Personnel Notebook

For Your Most Important Resource -- The Human Resource

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GAINSHARING
WHEN WORKERS BECOME PARTNERS

There are many ways to motivate workers to improve performance. There are certainly those who believe that fear is still the best motivator. Behind many politically correct titles in today's business literature lies an entrenched message of fear and intimidation. In fact, it actually does work! But we know that it only works for a short time and not on all people. We also know that in today's workplace it cannot last long. People on or off the job are motivated most effectively throughout their lifetimes by positive rewards.

Industrial Psychologist, A.H. Maslow's "Hierarchy of Needs" describes how humans have an irresistible drive to satisfy increasingly higher levels of *positive* needs. Even among positive motivators there is a wide range of incentives that are applied to employees on the job. These include: time off, improved status, skill development, greater freedom and achievement recognition. But when it comes to improving the company's performance, few methods can compete with Gainsharing.

Gainsharing is a tried-and-true system that, although not without its honest detractors, is still the most successful of all employee incentive methods used to directly impact the bottom line.

Let's take a look at what it is, how it works and what companies have to say about it.

WHAT IS GAINSHARING?

Gainsharing is the name used to describe a wide range of incentive systems that measure the gains or profits experienced by a company that resulted from the efforts of individuals or groups within the company. Those individuals or groups then receive a share or percentage of that gain.

The company's gains are usually measured in increased profits before taxes but may include reducing waste, improving quality, reducing production time, increasing market share, reducing employee turnover or improving customer satisfaction. We will concentrate on those methods based on profit.

The financial rewards earned by employees may be quarterly/monthly bonuses or stock ownership. The best plans are based on a measured share of the company's gains being awarded to employees.

Chart #1 (on Page 3) shows a list of the most used reward system in the American workplace. Items #2 through #8 in the chart could be all included in a Gainsharing plan. Not included in that survey was the Scanlon Plan, a system originally designed by an American steelworker in the 1930s, that measures cost-saving ideas from an employee and rewards him/her with approximately 40% of the first year's savings or profit resulting from that idea.

GAINSHARING PLANS THAT WORK

The Lincoln Electric Company, the makers of the Lincoln Welder, uses a Gainsharing bonus plan that can have a very dramatic impact on an employee's earnings. Employees are given a share of the company's profits through a year-end lump-sum bonus.

At various times throughout the year, all employees are evaluated individually on ideas, cooperation, output, dependability and quality. They are rated between 80% and 120%. At year's end, after a dividend is declared and the future financial needs of the company are taken care of, the balance is set aside to be divided up among all employees. Chart #2 (on Page 3) shows an example of this calculation.

The average Lincoln bonus paid out was $20,800 while some production employees earned over $90,000!

James F. Lincoln, the founder said, "Workers should be paid on the basis of their accomplishments and efficiencies and they should share in the profits their efforts make possible." Their slogan? "Work smarter *and* harder."

At Motorola, the Participative Management Plan (PMP) is a team approach to Gainsharing. Every Motorola employee is a member of the team. Each team is given certain performance goals by a PMP steering committee.

For employees involved directly in manufacturing, team goals usually focus on cost, quality, delivery, inventory, housekeeping and safety standards. For managers, supervisors and other workers who are engaged in support positions, the goals emphasize strategic and human resource issues and completion of projects. To qualify for a bonus, the company must meet its pre-tax profit target and the team must meet its goals. Only then does the plan kick in. A proportion of the additional profit is set aside in a fund. Each member's bonus is based on the employee's individual performance appraisal rating as shown in Chart #3 (on Page 3).

Tom Peters, in his book "Liberation Management", cited a case where the company's various departments could not calculate which department contributed how much to a completed goal. So all departments were given full credit for the entire project. They called it "rewarding teamwork".

When workers become partners, or have some sort of vested share in the success of the company, they take a new interest in the health of the firm and usually do a better job within their scope of influence. They begin to think, not only about today, but what is good for the long-term future of the company. "Employee ownership plans", says Robert Strickland, chairman of Lowes lumber and retail chain, "are the most dynamic and most flexible of all Gainsharing plans."

Strickland says, "In the late 50s and early 60s, when we adopted our Gainsharing plan, there were at least five other companies, just like ours, same geography, same business and not bad management. None used any such Gainsharing programs. Three of them didn't make it and sold out. The fourth, about one quarter the size of Lowes, has just adopted a Gainsharing plan. It was an Employee Stock Option Plan (ESOP). The fifth company, with no Gainsharing program, has had a continuously mediocre performance record." Lowes' credits Gainsharing as their primary employee program that has contributed to the company's growth from 6 to 205 stores in 19 states, and increased its sales volume 50 times over! By the 1980s, Lowes' sales per employee ratio was three times greater than those of its competing retailers, Sears, Kmart and J.C. Penney.

As one outstanding example of how Lowes' success story came to be, they cite one employee who never made more than $125 per week and retired with over $660,000 worth of stock!

One early study compared the performance of college freshman of equal academic ability, but from varying financial/economic background. They found that students who needed money performed better overall than those who where financially secure. They concluded that the hope of winning scholarships stimulated the neediest to work harder. Similar studies in the garment industry established that employees work exceeded previous standards when a financial incentive system was introduced.

According to the National Center for Employee Ownership (NCEO), in a complex 10 year study of 45 companies, sales grew 5 1/2% a year faster in those companies with ESOPs than in those without. In 1980 few companies could see the benefits of ESOPs because the concept itself was so foreign to the traditional employer/employee relationship our whole economy was built on. But, according to NCEO, by the mid 90's there were more than 4,000 IRS-registered ESOPs in place. Another 4,000 have alternative forms of stock, bonus and employee ownership plans.

CHART 1

This list of the most used Reward Systems shows the percentage of companies surveyed that reported that system as "very effective" or that it had a "positive effect" on performance.

1. Pay For Knowledge — 89%
   An increase in base pay for being able to perform more than one job. Often a 5% to 10% increase per job mastered.
2. Earned Time Off — 85%
   Extra vacation or days off with pay for achieving goals.
3. Gain Sharing — 81%
   Teams or individuals with significant controls over production share in the profits or company gains as a result of their efforts.
4. Small Group Incentives — 75%
   Small teams (i.e., quality circles) are rewarded for achieving specific goals.
5. Profit Sharing — 74%
   Paid to large groups (or all employees) if company experiences greater profits. Employees usually not required to meet specific goals.
6. Individual Incentives — 73%
   Each individual who achieves pre-agreed goals and objectives receives reward.
7. All Salaried — 67%
   receive reward if company reaches certain targets.
8. Lump Sum Bonus — 66%
   All employees receive an identical lump sum bonus if company reaches certain targets.
9. Recognition — 30%
   Individuals/teams/departments achieving goals are recognized with awards, presentations, recognition before fellow employees and/or public.

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CHART 2

LINCOLN ELECTRIC PLAN

EMPLOYEE'S SALARY ÷ TOTAL GROUP SALARY = X%
X% x FUND AMOUNT = EMPLOYEE SHARE

CHART 3

MOTOROLA PLAN

ANNUAL WAGE RATE	EMPLOYEE'S MERIT RATING	COMPUTED BONUS (Rate times Rating)	TOTAL EARNINGS
$17,000	85%	$14,450	$31,450
$24,000	118%	$28,320	$52,320

HOW TO DESIGN, CREATE AND OPERATE A GAINSHARING PLAN

Before starting a Gainsharing plan, wages should already be fairly compensating employees for the work they are doing. Gainsharing is not like "tipping" for service. It is not intended to bring wages up to an equitable level; it is intended to build a team that mutually accomplishes predetermined goals and shares in the extra rewards of that effort.

The company should (and in some cases is legally required to) gain the support of the employees in the development of any Gainsharing plan. The plan should be understandable to all participants. Employees must see clearly that it is in their self-interest to accomplish the goals. The reports of results must be issued regularly and be readily available to all.

Guidelines to follow in the development of the plan should include the following:

1. Identify who should participate in the design and administration of the plan. Employee and employer involvement is integral.
2. Identify the goals. What specifically does the company need and want to gain? How will it be measured?
3. Identify who the plan will cover: all employees, certain divisions, specific groups, teams, key players or individuals?
4. What standards will be used to judge and measure employee performance? Who does the measuring, and are there any appeals? This will cause a few healthy debates but that's good for the process. All participants must know and agree on the standards. In most cases this one step alone produces such new insights for all concerned that the team-building process begins anew.
5. How will you identify and measure the gains? How will the gains be divided? What part of the gains are not included in the calculation? The amount that goes to the employee must be sufficiently large to encourage the extra effort.

This should not be a "top-down" process, but a developed consensus from discussion and learning with the employees and management.

When your need is to achieve individual performance, design your plan to measure accurately and reward the individual. When your greatest need is to achieve a team or department gain, then design your program to measure and reward that group. Identify what you want, from whom, and where. Consider the following:

Individual sales people - For new client development you need an individual goal and incentive.

Machine down-time in the plant - Reward maintenance crews for better efficiency and less down-time or repair costs.

Productivity - Reward the entire department for measured improvements.

Company cost cutting or increased profits - Reward the entire company for identified and measured gains.

You must also ensure that employees believe and trust in the equitableness of the plan and its absolute fair administration. Employees must believe that top management is integrally committed to the plan, that it is not just another Band-Aid on the problems, but a new way to do business. They must be confident that the plan is measuring input and results and targeting the rewards to the right place. Don't be sloppy in the administration of the plan by allowing unfair rewards for political purposes, or by paying out when the goals are not met.

WHY PLANS OFTEN FAIL

An early study of Gainsharing plans identified the following three causes for plan failures:

1. Fundamental design deficiencies: Poor goal-setting, bad work measurements, poor performance evaluation, too few participants in the plan, insufficient rewards to energize employees.

2. Inadequate personnel relations: Inadequate training of supervisors (they don't

know how to manage, they are unable to achieve results, etc.); no assurance to employees of equitable standards, no quality just quantity; a fair day's work was not required; plan not promoted or understood; no individual coaching or encouragement, or lack of support or interest from the top.

3. Poor technical administration: Work methods did not change to allow the new standards; use of faulty base rates; poor grievance procedure; poor production planning; employees get ready for action but company is not prepared or it allow bureaucracy to interfere; supervisors reluctant to loosen reins to accomplish goals, and failure to trouble-shoot and monitor the process.

One complex problem in the administration of plans is that employees are often penalized, or their success is impeded, by conditions or events over which the individual has no control. When employees are performing their part successfully but are unable to produce the desired results they become frustrated and discouraged. The problem must be discovered, brought to light and resolved.

One classic example of this is the often-found case of the employer who ties the incentive payout to the value of the company stock. Although this may have very well been the gain that the company wanted, employees often feel that the stock value is more controlled by outside influences. This includes such concerns as the outside buying and selling of the stock, the general condition of the market, mergers, manipulations and factors other than the employee's productivity.

Under incentive plans employees will become quite sophisticated in the maze of intricacies inherent in the plan. They may ignore, or pay little attention to, those parts of the job that may be necessary but do not contribute to the extra earnings (i.e., cleaning up around machines, doing maintenance jobs or employing safety standards). In a sloppily administered plan the tendency to sacrifice quality for quantity becomes a problem to which either side may succumb. The program must be so designed as to uphold quality standards, maintenance and safety and to achieve the identified goals.

Other red flags to watch for include participating employees who are assigned to other (non-incentive) work that will lower their earnings, such as the need to train new employees or to handle emergency projects.

When a company pays out the employee incentives even though the goals are not achieved, it sends a message that the goals are unattainable or that the company does not take the program seriously. Such classic examples of executives and/or other employees receiving incentive and performance bonuses while the company is losing money are plentiful. Executives in the major U.S. railroads in the 1970s were receiving bonuses for outstanding work <u>while</u> their railroads were filing for bankruptcy.

Under the Carter Administration federal employees, through an incentive/recognition program, received millions of dollars in excellent performance awards while their budgets were bursting and their programs were failing.

In the U.S. automobile manufacturing industry, throughout the 1970s and 1980s, bonuses were abundant, some individual executives were receiving millions in performance awards while their companies were losing market share and their warehouses were bulging with unsold cars. During this time of "outstanding performance" the list of the top 10 cars sold in America had 9 of the spots filled with foreign cars and that condition didn't improve much in the 90's.

This is not the kind of Gainsharing program you want!

<u>IS GAINSHARING GOING TO WORK OR IS IT JUST ANOTHER BUZZ?</u>

Gainsharing is already a winner. Employees today expect to be rewarded in an outstanding way when they do outstanding work. The newly designed, leading-edge companies are stating that this is the way we are going to compete in the new world economy.

General Motors in UAW contract negotiations, in the mid 1990'sproposed that compensation be directly tied to productivity increases in each individual plant and thereby <u>eliminating all across-the-board wage increases</u>. Although the UAW rejected this proposal, it is likely that as more companies adopt these methods (and they are) we will likely see it come up there again.

One reason the business revolution of the Japanese succeeded so well was that they designed their work systems were designed to fit their culture: subservience to authority, self-sacrifice and rejection of personal life and interests. Americans cannot compete in that arena. To succeed we must design our work to fit our culture, that means participative management, recognizing and using individual ability as well as team effort, freedom on the job, pride in accomplishment, recognition and to be rewarded equitably for what we do. A day's pay for a day's work, a good day's pay for a good day's work and outstanding pay for outstanding work!

As further evidence of this, when the Japanese culture began to change rasically in the 90's, their business revolution began to fail. Japanese companies are now redesigning their work systems to meet the new culture.

Gainsharing plans will not replace good company-employee relations. Indeed, few incentive plans will work in an environment that lacks good relations and trust. Each side must be able to depend on the other to succeed.

One of the most important but overlooked features of incentive plans is that participation brings all parties together as part of a communicating, planning, working, and bonding environment. It establishes working, problem solving and winning relationships. Once that relationship is established it becomes the foundation on which to build productivity, a healthy, successful company and a workforce that, again, the rest of the world looks up to for know how and quality.

Gainsharing, approached in a participative way, can create a fundamental change in the cultural, as well as economic environment of your company. Gainsharing, by definition, is mutual participation, a team building and team working process. Such a system will work most effectively if it is designed and operated the same way.

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