Self-Adjusting Labor Costs

How to Get Your Employees to Drive Your Labor Savings

By Charles DeBettignies, Ph.D.

Ten years ago, two young men, Dave and Larry, graduated from the same university. They were close friends, and coincidentally went into the same line of business.

When Larry ran into Dave at the National Conference for his industry, he was eager to catch up on "the news" since they had seen each other last. Although the two men had been close friends, there had always been a subtle rivalry between the two. After a brief conversation, Larry could no longer resist finding out how his friend had been handling the tough business conditions that most companies were currently facing. Larry asked, "Have business conditions been as tough at your Company as they have at mine?"

Dave responded, "Our sales have been down for the past two years, but we haven't had any layoffs or forced reductions." Dave adds, "It's been tougher to get new business. In fact, we have had to accept much lower prices than we have in the past to get some of the new business we recently landed."

Larry says in a sympathetic tone, "Wow! I bet your profits have really taken a hit."

"Well, our profits have not been hit as bad as they might have been, due to the productivity improvement system we got underway a couple years ago," said Dave.

"Our people aggressively worked to improve overall company performance and were able to achieve regular monthly Gainsharing bonuses between 10 to 20% before the downturn began. They got accustomed to these bonuses, and when things got tougher, they really dug in to keep as much of the gains they had achieved as possible. It seems people will work twice as hard to keep something they have, as they will to get something they have never had."

"Their bonuses are tied to the total pay and benefit costs relative to the total production output. As the sales volumes declined, they aggressively went after ways to cut costs and get by without replacing employees that left. We also used lean manufacturing techniques and constraint elimination to further increase productivity as things got tougher."

"With our Gainsharing system, labor costs become variable costs that stay the same as a percent of production or value added. When volume goes down, labor costs go down."

By this point Larry was in disbelief. "You mean your people are reducing your labor costs? Why would they do that?"

"Well" Dave said, "Our people make it happen because their pay (Gainsharing bonuses) is tied to it and they are accustomed to getting the money. They do what they can to avoid losing their bonuses. That means they use fewer temporaries, try to trim unnecessary overtime, avoid replacing employees that leave on their own, and move people around to where the work is at the moment. Generally, people still work 40 hour weeks. But we have worked shorter weeks on occasion."

"The key is to be willing to make the tough decisions necessary to put bonuses within reach of your people. Once they are "in the hunt" for a bonus, they will fight tooth and nail to keep "their money."

"I think I understand how this works." Larry says, "But can you show me an example?" So Dave grabs a napkin on a nearby table and puts some numbers together. (See Table 1.)

Table 1.

	Starting Scenario	10% Sales Decrease
Sales	200,000	180,000
- Material	80,000	72,000
= Value Added	120,000	108,000
Pay and Benefits Target (Calculated as 50% Value Added)	60,000	54,000
Actual Pay and Benefits	52,000	50,000
Gainsharing Bonus	8,000	4,000
% Bonus	15%	8%
Total Pay and Bonus	60,000	54,000
% of Sales	30%	30%

Dave explains, “As our sales went down, Gainsharing bonuses went down too. The bonuses are now in the 5 to 15% range - not as high as before; But the Gainsharing system has softened the blow to the company, kept us reacting to the challenges, and automatically adjusted to these more difficult conditions.”

“It’s true, this can only go so far,” Dave continued.” “ If volume goes down suddenly and drastically, headcount reductions or reduced work weeks may be necessary. But you would be making these changes without a Gainsharing System! Your Gainsharing system will keep your labor costs variable (constant as a % of volume) more aggressively and consistently than if you did not have Gainsharing. And it puts it in their self-interest to keep the total labor costs below your targeted levels.”

“It seems people will work twice as hard to *keep* something they have, as they will to get something they *have never had.”*

“So your sales went down, but your people costs went down too.” Larry laughs, “Actually we’ve been wondering why our overtime hasn’t been lower as sales dropped off. Sales are lower, and our overtime costs are as high as they usually are!”

Dave laughs too, “Well, our people are doing this, I mean driving performance, because it’s their way to get what they want. If we didn’t have Gainsharing, it would be in their self-interest to work more slowly to protect their hours. With Gainsharing, they want to hit their goals, so they have the extra money to spend and the time off to spend it.”

Larry pauses, then adds, “It sounds so easy. You mean you just implemented Gainsharing and your people started driving the performance?”

“It wasn’t quite that simple” Dave said. “We found that management needed to push through ideas and changes to drive the initial performance improvements to get the company “into the hunt” for bonuses. Once our people had received some initial bonuses, they got behind the system and are driving the performance improvements themselves now. But management had do provide the initial momentum and drive to hit the goals at the beginning.”

“Well,” Larry said, “we have had two headcount reductions and things are in pretty good balance right now in terms of labor and output. We are anticipating an increase in demand in the next few months though.”

“This would be a terrific time to get a Gainsharing System underway then,” Dave responded. “If you could set your goals to handle the gradual increase in production demand with the people you currently have, and target scrap reductions, you could get into the bonus range and be underway.”

“I’ll give what you have told me some thought,” Larry said. “This year may turn out much better than I thought!”

In Summary

A Profit Driver Gainsharing® System makes your labor costs act like variable costs – going up and down with volume, but staying constant as percent of production value.

It does this by changing your employees’ self interest from working slower when the volume goes down, to trimming total labor costs and keeping the Gainsharing bonuses they are accustomed to.

As production demand goes down, there typically are opportunities to minimize labor costs. Will your people be looking for them and eager to take advantage of them to preserve bonuses they have gotten used to? Or, will they work more slowly so the work expands to fill the time available (Parkinson’s Law)?

Gainsharing companies have been using these concepts successfully for more than 100 years.

If you would like to discuss the details of how this would work in your Company, please give us a call.

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