results and poor performance of TSR during 2001 and 2002 the comparison between CEO compensation and return becomes even more interesting.

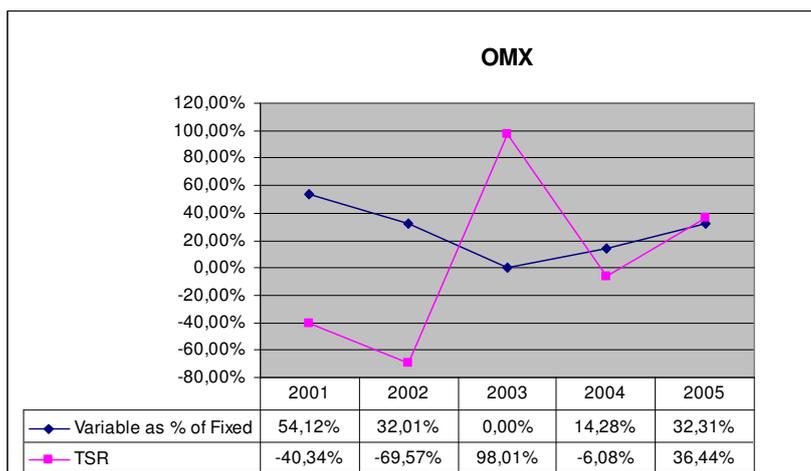


Figure 5-5 OMX, Variable wage as % of fixed and TSR

In 2001 and 2002 the CEO did get variable salary despite the fact that the TSR were negative. In 2003 the restructuring of OM to OMX were complete and the incentive scheme was restructured to a more reasonable one. Considering the five years period in the figure above (see, figure 5-5) there seem to no relation between what the total return to shareholder are and the variable wage that the CEO obtains. However in the last two years there is a tendency, however weak and it may be a coincidence, that the TSR and the variable wage are following the same pattern (see, figure 5-5), and hence the company's explanation of why and to what purpose they do use monetary incentives is probably accepted by the shareholders.

The remuneration programs are created to strengthen the relationship between management and the shareholder's (see, The Head of Compensation & Benefits at OMX, personal communication, 2006-10-10. See ch. 4.1.1). This in order to minimize the gap between the principals and the agents and reassuring that optimal decisions in the shareholder's best of interest are taken (see, Jensen and Meckling, 1976. See ch. 3.1). The authors have found that during the years 2001 and 2002 a variable salary of 54,12 percent in 2001 and 32,01 percent in 2002 of the fixed salary was paid to the CEO, this despite the negative ROE figure.

According to the annual report 2003 this created a discussion between the company and the shareholders', which resulted in a new remuneration policy and further that no variable salary was paid to the CEO during 2003. The new remuneration structure lowered the maximum variable salary from 100 percent to 50 percent of the fixed salary and a stronger emphasizes to sharpen employees' focus on shareholder value related to growth and profitability. Based on the 2005 data the maximum variable incentive would be 50 percent of the fixed salary, from the fact that no long term incentive or stock matching programs has been introduced.

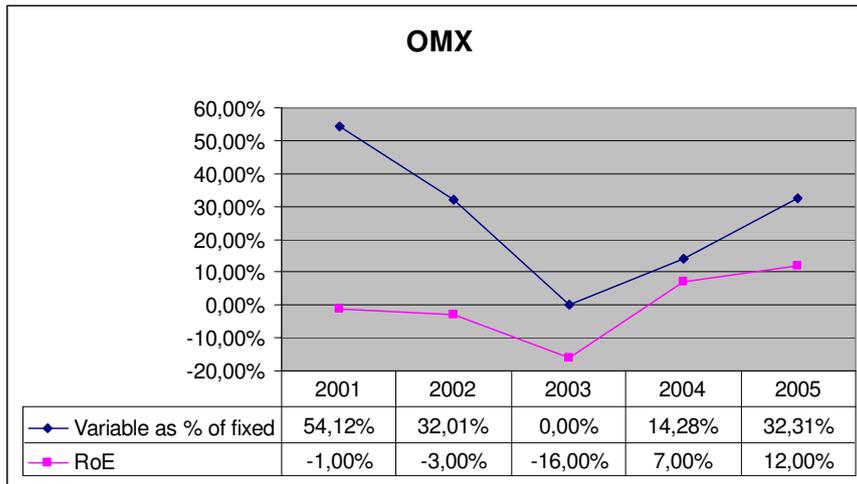


Figure 5-6 OMX, Variable wage as % of fixed and ROE

Looking at ROE to determine the company's performance, one can see that in 2001 OMX had a negative return on shareholder's equity (see, figure 5-6). Which last until 2004 when ROE has turned positive and in 2005 the company almost made it to the 15 percent the investors generally are demanding (see, McClure, 2005. See ch. 3.6).

ROE and variable salary as a percentage of fixed is however more closely related. Though in 2001 and 2002 the CEO got bonus despite that the return on shareholders equity were negative, but here as well as compared to TSR from 2003 and onwards there seem to be a closer relation to the performance and the variable wage the CEO collects.

Swedish Match

During these five years SM has had a steady growth both in terms of stock price on the stock exchange as well as ROE. Furthermore SM was not as severely affected by the burst of the IT-bubble during the year 2000 which is evident when one compares SM to other companies. To some extent this can be explained by the type of goods SM produce and the elasticity of demand on tobacco. In order to create acceptance from owners and legitimacy for the remuneration programs, it is important that there is clear connection between the results of SM and the size or value of the variable incentive.

Considering the increased value of SM's shares, an investor will most likely be satisfied. The percentage increase gives the owners a good return on their invested capital. If assuming a large increase in the share value is the sole goal for the investors, one can conclude that the company and its CEO have succeeded to overcome the conflict of interest that appears between the principals and the agent. At the same time the CEO's compensation has increased both in terms of the set wage as well as the variable wage. One can see interplay between the two values and that could be explained with the fact that the CEO has managed to take decisions that have been beneficial for the company.

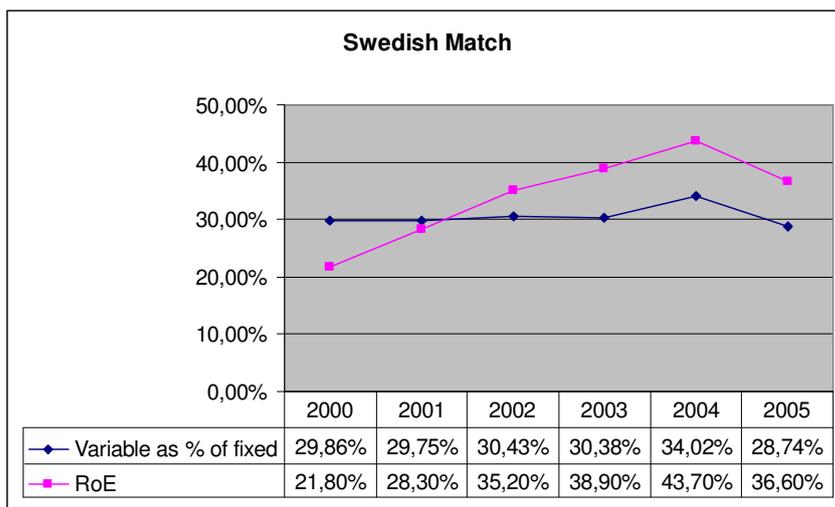


Figure 5-7 Swedish Match, Variable wage as % of fixed and ROE

When looking at the company’s ROE, an investor would be satisfied. The ratios presented by the company meet the professional investors’ expectations with a good marginal (McClure, 2005. See ch. 3.6). SM has had quite a stable percentage, around 30 percent, of variable salary as a percentage of fixed. A interesting point is that in 2005 when the ROE decreases so do the weight of the variable wage, the data indicates that the ROE and variable wage is somewhat connected for SM during the past five years.

According to the VP Compensation and Benefits is it very hard to monitor the effects of the remuneration program, but the company and the stock has had a positive development during the last five years. However, what the development would have looked like without the remuneration and incentives is impossible decide.

The repurchase program, and the reason behind it, is an example of how owners are able to steer agents to behave in their preferred way, the cash that Swedish Match use to purchase stock is appropriate labeled as Free Cash Flow, and one can identify the problem brought up in the principal agent theory (VP Compensation and Benefits, SM, personal communication, 2006-11-22. See ch. 3.1.4).

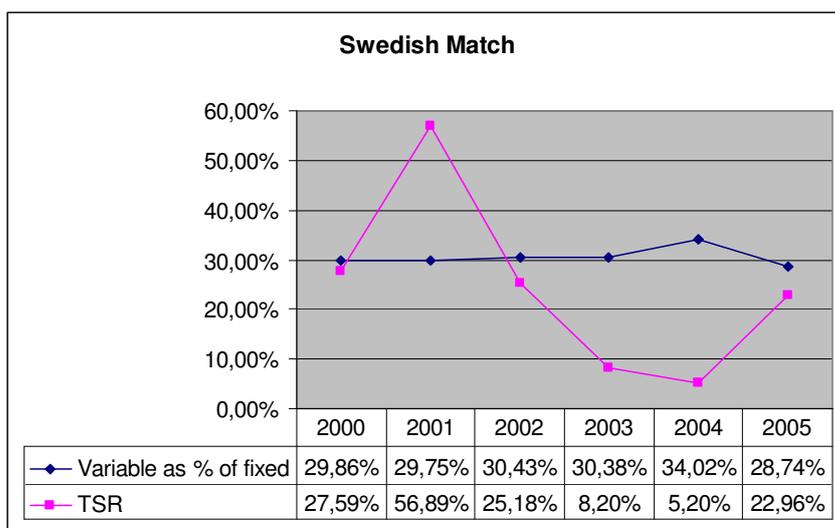


Figure 5-8 Swedish Match, Variable wage as % of fixed and TSR

In SM their TSR and variable wage are not at all correlated, this indicates that the shareholders return and the wage their CEO receives does not reflect what return the shareholders earn on their stock, see figure 5-8.

Ericsson

If one judge a CEO's performance by looking at the share value, one should be pleased to know that the Ericsson CEO did not receive any variable wage during the two of the three years during the period investigated. However, the year following when the company managed to turn the results again, the CEO were ones again rewarded with a variable wage.

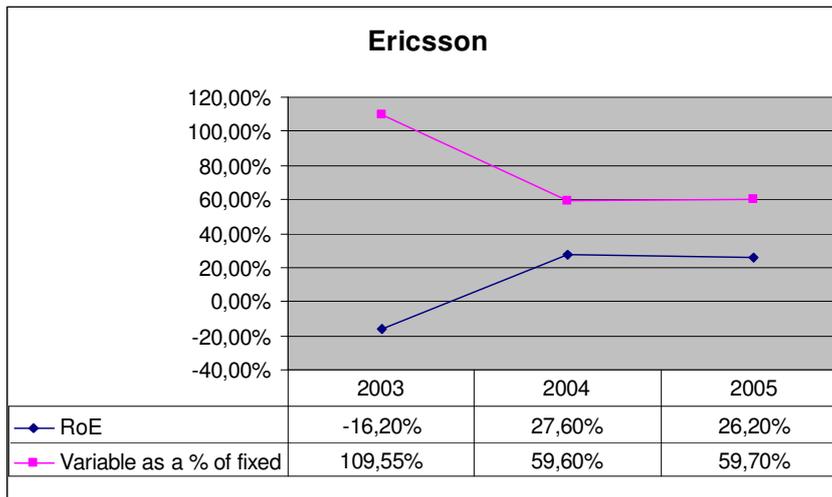


Figure 5-9 Ericsson, Variable wage as % of fixed and ROE

Looking at the value of ROE for Ericsson, one realize that during their good years 2004 and 2005 the company fulfils the requirement of what a professional investor require (see, McClure, 2005. See ch. 3.6). Therefore, if one makes use of this ratio to measure a company, and therefore a CEO's performance, one can claim that the company has made sure to fulfill the shareholders interest. Looking at the Principal Agent Theory (see, Jensen and Meckling, 1976. See ch. 3.1) one can therefore also state that the conflict of interest that occurs between the principal and the agent has been managed during the good years, but not during the bad years (see, figure 5-9).

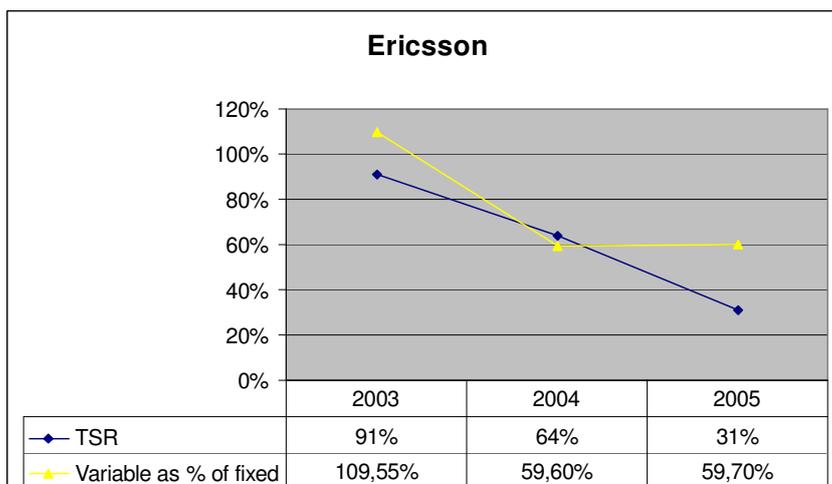


Figure 5-10 Ericsson, Variable wage as % of fixed and TSR

Comparing the shareholders total return and the CEO's variable earned in Ericsson between 2003 and 2005 there are no tendencies that indicates any relationship between (see, figure 5-10).

5.1.4 Motivation Theory

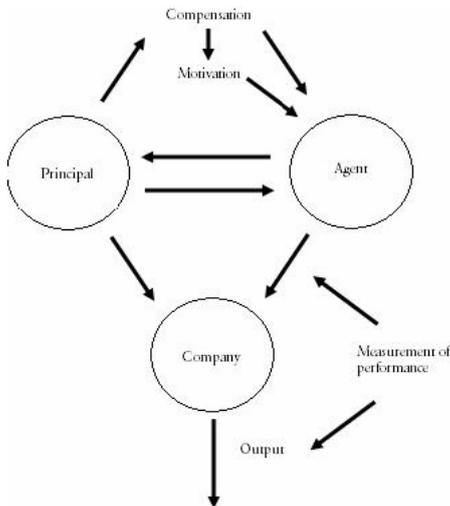


Figure 5-11 Motivation Theory

When talking about remuneration programs, motivation is frequently mentioned as a reason behind incentive schemes. The companies investigated in this thesis that uses a remuneration program state that they do so, partly, because the program motivates their CEO to perform better. From one perspective humans are and probably always will strive for wealth.

Consequently the agents will, according to the Principal Agency Theory, take decisions that they personally benefit the most from, not necessarily the decisions that maximizes the company's value (see, Jensen and Meckling, 1976. See ch.3.1). In those cases a well designed remuneration program can motivate a CEO to make decisions that are in line with what is best for the company, since the remuneration program will make the CEO receive more monetary benefits by taking decisions that are inline with the board.

Maslow's Hierarchy of Needs

An intuitive assumption, and probably very much the truth, is that any given CEO in either of the investigated companies is striving for the higher steps on Maslow's hierarchy of needs. With higher steps the authors refer to the part where money does not really make any difference, hence from "contact" to "self-fulfillment" (see, Maslow, 1943. See ch 3.3.1). The above statement is true whether or not the CEO is rewarded any variable wage or not.

What else may the money itself contribute with if it is not necessary for the basic needs? Even though money to some extent can buy extra security, however, the authors claim, that money itself cannot buy self-esteem or dignity.

To understand why and what purpose the incentive schemes are implied the authors remember a interesting point made by the VP Compensation and Benefits at Swedish Match (see, personal communication, 2006-10-31. See ch. 4.1.2) "If the company produces a good result the management's compensation will increase which strengthen the loyalty and unification as well as increased the motivation". Is this absolutely true in every situation? The authors have interpreted the statement as a psychological motivation factor, if the manager

is able to manage a large corporation in a suitable manner he or she will at least get to the “appreciation” level. Hence a connection between the motivation that the VP Compensation and Benefits at Swedish Match observes and psychological factors, to climb Maslow’s hierarchy, does exist.

However, important to take into consideration is what part of the remuneration program is actually uniting the group. Is it the money earned by the CEO or is it the overall goal achieved by the company? Walking up the stairs of Maslow’s hierarchy of needs one can make use of this kind of reasoning. Is it monetary compensation itself or rather everything that comes together with them that in the end is the major motivator for the CEO.

Herzberg’s Motivation-Hygiene Theory

Considering Herzberg’s Motivation-Hygiene Theory (see, Herzberg, 1993. See ch. 3.3.2), the above reasoning is taken one step further. Herzberg talks about two different components that are essential for a person to be fully motivated. The first component is the hygiene factors, which include the wage and the remuneration and the second is the motivation factors which are related to the assignment.

Both OMX (see, Head of Compensation & Benefits, OMX, personal communication, 2006-10-10. See ch 4.1.1.) and Swedish Match (see, VP Compensation and Benefits, SM, personal communication, 2006-11-22. See ch. 4.1.2) mention that the remuneration programs are required both to recruit new personnel to the company as well as to keep key personnel within. This can be interpreted as hygiene factors, since if the person is unhappy with the monetary compensation from the company, and believe that another company offer compensations that fit the CEO’s hygiene factors more accurate. The company may either loose their manager or the manager may take actions that are in his or her own interest which Jensen and Meckling describes in their Principal Agent theory.

On the other hand, if the motivation factor is not fulfilled, i.e. the working tasks do not challenge the manager. According to Herzberg’s Motivation-Hygiene Theory (see, Herzberg, 1993. See ch.3.3.2), it will not matter if the remuneration program is generous; the CEO will still not be fully motivated and will therefore not perform. To sum up, the monetary compensation is important when it comes to motivating the agent however it is far from the only component that matter.

Furthermore, does the Principal Agent Theory mention anything about motivation (see, Jensen and Meckling, 1976. See ch 3.1)? The Principal Agent Theory stresses the fact that an employed manager is not as motivated, or at least may have different incentives to run the business, as an owner-manager. If the agent, in a principal agent relationship, is unsatisfied he or she may work in their own manner and are unsatisfied.

In OMX, Swedish Match and Ericsson, one realizes that they all make use of option programs as part of the remuneration scheme, in the long run this part of the remuneration does imply that the manager will own a part of the company that he or she works for and may provide the management with a long term incentive to run the firm properly.

In an owner-manager situation there exist no such thing as a Principal Agent relationship, however in a relationship whereas the agent is a part owner of the company he or she will get the same return on the shares as any shareholder. The conflict may decrease if the manager partly owns the firm since he or she will strive to increase the value of the shares. Therefore the principal becomes motivated to make decisions that are in the best interest for the shareholders, since he or she is part of that group.

5.1.5 Comparing the Companies with a Remuneration Plan

Having analyzed all the companies one at a time it is time to compare them with one another. The authors have found that the companies making use of a remuneration program make use of similar arguments why they are doing so.

The companies that have a variable wage system have a clear purpose why they have an incentive based remuneration program. The arguments in favor of a remuneration program were almost the same in all of the companies. In the short term perspective the companies claim that they are able to steer the management and hence reduce the conflict of interests. In a long term perspective their arguments were to be able to attract new employees, which could be interpreted as bonding expenditures (see, Jensen and Meckling, 1976. See ch. 3.1.2), and to create a loyalty to the company.

At the same time it is important to realize that the remuneration program also works as a means of competition, the company need to pay more, or at least as much as their competitors in order to be able to tie the agent to their company.

Figure wise, OMX and Swedish Match had a return on equity that were somewhat correlated to the variable wage that their respective CEO received. Ericsson on the other hand did not have any connection between their ROE and variable wage. The Total Shareholder's Return could not in any of the companies be related to the weight of variable salary to the fixed. As the TSR is what the shareholders money wise, actually are able to collect annually from their shareholding, this seem surprising that the TSR return is not connected to the agents "return". It is worth mentioning that for all the companies the relationship appears to improve from 2003 and onwards.

By considering the companies that make use of a remuneration program, the authors have become aware that the variable wage functions as the hygiene factory in Herzberg's Motivation-Hygiene Theory (see, Herzberg, 1993. See ch. 3.3.2). However, for any person to become fully motivated one also need to fulfill the motivation factors. And those can no variable wage manage, but only the working environment and the work tasks.

5.2 Companies without a Remuneration Plan

In this section, the two companies not making use of a remuneration plan, Holmen and SHB will be analyzed first separately and will then be compared with one and another.

5.2.1 Principal Agent Theory vs. Stewardship

Holmen

Holmen does not make use of any variable wage. However, this is more due to tradition than a set statement (see, Executive Vice President CFO, Group Finance, Holmen, personal communication, 2006-12-07. See ch. 4.2.1). The fact that the company has never made an analysis of the pros and cons of making use of remuneration plan, one can assume they have never felt that it is necessary to implement an incentive based remuneration scheme. Furthermore, one can assume that Holmen have never experienced the conflict between principal and agents to be a problem that has to be dealt with.

The case might be that the CEO is rather motivated by what is the best for the company than his own personal incentives, which can be related to the features from a Steward relationship rather than a Principal-Agent relationship (see, Davis, et al. 1997. See ch. 3.5).

The companies making use of a remuneration program all mention that the programs are demanded in the recruitment process, this, however, is something Holmen has not noticed. Their applicants that have been of interest for the company has not experienced any expensive bonding cost since the applicants have felt that they have been motivated by the work tasks and what is best for the company (see, Executive Vice President CFO, Group Finance, Holmen, personal communication, 2006-12-07. See ch. 4.2.1).

Svenska Handelsbanken

SHB does not use an incentive based remuneration program since they argue that it does not align with the products and services they sell. Their customers should be able to feel that they can trust the seller or adviser that the products they are offering are the best ones for the customers and are not made to increase the seller or advisors salary (see, Head of Investor Relations, SHB, personal communication, 2006-11-23. See ch. 4.2.2). The statement, "what is difficult is not to sell credit but to get the money back" (see, Head of Investor Relations, SHB, personal communication, 2006-11-23. See ch. 4.2.2) one can assume that the management do care more about the overall result of the company than if the sales figures.

Therefore, within SHB the relationship between owners and managers features the Stewardship Theory (see, Davis, et al. 1997. See ch. 3.5) rather than a Principal Agent relationship. If this is the truth this kind of relationship will save both the company and the CEO extra costs that a Principal Agent relationship incurs.

As mentioned above, the companies that use a remuneration plan all mention that the program where needed for the company to be able to recruit and keep key personnel. However, this does not seem to be a problem for SHB since their CEO as of 2006 has been employed within the company since 1991. Apparently the company is able to compete on other means than variable wages.

5.2.2 Measurement of Management Performance

Holmen

Holmen's share value has declined during the six years the authors have investigated, as well as a decrease in their earnings (see, appendix 3). This may indicate that the company has not managed to meet the interest of their shareholders. However, only analyzing at the share value and earning when judging a company's performance does not give a fair picture of a company's performance since share value is dependent of many other factors than just the company's own performance, such as the whole economy's performance for any given year.

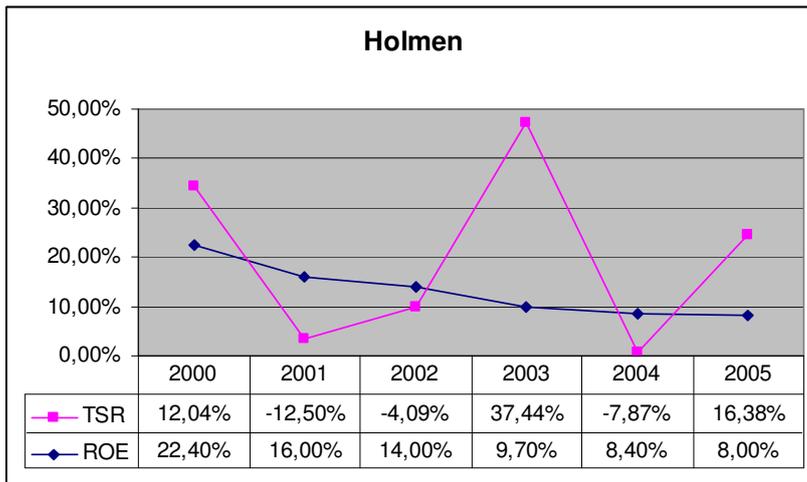


Figure 5-12 Holmen, TSR and ROE

As mentioned earlier, McClure (2005. See ch. 3.6) state that a professional investor usually require a ROE of approximately 15 percent, which Holmen managed to live up to during 2000 and 2001. After that the ratio does not meet the requirements of the professional investors, the decrease in the return on shareholders equity may indicate that the shareholders as dissatisfied by the performance of the management and the conflict between Principals and Agents are about to be recognizable.

Svenska Handelsbanken

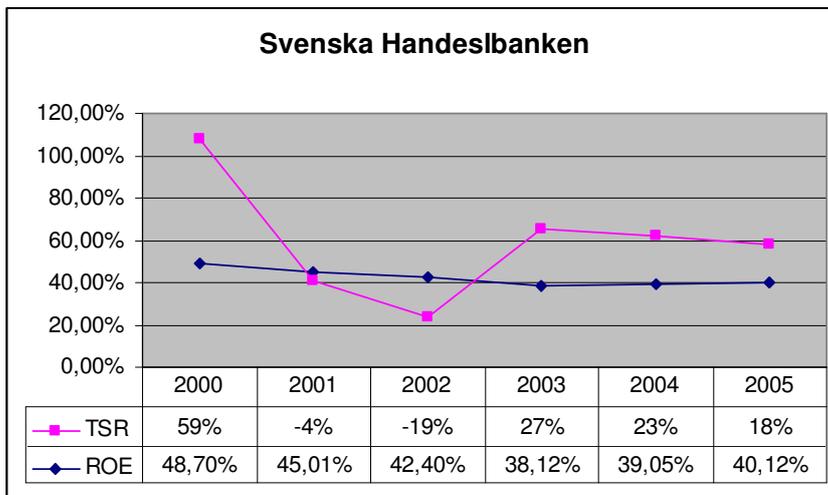


Figure 5-13 Svenska Handelsbanken, TSR and ROE

SHB is a proof of that a company can perform a good increase in stock value without making use of a remuneration program. Therefore one can expect the company not to suffer from a Principal Agent conflict at the moment, since the shareholders probably are satisfied by the performance of the current management (see, Jensen and Meckling, 1976. See ch 3.1). The ROE the company has is far above the 15 percent a percent a professional investor expects.

5.2.3 Motivation Theory

Maslow's Hierarchy of Needs

The two companies without remuneration program, examined in this thesis, does have a different approach to the discussion and do argue that there are more than financial means that motivates their agent. Both Holmen and SHB does argue that their CEO have incentives to run a company that goes beyond monetary incentives, they claim that the CEO are motivated, and self-fulfilled, through good company results.

Their view of a CEO is in accordance with the Stewardship Theory (see, Davis, et al. 1997. See ch. 3.5), that running the business is what motivates the manager. However they do declare that a competitive wage is important for the CEO to be satisfied.

Maslow's hierarchy of needs may be applicable to agents who experience the situation as described above; they value psychological factors such as fellowship and having a meaningful existence (see, Maslow, 1943. See ch. 3.3.1). Hence a remuneration plan would not, according to them, help these companies affect the conflict of interest occurring between the principals and the agent.

However it is important to point out that neither Holmen nor SHB have recently evaluated an implementation of a variable salary system.

Herzberg's Motivation-Hygiene Theory

Moving on to Herzberg's Motivation-Hygiene Theory (see, Herzberg, 1993. See ch. 3.3.2), one can once again claim that the set wage their CEO's earns provides enough money for the manager to be able to finance their basic human needs and are striving for the higher levels, in Maslow's hierarchy (see, Maslow, 1943. See ch. 3.3.1), of motivation. Hence, one can argue that the person's hygiene factors are already at a satisfactory level. Since these people are already pleased with their economic situation, and the companies strive towards reaching a satisfactory level when it comes to the motivation factors the managers do experience challenging and motivation work environment.

5.2.4 Comparing the Companies without a Remuneration Plan

Even though the companies that use a remuneration plan showed a united face when it comes to why they make use of a remuneration program, the companies that does not use them mentioned different reasons. What is similar for both companies investigated though is that the relationship between the principal and the agent seem to be more informal and that their goals with the company are aligned. This perspective the authors explain through the Stewardship Theory (see, Davis, et al., 1997. See ch. 3.5).

Holmen claimed it was due to the history that the company does not use a remuneration program, however they have not ruled out the possibility to apply an incentive based remuneration program in the future. SEB on the other hand have, at least in the near future, ruled out the option to have an incentive based remuneration scheme for their CEO. SHB's strict reasoning is due to the nature of the products and services they sell. However, important to remember is that there are still a number of the largest banks in Sweden today that do use remuneration programs.

SHB and Home have made the choice to run their company without compensating their CEO with an incentive based remuneration program. Instead they claim that their CEO is

motivated with what is the best for the customers. The authors want to claim that these features have to do with the Stewardship relation the principals and the agents within the companies' experiences (see, Davis, et al., 1997. See ch. 3.5).

5.3 Comparing the Two Sample Groups

When comparing the two sample groups, it appears to the authors that the group that use a remuneration plan appear to be more homogenous when it comes to why they do use it, while the sample group that do not use a remuneration plan tend to be diverse in there decision not to use a remuneration program.

The sample group that do use a incentive based remuneration scheme does, indeed, have a clear expectation from the results from it and do have better explanations why they have chosen to implement such a remuneration program. The companies are unite in the question whether or not a variable remuneration does affect the conflict of interest between owners and managers, and all of them does claim that the agent is affected by the short term incentives. Their claim is hard to validate or reject, however from 2003 and on the incentive schemes does seem to be more appropriate and there are some, however wage, indications that in the short term the interest of the principals and agents may be aligned by variable incentives.

The sample group that does not use variable incentives for their CEO's has not, as it appears, experienced the conflict between principals and agents described by Jensen and Meckling (1976. See ch. 3.1.2). From their perspective the owners and managers have a Stewardship relation (see, Davis, et al., 1997. See ch. 3.5) that are more beneficial for both parties if the agent are satisfied with both situational and individual factors within the company.

6 Conclusion

This section will summarize the findings from the analysis. It will also answer the research questions stated and the purpose of the thesis.

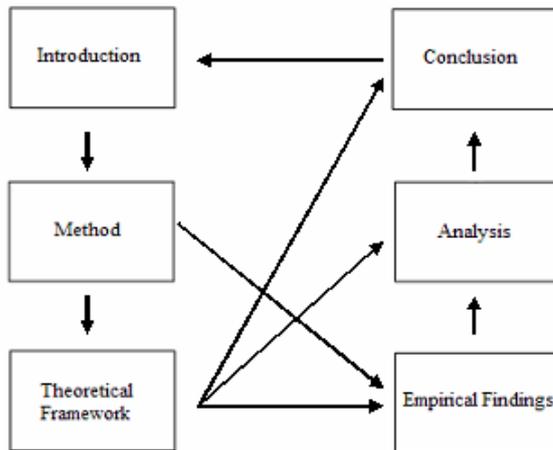


Figure 6-1 Conclusion

The purpose of this thesis is to examine whether the conflict of interest presented by the Principle-Agent Theory is affected by a CEO remuneration program (see ch. 1.3).

Before answering the purpose of this thesis a few interesting facts occurred during the study. First, companies with a remuneration program do have superior explanation why than companies without. Second, companies with a variable incentive scheme do have a clear purpose why and to what extent. Third, companies with variable remuneration were more international oriented.

The authors have been able to conclude that a remuneration plan might help the principals steer the agent, if the remuneration plan is constructed in an effective way. It is more likely that the remuneration plan will affect the way an agent behave in the short term, where the cause and affect are closely linked to the behavior of the agent. For the same reason it is harder for a remuneration plan to affect an agent's behavior in the long term, since the connection between actions and results are harder for both the principals and agents to grasp.

The ability for principals to steer their management do in fact influence the conflicts within the company, since the agents will act in the interests of the shareholders the conflict do decrease with an effective incentive scheme.

By comparing a group of companies that do use a remuneration plan with a group that do not, the authors have been able to realize that whether or not a remuneration plan is an effective mean to decrease the conflict of interest depends upon the relationship between the principal and agent. If the companies choose to have a Stewardship relationship instead (as indicated by the companies that not use a remuneration plan), the companies do not need to steer the agent's behavior, since the agents in these companies are motivated by company performance. Therefore such a relationship will assure the conflict of interest are minimized.

The authors have found that the effectiveness of the remuneration program does depend on some situational, personal and structural factors. The situational factors are the expectations the principal and agent have on the relationship, the personal is how the agent interprets different compensation schemes and the structural is how the incentive program is constructed. The incentive program is of high-quality if it is properly managed and the parties share the purpose behind. The remuneration plan will be less effective if it is too expensive for the principals or if the agent gets restrained. This, however, is a balance act that is impossible, or close to impossible, to measure.

7 Discussion

In this chapter the authors will continue the discussion referring to the remuneration programs and the empirical findings, and finally some suggestions for further studies will be presented.

7.1 Thoughts by the Authors

Remuneration programs have frequently been in the spotlights lately. In media the discussion has been more about how much money the CEO's make from the programs rather than why the companies use them. While writing this thesis it have become clear for the authors that the companies that use remuneration programs believe the remuneration programs affect the conflict of interest in the company. At the same time all companies that use a remuneration program mention that it is a competitive tool for the company when recruiting new management. This is something the authors believe is of greater importance than the interviewees admitted.

The authors have an idea about the fact that even from this perspective a remuneration plan can affect the conflict of interest in the company. Since, if the company manages to recruit a more competent CEO that would have been possible if the company did not offer a remuneration plan, one can assume that the owners of the company will be more satisfied and more competence will be better for the company. Consequently the conflict between managers and owners will decrease.

Even though this thesis has focused on Swedish companies, the authors would like to take the opportunity to mention that companies situated in Sweden do compete with companies abroad for competent personnel. Therefore it is of vital importance for the companies to be able to offer monetary compensation that is competitive on the global market, which often means offering a variable wage.

A remuneration scheme may seem to be an expensive solution to the Principal Agent conflict, however if the manager chose to act accordingly the cost the principals bear may be small relative to the cost of an agent that act in his or her own interest.

7.2 Suggestions for Further Studies

While writing the thesis a number of questions that the authors were not able to include in this thesis were brought to the authors mind. Therefore further research is suggested within the area. The authors of this thesis has conducted a qualitative research, however, it would be interesting to carry through a quantitative research in order to test the conclusions made in this thesis among a larger sample group. A quantitative study would also allow a regression analysis to see if there is any stronger correlation between incentive based remuneration and the company's performance.

During the research the authors has found that companies without a remuneration program tend to have a Stewardship relationship rather than a principal agent relation, which do not by definition assume a conflict of interest between owners and managers. Hence it would be interesting to examine how a company creates and maintain such a relationship.

The authors of this thesis have not focused on the size of the remuneration programs offered for the CEO's. However, it would be of interest to find out if there is a monetary amount where the remuneration program is large enough, where an increase does not change the manager's motivation or attitude. One can assume that there is a point when the manager's private financial status does make him or her indifferent to larger monetary incentives. Intuitively in such a case the incentives would have no effect nor may it steer the manager's decision making.

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A paper that does not have references is like a child without an escort walking at night in a big city it does not know: isolated, lost, anything may happen to it. (Latour, B, 1987, p.33)

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Interview information

OMX

Contact person: Elin Sebö Malmström

Position within the company: Head of Compensation & Benefits

Date of e-mail: 2006-10-10

Date of phone interview: 2006-11-28

Length of interview: 25 min

Swedish Match

Contact person: Mats Rosenqvist,

Position within the company: VP Compensation and Benefits

Date of e-mail: 2006-10-31

Date of phone interview: 2006-11-22

Length of interview: 40 min

Ericsson

Contact person: Susanne Andersson

Position within the company: IR Manager at Investor Relations department

Date of e-mail: 2006-11-10

Date of follow up e-mail: 2006-11-21

Holmen

Contact person: Anders Almgren

Position within the company: Executive Vice President CFO, Group Finance.

Date of phone interview: 2006-12-07

Length of interview: 15 min

SHB

Contact person: Bengt Ragnå

Position within the company: Head of investor relations

Date of e-mail: 2006-11-23

Appendix 1, Questions sent to companies with a remuneration program

Inledande frågor

1. Vem är det som besvarar frågorna, beskriv din position i företaget?
2. Vad är ett bonussystem? Beskriv med egna ord ditt/företagets tolkning.
3. Anser ni bonus vara det samma som belöning?

Beskrivning av det egna systemet

4. Beskriv erat bonussystem till VD och ledningen, vilka delar finns det och hur är det uppbyggt?
5. Varför har ni valt att ha ett bonussystem?

Resultat och kvalitetssäkring av det egna systemet

6. Vilka positiva effekter för företaget, anser ni att bonussystemet har?
7. Vilka positiva effekter för ägarna, anser ni att bonussystemet har?
8. Kan ni härleda olika positiva eller negativa effekter som de olika delarna i bonussystemet har? Ex: Optioner, pensionsavtal, vinstdelning etc.
9. Minskar bonussystemet konflikter mellan ägare och agenter (VD) i företaget och motverkar att suboptimala beslut fattas?
10. Hur mäter ni VD:s prestation och hur relaterar ni det till bonussystemets storlek?
11. Vilken form av ”kvalitetssäkring” av bonussystemen använder ni för att säkerställa/mäta effekten av bonussystemet i relation till ägarna?

Utveckling och förändring av bonussystemet

12. Har några förändringar på utformning och storlek av bonussystemet gjorts efter all uppmärksamhet i media?
13. Anser ni att en ökad transparens i bonussystemen skulle skapa större legitimitet?
14. Har ni stött på motstånd från ägarna vad beträffar bonussystemets utformning och storlek?

Appendix 2, Questions sent to companies without a remuneration program

Inledande frågor

1. Vem är det som besvarar frågorna, beskriv din position i företaget?
2. Vad är ett bonussystem? Beskriv med egna ord ditt/företagets tolkning.
3. Anser ni bonus vara det samma som belöning?
4. Varför har ni valt att inte använda er av ett bonussystem?

Resultat och kvalitetssäkring

5. Vilka positiva effekter för företaget, anser ni det i innebära att inte ha ett bonussystem?
6. Vilka positiva effekter för ägarna anser ni det ha, att inte använda något bonussystem?
7. Tror ni att ett bonussystem skulle kunna minska konflikter mellan ägare och agenter (VD) i företaget och motverka att suboptimala beslut fattas?
8. Hur mäter ni VD:s prestation, i relation till ersättning och lön?

Utveckling och förändring av bonussystem

9. Anser ni att en ökad transparens i bonussystem skulle skapa större legitimitet?
10. Har ni någon gång vid rekrytering eller dylikt upplevt problem på grund av att ni inte använder er av bonussystem?
11. Har ni inom företaget upplevt att ni bemöts mer positivt från media och ägare på grund av detta ställningstagande?

Appendix 3, Company Figures

OMX	2000	2001	2002	2003	2004	2005
Net Income MSEK	730	-25	-71	-431	524	979
EBIT	703	-453	-24	-449	616	910
Total assets	5 505	5 985	4 920	6 746	6 534	10 612
ROE	25,00%	-1,00%	-3,00%	-16,00%	7,00%	12,00%
ROA	13,26%	-0,42%	-1,44%	-6,39%	8,02%	9,23%
ROCE	25,00%	-8,00%	2,00%	-7,00%	12,00%	14,00%
D/E ratio	-45%	6%	33%	17%	-4%	12%
Stock Price 01-01 SEK	190,00	233,00	140,00	45,20	90,50	85,75
Stock Price 12-31	233,00	138,00	41,60	89,50	85,00	110,50
Dividend/share	6,00	1,00	1,00	0,00	0,00	6,50
TSR	25,79%	-40,34%	-69,57%	98,01%	-6,08%	36,44%

Swedish Match	2000	2001	2002	2003	2004	2005
Net Income MSEK	1 153	1 228	1 429	1 558	1 828	1 777
EBIT	1 886	2 113	2 371	2 224	3 593	2 825
Total Assets	16 281	16 623	15 447	15 102	14 621	16 806
Current Liabilities	4 314	4 290	3 858	3 775	4 099	5 474
ROE	21,80%	28,30%	35,20%	38,90%	43,70%	36,60%
ROA	7,08%	7,39%	9,25%	10,32%	12,50%	10,57%
ROCE	15,76%	17,13%	20,46%	19,63%	34,15%	24,93%
D/E Ratio	52,60%	90,50%	74,40%	58,90%	10,40%	13,30%
Stock Price 01-01 SEK	29,9	36,3	56	69,5	75	77,75
Stock Price 12-31	36,8	55,5	68,5	73,5	77	93,5
Dividend/Share	1,35	1,45	1,60	1,70	1,90	2,10
TSR	27,59%	56,89%	25,18%	8,20%	5,20%	22,96%

Ericsson	2000	2001	2002	2003	2004	2005
Net Income MSEK	21 018	-21 264	-19 013	-10 844	19 024	24 460
EBIT	30 828	-27 380	-21 299	-11 239	26 706	33 084
Total assets	250 314	250 056	208 267	182 372	183 040	208 829
ROE	26,10%	-26,10%	-26,70%	-16,20%	27,60%	26,20%
ROA	8,40%	-8,50%	-9,13%	-5,95%	10,39%	11,71%
ROCE	26,50%	-15,80%	-11,40%	-5,90%	29,40%	28,70%
D/E Ratio	127,10%	151,30%	86,70%	73,90%	94,80%	67,80%
Stock Price 01-01 A SEK	102,01	79,44	41,17	9,70	14,40	21,80
Stock Price 12-31 A	79,44	42,25	8,60	13,90	21,70	27,50
Stock Price 01-01 B	100,21	75,47	40,44	6,75	13,10	21,20
Stock Price 12-31 B	77,64	41,35	6,10	12,90	21,20	27,30
Dividend/share	0,36	0,00	0,00	0,00	0,25	0,45
TSR	-22%	-45%	-85%	91%	64%	31%

Appendix 3

SHB	2000	2001	2002	2003	2004	2005
	20	21	22	21	23	26
Net Income MSEK	680,00	654,00	130,00	664,00	963,00	338,00
EBIT	11 683	11 208	10 190	11 550	13 553	15 665
	1 020	1 174	1 277	1 260	1 316	1 580
Total assets	353	521	514	454	789	733
Current Liabilities	220 126	155 414	235 113	202 689	258 995	289 053
ROE	48,70%	45,01%	42,40%	38,12%	39,05%	40,12%
ROA	2,03%	1,84%	1,73%	1,72%	1,82%	1,67%
ROCE	1,46%	1,10%	0,98%	1,09%	1,28%	1,21%
Stock Price 01-01 A SEK	108,00	160,50	151,50	122,50	148,50	173,00
Stock Price 12-31 A	161,50	154,00	116,00	147,00	173,00	197,00
Stock Price 01-01 B	103,00	157,00	143,00	116,00	144,50	173,00
Stock Price 12-31 B	160,00	146,00	111,00	142,50	172,00	196,50
Dividend	4,00	4,50	4,75	5,25	6,00	7,00
Shareholders' Equity M	42	48	52	56	61	65
SEK	466,00	112,00	192,00	835,00	372,00	651,00
TSR	59%	-4%	-19%	27%	23%	18%
Holmen	2000	2001	2002	2003	2004	2005
Net Income MSEK	3 972	2 186	1 959	1 451	1 275	1 256
EBIT	4 842	2 446	2 713	2 338	1 860	1 973
Total assets	26 300	24 948	26 967	26 358	28 989	32 183
ROE	22,40%	16,00%	14,00%	9,70%	8,40%	8,00%
ROA	15,10%	8,76%	13,70%	5,50%	4,40%	3,90%
ROCE	15%	18%	16%	12%	10%	9%
D/E Ratio	41%	36%	22%	25%	22%	-2%
Stock Price 01-01 A SEK	315,00	299,00	233,00	219,00	270,00	243,00
Stock Price 12-31 A	295,00	237,00	212,00	262,00	244,00	277,00
Stock Price 01-01 B	311,50	284,00	232,00	215,00	260,50	235,00
Stock Price 12-31 B	280,00	238,50	211,50	255,50	230,00	262,50
Dividend/Share	69	10	11	40	10	11
TSR	12,04%	-12,50%	-4,09%	37,44%	-7,87%	16,38%