Profit Sharing, Gainsharing: Are they different?

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Most healthcare organizations now seem to have their fiscal year matched to the calendar. Many of them pay some sort of bonus to their employees at the end of the year. While many in HR understand that gainsharing is something different, one often hears the terms “bonus” and “profit sharing” used interchangeably.

Yet, none of these programs are the same. All three terms refer to different programs with different goals and outcomes. Not only does each term mean something different, one consultant stated that he consistently sees businesses using the wrong program for what they are trying to accomplish.

Since we are ending this year and getting ready to start a new one, I thought it would be a good idea to have a brief review of the three incentive programs and highlight the pros and cons of each one. Since some programs, such as profit sharing need to be defined and structured in advance, the review may be helpful before the beginning of the new year.

Again, let me stress that this review will be very high level and basic. For more detailed information on each type of program, there is considerable information on the internet.

Bonuses, profit-sharing and gainsharing–let’s look at each one individually and see if we can discover the best use of each.

Bonuses

Bonuses are monies in addition to their regular pay that are shared with the employees of the organization most often at year’s end. They are totally at the discretion of the employer and are not dependent upon whether the organizations was profitable during the year. The most common form of bonus payment is for each employee to receive the same dollar amount, often prorated based upon FTE status. In some organizations, there may be different bonus amounts based upon management level.

Some organizations link them to Christmas (as in Christmas bonus) or other holiday. As said earlier, an organization can decide to award bonuses regardless of whether it was profitable during the year.

The advantages of bonus payments include ease of payment and administration, surprise or "wow" factor if significant or unexpected, acknowledgment of employees regardless of profitability, and elimination of complaints regarding all employees not being treated the same.

Discretionary bonuses also have some disadvantages. There is no link between profitability and bonus, no link between any type of increased productivity or efficiency, no motivational factor involved, and no differentiation based upon differing employee contributions.

Discretionary bonuses are taxable as regular income unless contributions can be made to a qualified benefit program such as a 401(k). If they are structured to allow this, employees are often given opportunity in advance to contribute to the plan or not.

Regarding FLSA, the IRS has ruled that these bonus payments can be excluded from calculating the regular rate of pay they meet two requirements: the decision to make an award and the amount of the award are at the sole discretion of the employer, and the bonus payment is not made according to any prior agreement, contract, or promise causing an employee to expect such payment regularly.

Bonuses are easy to do if you want a "feel good" experience but should not be used if the goal is to improve organizational performance or meet specific objectives.

Gainsharing and Profit Sharing

Discretionary bonuses stand alone, but gainsharing and profit sharing are both pay-for-performance programs that seek to improve organizational performance in some way. Both these programs strengthen organizational collaboration, cooperation and self-policing by building on the idea of "common fate". (We all rise or fall together based upon group performance.)

Profit sharing is based upon the the profitability of the organization as a whole and usually divides a defined portion of the profits equally among qualified employees.

Gainsharing is usually paid for improvements made in an internal process and are usually awarded to an internal team responsible for those achievements. Gainsharing is most often paid for improved productivity or cost reduction as these are easily measured. For example, in my experience we have used gainsharing to reward all the employees in a department or nursing unit for meeting productivity targets.

Differences between gainsharing and profit sharing

Some differences should be readily visible to you. Since it is organization-wide, profit sharing does not require participatory management styles. It is simply paid when the organization achieves certain profitability targets. Since it is organization-wide, employees may think that their individual contributions may not make a difference since other employees may screw it up.

In contrast, gainsharing does require a participatory management approach as the goal of the program is to elicit suggestions and implement improvements by the employees involved. The employee generally sees the direct link between his/her performance and the award being offered.

Another apparent difference, profit sharing programs may be impacted by outside negative factors. Regardless of the contribution of the employees, outside factors or other non-operational adjustments can impact earnings. For example, if a realtor had a profit sharing plan in 2016, the collapse of the housing market may have erased all profit regardless of the efforts of the employees. Gainsharing is paid for achieving defined internal improvements regardless of the outside environment or even the performance of the rest of the organization.

Profit sharing programs generally pay at year end. This may require more “long term” thinking from employees and may also explain why many profit sharing programs are limited to certain management levels. Most employees will not alter behavior today for a reward 12 months later.

Gainsharing programs usually pay as soon as the improvement target is met.

There is immediate reward for performance improvements and this can emphasize the link between the two.

There are many internet sources that list many additional advantages and disadvantages of each. I have listed the most basic that I think have the strongest impact on effectiveness.

Do these programs work?

Both profit sharing and gainsharing programs require investment of money, time and human resources. It is important to answer the question, “are these programs effective?” If there is no benefit to the organization, then you created a lot of work to get something of dubious value.

There is much research available that demonstrates that both programs do have benefit to an organization. Some of this may be taken with a grain of salt as the sites making the claims are hosted by those who want to sell you their expertise in designing one for you!

Without getting to far into the weeds, one of the simplest summations of the effectiveness of gainsharing and profit sharing plans is cited in the article, “Gainsharing and Profit-Sharing”, posted on the site.

They state, “Both GS and PS plans have been shown to be effective. GS plans have been shown to result in labor cost savings of approximately 29% (Lawler, 1988). Rynes et al. (2005) write that PS plans, with a payout based on meeting a profitability target—such as return on assets (ROA) or return on investment (ROI)—have been shown to have a median effect of +4.4% and a mean effect of +7.4% on the criteria being used in the PS plan. “

Their evidence shows that gainsharing programs are effective in delivering results to the organization. Profit sharing does show positive results but they are much less.

Way back in 1990, Weitzman and Kruse of the Brookings Institute did an exhaustive study of profit sharing and productivity. Their conclusion was that it was hard to see link measurable productivity improvements with a profit sharing plan, but in their words: *“From many different sources there emerges a* *moderately consistent pattern of weak support for the proposition that profit sharing improves productivity. Any one piece of evidence can legitimately be challenged because no single piece is conclusive. But taken as a whole, the many different parts add up to a fairly coherent picture of a weak positive link between profit sharing and productivity. "*

Which to use?

My personal bias follows the research. I have participated in profit sharing programs and could not see measurable difference in the performance of the organization. I could not say that my own performance was affected or that I ever worked thinking of the profit sharing that awaited me down the road.

On the other hand, I have seen gainsharing programs produce financial and productivity results that the organization would not have dared ask for. When structured with the right goals and proper rewards, they achieved such significant results that we moved the goalposts several times. Each time the employees received increased reward for increased achievement.

HR professionals know an organization has to choose the right program. Profit sharing can strengthen employee identify with the company and puts all employees on an equal footing. Gainsharing programs can develop effective subcultures of achievement and directly link the employee to the outcome.