Employee bonuses and other forms of rewards are standard practice in the private sector. When a company has a profitable year, employees hope to enjoy some of the fruits of the success. If the company has a profit-sharing plan, a formula prescribes the employee’s share. Companies without formal profit-sharing systems may distribute bonuses in hopes that employees will appreciate their gesture of gratitude, will respond with loyalty, and will be motivated to expand profits in the future. Profit-sharing plans, whether formal or informal, help attract and retain talented employees and provide a personal incentive to increase the company’s net revenues.

Profit-sharing and other incentive plans are hardly novel in the corporate world. They are regarded simply as good business—good for employees and good for the company and its shareholders.

The public sector is different. Profit sharing technically is impossible in the public sector, for governments have no profit to share. Nevertheless, governments do have budgets and balance sheets, and actions that trim costs without reducing service quality can improve the bottom line, even if the improvement is not called profit. Increasingly, governments...
An Explanation of Gainsharing
Some people suggest simplistically that gainsharing is the public sector’s version of profit sharing, as if the public sector exclusively owns gainsharing. Actually, gainsharing and profit sharing both originated in the private sector, and both are found there today. A key distinction between the two systems is in their scope, profit sharing’s being broad compared with the relatively narrow scope of gainsharing. Profit sharing focuses on a company’s bottom line, which may seem far removed from the efforts of a single contributing unit. A host of factors and accounting maneuvers can influence the profit line on a company’s income statement and may seem distant and unintelligible to most employees. Yet in profit-sharing systems, the employees’ bonuses are tied to that line. Employees’ rewards rise and fall with company fortunes, but executive decisions and outside forces may have a greater influence on company profits in a given year than the performance of rank-and-file workers.

Employees’ rewards rise and fall with company fortunes, but executive decisions and outside forces may have a greater influence on company profits in a given year than the performance of rank-and-file workers.

Consistency with Current Management Thinking
Profit-sharing and gainsharing plans adhere to notions of employee motivation long accepted in the private sector. Also, they coincide with current management thinking about the importance of encouraging employee initiative as organizations strive for continuous process improvement. Advocates of Total Quality Management and its variants argue that no process or pattern of service delivery is ever perfect or even good enough. Each deserves constant scrutiny, and employees should be encouraged to find better tools, better processes, and better options to meet the needs of customers and citizens. Gainsharing is a method of providing this encouragement.

Furthermore, gainsharing is consistent with the management concepts associated with the reinvention movement, initiated by David Osborne and Ted Gaebler’s Reinventing Government and developed further in subsequent books on the topic. The reinvention philosophy emphasizes a focus not on effort, activities, or promises but on results. By methods embodied in a “consequences strategy,” public officials are encouraged to raise the stakes for success and failure. They are encouraged not only to provide real incentives for achieving the desired results but also to raise the prospect of negative consequences for departments or programs that consistently fall short.

Greater managerial flexibility as a reward for high achievers, the selection of service producers through managed competition, and gainsharing are among the featured tactics in the reinventor’s arsenal.

Greater managerial flexibility may take the form of increased discretion in operating methods and limited freedom from bureaucratic rules governing budget procedures, hiring practices, and purchases. In some cases it even allows the carryover of budget savings from one year to the next and puts a stop to the year-end spending spree that a “spend-it-or-lose-it” budget rule often spurs. This flexibility comes to managers not as a gift but as a trade. In exchange they must promise results and deliver on the promise. Departments or programs agree to be accountable and to provide full documentation of the results that they achieve. In return, those that demonstrate the ability to achieve and sustain favorable results are freed from a few of the rules that many managers regard as bureaucratic straitjackets.

Examples of North Carolina local governments adopting various forms of the greater-flexibility-for-greater-accountability exchange include Catawba County and Davidson County, as featured in the Winter 2005 issue of Popular Government. Since 1993, Catawba County has extended greater management flexibility with budget and personnel (that is, the ability to shift funds, adjust positions, and carry over a portion of unspent

in North Carolina and across the nation are experimenting with a system called “gainsharing.”

This article describes gainsharing and distinguishes it from profit sharing. The article examines gainsharing as a performance management strategy and highlights examples of its use.
funds from one year to the next) to departments willing to commit to, and able to achieve, ambitious objectives and high levels of service. More recently, Davidson County has followed Catawba County’s lead and begun rewarding volunteering departments with similar managerial flexibility in exchange for results.

Another tactic in the consequences strategy is managed competition, which requires government departments to vie with private, nonprofit, and other government competitors for the privilege of delivering various government services. When a given service is subjected to managed competition, each competitor, including the government’s own department, submits its bid for the service, and each bid is evaluated for service quantity, quality, and cost. Local governments choosing this tactic do so not because they favor private-sector production of services but because they desire the best services at the lowest price, whether produced by contractors or the government’s own employees. Employees in such governments recognize the importance of focusing on service quality, costs, and results, and they understand the consequences of failing to do so.

Government departments and programs that find themselves engaged in managed competition enjoy some advantages relative to their private competitors but also confront some disadvantages. Chief among the advantages are freedom from taxes, freedom from the necessity of making a profit, and favorable access to capital. Private competitors must build taxes, profit, and higher capital costs into their bids. On the other hand, private competitors are widely regarded to have the advantages of greater managerial flexibility, greater willingness to innovate, greater willingness to invest in new technology, and greater freedom to offer incentives that engage the creative energy, enthusiasm, and commitment of their employees. These private-sector advantages prompt public-sector managers, especially those engaged in managed competition, to appeal for a level playing field.

Gainsharing is perceived to be a major leveler of the playing field. It allows government units to give their workers a personal stake in their unit’s bottom-line success, an incentive akin to what vendors competing with a government unit might give their employees.

Typically, funds for gainsharing bonuses in local governments are drawn from savings during a given year. If a department just recently won with the low bid in a managed competition, that bid can serve as the baseline. Lower-than-expected expenditures would constitute savings and create a gainsharing pool. If no actual bid competition is involved, a local government that offers its employees a gainsharing incentive establishes its baseline (that is, the expected expenditure) through the budget process. The gainsharing award is drawn from the difference between the projected expenditure and the actual expenditure. The distribution to employees may include the entire amount, but more often it is a fixed proportion such as 50 percent. If, for example, total annual savings come to $100,000 and the gainsharing plan calls for a distribution of 50 percent, then $50,000 would be apportioned to employees, and the other $50,000 would be returned to the fund balance (equity in the case of enterprise funds). Typically, gainsharing payouts are conditioned not only on savings but also on the achievement of specified objectives or the continuation of services at previous levels or greater. Work units that fail to meet these standards forfeit their gainsharing payments.

Controversy over Gainsharing

In some places, gainsharing plans are controversial. Opponents in some states have challenged their legality, arguing that they deviate from authorized forms of payment to public employees.
Concern that service quality might suffer as workers cut expenditures—and corners—in hopes of creating a substantial gainsharing pool is countered by arguments that mechanisms can be put in place to hold any such tendencies in check. Chief among these mechanisms is an accountability system that ensures achievement of key objectives and maintenance of quality-of-service standards.

Gainsharing plans address the problem of free riders in various ways. Some disqualified employees who have unsatisfactory individual performance reports. Others tie awards to a combination of group and individual performance factors. An employee serving on a successful team receives a gainsharing bonus, but an employee with a mediocre individual performance rating receives a smaller bonus than one making a stronger contribution to the team’s success. Still other local governments, though, base the award entirely on group achievement, insisting that the gains from developing team spirit and cooperation more than offset an occasional free-rider problem.

**Philosophical opposition often centers on the belief that the wages being paid to local government managers, supervisors, and other employees already oblige them to share their most creative ideas and contribute their most diligent efforts.**

**Bid to Goal**

Although managed competition brings the advantage of competitive prices for local services, it also carries risks. Engaging in managed competition can be threatening to local government employees and can jeopardize morale. When an outside contractor wins the bid, the displacement of employees must be handled with sensitivity and care to avoid long-term damage to the government’s employee relations. Follow-through also is important. Contract management must be aggressive and thorough to ensure that contract promises are kept.

Local governments wishing to enjoy many of the benefits of managed competition without incurring the potential disruption and risks associated with it have begun to experiment with a process called “bid to goal.” Coupled with gainsharing, this process can provide a powerful incentive for innovation and cost-effective service delivery.

The bid-to-goal process begins with the hiring of a consultant who is an expert in a given local government function. The consultant prepares a cost estimate for performing that function in the client’s jurisdiction, based on his or her familiarity with companies that provide this service. In essence, this estimate is the consultant’s prediction of a competitive contractor’s bid, if bids were being sought.

Once the consultant’s figure has been received and the government is satisfied as to its reasonableness, the department responsible for producing the service is invited to match or even beat the bid. If the department cannot do so, the local government is likely to seek outside bids. On the other hand, if the department streamlines its operations and beats the consultant’s estimate, the department retains responsibility for producing the service. The department’s bid becomes its budget, and if gainsharing is authorized, employees are encouraged to find additional savings with the promise of bonuses if expenditures come in below the budget. In fact, department managers facing the prospect of privatization often consider gainsharing to be an essential device in designing and delivering a competitive operation.

**Examples of Gainsharing across the Nation**

Many local governments across the country have ventured successfully into gainsharing. For instance, in the late 1990s, a gainsharing plan for the wastewater treatment operation serving the Seattle area produced savings of $2.5 million over a four-year period, without a decline in effluent quality. Under provisions of the plan, employees received half of the savings.

In 1997, using a bid-to-goal approach, San Diego’s metropolitan wastewater department persuaded the union to agree to a set of operating revisions that promised to reduce cost by $78 million over a six-year period while achieving compliance with environmental standards. A gainsharing plan, distributing...
Charlotte’s Gainsharing Program

The department and its employees were driven by another important factor: gaining the support of the union. Osborne and Hutchinson report, “Union officials were quietly approaching managers and suggesting functions that could be outsourced, to reduce costs. Since their members could now share in the savings, their interests were aligned with the mayor’s.”

Other cost savings and program innovations have been credited to gainsharing programs in Baltimore County, Maryland, and College Station, Texas.

Gainsharing in North Carolina Local Governments

At least four North Carolina local governments have introduced gainsharing plans: Charlotte, High Point, Pitt County, and Zebulon. Of this group, only Zebulon has chosen to discontinue the incentive.

Charlotte

Charlotte features two varieties of gainsharing. First, some departments, called “business units” in Charlotte, compete with the private sector in managed competition. When they win the bid, they can enjoy the benefits of gainsharing if they can find ways to spend even less than their bid amount. Employees share 50 percent of the additional savings, provided that performance objectives are met.

For example, in the mid-1990s, Charlotte-Mecklenburg Utility employees won the managed competition for the opportunity to operate a water treatment facility and a wastewater treatment facility. Gainsharing bonuses were conditioned not only on achieving additional savings but also on complying fully with all environmental standards and suffering no lost-time accidents.

In managed competition the operating strategies of the public sector are subjected to the test of competition, and the risks to public-sector employees are significant. When municipal employees win the competition and subsequently find ways to reduce costs further, the gainsharing rewards—at 50 percent of additional savings in Charlotte—can be substantial.

When program officials in Charlotte come up with ideas for improving operations, sometimes gleaned from the lessons of competition, and proceed to implement these ideas without actually facing managed competition, the process is called “optimization.” These optimization projects also can qualify for gainsharing bonuses, but because the ideas have not stood the test of actual managed competition, the gainsharing pool is established at a lesser rate, 33 percent of savings. Nevertheless, the savings and gainsharing payouts from these optimization projects can be substantial.

Table 1. Charlotte’s Gainsharing Program

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Savings</th>
<th>Gainsharing Distribution</th>
<th>Individual Gainsharing Awards</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Managed-Competition Projects</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>$ 35,000</td>
<td>$ 17,359</td>
<td>$1,073–$1,690</td>
</tr>
<tr>
<td>2001</td>
<td>195,000</td>
<td>97,406</td>
<td>$282–$3,797</td>
</tr>
<tr>
<td>2002</td>
<td>387,000</td>
<td>193,253</td>
<td>$157–$1,113</td>
</tr>
<tr>
<td>2003</td>
<td>325,000</td>
<td>162,709</td>
<td>$322–$4,055</td>
</tr>
<tr>
<td>2004</td>
<td>5,000</td>
<td>2,551</td>
<td>$386–$1,380</td>
</tr>
<tr>
<td>2005</td>
<td>12,000</td>
<td>5,993</td>
<td>$205–$449</td>
</tr>
<tr>
<td>Optimization Projects (Cost Savings without Managed Competition)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>$ 469,000</td>
<td>$154,770</td>
<td>$124–$3,822</td>
</tr>
<tr>
<td>2001</td>
<td>1,339,000</td>
<td>441,901</td>
<td>$28–$3,501</td>
</tr>
<tr>
<td>2002</td>
<td>2,170,000</td>
<td>715,267</td>
<td>$84–$6,497</td>
</tr>
<tr>
<td>2003</td>
<td>1,670,000</td>
<td>551,998</td>
<td>$177–$3,334</td>
</tr>
<tr>
<td>2004</td>
<td>2,000,000</td>
<td>660,283</td>
<td>$32–$5,610</td>
</tr>
<tr>
<td>2005</td>
<td>3,650,000</td>
<td>119,046</td>
<td>$205–$3,812</td>
</tr>
</tbody>
</table>

Source: Information provided by Kim Eagle, Eval. Manager, Budget & Eval. Dep’t, City of Charlotte.
The department submitted a bid for operation of the wastewater treatment plant that shaved 30 percent from its previous operating expenses and met the consultant’s bid-to-goal target. A three-year contract then was signed, specifying performance and safety standards and authorizing gainsharing in the form of quarterly bonuses for cost savings beyond the department’s bid. Half of any additional savings would be retained to increase fund equity. The other half would be distributed to employees as gainsharing bonuses.

High Point’s bid-to-goal system has since been expanded from the wastewater treatment plant to other operations. Contracts based on the bid-to-goal methodology now are in place for other divisions of the public services department, including the water filtration plant, central lab services, the industrial pretreatment program, and maintenance services. (For savings and gainsharing distributions at the Westside Treatment Plant, see Table 2.)

**Pitt County**

The employee incentive program adopted by Pitt County in 2001 invited employee suggestions that would “save money [or] increase revenues without reducing services or increasing taxes or fees” and good ideas that would improve services or provide intangible benefits. The awards have differed across these two categories. Employees whose suggestions provide benefits but produce no savings or additional revenues earn $230 and a certificate of appreciation. Awards in this category are limited to twenty-five per fiscal year. Employees whose suggestions produce savings or additional revenue receive 10 percent of the first year’s savings, up to $10,000 per suggestion. (If a group of employees makes the suggestion, the award is shared equally among the group members.) These awards are not restricted in number because the savings create their own gainsharing pool.

Employees submit their suggestions to their immediate supervisors. The supervisors forward the suggestions to Pitt County’s monetary awards review committee, which considers whether a given suggestion does one or more of the following:

- Identifies and reduces safety hazards
- Saves money or increases revenues
- Increases productivity or efficiency
- Improves conditions
- Improves services to the public
- Conserves resources
- Increases employee morale

Once approved, a suggestion is implemented and monitored for twelve months to confirm its value. If a team submits a suggestion, all team members must be identified at the time of the suggestion, and the monetary award is divided equally among them. (For savings and gainsharing distributions in recent years, see Table 3.)

Pitt County’s approach to its larger monetary rewards requires monitoring and documentation of success. Through this single program, Pitt County has simultaneously encouraged employee suggestions, performance measurement, and program evaluation.

**Zebulon**

Gainsharing in Zebulon was initiated in 1992, when town officials sought an alternative to a merit-pay system that seemed driven less by merit considerations than by the need for cost-of-living adjustments. Gainsharing was introduced in hopes of encouraging and rewarding greater efficiency and excellent employee performance.

Zebulon’s gainsharing pool was modest relative to others described in this article. Only 5 percent of any end-of-year savings went into the pool. The other 95 percent went to the fund balance.

Two factors determined employees’ eligibility for gainsharing bonuses. One

---

**Table 2. Gainsharing at High Point’s Westside Treatment Plant**

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Bid-to-Goal Prescribed Savings</th>
<th>Actual Savings</th>
<th>Gainsharing Distribution</th>
<th>Individual Gainsharing Awards</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999–2000</td>
<td>$290,000</td>
<td>$336,142</td>
<td>$17,496</td>
<td>$1,458</td>
</tr>
<tr>
<td>2000–2001</td>
<td>290,000</td>
<td>303,229</td>
<td>5,568</td>
<td>464</td>
</tr>
<tr>
<td>2001–2002</td>
<td>290,000</td>
<td>255,960</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2002–2003</td>
<td>290,000</td>
<td>362,874</td>
<td>1,164</td>
<td>97</td>
</tr>
<tr>
<td>2003–2004</td>
<td>355,744</td>
<td>514,556</td>
<td>6,768</td>
<td>564</td>
</tr>
</tbody>
</table>

**Table 3. Gainsharing in Pitt County’s Employee Suggestion Program**

<table>
<thead>
<tr>
<th>Fiscal Year</th>
<th>Savings</th>
<th>Gainsharing Distribution</th>
<th>Individual Gainsharing Awards</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001–2002</td>
<td>$95,678</td>
<td>$2,004</td>
<td>$250–$1,504</td>
</tr>
<tr>
<td>2002–2003</td>
<td>5,957</td>
<td>753</td>
<td>$250–$253</td>
</tr>
<tr>
<td>2003–2004</td>
<td>6,933</td>
<td>943</td>
<td>$154–$279</td>
</tr>
<tr>
<td>2004–2005</td>
<td>25,900</td>
<td>2,590</td>
<td>$2,590</td>
</tr>
</tbody>
</table>

**Source:** Information provided by Michael Taylor, Chief Info. Officer, Mgmt. Info. Sys., Pitt County.
was performance on annual organizational goals set by the town council and the town manager, although exceptions were granted even when targets were not met. The other was satisfactory performance on individual employee performance appraisals, judged to be a performance rating of 2.95 or higher on a 3-point scale.

The town council eliminated the gainsharing initiative in Zebulon in 2000, following the recommendation of a new town manager to replace gainsharing with an annual contribution of 5 percent to 401(k)'s for all employees. The gainsharing program was thought to have little employee support, and it was only loosely anchored in a set of organizational goals produced with little, if any, employee participation and little employee buy-in. With the establishment of 401(k) contributions from the city, the passing of the gainsharing program stirred little sentiment.

The rise and fall of gainsharing in Zebulon should not be regarded as especially unusual. Some private-sector management experts note that fewer than half of all gainsharing plans survive beyond five years and many appear to begin losing effectiveness after two or three years. Some, however, exhibit much longer staying power.

**Conclusion**

Gainsharing has been shown to produce favorable results in local governments that are willing to establish a substantial gainsharing pool and are prepared to monitor the pool’s distribution rigorously. Gainsharing programs that are self-funded by savings in local government operations offer the opportunity for a win-win result. That is, they produce bonuses for employees while expanding, rather than drawing down, local government resources.

**Notes**


5. Corporations have regarded incentive plans as the positive side of a rewards-penalties coin. On the negative side of the coin are terminations for poor individual performance and broader layoffs for poor company performance. Although various limitations apply, governments have these negative options too, but typically have been less inclined and slower to exercise them.


14. Id.

15. Id. at 328.


18. Information on Charlotte’s citywide gainsharing program is based on a telephone interview with Ann White, budget manager (Feb. 25, 2004).


23. E-mail Correspondence with Rick Hardin, Town Manager, Town of Zebulon (Feb. 18, 2004).