

SCANLON PLAN

Authored by
mohammad looti

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SCANLON PLAN

Primary Disciplinary Field(s): Organizational Management, Industrial Relations, Behavioral Economics

Proponents: Joseph Scanlon (Originator); Frederick G. Lesieur, Carl F. Frost (Later Developers and Promoters)

1. Core Definition and Overview

The Scanlon Plan is a sophisticated and widely recognized organizational development and gainsharing methodology designed to improve corporate performance by fostering high levels of employee participation and ensuring equitable sharing of the resulting financial gains. Fundamentally, it serves as a type of business plan wherein improvements in operational efficiency, primarily measured through reductions in labor costs relative to production output, translate directly into monetary bonuses distributed throughout the company or specific work group. Unlike traditional profit-sharing schemes that are calculated based on net profits (which can be affected by external factors like taxation or capital investment), the **Scanlon Plan** focuses on internal cost control metrics that employees can directly influence, specifically the ratio of payroll costs to the sales value of production. This structure incentivizes collective effort and promotes a deep sense of ownership among the workforce regarding organizational success and continuous improvement initiatives.

The core premise of the plan rests on the belief that employees possess invaluable knowledge regarding the efficiency of their daily work processes and that involving them in problem identification and solution generation is the most effective path toward cost reduction and productivity gains. The system combines two critical elements: a formal, measurable system for distributing financial rewards (the bonus formula, or "gainsharing") and an integrated structure for employee involvement and labor-management cooperation (the participation system). This integration ensures that the financial rewards are directly tied to implemented efficiencies generated through collaborative effort, creating a virtuous cycle of engagement and performance improvement across the enterprise.

2. Etymology: Joseph Scanlon and Historical Context

The Scanlon Plan is named for its originator, Joseph Scanlon (1899-1956), a significant figure in U.S. labor relations who served as a union leader and later a consultant and academic. Scanlon developed the framework during the volatile economic landscape of the Great Depression and the subsequent industrial mobilization of World War II. While serving as the research director for the United Steelworkers of America in the 1930s, he encountered a financially troubled steel company, where he proposed a radical solution: if workers collaborated with management to save the

company, they should receive a share of the resulting financial recovery. This early implementation proved highly successful, stabilizing the company and demonstrating the power of shared purpose.

After World War II, Scanlon formalized this approach while teaching at the Massachusetts Institute of Technology (MIT), refining the system into a structured management philosophy rather than a mere crisis intervention tool. His work, particularly in collaboration with MIT colleagues and later consultants like Frederick G. Lesieur, helped institutionalize the plan's core tenets: organizational identity, competency, participation, and equity. The historical context is essential, as the plan emerged not during a period of industrial peace, but rather as a mechanism to bridge the profound adversarial divide between labor and capital prevalent in mid-20th-century America. It challenged the traditional Taylorist separation of thinking (management) and doing (labor), advocating for a collaborative model that recognized the intellectual capacity of the shop floor worker.

3. The Philosophy of Cooperation and Participation

Beyond its mathematical formula, the Scanlon Plan is fundamentally rooted in a specific managerial philosophy that emphasizes **industrial democracy** and mutual trust. This philosophy rejects the assumption that employees are motivated solely by extrinsic, hourly wages and embraces the idea that intrinsic motivators--such as recognition, influence over one's work environment, and psychological ownership--are critical drivers of efficiency. Management must genuinely commit to sharing information, empowering lower-level decision-making, and treating employees as valuable partners capable of contributing intellectual capital.

The plan necessitates a profound cultural shift. For it to succeed, traditional hierarchical boundaries must soften, allowing ideas to flow freely upwards from the shop floor to executive management. This concept of organizational identity requires all members, regardless of rank, to view themselves as part of a single, unified effort aimed at common goals (profitability and efficiency). This shared identity allows employees to see the organization's financial success as directly linked to their personal and collective well-being, moving them beyond narrow self-interest toward a broader view of organizational health. The participation element is therefore not an optional add-on but the central engine that drives the efficiency gains upon which the financial rewards are based.

4. Key Components: The Ratio and Gainsharing Mechanics

The defining feature of the Scanlon Plan is the use of the **Scanlon Ratio**, which is the primary metric used to measure performance improvements and calculate the monthly bonus pool. This ratio standardizes labor costs against the sales value of production (SVOP).

The calculation requires careful historical analysis to establish a fair and stable baseline ratio. The general formula is:

Establish the Standard Ratio:

Total Labor Costs (Base Period) / Sales Value of Production (Base Period) = Standard Scanlon Ratio

Calculate Expected Labor Costs for the current period:

Current Sales Value of Production x Standard Scanlon Ratio = Expected Labor Costs

Determine Labor Savings (Gain):

Expected Labor Costs - Actual Labor Costs = Total Labor Savings (The Bonus Pool)

Distribute the Gain:

Typically, a portion of the total savings (often 75%) is allocated to the employee bonus pool, while the remaining portion (often 25%) is retained by the company. Furthermore, a reserve fund (usually 25% of the employee share) is often held back to cover months where the ratio is not met or losses occur, ensuring stability.

The use of the Sales Value of Production (SVOP)--which adjusts for inventory changes--ensures that the measure reflects productive effort rather than just shipping volume, providing a clear, understandable, and timely feedback mechanism. The distribution of the bonus is usually calculated as a percentage of each employee's gross monthly payroll, ensuring fairness and proportionality based on earnings, and is distributed monthly to maintain immediate reinforcement of productive behaviors.

5. The Role of the Suggestion System and Committees

To institutionalize the participation philosophy, the Scanlon Plan mandates a formal, two-tiered suggestion and committee structure, ensuring that employee input is systematically gathered, reviewed, and acted upon. This structure is the operational heart of the plan, translating ideas into measurable financial gains.

The participation system typically involves two primary types of committees:

Production Committees (Departmental or Workplace Level): These decentralized committees consist of elected employee representatives and the relevant supervisors. They are tasked with soliciting, evaluating, and implementing suggestions related to immediate workplace efficiency, waste reduction, quality control, and procedural improvements that fall within the scope of their department's authority. They meet frequently and prioritize rapid implementation of feasible ideas.

Screening or Review Committees (Plant-wide Level): This central committee comprises high-

level management (including HR and Finance), union representatives (if applicable), and elected employee representatives from the Production Committees. Their role is strategic: to review suggestions that impact multiple departments, require significant capital expenditure, or necessitate changes to policy. They also review and approve the monthly bonus calculations and act as the primary communication link between management and the entire workforce regarding the plan's performance.

Crucially, the suggestions are not individually rewarded (as in traditional suggestion boxes), but contribute to the collective gainsharing pool. This **collective reward system** encourages employees to share their best ideas openly and to actively help implement the suggestions of their peers, reinforcing teamwork rather than competition. The system ensures that all proposed efficiencies are directly tied back to the financial metrics used in the bonus formula.

6. Implementation and Prerequisites for Success

Implementing a successful Scanlon Plan requires more than just installing the financial formula; it demands rigorous adherence to organizational prerequisites and preparatory steps. The process is lengthy, often taking 12 to 18 months of preparation before the bonus system is fully operational.

Key prerequisites identified by Scanlon's adherents include:

Organizational Size and Structure: The plan typically works best in organizations or subunits that are small to medium-sized (under 5,000 employees) and are structured in a way that allows employees to see a direct connection between their efforts and the overall organizational results (high "line of sight").

Supportive Management: Top management must demonstrate a deep, unwavering commitment to employee participation, trust, and shared decision-making. If management views the plan merely as a tactic to extract more work without genuine empowerment, it is destined to fail.

Stable Market and Production: The organization should ideally operate in a relatively stable market environment where changes in the sales value of production are primarily driven by internal efficiency rather than sudden external price fluctuations, thereby ensuring the stability of the baseline ratio.

Union Acceptance (if unionized): If a union is present, its leadership must fully endorse and participate in the plan, viewing it as a mechanism for strengthening labor influence and economic benefit, not as a management ploy to circumvent collective bargaining.

Accurate Financial Data: Reliable, understandable, and timely financial reporting is essential. Employees must trust the transparency and accuracy of the figures used to calculate the bonuses, which is managed by the Screening Committee.

The implementation phase involves extensive communication and training efforts to ensure every employee understands the economic metrics, the committee structure, and the philosophical commitment underlying the shift toward collaborative organizational management.

7. Advantages for Management and Labor

The adoption of the Scanlon Plan yields significant benefits for both management and the labor force, establishing a framework of mutual gain that transcends conventional wage negotiations.

For management, the primary advantage is sustainable operational improvement. By decentralizing problem-solving, the organization harnesses the latent creative intelligence of its entire workforce, leading to reduced waste, improved material usage, better quality control, and faster cycle times. Because the bonus is self-financing (paid out only from realized labor cost savings), the plan guarantees that the company's retained share is pure profit. Furthermore, the plan dramatically improves labor relations, reducing grievances, turnover, and absenteeism by fostering a positive climate based on trust and shared objectives.

For labor, the benefits extend beyond the supplementary monthly income derived from the bonuses. Employees gain a legitimate voice in operational decisions, leading to increased job satisfaction, greater job security (as the company becomes more competitive), and enhanced dignity in the workplace. The plan transforms the perception of labor from a variable cost to a strategic resource, giving workers a tangible stake in the organization's economic performance and stability. The immediate, company-wide distribution of the bonus emphasizes the importance of collective success over individual effort, promoting a highly cooperative work culture.

8. Criticisms, Limitations, and Modern Adaptations

Despite its long history and philosophical strengths, the Scanlon Plan faces several practical limitations and criticisms. A major challenge is the difficulty associated with establishing the initial, fair **standard ratio**. If the historical period used for the baseline was atypical (e.g., highly inefficient or influenced by a temporary market boom), the ratio may be skewed, leading to unearned bonuses or making earned bonuses nearly impossible to achieve, thereby undermining employee trust.

Another significant limitation arises when the plan is implemented in large, multi-site, or highly diversified organizations. In these complex structures, the "line of sight" weakens; employees struggle to connect their localized efforts to the overall company-wide labor cost ratio, diminishing the motivational impact of the bonus. Furthermore, since the ratio is tied only to labor costs, high-performance bonuses can theoretically be generated even if the company suffers overall losses due to poor management decisions in areas outside of labor's control (e.g., procurement or marketing).

Critics also point out the inherent risk that management might withdraw the required level of participation and trust after the initial gains are realized, reverting to traditional authoritarian styles and causing the plan to collapse. In modern management, the Scanlon Plan is often studied alongside other gainsharing variants, such as the Rucker Plan (which incorporates material and supply costs into the formula) and Improshare (Improved Productivity Through Sharing), which focuses on output measures rather than cost ratios, adapting the core principle of shared rewards to different organizational realities.

Further Reading

[Scanlon Plan \(Wikipedia\)](#)

[The Scanlon Plan: An American Productivity Technique \(Journal of Industrial Relations\)](#)

[ScienceDirect: Scanlon Plan Overview](#)

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