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For higher profits, pay workers more?

Douglas Himes

Nearly 100 years ago, Ford Motor Company astonished the nation by announcing that it would pay many of its workers $5 per day (the equivalent of over 23 times that dollar amount today, according to the Consumer Price Index program's inflation calculator). What was important to Henry Ford was that improved worker morale would result in lower worker turnover, thereby reducing overall labor costs.

Today, almost a century after Ford's announcement, the question of whether businesses can earn higher profits by paying higher wages would seem to be settled quite differently. The conventional wisdom today says that reducing labor costs directly is the best, if not the only, way for businesses to prosper. In "Why 'good jobs' are good for retailers" (Harvard Business Review, January-February 2012, http://hbr.org/2012/01/why-good-jobs-are-good- for-retailers), author Zeynep Ton, who has been on the faculty of Harvard University and the Massachusetts Institute of Technology, writes that it is common for businesses to pay low wages, offer few benefits, and change workers' schedules with little notice. However, there are a few businesses that pay substantially higher wages than their competitors in the same industry, and they also provide benefits and allow employees to work a regular, predictable schedule. And these businesses earn higher profits. In the author's analysis, businesses might underinvest in labor because the short-term benefit for doing so (lower costs and higher profits) is both immediately tangible and easy to measure. The benefits of higher wages are slower to appear and harder to measure, though they ultimately outweigh the short-term, and temporary, benefits of lower wages.

Ton studied four low-price retail chains: two supermarkets, a convenience store, and a wholesale club, all of them noted for higher wages, better benefits, more training, and more convenient work schedules than their competitors. According to Ton, because employees at these low-price chains perform their job duties so much better than the employees at their competitors, the four chains can offer competitive prices, better customer service, and also earn a higher profit. The higher labor costs are the first part of a virtuous cycle. Higher wages lead to a higher quality and a higher quantity of labor and less labor turnover. Improvements in labor lead to better operational execution, which in turn leads to the higher sales and profits that sustain the higher wages. One example of operational execution is the not-so-simple task of getting the right products on the right shelves—where customers (or an employee being asked for assistance) can find them. A surprisingly large percentage of "stockouts" (that is, instances when the store misses a sale because the item the customer wants is thought to be not in stock) are actually "phantom stockouts": the item is in the store but not where it should be. Apparently, paying employees enough to show up for work and actually care about doing their jobs improves operational execution.

The prices of goods are sometimes justified with a reference to quality and the old maxim, "you get what you pay for." Zeynep Ton would have businesses think about whether the same saying might also apply to the cost of labor and the quality of employee.