PROFIT SHARING IN MULTINATIONAL CORPORATIONS

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Multinational corporations are proliferating throughout the world. They are coming not only from the United States, but from Europe and Asia as well. The purpose of this article is to build a case around which is based the concept that profit sharing may be a force which will enable multinational corporations to transcend local situations and bring all employees to work for the benefit of the parent corporation, regardless of the corporation's nationality. The author recognises that local nationalism will always play an extremely important part in the eyes of employees and that corporate citizenship will continue to be secondary. However, it is clearly apparent that the influence of the multinational corporation is only beginning to be felt, and when combined with the influences of transnational unionism, corporations must begin to find newer and better ways of bringing employees under the corporate umbrella and working for the good of the corporation. A force which can provide one meaningful step in that direction is sharing the profits of the enterprise.

Individual Dignity

The speciality of the free enterprise system over the years since its inception has been to provide the owners of the business with a fair return on their capital. This comes from the process in which owners loan or invest money in a business. The enterprise uses the money for creation of products or services which are purchased by people and which in turn, hopefully, return a profit to the owners. Owners measure the success of the enterprise through the amount of assets which are returned to him. This concept of return on assets is one which capitalists around the world use in assessing their propensity to make new or additional investments.

With few exceptions, the concept of employees receiving a return on the investment of their time in the enterprise has only occurred in recent years. Employees, as much as investors, invest a portion of their lifetime to the well-being of the corporation. In doing so, they are entitled to expect a certain amount of return on their own assets. This has been recognised by some corporations, usually operating on a national basis, but has been rarely recognised by large multinational corporations, except where legally required. But, then, employees are equally entitled to expect return on the investment of their time and services, particularly where this investment occurs over a long period of years. A corporation can make up the entire lifetime of many of its employees. And their contribution, when measured solely in terms of salary, may inadequately reward them in terms of time spent. Thus, *just as investors are entitled to expect a return on their assets, so are employees entitled to expect a return on the investment of their assets. This return, which we will discuss, is the concept of universal profit sharing.*

What is profit sharing? Profit sharing is a programme where employees, through some defined programme established by the company and approved by the union, receive a return on individual assets. In other words, as the enterprise succeeds, employees receive a piece of the action. Some employers think of this as an employee incentive. They visualise it as a device for encouraging employees to achieve and maintain high levels of productivity. But profit sharing may also serve a higher master. The concept that employees are more productive under a profit sharing system is a side benefit of involving the employees in the goals and objectives of the business. That they are productive stems from the fact that they share in a piece of the action, and that when the corporation is successful, so are they.

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Vesting conditions

Requirements for vesting are customarily used as a 'golden handcuffs' vehicle. Vesting means that while you are a participant of the programme, you may not be able to receive the entire value in your profit sharing account in the event of termination. A partially vested individual with a significant account balance is disinclined to terminate. Therefore, turnover is reduced and the company retains employees until the vesting conditions are satisfied.

Vesting conditions are frequently as few as one year or as many as fifteen years. Most companies tend to favour larger vesting schemes in the neighbourhood of five to ten years. This means that an individual who participates in a plan with a ten year vesting requirement, and who leaves at the end of five years, may only receive one-half of the balance in his profit sharing account. Many of these schemes are also counter-productive in that they occasionally encourage people to stay for reasons which are totally company related, even in the event that they dislike their jobs.*

If profit sharing programmes are designed to encourage employee ownership and a feeling of participation in the success of the enterprise, then vesting schemes are also counter-productive to that purpose because they are schemes which tend to be viewed by employees as a threat — 'if you leave, I'm not going to give you the full balance in your account' — rather than a concept of high expectations which encourage employee participation in ownership.

Age Conditions

Many profit sharing plans have provisions which permit entrance into the plan only upon attaining a specified age, such as age twenty-one. For companies with high labour intensive work forces, this is also a plan which may be easily counter-productive to the goal of including all employees, because the minimum employment age in many companies is sixteen or seventeen years old. Therefore, it would be easy for one to be excluded from profit sharing for four or five years in the event that they were hired at the minimum age.

Who should share? It is good practice for companies to develop plans which include all full-time employees, perhaps with a minimum one or two year waiting period, but which are not discriminatory towards age or union membership. In most cases, every step toward restricting participation is retrogressive and counter-productive toward the goal of most profit sharing plans.

WAYS TO DETERMINE THE CONTRIBUTION

Profit sharing schemes typically include formulas which are calculated by taking a percentage of the profit, before or after tax, for distribution among employees, based on the annual compensation of the employees participating.

Another technique for determining profit sharing contributions is through using a table based on any number of varieties of relationships of company indices. A table could be constructed to yield a profit sharing percentage based on the delta increase in profits, or based on the company's return on assets, or based on the company's percentage growth in sales or percentage return on assets increase. Most formulas provide that in the event of a company experiencing a marginally profitable or unprofitable year, the profit sharing contribution rapidly approaches zero, and, in the case of unprofitable years, is always zero.

Some companies elect to determine individually the profit sharing contribution each year. In those cases the contribution is determined by the company's board of directors or a managerial committee appointed for that nature. The advantage to this is that companies may selectively increase or decrease the contribution at their own discretion. The disadvantage is that employees, particularly unionised employees, will be suspicious about the company's contribution, thinking that in years in which the contribution is less than what is deemed appropriate, the management has manipulated or edicted a contribution which will save the company money. Also, in years in which profits are lower than usual, employees may feel that management manipulates a zero contribution in cases where it might not otherwise be appropriate.

When viewing the contribution formula from the perspective of a multi-national corporation, it appears wise that certain characteristics should be designed in it at the outset. First of all, the formula should be worldwide in nature, that is, it should take the bottom line profits of the corporation for use in the contribution formula. All elements, all subsidiaries and all employees should be used in determining the contribution percentage. Second, the formula should be clearly described in an employee handbook, and, therefore, must be of the nature of an expression, a percentage of profits or a table which clearly yields the profit sharing percentage from readily available numbers. Third, the formula should be used to distribute profits to all employees worldwide, where legally feasible.

HOW WOULD THE ALLOCATION BE MADE BETWEEN EMPLOYEES?

As a uniform percentage of pay?

One of the things about profit sharing is that it is most frequently communicated to employees as a percentage of base pay. This leads to complications with respect to the definition of base pay, which will be discussed in a later section. By using the contribution, expressed as a percentage of base pay, it is easy to relate employee contributions worldwide. Therefore, the challenge of a multinational company in determining contributions is quite easily solved. Additionally, employees in a low paying area of the

* Vincent S. Flowers & Charles L. Hughes, 'Why Employees Stay', *Harvard Business Review,* July/August 1973

Far East, when compared with a high paying area in Europe, or the Americas, could compare their contributions because each receives a constant percentage of base pay, that is, all employees receive the same percentage.

The argument has been put forward that employees in extremely low wage rate countries are not very interested in profit sharing because it is a percentage of such a low number. However, when the employees in those countries are asked, the opinion most frequently expressed is that something is better than nothing. By using the constant percentage as the approach, companies can convey an image of corporate citizenship.

In defining base pay many companies have run into problems. One company found that it had forty-six (46) different types of pay other than base pay. No two countries had the same components of total pay. If this company were considering installation of a profit sharing plan, many management decisions would be necessary with respect to which types of other pay would be included for purposes of calculating profit sharing. This could be substantially different in each of the many countries where it operated. Therefore, there would be administrative problems as well as problems of ensuring comparability between countries. While this is a problem, however, companies may frequently make broad policy decisions with respect to including base pay as a standard, and excluding all other types of pay, or selectively including certain types, which are paid frequently in the countries where the company has the most population.

By points?

Another concept of allocating contributions is that of using points and allocating a certain number of points for each hundred units annually of compensation, and additional points for periods of long service, or other characteristics which the company may deem to be important. These schemes are typically designed to be used for individuals who have substantial lengths of service, and are discriminatory towards higher paid employees. In multinational corporations where high seniority and high compensation levels occur most frequently in the home country, this can be a significant problem.

LOANS AND WITHDRAWALS

Most profit sharing plans provide for loans during the tenure of the programme. The purpose of loans is to provide a mechanism for employees to have access to a portion of the balance of their account, without actually withdrawing that balance. Loans are generally made for a period of several years, during which time they are repaid through payroll deductions. Therefore, the principal of the account is never actually disturbed.

Many plans also provide for employees to withdraw a portion of prior years' contribution to the plan. Plans normally have fairly strict requirements with respect to withdrawals in order to completely avoid easy conversion of a deferred plan to a cash plan. Plans with liberal withdrawal features generally are counter-productive to the goal of employee estate building.

FORFEITURES

Employees who terminate during the vesting period and who are not 100 p.c. vested in the contribution to their fund at the time of termination leave a residual in their account. This account reverts to the trust and, when combined with other forfeitures from other terminating participants, may then be allocated on the same basis as the annual contribution to the trust. It is most frequently also expressed as a percentage of pay. This provides for complete distribution of excess trust assets.

DISTRIBUTION OF FUNDS

The payout of trust funds upon termination or retirement of participants is frequently made as a lump sum. This provides immediate receipt by retiring or terminating employees. An alternative payout may be in the form of an annuity, where legally and culturally practical. Other forms of dispersement may be necessary depending upon the country in which the dispersement is made. It would be wise to write any trust vehicles such that they provide for a dispersement committee which may approve non-standard trust dispersements. This will minimise changes to the trust to provide for the local situation.

FREQUENCY OF CONTRIBUTION

Most trusts provide for a contribution which occurs on an annual or fiscal basis. In any event, most contributions are made in conjunction with the company's accounting year. Since many multinational corporations operate on the same fiscal year worldwide, it is easy to integrate this concept of annual contributions within the framework of the multinational corporation.

INVESTMENT OF PROFIT SHARING TRUST ACCOUNTS

Philosophically, employees 'own' the funds contained within their accounts. While they do not have possession of them, in order to achieve favourable tax treatment in a deferred trust, most companies provide an opportunity for employees to manipulate the funds held on their behalf by the trust. One advantage which multinational corporations have over non-multi-nationals is that they frequently find it easy and advantageous to establish trusts in tax haven areas which exist in certain parts of the world. Through operating in these areas they may achieve substantial gains for the employees by applying special tax rules to their situation.

For security

Most trusts provide the opportunity for employees to invest their funds in several different types of investment. In the event that employees make no selection, the funds are invested automatically in a security fund to maximise protection and provide a minimal return on investment. The security fund is most typically invested in governmentally secured debentures with a guaranteed payout. Many individuals approaching retirement may also select a security fund.

For growth

Employees may also be permitted to invest their stocks in a growth fund. A growth fund portfolio typically works in quite a similar way to a growth mutual fund, in that the portfolio is comprised of the shares of stock of many companies which are in substantially growth businesses. A portion of such a growth fund is typically invested in the company's own stock, but this is not a required feature.

Investments in the Company's stock

A third alternative available to most trust is that of investment in the company's own stock. This may frequently offer the best vehicle for long term appreciation. In the event that the overall profit sharing concept is successful within the company, such success may produce a growth in excess of that normally achieved by balanced growth funds. A problem frequently experienced with this type of situation, however, is that during periods of economic instability the growth of company stock values may be negative, resulting in significant short term losses for individual accounts. This may also result in unfavourable employee attitudes.

The balanced portfolio

It is regrettable that many countries restrict investments in stocks which are not based in their country. Investment taxes, prohibitions, and other deterrents may work to the detriment of employees in those countries. A balanced approach may be achieved by providing an apportunity to invest a portion of the employee's account in one fund such as the company stock, with the balance being invested in one or two of the other funds. In this way, it is entirely possible for an employee to invest 30 to 40 p.c. in each of the funds and therefore, maintain a balanced portfolio.

EMPLOYEE CONTRIBUTIONS

A number of profit sharing plans have conditions which require employees to contribute to the profit sharing trust as a condition for participation within that trust. Others have voluntary contributions with company matching. Programmes which require contributions, or which dilute contributions by giving more to individuals who voluntarily contribute, are programmes which discriminate against lower paid employees. Such de facto discrimination works to the overall imbalance of the plan.

The experience of most companies which have required contributions is that employees in the lower economic groups spend most of their earnings on meat, bread and potatoes and, therefore, do not have any money remaining with which to contribute to a profit sharing plan, even if it would result in matching. Therefore, these employees are not receiving the benefit of profit sharing and such contributory plans work to the benefit of the higher paid. In a multinational corporation, one should not support a policy which continually promulgates the problem of the 'haves' and 'have-nots'. Contributory schemes do work to that end and might best be dropped in favour of non-contributory schemes.

STATUTORIALLY REQUIRED PLANS

Many countries in the world are trending toward requiring companies to provide profit sharing for their employees. The number of such profit sharing plans is relatively low at this point in time. Countries which do have required profit sharing have clearly established formulas based on company profits, established ratios, and employee participation. The question thus arises, *what should a multi-national corporation operating in a country which has statutorially required profit sharing do?* Should they add these employees to their world-wide scheme or should these employees be excluded? If the employees are excluded, the plan will be just one more 'maintenance'* factor. This would not achieve any of the objectives mentioned earlier but would still result in the significant expense of the involuntary plan.

A 'top hat' scheme for companies with statutorially required profit sharing plans is an interesting and unique concept. In such a plan, companies would provide for the basic governmentally required percentage; and the company would make an increased contribution into the trust on a voluntary basis. This assumes, of course, that such increased contributions would be considered tax deductible by the host country. The advantage of such a plan is that it provides for meeting all of the objectives mentioned previously and, in addition, demonstrates clearly to the employees that the multinational corporation is interested in the welfare of all its employees worldwide, regardless of the circumstances existing in that country.

COMMUNICATIONS

One of the true challenges to installing successful profit sharing programmes in multinational corporations is that of how the plan is communicated. Profit sharing plans are expensive and complex, as are other benefit plans. In many companies these plans are perceived by employees with less than complete impact, because the company does an extremely poor job of communicating the plans to the employees.

There are several types of communication. The first is that communication which is statutorially required to governments involved. Many governments are not aware of the complexities of profit sharing since such concepts have not previously existed in their country. When one operates in such a country, it is wise to communicate directly with the Minister of Labour and provide him with complete information with respect to the proposed company actions. Such communication should include all pertinent features of the plan, including eligibility, contribution determination, deferred trusts, tax situations, etc.

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* M. Scott Myers. 'Who Are Your Motivated Workers? *Harvard Business Review*, January/February 1964

Communication should also occur for praticipants. Communication should take place in the language or languages of the country involved. It is best to secure translations locally in each country rather than relying on a central source for translations in the home country. Information for participants should be clearly communicated based on the value systems of each country. Such communication requires a great deal of study and cannot be undertaken by simply translating documents from the home country for use in another country. This will not work unless coupled with, and modified for, value systems in each local country.

The Concept of profit sharing in its very elemental and basic form must clearly be established, particulary in those countries where the concept is totally unknown.

In addition to these cautions, the normal methods of communication, such as letters to employees, meetings in natural work groups between employees and their supervisors, company newspapers, posters, etc., may be very effective. However, one must be extremely careful to modify home country information for cultural values and systems prevalent in the country to whom the communication is directed.

THE CASE FOR MULTINATIONAL PROFIT SHARING

As has been shown, when the concept of profit sharing is integrated into the management philosophy through overall goal setting for the objectives of the company, as well as the people, a company many implement a concept of profit sharing worldwide with the confidence that it may be a force used to transcend local situations and thrust the multinational corporation into providing corporate citizenship for its employees around the world.

Profit sharing thus provides the thread of consistency for unifying employees and having them think of the company as one interested in employee well being, regardless of the local environment.

Is such a concept paternalistic? Such a programme as this may be considered to be paternalistic by some. However, those with the larger view may see profit sharing as that which clearly demonstrates to all employees worldwide, in economic terms, the fundamental understanding that the company has with respect to employees— employees are assets to themselves, earning and deserving a good return on their investment, in addition to providing decent returns on investment for company shareholders. Thus, profit sharing in the multinational corporation is a concept which has been overlooked — not just from the shareholder's point of view, but also from the employee's. The synergistic cycle of mutual success will provide rewards for all interested parties with the mutual dignity of controlling and influencing one's own labour and rewards.