

The hidden cost of minimum wage

Faced with an increase, many BSCs will find themselves “between a rock and a hard place”.

By Jim Peduto

The U.S. House recently approved tax breaks for small businesses worth \$1.8 billion over 10 years, easing the way for a bill that calls for increasing the federal minimum wage to \$7.25. This \$2.10 increase, which is likely to occur over a two-year period, will affect some BSCs more than others.

As of January 2007, the U.S. Department of Labor reports that nine U.S. states have minimum wage rates of \$7.25 or more. The rest of the country pays a minimum rate less than \$7.25, with 15 states doling out the current federal rate of \$5.15 and four states with no minimum wage laws. This means BSCs in all but nine states will be affected by the federal increase.

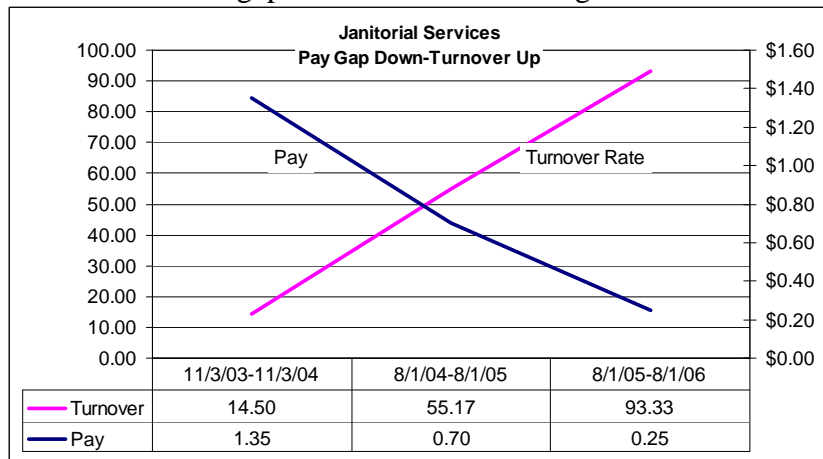
Even if a firm pays above the minimum wage, as many BSCs do, the increase still needs to be managed because it can erode the premium that many firms pay above the minimum. These breaks might help, but research clearly establishes that minimum wage increases cost business owners more than just the cost of wages. The increases have a significant impact on service levels and employee turnover.

Pay vs. turnover study

We recently conducted a study of 450 workers at 60 job sites over three years to measure the impact minimum wage rates have on service programs. In 2003, the average worker was paid \$1.35 more than the minimum wage. In 2006, workers were being paid only \$.25 more than the minimum. We charted the gap between minimum wage and the actual wage paid. Next, we plotted the pay against the reported turnover rate.

As the chart illustrates, there is an almost perfect correlation between turnover and the gap between pay rates and the minimum wage. While a variety of factors influence turnover rates, it is clear that the higher

BSCs are above the minimum wage, the lower their turnover will be. Conversely, turnover rapidly rises as the pay rate approaches the minimum.



Higher pay or higher turnover?

Considering the relationship between pay and turnover, the challenge for BSCs is to balance turnover rates and the financial impact of higher wages rates. BSCs have to decide whether they can afford the cost of higher than minimum wages (which for some BSCs could be more than \$2 per hour higher than what they are currently paying) or absorb the cost of increased turnover and decreased service. There are three questions that can help BSCs decide how to handle wage increases:

1. Do my margins allow me to absorb the cost of minimum wage increase? This means the wage increase would come directly out of the BSC's bottom line, without passing any of the cost onto customers.
2. Can I convince my customers to accept the cost of a wage increase? While some customers can be educated, not all customers are going to accept service cost increases as a result of a higher minimum wage. There is always a risk that your customer will test the waters by soliciting competitive prices.
3. If I choose to keep my wages at the minimum rate or let increases dramatically erode the premium that I pay, can I live with the turnover? Remember there is no free lunch. BSCs who choose to keep their wage costs down by keeping the wage low, should prepare themselves for accepting additional costs of recruiting and training new employees – and decreased service levels.

Many BSCs already pay their workers wages that are significantly above the mandated minimum in order to stay competitive. However, the likely future federal increase will put BSCs currently paying competitive rates near minimum wage, if not slightly below. It's a tough choice: pay the cost of a higher wage or pay the cost of a higher turnover? Perhaps the best option is a candid conversation with your customers.

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