

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 Profitability, 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 Profitability'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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Profitability 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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