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Impact of New Wage Rates and Exempt Staff Rules

Are You Ready for Some OT?

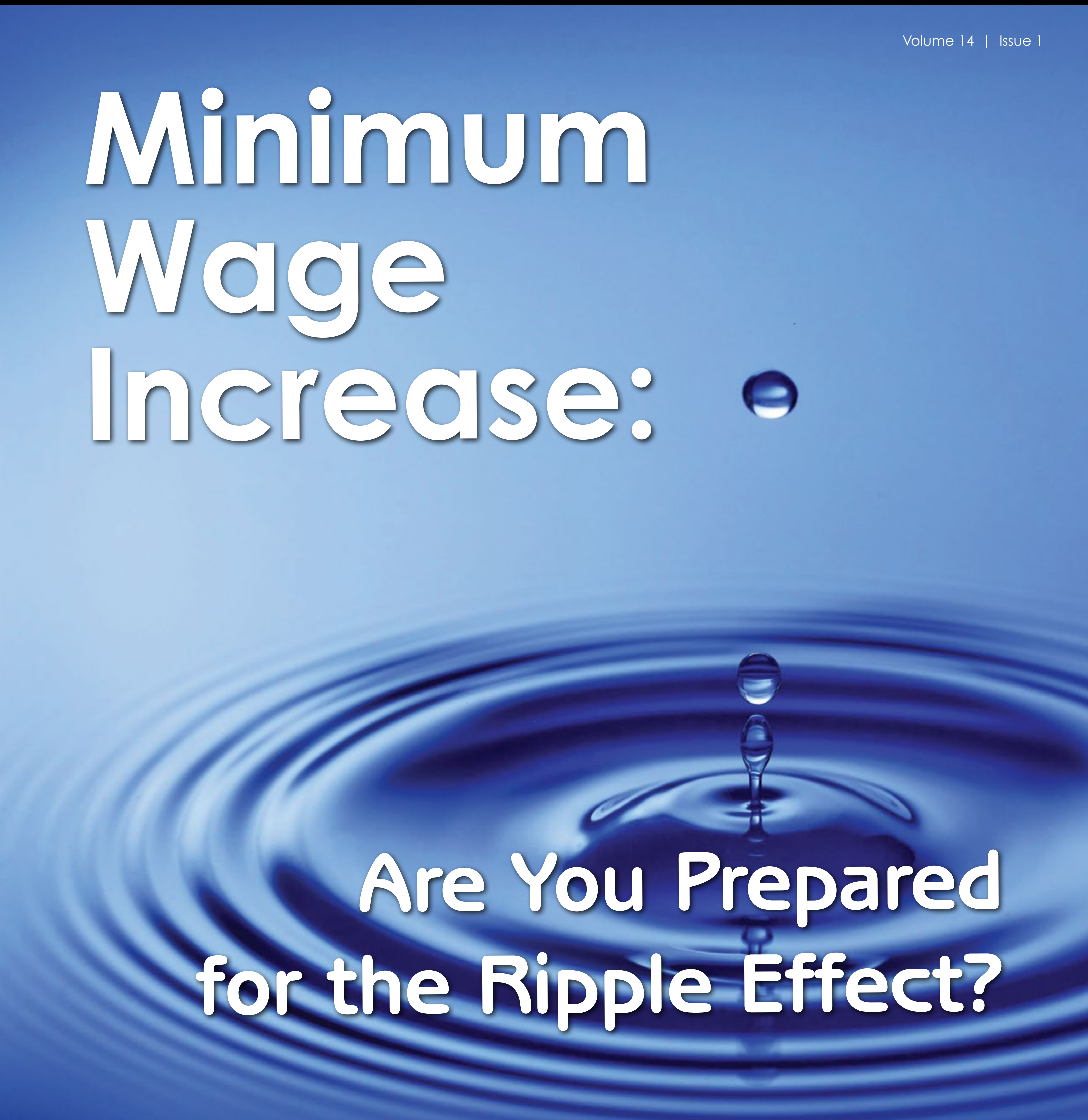
Experts Discuss: Impact of Higher Wages on the Restaurant Industry

Offset the Increase: Focus on Productivity

Volume 14 | Issue 1

Minimum Wage Increase:

Are You Prepared for the Ripple Effect?



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FocusED is published by UniFocus and highlights topics of interest to labor-intensive, service-oriented businesses.

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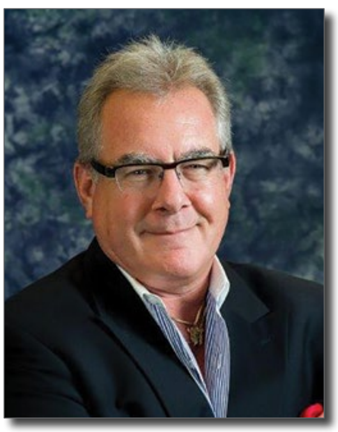
New Wage Rates and Exempt Staff Rules:

What Will the Impact Be?



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Cost of goods, labor costs, overhead, fixed charges, rent/mortgage costs. All have a direct impact on the size of your bottom line. Which is the most critical, and which do you have the most control over?

Well it depends, but in most cases within the service industry, direct operating costs, of which labor is the largest, is the definitive answer not just from a pure dollars and cents perspective but also in terms of impacting customer perceptions. Will the customer come back? Will he/she recommend this place to others? Was the value received "good to great"? Your labor force directly impacts these thoughts and conclusions.

The absolute cost of labor (wage rate) is impacted by a few factors, most of which an organization has little control over.

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1. Supply and Demand: The more demand exceeds supply, the higher the wage rate will generally be. Of course, the inverse is also true, as exemplified over the last seven to eight years.

2. Union Agreements: Pre-determined wage rate changes are "baked-in" to the agreement, and when it is time to renegotiate, the rates rarely go down.

3. Government Regulations: Simply, an organization must comply with the law and stated regulations that stipulate the minimum that must be paid per hour and when overtime should be paid.

If there is one thing that has been made crystal clear over the past few months, it is that the cost of an hour of labor has and will continue to increase across the country based on government directives. Further, with new rules announced regarding exempt and non-exempt staff, the labor costs of running a business related to supervisory and/or managerial staff will also increase for many operations. While I am starting from an absolute perspective relative to wage rates, the impact of these changes on the bottom line results will have to be mitigated to some degree if businesses are going to continue operating effectively and, most important, profitably.

From a mitigation standpoint, an increase in product and/or service prices will create some level of offset to the wage rate increase. Another approach is to find ways to increase overall productivity. Organizations will need to look at how they staff and how their teams are deployed and move to greater utilization of staff, which may well include more thorough cross utilization. This will also drive a need for better and more broad-based training. Automation must, and will, also be considered. As an example, I recently recommended the use of QR codes to a prospective partner for placing orders instead of having a cashier punch the order into the POS. This, obviously, would work for customers who order the same product time and time again. We are already seeing ordering kiosks pop up in certain operations, such as fast service and on-table devices in family-style restaurants, a trend we expect to continue. In fact, there is a movement away from front desk check-in to using smartphones as room "keys." Finally, on the other side of the equation, it is very possible that increases in income will lead to volume increases in various operations. All of these will have mitigating effects on wage increases.

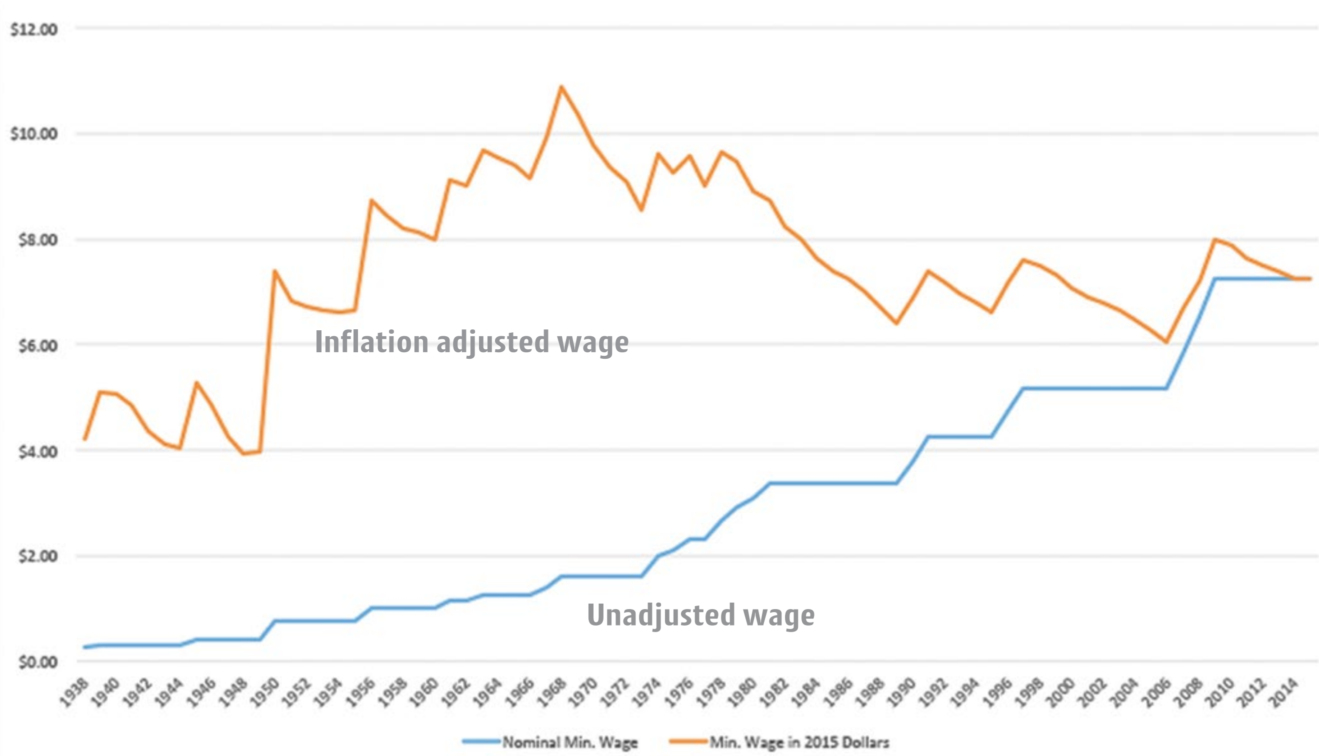
Suffice to say, the markets are going to be impacted by the new wages. In this edition, you will find discussions of impact, mitigation, and operational modifications related to the wage rate changes. We have attempted to bring additional perspective and ideas as to how to address this higher costs environment. I am sure you will recognize that there are other ways of impacting the wage rate increases, but we trust that the enclosed articles will contribute to your discussions. I look forward to your feedback and hope you enjoy this edition.

Best regards,

Mark

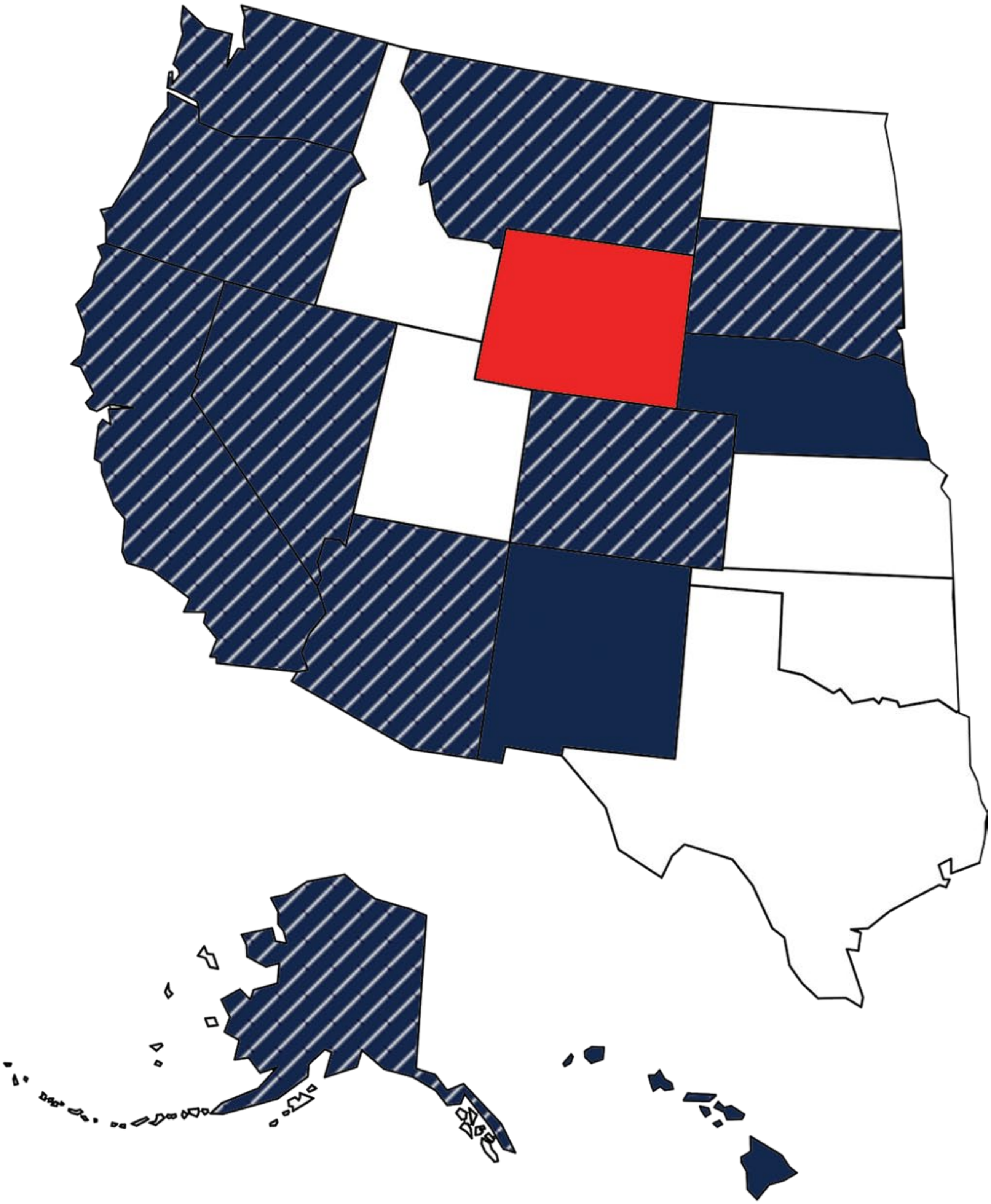
Minimum wage since 1938

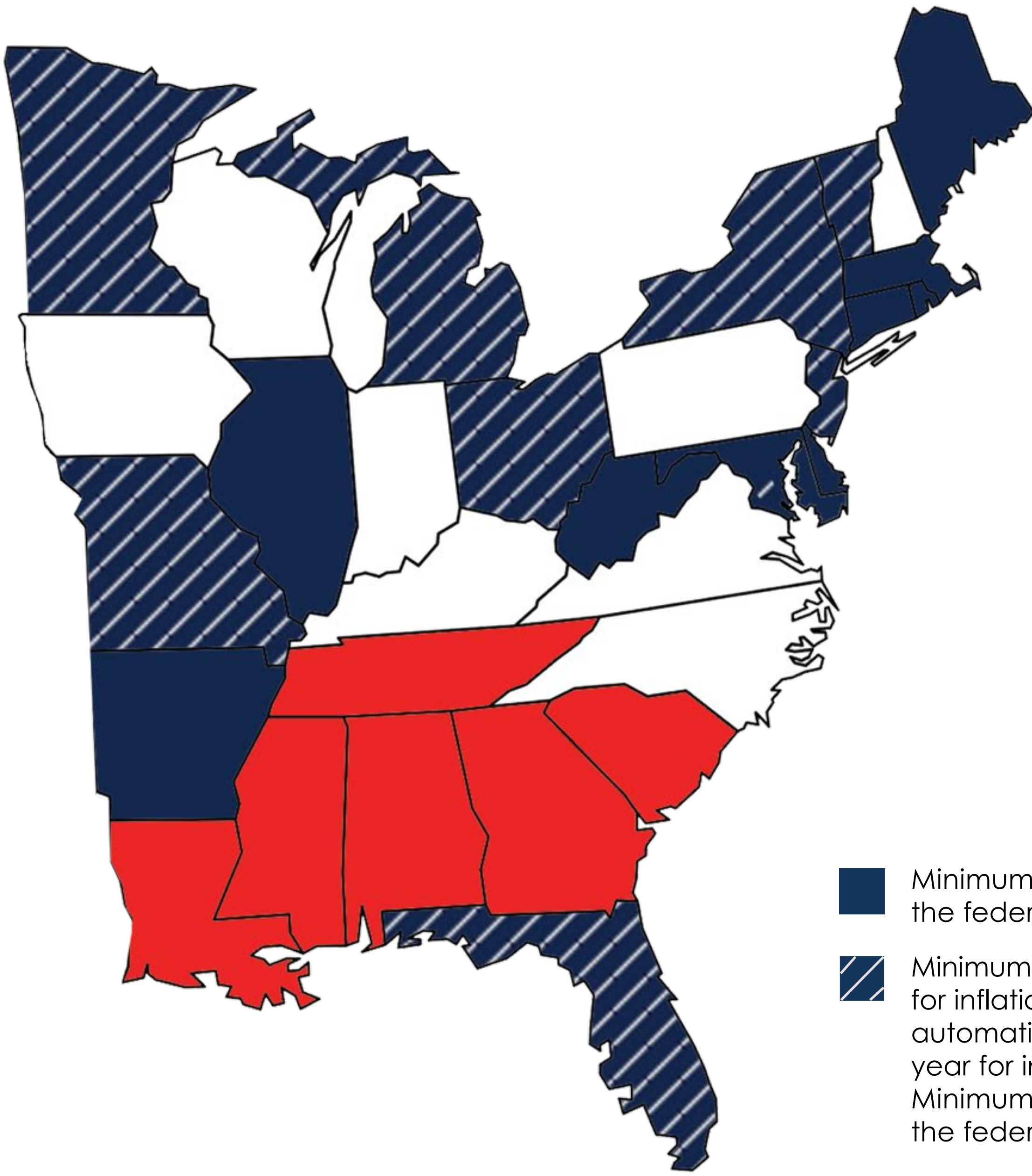
When the federal minimum wage first became law in 1938, it was 25 cents. Adjusted for inflation, that would be worth $4.13 today. See how the historical minimum wage corresponds to the value of today's dollar.



Sources: BLS, DOL; Figures adjusted to 2015 dollars using the CPI-U

Quick Facts on Minimum Wage



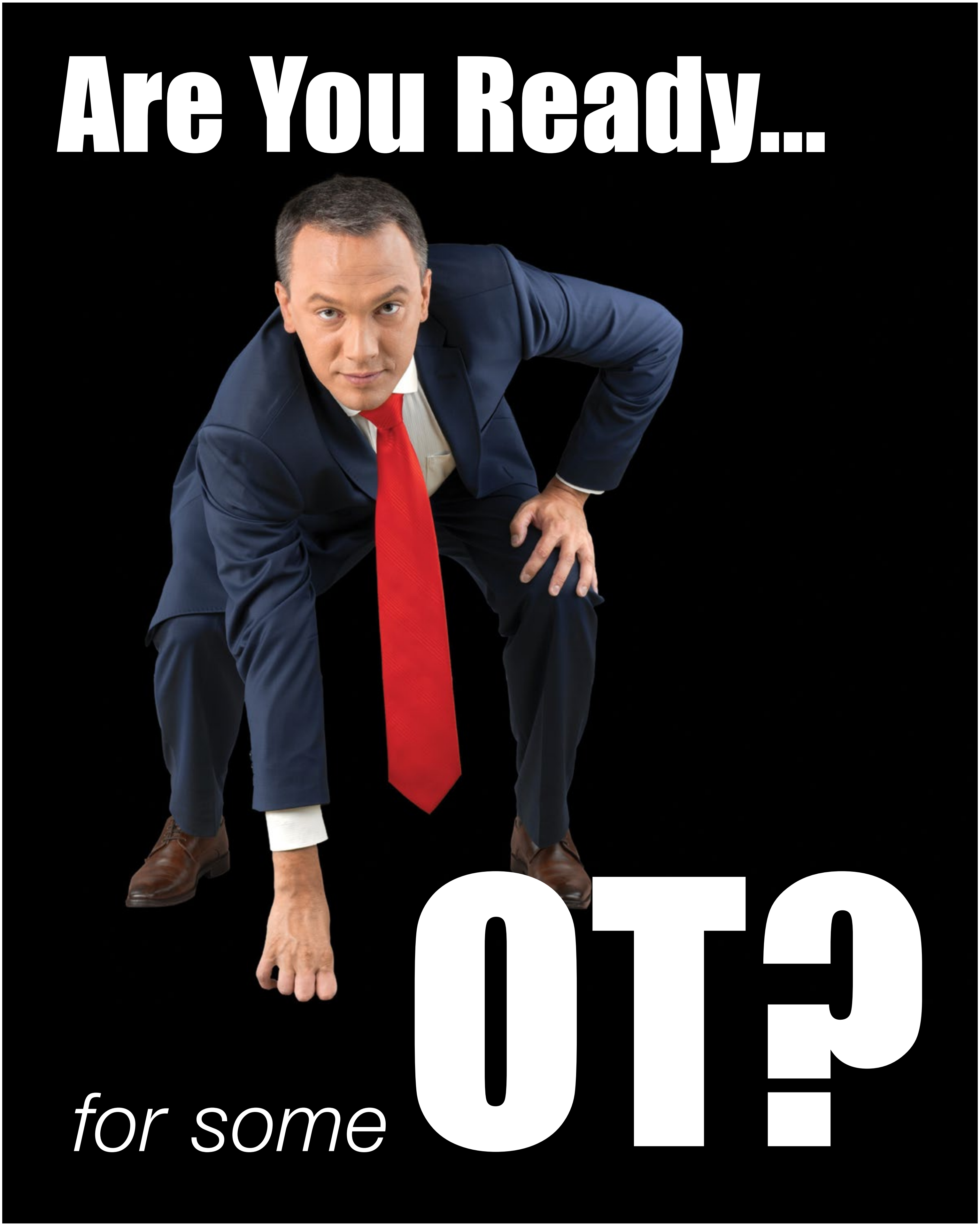


Minimum wage is higher than the federal minimum wage.

Minimum wage is indexed for inflation, meaning it is automatically adjusted each year for increases in prices. Minimum wage is higher than the federal minimum wage.

No minimum-wage law or a state minimum wage below the federal minimum wage. The federal minimum wage applies in all of these states.

Source: Economic Policy Institute, Minimum Wage Tracker


Are You Ready...
for some OT?

For many years, the hospitality industry has had the benefit of paying assistant managers an annual salary of about $30,000 - $40,000 (the equivalent of $15 - $20 per hour) while receiving 45 – 55 hours of work per week from the employee, or even more hours in some instances.

This has been the price one pays to become a department head, a GM, or to go even further in the organization. In an industry that uses a large pool of relatively unskilled labor, we have been fortunate to have access to a group of middle managers who skew young and are willing to work long hours.

All of that is about to change.

"The passage of the Fair Labor Standards Act gave most Americans the right to a minimum wage and time-and-a-half pay for more than 40 hours of work in a week. These rules apply to most hourly and salaried workers, but not to some white collar workers whose salaries and duties exempt them from the overtime pay requirement," according to the Department of Labor. The most recent threshold for white collar exemptions was set in 2004 at $455 per week or $23,660 annually.[1] But, due to prompting from President Obama, the salary threshold for exempt employees will soon be updated.

In July 2015, the Department of Labor proposed a rule that would update and extend overtime protections for more white collar workers. Then, on May 18, 2016, the final rule was announced by President Obama and Labor Secretary Perez. According to the Department of Labor[2], the rule "will automatically extend overtime pay protections to over 4 million workers within the first year of implementation."

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What Changes

1. As of December 1, 2016, the minimum salary threshold for exempt employees will rise significantly from $455 to $913 per week (or $47,476 per year). This means that a manager now making $35,000 a year will be eligible for OT.

2. The rule[3] will affect Administrative, Executive, and Professional workers, and "Establishes a mechanism for automatically updating the salary and compensation levels every three years to maintain the levels at the above percentiles and to ensure that they continue to provide useful and effective tests for exemption."

What it Means

Many organizations will have to make changes to comply with the new rules. If the organization needs managers to work more than 40 hours per week, compensation levels will have to be increased to match or exceed the new minimum. Another option is to increase bonuses and commissions to exceed the new threshold. Some employees may have to be reclassified to non-exempt status. Alternatively, the organization may simply have to pay more in OT to these managers. It is also possible that middle managers will now have to punch a time clock to track hours.

Some companies will look to add more non-exempt supervisors and reduce management staff. And there is inevitably an opportunity to revisit and rethink management responsibilities and duties. How long does a manager really need to be present?

While the new rules won't take effect until Dec. 1, the smart organization has been looking at options and preparing for change. If you're already prepared for the change, send an email to info@unifocus.com and tell us how your organization will handle the new rules. We may post your comments in a follow-up article.

Author's bio

A 30-year hospitality industry veteran, Ken Heymann oversees all business operations at UniFocus. He is an expert on organizational development, change and quality management.

Ken has contributed to such industry publications as The Cornell Hospitality Quarterly, The Bottom line, Lodging Hospitality, and Hospitality Technology. He authored a chapter on Managing Change in Leadership and Quality Management, published by the Educational Institute of the AH&LA. He is the former chairman of the Board of Governors of the College of Merchandising, Hospitality, and Tourism at the University of North Texas and has taught at UNT as an adjunct faculty member.

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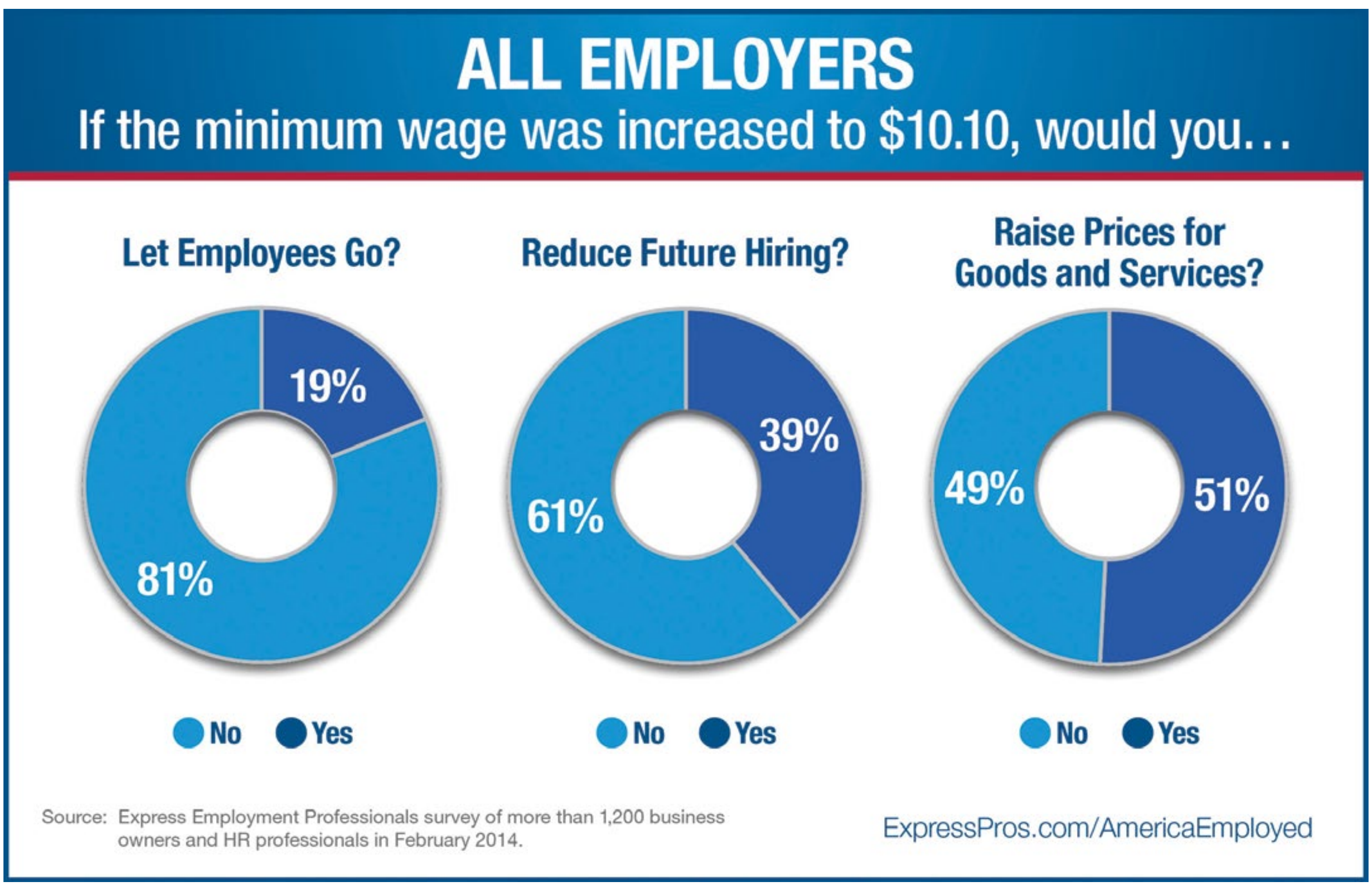
[1]Department of Labor, "Overtime for White Collar Workers: Overview and Summary of Final Rule." https://www.dol.gov/sites/default/files/overtime-overview.pdf
[2]Federal Register (80 FR 38515)
[3]Department of Labor, "Final Rule: Overtime." https://www.dol.gov/whd/overtime/final2016/index.htm



The Impact of Higher Wages on the Restaurant Industry

by Lucy Vlahakis

As restaurant workers' pay rises with the increased minimum wage, will it lead to lower turnover? And what will be the cost to their employers and customers? These questions were the focus of a 2015 study led by Dr. Richard Ghiselli, professor and head of the School of Hospitality and Tourism Management at Purdue University. Spurred by the high rate of turnover in the foodservice industry, the study examined the effect that higher wages and healthcare benefits have on costs and prices in limited-service restaurants, and whether higher pay would create a more permanent workforce.

We caught up with Dr. Ghiselli (RG) as well as Dr. Juan Martinez (JM), principal of Miami-based Profitality, an industrial engineering consulting firm specializing in the hospitality industry, to glean their perspectives on the issue. Here are their insights.

The experts dish

What do you expect the impact of the minimum wage increase to be on the restaurant industry?

JM: A minimum wage increase will force the restaurants that are not already doing so to take action on reducing their labor requirements. The more progressive brands are already doing this, trying to get ahead of the curve.

Our position is that regardless of where the minimum wage is set, or is going, restaurants should always be in a mode to reinvent and innovate in this area, since any savings on labor makes the bottom-line profit higher and drives better “unit economics” that can fuel brand growth.

RG: Focusing on quick service restaurants, the types of positions in these establishments traditionally have been for people who need something part-time to carry them over or for entry-level employees. If we start paying $15 or more per hour, we’re transforming what were part-time and entry-level jobs into full-time, permanent jobs. They become our new manufacturing jobs, if you will, now that the labor force has moved from manufacturing to service.

Do you see a difference in how the minimum wage increase is affecting the various segments?

JM: I would expect a difference, since the baseline labor line is different for various types of restaurants – for example, QSR, fast casual, casual dine, and family dine. The segments that rely on lower-cost labor will feel it more, all other things being equal.

Do you expect service levels to change?

JM: Yes, and it's already happening. You can see it in the application of more self-order technology – at the table, with kiosks and smart phone ordering. By the way, this does not mean service will be worse, since a machine can be as nice, or nicer, than a bad employee. Service as we know it today will be different, for sure.

RG: To the extent possible, we will try to engineer service out of the equation, reducing the human inputs as much as we can. Hotels do this already. You can make a reservation, check in with your phone and never visit the front desk. You've engineered a whole job out of the equation. If possible, restaurants will likewise try to minimize the labor that's needed, replacing it with technology.

Do you expect a reduction in turnover rates?

JM: Possibly, but this will be strongly tied to the fact that the baseline on the number of employees will be lower. There will likely be more full-time employees.

RG: I think there will be. The whole premise of my 2015 paper on higher wages is that the increase would lead to a more permanent workforce.

With an increase in minimum wage, do you expect to see a reduction in employees who have two jobs?

JM: This question has an economic implication to it, and I am not an economist by any stretch of the imagination. From a basic need perspective, however, a worker who puts in fewer hours for one employer might need to get a second job, unless the hourly rate rises to such a level that his or her income is maintained. The economic-based question in my mind is whether or not there will be two jobs available. If all businesses get hit with the wage increase, there may be cuts across the board. So will the overall number of jobs decline?

RG: If quick-service jobs evolve from part-time, entry-level work into permanent, full-time positions, a wage of $15 per hour for 30 to 40 hours still leaves many workers on the edge of needing a second job. Raising a family would continue to be a challenge at $15 per hour.

Do you see anyone focusing on productivity as a way to offset the increase in minimum wage?

JM: Yes, yes, yes. Restaurants will have no option but to do this. Fortunately, there are many ways to achieve an increase in productivity to help offset the labor cost increase.

RG: I think they'll be looking for ways to reduce labor via technology, perhaps using some kind of forecasting model. If organizations can maintain sales, reducing labor will automatically increase productivity.

What impact do you see the increase in minimum wage having on the healthcare mandate?

JM: I would guess that more employed workers will be able to afford healthcare since they will make more money, unless their hours get reduced. But how will those who are not employed pay for it? So perhaps there will be an impact, but this question again is one for an economist.

RG: When some of the small-business subsidies go away in the next year or two, that's when the healthcare impact will kick in. It will potentially be a considerable challenge for companies to provide healthcare or enable workers to purchase healthcare. There's work to be done in that area.

How have past minimum wage increases impacted the restaurant industry and what has been the time frame for normalization historically?

JM: I have no statistical information to support my statement, but any minimum wage increase impacts the need for restaurant concepts to become more labor efficient. This is also the case when development costs go up. My position is that restaurants should be on a continuous improvement path in all areas. This approach will keep them lean, providing them with a competitive advantage in the marketplace. The essence of Profitality's industrial engineering approach is based on the premise of continuous improvement in efficiency: efficiency of people (labor), place (facility design), platforms (equipment and technology), products (quality and ease of delivery), promotions, etc.

RG: We haven't had a minimum wage increase in quite a while. When they do occur, employers look to minimize impact in terms of the number of hours they schedule. I anticipate the same here. I also anticipate that higher wages ultimately will lead to inflation and we're going to see the cost of dining out rising. When that happens, everyone else will have to pay for it. Maybe business declines a little as people manage their incomes. Some might, for example, approach their employers for more money in order to maintain their living standard, which might include going out several times a week.

Quick-service restaurants specifically are very price-sensitive. They compete on price. We should expect that if wages go up, there will also be an increase in quick-service prices. The extent of the impact will depend on current wage rates in a particular prevailing area. Some cities are currently close enough to a $15 wage that the impact will be minimal. But rural communities are going to feel it much more.

For more on Dr. Ghiselli's research, see The Minimum Wage, A Competitive Wage and the Price of a Burger: Can Competitive Wages be Offered in Limited-Service Restaurants?

Try out the Purdue HTM Wage Impact Calculator. This online calculator was developed by The School of Hospitality & Tourism Management researchers to assist owners and managers of limited service restaurants in determining the impact an increase in hourly pay has on profit income.

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Profitality provides industrial engineering consulting services to the hospitality industry. Its experts apply principles of operations engineering, industrial engineering and ergonomics to develop "employee centric" designs that simplify operational execution, resulting in better customer service throughput, sales, profit and return on investment.

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The School of Hospitality and Tourism Management (HTM) is a global leader in hospitality management education. Students gain professional skills required for corporate management careers or for managing the demands of their own future enterprise.

Long-recognized as a leading hospitality management program, its mission is rooted in experiential, theoretical and analytical learning. Endorsed by the Accreditation Commission for Programs in Hospitality Administration, HTM's program combines sound research and real-world engagement, leading to highly sought after graduates throughout the industry.

To Offset the Increase in Minimum Wage...

Focus on Productivity

Published in Hotel Business Review - April 2016

Fourteen U.S. states started 2016 with a higher minimum wage, and it seems all but certain that the federal minimum wage, which has remained at $7.25 since 2009, will soon follow. The White House has thrown its support behind the Raise the Wage Act, which would increase the federal minimum wage to $12 by 2020 - a move that also has the support of 60 percent of small businesses, according to a poll conducted for Small Business Majority by Public Policy Polling.

Meanwhile, a Hart Research poll shows that 63 percent of the public favor an even larger federal increase - to $15 - over the same time frame. This higher figure has been embraced by New York's governor, who has signed a bill implementing a 70-percent raise in his state's fast food minimum wage to $15 by 2018, and by several cities that have committed to phase in a $15 minimum wage, including Los Angeles; Portland, Ore.; San Francisco; and Seattle.

Bottom-Line Impact

The benefits of a higher minimum wage are clear for those workers who will bring home a bigger paycheck, but what will it mean for service industry employers and their customers? While historically raising the minimum wage has had little impact on profitability, those increases were typically incremental. In 1978 for example, the federal minimum wage grew from $2.65 to $2.90 - a 25-cent increase. Today's proposed changes are in the ballpark of four or five dollars an hour, which will have a more dramatic effect on organizations. And those that fail to review their business model and adjust their operating philosophy to offset the higher labor costs could potentially experience a dollar-for-dollar negative impact on their bottom line.

The Ripple Effect

Minimum-wage workers may be only a limited percentage of a hotel's staff (this will vary by area of the country and by state), but raising their pay will likely create a ripple effect in the market. Consider that there also will be employees who are paid above the current minimum wage but below the increased minimum wage. If the hotel only raises those workers' wages to the new minimum, it puts them at the same wage level as workers who had been earning less. This could well lead to a discouraged group of employees or a less engaged team, and that could have a broader impact on the bottom line. The alternative would be to increase those employees' wages at the same differential as their minimum-wage-earning colleagues.

Whether that differential is a percentage or an absolute dollar-for-dollar increase could make a significant difference in labor costs. For example, one employee is paid $7.25 per hour and another earns $10 per hour, or 38 percent above minimum wage. If the minimum wage is raised to $10.50 per hour, does the employee who had been paid $10 per hour get the same dollar increase as the minimum-wage employee, for a new wage of $13.25 per hour? Or does the higher-paid employee continue to earn 38 percent above minimum wage, bringing his or her wage to $13.80? That's a larger gap than a pure dollar-for-dollar increase. Now consider the impact in a city like Los Angeles, where the differential will be even greater as the city phases in a $5, or 50-percent, increase that will take the minimum wage from $10 in 2016 to $15 by 2020.

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Offsetting Higher Labor Costs

So how can hoteliers and other service operators make up the difference? Mitigating the effects of a higher wage will require a heightened focus on the bottom line. Operators will therefore need to keep costs in line not only with financial goals but also with service delivery goals. They'll need to look at how they structure staffing levels and how flexible their team is. And, they'll need to find the point at which intent to recommend and return remains high while creating a least-cost structure for service delivery.

Pass the Increase to Customers

A simple solution is just to increase prices; in some cases the market may well absorb some of the higher labor cost. Hotel room rates might be the simplest to address in that manner. For example, if the ADR is $200 and the wage rate for housekeeping staff increases from $10 to $15 per hour, assuming all positions in the housekeeping department use one hour per room, the hotel could easily absorb the wage difference into the ADR by pushing it to $205 -- a 2.5% increase. This might not even be noticeable because of the high starting point of the revenue per unit.

Although likely not as easily, a similar approach could be taken with a hotel's food and beverage operation. If a restaurant's cost of labor goes up by $250 per day, the business could calculate average covers and increase menu prices by an amount that offsets the higher labor cost, just as in the room sales operation. How much of an increase customers would be willing to absorb will depend on the price elasticity of the organization, but in a 2014 Reason-Rupe poll, a slight majority - 51 percent - of respondents indicated they would support a higher minimum wage even if that increase caused businesses to raise prices. Obviously, the market will dictate what can be done from a pricing standpoint.

Improve Productivity

Organizations that offset the wage increase by identifying opportunities to improve productivity will ensure that their value proposition remains strong, giving them a competitive advantage. Hoteliers will need to rethink how their business is run and strive to better match staff availability to customer demand. This may mean reducing staff, but not necessarily. Rather it will also be a matter of better allocating hours for the workers they have. In making its case that job loss is not an inevitability with a minimum wage hike, the U.S. Department of Labor cited San Francisco as a market that last year experienced positive job growth in the leisure and entertainment industry (which includes full-service restaurants) despite a recent increase in minimum wage. Increases in business can help distribute the impact of higher wages over a larger number of customers, particularly in fast-transaction operations, such as quick-service restaurants.

Organizations can also address the minimum wage increase by assessing under-utilized hours and redeploying them for better bottom-line results. They might also consider employing more part-time workers who only cover business peaks and are willing, or even prefer, to work shorter shifts.

Staff Flexibility

One approach to boosting productivity is flexible staffing, which could include having certain employees work across departments. Consider the front desk at a hotel, where from 11 a.m. to 3 p.m. there may be little activity. That presents an opportunity to move a front desk employee to the restaurant for those hours to serve as host. The service industry has been challenged by minimum shift requirements that negatively impact labor costs. While its clearly reasonable for employees to expect to be utilized for a certain number of hours when they come to work, departmentalization coupled with minimum shift requirements has reduced productivity as well as job enrichment. Cross-departmental staffing, possibly coupled with a pay-for-skill program, can reduce the impact of minimum wage increases while also having a positive impact on staff attitudes.

Reduce Shift Hours

Historically, reducing shift hours has been perceived as a penalty rather than a positive strategy to offset

the overall costs of doing business. Yet staffing shorter shifts at a slight premium can be a creative approach to applying labor from a pure dollar component. Washington, D.C. is one market that currently pays such a premium, in this case time and a quarter, for an employee working fewer than 20 hours.

Taking this approach to a natural extension, organizations could strive to better match hours worked to the actual work content required. For example, assume an operation needs to cover a two-hour peak. Instead of a minimum four-hour shift at a $15-per-hour wage rate (or $60 for the work to be done), management could seek out staff to work a three-hour shift for $16.50 per hour ($49.50), or a two-hour shift for $18 per hour ($36). This would save the business either $10.50 or $24 for the same work content that formerly cost $60. From the worker's perspective, the same four hours that used to produce a $50 payday could now be worth $72, or a 20-percent premium.

Admittedly, there are challenges to this scenario. It assumes the individual could find another two-hour shift at the higher rate. It also would require changes in union agreements. And, it would take greater coordination and understanding of real work needs on the organization's part (technology no doubt can help on that front). Assuming these challenges are surmountable, moving to shorter shifts could lead to the market rethinking its absolute dollar cost of service versus the hourly wage rate. At the same time, it would create greater flexibility in the workforce as well as higher wages for staff who embrace that flexibility.

Food for Thought

Beyond higher labor costs, increasing the minimum wage will have ramifications on everything from employee engagement to healthcare costs. Here are a few areas to consider:

- Effect on spending habits. Higher wages mean more disposable income. Will higher paid minimum-wage workers be inclined to dine out or travel more often, creating new service industry customers? What about those who were making $14 an hour and are now making $20? This creates a real potential for positive growth.
- Crossing borders for higher pay. Will workers be willing to travel farther to take advantage of a higher minimum wage in a bordering state or city? If California is paying $10 per hour while Nevada pays $8.25, how many Nevada residents living near the border will cross the state line for a 20-percent higher wage? What if the wage difference is 30 to 50 percent?

- Effect on engagement. From an attitudinal standpoint, how an organization handles the minimum-wage increase will also have an impact. Those businesses that don't provide a proportional raise will experience wage compression and most likely a disgruntled workforce. How will this affect employee engagement and turnover rates? Will those businesses that do raise wages proportionally create a higher satisfaction level among staff? What will be the impact on how their workers approach tasks and the level of service they provide customers? Keep in mind that wage changes impact attitudes only for a short period of time. Engagement is driven more by managerial practice that hourly wages.

  Businesses in the lower-paying market also need to consider the potential negative impact on staff turnover and training costs.
- Quality of work. Does an employee work harder, and better, for $15 per hour versus $10? Perhaps in the short term, but not over a longer period. That said, an improved quality of life for employees who, thanks to a higher wage, no longer have to carry two jobs to make ends meet could lead to better on-the-job performance. This could theoretically also impact total market employment, which can increase market spend on the service industry.
- Mitigating healthcare costs. With the advent of changes to healthcare regulations under

the Affordable Care Act, a minimum wage increase will offer a positive side effect for organizations that provide healthcare to their workers. Since the employee contribution is a percentage of income - which for 2016 is capped by the IRS at 9.66 percent - a higher wage means a higher employee contribution, offsetting some of the employer's healthcare costs. For instance, full-time employees at $10 per hour whose income is raised to $15 per hour will then contribute $1,000 per year more to their employer-funded health care plans.

At the end of the day, the industry will probably address the minimum-wage hike with a mix of several approaches. Hotels will look to improve productivity with more covers per hour or more revenue per hour while at the same time potentially increasing prices. And those that do a better job of truly understanding customer demand for service, match their labor to that demand, and increase employee flexibility, will likely create a greater offset financially to the impact of higher labor wage rates.

Author's bio

Mark Heymann is a founding partner and the chairman and CEO of UniFocus, the leading workforce performance firm in the service sector. He brings to his position more than 40 years of expertise in the industry, particularly in hospitality.

Did You Know that Minimum Wage Increases Stimulate Small-Business Growth?

By Ralph Varble
VP of Operations, UniFocus

Opponents of raising the minimum wage argue that higher wages increase operating costs for small businesses, implying an inherent increase in small business failures, which outweighs the benefits of raising the minimum wage. However, a study published in 2004 by the Fiscal Policy Institute found that small-business growth doubled in states with higher minimum wages for the four years following the 1997 minimum wage increase[1]. A 1998 article in *Journal of Economic Issues* published research that echoed these findings. The article stated that over a 30-year period, there was no correlation between business failures and increased minimum wage during the two years after an increase[2]. Furthermore, both studies actually found that a raise in the minimum wage increased small-business activity and growth.

Ralph Varble, VP of Operations at UniFocus, is an expert in labor management and operations. He has 20+ years of hospitality experience, including a previous role as the VP of a hotel management company.

[1] "State Minimum Wages and Employment in Small Businesses," Fiscal Policy Institute, April 20, 2004.
[2] Jerold Waltman, Allan McBride and Nicole Camhout, "Minimum Wage Increases and the Business Failure Rate," *Journal of Economic Issues*, Vol. 31, No. 1, March 1998.

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