BusinessAdvisor

a resource for business owners

FROM THE LAW OFFICE OF MARY HANSON

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About the BusinessAdvisor

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She provides legal services related to owning, operating, buying, selling, and structuring businesses. Her clients are business owners in many different industries. She handles corporations, LLCs, new businesses, new ventures, and a broad range of contracts and business decision-making.

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WHAT WILL REALLY HAPPEN WITH INCREASES IN THE MINIMUM WAGE?

by Mary Hanson

On January 1, 2017 the state minimum hourly wage in California will increase to $10.50 and will increase each year until it will reaches $15.00 per hour in 2022. The increase will be to $11.00 per hour on January 1, 2018 and then $1.00 more per hour each year from 2018 to 2022. The increases will be delayed by one year for businesses with 25 or less employees, but by 2023 essentially all California employers will be required to pay at least $15.00 per hour, unless the employer is located in an area with a higher minimum wage already in effect.

A number of cities, including San Francisco, Seattle, Los Angeles, and Washington, D.C., passed laws increasing the minimum wage to $15.00 per hour in a shorter time-frame. The first city to reach a $15.00 per hour minimum wage is set to be San Francisco, on July 1, 2018. Los Angeles and Washington D.C. will reach the $15.00 per hour mark on July 1, 2020.

Los Angeles County also passed a law matching the wage increases adopted by the City of Los Angeles to gradually increase the minimum wage each July 1, so that from 2016 to 2020 employers in the city of Los Angeles and in the unincorporated areas of Los Angeles County will face increases of around 10% per year. Both the county and city defer the wage increase by one year for businesses with 25 or fewer employees.

The City of Los Angeles and Los Angeles County minimum wage is set to increase as follows:

	26 or more employees	25 or fewer employees
July 1, 2017	$12.00/hr	$10.50/hr
July 1, 2018	$13.25/hr	$12.00/hr
July 1, 2019	$14.25/hr	$13.25/hr
July 1, 2020	$15.00/hr	$14.25/hr
July 1, 2021	$15.00/hr	$15.00/hr

A number of other cities in California and 26 other states have increased their minimum hourly wage to various levels. On November 8, 2016 voters in 4 more states (Maine, Washington, Colorado, and Arizona) approved increases in state minimum wage levels, although not to the $15.00 per hour level established in the California law.

Polls have indicated that increases in the minimum wage have broad support. Many political leaders have expressed support for increases in the minimum wage and the federal Department of Labor mandated a minimum wage that federal contractors must pay covered workers of $10.20 per hour beginning January 1, 2017. A January 14, 2014 letter signed by 600 economists addressed to congressional leaders appealed for an increase in the minimum wage – to $10.10 per hour by 2016 – citing academic studies that predicted little or no effect on employment levels from such an increase. The letter also claimed that an increase in the minimum wage could have a small stimulative effect on the economy, *"The financial impact on businesses employing minimum wage workers will be more than just the increase in the hourly rate for those workers."*

based on low-wage workers spending their additional earnings.

A campaign called "Fight for $15," advocating a $15.00 per hour minimum wage, is being funded by SEIU (Service Employees International Union), which spent $20 million in 2015 (on top of $25 million since 2012) to promote a $15.00 per hour minimum wage. Presidential candidate Bernie Sanders pressured Democrats to support the increased minimum wage and in July 2016 the Democratic Party Platform Committee added a $15.00 per hour minimum wage to the party platform.

Here's a review of some consequences of increasing the minimum wage:

While 600 economists concurred in writing (in 2014) that an increase to $10.10 per hour in 2016 would not result in the elimination of jobs, it does not seem realistic to think that many businesses that employ minimum wage workers could survive a 50% increase in labor costs without major adjustments. A $15.00 per hour minimum wage is more than 50% higher than most current state minimum wage levels and more than 100% higher than the current federal minimum wage, which is $7.25 per hour.

The financial impact on businesses employing minimum wage workers will be more than just the increase in the hourly rate for those workers. A higher minimum wage has a ripple effect, increasing the wages of supervisors, managers, and more senior workers in the levels above the minimum wage workers. Labor intensive businesses (which typically employ minimum wage workers) have a hierarchy of management and each level is likely to be impacted.

In addition to a ripple effect on wages, other labor-related expenses increase along with the increase in the minimum wage. Workers' compensation insurance, employer social security contributions, employer Medicare contributions, state payroll taxes, sick leave and other paid leave are based on employees' wages, and the total labor cost for businesses employing low skilled workers will be increased beyond the paychecks to workers.

Other employment issues are affected by a change in the minimum wage. Under California law the definition of an "exempt" employee (a non-hourly, salaried employee who is not required to clock in and track his or her time on the job) is determined in part by the minimum wage level. An employee's salary must be at least double the state minimum wage in order to be treated as a salaried exempt employee. Most employees making less than double the state minimum wage must clock in, track their time, and be treated as hourly employees with respect to breaks, meal periods, and overtime.

When the minimum wage reaches $15.00 per hour in 2023 California employers will be unable to treat an employee making a salary of less than $62,400 a year as an exempt employee. Even at $13.00 per hour (the state minimum wage in 2021), that level is $54,000 per year. Unless there is an exception for a particular industry, employees with a salary below that level must be treated as hourly employees without regard to the intent or desire of the business managers or the affected employees.

Any plan for a new business (or expansion of an existing business) utilizes estimates of future expenses, including labor, to determine whether the proposed business would generate a profit and an adequate return on the capital investment required. An area where labor costs are mandated to increase over 50% (in 4 years for businesses in Los Angeles) would be unlikely to be selected as a place to start or expand a labor-intensive business.

In large businesses doing yearly financial planning the high and increasing cost of labor can't go unnoticed. Even small businesses that don't do annual budgets will see the impact of higher wages when doing financial projections for new loans, new lease commitments, and major investments in new equipment or some type of expansion.

An example from the restaurant industry is that the typical cost of labor ranges from 25% to 35% of the gross income, with fast food restaurants at around 25%. An increase in the labor cost of 50% would mean an increase in costs of 12% of the gross income – exceeding the net income of the typical business. Major changes would be required for a business in that situation to survive.

While some businesses can relocate to lower cost areas, labor-intensive jobs related to personal services that need to be located where their customers are (such as restaurants, hospitality, medical care, food service, child care, and home health care) would have to make other adjustments.

Each affected business owner will need to find his or her own best approach to staying in business based on the business finances, size of the business, goods and services offered by the business, labor requirements, possibilities for automation or other labor saving techniques, location requirements or limitations, the location of competitors, and other unique circumstances of the business. No "one size fits all" recommendation is possible.

One general suggestion is that affected businesses re-write their business plans now. Businesses should be able to estimate now what their cost of labor will be over the next few years.

For businesses that cannot relocate the most common adjustments are expected to be elimination of jobs and increases in prices. Business managers need to calculate the price increases that will be necessary to survive in the higher labor-cost environment and then try to estimate the level of sales at the higher prices. Rapid changes in prices make it difficult to project sales, adding to the risk for affected businesses.

A higher minimum wage will likely impede job creation. Each year an estimated 1.7 million people join the workforce (including teenagers getting their first job, high school graduates seeking employment, college graduates and other educational program graduates seeking permanent positions, and mothers and others returning to the workforce after years away). The main need for new jobs is at the bottom of the scale, where new workers need experience and training. Historically job seekers with low education and no work experience would find employment in fast food restaurant jobs, manufacturing jobs, and agricultural jobs. Robotics, automation, and mechanization have reduced the number of these entry-level jobs. Rather than creating an incentive for labor-intensive businesses to expand or utilize more labor, the increased minimum wage provides a disincentive for hiring and an incentive for labor-intensive businesses to further automate or to relocate to lower cost communities.

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Publisher's Note

Business planning requires anticipating what will happen in the future and trying to distinguish between definite future changes, expected changes, and possible changes. Business owners (and politicians) should strive to review facts and at least consider both costs and benefits of both actual data and potential consequences. Rapid change means that planners must look at speculation as much as actual numbers or well-founded estimates.

Some of the suggested consequences of a higher minimum wage include inflation resulting from higher wages, a need for greater welfare benefits for those unable to get into the job market, greater homelessness, slow economic growth due to lower productivity, and government incentives or programs needed to encourage businesses to hire and train low-skilled workers.

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As the cost of goods and services provided by minimum wage businesses increases, many potential customers (including the minimum-wage workers themselves) may be unable to afford them. It is predicted that home health care will become unaffordable for many senior citizens needing such services. Similarly, child care may become too expensive for lower income workers and the cost of fast food may increase beyond the budgets of many families.

It may become quite difficult for new job-seekers to get their first job in high minimum wage areas. Minimum wage workers typically seek employment where they currently live. If the minimum wage is high in their area, three separate factors might influence the challenges they face in getting a job. First, the higher minimum wage might attract more applicants. Secondly, employees might stay longer at a $15.00 per hour job. Historically minimum wage jobs were the first rung on the ladder and employees moved up or out from the entry-level jobs to jobs offering more than minimum wage. Due to a higher minimum wage, less churn in the job market may mean that fewer jobs open up for those seeking their first paycheck. A third factor is that employers may try harder to attract and retain employees that are most likely to have a $15.00 per hour value. Applicants who need more training, supervision, or assistance would be disfavored. The most vulnerable - the poorly educated, the handicapped, non-English speakers, refugees, and others who need help - could be excluded from the job market. BA