

# **THE PROFIT SHARING SYSTEM**

**of**

**San Jose Kitchen Cabinets Manufacturing**

## **SUMMARY OF THE STUDY**

- Company** : **San Jose Kitchen Cabinets Manufacturing**
- Established** : **1982**
- Products** : **Kitchen cabinets, wire baskets, dish organizer cabinets, counter tops.**
- Factory Address** : **People's Technology Complex, Carmona, Cavite, Philippines**
- Website** : **[www.sanjosekitchencabinets.com.ph](http://www.sanjosekitchencabinets.com.ph)**
- Average No. of Employees** : **50**
- Branches** : **SM Megamall, SM North Edsa, SM Southmall, SM Dasmariñas**
- Mission** : **To contribute in the study and promotion of social justice (in particular profit sharing)**
- Strategy for Sustainability** : **To develop a profit sharing system that is both advantageous to the owners of business and the employees. A system that results in better net profit to the company in the long term and much larger total compensation for the employees. A win-win formula. In the end society also benefits.**

**Period of Study** : 1982 to the present

**Results** :

- 1. The principles hold for the last 22 years. In the words of a friend, Vic Villegas: "The sustained long-term viability of the business appears to be a valid empirical evidence".**
- 2. Average return on equity from 1987 to the present is 36%**
- 3. Cash distributed to employees from 1987 to the present is about US\$ 558,139.**

**Proposition** : **This method may be tried first by big companies in one of their smaller subsidiaries. We recommend a ten year test.**

**Observation** : **Some companies total benefits to their employees may in fact be approaching or exceeding the 50% bracket**

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Unity is always necessary, whether in the family, community, company or world affairs. Without unity all sorts of problems occur. Among the various ways to foster unity in the company, one of the best is profit sharing. The other reason why profit sharing is important is that it can play a major role in eradicating poverty. Contrary to the common notion that profit sharing will reduce profits, in the long term (at least 10 years) we believe the profits of the company will even be more.

Our company, San Jose Kitchen Cabinets Manufacturing, started studying the concept of profit sharing in 1982. For about five years, we practiced what I call the abot-abot system which is actually just giving a portion of our profits to our employees without a formal system. In 1987, we found the principles on which to base percentage to be shared with our employees. For about 20 years now, these principles hold and the percentage has not changed.

The application of the profit sharing system is rather simple. Except for salaries and wages, other compensation such as employees' benefits are already part of the 50% employee's share and therefore not anymore part of the company's expenses. Also, before declaring the percentage share for the employees, the inflationary allowance due to equity is first deducted.

# Principles

1. In any economic activity or business enterprise, there are always two partners that are necessary. They are the employees and capital. One cannot exist without the other. Thus, both deserve a share in the fruits of their partnership.
2. The similarity of both partners is that before we can talk of profit sharing, we first have to satisfy the basic needs of each partner. Employees need to receive a regular income or salary to meet their daily expenses. Without it, employees will not be able to maintain their physical and mental health. Similarly with capital, it has to receive some kind of additional funds to correct its value due to inflation.
3. In any business organization, weight of responsibility differs on each category of position. Supervisor has more responsibility than his subordinates. Auditor has more responsibility than a clerk.

Also, since there are many factors that affect individual performance such as talents, motivation, skills attitude, age and physical condition, each individual differs in performance from each other.

Thus compensation to employees should also be based on performance and job levels

# Accounting system

From the above principles, we designed an accounting system with the following major features:

1. Since neither employees nor capital can exist without the other, a logical profit sharing would be 50-50.
2. Before we can declare a 50-50 profit share, we need to satisfy the maintenance needs of both partners:
  - For employees, there should be a regular salary enough to maintain their physical and mental health. The salary of the employee at the lowest level should however not exceed what is enough to satisfy his daily needs as stated above; otherwise, the 2nd principle will be violated. In a study made several years ago by the University of Asia and Pacific, the monthly living wage for a family of five is around Php 15,000.
  - For capital, an inflation allowance shall be provided equivalent to the inflation rate multiplied by the owner's equity. This inflation allowance shall have to be deducted first before the 50-50 profit sharing is computed.
3. The basis for profit sharing distribution to employees are performance and job levels.
4. All employees' compensation outside of salaries and wages, such as employee's benefits are already considered part of the employee's 50% profit share. These do not form part anymore of the operating expenses.

5. If and when the company incurs a loss or when the employee's benefits exceed the 50% share for the employees in a particular year, the losses (which include the inflation factor) will be a receivable of the company from the employees' profit share in the next profitable year(s). A maximum of 50% of the profit share for distribution shall be used to pay for the losses of the previous year(s).

### **Coverage**

All regular employees from the lowest to the highest level. (Although I am the proprietor, as the General Manager of the company, I am also an employee. Therefore, I draw a regular salary and participate in the employee's profit sharing.)

### **Important factors to ensure effectiveness of the system**

1. The difference between the compensation, both salary and profit share, of the highest and lowest ranking employees should be reasonable. ( As a practice, we are using a maximum of 10 times but other companies may differ depending on their size and other factors.)
2. In line with are the principles of proper governance, the owner should use the company's resources only for legitimate business related purposes and there should be proper accounting for this.
3. There should be transparency in the financial statements.

## Example of income statement using the accounting system with 50% profit share

### Step 1. Income statement using conventional accounting system

Sales	<i>US\$</i>	1,509,720	100%
Cost of sales		<u>905,832</u>	60%
Gross profit		<u>603,888</u>	
Less operating expense:			
A. Salaries & wages		211,630	
Rental expense		68,650	
Others		<u>190,980</u>	
		471,260	31%
B. Employees benefits:			
SSS employer share			
Retirement funds contribution			
SL/VL conversion			
Christmas party, etc.		<u>47,350</u>	3%
Net income		<u><u>85,280</u></u>	6%

## **Step 2. Income statement using 50% profit share accounting system**

Net profit before tax	US\$	85,280
Addback: Other compensation & benefits		<u>47,250</u>
Net income		132,630
Less: Inflation allowance (Equity x inflation rate / tax provision) (US\$ 347,744 X (2.8% / .067))		<u>14,530</u>
Net income for profit sharing		118,120
Employer share (50%)		<u>59,050</u>
Employee's share (50%)		<u>59,050</u>

## **Step 3. Computation of employees profit share**

Employees profit share	US\$	59,050
Less: Other compensation & benefits (as advanced by the company)		<u>47,350</u>
Net cash for distribution		<u>11,700</u>

## **Step 4. Net income for the company**

Employees profit share	US\$	59,050
Add: Inflation allowance		<u>47,530</u>
Net income		73,580

## **Advantages**

Compared to a company with no profit sharing, all other things being the same, a company that adopts this profit sharing system will have the following advantages:

1. (Theory) In the long term (ten years at least), the company's total profitability will be better. The following are my bases:
  - A period of more than 25-year test (1982 – present).
  - Employees' engagement study – defined as the measure of emotional connection that an employee feels for his organization that influences the employee to exert greater discretionary effort to his work. Worldwide average is 12%. Only one in seven employees worldwide is fully engaged and willing to go the extra mile for his company. ([www.management-issue.com](http://www.management-issue.com))
  - Proverbs 11:24-25 – Some people spend their money generously and still grow richer. Others are cautious, and yet grow poorer. Be generous, and you will be prosperous. Help others, and you will be help.
2. It is less difficult to manage the company.
3. It can do away with some of the stressful part of a Collective Bargaining Agreement.
4. Profit sharing is contributory to social justice and therefore to long-term peace.
5. Winning the employees to come to the faith will be more effective (for Christian employers)

And again, just to restate: The application of the profit sharing system is simple. Except for salaries and wages, all other employees' compensation such as employee's benefits are already part of the 50% employee's share and therefore not anymore part of the company's expenses. Also, before declaring the percentage share for the employees, the inflationary allowance due to equity is first deducted.

If you would like to know more about our profit sharing system, please feel free to contact me using the contact details below.

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