Revolutionizing Workplace Culture through Scanlon Gain Sharing

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Scanlon Gain Sharing: Where the Best Ideas Come Together

In the novel, *Moby Dick*, Ishmael signed on for “the three hundredth lay.” Provided that he survived the three years at sea, he would receive 1/300th of “the clear net proceeds of the voyage.” His friend Queequeg was a master harpooner, so he signed on for a nineteenth lay, or 1/19th of the net proceeds. These nineteenth-century whalers were engaged in gain sharing, a concept as old as human history.

Gain sharing has stood the test of time because it meets a fundamental human need for fairness and combines a primal understanding of group dynamics with the realities of a business enterprise; that is, *as we work together, we should all benefit according to what we have contributed. Unless we work together to create a ‘gain’ or something of value, there will be nothing to share.* The nineteenth-century whalers were motivated. They faced hardships together, and when successful, they shared in the rewards that resulted from both their individual talent and group effort.

Multiple studies by Jerry McAdams and Elizabeth Hawk conducted by the Consortium for Alternative Reward Strategies Research have shown that gain sharing is a powerful tool for creating high-performance workplaces.¹ Gain sharing, on average, produces a 3 percent increase in pay for employees and a 134 percent return for the company while fostering teamwork, enhanced communication, and improved morale. In *The Ultimate Advantage*, Edward Lawler notes, “[T]he most important thing we know about gainsharing plans is that they work.”²
Research conducted by Gallup worldwide shows that 70 percent of employees are not “engaged” in their work (Gallup, 2013). They are waiting to jump ship, to find more rewarding work. With the retirement of the baby-boomer generation, reduced immigration, and lower birth rates, the competition for talent will increase. Attraction and retention of talent will become even more critical.

Compensation is important for attracting and retaining talent, but alone it is at best a blunt tool. For decades, surveys have shown that pay is just one of the many reasons that employees stay with an organization (e.g., Hausknecht, Rodda, and Howard, 2009). Gain sharing provides increased pay, but it also can provide the psychological rewards that research shows people want and a method for aligning organizational goals with employee efforts.

As competition increases, organizations are faced with two critical areas that must be managed for survival. First, they must maximize efficiency and productivity by reducing all forms of waste in systems and processes. Traditionally the domain of production area industrial engineers, Lean methods are becoming a job requirement in all areas of manufacturing, including the office. Lean methods are now rapidly spreading to healthcare and other areas of the economy. The second area that must be managed is innovation. New products and services were once the domain of product-development departments. Today, the most successful companies tap all employees, asking them to constantly scan the environment for new products and services that can increase the “top line” of the organization and to devise more efficient methods for producing those products and services. The idea is to tap into employee knowledge of the business and bring innovation more quickly to fruition by engaging employees in the development of products and improvement in processes.

Gain sharing is a group, operation, or facility-wide reward system that can improve productivity, efficiency, and innovation by developing and better using human capital. Gain sharing—in particular, Scanlon plans—has been studied extensively (e.g., Gerhart, Rynes, and Fulmer, 2009; Ledford and Allen, 2012; Schuster, 1984) and has proven itself in a wide variety of industries, including manufacturing, retail, nonprofit, government, distribution, telecommunications, financial services, hospitality, and healthcare. Gain sharing is successful in union as well as in nonunion environments and has proven successful in various cultures around the world.

The goal of this chapter is to help compensation professionals understand how to create and maintain work cultures of innovation, engagement, leadership, and performance through Scanlon gain sharing.

The Crow and the Cormorant

In this classic Japanese fable, a starving crow watches as a cormorant fills its belly with fish. The cormorant, like the crow, is a black bird, but it is able to swim and dive underwater to catch its prey. The crow, reasoning that he too is a black bird, dives into the water only to drown. The moral of the story is: *pay attention to what is truly important, and do not get distracted by what isn’t important.* In the crow’s case, the ability to swim was more important than the color of his feathers.

Compensation practitioners would be wise to consider this fable as they explore various gain-sharing systems. Gain-sharing systems that seem similar at first glance reveal critical differences in philosophy, scope, and results on closer inspection. Gain-sharing systems are often classified by the nature of the bonuses they use. Just like the crow, focusing on the wrong thing—the formula—can result in missing what is really important. Years of
research have shown that the magic of gain sharing has less to do with the type of formula (i.e., single ratio, operational measures, profit sharing, etc.) than with the way in which the system creates gains, the leadership of the unit doing gain sharing, and the method by which the plan is installed (e.g., Scott, Davis, and Cockburn, 2007; Scott et al., 2002; Shivers and Scott, 2003).

The Consortium for Alternative Reward Strategies Research Study IV found that

1. Differences in plan implementation and support drive effectiveness twice as much as differences in plan design.
2. The strongest driver of the culture that supports gain sharing is the plant manager.
3. The clearest element that separates effective from ineffective gain-sharing plans is employee understanding of measurement details and how to implement them.
4. A key indicator of effectiveness is how much people think about the plan.
5. Companies are missing the boat on providing the recognition that employees want from their gain-sharing plans.4

The Scanlon Plan: Setting the Record Straight

Any student of gain sharing will eventually read about the Scanlon plan. It is one of the longest lasting and most researched approaches to gain sharing. It is also the only classical approach that is neither trademarked nor copyrighted. And while there are over 400 books in print that cite the Scanlon approach to gain sharing, much of the information published is misleading or simply wrong. Like the crow, these works focus on the wrong elements of the Scanlon plan and miss the most important ones.

We have spent a major part of our careers—a combined total of over 60 years—studying and implementing Scanlon plans. It is our hope that this chapter will set the record straight so that compensation professionals will know what aspects of gain-sharing plans truly drive organizational performance and employee engagement.

Carl Frost, who spent a lifetime researching and developing Scanlon plans, stated

The Scanlon Plan is an innovative management process for total organization development. It consists of a set of assumptions about human motivation and behavior, general principles for the management of organizations based on these assumptions, and specific procedures for implementing these principles.5

Scanlon plans are named for Joseph N. Scanlon, a prizefighter, steelworker, cost accountant, researcher, and lecturer at the Massachusetts Institute of Technology (MIT) who lived from 1899 to 1956. Articles in Fortune, Life, and Time magazines made this modest man “the most sought after consultant in America.” Joe’s radical idea was that the average worker has value and knows his or her own job better than anyone else in the company. Scanlon believed that most companies did not tap into the creativity and talent of the majority of workers. He resisted the notion of “the economic man.” In other words, he believed that people are motivated by much more than money. He recognized that people want to do good work, enjoy being part of a team, and have many ideas for reducing waste and improving the efficiency and effectiveness of organizations. Scanlon believed that lack of business literacy and skills development severely limits the contribution employees can
make. He felt that there was too much external competition to encourage internal competition in organizations. Scanlon found that many human resources practices and systems designed to increase productivity actually prevented people from cooperating and resulted in decreased productivity and efficiency. They often pitted one group against another to the detriment of the organization.

Based on these beliefs, Scanlon developed one of the most successful models for labor-management cooperation just prior to the entrance of the United States into World War II. The war years proved that labor and management could work together cooperatively to increase productivity and improve quality. By the end of the war, Scanlon’s faction within the Steelworkers Union that advocated cooperation found itself pushed out as the unions and management returned to their traditional adversarial relations. Scanlon was invited by Dr. Douglas McGregor to join the faculty of MIT as a lecturer, where he continued the work that today is known as the Scanlon plan. At MIT, Scanlon joined Paul Pigors, Charles A. Myers, Douglas McGregor, Paul Samuelson, Walter W. Rostow, George P. Schultz, Robert M. Solow, Charles P. Kindleberger, Fredrick Lesieur, and Carl Frost. This interdisciplinary group of scholars engaged in pioneering work in industrial relations.

Dr. Frost continued to evolve and test Scanlon’s ideas in organizations such as Herman Miller, Donnelly, Motorola, Bridgestone-Firestone, and Beth Israel Hospital, eventually developing the four basic principles/processes and a participative implementation strategy that are the basis for designing and successfully implementing Scanlon plans today.

Scanlon Principles

The following four principles are the critical elements of the Scanlon plan—this gain-sharing program is definitely not just another bonus formula.

*Identity/Education.* In order to make a meaningful contribution and to take ownership of business challenges and opportunities, every employee must understand the reality the organization confronts in its business environment. In addition to financial information about the business, employees need fundamental knowledge of the wants and needs of customers, the strengths and weaknesses of competitors, and the contribution that investors make to the organization’s success. As a result, companies committed to the Scanlon principles were practicing open-book management long before it became a popular management strategy. Management is challenged to create a compelling mission and vision for the organization that all employees understand and embrace.

*Participation/Responsibility.* The Scanlon plan is based on the premise that most improvements or gains come from “working smarter, not harder.” As a result, to increase productivity, employees must have the opportunity and feel the responsibility to provide input and influence decisions. Scanlon companies are high-involvement organizations, and Scanlon leaders use a variety of techniques, such as formal suggestions programs, team meetings, kaizen events, and special task forces to encourage participation. Key to meaningful employee involvement is a disciplined and rigorous process in which employees trust that their input will be heard and that their ideas that can contribute to the business will be quickly implemented. In fact, employees in Scanlon companies are expected to contribute their ideas for improvement; it is part of their jobs.

*Equity/Accountability.* Systems must be developed that ensure accountability to the multiple stakeholders in every organization; these stakeholders include investors, customers, and employees. Scanlon companies use gain-sharing, goal-sharing, or profit-sharing formulas.
to help employees focus on the critical needs of these stakeholders. Bonuses are often
distributed monthly so that employees can fully appreciate the connection between their
efforts and the success of the organization. The formula rewards the contribution of inver-
tors and offers discounts in prices or rewards for customers. However, for employees, pay
is not put “at risk.” Employees are paid competitive wages within their industry and labor
markets. Equity formulas reward excellence, defined as performance beyond what nor-
mally could be expected by the company or within the industry. To build trust and trans-
parency, employees are often involved in calculating the bonus payouts. In some companies,
the concept of equity includes dispute-resolution systems should disagreements occur. As
is evident, the equity formula is not just about cash bonuses for employees but also about
recognizing and rewarding the contributions of important stakeholders. Even if the bonus
is very small, bonus checks are still paid because they provide a clear message regarding the
success of employee and management efforts that month.

**Competence/Commitment.** Everyone must commit to continually improving on personal,
professional, and organizational levels. Scanlon organizations have learned that employee
development is an important investment, especially in a participative work environment
where the scope of employee job duties is broader and where employees are expected to
offer innovative suggestions for improving organization effectiveness and efficiency. Lead-
ers of companies where Scanlon plans have been implemented often state that higher levels
of competence are required than in traditionally managed companies. The Scanlon mantra
is “Continuous improvement requires continuous learning.” Scanlon organizations invest
heavily in the training and development of employees; they follow the basic principles of
what are often termed learning organizations.

Scanlon principles are believed to be universal. They can be applied in any organiza-
tion in any culture or country. Processes or applications are flexible and can be changed to
meet the unique needs of each organization. For example, the identity principle requires
that everyone understand the reality of their organization and business environment. How-
ever, the process of education is multidimensional, and companies employ a variety of
methods to help employees become business literate. These methods include face-to-face
meetings with management, published financial statements, business games, and posting
performance results on bulletin boards and company intranets. As another example, equity
is established through a variety of formulas that include labor cost savings, goal sharing,
economic value added, and profit sharing. The combination of universal principles com-
bined with flexible processes has allowed Scanlon plans to create a competitive advantage
for over 75 years.

**Implementation Strategy for Installing Scanlon Plans**

Carl Frost and subsequent generations of academicians and consultants have developed a
specific process or road map for successfully installing Scanlon gain-sharing programs. The
road map mirrors the high involvement/informed culture the Scanlon plan is designed to
create. Scanlon gain-sharing plans are created by the people who will be affected by the
plan. They are not generic programs created by consultant or compensation professionals
and then “sold” to the organization, as are many traditional gain-sharing plans.

Implementation of a Scanlon gain-sharing program begins with the top leader(s)
developing a mandate. A mandate is a statement that describes what the organization must
do to survive and prosper. Just as the Declaration of Independence outlined why the United
States sought independence and change, a mandate outlines why an organization must
change. Beginning with the top leadership team, the mandate is discussed and debated. In some organizations, a secret ballot is taken among the senior management team. Is the mandate compelling? Is there a critical need to change? Is the leadership team on board and unanimous in the need for change? Is the leadership team convinced that Scanlon principles and implementation strategy offer the best means for responding to the mandate? If the leadership team is not convinced that the plan is going to drive organizational performance, then it is time to go back and build a compelling reason for implementing the plan.

Assuming that the leadership team is committed, the process of building commitment continues throughout the various management levels and down to the front-line supervisors. Where a union exists, the mandate is shared with the union leadership. This part of the Scanlon implementation process is designed to build commitment and vision for the future.

Eventually, the mandate is shared with all the employees, who are asked if they are willing to participate in a design team, representing a cross section of employees, to develop a Scanlon gain-sharing program to respond to the mandate for change. Management may ask employees to formally indicate their commitment to building a Scanlon gain-sharing plan. An employee vote forces the leadership and management team to explain the reason that change is needed and their commitment to this change in language that the average employee can understand. Often the front-line employees know that change is needed but do not believe that management is serious, focused, and willing to work with them to improve the organization. This phase of the road map requires honest communication, a willingness to admit past mistakes, and trust in team building. If most employees do not vote to proceed, management must take this as a sign that employees are not convinced, and other changes may have to be made before employees are willing to commit themselves to the Scanlon plan.

The next step is to create a design team charged with leading the efforts to create a Scanlon plan adapted specifically for their organization. The design team consists of both elected and appointed members and is chaired by the senior manager of the organization unit for which the program will be installed (e.g., CEO or plant/facility manager). Top leader involvement sends a strong message that the Scanlon initiative is an important priority. The design team has four subcommittees charged with designing the best system(s) to practice the four Scanlon principles of identity/education, participation/responsibility, equity/accountability, and competence/commitment. These are described in detail next.

The identity/education subcommittee wrestles with the problem of how to make sure that everyone knows the critical issues or realities that are important to the organization. Who are the organization’s customers? Who are the investors? Who are the competitors? How will information about the organization and the program be shared? This subcommittee is charged with helping employees to understand the business. If employees do not have this fundamental business literacy, their ability to contribute to the effectiveness and efficiency of the company will be limited.

The participation/responsibility subcommittee has one of the toughest jobs—how to tap into the creativity and improvement ideas of all employees. Participation is key to creating the gains that later will be shared through the financial formula. Research conducted by Daniel Dennison (1990) at the University of Michigan showed that participative organizations have a three times greater return on investment (ROI) than do traditionally managed organizations. Identity creates knowledge about the organization. Participation puts the knowledge to use to make improvements.

Because Scanlon gain sharing is based on the idea of “working smarter, not harder,” employees must have the opportunity to provide input and influence decisions. The traditional Scanlon plan has a suggestion system that drives organizational improvement. All
ideas are recorded and tracked so that no idea falls through the cracks. Employees share
their ideas with their immediate work team. If the team likes the idea, it can be quickly
implemented. If the idea needs the support of other teams or departments, or if it requires
more money to implement than the team is authorized to spend, the suggestion goes
to a screening team. The screening team is made up of representatives from all the work
teams and the top leader. The screening team has the authority and resources to act, allowing
improvement ideas to be debated and implemented quickly. Ideas that require addi-
tional research are assigned to the necessary resource (e.g., industrial engineering, human
resources, or finance) and are tracked. Because everyone shares in the reward for increased
productivity or profits, other employees, supervisors, or managers are motivated to make
sure that good ideas are clearly articulated and quickly implemented.

This classic approach resulted in over 10,000 suggestions at National Manufacturing,
resulting in millions of dollars in savings (Davis, 2000). This approach continues to be used
successfully in organizations such as the ELGA Credit Union and was used by Watermark
Credit Union to become one of the “50 best places to work” in the state of Washington
(Scott, Davis, and Cockburn, 2007).

Scanlon companies have experimented with all forms of participation and employee
involvement. Donnelly (now Magna) was one of the first organizations to be totally orga-
nized into teams. Self-directed, cross-functional, and Six Sigma teams, Lean cells, and kai-
zan events are all used in Scanlon organizations to mine the ideas of employees, to improve
productivity, and to reduce waste. In 1991, the average employee in a Scanlon organization
contributed over $2,200 per year in cost-saving suggestions (McAdams, 1993). Scanlon
high-involvement systems are not limited to cost-saving ideas. Employees are also encour-
gaged to submit innovation ideas for new businesses or products, and this input has resulted
in the creation of new billion-dollar industries and services—a direct result of their Scan-
lon involvement systems.

The equity/accountability subcommittee is charged with designing the performance mea-
surement and reward system(s) to make sure that the organization is accountable to key
stakeholders. Accountability to Scanlon practitioners means balancing the needs of all
organizational stakeholders, building valid and reliable measures of organizational perfor-
mance, and taking responsibility for that organizational performance.

The idea that companies must focus on multiple stakeholders instead of just the stock-
holders is still not universally accepted. One business writer wrote about “stakeholder folly”
when describing a public Scanlon company’s efforts to balance the needs of multiple stake-
holders. His view, shared by many business writers, was that a company does best when it
focuses exclusively on the needs of the stockholders. Yet this is a simplistic view of busi-
ness. It begins with employees who care about their company and the work they do. This
drives employees to meet the needs of customers. Customers shop where their needs are
met. When satisfied customers buy products and services, the investor makes more money.
Kotter and Heskett (1992, p. 11) contend that

Corporate Culture can have a significant impact on a firm’s long-term economic
performance. . . cultures that emphasized all the key managerial constituencies
(customers, stockholders, and employees) and leadership from managers at all levels
outperformed firms that did not have those cultural traits by a huge margin. Over
an eleven year period, the former increased revenues by an average of 682 percent
versus 166 percent for the latter, expanded their work forces by 282 percent versus
36 percent, grew their stock prices by 901 percent versus 74 percent and improved
their net incomes by 756 percent versus 1 percent.
The research is clear: investors who wish to maximize their investment must support employees so that employees can create products or services of value for customers.

When organizations are performing and customer and investor needs are being met, employees naturally expect to be treated fairly and to share in the gains (i.e., gain-sharing formula). Financial and compensation professionals are usually appointed to serve on the equity team, along with a cross section of elected employees, to make sure that the system is fair, economically viable, and meets the requirements of all wage and hour laws.

Early Scanlon plans often used a ratio of labor costs to sales as a measure of gains. As the cost of labor was reduced below a historical baseline, gains were shared between the employees and the company. Joe Scanlon used this approach not because he believed that it was the only approach, but because it was easy for the average employee to understand and implement.

The labor-to-sales formula stuck, and today this remains the most misunderstood part of the Scanlon plan, with many authors claiming that the formula is the Scanlon plan. Like the crow, they have made a serious mistake. Scanlon plans are created with every type of formula imaginable. Profit sharing and economic value added (EVA) are popular financial formulas. Scrap reduction, safety, and quality measures are popular operational measures. The formula is limited only by the equity team’s imagination and creativity. The key to a successful formula is twofold: employees must be able to understand how it will enable them to increase performance (as measured by the formula), and they must believe in its intrinsic fairness.

There are countless books and articles available for the compensation professional on how to design bonus systems, but very little has been written about why they should create an equity system instead. Incentive systems focus on the dollars employees can earn, whereas an equity system focuses on the relationship among investors, customers, and employees. Each of these important stakeholders must benefit from the program.

The identity principle requires that Scanlon organizations share both good and bad information. Scanlon employees understand that in order to survive, their companies need customers and investors. They understand that sometimes in the life of an organization everyone may be called on to make sacrifices. Scanlon organizations have had to lay off employees, eliminate bonuses, require transfers, outsource, and so on to meet the needs of their customers and investors. More often than not, these sacrifices are made participatively and cooperatively because Scanlon employees know why the sacrifices are needed (identity), are involved in creating solutions to the problems (participation), and trust that they will be treated fairly (equity).

During a time when Beth Israel Hospital was struggling economically, employees participated by donating their own blood. Each donation helped the hospital save $200. The aggregate savings prevented layoffs. Employees at Spring Engineering gave up their bonuses so that they could save two jobs during a downturn in their business. Faced with huge deficits during a business downturn, Scanlon employees at Herman Miller offered millions of dollars of cost-saving suggestions. Donnelly Mirror (Magna) employees found ways to save a million dollars during a business downturn through their active involvement in the job elimination process, and their acceptance of the suspension of bonus payments.

The competence/commitment subcommittee is responsible for ensuring that all employees have the means for improving personally, professionally, and organizationally. In smaller organizations, the task may be as simple as designating core training competencies and documenting how to obtain them. In larger organizations, it could be as complicated as creating a corporate university. Most often the task requires identifying available training resources and encouraging employees to use them. It also may involve developing a system
to provide accurate and timely feedback to enhance what employees have learned from the work experience.

Scanlon practitioners believe that increasing personal competency ultimately benefits their organizations. Atlantic Automotive found that among its minority employees, very few were homeowners (Scott, Shivers, Bishop, and Cerra, 2004). The controller provided free classes after work on personal financial management. He then helped the employees complete mortgage applications with the local bank. The increased understanding of business realities (i.e., investors) had a sizable side benefit of dramatically increasing home ownership among hourly employees.

Minutes from subcommittee meetings are shared throughout the organization while the design team works to create the plan. The organization follows the debates as the plan takes form. This part of the Scanlon implementation process requires communication, facilitation, and leadership skills.

Once the draft plan is completed, it is taken back to the organization, where a secret ballot determines if employees are agreeable to a one to two trial implementation period. The trial period allows those with doubts to test the system before granting their full support. It also allows the design team to test their systems to discover what works and what does not. At the end of the trial period, the design team makes any necessary changes, and the plan is submitted for a final vote. In most Scanlon companies, the Scanlon plan then becomes a way of life, and the plan is not subjected to additional votes. Some Scanlon organizations will continue to vote and renew their plans when major changes occur or after a certain number of years have passed.

Although this implementation process seems long and complex, experience demonstrates that long-term success of the plan is enhanced with this process. Furthermore, productivity improvement begins to appear during the development of the plan as employees better understand how the business operates and become more engaged.

Scanlon Servant Leadership

It takes an unusual leader to practice the Scanlon principles and processes. These leaders must be dedicated to developing others. They must be willing to share information and power. They must trust others. Douglas McGregor identified them as “theory Y” leaders. The great Scanlon leader and best-selling author Max DePree wrote in Leadership as an Art that “[t]he first responsibility of a leader is to define reality. The last is to say thank you. In between the two, the leader must become a servant and a debtor.”

Today many leaders inspire to be “servant leaders,” as popularized by Max DePree, Robert Greenleaf, and Larry Spears. The Scanlon plan provides a proven method for servant leaders seeking to create high-performance cultures. In sum, one might say that Scanlon considers human resources an investment to optimize not a cost to minimize.

Resources and Support

Anyone can use the Scanlon name, principles, and implementation process without paying royalties or seeking permission. A tremendous amount of Scanlon-related information is available at no cost at www.EPIC-Organizations.com. The site contains links to videos and podcasts. It also contains free downloadable articles and essays. Scanlon EPIC Leadership: Where the Best Ideas Come Together (Davis and Speers, 2014) is the best anthology of

**Notes**


**References**
