RESTAURANT BYTES

Who's the Boss? Changes in Joint Employer Liability

Last April, the restaurant industry warily watched as a series of National Labor Relations Board (NLRB) hearings sought to name fast-food giant McDonald's as a joint employer with its individual franchisees.

We wrote in Franchising World about how changes in joint employer liability could affect franchisors and franchisees, potentially upending long-standing industry employment practices and causing major ripples throughout the restaurant and retail industries.

The potential economic costs of such a significant change fostered worries in the restaurant sector that franchisors would struggle to absorb new costs for overhead and liability, and that some would ultimately need to buy back or shut down locations. Though the NLRB has offered some clarity around the standard in the months since the initial hearing, uncertainty remains.

What has the NLRB ruled so far?
In August 2015, the NLRB redefined its standard for determining joint employer status, expanding the standard that had been in place since 1984. In its decision, the NLRB asserted that an entity with the potential to exercise control over another entity's employees–regardless of whether that control is directly exerted–is a joint employer and therefore obligated to assume responsibility for the other entity's employment practices, such as participating in the collective bargaining process. This ruling has direct implications for restaurant franchisors, who might require franchisees to apply certain standards for the purpose of consistency or trademark protection. Because these practices can indirectly affect employment conditions of the franchisees' workforce, some commentators have argued that they could satisfy the new standard for determining a joint employer.

A few states, such as Michigan, Texas, Virginia and Wisconsin, reacted with legislation designed to redefine "employer," protect franchisors and maintain the traditional model the industry has operated under for decades. The NLRB's first application of the new joint employer standard, the Browning-Ferris case involving a Houston-based waste management firm, also offers some guidance as to which practices could precipitate a finding of joint employer status. Specifically, the NLRB stated that a parent entity could be considered a joint employer for another company's (or companies') workforce if it:

- Maintains a common-law relationship with the employees in question, meaning the joint employer has control over what employees do and how they perform tasks, and
- Has sufficient control over employees' essential terms and conditions of employment to permit meaningful collective bargaining.

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What's on the horizon?
The issue is once again in the spotlight after the Department of Labor earlier this month issued new guidance broadening the definition of joint employer, explaining that under the Fair Labor Standards Act of 1938 and the Migrant and Seasonal Agricultural Worker Protection Act of 1983, "it is possible for a worker to be jointly employed by two or more employers who are both responsible, simultaneously, for compliance." The NLRB is also preparing to hold hearings, though they've been delayed, to determine whether McDonald's had a significant hand in setting work conditions for employees who were fired in association with wage protests in 2013.

What does this mean from an economic perspective for restaurants considering the impact of these changes on their business? While the uncertainty has eased somewhat since last year, it remains critical for franchisors to evaluate how their workforce-related practices may expose them to potential liabilities under a joint employer standard, such as employment-related lawsuits filed by their franchisees' employees. Moreover, both franchisor and franchisee should consider analyzing the economic impact of any future employment practices they may implement through the lens of how those decisions may trigger a joint employer determination.

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Compensation Strategy in the Restaurant Industry

In step with the industry as a whole, compensation for restaurant managers and professionals is evolving faster than ever to support increased focus on–and demand for–enhanced customer experience. Restaurants are recalibrating their compensation practices to respond to the competitive environment and attract career-oriented staff in an increasingly tight labor market.

Average hourly wages of restaurant industry employees increased at a 3.7 percent rate on a year-to-date basis through late 2015, according to figures from the Bureau of Labor Statistics. To contend with these increases, it's important for restaurants to put a plan in place.

What's the key to having an effective compensation program in this environment? Preparing a well-articulated strategy that serves as a guide for making compensation decisions. Furthermore, building a management compensation package will ensure that a company can attract and retain talent that will contribute to the company's growth.

The following are key components to consider when creating your compensation strategy:

Market Definition: Most companies use both local and regional markets to benchmark compensation levels for positions such as restaurant manager and regional manager.

Market Comparisons and Market Position: Consider and define target total compensation, including base salary, bonuses and long-term incentives for each job group. It's worth noting that in the most competitive markets, a target total compensation at the 75th percentile of the market can be essential for retaining top talent.

Pay Mix: Based on our research, about 75 to 90 percent of total pay for management positions, such as general manager or restaurant manager, typically comes in the form of a base salary. The rest is variable pay, like annual performance-based incentives and, possibly, long-term compensation.

Annual Incentives: Annual incentives are typically determined by more than one performance metric. For example, one popular incentive program among restaurants is profit sharing based on regional or restaurant profits after controllable expenses. After a specific profitability threshold is met, the percentage of "sharing" accelerates.

Long-term Incentives: There is a growing trend of including regional managers and high-performing restaurant managers in long-term incentive programs to promote loyalty and boost retention. Equity programs are preferred, but aren't always viable. Of course, the company must have an ownership structure that is willing to share a piece of the pie with top performers.

Another program gaining in popularity, regardless of the equity structure of the company, is a three-year performance unit plan. Units, which have a cash value, are awarded after three years. The value is often based on both the performance of the group receiving the unit (e.g., a region) and the appreciation in the value of the company over three years.

A key goal of these programs, whether equity or cash-based, is to provide a sense of ownership in the company, helping management feel more vested in the business and its successes.

Deferred Compensation/Benefit Programs: Some benefit and deferred compensation programs have historically been viewed as entitlements with little relationship to individual or corporate performance. However, amid heightened competition for mid-management talent, these programs can promote long–term retention in an industry notorious for turnover.

401(k) with Vesting Match: 401(k) plans are a traditional—yet still effective—incentive tool to encourage retention. A discretionary match with a vesting schedule can serve as an incentive for key employees and management to save for retirement and stay to earn the benefits of vesting. For example, a plan can start with zero vesting for the first three years of employment and then jump to 100 percent cliff vesting, or it can be a gradual schedule of 20 percent per year with full vesting after 5 years.

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Retention Bonuses: Retention bonus programs run the gamut among restaurant companies and can take a number of different forms. Essentially, they stipulate a promise to pay a lump sum after a period of employment (e.g., three years). The amount is usually established as a percentage of base salary at the beginning of the vesting period.

One of the key differentiators among companies in this industry is the ability to both attract and retain talent. The fluid nature of the talent pool makes job changes in pursuit of a few additional dollars an ongoing reality that's unlikely to fade. A well-developed compensation strategy can not only help mitigate this risk, but also bolster loyalty and strengthen the commitment of employees to their company.

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Why Should Restaurants Embrace Transparency in Management?

As Jack Stack says in his book, The Great Game of Business, the more employees know about their company, the better the company will perform. He goes on to outline the goal of open book management: to teach people how to work together to achieve common goals.

Open book management is a philosophy of transparency that includes the sharing of financial information with employees so they become aware of the implications of their actions, where the business stands at any given moment and how they can contribute to the business in the future. The concept is popular among many restaurants, originally gaining popularity and prominence with business consultant John Case's book on the subject.

While some restaurants have a hard time buying into the idea of open book management and consider the idea crazy, anti-business and a threat to security and privacy, more and more business owners are adopting the style. Open book management styles satisfy the thirst today's workforce has for transparency and honesty in business. It also helps employees feel more vested in the company and its successes by helping them understand exactly how the business works and how it makes–or doesn't make–a profit. Information is shared as an educational tool and not as a way to intimidate, control or manipulate people. If used correctly, the practice can contribute to a satisfied and productive staff, as well as improve retention.

It's important to note that not every detail needs to be shared in order for a restaurant to see positive results. Management transparency, when employed strategically, can give restaurant employees direction and help them visualize their own impact on the restaurant's bottom line. Further, restaurant owners who create a free flow of information will likely see a stronger bond of loyalty and trust with their staff, which helps prevent an "us versus them" mentality.

On the other hand, revealing too much information has its disadvantages. Risks include information security concerns, fraud schemes and potentially overwhelming workers with too much financial information they cannot understand. Restaurants can avoid pitfalls by creating a roadmap for presenting fiscal information to their employees.

Consider using a financial whiteboard to post weekly results and metrics, including sales, costs, guest retention figures, customer comments and a sales thermometer. Share and discuss the information at regular fiscal meetings open to all employees.

Explaining the company's metrics and working through specific line items as a group might require some investment of time and resources. However, improving transparency practices can help management and employees come together as a team, understand how their roles function as parts of the whole and, ultimately, boost performance.

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Perspective in Restaurants: Private Equity Hungry for Deals in the Restaurant Sector

Over the past year, private equity activity has heated up in the restaurant industry. Historically, investors wanted to see proof of concept in multiple markets, minimum revenues, EBITDA, number of units and a good story before they were willing to invest in a restaurant.

But as the sector continues to evolve, investors are increasingly setting aside some of their more stringent standards as they seek to take advantage of emerging opportunities. And private equity firms are not the only ones looking to enter the space. Venture capitalists, other restaurant groups and even non-restaurant companies, such as Ford, are looking to enter the game. What has led to this change of heart?

- **The cost of money remains low, and new concepts have proliferated.** PE firms have more to lend and have subsequently become less risk averse. At the same time, following the wild successes of the fast casual segment, restaurants are exploring new concepts in the hopes of launching the next big thing. As a result, PE firms appear more willing to invest in earlier-stage restaurants, hoping to ride the wave of the sector's boom in innovation.
- **The "healthy" fast casual segment is ripe for investment.** Shifting consumer preferences have driven a paradigm shift in the restaurant industry in recent years. Though many diners on the go are looking for speedy, easy service, they are less willing to compromise on the quality and nutrition of their food. In addition, consumers are interested in knowing where their food is coming from, supporting local sourcing and eating organic. This has created significant growth opportunities for fast casual restaurants and, with the trend set to continue for some time, PE firms are eager to enter the market.
- **Investors are more willing to share.** PE firms typically prefer to seek out deals that allow them to maintain full control—or at least a majority—of the investment. But competition for restaurant deals can be fierce, and PE firms must be nimble in order to quickly jump on opportunities and take advantage of the industry's growth now. With time at a premium, investors are seriously considering going into an investment with a smaller piece of the pie, or even sharing with other funds.
- **Other sectors are not as attractive.** Though the overall U.S. economy has improved incrementally over the years, many industries remain stagnant or continue to decline, reducing investment opportunities for PE firms in more traditionally attractive sectors like retail and energy. But the restaurant industry is surging and, with PE sponsors rising and falling on their ability to make a strong return on investment for their limited partners, it comes as little surprise that they are funneling dollars toward this growing market.

PE interest, generally speaking, is good news for restaurants looking to grow, scale up or explore new services and concepts. But restaurants being courted by private equity should remain wary, being sure to "date before they marry." The financials are only one aspect of the relationship between the restaurant and its investors. A shared set of values, goals and vision for the exit is also critical to ensuring that the relationship benefits all parties.

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