Front. Bus. Res. China 2015, 9(3): 420–442
DOI 10.3868/s070-004-015-0017-7

RESEARCH ARTICLE

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Integrating Macro and Micro Perspectives on Profit-Sharing in China

Abstract Despite considerable interest in the adoption of profit-sharing plans in small firms in China, there lacks a comprehensive theoretical framework to explore why these plans are adopted. Much of the literature on profit-sharing originates from a pure economic perspective based upon agency theory. However, when profit-sharing is adopted in small firms at the discretion of the CEO, often psychological mechanisms become an important factor. This paper provides an integrated theoretical framework combining the economic perspective with the psychological perspective to investigate the reason why CEOs in Chinese private firms choose to adopt profit sharing schemes. Specifically, we develop a model examining both internal and external factors specific to the individual and the firm. We then theorize whether the reasons for using the profit-sharing plans will ultimately lead to improved firm performance.

Keywords profit-sharing plans, compensation, China

1 Introduction

As China by some measures has transitioned into one of the largest economies in the world, firms are also examining ways to expand into larger, more profitable

Received March 20, 2015

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and sustainable companies. One of the possible mechanisms for organizational growth and profitability is through a compensation incentive such as a profit-sharing plan. Profit sharing plans have been widely used in North American companies for many decades in both small and large firms (e.g. Katz and Meltz, 1991; Kruse, 1992, 1996; Long, 1997; Long and Fang, 2012; Tyson, 1996; Magnan and St-Onge, 2005; Peters, 1984). Primarily, its popularity can be attributed to its effectiveness in aligning the goals of employees with the goals of the firm in order to increase firm performance (Long, 2000b; Pierce, Kostova, and Dirks, 2001; Coyle-Shapiro, Morrow, Richardson and Dunn, 2002; Ugarkovic, 2007).

The practice of profit sharing has also been observed in Chinese private firms (Ahlstrom and Bruton, 2001). While there have been many studies examining the effects of a profit-sharing plan on firm performance specifically in the North American context, there have been far fewer studies that investigate this relationship in China. Of even greater importance is that while the question of the effects of profit sharing on firm performance has been examined to varying degrees, the reason why firms decide to choose to adopt this compensation scheme has not yet been fully investigated (e.g. Kruse, 1996; Long, 1997; Pendleton, Poutsma, and Van Ommeren, 2003), especially in small firms from emerging economies. Without a robust theoretical foundation of *why* firms choose to adopt profit sharing plans, it is difficult to link the conceptual basis of motives underlying the adoption of a profit-sharing plan with the subsequent impact of this specific practice on firm performance.

To investigate the underlying motives in adopting a profit-sharing plan, we develop a set of theoretical propositions examining the antecedents underlying the adoption of a profit sharing plan from the perspective of the owner or CEO of small firms in China. Unlisted small firms are unique because the owners (with the majority also being founders) have full discretion as to whether a profit sharing plan is adopted, allowing for an unconfounded examination of the influencing processes behind this decision. Based on the motive of the CEO, we also provide a theoretical basis as to *how* the adoption of a profit sharing plan can result in increased firm performance. In the next section we explicitly define the characteristics of profit sharing plans to provide specific parameters through which this compensation practice is to be viewed. In subsequent sections we adopt a framework which integrates the economic and psychological mechanisms underlying this process and operationalize it in the form of external

and internal influences and individual-level and firm-level factors. Furthermore, we then examine how these factors underlying the adoption of a profit-sharing plan in turn impacts firm performance.

2 Characteristics of Profit-Sharing Plans

Following previous studies (Bell and Hanson, 1987; Tyson, 1996; Long and Fang, 2012, etc.), we define a profit sharing plan as any system which has a direct link between the profits of a company in a particular time period and the compensation of employees in that period. Under the parameters of this paper, a couple of characteristics need to be present in order for this compensation practice to be formally classified as a profit sharing plan within the firm. The profit-sharing plan needs to be a formal arrangement between the firm and the employees of the firm. It needs to be broad-based and include both managerial and non-managerial employees. The profits shared must be based on the overall profitability of the firm and not just the profits from a specific project or based on individual or group performance (classified more as commission pay or merit-based bonus pay). Moreover, this profit-sharing plan is not simply a way for the owner to transfer firm risk to employees. To be classified as a profit-sharing plan, the base compensation of employees must not be decreased, as the presence of a profit-sharing plan is meant to act as an incentive that is intended to provide an increase in total compensation, if a firm reaches its profit goals.

First, a profit sharing plan needs to be a formal compensation program that is announced to employees within the firm. The intention of this formalized program is to provide a direct salient link between the profits of the firm and the resulting income of the employee. In the context of China, a formalized profit-sharing plan also avoids the moral hazard problem (Hölmstrom, 1979) where firm owners can renege on their plan to share a specific amount of profits with employees once the profits have been achieved.

Second, the profit sharing plan needs to be broad-based enough to include both managers and non-managerial employees. Special incentive compensation plans which take into account the overall performance of the firm already exist for most employees at the managerial level (e.g. managerial ownership, see Himmelberg, Hubbard, and Palia, 1999; option compensation, see Efendi, Srivastava, and Swanson, 2007). The difference in a profit-sharing plan is the inclusion of many workers, especially employees at a non-managerial level. The

purpose of the plan is to provide employees with an incentive to consider the overall performance of the firm with the intention to motivate employees at a lower level to strive for higher firm performance.

The profit sharing plan needs to be based on the overall profitability of the firm. There are many different incentive plans that are effective in eliciting individual or group performance that is beneficial to the firm on a small-scale basis. The purpose of the profit-sharing plan is to share profits with employees based upon the macro performance of the firm. Moreover, different from many definitions of a profit-sharing plan, this compensation practice is intended to raise the overall compensation level of employees. As such, with the implementation of this profit-sharing plan there can be no corresponding decrease in an employee's base salary.

Based upon these parameters, the profit sharing plan can act as a mechanism to align the goals of the firm with the goals of employees as predicted by agency theory (Eisenhardt, 1989). There are two mechanisms through which agency theory functions: (1) if employees take actions which may be costly to themselves in the short-term but enhancing to the firm in the long-run or (2) a majority of employees working together with a specific goal centered around the firm may be more productive than employees working together without a firm specific goal. Under this first condition, employees may take a longer term outlook for the firm and hence make decisions that may be more beneficial in the long run. Under the second condition, employees working towards a common goal may be more productive.

In large firms with a complex management structure, the primary factor that determines the adoption of a profit-sharing plan is whether or not the management team of the firm believes that this plan is likely to result in enhanced profits that exceed the costs of implementation. In larger firms, the predictions of agency theory are evident due to the complex management structure, the high bureaucratic costs in monitoring employees and the reduced line of sight for employees in understanding the operations of the firm. Consequently, a profit-sharing plan may be effective in reducing these problems and aligning the goals of employees with the firm. While the literature has extensively examined profit-sharing plans for large listed firms, the theoretical underpinnings of agency theory may not be as applicable in smaller firms. Consequently, this study focuses on the theoretical reasons why smaller firms that do not necessarily have a misalignment of employee and firm goals due to

the lower costs of monitoring, choose to implement this plan. This paper focuses on these types of firms for two reasons: (1) most of the literature has focused on the impact of profit sharing for large, publicly listed companies with complex ownership structures. For these larger companies, the decision to implement this plan is institutionalized and less personalized with the decision to adopt this compensation practice likely to have been made by a joint management team. Subsequently, personal factors such as the relationship between the decision maker and employees are removed from the equation making the antecedents based solely on financial considerations as predicted by agency theory. Instead, we decide to focus on modeling why profit sharing is adopted by firms where there is sole ownership and the decision is made by the owner/CEO, allowing for psychological mechanisms to enter into this equation. (2) One of the key challenges facing small Chinese entrepreneurial firms is increasing their size, operations and profits. The use of a profit-sharing plan is viewed as a possible mechanism to achieve this goal. Consequently, we provide our overall theoretical framework in Figure 1.

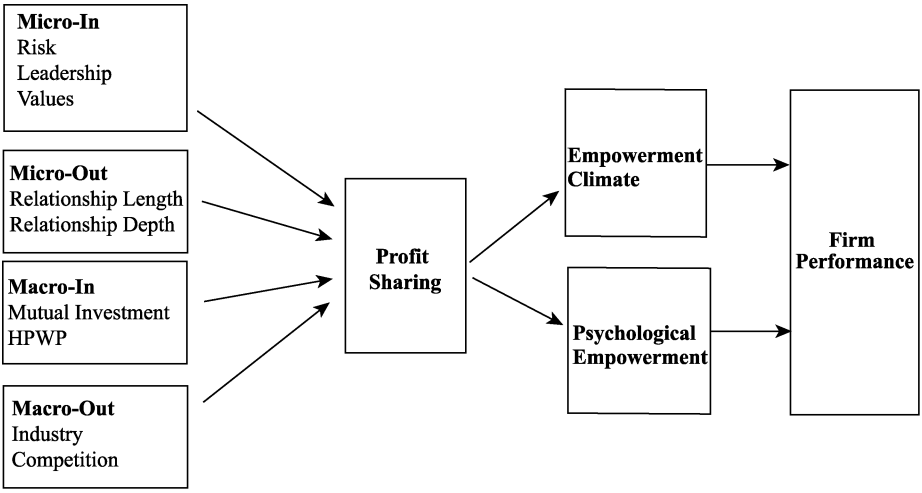

Figure 1 Internal and External Factors at a Firm or Individual Level Influencing the Adoption of Profit Sharing Arrangements in Chinese Private Firms, and the Influencing Process of Psychological Empowerment

3 Adoption of Profit-Sharing Plans

Inspired by the decision-making framework of prospect theory (Kahneman and

Tversky, 1979) as well as strategy-making approaches (Andrews, 1971; Ansoff, 1965; Porter, 1980; etc.), we postulate that CEOs in small firms tend to simultaneously consider both internal and external environmental factors before deciding whether or not to adopt a profit sharing plan. Meanwhile, given the nested structure of organizations, variables at one hierarchical level can influence variables at another hierarchical level (Hofmann, 1997). From this perspective, we believe that a small firm owner's behavior in adopting a profit sharing plan is jointly determined by factors at both the individual level and the firm level.

Consequently, there are two groups of factors which influence decision-makers in their choice to adopt a profit-sharing plan in their firm. There are external factors (factors outside of the firm) such as competitors or strategic partners which will influence the decision of the CEO. There are also internal factors (factors within the firm) such as colleagues, employees or the structure of the firm. In addition, affecting the adoption of a profit-sharing plan is not only influenced by internal or external factors, it is also a decision that can be influenced at different levels. There exists macro or firm level factors such as the size of the firm that will affect this decision. In addition, there are micro level factors such as relationships among the employees that will also influence the decision to adopt a PSP. Given these factors and levels that can influence the adoption of a profit-sharing plan, we generate a matrix displayed in Figure 2 to identify the key reasons.

		Environment	
		Internal	External
Levels	Individual	*Micro-In*	*Micro-Out*
	Firm	*Macro-In*	*Macro-Out*

Figure 2 Factors that Affect PSP Adoption

Factors that can affect the owner at the internal, individual level are factors that are internal to the personality or leadership style of the decision-maker. In this case, we refer to this factor as a *micro-in*, whereby internal forces such as the leadership style, the level of risk aversion and the personal values of the CEO may have an impact on whether this compensation practice is adopted. Factors that can affect the owner at the external, individual level are factors whereby other individuals may influence this decision by the decision-maker. We refer to this factor as *micro-out*. External to the individual, these forces primarily center upon the relationship of the decision-maker with employees as a strong factor

that will influence the decision to profit share in the firm.

Factors that affect profit-sharing adoption at the firm-level but are internal to the firm are labeled as the *macro-in*. Examples of this force are the size of the firm, the structure of the firm, the competitive advantage of the firm, the industry of the firm, etc. These are all characteristics of the firm which may lead to higher profits if a profit-sharing plan is adopted for the company. The final factor in the matrix is labeled as the *macro-out*. This level focuses on conditions at the firm-level that are external to the firm. Examples of this force are variables such as whether or not competitor firms are using this practice or whether macro environmental conditions such as the change in GDP or unemployment rates affect the adoption of a profit-sharing plan.

3.1 The Micro-In Factor

One key internal factor specific to the decision-maker is the risk attitude of the individual. An individual's risk attitude can be explained using the expected utility framework where risk attitude is representative of an individual's utility function which measures a person's choices (Arrow, 1971). This is a purely economic explanation of risk aversion. A more psychological explanation of risk aversion is that someone who prefers the expected value of the gamble over playing the gamble itself is classified as risk averse (Rabin, 2000). Researchers have developed psychometric measures of risk attitude across different domains, and some may be related to the domain of profit sharing (Weber, Blais, and Betz, 2002).

Prospect theory is the seminal theory on risk attitude (Kahneman and Tversky, 1979). To summarize, prospect theory posits that individuals are risk averse when there are gains and risk taking when there are losses. The cumulated research indicates that individuals behave in terms of loss aversion which is the psychological propensity that losses loom larger than equal-sized gains relative to a reference point. This can occur in both riskless and risky choices (Tversky and Kahneman 1991). An example of loss aversion in risky choices is the observation that people reject small-scale gambles that have a positive expected value but may involve losses (see Wakker 2010, for a comprehensive review of these empirical studies).

Owners who have previously not adopted a profit-sharing plan receive one

hundred percent of the profits of the firm. In adopting a profit-sharing plan, it is only economically beneficial to the extent that the present value of future profits is greater than the amount shared with employees. For example, if x% of profits are shared with employees and profits only grow at a rate $y < x$ %, then the financial returns received by the owner would be reduced, making the institution of a profit-sharing plan a non-profitable venture, ceteris paribus. While the literature has indicated a positive correlation between this compensation practice and firm performance, it is not guaranteed that this practice leads to better firm performance. Indeed, owners are uncertain whether a profit-sharing plan acts as a mechanism in aligning employee incentives with firm goals and whether this makes a difference to firm performance. Moreover, even if the profit-sharing plan functions as an aligning mechanism, ownership needs to ensure that this mechanism is able to garner an increase in profits greater than the amount shared with employees, which is an uncertain proposition and hence one that is placed in the risky choice domain. Consequently, owners who have a higher attitude towards risk will make a choice to adopt a profit-sharing plan given the risk entailed in using this compensation practice as a mechanism to capture increased financial returns. As a result, we develop our first proposition:

Proposition 1: CEOs who are more risk averse will be more likely to adopt a profit sharing plan.

While most studies related to profit-sharing have focused on the economic predictions of agency theory, one innovation of this framework is to not only examine the actions of a CEO from a profit-maximizing perspective, but also to investigate other more psychologically-related factors which may influence this decision. In this vein, previous studies examining the antecedents of PSP adoption did not focus on the leader's role, except Long (1997) who suggested that a CEO's managerial philosophy predicted the intention to adopt PSP. Long (1997) distinguished two kinds of managerial philosophy, the classic managerial philosophy, which asserts that people work because they are paid to do so, and the industrial humanism philosophy insisting that people work because they enjoy the challenge and learning embedded in the job. While managerial philosophy provides an interesting framework, this study explores the origins of this philosophy by focusing on the personal values of the CEO. Recent research

has begun to identify that Chinese CEO values can influence a firm's organizational culture and performance (Berson, Oreg, and Dvir, 2008). CEO values also interact with their leadership behavior to influence middle manager commitment (Fu, Tsui, Liu, and Li, 2010). Given the emerging research pointing to the importance of CEO values in firm outcomes, it is also likely that CEO values influence the decision to adopt a profit sharing plan.

Specifically, self-transcendent values are important in this process. Self-transcendent values are related to the enhancement of others' happiness, the transcendence of selfish interests, and the acceptance of others as equals (Ros, Schwartz, and Surkiss, 1999). Previous studies have demonstrated that CEO's values will affect the company's culture (Schein, 1992) and management system (O'Reilly and Pfeffer, 2000). Therefore, if a CEO has a high level of self-transcendent values, a profit sharing plan will be more likely to be adopted because the plan reveals that senior managers care about the interests of their employees (Coyle-Shapiro, Morrow, Richardson, and Dunn, 2002). This leads to the first of several propositions focused on individual values and profit sharing plans.

Proposition 2a: CEOs' level of self-transcendent values is positively associated with the adoption of PSP.

Values are often integrated into the leadership style of the CEO. Consequently, the resulting leadership style in the Chinese context may have an influence in the compensation choices made by the CEO. Specifically, in examining the predominant leadership styles in China - transformational leadership (Li and Shi, 2005), Chinese leadership (Tsui, Wang, Xin, Zhang, and Fu, 2004), and paternalistic leadership (Farh and Cheng, 2000; Farh, Cheng, Chou, and Chu, 2006) - we discover that paternalistic leadership is based upon a strong theoretical foundation while simultaneously being rooted in Chinese traditional culture. Consequently, we choose to examine the theoretical relationship between this leadership style and the adoption of a profit-sharing plan.

There are three dimensions to the paternalistic leadership style: authoritarianism, benevolence, and morality (Farh and Cheng, 2000). The paternalistic leadership construct also covers the dimensions of Chinese transformational leadership (Li and Shi, 2005).

Among the three dimensions, we put forward propositions related to

benevolent and moral leadership influences on profit-sharing plans. Benevolent leadership is defined as a leader's individualized, holistic concern for subordinates' personal and familial well-being (Farh and Cheng, 2000). A benevolent leader tends to improve subordinates' benefits. As a result, the leader will be more likely to implement PSP because it can promote both employees' cash payments and perceived well-being.

Proposition 2b: The benevolent leadership dimension is positively associated with the adoption of PSP.

Moral leadership is depicted as a leader's behavior that demonstrates superior moral character and integrity through acting unselfishly and leading by example (Farh and Cheng, 2000). Hence, a CEO with a moral leadership style will be more inclined to share the company's benefits with employees. So he/she is more likely to take advantage of PSP to show his/her integrity.

Proposition 2c: The moral leadership dimension is positively associated with the adoption of PSP.

Using the micro-in factor, we explore factors that are internal to the CEO at an individual level of analysis. First, we propose that the risk propensity of the CEO is an important factor in influencing the CEO to adopt a profit-sharing plan. While this is primarily considered from the economic perspective of maximizing profits it is a perspective that has not yet been explored in the profit-sharing literature. Subsequently, we then proceed to examine more psychological factors such as the values and leadership style of the CEO and its impact on the adoption of profit-sharing. In this section, we are able to investigate internal factors to the CEO from both economic and psychological frameworks to predict the adoption of profit-sharing practices.

3.2 The Micro-Out Factor

Another main reason why executives may choose to adopt a profit-sharing plan for their employees is at an individual level but due to external factors related to outside stakeholders such as employees. This is termed as the micro-out factor. In a qualitative interview with a CEO in China, he mentioned that his firm decided

to adopt profit sharing plans not because this compensation practice will lead to more profits but because of reasons such as an enhancement in reputation or because he felt that employees are "like family" and he should share the profits of the firm with these employees (Song and Tsui, 2012; Song, Li, Sun, and Si, 2014). In line with this perspective, Long (1997) found that firms with CEOs that adhere to the industrial humanism school of thought were more likely to participate in profit sharing. The relationship between the CEO and employees can be measured on many dimensions. We focus on two dimensions: the length of the relationship and the depth of the relationship. If the employees have been with the firm for a long time and the employees have acted loyally and remained with the firm during the startup phase, the CEO is likely to feel more indebted to the employees for helping grow the firm. A feeling of ownership of the firm is likely to be shared with the employees and as a result, it is more likely for the firm to implement a profit sharing plan with these employees. The second dimension examines the depth of the relationship between the CEO and the employees. If the CEO treats the employees as family, then by extension the CEO will want to share all the returns of the firm with employees leading to the adoption of a profit sharing plan.

According to the philanthropic and justice principles of Confucianism, excellent Chinese leaders are characterized by "Ren" (benevolence and harmony) (McDonald, 2012), and they emphasize high involvement HR systems that share power with employees (Heller, Pusic, Strauss, and Wilpert, 1998; Han, Chiang, and Chang, 2010; Warner, 2009). CEOs treat employees as their family members and this motivates employees to work longer in the companies. As a result, this leads to our next propositions.

Proposition 3a: The longer the relationship between CEOs and employees the more likely a firm is to adopt a profit-sharing plan.

Proposition 3b: CEOs who have strong relationships with employees and treat them like family will be more likely to adopt a profit-sharing plan.

3.3 The Macro-In Factor

The third factor in our model explores the internal characteristics of the firm which influence the adoption of profit-sharing plans. At this level, most

decision-makers will only choose to adopt this practice if there is a fit between the characteristics of the firm and profit-sharing. Furthermore, this fit will only be beneficial if profit sharing in combination with the characteristics of the firm acts as a mechanism to increase the profits of the firm. To provide a basis for our theoretical postulations of what variables are applicable to the *macro-in* category for Chinese firms, we first examine whether the previous empirical research indicates a fit between profit-sharing and firm characteristics.

The previous research done in the Western hemisphere found that profit sharing plans correlate positively with the adoption of high performance work practices (HPWP) (Long, 2000a). According to Datta, Guthrie, and Wright (2005: 136), HPWP describes a "system of HR practices designed to enhance employees' skills, commitment, and productivity in such a way that employees become a source of sustainable competitive advantage". This system consists of internally coherent human resource management practices instead of isolated practices (Lepak, Liao, Chung, and Harden, 2006), focusing on promoting employees' commitment instead of controlling employees. The research by Aryee and colleagues (Aryee, Walumbwa, Seidu, and Otaye, 2012) revealed the impact of HPWP on a climate of empowerment and performance at the individual and firm levels.

The literature has also shown that profit sharing is found to be a supportive compensation practice for some motivational programs, as it is more popular in firms with job enrichment, flexible work design, employee involvement programs or self-managed teams (Kruse, 1996; Kato and Morishima, 2003; Long and Shields, 2005). One of the key mechanisms of a profit-sharing plan that may lead to higher firm profits is the incentive that focuses employees work efforts on the macro-performance of the firm. Firms that already motivate employees with high performance work practices may need a practice such as profit-sharing to focus their efforts on the profits of the firm. As a result, there is a fit between this practice and the other human resource practices of the firm. Given the previous research, it is expected that in the context of China, a profit-sharing plan that fits with the other human resource practices that help motivate and encourage individual performance is likely to provide overall benefits to the firm. In this context, the implementation of a profit-sharing plan in China is expected to lead to positive returns for the firm.

As a result, this lead to our next proposition:

Proposition 4: Firms who have adopted high performance work practices are more likely to adopt a profit sharing plan.

We also propose that a profit-sharing plan offers a good combination of intrinsic and extrinsic motivation, and is positively related to a mutual investment employment relationship. According to Tsui, Pearce, Porter and Tripoli (1997), mutual investment refers to one approach to the employee-organization-relationship that balances economic and social exchange. A mutual investment relationship combines open-ended inducements provided by employers (such as extensive training, career development, and job security) with open-ended contributions from employees.

A mutual investment employment relationship is compatible with high involvement work practices. High involvement work practices are featured by employee-orientation, information sharing, teamwork, and participative decision making. Employees take more responsibility for firm operation and success (Lawler, 1992, Arthur, 1994; Huselid, 1995; Shaw, Delery, Jenkins, and Gupta, 1998; Guthrie, 2001). Based upon these features, profit-sharing is aligned with a "mutual investment employment relationship" (Hom, Tsui, Wu, Lee, Zhang, Fu, and Li, 2009; Tsui, Pearce, Porter, and Tripoli, 1997; Wang, Tsui, Zhang, and Ma, 2003) or a "high-involvement work practice" (Huselid, 1995; Lepak, Taylor, Tekleab, Marrone, and Marrone, 2007) tenet. As a result, we develop the following proposition:

Proposition 5: Profit-sharing plan adoption is positively associated with a mutual investment employment relationship approach in China.

3.4 The Macro-Out Factor

Finally, we examine what factors at the firm level, but external to the firm affect profit-sharing adoption. Previous research has examined the influence of environmental factors leading to profit sharing. For example, Drago and Heywood (1995) find that companies facing stiff product market competition are more likely to adopt profit sharing. We argue that there are two major reasons

why environmental factors at the firm level influence the adoption of profit-sharing. First, according to institutional theory (Powell and DiMaggio, 1991; Scott, 2001), firms will imitate successful firms and follow the industry routine in order to gain legitimacy. Thus, the more prevalent the adoption of PSP in a certain industry, the more likely the CEO is willing to adopt PSP. Second, industry competitiveness (Porter, 1980) is another environmental factor which pushes firms to adopt profit sharing plans. High competition intensity is often accompanied by environmental turbulence (Porter, 1980; Ramaswamy, 2001) and forces the firms to consider human resource management strategies to reduce costs and boost profits to gain a competitive advantage (Tsui, Pearce, Porter, and Tripoli, 1997). According to a resource-based view (Barney, 1991; 2001), in highly competitive industries, CEOs are more likely to treat employees as assets and partners. On the other hand, PSP adoption can be a signal to the industry for outstanding performance and the aspiration to higher achievement in the future.

Proposition 6: The more prevalent the industry-level adoption of PSP, the more likely CEOs will adopt profit sharing plans.

Proposition 7: The higher the competitiveness of the industry, the more likely CEOs will adopt profit sharing plans.

The profit-sharing plan decision is influenced by both internal and external factors at both the firm and the individual level. However, there are also effects that occur at multiple levels and are influenced by both internal and external factors. Consequently, this paper goes further to propose interaction effects of CEO characteristics and environmental factors on PSP adoption decisions. That is, when companies are faced with industry-level prevalent adoption of PSP and/or when the firm operates in a highly competitive industry, CEOs are more likely to adopt PSP if they are risk averse, hold self-transcendence values, or lead the company via benevolent and moral styles. In other words, the internal factors at the individual level (personal characteristics of the CEOs) accentuate the external factors at the firm level in the adoption of profit sharing plans.

After establishing a theoretical framework that explains why small solely-owned firms in China choose to adopt profit sharing plans from an internal and external perspective at the individual and firm level, we proceed to discuss

the mediating process through which profit sharing plans lead to improved firm performance.

4 Profit-Sharing Process on Firm Performance

The majority of studies focusing on profit sharing plans indicate that this plan has positive effects on both the firm and the employee. Previous research has found that profit sharing has substantially increased the productivity of its employees (Magnan and St-Onge, 2005). In addition, most of the studies on profit sharing conducted in the United States of America indicate that firms attribute much of their economic successes to profit sharing (Peters, 1984; Magnan and St-Onge, 2005). Other studies have tried to directly link profit sharing schemes to corporate performance with measures such as income, sales, and stock returns (Akhtar, Ding, and Ge, 2008; Zhang and Li, 2009). Studies have also linked profit sharing to employee satisfaction, and lower turnover among employees (Wilson and Peel, 1991; Long, 2000b; Azfar and Danninger, 2001; Milkovich, Newman, and Gerhart, 2010). All in all, most of the literature indicates that profit sharing is positively associated with firm growth, profitability and employee satisfaction.

Previously, the key motivating and retention mechanisms of Chinese enterprises included merit-pay, base salary, and housing (Chiu, Luk, and Tang, 2002); however, due to the magnitude and efficiency of the economic expansion in China, previous motivating mechanisms may no longer be as effective. Instead, in today's China it is likely that profit sharing may become a more attractive and viable policy in addition to the above mentioned human resource management practices. One of the reasons is that merit pay only connects individual performance with their salary, putting a greater emphasis on individual performance instead of the overall success of the company. Currently, if firms want to retain employees and to provide them with a long-term orientation based upon the success of the company, profit-sharing provides a greater incentive than merit-pay.

Despite the literature linking the implementation of a profit sharing plan with firm performance there are very few studies investigating the mechanisms and the circumstances under which profit sharing has a positive influence on these outcomes. Some of the possible mechanisms through which profit sharing may

have an impact on firm performance is through constructs such as organizational commitment, job satisfaction, retention and organizational citizenship behavior. All of these behaviors at an individual level have been found to be associated with the presence of a profit-sharing plan (Long, 2000a; Chiu and Tsai, 2007). Even with this preliminary evidence there is still a lack of understanding on the mediating mechanism between a profit sharing compensation plan and these positive job outcomes of employees. We provide a possible theoretical framework as to why the presence of a profit sharing plan can impact employees using a psychological framework.

Drawing on psychological empowerment theory (Spreitzer, 1995, 2008; Thomas and Velthouse, 1990; Logan and Ganster, 2007), we propose that psychological empowerment acts as the mediator between a profit sharing plan and employee attitudes and behaviors. We argue that the presence of a profit sharing plan sets a platform for employees to exhibit their potential in managing the company through financial participation and management participation. The escalated level of psychological empowerment creates the perception among employees that they are in effect business partners of the CEO. This is because they perceive a direct connection between their efforts and the outcome of that effort in the form of profit sharing. They not only have increased motivation to do their own job well, but they are also motivated to help others achieve their goals since the overall profit of the firm depends on high performance by everyone in the company and coordination among them. In addition, they are able to think about their decisions at a more macro-level taking into account the long-term interests of the firm, thereby possibly increasing firm performance.

Psychological empowerment is especially important for Chinese employees, because the Chinese have collectivist values and high power distance. Chinese employees will be most productive when they are psychologically empowered since they could combine the merits of individual enthusiasm with team collaboration and high quality social exchange relationships with their leaders.

Spreitzer (1995) validates a four-dimension psychological empowerment construct of meaning, competence, self-determination and impact. Psychological empowerment is found to predict employee performance (Liden, Wayne, and Sparrowe, 2000; Seibert, Wang, and Courtright, 2011, Seibert, Silver, and Randolph, 2004) as it increases the active orientation of employees towards their work (Spreitzer, 2008). So in our framework, we argue that profit-sharing plan

adoption motivates employees by instilling meaning and competence for them in their work. Employees will feel more autonomy and self-determination working of their own volition with high impact. Their job outcomes may therefore be improved. This leads to our first proposition:

Proposition 8: Psychological empowerment mediates the relationship between profit-sharing plan adoption and employee job outcomes.

An empowerment climate has been defined as "a shared perception regarding the extent to which an organization makes use of structures, policies, and practices supporting employee empowerment" (Seibert, Silver, and Randolph, 2004, p. 334). Although there are some studies examining the antecedents of individual level psychological empowerment (Liden, Wayne, and Sparrowe, 2000; Seibert, Wang, and Courtright, 2011), the research on the firm level empowerment climate and its antecedents is still lacking.

Profit-sharing plan adoption signals the autonomy and meaning of work to all employees according to social information processing theory (Salancik and Pfeffer, 1978). Profit-sharing cultivates an empowering climate featured by three pillars including information sharing, autonomy through boundaries and accountability (Blanchard, Carlos, and Randolph, 1995). Employees are thus empowered to contribute to the organization (Seibert, Silver, and Randolph, 2004). The mediating influence can work on both firm and individual levels outcomes. So we put forward the following proposition:

Proposition 9: An empowerment climate mediates the relationship between profit-sharing plan adoption and firm performance.

5 Conclusion

The intent of this paper is move scholarship towards improving predictions, understanding why firms choose to profit share and how these reasons can lead to improved firm performance. To this extent, we have developed a theoretical model that examines this question. We develop a model based upon two major categories: the level of influence (firm or individual) and environmental factors (internal vs. external). For privately-owned firms in China, we propose that not

only are individual characteristics important in the determination of whether or not to adopt this compensation practice, but that they also affect the effectiveness of this practice on firm performance. Overall we model *micro-in* factors and believe that CEOs who are more benevolent, moral or risk adverse may choose to adopt a profit-sharing plan, but that ultimately it will not have an effect on firm performance. Conversely, leaders who are less authoritative, self-transcendent or self-enhancing may also choose to adopt this plan, but it is through creating psychological empowerment or an empowerment climate that this will lead to increased firm performance.

In addition, we also examine *micro-out*, *macro-in* and *macro-out* factors and propose that leaders who adopt a profit-sharing plan based upon *micro-out* or *macro-in* factors are more likely to enhance an empowerment climate environment making the profit-sharing plan effective in increasing firm performance.

Ultimately, the purpose of this paper is to provide a theoretical basis to examine why profit-sharing plans are adopted in China. How effective this compensation practice will be depends on the reason why the plan is adopted. We provide a lens through which to think about profit sharing plans and why there is a disparity in the literature on how effective this compensation practice is on firm performance. However, the effectiveness of this framework for examining profit sharing plan adoption must be decided in the empirical arena of research.

Acknowledgements Financial assistance from the National Natural Science Foundation Grants (No. 71072142, 71202147, 71372161) is gratefully acknowledged.

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