

Surviving the Minimum Wage Increase: A Case Study Of An Independent Restaurant

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Introduction

According to the International Labor Organization (1992), minimum wage is defined as “the minimum amount of remuneration that an employer is required to pay wage earners for the work performed during a given period, which cannot be reduced by collective agreement or an individual contract.” The federal government had increased the minimum wage from 1938 to 2009 trying to reflect the living cost and inflation as well as to reduce poverty and increase the consumption level (Committee on Education and the Workforce Democrats, 2018; Doyle, 2017). As of 2018, the federal minimum wage is set at \$7.25 per hour, and the current federal minimum wage has not changed for almost 10 years.

The state minimum wage for each state varies depending on their state policies. For example, Georgia and Wyoming have a state minimum wage of \$5.15 per hour, which is lower than the federal rate while Washington, D.C., has the highest minimum wage rate of \$12.50 per hour. As for Mississippi and Louisiana, they do not even have a state minimum wage (United States Department of Labor, 2018a). Some counties and cities also set their own minimum wages based on the living costs that may differ from the federal and state minimum wage. For situations where an employee is subject to different minimum wage rates from federal, state, and local law, the highest minimum wages among them will apply (United States Department of Labor, 2018a).

Recent trends show that minimum wages are increasing (Doyle, 2017). On September 15, 2017, the Department of Labor issued a notice that the minimum wage rate for federal contractors would be increased to \$10.35 per hour beginning January 1, 2018, under Executive Order 13658 (United States Department of Labor, 2018b). As of January 1, 2018, 18 states have increased their minimum wages reflecting the heightened living costs and inflations (Horowitz, 2017). Among them, 10 states (Arizona, California, Colorado, Hawaii, Maine, Michigan, New York, Rhode Island, Vermont, and Washington) have increased their minimum wages adhering to previously approved ballot initiatives or legislation (Jennings, 2017). Eight other states including Alaska, Florida, Minnesota, Missouri, Montana, New Jersey, Ohio, and South Dakota have also increased their minimum wages based on annual cost-of-living statistics (Jennings, 2017).

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This case study focuses on the impact of increased minimum wages in the restaurant industry because it is highly dependent on minimum wage labor. As the possibility of going out of business becomes higher and higher due to this increase, it has raised some critical concerns among restaurant owners and employees. Especially, independently owned and operated restaurants are concerned as they are more vulnerable to the effects of the minimum wage increase than their chained or larger counterparts. With minimum wage increases directly affecting small businesses, the impact can be quite serious. Many restaurants have already taken various measures to remedy this situation and minimize the costs. Therefore, this case study illustrates the impact of the minimum wage increase on restaurants and suggests some possible solutions to address the minimum wage increase for the restaurant in question. In addition, the effects of the minimum wage increase influencing the employees will be discussed as well. After reading this case study, completing assignments, and answering discussion questions, students will be able to:

- Analyze the effects of the minimum wage increase on restaurant businesses and employees
- Evaluate the pros and cons of potential solutions for the minimum wage increase from a managerial perspective
- Develop strategies to overcome financial issues caused by minimum wage increases in restaurant businesses
- Conduct supplementary research on the impact of increased minimum wages on independent businesses and employees (graduate students only)

Pros and cons of increasing the minimum wage

There are several pros and cons of increasing the minimum wage. One of the pros is that low-wage, low-skill workers can earn a higher income and a higher standard of living. Also, government expenses for social programs can be reduced as the higher income for workers can potentially help them out of poverty (ProCon.org, 2018; Sherman, 2014). In addition, employee productivity may be improved due to an increased income level (Committee on Education and the Workforce Democrats, 2018). Increasing consumer spending to help with the overall growth of the economy is also another possible benefit that can be expected from minimum wage increases. Last, the government may be able to generate more revenue due to increased payroll taxes paid by consumers when they spend more with their extra earnings.

Conversely, there are several cons to increasing the minimum wage. Numerous studies have indicated that higher minimum wages lead to lower employment and job reduction as employers are burdened with heightened labor costs (Burkhauser, Couch, & Wittenburg, 2000; Deere, Murphy, & Welch, 1995; Kim & Taylor, 1995). This leads to a challenge for existing employees as they face being laid off by the employers who opt for investing in business automation, machinery, and technology to boost productivity over human resources. Also, despite the good intentions of the government to help reduce poverty, the low-wage, low-skill employees are most likely to be affected by lower employment as they are the easiest to lay off (DePillis, 2018; Doyle, 2017).

Minimum wages in California and San Francisco

In California, the state minimum wage has been increasing for the last 10 years as seen in Figure 1. As of January 1, 2018, the state minimum wage for businesses with 25 or less employees is set at \$10.50 per hour, and the state minimum wage for businesses with more than 26 employees is set at \$11.00 per hour. Moreover, the state minimum wage is scheduled to be increased even further to reach \$15.00 per hour for both businesses with 25 or less employees and businesses with 26 and more by 2023 and 2022, respectively. This minimum wage increase would allow about 5.26 million workers in California to earn a higher income, and among them, about 79.2% of the restaurant industry workers would receive a wage increase as well (Reich, Allegretto & Montialoux, 2017).

Some cities have their own city minimum wages (United States Department of Labor, 2018a). San Francisco was the first city in the U.S. to apply a citywide minimum wage that was higher than the state and

federal minimum wages in 2003. In 2014, the voters in San Francisco passed an initiative to raise the local minimum wage rate to \$15.00 per hour by July 1, 2018, and to adjust the wage rate to reflect the annual increase in the Consumer Price Index each year from then on (Office of Labor Standards Enforcement, 2018). All employees in San Francisco who work at least two hours a week including part-timers and temporary workers are affected by San Francisco minimum wage (Office of Labor Standards Enforcement, 2018).

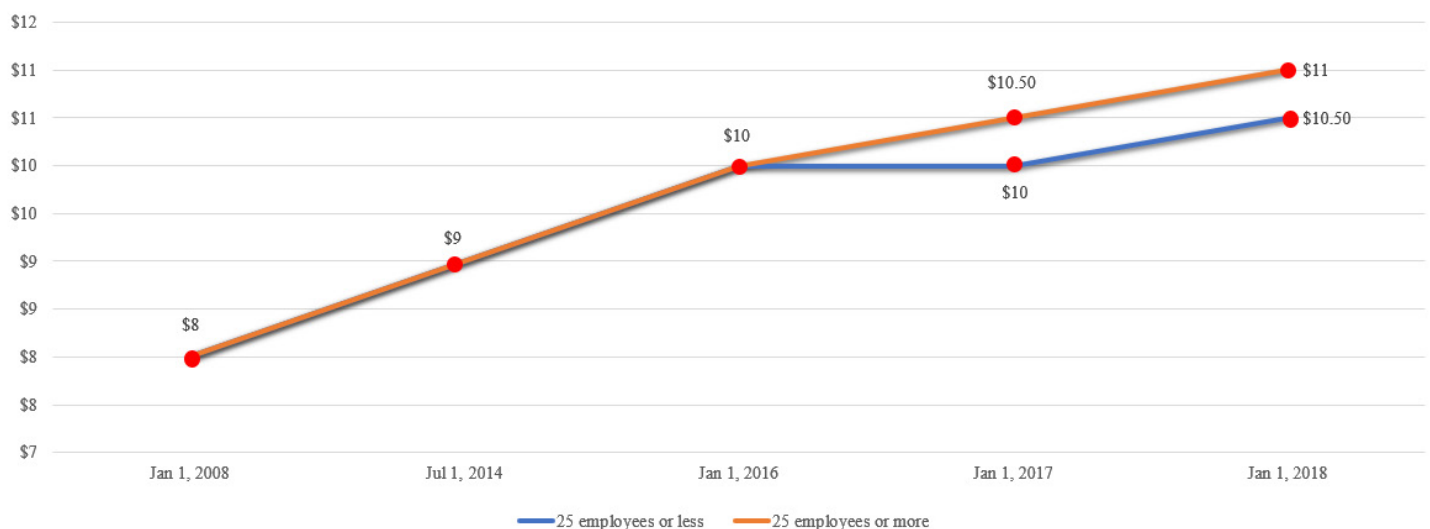
The impact of the minimum wage increase on the restaurant industry

In general, 50% of all employees working for minimum wage work in restaurants, and over 50% of restaurant workers are on minimum wage. Therefore, the minimum wage increase affects the restaurant industry more seriously than other industries (Worstall, 2017). Specifically, restaurants as a whole are expected to experience about a 16% increase in total wage costs (Reich et al., 2017). With this increase, restaurants may not be able to hire as many employees as before.

The minimum wage hikes will also increase the percentage of labor cost that will affect the profit of the restaurant owners (Buckley, 2018; Houck, 2018). The average labor cost in table service restaurants ranges from 30-40% of the total volume of sales depending on the number of menu items and the size of the restaurant, and food costs including beverage costs usually account for 28-35% (Buckley, 2018). In order for a restaurant to make a profit, the prime cost that includes food, beverage, and labor costs (salaries, wages, and benefits) should stay between 60-65% (Buckley, 2018). With the increase in minimum

Figure 1

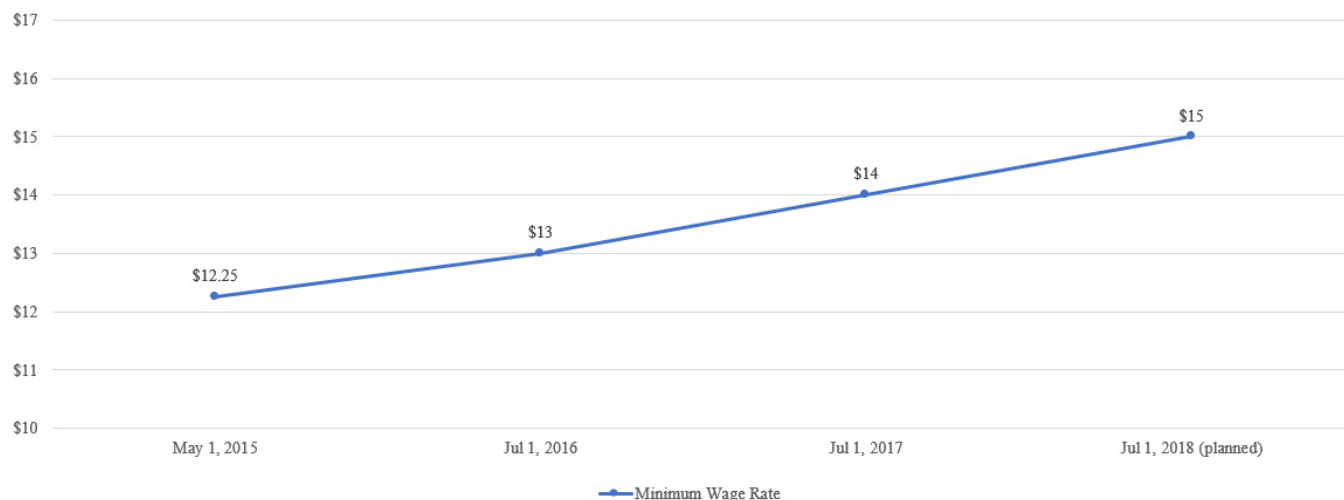
History of California minimum wage.



Adapted from State of California Department of Industrial Relations (2018)

Figure 2

History of San Francisco minimum wage.



Adapted from City and County of San Francisco (2018)

wage, the percentage of labor cost will go up which, in turn, potentially reduces profit unless other measures are taken.

The majority of restaurant employees are tipped employees. Tipped employees are defined as “those who customarily and regularly receive more than \$30 per month in tips” (United States Department of Labor, 2018c). Under the Fair Labor Standards Act (FLSA), employers should pay the cash wages of at least \$2.13 per hour to tipped employees, and, if an employee does not earn the hourly minimum wage after combining the cash wages and tips, the employers must make up the difference (Workplace Fairness, 2018). If the minimum wage increases, the difference that employers are responsible for would also be raised.

Business Background

Julio's Mexican Restaurant is an independently owned and operated Mexican restaurant located in the San Francisco Bay Area. Julio, the owner and manager of the restaurant, has been operating the business for seven years serving authentic Mexican cuisine to locals and tourists alike. It has received an average of 4.5 stars on Yelp's rating system from hundreds of customers since it opened. Julio's has 15 tables serving lunch and dinner from 11:00 a.m. to 10:00 p.m. It is open six days a week from Tuesday to Sunday. Julio's provides a wide range of appetizers, salads, soups, main entrees (e.g., tacos, burritos, enchiladas, and fajitas), and desserts at a price range of \$7 to \$23. In the front-of-the-house, there are eight employees in total including two hosts and six servers who are nonexempt, tipped employees directly affected by minimum wage. In the back-of-the-house, there are a total of 12 employees including a chef, a sous chef, eight assistant cooks, and two dishwashers, among which, except for the chef and the sous chef, are nonexempt employees. The chef and the sous chef are

exempt employees who are paid by salary and are not impacted by minimum wage. There are two shifts for each day: 11:00 a.m. to 4:30 p.m. and 4:30 p.m. to 10:00 p.m. The current food/beverage cost for this restaurant is 34% and the labor cost is 31% of the total sales.

Recently, the City of San Francisco increased the minimum wage from \$13.00 per hour to \$14.00 per hour and is planning to further raise the minimum wage to \$15.00 per hour in July 2018, which is higher than California's minimum wage as seen in Figure 2. This is due to the high living cost in San Francisco, and restaurant owners are to follow the local minimum wage regulation, which is to pay all hourly employees the minimum wage as specified by San Francisco (Minimum-Wage.org, 2018). This will impact the hourly paid restaurant employees including hosts, servers, assistant cooks, and dishwashers (City and County of San Francisco, 2018). Among these workers, hosts and servers are tipped employees. Unlike some states that set their minimum cash wage payment the same as required by Federal Fair Labor Standards Act of \$2.13 per hour, the state of California requires employers to pay tipped employees the full state minimum wage before tips (United States Department of Labor, 2018d). With this increase in the minimum wage, Julio faces some critical financial challenges in his operation due to the increased labor costs. Looking at his neighborhood competitors, Julio has noticed some restaurant owners have already taken actions to minimize the risks.

In order to thrive in this situation, Julio has come up with the following five possible solutions that may help him minimize the risks and maximize the profits for his business. He needs to evaluate each solution and decide which one to implement in his restaurant to best help him address this situation.

Solution 1

Julio can increase the menu prices in order to increase the amount of profit. By identifying any menu items that are cheaper than the competition through market research, Julio can increase the prices of those items to match the prices of the competition. This would allow Julio to gain more profit and to justify the price increases, enabling him to utilize the extra income to make up for the increased labor costs derived from the rise in the minimum wage.

Solution 2

Another solution is to reduce the portions of certain menu items in order to save on food costs. By reducing the portion of high-cost items that are relatively expensive to prepare, Julio would be able to compensate for the increased labor costs with the reduced food/beverage costs.

Solution 3

Julio can also choose to implement 2 hours of break time between the lunch and dinner operations in order to reduce the operating hours and thereby save on the labor costs. The break time should be between 3:00 p.m. and 5:00 p.m. because it is the slowest period of operation. The new hours of operation would be 11:00 a.m. to 3:00 p.m. (lunch) and 5:00 p.m. to 10:00 p.m. (dinner). This will allow the restaurant the time to prepare for the dinner operation, which tends to attract more customers compared to lunch, as well as to cut down on the labor costs since Julio will be paying for fewer working hours.

Solution 4

Another possible solution is to have no hosts at the restaurant. Customers would seat themselves and servers would only deal with taking orders, bussing, and transactions. Julio would be able to cut down on the labor costs with this option.

Solution 5

The last option is for Julio to choose to fully automate the front-of-the-house by installing a point-of-sales (POS) system on each table and eliminating both hosts and servers. Using the POS system on kiosks, customers would create orders and make payments at their tables directly. Also, by eliminating the hosts and the servers, the restaurant can be turned into a self-service operation where customers order using the POS system, then pick up their own foods from the counter. This scenario would boost the productivity of the restaurant even with fewer employees (exempt and nonexempt) and save considerably on labor costs.

Discussion

With the increased labor costs caused by the minimum wage increase, Julio's Mexican Restaurant faces some critical financial challenges. In order for Julio to successfully tackle the situation, the following questions need to be answered:

- Will the increase in minimum wage affect independent restaurants positively or negatively? Why or why not?
- Will the minimum wage increase affect the job satisfaction of the restaurant employees? Discuss the possible pros and cons from the perspective of employees.
- Identify the benefits and challenges of each of the 5 solutions offered.
- Considering the benefits and challenges of each option, what would be the best choice for Julio's restaurant that would minimize the risk and maximize the profits? Justify your answer.

Additional Readings

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