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AN EQUAL SAY AND AN EQUAL CHANCE FOR ALL

Fast Food Failure

How CEO-to-Worker Pay Disparity Undermines the Industry and the Overall Economy

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Dēmos is a public policy organization working for an America where we all have an equal say in our democracy and an equal chance in our economy.

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EXECUTIVE SUMMARY

he link between income inequality and economic instability has drawn renewed attention from economists, policy makers, global financial institutions, media, and investors. From Davos to Wall Street to Main Street, there is a growing consensus that inequality slows economic recovery and dampens consumer demand.

Yet the gap between the highest and lowest earners in the US economy continues to grow, with consequences for the economy and firm performance. New analysis of the CEO-to-worker compensation ratio across industries shows that Accommodation and Food Services is the most unequal sector in the economy, and that this extreme pay disparity is primarily driven by one of the sector's component industries: fast food. The fast food industry is also one of the highest growth employers in the nation.

Over the past year, frustrated front-line fast food workers, striking for higher pay and union representation, have increased public scrutiny of low wages and poor conditions. Workers' nationwide protests, among other factors, spurred industry-leader McDonald's to identify several consequences of inequality as a threat to its long-term performance.

Fast food income inequality has serious repercussions for the entire industry—not just McDonald's—and across the economy as a whole. Fast food companies and other firms will need to address their imbalanced pay practices in order to mitigate the damaging effects of income inequality.

Key Findings

Analysis of US company-level pay disparity shows that Accommodation and Food Services is the most unequal sector in the American economy, driven by extreme inequality within the fast food industry.

> Accommodation and Food Services had a CEO-to-worker pay ratio of 543-to-1 in 2012. Over the period from 2000 to 2012 the average ratio was 332-to-1, 44 percent higher than the sector with the next-highest compensation ratio.
>
> In 2012, the compensation of fast food CEOs was more than 1,200 times the earnings of the average fast food worker. Proxy disclosures recently released by fast food companies reveal that the ratio remained above 1,000-to-1 in 2013.

Pay disparity in the fast food industry is a result of two factors: escalating payments to corporate CEOs and stagnant poverty-level wages received by typical workers in the industry.

> Fast food CEOs are some of the highest paid workers in America. The average CEO at fast food companies earned $23.8 in 2013, more than quadruple the average from 2000 in real terms.
>
> Fast food workers are the lowest paid in the economy. The average hourly wage of fast food employees is $9.09, or less than $19,000 per year for a full-time worker, though most fast food workers do not get full-time hours. Their wages have increased just 0.3 percent in real dollars since 2000.

Growing income inequality within fast food has troublesome implications for the economy and for companies in the industry.

> The most unequal sectors are among those providing the greatest numbers of new jobs in the economy, replacing jobs in sectors with lower income inequality.
>
> Income inequality is increasing legal, regulatory, and operating risks for fast food firms. Millions of dollars in legal fees, increasing customer wait times, and labor unrest are evidence of the systemic problems of income inequality in fast food.

Shareholders interested in the continued success of the fast food industry should be particularly attuned to these issues, since according to the industry leader inequality is already threatening the bottom line. Reducing the proportion of CEO-to-worker compensation by addressing bad practices on both halves of the ratio is one step toward realigning the interests of stakeholders in the firm, including shareholders, executives, and the workforce overall.

INTRODUCTION

"In 2012, the CEO-to worker compensation ratio in fast food topped 1,200-to-1; recently released proxy disclosures reveal that the ratio remained above 1,000-to-1 in 2013."

he systemic risk of rising income inequality has captured public attention and the focus of policy makers, but the most unequal companies in the US economy have yet to address their exposure by reporting and reducing pay disparity within their own firms. The corporate response lags that of policymakers and organizations like the IMF and the World Economic Forum, who have called for the development of measurement tools and a plan to mitigate this risk.[1] Last year the SEC proposed rules for companies to disclose the CEO-to-worker compensation ratio in their annual reports to the agency, but that requirement has not yet taken effect. In its absence, investors lack valuable information about the risks that accompany income inequality.

The fast food industry epitomizes business' vulnerability to income inequality. In the past year, fast food workers have prompted increased scrutiny of the divergence between the poverty-level paychecks earned by typical workers and the millions reaped annually by executives at McDonald's, KFC, Domino's, and other fast food companies. McDonald's, most recently, identified income inequality as a risk to the company's bottom line, but corporate management did not provide a plan to deal with potential consequences.

Against this backdrop, this report calculates the CEO-to-worker pay ratios for the major sectors of the US economy in order to identify the areas where income inequality is starkest—and to inform economists, policy makers, global financial institutions, media, and investors concerned with this issue. Fast food emerges from the sector and industry analyses as a major driver of large scale pay disparity. Accommodation and Food Services—the sector that includes the fast food industry—was the most unequal sector in the economy in almost every year from 2000 to 2012, and in every year since the end of the Great Recession in 2009. Pay disparity at companies in the fast food industry drove this result, with CEO-to-worker compensation ratios from 2009 to 2012 that were at least twice those of nearly every sector. In 2012, the CEO-to worker compensation ratio in fast food topped 1,200-to-1; recently released proxy disclosures reveal that the ratio remained above 1,000-to-1 in 2013.

Even in an era characterized by a widening gap between executive pay and the income of the average worker, the compensation practices at companies within the fast food industry are considerably out of line with the rest of the economy. Both components of the CEO-to-worker compensation ratio contribute to the result, as fast food CEOs reap greater and greater economic rewards while workers have seen no gains. Among the fast food companies in this study, CEO average pay since 2000 more than quadrupled, while workers' incomes rose just 0.3 percent. In 2013, the average fast food CEO took home $23.8 million. In contrast, the paycheck of the average fast food worker would leave a family of three below the federal poverty line, even if she works 40 hours a week, which is far from the norm in the industry. At an average $9.09 per hour, a full-time, full-year employee earns less than $19,000 a year. But most fast food workers are hired on a part-time basis, making it unlikely that their annual incomes will even approach that sum. At the bottom of the wage scale, the erosion of the real value of the minimum wage has excluded those earners from the benefits of economic growth and the success of the industry.

The extreme income inequality in the fast food industry poses problems for the economy and for the performance of these companies. The sector and industry-level analyses in this paper show that the areas contributing some of the largest job growth in the economy over the next decade are also the most unequal. The increasing share of workers in these low-wage, highly disparate industries could lead to increasing income concentration in the economy overall. At the firm level, the negative impact of income inequality on brand perception, operations, and other factors may pose a threat to the business. McDonald's alluded to that possibility in a January SEC filing when it listed the protests of its low-wage workforce, growing attention to income inequality, and the public perception of the company's working conditions as increasing the risks for shareholders in the year ahead. Since then, class action lawsuits alleging wage theft at a number of companies have only intensified the exposure.

As the risks of growing income inequality materialize across industry sectors, dealing with the extreme disparity in the fast food industry will be a critical concern for shareholders, consumers, and policy makers who hope to limit the consequences of inequality overall. The CEO-to-worker compensation ratio provides vital information about fast food companies and other industries with high pay disparity, and demonstrates that changes at the top and bottom of the fast food pay scale are essential to moderating the trend.

METHODOLOGY

his study adds to the existing literature on executive compensation by examining the data at the industry level. The calculations for CEO and worker total compensation are consistent with previous academic and policy research on rising executive pay.

Compensation Calculation

The estimate of CEO compensation draws from executive compensation data compiled in Standard & Poor's ExecuComp database. The estimate of average worker compensation combines Bureau of Labor Statistics data on the average wage for non-supervisory and production workers with Bureau of Economic Analysis data on non-wage compensation.

Publicly-traded companies are required to disclose executive compensation in their annual reports to the SEC, but inclusion of many different categories of income can result in significant variation in the estimates compiled from corporate filings. This paper follows the 2013 work of economist William Lazonick by defining CEO total compensation as the sum of six categories of payment: salary, bonus, restricted stock grants, long-term incentive plans, the value of exercised options, and other compensation.[2] This definition is equivalent to the measure for total compensation constructed by Standard & Poor's for the ExecuComp database and included in that dataset.

The definition of CEO total compensation used here omits several categories of executive income, including changes in pension value and non-qualified deferred compensation and dividend payments from company ownership. The methodology also omits payment to CEOs who retired or left the company for other reasons before the corporate filing date. As a result, the estimates in this paper tend to understate total executive income. (For a detailed example, see *Undercounting Executive Pay* on page 17.) Options awards are valuated during the year that they appear as reported wages on the CEO's IRS form W2.[3] Inclusion at the year of exercise follows the conventions of the *Wall Street Journal*'s annual analysis of CEO pay at the largest firms in the US, and the Economic Policy Institute's *State of Working America*.[4] Moreover, it is the most appropriate measure for comparison to annual worker earnings because it reflects the CEO's annual labor income.

There are no disclosure requirements for worker compensation in effect for companies today. Consequently, literature on the CEO-to-worker compensation ratio must compare CEO earnings to broader estimates of worker income. The total worker compensation estimates in this paper replicate the calculations used by the Economic Policy Institute in the *State of Working America* and other publications for comparison to CEO pay.[5] Wage and salary data come from the Bureau of Labor Statistics Current Employment Statistics database, where the average wages for non-supervisory and production workers are available at the various sector and industry levels. This study converts the hourly wage into an annual sum by assuming a 40-hour work week over 52 weeks per year, or 2080 hours. The calculation describes the highest attainable average wage and salary income for workers, and overstates worker pay in industries that rely on a part-time workforce. Non-wage compensation was computed using data from the Bureau of Economic Analysis' National Income and Product Accounts (NIPA).[6] Total worker compensation is the sum of the annual estimate of wage earnings and the annual value of non-wage income.

Industry Definition

The paper focuses on analyses at two industry levels: sector and industry. The Accommodation and Food Services sector comprises a number of industries including Accommodation (hotels and casino hotels), Full-Service Restaurants, Limited-Service Eating Places, and others.[7] The Limited-Service Eating Places is what is commonly referred to as fast food.

Companies in the ExecuComp database are identified by industry with 6-digit North American Industry Classification System (NAICS) codes. The first section of this paper examines the CEO-to-worker compensation ratios by sector, grouping firms together at the 2-digit NAICS level and comparing the compensation of CEOs at those firms to worker compensation evaluated at the same 2-digit NAICS level. The emergence of Accommodation and Food Services as a sector-level outlier in the data provoked further disaggregation to the industry level within that sector. Analysis of the industries composing Accommodation and Food Services used firm groupings at the 6-digit NAICS level and compared the CEO compensation at those firms to worker compensation at the same 6-digit level.

The firms included in this study currently appear in three of the major S&P indices: the S&P 500, MidCap, and SmallCap indices. Among the major S&P indices, the following companies compose the fast food industry: Chipotle, Domino's Pizza, Jack-in-the-Box, McDonald's, Papa John's, Panera Bread, Sonic, Starbucks, Wendy's, and YUM! Brands, owner of KFC, Pizza Hut, and Taco Bell.

Time Period

Previous research from the Economic Policy Institute shows that the late 1990s was a period of rapid growth in CEO compensation.[8] This paper examines the trends since that escalation, and covers the time period from 2000 to 2012. Those years span two business cycles and provide a basis for comparison of trends before and after the Great Recession that began in December 2007 and ended in June of 2009. Compensation data for 2013 is not yet available for many companies, making the sector-by-sector comparison impossible. After identifying income inequality in the fast food industry as a major driver of inequality overall, the data on 2013 fast food CEO compensation was culled by hand from the companies' 2014 proxy statements to provide the most up-to-date information.

SECTION I:
CEO-TO-WORKER COMPENSATION RATIOS BY SECTOR AND INDUSTRY

hile inequality affects the entire US economy, the analysis here reveals that some sectors are propelling pay disparity far beyond the rate of the economy as a whole. Among firms from the major S&P indices, Accommodation and Food Services has consistently placed as the most unequal sector over the past decade, with fast food as the constituent industry with the most extreme CEO-to-worker pay disparity.

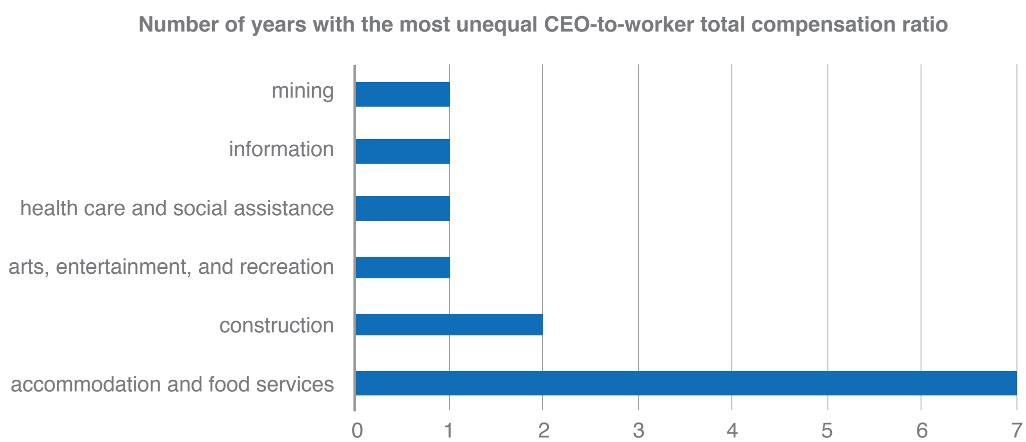
Accommodation and Food Services is the Most Unequal Sector in the Economy

During 2012, CEOs in Accommodation and Food Services earned 543 times the annual income of the average worker in the sector - the highest CEO-to-worker ratio of any sector in the economy in any year since 2000.

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Average, 2000-2012
retail	145	174	250	206	248	278	274	309	171	177	228	226	304	230
information	540	111	110	129	231	206	196	219	110	92	132	140	513	210
construction	102	203	309	234	325	490	184	164	189	158	107	92	93	204
mining	176	75	87	102	135	346	330	199	282	106	134	175	121	174
health care and social assistance	163	456	187	129	155	168	193	122	84	139	114	134	171	170
finance and insurance	266	237	127	175	205	207	180	145	84	78	106	96	123	156
arts, entertainment, and recreation	51	191	59	309	63	59	299	147	170	95	146	145	241	152
manufacturing	184	110	99	121	156	143	154	166	128	99	131	146	158	138
administrative and support, and waste mgmt	77	83	87	69	139	220	260	200	117	104	112	127	137	133
real estate, rental, and leasing	63	144	79	65	116	124	149	134	114	76	146	172	151	118
transportation and warehousing	102	91	64	83	88	134	112	107	102	84	130	106	96	100
wholesale trade	45	46	80	72	82	112	155	140	98	82	145	106	95	97
professional, scientific, and technical services	105	140	51	63	80	96	86	85	76	56	87	88	85	84
other services	38	35	37	101	51	80	58	121	149	76	82	143	93	82
utilities	44	38	35	44	57	78	74	73	71	58	59	61	66	58

Source: Demos analysis of ExecuComp, BLS, and BEA data

Accommodation and Food Services has the highest pay disparity ratio as a result of both high CEO pay and low average worker compensation. For example, 2012 was a particularly good year for executives in both the Accommodation and Food Services sector and for those in the Information sector. The average total compensation of CEOs in these two sectors registered well above all others as executives cashed-in valuable incentive pay. But while the average Information CEO took home more than twice the income of CEOs in Accommodation and Food Services, Information ranked second in pay disparity for 2012. That is because the average worker in the Information sector is among the highest paid employees in the economy, while the average worker in Accommodation and Food Services is among the lowest-paid. The combination of high CEO compensation and very low average worker compensation pushed the Accommodation and Food Services pay ratio to the top. CEOs in Accommodation and Food Services are among the best paid workers in the world, but the reason their relative earnings are out of step with the economy is that their employees make so little.

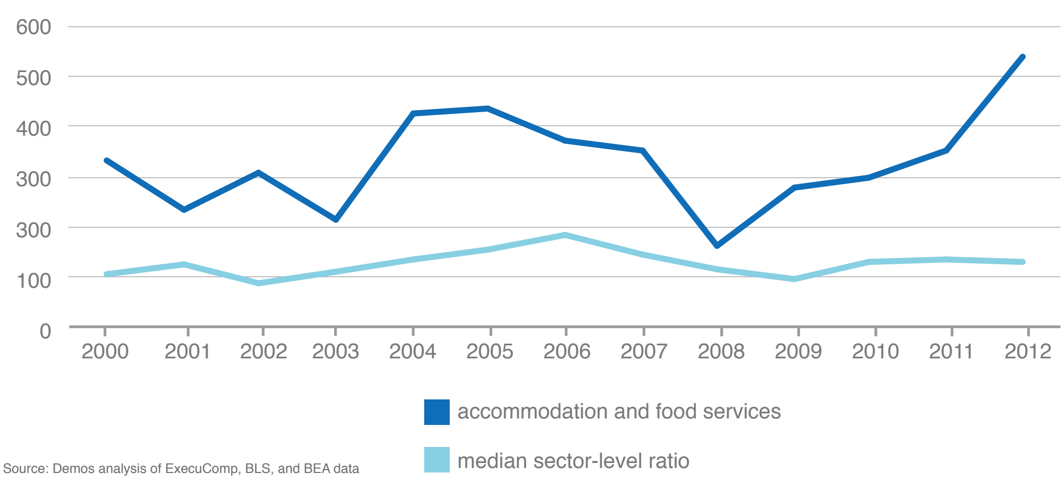


Source: Demos analysis of ExecuComp, BLS, and BEA data

High levels of pay disparity have been persistent within the Accommodation and Food Services sector, which had the highest CEO-to-worker compensation ratio in 6 of the past 7 years, and in 7 years over the 13-year period. As a result, Accommodation and Food Services also has the highest annual average CEO-to-worker ratio among all sectors for 2000 to 2012 period, at 332-to-1. The average ratio is 44 percent higher than the second-highest ranking sector, Retail, a sector also known for part-time, low-wage work.

Outliers in the CEO-to-worker ratio appear in the data for nearly every sector during the period. These arise because many companies allocate incentive pay in the form of stock options, which CEOs can accumulate over time and exercise in a single year. CEOs often wait until the company's share price rises and then cash in many options contracts all at once. When an industry is performing well, it is more likely that executives will exercise options, thus increasing CEO compensation for the entire sector. Conversely, during an economic downturn or a year of declining performance, CEOs hold their options since those that are exercised in that economic climate generate less income. These patterns explain, in part, why the CEO-to-worker compensation ratio declined for all sectors during the Great Recession in 2008 and 2009, and then climbed again in the ensuing years. These outlier years, however, are only a temporary interruption in an otherwise consistent trend putting Accommodation and Food Services in the lead for compensation inequality economy-wide.

The Great Recession pulled down the income of CEOs in the sector, so that 2008 was the only year out of the past seven that Accommodation and Food Services was not ranked as the most unequal sector in the economy, and the only year in the entire series that it was not in the top three. In fact, Accommodation and Food Services has had the highest or second-highest CEO-to-worker compensation ratio in 10 years since 2000. And pay disparity that is consistently higher than the more densely distributed range of other sectors.



Source: Demos analysis of ExecuComp, BLS, and BEA data

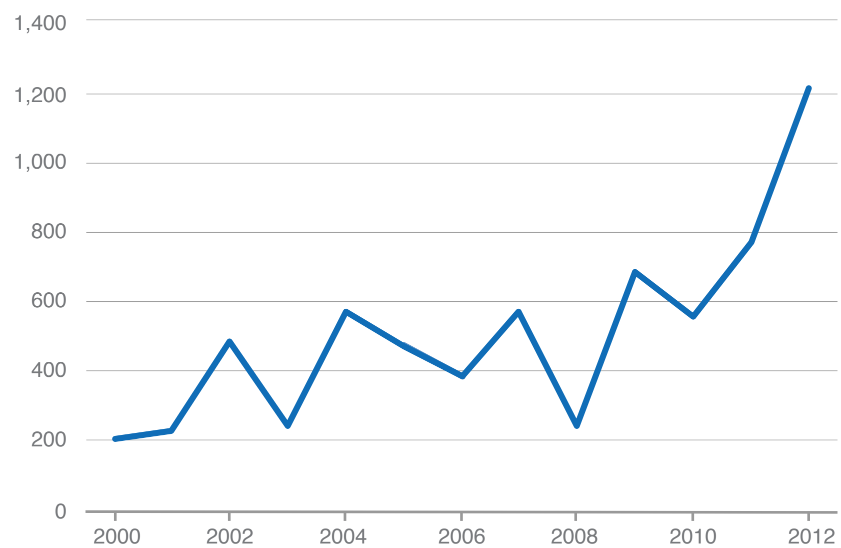
Fast Food is Driving High Pay Disparity in Accommodation and Food Services

Wide disparity in the fast food industry drives the extraordinarily high sector-level CEO-to-worker compensation ratio in the Accommodation and Food Services sector. Among the industries that compose Accommodation and Food Services, both the Accommodation and fast food industries have ratios well above the sector-level ratios for most years since 2000. Yet the fast food industry ratios eclipse those of the Accommodation industry in all but three years. The thirteen-year average for the fast food ratio is 512-to-1, which is 32 percent higher than the Accommodation subsector and 54 percent higher than the Accommodation and Food Services sector as a whole. In 2012, CEO incomes in fast food were 1,203 times higher than the earnings of their average worker—a ratio approaching double that of Accommodation, the nearest industry, and far beyond any ratios found at the sector level.

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Average, 2000-2012
accommodation and food services	334	232	308	215	429	439	374	350	161	280	300	352	543	332
accommodation	182	163	151	135	1,021	821	541	472	165	113	361	288	618	387
full-service restaurants	473	268	266	231	171	310	305	197	112	128	116	152	143	221

Source: Demos analysis of ExecuComp, BLS, and BEA data

Most recently, the CEO-to-worker compensation ratio in fast food jumped from 765-to-1 in 2011 to 1,203-to-1 in 2012. The steep climb results from big equity payouts to fast food CEOs. The CEO-to-worker ratio in fast food grew rapidly since the end of the Great Recession in 2009, catapulting from 692-to-1 in 2009 to 1,203-to-1 in 2012 and revealing the ability of CEOs to rebound from the economic downturn much faster than other workers in the economy. The year 2012 marks the highest CEO-to-worker compensation ratio in the series—well above the prerecession ratio for the industry.



SECTION II: A CLOSER LOOK AT PAY WITHIN FAST FOOD

he average compensation of fast food CEOs was $23.8 million in 2013, making these executives some of the best-paid workers anywhere in the economy. At the same time, the fast food workforce is the lowest paid, with wages that fall below those of other employees in the sector and with little access to non-wage benefits. The CEO-to-worker compensation ratio is being pushed to its heights from both the top and the bottom, as executives in fast food have seen incomes grow substantially since 2000 while workers experienced virtually no growth at all.

After the Great Recession ended in 2009, CEOs captured the tide of economic growth with impressive rapidity. Executive pay recovered and outstripped previous levels within a single year. Workers, though, were left out of these gains. Since 2000, the average fast food worker has seen her total compensation climb by just 0.3 percent in real terms, and in 2013 was still making less money than before the recession. As a result of the trends for both components of the CEO-to-worker ratio, fast food stands out for its extreme imbalance in compensation practices.

The companies analyzed in this report include the largest publicly-traded fast food companies in the world and the leaders of the most important quick-service and fast casual restaurant submarkets.[9] McDonald's dominates the world of hamburgers, the largest fast food submarket, pulling in more than ten times the revenue of its nearest competitors, Wendy's and Burger King. Sonic and Jack in the Box round out the top five companies in the hamburger submarket. YUM! Brands is the largest public company in three fast food submarkets: Chicken (KFC), Mexican (Taco Bell), and Pizza (Pizza Hut). After Pizza Hut, Domino's and Papa John's are the second and third largest pizza chains. Starbucks—the third-largest fast food Company in the US—is the unparalleled leader in the quick-service snack submarket, with a menu that has spurred other fast food giants to compete on coffee sales.

From This Year's Proxy Statement:
CEO Compensation at YUM! Brands:

YUM! Brands experienced a number of challenges in 2013. After more than a decade of growth in earnings per share at YUM!, in 2013 earnings per share declined by 9 percent.[13] A slump in sales followed a food safety scandal in China and caused significant losses in their largest non-US market.[14] Yet CEO David Novak still took home more than $22 million, including $939,600 in non-equity incentive awards intended to "Motivate high performance and reward short-term Company, team and individual performance."[15] The company's chief executive in China, Jing-Shyh S. Su, also received $17.2 million in pay in 2013. In calculating Su's compensation, the company determined that the China division had reached 172% of its system customer satisfaction target[16] (up from 165% in 2012[17]) despite the scandal, which involved an investigation into a chemical residue found in some of its chicken supply.[18]

YUM! Brands CEO David Novak, 2013 Compensation

Salary	$1,450,000
Non-equity incentive compensation	$939,600
Other compensation	$776,268
Stock awards	$1,568,655
Exercised option value	$17,315,657
Total:	**$22,050,180**

CEO Compensation

Over the entire period, and including 2013 data for the nine companies that have released proxy statements thus far this year, the average fast food CEO received annual compensation of $12.5 million. Starbucks, YUM!, Chipotle, McDonald's, and Domino's have had the most persistently high levels of CEO pay during this time. For most of these companies, CEOs earn hundreds of times the incomes of the average non-supervisory and production worker, even in years of lackluster sales. All of the corporations except for two have offered annual compensation of more than $10 million to the company CEO in at least one year since 2000. The two exceptions—Sonic and Papa John's—were the only fast food companies with CEO-to-worker pay ratios below 200-to-1 in 2013.

Average CEO compensation has more than quadrupled since 2000, with the most recent years dramatically exceeding the average for the period. In 2012, fast food CEOs received average annual compensation of $26.7 million, and in 2013 average CEO compensation was $23.8 million. The CEO-to-worker pay ratio in both years was over 1,000-to-1.

	Total Compensation, 2000 (2013 dollars)	Total Compensation, 2013	
Starbucks	$17,774,886	$137,780,923	
YUM!	$3,253,652	$22,050,180	
Chipotle		$13,791,654	
McDonald's	$6,874,169	$7,726,977	
Domino's		$10,524,732	
Burger King		*$4,770,787*	
Wendy's	$2,744,400	$5,421,106	
Panera Bread	$574,955		
Jack in the Box	$2,702,153	$13,393,205	
Sonic	$816,862	$1,515,728	
Papa John's	$640,446	$2,116,837	
Average Fast Food CEO	$4,422,690	$23,813,482	

Source: Demos analysis of ExecuComp data
Averages computed using all years available for the period 2000-2013
Note: Burger King is not included in the CEO-to-worker ratio calculations or the fast food CEO compensation averages in this table because it did not meet the criteria for S&P index inclusion due to its ownership structure. Because it is a major fast food company, it is shown here for reference.

In 2013, the highest-paid CEOs in fast food were the ones with the largest stock awards and options exercised. These forms of payment comprised 86 percent of the total value of fast food CEO compensation last year, 18 times the value of salaries. At Starbucks, YUM! Brands, and Chipotle, exercised options made up the majority of executive compensation in 2013, and made their CEOs top earners for the year.

Starbucks	97%
Yum! Brands	86%
Jack in the Box	78%
Chipotle	70%
Domino's	66%
McDonald's	60%
Burger King	60%
Wendy's	26%
Papa John's	24%
Sonic	2%

Source: Demos analysis of ExecuComp data
Note: Burger King is not included in the CEO-to-worker ratio calculations or the fast food CEO compensation averages in this report because it did not meet the criteria for S&P index inclusion due to its ownership structure. Because it is a major fast food company, it is shown here for reference.

Undercounting Executive Pay

The measure of CEO total compensation outlined here follows a standard definition for executive income, but is far from exhaustive of the sums received by CEOs from the firms where they work. For example, it is not uncommon for CEOs to draw dividend payments from their share ownership awards, compensation from relationships with private equity firms that have stakes in their companies, or anti-dilution protection in case the value of share ownership changes unfavorably following later issues of stock.

At YUM! Brands, changes in pension value and non-qualified deferred compensation earnings have been an important category of income that is left out of the measure. In the five years from 2008 through 2012, YUM! CEO David Novak earned $19.7 million under this category of payment. If changes in pension plan value and non-qualified deferred compensation earnings were included, his total calculated compensation for 2012 would have been $1.3 million higher, at $37.8 million.

In addition to the forms of compensation listed above, companies pay out big awards when leadership changes hands. Since nearly every fast food company incurred these expenses over the period from 2000 to 2013, the measure used to tally total annual CEO compensation undercounts the cost facing almost every firm in one or more years. Chipotle, Domino's, Jack-in-the-Box, McDonald's, Papa John's, Starbucks, and Wendy's all paid multiple individuals for service as CEO in at least one year out of the past 10, but only the compensation information for the CEO in place at the corporate filing date is included in the accounting here. Incorporating the incomes of all CEOs paid within a given year would drastically increase the estimates for the years when CEO transitions occurred.

For example, when McDonald's Donald Thompson took over the CEO position from James Skinner in July 2012, actual CEO payments towered over the figure used in this study. Skinner and Thompson were the two highest paid employees at the company in 2012, with Thompson earning $12.9 million and Skinner earning $34.6 million, including more than $10 million in 'other compensation' awarded as part of his retirement agreement and $9.5 million in exercised options. In 2012, McDonald's CEOs actually took home $47.5 million in compensation, 2048 times the average fast food worker's earnings for the year. ■

Worker Compensation

Fast food workers earn the lowest average wage of all occupations, with the average worker in the industry earning $9.09 per hour according to the Bureau of Labor Statistics Current Employment Statistics data.[19] At that average, a full-time, year-round employee makes an annual income of less than $19,000—below the poverty threshold for a worker supporting a family of three. But fast food paychecks are unlikely to reflect even that level of income, because workers are unlikely to get paid for 40 hours on the clock per week. The average work week in the industry amounts to just 24 hours and schedules can change from week to week erratically, making paychecks unpredictable and vitiating any attempts of involuntary part-time workers to find supplementary jobs. An employee in a fast food restaurant earning the average wage for the average hours brings home less than $12,000 per year.

Low-wage jobs	2013 Hourly Wage
Fast food restaurants	$9.09
Cafeterias, grill buffets, and buffets	$9.16
Bowling centers	$10.20
Gasoline stations with convenience stores	$10.30
Convenience stores	$10.31
Snack and nonalcoholic beverage bars	$10.36
Gasoline stations	$10.47
Book stores and news dealers	$10.57
Family clothing stores	$10.83
Used merchandise stores	$10.88
Women's clothing stores	$11.07
General merchandise stores	$11.20

Source: BLS Current Employment Statistics database

Stagnant wages at the bottom of the pay scale are an important component of income inequality growth. Every year of increased earnings for fast food executives pulled the ratio of CEO-to-worker compensation upward, because fast food worker wages did not budge over the period since 2000. In 2013 the total compensation of the average fast food worker actually declined, falling to its lowest level since 2006.

The estimates of total worker compensation employed in this paper also assume that employees in fast food receive non-wage compensation—benefits such as employer contributions to pension funds, group health insurance, or paid vacation time—in the same proportion as workers in all food service establishments, including full service restaurants, which amount to less than a fifth of the value of wage and salary compensation. These assumptions, however, likely overestimate the non-wage benefits received by the typical fast food worker. According to a recent analysis from economists at the University of Illinois and the UC Berkeley Labor Center, 87 percent of front-line fast food workers do not receive health benefits through their jobs.[20] Since fast food employers do not pay for the critical needs of low-wage workers and their families, public programs foot the bill. According to the same study, more than half of front-line fast food employees are enrolled in a public assistance program, at a cost of nearly $7 billion per year.[21]

As a result, the calculations in this report likely understate the extent of pay disparity in the fast food industry because of the assumptions necessary to generate comparable annual earnings numbers for CEOs and non-supervisory and production workers. The assumption of full-time employment overstates the value of earnings, and the assumption of benefits overstates the non-wage income for most of the fast food workforce.

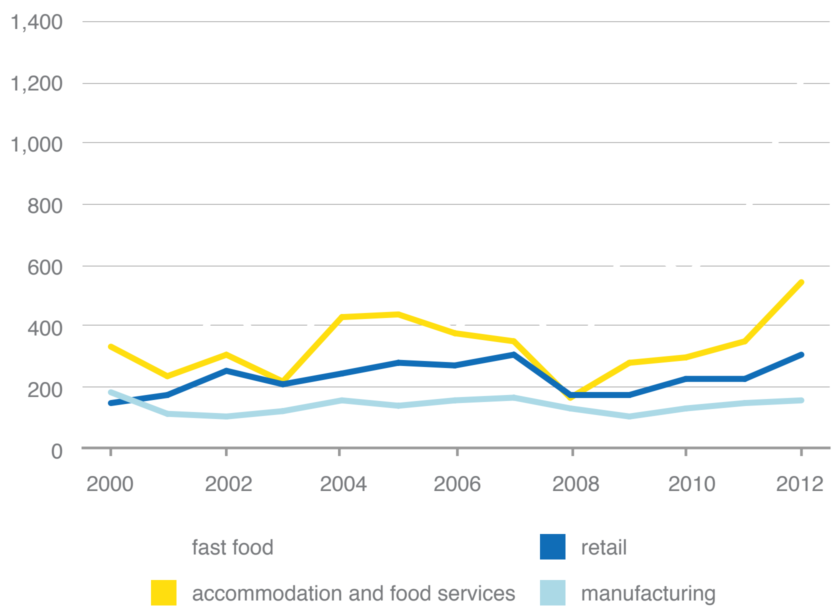
SECTION III: IMPLICATIONS OF FAST FOOD INEQUALITY FOR THE ECONOMY AND COMPANIES

he implications of extreme pay disparity at fast food companies begin within the firm but reverberate across the entire economy. Addressing inequality in fast food and other highly unequal industries is especially important because low-wage positions in these sectors have been central contributors to labor market growth since the Great Recession and are projected to be an important source of jobs added to the economy over the coming years.[22] As shown in the Table F, food preparation and retail occupations are among the top five occupations expected to add the most jobs to the economy through 2022. The increasing reliance on employment in these highly unequal industries will make it harder for working people to share in the gains of economic growth as more and more income becomes concentrated at the top. These findings suggest an escalation of income inequality over the next decade, and a break from the kind of employment opportunities that supported middle-class living standards in the past.

	New Jobs	2012 Sector-level CEO-to-worker ratio
Personal care aides	580,800	171
Registered nurses	526,800	171
Retail salespersons	434,700	304
Home health aides	424,200	171
Food preparation and serving workers, including fast food	421,900	543

Source: BLS Current Employment Statistics database

For example, the generation that preceded the rapid growth in CEO-to-worker compensation ratios in the 1990s benefited from employment in sectors that offered workers a greater share of the output they created. Industries like manufacturing—where workers organized unions that bargained to improve working conditions, including pay—provided dependable paychecks and a stake in higher productivity and prosperity. During the 13-year period examined in this paper, the average CEO-to-worker compensation ratio for fast food was nearly four times higher than in the manufacturing sector; in 2012, the fast food ratio was over seven times higher than in manufacturing. Over the past decades, the declining share of national income generated in more equal sectors like manufacturing, the decline in union density, and the rising importance of low wage work, have affected the distribution of income broadly. A growing consensus among economists and policy makers points to the negative impacts of widening income disparity on economic growth and volatility and social and political stability.[23]



High levels of pay disparity also appear to be increasing risk at many fast food companies, with potential consequences for long-term performance. Last year, thousands of fast food workers rallied outside of businesses in hundreds of cities, calling on their employers to raise wages and end retaliation for workplace organizing.[24] The waves of strikes put fast food at the center of the minimum wage debate, with federal legislation to raise the minimum wage a major political issue with the potential to affect future costs in the industry. Extensive media coverage also made it difficult for consumers to ignore the frustrations of fast food workers. And since fast food employment is prevalent and growing, customers are likely to know a fast food worker and be sensitive to their grievances. As the jobs added to the economy are increasingly service industry jobs, there is a changing perception of fast food workers from kids trying to earn some spending money to adults trying to support their families. That perception is rooted in fact: according to the Center for Policy Research, 70 percent of the fast food workforce is aged 20 or older, and more than a quarter has children.[25] Attention devoted to the taxpayer subsidies that support the fast food workforce adds to the impression that fast food is having a negative impact on families and the economy.

Operational Issues

Operational issues appear as another symptom of widening income inequality. Consumers are increasingly dissatisfied with their experiences at the biggest fast food companies. Last year, customer service ratings at Burger King, Domino's, KFC, McDonald's, Pizza Hut, Taco Bell, and Wendy's, were all beneath the industry average, based on analysis by the customer experience research firm Temkin Group.[26] Taco Bell, KFC, and McDonald's stood out at the very bottom. Other industry studies provide supplementary details about the neglect of the consumer's experience as profits are increasingly captured by those at the top.

The recent challenges to the fast food drive-thru businesses are illustrative. Drive-thru business is a key source of fast food revenues and can account for between 60 and 70 percent of industry sales. According to a study of drive-thru performance last year, average service time increased while the accuracy of orders declined.[27] Since customers rely on the drive-thru window for convenient, time-saving meal choices, failures in those capacities can have a big impact on the brand. McDonald's acknowledged as much with their renewed focus on customer feedback following disappointing earnings last year, but the company still registered its slowest speed for drive-thru service in the entire 15 years of the study's existence.[28] Driving sales through customer service starts with well-trained, happy, and loyal employees, so continuing underinvestment in the fast food workforce sabotages other consumer-focused efforts.

Legal Risks

In addition to operational issues, the low pay practices of fast food employers have opened the companies to expensive legal risks. Most recently, in March of 2014, McDonald's workers filed seven class action law suits against the company for wage theft violations. [29] But the exposure to risk from low wage employment is not limited to McDonald's. Over the past year they and other fast food companies have faced increasing legal scrutiny for their pay practices. In New York, Domino's Pizza and McDonald's have settled cases of labor market violations with the Attorney General's office for amounts that sum to more than $2 million.[30] Large, comprehensive private law suits have been filed against McDonald's and its franchisees in Michigan and California as well as against Pizza Hut locations in Colorado and other states.[31] Taco Bell was named as a defendant in class action law suits in every year from 2007 to 2010 for violations of California labor laws.[32] In 2009 Papa John's Pizza faced a collective action suit by delivery drivers in Missouri.[33] The suits allege that fast food companies have pushed wages below the legal threshold for workers by denying payment for hours worked or overtime, and taking workers off the clock illegally in order to hold down the costs of operation, in addition to other violations. The real expense of these disputes takes the form of millions of dollars in legal fees and settlement claims as well in the deterioration of the brand. The suits have implicated franchisees and the parent company as complicit in illegal practices that deny the basic standards of decent work. As a result, the growing CEO compensation and widening inequality happening at fast food companies is enmeshed in the story of the illegal underpayment of workers at the bottom of the pay scale.

McDonald's filing with the SEC in March of 2014 reflects the growing impact of extreme income inequality on the performance of the firm. The company directly identifies the actions of a discontented workforce as a risk factor to their future earnings, and goes on to specify the attention to inequality overall and the workplace conditions of fast food as a threat to profits.[34] They cite multiple exposures as a result of low wages at the bottom of their business model. (For more detail, see the textbox *McDonald's 2014 SEC Filing Identifies Income Inequality as a Key Risk*.)

McDonald's 2014 SEC Filing Identifies Income Inequality as a Key Risk

In a filing to the SEC in 2014, McDonald's cites exposure to risk from the following sources:

> "The impact of campaigns by labor organizations and activists, including through the use of social media and other mobile communications and applications, to promote adverse perceptions of the quick-service category of the IEO segment or our brand, management, suppliers or franchisees, or to promote or threaten boycotts, strikes or other actions involving the industry, McDonald's or our suppliers and franchisees;"

◆

> "The impact of events such as boycotts or protests, labor strikes and supply chain interruptions (including due to lack of supply or price increases) that can adversely affect us or the suppliers, franchisees and others that are also part of the McDonald's System and whose performance has a material impact on our results;"

◆

> "The impact on our margins of labor costs that we cannot offset through price increases, and the long-term trend toward higher wages and social expenses in both mature and developing markets, which may intensify with increasing public focus on matters of income inequality;"

◆

> "The increasing focus on workplace practices and conditions and costs and other effects of compliance with U.S. and overseas regulations affecting our workforce and labor practices, including those relating to wage and hour practices, healthcare, immigration, retirement and other employee benefits and unlawful workplace discrimination, and our exposure to reputational and other harm as a result of perceptions about our workplace practices or conditions or those of our franchisees."

CONCLUSION

nequality gained renewed attention in the wake of the unbalanced economic recovery and a wave of popular protest. In the US, the highest earners pocketed nearly all of the economic growth since the Great Recession, with the top 10 percent taking home their greatest share of income in recorded history.[35] Increasingly, research shows that economies with such wide divergence are made vulnerable by inequality through slow growth and volatility, as well as social instability and declines in the quality of health and education.[36] Among US companies the biggest fast food chains lead the trend. In the five years since the end of the Great Recession, fast food firms have exhibited spectacular growth in CEO compensation, while wages for their front-line workforce actually declined.

The CEO-to-worker compensation ratio provides valuable information for economists, policy makers, global financial institutions, media, and investors who are concerned about the effects of inequality. The disclosure requirements from the Dodd-Frank Act and the SEC proposal would improve shareholders' ability to evaluate the extent of risk to their investments.

Since current law already requires firms to report CEO compensation, the new legislation simply adds an equivalent reporting standard for the rest of the workforce. Moreover, companies would enjoy great flexibility in implementing the rule, with discretion over the choice of measures and the method of identifying the median employee.[37] Yet more than three years after its passage, the requirement still has not taken effect. Ironically, groups representing some of the most highly paid CEOs have submitted comments denouncing the expense of compliance.[38]

While executive compensation climbed since 2000, earnings for the average worker and those at the bottom of the income distribution were stagnant or decreased, widening the gap between CEOs and other workers. Employers' reluctance to reward their lowest paid workers in proportion to the rest of the economy is a key component of the increasing pay disparity in the US.

Shareholders interested in the continued success of the fast food industry should be particularly attuned to the growth of inequality, since according to the industry leader inequality is already threatening the bottom line. The SEC disclosure rule will improve reporting standards, but companies need to do more in order to arrest the damage from pay disparity and restore the focus on long-term interests of the firm. Reducing the proportion of CEO-to-worker compensation by addressing bad practices on both halves of the ratio is one step toward realigning the interests of stakeholders in the firm, including shareholders, executives, and the workforce overall. ■

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