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Profit Sharing - A Means of Economic Cooperation between Labor, Management, And Government

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PROFIT SHARING - A MEANS OF ECONOMIC COOPERATION
BETWEEN LABOR, MANAGEMENT, AND GOVERNMENT

by
James H. Quill

A Thesis Submitted to the Faculty of the Institute of Social and Industrial Relations of Loyola University in Partial Fulfillment of the Requirements for the Degree of Master of Social and Industrial Relations

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INTRODUCTION

Profit sharing has had a long and interesting history, and has had persistent vitality, especially in America. Despite many failures and criticism against it by both employers and employees, it continues to grow. Success in profit-sharing plans can now be found in every part of the United States, and in many types of businesses. The wartime and post-war prosperity in recent years has added impetus to the growth of profit sharing.

Profit sharing deals with the fundamental economic relationships of our economic system in the United States. It influences profit level returns to capital investors, wage earners' incomes, government tax revenues and the rate of employment. The government, acting in the best interest of the nation, can join hands with labor and management in profit sharing by the use of encouraging legislation to achieve better harmony in our economy. Profit sharing, by its very nature, implies cooperation, and is far more than a mere technique in industrial relations. It is not only an ideal and a dream, but an intensely practical and successful way to conduct a business.
CHAPTER I

THE PROFIT SHARING MOVEMENT

Origin and European History

The historical origins of profit sharing are usually credited to France. Maison Leclaire, called the "father of profit sharing," started a plan that aroused great interest in profit sharing. M. Louis Blanc brought it before the French public in 1845, in the fourth edition of his work on the "Organization of Labor." Early examples of profit sharing are the French National Fire Insurance Company in 1820, the British Fire Insurance Company in 1838, and the General Fire Insurance Company in 1850.¹

The Christian Socialists in England became interested in it in their many co-operative movements, but made little progress in the development of profit sharing. The first important plan in England, introduced in 1865, was that of Henry Briggs, Ltd., a coal owners' firm at Yorkshire, England. It later failed when a strike developed.²

It was in England that a famous mathematician, Charles Babbage, made the first active exposition of the philosophy of profit sharing. His idea was

derived from the system he saw in the Cornish mines of paying according to the value of the vein, and the coal taken from it. He believed that this could be applied to large businesses by basing their wage payments on the success of the business.  

The profit sharing plans started in France and England were mostly of a social reform type rather than an incentive to increase production.

**Profit Sharing In The United States**

In the United States the development of profit sharing was primarily the result of employer initiative. Some plans were started in the seventies, and profit sharing did not gain any importance in this country until the eighties.

In 1882 the first organized American effort to spread the merits of this means of industrial cooperation was made with the formation of the Association for the Promotion of Profit Sharing. It only lasted four years, but the idea of profit sharing was explained to the American people through their magazine, speeches by members, and press releases.  

Early profit sharing plans, except for a few, did not enjoy much success. A survey in 1896 showed that fifty plans had been introduced. Thirty-three of these had been discontinued permanently and five had been indefinitely discontinued, leaving twelve systems still in operation.

Famous early American plans are those of the Brewster and Company of

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New York, N. O. Nelson Company of St. Louis, Missouri, and the Peace Dale Manufacturing Company of Peace Dale, Rhode Island. Newspaperman Horace Greeley introduced a plan for his New York Tribune employees.\(^6\) One of the most famous profit sharing plans was set up at Cincinnati's Proctor and Gamble plant in 1886. The Ilg Electric Ventilating Company of Chicago, a plan still in operation, started at the beginning of the century.\(^7\)

The periods of increased business activity prior, during, and after the First World War brought about a great interest in profit sharing. These years were characterized by high profit levels, restive labor, fear of radicalism, lowered worker productivity and employer-employee conflict. Some of the current plans which were started during this time were the Eastman Kodak Company, Sears, Roebuck and Company, and the Joslyn Manufacturing and Supply Company.\(^8\) Management, however, was more interested in employee-stock schemes, and profit sharing was more for the benefit of restricted, management-supervisory groups.

The years of the "great depression" brought about the abandonment and suspension of many employee profit-sharing plans, but a gradual upsurge of new and old profit-sharing plans developed in the late thirties. Before World War II, the most comprehensive study to date of profit sharing was conducted in

\(^{(3\text{rd.ed.}, \text{New York}: \text{D. Van Nostrand Co., Inc.}, 1947), 370.}\)

\(^{6}\) Lyle W. Cooper, "Profit Sharing," Encyclopaedia of the Social Sciences, Vol. 11, \(^{489-490.}\)

\(^{7}\) Senate Report. Survey of Experiences in Profit Sharing and Possibilities of Incentive Taxation, (U.S. 76th Congress, 1st session. Senate Report 610), \(^{71-73, 1939.}\)

\(^{8}\) Ibid.
1939 by the United States Senate Committee on Finance, following the adoption of a Senate resolution by the late Senator Arthur H. Vandenberg of Michigan. The reports and findings of this Committee started a new interest in the sharing of profits on the part of management and the American people.

Recent Developments In Profit Sharing.

Profit sharing has reached its greatest development in the United States during the last fifteen years. With wartime and post-war prosperity, profits have been large, and many plans were started. Figures of the Bureau of Internal Revenue show that over twenty-five hundred profit-sharing plans had qualified by the end of 1946, for tax exemptions under the requirements of the Internal Revenue Code. Discontinuances are now lower than ever. In surveys conducted in 1920 and 1934 over half the plans had been discontinued, while in 1937 sixty per cent were abandoned. In a 1948 survey only seventeen per cent of the plans studied were discontinued.⁹

Representative Clara Boothe Luce introduced a House resolution in 1947 calling for another survey to study the sharing of profits as a means to industrial peace. Senator William S. Knowland, in the same year, 1947, urged the adoption of a similar resolution as a part of the general movement for industrial peace.

The Council of Profit Sharing Industries was founded in 1947 by the late Hiram C. Nicholas, then president of Quality Castings Company, Orrville, Ohio, and some of his friends and business associates in Ohio. These men had experienced success with profit sharing and felt that our whole economy would benefit from the spread of the profit-sharing concept.

The Council exists to study the methods of profit sharing; to be a clearing house for information on profit sharing, and to help spread the theory and practice of profit sharing in industry. In 1953 the Council had over six-hundred member companies. Another organization that aims to discover and publish facts, favorable or otherwise, about the experience of American companies with profit sharing is the Profit Sharing Research Foundation of Evanston, Illinois. This organization is an outgrowth of the Research and Planning Committee of the Council of Profit Sharing Industries, but is separately directed and financed.

The Meaning of Profit Sharing

The term "profit sharing" is often used to mean any extra payments over the basic rate or wage. They would include anything from cash bonuses, supplemental wages, guaranteed wages, deferred compensation, and retirement plans for employees. This confusion over the meaning of the term of profit sharing has hindered the profit-sharing movement over the years. In a recent survey on profit sharing, undertaken at St. Louis University, the gathering of material in the St. Louis area was hampered by the lack of commonly accepted terminology in the definition of profit sharing.

The International Co-operative Congress in Paris in 1889 defined


profit sharing as follows: "Profit-sharing is an agreement (formal or informal) freely entered into by which the employees receive a share, fixed in advance, of the profits." This definition has two essentials and implies a third possibility of true profit sharing. The amount to be shared is related to the profits of business; management would be committed in advance to a share of profits, and it seeks to make profit sharing an economic fact as well as a moral right. 13

Albert Galtatin's, called the father of American profit-sharing, concept of profit sharing was that "the democratic principle upon which this nation was founded should not be restricted to the political processes, but should be applied to the industrial operation." He believed you could have Democracy in industry as well as political life. 14

Differences over the meaning of profit sharing was probably increased by the study made in 1939 by the United States Senate. Profit sharing, to the committee making the study, meant "all payments, to employees regardless of the form in which they are allocated or distributed, which are in addition to the market or basic rate." This definition was probably necessary as the nature of the study was an investigation into the whole field of extra compensation to employees. It included all employee, benefit plans, where the employer makes a contribution or incurs any expenses. 15

The Council of Profit Sharing Industries has defined profit sharing as: "Any procedure under which an employer pays to all employees, in addition

to good rates of regular pay, special current or deferred sums, based not only upon individual or group performance, but on the prosperity of the business as a whole." This definition goes further than the International Congress' definition. It includes good rates of regular pay as a foundation, and bases the distribution of the profits on the prosperity of the business as a whole. The employer is not giving, he is paying, to all employees and not just a select group. It does, however, include many plans in which the amount of employee profit sharing is not predetermined.

The meaning of profit sharing has advanced from the early period, when the plans were based on the moral concept, to the present time, when it is now recognized not only as a combination of ethicalism and idealism, but also hard practicality. The definition of the Council of Profit Sharing Industries will be used in this thesis because of its wide acceptance and the meaningful scope of principles imbodied in it.

CHAPTER II

MANAGEMENT AND PROFIT SHARING

Management is divided over the merits of profit sharing. The past history, lack of knowledge of just what profit sharing is, bad experience, and a difference of philosophy, are some of the reasons for this division in the ranks of management. The purpose of this chapter will be to look at the role that management plays in profit sharing.

Why Profit Sharing Plans Are Established

Many reasons are given by the businesses that have profit sharing as to why they have established these plans. They differ from one another as much as the plans themselves vary from business to business. Moral, social, political, and economic criteria are to be found in the many reasons why managements established profit sharing in their businesses.

Many companies believe profit sharing to be not only a socially sound but a desirable and smart feature of a good business policy. It is a means of educating employees on how a business works, and to what extent the employees take part in that business. It also helps to stabilize the working force. This would reduce the costs which are caused by an excessive rate of labor turnover. The expenses involved in hiring and training a new employee are high, and profit sharing can reduce them.
Other companies feel that profit sharing creates good human relations, and brings about a mutual cooperation between employers and employees to make the business more profitable for all concerned. It is also good psychology in that it removes the mental barrier between employers and employees, and makes their goal the same: the obtaining of more profits.

Some believe it is the answer to industrial peace, and that profit sharing would help reduce the number of strikes and grievances. A good example of industrial peace brought about with the help of profit sharing is the American Velvet Company and the Textile Workers' Union of America. The company was faced with poor business conditions, a hostile attitude between the parties, and an immediate past of sixteen months of strike. The union members had lost large sums of wages, and faced the loss of their jobs and homes.

Clarence A. Wimpfheimer, the company's president, offered a profit-sharing plan to the workers. They refused at first, but he won their confidence when the company offered to share profits for a past year by paying each employee eleven per cent of his wages as his share of the profits. This was the beginning of an idea and philosophy which has brought industrial peace and profits for the company and the employees.¹

More efficient production and a reduction of production costs are claimed to be the reason for establishing a profit-sharing plan by others. Wasteful handling of material, machines, and tools would be reduced by the employees. The employees would want to reduce costs, and they would more freely

offer suggestions on how it could be done. The employee would realize that the savings he makes possible will result in more profits, and he will thus receive more money in his pay check as a result of his savings in costs.

It creates a desire in the employee to do better work, because he realizes that he will benefit by his increased efforts. Allied with this reasoning is the point that profit sharing gives recognition to all employees. Many employees have the feeling that their efforts are not important or recognized in our highly mechanized society. They would become members of a team in profit sharing, and with it the realization that the success of the team depends upon the efforts of each member. It is also contended that the cost of supervision can be reduced greatly by profit sharing.

Some members of management consider it as a means of spreading the purchasing power to keep our economic machine functioning smoothly. Profit sharing is considered by some to be good world strategy, because it would increase the productive power of American industry, and thus draw the attention of the world to the ability of our system to satisfy the material needs of mankind.

Others feel that it helps fight the evils of Communism and Socialism. It promotes harmony among workers and management, and thrives on cooperation, while Communism stresses the theory of the class struggle and strife between the workers and the employers, to promote its evil ends. Profit sharing really makes the employee a part-owner, and Socialism and Communism would have no appeal for the worker who owns at least a partial interest in capital. Property also gives man dignity, and by providing the workers with an interest in property, or at least the means to obtain property, profit sharing helps fulfill
the moral responsibilities of American industry to society.

Some managements have been influenced by the fact that profit sharing is endorsed by many political, labor, and religious as well as management leaders in our society; i.e., the late Senator Arthur H. Vandenberg, Reverend Bernard W. Dempsey, S.J., of St. Louis University, the late Senator Robert A. Taft, and George Baldonzi, A. F. of L.²

Pitney-Bowes, Inc. conducted a survey of their stockholders, and it included questions on profit sharing to test their attitudes toward the plan. Eighty-one per cent favored the plan, and only six per cent desired any change. The reactions of the larger stockholders were practically the same as those of the smallest. They both rated profit sharing high on the list of factors contributing to the company's postwar success.³ This is the report of the survey of only one company's stockholders, but many believe the stockholders of most companies would surely be in favor of a plan that can increase the value of their investment by increasing productivity that workers and stockholders can share.

Results of Profit Sharing

Many people favor the principles of profit sharing, but are skeptical of its value to business. They contend that profit sharing does not pay, or will only work in the smaller companies in our country. They want tangible evidence of the economic value of profit sharing. The many profitable companies

² Profit Sharing, (Akron: Council of Profit Sharing Industries), 3.
that have profit sharing offer to show these people the tangible evidence they want. In 1950 the payments from the profit-sharing plan at the Sheaffer Pen Company, Fort Madison, Iowa, meant a twenty-seven per cent increase in wages for employees, and a bigger dividend return to the owners. The company felt that the plan was so good that they established it in their new Canadian plant.4

Pitney-Bowes, Inc. reports an estimated forty per cent increase in productivity since the war's end, and the stockholders' dividend rate has increased from fifty cents to one dollar a share. They believe that profit sharing is a big factor in their increased production and profits.5 Another example of what profit sharing can do is the Commercial Steel Treating Company of Detroit, Michigan. In September, 1947, the money value of their average production for an hour of labor was $3.53, while in September, 1951, it was $6.23.6 Other good examples that profit sharing does pay can be found at the American Velvet Company; Sears, Roebuck, and Company; and Proctor and Gamble Company.

The answer to how does it pay, can be found in some of the objectives of management in establishing profit-sharing plans. A decrease in taxes is effected, especially when you have a high excess profits tax. Reductions in


6 Lucas S. Miel, Management Report No. 149, How We Doubled Productivity With Profit Sharing, an address given before the California Personnel Section of the Western Management Association, 1952.
reject or salvage material, labor turnover, lateness, absenteeism, grievances, strikes, price to consumers, and the need of supervision are some of the results of profit-sharing plans. Many immeasurable intangibles such as better human relations, a general sense of security, and a real interest in the company's future, are the achievements of good profit-sharing plans.\footnote{Council of Profit Sharing Industries, Revised Profit Sharing Manual, (Ann Arbor, Michigan: Edwards Brothers, Inc., 1953), 3.}

It has been said that profit sharing only works in small companies, and would not effect our economy much. Most of the businesses in the United States are small, and if profit sharing can help only that group, it is still able to make a real contribution to American business. Profit sharing works in large companies, too, as proven by the experiences of Sears, Roebuck, and Company, and Proctor and Gamble Company.

**Analysis of Reasons Why Profit Sharing Fails**

The biggest argument against profit sharing is probably the one that many profit-sharing plans have failed. This argument has to reach back into history for material to support its claims. The opponents of profit sharing hesitate to use the present period because of the high degree of success that profit-sharing plans have had in the last ten years. There still are failures, and the experience of the past can help make the present profit sharing plans wiser and sounder.

Certainly you cannot have profit sharing, if there are no profits to share. During the "Great Depression" many businesses failed to yield a profit, and they had to discontinue their plans. The long period of time when there
were no profits really hurt the profit-sharing movement. Some plans that were soundly installed survived, but many failed because they had just got started, or the economic situation did not let them develop.

Many failures of plans can be traced to a lack of understanding of the plan itself or profit sharing in general by employers and employees. Plans were not worked out in detail, or they were not clearly understood by the employers or employees. Some companies just wanted to get rid of the union, or even force wages down. Discrimination was found in some plans, or the employer wanted to reap all the benefits. Employees often felt that they had the money coming to them, while others just refused to cooperate. Other reasons are company re-organizations, mergers, or a substitution of other benefits.

The above reasons, and many more are now being studied by the Council of Profit Sharing Industries and individual management representatives to prevent failures in the future. This is probably one of the big reasons for the current success of many profit-sharing plans. The growth of a knowledge of profit sharing on the part of employers and employees will eliminate many of the reasons for failures in profit-sharing plans. The better economic situation will help to prepare for and survive periods of no profits.

Classification of Profit Sharing Plans

Profit sharing may be classified in general as: the current

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distribution type, the deferred or trusted type, or as a combination of the two. Most of the pre-World War II plans were of the current distribution type, but with the entrance of government regulations, the trend has shifted to the deferred type. Each employer's own individual situation usually determines the type of plan used by him.10

Under the current distribution type, a certain percentage of the profits are paid, as earned, to the participants, usually in cash, but sometimes in other forms of remuneration. The intervals are usually quarterly, semi-annually, or even more frequently. The deferred type specifies that a certain percentage of the profits should be deposited in a fund or trust for distribution later under defined conditions. Combined plans are those that pay out some profits as earned, and defer the payment of the remainder until specified conditions exist.

The current distribution type has some attractive advantages. When payments are more frequent, they are more visible evidence of the results of profit sharing to the employees. Plants that have many young employees are more likely to prefer this type. It gives the employee more freedom of choice in deciding what to do with his share, and also enables him to raise his standard of living immediately through the increased purchasing power. One of the disadvantages of a current distribution type plan is that people are easily tempted to spend their money, rather than save it. The laying away of the funds under the deferred type conveys the idea that the profit-sharing payment is something extra, and the employee wouldn't come to look

upon it as just a part of their wages.11

The deferred type has grown greatly in recent years. It offers many advantages, especially in the area of taxation. Contributions to a qualified profit-sharing trust are deductible in measure of net income, provided the company qualifies under Section 165 (a) of the Internal Revenue Code as amended. The cost to the employer can be as low as eighteen cents on the dollar. The difference would otherwise have been paid to the Government in income or excess-profits taxes. The actual cost is determined mostly by the employer's tax bracket, and the amount specified in the profit-sharing formula. This type of plan appeals to employees who wish to provide for their old age or some disability. The employee's share is taxed in the year received by him, not in the year earned. Thus, he will probably have a lower tax rate later, if profits are paid after retirement when his income is much less. The earnings and capital gains of qualified trusts are tax exempt.12

It has been said that the deferred type is a paternalistic devise of management. This need not be true. It is quite in harmony with the employer's function to encourage his employees to save, and might even be considered part of his duty to society. If management wants to use this way of encouraging savings, it would not be unethical.13

The biggest problem in a deferred type of plan is presented when it

11 Ibid., 6-7.


is used as a pension fund. Since the contributions are based upon profits, the element of security is often missing. If the company has a period of no-profit years, the retirement funds may be very low, and the employee that retires receives very little money.\footnote{14} Plans that have been in operation for a long period of time usually have a big trust or fund built up. The problem usually lies in the plans that have just started, or in the case of no profits for a number of years. Many small businesses cannot bear the fixed cost of a pension, or would not want to strangle their financial position in the future with a heavy fixed cost. They find that a deferred type plan can provide some form of retirement to their employees, and not handicap the growth of the business. Others have a small pension plan with a deferred plan attached in order to give the employee some security, and not harm the financial structure of the business.\footnote{15}

The Profit Sharing Formula

The formula that establishes and distributes the profit-sharing fund is very important in the profit-sharing plan. This formula must be fair to everyone concerned. If the formula does not provide adequate and fair compensation to the employees, it may hurt the whole profit-sharing plan. The formula should be subject to revision. This would take care of any inequities or other situations that may arise later.

There are many types of formula for determining the amount to be

\footnote{14 National Industrial Conference Board, Inc., Profit Sharing for Workers, Studies in Personnel Policy, No. 971, New York: 1948, 43.}

\footnote{15 "Combining Pensions and Profit Sharing," Management Review, Vol. 41 (September, 1953), 761.}
distributed, and also many different methods are used for allocating it to the eligible individuals. The most common means is a percentage of the profits before taxes and before dividends. Another frequently used method is to base the reward on wages or salaries of the participants. It is presumed that the wage and salary scales have been equitably set, and that they also are an indication of the employee's contribution to the enterprise. A percentage of profits after taxes but before dividends, or after taxes and after dividends are paid, are other basis for profit-sharing.

16 A. Lee Belcher, Profit Sharing and Bonus Plans, Talk before the NAM Institute of Industrial Relations at Sulphur Springs, West Virginia, November, 1953.
CHAPTER III

ACCOUNTING AND FINANCIAL ASPECTS OF PROFIT SHARING

The Determination of Profits

One of the most important aspects of profit sharing is to determine fairly the profits of the business. This places a great responsibility on the accountant. He not only has to determine the profit, but also has to be able to explain how he arrived at that profit to all the parties involved. The employees and stockholders will become dissatisfied if they think the company is not giving them their fair share of the profits, and the whole concept of cooperation is endangered.

No uniform methods of accounting are followed in determining profits, and the circumstances surrounding the business largely shape the procedure used. Profits are usually the amount remaining after payments for such items as material, labor, interest, the cost of keeping the business property and equipment in good condition, other operating costs, and certain taxes (other than income taxes). When you subtract the income tax from the resulting figure after all the above mentioned items have been considered, you have the profits available to the firm.

The amount that is available for distribution between the owners and the employees in a profit-sharing fund present several problems. Some plans allow a stipulated rate of dividends on the invested capital before the fund for employees is established. Other plans determine the fund directly
by the rate of dividends declared on the capital stock, and the employees receive a rate, based upon their wages, which is in a ratio to that declared on capital.\(^1\)

There are advantages and disadvantages to each method of computing the fund. Under some funds the employees would receive at least some part of the profit in normal years even if no dividends are first given to the investors. The investors in these cases may not receive what they consider a fair return for their investment, and for the risk they take in investing their money in the business. This would discourage new capital.

If the fund is directly determined by the rates of dividends declared on capital, and you have no profits in a particular year, a good portion of the next year's profits may have to go to the capital investors in the form of dividends for the previous year. This leaves little or no profits for the workers to share for two years or more.

Another situation may also arise when there is just enough profit to pay the dividend rate for investors, and the employees will not receive any profits, even though there was a profit shown on the balance sheet for that year.

When the formula for determining each group's share of the profits is drawn up, careful consideration must be given to all these factors. One of the best ways to satisfy both the owners and employees is to have a certified public accounting firm certify the reliability of the financial statements as a basis for determining profits. Also the provisions of the plan must be

\(^1\) Chamber of Commerce of the United States, *What You Should Know About Profits*, 1953.
understood by all the parties involved. If there is disagreement on particular points, they should be worked out by a committee composed of the management, the owners, and the employees.

The accounting system must also be organized so that is inexpensive and informative. If it is too complex or expensive to operate, small and medium-sized companies could afford it.

**Importance of Investment**

Years of high profits and the rapid growth of profit-sharing plans, especially those of the deferred type, have caused a big problem. The problem is to determine where the funds accumulated from deferred profit sharing should be invested. Caution must be used because the future income of the participants and the plan itself depend upon safe, profitable investments. A committee composed of management, owners, and employees should be formed to supervise the investment procedure. A clause setting up such a committee may be inserted in the investment agreement. An example of how these funds can grow is evidenced by the purchase of E. G. Shinner and Company, a midwest chain of retail markets, by its own employee's profit-sharing fund, which was established in 1942. The trust fund, in purchasing the assets of the business, has created a new corporation. It is subject to regular corporate income and excess profits tax, but dividends received by the trust from its stock in the new corporation will be exempt.\(^2\)

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Many plans, which have provisions to buy company stock, have done very well in the last decade. One big disadvantage of this type of plan is that the stock of the company may drop in market value if there should be years of no profits. This is placing the whole investment in one place, and it can lead to serious losses. Most of the plans now are spreading their investments by various means. This may not produce the big profits that investing in company stock might, but it gives more security to the participants in the plan. Since the deferred plans are really a means of saving for the future, the element of security in the investment of the fund must have the highest priority.

Types of Investment Agencies

There are investment agencies to help in the investment of money accumulated under a deferred profit sharing plan, the main ones being banking institutions, investment houses, mutual funds, and insurance companies.

These investment agencies have the research facilities to study the best means of investment, that the average company does not have. By the careful selection of many types of investments, and a better knowledge of the shifts in investment called for with changes in economic conditions, they can offer higher income and better security. Small companies that do not have large funds, can receive the advantages of having their money pooled with others, thus gaining greater income and security with diversification.

Investments by these various agencies can be shifted from common stocks to bonds and back again as the economic conditions change. Advantages of investing in common stocks are: common stocks pay a higher rate of dividends
and rise in market value during inflationary times, thus offsetting the de-
preciation of the dollar; better return than higher priced bonds, and the
effect of income is important because the income, being tax free during the
life of a trust is compounding at its gross rate. Common stocks have certain
disadvantages: they decline in a deflationary period, and suffer extreme
fluctuation in price.

Some insurance companies have advocated investing at least one-third
of the fund in insurance. The main reason for investing only one-third is
that the contributions to the fund are contingent upon the earnings of the
corporation or business. The earnings of a business may very greatly from
year to year. If you have an insurance policy or an annuity, both of which have
a fixed charge, you have to meet the premiums on them, or they will lapse or
lose their value. Other reasons are the need for diversification of investment,
for the growth of income to provide for the inflation of prices.

Advantages of inserting insurance policies in the investment agree-
ment are many. Greater death benefits are made possible for the family of
the employee. If the worker dies before retirement, his family would be
helped by the proceeds from the insurance policy, and this would make the
worker feel more secure. The policy can also be converted to provide a
retirement benefit to the employee. Banks and investment houses are not
annuity-paying institutions and cannot distribute the interest and principle
of the employee's account until it is exhausted. A tax advantage is also
secured because life insurance proceeds are not taxable, as are proceeds from
the trust, if paid in a lump sum. The annuity cost would be pegged at the
rates when they were taken out, and not at the time of retirement.
One important disadvantage to insurance is that it would not cover everyone in the plan on the same basis. Many people cannot obtain insurance because of physical defects, and these are the ones who often need the security more than anyone. The insurance companies in most cases would take these people in the plan under certain conditions. These conditions are usually a higher rate of premium or certain restrictive clauses for them. With more and more companies using insurance as a part of their investment, the ideal situation of group coverage including every employee may be possible in the future.

Explaining Profits to the Employee

The average employee would be confused by the figures that appear on the financial statements of most businesses. He wants to know how the profits are determined, and what is his share. He wants these figures put into terms that he can understand. One of the major reasons for opposition to profit-sharing plans is that the employee would not be able to determine if he is getting his fair share of the profits. Many companies try to help the employee in providing for his future, but either fail to make sufficient profits, or do not publicize the fact as they should.

The important items in the reports to the employees could be dramatized. Instead of putting them under headings such as selling, wages, employee benefits, etc., they could be broken down into more meaningful phrases. If comparisons are used, dollars and cents rather than, or in addition to,

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percentages could be used. Intangibles are hard for the average employees
to understand. A picture of a new building or machine can be used to illustrate different costs.\(^4\) Concerns have to set aside a certain amount of their
profits for improvement of products, service, or expansion. This will help
both the company and the employees in the long run, but unless they are brought
out and explained to the satisfaction of the employees, many would think the
company is hiding profits.\(^5\)

New trends in helping the employee understand profits are now being
used by management. The employee reports are becoming more of a verbal
report. Pitney-Bowes, Inc. has been very successful in the use of this tech-
nique. Audio-visual devices are also being widely used. Another interesting
trend is the use of the personal interview. A company official may be inter-
viewed by employees in a role-playing situation, and the report is brought
out by the conversation. Television or radio programs could be used to reach
widely scattered plants where the cost is not too great. All the above
personal approaches should be followed up by written statements in a letter
to the employees or in the company's magazines.\(^6\)


CHAPTER IV

ORGANIZED LABOR AND PROFIT SHARING

The Situation Today

Organized labor is not opposed to the principles of profit sharing, but some unions are skeptical of it because of its past history, and the problems involved in its administration. Several firms have been able to work out agreements with unions in regard to profit-sharing plans, but these have been mostly on the local level. Many national unions do not have a policy on profit sharing, but let the locals decide on the merits of the situation.

The reasons for organized labor's suspicion of profit sharing can be eliminated by mutual cooperation between labor and management. Mr. Clarence A. Wimpfheimer, President of the American Velvet Company, brings out this point in Partners magazine. He emphasizes the fact that in our system of free enterprise, there is room for employee and employer organizations in order to defend and promote their own interests. The two types of organizations are compatible and compliment each other, especially when mutual partnership exists

through profit sharing. In the case of the American Velvet Company and Local 110 of the Textile Workers Union of America, management and labor have been able to benefit by their mutual cooperation. When inventories were high, the workers suggested a four-day week on their own accord. Profit sharing has been an incentive for these workers to be more interested in the business, and contribute towards the objective of improving the business and their own status in life. Management and labor both share in the bigger profits, and also better human relations are found in this plant.

In the past many employers have used profit sharing as a device to keep unions out of their plants. Many managements saw that profit sharing did not work under that situation. If the pay and working conditions were below normal, there existed a need for unionization, and eventually the union came in and changed the situation.

The claim that profit-sharing undermines the union's political strength is challenged by the fact that profit sharing thrives on mutual cooperation, and political strength achieved by strife and struggle will not bring about good relations between management and employees. Managements that recognize that men have a right to organize will not want to undermine the political strength of the union, but will want its help in achieving greater unity between employer and employee.

The past history of profit sharing has influenced many union leaders


3 George S. Paul, Causes of Industrial Peace Under Collective Bar-
to believe that such schemes are not stable. Many plans were started in times of prosperity, and discontinued in bad periods. When profits went down or there weren't any, employee dissatisfaction mounted and many plans had to be abandoned. This argument may have been good ten years ago, when you could point to the failures due to the "great depression," but the economic picture has changed. Many plans have been in operation for more than ten years now, and have built a good foundation to survive periods of low profits or even no profits.

Organized labor has fought for a high basic rate of pay, and they fear that under profit sharing, the emphasis will be shifted to increasing the profit-sharing payment. The worker would not have as high a steady income to depend upon, and it would bring about greater risks and uncertainties into the workers' lives. Under the Council's definition of profit sharing, organized labor would not have to worry about a high basic-wage or a steady income. A profit-sharing firm pays a good wage, and profit sharing is taken care of after that good wage is paid. Without that the employer is not practicing true profit sharing, and labor has a valid argument against other types of employer's plans.

Some union officials contend that management likes the "flexibility" that is possible under profit sharing. In a period of good business, the worker receives more money, but in periods of poor business, that extra income is automatically taken away. When it is in the wage contract, it cannot be

5 Henle, op. cit., 14.

5a See page 7.
taken away without negotiations. Another part of this argument is that in poor business periods the worker's pay, instead of the company's profits, takes the risks of competition. This "flexibility" does not really exist in true profit sharing. The worker receives a good wage, and the profit sharing is extra and contingent upon profits. This argument would have validity if the worker's wage were entirely determined by profits, which is not the case in true profit sharing.

The risks of a business are passed on to the workers in profit sharing is another argument used against it. If management makes a bad judgmentment regarding inventories, sales campaigns, etc., the workers will suffer a loss of income through layoffs, short hours, etc., even through they had no part in the making of the decision. It is true in all types of business that workers do suffer when management makes errors. This reason cannot, therefore, be used only against profit-sharing industries, because all workers take this risk.

Some people argue that workers can increase production by speeding up, but that their health is endangered and they become so tired it is difficult for them to take care of their family and social obligations. Profit sharing is not like a piecework system where this might be true because the worker's production determines his pay check. Savings in profit sharing are created by more efficient means of production, less waste, less turnover, greater team spirit, and a general over-all interest in the business.

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Another point that some union officials bring out is that profits depend more on the company's ability to sell, and the price they receive for their products, and thus the worker can have little influence on the size of the profits. To a certain extent this is true, but the quality and quantity of output are directly related to the employee's efforts, and, therefore, the price and ability of the company to deliver on orders effects the progress of the company. Poor workmanship and low output on the part of the worker can ruin a business, because the company loses customers through the inability of the company to sell or obtain a certain price for the product, both of which effect the profits.

Probably one of the biggest reasons why unions are suspicious of profit sharing is that it creates inequality in the take-home pay among workers doing the same work. Profit sharing combined with a good wage can cause one plant to be far above the uniform rates that unions often seek for the industry as a whole. Workers in other plants, who belong to the same union, will question the fact that the workers in the profit-sharing plant are taking home more money than they are for the same type of work. This causes an inequality in income that is hard to explain to the members of the union. The prestige of the union is often hurt, and so is its membership strength. Unions may, therefore, strive to have profit sharing in all the plants under its jurisdiction, and thus try to help all their members, rather than try to abolish it in the plant where it works well.

7 Ibid., 3.
8 C. Canby, Balderston, Profit Sharing For Wage Earners, (New York: J.J. Little and Ives Co., 1937), Ch. 2, 17.
Many people contend that profit sharing discourages mobility, since the workers would hesitate to change jobs when an opportunity exists, because they would lose their profit-sharing payments. This immobility factor can also be said to exist where they have pensions and seniority agreements. It is up to the worker to weigh all the advantages of one job as compared to another, and then make his decision. The profit-sharing payment is offered to help the worker, and it is not designed to hinder his progress. Other non-monetary factors determine the workers' mobility, and not just the profit-sharing payment.

Payments that are too small will not be appreciated by the workers, and might even make them feel cheated, because they may feel that the owners and management benefit more than the workers.9 It must be remembered that profit sharing is not charity, and that the workers can help make the payments beggar. If the business cannot afford a presentable payment there really isn't any basis for profit sharing. Management and stockholders do benefit by profit sharing, but in true profit sharing their benefits depend upon a mutual agreement as to what is a fair share for all, measured according to the profits of the business as a whole. If management and the stockholders try to obtain too much of the profit at the expense of the worker, it is not true profit sharing because the idea of mutual cooperation is missing.

The recent trend of profit-sharing plans toward the deferred type has aroused new fears in labor. It is argued that this method really creates an inexpensive way for management to provide pensions. Employer's contributions

are only made when they make a profit, and are confined to a certain percentage of the profits. The pension plan thus created does not give any real security because the fund depends upon profits, and over long periods there may not be any profits. Also the older worker who is nearing the retirement age, and has only a few years to accumulate money in the fund will get a very small pension when he retires. Many managements have recognized this weakness, and have revised their plans to correct it. Many plans now provide for the giving of credits in times of no profits, and some have added insurance policies to their agreement.

Objection is raised by union leaders that the employee is caught at times between a double allegiance, especially if he receives stock in the company as a part of his profit sharing payment. When a collective bargaining conflict arises, he will often hesitate as a worker to force his demands against a concern in which he is a part-owner. Union agreements, which include profit sharing arrangements, are becoming more common in American industry. With the inserting of profit sharing in union contracts much of the opposition of organized labor may be removed, because the control of the plan then becomes subject to negotiations and mutual agreement.

In a recent survey made in 1953 by the Profit Sharing Research Foundation a surprising fact was revealed. In a survey of 300 plans it was found that 295,020 employees were non-union, 47,270 employees were partly union, and


CHAPTER V

THE GOVERNMENT'S ROLE IN PROFIT SHARING

The government has played an important role in the development of profit-sharing plans in recent years. There was little worry about government regulations of plans started by management before the Second World War. The employer could deduct his contributions as operating expenses, and the employee reported their whole share of the cash distribution as taxable income. If the contributions by employers went into a trust, the employer could deduct it in the year contributed, and it became income to the employee when received.¹

During and after World War II, the government has enacted many laws pertaining to profit-sharing plans. The tax regulations are some other laws have been favorable to the development of profit-sharing plans. Restrictions have also been placed on profit-sharing plans by the government to prevent abuses. As recent as this year, 1954, the House Ways and Means Committee has voted for an exemption of up to twelve hundred dollars a year on the taxable income of retired persons. If this becomes a law, it will greatly benefit the employees under a deferred-type, profit-sharing plan.²

Taxation And Profit Sharing

The principle tax advantages resulting from the use of a profit-sharing plan are to be found in the Federal and State income taxes, Federal excess profits taxes, State and local taxes on valuations of intangibles, Federal and State inheritance and Social Security taxes, and local taxes concerned with the earnings of the participating employees.

The Internal Revenue Code, and particularly Sections 23(p) and 165(a) give the conditions under which an employer can qualify his deferred-type, profit sharing plan for tax deductions. A cash plan need only meet the test of "reasonable compensation" to qualify for a tax deduction.

The trust or fund under a deferred-type plan must be for the exclusive benefit of employees or their beneficiaries, and not to serve some purpose of the employer. The plan must be permanent in nature, not temporary, and it must be in writing and communicated to the employees. The law does not state these requirements, but the Treasury Department's interpretative rulings have declared them essential. The above rulings are to prevent employers from adopting a plan in periods of high taxation and then discontinuing it in years of low taxes. Contributions to the trust are irrevocable, and the employer can never recapture the money he has contributed. The rights of the employees may be modified or terminated if there has been a previous agreement to that effect.

The plan must not discriminate in favor of employees who are officers, shareholders, supervisory personnel, or highly paid employees. The big test

used by the Commissioner in determining discrimination as far as salaried
employees is concerned is that of "reasonableness." The coverage cannot be
discriminatory either as provided for in Section 165(a). The statute provides
a mathematical formula: either seventy per cent of the employees must be
covered, or seventy per cent of all employees must be eligible, and eighty
per cent of that group must be covered. There must also be no discrimination
as far as benefits and the amount of the contributions by employer for each
employee.

The profit-sharing formula has to be definite and predetermined,
and this has to be in the agreement. A formula that permits the exercise of
judgment by management as to the proportion of the profits to be contributed
will not be accepted by the Treasury Department. The maximum permissible
contribution for a tax deduction under a profit-sharing plan is fifteen per
cent. Any excess can be carried forward for deduction in future years when
contributions fall below this amount. You could also have more than one trust,
in which case fifteen per cent for each trust is permitted, resulting in a
larger contribution.

In the situation where there are state and local taxes on the valua-
tions of intangibles, such as goodwill, a profit-sharing plan offers an
advantage. The reduction of the earnings of a business through contributions
to the fund results in lower values and lower taxes when earnings are capital-
ized for tax assessment purposes.

The Federal Social Security Act of 1939 provides for the exclusion

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4 Council of Profit Sharing Industries, Proceedings, Fourth Annual
of contributions to profit-sharing plans when totaling the amount contributed by the employer to the employees, as a basis for the tax. It is believed that profit sharing would reduce labor turnover, and thus give the company a better "Experience rating" under unemployment compensation.

In the area of Federal and State inheritance taxes, profit sharing also offers advantages by reducing the earnings bases of stocks of a business, and will serve to keep down the valuations that must some day be used in scheduling the stocks of the business. These schedules are used in the assessment of estates and inheritance taxes.5

The employee under a cash-distribution type plan does not gain the tax benefits that he could gain under a deferred-type plan, where the tax is deferred until he actually receives his share of the profits in a lump sum. It can then be reported as a capital gain. Usually he receives the payment later in life, when he is most likely to be in a lower income bracket.

Legislative Action Affecting Profit Sharing

Under the Fair Labor Standards Act, the employer's contribution to the worker through a bona-fide profit-sharing plan is not a part of the employee's regular rate of pay for the purposes of computing overtime. The plan must have for its purpose the sharing of profits over and above the employee's wage, contributions must come solely from profits, and they must be made periodically in accordance with sound accounting methods.6 The require-

5 Winslow C. Morton, Profit Sharing and Pension Plans, (Chicago: Commerce Clearing House, 1946), 32-34.

ments have been subject to constant change in the last ten years because of changes in our economy as a result of wartime and peacetime conditions.

The wage and salary controls under the Wage Stabilization program were suspended by Executive Order in January, 1953, but would have expired on April 30, 1953, anyway. They had a great effect on profit-sharing plans, and give a good indication of how the Federal Government would treat profit-sharing plans, in case controls were necessary again. Profit sharing gave an employer an opportunity to compensate his employees over the regular rate of pay. The biggest problem was to determine if the compensation was really profit sharing or merely an attempt to hide an increase in wages or salaries. Cash plans ran into the most difficulty because the money was immediately paid out, while a deferred-type plan indicated a desire to create a retirement fund, and not to increase wages or salaries immediately.

The Renegotiation Act of 1951 sets down certain rules in determining whether or not the profit-sharing contributions are allowable costs in government contracts. In the case of a deferred-type plan, deductions or contributions to profit-sharing trusts are usually allowable if they meet the requirements of the Internal Revenue Code. The employer cannot deduct more than fifteen per cent, even if he has a formula which permits deductions up to thirty per cent. A carry-over provision in the formula does not apply as far as renegotiations is concerned.7

A cash-type plan that provides for frequent cash payments are not excessive. The law in effect aims to protect the public from profiteering.

The Securities and Exchange Commission requires the business to give information to stockholders when a profit-sharing plan is started, on its progress, and its effect on the business. They sometimes require the business to give information to the employees, if they are given company stock as part of the profit-sharing payment. The purpose of the Commission's role through profit sharing is to protect stockholders, whether they be employees or outsiders, against frauds or shady business schemes.

CHAPTER VI

CONCLUSIONS

Profit sharing is a good example of the unity that can be achieved between management, labor, and government. The government has been able, through the use of taxation and other laws, to help in the development of the profit-sharing movement in the United States. It has not made it compulsory for management to participate in it, which would have destroyed the cooperative spirit of profit sharing. Management has found it a good economic, social, political, and moral way to conduct a business; unions have found that most of their reasons for opposition to profit sharing are not now present, and that plans can be worked out on the local level.

Profit sharing is not the one big answer to industrial peace in the United States, but has provided "isles" of industrial peace throughout this great country of ours. Where profit sharing is successful, one can usually find it the cornerstone of a good industrial relations program, which includes many other benefits. The fact that organized labor approves the principles of profit sharing seems to indicate that when union leaders are assured that profit sharing will not undermine their organizations, and that it can become a part of the collective bargaining agreement, the way for wider acceptance of profit sharing in the United States will open up.

The full-employment and high-production economy we have enjoyed
through the last fifteen years has given profit-sharing plans the foundation they need to survive years of no-profits. The recent increase in the development of the deferred-type plan has created a reserve, which provides profit sharing even during years of no-profit.

Profit sharing has shown its ability to succeed when properly operated. One has only to look at the profits of the companies that have successful profit-sharing plans to see the results. The programs have worked best in the small or medium-sized companies, which form the backbone of American business, but successful plans can also be found in large businesses.

Profit sharing has become a part of our great economic system, and it will grow in the future. Profit sharing is no longer a utopian reformer's dream; it has become an economic reality. The plans may vary from business to business, but the sound principles, i.e., a good wage, recognition of the worker, sum of money fixed in advance, can be found in all successful plans.
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