In This Chapter

GAINSHARING PLANS
PLAN DESIGN AND STRUCTURE GAINSHARING FORMULAS

OVERVIEW

Gainsharing programs actively encourage employees and employers to work together to solve the problems of cost, quality, and production efficiency. Where there is an improvement in one of these areas—based on a comparison with predetermined performance measures—employees share in any resulting financial gains.

Gainsharing is related to profit sharing in that both plans are designed to relate employee compensation to the performance of the organization and to engender employee commitment. However, gainsharing is fundamentally different from profit sharing because gainsharing rewards are related to departmental and/or organizational performance rather than profit. Therefore, in some circumstances gain sharing plans provide employees additional rewards when the company is experiencing productivity and performance improvements but not making a profit.

To be effective, gainsharing programs must have the full support of employees at all levels of the organization: executives, managers, supervisors, union representatives, and line employees. The three main components of effective gainsharing plans include:

- A management philosophy emphasizing employee participation, potential, and ingenuity;
- A structured involvement system for gathering and implementing employee suggestions toward performance improvements; and
- A formula to share benefits of performance-generated savings between workers and their employers.

Overall, gainsharing programs are designed to encourage employees and management to work together in order to maintain or increase productivity and performance throughout the organization. There are a number of different types of gainsharing plans, but the "traditional" plans are the Scanlon, Rucker, and Improshare plans. Most new gainsharing plans borrow elements from one or more of the traditional gainsharing plans, but are customized to meet the specific needs of the organization.

GAINSHARING PLANS

The Scanlon Plan

The gainsharing concept stems from the "Scanlon Plan" developed in 1935 by labor leader Joseph Scanlon. In general, a Scanlon Plan provides a cash bonus to employees each month in which productivity goals are met. The bonus is proportionate to an employee's base pay, and is paid to all the workers in a plant or facility.
Supporters of the Scanlon concept argue that rewarding employees for increased productivity will translate into higher pay for the workers, greater profits for stockholders, and fewer price increases for consumers.

As an organization-wide incentive system, the Scanlon Plan utilizes three basic elements:

- Employee teamwork to find ways to cut costs, assisted by management-supplied information on production concerns;
- Suggestion systems that channel cost-saving ideas from the workforce to an employee-management committee that evaluates and acts on accepted suggestions; and
- Bonus systems established on a formula that measures productivity gains and sets a procedure for sharing these gains among workers.

Of the three different traditional gainsharing plans, Scanlon plans emphasize employee involvement to a greater extent than Rucker and Improshare plans. Indeed, the principal feature of a Scanlon plan's employee involvement system is a formal suggestion program with a committee structure of at least two levels, as follows:

- **Production-level committees** - Production-level committees, usually composed of a department supervisor and at least one selected worker, explain the suggestion program and its reward features to other employees. Committed members encourage and assist employees in making suggestions and formally record suggestions for consideration. Production committees may reject suggestions, but must provide a written explanation to those submitting suggestions. In addition, the production committee ultimately is responsible for overseeing the implemented changes and providing feedback to the plant-wide committee on their effects on productivity.

- **Plant-wide screening committee** - Suggestions not unanimously rejected by the production committee and those involving interdepartmental changes are passed on to a plant-wide screening committee. Typically, workers are also represented on the screening committee. After deliberation and research, the screening committee delegates the task of drafting an implementation plan to an appropriate area of the company or, in some cases, to an outside consultant.

**Bonus Formula**

Another major feature of the Scanlon plan is the formula used to tie bonus distributions to productivity improvements.

The archetypical Scanlon plan measures productivity as a ratio of payroll costs to the value of production or net sales. Normally, a historical study is made to determine the proper base ratio for which bonuses are determined.

In any month when actual labor costs are less than the established base ratio, a bonus pool results. Some of the bonus pool is reserved for deficit months and for a special year-end bonus to reward continued high performance. A percentage usually is given to the company to pay for capital
expenditures. The remainder is paid to all participating employees as a monthly bonus based on percentage of their wages.

The Rucker Plan

The Rucker Plan, built on the gainsharing concept, provides incentives for all employees in a plant by calculating the value of labor used to produce goods.

The monthly bonus payment is determined using a mathematically measurable relationship between the "value added" to production by manufacture and the total compensation of employees. (A figure for value added is obtained by subtracting the value of what a manufacturer has sold from the value of what it has bought.)

To set standards for a Rucker Plan, an employer must examine accounting figures over a long period of time to find a stable ratio between labor costs and value added. For each accounting period, the following figures should be examined:

- Sales value of finished goods;
- Costs of raw materials, supplies, and services; and
- Payroll, including wages and fringe benefits for direct and indirect employees.

The figure for costs is subtracted from sales value to arrive at a "value added" figure, and the results are then put into the following formula: Labor Cost Productivity = Payroll/Value Added.

This standard should be based on the previous production figures from two to three years before. Allowances should be made for special circumstances, such as years when performance was negatively affected by a shortage of workers or when sales were unusually large for high profit items.

The key element in a Rucker Plan is the productivity standard. Specifically, if productivity is too low, payments will not provide sufficient worker incentive; if it is too high too much will be paid in bonuses.

In general, most Rucker plans pay monthly bonuses. Savings-through higher sales, more efficient work methods, and less waste-are calculated by multiplying the value added by the standard percentage to arrive at the allowable payroll for the month. Actual payroll is then subtracted from the allowable payroll to get savings for the month.

Savings are divided between the company and employees. The company usually gets one-third of the savings, while the remaining amount is divided by a 65-35 split-65 percent going to employees and 35 percent to a reserve to set off losses during months of low productivity. At the end of the plan year, any amount still in the reserve pool is distributed according to a 2:1 company ratio.

To maintain pay differentials within the company, bonuses usually are paid to employees based on their monthly earnings. In some firms bonuses also are linked to attendance by dividing the bonus amounts by the number of working days to arrive at a daily added figure, which then is paid only to
those who worked on a given day.

**Improshare**

Improshare (Improved Productivity Sharing Plan) uses a labor hour ratio to arrive at a bonus formula. The standard used to calculate the bonus is the number of labor hours used to produce a finished product and/or the output of any work group or division.

Productivity is then measured as the ratio of output to input - output determined in standard labor hours and input in actual labor hours. Normal productivity is set at 100 percent.

Unlike some other plans, Improshare programs are not influenced by outside factors beyond an employee's control, such as sales value or market conditions. Product changes do not upset the plan because labor hours per product are being measured and productivity bonuses are not affected by sales volume.

Improshare plans provide an equal division between employees and an employer on all productivity gains except those due to technological improvements or capital expenditures over $10,000. In these cases, 80 percent of the gains go to the firm and the remaining 20 percent is divided equally between the company and workers.

One unique feature of Improshare is a "buy-back" feature, which allows any natural deterioration in the standards to be incorporated into the plan. Under this provision, a ceiling is placed on productivity gains. If productivity improves to the point where the ceiling is regularly exceeded, the firm "buys back" the increase over the ceiling with a one-time payment. In doing so, the company automatically adjusts the standards so that the new ceiling is at the top level of productivity.

Unlike other bonus plans which exclude non-productive labor such as repair and waiting periods, or non-production standards such as shipping or maintenance, Improshare considers all of these figures as labor expenditures. Because Improshare standards only calculate improvements and productivity gains, they must be based on historical realities, such as actual production levels for the past year.

**PLAN DESIGN AND STRUCTURE**

A gainsharing program must fit the needs of a particular organization. According to compensation consultants, the following factors should be considered when tailoring a gain sharing plan to fit an organization's specific needs:

- **Organization value systems and employee attitudes** - Employers should ensure that the extensive involvement of employees in gainsharing efforts are compatible with the culture of the organization. For instance, those organizations that emphasize individual competitiveness may not be able to adjust to the increased participation and team approach common with gainsharing.

- **Plan objectives** - The design of the gainsharing plan must reflect organizational goals. The thrust of gainsharing is not solely to measure productivity, but to improve and manage it. All objectives, whether they be to help employees develop new skills, or to bolster financial performance, improve quality, or a combination thereof, must be spelled out specifically in
designing a plan.

- *Day to day administrative support* - Gainsharing, like other human resource activities, requires detailed record keeping. Employers should communicate information continually and audit the program annually to evaluate its effectiveness. Actual bonus distributions also should be monitored.

- *Gainsharing formulas and bonus distributions* - Once appropriate performance and productivity measures are selected, employers must select a reference point against which to measure performance and productivity changes. When productivity increases, the results are shared on a predetermined arrangement. One approach is to give 75 percent of the savings to the employees and 25 percent to the company, while another is to split the savings equally between employees and the employer.

- *Payout cycle* - Bonuses can be paid out weekly, monthly, or quarterly. Research on gain sharing programs have revealed that monthly payouts are most desired by employees. Any longer than a quarter for a payout diminishes the immediate link between performance improvement and individual rewards. Some gainsharing plans contain a holdback or reserve account which is beneficial to organizations that anticipate peak and slow periods.

**Performance and Productivity Measures**

Performance and productivity are measured differently by different organizations. Employers opting for custom-made gainsharing plans have the opportunity to choose measures that reflect their specific criteria for success. The following measures are the most commonly used in gain sharing plans:

- Physical measures correspond most closely to the traditional definition of productivity, typically rewarding employees for improving the relationship between physical units of output and physical units of input.

- Financial measures relate output to input in dollar terms, as in the ratio of costs to sales. Those organizations that wish to tie employee bonuses more closely to overall business results generally choose a financial formula as the basis of their gainsharing plan.

- Combination measures offer the greatest opportunity for creativity. The combination approach is often employed by those organizations that wish to focus employees' efforts on multiple performance variables with a separate measure for each variable.

**The Modifier**

A creative feature that appears in some gainsharing programs is the modifier. A modifier is a measure of such importance that it can override the gains achieved through other measures. The most common type of modifier is some measure of overall organizational profitability. With the profit modifier, the employee share of gains is dependent on the level of profitability. For example, if profits were high, the employees would receive a 50 percent share of the company's gains; if profits were just average, the share would drop to 35 percent; and if profits were low, the payout would fall to 20 percent. The purpose of the profit modifier is to ensure that high bonuses are not paid in times of low or non-existent profitability.
A basic component of a gainsharing plan is a formula to share the benefits of productivity-generated savings between workers and their employers. According to gainsharing experts, the ultimate success of any formula depends on several factors. It should be perceived as fair by the employees, employers, and customers; it should meet management's objectives; and it should be understandable and relatively easy to administer. Experts recommend that employers considering a gainsharing plan should decide on the following:

- A measure of output and input;
- A historical base period, one based on future productivity expectations, or both;
- The percentage of profits going to employees (ranges from 10 to 75 percent of improvement);
- How payments will be distributed;
- Time standard to pay the bonus on (all time paid or worked);
- Participation requirements;
- Effect of adjustment procedures (e.g., change in products or location); and
- Bonus payments included in regular pay check or given separately.

[Note: The examples provided on the following two pages outline some of the key measurement decisions that may need to be considered. The first example is based on a broad measure of performance, while the second is more specific, based on a pool concept.]

<table>
<thead>
<tr>
<th>Multicost Calculation Example</th>
<th>Period A</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Output (could be revenue, total standard cost, or some other measure)</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>2. Costs allowed (assume 80% of line 1)</td>
<td>$800,000</td>
</tr>
<tr>
<td>3. Actual costs</td>
<td>$770,000</td>
</tr>
<tr>
<td>4. Bonus pool (line 2 minus line 3)</td>
<td>$30,000</td>
</tr>
<tr>
<td>5. Employee share (assume 50% of line 4)</td>
<td>$15,000</td>
</tr>
<tr>
<td>6. Reserve for year end (1/3 of line 5)</td>
<td>$5,000</td>
</tr>
<tr>
<td>7. Net bonus (line 5 minus line 4)</td>
<td>$10,000</td>
</tr>
<tr>
<td>8. Participating payroll (all participating payroll)</td>
<td>$200,000</td>
</tr>
<tr>
<td>9. Bonus % (line 7 divided by line 8)</td>
<td>5%</td>
</tr>
</tbody>
</table>

This calculation is fairly broad, and the more costs included, the closer one gets to profit sharing.
### Expanded Labor Calculation Example:

<table>
<thead>
<tr>
<th>Pool 1 – Labor Productivity</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Allowed hours (based on history)</td>
<td>4840</td>
<td>Hours</td>
</tr>
<tr>
<td>2. Actual hours</td>
<td>4400</td>
<td></td>
</tr>
<tr>
<td>3. Performance improvement</td>
<td>440</td>
<td></td>
</tr>
<tr>
<td>4. Percent improvement (line 3 divided by line 2)</td>
<td>10%</td>
<td></td>
</tr>
<tr>
<td>5. Participating payroll (assume)</td>
<td>$100,000</td>
<td></td>
</tr>
<tr>
<td>6. Net addition (line 4 x line 5)</td>
<td>$10,000</td>
<td>Pool 1</td>
</tr>
</tbody>
</table>

**Pool 2 – Other Costs or Quality**

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>7. Examples of costs allowed as a % of revenue, or standard hours or standard cost (based on history or targets)</td>
<td>8%</td>
<td></td>
</tr>
<tr>
<td>- Scrap</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Overtime</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Material Quantity Variance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Supplies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Travel</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Revenue (as an example)</td>
<td>$1,000,000</td>
<td></td>
</tr>
<tr>
<td>9. Allowed costs (line 7 x line 8)</td>
<td>$80,000</td>
<td></td>
</tr>
<tr>
<td>10. Actual costs</td>
<td>$75,000</td>
<td></td>
</tr>
<tr>
<td>11. Net addition (line 9 minus line 10)</td>
<td>$5,000</td>
<td>Pool 2</td>
</tr>
</tbody>
</table>

| Pool 1               | $10,000  |
| Pool 2               | $5,000   |
| **Total Bonus Pool** | $15,000  |

Employers could distribute a different percentage of each pool. Three pools are common labor productivity, quality/customer service, and expenses.

### Implementation Advice

In designing any gain sharing program, there are a number of guidelines which should be followed:

- Design a plan individually for each operation and include as many employees as possible at each location.
- Establish the plan for a minimum one-year trial period, with continuation subject to a review by executives, managers, supervisors, and employees.
- Stress quality along with quantity.
- Emphasize that the organizational screening committees are advisory bodies and that management continues to have the responsibility for managing the organization.
- Involve supervisors and employees from the start of the plan and have communication and education efforts continually.
- Involve union leaders and members early.
• Review all individual incentive plans before introducing a group gainsharing plan.

• Monitor the formula regularly.

• Reserve a percentage of the bonus for deficit months.

• Separate gainsharing payouts from regular wages or salary, and pay them in a separate check. This separation emphasizes that the gainsharing rewards reflect exceptional performance, and is not simply an extension of the base pay program.

• Evaluate the plan at regular intervals, checking to see if employees at all levels understand the plan.

Gainsharing Pitfalls

Experts caution employers that gain sharing programs cannot be set up overnight, and should not be considered by managers unwilling to devote the necessary time and effort to implement the plans effectively. Pitfalls that could prevent a gainsharing program from becoming successful include:

• A lack of commitment from management that trickles down through the corporation.

• A bonus formula that is not workable.

• Rejection of the program by employees, management, or unions. Employees may fear a loss of income, while some managers may resent employee inclusion in the decision making process.

• A lack of records to establish performance baselines.

• Difficulty, because of the nature of its service or product, defining success at any level other than total profits.

• Insufficient monitoring and performance recording.

• Poor corporate financial performance leading to an inability to make performance payments.

• Difficulty determining the extent to which productivity improvements are employee-related.

• Poor communications between labor and management diluting the motivational power of the plan.

Gainsharing Plans in Practice

Increased foreign and domestic competition and labor costs that have outpaced productivity improvements are prompting U.S. employers to examine gainsharing systems, including:
• A large chemical company that gives employees the opportunity to win bonuses from two sources. Half the gain sharing bonus is based on a plant's performance in such categories as quality, productivity, and "throughput" (the amount of units produced for a given period). The other half is based on how the company as a whole meets or exceeds its return on investment.

• A manufacturer that treats very large departments as separate operating units, each with its own gain sharing pool (the gainsharing pool consists of bonus funds created by cost savings and productivity improvements). But if the pool for a department exceeds six percent of base pay, the balance goes into a pool for plant-wide distribution. This approach prevents problems with people resisting transfers to a low-earning department.

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