Engstrom Auto Mirror Plant Case

Motivating in Good Times and Bad

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- Introduction to Engstrom
- Scanlon Plan
- Scanlon Adoption Plan at Engstrom
- Problems and Solutions?
A privately owned business manufacturing mirrors for trucks and automobiles

Located in Richmond, Indiana

209 employees

Use Scanlon Plan as an incentive for staff
Introduction to Engstrom (II)

**1948**
- Creation

**Late 1990s**
- Troubles: unprofitability, production delays

**1998**
- Ron Bent hired

**Dec. 1999**
- Scanlon plan is voted by 81% workers

**2005**
- Downturn in industry

**June 2006**
- 46 employees lay off

**May 2007**
- Need a new solution!

**Economical Context**

1948 1990s 1999 2005 2007
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Scanlon Plan

- Developed in 1930s by Joseph Scanlon, a cost accountant by training and a steelworkers’ union official at a steel mill facing bankruptcy.

- The heart of the plan is the concept of **participative management**.

- The three plan components:
  - the submission of **suggestions for improvement** by employees at all levels
  - the structure of the company committees that **evaluate** the suggestions
  - then the sharing of the fruits of **increased productivity** through monthly bonuses

*Employee Motivation!* Ideally work together to drive big changes in behavior and attitudes!
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Scanlon Plan Adoption at Engstrom (I)

- Employees signed a **Scanlon Bonus Plan Agreement** at Engstrom
- The strategy was to start with the **total sales revenues** generated during a specified period and then establish a percentage of that total as a standard or normative cost of labor, including managerial support.

  e.g. A ratio of 0.50 to 1 would mean that the normative payroll cost was 50% of total sales revenue—and that employees would be paid a bonus for any month in which the payroll cost was less than 50% of total sales revenue (with the size of the bonus based on the percentage of savings achieved).

\[
\text{Basic Ratio} = \frac{\text{Normative Payroll cost}}{\text{Total Sales Revenue}}
\]
Scanlon Plan Adoption at Engstrom (II)

Labour savings

Employees 75%  Engstrom 25%

25%  25%

25% of all bonus (both the employees’ and the company's share) would be set aside as a reserve in case of a deficit month - a month when total payroll costs exceeded allowed payroll.

Production and Screening Committees

- Methods for appointing or electing members established
- To stimulate and evaluate employees’ suggestions

Base Ratio

- Conditions of base ratio adjustment were made explicit: changes in wages, sales volume, pricing, product mix, subcontracting, or technology may lead to increases or decreases in selling prices or standard costs
Suggestion plan process

- Employees suggest ways to improve productivity at the plant.

- **Eight production committees**, each composed of a supervisor and two elected employee representatives, review the suggestions, passing along disputed suggestions or suggestions **costing more than a specified amount** to the screening committee.

- **The screening committee** determines how to handle all these suggestions passed from the production committees and also reviews the monthly bonus calculations from plant management. This committee is composed of:
  - Five employees elected from the production committees
  - Four management representatives appointed by the plant manager
  - The plant manager
## Scanlon Plan Adoption at Engstrom (V)

### Sample bonus calculation:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sales value of production</strong></td>
<td>$4,000,000</td>
</tr>
<tr>
<td><strong>Allowed payroll at 38% (or 38% of sales value)</strong></td>
<td>1,520,000</td>
</tr>
<tr>
<td><strong>Actual payroll</strong></td>
<td>1,280,000</td>
</tr>
<tr>
<td><strong>Scanlon bonus pool</strong></td>
<td>240,000</td>
</tr>
<tr>
<td><strong>Set aside for reserve</strong></td>
<td>60,000</td>
</tr>
<tr>
<td><strong>Bonus balance</strong></td>
<td>180,000</td>
</tr>
<tr>
<td><strong>Company share: 25%</strong></td>
<td>45,000</td>
</tr>
<tr>
<td><strong>Employee share: 75%</strong></td>
<td>135,000</td>
</tr>
<tr>
<td><strong>Participating payroll</strong></td>
<td>1,260,000</td>
</tr>
<tr>
<td><strong>Bonus % (employee share/participating payroll)</strong></td>
<td>10.71%</td>
</tr>
</tbody>
</table>

a. Management adjusted this value for returns, increases, or decreases in inventory—number is not equivalent to shipments.
b. The normal total labor cost is 38% of the sales value of production, or 38¢ for each $1 of product produced at sales value.
c. 25% set aside before bonus distribution to form a reserve to cover deficit months.
d. Actual payroll minus payroll for employees on paid nonworking days (vacation, holidays, jury duty, etc.) or on job less than 60 days.
Example of a Scanlon bonus in a floor worker’s monthly paycheck

<table>
<thead>
<tr>
<th>Name</th>
<th>Hours</th>
<th>Overtime Hours</th>
<th>Hourly Rate</th>
<th>Total Pay</th>
<th>Bonus %</th>
<th>Bonus</th>
<th>Total Earnings</th>
</tr>
</thead>
<tbody>
<tr>
<td>J. Smith</td>
<td>184</td>
<td>36</td>
<td>$15</td>
<td>$3,570</td>
<td>10.71</td>
<td>$382</td>
<td>$3,952</td>
</tr>
</tbody>
</table>

- Bonus paid monthly as part of regular paycheck
- Calculated as (total payroll costs plus vacation and holiday accruals)/sales value of production
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Problems of Scanlon Plan adoption at Engstrom

- Quickly received positive feedback
  - Higher profit and consistent quality standards
  - High morale

- However, things changed over time
  - Enthusiasm faded and dissatisfaction grew
  - **Distrust of bonus calculations:**
    - Company might be “playing with” the numbers.
    - **Suspicious** whenever the management team changed the ratio, which occurred four times between 2000 and 2005 (the final reduction was to 32.6%).
  - **Question of fairness**
    - Supervisors should have received a reduced bonus—“not working as hard as we are.”
What Are the Solutions?

Bent finds no reason to replace the Scanlon with another plan. Can you help him find solutions?
Analysis of the Scanlon Plan at Engstrom

- **Positive aspects**
  - Win-win contract
  - eliciting active employee inputs for improvement
  - increasing communication at all level
  - participation of workers
  - Improving product quality

- **Negative aspects**
  - protection of low performers
  - Complexity & fluctuation of the **base ratio**
  - management-labor conflict- lack of honesty
  - inelasticity for market and economy changes
  - workers began to perceive the bonus as part of their regular paycheck rather than a **reward**, which reduces the durability of plan's results
Possible Solutions - Modified Scanlon Plan

Keep Scanlon Plan, but make modifications

- IMPROSHARE (improve productivity through sharing) plan—a form of gain sharing, focusing on sharing physical productivity gains with employees. Standard hours are calculated for the production of each unit, and Improshare pays a bonus when the time needed in the production process is reduced. Gains realized by working either faster or more efficiently are then split between the employer and employees, and the employee portion is shared among all workers.

  e.g. we set a standard hour for each unit as 10 hrs. The actual production time on average is less than 10 hours. Savings between standard and actual production will be shared between the company and employees.

- Advantages:
  - Easier to be understood
  - Physical productivity is something workers can control
  - Bonus is not a part of regular paycheck any more
  - The plan does not oblige management to reveal sensitive corporate financial information
Other Possible Solutions to Increase Productivity

- **Production Committee and Screening Committee Improvement**
  - Yearly Committees Members Vote Mechanism
  - Improve Screening Committee Structure
    - 5 employees elected from non-committee members
    - Management rep. designated by each dept.
    - Plant Manager
Other Solutions

- Dry shares allocation mechanism (Long term plan for staff perform a consistently and progressively growing contribution to the company to build up Loyalty)
- Professional Development Plan for employees' career path
- Leadership Cultivation
- Professional Ethics Establishment
Thanks for your attention!