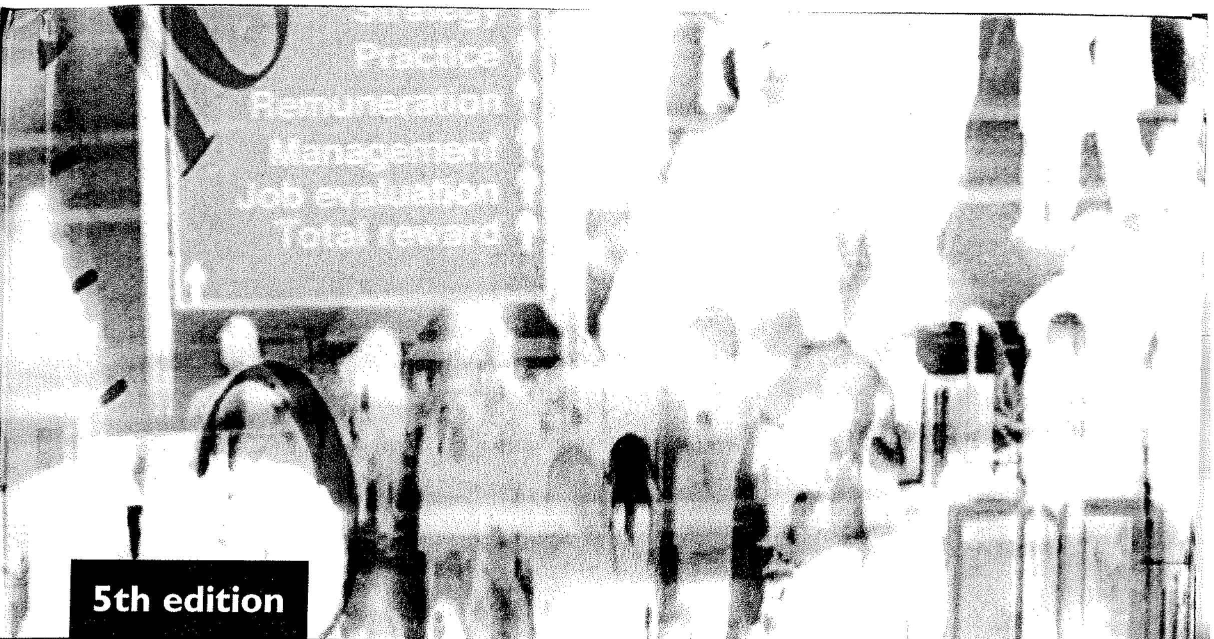

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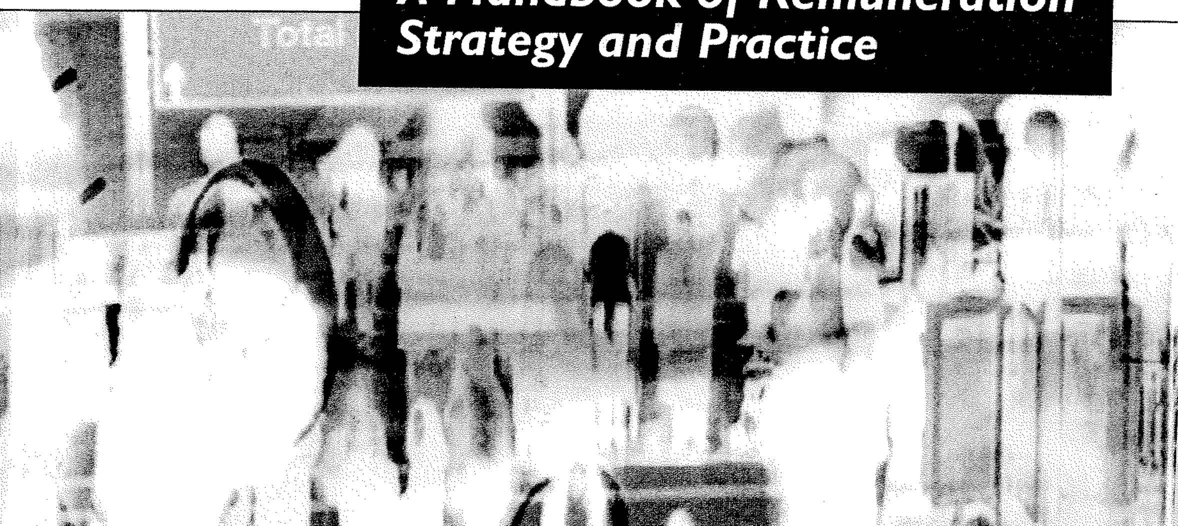

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Gainsharing – Sharing in Corporate Success

GAINSHARING DEFINED

Gainsharing can best be defined as 'a commitment to employee involvement that ties additional pay to improvements in workforce performance'. The primary components of a successful gainsharing plan are: 1) a formula to keep track of gains; 2) a link between the formula and process improvement initiatives; and 3) effective communications of how employee-generated improvements are creating gains.

Gainsharing differs from profit sharing in that profit sharing is based on more than improved productivity, and includes a number of factors outside the individual employee's control, such as depreciation procedures, bad debt expenses, taxation and economic changes. Gainsharing aims to relate its pay-outs much more specifically to productivity and performance improvements directly under the control of employees.

Gainsharing is well established in the United States, the first schemes having been introduced in the mid-1930s. They have not made such an impact in the UK. However, interest is increasing in gainsharing as a method of paying for performance that can be related to more reliable measures, encouraging teamwork and providing a basis for participation and empowerment. Based on 663 experiences in the United States, the median value of gains attributed to gainsharing plans is $2,200 per employee per year.[1] Is it any wonder that interest is rising?

Gainsharing is examined in this chapter under the headings of:

- goals;
- fundamental principles;
- formulae;
- ingredients for success;
- introducing gainsharing;
- conclusions.

GOALS

Fundamentally, the goal of gainsharing is to improve organizational performance by creating a motivated and committed workforce who want to be part of a successful company. Gainsharing is often implemented to address one of the following:

- need for a change agent, probably, and desirably, in association with other structural and process initiatives designed to achieve cultural change;
- increased competition – national or global – or declining productivity are reasons for introducing gainsharing; they have spurred managements to devise more creative pay arrangements that will stimulate both productivity and quality and keep employment costs under control.
- disillusionment with traditional incentive and bonus schemes; some organizations have abandoned piece-work or individual work-measured incentive schemes and are paying their manual workers a high basic or day rate, adding to that rate a group- or enterprise-wide incentive plan.

More specifically, the goals of gainsharing may include the following:

- focus the attention of all employees on the key issues affecting performance;
- enlist the support of all employees to ideas for improving performance;
- support programmes for empowering employees – decision making can be pushed down the organization hierarchy and employees can be given more control over their work;
- encourage teamwork and cooperation at all levels;
- promote better two-way communication about issues concerning work and productivity;
- encourage trust between employees and the company;
- share a meaningful proportion of performance gains with the employees who have collectively contributed to improvements;
- create a win–win environment in which everyone gains as productivity rises.

Certainly companies embarking on major change programmes, which often include a degree of employee empowerment, should consider whether this approach is a suitable vehicle to reinforce the changes taking place.

FUNDAMENTAL PRINCIPLES

Although the financial gain and subsequent pay-out elements are key features of gainsharing, its strength as a tool for improving performance lies equally in its other important features – ownership, involvement and communication. As Masternak and Ross[2] put it, gainsharing is 'an involvement system with teeth in it'.

Ownership

The success of gainsharing depends on creating a feeling of ownership. This feeling first applies to the gainsharing plan and then extends to the operation. When implementing gainsharing, a company should enlist the involvement of employees so that it can increase their identity with, and their commitment to, the plan, and build a core of enthusiastic supporters. Employees will own the gainsharing plan if they design it, sell it to management and communicate it to their co-workers.

Involvement

Involvement is the opportunity, which only management can give, and the responsibility, which only employees can accept, to influence the work and processes in employees' areas of competence. The increased involvement is the source of performance gains. For optimal success, employees should be heavily involved in designing a programme that will encourage the involvement of others.

Communication

The communication process is two-way: management communicates performance information to employees, who in turn communicate their ideas for improvement back to management. Employees must understand how their day-to-day activities influence the performance of the organization, and the organization must commit to providing employees with timely information on their performance and how it influenced company gains and their gainsharing payment.

FORMULAE

The traditional forms of gainsharing are the Scanlon Plan, the Rucker Plan and Improshare. Although these three plans demonstrate the roots of gainsharing, most plans today are developed with some level of employee input and can cover any of a large number of performance factors that are important to the organization. There is no such thing as a standard formula – there is always plenty of choice. Keep in mind that the formula does not define 'the plan': it simply provides the vehicle to track, or 'keep score' of, employee-generated improvement. The commitment to process improvement will, in fact, define the plan.

The Scanlon Plan

The Scanlon Plan was the first to connect employee involvement and employee-generated gains with pay. The Scanlon formula measures employment costs as a proportion of total sales. A standard ratio of employment cost/sales, say 40 per cent, is determined and, if labour costs fall below this proportion, the savings are distributed between employees and the company on the basis of a pre-established sharing formula.

The Rucker Plan

The Rucker Plan, like the Scanlon Plan, is based on employment costs, but they are calculated as a proportion of sales less the costs of materials and supplies (ie value added). Allen Rucker contended that the pay proportion of value added remains a near-constant share unless the organization suffers from severe mismanagement or a drastic change of policy. On the basis of this assumption, the Rucker Plan determines a constant share of whatever added value is created by the joint efforts of management and employees. Unlike the Scanlon Plan, Rucker offers only a formula, with little attention to an improvement means to generate gains.

Improshare

Improshare is a proprietary plan, which is based on an established standard that defines the expected hours required to produce an acceptable level of output. The standard is derived from work measurement. Any savings resulting from an increase in output in fewer than expected hours are shared between the organization and employees by means of a pre-established formula. Like the Rucker Plan, Improshare is only a formula for tracking gains, and does not offer a link to employee involvement.

Value added

Many versions of gainsharing are based on value-added elements as the key performance measures. Value added is, in effect, the wealth created by the people in the business. It can be specifically defined in many acceptable ways, but often calculated by deducting expenditure on materials and other purchased services from the income derived from sales of the product.

A manufacturing business buys materials, components, fuel and various services. The combined contribution of management and employees converts these into products that can be sold for more than the cost of the materials. In doing so, the business 'adds value' by the process of production.

In a value-added gainsharing plan, increases in value added are shared between employees and the company. Typically, the employees' share is between 25 and 35 per cent in the early years of a plan, and can exceed 50 per cent in the later years (year 5 to year 10). A value-added statement is set out in Table 25.1.

Table 25.1 A value-added statement

	£m	%
Sales income	10.0	100
Deduct: cost of goods, consumables and energy	4.0	40
Value added	6.0	60
Disposal of value added	6.0	100
Employees' share	1.8	3.0
Company's share: allocated to	4.2	70
Operating expenses	3.0	50
Operating profit	1.2	20

Value-added ratio (6.0/1.8) 3.3

A value-added gainsharing plan provides for an incentive to be paid as gains increase beyond a reference point. The fund is in deficit if the gains fall below that point. Following is an example pay-out calculation:

- A company has 100 employees.
- Average base pay per employee is £20,000 a year.
- Average employment cost per employee (pension, etc) is £4,000 a year.
- Total pay bill is therefore £2.4 million a year (£2.0 million base plus £0.4 million employment cost).
- Value added in a quarter increases by £200,000 from £6.0 million to £6.2 million.

- The increase of £200,000 is shared in the ratio of 30 per cent to employees (£60,000) and 70 per cent to the company (£140,000).
- Of the employees' share of £60,000, 25 per cent (£15,000) is placed in a reserve fund, leaving £45,000 available for distribution as an incentive for the quarter.
- The £45,000 incentive is distributed to the 100 employees in proportion to their base pay.
- The average incentive is therefore £225 for the quarter, or 4.5 per cent of the average base pay for the quarter of £5,000.

Developing a gainsharing formula

The following are the key considerations when developing a gainsharing formula:

- *How should value added be calculated?* Although it will follow normal accounting standards and principles, this can be flexible, depending on the individual company. Critical determinants are 'Do employees significantly influence this factor?' and 'Do improvements to this factor contribute to the profitability of the organization?'
- *What reference point or threshold should be used to trigger payments?* Determining a 'standard' or 'basis of comparison' is a critical decision. When the organization speaks of improvement, it is referring to improvement over what? Historical performance? Budget? Forecast? Plan? Industry benchmark? If value added rises above the threshold, this surplus will be shared between employees and the company.
- *What happens if value added falls below the reference point?* This implies that the value-added ratio (the employee share) is less than the norm. In this instance no payment is made and the company bears the 'loss'. In addition, some organizations take a portion of this loss and create a 'deficit reserve' that must be paid off with future gains before future pay-outs are made.
- *How can subjective factors such as quality or customer service be incorporated into the plan?* In order to be self-funded, the plan must rely on the creation of a quantifiable value-added gain. However, many organizations use qualitative factors, such as customer service, to 'modify' the share of gains that employees receive. For example, employees may receive 25 per cent of the value added if customer satisfaction remains at current levels, but 50 per cent of the gain if customer satisfaction improves dramatically, and 0 per cent of the gain if customer satisfaction falls in dramatic fashion.
- *How should gains be shared between employees and the company?* At first glance, a 50/50 sharing formula would seem to be the fairest to employees and the organization. However, in a loss period (poor performance) the organization takes on 100 per cent of the loss, so in a gain period it clearly deserves more than 50 per cent of the gain.

Determining the appropriate sharing formula depends on how much control employees have on the plan factors, and what measures have been taken to protect the organization from a loss (year end reserve, deficit reserves, etc). Most plans share less than 50 per cent of the gains in the early years.

- *What should be the performance period for the plan?* Most gainsharing plans are monthly or quarterly. The more frequent the pay-out, the more motivational the plan. However, in determining the right time-frame, the organization must also review current reporting cycles and the administrative burden of more frequent pay-outs.
- *What level of incentive can be achieved?* This is always an issue because it cannot be predicted. How much opportunity is there to perform above the standard? Certainly there are case studies of companies improving economic productivity by 10 per cent to 20 per cent. In the United States, it is not uncommon for Nucor Steel to have gainsharing pay-outs equal to 150 per cent to 200 per cent of base pay. There are equally examples of corporate failure. In any event, if an organization has designed a formula that it is confident will track with employee contribution, the incentive should not be capped.
- *What should be the basis of distribution of gains to employees?* The preferred arrangements would be an equal dollar amount to all, or in proportion to base pay. Some organizations have also elected to pay out based on attendance or seniority. This is the decision that employees will have the most emotion about. In addition to allocating gains to employees, some organizations have given a portion of gains to charity, or to employees to work on their ideas. These alternatives may serve as a bigger motivator to employees than cash.

Choice of formula

There is no such thing as a standard gainsharing formula that can be applied in any organization. Every gainsharing plan is unique because it has to fit the particular needs and characteristics of the company and its employees. There is always a choice, and companies will inevitably be faced with a dilemma – should they select a relatively simple but crude value-added plan or go for a more complex set of criteria? In general, for each factor you add to a plan, you make it 10 times more difficult to understand. Do your best to keep it simple.

Ingredients for success

The potential benefits of gainsharing are considerable, but the commitment is enormous. There are a number of demanding requirements for success. The main ingredients are the following:

- *Management style and commitment* – the management team must believe in shared decision making. They must be willing to go out and talk to employees and to listen to and act on their suggestions. A 'command and control' organization is not likely to succeed with gainsharing.
- *Culture* – the norms and values of the organization should support the thrust for performance improvement, teamwork and cooperation. Gainsharing can be a lever for developing a more performance-orientated and cooperative culture but it will not work if it starts from scratch.
- *Climate* – employee relations should be reasonably stable and there generally should be a working atmosphere of mutual trust between management and employees. Again, gainsharing can help to develop trust, but it cannot do it alone.
- *Involvement* – the underlying philosophy of gainsharing is that organizational members want to be involved in their work, employees have something worthwhile to say, employee suggestions can save money and improve corporate performance, and all contributors should share in the gains generated by these improvements. Employee involvement in a gainsharing plan can be said to be the most critical factor in its success. Employees must be encouraged to assume their new and expanded role because no gainsharing plan will work without employee enthusiasm, support and trust. It is necessary to believe not only that people actually carrying out the work have the best ideas about how it should be done but also that they will be most receptive to their own ideas.
- *Communications* – management must be prepared to communicate information on organizational goals, projects and problems that have previously been in their private domain. This information can include news about orders, customer reactions, quality initiatives, new market developments, changes in product mix and plans for introducing new technology. Management must also be prepared to listen to the reactions and comments of employees about the information. Gainsharing is more likely to be successful if effective systems for communication are already in place, but its introduction can stimulate all-round improvements – an important benefit.
- *Corporate strategy* – one of the most important criteria for the successful implementation of gainsharing is that it should be an integral part of corporate strategy. It must therefore be congruent not only with corporate culture but also with the organization's goals and objectives. It may have to be recognized that developments in corporate strategy may influence the way in which gainsharing operates.
- *Scope for improvement* – there must be scope for improvement in performance by means of the joint efforts of management and employees. Clearly, there is no point in introducing gainsharing if the

chances of increasing value added are slim. It is dangerous to make any promises on financial outcomes, but there should be some basis for a shared belief that performance can be improved and that, as a result, there will be financial gains.
- *Nature of the organization and its technology* – a delayered organization relying largely on teamwork will be more likely to benefit from gainsharing. The size of the organization or plant working under a plan should not be so huge that employees cannot understand the work going on elsewhere and how the efforts of each area interrelate. Gainsharing can work well when jobs are highly interdependent, as in flexible manufacturing systems, when just-in-time is in operation, and in cellular manufacturing operations. A full computer-integrated manufacturing (CIM) system would be an ideal environment for gainsharing.

INTRODUCING GAINSHARING

The initial steps to take when considering the introduction of gainsharing are the following:

- Define as clearly as possible the reasons for introducing the new culture and its objectives.
- Review the organization's culture, climate, structure, processes, technology, and strategies for growth. Specifically, gather input on the five enablers of gainsharing success:
  - *business focus:* the extent to which the organization has a clear focus and consistent goals and directions;
  - *team dependence:* the degree to which accomplishments depend on integrated efforts among employees and departments;
  - *empowerment:* the extent to which employees are encouraged to take risks and suggest improvements;
  - *willingness and ability to change:* the degree to which employees: a) trust supervision, and b) are more motivated to get the job done than by fear of making a mistake;
  - *human resource programmes:* the extent to which: a) the current HR programmes effectively measure job performance, and b) the compensation system is perceived as equitable and motivational.
- Sound out the views of line managers, other employees and, if appropriate, union representatives, on their attitudes to gainsharing – an attitude survey may usefully be conducted for this purpose, or 'focus group' discussions can be held.

It is highly desirable for the design to be done in consultation with line managers and employees. Gainsharing is about involvement, and those concerned should participate as fully as possible in the design of the plan and in discussing the arrangements for future communication and involvement. A project team may be set up consisting of management and employee representatives but it is also essential during the design phase to communicate to all employees what is happening and why.

Once the initial design of the plan has been completed, it should be communicated to all employees by a team-briefing process. The brief should explain the philosophy of the programme, the basis upon which the formula will operate and be revised, how they will be involved and how they may benefit. There should be no doubt in anyone's mind at this stage about the purpose and components of the plan. It is also advisable to build in a review stage after, say, six months' operation, rather than wait for a whole year. The briefing should have emphasized that the reference point in the basic formula could be amended as necessary at the end of each financial year and it is desirable to make provision for such an amendment within the established rules. It is essential to validate the scheme. The organization should have a clear idea of the intended results and track the programme's performance against those expectations.

CONCLUSIONS

Gainsharing is a potentially valuable component in an organization's overall reward strategy. However, it must be developed and maintained as part of an integrated process of business communications, process improvement, employee involvement and reward management – it cannot work in isolation. It should also be remembered that gainsharing is essentially a participative process. It is not, like most profit-sharing schemes, simply a method of handing out money for reasons that are beyond the ken and control of employees. The success of gainsharing depends largely on the opportunities it presents for involvement so that employees can establish a clear link between their performance and their rewards – an essential requirement for success in any pay-for-performance scheme.

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