

**THE PROMISE OF GAIN SHARING**

by

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### Introduction

We again appear to be in a period of social history when considerable interest is being shown in the concept of gain sharing. There are various definitions but the language used by the Profit Sharing Research Foundation captures some of the key elements:

"A system incentive (or gain sharing plan) motivates the individual as an individual and as a member of a productive team. It is a participation incentive and increases productivity as a result of employee cooperation and involvement".\*

In some early work that George Shultz and I did on this subject, we used the trilogy of participation, achievement and rewards to capture the key features of what has come to be called gain sharing plans.\*\*

The "participation" premise of gain sharing rests on the assumption that all members of the organization if given an opportunity can solve problems and make a contribution beyond what might be thought of as standard performance. As a result of emphasizing team work and coordination across all elements of the organization costs can be reduced, products delivered on schedule, quality improved and a host of other important achievements realized that favorably affect the bottom line.

\*Participative Gainsharing by Profit Sharing Research Foundation, Evanston IL.

\*\* George Shultz and Robert McKersie, "Participation-Achievement - Reward Systems", Journal of Management Studies May 1973, Volume 10, number 2, Pages 141-161.

The "achievement" part of the program places emphasis on reducing costs and increasing profits in distinction to the emphases of piece work and other individual incentive systems that aim at improving productivity by inducing workers to produce more units in a given period of time. As the phrase goes, the big gains come from "working smarter, not harder"--this is the essence of the achievement that is sought via gain sharing.

Rewards are paid at intervals, sometimes monthly or quarterly; sometimes in cash and in other instances deferred into pension programs. A distinguishing feature is that all members of the organization receive a payout (usually figured as a percentage of their base pay) and the plan thereby focuses on identifying the organizational unit as the achieving team.

#### A Field Guide to the Species

When the term gain sharing is mentioned, many branded products are available and there are even some unbranded or generic varieties on the scene. In classifying the schemes that are being used, I find it useful to distinguish between those that are motivational versus those that are organizational equity in purpose.

The motivational category includes such plans as Scanlon, Rucker, and Improshare. In terms of the concepts of participation, achievement and rewards, these plans identify the participating group as a particular location such as a store, a factory, or an office, the achievement emphasis is on reducing costs, primarily the labor factor, and rewards are paid usually on a monthly basis.

By contrast, organizational equity plans seek to reward the organization for gains that have accrued on a global basis. Thus, profit sharing which usually pays the same percentage to all members of the organization (across all facilities and locations) is a simple and clear method of "sharing the fruits". But unless the plan applies to subunits, i.e. to natural achieving components, profit sharing is likely to be seen as a fringe benefit without much motivational value.\*

#### Reasons for the Surge of Interest

While there are no firm statistics, rough estimates are that there are over 1000 plans in the motivational category and many more in the organizational/equity category. And these numbers are growing rapidly.

Here at MIT where the Scanlon Plan was designed and first introduced, a conference organized by Fred Lesieur and Associates, is held every other year and brings together representatives, both management and labor, from sites that have the plan as well as those that are investigating its possibility. Interest has remained at a high level and this past fall we held the 21st gathering, with several hundred participants in attendance. Carl Frost and Associates hold conferences for Scanlon companies and unions in their orbit (mainly in the midwest) and attendance at these events has increased dramatically.

\* Thus while the term gain sharing describes a range of approaches, most of the discussion in this article will consider Scanlon, Rucker, Improshare and their generic descendents.

Another clue to the surge of interest can be seen in the fact that half of the sites that we are currently studying for the U.S. Department of Labor to determine the staying power of different types of innovations in industrial relations are considering some type of gain sharing.\*

One of the most significant indications of the fact that gainsharing appears to be at the top of the agenda for many companies (and unions) is that it represents a key provision in the design of the new Saturn plant between General Motors and the UAW. Specifically, the agreement provides for the development of some type of gain sharing plan that will allow the workers at the new plant to move from their base pay, set at 80% of the industry, to higher levels--presumably to 100% and above.

And with respect to profit sharing, many collective bargaining agreements are including this feature for the first time. For example, in the recent round of bargaining in the steel industry several of the key settlements (Wheeling-Pittsburgh and LTV) have provided for profit sharing.

What explains the surge of interest in gain sharing? Some of the increased activity stems from the very pragmatic consideration that workers, who have given up concessions in the form of wage cuts and reduced fringe benefits, require some quid pro quos for these concession

\*It should be noted that our choice of these sites did not involve the subject of gain sharing. Rather we chose these sites because of the experimentation that was taking place with quality of work life, labor management committees (dealing with training) and union representation on the board. As a number of these sites have moved further into the transformation process, they have turned their attention to some type of gain sharing.

agreements to be saleable. In more colloquial terms, "If workers are asked to give up wages now, then they need to have some prospect at the back end that may partially offset the cuts up front."

There is also considerable interest these days, especially on the part of management, in making compensation much more flexible. A gain sharing plan does just this -- it only pays out a bonus when economic performance is better. In fact a whole movement has developed, spearheaded by the work of Martin Weitzman and his key book, The Share Economy that presents a well thought through theoretical argument about the overall advantage in having wages be more flexible and tied to firm performance.

Finally, in many situations gain sharing is being introduced as "the frosting on the cake". Over the past several years many companies have introduced new work systems that emphasize the use of teams, problem solving and delegation of management to operating personnel-- with remarkably positive results. When these "high commitment" systems produce better than average economic results, management often finds it desirable to engage in some sharing of these gains--both from an equity point of view as well as meeting the objective of institutionalizing the changes and motivating the organization to continue the process of improving economic performance via the reinforcement value of financial rewards.

#### The Relationship of Gain Sharing to the Employee Involvement Movement

The preceding comments suggest that in a number of situations today gain sharing is being introduced as a final piece that locks in place a

new system of work organization and involvement. This is an extremely important point and some elaboration is in order. It is interesting to contrast the circumstances that led to the use of gain sharing for most of the post World War II period and those that obtain today for situations where gain sharing is coming on the scene for the first time.

To take the Scanlon Plan as a case in point, most of the early installations occurred where the Scanlon Plan represented a solution to some type of crisis or severe economic problem. In a good number of cases the firm was bankrupt or about to go under. In other situations traditional incentives of the individual and small group variety had become demoralized and rather than take the "pull" of an incentive out of the situation altogether, the parties replaced piece work with the Scanlon Plan. And then in a few instances the introduction of the Scanlon Plan came about as a result of a philosophical commitment by management to involve workers and to share the economic gains. Often, this value commitment to the principles of gain sharing occurred where the businesses were privately held and the owners wanted to foster a family - type culture.

In passing, it should be noted that early gain sharing, especially the Scanlon formulation, was seen by scholars and other commentators as one of the best examples of progressive labor-management relations. Douglas MacGregor and his famous theory Y (the book was published 25 years ago) gave prominent attention to the Scanlon Plan as a device for achieving positive labor relations. Students in industrial relations courses knew about the Scanlon Plan because it captured the imagination of analysts who hoped that labor-management relations would be more than just an adversary system that distributed the profits that accompanied a

growing economy. Thus, while it was not described as the "new industrial relations", nevertheless, gain sharing possessed many features of what has come to be known today as the new or non-traditional system of labor management relations.

Just why gain sharing did not diffuse more than it did between the 1940s and the late 1970s is not clear. It captured the participation elements that are so central to the quality of work life movement today; it decentralized responsibility to lower levels of the organization that characterizes current efforts to eliminate levels of management and to push responsibility downward; and it created much more flexibility in compensation and in the deployment of labor--again, themes that are pre-eminent today. The answer is not completely clear.

Some of the reasons for this limited diffusion may be related to some inherent limitations of gain sharing which I will touch on in a minute. But for the most part the explanation for the limited role of gain sharing until recently must rest with factors of tradition, lack of a crisis, and management's desire to keep control and to keep workers and their union representatives within traditional boundaries.

Nevertheless today, gain sharing appears to be an idea (perhaps an old one) whose time has come. Today, it does not come to the scene as a brand new idea but as part of a larger system of concepts and in this respect it is not by itself carrying the full load of introducing participation, delegation of responsibility, and the restructuring of compensation towards more flexible forms.

In some respects the use of financial incentives in industry has come full circle. As of 1960, when Slichter, Healy, and Livernash wrote their classic book entitled The Impact of Collective Bargaining on Management, wage payment systems that related extra pay to extra performance covered approximately 30% of the production and maintenance

workers in the United States. That coverage has dropped steadily as management abandoned these traditional incentives in favor of measured day work and salary plans. By getting rid of variable pay, management was able to establish control over worker effort and to allow technology and performance monitoring systems to elicit acceptable levels of worker effort.

Now today financial incentives are returning, although they emphasize other targets for improving economic performance than increasing output and they are being applied to large units of the corporation.

#### The Benefits of Gain Sharing

A much cited study by the general accounting office estimates that the introduction of some form of gain sharing on average increases productivity by 17%.\* For organizations that are bottom line oriented this is quite a sizeable impact. Other gains from the viewpoint of the organization include: economic education (a process that is inherent in spelling out problems for the organization), improved team work between all groups in the organization (especially between office and factory personnel), management development (companies have often spotted talent in the screening and suggestion committees), increased flexibility in the use of labor (workers spend considerably less time worrying about job jurisdictions) and the acceptance of change. From an institutional point of view labor-management relations usually are improved although it is hard to separate cause and effect because labor-management relations need to be positive before a gain sharing plan can be installed. For a recent

\*Productivity Sharing Programs. Report of GAO, U.S. Congress, March 1981.

case study that documents the range of improvements that can accompany gain sharing (and employee involvement) see the U.S. DOL publication on Eggers Industries.\*

From the workers' side of the ledger, aside from higher earnings (the payouts usually average about 10%), there are other gains such as fewer health problems and more job satisfaction. The latter findings were noted by Jim Driscoll in a comparison of Scanlon sites with a matched set of sites not using any form of gain sharing.\*\*

#### Factors that Help Gain Sharing Plan Work

Organizations have found that a gain sharing plan does not run itself. Management must develop a plan to keep the program energized. This means spelling out problems and communicating on an open and full basis about areas that need attention, about developments that present challenges to the organization, e.g. the introduction of new technology.

Management must give up tight control and be willing to listen to the suggestions that are stimulated by the plan and to defer judgement on the best course of action until the organization has had a chance to grapple with the problems at hand.

\*"Employee Involvement and Gain Sharing Produce Dramatic Results at Eggers Industries," U.S. DOL Bureau of Labor Management Relations and Cooperative Programs, March 1985.

\*\*A Multiple-Constituency, Control-Group Evaluation of the Scanlon Plan. James W. Driscoll Sloan School of Management Working Paper, 1982.

Gain sharing systems only work when a structure is in place that enables all members of the organization to participate, to come forward with ideas and to have these ideas discussed and evaluated as well as reviewed and authorized by the proper personnel. All of the know-how that is involved in making quality of work life programs and labor-management committees effective skills are central for making a gain sharing plan effective.

Another pre-requisite that is essential for making a gain sharing plan effective is the provision of some type of assurance that members of the organization will not become unemployed as the result of the plan operating successfully. When gain sharing plans first came on the scene in the late 1940's, the provision of this type of employment security assurance was difficult for firms to institute--primarily, because the technical know-how was not present to implement such a commitment. Today, more and more organizations realize that they can manage attrition and work flows so that the consequences of decisions that are within the control of the organization (such as displacement due to new technology or in this case the improvement of productivity as a result of a gain sharing plan) will not redound to the detriment of the organization. Precisely, because of human resource planning and the knowledge of ways in which to accelerate attrition if excess people are on hand, it is much more feasible today than was possible for management in an earlier era to give employment assurances.

These precepts about what it takes to make a plan successful were borne out in a survey that Joel Cutcher-Gershenfeld conducted at our recent Scanlon Conference. When the participants were asked to rank the driving forces for successful operation, the following factors received 75% of the votes:

16%	Management Support
14%	Employee involvement
12%	Good communications
9%	Trust
6%	Change in labor-management attitudes
5%	Union Cooperation
5%	Willingness to listen
4%	Appropriate financial rewards
4%	Immediate implementation of ideas

Problems and Challenges

Obviously, since gain sharing (even with the rapid growth now taking place) has not diffused to more than a small fraction of employment (the high side estimate would be 20% of all employees), substantial problems must exist and they involve more than the assertion that "Management does not know a good thing when it sees it". At this point it is necessary to touch on some of the inherent difficulties or limitations of gain sharing plans -- while the next section considers some of the steps being taken to deal with some of these issues.

First, a number of organizations have found a type of plateau effect with the installation of gain sharing, that is, dramatic results occurring over the first several years but then stagnation in terms of continuing improvement.

One of the reasons for the leveling off of results is that most gain sharing plans especially those that emphasize cost reduction, pay for improvement measured against an historical period. But if external product market conditions change so that the standard (for what is considered better performance compared to competition) has increased in effect, then the payment of bonuses based on improvement in performance over an historical period may be distributing rewards that are not

justified by external market standards. On this score profit sharing possesses a distinct advantage, if the plan is designed so that it only pays a bonus when the performance of the corporation is better than some market average.

Given the fact that many companies feel that their compensation costs are already above market, these same companies may be leary of entering into a system that would generate bonuses, even though large monetary concessions may have been instituted in the same negotiations that also provided for a gain sharing plan. The point is that costs may have to be driven down so substantially and so rapidly -- with management taking the initiative (the organization cannot be expected to initiate such dramatic changes)--that it is not feasible for the company to share even a portion of these gains with employees. And other companies do not want to experience the uncertainty of whether they will be able to revise the ratio when circumstances change.

Another challenge of gain sharing is that it requires a continuing effort to maintain its vitality and the commitment of the organization to its operation. Some companies that have used the approach have found a type of generational sequence wherein the plan works for a period of time (sometimes as long as 10-12 years) and then it starts to lose its momentum because the organization has not been successful at orienting new members as they come on board. This type of life cycle is probably inevitable and suggests some type of periodic refurbishing operation that refocuses the attention of the organization on the basics of the plan.\*

Another problem and one quite pertinent to the current scene is that a gain sharing plan can be negotiated and ratified with exaggerated expectations that it will provide an opportunity for the workers to recoup their concessions. If a plan is installed on such a basis, then

\*Lawrence Williams identified this characteristic in some early work~~s~~ that he did on gain sharing.

it is not a plan that will be long lasting, because either it will create disappointment for employees or for management. Gain sharing requires that there be new gains before there can be sharing.

Space does not permit a full discussion of all issues and challenges that are involved in the effective implementation of a gain sharing. The following list, ranks the factors that received 75% of the votes for barriers in the operation of a Scanlon Plan:\*

- 12% Improper follow-up
- 10% Unwillingness to adapt to change and fear of the unknown
- 9% lack of trust
- 6% Lack of knowledge of the plan (it is complex) at all levels - leading to mistrust
- 6% Unwillingness of some managers to allow time to participate
- 6% Negative peer pressure
- 5% Unwillingness of management and labor to give up traditional roles
- 5% Lack of communication
- 5% Lack of funds to implement suggestions
- 4% First line supervisor's fear of losing authority
- 4% Employees' fear of job loss from suggestions
- 4% Focusing only on financial aspects of the Plan and forgetting the participative part

#### New Perspectives on the Design of Gain Sharing

Given the inherent weakness of gain sharing that the ratio against which bonuses are determined may diverge over time from true achievement in terms of the market place, some new thinking is required to keep gain sharing in step with current economic realities. One possibility is to have the ratio be based on competitive standards, for example the price at which a particular operation can be purchased on the outside, should management decide to "stop the 'make' and shift to the 'buy'".

\*Credit: Joel Cutcher Gershenfeld and the 1985 Scanlon Conference.

To the extent that profits can be measured on a disaggregated basis, then these can be the standards against which true performance can be measured. Historically, the difficulty with profit sharing has been that it only used one bench mark, the overall performance of the company. With profit information available on a much more decentralized basis and with companies more willing to reveal such information, it may be possible to use these measures in the design of gain sharing.

Another idea relates to the fact that payment under a gain sharing plan does not necessarily have to derive from a formula, i.e. payment of certain bonus levels for certain levels of achievement on an on-going basis. Often, true achievement is a episodic event and organizations might consider paying "one shot" rewards for such achievement. For example, one of the airlines that we have been studying gained a windfall in business several years ago when a competitor went on strike. The resulting challenge for the workforce was to perform so effectively that the customers who were shifted by the strike would choose to fly with the replacement airline on a repeat basis. In cases such as this it should be possible to identify what would be considered extra achievement and then to pay some special bonus to the organization. It would not make sense to pay this bonus on a continuing basis but only for the extra effort and extra service that was required during the opportunity period afforded by the strike.

Time and time again organizations that are involved in high commitment systems have say in effect: "We would like to find a way to recognize impressive economic results but we do not want to enter into

a formal gain sharing plan that would get us tied up in a system that might be hard to revise in the future". The answer is to fashion a variety of ad hoc economic rewards that share the benefits of higher performance and reinforce a high commitment system.

### The Future of Gain Sharing

We are at a point in time where for reasons already outlined there is considerable interest in this concept. For organizations that are able to set up new operations and to introduce all of the principles of the new industrial relations, gain sharing can be a key feature, albeit only a piece of a larger system.

However, for most organizations that are locked up in traditions and status quo arrangements, gain sharing can be a powerful intervention for more general organizational change. For one thing, it signals to every one in the organization the importance of improving economic performance. By contrast, quality of work life is usually introduced on a voluntary basis and our experience is that it never applies to more than 40 or 50 percent of the organization.\*

Clearly, the wage payment dimension (that is, sharing rewards) of gain sharing is a powerful technique for getting the attention of the organization. The test is to design the plan and to administer the plan in a way that induces the organization to strive for better results and to share rewards that represent true achievement on a continuing basis. Surely, the stakeholders in today's employment relationships should be able to think creatively about the opportunity and the challenge of designing and implementing viable gain sharing plans.

\*For documentation of this point and many other research points contained in this essay, see Thomas Kochan, Harry Katz, and Robert McKersie, The Transformation of U.S. Industrial Relations, Basic Books, forthcoming.