Master's Programme in Industrial Engineering and Management

Designing a Compensation System in Low-hierarchy Scaling Talent-driven Organizations

A multiple case study into interdisciplinary perceptions

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Abstract

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Abstract

This thesis examines compensation practices in Finnish low-hierarchy, scaling and talent-driven companies using Gioia methodology on a multiple case study. The aim of the study is to establish compensation structures utilized and their effect on employee motivation, retention and employer attraction, as well as suggest guidelines for how compensation systems should be designed and implemented in entrepreneurial organizations.

The findings are separated into two categories: components of a compensation structure and implementation of a compensation system.

Fixed pay (salary) is generally viewed as a hygiene factor by employees, meaning that exceeding an individual's expectations will do little to boost motivation or retention. Bonuses are an excellent method for profit-sharing and harbor a sense of trust and fairness among employees. Commissions are exceptionally effective at directly motivating some employees but require easily quantifiable metrics to be effectively utilized. Long-term incentives, such as equity programs or stock options, effectively increase organizational commitment, with a positive effect towards retention and motivation.

The implementation of a compensation system is crucial for its success. While flexibility can be seen as an advantage in early-stage companies, it can quickly develop into a liability. To avoid this a company must undergo a formal structuring and simplification of compensation practices. Additionally, transparent communication is necessary to instill a sense of fairness in employees. Interviews show that perceived inequity has a demotivating effect, regardless of a compensation system's objective fairness.

The findings are complementary to previous research into compensation design. This thesis builds upon and enhances existing research in the selected more specific niche.

Keywords compensation, entrepreneurial HRM, rewards system

Contents

Preface

Even in academic circles, a decade is considered a long time. These years have fit some incredible experiences that have shaped me into who I am today. While this period in my life could certainly have been shorter, I do not regret taking my time, on the contrary. As Miinusmaa (1977) aptly states: "Kiirehtiminen aiheuttaa hosumista. Välillä on parempi istua jalka savessa ja nauttia."

This thesis could not have come to fruition, nor would these years have been as meaningful or influential, without the involvement of incredible individuals and communities. Some recognition is deserved.

Above all, I would like to thank Assistant Professor Natalia Vuori for her invaluable role in supervising my thesis. The process may not have followed the schedule recommended by Aalto, but you helped create a thesis I can truly feel proud of. Additionally, thank you Reko Morikawa for giving me the chance to explore a thesis topic I learned to appreciate. Surely your role as my advisor will continue beyond this thesis and my studies.

Moreover, I wish to express my gratitude to every one of you for the part you played in this chapter of my life. Thank you:

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As I bring this chapter to a close and reflect on its significance, I take pleasure in realizing that these people and communities will remain an enduring part of my future.

Rektorsgatan 1, December 23, 2023
Julius Luukkanen

Abbreviations

CDO	Chief Data Officer
CEO	Chief Executive Officer
CHRO	Chief Human Resources Officer
COO	Chief Operating Officer
CPO	Chief People Officer
CTO	Chief Technical Officer
HRM	Human Resource Management
KPI	Key Performance Indicator
SME	Small and Medium-sized Enterprises

1. Introduction

1.1 Introduction

A significant majority of Finnish startups and scaleups established in the last 10 years are knowledge-intensive organizations at heart, meaning that their greatest assets lie in their workforce. Studies indicate a correlation between the success and expansion of a small business and its capacity to allure and retain staff through the offering of competitive salaries and other relevant incentives (Barrett and Mayson, 2007; Kurdi & Alshurideh, 2020). In addition, when early-stage companies are hiring, they should be focused on attracting top-talent. Unfortunately the top-talent that would bring with it the most positive impact on company performance, tends to be highly competitive, so the employee market is not only cannibalized by competing start ups and scale ups, but also established knowledge-intensive organizations such as top-tier management agencies and investment banks. The recruitment and retention of skilled personnel poses significant challenges for small enterprises (Cardon and Stevens, 2004; Khan 2020).

This is where the core issue for early stage companies lies: the growth potential of early stage companies tends to be directly related to their ability to re-invest liquidity into growth, for example in hiring more employees. Unfortunately, this means that they are less capable in attracting top-talent with innately high compensation as larger corporations, and must find other methods for compensation (Kim, 2019).

The problem does not limit itself to attracting talent but also talent retention. Modern skilled employees are looking for opportunities and switching workplace no longer has a stigma attached to it. On the contrary, the norm for skilled individuals is to often search for new opportunities and aim to complete several short stints in high performance organizations to diversify their personal experience portfolio, rather than building decades-long careers in a single organization. (Singh, 2019; Pries & Rogerson, 2022)

The modern paradigm for research into employee motivation and job satisfaction seems to attribute most of the blame and success to organizational culture, while compensation tends to be viewed as more of a hygiene factor (Chiat & Panatik, 2019). In short, if compensation is sufficient and employees feel valued, their motivation and satisfaction are affected by other factors, mainly organizational culture (Sageer et al., 2014). This thesis does not aim to refute or enforce the significance of other factors, but it aims to explore the effects compensation has on indicators generally explored from a different perspective. Research indicates that organizational reward systems have a substantial predictive influence on both initial public offering (IPO) pricing and the long-term sustainability of companies (Welbourne and Andrews, 1996; Boudreaux, 2021), therefore it can be hypothesized that compensation schemes have an effect on motivation (and hence company performance) as well as employee retention.

In early-stage enterprises, founders or managers frequently find themselves constrained by time or expertise to formulate intricate incentive systems, despite the pivotal role these systems play in the attraction and retention of proficient employees (Purhonen, 2019). Thus, a general understanding of compensation structures and how they should be developed has significant managerial implications.

Compensation system and *Rewards system* are terms which are used in varying meanings, and at times interchangeably. This thesis uses the term compensation system to signify any direct compensation of monetary value that the company considers a part of the firms compensation system. This excludes several benefits offered by companies, which are generally placed under the broader term "rewards system."

1.2 Research Questions

This thesis aims to establish how compensation systems are structured in Finnish Low-hierarchy scaling talent-driven companies, analyse the structures' impact on employee motivation and retention as well as employer attractiveness, and suggest a model for designing a compensation scheme. The study focuses on companies that fulfill all three traits (talent-driven, low-hierarchy and scaling), but at least two of the three defining traits .

The research questions driving the study can be summarized as the following:

Question 1: *How are employees compensated in talent-driven, low-hierarchy, scaling companies?*

Question 2: *How do different compensation system components affect motivation, retention and employer attractiveness?*

Question 3: *How should companies within the scope of this thesis design their compensation system?*

As the research questions highlight: the study forms a three staged continuum, where initially the current situation is established. Then the current way of things is used to analyze its impact and effectiveness across several indicators. Finally, once issues and successes have been established the study will suggest managerial implications, mainly how a compensation system should be designed.

1.3 Scope and Structure

This thesis is a qualitative study, that will limit itself geographically to Finnish companies, or autonomous sections of multinational companies that function solely in Finland. The companies have been broadly defined as talent-driven, low-hierarchy and scaling. Each term is explicitly defined in the context of this study in chapter 3: "Methodology." While a majority of the relevant research into the topic is international, it is important to note that there may be significant differences across the world. As such the literature review conducted in chapter 2 serves as a baseline for hypothesis, but local differences are expected when limiting the study to Finnish companies.

This thesis is structured across eight chapters. The initial chapter introduces the subject, highlights the motivation driving the thesis, and presents the research questions and goals of the thesis. The following chapter will offer an in-depth exploration of existing literature and previous research, focusing on international compensation research, particularly delving into compensation and reward systems within knowledge-intensive entrepreneurial firms. Chapter three will explain the methodology employed in the study, detailing the data collection and analysis procedures. The fourth chapter will showcase the study's findings and surface level implications in a structured manner, represented in two separate models. In chapter five, the thesis will draw comparisons between the findings and earlier research in the field, highlighting similarities, differences, and presenting new insights, additionally proposing avenues for future research. The chapter also contains managerial implications: effectively a proposal for how compensation systems should be designed.

2. Literature Review

This section aims to set the study's context by providing background information. The literature review was executed by searching Google Scholar for a broad range of studies using the following keywords: Compensation management, Rewards systems, and Entrepreneurial HRM. A focus was added to most recent studies, prioritising studies published after 2019. Generally, more recent studies expand rather than contradict past studies in the domain.

Firstly, this section provides a definition of compensation management along with its distinctive features, emphasizing an entrepreneurial context. Subsequently, it delves into established theoretical frameworks relevant to the topic. Following that, the connection between compensation and performance is investigated. Finally, the literature review is summarized.

2.1 HRM and Rewards Systems

Human Resource Management (HRM) holds a crucial role as an organizational resource, sustaining effective operations and influencing the attitudes and behaviors of employees. Lee and Heard (2000) highlight its impact on employee intent to leave, levels of job satisfaction, and organizational commitment. Pfeffer (1998) distinguishes soft or high commitment HRM practices, emphasizing practices that foster trust, such as empowering employees in decision-making, facilitating extensive communication, providing skill-focused training, employing selective hiring, promoting team collaboration, implementing fair rewards systems, reducing status differentials, and valuing all workers irrespective of their roles. Macky and Boxall (2007) propose a causal link from HRM practices to organizational performance through employee responses. Equitable compensation is identified as critical by Adams (1965), warning that organizations offering non-competitive compensation packages may face employee attrition. Lawler (2005) emphasizes a new era in the organizational-employee relationship, asserting that a company's competitive advantage and survival hinge on the treatment of employees.

Several studies identify compensation and rewards systems as key HRM practices that affect company performance through its employees.

Milkovich and Newman (2005) characterize compensation as encompassing "all forms of financial returns and tangible services and benefits that employees receive within an employment relationship." They propose a pay model that categorizes total returns for work into two primary components: total compensation and relational returns. Total compensation comprises monetary elements, encompassing base pay, short-term incentives, and long-term incentives, along with non-monetary benefits like income protection, allowances, and a focus on work/life balance. Relational returns are characterized as factors such as recognition, status, job security, engaging work, and opportunities for learning. On the other hand, Balkin (1988) identifies previously stated parts as a part of a more comprehensive "rewards system," isolating compensation to specifically monetary compensation. Chen and Hsieh (2006) emphasize that remuneration alone is insufficient for attracting, motivating, and retaining employees. Total rewards encompass everything that employees perceive as valuable within the employment relationship.

This study will use the term *rewards* to refer to any value gained by employees in exchange for their employment, while limiting the term *compensation* so strictly monetary compensation. Equity programs' monetary compensation in reliant on the companies future success, but they are given with the intent of delivering monetary compensation to employees.

Rewards systems can be divided into four distinct categories: compensation, benefits, learning opportunities, and work environment (Purhonen, 2019). Compensation encompasses fixed pay, including base pay, and variable pay, containing short-term incentives such as skill-based pay, bonuses, profit-sharing, and signing bonuses, as well as long-term incentives involving employee stock options. Examples of benefits include health care, insurance, lunch and recreational vouchers, fitness center access. Learning and development opportunities contain opportunities for employees to develop their personal capabilities in a manner that does not directly contribute to company performance. This include courses, career planning, and mentoring. The work environment is shaped by factors like flexibility, autonomy, recognition, status, job design, opportunities for decision-making participation and influence, work-life balance, security of employment, and a positive and exciting organizational vision. (Milkovitch & Newman, 2005; Chen & Hsieh, 2007; Balkin, 1988)

It is important to recognise that the above list contains examples, but total rewards can be seen as including anything the employees considers as valuable returns for employment (Purhonen, 2019). However, in this study we will consider factors that companies expressly offer with the intent of them being compensation, rather than basing the definition on employee perception. This limits many cultural aspects from being inadvertently considered a form of compensation. This distinction does not negate their effect on the general objectives of HRM.

2.2 Compensation Management

Ogohi (2019) describes compensation management "as a systematic approach to providing monetary value to employees in exchange for work done or service rendered." Following this definition, this section delves into the objectives, components and development processes of monetary compensation.

2.2.1 Objectives of Compensation Management

Effective compensation management plays a pivotal role in achieving various organizational objectives, as highlighted by different perspectives in the literature. According to Wiley (2007), one of the primary objectives of compensation management is to boost morale, productivity, and work quality among employees. Effective rewards systems contribute significantly to creating a positive work environment and motivating employees to perform at their best.

Bhattacharya and Sengupta (2014) highlight the centrality of compensation as a critical element in human resource management. It serves as remuneration for an employee's contributions to the organization and plays a crucial role in motivating employees. Furthermore, adequate compensation packages are instrumental in attracting and retaining top talent, contributing to overall organizational effectiveness, performance, and commitment.

Tessema and Soeters (2006) provide a broader perspective, describing compensation as a critical component of the employment relationship. The strategic use of these components aims to motivate employees to strive for higher levels of productivity, fostering a motivated and engaged workforce.

Additionally, Ash (1993) underscores compensation management as an essential tool for integrating employees' efforts with strategic business objectives. By aligning compensation practices with the organization's goals, employees are encouraged to focus on tasks that contribute to the overall efficiency of the workplace, thereby driving organizational success.

Compensation management is widely recognized as a potent instrument for achieving overarching organizational objectives, with a primary focus on enhancing overall organizational performance and aligning employees' individual goals with the broader organizational strategy through incentive structures. The direct correlation between employee performance and organizational commitment and loyalty underscores the pivotal role of compensation management. High turnover rates can significantly impede organizational performance (Macky & Boxall, 2007; Lawler, 2005); hence, compensation management aims to address this challenge by positively influencing employees' motivation, job satisfaction, and commitment to the organization. In essence, the strategic design and implementation of compensation systems not only act as a means to attract and retain talent but also serve as a catalyst for fostering a dedicated and loyal workforce, ultimately contributing to the realization of organizational excellence. A effective reward system is characterized by its ability to attract, retain, motivate, and engage employees, thereby aligning with the firm's strategy and goals (Bhattacharya and Sengupta 2014).

2.2.2 Components of Compensation Structures

Compensation structures can comprise of a variety of different elements. Their sum, inclusive of potential, is viewed as total compensation. How a company chooses to structure their compensation package is largely reliant on the resources at a companies disposal, as well as what the company wishes to achieve with their compensation system.

Cameron (2022) divides the components into two broad categories: fixed pay and incentive plans.The components are demonstrated in table 2.1. This thesis will consider this framework as the basis for itemizing components of a compensation structure. While the framework proposes only

Fixed Pay	**Attributes**
Salary	Fixed compensation, may include overtime.
Hourly Wage	Paid based on number of hours worked
Piecework System	Paid based on the number of items/services produced
Incentive Plans	**Attributes**
Commission	Extra pay based on measurable results, eg. sales
Bonus	Bonus for meeting some goal previously determined
Profit-Sharing	Bonuses based on company performance
Stock Options	Right to purchase company stock in future

Table 2.1. Compensation structure components (Cameron, 2022)

options programs as a means to share equity with employees, more direct equity sharing, common in early stage companies, will be included in analysis.

Compensation development is a significant part of compensation packages. This can be divided into personal and organizational compensation development. Personal compensation development refers to an individual compensational growth potential, through raises and access to further incentives plans. Many companies have more extensive incentives plans in place for more senior employees. Organizational development is directly related to the expected appreciation of stock options and equity. (Milkovich & Newman, 2005)

2.2.3 Developing a Compensation System

Cameron (2022) suggests that development of a compensation system should be started by determining what employees consider a fair wage and determining how much the organization can afford to pay while still staying financially healthy. Once these questions are answered, a compensation philosophy needs to be developed based on both internal and external factors. Some companies follow a market compensation philosophy, paying salaries based on the current market rates for specific jobs. Others might choose a market plus philosophy, offering higher-than-average pay. On the flip side, a market minus philosophy involves paying less than the market rate, but the organization might make up for it by providing additional benefits. Only once the level of total compensation is determined, the structure should be determined in accordance to a company's financial capabilities.

Developing a compensation structure for a company involves a multi-faceted approach. Firstly, comprehensive market research is crucial to understanding industry standards and regional compensation trends, ensuring that the company remains competitive in attracting top talent. Next, internal equity must be carefully considered, as it entails establishing fair pay differentials based on job responsibilities and skill levels within the organization. Crafting an attractive compensation package goes beyond basic salaries; it involves thoughtful consideration of benefits and perks such as health insurance, retirement plans, and bonuses. The inclusion of performance-based pay, tied to individual or team achievements, serves as a motivational tool and aligns employee efforts with organizational goals. Similar results can be achieved through long-term incentive plans, which often help in boosting organizational loyalty. (Cameron, 2022)

Effective communication of the compensation structure to employees is vital, fostering transparency and ensuring a clear understanding of how their pay is determined, ultimately contributing to a positive and trusting work environment (Cameron, 2022). Without trust a well established compensation structure can be viewed as unfair, reducing organizational commitment (Colquitt et al., 2009).

Once a compensation system has been designed and implemented, it should not be treated as static. On the contrary, it should constantly be evaluated and developed. Regular review and updating should be done to align the model with changes in the business environment, industry standards, and company growth. This ensures ongoing competitiveness and employee satisfaction. Additionally, seeking feedback from employees to gain valuable insights into the system's effectiveness and identify areas for improvement, fostering a culture of transparency and responsiveness. (Cameron, 2022)

Studies indicate that the HRM systems, particularly the rewards systems, of SMEs tend to evolve in tandem with the firm's life cycle (Picken, 2017). In early stage companies HRM practices, including compensation, tend to be less formalized and fluid, with adaptability seen as a positive (Davila, 2005). According to Heneman and Dixon (2001), the establishment and execution of a reward system in SMEs typically follow behind the implementation of other organizational processes and policies. This delay is attributed to the limited resources, including time and expertise, available to executives and founders for designing and implementing effective reward practices (Heneman & Berkley, 1999). Additionally, Marlow (2002) suggests that, in the initial stages of operations, startup managers may not perceive the formalization of human resource management practices as a priority.

Frequently, rather than employing experts, initial formalization of HRM practices is executed by founders and executives based on personal experience and benchmarking (Heneman and Dixon, 2001). Unfortunately, startup CEOs and founders frequently face challenges in allocating time and, at times, lack the necessary expertise for the implementation of complex reward systems (Heneman & Berkley, 1999). The development process often involves a process of trial and error, which can be detrimental to an early stage company that has a reduced resilience to the issues caused by an inadequately performing compensation structure.

2.3 Relevant Theoretical Frameworks

In this section, we delve into recurring and established theories that serve as foundational frameworks applied to the domain of compensation management. These theories, emerged in several studies explored in the literature review, offer valuable insights into the principles and dynamics that underpin how organizations design compensation practices. Through examination of these theories, the aim is to offer a comprehensive insight into the often implicit theories that influence the design of compensation practices in HRM. The frameworks are applied to the context of this thesis, focusing on their interpretation in talent driven, scaling, low hierarchy companies.

2.3.1 Equity Theory

Adams' (1963) Equity Theory is a motivational theory that revolves around the concept of fairness in the workplace. The theory is grounded in the idea that individuals are motivated by their perceptions of fairness and equity in the distribution of rewards, both tangible and intangible, compared to the contributions they make to their work.

The key components of Adams' Equity Theory include inputs, outputs and comparison. *Inputs* refer to the contributions or efforts made by individuals in the workplace, such as time, skills, effort, and dedication. Inputs represent what employees bring to their jobs. *Outputs* refer to the rewards or outcomes that individuals receive for their contributions, including salary, recognition, promotions, and other tangible or intangible benefits. In addition, individuals make social comparisons by assessing their own inputs and outputs in relation to those of their colleagues or peers. Adams (1963) suggested that people compare their input-to-output ratios to others to determine if they are being treated fairly. (Adams, 1963)

The theory establishes three distinct scenarios related to perceived equity or inequity of their situation in the workplace. In situations of *equity*, individuals perceive a balance between their inputs and outputs when compared to their colleagues, fostering a state of equity that contributes to job satisfaction and motivation. On the other hand, *under-reward inequity* occurs when individuals feel that their contributions outweigh the rewards received in comparison to their peers, leading to sentiments of frustration and demotivation. Conversely, *over-reward inequity* arises when individuals believe their inputs are less than the rewards received in comparison to others, potentially triggering feelings of guilt or discomfort. These scenarios illustrate how perceptions of fairness in the distribution of rewards can significantly influence employee motivation and satisfaction in the organizational context. (Adams, 1963)

Equity theory is linked to the idea that compensation systems are fair if they are felt to be fair (Jaques, 1961). According to the equity theory, motivation is influenced not only by an individual's own beliefs and circumstances but also by what they see others experience. Additionally, the theory proposes that employees construct a mental ledger in which they keep track of the rewards they receive from their job responsibilities and the inputs (contributions and investments) they dedicate to their work tasks (Colquitt et al., 2009).

2.3.2 Agency Theory

Agency Theory is a theoretical framework in economics and organizational studies that investigates the dynamics of the relationship between principals and agents within an organizational structure. This theory is particularly relevant in situations where decision-making authority is delegated from one party to another. In the principal-agent relationship, the principal is the entity or individual delegating tasks or responsibilities, while the agent is the party entrusted with carrying out these tasks on behalf of the principal. (Eisenhardt, 1989)

A foundational concept in Agency Theory is the notion of information asymmetry. This refers to situations where the agent possesses more information about certain aspects of the organization's operations than the principal. This information gap can create potential conflicts of interest and challenges in ensuring that the agent acts in the best interests of the principal. (Eisenhardt, 1989)

Crucially, the principal and agent may have divergent goals and objectives. The principal typically seeks to maximize the overall well-being and success of the organization, while the agent may have personal interests or objectives that do not perfectly align with those of the principal. This misalignment of interests can lead to challenges known as moral hazard, where the agent takes actions that benefit themselves at the expense of the principal. (Eisenhardt, 1989)

Effective incentive structures play a pivotal role in Agency Theory. Principals design these structures to align the interests of the agent with organizational goals. Incentives may include performance-based bonuses, stock options, or other mechanisms that motivate the agent to act in a manner consistent with the overall objectives of the principal. (Eisenhardt, 1989)

In low-hierarchy organizations, where decision-making authority is often distributed across a flatter structure, Agency Theory is relevant in understanding and managing the dynamics between principals and agents. In these settings, where the lines of authority are less existent, potential for agency problems may arise as individuals within the organization are entrusted with decision-making responsibilities (ie. self-management principles) (Weerheim et al., 2019). Agency Theory becomes crucial in the context of compensation management, as the principles of aligning interests, designing effective incentive structures, and mitigating information asymmetry are paramount. In low-hierarchy organizations, where employees may have a more direct impact on organizational outcomes, ensuring that compensation practices incentivize behavior aligned with organizational goals is essential (Weerheim et al., 2019).

2.3.3 Expectancy Theory

Vroom's (1964) Expectancy Theory is a motivational framework that seeks to explain and predict individual behavior based on the relationship between effort, performance, and outcomes. According to this theory, individuals are motivated to act in a certain way if they expect their efforts will lead to successful performance and, subsequently, desirable outcomes. The theory comprises three key components: Expectancy (E1), Instrumentality (E2), and Valence (V).

Expectancy (E1) is the belief that a specific level of effort will result in the attainment of a performance goal. In essence, individuals assess the likelihood that their effort will lead to successful task accomplishment. *Instrumentality (E2)* refers to the belief that successful performance will be followed by a particular outcome or reward. Individuals evaluate whether achieving the desired performance will result in the anticipated reward. *Valence (V)* represents the subjective value or desirability that an individual places on a specific outcome or reward. (Vroom, 1964)

The formula for calculating motivation (M) in Vroom's model is expressed as $M = E1 * E2 * V$. In practical terms, an individual will be motivated to exert effort if they believe that their efforts will likely lead to successful performance and that the anticipated reward is highly valued by them. (Vroom, 1964)

This theory underscores the importance of individual differences in motivation, recognizing that individuals have unique expectations, preferences, and valuations of outcomes that influence their motivation.

In a compensation design context, Vroom's expectancy theory allows us to understand the effect of variable compensation components on motivation. Salary hikes, bonuses, and informal rewards exemplify outcomes with a "positive valence," signifying their attractiveness (Colquitt et al., 2009). Conversely, disciplinary measures, demotions, and terminations exemplify outcomes with a "negative valence," indicating their undesirability. This implies that employees tend to be more motivated when their successful performance leads to favorable outcomes like bonuses.

2.4 Compensation linked to Performance

Compensation serves as a pivotal tool in augmenting company performance, functioning as a valuable indicator for assessing future organizational success (Barrett & Mayson, 2007; Kurdi & Alshurideh, 2020). Its significance stems from the profound impact it has on employees, as compensation systems are widely recognized for their role in enhancing employee motivation, commitment, and attraction, ultimately influencing company performance.

The concept of perceived fairness, integral to the equity theory proposed by Adams (1963), is identified as a crucial factor influencing performance. According to Cameron (2022), transparency plays a pivotal role in shaping employees' perceptions of fairness regarding compensation. Consequently, fostering internal transparency in compensation is implied to have a positive and influential effect on overall organizational performance. Fulmer and Li (2022) further enforce this view, stating that perceptions of fairness are the key to harboring trust between employees and their employer.

Osibanjo et al. (2014) show that significant positive correlations exist between salary, bonuses, incentives, allowances, and fringe benefits. In simpler terms, these variables are correlated and, as such, serve as predictors of performance. Osibanjo et al. (2014) highlight bonuses as the most significant factor in incentivizing employees to improve performance. However, Pfeffer (1998) argues that once an workforce grows, employees perception of their capability to influence the achievement of organizational goals diminishes, meaning that bonuses should be tied to tangible goals.

Following Allen and Meyer (1990), organizations with well-established compensation systems and policies have a significantly positive impact on their employees willingness to engage in the company, greatly improving performance. Organizations thrive when they recognize that employee motivation should not be assumed, acknowledging that employees bring expectations and needs to the workplace that they aim to fulfill through their efforts (Osibanjo et al., 2014).

As performance is a strong predictor of employee retention (Osibanjo et al., 2014), the correlation effect between retention and performance must be noted. There are likely underlying factors that affect both performance and retention. Retention is seen as directly affecting performance, as lower turnover rates allow an organization to focus on organization goals rather than on boarding practices (Macky & Boxall, 2007). Employees tend to become more effective in their role as time goes on (Lawler, 2005), highlighting the effect high retention rates have on performance.

2.5 Compensation linked to Organizational Commitment

Organizational commitment can be defined as the extent to which an employee is inclined to sustain affiliation with the organization based on their alignment with and connection to the organization's goals, values, and objectives (Ogohi, 2019).

Allen and Meyer (1991) separate organizational commitment into three distinct categories: *affective commitment (AC), continuance commitment (CC), and normative commitment (NC)*. Affective commitment manifests when employees desire to remain, driven by emotional connections with the organization. Continuance commitment is evident when employees feel compelled to stay, influenced by factors such as salary, benefits, and their level of integration into the community. Lastly, normative commitment emerges when employees believe they should stay, often influenced by the organization's investment in its employees or its involvement in philanthropic initiatives. Continuance commitment is the category with the most relevance to this study, as it focuses on how compensation practices translate to retention.

Employees with high continuance commitment assess the potential costs and sacrifices they would face if they were to leave the organization. These costs may include financial implications, the loss of seniority, benefits, and the time and effort invested in the current position. High levels of continuance commitment are often associated with a perception that there are limited alternative opportunities available in the external job market. Employees may feel that leaving the organization would entail significant risks and uncertainties. Understanding continuance commitment is crucial for organizations as it provides insights into why employees may choose to remain despite potential dissatisfaction. (Allen & Meyer, 1991)

Continuance commitment offers insight in to the relativity of evaluating compensation practices. While a compensation system may not be 'good' it may well be the 'best.' The effect may be positive from a retention point of view, but will likely translate to a negative effect on satisfaction and subsequently motivation and performance.

Effective compensation management has the potential to inspire employees to maintain allegiance to the organization, thereby contributing to enhanced organizational performance. According to Chiu et al. (2002), offering higher compensation packages plays a significant role in retaining employees as it fosters higher satisfaction levels, commitment, and loyalty among the workforce.

The role of communication and trust is vital in maintaing a healthy discourse between employers and employees. A lack of trust, often caused by a lack of transparency and communication can result in significantly decreased organizational commitment. (Montag-Smit & Smit, 2021)

2.6 Conclusions

When considering the designing of a compensation system, it is noteworthy that a generalized solution is an overwhelmingly unlikely outcome. As Purhonen (2019) states, no one size-fits-all solution exists, as organizations are unique with differing capabilities and needs. However, relying on this literature review there are recurring motives that can be explored and addressed on a generalized level.

The focus of evaluation, as per the research questions established, is aimed at improving organizational performance and commitment through the means of compensation. These can be affected and evaluated by assessing effects on abstract but more narrow indicators, mainly employee motivation, retention, employer attraction and perceived fairness.

Much of previous literature is conducted on larger companies. The needs and capabilities of SMEs are potentially significantly different, and research into this niche is much more shallow. This study will offer an opportunity to explore more generalized theory in the chosen niche, validating which principles apply and which do not.

Some research gaps can be identified through the literature review. Existing theoretical frameworks are mainly motivation theories, with implications to fairness and attraction. A minimal amount of theories quoted in relevant studies contain established theories related to commitment.Another research gap relates to how compensation's effect on indicators is almost always analyzed from view of compensation as a whole, rather than individual component views. At best the distinction is made between fixed pay and incentive plans. This study aims to take closer and identify differences within different types of incentive plans.

Brown and Reilly (2009) propose length of service, turnover rate, employee satisfaction, job offer refusal rates, measures of staff commitment as well as productivity per employee as metrics for assessing the success of a compensation system, but recognise that these metrics are also affected by other factors. Surprisingly, despite the growing recognition of the importance of reward systems, a relatively small number of organizations actively endeavor to systematically evaluate the effectiveness of these systems (Brown & Reilly, 2009). Academic literature on the objective evaluation of compensation systems is fairly minimal, and considering that evaluation is a key to development, this can be seen as a research gap relevant to this thesis.

The aim of the empirical study performed in this thesis is to both validate claims from precious literature in a much more narrowly defined context and propose answers to the established research gaps. As stated, a full solution is an unlikely outcome, but the study aims to provide guidelines with a firm footing in empirical study as well as established research in the domain.

3. Methodology

This chapter describes the methodology that was undertaken in order to conduct this study. The aim of the study is to provide a sufficient answer to it's research questions, which were defined in the introduction of this thesis as:

Question 1: *How are employees compensated in talent-driven, low-hierarchy, scaling companies?*

Question 2: *How do different compensation system components affect motivation, retention and employer attractiveness?*

Question 3: *How should companies within the scope of this thesis design their compensation system?*

The following section will characterize the chosen research methodology and why it is suitable for this study, as well as acknowledge the limitations posed by the chosen methodology. Methodology encompasses research design, sample selection and methods for analysis.

3.1 Research Design

As all of the research questions begin "How?" and within the research parameters lie many implicit "Why?" questions, such as *Why are current compensation systems structured in the way they are*?. This paired with limited previous research into the exact niche of this study direct the study towards a qualitative approach.

Eriksson and Kovalainen (2008) propose that a qualitative research approach is particularly fitting when there is limited prior research on a topic. In such instances, they advocate for a qualitative method over quantitative, citing the flexibility of qualitative research, especially in the adjustment of interviews to varied situations. The utilization of semi-structured interviews for data collection further enables the emergence of new information and themes that might not have been addressed in previous research.

In order to focus on the development of compensation structures and their effect, the study will be conducted as a multiple case study. According to Easton (2010), multiple case studies are especially well-suited for explanatory research and addressing questions related to "how" and "why," aligning with the research inquiries established for this study. While a single case study would have afforded more insight into the underlying reasoning behind the how and why a compensation system has developed in the manner it has, a multiple case study offers insight into the multitude of different approaches, highlighting and contrasting successes and failures. As interviews were conducted with a semi-structured method, it is important to consider each case study as an independent experiment, where they cover common ground but may diverge into unique territory.

The research was conducted using Grounded theory (Strauss & Corbin, 1990). It is especially suitable for semi-structured interviews, where unforeseen insights may emerge. The methodology of coding and memo-writing supports the comparing interviews and case-studies to form a holistic basis for theory building.

3.2 Sample Selection

Eisenhardt (1989) asserts that there isn't an ideal number of cases for a case study, but suggests that an appropriate range is between 4 and 10. Having fewer than four cases is believed to primarily emphasize distinctions among cases, while exceeding ten cases may lead to an exceedingly intricate depiction of the studied phenomenon, making it challenging for the researcher to comprehend and succinctly summarize.

In the pursuit of a comprehensive understanding of compensation and reward systems within entrepreneurial firms, a thorough research approach was undertaken. Outreach was made to 28 companies, resulting in successful interviews with representatives from 7 of them, totalling 17 interviews. Each company was asked to provide 2-3 interviewees, specified as managers that either have been or are intimately acquainted with the company's compensation practices and the reasoning behind them. This is because a large part of the interview focused on the perception of successes and failures, and relying on a single perspective would have affected the reliability of the data. All representatives were individually interviewed to ensure uninfluenced perspectives.

Companies were selected through purposeful sampling, where the objective is to deliberately choose informants who possess the highest level of expertise on the study subject and express a willingness to actively participate in the study (Palinkas et al., 2015). In addition, this sampling method worked to ensure that selected companies fit the chosen profile as closely as possible. Willingness to participate in the study was vital to guarantee interviewee's motivation in sharing their experience.

The long-list of companies was formed based on a list of fastest growing companies in Finland. This metric was seen as a way to fulfil the description of "scaling" in case companies. To ensure companies fit the profile, companies' plans for growth were ensured in the interview. The least ambitious growth prediction among companies was a 30% increase in personnel in the following year. Therefore, all companies can be considered scaling for the purpose of this study, as a primary goal of all case companies is scaling growth.

The list was further reduced by inspecting companies' fit to the chosen profile. Low hierarchy organizations are defined as organizations with few or no levels of middle management between executives and staff (Diefenbach & Sillince, 2011). Low hierarchy is often related to a culture of self-management within an organization. For the purpose of this study, low hierarchy was defined as a maximum of one level of middle management between staff and executives, effectively limiting tiers of hierarchy in case companies to a maximum of three. Low hierarchy and its cultural implications were inquired about in the interviews, but a lack of such culture was not seen as a limiting factor for the study.

The process of selecting potential case companies posed challenges, particularly when considering the concept of talent-drivenness, which proved to be more difficult to define and recognise based on public data. The focus, therefore, leaned towards organizations that demonstrated a knowledge-driven attributes. External assessments alone could not explicitly determine a company as talent-driven; hence, a definitive judgment was only possible during the actual interviews. What could be evaluated externally was whether a company could be considered a knowledge intensive organization. Knowledge intensive organizations are defined as a types of organizations that heavily rely on the generation, acquisition, and application of knowledge and expertise. In such organizations, knowledge is a critical and strategic asset that contributes significantly to their competitive advantage and overall success (Nurmi, 1998). Therefore knowledge driven organizations can be used as the corner-stone for defining talent-driven organizations.

After the short-listing process 28 companies were approached through cold contact via email. Out of the contact efforts, a total of twelve companies responded, eight of which demonstrated an initial level of interest. Seven of these companies showed willingness to participate in the extent necessary for this study, primarily an ability to provide 2-3 representatives for individual interviews. Notably, one company, despite expressing interest, was not included in the study. This decision was based on the practical consideration that they could only provide a single representative for the interview, which was deemed insufficient for a comprehensive and unbiased understanding of the compensation practices within the organization.

The following tables (3.1, 3.2) present chosen case companies' fit to named characteristics and their generalized size of workforce, as well as the positions held by company representatives. It is important to highlight that in subsequent tables, the labels assigned to companies will be randomized as a measure to anonymize their characteristics. For example, the designation of Company A in the first table will not correspond to Company A in the following table.

	Personnel	Levels of Hierarchy	Talent driven	Scaling
A	10-20	2	Yes	Exponential
B	20-40	3	Yes	Exponential
C	40-80	3	Yes	Linear
D	40-80	2	Yes	Exponential
E	40-80	3	Yes	Linear
F	80-120	3	Yes	Linear
G	200+	2	Yes	Exponential

Table 3.1. Case companies size in personnel and fit to chosen characteristics.

Company	Positions held by representatives
A	HR & OPs Manager, CEO
B	CEO, COO, Head of Talent
C	CTO (&HR), COO
D	COO, Head of Sales, Head of Recruiting
E	Head of Comp., Comp. & Rewards specialist
F	CPO, HR Manager
G	CEO, CHRO, CDO

Table 3.2. Positions held by company representatives interviewed.

3.3 Data Collection

The interviews, conducted both in-person and over Zoom, were scheduled to last approximately an hour. Interview durations ranged from 32 to 78 minutes with a median duration of 58 minutes. Remarkably, there was no statistically significant difference between the in-person and Zoom interviews. The interviews were conducted within the span of a single month to ensure a consistent approach. The interviewer's objective was to refrain from restricting the interviewees flow of thought and only intervene to request elaboration on topics that were shallowly covered, allowing for deeper reflection. Transcriptions of the interview recordings were considered the raw data for analysis.

Company representatives were informed that all collected data would be treated anonymously and company data would be processed in a manner that could not be traced back. This is due to the fact that relevant data is expected to not only be positive. Thus, interviewees should feel safe and inclined to share an accurate and honest experience of their compensation practices.

Employing a semi-structured format, the interviews were organized into four distinct stages, each contributing to a layered exploration of the subject matter.

The first section of the interviews focused on establishing the background of the interviewee in addition to updating facts about the company. While companies were chosen for the study based on their fit to the research niche (talent driven, low hierarchy, scaling), the representatives' perception of their fit to these terms was explored in this section.

The aim of the second section was to establish the current compensation system employed by the company. This included separating elements that form the compensation structure as a whole as well as discussion on how compensation development is structured at the company. The focus of this section was directed at understanding the reasoning behind why the company had applied their chosen structure and components. In addition to active choices, representatives were interviewed on the reasoning behind electing to avoid unapplied components.

The third section gave interviewees a chance to describe how the current compensation system came to be. This section largely relied on the interviewee being familiar with the background of the compensation system. If the interviewee was not familiar with the entire history and development of the compensation system, the focus was directed at how it is developed currently. The final part of this section was used as a natural gateway to the final section, where interviewees were asked to state the main goal of their compensation system as simply as possible. This statement was referred to in the last section to aid the interviewees in their evaluation of their compensation system.

The final section was entirely focused on evaluation of the successes and shortcomings of the compensation system. This section was more structured than previous ones, ensuring that all interviews gave comparable answers to the perceived effect of the system on the relevant indicators: employee motivation, retention, employer attractiveness and perceived fairness of the system. Furthermore, interviewees were pressed for concrete reasoning behind their claimed perceptions of effects. Distinct explanations behind why interviewees believed their perceptions to be true would form a foundation for comparison and analysis between different case companies.

After the structured interview, interviewees were given a chance to add insight they thought the interview structure had not covered. The interviews ended with the interviewee being allowed to give a closing statement highlighting their view on the role of compensation systems in general and how they think they should be structured. Most interviewees saw this a chance to share their key takeaways from personal experience.

Before conducting interviews, the interview structure (Appendix 1) was sent to each interviewee, while ensuring the semi-structured nature of the interview. This was to ensure interviewees had the chance to develop thoughts on the topics, but was intentionally left on a broad level to not limit their thinking.

3.4 Data Analysis

As explained in the "Research design" section the analysis was conducted on a basis of grounded theory. The qualitative analysis was performed in a staged manner as represented in the research questions, in order to form a solid foundation for theory building. Analysis was conducted following the principles of Gioia methodology (Gioia et al., 2013). Gioia methodology was well suited for this study, due to its ability to provide rigor and a structural approach to a qualitative study.

The initial step following Gioia principles was coding the collected data. Interview transcripts were indiscriminately coded with a focus on quantity of codes over quality. After all interviews had been coded a second round of iteration was applied, grouping similar codes under larger grouping identifying repeating patterns and thoughts across the interviews. At this stage data was also grouped within companies, and any conflicting information between different representatives was removed altogether. As codes could belong to several groups at the same time, the process developed a interlinked network of codes and code groups.

Memo-writing was the next stage of analysis. The purpose of memo-writing is to articulate the code, describe and analyze its characteristics, outline the conditions that influence its existence and alterations, illustrate its connections to other codes, and assess its importance in relation to the processes identified in the field (Charmaz, 2001). Memo-writing is still intentionally limited by the data collected and allows to recognise emerging theories, without yet straying into theory building. Memo-writing was also the stage where gaps in collected data were identified, allowing for recognition of claims that cannot be made by relying on the data collected.

After coding and memo-writing, a foundation for theory building was formed. In theory building the key is to recognise what the study is able to imply through recurring observations. This final stage of analysis formed the contents of the findings of this study. The results of this analysis method are presented in the findings section of this thesis, while broader managerial implications presented in the "discussion" chapter should be treated as suggestions implied by the study.

3.5 Limitations posed by Methodology

Even before collecting and analyzing data, it is important to recognise the limitations posed by methodology itself. This allows for prudent theory building.

The assessment of of the objectivity of the effects of compensation systems can be disputed. Presently, the analysis hinges on the perceptions of top management, introducing a potential bias in the evaluation. To counteract this, a minimum of two employees from each company were interviewed, and any conflicting viewpoints were systematically excluded during the analysis. It is noteworthy, however, that the majority of interviewees held executive positions within their companies. Because most interviewees were in higher positions, there's a risk that their views might not represent the entire workforce. It is important to be cautious when applying the findings to everyone in the organization. It can be argued that executives are biased to perceive the results they are expecting to see as a consequence of their actions. The interview process focused on requiring tangible evidence for perceptions to limit the effect of bias.

The aforementioned lack of certain objectivity could have been counteracted by interviewing a larger, hierarchically more diverse employee population. The scale of this would have limited this study to a single case study, and the benefits of a multiple case study were seen to outweigh the benefits of an extensive single case study. Typically, multiple case studies sacrifice attainable information for increased generalizability (Gerring, 2004). In this study the sacrifice is visible in the form of narrow and potentially biased perspective.

4. Findings

In this chapter, the key findings of the multiple case study are examined. The chapter is structured into three main sections, with the initial two sections delving into the existing compensation systems and their perceived impact on the chosen indicators of success: motivation, retention and attraction. The final section concentrates on the process related findings derived from the application of the Gioia methodology to the interview data. These findings focus on the successful implementation of a compensation system, and the process' continuous adjustment.

Through the incorporation of direct quotes from interview transcriptions, the majority of which have been directly translated from Finnish to English, this chapter presents an authentic depiction of the insights obtained from the multiple case study.

4.1 Current Structures and their Reasoning

In shown in the interview structure (Appendix A), representatives were asked to describe their compensation structure, without explicitly defining it's potential contents by the interviewer. This was done so to ensure that interviewees list all aspects they perceive as part of their compensation structure, without being limited to the mindset of the study. The structures are presented in Table 4.1.

In line with expectations, each of the seven companies examined provides its employees with a fixed monthly salary. Notably, four of these companies extend substantial bonuses to their employees, while an equal number offers ownership programs—two in the form of equity and two through stock options. Surprisingly, only three companies integrate both an ownership program and a bonus program into their compensation structures. It's

	Salary	Bonuses	Equity/Options	Benefits
A	x	Commission	-	Not seen as comp.
B	x	0-20%	Equity	Minimal
C	x	0-10%	-	Not seen as comp.
D	x	Commission	Options	Minimal
E	x	0-30%	-	Minimal
F	x	0-10%	Options	Not seen as comp.
G	x	-	Equity	Minimal

Table 4.1. Compensation structures within case companies. Bonus percentages represent potential bonuses annually in relation to annual salary.

worth noting that one company stands out by not having a company-wide incentives program, opting instead for commission-based incentives for specific roles.

The stance toward benefits is an intriguing aspect of the study. Representatives from these companies either saw their benefits packages as minimal, or outright did not consider the benefits they offer as a part of their compensation structure. This observation underscores the compensation strategy adopted by the interviewed companies, deviating somewhat from the literature review, which generally highlights benefits as a crucial component of rewards systems.

> *"In benefits, we have the same as everyone else. Lunch, sports benefits, office amenities etc. [...] We are not actively trying to have the best benefits, but we don't want our benefits to negatively affect people's choices either."*

> *"We consider benefits a non-negotiable basic necessity. Not much to win there [by excelling]. If you're looking for an office with a bouncy castle, good for you, but most people focus on other aspects, in our experience."*

Due to this attitude, benefits will not be explored, and the focus of analysis will lie in monetary compensation.

4.1.1 Goals for Compensation Systems

After describing their compensation structures, interviewees were asked to outline their main objectives for their compensation systems. In simple terms, what does the company wish to achieve with its system? The objectives stated by company representatives can be divided into three main categories: motivating employees, retaining employees, and attracting talent. Many representatives stated more than one of the previously mentioned goals.

Generally, motivating employees was mentioned the most in relation to short and long term incentives plans. However, the general sentiment in regards to motivating employees with compensation was that total compensation is viewed as a hygiene factor.

> *"I would say our goal is that top performers feel sufficiently motivated by the amount of compensation they receive and they do a good job relative to the to the amount of money you receive."*

> *"Regardless of what one's own job task is in the organization, the idea that everyone shares the same incentive for actively participating in building our business is in everyone's best interest."*

Retention and organisational commitment were the most mentioned objective across all companies. Motivation was recognised as an aspect that affects organisational commitment, in turn improving retention. In knowledge intensive organisations, a capable workforce is the main asset of a company, so it makes sense that retaining talent is given a high priority.

> *"We want our compensation to guide people towards long-term, good-spirited, and healthy working relations."*

> *"The most important thing is that people stay with the company because expertise is what we sell, and if they leave, expertise is what we lose."*

> *"Then there must be some way to commit people for a long time. Whether it's through an ownership program or some long-term bonus goals or something. A way to motivate people in the long term if we can't offer a full career path."*

Attracting talent is key for sustaining talent-driven organizations. From an attraction point of view, many representatives emphasized that they want their compensation structure to be attractive to the exact type of demographic they are looking for. This for example excluded employees that are primarily motivated by high compensation, as they were seen as employees that can just as easily be attracted elsewhere. The objective seemed to be for compensation to be sufficient as an attractor, but never the main attraction. Companies displayed realism, in stating that they are unable to compete with especially foreign compensation, but presented it in a manner that emphasized that this competition was never the goal either.

> *"With our compensation, we wish to succeed in attracting exactly the type of employees that we want."*

> *"In a way, we'd like our brand to be such that people are paid quite well, maybe not market leaders in compensation, but people wouldn't at least think that money is a reason to decline a position."*

4.1.2 Fixed pay: Salary

As expected, a monthly salary is generally viewed as the foundation of the compensation structures across all companies.

> *"The basic level of compensation is in the form of a monthly salary. It is definitely the majority of the compensation we offer. We consider our salary very competitive, especially for younger professionals. We offer them the recommended salary by TEK, which to my understanding is more than many expect to receive at other companies, especially if they have not yet graduated."*

> *"We have a few employees who are paid by the hour, but the majority are on a monthly salary. So, we have a foundation, a basis, a monthly salary for everyone, and on top of that, we've built systems that can be seen as extra compensation. But salary is the bulk of our compensation"*

> *"I think the industry standards is typically a base salary. There really is no way around paying a competitive salary, no one would accept getting paid without a decent component in fixed salary."*

Salary is viewed as a necessary hygiene factor by some, often resulting in a salary reflecting industry standards. Companies monitor this by benchmarking their competition and striving to either stay slightly ahead or on par with competition. It appears that the fixed pay component is viewed as a reflection of the level of total compensation, and incentives structures beyond salary are viewed as extra, that especially potential recruits may not consider when assessing compensation.

"Obviously we bench-mark and a lot of the people we hire are from other companies that are at a similar stage or other start-ups. So we know how much those people are currently getting paid and we typically give them a raise when they join."

"Salary is what people ask about and look at during the recruitment process. All aspects beyond are appreciated, but the bottom line is that salary is king."

A majority of companies lamented the fact that in Finland it is practically impossible to compete with international compensation levels. Thus, the scope for bench-marking is set on a national level. In addition, larger more established companies are able to offer a higher salary even on a national level. Case companies realise that if competing purely with salary, they are fighting a losing battle and must be able to offer something else in addition.

"One issue is that in the industry, there are many foreign companies that pay really outrageous salaries, which we simply can't compete with directly.

"We can't compete for employees with only salary. Any capable analyst can find a position with 2-3 fold compensation in the US, or alternatively join an investment bank or such."

Essentially, fixed pay is viewed as the necessary major component that is aimed to be fairly neutral in it's effect. As a component, salary has to be competitive in comparison to the market, but it is not the component used to create a significant competitive edge.

4.1.3 Short-term Incentives: Bonuses and Commissions

As illustrated in Table 4.1, six out of seven companies incorporate bonuses or commissions as short-term incentives within their compensation systems. The bonus systems are universally applied across the companies, tying the payout to a percentage of an employee's fixed pay. Conversely, commissions are selectively allocated to a minority of employees, serving specific motivational objectives. Typically, for those under a commission-based compensation structure, the majority of their total compensation is derived from commissions rather than fixed pay.

When discussing short-term incentives such as performance based bonuses and commissions, the reasoning behind the chosen structure comes up. Are they meant to be a method of profit-sharing, or a form of incentive to boost performance. Based on this study, a mix of both: commissions especially are aimed at motivating employees to improve personal performance. All bonus systems however, were designed around company-wide KPIs, company growth being the primary among them. Bonuses were seen as a way to commit employees and align their goals with company strategy.

Profit-sharing holds particular value in smaller companies where financial results directly influence the capacity to compensate employees, especially when a significant portion of costs is allocated to employee compensation. The capability to introduce variability tied to company performance serves as a protective measure. When employees observe bonuses linked to company performance, it serves as an incentive that encourages them to actively engage with and enhance company performance within their abilities and roles. In essence, profit-sharing not only aligns the interests of employees with overall company success but also motivates a collective effort toward improvement.

> *"Our annual bonus is tied to our annual result. It's intended as a profit sharing mechanism. The benefit for us is reduced risk, since when the company result is bad, we may not be able to compensate as much. Especially since compensation is our main cost. Then, when we do well, we want to share the wealth and not look like founders are counting profits while employees gain nothing."*

Bonuses were praised for their simplicity. A simple comprehensible system was seen as the best way to align employee goals with company strategy.

> *"Bonuses are our choice. We don't want to make things difficult, just that it would be easily understandable for everyone. And also, so that it would be equal for everyone, that kind of equality is what we strive for. Complex systems, where people don't understand how their bonus came to be do very little to direct the bonus' positive impact into action."*

Commissions are particularly effective when employee performance is easily quantifiable. They cater to a specific demographic, often those inclined to take risks, which is desirable for certain roles. Sales was the specific role, where commission-based pay was seen as advantageous. In addition to being an industry standard, the model was seen as effective at attracting and motivating people willing to perform at the highest level.

> *"The value that sales create is also something that clearly propels the company forward; it's the bottleneck. The more deals we get it the easier it makes things for the rest of the company. It's easy to justify why it's worth motivating for this."*

Another approach to utilizing commissions is using them as a strategy for retaining and rewarding top talent. In smaller companies, it might be challenging to meet the compensation expectations of highly skilled individuals. However, by tying their compensation to metrics such as billable hours, it becomes possible to remunerate them proportionally to their expertise. Since these individuals significantly influence company performance, it becomes crucial to address their needs through an additional model. This ensures that they receive comparable benefits, preventing scenarios where they might consider founding a competing company and leveraging their expertise elsewhere.

> *"Fundamentally we are all here to develop our business. And our most senior experts have the capability to do so most effectively. Even if their role isn't directly in sales or retaining clients, they have the greatest impact on the most significant level. [...] We cannot pay them a fixed salary at the level they deserve, and they understand it. Allowing them to opt for commissions based on billable hours, centres them on activities that bring the most money in for the company, and they directly receive their fair share."*

The decision to not employ individual bonuses or commissions is generally rooted in a "we're all in this together" mindset, emphasizing unity among employees. Additionally, prioritizing liquidity as an asset for growth discourages the diversion of company resources to employees, as this could hinder growth prospects. Instead, the focus leans towards ownership programs, fostering profit-sharing mechanisms that align employee incentives with the company's success.

> *"Our commission model created competition within the company, and sales reps were discouraged from working together and helping each other. We harmonized the system, where bonuses are all shared and noticed a clear improvement*

in collaboration between sales associates."

"For the past two years we've explored different bonus models, but we haven't found anything that doesn't restrict our growth potential in our ability to reinvest profits. That is why we opted for no bonuses."

In certain interviews, a critique of performance-based bonuses surfaced, highlighting the perception that external factors significantly influenced overall company outcomes. Consequently, the intent behind bonuses, which is profit-sharing, led to a scenario where challenging years acted as a discouraging factor for employees.

"Sometimes the company has a bad year due to a global pandemic or some external factor. It feels bad to not pay bonuses due to external factors, even if everyone worked just as hard as previous years. We've started thinking of other metrics now, so I guess our focus isn't entirely in profit-sharing but rather in motivating."

To generalize: bonuses are widely used a profit-sharing mechanism that limits risks for the company. Commissions are used to motivate and fairly compensate employees that perform at a level directly and measurably affecting company performance. Both commissions and bonuses ideally work to align employee goals with company strategy. Short-term incentives are praised for their simplicity, but criticized for diverting liquidity away from reinvestment into growth.

4.1.4 Long-term Incentives: Equity and Stock Options

Many employees anticipate ownership programs when joining a rapidly growing early-stage company. Out of our case companies, four offer an ownership program for employees. Three of them are company-wide, with one directed at executives.

Options programs entail a vesting period of around three years. Typically, companies provide various choices within ownership programs, allowing employees to tailor their compensation structure based on personal preferences, whether leaning towards a more salary-based or equity-based approach. It it noteworthy that all equity programs adhere to the lowest valuation determined by the Finnish tax authority (Verohallinto) standards. The valuation method is exceptionally low, not taking into account growth potential, essentially leading to the generous distribution of equity for below actual valuation as a motivational strategy.

Ownership programs are generally seen as a way to allow employees to feel a sense of ownership of the company. This in turn increases both long-term commitment and motivation.

> *"Obviously our equity model has the retention aspect. But in addition we see it a way to commit employees to growth. They see growth potential and have more incentive to apply themselves and their knowledge to improve the company."*

In addition, ownership programs allow for profit-sharing, without compromising a company's ability to reinvest profits into growth.

> *"We want to reward people for reaching company goals. But then again, that money could have been invested into more growth. Equity allows for that reinvestment to eventually reward employees. It's a solution to both issues."*

Equity held by employees also serves as a benefit even after they have left the company, especially when they remain in the industry. In such cases, former employees have an incentive to see the company thrive, and they may actively contribute to the industry, potentially driving additional business towards their previous workplace. This connection creates a mutual interest between the company and its former employees, benefiting both in the process.

> *"We don't require employees to give up their equity when they leave the company. They tend to leave to high ranking positions in the industry, where it is a mutual benefit that our company growth is still within their interests. Our 'alumni' are a great asset in leads, advice and driving the business forward."*

Interestingly, employee stock options are less commonly understood in the Finnish context. Individuals may exhibit hesitancy towards accepting risks associated with stock options, necessitating a thorough explanation of the potential benefits when employees sign up for such programs. To encourage participation, companies are forced to offer options at a very low strike price to make the opportunity more appealing and accessible to employees. This strategy aims to address the potential apprehension surrounding the perceived risks and to emphasize the long-term benefits of equity ownership..

"Since options are not the standard in Finland, we have to work hard to explain them to potential recruits. We have a model where we show three scenarios to recruits, one expected, one excellent, and one worst case. This helps them understand the value of their options and the role it plays in compensation."

"For options to make sense you need to believe in the growth potential of the company. Especially at recruitment phase, before the individual has experienced the company, it can feel like a tremendous risk to take, going for an options based compensation model."

In essence, options/equity programs create a sense of ownership for employees, which ideally aligns their goals with company strategies for growth. They have the potential to instill a sense of fairness among employees, and allow for profits to be reinvested into growth. These programs carry the risk of being difficult to understand, negating their effect in improving employer attraction. The low pricing necessitated by the rarity of such programs may dilute the effect on liquidity, especially if company holdings are the driving factor for future funding rounds.

4.1.5 Compensation Development

While compensation development, in effect how compensation develops for employees over their tenure, is seen as an important aspect of compensation systems, it seems that rather few companies had set practices in place for consistently determining this. The overarching sentiment is that as people develop, companies ensure that their compensation develops alongside them. The concrete form of development is salary development through raises, as well as access to more extensive ownership programs. Many elements, such as bonuses, automatically scale with salary.

"The problem is just that there is no clear and structured framework or how the compensation will develop in the future. We have noticed a need for developing some kind of structure."

"Development is of course important, and we try to follow along on a set cycle, but every situation is determined on a case by case basis. When someone is showing the will and ability to improve, we set goals together and achieving these goals results in increases in compensation."

"We don't follow any index cycles, but rather want to tie compensation development to people improving, taking more responsibility, developing their capabilities."

In all companies compensation development is monitored and determined through annual or biannual conversations with employees. These one-on-ones are used to set personal goals and assess an employees development, reflecting this in their compensation. These discussion are held at equal footing, where compensation development is an open question to be discussed rather than something determined from above. Compensation development and how it is discussed is viewed as a way to demonstrate trust to an employee.

"We want it to feel like a dialogue, not us telling you what you are worth. We trust our employees and have noticed that open discussion often lead to us offering higher raises and arguing for them. Employees tend to be almost too humble and underestimating themselves."

"I want us to be ahead of our employees. When we see potential we want to offer raises and new positions before the employee has time to ask for them or realise they want them. Our best employees should feel like the company is rooting for them and building them up."

As companies expand while maintaining a flat hierarchy, it can become challenging to acknowledge that individuals may be handling more demanding responsibilities even though their job title or position remains unchanged. As a company grows exponentially, employees may find themselves handling more complex tasks and increased workloads without a corresponding adjustment in their official roles or acknowledgment in compensation.

"For example a HR manager in a 20 person company is a vastly different role than an HR manager in an 80 person company. The same applies to different positions. We've found that people have the same title and job description as project managers, but find themselves managing teams 2-3 times the size in a couple years as the company scales. The only real way to monitor this is discussions with employees as the subtle change can easily go unnoticed."

While the general approach to compensation development may be less structured, two companies emphasized the importance of having a structure in place in order to make the process comprehensible and transparent. This meant having tracks in place for employees, where salary ranges are clearly defined as well as what the company requires for you to move to a higher bracket. An interesting point that surfaced was the need to have two tracks: one for leadership and one for experts.

> *"The clear definition of role levels is essential, but at the same time, there is a desire to avoid creating a rigid system. The challenge lies in not wanting to establish anything overly inflexible, as each growth path is somewhat unique. This is an ongoing balancing act where we strive to provide clear guidelines for progressing to the next role level, yet we recognize the need to maintain flexibility to accommodate individual circumstances."*

> *"Someone might have no wish to rise to a managing role, but rather they'd want to become an expert in their niche. We need to have systems in place for those people as well, because they're just as valuable for the company in their expertise."*

4.2 Effects on Indicators of Success

This section explores the effects different structural components had on indicators of success: motivation, retention and attraction. It must be noted that the strength of effects varies between individuals, but this analysis provides a generalized summary across the demographics that case companies seek to accommodate with their compensation structures.

Figure 4.1 is a visual representation these effects. Component groups and indicators of success are numbered according to their subsections in this chapter. Analysis indicates that fixed pay does little to boost indicators, but has a hygiene level effect on both retention and attraction (indicated by a dashed connector). Bonuses on the other hand have a similar effect on motivation. Commissions have a significant effect on motivation, but are very situational in their application potential. Long term incentives affect motivation and retention and are viewed as a must by some, affecting attraction. There was no notable difference between the effects of options and equity programs.

While a sense of fairness is not considered a direct indicator of success, analysis shows that it has a profound effect on motivation and retention. Profit-sharing methods (bonuses and ownership programs) are components that appear to foster a sense of fairness and indirectly have a positive impact on motivation and retention.

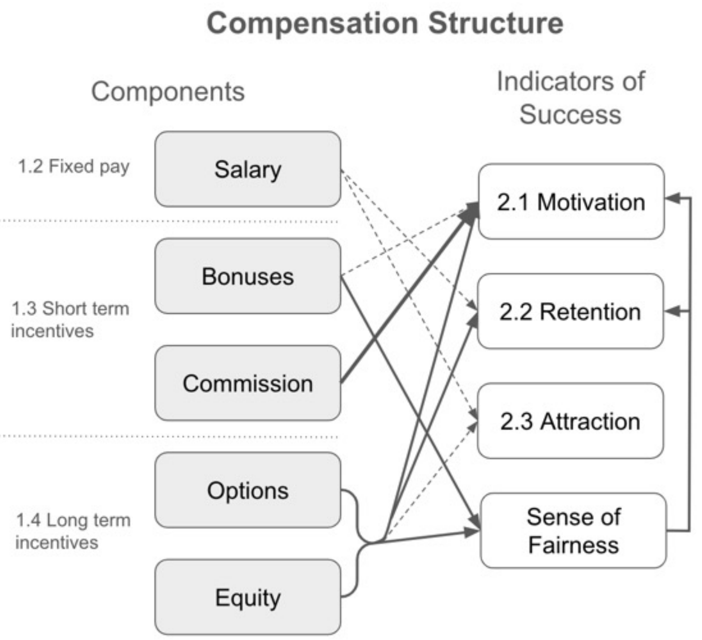

Figure 4.1. Model for components' effect on indicators of success. Dashed arrows represent a hygiene-level relation.

4.2.1 Motivation

Overall, compensation was not perceived as a highly effective tool for enhancing workplace motivation. However, if employees view compensation structures as dysfunctional, it can have a negative impact on motivation. Companies, instead, regarded compensation as a means to influence job satisfaction. The belief was that by positively impacting satisfaction, companies could indirectly affect motivation.

> *"You can't gain much in terms of motivation with compensation. You can lose a lot though. Before we overhauled our compensation structure we had a mass exodus from the company. General dissatisfaction with management was behind it, but massive changes to culture and structures, including compensation, have set us on the right track."*

Ownership programs were seen as a way for fostering a sense of togetherness and engagement among employees. Some employees in different companies have requested them, and the employer response has had a massive effect on these employees motivation and commitment.

> *"People asked about equity programs, so last year we developed one. Everyone isn't interested, but most have participated and those that asked for it have given very positive feedback about it."*

> *"There's discussions about employees asking for equity programs. At the moment we aren't able to provide such a program, it would require a huge restructuring. We are trying to counter this by offering bonuses as a way to share profits. [...] For the employees that feel strongly about this it has not been enough, most have been satisfied though."*

Commissions however have a very direct effect on motivation. Commissions, when both applied to a suitable role and to a receptive employee were seen as a very effective way to boost motivation and increase employee performance. However, this is limited to positions with easily quantifiable KPIs, and commission based compensation models are sure to turn away many employees that do not resonate with the system. By utilizing commissions, companies accept they are targeting a certain personality type, but are very effectively motivating that smaller pool of potential employees.

"When we switched to commissions, we noticed an initial decline in sales. Later on many people from our sales team left the company or switched to different roles. After the initial decline and some new hires we noticed a gradual boost in sales, and now our sales teams is performing at a much higher level than pre-commissions. We still have some people start in sales and after a while they realise they are not cut out for a commissions based salary. Those that remain are very happy with it, saying they love getting directly paid for everything they achieve."

All in all, with the exception of commissions based systems for specific roles, compensation is not an effective tool for improving motivation. However, a hygiene level must be maintained, otherwise the impact can be negative. Open discourse with employees is necessary to cater to their needs and allow them to be heard.

4.2.2 Retention

Compensation was widely seen as an effective tool for increasing employee retention within a company. Some aspects, such as ownership programs, were seen to have a direct effect on retention, but generally sufficient compensation and a sense of feeling valued was seen as vital for nurturing organizational commitment.

"Whenever we do exit interviews we always ask if they were dissatisfied with anything. Compensation rarely comes up. We also have a culture of discussing pay whenever our employees receive competing offers. Our best talent receive constant messages from headhunters, and more often than not are happy to stay, if we acknowledge their value by matching offers they've received. Of course sometimes this is simply not possible."

Ownership programs stood out as a means for directly increasing retention. The long term incentive for remaining within the company was seen as effective, even to the point that some expressed fear they are retaining uncommitted employees. Some employees were actively looking for ownership programs, with the intent of tying their future to company success.

"Through [stock] options, there is a kind of commitment and enthusiasm that if this company takes off, then there will be a significant upside from it."

"Some of our employees were looking to commit to an early stage company for the long term through equity programs. They see equity as a reason to commit for a longer period and apparently would have opted for other similarly sized companies with ownership programs if we hadn't offered one."

Compensation development was another aspect that was highlighted for its importance in retaining employees. when employees felt that their growth was noticed and appreciated, they were seen as more likely to want remain and grow in (and with) the company.

"We have focused on hiring young professionals and showing them their potential in compensation development. We have had success with this, with many young and talented professionals doing long stints at out company, at least compared to similarly skilled professionals in other companies."

"Recognising growth in employees is vital. You can always praise them and give positive feedback, but raises are concrete way for the company to say 'thank you, keep doing what you're doing, we appreciate you'."

4.2.3 Attraction

Case companies agree that attracting people solely with compensation is undesirable. The overarching goal is to ensure that compensation reaches a competitive hygiene level without becoming the sole motivation for choosing employment. It is acknowledged that compensation should not be a deterrent to working for the company.

"In our approach, we've consciously decided not to strive to be the highest-paying company in the market at any point. Of course, our salaries need to align reasonably with the market standards, ensuring that it doesn't hinder our growth or lead to a constant loss of potential employees."

From a attraction perspective, compensation systems must find the perfect balance for attracting the right kind of employees. A prevailing sentiment among companies is that individuals solely attracted by high compensation are more likely to leave for similar reasons, and less likely to be committed employees.

"If someone joins us for the sake of money, chances are a couple

years down the road they will leave us for money. Even if they are extremely capable, we prefer to hedge our bets on people that see more in our company than just a source of compensation."

"Even if you manage to pay ourselves sick to get someone amazing, we know we'll lose them when someone offers more. We can't compete with the biggest multinationals, so we might as well not try to recruit people whose only motivation is money."

4.3 Implementation and Continuous Adjustment

This section delves into the key findings have an effect on the processes related to compensation design. The findings describe a model for implementing and maintaining a compensation system, through the reported successes and shortcomings of case companies. Multiple case analysis across case companies made the identification of patterns possible, which lead to a clear picture of best practices regarding the implementation and upkeep of a compensation system.

Figure 4.2 presents the findings of this section in a visual form, labeled boxes referring to their respective subsections. Effectively the upkeep of a successful compensation system can be viewed as a cyclical process. Indicators of success must be evaluated to form a basis for structuring. While structuring focuses on the substance of the compensation system, it's effect is null without satisfactory transparency and communication. An individuals' perceived fairness has a strong impact on motivation and retention.

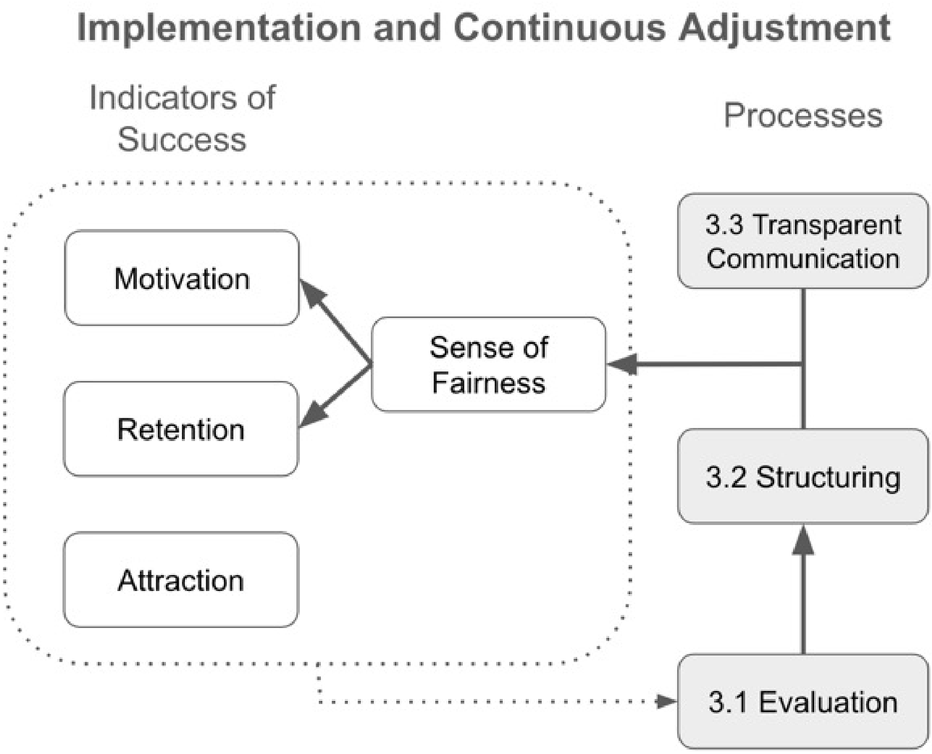

Figure 4.2. Model for processes related to successfully implementing and maintaining a compensation system.

4.3.1 Evaluation

Evaluation is a vital process in the continuous adjustment of a compensation structure. The analysis indicates that companies should be actively engaged in measuring the effects of their compensation system, and determining its effectiveness. Objectives (indicators of success: motivation, retention and attraction) should measured at the very minimum, but intermediary indicators can prove beneficial. To adjust or create a compensation system, its current effects must be understood comprehensively. This kind of evaluation can be done by directly enquiring employees and compiling the results for analysis.

Case companies agree that compensation structures should not be treated as set in stone, but should constantly be measured, evaluated and developed. Nevertheless, very few companies utilize practices for evaluation and continuous adjutment. Most companies seem to share the view that when no issues arise, no action needs to be taken.

> *"Everything works fine. As long as our exit interviews don't indicate people leaving because of compensation and people are generally satisfied with pay, it is hard to argue to executives why we should divert resources to compensation design. HR is already swarmed with our recruiting pace."*

> *"We always try to add more according to employees wishes, but there isn't really a set goal for what we want to achieve. We appreciate our employees and go out of our way to compensate them as much as we can, in ways they want, within our capabilities."*

When asked about how compensation systems are evaluated, no companies directly measure the full range of effects of the system. Compensation is analysed based on generalized indicators, primarily employee satisfaction. During biannual interviews employees are asked for their opinion regarding their compensation, but the data is rarely compiled. Instead employers rely on the general sentiment they perceive around the office.

> *"There's no explicit metric we use. We really base our understanding on how compensation is discussed, thank god it is discussed, around the office. We feel our culture is open enough that people would approach us if they're not satisfied."*

When issues arise, employers have difficulty in identifying whether dissatisfaction is related to compensation. In turn they have a hard time understanding if these issues could be fixed with alterations to their compensation policies.

> *"Compensation can't be the whole story. Our issues stem from larger problems that we are working on solving. Clarifying compensation is only a small part of, an important part, but not the whole story."*

Some representatives had negative experiences that they are determined not to repeat. It seems the consequences of failed compensation systems can be catastrophic, potentially company ending, so it is curious to see so little effort directed towards direct evaluation.

> *"I worked for a company that created a failed options scheme. They were advertised as a significant boost to compensation, but due to financial difficulties and bad results barely anyone ended up exercising the options. Employees naturally felt like they were cheated and many left the company within six months. This experience has made me very wary of the potential damage that can be caused by miscommunicating a bad compensation system."*

4.3.2 Structuring

Structuring can be described as a two part process: formalization and simplification. Initially current compensation practices must be formalized into a comprehensive structure. This refers to both identifying components, which generally are formal already, but also any informal structures that have emerged. Naturally, modifications to the components of a compensation structure are viewed as a part of this structuring process.

The process should strive to recognise which practices are producing desired results (based on evaluation) and which should be modified. Simplification is needed to render the structuring comprehensible, as complex systems do not have the desired effect on perceived fairness.

Initial structuring often necessitates the creation of a model for internal compensation hierarchy. This means creating an formal internal model for compensation hierarchy. Low hierarchy organizations intuitively tend to avoid this, but compensational hierarchy does not diminish cultural hierarchy, it only formalizes existing informal structures.

Flexibility: Asset or Liability?

Many representatives speak positively of more flexible compensation systems that set them as SMEs apart from large corporations. A more tailor-made approach to forming compensation can be beneficial from an individuals point of view, when your compensation is built to your liking. Many different optional components and structures are praised, as they offer the company a chance to cater to different needs, thus being able to attract and motivate a wider range of personas.

> *"It's good for retention and motivation, if say there's an aggressive sales type whose heart beats for sales, in their opinion incentives are ideal. And then again, for someone who is a bit of a sensitive artistic soul, the idea that here we are all reasonably equal, plus everything is stable, is the best thing ever."*

> *"Early on, it was an asset to be able to give people exactly what they wanted. Well not what they wanted, total compensation was still limited, but how they wanted to be compensated could be altered. This gave rise to emergent structures that were incorporated into our wider structure, giving future employees the same choices."*

However, as companies grow a lack of structure turns from an asset to a liability rapidly. Tailoring compensation with little standardization makes HRM very labor-intensive. Also questions about fairness start to rise, once the company is large enough to not easily and naturally be able to provide an explanation.

> *"Once we grew to a bigger workforce than one that fits in a single meeting room, we noticed discussions about compensation circulating without ground in truth. Rumors really. We had to fight hard and communicate transparently to shut these talks down. It was an uncomfortable time."*

Recruitment also becomes a more intensive process, as recruiters a faced with an impossible task of determining employees worth and thus compensation without an internal structure to rely on. Representatives also recognised the issues building as the company grows and we're calling for a formalization of practices.

> *It was difficult. I could make my best estimate based on market value, which works on paper. But people don't compare them-*

selves to the market, they compare themselves to their peers in the company. If compensation doesn't make sense between employees they are dissatisfied, you can't tell them that we had to hire them at a different time and thus had to pay more etc."

"It's becoming more and more difficult to make judgement calls. The more people we have the more we would need a fixed standardized system to rely on. It feels unsustainable to be recruiting someone and hoping the proposed compensation would fit other in the company. And often finding myself fixing issues by correcting others salaries to match what we recruited."

It can be said that as companies grow, they outgrow their early 'structureless' compensation structures and should formalize their emergent policies. The case companies demonstrated that companies with the least structure guiding compensation faced the most issues due to discrepancies and constantly had to work contain their system within an acceptable margin of error. While absolute flexibility is an asset with few employees, the cons outweigh the pros very quickly. A structured approach to compensation does not mean a rigid approach, a good structure leaves room for adaptation, without compromising the fairness of the system.

The case company with the most structured approach to compensation had established their structure very early in the company's life cycle. This was done to avoid the issues that would come from harmonizing the structure in the future. They reported the least issues related to compensation out of all case companies and almost all their arguments lead back to a clear structure, that still gave enough room for flexibility when needed.

"When you realise you need structure, it is almost too late. Sure it is easy and agile in the beginning when you can tailor compensation to everyone's needs and wants, but around 40 employees is when it becomes impossible to run HR without a clear structure. The later you implement a structure the more painful it is to shove your emergent monstrosity into a rational structure. Structuring needs to be done when it is least painful, when you have less than 20 employees."

System Comprehensibility

Arguments for structuring compensation practices after the early stages of a company are clear, but several formalization processes end up only formalizing an entirely emergent system without creating much structure. The result is a lack of structure, only written down. Further simplification is needed to reap the benefits of structuring.

> *"A good structure is one that is understandable and justifiable."*

> *"It is perhaps a goal in everything we do, that we don't want to make things difficult, just that it would be easily understandable for everyone. If people don't understand their compensation, they can't truly be satisfied with it."*

An easily understandable compensation system promotes transparency. Employees can clearly see how their compensation is determined, including the various components such as base salary, bonuses, and benefits. This transparency fosters trust between employees and the organization.

> *Without a clear structure, it's hard to comprehensively communicate it to employees. Even if you try, efforts for transparency will likely fail. Complexity is a tool to avoid transparency after all, even if it isn't the intention."*

The benefits of comprehensibility are not limited to ease of communication. A simple structure allows for HR to operate seamlessly, when it comes to recruiting and compensation development. Initially when formalizing emergent policies, the resulting system can be somewhat complex, containing a magnitude of exceptions and minor systems applied to few. It is important to further simplify the system before applying it, or else the formalization will have gained very few benefits.

> *"Our first structuring resulted in a mess of a system. It was unusable in its state, and we had to design a full structure and then make sure everyone found their place within the new system. There were outliers, initially, but after a year or so everyone fit the new system, making recruiting and performance appraisals so much easier."*

In summary, an easily understandable compensation system contributes to a positive work environment and fosters trust for employees and allows HRM to function on a rational and fair basis.

4.3.3 Transparent Communication

Transparent communication refers to the importance of communicating a compensation system to employees effectively. A sense of fairness stems from employees understanding and accepting their position in the compensation hierarchy. Transparent communication does not necessitate full transparency, but refers to a level of openness when compensation is discussed. The process of transparent communication is constant, and should not be neglected even if compensation implementation or adjustment is not viewed as an active process in a company.

A significant finding in the study is the role perceived fairness plays in how successful a compensation system is. This all stems from how it is communicated to employees. It appears that even rational structures that are not communicated in a satisfactory manner.

The model for equity within a case company was collaboratively designed with input from the entire staff to ensure fairness and equity. This approach successfully avoided any significant issues related to their equity structure. The transparent and inclusive design of the equity model aimed to provide a fair distribution among employees, fostering a sense of equality and satisfaction.

The establishment of a clear structure is deemed necessary not only for the ease of justifying current compensation but also to alleviate concerns about future compensation. A structured approach includes a tiered list that allows individuals to understand their position within the organization and explicitly outlines the steps needed for advancement. This style of a structured framework has received positive feedback, with no reported issues in two case companies.

Companies with a lack of tiered structure report more issues related to perceived fairness. Earlier employees or founders might have received higher compensation, posing a potential fairness concern. To address this, the introduction of a slider, allowing employees to choose between options and salary, has been implemented in some cases. This empowers individual employees to make decisions based on their preferences, contributing to a fairer compensation distribution. One company reports the issue of a case by case model having individuals that seem to fall outside the system for some reason.

"Every year we order our employees based on their compensation and identify outliers. Every time, no matter how much we try to avoid it we find people getting paid way more or way less than they deserve based on position and performance. We try to correct and avoid these mistakes but it is easier said than done."

All issues related to perceived fairness seem to stem from a lack of internal structure, and above all a lack of transparent communication.

Companies without compensation related issues report their stance on transparency as either passively transparent or full transparent communication. Passive transparency refers to readily sharing compensation information when employees inquire. Open discussions about pay are encouraged, fostering a culture of transparency, trust, and fairness. This approach aligns with the organization's values, creating an environment where employees feel informed and engaged in discussions about compensation. Fully transparent communication refers either to fully disclosing employees salaries to each other, or more commonly communicating a clear tiered structure, where employees can locate themselves and their peers, without relaying exact salary transcripts.

"Compensation is communicated directly to individuals. If they have questions about where they sit on a company level they are answered without withholding information. We want a sense of transparency, but some employees have communicated that they feel uncomfortable with their salary being openly broadcast to everyone. This compromise has suited us well and quelled any questions. It's important that people know they will receive answers if they ask, then they don't speculate."

"Our structure is clearly tiered and each tier is defined on a flexible but clear level. This allows employees to approach us if they feel they have ascended their tier and almost always when they have given their reasoning we have agreed with them and bumped their pay to the next tier. We know we are in trouble when employees stop approaching us with issues, everything needs to be clearly rationalized."

Companies that do not embrace any level of transparency often fall victim to employees sharing compensation levels unofficially. This leads to employees not gaining a full picture and can breed a sense of distrust between employees and the employer.

> *"There isn't much transparency, I guess it's a bit of a taboo in Finland. I only know the salaries of my own team for example. [...] There are issues. I have trouble answering when my subordinates ask how their salaries compare to other teams. I don't know. When people ask I have to resort to saying that we simply can't pay the highest compensation on the market. Often this answer is not satisfactory but I can't do much about it."*

> *"With a lack of a structure we often land in awkward situations where employees demand explanations for rumors that are not true. To dispute these rumors we'd have to give information that we have chosen not to share. People are sometimes left with the wrong image, even if there is sound reasoning behind discrepancies."*

The interesting fact is both companies reporting issues with a sense of fairness can inherently demonstrate that their compensation systems are 'fair.' The issue seems to be in the lack of communication and transparency. It can be deduced that the perception of fairness is a far superior indicator compared to actually designing a fair system. Companies miss out on any benefits from a fair compensation system, if the elect to not actively communicate it to their employees. The perception of fairness is directly tied to transparency.

5. Discussion

5.1 Relating Findings to Literature

The general structures exhibited by case companies matched components present in literature. The only difference was in how they were organized and intended. Cameron (2022) proposed broad terms for fixed pay, short and long term incentives that fit case companies ideas best. A significant difference was in the perception of benefits: literature (Milkovitch & Newman, 2005; Chen & Hsieh, 2007; Balkin, 1988; Purhonen, 2019) describe benefits as an integral part of rewards systems, but no case companies shared this view. It is possible that companies were influenced by the topic of the study and naturally focused on monetary compensation. On the other hand, this could be seen to imply that companies in the chosen profile of the thesis view benefits as less important than a wider pool of companies.

Several studies highlight compensation as an effective tool for managing employee motivation (Bhattacharya & Sengupta, 2014; Tessema & Soeters, 2006; Colquitt et al., 2009). The findings of this thesis imply that this is too wide a statement and can lead to misleading assumptions. Motivation (through satisfaction, and commitment) can be severely hindered by unsatisfactory compensation systems. However, little evidence in interviews indicated that compensation could be used as tool for boosting motivation. Studies presenting compensation as a hygiene factor (Chiat & Panatik, 2019) align with the findings of thesis in regards to their effect on motivation.

Expectancy theory (Vroom, 1964) as a basis for motivation and compensation functions to an extent. In addition, findings indicate that as a workforce grows the level of instrumentality experienced by employees over how much they can affect company results, and thus improve company performance diminishes. This implies that based on expectancy theory, the impact of bonuses and ownership programs on motivation diminishes as a company grows, which was apparent in interviews.

Compensation as a driver for retention is largely validated in this context as well. However, previous research was shallow on the importance of compensation development. A logical and constant pace of development was seen as a crucial aspect for boosting retention by case companies.

The effect of compensation on attraction largely aligned with previous research. The glaring difference was that research was generally conducted with the idea that companies aim to attract employees using their compensation. This study found this to be largely untrue. In regards to attraction, compensation was seen as sufficient if it was not a deterrent. Too high a compensation was seen as undesirable, as it was expected to attract employees driven solely by money.

The lack of a structured approach to forming a compensation scheme matches with the findings of Purhonen (2019). Compensation systems in early stage companies are almost exclusively emergent, and professionals are rarely utilized in the process, relying on in-house knowledge.

The importance of perceived fairness is a key finding of this study. It matches with previous literature, matching Adams' (1963) Equity theory. Adams (1963) especially outlines feelings of demotivation and frustration when inequity is established. However, equity theory attributes the source as an individuals own analysis, weighing factors to determine the equity, or inequity of a situation. The findings of this thesis attribute the sentiments to a lack of communication and transparency, indicating that employees have a tendency to assume the worst. This is supported by Montag-Smit and Smit (2021).

Overall, the findings of this study fit previous research, but as previous research was more generalized, the findings specify implications and build upon existing theory in regards to the scope of the thesis.

5.2 Managerial Implications

The managerial implications of this study focus on the title "Designing a Compensation System for Low-hierarchy, Scaling, Talent-driven Organizations." While a more comprehensive framework was an ambitious goal, some realism must be faced about the extent of the implications of this study. Rather than forming a set framework, a set of guidelines is proposed, separated into two categories: components of a compensation structure, and the process of designing a structure. Both are directed at companies with informal emergent systems, that are looking to transfer to a formalized and consciously designed structure.

Regarding the Components

The basis for designing a compensation structure is visually represented in Figure 4.1.

A base level of salary is a must. Salaries cannot fall below market standards, but need not exceed it significantly. Attraction should be established using other components.

Incentives, short or long-term, provide a competitive edge in recruiting, and have a positive effect on an existing workforce. The choice, or rather focus, should be decided between profit-sharing (with the goal of affecting satisfaction), or incentivizing (affecting mainly organizational commitment). Ownership programs nurture organizational commitment, and are effective for motivating employees to remain within the company. Bonuses are excellent for increasing employee satisfaction, and have the potential to create a sense of fairness, as employees gain from company success.

Commissions should be considered, if a company has an easily quantifiable metric that they want to improve. You receive what you measure, or in this case reward. Note that commissions attract a driven personality type, and drive away potential recruits that do not resonate with variability in compensation.

Components of a compensation structure should be considered hygiene factors on a general level. When utilized effectively, they offer a basis for positive traits to emerge, but when unsuccessful can have a devastating effect on employee motivation and organizational commitment.

Regarding Implementation

A visual representation of the processes that successful implementation necessitates can be viewed in Figure 4.2. Structuring has been separated into two parts here: formalization and simplification. While the process should be viewed as a continuous cycle, structuring can be viewed as a natural starting point.

Early stage companies benefit from having a less formalized compensation structure that can adapt to both the company's and employees' needs. However, at some point, preferably earlier rather than later, a company will avoid significant issues by going through a process of formalization and structuring. The study shows that issues without a formalized structure start emerging as early as when a threshold of 20 employees is crossed.

The guidelines for the process in order are as follows:

Formalize: Identify the variety of current practices and formalize tacit policies. Consider the components in use, and whether they have a chance of creating desired results on indicators for success.

Simplify: Establish goals and capabilities, simplify the current structure into a comprehensible package. This will almost certainly require generalization, and employees will find them selves in categories that are not a perfect fit.

Apply - Communicate: Apply the system, and most importantly communicate the system transparently. Better yet, employees should be actively partaking in the design process. This harbors trust and boosts perceived fairness.

Evaluate: Establish indicators that match the established goals for the system. Actively monitor indicators for system issues and for individual outliers.

As a single generalized solution cannot be found, already simple because of the differences in capabilities and objectives, these guidelines are formed on a generalized level, that would ideally be applicable in most scaling SMEs facing a structuring of compensation policies.

5.3 Limitations and Further Research

This thesis, like all research, is bound by its limitations. The insights of this study are constrained by the limitations in existing literature and the qualitative data employed, along with its interpretations. Nevertheless, the identified limitations in this thesis present opportunities for future research. This multiple case study recognises a multitude of patterns and emergent ideas from interviews, but more rigid quantitative research is necessary to validate these ideas.

The scope of the study is its foremost limitation. Interviewed companies were based in Finland, and chosen companies fit a rather narrowly defined profile. While this limits the ability to propose generalized findings, it does enforce the validity of findings in the narrow niche. Results may be vastly different in an international context, or when studying companies outside the profile of low-hierarchy, scaling, and talent-driven attributes.

As mentioned in the "methodology limitations," assessing the objectivity of compensation system effects is contentious. The analysis hinges on the perspectives of top management, which may introduce bias. Mitigation strategies included interviewing at least two representatives per company and excluding conflicting viewpoints systematically. However, the predominant executive positions of interviewees raise concerns about workforce representation. Further research could enhance objectivity by interviewing a more diverse employee population, and potentially forming a single case study for a company. Such a study could form as a foundation for validating the causality between components and indicators proposed by this study.

An emergent theme in the study was the lack of structuring and its effects as a company grows. Further research specifically focusing on this aspect could be beneficial, especially in validating the approaches proposed for formalizing and structuring a compensation system. This kind of research would require empirical evidence of the guidelines in action.

This thesis offers a rather shallow suggestion for when a structuring of a compensation system should take place. This is due to almost all case companies having attained a quite large workforce by the time of interviews. Case companies had either completed a structuring process or were already suffering from the consequences of a lack of structure. Early stage companies (20 employees or less) should be studied to pinpoint the timing and indicators for when such a structuring should be organized.

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A. Appendices

A.1 Interview Structure

Introductory questions

1. What is your role within the company?
2. How many people does your company employ?
3. Would you define your company as:
   (a) Low-hierarchy
   (b) Scaling
   (c) Talent-driven

Establishing current structure

Explain your current compensation structures. Examples: salary, options, bonuses, equity, benefits

1. What elements does your compensation structure contain?
2. Why were these chosen? What was the goal for each element?
3. How does compensation develop for employees?

Establishing development process & motives

1. How was the system created?
2. Explain the process, who was/is involved, different phases, how it was approached etc.
3. What kind of challenges were faced in the development process?
4. What is your compensation structure's main goal?

Evaluation

1. Has the structure worked as intended? Why yes/no?
2. How do you measure the success of your structure?
3. What works well? How do you know?
4. What are the current system's shortcomings? How do you know?
5. What would you like to develop / modify in the future?
6. Evaluate the system's impact from the perspective of:
   (a) Employee motivation
   (b) Retention
   (c) Employer brand
   (d) Fairness

Remarks

1. How do you view the role of compensation structures in your company?
2. Is there anything you would like to add that was not discussed in the interview?