

Employer responses to minimum wage adjustments

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1. Introduction

This Research Report presents the Executive Summary of the *Employer responses to minimum wage adjustments* report commissioned by the Australian Fair Pay Commission.

The report was completed in August 2008 by TNS Social Research (TNSSR) on behalf of the Commission. The National Director of TNSSR, Ms Angela Southwell, presented key findings from the report to the 2008 Minimum Wage Research Forum.

The full report is published as part of the Commission's Research Series and is available from the Commission's website at www.fairpay.gov.au and in hard copy by contacting 1300 139 699.

2. Research background and objectives

The Commission is an independent body responsible for adjusting federal minimum and classification wages to promote the economic prosperity of the people of Australia. In setting and adjusting pay for around 1.3 million workers in Australia, the Commission plays a significant role in the management of the Australian economy.

The overall aim of the current research is to provide the Commission with some understanding of the impact of changes in the Federal Minimum Wage (FMW) and Australian Pay and Classification Scales on employers operating within industries with a high proportion of low-skilled workers, and in particular the adjustment variables used by these employers in response to changes in wage rates. The research provides information for use by the Commission for monitoring the impact of minimum wage decisions and to feed into the decision-making processes for future minimum wage reviews.

3. Research methodology

TNSSR was commissioned to conduct a series of eight online discussion boards with employers around Australia. The focus of these discussion boards was on the impact of changes to the FMW and Pay Scales on small and medium businesses within the Retail; Health and community services (HaCS); and Accommodation, cafes and restaurants (ACR) industries. The research explored the strategies these businesses have considered or implemented in response to these changes. A total of n=92 participants took part in the discussion boards across the three industry groups.

4. Key findings

4.1 Business operating environment

Understanding the business operating environment is critical to understanding the context within which workplace relations and wage decisions are made. The recruitment environment experienced by employers, current industry and business performance, as well as employer approaches to business management, profitability and workforce structure provide the context within which employers operate and make decisions.

Some businesses reported minimal difficulties filling positions, while other businesses reported significant challenges filling both relatively high-paid positions and, in some cases, positions that are lower skilled. Factors such as skills shortages within particular industries, local labour market conditions, location, and industry-based factors influenced the experiences and behaviours of employers in relation to recruitment and retention of staff.

A diversity of opinion was reflected in relation to current industry performance. Some employers described benefiting from a buoyant local economy, while others described an industry under pressure due to increasing costs and declining profit margins. The size of the business, the industry type, the level of expertise of the business manager and the location of the business are just some of the factors that can affect perceptions of current industry and business performance. Overall, many employers commented that their industry is performing well. Some attributed this to local economic conditions, while others attributed it to factors related to demand for their specific offering.

Most participants were able to articulate their approach to workforce management and the form of targets they strive to meet within their business, both when recruiting new staff and managing staff rosters. The nature of these targets was seen to vary, with a combination of financially specific targets and broader workplace considerations evident. A primary vehicle for attaining financially based targets was through employment of casual staff. This was most frequently reported by participants in the ACR and Retail industries; however, some participants in the HaCS industry also reported using this method. Participants also looked at other requirements of their business, both in terms of the skill set and qualifications which are required, and also in terms of the need for a homogenous team and a positive working environment.

The importance of labour costs, and specifically pay rates, to the successful operation of the business was linked to the proportion of total business costs allocated to labour. While the majority of businesses felt that labour costs are very important, employers for whom labour costs represent a comparatively larger proportion of total costs were more likely to feel labour costs are critical. Generally, participants operating in the HaCS industry reported significantly higher proportional labour costs than those operating in the ACR or Retail industries.

Employers described using a variety of strategies to manage business profitability and as part of their general approach to business operations and management. Generally participants were aware that dealing with increased costs meant that they needed to either increase business revenue or reduce other costs to the business.

4.2 Workplace relations practices

Similar to the business operating environment, the workplace relations environment and practices that characterise a particular business provide important context for

understanding the impact of changes in wage rates. As individuals, business owners manage their business by drawing on their own attitudes, beliefs and skills. Previous research¹ undertaken for the Commission with employers has highlighted the diversity of approaches used by individual business owners as they face business decisions including employment and wage-rate determination.

The research included a purposeful mix of employment arrangements. These ranged from informal type arrangements and common law contracts to formal registered agreements and arrangements where employees are paid according to awards or Pay Scales. Employment arrangements based on Pay Scales were most common among employers in the ACR industry. Within both the Retail and HaCS industries there was greater diversity in the approach adopted in setting pay rates.

Employer reliance on statutory minimum wages generally resulted from considerations such as costs/business viability, a sense of what is fair and correct, a desire for a 'level playing field' (where transparency and wage parity was highly valued for managing staff), or the use of legal obligations to guide their behaviour.

Despite the reliance on statutory minimum wages for many employers in this study, there was a low level of knowledge about the specifics of the wage-setting regime in Australia, similar to the findings of previous research conducted by TNSSR in relation to the FMW.² The majority of employers felt that the Government is responsible for setting minimum wages, and only a few employers were aware of the Australian Fair Pay Commission. The discussion highlighted some understanding of Pay Scales and awards, although many participants confused the terms 'award' and 'Pay Scale', with their comments often indicating a belief that these terms are interchangeable.

Employers were also asked to describe the information sources they use to find out about changes to wage rates. The primary channels included employer associations, the media, business networks and relevant websites (both government and employer association websites). Employer and business associations, such as chambers of commerce and industry-specific bodies, were a common source of information and alerts, particularly for employers in the ACR industry.

Differing approaches to workplace relations were highlighted by the research in relation to employer reactions to changes in wages rates. A rudimentary dichotomy was identified, placing employers broadly into two categories: those who exhibit a more reactive approach ('*Responders*') and those with a more proactive approach to wage-rate management ('*Planners*'). Many participants were *Responders* when it came to dealing with wage increases, and these participants reported that increases in wage rates were not budgeted for, but responded to as and when required. Compared to *Responders*, employers who were in the *Planners* category were more aware and more proactive with regard to wage-rate management. Employers who were *Planners* generally incorporated wage-rate rise considerations into their business planning or budgetary cycle.

Differences in approach were also observed based on the level of perceived control employers felt they had over wage rates. Participants reporting that they had a high level of control over wage rates tended to be paying above-award wages. In addition to this, they did not feel excessive outside pressure in relation to their wage levels. Participants felt these factors in combination gave them the freedom to pay on the basis of merit and performance. Participants paying exactly the Pay Scale rates, participants with formal

¹ Report on Public Consultations for the Australian Fair Pay Commission's 2008 Minimum Wage Review, 2008, TNS Social Research.

² Report on Public Consultations for the Australian Fair Pay Commission's 2008 Minimum Wage Review, 2008, TNS Social Research.

agreements, and participants experiencing external wage pressures impacting on their business often saw themselves as having a lower level of control over wage rates. External pressures included operating in proximity to high-paying industries (such as mining or certain areas of the public sector) as well as operating in an industry experiencing a skills shortage.

The research highlights that the impact of minimum wage increases on business and employment decisions is ultimately influenced by the individual behaviours of business owners. Whether employers are *Planners* or *Responders*, and whether or not they feel in control of the wage rates paid in the business, impacts the way in which they are able to manage wage increases, and – in light of increased labour costs – adjust and grow their businesses. This provides relevant context for the analysis of the adjustment variables used by business, and associated business impacts, discussed in the following sections.

4.3 Links and flow-on effects

The familiarity of employers with the technicalities of wage determination in Australia is variable. Many employers are not fully across the links and flow-on effects between their own arrangements and changes to statutory minimum wages. While cognisant of the concepts of the FMW, and of minimum pay rates being set via awards and Pay Scales, employers do not fully appreciate or recognise that adjustments in minimum wages announced by the Commission may be behind changes in the rates that they pay their staff.

Further, the research has shown that depending on their approach to wage setting and their experience of internal or external pressures on wage rates, some employers feel in control of their own wage rates while others do not. The study also indicated that there is no single source of information on wage-rate adjustments for employers. This lack of clear understanding by some employers, coupled with a perceived lack of control, makes drawing conclusions with regard to Pay Scale reliance and links with adjustments to minimum wages somewhat difficult.

Links and flow-on effects were observed to differing degrees in the actions of individual employers. Those who paid the minimum rate only, and made reference to sources such as Wageline or were signed up to receive alerts from their chamber of commerce or industry body, were likely to hear of changes and adjust wages accordingly. Others were aware of the regularity of adjustments to award rates and Pay Scales, and the specific timing of annual wage changes. However, many participating employers were less aware of wage-rate determination mechanisms in general, and lacked a connection to a clear information source to notify them of changes. They did not all appear to be aware of the cyclical (annual) nature of minimum wage rate reviews.

A challenge to determining links and flow-on effects is references to specific dates of implementation (October 2007) and specific award and Pay Scale change announcements (mid-2007). These references are key indicators of FMW adjustments; however, they do not provide definitive evidence of the links and flow on effects from changes in federal minimum wages.

Links were less easily recognised where employers paid 'above award' wages. It appeared that for some employers, there could be an impact or flow-on effect, but they did not make the connection. While for others – where the increase in minimum wages was not passed on to employees – the difference in 'above award' would diminish over time, until the 'above award' rate was no longer competitive, or fell below the minimum, and had to be adjusted upwards.

While many employers relied on Pay Scales, at least as a guide for setting pay rates, the comments of participating employers highlight the strong impact of local economic conditions and the activities of competitors on the setting of pay rates.

Focus on competitors may result in indirect flow-on effects. This is evidenced in wage rises following minimum wage rate increases: as competitor wages go up following an increase in statutory minimum rates, so do the rates offered by other businesses, whether directly linked to statutory minimum wages or not. However, some employers highlighted that this focus on competitors demonstrates that changes in minimum wage rates are of little, if any, consequence to them given current labour market conditions.

Local economic conditions were also seen to play a key role in the determination of pay rates. For example, employers operating in 'boom' areas and tight labour markets described having to offer wages substantially above the Pay Scale rate to attract and retain staff. In these markets, the reality is that changes in statutory minimum wages are largely irrelevant as they remain below the 'market' rate.

4.4 Adjustment variables

Employers reported using a variety of strategies to help them deal with the impact of increased labour costs following an increase in wage rates (not limited to increases in statutory minimum wages). For many employers, the strategies used were similar to those applied to manage business profitability and reflected their general approach to business operations and management. As a result, employers who generally displayed higher levels of business acumen, or more sophisticated strategies in relation to the management of business costs and profitability, also displayed a more considered approach to dealing with increases in wage rates.

Thus the variety of approaches used to deal with increases in wage costs is reflective of the diversity of businesses. At one end of the spectrum, some employers described either experiencing no impact from wage increases, or simply continuing to operate following increases in wage costs without making any adjustments to their business operations. At the other end of the spectrum, employer comments indicated cases where a comprehensive range of adjustment variables formed part of a proactive business strategy. These businesses displayed a strategic approach to business management, which often involved planning and budgeting for wage increases and using a combination of adjustment variables to deliver business growth and profitability.

Across all industries the most commonly *considered* strategy was increasing prices, although it was not the most commonly *implemented* strategy. For many employers, increasing prices was a 'top-of-mind' consideration; however, the final decision is a complex one involving consideration of a range of factors. Personally working an increased number of hours was likely to have been implemented by around half of participants following the most recent increase in wage costs experienced by the business. Participants recognised that this could negatively impact their work/life balance and personal life; however, this strategy was viewed as a potentially unavoidable measure that was necessary to ensure the ongoing financial solvency of their business. Other commonly implemented strategies focussed on reducing staff costs through direct measures (such as reducing the number of staff overall or the number of staff per shift) and indirect measures (such as training existing staff to fill a vacancy or to deliver an increase in productivity).

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Differences were observed between the ACR, HaCS and Retail industries in relation to the strategies implemented by participating employers in response to increases in wage rates. Generally, employers in the ACR industry tended to implement a greater number of strategies, often in combination, while employers in the Retail industry tended to implement a smaller range of strategies. Within the HaCS industry, legislative requirements in relation to care ratios and the nature of funding arrangements appear to restrict the types of strategies that are considered suitable.

Differences in the business strategies implemented in response to wage rises were also evident depending on the size of the business for which the participant was working. Participants from businesses of all sizes reported that they had considered a wide range of strategies; however, participants from medium-sized businesses were more likely to have implemented a wider range of adjustment variables. Small and micro businesses participating in the research were most likely to report having considered and implemented the strategies of personally working an increased number of hours and increasing prices as a response to increasing wage rates, while medium-sized businesses were most likely to train existing staff to increase productivity, or to increase prices.

Forum discussion

General discussion following the presentation focussed on:

- the diversity of approaches taken by different employers to changes in minimum wages; and
- the role of norms in shaping labour market outcomes.

Many participants found the qualitative research on firm responses to minimum wage increases to be a valuable, additional perspective to labour market analysis.

There was considerable interest in the research as a different approach to the experimental analysis of a minimum wage adjustment. Provided that the research was appropriately timed, it could assist in identifying and then distinguishing any shock effects of minimum wage increases from the adjustments that businesses may make over time. This information could usefully inform the design of further surveys and econometric analyses of the labour market.

The research was also thought to demonstrate the importance of norms in the labour market. As a result, it pointed to the difficulty of identifying the coverage of minimum wages and their broader influence, an area in which the data are relatively weak. There was considerable interest in the possible quantification of the different categories of firms identified through the survey according to their approach to minimum wage adjustments.

There was some discussion of the extent to which the four broad types of adjustments by firms to changes in minimum wages are independent of each other. A case was made that some of the adjustments by firms may be interdependent. For example, many firms may respond to higher labour costs by looking to expand their businesses at the same time as looking to increase productivity.