



Master Thesis in Business Administration, 15 ECTS

Motivation by monetary rewards

- A study about motivation and performance-based salary increase

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Abstract

Background and discussion of the problem: As an employer, you want to keep your employees happy and motivated to perform at their best in the same direction as the company's objectives. This is not always easy because people are all different with different needs, interests, goals and thoughts and therefore would be motivated by different things. Sometimes employees even have goals that conflicts with the companies objectives. Monetary rewards are frequently suggested as a method for increasing the motivation and performance of employees and to align the employee's objectives with the companies. A common type of monetary reward is Performance-based salary increase which is used by many companies to motivate their low- and middle-income employees. According to the law of diminishing marginal utility, as the money stock increases, the exchange value of a money unit decreases. This logically means that the change in the satisfaction derived from a unit of money received as a salary increase, would be less for a middle-income employee and therefore get less motivated, compared to a low-income employee. Since companies strive for an effective use of their scarce resources, it should be of great interest to many companies to further study if performance-based salary increase is more effective to apply on low-income employees compare to middle-income employees.

Aim of research: The purpose of this study is to create a deeper understanding about the motivational effects of performance-based salary increase, on low- and middle-income employees.

Research question: Do low-income employees perform better in response to performance-based salary increases compared to middle-income employees?

Method: The study begins by reviewing different theories about motivation and rewards, Principal-Agent theory and Motivation-Hygiene Theory and based on reasoning the law of diminishing marginal utility and is selected as a framework of this study. This study has compared interviews with 12 employees (six low- and six middle-income) from eight different companies and 55 survey respondents (30 low- and 25 middle-income) from one company. The author has chosen to apply both qualitative and quantitative method when gathering the primary data.

Result: The most obvious result from this study shows that both low- and middle income employees think of performance-based salary increase as an important factor to them and their motivation at work but their reasons varies considerably. Many of the low-income interviewees had a greater focus on the amount of money in the raise while most middle-income interviewees think of salary increase as an important feedback and recognition from their manager. The results of this study also shows that low-income employees are more than middle-income employees, ready to increase their efforts and performance; if they know they can get valuable salary increase in exchange.

Keywords: Motivation, reward system, monetary rewards, performance-based salary increase, outcome-based compensation.

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Introduction

This chapter will give a background and present the problem discussed in this study. The research question and purpose of this study will be presented followed by limitations and structure of this thesis.

1.1 Background

Motivation can be defined in a number of ways. Generally, it is defined as a driving force that initiates and directs behavior (Morsella, Bargh, & Gollwitzer, 2009). In other words, motivation is a kind of internal energy which drives a person to do something in order to achieve something. According to Herzberg's motivation-hygiene theory there are two different factors that describe what people want from their work, these being factors of motivation and factors of hygiene. The motivator factor leads to satisfaction when they are fulfilled, opposite to the hygiene factors that trigger dissatisfaction when they are unfulfilled (Kressler, 2004). Satisfaction (or "happiness") is also mentioned as utility and is a subjective concept. Utility rises when an individual increases his or her state of satisfaction and conversely, when someone considers himself in a worse state, his utility decreases (Polleit, 2011).

Different types of rewards are used by companies in order to motivate, attract and retain competent employees (Kaplan & Atkinson, 1998). Rewards can be monetary such as bonuses, stock option programs and salary increase or non-monetary such as development possibilities, promotion and extra vacation days (Merchant, 2007). To motivate employees is not always easy because people are all different with different needs, interests, thoughts and experience and therefore would be motivated by different things. Sometimes employees even have goals that conflicts with the companies objectives. As an employer, you strive for motivating your employees to perform at their best in the same direction as the company's objectives, but there might occur two different types of problems in an agency relationship (in this case employer/employee relationship) (Eisenhardt, 1989). The first problem is agency problem that arises when the desires or goals of the principal (employer) and agent (employee) conflict and it is difficult or expensive for the principal to verify what the agent is actually doing. The second is the problem of risk sharing that arises when the principal and agent have different attitudes toward risks. The focus of the principal-agent theory is on determining the optimal contract between the principal and the agent (Eisenhardt, 1989).

Depending on the circumstances, some companies decide to apply a contract that ties monetary rewards to employee's performance. According to Samuelsson (1999) monetary rewards based on performance can either be short-term incentives in form of bonuses based on up to one year's performance, or long-term incentives based on performances during a period of time greater than one year and often received in form of shares or options. A third category is performance-based salary increases. Samuelsson (1999) argues that the performance-based salary increase is often considered to be the greatest motivational tool of them all. The other two rewards are more common on managerial levels. Many companies apply performance-based salary increase for their low- and middle-income employees as a way to motivate them to perform better. But there is some empirical evidence that monetary rewards have widely varying effects and often do not improve performance (Bonner et. Al.,

2000; Camerer & Hogarth, 1999).

1.2 Problem discussion

Monetary rewards are frequently suggested as a method for motivating and improving the performance of employees (Bonner & Sprinkle, 2002). Some empirical evidence indicates that monetary rewards have widely varying effects on effort and consequently often do not improve performance (Bonner et. Al. 2000; Camerer & Hogarth, 1999). Other studies show mixed results in regards to how effective monetary rewards are on individual performance (e.g. Tuttle & Burton, 1999; Sprinkle, 2000). Many organizations have failed in designing an effective reward systems based on incentives and some researchers hold that incentives cannot work at all (i.e. Alfie Kohn in his research “Why incentive plans cannot work at all”). Despite all mixed results from performed studies, many companies continuous to apply monetary rewards in general and performance-based salary increase in particular for their low- and middle-income employees (Samuelsson, 1999). However, there is a lack of research concerning the performance-based salary increase’s motivational effect on different income groups.

According to the law of diminishing marginal utility, as the money stock increases, the exchange value of a money unit decreases (Polleit, 2011). This logically means that the change in the satisfaction derived from a unit of money received as a salary increase, generally is less for a well paid employee compared to a low-income employee, if ALL other parameters assumed to be the same. If new empirical researches could show that different income-group’s motivation is affected differently by performance-based salary increase, it could be part of the explanation to why previous studies on effectiveness of monetary rewards on individual performance shows mixed results. Since companies strive for an effective use of their scarce resources, it should be of great interest to many companies to further study if performance-based salary increase is more effective to apply on low-income employees compare to middle-income employees.

1.3 Problem formulation and purpose

By the reasoning above the author found it interesting to investigate if the employee’s current salary level is an important factor for the employer to consider, when applying performance-based salary increase to motivate employees. It is interesting to investigate if this type of outcome-based contract is more effective for the employer to apply on low-income employees compared to middle-income employees.

The purpose of this study is to create a deeper understanding about the motivational effects of performance-based salary increase on low- and middle-income employees. New knowledge in this area would be very valuable for companies in order to use the company’s scarce resources in the most efficient way.

The research question for the study is as presented below:

-Do low-income employees perform better in response to performance-based salary - increases compared to middle-income employees?

1.4 De-limitations

Only low- and middle-income employees in Stockholm, Sweden will be covered by this thesis. High income employees and employees in other countries and cities will be excluded in this study.

Only employees with 100% fixed salary are covered in this thesis and all other employees with variable salaries, bonuses and commissions are excluded in this thesis.

According to the Statistics Sweden (SCB) which is an administrative agency, the average income for people between 20 and 64 years living in Stockholm Sweden was 307 800 SEK / year during 2009. This is equal to a monthly income of 25 650 SEK. If we assume the salaries has increased by 2% in 2010 and 2% in 2011, the average monthly income has grown to ~26 676 (25 650 x 1.04) since 2009.

SCB don't publish any definition for low-, middle- and high-income for people living in the country. Therefore there are different definitions in different documents and researches depending on the authors. The author of this thesis decided to choose one of the common ways of defining low- and middle-income employees, used in several other documents found at both SCB and other websites:

The range for middle-income = Average monthly income \pm 25% \rightarrow 26 676 \pm 25%

The reasoning above leads us to the following definitions:

Middle-income: 20 007 – 33 345 SEK / month

Low-income: 0 – 20 006 SEK / month.

Monetary rewards based on performance can be classified into three main categories: performance-based salary increases, short-term incentive plans, and long-term incentive plans. This study will only focus on performance-based salary increases and excludes the other two categories of monetary rewards.

1.5 Thesis' structure

Introduction

The first chapter will provide the reader with a background and a discussion that leads up to the forthcoming question, the purpose with the study and its scope.

Theory

In the second chapter the choice of theories are explained, which will help the author to carry out the investigation, analyze the collected data and come to conclusions from the theoretical framework.

Method

In the third chapter the author will describe how the study will be conducted, including the choices and considerations made during the thesis.

Empirical results

In the fourth chapter the results from the survey will be presented.

Analysis

In the fifth chapter the collected data is analyzed from both a theoretical and empirical perspective. The similarities and differences will be presented.

Conclusions

In the sixth chapter the conclusions the author has reached during the study will be presented and answer the question of this thesis.

2. Theoretical framework

In the following chapter the author will present a variety of theories found relevant for the research question. Description of motivation and Herzberg's Motivation-Hygiene Theory gives us an understanding of what gets people motivated and de-motivated to work. Different monetary rewards will be described and a background to the goal conflicts that exists between companies and its employees will be presented, followed by theories about total satisfaction derived from change in the quantity of money. These theories will later be put in relation to the empirical data in order to be analyzed.

2.1 Motivation of human beings

To be able to understand why individuals feel and act in a certain way, we need to find out what motivates and de-motivates an individual. In this section, different views of motivation of human beings, behaviors, needs and driving forces will be presented.

2.1.1 What is motivation?

Motivation can be defined in a number of ways. Generally, it is defined as a driving force that initiates and directs behavior (Morsella, Bargh, & Gollwitzer, 2009). Motivation is something that determines how a person will handle a situation in terms of strength and psychological energy (Samuelsson, 1999). Motivation is simply what drives people to behave or act in certain ways (Armstrong, 1993). Motivation could be described as a tool for influencing people by rewards and punishments (Bakka et. Al, 2006). We normally do things because we believe that it will fulfill some of our current or future personal goals. It is therefore important for the corporate management to identify what motivates their employees and try to join their personal objectives with the ones of the company (Pepiton, 1998).

Factors such as satisfaction, effectiveness and motivation have been shown to have a relationship. Increased motivation leads to better performance and results. Good results in turn lead to increased motivation (Lindblom, 1996). Rewards can help increase efficiency, which in turn benefits the motivation.

According to Bengtson (2001), there are six factors which help improve the motivation of people at work:

- 1) transparency
 - 2) praise and criticism
 - 3) humor and joy
 - 4) being seen and acknowledged
 - 5) standards
 - 6) good team spirit
- (Bengtson, 2001).

The word "motivation" has an origin in the Latin verb "to move", something that moves us to action, which can come from inside us or from external sources, or more commonly a mix of both (Adiar, 2006). Internal motivation is a positive emotion coming from the individual himself

(Jacobsen & Thorsvik, 2008). Internal motivation could be a feeling that the work is interesting and stimulating. Level of responsibility, type of job tasks and be trusted are important factors for internal motivation. Other factors with impact on internal motivation are opportunity to influence own situation, good relationships at work and participation (Jäghult, 2005). Internal rewards are crucial to achieving lasting change in behavior (Jäghult, 2005).

According to Jacobsen & Thorsvik (2008), money is an external reward which provides internal motivation when it leads to higher self-esteem. External motivation refers to external rewards and is often financial but could also be non-financial such as encouragement and praise. Examples of external rewards are bonus, salary increase and profit sharing. The purpose of external rewards is to improve performance, create job satisfaction and motivation and to increase the likelihood of repeated behavior. Rewards are often important tools to retain employees within the organization (Jäghult, 2005).

To split motivation into external and internal motivation has been criticized for being too categorical. In real life an external reward may also affects the internal motivation e.g. money which have impact on both external and internal motivation (Jäghult, 2005).

2.1.2 Motivation to work

Herzberg suggested that motivation is like an internal self-charging battery. For an employee to become motivated, the energy or desire to move must come from within. For Herzberg, motivators are internally-generated drives, not externally-stimulated incentives (Bassett-Jones, & Lloyd, 2005).

One theory that deals with work motivation is The Motivation-Hygiene Theory, also referred to as The Two Factor Theory, developed by Frederick Herzberg in 1957. Herzberg applied Maslow's thoughts to a working environment, by studying working motivation (Adiar, 2006). The aim of his research was to discover which work situations and conditions were experienced positively versus negatively by the workers. He presumes that there are two different factors that describe what people want from their work, these being factors of motivation and factors of hygiene. The motivator factor leads to satisfaction when they are fulfilled, opposite to the hygiene factors that trigger dissatisfaction when they are unfulfilled (Kressler, 2004). According to Motivation-Hygiene theory, when people have a positive feeling about their job it is as a result of factors of motivation, conversely when people have feelings of discontent this is relatable to factors of hygiene.

Herzberg and his team used interviews to explore the impact of fourteen factors on job satisfaction (motivation factors) and dissatisfaction (hygiene factors) in terms of frequency and duration of impact. Sources of satisfaction included a sense of achievement, recognition, the work itself, the opportunity to take responsibility and prospects for advancement. Employees indicated strong dissatisfaction if they were unhappy with company policy and administration, technical and interpersonal supervision, financial reward and working conditions. According to Motivation-Hygiene theory, the hygiene factors do not cause higher motivation but a lack of them can cause dissatisfaction (Bassett-Jones, & Lloyd, 2005).

According to Herzberg money is a so-called hygiene factor that create dissatisfaction if not received in appropriate amount, but it is not seen as a potential satisfier or positive motivator Herzberg further argues that a hygiene factor such as salary increase gives a favorable short-

term feeling while motivators create a longer lasting satisfaction (Herzberg, 1959). Critique were offered by Opsahl & Dunnette (1966) who concluded that there was no substantial support for a so-called differential role for money in leading to job satisfaction or job dissatisfaction. Others have continued to argue that money can motivate and that Herzberg's results could be attributed to a range of factors including personality (Evans & McKee, 1970), and social desirability bias (Wall, 1972).

2.2 Reward systems to motivate

Since the focus area of this thesis is monetary rewards based on performance, the author will present the purpose of rewards and different types of monetary rewards in this section.

2.2.1 Introduction and purposes of reward systems

There are a variety of purposes of a reward system. A very common purpose is to motivate employees to perform better but also to keep skilled employees (Ax, Johansson & Kullvén 2005). Every company has some form of reward system, whether it is explicit or not, it exists (Jäghult, 2005). Svensson and Wilhelmson argue that successful performances should be rewarded and recommend reward systems to motivate employees. To reward employees accomplished actions will help the company to obtain better results (Svensson & Wilhelmson, 1988). Reward systems can contain both positive and negative rewards. The negative rewards, often seen as punishment, are usually through an absence of positive rewards (Merchant, 2007). Examples of positive rewards are power, autonomy, salary increase, bonuses.

Merchant (2007) argues that people sometimes need an incentive to perform better and work harder. Many organizations use reward systems to emphasize on which parameters their employees should put extra effort on, by including them in their reward program. For a reward system to be motivational, the reward should satisfy a number of criteria:

- have a value
- be large enough to have an impact
- be timely
- be understandable
- the effect should be durable
- the reward should be cost efficient

(Merchant, 2007).

According to Kaplan & Atkinson, (1998) rewards can be divided in two different types: intrinsic and extrinsic. Intrinsic rewards comes from within and could be describes by positive feelings, feeling happy and proud over something you have done. Extrinsic rewards are brought to you by another person or organization and can be either monetary or non-monetary (Kaplan & Atkinson, 1998). Be given a tap on your shoulder from you manager or being thanked by your co-workers are both examples of non-monetary rewards. Other examples of non-monetary rewards could be when managers recognize the individual's performance in front of the team or invite the employee having lunch with the head of the organization. Non-monetary

recognition can be very motivating, helping to build feelings of confidence and satisfaction.

Monetary rewards are usually a variable compensation, separated from the salary. It is usually received as a consequence of extraordinary performance or as an encouragement of a behavior and is either group based or individually based (Eisenhardt, 1989). The performance should be measurable and the conditions to obtain this reward should be set in advance, if a company's decide to apply monetary reward system based on performance (Jäghult, 2005).

The focus of this study is on monetary rewards based on performance.

2.2.2 Monetary reward system

As mentioned earlier in this section, for a reward system to be motivational, the reward should have a value. Since people value money, money is an important form of reward.

According to Merchant (2007) the monetary reward is not the only form of reward and is not necessarily always the best one, but it is so common used that it deserves special attention. Kaplan and Atkinson (1998) argue for three suggestions about monetary reward systems. The first one is that they should be competitive so that they will attract and retain high-quality co-workers. The second is that they should communicate and reinforce key priorities in the company. The third is that companies should develop a performance-oriented climate by rewarding high achievement. All these authors' suggestions harmonize with each other and give a representative view of the purposes of the reward.

Monetary rewards are usually based on either employee's behavior or performance (Anderson & Oliver, 1987). According to Samuelsson (1999) reasons to utilize monetary rewards based on performance are:

- to align labor costs with productivity
- to retain top performers
- to reinforce company objectives

Companies can base pay on individual or group output, or company-wide performance. For a monetary reward system based on performance to be successful, employees must:

- believe they will receive more pay if they improve their performance
- desire more pay
- be physically able to improve their performance
- trust the company to administrate the plan fairly

(Ax, Johansson & Kullvén 2005).

Some employees appreciate the possibility of receiving a reward for their performance. Variable pay can also be an advantage for the company in terms of risk-sharing because the expense for compensation varies more with company performance. The company's costs will be lower when the profit is low and when the profit is larger, it can be shared with the employees (Merchant, 2007).

Monetary reward based on performance, can be classified into three main categories:

1. Short-term incentive plans
2. Long-term incentive plans
3. Performance-based salary increase

(Ax, Johansson & Kullvén, 2005).

Short-term incentives, including annual incentives, cash bonuses, commissions, gain sharing, and reward the individual employee for achieving certain goals over a short period. A cash bonus is usually based on performance measured on a period of time up to one year. Short-term incentives can be measured based on the group's performance, individual's own performance or the company's overall performance.

Long-term incentives are rewards based on performance measured over periods of time longer than one year. The intent of this type of plans is to provide incentives for employees to improve the overall performance of the organization by linking the employees' long-term rewards to the organization's long-term results. This also works to attract and retain key talented persons (Merchant, 2007). Examples of typical long-term rewards are stock-option programs, restricted stock plans or a reward that is put in a bonus-bank running over several years that change according to result (Samuelsson, 1999).

The performance-based salary increase, which is the focus area of this thesis, is often considered to be the greatest motivational factor of them all. The other two rewards mentioned above in this section are common on managerial levels and often linked to performance during a specific time of period (Samuelsson, 1999).

2.3 Principal-Agent theory

In this section Principal-agent theory will be presented which helps us to understand the concept of goal conflict that exists between companies and its employees and why companies try to control their employees with different tools e.g. performance-based pay system, where rewards are given when employees has achieved something.

2.3.1 Principal-Agent theory in general

The *Principal-Agent Theory* (also called Agency Theory) concerns the problem of motivating a party to act on behalf of another despite a conflict of interest. The principal-agent problem is common in most owner/manager or employer/employee relationships. In this relation, the agent (employees) is supposed to make something on behalf of the principal (could be an employer or an investor with a stake in a company) and in exchange receive some kind of reward, often monetary reward (Ross, 1973). The agency relationship situation requires the principal to delegate decision-making authority to the agent. Within the field of management control systems there are two different types of relationships:

Type 1: Owners or shareholders act as principals and hire a chief executive as their agent.

Type 2: The firm's top management is the principal and hires division managers to manage

the decentralized units in the organization.

The focus of the principal-agent theory is on determining the optimal contract, behavior-based or outcome-based, between the principal and the agent (Eisenhardt, 1989). A behavior-based contract ties compensation to employee's behavior and is typically characterized by extensive monitoring of employees, more direction provided by management, and more complex methods of evaluation and compensation. Conversely, outcome-based contract is typically characterized by a minimal amount of monitoring of employees, minimal managerial directions and use of objective performance measures (e.g. sales) for evaluation and compensation of employees (Anderson and Oliver, 1987). These two are the most common situations but the principal agent relationship exists on all organizational levels. The aim of this theory is to answer the question about how contracts can be constructed to motivate the agent to work in the best interest of the principal.

2.3.2 Conflicts between the agents and principals

There are different types of problems and conflicts in the principal agent relationship. The principal-agent problem arises when a principal is paying an agent for performing certain acts that are useful to the principal and costly to the agent, and there are parts of the performance that are costly to observe. This means that principals do not always know enough about whether a contract has been satisfied (Ross, 1973).

Agents put value to their leisure. Leisure is defined as the opposite of efforts that increases the expected return to the firm. This implicates that agents who work hard sacrifice their leisure and in return the company increases its value. If an agent tries to escape his or her duties they can always be observed and disciplined. This control has been introduced to verify that the agent lives up to the provisions of the contract. Therefore monitoring is an important element in principal-agent theory (Ross, 1973).

This theory assumes that agents prefer more wealth to do less. This means that the marginal utility, the satisfaction that every extra unit of wealth gives, decreases as more wealth is obtained. This implies that the agent is risk averse which means that they value the outcome of an investment less than its expected value. In the same time principals tend to be risk-neutral, meaning that they value the outcome at its actual value. This risk difference between agent and principal is one of the reasons to conflict between the agents and principals.

Another issue in the agent principal paradigm is called *adverse selection problem* implying the difficulty of selecting agents with the appropriate skills for required tasks. It is common that when agents are offered contracts, these often appeal to agents who have opportunities that are equal to or lower than the level of skills and compensation represented in the contract. People who are not qualified for the job are sometimes encouraged to apply. As there are differences in information and skills between the agents and principals the latter can never be certain how the agents' effort and skills contribute to the actual outcome. This difference, called *information asymmetry*, creates problems in contracting (Kaplan & Atkinson, 1998). Information asymmetry means that the agent often knows more than the principal. This might lead to decisions made by the agent that are good for him/her, but not optimal for the principal. Since the principal might not be aware of these decisions, he cannot affect them

(Baker, Jensen, & Murphy, 1987). Information asymmetry forms the situation of moral hazard where the agent does not live up to the terms of the contract. An additional problem with information asymmetry is that the best information for control and planning is in the hands of the agent and not in the possession of the controller. The controlled do not always wish to reveal this information in fear of it being used against them. This information impaction or reluctance to disclose the information has led to a great interest in designing organizations to encourage agents to reveal what they actually know or believe (Kaplan & Atkinson, 1998).

2.3.3 Overcoming agency problems

Which contract is the most efficient for the principal, depends on level of outcome uncertainty, risk aversion and information (Eisenhardt, 1989). Eisenhardt (1989), agree that outcome-based contract is more attractive for the principal in following circumstances:

- Agent's behavior is unobservable for the principal
- Goal conflict between the two parties
- High measurability of outcome
- Risk aversion of principal
- Appropriate behavior of agent to perform a task cannot be specified in advance

Principals should continuously strive for designing systems to overcome agency problems and minimize agency costs and the amount of asymmetric information through an efficient reporting system (Baker, Jensen, & Murphy, 1987).

Agents face a risk when having to decide whether to sacrifice their leisure for a potential increased outcome. Normally the owners should bear all the risk in the company but by rewarding agents by performance the principal's split parts of that risk onto agents. This is done as the principal do not possess the same information as the agent. According to Kaplan & Atkinson (1998) it is important to compromise between the desirability of principals bearing all the risk and the necessity of splitting some of that risk to the agents, when designing the optimal incentive system. This projection is made to minimize shirking and over-consumption of benefits.

To overcome the adverse selection problem in the hiring process, contracts should be structured so that they identify and avoid individuals who are not qualified. For example, high sales should be rewarded with high rewards. To avoid the burden of risk, the principal should be able to predict whether the outcome provides any information about the principal's input. This means that if the agent does not fulfill the contracted work, he or she should be penalized or maybe fired. If this penalty is efficient enough, shirking can be avoided (Kaplan & Atkinson, 1998).

According to Baker, Jensen & Murphy (1987) the principals can chose to design a system that align the interest of the agent with the interest of the principal OR the principal can set up a remuneration system that rewards decisions that are convenient for the principal. The second solution increases the cost for the principal and is regarded as the "agency cost" which the principal wants to minimize. Therefore principals should try to apply the first solution and try to solve the agency problem by making the interest of the agent to coincide with the interest of

the principal. To align the interests of the agent with those of the principal, different mechanisms may be used, such as piece rate or commissions, efficiency wages, profit sharing and performance measures or a fear of firing (Baker, Jensen, & Murphy, 1987).

To be able to control an individual's work and in this way obtain company goals you can within the walls of the organization affect the individual's behavior. An organization utilizing pay-for-performance is a good example of an organization implementing control of the employees' results (Merchant, 1998). This can be looked upon as result control as it rewards individuals who generate a good result while it at the same time punishes those who do not. Rewards interlinked to the result inform or remind employees that generating results for the organization pays off. Result control influences actions of individuals as it makes them worry about the consequences of their actions.

2.4 The law of diminishing marginal utility

In this section The law of diminishing marginal utility will be presented which gives us an understanding of the change in the total satisfaction derived from change in the quantity of money and the relationship between individual's performance and received monetary rewards.

Marginal utility means the utility of increments of goods which means the utility of enjoying an additional good (Polleit, 2011). The marginal utility of each unit decreases as the supply of units increases and vice versa (Rothbard, 2007).

The law of diminishing marginal utility could be explained as a numerous economic phenomena, including time preference and the value of goods. This economic law developed by Carl Menger (1840–1921), can be logically deduced from the axiom of human action. Utility denotes "satisfaction" (or "happiness") and is a subjective concept. Utility rises when an individual increases his or her state of satisfaction and conversely, when someone considers himself in a worse state, his utility decreases (Polleit, 2011).

Utility cannot be measured in terms of higher or lower utility from the viewpoint of an individual, and changes in utility among different people cannot be measured. All one can say is that utility is higher or lower from the viewpoint of an individual (Polleit, 2011). According to Rothbard, (2007), the individual must determine subjectively for himself whether he is better or worse off as a result of any change.

The definition of marginal utility of money is the change in the total satisfaction derived from money that results from one unit of change in the quantity of money (Polleit, 2011). A rise in the money stock should logically reduce the exchange value of a money unit. This is because the additional money unit can be used to satisfy an additional end that is less urgent than the satisfaction of the preceding end. According to Polleit (2011) a rise in the money stock will lead to a decrease in the marginal utility of the money unit compared to the situation in which the money stock had remained unchanged. According to this economic law, as a person gets more money to spend, he will buy things that give him less and less utility. For example, if a person is given a gift certificate for a CD in a music store, she will use the gift certificate to buy the favorite CD she will enjoy the most. If she is given another, she will buy her second favorite CD, and so on. Each additional CD the person buys is slightly less desirable than the one before. After buying her favorites, the person will start choosing CDs she is curious about. In

the end when the person has all the CDs she likes, she will take CDs that he does not really like at all. It is important to note that a rise in the money stock affects different market agents differently.

3. Method

In this chapter the author will present and discuss the applied methods for this study. The author's intention is to inform the reader about how this study is performed and how the author has chosen to view, interpret and finally understood the information.

3.1 Choice of subject

The subject chosen to study is to examine if there are any differences in how performance-based salary increase is affecting the motivation of low-income and middle-income employees to perform better. Since companies strive for an effective use of their scarce resources, it should be of great interest to many companies to further study if performance-based salary increase is more effective to apply on low-income employees compare to middle-income employees.

The idea for the thesis has its origin in the author's increased interest in the subject of motivation and rewards systems during 2010, when the author was responsible manager for a team of 20 warehouse workers with low income, at a Swedish company called Alfa Laval. The salary range for these warehouse workers was between 16 000 to 19 700 SEK per month. As a manager the author observed individuals in the team and tried to find different ways to increase the job motivation of individuals to perform better, in order to reach performance targets.

Performance-based salary increases as a monetary reward is used by Alfa Laval Tumba AB within the logistic department. One of the tasks as a team manager was to have a yearly salary review with all employees within the team, in October 2010. The salary increase was differentiated between warehouse workers based on their individual performance during last 12 months. The performance of individual warehouse workers was assessed based on average number of customer order lines picked and packed per month and percentage of errors made (picked or packed wrong item or wrong quantity).

The reaction and comments was different between individuals, at the moment when the new yearly salary increase was presented. The amount of money for the raise was very important for almost all 20 employees. The reactions and the discussions were very interesting to the author of this thesis who was responsible team manager. The author started to wonder if employees with higher salary have same reaction when they are informed about their performance based salary increase. Are people with low salary more eager to increase their income in comparison to people with higher salary? Is it easier for the employer to motivate low-income employees to perform better by applying salary increase? The answers to these questions would help employers to be better at motivating their employees by adjusting their rewards systems to better fit their employee's needs and interest.

3.2 Choice of method - Qualitative and quantitative

The author have interviewed 12 employees (six with low-income and six with middle-income) and after reviewed the answers he asked 85 employees (43 low-income and 42 middle-income) to answer the survey questions. 55 (30 low-income and 25 middle-income) employees actually answered the survey questions.

The author has chosen to use a combination of both qualitative and quantitative approach because they can complement each other by bringing width and depth into the research. This approach with both interviews and questionnaire survey will help the author to examine how a performance-based pay system is perceived by employees and if there are any differences between low- and middle-income groups in how motivated they get by this type of reward. The author believes this will help us to answer the research question. To remind you as a reader, the research question for the study is:

Do low-income employees perform better in response to performance-based salary increases compared to middle-income employees?

The goal of the qualitative method is to widen the knowledge and the whole pre-understanding through field observations or in laboratories. By interviewing 12 employees (six with low-income and six with middle-income) before survey questions were designed, the author's ambition was to get a slight pre-understanding of low- and middle-income employees perception of performance-based salary increase and its impact on their motivation and performance. The author included both low- and middle income-employees in the interviews and surveys, in order to study if there are any differences between these income groups.

Interviews are more time consuming than surveys and with regards to the very limited time in this MBA thesis work, the author has decided to limit number of interviews to 12. Interviewing 12 employees is what the author considered as realistic to perform within the time frame of this thesis. The author of this thesis is aware that interviewing only 12 employees will not bring enough data to answer the question of this research and the result will not be statistically significant. More data need to be collected.

A survey is useful when you need to reach more people than its possible with interviews or observations and when you already have a clear picture of what information you need (Winter, 1988). The author believed the best way to collect more data in this study was to perform a questionnaire survey after all 12 interviews were completed and answers were reviewed.

The author designed structured questions in the survey which means that questions can be answered only with specific alternatives, such as true or false, yes or no. Tree out of five survey questions attempts to measure on an interval level 1 to 5. This makes it easier to compare low-income employees with middle-income employees in regards to some factors like their motivation level at work and the importance of salary increase to their performance. A requirement when using structured questions in a survey is to have a good knowledge about what you need to ask about. Otherwise there is a risk that survey questions are asked in a wrong way and will get answers that are not connected to the research question at all. Since survey questions in this study was designed after performed 12 interviews, the author believes he had a good pre-understanding and a sense of which questions to be stated in the survey in order to try to close the knowledge gap detected in the performed interviews.

The respondents were asked same questions in the same order and could choose same alternative answers. The idea of the selected survey form was to obtain information as standardized as possible. This creates favorable conditions for the quantitative processing and analysis of responses (Lundahl & Skärvad, 1999). The negative thing with surveys is that you

cannot be sure the questions are understood correctly (Winter, 1988). With that in mind, the author did his best to design the survey questions as clear as possible in Swedish which is the native language. To minimize the risk of misunderstanding, the author was available to answer possible questions of respondents while the survey questions were answered,

55 employees (30 low-income and 25 middle-income) answer the survey questions about how performance based salary increase affect their job motivation and performance and whether or not they are ready to put more efforts if the connection between performance and salary is more clear. The distribution of the surveys was done through personal visits at respondent's coffee breaks and explained the purpose of this study. The survey will be anonymous and it will be voluntary to answer these questions. By bringing cakes to their coffee brakes, the author tried to obtain a higher response rate.

The author tried his best to reach a higher number of respondents but due to the limited time for this MBA thesis and the number of negative answers he got from the Human Resource departments at different companies, 85 employees could be asked and 55 actually answered the survey questions. The author is aware of the fact that a result from a survey answered by only 55 respondents will not be statistically significant to come to a conclusion but still enough to be used as an indicator. This information from the collected surveys is presented in tables in chapter 4 in this thesis.

3.3 Selection of company and respondents

When the author selected a company to perform this survey at, five branches with a large number of employees within Stockholm area were selected: Health care, IT, Food processing, Manufacturing, Sales and Marketing. The top three companies within each branch with most employees in Stockholm area were contacted and asked to be part of a study. Smaller employers was excluded simply because the author of this thesis believes it is very time consuming to contact many smaller companies that often do not have any Human Resource department and ask for permission to conduct a survey at their company. According to the author's experience, smaller companies often don't have any organization to handle these kinds of questions about different thesis works and researches.

All contacted companies except one, did not want to be part of this study. The answer was either that they did not have enough time or the subject of this study (motivation and performance base salary increase) was too sensitive questions to be touched at this moment and therefore they chosen to not be part of this study. Only one manufacturing company was interested to be a part of this study. This company hopes that the result of this study will help them to increase the motivation and performance of their employees. The reason why the author chose this manufacturing company for his survey is mainly because they have many employees within both low- and middle income level in Stockholm and was positive to be part of this study.

The survey had a respond rate of 64.7%. 85 were asked and 55 actually responded the survey questions, 30 low-income and 25 middle-income employees. All respondents within the low-income group are working as warehouse workers. The middle-income respondents have

different administrative job i.e. purchaser, order handler, project manager and two of the respondents are team managers.

The author wanted to interview employees with both low- and middle-income from more than one company in order to obtain a higher quality and reliability of the data. To find people with middle income to be interviewed, the author contacted eleven student fellows from when the author studied engineering program at KTH during 1997 to 2000. The chance to find people with middle income is high among people with university degree. These persons are working in the Stockholm area in different positions, branches and companies. The author explained the purpose of his study and then asked which salary interval they belong to. The alternatives of salary intervals presented were:

- ❖ < 20 000 SEK/month
- ❖ 20 000 – 33 500 SEK/month
- ❖ > 33 500 SEK/month

Two former student fellows had an income above 33 500 SEK/month and therefore excluded in this study and two did not want to participate in the interview. Seven of the former student fellows participated in the interviews. Six had an income between 20 000 and 33 500 SEK/month and one had lower income than 20 000 SEK/month.

The chance to find people with an income below 20 000 SEK/month, is higher among younger workers without university degree and with a short work experience and low level of special competence. To find five more interviewees with low income, the author asked some of his contacts at different manufacturing, logistics and health care companies. The author also asked his former student fellows if they had colleagues at their companies with lower income than 20 000 SEK/month and later contacted them. The author managed to find 5 respondents within the low income group in two different companies.

Those within low- and middle-income group were asked to be interviewed individually during an extended lunch break and answer few questions. The lunch was paid by the author at the nearest restaurant to the respondent's work place during weekdays, in order to save time for respondents and make it easier for people to participate in the interview.

Finally 12 persons were interviewed, six within the low income group (> 20 000 SEK/month) and six within the middle income group (20 000 – 33 500 SEK/month). In the low income group, five are married and one is single. One has a M.Sc. degree in Chemical Engineering but works as an operator and the others has at least finished their high school but have no university degree. All interviewees within low income group are between 22 and 50 years old and have between 1 and 23 years of work experience. All six interviewees within the middle income group are married, 29-34 years old, have a B.Sc. or M.Sc. degree and have between 4 and 10 years of work experience. One has a manager position with 14 employees.

Only low- and middle-income employees in are covered by this thesis because employees with high salary are often higher in the organization hierarchies and often receiving other types of monetary rewards like long-term incentives. The author believes also that low- and middle-income employees are more often available and may have more time to attend this research.

3.4 Analysis

The study begins by reviewing different theories about motivation and rewards, Principal-Agent theory and Motivation-Hygiene Theory and based on reasoning the law of diminishing marginal utility and is selected as a framework of this study. The author believes these are relevant to use as different lenses to view and analyze the collected data through interviews and surveys, in order to answer the research question: To remind you as a reader, the research question for the study is:

Do low-income employees perform better in response to performance-based salary increases compared to middle-income employees?

Data from the quantitative part of this research is presented in tables and diagrams to visualize the result in order to easier analyze it and come to a conclusion.

Data collected from the interviews will gain greater and deeper understanding of low- and middle income employees feeling about performance-based salary increase and if this type of reward is motivating them to perform better. This information complement the result from the data collected in surveys. Based on the presented results, comparisons between low- and middle-income groups is made and analyzed which helps us to answer the research question.

3.5 Credibility of the study

The author's intention was to provide knowledge about the subject utilizing the collected data during the research process. The empirical material has been utilized as the first step to answer research question. Norén (1990), states that the researcher profits from presenting and reasoning about the mode of operation performed by the researcher. The method section of this thesis shows how the author has set about this study to strengthen the credibility.

In order to be able to investigate the credibility of the essay on a more detailed level, the author chosen to discuss three different aspects of credibility: generalization, validity and reliability. These are as presented below:

3.5.1 Generalization

The intention with this study is to make it possible to be generalized for employers who have low- and middle-income employees and apply performance based pay system. A study which can be generalized means that the research findings, in some form, are transmittable to other environments Norén (1990). The author chose to apply this study at eight different companies within different branches and employees within both low- and middle-income group, instead of interviewing people from the same company and same income group. Because of the performed interviews, the author could obtained a picture of the employees opinions about performance based salary increase and whether or not they would increase their efforts and perform better if their performance was rewarded by a salary increase. After 12 interviews (6 low- and 6 middle-income) the author also performed a survey with 55 respondents to see if the result from the interviews could be supported by asking more employees.

Unfortunately, these 12 interviews and 55 survey respondents may not be apprehended as a generalization of all low- and middle-income employees within Stockholm area in Sweden, because the assortment is very small compared to all employees within the defined income level and geographic area. The author therefore believes that the result of this study can be used as an indicator but has not obtained an enough wide picture of what existing appreciations there are because a bigger selection might have contributed with something new.

3.5.2 Validity

Essential for the validity is that the results from an investigation are interpreted correctly and the researcher discusses the kind of truth he/she has reached Norén (1990). There are two different kinds of validity, inner and external. The author believes this study obtained a high external validity which means that the author thinks that the interviewees tell the truth. When the interview questions were designed, the research question was a starting point in order to make the questions relevant and valid for the study. In order to obtain truthful answers the author has used Swedish language instead of English and been careful in forming the questions to minimize the risk of misunderstanding. The author did not describe the research too detailed and did not send the questions in advance. This is to make the interviewees give spontaneous answers.

There might be several incentives for not giving the whole truth, for example try to manipulate the employer or fear of the boss finding out what has been told. In this study the author has therefore made the choice of not mentioning any names or firms to keep the interviews anonymous.

The author believes that the inner validity is good, as the author believe that this investigation measures what it is intended to be measured.

3.5.3 Reliability

The reliability is normally defined as the absence of haphazard errors in measurement, thus the meaning could be interpreted in several ways (Norén 1990). One aspect of reliability is the stability in what is measured. To avoid the surveys from varying too much from time to time from each group, the author had the same information to the teams before survey sheets were distributed. The setup and the structure in the questions asked was the same as well.

The same setup and a structure were applied in interviews. This implies that this study has a stable approach and the ways of conducting the surveys and interviews may be looked upon as equalized.

The author has been well prepared for every interview. The interviews have been carried out at the nearest restaurant to the interviewee's workplace but not at their company. Interviews have been recorded in order to not leaving anything out. The author has tried to not influence the interviewees and respondents of the survey.

4. Empirical findings

Information gathered throughout the interviews and surveys carried out are presented in this chapter. The information is divided in two sections, one with the information about the importance of performance-based salary increase to low- vs. middle income group’s motivation and the other section with information about the impact of performance-based salary increase on these income group’s performances. Questions used in the interviews and the survey can be found in Appendix A and B.

4.1 Importance of Performance-based salary increase to employee’s motivation

When asked if they currently have a clear performance target, either individually or team-based, most interviewees and 100% of survey respondents within both income group answered they at least have one performance target communicated by their managers. Most of them had targets based on their team’s performance and some respondents had individual targets or a combination of both individual and team-based targets. See the result below in the table 4.1.

Income group	No performance targets	Individual performance targets	Team performance targets
Low-income interviewees (n=6)	1	0	5
Middle-income interviewees (n=6)	0	0	6
Low-income survey respondents (n=30)	0	6	26
Middle-income survey respondents (n=25)	0	13	25

Table 4.1: Interviewees and survey respondent’s answer to question if they currently have a clear performance target, individually or group based.

One low-income interviewee mentioned that his manager follow up five different team performance measures on a daily basis and every morning present the result versus target of the previous day to the team. He also added that his manager also present the team performance measures every month. His manager is also following up each individual’s performance on a monthly and yearly basis, e.g. number of order lines shipped/month or tons of goods picked/month.

When asked if they consider salary increase based on their performance as an important factor for their overall motivation to work, all 12 interviewees, both in the low- and middle income group answered that it is an important or very important factor. This result was supported by the survey result as well. On a scale 1 – 5 (1 = salary increase based on their performance has no impact on their motivation and 5 = very important), the middle income group had a range from 3 to 5 with a mean = 4.64 (n=25) and low income group had the same range with a mean = 4.70 (n=30). This result make the author to believe that the impact of

performance-based salary increase on employees overall motivation is very high in both income groups as much but their reasoning about why it is important, varying a lot between individuals and income groups.

4.1.1 Importance of Performance-based salary increase to middle-income employees

Three of the middle-income interviewees think of performance-based salary increase as an important feedback and recognition from their manager which motivates them. They like to be seen and recognized for their efforts and performance and think verbal feedbacks from their manager is good for their motivation but not enough. One of middle-income interviewees (Clinical Research Associate) stated: *“The size of salary increase I get, is the only non-verbal tool my manager can use to give me a feedback about how happy she is with me and my performance. My previous manager gave me a lot of positive feedback verbally most of the time but I got a very small salary increase in the end in the year, compared to my colleagues”*. She also added: *“If my manager is happy with me and my performance she has to show it with a concrete action like salary raise. I don’t like empty words!”*. Another middle-income employee (Nurse Practitioner) stated: *“The money is important but it is not always about the money itself. It’s more about how appreciated my services are to my employer. The raise I get is an important signal from my manager to me about how he thinks I am performing my job”*.

Most of the middle-income interviewees told that they think a salary increase is motivating them only if it’s fair and according to their expectations, otherwise it would make them demotivated. One middle-income interviewee (Medical Physicist) stated: *“Of course I like my manager to see me every time I do a good thing at work and give me positive feedback continually because that will boost my motivation at work. But if the salary rises in the end of the year is not aligned with my expectations based on my results and the feedback I got from my manager, I would be disappointed and my motivation would go down”*. Another middle-income interviewee stated: *“I’m happy if the raise I get is on or above the average raise, because my contribution to the company is above average I think”*. She also added: *“Unfair salary raise gets me mad and frustrated”*.

Three of the middle-income interviewees think of performance-based salary increase primarily as an important way to increase their income for different reasons. The first interviewee of these three strived for earning more money in order to afford buying a new car. The second of these interviewees, an IT engineer thinks he is underpaid compared to other IT engineers at other companies within Stockholm area and said he gets embarrassed every time somebody asks about his salary. It seems like his low salary gives him a lower self-esteem. He stated: *“My salary is 33 300 SEK/month and I think I’m underplayed for the job I do. I think the salary you earn is the price tag on you and your competence and if your salary is low, people may think you have a low level of knowledge and competence as well. Since my salary is low, the salary increase is more important to me until I come up to an average level”*. The other interviewee, a team manager, seemed to be very de-motivated and stressed because of negative atmosphere and stressed situation at his workplace. He thinks of salary increase primarily as an important way to be compensated for his unfavorable work situation. He stated: *“When nothing is working properly at work and I have to firefighting all days, the salary raise is very important to me. If I get a low salary increase next time I will quit my job”*.

4.1.2 Importance of Performance-based salary increase to low-income employees

All six low-income interviewees think of performance-based salary increase as an important factor for their motivation at work and most of them primarily think of the extra money which could give them the possibility to cover their living expenses or increase their living standards. One of the low-income interviewees stated: *"I have a low income and high costs and a salary increase based on my results would motivate me because it makes so much difference in my standard of living if the raise is not eaten up by raises in all other prices like higher rent for my apartment, food and gas for my car"*. Another interviewee stated: *"I have a very low salary and therefore every extra Krona I can earn is appreciated"*.

One low-income interviewee said that there was no connection between his performance and his salary increase. He stated: *"We only get an annual salary increase which is divided almost equal between all employees. It would be better if the salary increase I get was based on the quality of my job and my performance. But today it's all about how many hours I'm ready to spend at work which matters. I'm working extra on weekends to increase my income"*.

Two of the low-income interviewees stated that they think a performance-based salary increase is motivating if it's fair and not affected by factors out of their own control. A comment from one of these interviewees was as follows: *"I feel I have very limited power to improve the result of a team of 22 employees. We don't measure individual performance at all and most of the measurements are more or less affected by factors controlled outside the team which is not fair and therefore does not motivate me at all"*. The other interviewee who is a colleague to the previous interviewee stated: *"The big size of the team makes it possible for some colleagues to be anonymous and deliver what is absolutely a minimum but all team members receive the same percentage of salary-increase based on the team's performance. It is unfair and de-motivating"*.

4.2 Change in performance level as response to Performance-based salary increase

On the question about survey respondents current motivation level to reach their performance targets on a scale 1 – 5 (1 = not motivated at all and 5 = 100% motivated), the answers from the middle income group had a range between 3 and 5 with a mean = 4.12 (n=25). The low income group had a range between 1 and 5 with a mean = 3.73 (n=30). There was a big spread in motivation level between individuals interviewed as well.

As presented in earlier theory section, there are many different parameters with impact on people's motivation to work and how well they are performing to achieve targets. Interviewees and survey respondents in this study are all on different level of motivation to reach their performance targets and we cannot possibly know about their actual performance level at work. To investigate if low-income employees perform better in response to performance-based salary increase compared to middle-income employees, the author asked respondents to exclude all parameters with impact on people's motivation and performance, except salary increase. The question was designed as follows:

“Would you increase your efforts and perform better at your current job, if your salary increase would only depend on how well your reach your performance targets? (All other parameters like working conditions, atmosphere at workplace, relationship with your colleagues and manager etc. remains the same as today)”.

In answer to this question, a higher percentage of low-income employees (both interviewees and survey respondents) answered that they would increase their efforts and perform better. See table 4.2 below:

Income group	Not at all		Yes, but slightly		Yes, a lot	
	Number	%	Number	%	Number	%
Low-income interviewee (n=6)	2		0		4	
Middle-income interviewee (n=6)	3		0		3	
Low-income group (n=30)	4	13.3%	3	10%	23	76.7%
Middle-income group (n=25)	11	44%	7	28%	7	28%

Table 4.2: Number and percentages of interviewees and survey respondents answered the question on if they would perform better if their salary increase would only depend on how well they reach their performance targets.

The content of comments from 3 of low-income interviewees and 2 from the middle-income group was that they would increase their efforts a lot if their performance targets were clearly defined and their individual performance was measurable and not affected by other team members or outside factors out of their control. One of these low-income interviewees added: *“While I’m young and have a lot of energy, I would perform much better than I do today if my salary increase was on a higher amount of money and based on my individual performance. Today all performance measurements we have are measuring the team performance and even if I would deliver 20% more per day, some colleagues in the team would think they could relax because somebody else is doing the job”.*

One of the middle-income interviewees (project manager) who said he would increase his performance in answer to the latest question also added that his individual performance cannot be measured in fair way in his job as project manager. *“The result of my projects is dependent on hundreds of different things, e.g. if project members keep their deadlines, different management decisions, employees who quit their job in the middle of the project and so on. Today there are so many different variables which impact the result of my projects and it sometimes gives me a feeling of giving up. But if my individual efforts would be measurable and rewarded by salary increase, I would definitely put much more efforts to my job”.*

44% of middle-income and 13.3% of low-income survey respondents said they would not increase their efforts and perform better at all, if their salary increase was only dependent on their performance. Two middle-income interviewees said that salary increase based on performance would not make them put more effort and time to improve their performance at work. Both of them mentioned that they prioritize their family life more than their job and would not spend more energy and time on their job. One of these interviewees added: *“I must be*

honest and say that I would not put more effort and time in to my job than today even though my performance was measured and good results was rewarded because I would not want to spend less time with my 1,5 year old son and my husband". The other middle-income employee stated: *"I'm already performing as good as I can".*

5. Analysis

In this chapter the author will relate the theoretical framework to the collected material through surveys and interviews with low- and middle-income employees. This will be the foundation for the conclusions made in the following chapter.

5.1 Importance of Performance-based salary increase to employee's motivation

Monetary reward based on performance, can be classified into three main categories: Short-term incentive plans, Long-term incentive plans and Performance-based salary increase (Ax, Johansson & Kullvén 2005). According to Samuelsson (1999), the performance-based salary increase is often considered to be the greatest motivational factor of them all. In this study both low- and middle income employees were asked whether or not they consider salary increase based on their performance as an important factor for their overall motivation to work. All interviewees and survey respondents in both income groups answered that performance-based salary increase is important or very important to them and their motivation. It was a very small difference in mean between low- and middle-income groups. On a scale 1-5 (1=not important at all and 5=very important), mean for middle-income group = 4.64 and low-income = 4.70. When interviewees were asked why they consider performance-based salary increase as an important/very important factor for their motivation, they had various ideas.

Three of the middle-income interviewees think of performance-based salary increase as an important feedback and recognition from their manager which motivates them. They like to be seen and recognized for their efforts and performance and think verbal feedbacks from their manager is good but not enough for their motivation. One of middle-income interviewees stated: *"If my manager is happy with me and my performance she has to show it with a concrete action like salary raise. I don't like empty words!"*. According to Bengtson (2001), there are six factors which help improving the motivation among people at work and one of these factors is being seen and acknowledged. Arvidsson (2004), argues that giving feedback for employees achievements increase their motivation, and in this study middle-income group consider the performance-based salary increase as an important feedback.

The other three middle-income interviewees think of performance-based salary increase primarily as an important way to increase their income for different reasons. The first of these interviewees, an IT engineer thinks his base salary is unfairly low compared to other IT engineers and that thought lower his self-esteem. He stated: *"I think the salary you earn is the price tag on you and your competence and if your salary is low, people may think you have a low level of knowledge and competence as well"*. According to Jacobsen & Thorsvik (2008), money is an external reward which provides internal motivation when it leads to higher self-esteem and vice versa. This statement is also consistent with Herzberg's thought of money as a so-called hygiene factor that creates dissatisfaction if not received in appropriate amount, but it is not seen as a potential satisfier or positive motivator (Herzberg, 1959). The second of these middle-income interviewees simply strives for improved standards of living. The third middle-interviewee, a team manager, thinks of performance-based salary increase primarily as a way to be compensated for his unfavorable work situation. He stated: *"When nothing is*

working properly at work and I have to firefighting all days, the salary raise is very important to me. If I get a low salary increase next time I will quit my job". According to the Motivation-Hygiene theory, working conditions is classified as a hygiene factor and do not cause higher motivation but a lack of them can cause dissatisfaction (Bassett-Jones, & Lloyd, 2005). According to the Motivation-Hygiene theory this team manager's motivation would probably not increase for a longer period of time even though he would get a high salary increase, since the bad working conditions still remains.

Most of the low-income interviewees in this study had more focus on the amount of extra money they could earn when talking about performance-based salary increase. They talked about the extra money which could give them the possibility to cover their living expenses or increase their living standards. The author found the low-income interviewees great focus on money noticeable during the interviews. One of the low-income interviewees stated: *"I have a very low salary and therefore every extra Krona I can earn is appreciated"*. The author believes that the difference between low- and middle-income interviewee's focus on money might be explained by the law of diminishing marginal utility. This economic law gives us an understanding of the change in the total satisfaction derived from change in the quantity of money (Polleit, 2011). According to this economic law, the marginal utility of each unit of money (or goods) decreases as the supply of units increases and vice versa (Rothbard, 2007). In other words, the more money you already earn, the less satisfaction will every new unit of money bring.

One low-income interviewee said that there was no connection between his performance and his salary increase. He stated: *"We only get an annual salary increase which is divided almost equal between all employees. It would be better if the salary increase I get was based on the quality of my job and my performance. But today it's all about how many hours I'm ready to spend at work which matters"*. Samuelsson (1999), argues that companies would better using monetary rewards based on employee's performance to align labor costs with productivity, retain top performers and reinforce company objectives. According to Svensson & Wilhelmson (1988), rewarding employees accomplished actions will help the company to obtain better results.

Two of the low-income interviewees stated that they think a performance-based salary increase is motivating if it's fair and not affected by factors out of their own control. A comment from one of these interviewees was as follows: *"I feel I have very limited power to improve the result of a team of 22 employees"*. The other interviewee who is a colleague to the previous interviewee stated: *"The big size of the team makes it possible for some colleagues to be anonymous and deliver what is absolutely a minimum"*. He also added: *"It is unfair and de-motivating"*. This statement is consistent with thoughts of Arvidsson (2004) that rewards based on group achievement brings a risk that some people becoming passive and rely on team members efforts and obtains the reward of the group even though he or she has not participated enough. On contrary, Jacobsen & Thorsvik (2002), highlights the positive side of rewards based on group achievements for the company. They argue that it could stimulate the individuals to cooperate and creates responsibility and loyalty.

Most of the interviewees in both low- and middle-income told that they think a performance-based salary increase is motivating them only if it's fair and according to their expectations, otherwise it would make them de-motivated. One middle-income interviewee (Medical

Physicist) stated: *“If the salary rises in the end of the year is not aligned with my expectations based on my results and the feedback I got from my manager, I would be disappointed and my motivation would go down”*. She also added: *“Unfair salary and rewards gets me mad and frustrated.”* This statement was consistent with Herzberg’s thoughts that if salary is not received in an appropriate amount according to the individual’s expectations, it will cause a great dissatisfaction (Herzberg, 1959).

5.2 Change in performance level as response to Performance-based salary increase

As presented in earlier theory section, there are many different parameters with impact on people’s motivation to work and how well they are performing to achieve targets. Interviewees and survey respondents in this study are all on different level of motivation to reach their performance targets and we cannot possibly know about their actual performance level at work. To investigate if low-income employees perform better in response to performance-based salary increase compared to middle-income employees, the author asked respondents to exclude all parameters with impact on people’s motivation and performance, except salary increase. The question was designed as follows:

“Would you increase your efforts and perform better at your current job, if your salary increase would only depend on how well you reach your performance targets? (All other parameters like working conditions, atmosphere at workplace, relationship with your colleagues and manager etc. remains the same as today)”.

In answer to this question, a higher percentage of low-income employees (both interviewees and survey respondents) answered that they would increase their efforts and perform better. 86.7% of low-income and 56% of middle-income survey respondents said they would increase their performance slightly or a lot and 44% of middle-income and 13.3% of low-income said they would not increase their efforts and perform better at all. The difference between these income groups is interesting to the author. A t-test was performed to test if there is any significant difference between mean of low-income and middle-income in regards to survey respondent’s willingness to perform better if their salary increase would only depend on their performance and goal achievements. A t-test is appropriate when all you want to do is to compare means.

The t-test result shows that the low-income employees are more than middle-income employees willing to perform better if their performance is rewarded by salary increase. The P-value of this test was 0.004 which would indicate that the result is statistically significant if the number of respondents was on a higher satisfying level. Due to the low number of respondents the author cannot consider the t-test as statistically significant but only use the test as an indicator. See the result from the t-test below:

Two-Sample T-Test and CI: Middle-income; Low-income

Two-sample T for Middle-income vs Low-income

	N	Mean	StDev	SE Mean
Middle-income	25	2,68	1,70	0,34
Low-income	30	4,27	1,44	0,26

Difference = mu (Middle-income) - mu (Low-income)

Estimate for difference: -1,59

95% CI for difference: (-2,834; -0,566)

T-Test of difference = 0 (vs not =): T-Value = -3,7511 P-Value = 0,0004 DF = 53

Table 5.1: A Two-Sample T-test to compare the mean of low- and middle-income respondents willingness to increase their performance if their salary increase was dependent on their performance.

The author believes there could be a possible explanation in the law of diminishing marginal utility. In sum, this theory establishes that the marginal value of money is higher when we have less money. The author believes an additional Krona is more valuable for individual who earn 17 000 SEK / month compared to another who earn 30 000 SEK / month. According to The theory of diminishing marginal utility, a rise in the money stock can never be "neutral" in economic terms. It necessarily leads to a decline in its exchange value, compared with a situation in which the money stock had remained unchanged. One of the low-income interviewees said he would perform better if his extra efforts was rewarded by salary increase and added: *"I have a low income and high costs and a salary increase makes so much difference in my standard of living, if the raise is not eaten up by raises in all other prices like higher rent for my apartment, food and gas for my car"*.

Two middle-income interviewees said that salary increase based on performance would not make them put more effort and time to improve their performance at work. Both of them mentioned that they prioritize their family life more than their job and would not spend more energy and time on their job. One of these interviewees stated: *"I must be honest and say that I would not put more effort and time in to my job than today even though my performance was measured and good results was rewarded because I would not want to spend less time with my 1,5 year old son and my husband"*. On the other hand, one of the low-income interviewee stated that he usually is working extra on weekend to increase his income. According to the Principal-Agent theory, agents put value to their leisure. Leisure is defined as the opposite of efforts that increases the expected return to the firm (Ross, 1973). This implicates that agents who work hard sacrifice their leisure and in return the company increases its value. According to Principal-Agent theory, agents face a risk when having to decide whether to sacrifice their leisure for a potential increased outcome (Eisenhardt, 1989). Normally the owners should bear all the risk in the company but by rewarding agents by performance the principal's split parts of that risk onto agents. The result from the interviews shows that less percent of middle-income employees are ready to scarify their leisure. According to Kaplan & Atkinson (1998) it is important to compromise between the desirability of principals bearing all the risk and the necessity of splitting some of that risk to the agents, when designing the optimal incentive system.

The content of comments from 3 of low-income interviewees and 2 from the middle-income group was that they would increase their efforts a lot if their performance targets were clearly

defined and their individual performance was measurable and not affected by other team members or outside factors out of their control. One of these low-income interviewees added: *“I would perform much better than I do today if my salary increase was on a higher amount of money and based on my individual performance. Today all performance measurements we have are measuring the team performance and even if I would deliver 20% more per day, some colleagues in the team would think they could relax because somebody else is doing the job”*. This statement is consistent with Arvidsson’s thoughts that rewards based on group achievement brings a risk that some people becoming passive and rely on team members efforts and obtains the reward of the group even though he or she has not participated enough (Arvidsson, 2004). Since there are also could be positive aspects of rewards based on group achievements, e.g. stimulating the individuals to cooperate and creates responsibility and loyalty (Jacobsen & Thorsvik, 2008), the author believes companies should find a balance between individual- and group-based performance measures to be rewarded.

6. Conclusions

The purpose of this study is to increase the knowledge about the motivational effects of performance-based salary increase, on low- and middle-income employees. In this final chapter the most important conclusions will be explained and the research question will be answered. Strengths and weaknesses of this study will be discussed and suggestions for further studies will be presented.

6.1 Conclusions

It has been clearly demonstrated that both low- and middle-income employees consider the performance-based salary increase as an important factor for their motivation at work but for different reasons. Middle-income employees often considered the performance-based salary increase as an important feedback and recognition from their manager but also as a way to increase their self-esteem or be compensated for their stressed working situation, before some mentioned the money to increase their living standards. Low-income interviewees had a greater focus on the extra money they could earn to cover their living expenses or increase their living standards. If the performance-based salary increase is not received in an appropriate amount of money and according to the individual’s expectations, it will cause dissatisfaction among both low- and middle-income employees. Many interviewees also mentioned that salary increase based on their individual performance would motivate them more than if it was based on the group’s performance and most of the interviewees agreed that performance measures is de-motivating if it is affected by factors out of their own control.

To remind you as a reader, the research question for the study is:

-Do low-income employees perform better in response to performance-based salary - increases compared to middle-income employees?

Throughout this thesis the author has examined if low-income employees would perform

better in response to performance-based salary increase, compared to middle-income employees. To get a fair answer to this research question, all parameters with impact on people's motivation and performance, except salary increase, were excluded when respondents were asked. It has also been clearly demonstrated that a higher percentages of low-income interviewees are willing to increase their efforts and perform better if their salary increase would only depend on their performance and goal achievements. A higher percentage of middle-income respondents said they would not increase their efforts and perform better at all and mentioned that they put more value to their leisure.

It is important to note that a rise in the money stock affects different individuals differently. This thesis is an indicative study and not statistically ensured. In this study 12 qualitative interviews with low- and middle income employees was conducted and 55 responded to the survey questions. Therefore it would be interesting to involve more respondents in different income groups in future studies.

6.2 Strength and weaknesses

The mix of qualitative and quantitative approach in this study is considered as strength of the study. Data was obtained through face-to-face interviews which are identified as best form of data gathering for qualitative researches. Information was obtained from the interviews, before survey questions were designed which resulted in a better quality of survey questions. Furthermore, all written and verbal communication with all respondents was in Swedish to avoid the study language related biases.

The most important limitation of the study is that it is based on data gathered only from 12 interviewees (six low-income and six middle-income) and 55 survey respondents (30 low-income and 25 middle-income) from 8 different companies in Stockholm area, Sweden. Unfortunately, this study may not be apprehended as a generalization of all low- and middle-income employees because the assortment is very small compared to all employees within the defined income level and geographic area. The author therefore believes that the result of this study can be used as an indicator but has not obtained an enough wide picture of what existing appreciations there are because a bigger selection might have contributed with something new.

Another weakness of this study is the definition of low- and middle-income employees in Stockholm. There is no universal definition for low- and middle-income groups known to the author.

6.3 Suggestions for further research:

It would be interesting to conduct a study similar to this study to compare different generation's or gender's or cultures willingness to increase their performance in response to performance-based salary increase.

One very interesting idea would be to take this study one step further and also cover high-income employee's willingness to increase their performance in response to performance-based salary increase.

The author of this thesis hope that the research on employee's motivation and reward systems will continue and yield useful insights that will contribute to designing more efficient reward systems that really motivate employees.

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Appendix

Appendix 1: Interview questions (Swedish)

Intervjufrågor:

Namn:

Ålder:

Arbetsgivare:

Befattning:

1) Har ni några gemensamma eller individuella prestationsmål på jobbet? Ge någon exempel.

Om Ja: Hur motiverad känner du dig för att uppnå dessa mål?

Inte alls

100% motiverad

1

2

3

4

5

Varför inte 100% motiverad?

2) Får du någon finansiell belöning i form av lönehöjning baserad på hur väl du presterar och uppnår dina individuella- /grupp-mål?

- Om Ja: Vad och hur stor var din senaste lönehöjning och hur ofta får du en höjning?

3) Om din lönehöjning skulle vara baserad på hur väl du presterar och uppnår dina individuella- /grupp-mål, hur mycket skulle du öka din prestation för att uppnå dessa mål?

(Förutsättningen är att alla andra arbetsförhållanden förblir det samma, d.v.s. du jobbar på din nuvarande arbetsplats med samma arbetsuppgifter, arbetsklimat, samma chef och medarbetare etc.)

Inte alls

Måttligt

Väldigt mycket

1

3

5

4) Hur viktig är en prestationsbaserad löneökning för dig och din motivation på jobbet? Motivera varför!

Appendix 2: Survey questions (Swedish)

Enkätfrågor

1) Har ni några gemensamma eller individuella prestationsmål på jobbet?

Nej	Ja, individuella	Ja, gemensamma
-----	------------------	----------------

2) Hur motiverad känner du dig för att uppnå dessa mål?

Inte alls				100% motiverad
1	2	3	4	5

3) Finns det någon samband mellan hur väl du presterar och uppnår dina individuella- /grupp-mål och din lönehöjning?

Ja	Nej
----	-----

4) Om din lönehöjning skulle vara baserad på hur väl du presterar och uppnår dina individuella- /grupp-mål, hur mycket skulle du öka din prestation för att uppnå dessa mål?

(Förutsättningen är att alla andra arbetsförhållanden förblir det samma, d.v.s. du jobbar på din nuvarande arbetsplats med samma arbetsuppgifter, arbetsklimat, samma chef och medarbetare etc.)

Inte alls	Måttligt	Väldigt mycket
1	3	5

5) Hur viktig är en prestationsbaserad löneökning för dig och din motivation på jobbet?

Inte alls				Väldigt mycket
1	2	3	4	5