CHAPTER 3

WAGE AND HOUR LAWS AFFECTING SALARIED, HOURLY, AND TIPPED EMPLOYEES

A server who continues to improve himself or herself will qualify for a higher wage. Instead of $50,000 a year, it could be $60,000 a year.[1]

Charlie Trotter, chef/owner, Charlie Trotter's, Chicago

CHAPTER OBJECTIVES

After completing this chapter, you will be able to

- Describe the evolution of local and federal laws with respect to worker's rights, minimum wage, and child labor laws.
- Identify the importance of employee wages and salaries and their role in affecting workplace morale.
- Distinguish between exempt and nonexempt employees and their eligibility for overtime compensation.
- Understand the federal tip credit and tip pooling and their impact on an operation's labor costs.
- Recognize the effect that labor costs have on a hospitality operation's profits.
- Identify what is most important to employees when it comes to job satisfaction.

HRM IN ACTION To say that the hospitality industry is labor-intensive is an understatement. Unlike the manufacturing industry where state-of-the art machines and futuristic robots manufacture and assemble parts, the workflow in a typical restaurant or lodging operation is quite different. It takes a lot of worker bees to prepare, cook, and serve the food, not to mention the need for additional staff to clean up the mess at the end of the night and to put everything away in preparation for business the next day. Hotel beds are not made up daily by machines, and you won't find any robots scrubbing the toilets either.

The hospitality industry has the restaurant and lodging chains to thank for the relatively high levels of technology that we find in use today in modern restaurants and hotels, but even the chains understand that this is an industry driven by people performing tasks that are not always pleasant and for which they are not often well paid.

We learned in earlier chapters that the ability to attract and retain a quality workforce might be the single most important factor in determining the success or failure of a restaurant or a lodging operation. In this chapter, we investigate the importance of employees' wages and salaries and how these factors affect morale in the workplace. In addition, we review important wage and hour laws with which all hospitality managers and supervisors must be familiar. Many of these laws are frequently violated by hospitality organizations.

A BRIEF HISTORY

Your grandparents, and certainly your great-grandparents, probably never heard of such things as **minimum wage, child labor laws,** or workers' rights in general. That's because these concepts were not even invented until 1938—less than 70 years ago! Most of us today take labor laws that protect us from the evils of unregulated industry for granted. In fact, during the course of our nation's history, many workers have fought and often died for rights within the workplace. Figure 3.1 provides a glimpse at some of the events that make up our nation's tumultuous labor history.

During the **Industrial Revolution,** children sometimes as young as seven years of age were often forced to work for 14 hours a day, under conditions that are prohibited for people of any age in the workforce today. The government was under a lot of pressure to control this abuse of labor. The first attempt to establish more control over conditions and wages in the workplace was to determine a minimum wage in the United States. Establishing the first minimum wage came in 1933, when a $0.25-per-hour standard was set as part of the **National Recovery Act,** a law that was designed to promote recovery and

TALES FROM THE FIELD

The waitstaff at Charlie Trotter's Chicago restaurant are highly motivated and well paid. They are not working their tables for tips; however, they work for a regular paycheck in which their annual compensation can range anywhere from $40,000 to $80,000 per year. In addition, staffers also receive health and dental insurance, paid vacations, and a 401(k) plan. The restaurant is closed about three weeks a year, and employees schedule their vacations at that time. Employees can invest up to 15 percent of their salary in the 401(k) program, and Trotter's will match 25 percent of their contributions. Servers are eligible for annual merit-based raises, salary bonuses for exemplary service, and promotion to manager status. The top supervisors can earn about $120,000. Benefits, not to mention a regular wage as opposed to tips, are the exception for front-of-the-house employees in the hospitality industry where the rule of thumb is cash-and-carry.

February 24, 1912
Women and children were beaten by police during a textile strike in Lawrence, Massachusetts.

January 5, 1914
The Ford Motor Company raised its basic wage from $2.40 for a nine-hour day to $5 for an eight-hour day.

September 7, 1916
Federal employees win the right to receive worker's compensation insurance.

June 3, 1918
A federal child labor law, enacted two years earlier, was declared unconstitutional. A new law was enacted February 24, 1919, but this one too was declared unconstitutional on June 2, 1924.

June 25, 1938
The Wages and Hours (later Fair Labor Standards) Act is passed, banning child labor and setting the 40-hour work week. The act went into effect in October 1940 and was upheld in the Supreme Court on February 3, 1941.

June 10, 1963
Congress passes a law mandating equal pay to women.

October 6, 1986
One thousand, and seven hundred female flight attendants won an 18-year lawsuit (which included $37 million in damages) against United Airlines, the company that had fired them for getting married.

Figure 3.1 Highlights in twentieth-century labor history.

Month/Year	Minimum Hourly Wage
October 1938	$0.25
October 1939	$0.30
October 1945	$0.40
January 1950	$0.75
March 1956	$1.00
September 1961	$1.15
September 1963	$1.25
February 1967	$1.40
February 1968	$1.60
May 1974	$2.00
January 1975	$2.10
January 1976	$2.30
January 1978	$2.65
January 1979	$2.90
January 1980	$3.10
January 1981	$3.35
April 1990	$3.80
April 1991	$4.25
October 1996	$4.75
September 1997	$5.15

Table 3.1

History of Federal Minimum Hourly Wage. *(Source: U.S. Department of Labor.)*

reform, encourage collective bargaining for unions, set up maximum work hours and minimum wages, and forbid child labor in industry. However, in 1935 the United States Supreme Court declared the National Recovery Act unconstitutional, and the minimum wage was abolished. It was not until 1938 with the passage of the **Fair Labor Standards Act (FLSA)** that a federal law to set national minimum-wage and maximum-hour standards for workers was firmly in place. Table 3.1 details the history of the federal minimum hourly wage.

The law also placed many limitations on child labor. Some states have no unique child labor laws and, thus, simply adhere to the federal laws. Other states have stricter child labor laws of their own. In some states, almost all jobs are totally prohibited for persons under the age of 16. Currently, the federal minimum wage is $5.15 per hour. During his presidency, Bill Clinton gave states the power to set their minimum wages above the federal level. As of 2004, 12 states had done so, and on November 2 of that year, two additional states (Florida and Nevada) approved increases in statewide referendums. Figure 3.2 provides a comparison of state and federal minimum wage.

Effective January 1, 2006, minimum wage increased in the states of Hawaii and Vermont to $6.75 and $7.25, respectively. Some government entities, such as counties and cities, have set minimum wages that are higher than the state and the federal government as a whole. San Francisco's $8.82-per-hour minimum wage is the highest in the nation. While the San Francisco ordinance covers all workers in any company with more than 10 employees, the vast majority of these local ordinances does not cover all businesses operating within the city or county, but rather, narrowly focus on businesses that sell goods or services to local governments, or receive subsidies from that government. Examples of such subsidies include grants, loans, bond financing, and tax abatements, to name a few. These are called **living wages**, or livable wage ordinances, and their levels reflect the income needed to maintain a family at the poverty level in that area. The stricter law, or the one most favorable to the employee, is the law that must be followed.

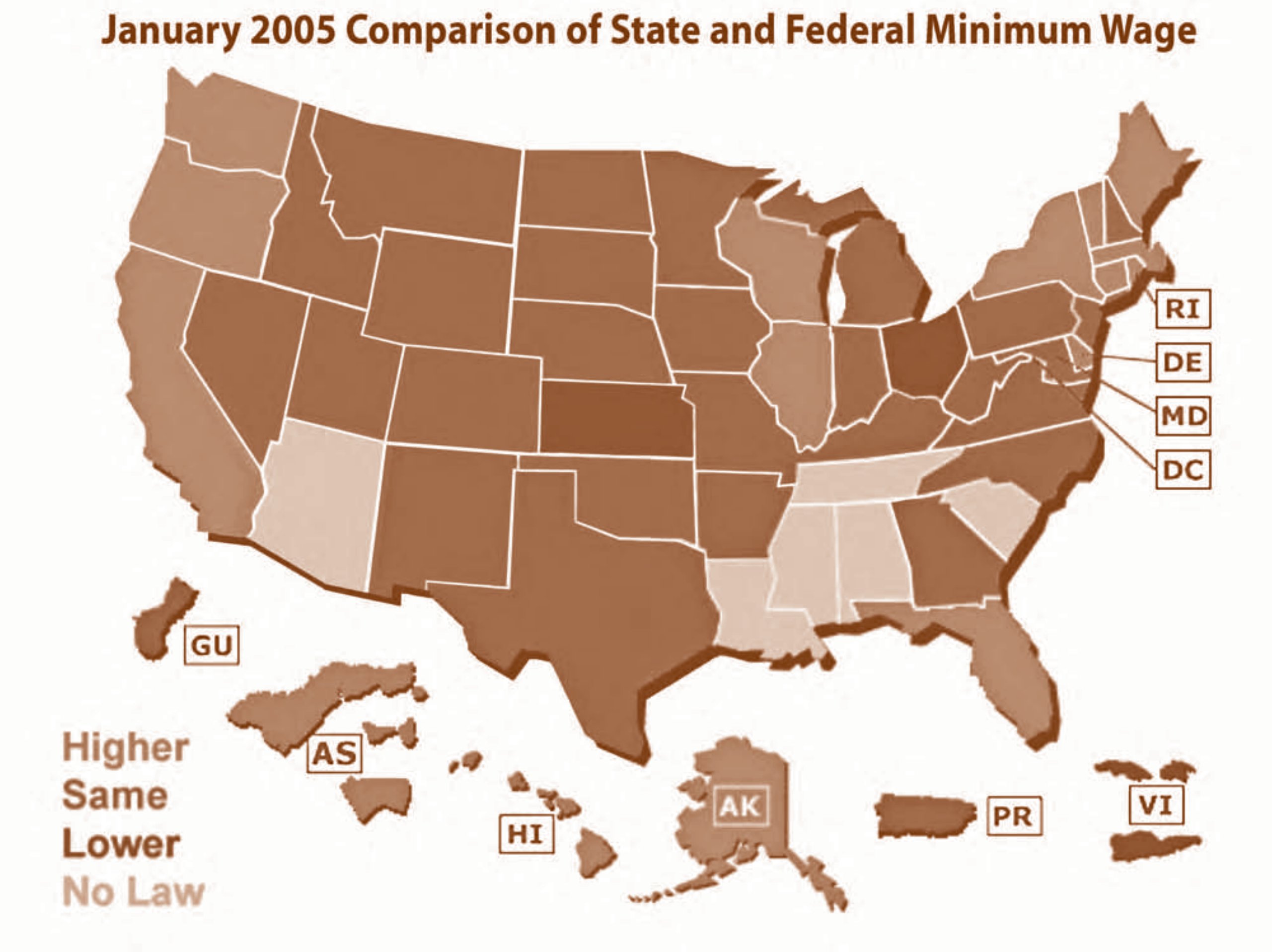

Figure 3.2 Comparison of state and federal minimum wage. *(Source: U.S. Department of Labor, Employment Standards Administration, Wage and Hour Division.)*

TIP CREDITS AND TIP POOLS

A **tip** is a sum a customer gives as a gift or a **gratuity** in recognition of some service performed. Whether a tip is given, and how much, is determined solely by the customer. The history of leaving a tip or a gratuity is somewhat clouded. Some research suggests that tipping has its roots in the Roman Empire. Other experts claim that the word "tip" was medieval street talk for "hand it over." Regardless of its origins, leaving a tip for a hospitality industry service worker today is commonplace, and one's failure to do so will cer-

- *Restaurants and bars.* Restaurant servers are normally given between 15 and 20 percent of the total bill. Depending on the restaurant, you may also need to tip the sommelier or wine steward 10 to 15 percent. What you also have to remember is that your server tips all of the other servers who assisted them throughout your meal, such as the bushelp, the bartender, and others.

  In bars, 10 to 15 percent is considered average, but you should also take into consideration the complexity of your drink orders.

  At buffets where you serve yourself, you might be tempted to skip the tip, but remember that someone also has to clear your table, refill your drink, and bring you more plates. Ten percent is the usual amount to tip in these restaurants.

- *Hotels.* Gratuities to hotel staff vary from location to location, usually depending on the size of the metropolitan area. Typically, however, you should give bellhops at least $1 for each bag they carry (more if the bags are especially large, heavy, or awkward to carry), and more if they go above and beyond the call of duty to make your stay more pleasant.

  The standard tip for the maid is $1 to $2 per night. This, of course, depends a lot on the mess you make, the price of the room, and the extra services you request. The standard amount for the concierge is $5 to $10 depending on how helpful he or she was. If the concierge suggested and made reservations for you at a great restaurant, then you might tip more. Tips are not usually necessary for the doorman or the desk clerks, unless they do something out of the ordinary that you really appreciate.

- *Airports.* Standard practice is to tip skycaps $1 to $2 per bag for carrying and checking your luggage. The same goes for shuttle drivers if they help you with your bags. If they don't, which often happens, then no tip is necessary.

- *Parking and auto-related.* The usual amount for tipping valets is $1 to $2 per car when you pick the car up. If you ask for special care or for quicker retrieval, then you might also tip when you drop the car off.

Figure 3.3 United States tipping guidelines.

tainly result in a withering cold stare, if not worse. Figure 3.3 provides tipping guidelines in the United States, and Figure 3.4 provides tipping guidelines overseas.

A **service charge** is an amount of money added to the customer's bill by management. Under federal law, because service charges belong to the establishment, they should be considered part of the establishment's gross receipts and must be considered as income to the employer. Service charges may be retained entirely by management or distributed to employees in any amount management chooses. When restaurant management chooses to institute such a charge, customers should be notified in advance, either by a conspicuous notice on the menu or by some other clear and obvious means.

Australia
Keep your change! Except at upscale restaurants—where a 10 percent tip is common. Taxi drivers, hairdressers, and porters do not expect tips.

Brazil
Restaurants will typically add a 10 percent service charge to your bill, in which case it is customary to leave an additional 5 percent for good service. If no service charge is added, you should leave 15 percent for good service.

Britain
For the most part, service charges aren't included in restaurant or hotel bills, and a tip of 12 to 15 percent is expected for good service. In pubs and bars, tips aren't expected. For housekeepers, small change—up to 1 pound per day—is reasonable. Taxi drivers are generally tipped 10 percent, depending on the distance.

Canada
For restaurant staff and taxi drivers, a 15 percent tip is the norm. Porters and bellhops generally receive 1 Canadian dollar per piece of luggage.

France
Almost all restaurants will add a 15 percent service charge to the bill. It is customary to leave an additional 2 to 3 percent—or any remaining small change—for good service. If the service charge is not included in the bill, a 15 percent tip is the norm. Porters and bellhops are generally tipped 1.5 euro per bag. Taxi drivers are usually tipped 10 to 15 percent of the fare.

Germany
Tipping is not a traditional German custom, and overtipping is supposedly frowned upon, although it is doubtful anyone would refuse to take your money. Most hotel and restaurant bills include a service charge, and it is now customary to tip up to an additional 10 percent of the total bill if you receive good service.

Greece
Restaurant bills usually include a service charge of 15 to 20 percent, in addition to a "cover charge" for use of the table. It is also customary to leave the change from your bill (some on the plate for your waiter and some on the table for the busboy).

Italy
In major cities, restaurant bills usually include a 10 to 15 percent service charge. If not, a tip of 10 to 15 percent is appropriate for good service. Hotels will usually add a 15 to 20 percent service charge to your bill. Bellhops or porters are tipped 1.5 to 2.6 euro for carrying your bags to your room.

Japan
Tipping is not customary in Japan, and most service-industry employees do not expect tips. However, restaurants and hotels will usually add a 10 to 20 percent service charge to your bill.

Mexico
Except in resorts, most restaurant bills do not include a service charge. A 10 to 15 percent tip is customary. Porters and bellhops are generally tipped 9 to 10 pesos, while taxi drivers receive 5 to 10 pesos.

Figure 3.4 Overseas tipping guidelines.

Tips, on the other hand, belong to the employee and cannot be used to pay for uniforms or to reimburse management for shortages, breakage, walkouts, or other establishment losses. While a few states prohibit this practice, restaurant employers can pay most employees who receive tips less than the minimum wage by taking a "tip credit." The **tip credit** can be used whether the tips involved are received directly from customers or are received indirectly through a **tip pool** or sharing system. By using tip credits and tip pooling arrangements, a restaurant can obtain steep cuts in labor costs. For example, payroll outlays for minimum-wage servers drop from $5.15 an hour to $2.13 an hour. To obtain this $3.02 per hour in labor cost savings, however, the restaurant must adhere to strict notice and administrative requirements. It is important to note, however, that some states prohibit employers taking a tip credit against minimum wage. The prudent hospitality manager will always consult with a local labor attorney to ensure that the establishment is in full compliance with local and state laws. This information can normally be obtained from a specific state's department of labor.

Regular Tips

For purposes of the tip credit, an eligible employee is one who is in an occupation that regularly and customarily receives $30 or more per month in tips, and the employee actually receives that amount. In the restaurant and lodging industry, food and beverage servers and bartenders are obviously in this category. Other positions, such as food runners and hosts or bellhops and housekeepers are not always regularly and customarily tipped.

Tip Retention

For the tip credit to apply, an employee must be able to retain all of his or her tips, aside from any portion placed into a tip pool. Thus, if the restaurant uses a system in which the house takes a cut of an employee's tips, using the tip credit is not an option.

Slow Shifts

To prevent an employee's total compensation from falling below the minimum wage, the restaurant must have a system for monitoring employee tips and compensating employees when business is slow or whenever tips are not at least equal to the tip credit. If the restaurant takes the full $3.02-per-hour tip credit, covered employees must each receive at least $3.02 per hour in tips. If they don't, the restaurant has to make up the difference.

Advance Notice

Finally, an employer seeking to take a tip credit must provide advance notice to the affected employees. Some restaurant employers rely on a posting in the break area or on the employee bulletin board, but a better practice is to use a notice system that creates a written record that the notice has been received and read. This can be either a written receipt for the **employee handbook** (which itself contains a tip credit notice) or a stand-alone tip credit notice that contains an employee acknowledgment to sign and date. In either case, a copy of the record should be maintained by restaurant management.

Tip Pools

The tip credit can be expanded beyond the core of servers and bartenders through the use of a tip pool. When employees who receive tips contribute a portion of their tips to other employees, this is considered a tip pool. When a tip pool is purely voluntary in the sense that it is not the result of management involvement or coercion, the employees are free to share their tips with any other employees, such as the back-of-the-house staff. If, however, management requires employees to contribute to the tip pool or is involved in the collection of contributions, then the tip pool is deemed mandatory and will be legal only if the sharing is limited to certain employees. Mandatory tip pools can include only employees who are in positions that are regularly and customarily tipped. Back-of-the-house staff, such as cooks, dishwashers, and managers, is generally ineligible because these workers are not regularly and customarily tipped. Keep in mind that penalties can be severe. The consequences of ignoring this restriction may result with the employer losing both the tip pool program and the tip credits. When this occurs, back-pay awards are distributed to each employee for the full amount taken as a tip credit. Nevertheless, the risks associated with a mandatory tip pool are generally outweighed by the benefits of making the tip credit apply to more employees. For example, a bus person typically does not have enough customer contact in most restaurant settings to receive a separate tip directly from the customer. Rather, direct tips generally go to the servers and bartenders. As a result, the bus person's direct tips are almost never enough to cover the $3.02-per-hour tip credit, making it impossible to take the credit for that position. By redistributing customer tips from highly tipped positions, however, a tip pool provides the bus person with sufficient indirect tips to allow the employer to take the full tip credit. When a tip pool is instituted, the bus person's hourly labor costs drop substantially from $5.15 per hour to $2.13 per hour. Food and beverage service employees employed by hotels might also participate in a tip pool. Lodging positions such as bell staff and housekeepers, which are not customarily tipped, would most likely not. It is important to note that some state wage and hour laws may prohibit mandatory tip pools enacted by management, so the prudent hospitality manager would consult a local labor law attorney before implementing such a plan.

ethical dilemma

Dale was recently hired as a kitchen manager in a restaurant that is part of a large national chain. Management generally frowns on paying overtime, and, consequently, the kitchen staff must work quickly and efficiently to get out on time so that no one goes beyond his or her prescribed work schedule. Dale has noticed that on certain nights when the sous chef, who is on salary, is closing, he asks certain workers to clock out, yet remain for the 30 or 40 minutes required to complete the kitchen's closing procedures. Dale later learns that to "compensate" the employees who have remained while off the clock, the sous chef awards them with a six pack of beer he has taken from the bar. Dale is reluctant to mention this practice to higher management or even to the sous chef, realizing that the practice is an effective way—albeit an unusual one—to control overtime and that a six pack of beer is much less costly to the organization than would be average kitchen wages paid at time-and-a-half. Which of the *10 Ethical Principles for Hospitality Managers* is being violated? Should Dale end the practice or allow it to continue? How will Dale's decision affect his position with the organization? How will his decision affect his relationship with the sous chef and the hourly workers in the kitchen?

Overtime

Once a mandatory tip pool has been set up and the restaurant is ready to take a tip credit for all eligible staff members, there is the problem of calculating **overtime**. For purposes of determining the regular wage rate for a tipped employee, management simply adds the tip credit back into the hourly wage actually paid to the employee. For the bus person, the correct hourly wage rate for overtime purposes is $2.13 per hour plus the tip credit of $3.02 per hour, for a total of $5.15 per hour. Thus, **time-and-a-half** (the overtime wage rate) for the busperson would be about $7.73 per hour.

Of course, this does not mean the restaurant will actually be paying the bus person $7.73 per hour for each hour worked over 40. The restaurant still will get to take the $3.02-per-hour tip credit (assuming the bus person makes enough in tips) for each overtime hour. This will lower the effective hourly overtime wage to $4.71 per hour.

Despite having to strictly comply with another set of regulations, a properly administered payroll system using both tip credits and tip pools, when permitted under state law, can dramatically lower labor costs. Given the ever-growing pressure to scrutinize margins in the restaurant industry, these are savings management cannot afford to overlook.

As pointed out earlier, the Fair Labor Standards Act (FLSA) provides that when any state law or municipal ordinance establishes a minimum wage higher than the federal minimum wage, the law that benefits and is most favorable to the employee must be followed. The same principle applies to the tip credit. Some states have laws that prohibit employers from taking a tip credit or that limit the tip credit to an amount less than that authorized by the FLSA. Figure 3.5 provides IRS contact information.

Call the IRS hotline at (800) TAX-FORM, or visit www.irs.gov for copies of any of the following:

- IRS Form 4070A, Employee's Daily Record of Tips. Helps employees keep track of daily tips.
- IRS Form 4070, Employee's Report of Tips to Employer. Employees can use this form to report tips to employers once per month.
- IRS Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips. Filed annually by large food and beverage establishments.
- IRS Publication 531, Reporting Income from Tips. Explains reporting laws to tip earners.

The National Restaurant Association also offers materials to help restaurant owners and managers explain the do's and don'ts of tip reporting to employees. Call the association at (800) 424-5156 for more information, or visit www.restaurant.org.

Figure 3.5 Federal tax reporting documents for tip earners. *(Source: Internal Revenue Service; National Restaurant Association.)*

CHANGES IN OVERTIME LAW

As noted earlier, the FLSA contains provisions that determine overtime pay as well as the proper classifications of an employee as either **exempt** or **nonexempt.** In August 2004, these rules were changed for the first time in more than 50 years. An exempt employee is one who is not eligible to receive overtime. Employees who are classified as nonexempt must be paid a minimum of one and one-half times their normal rate of pay for each hour worked over 40 during a normal work week.

As you might expect, there has been a lot of controversy regarding these changes. Some felt that the new law would eliminate the overtime pay that many workers were accustomed to receiving. Others believed that unscrupulous

Photo 3.1 The restaurant's salaried general manager in the center would be classified as exempt and ineligible to receive overtime pay, whereas the waiters would be classified as nonexempt and would be eligible for overtime pay.

business owners would "reclassify" nonexempt positions as exempt, forcing those workers to put in more hours for less pay. Nearly one year later after the dust had settled, many human resources professionals said that with a few minor exceptions, things had not changed that much at all. Some businesses have acknowledged that they have reclassified a few positions as nonexempt, but many more businesses claim that they have now converted nominally exempt employees to nonexempt, entitling those employees to time-and-a-half pay for hours worked over 40 per week.

Any small-business owner with gross annual revenues over $500,000 must comply with the Department of Labor's new overtime rules. Failure to comply with these new regulations could result in the business owner being charged with the willful violation of the act. The penalties for such a charge can be severe; the statute of limitations is three years, and the monetary damages awarded to the employee double.

THE NEW RULES

Almost all employees who make less than $455 a week ($23,660 a year) are eligible for overtime. The old rule set overtime for anyone who made less than $250 a week. The new rule applies whether the employee is blue-collar or white-collar, or whether he or she supervises people. The exceptions to this rule are teachers, doctors, and lawyers. They do not get overtime, no matter what they are paid. Employees who earn between $23,660 and $100,000 a year and who are in most executive, professional, or administrative positions are not eligible for overtime. Managers are not entitled to overtime if they oversee two or more people and have the authority to hire, fire, or recommend that someone be hired or fired. Administrative employees who have decision-making power and run some sort of operation are also not eligible for overtime pay.

The new federal overtime regulations require that each of the following three tests be met for an employee to qualify as exempt from federal overtime pay requirements:

- Test 1—Salary-Basis Test. Is the employee paid on a salary basis? The employee must receive a predetermined and fixed minimum salary that is not subject to reduction because of variations in the quality or quantity of work performed.
- Test 2—Salary-Level Test. Executive, administrative, and professional employees must earn a minimum weekly salary of $455 ($23,660 per year) to be considered exempt from federal overtime requirements.
- Test 3—Duties Test. What are the employee's duties? To be exempt, white-collar employees must perform a job that primarily involves executive, administrative, or professional duties.

EXECUTIVE (MANAGERIAL) EXEMPTION

In the hospitality industry, many managers and even some supervisors would be exempt because they fall under the executive or managerial exemption. Figure 3.6 provides an overview of the duties test as it applies to the executive or managerial exemption from federal overtime requirements.

In many hospitality operations, managers, assistant managers, and even some supervisors perform not only exempt duties, such as scheduling employees, managing inventory, and authorizing bill payment, but they may also perform nonexempt duties, such as helping out in the kitchen, manning the cash register, or checking in guests at the front desk. Does performing nonexempt duties such as

DUTIES TEST

An employee is considered an exempt executive if

1. The employee's *primary* duty is management of the enterprise of which the employee is employed or of a *customarily recognized department or subdivision thereof.*
2. The employee customarily and regularly directs the work of two or more other employees.
3. The employee has the authority to hire or fire other employees, or his or her suggestions and recommendations as to the promotion, hiring, advancement, or any other change in status of employees are given *particular weight*.

Figure 3.6 Executive exemption duties test. *(Source: U.S. Department of Labor, Employment Standards Administration, Wage and Hour Division, Fact Sheet #17A.)*

these mean that the manager should be paid overtime? The Department of Labor says that in order to be exempt, managerial employees should not spend more than 50 percent of their time at work performing nonexempt duties.

ADMINISTRATIVE EXEMPTION

The second major exemption from federal overtime rules is for certain administrative employees. The new rules make only modest changes to the old rules in this area. In general, the rules require that exempt administrative employees have a primary duty of performing office or nonmanual work directly related to the management or general business operations of the employer. The new regulations also require that exempt administrative professionals exercise "discretion and independent judgment."

PROFESSIONAL EXEMPTION

Professionals—including both **learned professionals** and **creative professionals**—might be exempt from federal overtime pay requirements if they meet certain duties tests and pass the salary-basis and salary-level tests. For example, the new rules provide two new ways that a chef might be classified as exempt:

1. Chefs, such as executive chefs or sous chefs, who have obtained a four-year academic degree in a culinary arts program generally meet the du-

ties requirement for the “learned professional” exemption. This exemption would not be available to cooks who perform mostly routine mental, manual, mechanical, or physical work.

2. A chef who is considered a “creative professional” could be exempt from federal overtime requirements, but the Department of Labor notes that there is a “wide variation in duties of chefs, and the ‘creative professional’ exemption must be applied on a case by case basis with a particular focus on the creative duties and abilities of the particular chef at issue.” Most likely, this exemption would extend only to truly “original” chefs, such as those who work at five-star or gourmet establishments, whose primary duty requires “invention,” “imagination,” “originality,” and “talent.”

It is important to remember that many states have their own overtime regulations that may or may not exactly coincide with those of the federal government. The prudent business operator will always seek the legal advice of informed counsel before entering the murky waters of state and federal employment law.

LABOR COSTS, PROFITS, AND EMPLOYEE MORALE

Aside from the hospitality industry, there are very few other industries in which labor costs, profits, and employee morale are so closely related. Most employees want to engage in meaningful work, and, of course, everyone wants to be fairly compensated. Owners and managers must always keep a keen eye on the operation’s bottom line, balancing the need to earn a fair return on investment with their employees’ needs for adequate wages, salaries, and benefits. Many hospitality operations do not manage this tightwire act very well, and they consequently go out of business. Plenty of others, however, manage quite nicely and, as a result, become very successful.

In most full-service restaurants today, the cost of labor is the single largest cost. In some establishments, the combined costs of salaries, wages, and employee benefits can be anywhere from 38 to 42 percent of sales. This means that for every one dollar that a customer brings through the front door, 38 to 42 cents of that dollar must go to pay wages, salaries, and fringe benefits. Owners and managers who strive to have profitable operations must manage labor costs very closely, ensuring that the ratio between labor costs and sales revenue stays within acceptable boundaries. However, what is acceptable to one operation versus another operation will largely depend upon the type of operation, as well as on the target market to which the operation primarily caters.

When so much emphasis is being put on labor costs these days, it would be fair to assume that most managers, owners, and even the employees themselves must rank wages and salaries very high on their list of matters of importance.

From the list below, please identify the single most important challenge facing your business today.

1. Gas and energy prices
2. Food costs
3. Building and maintaining sales volume
4. Competition
5. Labor costs
6. Recruiting and retaining employees
7. Insurance costs
8. Operating costs
9. Economy
10. Other

Figure 3.7 Challenges most likely to keep restaurant operators awake at night. *(Source: National Restaurant Association.)*

Interestingly enough, however, they do not! A recent National Restaurant Association "Industry Tracking Survey" asked restaurant operators to rank 10 challenges. These challenges are listed in Figure 3.7 in no special order. Take a moment to review these. How do you think these challenges stacked up in order of importance?

If you guessed that "labor costs" was the single most important challenge, you're probably with the majority of your fellow students. However, though most people probably would not have guessed "recruiting and retaining employees," the majority of respondents in this survey cite this as the challenge that "keeps them up at night."[2]

When asked, most employees will not cite "wages and salaries" as their number one job satisfier. In fact, most employees will tell you that "meaningful work" or a feeling of "being in on things" is what matters most to them when it comes to job satisfaction. It is important for managers to keep in mind that the wages and salaries that they choose to pay their employees will mostly be dictated by certain laws as well as by market conditions. That being said, their control over these things is relatively minimal, and that's good news for managers. If managers asked their employees what is most important to them as a job satisfier, employees would likely *not* rank salaries and wages very high on this list, noting instead such things as leadership styles, management styles, and other nonwage-related working conditions—all things that managers have complete control over. They have the ability to foster job satisfaction among their employees.

SUMMARY

- The hospitality industry is extremely labor intensive, and it requires a lot of workers to produce the quality products and services that more sophisticated travelers and diners have come to expect.
- Today's labor force is protected by a myriad of federal, state, and local laws with respect to minimum rates of pay, child labor law issues, exempt and nonexempt employee classifications, and overtime rates of pay for all hours worked over 40 in one workweek.
- Restaurants may legally pay tipped employees $2.13 per hour and may take a $3.02 tip credit. This payment method is legal but requires close attention to payroll matters and proper documentation in order to avoid running afoul of the law.
- While it stands to reason that most employees want to receive fair wages for a fair day's work, most would not rank wages as their number one job satisfier; rather, most employees see open communication between employees and management as well as a feeling that their work matters to the overall operation as being more important job satisfiers.

PRACTICE QUIZ

1. Restaurant and lodging chains have been quicker than independently owned and operated hospitality operations to adopt new technologies in the workplace.

A. True B. False

2. Minimum wage, child labor laws, and workers' rights in general have been in place in the United States since the mid-1800s.

A. True B. False

3. With regard to federal minimum wage, in which a state law is in conflict with the federal guidelines, the federal guidelines must *always* take precedent.

A. True B. False

4. The federal law that sets minimum-wage and overtime pay guidelines is the Fair Labor Standards Act (FLSA).

A. True B. False

5. The custom of requiring employees to "pool" or share their tips is illegal, and management should avoid this practice at all times.

A. True B. False

6. A service charge is

A. The same as a tip given to an employee by a customer and it belongs to the employee.

B. The same as a *gratuity.*

C. An amount of money added to the customer's bill by management and it belongs to management.

D. None of the above.

7. An employee who is classified as exempt

A. is not allowed to work overtime.

B. does not have to be paid time-and-a-half for overtime.

C. must be paid time-and-a-half for overtime.

D. None of the above.

8. An employee who is classified as nonexempt

A. Is not allowed to work overtime.

B. Does not have to be paid time-and-a-half for overtime.

C. Must be paid time-and-a-half for overtime.

D. None of the above.

9. Almost all employees who make less than $________ per week are eligible for overtime.

A. 250.00

B. 325.00

C. 455.00

D. 635.00

10. Which of the following is *not* one of the tests required by the federal government when determining whether an employee is exempt from federal overtime pay requirements?

A. Salary-Basis Test

B. Wage and Hour Test

C. Salary-Level Test

D. Duties Test

REVIEW QUESTIONS

1. Interview the manager of a local hospitality business to determine whether the operation utilizes a tip pool. Is it mandatory and required by management, or is it a system put into place voluntarily by the employees? If mandatory, how does management determine the best way to distribute the tips in the pool? If voluntary, how do the employees choose to distribute their tips? What are the benefits to management if it decides to implement a mandatory tip pool? What are the benefits to the employees who decide to voluntarily participate in a tip pool? Be prepared to share your findings with the rest of the class.

2. As the manager of a small lodging operation, you have decided to implement a mandatory tip pool policy in the bar and the restaurant of your operation. Your reason for doing this is to lower labor costs by taking a $3.02- per-hour tip credit for each individual in the pool. Write the new policy and be sure to clarify which employees will be required to participate. Explain your policy in detail.
3. You manage a local restaurant where the minimum hourly wage for tipped employees is $2.13 per hour. Overtime is calculated at 1.5 times the regular rate of pay for each hour worked over 40 in a workweek. You are allowed a $3.02-per-hour tip credit for each tipped employee. You are calculating payroll for Suzie, your bus person, who worked 47 hours last week. What will Suzie's gross pay (before taxes and other required withholding) be for the 47 hours that she worked? Be sure to show your calculations as backup for how you arrived at your answer.
4. Many consumers complain that hotels and restaurants should pay *all* of their employees a decent wage and that the practice of expecting customers to leave a 15 to 20 percent tip should be abolished. Do you agree or disagree? Why or why not? Explain your answer in detail.
5. The sous chef in your hotel has been paid an hourly wage of $14.50 per hour since she was hired two years ago. You would now like to make this a salaried, exempt position. You will expect the sous chef to work 50 hours per week, and she will no longer be eligible for overtime. Would you be able to apply the professional exemption to this position? Why or why not? What other information would you need to determine before you take this action? Explain in detail.

HANDS-ON HRM

For the past three years, Mona has been a general manager at Duke's Restaurant, which belongs to a large, well-known chain that has more than 1,000 units nationwide. Lately, Mona and some of the other general managers in her region have begun to complain to the district manager about the method in which the company classifies exempt and nonexempt employees. Specifically, they feel that even though they are paid fixed salaries, they should be paid overtime, because the company requires each of them to log approximately 60 hours per week.

The managers complain that Duke's routinely requires them to spend most of their time at work doing chores such as washing dishes, sweeping floors, picking up litter in the parking lots, cooking food, and serving food to customers. They also claim that during the small amount of time that they are actually allowed to "manage," they are given little discretion and make few genuine management decisions.

The district manager, while empathetic to their concerns, explains that this has been Duke's policy for years and that the only way to advance to the position of district manager is to "follow the rules, run a tight ship, and not stir up trouble within the ranks." After months of frustration, the managers decide to pool their resources and hire a labor lawyer to help them determine whether they have a case. During their first meeting with the attorney, Mona says, "Our titles are impressive, but what we really do for the majority of each work day is serve meals, cook food, wash dishes, and clean up our restaurants." "They only pay us $24,000 a year," another manager adds. "I barely make $7.50 an hour when you add it all up."

After careful consideration, the attorney tells them that he does believe that they have a case. He explains that based upon what they have told him, Duke's may be in violation of the Fair Labor Standards Act. He advises them to continue with their duties as they normally would, and that he will get back in touch with them as soon as he has had a chance to consult with his senior partners in the law firm.

As Mona and the other managers return to their normal routines, they each are somewhat relieved that they have finally found someone who seems to take their concerns seriously. While they don't want to hurt their company, they do feel that if Duke's has in fact been breaking the law, then the company should "make things right" with their restaurant managers. A few weeks after meeting with the labor lawyer, Mona and the other managers involved detect a definite difference in the way the district manager has been interacting with each of them. He has visited their stores more often than usual, and during those visits, he has seemed abrupt and more businesslike than normal. They are each shocked as the week comes to an end and the district manager pays them another visit; this time he is accompanied by the company's director of human resources who hands each general manager a termination letter that immediately severs their employment with the company.

QUESTIONS

1. Is Duke's in violation of the Fair Labor Standards Act with respect to the way the company classifies exempt and nonexempt employees? What other information might you require in order to make this determination? Why?
2. Even though the labor attorney had not yet filed a lawsuit with the courts, was it wise of the company to terminate each of the general managers? Why or why not?

3. If the general managers win their lawsuit against the Duke's Restaurant chain, what could be the outcome for the chain? For the general managers?
4. What policies or procedures should a restaurant follow when determining the overtime classification status of its general manager?

KEY TERMS

Minimum wage The current federal minimum wage is $5.15 per hour.

Child labor laws Federal, state, and local laws that set minimum-age requirements as well as other requirements for employees under the age of 18.

Industrial Revolution Refers to the time period of roughly late-eighteenth to early-nineteenth century, which saw many social and economic changes due to a shift from an economy based primarily on manual labor to one based on industry and manufacturing.

National Recovery Act A law designed to promote recovery and reform, encourage collective bargaining for unions, set up maximum work hours and minimum wages, and forbid child labor in industry.

Fair Labor Standards Act (FLSA) Federal legislation passed in 1938 that governs overtime laws, child labor laws, and other labor-related issues.

Living wage Also referred to as livable wage ordinances. It is similar to minimum-wage laws set by state and federal government; these ordinances carry the same weight but normally are enacted by cities and other municipalities.

Tip A sum of money given to a service employee by a guest in recognition of good service.

Gratuity A sum of money given to an employee by a guest in recognition of good or quality service. Term is interchangeable with tip.

Service charge A fee set by management that is normally kept for the house and not given to the employees in the form of a tip or gratuity.

Tip credit Currently the difference between $2.13 an hour and the federal minimum wage, which is currently $5.15 per hour. Tipped employees are paid $2.13 per hour, and the employee takes the remaining $3.02 per hour as a tip credit against the $5.15-per-hour minimum wage.

Tip pool When tipped employees share a portion of their tips with other front-of-house employees such as bus help.

Employee handbook A book that provides workplace rules, regulations, and guidelines that employees must follow.

Overtime Nonexempt employees must be paid at a rate of one-and-one-half their normal rate of pay for each hour worked over 40 in one week.

Time-and-a-half The rate at which a nonexempt employee must be paid for each hour worked over 40 in one week.

Exempt employee These employees do not have to be paid overtime for hours worked beyond 40 in any given week.

Nonexempt employee Employees who are classified as nonexempt must be paid time-and-a-half their normal rate of pay for each hour worked over 40 in one week.

Learned professional Based on certain Department of Labor guidelines, employees who meet these requirements could be exempt from federal overtime laws.

Creative professional Based on certain Department of Labor guidelines, employees who meet these requirements could be exempt from federal overtime laws.

NOTES

1. Reprinted with permission from *Lessons in Service from Charlie Trotter* by Edmund Lawler. Copyright 2001 by Edmund Lawler, Ten Speed Press, Berkley, CA, www.tenspeed.com.
2. "Restaurant Industry Operations Report," Washington, D.C.: National Restaurant Association, 2004.