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## EMPLOYEE PROFIT PARTICIPATION PROGRAM AS A MONETARY INCENTIVE

*The paper provides insights into the system of employee participation in company profits as a monetary incentive based on international experience. The possibilities to apply the system of personnel participation in company profits in Ukrainian realia is grounded. The problems in implementing profit sharing schemes in Ukraine are identified.*

*Keywords: motivation; company profit; employee participation in company profits.*

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## СИСТЕМА УЧАСТІ ПЕРСОНАЛУ В ПРИБУТКАХ ПІДПРИЄМСТВ ЯК ОДНА З ФОРМ МАТЕРІАЛЬНОЇ МОТИВАЦІЇ

*У статті розглянуто систему участі персоналу в прибутках підприємств як один із методів мотивації з урахуванням зарубіжного досвіду. Обґрунтовано можливості застосування системи участі персоналу в прибутках підприємств відповідно до українських реалій. Висвітлено проблеми застосування цієї моделі в умовах економіки України.*

*Ключові слова: мотивація; прибуток підприємства; участь персоналу в прибутку підприємства.*

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## СИСТЕМА УЧАСТІА ПЕРСОНАЛА В ПРИБЫЛИ ПРЕДПРИЯТИЙ КАК ОДНА ИЗ ФОРМ МАТЕРИАЛЬНОЙ МОТИВАЦИИ

*В статье рассмотрена система участия персонала в прибылях предприятий как один из методов мотивации с учетом зарубежного опыта. Обоснованы возможности применения системы участия персонала в прибылях предприятий в соответствии с украинскими реалиями. Освещены проблемы применения этой модели в условиях экономики Украины.*

*Ключевые слова: мотивация; прибыль предприятия; участие персонала в прибыли предприятия.*

**Problem setting.** One of the key factors in efficient functioning of contemporary enterprises is the financial interest of staff, primarily due to the level of salary subject to their performance. Financial encouragement aims to increase both income and profit of a company. However, every year the existing systems of financial motivation are becoming less successful, as they cannot fully satisfy financial needs. One of motivational methods to boost staff interest in their work, increase productivity and hence the overall enterprise efficiency is employee participation in company profits. Key companies of the world leading countries recognize the significance of profit participation systems implementation. Most of them consider it crucial for staff motivation. Therefore, the directions in the analysis of such system implementation at Ukrainian enterprises is of particular importance.

**Research and publications analysis.** A significant contribution to the development of employee profit participation was made by the following scholars: J. Adamik (2008), M. Armstrong and H. Murlis (2007), S. Brown and J. Sessions (1999),

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P. Dowling and D. Welch (2004), C.M. Ellis and C.L. Paluso (2000), O. Iashchenko (2006), O. Ieskov and N.D. Darchenko (2010), A. Kalina (2005), T. Kato (2002), V. Khomiakov (2008), S. Lanzeby (2008), R.J. Long (2002), M. Mathieu (2009), N. Samoliuk (2009), V. Soinyk and V.V. Urban (2012), M.L. Weitzman (1985), T. Zbrytska (2012).

Despite the fact that there is a large number of studies in this field, the analysis of domestic scientific literature evidences that the issue of personnel encouragement with the use of different systems of participation in enterprises' profits is understudied. The specific features of their use at Ukrainian enterprises haven't been revealed. Little attention has been paid to introduction of such systems at domestic enterprises. All these issues require more detailed coverage.

**The purpose of this research** is to analyze the existing practice of the enterprise income staff participation system operation as well as domestic and foreign experience of using such system of motivation.

**Key research findings.** Wide implementation of profit participation programs demonstrates positive changes in sharing a newly created product in favor of staff. The concept of "participation economy" appeared in the mid-1980s with the advent of M. Weitzman's works (1985). The history of its development began with the attempts to improve the system of personnel encouragement aiming at enhancing their motivation to expand company's overall industrial and economic performance. Thus, an opportunity to pay those employees, whose contribution into the overall results of the company was the most considerable, has been justified (Samoliuk, 2009).

Profit participation is an appropriate payment prepared and designed on the basis of a special plan developed by an employer. It cannot be changed without affecting financial interests of employees (Kalina, 2005). Profit participation programs mean that staff receives salary determined by the collective wage agreement which should not be lower than the minimum approved by legislation (1378 UAH as of January 1, 2016 to April 30, 2016) and payments from income determined by the agreement between staff representatives and administration of a company (Law of Ukraine, 25.12.2015, # 928-VII).

Profit participation program allows establishing a bonus fund (from a defined part of income) for personnel to receive regular payments. Distribution of income between the funds directed to implement various participation programs and production development is the problem. Small sums that administration accounts for distribution between employees may appear to be insufficient for them to feel as actual profit users. Large payments cut funds for production development and this threatens company's development and dooms it to hopelessness. Thus, it is important to distribute funds between payments for staff and contributions for development of the company efficiently (Zbrytska, 2010).

One should consider the difficulties in identifying a direct relationship between increasing income and contribution of a particular employee while constructing a participation program based on income index. It is the reason for implementation of motivation systems based on business performance. Profit participation programs, depending on indices and motivation methods, are classified according to the company overall performance and on the basis of ownership relations (Figure 1).

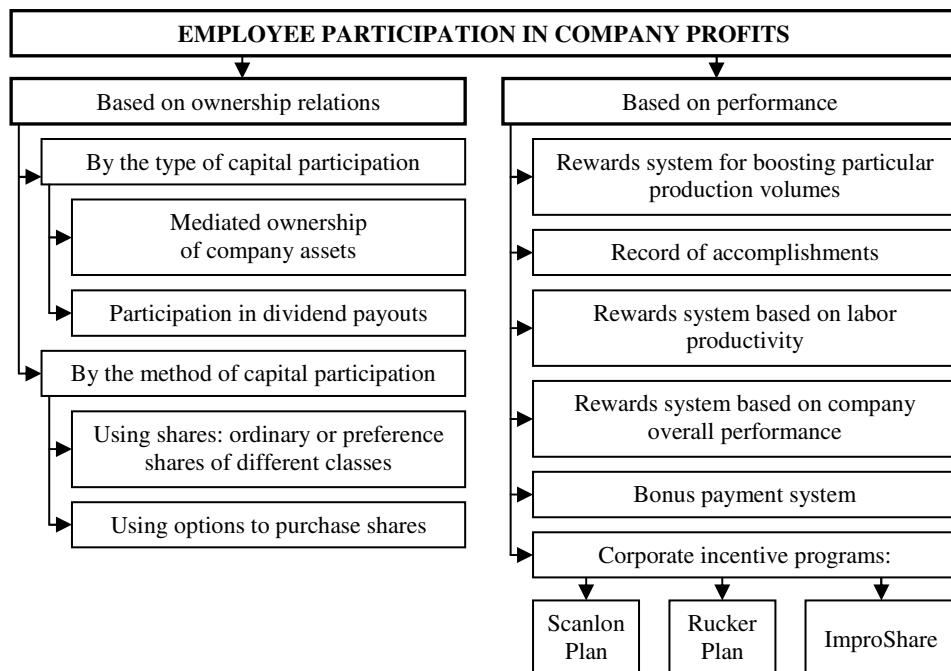


Figure 1. Classification of employee profit participation programs, compiled by the author

Employee profit participation based on company performance is oriented on the growth of production volumes and increase of labour productivity through applying rewards or bonuses plans. Sometimes only corporate incentive programs can be efficient. We suggest using the Scanlon, Rucker or ImproShare Plans for corporate encouragement, since they have become extremely popular abroad and already proved their efficiency.

**The Scanlon Plan** is a strategy that increases productivity. Since its development in 1927, the Scanlon Plan has been implemented in many organizations, especially in smaller unionized industrial firms. The basic concept underlying the Scanlon Plan is that efficiency depends on teamwork and plant-wide cooperation. The philosophy behind the Scanlon Plan is that employees should offer ideas and suggestions to improve productivity and, in turn, be rewarded for their constructive efforts. The plan requires good management, leadership, trust and respect between employees and managers, and a workforce dedicated to responsible decision-making. When correctly implemented, the Scanlon Plan can result in improved efficiency and profitability for the organization and steady employment and high compensation for employees (Lanzeby, 2008).

The key feature of this plan is the implementation of income distribution on the monthly, not annually basis depending on productivity increase. This allows employees follow all positive results of their company's activity as well as failures and drops the company faces. The basis of Scanlon's Plan is the calculation of basic coefficient. This formula includes a share of costs for employees equal the sold goods:

$$\text{Basic coefficient} = \frac{\text{Total costs for employees}}{\text{Cost of sold goods}}. \quad (1)$$

By using this coefficient with the amount of actually sold goods in every period we obtain acceptable expenditures on personnel as compared to actual salary. If the latter is lower than acceptable, one will pay the "prize" divided between the enterprise and employees by the ratio of 25:75 correspondingly. One can invest a certain share of money for personnel in the insurance fund that can apply in case of cash shortage during upcoming months or for additional reward for the progress in productivity. One can distribute money from the insurance fund left at the end of the year in the same way as monthly rewards, but without any funds preservation. The enterprise bears all losses in case the balance appears to be negative.

The Scanlon Plan is not a true profit-sharing plan, because employees receive incentive compensation for reducing labor costs, whether the organization makes a profit or not. Organizations that have implemented the Scanlon Plan have experienced an increase in productivity and a decrease in labor costs. Also, employees' attitudes have become more favorable, and cooperation between management and workers has increased (Armstrong and Murlis, 2007).

**The Rucker Plan**, almost as old as the Scanlon Plan, was developed in the 1930s by the economist Allan W. Rucker. The first stage in it is the accounting analysis required for determination of the net products cost index. Net products or added value is the difference between the market value of manufactured products and the cost of raw materials, other materials and services used for production. The next stage includes calculation of the Rucker's norm. This share of net products is paid to personnel as salary. In fact, it is net products per 1 USD of salary. The norm used shall be an average norm for several years (Khomiakov, 2008).

The Rucker formula is as follows:

$$FR = \frac{\text{USD Value of Labour Costs}}{\text{Value of Production} - \text{Value of Materials, Supplies, Services}}. \quad (2)$$

There are two major differences between the Scanlon and Rucker Plans:

1. Rucker Plans tie incentives to a wide variety of savings, not just labor savings as on in Scanlon Plans. Due to this greater flexibility Rucker Plans are more amenable to linkages with individual incentive plans;

2. In Scanlon Plan, rewards come from employee participation in improving productivity and reducing costs. In Rucker Plan, rewards come from the difference between labour costs and sales value of production (Adamik, 2008).

**The ImproShare Plan** is the method of standard hours and basic coefficients, it was created by Mitchell Fein, an industrial engineer. We begin calculations with standard hours in the frames of this system. It means production time required to manufacture one item. Standard hours are calculated by the following formula:

$$\text{Standard hours} = \frac{\text{Total costs per one production hour}}{\text{Quantity of manufactured products}}. \quad (3)$$

There is a specific standard hour for each type of products. This standard hour is used for calculation of general expenditures on labor by standards through multiply-

ing the bill of materials by the number of manufactured items. In case of manufacturing several types of products, we sum up these results and obtain the total standard expenditures on labor. Productivity basic coefficient (PBC) is calculated by dividing worked staff-hours with accompanying works for total standard expenditures on labor:

$$PBC = \frac{\text{All expenditures on labour}}{\text{Total standard hours}}. \quad (4)$$

The ImproShare bonuses are based not on dollar savings, as in the Scanlon and Rucker Plans, but on productivity gains that result from reducing the time it takes to produce a finished product. Employees and the company each receive payment for 50% of the improvement. Companies such as Hinderliter Energy Equipment Corporation pay the bonus as a separate check to emphasize that it is extra income (Ellis and Paluso, 2000).

However, employees have more stable interest in company performance when they participate in company capital, basically by means of shares or options.

Employees, who possess shares, receive dividends (from the balance left after all obligatory payments extracted from the income obtained due to business activity) according to annual results. Rewards from option shares create a particular dependence between the future profit of an employee and shares price of a company. By purchasing stocks employees become directly interested in their price increase and the company market value growth correspondingly and thus they link their own welfare with the long-term perspective of company's prosperity. In fact, option shares are a free form of the reward, since they give employees an opportunity to purchase stocks at fixed price instead of rewarding them with a free block of stocks.

Models of profit participation may vary in different countries due to the history of economics development, traditions and approaches to labor. Owners of enterprises have deep interest in such participation not only because of its huge encouragement effect, but also due to the support on the part of the state in form of these sums tax exemption. Thus, the state gives entrepreneurs a spur to expand this approach. Some countries implement these schemes on a willingly basis, others make them obligatory for entrepreneurs; it depends mostly on legislation (Iashchenko, 2006).

Currently the biggest number of enterprises that use the programs of income participation is located in the USA. Approximately 26% of enterprises and 75% of factories that operate since 1980, use this initiative. Nearly 36% of them tend to delay payments forwarding the part of bonuses to employees' pension fund. The reason for this is tax benefits provided by American legislation to the companies that apply these programs. Somewhat 16% of the hired employees participate in such programs. Approximately 350 000 of enterprises in the USA apply different kinds of income participation programs (Kato, 2002).

In Japan, profit participation program is one of the reasons for high level of motivation of staff and competitiveness of manufactured products. Apart from monthly rewards, many companies pay their employees a bonus from profit twice a year. On average, this amount constitutes more than 1/4 of the salary, while it may reach a six-months salary of an employee in successful years (Long, 2002).

In France, profit participation program obtained its statutory basis in 1967 and became obligatory for all private enterprises with more than 100 employees. An important point is that governing and control of profits distribution are provided by legislation in favor of hired employees, and state authorities manage distribution of profit proportionally to the expenditures on labor and capital (Brown and Sessions, 1999).

The system of staff monetary encouragement in Great Britain faced significant changes; in particular, the government adopted the so-called Green Paper law. According to this law, the reward system was implemented, and floating share of salary depends on the total income of an enterprise instead of the system of monetary labor encouraging on the basis of fixed prime rate that had been in effect previously. At the same time, the constant part of salary is fixed at a quite low rate. Currently Britain has two advanced systems of monetary encouragement that depend on profit – cash and stock-based, which allows partial payment for the work done in form of stocks (Dowling and Welch, 2004).

Enterprises in Sweden widely use monetary incentives to employees through income participation based on Regulations on Tax Charges. Regulations mention two ways of rewarding: 1) staff receives rewards that are part of salary and are subject to taxation on the annual basis; 2) bonuses are transferred to bank accounts of employees, but not earlier than in 5 years. Most of Swedish companies prefer the system of deferred rewards, since in this case tax is cut to 10%. This system ensures personnel's interest in successful business activity and gives an opportunity to enlarge production at the expense of credit fund created with the help of deferred rewards (Mathieu, 2009).

Unfortunately, profit participation programs in Ukraine are still not popular enough, because the best profit for many entrepreneurs is the one equal to zero leading to no taxation, and personal profit is hidden beyond expense items balance of enterprises. Besides, Ukraine does not provide tax benefits within the frames of the income participation program. Thus, tax legislation in Ukraine requires reformation. Articles on enterprises taxation, which could promote income participation programs for employees, are missing in the new Internal Revenue Code of Ukraine as well.

To make profit participation programs efficient in Ukraine, it is required:

1. To provide staff with timely and accurate information on company's activity. It means that employees must have access to all the information on enterprise gains and realize that it is possible to anticipate rewards only from actually obtained profit, and this requires efficient performance.

2. To punish legally those enterprises that pretend to face false losses so that not to pay staff their share. However, nowadays entrepreneurs often do not receive profits and lose invested capital, thus it is necessary to boost business development, create friendly environment for extended implementation of activity at the legislative level for profit participation programs to operate efficiently.

3. To ensure fairness and transparency of entrepreneurship, since business owners can raise their profits through cutting salaries and "honorably" allowing their employees to seek a share from the profit that, in fact, can be substantially lower than the "cut" salary.

4. To provide tax benefits, subsidies or transfers to those companies, that apply profit participation programs to motive personnel, at the legislative level. This

approach is of high priority in the sectors with the lowest salaries (for instance, in agriculture). This will be a spur staff to work more efficiently, since apart from the basic salary they will benefit from this financially in case of the efficient business activity of their enterprise.

5. To implement profit participation program for all the staff that will help to avoid industrial conflicts and offences and will boost team spirit.

6. To engage personnel in management, i.e. making business decisions, providing help in solving workplace issues, searching for the ways to improve production process. Only then income participation program will be successful for employees.

7. To arrange the efficient control system for managers to reasonably estimate the performance of their subordinates and the results of their individual activity to define the volume of rewards on the basis of the obtained results. Volume of rewards in the frames of profit participation program shall be based only on those figures the personnel can really influence on and control over at their working places or production areas (Soinyk and Urban, 2012).

8. To introduce an additional staffing position (supervisor) at an enterprise to control timely and fair payments being guided by standards exclusively. To avoid the influence of business department managers this supervisor should report to business owner only and generally have an open mind when it comes to estimations.

9. To engage staff in the profit participation program development or distribution of profits obtained from production improvement. It is not wise to develop such programs by a narrow circle of specialists, who can use these programs for their own benefits ignoring the interests of staff (Ieskov and Darchenko, 2010).

**Conclusion.** Income participation programs are not widely applied in Ukraine. One of the reasons for this is the shortcomings of tax legislation. Nowadays the most acceptable initiative for this country is combining domestic and foreign experience in distribution of net profit with the aim to create a national model for the enterprises in Ukraine to implement profit participation programs as monetary incentives. The state has to play a big role by fixing tax benefits system for the enterprises that apply such motivation approach.

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