case study

Ivar's Tipping Point: A case study

By Mark Beattie, Terry Umbreit and Jessica Murray

Introduction

The Fair Labor Standards Act originally passed in 1938 set a federal minimum wage. Several states, including Washington state have established their own minimum wage. Effective April 1, 2015, the Seattle Municipal Code 14.19 established its own minimum wage for the city. Implementation over six years with rates for small and large employers, the policy created controversy and confusion for Seattle employers (Tu, 2016). Particularly affecting restaurants since they are a labor-intensive industry.

Theoretical Concepts

Economic theory posits that minimum wage increases will adversely affect employment of low-wage workers (Lynn & Boone, 2015). This assumes a perfectly competitive economic system, which is difficult to establish in an area as large as Seattle and its surrounds. Institutional economists see markets in relation to the socio-political environment (Schmidt, 2015). Competiveness in labor markets recognizes the supply and demand of worker is in an area, but complicates the effects of minimum wage when employees work in locations outside of a city such as Seattle.

Conflicting studies have not produced clear explanations on the effects of minimum wage policy. O'Niell and McGinley (2015) concluded that "the effects of extreme minimum wage increases may be particularly acute in certain less profitable sectors of the hotel industry (p. 19). Conversely, Lynn and Boone (2015) found that "the industry's objection that minimum wage hikes will cause restaurants to close are largely unfounded" (p. 12). Jardim, et al., (2018) reported that "Seattle's second minimum wage increase to $13 in 2016 reduced hours worked in low-wage jobs by 6-7 percent, while hourly wages in such jobs increased by 3 percent" (p.1).

According to Dessler (2017), equity theory states that "if a person perceives an inequity, a tension will develop that motivates him or her to reduce the tension and perceived inequity" (p. 347). This tension is inherent in restaurants where front of the house service staff receives tips when the kitchen staff does not. The Seattle Municipal Code (2018) clearly states, "Tips are the property of the employee or employees receiving them, including employees who receive tips through a valid tip pool" (p. 14). Managing the disparity in equity between tipped employees and those who were not created a unique dilemma for Ivar's management.

Ivar's, Seattle's original seafood restaurant, operates more than 50 locations in Washington State, including three full service locations where customers leave tips for their servers or bartenders. This case explores the impact of Seattle's $15 minimum wage legislation on the tipping structure of Ivar's restaurants, especially within the city limits. The company was proactive in eliminating tipping, to ensure equitable pay between the "front" and "back" of house staff while remaining fair to its customers. Although tipping is uncommon in many parts of the world, Ivar's met with both substantial support and backlash when it eliminated them. The new tipping structure and payment system, discussed at length in the case, along with the management team's decision-making process that led to these new policies.

This case has several unique elements that allow for in depth analysis of the decision making process, the new policies, and the eventual outcome of those policies. Washington State is a non-tip credit state, which allows for more leeway in how the tipping policies can be changed, including the tip sharing aspect. Ivar's owned restaurants within the city that were affected by the new minimum wage, as well as a restaurant outside of the city that was not. Having two restaurants affected but one not allows for a unique side by side comparison of the new tipping structure and payment policies versus the old. The case study was conducted with the management team giving a unique insight into exactly what elements they considered in the decision making process and how those decisions were made.

The Case Dilemma

Ivar's leadership sought to minimize the disparity between its servers and bartenders (front of the house) and kitchen (back of the house) employees exacerbated through the tipping policies existing in the cultural norm. Because of tips, the front of the house employees earned twice as much as the back of the house employees. With the looming minimum wage policy affecting compensation, Ivar's wished to utilize the opportunity to provide equitable compensation for all employees. The plan to eliminate tipping and replace it with a service charge was determined after much research by the management team. While there were mixed feelings by employees initially, it became well-received. What the management team did not anticipate was the impact the shift to a service charge would have on their customers.

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Before Clams Could Dance

Michelle awoke to the sound of rain on her window. It was late September in Seattle when the rain has not yet soaked into your bones and your very soul. Residents move through the mottled gray dampness with only a glimmer of hope that the sun will return. This dampness hung over Michelle as she sipped her coffee with nervous anticipation for the day she knew would bring answers to long awaited questions.

Traffic was a mess as Michelle drove to Ivar's offices on Pier 54. Parking was no better since the Alaskan Way Viaduct and Seawall Replacement Project had torn up a good portion of the waterfront. Bertha, the world's largest tunnel-boring machine, was stuck and the city's project to replace the seawall was months behind schedule and millions over budget. Consequently, businesses along the waterfront saw sharply reduced customer counts but shouldered the losses, hoping that the finished project would allow prosperity to return to a rejuvenated Seattle treasure. Ivar's was rebuilding Pier 54, installing hundreds of new piles to bring the 120-year-old structure up to seismic standards, remodeling and expanding three restaurants; tasks far beyond the realm of normal Restaurateurs.

Founded in 1938 by Ivar Haglund, Ivar's on Pier 54 developed a strong following and became a central feature of any Seattle visit. Ivar was well-known in the city and maintained a prominent (and colorful) position as a top-shelf restaurateur his whole life. Ivar's began on Pier 3 (renumbered to Pier 54 during WWII) offering seafood and chowder to patrons of his Seattle Aquarium in the northeast corner of the pier. Ivar died in 1985 with a dozen restaurants. By 2014, the company had grown into five divisions with more than 50 locations and 1,400 employees. In addition to the three full-service restaurants, this included Quick Service Seafood Bars, Kidd Valley hamburgers, food concession booths in local stadiums under its Sports division, and the Seafood, Sauce, and Soup division. It's full service restaurants, Ivar's Acres of Clams is at the original location, the Salmon House is on the north shore of Lake Union, and Ivar's Mukilteo Landing is adjacent the ferry dock about 22 miles north of Seattle. Michelle was the General Manager of the Salmon House during the pivotal time for Ivar's from 2014-17.

Starting as a bookkeeper at the Mukilteo location, Michelle worked at all three full service restaurants over her 16 years with the company serving since 2011 as the GM at the Salmon House. Her story is similar to the rest of the executive team. Chris began as a busser at the Salmon House in 1999, working his way up through the front of the house to become General Manager at Mukilteo and then Acres of Clams. In 2012, Chris was promoted to the Director of Operations for the full service division. Frank began in 1980 as a bookkeeper and was closest to Ivar, acting as executor of his estate after his passing in 1985. Since 2001, Frank has been the Chief Operations Officer for Ivar's, Inc. Bob was a Yale management grad with a successful career under his belt. He served as Chief Financial Officer until September 2001, when he became president of the company.

The apprehension was as thick as the fog slowly lifting off Elliot Bay as Michelle made her way to the office at the end of Pier 54. Construction crews were already arriving, as the Acres of Clams remodel was about to begin. Bob, Frank, and Chris were just working through their first cup of coffee when Michelle walked in. Sabrie, the director of human resources, joined shortly afterwards. This was a day they had been anticipating for a long time ... the tipping point.

Rumbling Beyond the Viaduct

The leadership team gathered around the oval table to discuss what to do next. The windows looked out over Elliott Bay, just a fisherman's long cast away from the Colman Dock, packed with ferry commuters traveling to and from Winslow and Bremerton. Muffled sounds of seagulls and seals seeped through the windows, providing background to their discussion. The team knew the $15 minimum wage was coming. It was aware of the issue before most; Bob was active as the ordinance developed in the city of SeaTac just south of Seattle regarding the new law and was selected for Seattle Mayor's stakeholder committee on the $15 process when Ed Murray took office, January 2013. Other members of the management team were well networked and active locally and nationally. Bob noted,

> *Because of our involvement in $15, our network throughout the country, and my role as Chair of the Seattle Chamber and with the Restaurant Association Board, Ivar's was well aware of the issue long before it became public. We had been examining alternatives long before the Seattle law went into effect April 1st, 2015.*

Ivar's leadership team knew it had to do something, but it was unclear what direction to take. Bob framed the situation for them:

> *The old models of doing business in the hospitality industry are dying, especially here in Seattle, and we have to change to stay ahead of these changes if we want to stick around. As we face this 'death' there will be a grieving process for business owners to go through (the five stages), and it's not until we reach 'acceptance' that we will start figuring out the best ways to survive and thrive.*

The team knew it needed to fall back on Ivar's core principles—specifically, the culture that had sustained the company for more than 75 years.

The company was already a leader in paying good wages and high benefits in restaurants in Seattle, but the immigration situation and the start of the busy summer meant it would have to hire many more people than normal. Michelle recognized the significance of the situation:

> *When the wage conversation came into it, we were competitive anyway. But we had to go beyond competitive. We had to take our offering to the next level, because we were essentially hiring brand new restaurant kitchen crews. But then while we were going through this, the Seattle City Council wage conversation came up.*

And we didn't feel, because we were in this shotgun hiring process and with this turnover, that… just going to the $11 or $11.50 an hour, for that first step from I think it was $9.47, initially ...was going to be necessarily competitive enough to us.

Ivar's also offered a suite of benefits for all employees who worked more than 28 hours per week including health care, 401(k), and two Ivar Haglund Scholarships to any college. "Consequently, we have among the lowest turnover in restaurants. It is common for people to stay with us for 20, 30, 40 years. Our two longest tenure (active) employees are at 42 and 43 years. The record is 50 years," Bob shared with pride.

The team outlined some goals for whatever new approach they would implement. Bob again set the tone: "We also saw the $15 law as a means to rectify the discrepancy between front of the house [average annual compensation at $60-$80K] with back of the house [<$30K]." The Director of Marketing and Communications, Kirsten, added,

This project by far had so many deeper angles than just a communications challenge. And it goes back to the fabric of who we are as a company. I'm almost 17 years here, and I'm actually fairly young in my career here...[This is] because the owners have put together programs that enrich our employees' lives, as well as pay them well, make sure that they have great work/life balance, great benefits. And so this minimum wage really hits on all those pieces. And it's really intertwined in our culture as well. So it's not like this law was intersecting with our culture and it was really grating on it. It was part of who we were anyway, and it was just ...how do we make it Ivar-esque?

Bob reiterated his key points. We want to do the following:

- Reduce the discrepancy in wages between front and back of house;
- Keep prices at or below our competitors;
- Keep customer counts flat—don't lose customers;
- Do not reduce benefits nor wages of anyone at Ivar's; and,
- We know we will make mistakes, so we should be prepared to acknowledge and fix them.

Chris took the lead on researching what others in the industry were doing locally and nationally in response to similar initiatives bubbling up in various municipalities. The company had built up an impressive network, so it began to gather as much data as possible in quickly shifting seas. Starting with local Human Resource Roundtables in Seattle then looking at what was happening in San Francisco and New York, it was readily apparent that no one had settled on a definitive approach. Chris and Michelle struggled to pinpoint a direction for Ivar's. Should they implement a service charge, raise prices to offset wage increases, or do nothing and hope for the best? Uncertainty over whether tips would be included in the legal definition of minimum wage further muddied the water.

Frank noted that historically the tipping culture had developed differently internationally, creating a more inclusive service model where tips are included in the pricing. Could this be an opportunity for Ivar's to create the same kind of shift here in the States? Kirsten noted, "It's a really interesting cross-section of public policy, of private enterprise, and social change."

The leadership team had a great deal of collective knowledge, including 18 years of research within Ivar's itself. This expertise informed the in-depth analysis that eventually led to the policy decision. Bob summarized the internal analysis as follows:

- Ivar's average customer tipped 17% in the three years prior to 2015;
- We could NOT meet our five goals above if we kept all tips, reallocated among hourly workers;
- However, if we raised prices 4% on top of keeping all tips, we could get there;
- Our average hourly employee made $12.25 an hour, compared with the minimum wage of $9.47;
- In addition, our average server and bartender earned minimum wage +$19 an hour in tips; and,
- Only servers and bartenders were at minimum wage; all else started higher.

Chris added a particularly knotty observation:

If you leave tips as they are, servers and bartenders getting 60% base wage increase ($9.47 an hour to $15), where your non-tipped employees are not. So you're creating a larger wage gap. You now have this void in the center, which is mid-management asking, "What are you doing for me?" Well, but this doesn't really affect [managers]—you know. So how does that work? Can you get anyone to feel good as a manager, if now all the staff that I am managing is out-earning me by 10%, 20%, 30%? And then you've got the line cook or the dishwasher going, wait a second, now I'm making 15% of what the busser's making, or the host is making, or the bartender.

This seemed to drift further from the goal of creating a more equitable wage structure between the front and back of the house. The details of the law were vague, but it was clear that only those who had direct contact with the guests would collect and retain tips if there were no other changes to the compensation policies within restaurants like Ivar's full-service locations in Seattle. Chris observed,

So for me, it was feeling like there was going to be one of three ways people were going to go. Either people were going to go to a service charge so they could capture that money as revenue and distribute it throughout this staff ... [or] people were going to build it into the price of their items, so then it is just revenue, and you can what you want with it. Or people were going to stay put with tips, and then try to wait it out and see where the market's going to go.

Time was running out and they recognized it would take time to implement whatever strategy they agreed upon. Bob outlined the subsequent plan: Ivar's would eliminate tipping in the restaurants but raise prices of every item by 21%. Servers and bartenders would receive 8% of the total and 13% would be shared among all hourly employees in the restaurant. They added a guarantee that if an employee stayed on for a year, his or her wages would be the same or higher as the two previous years. Chris recalled,

> *There was a three-way sell job going on—sell it to yourself, sell it to your owners, and then when it's decided, then turn around and give that as a positive sell job to your staff and your management teams. You have people for their whole lives that have worked in this industry, have done it the same way and all of a sudden, whoa ... wait a second. We want to be the test balloon that changes an industry?*

There were days when not one of the team agreed on any point of the plan. They still recognized that something had to be done and the April 1st deadline was drawing nearer every day. The atmosphere was tense. Chris remembered the struggles vividly: "We oscillated back and forth for nine months, absolutely. 'Oh, we think we got it figured out. Aw, that's a terrible idea.' Well, now ... because you look at it. You put yourself in everybody's shoes." In the end, the team came to consensus. Bob recalled,

> *At one time or other, everyone on the team disagreed with the analysis, the plan, and the strategy with employees, customers. Because each of the people on the team was a senior manager with Ivar's, with long experience, we trusted them and therefore investigated [their] concerns and massaged the plan. In the end, all came to agree with it, though nervously.*

Time to fish or cut bait...

In March, everyone gathered into the alder-scented banquet room of the Salmon House. The anticipation filled the room like the low-lying clouds over Lake Union. It was a Saturday, and the busy season was approaching quickly. Despite many discussions with staff about ideas, management was notably concerned about the prospect of a major change in compensation and what impact it may have on the seasonal hiring as well as the customers. Two weeks prior they had received draft copies of the menu with the new pricing—a whole new revenue model with prices raised an average of 21% to meet the "tip-inclusive" philosophy. The managers were still digesting what it all meant when it came time to share the news of the final plan with the full staff.

Today was the day of reckoning: Chris outlined the game plan to every busser, hostess, cook, server, bartender and employee in the room, then they broke out into separate tables for one-on-one conversations with each team member. An envelope was handed to each employee comparing his or her compensation over the past two years with the proposed plan. Questions were answered and concerns addressed. The benefits would remain unchanged and remained better than industry standards.

In the end, Ivar's culture carried them all through the day. Michelle recognized, *"[O]bviously people were concerned, and we expressed that to them. We understand you're nervous. We're nervous ... [but] we're asking for you to trust us."* The staff gave the management team a standing ovation.

The Good, the Bad, and The Stranger

For the most part, everything went well the day of the team meeting ... with one exception. The company planned no public announcement of its plans, but one of the service staff brought his envelope to the local alternative newspaper, ***The Stranger.*** Decidedly on the left end of the political spectrum, *The Stranger* took the story and ran with its own interpretation: that Ivar's was hiking prices and pocketing the profits at the expense of the service staff. The traditional press hit fast and hard after the story broke, as noted by Kirsten:

> *So instead of a quiet opening where we talk with customers and staff and refine the program over time, we are now dealing with all the media. No other restaurant in town said or did anything, so everyone covered Seattle's new minimum wage law as implemented by Ivar's. We talked with Swiss Radio, NPR in Korea, The New York Times, and every local radio and TV station.*

Chris recounted the amount of communication that was required with the staff and messaging around the "Gratuity is not included" printed on the guest check. However, every wave of press created a flare up. Michelle cringed, "Are we gonna go through this again?" when the press would call.

The press was only one aspect of Public Relations. Messages to the public needed to be thought out in social media. Ivar's published a lengthy "Frequently Asked Questions" page on its website. Countless menus were drafted and redrafted, and similar revisions of the receipts were designed and previewed by management, staff, and customers alike. A manager personally escorted customers to their tables while explaining the policy and checked back at the end of the meal when the check (with no space for a tip line) was delivered. It was exhausting, and customers were polarized by the changes. Michelle shared both perspectives:

> *With all of the media coverage, we saw customers coming from all over the region to try it out and thank us for treating our staff so well. Our customer counts were up double digits because we were on every TV news broadcast, all filmed at the Salmon House. But there was, initially, a tremendous amount of backlash from certain guests. I mean, I got calls from people out of state who never even dined in the restaurant that were so angry that we took away their control. Because you had both sides of it, because it's a very political argument ...so you get some that are on the side of, like, "Fantastic. You guys are leaders in the community, that you continue to make choices that are not always financially driven, but it's more so that it's about the people. It's about your guests. It's about the employees." Those are the ones that I*

> *think were the most powerful for me, because it is.*

The success stories came from the employees affected most by the changes. Reminded that the revenue sharing was put in place to help equalize the pay disparities between the front and back of the house, Michael, the dishwasher at the Salmon House, shared,

> *I had the best time last night. I got to take my wife and my two daughters, and we went to this movie for my daughter's birthday. And we went and got a sandwich. And he [Michael] said, "We've never gone as a family. We've never gone to a movie." That was just something we could never afford to do.*

Dollars and Sense

Calm seas and quiet winds can shift to gale force in the Puget Sound quickly; so the story went for Ivar's. The changes took effect April 1st of 2015, and it did not take long to recognize there were many unforeseen hazards to navigate. Everything was proceeding well for the employees, though not without a great deal of continuous effort. The company was not faring as well, however. Not only were there unforeseen issues with the new revenue model, customer confusion, and the press, there were external issues that impacted the profits as well. Frank recalled,

> *From an employee perspective, we did everything we said we were going to do. We protected them, and we created a new revenue model that I think works well for them. From a company perspective we got hammered. At the same time, we were remodeling Pier 54 and the Acres of Clams restaurant so everybody's focused down here. We look up maybe six months later, and oh my god. We are bleeding profusely at the Salmon House. And we haven't stopped the bleeding since.*

Michelle recalled the hard work of communication to the employees while affirming they were continuing to do what they had committed to:

> *[W]e protected them....... [E]very two weeks, on a pay period, I would run analysis on it for every employee. I would take what their wages were two years ago and what they made on this cycle. And I did that for six months, every two weeks, to make sure. And I looked at specific individuals to make sure, "OK, this is working for you, and is this working for you." And there were a couple of people I would sit down and just kind of say, "Are you aware?" and to keep kind of pulling from the staff, to make sure that they were.*

While focused on assuring employees were protected and understood their compensation packages, unexpected (and unbudgeted) costs rose to the forefront. Sick leave accruals needed to be recalculated based on the new $15 per hour. This added a $60,000 adjustment in April 2015 and $8-9000 per month thereafter. Weather was particularly poor leading up to the summer season. The planned and unexpected increased labor costs—combined with higher food costs in the same quarter leading up to the summer season, which is when customer counts and revenues triple for Ivar's operations—hit hard. It was also bad harvest for salmon, so the volatility of salmon pricing took its toll about the same time.

The company restructured not only the compensation but also its menu pricing. This caused some surprise to the customers, especially the regulars. It also surprised families who were looking forward to visiting Ivar's for a vacation treat. Acres of clams on the pier re-opened on July 1, but Bertha was still boring a hole under the viaduct and into the pockets of all the businesses along the waterfront. Frank summed up the struggling times:

> *[F]rom an ownership perspective, we sort of hit a dark hole in September of '14. And I'll be quite truthful with you. I don't feel like we've pulled out of it quite yet. And it has nothing to do with the efforts of any of the people who work inside of our restaurants. It has everything to do with the fact that ... we rebuilt this pier during that same time period. We're a small company. We were financially extended during that time period, let's just simply say. Our flagship came back, and the fish bar out front, but the city didn't finish its portion of the work. And so we didn't get anywhere near the customer counts that we would otherwise have expected—which would simply be the counts that we had ended with ... And so we're still working our way back to those.*

Shooting the Messenger

Ivar's third full-service restaurant is located in Mukilteo, 22 miles to the north in Snohomish County. In October, 2003, it had its own version of catastrophe when tidal waves hit during a fall storm and demolished the facility, requiring a full scale redevelopment of the footings and restaurant itself, taking 471 days. Since that restaurant is not located within Seattle, it was not subject to the new minimum wage provisions, and it retained the traditional tipping model for servers. This turned out to be as much a problem as what was being experienced at Acres of Clams and the Salmon House. Chris recounted,

> *But then as the news articles started to come out, customers in Mukilteo asked, "Well, are you a tipping restaurant or are you not a tipping restaurant?" And so they would start to get some of that, to where, all of a sudden, a fantastic server's like ... there was no gratuity left for them ... because they had seen a news conferences that says, "Well, we have gone to this model." But it didn't take into the fact that Mukilteo was outside the Seattle limits ....*
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> *[W]e brought up everyone in the restaurant to a minimum of $15 an hour, everyone in the kitchen makes a minimum of $15. So, actually, their hourly pay range is the exact same as Acres and the Salmon House from an hourly rate. So it's ranging from $15 to $20. They just don't have the revenue share on top of that.*

While this added confusion for the customers at Mukilteo Landing, it was still a conundrum for customers at the other restaurants. Ivar's was battling a combination of customer perception and societal culture. Once again, here is Frank's observation:

> *Think about yourself. When you go to your favorite restaurant, whether you go with your family, you go wherever, you know that that restaurant's going to cost you $68 tonight. And when ... that bill comes and all of a sudden, it's not $68—because you don't add the tip into it, you know? That $68 bill isn't a $68 bill anymore. It's an $80 bill. Well, you notice it.*
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> *We thought, "But if I'm writing the tip in the end, which I was otherwise going to do, and it was still going to be $80, then you'd be OK." And the simple truth of the matter was it wasn't OK. Because you took my control away. And you know, why [do] I need to exercise control over this server, but I don't need to when I go to my dentist or when I go to somebody else, you know? But I need to have this control over my server.*

Where do we go from here?

Nothing seemed to be adding up and the management team was becoming exhausted. It was clear that the social experiment was not working and something needed to happen fast. The ownership knew it needed to make adjustments, but what? How do you turn a sailing ship starboard in a gale? Fortunately, Frank, Bob, and his team knew where the answers lay—in those who had been with them through thick and thin:

> *[O]ne of the great things in the Ivar's culture is just the level of loyalty. It's such a team-first environment... a lot of businesses say that, but [here] the employees always come first. And so many have been around for so long, the longevity factor of retention, they get to see firsthand. And they get to see these guys and gals and the caring and the compassion when they're in the restaurants, also. And so they want to try and many of them see, now, they know what's happening at the restaurant... [T]hey try and come up with ideas ... what can we do to turn that tide on that bleeding guest count?*

The leadership team knew something had to change ... and change fast. As they walked silently from the room at the end of Pier 54 and onto the sidewalk outside, the gulls circled Ivar's statute at the entrance as if to emphasize the legacy the team was now in charge of steering into the future. It would take tremendous courage to move forward, courage that would draw upon Ivar Haglund's legacy.