

# Pros and Cons of Employee Profit Sharing

## Pros and Cons of Employee Profit Sharing



Derek Croucher/ Photographer's Choice

By [Susan M. Heathfield](#)

Updated October 13, 2016

Profit sharing is an example of a variable pay plan. In profit sharing, company leadership designates a percentage of annual profits as a pool of money to share with employees or a portion of employees such as executives.

The pool of money generated is then divided across covered employees using a formula for distribution. This formula can vary from company to company. They can either share in terms of stocks and bonds, or straight cash.

Profit sharing, when distributed as a percentage of annual pay - a common practice - results in less money shared with employees in lower paying jobs and higher amounts shared with highly compensated employees.

A highly paid senior employee can sometimes see very significant profit sharing bonuses - 40 or 50% of annual salary is not uncommon for a senior executive. However, a lower level employee may only see 1 to 2% of his salary as his part of the profit sharing.

This reflects the belief that more highly compensated employees are responsible for managing the company, making decisions, taking more risk, and providing leadership to the other employees.

While a low-level employee is secure that his salary will be the same year after year, perhaps with a modest increase, a high-level employee knows that if she doesn't ensure the company's success, her compensation may become significantly less.

Profit sharing payments are generally made only if the company has been profitable for the time period specified, or when an employment contract requires the compensation. For people without contracts, the company can change the terms of the plan at will.

Profit sharing usually occurs annually after the final results for the annual company profitability have been calculated.

Employers can choose how to set up their profit sharing plans, but they must set up an official plan with the relevant documents. The Department of Labor recommends that you:

- Adopt a written plan document,
- Arrange a trust for the plan's assets,
- Develop a record keeping system, and
- Provide plan information to employees eligible to participate

Companies can decide whether to administer the plans themselves or hire a plan to administer. Companies must keep strict records and have a strict fiduciary responsibility for the plan. Plan documents are legal documents that must be followed exactly. Companies are free to change their plans, but they must do so with the proper oversight.

## Positives About Profit Sharing

The positive impact of profit sharing is that it sends the message that all of the employees are working together on the same team. The employees have the same goals and are rewarded equivalently to reinforce this shared service to customers and lack of competition with each other.

Employees who know that they will receive financial rewards if the company does well are more likely to want the company to succeed.

They have a vested interest in its success.

## Profit Sharing's Weakness

The weakness of profit sharing plans is that individual employees cannot see and know the impact of their own work and actions on the profitability of the company. Consequently, while employees enjoy receiving their profit sharing money, it gradually becomes more of an entitlement than a motivational factor.

Senior level employees, of course, who generally receive a much higher percentage of the profit share, know what is going on and make decisions that can make an impact on the bottom line. A front line receptionist may not understand that her interactions with vendors, clients, and random people off of the street can actually make a difference in the profitability of the company.

With profit sharing, employees receive the profit sharing money regardless of their performance or contribution.