Examining the Underpinnings of Labor Standards Compliance in Low Wage Industries

Final Report

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Executive Summary

This study examines the relationship between compliance with the Fair Labor Standards Act, the federal law regulating basic labor standards including the minimum wage, overtime, and child labor for the workforce and a set of business practices found in low wage industries: branding, franchising, and third-party management contracting. Through a study of two industries that draw on these practices—the limited service segment of the eating and drinking sector ("fast food") and the hotel / motel industry—we find that these practices have significant effects on workplace compliance with labor standards.

Key findings

The following represent major findings of the study. A detailed discussion of them are provided in the attached report.

1. **Franchising affects compliance with labor standards.** Within branded establishments using franchising (e.g. fast food restaurants like Burger King), establishments that are directly owned by the brand (company-owned) have higher rates of compliance than comparable outlets that are franchised owned. Franchisees have significantly larger levels of noncompliance, measured in a variety of ways. These results were particularly strong in the fast food industry, an industry with one of the longest histories of franchising.

2. **Third party management of properties is widespread and adversely affects compliance**. Third party management of enterprises, where an establishment / workplace is owned by one entity and managed by another, creates complicated agency relationships, further obfuscating the employer / employee relationship. It is widely found in the hotel / motel industry, creating complicated joint employment relationships with owners. Brands also impose standards on the practices of hotel properties, further complicating the forces governing workplace practice. As a result, we find complex relationships between ownership, third-party management and compliance.

3. **Brands tend to have better compliance than non-branded businesses.** Branding is a central component of firm strategy and profitability. This creates significant incentives to protect brand equity relative to businesses without brands (hotel / motel study). The interest of brands in quality and reputation (their core competency) leds to differences in relative compliance and can improve the ability to improve compliance at the workplace level.

4. **Deterrence effects are amplified in industry structures with branding / franchising**. General deterrence—the impact of investigations on one business entity on the behavior of other entities in related industries, geographic areas, or competitive markets—seems to be enhanced through franchise relationships. Given the incentives of protecting brand equity, sensitivity to enforcement is heightened leading to particularly large impacts of deterrence on future compliance behavior of other entities, particularly in close geographic proximity (fast food).

5. **Fissured employment is a more general characteristic of modern employment.** Franchising and third-party management represent two types of a broader set of changes in employment relationships. These practices—which we call "fissured employment"—involve three linked components: a focus of lead firms (hotel brands; fast food franchisors in this set of studies) on core competencies; shifting of employment relationships to other businesses operating in more competitive environments with access to a large pool of potential businesses; and organizational standards, monitoring, and incentives to make the first two pieces of the recipe work together.

6. **Enforcement of workplace laws must recognize the changed employment relationship documented by this research**. Franchising, third party management, and the spread of fissured employment creates challenges for workplace policies that were built assuming simpler and more direct relationships and definitions of employers and employees. As a result, enforcement of the Fair Labor Standards Act and other federal workplace policies need to be revised to reflect modern realities.

Research impacts: Academic and applied

The study has resulted in a number of articles, book chapters, and reports produced on its findings (listed in Appendix A). Its results have been widely disseminated through lectures, seminars, presentations, and conferences, including two keynote speeches on themes directly arising from the work. A number of papers are also under review at refereed journals.

The core question of the research revolves around the relationship of industry structure on compliance with labor standards. This relationship has direct implications for government enforcement efforts as well as broader public policy consequences. Accordingly, along with academic audiences, research findings and additional work growing out of it have been shared widely with government officials at the state and federal government levels. In addition, the work has been shared with government officials in Australia, the United Kingdom and at the International Labor Organization in Geneva. There have been a number of results of these efforts:

- The US Department of Labor's Wage and Hour Division has reviewed and discussed report findings and implications, including two reports on strategic enforcement, in fashioning policies. The approach by WHD has been influenced by ideas contained in this work. Other agencies within the US Department of Labor have also reviewed findings closely in devising programs.

- Study results have been presented to senior labor officials of state government labor standards divisions. Several states in the northeast have reviewed policies in light of these findings that have influenced subsequent enforcement approaches.

- The International Labor Organization invited the principal investigator to give the keynote address at a major meeting on "Regulating Decent Work" in Geneva, Switzerland in 2011 and implications to ILO approaches widely discussed.

- The Fair Work Ombudsman of Australia, one of the federal government agencies responsible for enforcing basic labor standards in Australia has reviewed study results on enforcement. The principal investigator has met with officials in the FWO and other Australian regulatory bodies. In the last year, the FWO has initiated new policies and approaches to the franchised sector of several industries.

Finally, this study has provided a foundation for a multi-industry examination of fundamental changes in employment related to those studied here. Research on "fissured employment" drawing on insights from fast food and hotel / motel industries continues, with an ongoing effort to both break new academic ground and provide insight to policy makers in seeking to protect vulnerable workers across the economy.

Examining the Underpinnings of Labor Standards Compliance in Low Wage Industries: Final Report

David Weil, Principal Investigator

Introduction

The purpose of the study is to examine the relationship between labor standards compliance and a set of business practices commonly found in low wage industries: branding, franchising, and third-party management subcontracting. These pervasive practices were hypothesized to have significant effects on workplace compliance with labor standards. In order to examine these relationships, the study focused on two major industries, both of which employ a large number of low wage workers: eating and drinking and in particular the limited service—"fast food"—sector of that industry; and the hotel and motel industry.

The two industries selected for this study are important for a number of reasons. First, they are sizeable, both in regards to the percent of workers paid low wages in them and in terms of their size in the economy as a whole. Osterman and Shulman (2011) estimate that in 2010, 73% of workers in the restaurant sector and 55% of worker in hospitality were low wage workers. It is therefore not surprising that these industries employ a disproportionate share of low wage workers: about 8% of all workers were employed in the two sectors combined, but they collectively accounted for almost 15% of all low wages workers in 2010 (Osterman and Shulman 2011). Further, these sectors will remain important sources of employment in the future: by 2018, the Bureau of Labor Statistics forecasts that the industries will account for more workers than the entire manufacturing sector (Woods 2009).

Eating and drinking and hotel / motel sectors also rank high in terms of workplace labor standards problems. The sectors have extremely high rates of noncompliance with minimum wages (18.2%), overtime (69.7%), and "off-the-clock" violations (74.2%) (Bernhardt et al. 2009).[1] Similarly, a high percentage of complaints under the Fair Labor Standards Act arise from workers in these sectors, constituting about 17% of all complaints under the Fair Labor Standards Act (Diab and Weil 2012).

Finally, these sectors warrant study because the business structures that characterize them play important roles in many low wage industries employing large numbers of vulnerable workers. Branding and franchising are fundamental elements of business strategies of many prominent industries. Third party management has also become an important feature of many sectors beyond those studied here, introducing another level of complexity into the employment relationship. In short, the forms of business organization in fast food and hospitality exemplify forms of workplace organization that have become pervasive in the workplace.

[1] Based on a random sample of low wage workers collected in three major urban centers, New York City; Chicago; and Los Angeles. The estimates were made for the combined restaurant / hospitality industries. See Bernhardt et al. (2009), chapter 4.

This final report provides a synopsis of the research on both sectors and the impact of branding, franchising, and third party management on compliance in them. It begins with a summary of central findings in the fast food sector. It then reviews findings from research on the hotel / motel industry. Based on that research, we discuss more general implications of these structures and other organizational forms that have emerged in recent years that have similar effects on compliance. We conclude with a discussion of the implications of these new structures of employment on the adequacy of current workplace laws.[2]

I. Fast food franchising

Industry characteristics: Branding and franchising

The fast food subsector is a very concentrated segment of the wider eating and drinking industry. Major companies like McDonald's, Burger King, Subway, and KFC are well-known national—and international—brands, illustrating the importance of major chains to the industry. The top 20 firms in the industry accounted for $80 billion or 59 percent of the $117 billion total revenue of the fast food sector and about 65 percent of the total number of fast food outlets in the U.S.[3]

Fast food companies spend significant resources in creating a well-known brand for their products. This strategy fits an industry where perceptions of the quality, consistency, and variety of the product are critical to competitive performance. By establishing a brand, a company can differentiate its product and create a loyal customer base willing to pay a premium for the product on an ongoing basis. In the fast food industry, return business is partly based on the customer's belief that the experience will be the same in any outlet of the company visited.[4] The investment in brand name and protection of its image is therefore a central part of the competitive strategy of national chains and an integral part of the way that it makes operational decisions.

One of the key operational decisions made by fast food companies is how to expand. Typically, companies add outlets in one of two ways. The first approach is opening new outlets that are both owned and operated by the franchisor itself. This expansion through the creation of “company-owned” outlets is an attractive option because the branded company (or “franchisor”) retains control over operational decisions and can therefore be better assured that brand standards are maintained. On the other hand, expansion through company ownership entails using the franchisor’s capital directly and introduces managerial challenges about ensuring efficient operation of the outlet.

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[2] The report also includes an Appendix that provides the complete set of papers and reports arising from the study where more complete results can be found.

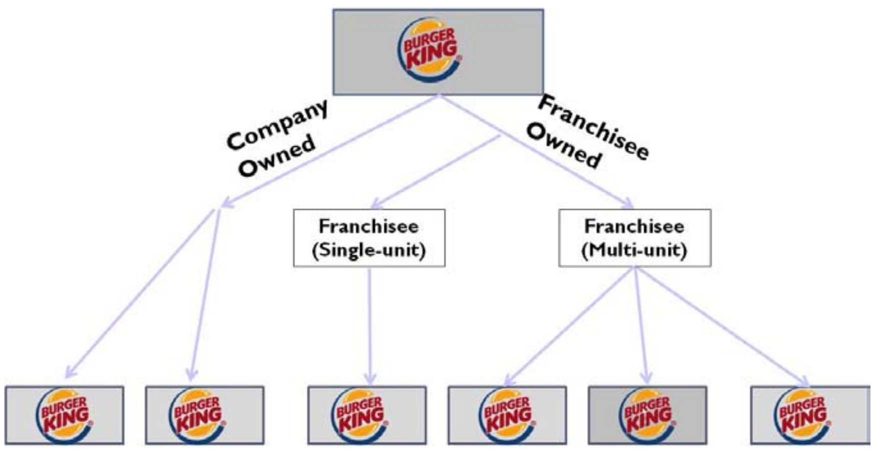
[3] 2002 Economic Census: Food Services and Drinking Places, pp. x-xi. We sum the company-owned and franchised outlets of each of the major limited-service companies to obtain these estimates.

[4] Bradach quotes the Vice President for public affairs of KFC, “KFC chicken should taste the same and be served with the same friendly service regardless of whether it is purchased in Tiananmen Square in Beijing, China or in Louisville, Kentucky.” (Bradach 1998, pp. 16-17). See also Kaufmann and Lafontaine (1994) for a discussion of this fundamental aspect of franchised brands.

Alternatively, the company can expand by offering outside investors the opportunity to franchise. Strong brand identity benefits franchisees: by purchasing or operating a franchise of an established brand, a franchisee gains a proven business strategy with a known and trusted name. At the same time, franchising allows for expansion by tapping into capital of franchisees, potentially expanding the opportunities for growth of the brand. Franchisors receive revenue streams both in the form of upfront fees by franchisees to purchase the franchise and ongoing payments based on sales. Under a typical franchise agreement, the franchisee purchases the right to own and operate an establishment using the franchisor's brand name and products for a set period of time. In return, the franchisee pays an upfront fee and agrees to provide a portion of revenues (typically around 6 percent, although it may go as high as 12 percent in the case of McDonald's) to the franchisor.[5]

Although invisible to customer as they walk through the door, a fast food outlet will therefore be either owned directly by the company or be owned and operated by a franchisee. In many cases, franchisees operate more than one outlet, with a small number of multi-unit franchisees being large, publicly traded companies themselves consisting of hundreds of outlets. The organizational structure for a typical fast food brand is depicted in Figure 1.

Figure 1: Fast food franchising structure



Franchising is also an attractive ownership form given the industry's geographically dispersed, labor-intensive, and service-based nature. In such an industry, an enterprise's profitability is closely tied to the productivity and service delivery of its workforce. Assuring workforce productivity, in turn, requires effective management, including careful monitoring of the workplace. A large company with geographically dispersed outlets can therefore use franchising—rather than relying on company-owned and managed outlets—to better align the incentives of the franchisee, whose earnings are linked to the outlet's profitability. For these

[5] The upfront fee is usually between $10,000 and $50,000, and is often, but not always, required for each store a franchisee wishes to open. Most royalty fees are set as a constant percentage at all levels of sales, with some contracts specifying a minimum monthly royalty payment. See Blair and Lafontaine (2005). Most agreements also have a separate advertising fee, typically less than three percent of sales and paid with the royalty fee, to fund any national or regional advertising conducted by the franchisor.

reasons, restaurants represent the most highly-franchised industry in the U.S., making up 36 percent of all franchised establishments.

Franchising, however, creates tensions between the franchisor (the company behind the brand that sells franchises) and franchisees. In particular, because franchisees pay royalties that are linked to revenues as opposed to profits, the franchisor benefits financially from increased sales (revenue), while the franchisee seeks to maximize profit (revenue less cost). One critical way that franchisors manage this principal (franchisor) – agent (franchisee) problem is through screening potential owners of outlets. More importantly, franchisors create and enforce detailed and explicit standards that franchisees agree to operate under once approved to open an outlet.

The importance of adhering to quality standards is central to a competitive strategy built on branding. This is demonstrated by provisions in agreements that franchisees sign when they become part of a national chain. For example, the franchise agreement with Taco Bell states, "You must operate your facilities according to methods, standards, and procedures (the "System") that Taco Bell provides in minute detail." Similarly, Pizza Hut's agreement lays out the distinctive operational decisions that underlie the brand:[6]

> *A broad spectrum of the general public patronizes Restaurants as a source of high-quality pizza and related products and services. A unique system characterizes Restaurants that consists of special recipes, seasonings, and menu items; distinctive design, décor, color scheme, and furnishings; standards, specifications, and procedures for operations; procedures for quality control; training and assistance programs; and advertising and promotional programs.*

But the agency tensions between franchisees and franchisors are not entirely solved by standards. This can lead to differences in terms of pricing, promotion, and cost control strategy.[7] In addition, although the franchisee has a stake in brand reputation, for the reasons cited above, its stake is not as great as that of the franchisor. In particular, a franchisee has incentives to "free-ride" on the established brand and may be willing to cut corners to reduce costs or improve its individual bottom line, even if such actions have negative consequences for the branded company.[8] This means franchisees may be more willing to violate the FLSA in order to reduce labor costs.

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[6] These quotations and more detailed evaluation of standards contained in various papers arising from this study are based on public disclosure documents required by the Federal Trade Commission that provide prospective franchisees examples of some (but not all) of the standards and operating practices that would be required of them.

[7] One of the reasons that franchisors use revenues rather than profits for this purpose is that they are more transparent for monitoring purposes. Since in many franchised relationships, the franchisee purchases its products from the franchisor, the larger company has an accurate means of monitoring franchisees' revenue. If the fee was related to profits, franchisors would require far more information about cost factors (particularly related to labor) and other inputs that are harder to monitor or are more easily manipulated by the franchisee.

[8] To illustrate, imagine an individual fast food outlet along a major interstate highway. The franchisee who owns the outlet may be willing to cut corners in terms of service quality by hiring lower quality employees if it believes that the majority of its customers represent non-repeat business (e.g., because most are simply driving by on the highway and will not return). Although the franchisee might benefit from increased profits due to lower labor costs, the poor service experience at that outlet may lead customers to avoid the restaurant elsewhere. For a discussion of this issue, see Lafontaine and Shaw (2005).

Effects of franchising on labor standards compliance

The US Department of Labor's Wage and Hour Division (WHD) is responsible for enforcing the Fair Labor Standards Act (FLSA) of 1938 which sets minimum wages, overtime compensation for work exceeding 40 hours, and restrictions on child labor. The FLSA creates the floor by which minimum working conditions can be measured. The study used compliance with this law, measured through the investigation-based records, as the basis of assessing compliance.[9] Specifically, we use a variety of measures of back wages owed to workers, representing the difference between the amount of money they were paid for actual work compared to the amount that the FLSA requires them to paid as the basis for assessing compliance (both in fast foods and in the hotel / motel industry). Detailed descriptions of the data and WHD investigations can be found in the papers cited to this report and listed in Appendix A.

The primary data set for the fast food assessment is a pooled cross-sectional sample of outlet-level investigations arising from the following four sources for the period 2001 to 2005. The data is extracted from the Wage and Hour Investigation Support and Reporting Database (WHISARD) which records every workplace investigation conducted by the US Wage and Hour Division (WHD). Each WHISARD record contains information about characteristics of the establishment investigated, investigation details such as type, method, and timeframe of the investigation, and a detailed record of compliance outcomes. Because WHISARD includes the universe of cases conducted by the federal WHD and provides complete investigation records, we are able to construct a compliance measure for each establishment inspected during the time period. We extracted all investigations initiated and completed between January 1, 2001 and December 31, 2005 for Top 20 fast food outlets. Ownership status for each investigated outlet was established using two different sources of data. FRANdata provides a complete list of all franchisee-owned restaurants for 18 of the Top 20 brands in the sample. Using owner names, addresses, zip codes and other fields, we match WHISARD and FRANdata to assign ownership status. Data from Dun & Bradstreet was used as a complementary source.[10]

Table 1 provides background information on franchise ownership and compliance for the top 20 fast food companies in the core sample constructed for this study.[11] About 95 percent of the restaurants investigated are franchisee-owned, which roughly approximates the percent of franchisees reported in an industry measure (85 percent) shown in the last row of Table 1, and implies that WHD investigations were somewhat skewed toward franchised outlets. In terms of comparative compliance, Table 1 indicates that in all brands except McDonald's, the average

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[9] Similar measures of compliance were used in studies of fast food and hotel / motel industries.

[10] Each record within the WHISARD database of Top 20 outlets was matched to one of the two ownership sources using location and contact variables. This initial matching process resulted in the assignment of ownership of 85% of the records. In an effort to identify franchise status of the remaining unmatched WHISARD records, a phone call was placed to each outlet. A few brief questions were asked to verify establishment ownership status and related information. This procedure increased the percentage of matched records to 90%. We were unable to determine ownership status for 404 of 3825 restaurants in the original sample.

[11] Data collection and matching for the eating and drinking analysis focused on the period 2001-2005 and all tables and figures, unless otherwise noted, refer to that period. It was not possible given time limitations to expand the sample to include more recent investigations. We have no reason, however, to believe that the strong relationships measured in this section have changed significantly in recent years.

back wages per employee paid in violation for franchised outlets is larger than that for company-owned outlets. Even more striking, almost one-half of the top 20 brands investigated by WHD owed no back wages to workers in their company-owned outlets.

To adequately account for these problems, we created statistical models that include all of the potentially relevant factors in predicting compliance levels. By doing so, the effect of franchise status can be observed holding the other factors constant, therefore allowing estimation of effect of franchising on an outlet with otherwise identical features as a company-owned outlet.[12]

Table 2 presents the core findings from these models, where we define compliance as the total back wages found in an investigation. This compliance measure provides a reliable measure of the overall amount of noncompliance in a typical investigation.[13] The differences between franchisees and company-owned outlets are striking. Column (1) indicates that once we control for all of the other factors that might also affect both compliance and franchise status, the franchise effect grows considerably: The average franchisee was found to owe $4,265 *more* in back wages than an otherwise similar company-owned outlet. Since the average back wages owed in a typical investigation undertaken during the study period is $1,350, this represents a very large effect arising from franchising.

Further insights into the franchise effect on compliance can be found by looking at the effects for directed versus complaint investigations. Directed investigations of outlets are investigations initiated by the Wage and Hour Division while complaint investigations arise from allegations of violations lodged by employees who believe an employer is violating labor standards.[14] These different investigation types lead to potential differences in the outlet involved in an investigation. Complaint investigations are more likely to result in back-wage findings than are directed investigations because those investigations are based on the presence of a potential violation (as ascertained by the WHD prior to sending an investigator to the workplace).

To test whether franchise effects are still present within each type of investigation, we estimated the same models described above, but for separate sub-samples for directed (column 2) and complaint (column 3) investigations. The franchise effect can be interpreted in a similar fashion as for column 1: It indicates how much additional back wages were found to be owed workers for a typical directed (or complaint) investigation because the outlet was owned and managed by a franchisee, all other relevant factors held constant. The estimated effect grows even larger for directed investigations, which imply that back wages were over $8,400 higher in franchised outlets than those owned and managed by the company. On the other hand, estimated franchise effects are more modest (about $1,100 higher) when we look only at complaint-based

[12] We used a variety of specifications and functional forms in making estimates as well as three different measures of compliance. Details on the statistical models created to undertake this analysis and the complete results from them can be found in Ji and Weil (2012).

[13] Since we control for the size of the outlet, the estimates hold constant the effects of any systematic differences in the size of company-owned versus franchisee-owned outlets.

[14] Although directed investigations arise from targeted sector- or geographic-initiatives, the specific outlets investigated are selected on a randomized basis.

investigations (and there is greater statistical uncertainty about the significance for that investigation type).[15]

The above results suggest that franchisees are less concerned about reputation than franchisors. This leads them to be more likely to find ways to reduce labor costs (the largest and most readily controlled cost facing them). This implies that multi-unit franchisees with a large number of outlets might act more like franchisors in their decisions regarding company owned enterprises than small franchisees with a limited stake in reputation. Our empirical results find this to be true: very large franchisees with a large number of units and operating in multiple states maintain compliance at the same level of company-owned outlets (Ji and Weil 2012; Ji 2011).

Franchising and deterrence in the fast food industry

General deterrence can be defined as the impact of an investigation on the behavior of other business establishments related in some way to the entity that has been inspected. This can be other establishments owned by the inspected business in other areas; other businesses in the same industry, in the same geographic area, or both. General deterrence is important because there are never enough inspectors relative to the size of covered workplaces under different government policies. For example, there are about 7.3 million employers who fall under the Fair Labor Standards Act. The Wage and Hour Division which enforces that law has about 1,000 full-time investigators at the federal level and conducts about 40,000 investigations each year. The probability of any single employer or workplace being inspected is therefore very small. Deterrence effects are therefore very important for policy efficacy.

We examined general deterrence in the fast food industry by measuring the impacts of prior investigations of top fast food companies in a geographic area on the behavior of other fast food outlets subsequently investigated in that same area. This allowed us to estimate if an outlet behaved differently if there were many investigations of other outlets in the same geographic area in the prior year than if there were no investigations of other outlets. From 2001-2005, the WHD conducted approximately 2,000 investigations among the top 20 fast food outlets in the U.S. Given that the top 20 brands have over 100,000 outlets affiliated with them, one would still expect low probabilities of investigations. The probability of receiving an investigation in the fast food industry reflects the imbalance between enforcement resources and the number of workplaces regulated

We created statistical models to look at the impact of prior investigations on current compliance behavior of fast food outlets. The models allowed us to directly measure how an additional investigation by the WHD in the prior period affected compliance levels, after holding constant all of the factors discussed above. Therefore, they provide a "clean" measure of how much employers in the fast food industry responded to prior investigation activities.

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[15] We also tested to see if the franchise effects varied for other measures of compliance. Using different measures of the incidence and severity of violations. For example, workers paid in violation of the FLSA in franchised outlets were owed $717 more in back wages than workers paid in violation in comparable outlets run directly by a major fast food company. This compares to an overall average back wage per employee paid in violation of $197 for the sample as a whole. See Weil (2010) and Ji and Weil (2012) for detailed results.

Table 3 provides our estimates of the effect of deterrence on compliance among fast food outlets. The estimates measure how much compliance (measured in different ways) changes given an additional WHD investigation of all outlets other than the specific brand being investigated in the prior year. The estimates have a negative value if the additional investigation in the prior period lowers the predicted levels of violations. The standard error of the estimate is provided for each as well as a measure of its statistical significance (probability value).

Regardless of the chosen measure for compliance, these results indicate that prior investigations have large impacts on the current behavior of fast food outlets, holding constant all of the factors described in the prior section. For example, one additional investigation of an outlet lowers the estimated total back wages owed by a fast food restaurant by $886, all else equal; it lowers the number of employees found in violation by 10 and the average back wages owed per worker paid in violation by $99. These are large numbers: the average back wages owed per outlet for this group was $1,350 and average back wages paid per employee in violation $178.

The final column of the upper panel of Table 3 provides the traditional measure of compliance: whether there was any violation of the FLSA found in the investigation. The value of .331 implies that an additional investigation lowers the probability of violations by 33 percent. Once again, this number is very large given that the average compliance level for the sample as a whole is 40 percent. Additionally, these results have high statistical significance—that is, they cannot be explained as a result of chance variation in the sample under study.

The estimated effect of prior directed investigations on current compliance behavior increases from the effects in the upper panel of Table 3, when we separated out the effects of an additional directed investigation (that is an investigation planned as part of a larger strategy by the Wage and Hour Division) than those that arise from worker complaints. These results are shown in the lower panel of Table 3. For example, an additional directed investigation in the past year is estimated to be related to a $1466 reduction in current back wages per investigation, as compared to a $886 reduction for any prior investigation (complaint and directed combined); the marginal impact on the probability of compliance goes from 33 percent for any prior investigation up to 56 percent for directed investigations. As in the upper panel, the estimated effects for prior directed investigations are highly significant.

In contrast, prior complaint investigations do not seem to have nearly the same impact on subsequent employer compliance behavior. For three of the four compliance measures, the estimated effect of an additional complaint investigation is less than half of the directed investigation (and about 75 percent of the size of the directed investigation for overall back wages per investigation). What is more, the effects of complaint investigations cannot be judged as statistically significant at typical levels of confidence because of the large size of variation in the estimated size of those effects. As a result, while the results allow one to confidently conclude that past directed investigations are associated with lower compliance, one cannot do so for complaints.

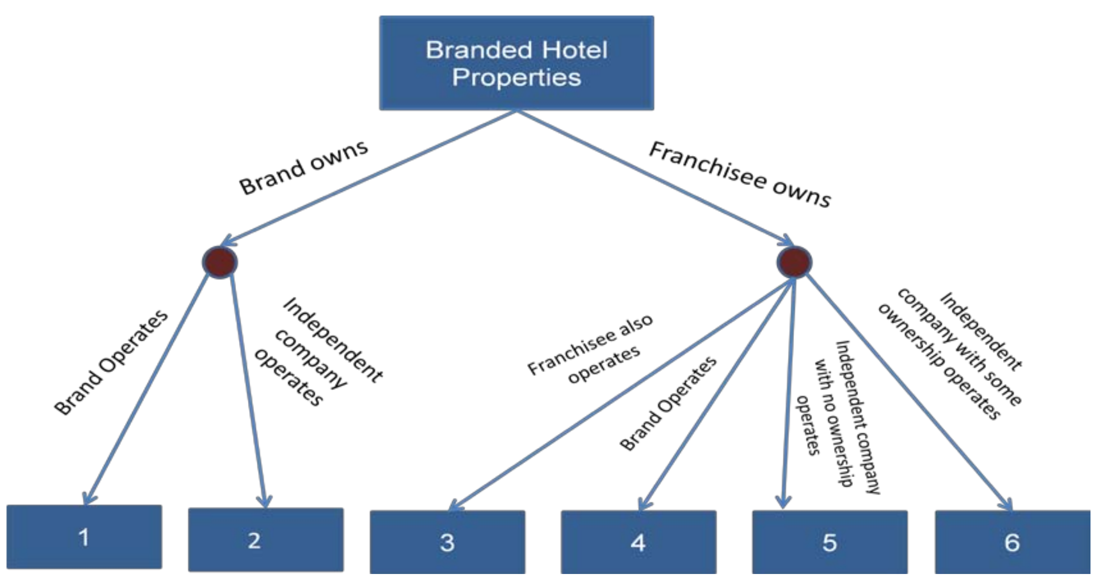
II. Hotel / motel industry: Franchising and third-party management

Industry characteristics: Branding, franchising, and third-party management

Employment takes a unique form in the hotel / motel sector, particularly on the side of the industry made up of well-known, branded enterprises. As in the fast food sector, hotel brands have been split off from ownership of properties via franchising and related arrangements so that, in most cases, a hotel property bearing the name of a well-known national or international brand is owned not by the brand company itself but by a franchisee, group of investors, or real estate development group. In addition, management of the property is increasingly undertaken by another company. These third-party operators may be affiliated with the brand or represent an entirely independent company that may provide third-party management services to multiple owners operating under multiple brands. The fact that many properties bear the brand of one entity, are owned by another, and managed by a third means responsibility for many operational policies, including those related to FLSA compliance, are blurred.

These relationships are depicted in Figure 2. The figure illustrates the different ownership and management relationships that may be present at hotels with well-known names (Hilton, Marriott, etc.). While the name on a fast food restaurant does not indicate whether it is owned and operated by the parent company or a franchisee, the brand name on a hotel tells even less about ownership and management. As we review below, a hotel can bear a well-known brand name, be owned by a partnership, public company, or in some cases hedge fund, and be operated by a national, third-party management company. The six different combinations depicted in Figure 2 have very different implications on how employment policies are handled, including the incentives for compliance.

Figure 2: Branded hotel industry organization



In order to examine the relationships between the various structural features of the hotel and motel industry and patterns of compliance, data is once again extracted from the Wage and Hour Investigation Support and Reporting Database (WHISARD). We created a database consisting of all hotel properties investigated between 2002 and 2008.[16] To identify ownership, management, and other property-level characteristics, we matched each property that was investigated in WHISARD with data collected from Smith Travel Research, a major provider of information on hotel industry structure, as well as with information gathered from a variety of industry sources on brands, management companies, and operations.[17]

Branding and compliance

As in the fast food industry, branded hotels invest heavily in the creation of brand equity for the properties that are part of its chain. Given the availability of many options to consumers at the economy, mid-scale, upscale, and luxury segments of the industry, perceptions of a brand's quality, consistency, and specialized services are critical to a chain's profitability. By establishing a valued brand, a hotel chain can differentiate its product and create a loyal customer base willing to pay a premium for it. The investment in brand name and protection of its image is therefore a central part of the competitive strategy of national chains and an integral factor in how they make operational decisions.[18]

In 2008, about 45 percent of all hotel properties were independent while 55 percent were affiliated with a brand (sum of rows for All major brands and Non-major brands). Because branded hotels tend to be considerably larger than independents, the dominance of brands is more apparent: About two-thirds of all hotel rooms are found in branded hotels versus one-third in independents.

Table 4 compares compliance between properties that are affiliated with a major brand versus independent hotels. Given the sensitivity that branded companies have to threats to their reputation, one would expect branded hotels to have higher levels of compliance than independent hotels.[19] Branded hotels also tend to be much larger (more rooms) than independent hotels, and therefore more likely to have standardized systems across properties that may be associated with better compliance.

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[16] These include all cases that had findings related to the FLSA, registered between fiscal years 2002 and 2008 and concluded by the end of fiscal year 2008.

[17] Details of this data set are provided in a separate, forthcoming report to WHD on the hotel / motel industry, "Improving FLSA Compliance in the Hotel / Motel Industry."

[18] Most analysts of the industry break the market into a set of "chain scale segments" based on the level of service, quality of accommodations, reputation, location, and price point of the hotel or motel. Generally, the breakdown is economy, mid-level (usually further split according to whether food is available at the property), and then two to three "upscale" designations (upscale; upper upscale; and luxury). These segments and their impacts on standards are discussed in Diab, Glass, and Weil (2011).

[19] This overall reputation-effect of branding is not necessarily related to potential consumer reaction to violations of minimum wage or overtime provisions. Instead, it may arise from the repercussions of persistent violations on quality, service, etc. (Ji and Weil 2010).

The results in Table 4 indicate that branded hotels do indeed have better compliance than independent hotels for all three compliance measures. For example, the average back wages found per investigation were $2,620 for branded properties and $3,603 for independent hotels. Similarly, back wages per employee paid in violation were $441 for branded properties versus $739 for independent hotels. Statistical models controlling for other factors confirm these results. Depending on the particular variable used, we estimate that back wages are between $1,100 and $1,200 lower in branded properties than independent properties, all other things held constant. These results confirm that brands as a whole have a higher stake in compliance than independent hotels.

Franchising and third-party management effects

As in the fast food industry, brands in the hotel / motel industry require franchisees to adhere to detailed standards and practices outlined in franchise agreements. These set out physical standards for construction, requirements for room décor, layout, room furnishings, bedding, and other products used in the property. More importantly from the labor standards perspective, they describe detailed operational procedures such as "… cleanliness and maintenance … methods and techniques for inventory and cost controls, record keeping, and reporting; personnel management and training, purchasing, marketing, sales promotion and advertising."[20]

Exacting standards—and the maintenance of those standards—therefore play a crucial role in seeing that expansion through franchising does not undermine the basic business model (and, in turn, diminish the value of additional franchises). Eyster and DeRoos (2009, p. 307) note:

> *… the trade-off for this penetration via franchising was a significant loss of direct control over quality and service standards; this loss of direct control required a commitment to a quality assurance program on the part of the brands. As the brands are painfully aware, lack of quality control leads to brand erosion and a very rapid loss of customers.*

Since 1986, brand parent companies moved away from the business of owning and managing their properties, turning instead to franchising as the major form of ownership. There has been a dramatic decrease in company-owned properties that coincides with the increase in franchised and management contract properties. In 1962, only 2 percent of U.S. motels were franchised. By 1987, that number had jumped to 64 percent. Today, 80 percent of hotel properties in the U.S. are franchised (Eyster and deRoos 2009, pp. 10-12).

Through franchising, major hotel chains are able to rapidly expand, especially in growth markets. Franchising allows the brand to tap capital, expand in multiple markets simultaneously, and draw on geographic expertise of local owners and (as we shall see) independent management operators. Often the attraction of franchising has led entire chains to flip from company ownership to franchising. Choice Hotels, for example, which owns the Clarion, Comfort Inn, Quality Inn, and Rodeway Inn brands, franchised all of its 4,884 hotels in 1999. Also in 1999,

[20] "Omni Hotels Franchising Company, LLC: Omni Hotels Franchise Disclosure Document." 18 April 2005. Filed and accessed through the California franchising database. http://134.186.208.228/caleasi/Pub/Exsearch.html.

Wyndham, which owns the Ramada, Howard Johnson's, Super 8, and Days Inn brands, franchised all of its 6,383 properties.[21]

Because of the manner in which Smith Travel Research—the source of data regarding the franchise status of each property—gathers information on ownership and management, we are unable to distinguish between properties owned and managed by a brand from properties owned by a franchisee but managed by a brand (i.e., using the terminology in Figure 5.1, we cannot distinguish type 1 from type 4 properties). This is problematic because we would anticipate that properties both owned and managed by the brand would have high levels of compliance, while the incentives for compliance are less clear for properties managed by a brand but owned by a franchisee.

To deal with this limitation, we use "brand owned and / or managed properties" to encompass both cases as the baseline against which we measure relative compliance of the other cases.[22] Table 5, therefore, compares compliance between franchisees and chain-managed (i.e., brand-managed) and / or owned properties. Franchisees had higher levels of back wages per investigation than chain-managed and / or owned properties, ($2,642 versus $2,385) and higher back wages per employee paid in violation although the differences were not large or statistically significant.[23] Franchisees are much more likely to be out of compliance with FLSA overall, with 75% of all franchisees in violation of one or more standard versus 41% of chain managed properties. These differences are statistically significant even after controlling for other factors.

Third party operating companies—managers, not owners

The franchised / company-owned distinction is not the only complexity found in the industry. Not only do hotel chains split off ownership from branding, they often split off ownership from management of properties as well. Although many franchised properties are managed by the parties who own them, branded hotel / motel properties can also be managed by either a *brand operating company* or an *independent operating company*. In both cases, a third party undertakes the actual operations of the property. The difference between these two forms of management companies is essentially whether the property is managed by the brand itself (a

[21] As with the case of the eating and drinking industry, a franchise is a written agreement between the franchisor (the grantor of the franchise) and its franchisees (those who acquire a franchise), granting the franchisee the right to operate under the name of the franchise (brand) and use / market its products and services for a specified period of time in a particular territory.

[22] In the course of our research, we used a variety of methods to try to separate the two groups out, including consultation with Smith Travel Research and other industry experts. We also tried to triangulate across other data sources (FRANdata; Dun & Bradstreet), but these alternative methods did not prove reliable. The trends in franchising described in a prior section suggest that a smaller percentage of the observations in this group are true "company-owned" enterprises versus brand-managed (but not owned) properties, implying that the "brand-operator" effects predominate, but we cannot test this claim at this time.

[23] Statistical modeling controlling for other factors that might be correlated with both compliance and ownership status indicates that the differences between franchisee and brand-managed and /or owned properties is very sensitive to specifications of the model. We suspect this arises because of measurement issues in franchising in the industry which are more complicated than in fast food. See Diab, Glass and Weil (2011) and Weil (2010) for further discussion.

brand operating company) or by a separate company specializing in hotel management (an independent operating company).[24]

The use of both types of management contracts in the hotel / motel industry arose in the late 1960s as a way for brand-holding hotel companies to attract new real estate investors and overcome capital constraints. Many developers and investors entered the industry and developed or acquired properties because of the high returns on hotel properties as assets. These property owners, however, were unfamiliar with (and often uninterested in mastering) the complexities of hotel operations. Management contracts permitted these investors to profit from their investments despite their lack of experience in operations.[25]

Using a combination of sources, we created a variable to indicate whether a hotel property was managed by one of the top 50 independent management companies.[26] The variable therefore indicates that the property was managed by one of the major independent operators, holding constant whether it was owned by a chain, franchised, or a member of a member association. Table 6 compares hotel properties that are managed by one of the top 50 independent operators versus those that are not. In this case, properties managed by one of the top 50 independent operators had higher back wages than properties not managed by one of the major independent operators. Properties managed by an independent operator had average back wages per investigation of $2,746, versus $2,616 for all other properties, and back wages per employee paid in violation of $636, versus $434 for properties not managed by a major independent operator.[27]

Using statistical models to control for other factors, we find further confirmation that properties managed by the top 50 independent management companies have substantially higher noncompliance: Back wages were about $2,500 higher in properties operated by one of the top 50 companies versus comparable properties not managed by the top 50. This suggests that the incentives to cut corners are potentially very significant among hotels that use independent operators.

The operations of hotels are buffeted by multiple incentives arising from the methods that the sector has used to expand and to farm out management to third parties. This creates conditions where contradictory incentives are present in terms of assuring adherence with quality standards (brands); finding managerial expertise to operate properties (franchisees / investors); and seeking to expand business operations by ratcheting down costs but not fully facing the consequences of those cost-cutting actions (operators). An understanding of this misalignment of incentives provides insight into future enforcement strategies.

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[24] Brand and independent operating companies may or may not have an ownership interest in the properties they operate.

[25] Management operating companies also became more widely used by independent hotel operators who grew and acquired multiple properties over time. We do not focus on this subset here.

[26] Specifically, we created a list of major independent hotel operators based on the companies that appeared in the annual Lodging and Hospitality (an industry trade journal) list of top 50 independent operators in three successive years—2006, 2007, 2008—and then collected information on all properties managed by that company from Internet sources. These were then matched with individual hotel properties in the database.

[27] We restrict the comparison in Table 6 to branded properties since only a handful of independent properties are managed by a major independent operator.

III. Franchising, third-party management and "fissured employment"

Branding, franchising, and third-party management of the workplace goes beyond the eating and drinking and hospitality industries. Studying the institutions, firm strategies, organizational structures, and workforce implications of these industries revealed more general changes affecting the workplace and the adequacy of government policies that week to protect workers. This phenomenon--"fissured employment" –includes, but is not limited to the practices documented in this study.[28]

In a growing number of industries, the employment relationship has become fissured, involving webs or networks of employers like those in the fast food and particularly hospitality industries, rather than on single organizations. Large businesses with national and international reputations that operate at the "top" of their industries continue to dominate the private sector landscape and play critical roles in shaping competition in their markets. However, they no longer directly employ legions of workers. Instead, like rocks split by elements, employment has been split off from these market leaders and transferred to a complicated network of smaller business units. Lower-level businesses typically operate in far more competitive markets than those of the firms that shifted employment to them, often with negative consequences on employment conditions.

Fissuring in employment relations further complicates the regulation of workplace conditions. Workplace policies in the U.S. assume clear relationships between employees and employers. Those who set workplace policies, supervise production, set schedules, and evaluate workers are assumed to directly represent and report to the owners (private) or responsible parties (public / non-profit) of record. As a result, many of the traditional presumptions underlying workplace regulation no longer hold, which requires a different approach to enforcement.

The fissured recipe

Workplace fissuring arises as a consequence of the integration of three distinct strategic elements, one focused on revenues, one on costs, and the final one providing the "glue" to make the overall strategy operate effectively.

The first element of fissuring can be linked to a broad movement traceable to the late 1970s that urged companies to focus on "core competencies." At that time, investors, lenders, and the capital markets in general led senior management of leading companies to focus their attention on those activities that added greatest value (such as product design, product innovation, cost or quality efficiencies, or other unique strengths) while farming out work to other organizations not central to its core mission. This strategy led companies to focus their key strategies and workforce on the development of brands and strong customer identification with a company's goods or services; building the capacity to introduce new products or designs; or on true economies of scale or scope in production and operation. Activities outside of this core were shifted away. As a result, companies outsourced customer relations to third party call centers; manufactures shifted production to networks of subcontractors for subassemblies; and

[28] The principal investigator coined this term to delineate the larger strategy including, but not limited to, shifting employment from other accounts that focus solely on practices like subcontracting, contingent work, and use of temporary agencies.

private, public, and non-profit organizations contracted out everything from cleaning and janitorial services to payroll and human resource functions.

Core competencies in the case of fast food and hotel both revolve around the same core theme: creating, sustaining, and expanding brands and their recognition among a consumer base. Successful branding provides customers more willing to pay price premiums for products or services as well as continue to provide a stable base for a company's products. Investing in the creation and maintenance as we see from the above cases is both costly and crucial in making a host of organizational decisions (e.g. expansion, management decisions, and product offerings).

The second element of fissuring flows out of the drive towards "core competencies." It seeks to break apart the elements of producing a good or providing a service and shifting out those parts that are not central to the profit model to other parties. Once again, the above cases are highly illustrative of this second element. Major hotel chains (and their investors) realized in the 1980s that shareholder value arose from control of a portfolio of distinctive brands—not from actually providing these services. As a result, more and more hotels followed the path already established in fast food by divesting ownership of properties and even leaving the management of properties to other organizations.

Fissuring the provision of service to others has the impact of allowing lead companies to lower their costs since externalizing activities to other firms (particularly those operating in more competitive markets) eliminates the need to pay higher wages and benefits that large enterprises typically provided as well as the need to establish consistency in those human resource policies since they no longer reside inside the firm. This aspect of fissuring also pushes liability for adherence to a range of workplace statutes (and other public policies) outward to other businesses.[29]

Clearly, there is a tension between the first two elements of fissured strategies: by shifting the provision of services to other businesses, companies that have created brands may jeopardize them if quality standards are not adhered to closely. The third element of fissured organizations is, therefore, developing clear, explicit, and detailed standards that provide the blueprint that the enterprises at lower levels follow. But detailed standards are not enough: the lead organization must also create contracts or develop organizational structures that allow it to monitor them and impose real costs if the affiliated companies fail to live up to them.

It is not coincidental, then, that the growth of fissuring has been accompanied by the creation of many different forms of standard setting and monitoring, from the promulgation of bar codes, electronic, standards, GPS, and other methods of tracking products through supply chains and monitoring provision of services to customers. At the same time, organizational forms like franchising that were once restricted to a few industries like fast food have become omnipresent, spanning sectors from janitorial and landscaping services to home health care.

[29] This is partly the case because competitive suppliers of goods and services outside the firm operate under more competitive conditions, forcing down price of the services provided. But it is also because of the nature of wage determination inside large organizations that tend to both drive up the absolute wages and the relative wages of linked wages within the organizations' walls. Fehr and Schmidt (2007) argue that this is fundamentally related to fairness considerations in wage setting. I develop this argument elsewhere.

Taken together, fissuring creates industries—and an overall economy—that is wired differently than the model it has gradually replaced. Large corporations, where value creation, market power, and notably employment were concentrated, dominated the economic system for much of the 20th Century. The fissured economy still is powerfully affected by the large corporation with its concentration of value creation and economic power. But employment now has been split off, shifted to a range of secondary players that function in more competitive markets and separated from the locus of value creation. Extrapolating out the findings in the industries studied here on employment and working conditions means that broader diffusion of fissured employment on the economy as a whole are enormous.

IV. Implications on public policies for the workplace

The enforcement problem in fissured industries resembles the regulation of a construction worksite—with its many small employers and indirect forms of coordination between owners, project managers, and individual contractor—rather than the stable factory setting assumed by workplace policies. As a result, there is ambiguity around some basic questions:

- Who is the employer (or are there joint employers) ultimately responsible for establishing workplace conditions?
- How much latitude does the employer of record (e.g., a small janitorial contractor to a large building owner) have to change workplace conditions on behalf of its workforce?
- How useful is the traditional enforcement approach, which focuses on individual establishments or direct employers, to the task of changing employer behaviors and improving workplace conditions?

If workforce vulnerability arises from the distinctive industry-level characteristics described in this final report, enforcement policies should attempt to act on and change those conditions in order to have systemic and sustainable effects that go far beyond traditional enforcement approaches focused on individual employers. Although interventions relating to other factors relating to vulnerability must also be considered—immigration policies, the need for skill development, increasing opportunities for union representation—a strategic approach to regulation that builds on these insights provides a critical means for changing the underlying conditions driving vulnerability.

Traditional enforcement strategies assume that enforcement efforts should focus at the level where workplace violations are occurring. Yet the forces driving noncompliance in many industries arise from the organizations located at higher levels of industry structures, as found in fast food and hospitality industries. Strategic enforcement should therefore focus on higher-level, seemingly more removed business entities that affect the compliance behavior "on the ground," where vulnerable workers are actually found.

For enforcement to be effective in a fissured workplace, agencies responsible for enforcing the law need to "map" the business relationships underlying a sector, carefully tracking all of the different players that impact the workplace conditions. Improving conditions in the eating and drinking industry should, for example, include not only investigations of outlets with violations (e.g., those arising from worker complaints), but also of other units owned by the particular franchisee. But it should also include a systematic analysis of all other investigations of the franchisor (brand) in question to detect the presence of multiple instances of violations at other franchisees. Finally, it could entail contacting the brand itself regarding the results of these investigations if it was clear that significant violations extended beyond the boundaries of any one franchisee or owner group.[30]

This approach implies a very different orientation where the government focuses its efforts at the portion of the industry driving conditions that ultimately result in compliance problems. Although this may differ from the employer of record, reorienting enforcement attention in this way alters how the various parties up and down industry structures behave in a manner more compatible with better workplace conditions.

More generally, understanding how industry structures relate to the creation of vulnerable work, also provides insight into how those same dynamics could be used as a regulatory mechanism to bring systemic compliance to an entire industry rather than on an employer-by-employer basis. Two of the reports related to this study provide detailed discussions of how such approaches might be taken in the industries discussed here as well as others where fissured employment has emerged.[31]

V. Conclusion

Accounts of low wage work often emphasize explanations of workplace restructuring—outsourcing, temporary agencies, contingent work, misclassification— rooted almost exclusively on the cost side of the business income statement. The problems of non-compliance in the eating and drinking and hospitality industries and other “fissured workplaces” need to be understood as part of a more general context arising from a coordinated strategy that businesses have increasingly chosen to take. Its motivation arises from both revenue and cost considerations. In particular, these strategies use branding and other avenues for securing allegiance by customers to a company’s products or services in order to generate, for themselves, more inelastic demand and capturing price premiums and devoted consumers. The lead company then focuses only on activities related to core functions, while allocating to other entities the production of products or provision of services. Lead firms thereby become the coordinator of other organizations rather than the vertically integrated company that most employment laws assume.

The coherent strategy underlying fissured employment makes it clearer why it is often difficult to alter the decisions made by companies in this regard. Since fissured employment is a reflection of larger integrated strategies, enforcement that responds to the effects of them as if they were only an expression of labor cost avoidance will be unsuccessful. Unwinding the labor cost strategy might be difficult without affecting the revenue side strategy.

[30] Alternatively, in an industry like residential construction, greater attention should be paid to systemic violations among contractors working under the umbrella of a national homebuilder, who typically employs a minimal number of construction workers directly, but contracts and subcontracts work. The enforcement strategy would then consider focused investigations of contractors for patterns of violations and, if violations are present, outreach to the homebuilder's division or, if there are patterns of more wide-scale violations, across multiple divisions of projects undertaken by the homebuilder’s national office.

[31] See Weil (2010) and Diab, Glass, and Weil (2011). Additional discussions of enforcement implications are found in Weil (2009); (2013a and 2013b).

On the other hand, by understanding that fissured employment rests on a desire to balance the benefits of branding with the benefits of shifting employment responsibility, a whole range of policy options reveal themselves. Interventions that can affect the tipping point of lead firm decisions may have the best chance to impact the underlying drivers of compliance behavior and change them in significant and lasting ways. Creative public policy responses are possible—and underway. But they must be built upon a clear understanding of the underpinnings of labor standards compliance.

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APPENDIX A: Publications, Working Papers, and Presentations Related to the Grant

The following provides a compilation of the publications, working papers and presentation by the principal investigators and other researchers associated with the grant, from 2008 to the present. These materials are available from the principal investigator upon request.

Publications

Diab, Amanda, Rae Glass, and David Weil. 2011. *A Strategic Enforcement Approach for the Hotel and Motel Industry*. With Amanda Diab and Rae Glass. Report to the Wage and Hour Division, U.S. Department of Labor.

Weil, David. 2008. "A Strategic Approach to Labor Inspection." *International Labor Review*, vol.147, no.4, pp. 349-375.

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Weil, David 2011. "Enforcing Labor Standards in Fissured Workplaces: The US Experience." *The Economic and Labor Relations Review*, vol. 22, no.2, pp. 33-54.

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Weil, David. 2013. "Enforcement Challenges in a Fissured Workplace." *Industrial and Labor Relations Review*. (Forthcoming).

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Working Papers / Under Review

Diab, Amanda and David Weil. 2012. "Who Complains? New Estimates and Models." Working paper, Boston University.

Ji, MinWoong. 2011. "Impacts of Multi-Unit Franchising on Workplace Compliance Behavior." Working paper, Boston University.

Ji, MinWoong and David Weil. 2012. "Does Ownership Structure Influence Regulatory Behavior? The Impact of Franchisee Free-Riding on Labor Standards Compliance." Working paper, Boston University.

Weil, David. 2012. "Market Structure and Compliance: Why Janitorial Franchising Leads to Labor Standards Problems." Boston University, working paper.

Selected Presentations

"Franchised Employment." Annual Meetings of the Labor and Employment Relations Association, Chicago, IL, January 7, 2012.

"Restructuring of Employment and the Future of Work." AFL-CIO Forum on the Future of Work. Washington, DC, October 20, 2011.

"Fissured Employment and Labor Law." National Labor Relations Board. Washington, DC, September 14, 2011.

"Fissured Employment and the Need for New Enforcement Approaches." Conference on Comparative Labor Standards Enforcement, Cornell University. Ithaca, NY, September 10, 2011.

"Strategic Enforcement for State Workplace Agencies." Conference of State Attorneys General. Columbia University Law School, New York, NY, August 17, 2011.

"Fissured Employment: Implications for Enforcing Decent Work." Keynote Address. Regulating for Decent Work Conference. International Labor Organization. Geneva, Switzerland, July 7, 2011.

"Market Structure and Workplace Compliance: The Role of Janitorial Franchising." 25th Annual International Society of Franchising Meeting, Boston, MA, June 18, 2011.

"Fissured Employment." 53rd Annual NYU Labor Conference. New York University Center for Labor and Employment Law, New York, NY, June 9, 2011.

"Strategic Enforcement at the US Department of Labor." Enforcement of Minimum Employment Standards. Centre for Employment and Labour Relations Law, University of Melbourne (Australia), December 8, 2010.

"Fissured Employment." Seminar on Labour and Employment Law, University of Melbourne Law School, Melbourne, NSW (Australia), December 9, 2010.

"Employment Fissuring." MIT Institute for Work and Employment Research Seminar. Cambridge, MA, MIT Sloan School of Management, November 30, 2010.

"Enforcement Strategy." Keynote address, Worker Protection Senior Leadership Conference, U.S. Department of Labor, Philadelphia, PA, September 28, 2010.

"Does Ownership Affect Compliance?" with Min Woong Ji. Labor Economics panel. Annual Meetings of the American Economics Association, Atlanta, Georgia, January 5, 2010.

"Strategic Enforcement in State Labor Agencies." Presentation to the New York State Labor Department, New York City, NY, November 13, 2009.

"Strategic Enforcement in Federal Labor Agencies." National Employment Law Project, Reclaiming Our Wages Conference. Washington, DC, November 6, 2009.

"Regulatory Jujitsu: A Strategic Approach to Workplace Enforcement." Cornell University, School of Industrial and Labor Relations. Ithaca, NY, October 6, 2009.

"Regulating Vulnerable Work: A Sector-Based Approach." Regulating Decent Work: Innovative Labour Regulation in a Turbulent World. International Labour Organization. Geneva, Switzerland, July 9, 2009.

"Does Ownership Influence Regulatory Behavior? The Impact of Franchising on Labor Standards Compliance." Society of Labor Economics, Annual Meeting, Cambridge, MA, May 9, 2009.

Table 1: Franchise Ownership Status and Compliance Findings by Top 20 Limited Service Brands in Eating and Drinking Industry

Brand	% of Franchisee		Total Back Wages Per Investigation			
	(Our Data)	(QSR)	Mean	Franchisee Owned (1)	Company Owned (2)	Difference (1) – (2)
McDonald's	97%	85%	$577.87	$574.99	$670.93	-$95.94
Burger King	91%	92%	$940.23	$990.48	$447.77	$542.71
Wendy's	89%	77%	$1,712.11	$1,881.18	$397.14	$1,484.04
Taco Bell	85%	79%	$1,318.96	$1,546.37	$0.00	$1,546.37
Pizza Hut	86%	76%	$169.79	$196.96	$0.00	$196.96
KFC	97%	77%	$1,089.86	$1,120.34	$0.00	$1,120.34
Domino's Pizza	95%	88%	$2,160.42	$2,171.98	$1,944.66	$227.32
Arby's	96%	93%	$1,629.42	$1,684.14	$124.61	$1,559.53
Sonic	91%	82%	$1,844.32	$1,967.60	$576.21	$1,391.39
Jack in the Box	68%	20%	$974.50	$1,424.26	$0.00	$1,424.26
Hardee's	63%	66%	$804.22	$954.38	$546.80	$407.58
Papa John's	97%	78%	$1,450.92	$1,502.74	$0.00	$1,502.74
Little Caesars	96%	87%	$399.32	$415.29	$0.00	$415.29
Subway	100%	100%	$1,720.67	$1,720.67	N.A.	N.A.
Dairy Queen	100%	99%	$934.28	$934.28	N.A.	N.A.
Dunkin' Donuts	100%	100%	$2,678.25	$2,678.25	N.A.	N.A.
Popeyes	100%	94%	$1,637.33	$1,637.33	N.A.	N.A.
Quizno's	100%	100%	$338.06	$338.06	N.A.	N.A.
Baskin-Robbins	100%	100%	$227.64	$227.64	N.A.	N.A.
Blimpie	100%	100%	$278.10	$278.10	N.A.	N.A.
Total	**95%**	**85%**	**$1,350.07**	**$1,398.06**	**$375.80**	**$1,022.27**

Notes: Source for '% of Franchisee (QSR)' is QSR Top 50 (2004).

Table 2: Effects of Franchising on Employer Back Wages

Dependent Variable: Total Back Wages per Investigation (2005 $s)

Variables \ Functional Form	(1) Overall	(2) Directed Investigations	(3) Complaint Investigations	(4) All Investigations, including conciliations
Franchise Ownership (Franchisee-Owned vs. Company-Owned)	**$4,265.4***	**$8,423.7***	**$1,113.1**	**$869.6***
Standard error	**(1568.4)**	**(2778.3)**	**(1913.3)**	**(458.7)**
Prob. Value	**[0.007]**	**[0.003]**	**[0.561]**	**[0.058]**
Statistical models include the following variables:				
Past investigation variables (number of investigations in local area in last year)	Yes	Yes	Yes	Yes
Product market variables (e.g. number of fast food outlets in local market)	Yes	Yes	Yes	Yes
Outlet size (number of employees)	Yes	Yes	Yes	Yes
Year Dummy	Yes	Yes	Yes	Yes
Demographic Variables	Yes	Yes	Yes	Yes
Brand Dummy	Yes	Yes	Yes	Yes
Three-Digit Zip Code Dummy**	Yes	Yes	Yes	Yes
Statistics				
McKelvey & Zavoina's R2	0.260	.655	.161	.194
N	1,654	892	762	3,073

Notes: *** Statistically significant at the 1% level, ** at the 5% level, * at the 10% level.

The estimated effects for franchising on compliance use statistical models to hold constant the effects of the other factors listed in each column. The "franchise ownership" estimate can therefore be interpreted as the effect of an outlet being franchised instead of company-owned, for outlets that are otherwise identical with respect to size, prior investigation histories, brand, geographic location, competitive environment, and year that the investigation was conducted.

Table 3: General Deterrence Effects on Compliance

Overall predicted effect of an additional prior investigation on predicted compliance

	Total back wages per investigation [a, b] ($)	Total number of employees paid in violation [a, b]	BW/ EEPIV [a, b] ($)	% noncompliance (% of brand outlets with violation) [a, b]
Effect of an additional investigation of top 20 outlets in prior year in local area, excluding outlets of the same brand (5-digit zip code)	**-$886**	**-10.2**	**-$98.56**	**-0.331**
Standard error	382.3	3.54	53.64	0.156
Prob value	0.021	0.004	0.066	0.034
Number of observations	1654	1654	1654	1051

[a] Total investigations excluding conciliations and audits. [b] The model used for these estimates include 3-digit dummy variables to control for geographic specific effects—a more geographically detailed control variable than used in the other models.

Effect of an additional prior directed vs. complaint investigation on predicted compliance

	Total back wages per investigation [a,b] ($)	Total number of employees paid in violation [a,b]	BW/ EEPIV [a,b] ($)	% noncompliance (% of brand outlets with violations) [a,b]
Effect of an additional *directed* investigation of top 20 outlets in prior year in local area, excluding outlets of the same brand (5-digit zip code)	**-1466.27**	**-14.0**	**-125.44**	**-0.563**
Standard error	458.4	3.58	57.35	0.17
Prob value	0.001	0.000	0.029	0.001
Effect of an additional *complaint* investigation of top 20 outlets in prior year in local area, excluding outlets of the same brand (5-digit zip code)	**-2.55**	**-6.37**	**-84.2**	**-0.133**
Standard error	591.2	4.55	78.62	0.13
Prob value	0.997	0.16	0.285	0.32
Number of observations	1654	1654	1654	1653

[a] Total investigations excluding conciliations and audits. [b] The model used for these estimates includes dummy variables for region, state minimum wages and other covariates.

Table 4: Compliance levels for Brands and Independent Properties: Hotel / Motel Industry

Compliance measure \ Statistics	N	Overall Mean [St.D]	Mean **Brand Owned** (1)	Mean **Indepen-dent** (2)	Difference (1) – (2)
Total Back Wages Per Investigation ($)	2,548	2,928.63 [6,848.75]	2,620.38 (144.48)	3,603.38 (291.02)	-983.00*** (291.85)
Back Wages Per Employee Paid In Violation ($)	2,548	534.13 [1,801.27]	440.65 (22.45)	738.77 (102.32)	-298.12*** (76.70)
Incidence of Employer Noncompliance[a]	2,548	0.676 [0.468]	0.707 (0.011)	0.608 (0.017)	0.099*** (0.020)

Notes: Standard error in parentheses. *** Statistically significant at the 1% level, ** at the 5% level, * at the 10% level.
[a] Noncompliance = 1 if back wages are present at investigation.
Estimates based on national data sample of all branded and independent hotels in the U.S. hotel / motel industry.

Table 5: Compliance levels for Franchises vs. Chain-Managed Properties: Hotel / Motel Industry

Compliance measure \ Statistics	N	Overall Mean [St.D]	Mean **Franchisee** (1)	Mean **Chain-Managed** (2)	Difference (1) – (2)
Total Back Wages Per Investigation ($)	1,610	2,617.51 [5,912.08]	2,641.62 (146.21)	2,384.55 (689.13)	257.07 (505.52)
Back Wages Per Employee Paid In Violation ($)	1,610	436.03 [906.17]	443.44 (22.00)	364.44 (92.76)	79.00 (77.46)
Incidence of Employer Noncompliance[a]	1,610	0.707 [0.455]	0.737 (0.012)	0.411 (0.040)	0.327*** (0.038)

Notes: Standard error in parentheses. *** Statistically significant at the 1% level, ** at the 5% level, * at the 10% level.
[a] Noncompliance = 1 if back wages are present at investigation.
Estimates based on national data sample of only branded hotels (excluding Best-Western and American Best Value Inn) in the U.S. hotel / motel industry.

Table 6: Compliance levels for branded properties managed by a top 50 independent operating company vs. those not managed by one of these operators: Hotel / Motel Industry

Compliance measure \ Statistics	N	Overall Mean [St.D]	Mean Managed by a top 50 independent operator (1)	Mean Not managed by a top 50 operator (2)	Difference (1) – (2)
Total Back Wages Per Investigation ($)	1,749	2,620.38 [6,042.39]	2,745.66 (831.28)	2,616.00 (146.73)	129.66 (800.49)
Back Wages Per Employee Paid In Violation ($)	1,749	440.65 [938.72]	636.16 (200.50)	433.83 (22.15)	202.34* (124.27)
Incidence of Employer Noncompliance [a]	1,749	0.707 [0.455]	0.407 (0.065)	0.718 (0.011)	-0.311*** (0.060)

Notes: Standard error in parentheses. *** Statistically significant at the 1% level, ** at the 5% level, * at the 10% level.
[a] Noncompliance = 1 if back wages are present at investigation.
Estimates based on national data sample of only branded hotels in the U.S. hotel / motel industry.