Minneapolis Mandated Wage Increase: Breaking Point for Small Business

Executive Summary

Business associations throughout the city of Minneapolis worked together to collect data from businesses regarding the impact of a $15 per hour Minneapolis city specific minimum wage. 246 businesses responded to our request for information[*]. These businesses ranged from less than a year (1) old to over one-hundred (100) years old. The majority of respondents were restaurant and retail establishments geographically located in the Southwest Minneapolis area.

Overwhelmingly (61%), respondents reported there would be a "*very negative*" impact to their business if the city implements a $15 per hour minimum wage. Some of those negative impacts are as follows:

Job Cuts: Businesses reported that there are some positions that are nice to have filled, but cannot be sustained at higher wage requirements. These positions would be cut and/or the duties split between remaining staff and owners. In some instances, these changes would require a complete restructuring of business model with decreased levels of customer service. Customer service is a principal differentiator for many small businesses; for consumers, it is often the hallmark decision factor.

Reduced Hours: Those planning to maintain staff head-count indicated they would be forced to reduce the weekly hours of many, if not all employees.

Position & Staffing Structure: Many businesses would be forced to decrease or eliminate hourly positions. Most of these eliminated positions would be entry-level, forcing any new hires to have higher skill and experience sets to sustain the higher wage. Existing staff would be restructured with increased job duties and responsibilities to sustain the higher wages. This would eliminate job opportunities for new Americans, teenagers, retirees, and other disadvantaged groups.

Increased Prices: Based on the survey results of current business and labor expenses, consumer pricing would increase about 15% at our most vulnerable businesses to cover the increased wage, increased employer taxes, and increased insurance costs. This does NOT factor the increased cost-of-goods that some businesses will have as their wholesale suppliers will experience the same wage increase costs, further driving the cost up for the consumer. ***These calculations are dependent on no decrease in consumer spending.*** Such increased prices will not increase the net profit for any business.

Increased Disparity in Suburban Competition: Many businesses already experience pressure from large national businesses, online consumerism, and border city offerings with lower regulation demands. Minneapolis businesses already have competitive disadvantages due to higher costs and subsequent higher prices. With significant decreases in consumer spending, consumers have proved they will put forth significant effort to achieve real and perceived savings. Minneapolis businesses will have to evaluate if business is sustainable within the city limits. Increased regulation in Minneapolis is driving new and

[*] Invitation to participate in the electronic self-guided survey was communicated primarily via eMail lists of the participating business associations. Hyperlinks to the survey were available publicly via association websites. The survey did not require a response to all questions.

existing businesses to other municipalities. This lack of a competitive environment disproportionately decreases opportunities for new Americans and other disadvantaged groups.

Increased Disparity in Large vs Small Business Competition: Large businesses have numerous cost and operational advantages due to their size and scale. Large organizations can more easily absorb changes in consumer spending and government regulations. Historically in all industries, there have been patterns of consolidation for market dominance and survival. Reactions to Federal, State, and Local policy and regulation cause even large businesses to geographically relocate in order to manage and maximize profitability. However, Minneapolis small business owners work and live in the same place – they are a part of the community. Small business owners think about profit, but they also have pride in their community; they see their establishments as part of the very makeup that makes Minneapolis what it is. Keeping and protecting small businesses is an effort to keep and protect a community. A small business has very little room to maneuver for any change; and it must be recognized that small businesses are faced with unprecedented simultaneous challenges. With a sustained sluggish economy, paradigm shifts in consumer spending, an onslaught of internet-based industry "disruptors," and low unemployment rates, small businesses are being choked at every turn.

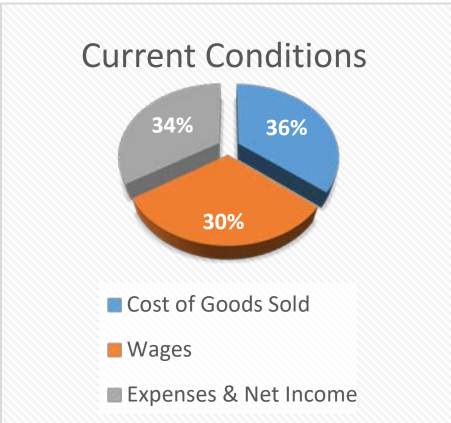
Wage Disparity: Within restaurant establishments, it is generally reported that a minimum wage increase would have a large impact on the viability of the business. Minneapolis has a growing reputation as an amazing place for quality and unique culinary experiences. Dining experiences provide a large draw for travelers and regional residents to visit Minneapolis. An increase to $15 per hour evenly across all employees will put our thriving restaurant industry at risk. Changes may come in the form of fewer servers on staff, fewer open hours, changes to a no-tip policy which would cut server earnings from current rates, or more drastically the removal of wait-service or business closure.

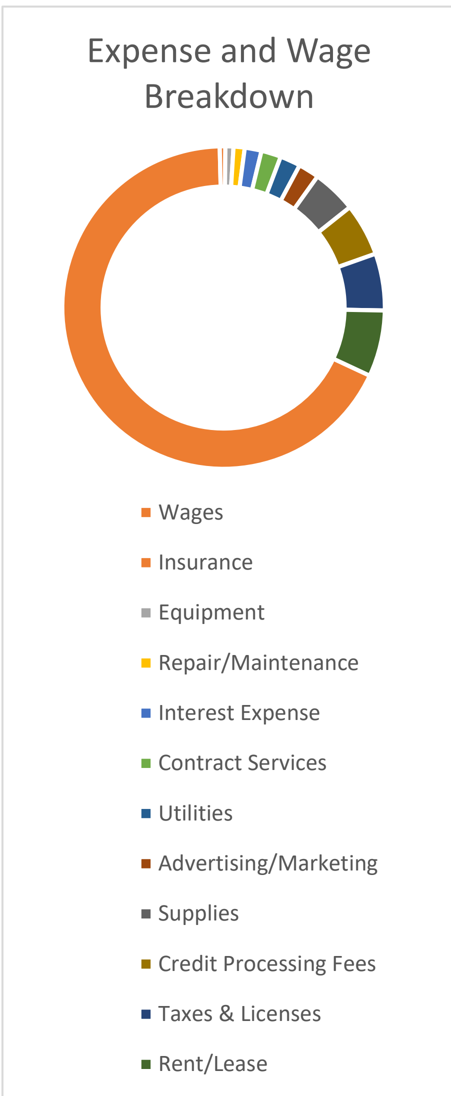
Wage Compression: Employees with higher-skill sets, position, and tenure will have a decrease in market value. Less experienced and less tenured employees will receive increases in compensation that other employees may not. Small business owners will be forced to decrease hours and decrease positions to find resources to retain experienced staff.

New Business & Growth: The survey shows that such proposed wage increase and subsequent costs would drive many small businesses that might be profitable today into a net loss. Most small business owners work every day in their business and rely on any profits as their wages; and the profits are slim! The existing businesses are providing existing jobs and existing wages. Further pressures to a loss of solvency will result in Minneapolis losing business and associated jobs. With a minimum wage increase to such high levels, it removes rungs on the proverbial ladder preventing those at the lowest end from being able to get on the ladder and reducing opportunity to move up the ladder.

It is important to find balance between stability and opportunity. Opening a business is a risky endeavor, and already many fail, but the potential reward to build your own way are open to those with an idea and ambition. The chances of succeeding with hard work are real. Keeping the costs to start up a business down means more opportunities for those who do not come from a family of means. In this environment, the bar to open a business is raised even higher; further limiting new business opportunities. This disproportionately affects disadvantaged and new Americans, and permanently changes the fabric of the community. Such events can create a cascading economic effect riddled with unintended consequences. Removing opportunity forces reliance on government mandates versus the pursuit the "American Dream."

Local coffee shops, restaurants and bars are a critical component of our neighborhoods. They act as our gathering centers and provide unique personality to each area in the city. One popular establishment shared their books with us to give a better understanding of what it takes to be open for business.





The Business of Coffee

Businesses in the Food & Drink industry shared that the goal for a business model is to strive for a 30/30/30 split between Cost of Goods Sold, Wages and Expenses with the remaining revenue to be used for capital improvements and profit. This business currently has numbers near this rate, with cost of goods at 36%, wages at 30% and 34% remaining to cover all other expenses and taxes; if there is anything left, perhaps a profit.

Cost of Goods

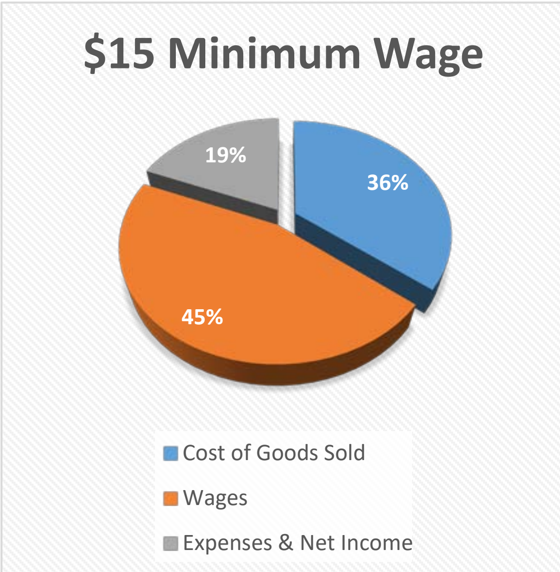
Cost of Goods covers the expenses directly incurred to have a product for sale. At a coffee shop this would include the coffee, baking supplies, dairy, produce, and other food expenses. These expenses can vary day to day depending upon the price of commodities.

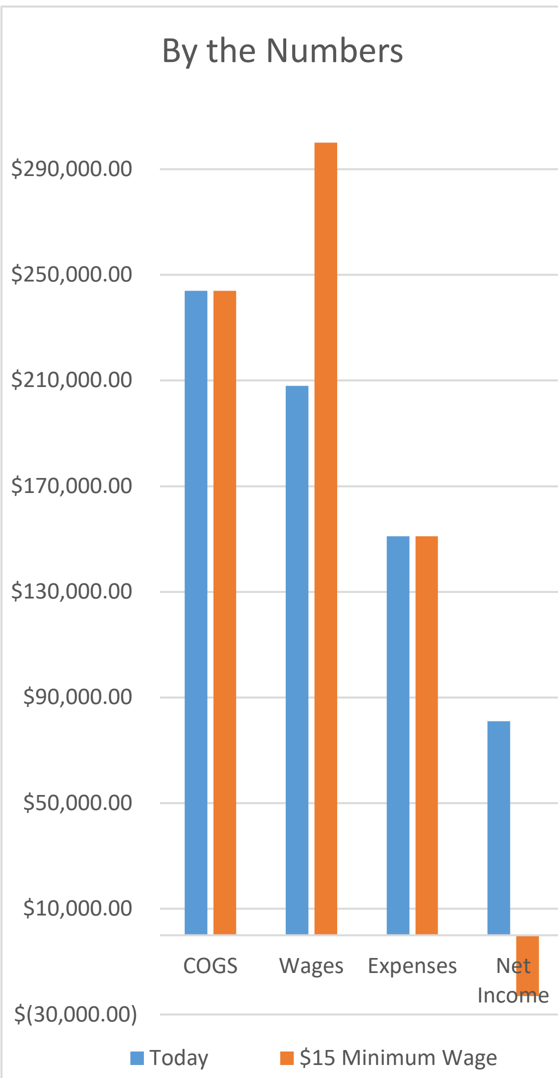
Employees

Repeat business is important for a local coffee shop. Shop owners know that creating a welcoming environment and a place where customers are known is critical to earning repeat visits, and the employees are the ones who ultimately make this happen. They pay their employees an average of $9.75 plus tips for an average hourly income of $13.40, which is above the required minimum of $9.50 for a business in Minnesota. While less service is required at a coffee shop than a restaurant, the business values its ability to provide a superior customer experience and this shows in its commitment of *30% of total revenue to employee wages.*

Remaining Expenses and Profit

34% remaining for expenses and profit can sound like a lot until you see the expenses that need to be paid. Rent, utilities, and credit card processing charges are the largest expenses, but there are many other supplies and services that are required to run a coffee business. After expenses, the business is left with 12% for net income. From this amount, the owners must pay income tax, any capital improvements, and finally their own income. Under current conditions, and factoring an average income tax rate of 19.8% (SBA estimation) the owners have just under $65,000 to





split and cover taxes if they don't make any capital improvements. Working full-time for the business, anyone can see that these owners are making a modest income.

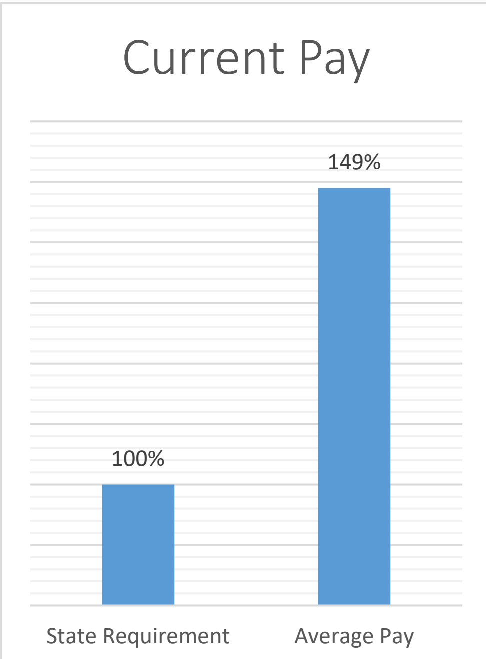
So what happens if the minimum wage is increased to $15 per hour?

If all other costs remained the same, and customers continued to visit at the same rate with the same orders as typically happen today, this business would see a 50% increase in wages. This percentage does not account for the increase in wage taxes, PTO/sick leave and other costs that increase along with a wage increase.

A 50% increase in wages would increase wages from 30% of revenue to 45%. That 15% increase reduces the amount of revenue remaining for expenses and net income to 19%. With business expenses currently at 22%, this popular shop would be pushed into an annual *LOSS* of $23,000 (or a year-over loss of $104,000). To maintain their current levels, the business would be required to raise prices by over 15%. This means that a medium coffee drink costing $4.85 would now be at least $5.58 plus the sales tax of 7.775%. That's $6.01 to the consumer for that medium coffee drink, that hopefully they will continue to buy every day!

With upcoming sick and safe time requirements within the city, businesses such as this coffee shop are going to see an increase in employee expenses prior to any minimum wage increase being considered. An increased wage added to these new benefits will have a compound effect that will have a larger impact than the numbers represented within this example.

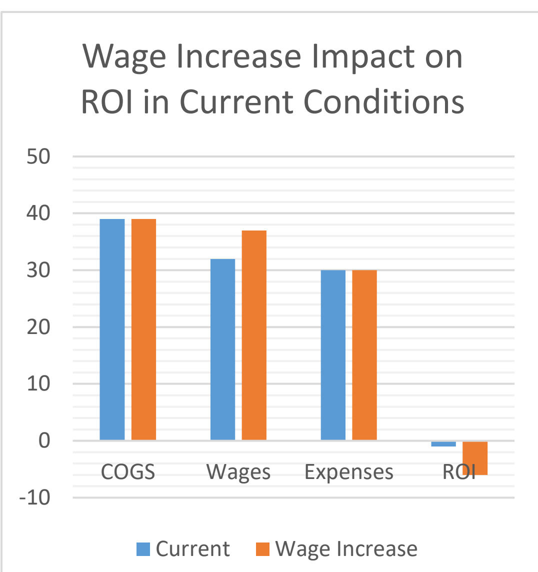
The Market Works



Over half of the responding businesses were less than $1 million in annual revenue. Over 1/3 were under $500,000 in annual revenue. This is the threshold the state has set to be considered a small business. Small businesses in Minnesota are required to pay just $7.75 per hour to their employees, but employers in Minneapolis that qualify for this rate are paying much higher. On average, our small businesses pay their NON-tipped part-time employees $11.60 per hour. That is 149% higher than the current requirement. Our small businesses pay more than the required minimum. So why aren't they willing to pay even more when there are calls for higher pay?

Consumer demand and disposable income both come into play. A business cannot charge more than what consumers are willing to pay for their products and services. Businesses reach a point in price increases where they see a drop in purchases significant enough to cause a drop in earnings. Going over this price means the business loses money. It cannot charge more than the market is willing and able to bear.

Minimum wage is a highly complex economic issue. Some workers will experience an increase in income, but others will find themselves with too few hours or completely out of work. With businesses needing to balance benefit to cost on employee wages, remaining jobs will require higher qualifications. Those most at risk in our economy are those that will be most negatively impacted. This sector of workers includes those of little to no education or experience, those with some sort of mental or physical disability, and those with language barriers. These are the very group of people most needing assistance, and they will likely be the first to experience hour and job cuts if the minimum wage is increased.



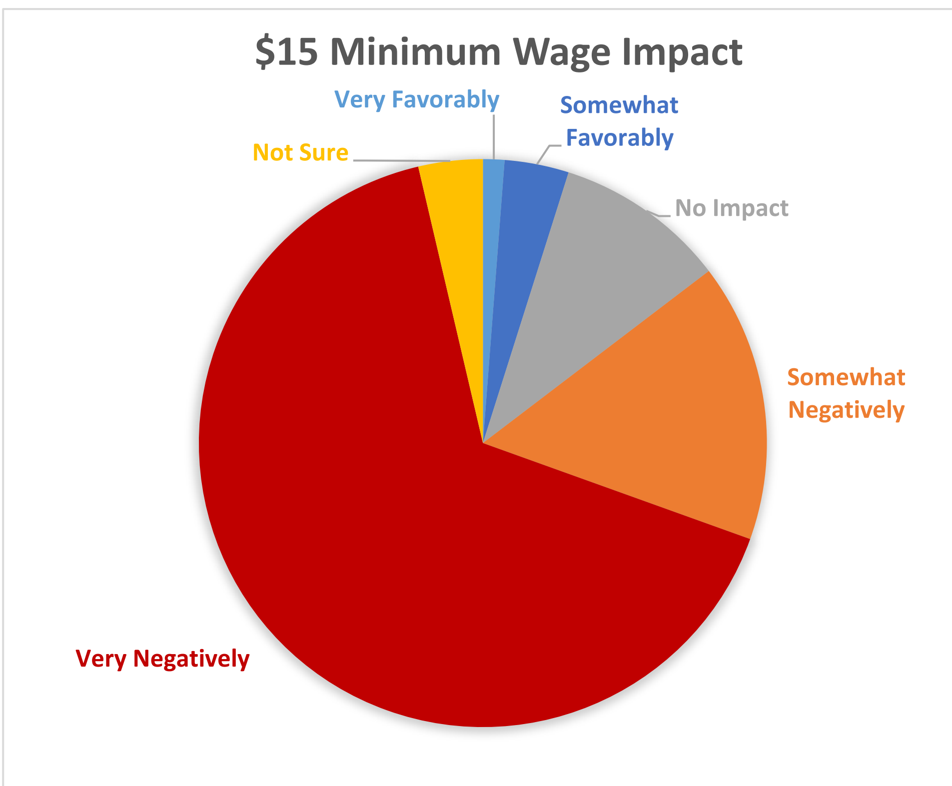
The target business model is to meet a split of 30% COGS, 30% Wages, 30% Expenses with 10% Return on Investment. Our survey is showing that businesses are already operating under less than ideal conditions because of internal and external forces. Restaurants are averaging 39% COGS, 32% Wage costs and the remainder being made up of Expenses and Net Profit. This indicates that their return on investment is already less than 5%. Even a modest 5% cost increase to wages has a significant impact on a business with razor thin return on investment. Because cost of goods sold and expenses must still be paid, this cost increase eats into the potential return on investment. While some of the cost increase may be covered with increased prices, market demands control how much a business can raise prices. With many of our small businesses already experiencing razor-thin margins, this change will accelerate the demise of small businesses on the edge of surviving. New businesses looking to enter the market will have a harder time getting started, and we'll see fewer businesses looking to replace those who have not made it. For those businesses that are on a growth path, these reductions in ROI will slow their ability to grow to a medium sized business where they can better afford the higher wages.

The Impact of Perception

As important as the numbers are, the feelings of the business environment are also very important for the future of the local economy in Minneapolis. When business owners perceive Minneapolis as a difficult environment to build and grow their businesses, fewer will opt to start or stay within the city. A good reputation is difficult to regain once it is lost.

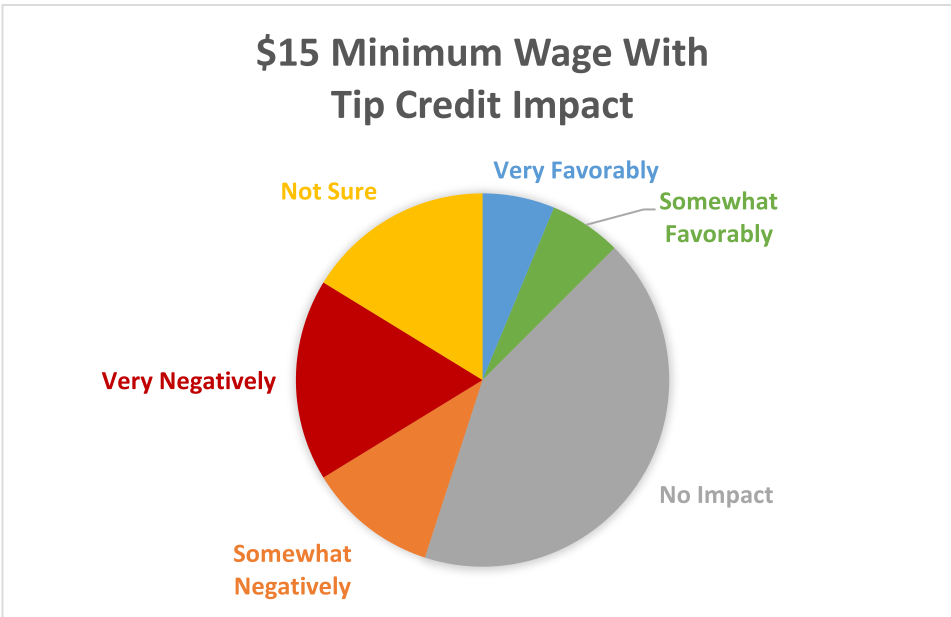
What are the long-term costs of fewer small businesses and fewer startups? Do we want to depend on fewer companies to provide jobs? Do we want fewer products and services available to the community? Small businesses are the most vulnerable to closure when looking at such large changes. Fewer larger businesses remaining in the market will provide more power to their singular executive decisions on deciding where jobs will be and how much they will pay.

> When asked how a minimum wage increase to $15 would impact their businesses, 82% of business owners responded there would be a negative impact to their businesses.

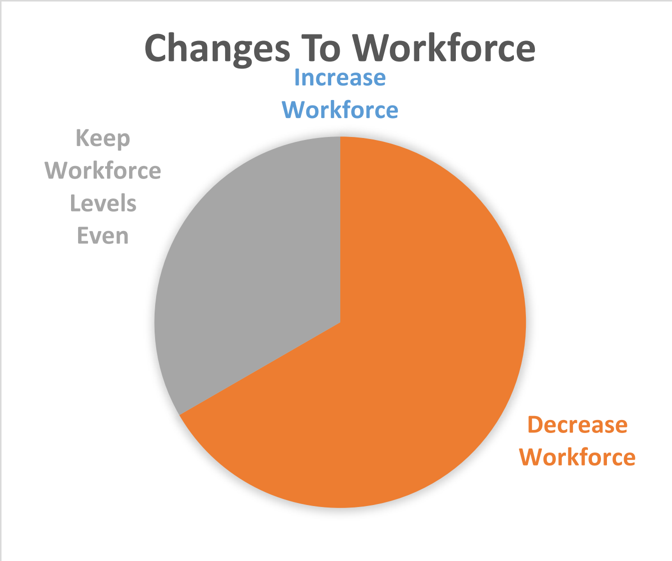


When asked how the minimum wage would impact business if a tip credit were implemented, responses changed considerably.

Of businesses reporting in, 59% of the workforce was in the restaurant industry. Of those in restaurants, 24% are PT tipped.



When asked if wages would increase for employees earning more than the proposed minimum wage, answers were more evenly split. 44% said no, 37% said yes for at least some employees while 19% remain unsure.

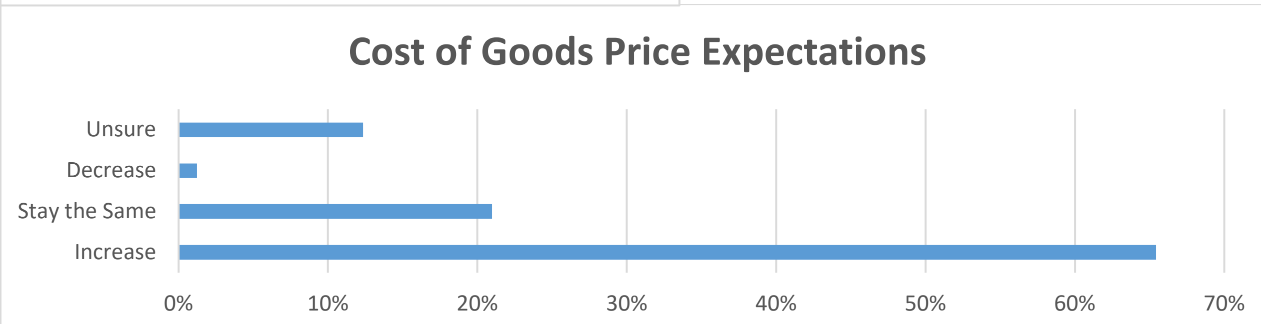


Likely to Reduce Staff

While a third of businesses will attempt to keep workforce levels even, a full two-thirds indicate they would decrease their workforce, with no businesses reporting in a likeliness to increase workforce.

Cost of Goods Increases Resulting from Minimum Wage

Businesses were asked what they expect to happen to the cost of goods sold (COGS) should the minimum wage increase in Minneapolis. Almost two-thirds responded that they would expect increases.



Adjustment Period

Businesses were asked the open-ended question of how long would they need for an adjustment period. The average among the responses was 5 years. Several businesses responded that an increase to 15 would put them out of business rather than indicate an adjustment time-frame.

Conclusion

An increase to minimum wage in Minneapolis will have strong negative impacts to our small, local, and independently owned businesses. The information provided directly from our local businesses show that the impact on its own will be significant. When factoring in additional mandated costs such as the City of Minneapolis Sick & Safe Time ordinance, the negative impacts will be even greater.

The unknown cascading effects and unintended consequences of such policy changes are often not understood until years later, when the effects are irreversible. Minimum Wage is a highly complex and multi-faceted economic issue that is very difficult for even federal and state governments to consider and create policy around. These government entities have dedicated departments and agencies to understand, monitor, and measure these economic and labor drivers. In addition, these agencies have detailed data directly from the employers and employees to provide the visibility needed to discuss and set policy on such sensitive economic and labor issues.

The City of Minneapolis does not have the economic and labor visibility needed to understand and monitor the impacts within the city nor the rippling impacts to the rest of the state. The discussion of minimum wage should be at the state and federal level, not the municipal level.