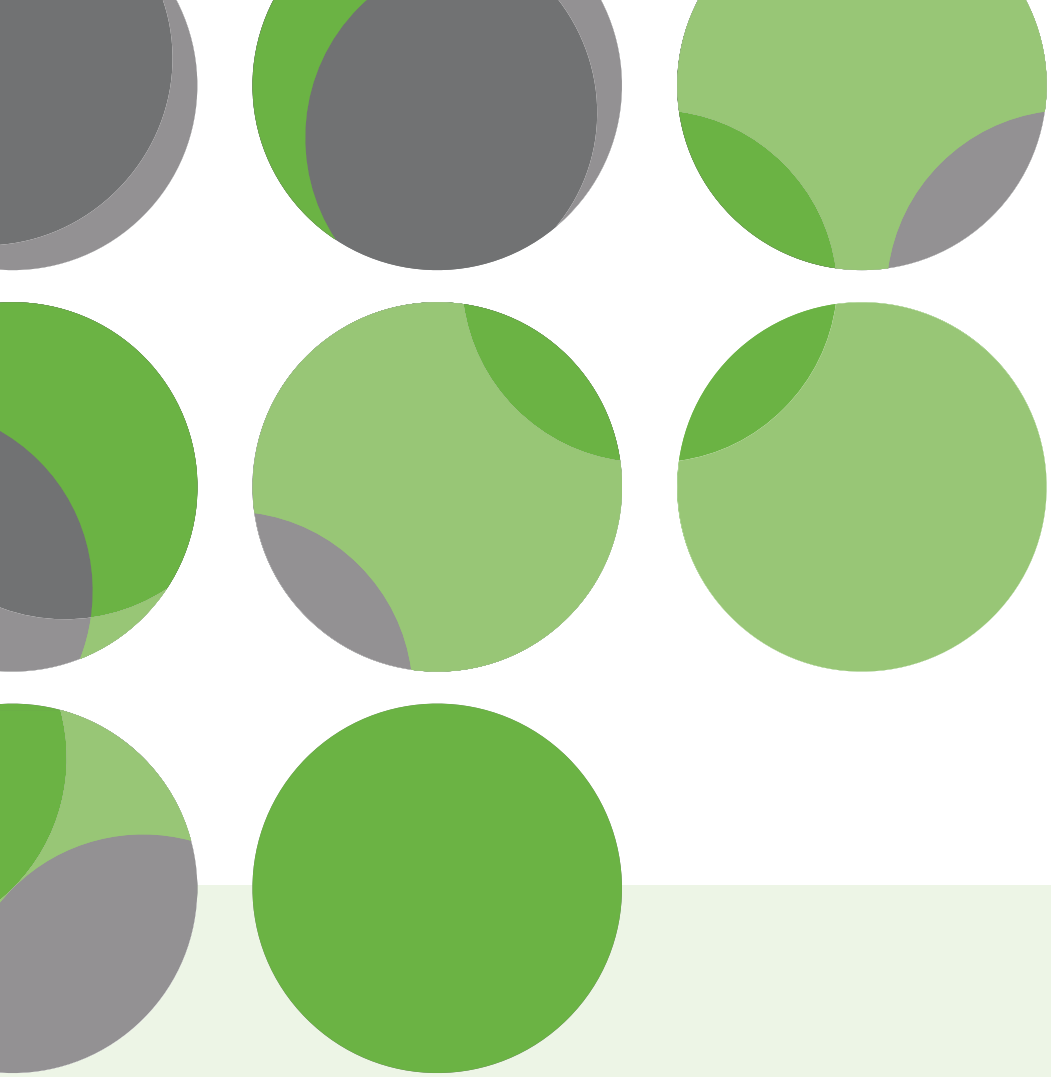

IMPROVING WORKPLACE CONDITIONS THROUGH

STRATEGIC ENFORCEMENT

A REPORT TO THE WAGE AND HOUR DIVISION

DAVID WEIL BOSTON UNIVERSITY
PRINCIPAL INVESTIGATOR

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MAY 2010

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The research contained in this report represents the collective effort of a Boston University research team over the past four years. Amanda Pyles and Rae Glass played a central role in analysis of enforcement data and institutional aspects of the Wage and Hour Division and in crafting portions of this report. Min Woong Ji and Anne Klieve worked on the creation of datasets and analysis of that data for the eating and drinking and hotel/motel sectors. Carlos Mallo played a similar role in analysis of the garment sector. Critical research assistance also has been provided by a talented group of Boston University undergraduates who have worked on the project in recent years: Tucker DeVoe, Claire Gerson, Sam Kornstein, Jeff Li, Ayumi Shimokawa, Huey Wu, and Jie Zheng. John Skurchak designed the graphics and layout for the final report. I am deeply grateful to all of these dedicated and hardworking individuals who collectively made major contributions to this report. I am solely responsible for any errors that remain.

INTRODUCTION AND REPORT OVERVIEW

The challenges facing the major agencies in the U.S. Department of Labor (DOL) that regulate conditions in the workplace are daunting. Public policies on health and safety, discrimination, and basic labor conditions cover millions of workers, and have to be implemented in hundreds of thousands of disparate workplaces in differing geographic settings. Conditions within those workplaces vary enormously—even within a single industry—and employers often face incentives to make those conditions as opaque as possible. Workers in many of the industries with the highest levels of noncompliance are often the most reluctant to trigger investigations through complaints due to their immigration status, lack of knowledge of rights, or fears about employment security. Even the laws, which set forth the worker protections DOL agencies are charged with enforcing, have limitations in the 21st-century business community. Compounding all of the above, agencies charged with labor inspections have limited budgets and stretched staffing levels, coupled with a very complicated regulatory environment.

These challenges, however, reach beyond the number of investigators available to the DOL or to the Wage and Hour Division (WHD) in particular. Profound changes in the workplace, including the splitting up of traditional employment relationships, the decline of labor unions, and the emergence of new forms of workplace risk make the task facing DOL agencies far more complicated. In addition, expectations and demands on all regulatory agencies to demonstrate progress toward achieving outcomes and the resulting impacts on how government agencies are overseen by Congress, accountability agencies, and the public have created intensified pressure and scrutiny.

These changes in the U.S. workplace require a revised approach to enforcement, one that is built on an understanding of how major sectors of the economy employing large numbers of vulnerable workers operate and then using those insights to guide enforcement strategy. Just as the forces driving workplace outcomes, including those related to compliance with workplace regulations, have changed, so must the strategies that agencies employ to improve conditions.

This report draws on a series of studies led by David Weil, Professor of Economics at Boston University School of Management, that have sought to examine how industry structures affect the way employers behave and, in particular, their likelihood to comply with the important provisions of the Fair Labor Standards Act (FLSA). These studies have examined key dimensions of the ways that many of the industries employing large numbers of vulnerable workers create incentives or disincentives for compliance. The research shows that insight into these relationships provides opportunities to increase compliance through different approaches to enforcement.

Key Findings

1. Changes in the structure of the economy and in the complexity of employment relationships, as well as the decline in unionization together render the traditional, workplace-focused approach to enforcement less and less effective. At the same time, the changing expectations of Congress, the OMB, key stakeholders, and the public have raised the performance demands on agencies like WHD. As a result, traditional approaches to enforcement are no longer sufficient, even given the significant increase in enforcement resources.

2. The employment relationship in many sectors with high concentrations of vulnerable workers has become complicated as major companies have shifted the direct employment of workers to other business entities that often

operate under extremely competitive conditions. This "fissuring" or splintering of employment increases the incentives for employers at lower levels of industry structures to violate workplace policies, including the FLSA. Fissuring means that enforcement policies must act on higher levels of industry structures in order to change behavior at lower levels, where violations are most likely to occur.

3. Deterring violations before they occur has long been recognized as part of overall enforcement policy, but has often not been incorporated as a central component of how investigations are targeted, conducted, and followed up on, or in the way that penalties are assessed and levied. As a result, deterrence incentives are often low, uneven, and inconsistent. There are many opportunities to significantly enhance deterrence incentives, particularly at the industry level.

4. The structure of industries—particularly the way that "fissuring" plays out in them—has important implications for strategic enforcement. Analysis of the structures of industries can give guidance on why some employers comply and others do not. These insights, in turn, can help shape sector-based enforcement strategies and policies to change employer behavior and improve compliance systemically. The impact of supply-chain relationships, branding, franchising, third-party management, and subcontracting all have important implications for patterns of compliance in an industry and for strategies that WHD can take to affect employer behavior.

5. The two main types of investigations undertaken by WHD—directed[1] and complaint—have often been treated as separate and distinct. Strategic enforcement and the demands placed on the agency by oversight institutions and the public require integration of these key tools of enforcement, particularly in the way they are undertaken in the context of specific industries and initiatives.

6. The external and internal changes in the environment in which WHD operates require new criteria for judging the success of enforcement initiatives. In particular, enforcement strategy should be guided and evaluated on the basis of the following four criteria: prioritization; deterrence; sustainability; and system-wide impacts.

Central Recommendations

The main recommendations of this report, discussed in detail in Section VI, pertain to industry priorities for WHD; four major enforcement strategies; and organizational requirements necessary to support strategic enforcement initiatives. The recommendations are summarized below.

SETTING INDUSTRY PRIORITIES

Labor standards violations occur in most sectors of the economy. However, problems facing particularly vulnerable workers are concentrated in a subset of sectors that require focused attention by the WHD. This report points to several clear principles regarding industry prioritization. WHD industry priorities at the national-, regional-, and district-levels should be guided by three criteria: (1) sectors with large concentrations of vulnerable workers; (2) sectors where the workforce is particularly unlikely to step forward; and (3) sectors where the WHD is likely to be able to change employer behaviors in a lasting and systemic manner. Based on these criteria, we identify a subset of industries that should be a focus of WHD attention over the next few years. These industries are listed (in no particular order) in Figure A.1.

ENFORCEMENT STRATEGIES

The environment in which the WHD and the DOL operate demands a more strategic approach to enforcement that both builds on successful policies used in the past and also breaks

FIGURE A.1

Priority Industries

(Listed in no particular order)

Priority Industries
Eating and drinking—Limited service (fast food)/ Full service
Hotel/motel
Residential construction
Janitorial services
Moving companies/logistics providers
Agricultural products—multiple sectors
Landscaping/horticultural services
Health care services
Home health care services
Grocery stores—retail trade
Retail trade—mass merchants; department stores; specialty stores

1. Directed investigations are those initiated by WHD as opposed to those instigated by a worker complaint.

new ground. We group recommended enforcement strategies into four major areas. The four major components of strategic enforcement are listed in Figure A.2.

First, WHD should pursue strategies that focus at the top of industry structures, on the companies that affect how markets operate and many of the incentives that ultimately affect compliance. This starts with having a clear "map" of how priority industries operate and how that results in employer behavior. It then requires putting in place coordinated investigation procedures built around related business entities rather than individual workplaces and using those regulatory tools (from persuasion and education to the use of penalties, hot goods provisions, and other legal tools) to craft comprehensive agreements.

Second, the WHD needs to enhance deterrence at the industry and geographic levels. We show that WHD investigations have had significant deterrent impacts in the eating and drinking and portions of the hotel/motel industries. Drawing on these lessons and those from other government agencies, we discuss how deterrence can be improved through changes in how investigations are carried out, penalties assessed and levied, and work of the WHD is coordinated with that of the Solicitor of Labor. We also discuss how information disclosure and transparency might be better harnessed to broaden the impact of investigation activity.

Third, the WHD must better integrate complaint and directed investigation activity. Since almost 75 percent of all WHD investigations are initiated by worker complaints, it is incumbent upon the agency to find ways to leverage those investigations in several ways. As noted above, it must use information on where complaints come from—and more importantly, where they do not come from—to set overall priorities. We also propose a special complaint handling procedure for targeted industries in order to help the WHD use incoming complaints as a vital source of information about compliance and as a key part of system-wide enforcement activities, as well as to enhance the deterrence effects of complaint investigations. More generally, we propose policies to expand outreach to worker advocate communities to broaden the impact of WHD's and other organizations' relationships with workers and communities given the continuing importance of the exercise of rights under the FLSA and other statutes. In a related vein, leveraging complaint investigations in a more strategic manner requires protecting workers who exercise those rights against retaliation.

Finally, we examine a variety of policies to enhance the sustainability of enforcement—that is, the impact of enforcement initiatives on employer behavior in an ongoing way. We review the WHD's experience in combining public enforcement with private monitoring in improving system-wide compliance in the garment industry and argue that model should be generalized to other sectors. We also review other available tools such as settlement agreements and related mechanisms to reinforce the incentives for proactive compliance and providing good jobs.

FIGURE A.2

Key Recommendations on Strategic Enforcement

Recommendations	
1	**Focusing at the top of industry structures** • Mapping business relationships and reaching out to the top • Coordinated investigation procedures • Clarifying the boundaries of employment responsibility • Expanding the application of hot goods beyond the apparel industry
2	**Enhancing deterrence effects at the industry and geographic level** • Industry-focused deterrence • Penalty policy as a central element of deterrence • Expanded litigation to prevent noncompliance • Enhancing deterrence through transparency
3	**Transforming complaint investigations from reactive to strategic resources** • Responding strategically to complaints • Special complaint handling procedure for targeted industries • Reaching out to the worker advocate community • Increase protections for employees who complain
4	**Enhancing the sustainability of initiatives through monitoring and related procedures** • Creating new monitoring arrangements • Expanded settlement agreements • Making compliance an integral part of employer monitoring activity

ORGANIZATIONAL REQUIREMENTS

Strategic enforcement requires that the WHD and the DOL undertake organizational changes to support these initiatives. As in the case of enforcement strategies, some of these proposals build on existing strengths or previous WHD initiatives. Others require rethinking the way that some activities are undertaken, the way that different levels of WHD interact, or the way WHD relates to other parts of the DOL. These organizational requirements are listed in Figure A.3.

Organizational requirements break into six major areas: (1) enhancing investigation capacities including by developing new training materials and modifying the WHD's Field Operations Handbook; (2) strengthening the interactions between the Solicitor and the WHD, in regard to litigation strategies generally and penalty policies in particular; (3) given an emphasis on sector-based strategies, improving the operation of MODOs in their crucial role in coordinating across District and Regional offices; (4) enhancing information systems, particularly WHISARD, to make them more useful as investigation and planning tools; (5) building joint efforts with other DOL agencies in key sector initiatives such as residential housing or on an issue like misclassification; and (6) undertaking systematic evaluations regarding program impact to learn from successful and unsuccessful initiatives in all of the above areas.

FIGURE A.3

Organizational Requirements for Strategic Enforcement

Organizational Requirements	
1	**Enhance investigation capabilities** • Investigation protocols • Training • Field Operations Handbook revisions
2	**Coordinate activities of the WHD and the Office of the Solicitor** • Penalty policies • Litigation activities • Clarification of joint employment and related matters
3	**Improve operation of MODOs** • Coordination of common employers, brands, and third-party management companies • Coordination of company- and industry-wide interventions
4	**Enhance the accuracy and utility of WHD information systems** • Increased ability to track linkages across companies and organizations • Expanded links to other information sources regarding employers and workplaces • Improved accessibility to the public beyond WHD
5	**Build stronger linkages to other key DOL agencies** • Strategic initiatives on particular problems (e.g., misclassification) • Coordinated initiatives in industries with multiple workplace problems (e.g., residential construction)
6	**Expand evaluation of strategic initiatives** • Investigation-based surveys • Alternative measures of underlying incidence and severity of workplace violations • Intermediate measures of compliance • Impacts of different tools and approaches through an experimental approach

Report Organization

The report is organized in the following manner. Section I provides an overview of enforcement trends over the last decade and frames the limitations of traditional approaches to enforcement. It concludes by describing four principles by which to measure strategies going forward to better ensure they meet larger DOL objectives. Section II presents a survey of the workplace landscape to see where the most vulnerable workers—those who might benefit the most from WHD intervention—are concentrated. Although noncompliance can be found in virtually every part of the economy, it is particularly prevalent in a subset of sectors, in part because of the way some industries are structured. These industries are particularly suited to sector-level strategic initiatives.

Sections III, IV, and V focus on prominent sector examples with implications for strategic enforcement more generally. Section III examines the apparel sector and the garment initiative undertaken by the WHD in the late 1990s. The garment industry represents a shrinking part of the manufacturing workforce, but the effort pioneered by WHD in that sector provides important lessons related to supply chain considerations that can be applied in many other sectors with vulnerable workers.

Section IV looks at the eating and drinking industry, in particular the fast food sector. Core features of that sector—brand identity and franchising—create both incentives and disincentives for compliance as well as potential methods for improving overall conditions. Section V examines the hotel and motel sector, where branding, franchising, and third-party management combine to create a particularly fissured employment situation, creating both challenges and opportunities for new enforcement approaches.

Section VI pulls together lessons from these sectors and recommends other sectors where similar dynamics may be at play. It then draws on the implications of the report for crafting enforcement strategy and describes the organizational requirements that are required to support those efforts.

I

THE ENFORCEMENT CHALLENGE

The challenges facing enforcement agencies within the DOL are longstanding and arise from factors both internal and external to workplace agencies. Historically, the WHD has measured its success—and indeed been evaluated by others—largely by the extent of back wages it recovers for workers. This emphasis on returning to workers the wages they rightfully earned continues to be important but, as we will argue in this section, such an emphasis is no longer sufficient for maximizing the protections WHD might provide vulnerable workers in this country.

In this section, we first talk about internal challenges facing WHD and other workplace agencies, and then a series of external challenges that have changed the landscape for regulators. We then discuss some of the limits of traditional approaches to enforcement before introducing four new criteria that we see as critical for strategic enforcement of the FLSA: prioritization, deterrence, sustainability, and system-wide impacts.

Internal Challenges

Economics is the study of achieving objectives in the face of limited resources, so to say that limited budgets for workplace agencies represent a major and longstanding problem is simply a statement about the basic challenge facing any agency. However, those resources have become more limited over the same period when the number of workplaces covered by laws has grown, creating extremely challenging circumstances. What is more, changes in regulatory oversight over the last decade—ranging from the Government Performance Review Act of 1996 (GPRA), to the expanding role played by the Office of Management and Budget (OMB) and the Office of Inspector General—have raised performance expectations and the level of scrutiny facing the WHD and other workplace agencies.

ENFORCEMENT BUDGETS AND INVESTIGATION RESOURCES

The fundamental challenge facing the WHD and most workplace regulatory agencies arises from limitations in resources available to them relative to the size and scope of U.S. workplaces covered by relevant statutes. This is true even though resources for the WHD have recently increased. Through reduction in the size and role of the federal and state workplace agencies, employers and industry sectors face a trivial likelihood of investigation in a given year. Reduced enforcement, in turn, diminishes the pressure for regulatory compliance in many sectors, thereby contributing to the growth of vulnerable workers in the economy. One can see a demonstration of this longstanding challenge by reviewing trends in enforcement.[2]

Budgets for enforcement for the WHD and the other major DOL regulatory agencies have been limited for more than a decade. Real spending for enforcement of the four major DOL regulatory agencies (WHD, Occupational Safety and Health Administration, Mine Safety and Health Administration, and Office of Federal Contract Compliance) went from $283 million (in 1982-84$s) in 1998 to $292 million in 2007, representing a

2. Unless otherwise noted, all figures reported in this section are based on analysis of data from the WHD's Wage and Hour Investigative and Reporting Database (WHISARD). To the extent possible, we use data from 1998 to 2008 in order to show trends over as long a period of time as possible. When there were questions about the reliability of WHISARD data in earlier years, we restricted our analysis to the time period 2003 to 2008. Included for analysis are all cases with FLSA findings (including findings of "no violations") and closed by the end of fiscal year 2009. We do not include investigations for which FLSA findings were not recorded, e.g., those cases with only child labor findings.

real increase of 3.1 percent. This tiny change in real expenditures for enforcement is indicative of long-term stagnation in budgets allocated to enforcement, going back to the late 1970s. In fact, as shown in Figure 1.1, average enforcement budgets for the four major workplace programs listed above have been either flat or declining in constant dollar terms from the Carter administration in the late 1970s through the end of the Bush II administration.[3]

While real resources going towards enforcement stagnated, the number of workplaces and workers in the U.S. economy grew, increasing from 6.94 million establishments in 1998 to 7.71 million in 2007, representing an 11 percent increase. Over the same period, the number of paid employees in the U.S. rose from 108.1 million to 120.6 million or 11.5 percent between 1998 and 2007 (U.S. Department of Commerce, County Business Patterns).

Long-term budget restrictions have constrained the resources available to agencies for enforcement. The upper panel of Figure 1.2 presents the number of total investigations (complaint and directed) conducted by the WHD over the last decade. Investigations declined substantially from the middle of the Clinton administration to the end of the Bush II administration, falling overall from 49,521 investigations in 1998 to just 25,852 in 2007. Measuring this reduction in investigations compared to the overall growth in establishments implies that the rate of investigations per establishment declined by about 53 percent over this period.[4] The lower panel of Figure 1.2 plots the number of WHD investigators on board at the end of each fiscal year and the average number of investigations per investigator over the same period. The number of investigators fell from 942 in 1998 to 731 by 2008, representing a 22 percent reduction. At the same time, the number of investigations handled per investigator also fell dramatically, from 53 to 32, or almost 40 percent over the period.

The falling number of investigations and investigators means even well-known employers (to say nothing of the 'garden variety' workplace) face little chance of seeing an investigator. For example, the likelihood that one of the top twenty fast food restaurants (e.g., McDonald's, Burger King, Subway) receives an investigation is about 0.008 in a given year (Ji and Weil 2009). But the more pernicious impact is that employers operate under an expectation where government investigators or other regulatory agents like unions are simply not seen as a matter of first order concern.[5]

3. Numbers from *Budget of the U.S. Government,* Various Years, for reported spending for enforcement by the Occupational Safety and Health Administration, the Mine Safety and Health Administration, the Wage and Hour Division of the Employment Standards Administration (ESA), and the Equal Employment Opportunity enforcement effort of the ESA. All numbers are in constant 1982–84 dollars.

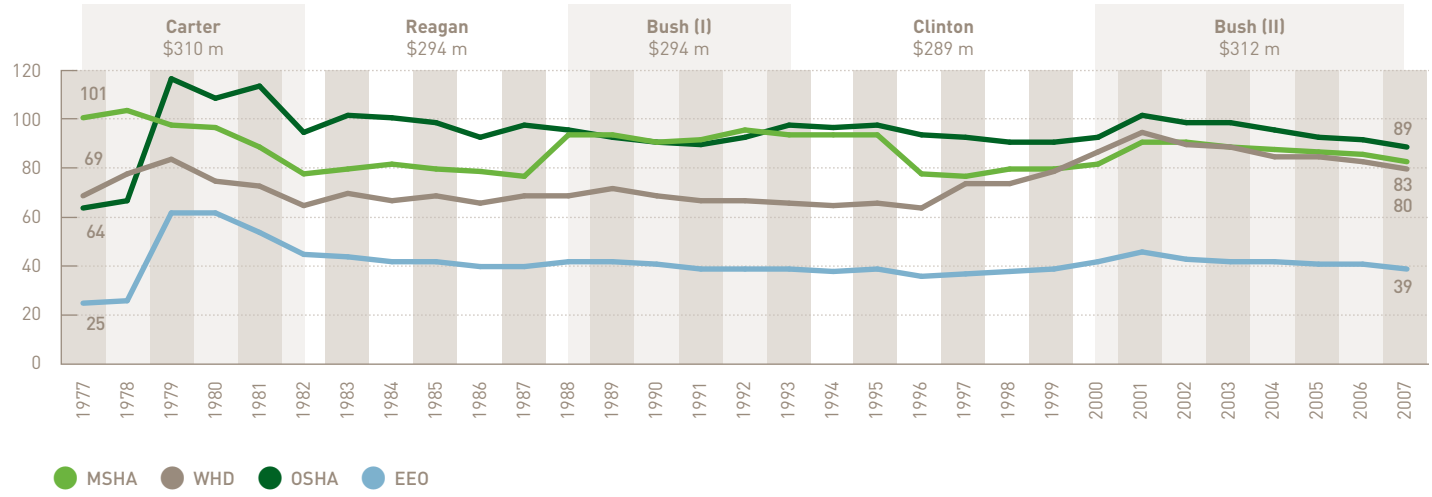
4. Not all establishments are covered by the FLSA so this comparison is approximate. However, since it is likely that the rate of increase in covered establishments grew at about the same rate as overall establishment growth, the estimated change in the rate seems a reasonable estimate of the decline.

5. Other industrial nations face the same enforcement challenge due to the declining presence of government regulators and growing number of workplaces. For example in the UK, "Each year since 1999-2000, HM Revenue and Customs [the government agency in charge of minimum wage enforcement] has made around 5000 visits to an employer … There are around 1.6m employers in the UK. Therefore a typical employer can expect a visit from HMRC once a millennium." (Metcalf 2008, p.499).

FIGURE 1.1

DOL Enforcement Spending by Program and Presidential Administration, 1977–2007

(Constant millions of dollars)

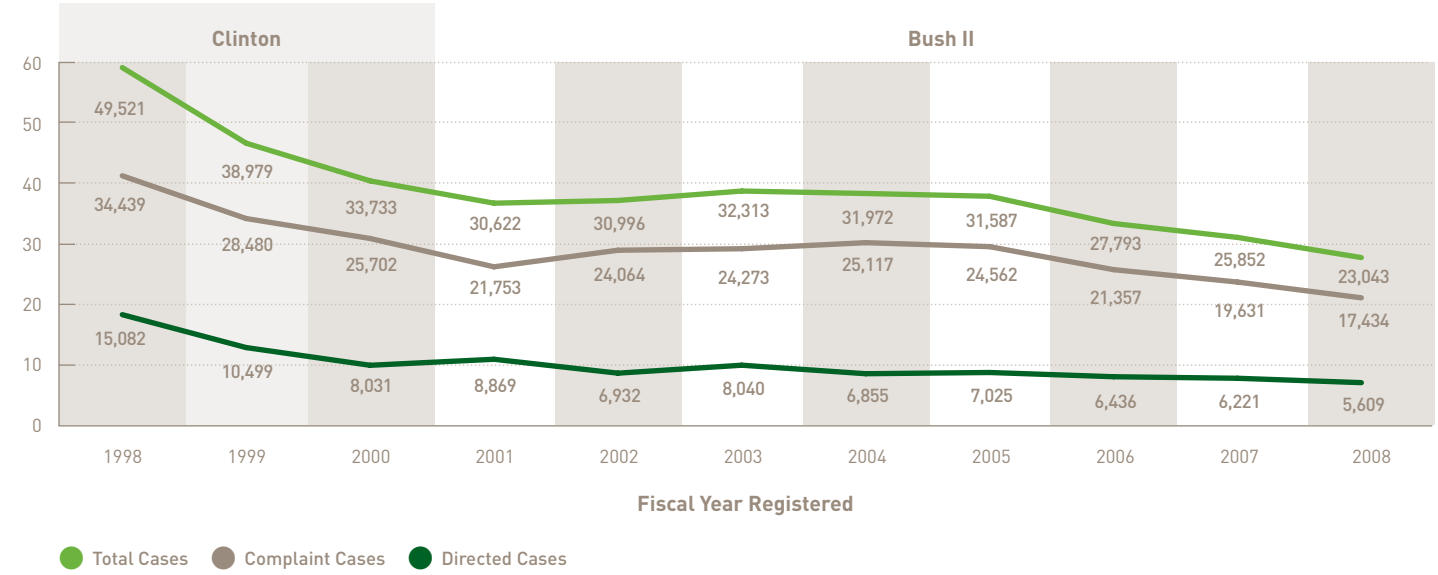


Source: *Budget of the U.S. Government,* Various Years (Constant 1982–84 dollars).

FIGURE 1.2

WHD Cases, 1998–2008

Number of Cases (Thousands)

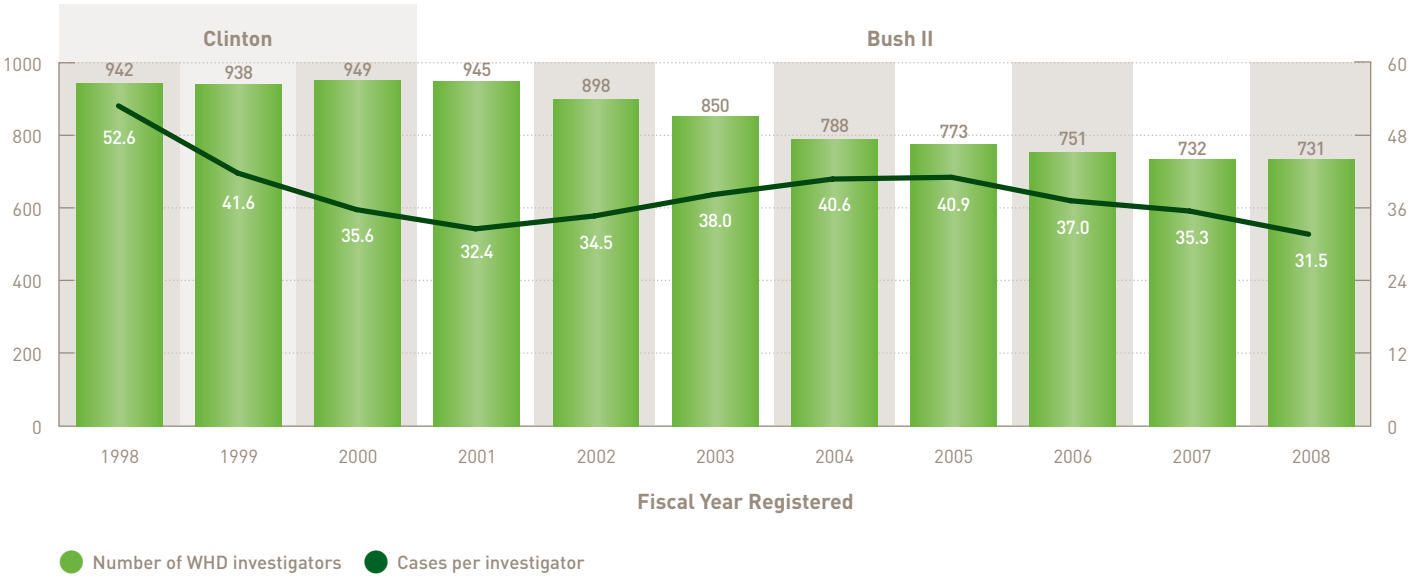


Source: WHISARD data. Includes cases registered fiscal years 1998 to 2008 and closed by end of FY2009. This may lead to undercounting of investigations in FY2008.

Number of WHD Investigators and Cases per Investigator, 1998–2008

Number of investigators

Cases per investigator

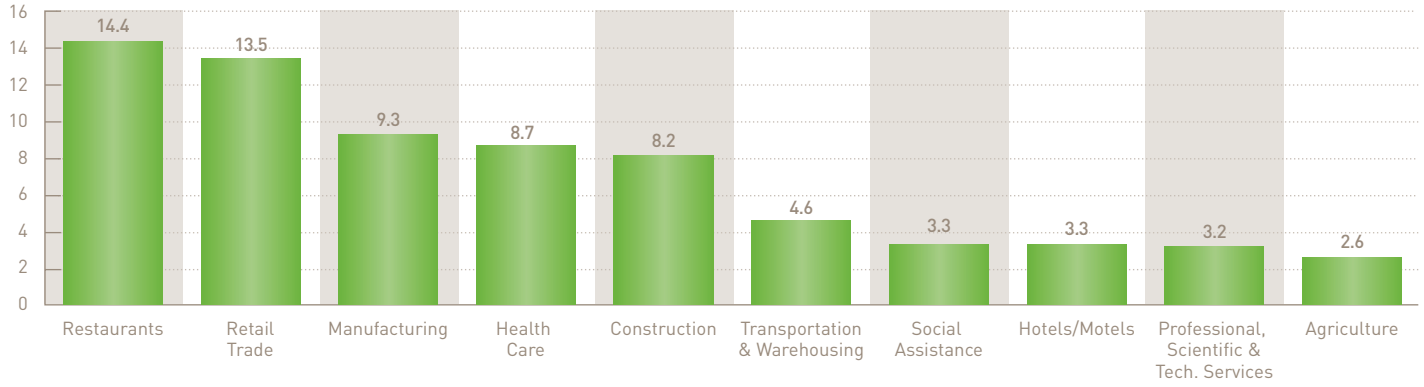


Source: WHD (staff numbers at end of each FY); WHISARD. Includes cases registered fiscal years 1998 to 2008 and closed by end of FY2009.

FIGURE 1.3

WHD Cases by Major Industries, All Cases 1998–2008

Share of all cases, 1998–2008 (Percent)



Source: WHISARD data. Includes cases registered fiscal years 1998 to 2008 and closed by end of FY2009.

Much of investigation activity during the period 1998-2008 was concentrated in industries with significant numbers of low-wage workers. Figure 1.3 portrays 10 major industries receiving investigations over the last decade. The five top industries listed on the figure—eating and drinking, retail trade, manufacturing, health care, and construction—constituted 54 percent of all WHD investigations. The concentration of investigations in these sectors is desirable given that, as we discuss in Section II, a significant number of vulnerable workers are employed in them. However, those sectors made up an estimated 58 percent of employment for all low-wage workers, implying that even greater emphasis on them (or more strategic approaches to these sectors) might be desirable.[6]

Compounding these resource limitations is the fact that a significant percentage of WHD investigations arise from worker complaints (Figure 1.4). The WHD has seen an increase in the number of enforcement actions resulting from complaints, from 70 percent in 1998 to over 75 percent in 2008 (but down from a high of 78.6 percent in 2004). While responding to complaints is, of course, critically important to the complainant and thus a priority for the WHD, complaints do not always lead WHD to the right place—in terms of finding serious violations and the most vulnerable workers or in terms of maximizing chances that the expenditure of WHD resources will lead to increasing, sustained compliance. Section VI discusses a variety of reasons why underlying problems prevent many workers from using their right to complain under the FLSA.

Although most complaints relate to real problems, there is nothing to say that they represent problems of the highest order if compared to those workplace problems that, for one reason or another, are not reported via complaint processes. In fact, prior studies by Weil and Pyles indicate no correlation between the prevalence of overtime violations of the FLSA and industry-level complaint rates (Weil and Pyles, 2005, 2006). Additionally, complaints are often driven by specific problems facing a particular worker. They may or may not be related to more systemic issues and even if they are, investigations arising from a complaint may not be perceived as part of a larger systemic problem. This compounds their reactive nature.

THE RISE OF PERFORMANCE-BASED REGULATION

Public attitudes and expectations towards regulatory agencies have shifted dramatically over time. Regulatory discussions have adopted the language of the private sector and regulatory agencies are increasingly judged—rightly or wrongly—by measures akin to those applied to businesses. The public, through their elected representatives, demand that agencies demonstrate that they have achieved performance outcomes given the resources they have been granted. This has played out institutionally in many ways. For example, the U.S. Office of Management and Budget, in its role in reviewing agency proposals as it assembles the annual federal budget, plays an increasingly prominent role as arbiter of performance through its use of benefit/cost analysis of regulatory initiatives.

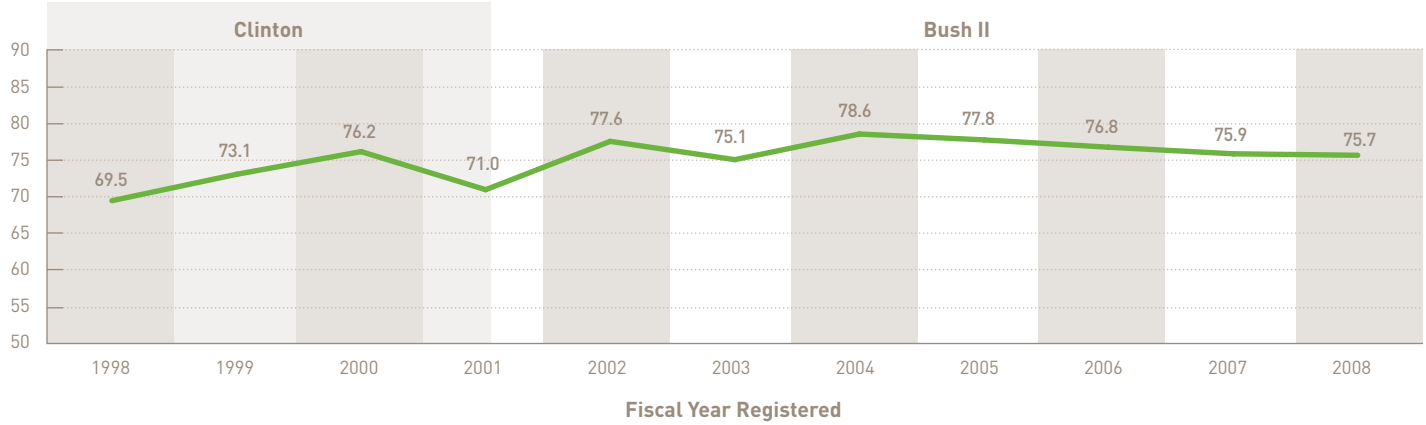
Since the Clinton administration, executive agencies have engaged in formal annual planning cycles, mirroring strategic planning exercises in the private sector. Most departments of

6. Distribution of low-wage workers based on estimates by Osterman (2008); employment data for wage and salary workers based on U.S. Department of Labor, Current Employment Statistics. See Table 2.1 for more detail.

FIGURE 1.4

Complaints as a Percent of All WHD Cases, 1998–2008

Share of all cases (Percent)



Source: WHISARD data. Includes cases registered fiscal years 1998 to 2008 and closed by end of FY2009.

the government now require their agencies to set out specific performance goals for upcoming fiscal periods, and those goals are increasingly being tied to budgeting processes.

As a result, performance-based criteria have become an intrinsic part of the appropriations and review process. Workplace agencies are increasingly being asked to demonstrate their contributions (in measurable terms) to larger economic development and societal goals. These requirements, often introduced as part of larger public service reforms, are frequently accompanied by the threat of downsizing programs that are unable to demonstrate these connections (Von Richthofen 2004). For example, the U.S. Congress explicitly built performance into its appropriations process via the Government Performance and Results Act (GPRA) of 1993. GPRA's legislative purpose is "… to provide for the establishment of strategic planning and performance measurement in the Federal Government, and for other purposes." With its ultimate objective stated to be "… to change agency and managerial behavior – not to create another bureaucratic system …" the Act requires federal agencies to submit a five-year strategic plan in 1997 and every three years thereafter, as well as annual performance plans.

Although the impacts of new methods of oversight on agency management and performance are disputed, they have become an institutionalized part of the appropriations and budgeting process.[7] As a result, agencies must justify their budgets, actions, and annual performance not only by traditional input measures like the number of investigations conducted or back wages collected, but on metrics regarding impact on workers or the larger incidence of underlying problems. Agency managers are also evaluated each year based partly on their progress related to GPRA goals. This creates new challenges—and a higher bar—for showing impact.

Changes in the Enforcement Landscape

Four major changes in the landscape surrounding WHD and DOL regulatory agencies have further compounded the difficulties of improving conditions at U.S. workplaces. These changes are: the breaking up (which we call "fissuring") of the basic employment relationship in many sectors of the economy; the decline of unionization; changes in the economy that have made the set of regulations on the books increasingly out of synch with realities on the ground; and changes in technology with significant consequences to the organization of work.

FISSURING OF THE EMPLOYMENT RELATIONSHIP

The relationship between worker and employer has become more and more complex as employers have contracted out, outsourced, subcontracted, and devolved many functions that once were done in house. Like rocks weakened and split apart by the passage of time, employment relationships have become deeply "fissured" in many sectors that employ large numbers of vulnerable workers. Multiple motivations underlie this change. The use of subcontracting, long used in construction, has become widespread in sectors ranging from building services to the hotel and motel industry. In some cases, subcontracting is motivated by a business decision to focus on "core competencies." In other cases, it arises from a

7. See, for example, Behn 2003.

desire to shift labor costs and liabilities to smaller business entities or to third-party labor intermediaries, such as temporary employment agencies or labor brokers. Finally, studies have documented increasing misclassification of workers as independent contractors and related practices as a means to subvert compliance with labor policies, including required payment of payroll taxes, workers compensation, and other employment-related taxes (e.g., National Employment Law Project 2004; Ruckelshaus 2008; Zatz 2008; Government Accountability Office 2009).

Regardless of motivation, fissuring in employment relations dramatically complicates the regulation of workplace conditions. Major workplace policies assume clear relationships between employees and employers (or at least managers representing employers). Those setting workplace policies, supervising production, setting schedules, and evaluating workers are assumed to directly represent and report to the owners (private) or responsible parties (public/non-profit) of record. Such clear lines of accountability have become murky and establishing the employer of record in order to assess responsibility has become more complicated. This creates significant problems for a workplace agency where foundational statutes like the FLSA assume that most employer-employee relationships are between easily identified parties. Consequently, the task of bringing regulatory pressure on the "employer" has become elusive. This change is discussed in far greater detail in Section II.

DECLINING UNION REPRESENTATION

Labor unions play an active role in workplace regulation. Typically, unions play this role by advocating for new or revised workplace regulations through the political/legislative process. Generally, they also play a decisive role in assisting workers to exercise rights granted them by government, such as by triggering workplace inspections through complaints, facilitating interactions with workers, and participating in inspection-related administrative processes.[8] Many studies demonstrate that labor unions play a critical role in helping to implement a variety of workplace policies (see Weil 1991, 1992, 2005).[9]

Since the 1980s, declines in union density have been well-documented, in both developed and developing nations.[10] Declining union membership decreases the political leverage of labor in many countries, reducing the legislative support for workplace-related policies. It also reduces union presence and undermines union strength at the workplace level, thereby decreasing trade union ability to play crucial roles in assisting workers to exercise statutory rights. As a result, the decline of labor/trade union movements reduces the capacity of regulators to oversee the workforce—an implication of union decline that is often overlooked in policy debates.

CURRENT REGULATORY FRAMEWORK OUT OF SYNCH WITH INDUSTRY COMPOSITION

Workplace regulations reflect the times in which they were developed. Many regulatory systems, including the FLSA, were designed in an age where the typical employer was a business entity like General Motors, characterized by large workplace establishments, stable workforces, expectations of career employment, fixed facilities, and clear structures of employment responsibility and liability. But for much of today's workforce, General Motors has little in common with the typical employer. First, employment has shifted away from manufacturing to service, health care, and other non-manufacturing sectors—many of which employ large numbers of low-wage, less-skilled workers. These sectors are driven by economic and competitive factors very different from those that drive their manufacturing counterparts.

Second, employment often takes place in smaller, more decentralized units. This partly reflects the fissuring of employment relationships and rise of the informal sector described above. But it also reflects differences in how production and work are organized in non-manufacturing sectors. Child care and home health care are often undertaken in community-based facilities or private homes. More than one-half of calories in the U.S. are consumed outside of the home, fueling the growth of the eating and drinking sector, where employment typically numbers around 40 people per establishment. Even among large employers, the nature of work is far different from the factory model, best exemplified by the fact that the single largest private-sector employer in the U.S. is now Wal-Mart.[11]

8. Unions play this role by providing information and assistance to covered workers regarding workplace rights under laws; through their role in administering collective bargaining agreements; and by being designated as employee representatives in administrative procedures. Unions play this role most explicitly under the Mine Safety and Health Act, which requires a designated miner representative to participate in investigations. Local union officers or health and safety committee members typically play this role in unionized mines.

9. The relationship between the labor movement and labor agencies varies markedly across countries. In some cases, unions act as important complements to the government (e.g., in Scandinavian countries with strong labor ministries and sophisticated labor movements). In other cases, unions virtually substitute for a weak labor agency (Bjorn and Graham 2005). A far more expansive role for unions and workers advocates in enforcement is discussed in Fine and Gordon (2010).

10. For example, in the Anglo-American countries between 1995 and 2004, private sector union density declined from 10.4 to 7.9 percent in the U.S.; from 22.2 to 18.0 percent in Canada; from 21.6 to 17.2 percent in Great Britain; from 45.0 to 28.2 percent (2003) in Ireland; from 25.1 to 16.8 percent in Australia; and from 19.8 (1996) to 12.0 percent in New Zealand. See Boxall, Haynes, and Freeman (2007), pp. 208-209.

11. Work relations within Wal-Mart are clearly characterized by a very different blend of practices, which challenge the traditional model of regulation. On one hand, like General Motors (GM), Wal-Mart operates on a huge scale, employing hundreds of thousands of workers in large, fixed facilities. Unlike GM, Wal-Mart's nonunion workforce receive low compensation and minimal benefits and accept far greater uncertainty regarding the duration of their employment. Like GM, Wal-

CHANGING TECHNOLOGY AND WORK DESIGN

Technological changes have always shaped the work environment, and every age seems to view new technology as creating greater disruption and dislocation than experienced in any previous era. However, the present wave of information-based technology change, and its associated impact on work and organizational design, is distinctive in how it makes duties and responsibilities of workers in many industries more fluid within the workplace (i.e., who is responsible for what activity) and between the once clear work/home boundary.

Changes in technology and work organization obviously have many implications for the regulation of workplace health and safety for an agency like OSHA. But they also raise difficult questions for WHD in (1) determining and tracking hours of work, when an increasing part of work in many jobs is done from home via computers, after the close of normal business; (2) determining and tracking hours worked for multiple employers that sometimes operate independently and other times operate under related business entities (such as third-party management companies); and (3) determining exemptions under the FLSA, particularly as they relate to supervisory and management activities of workers.

Limits of Traditional Approaches to Enforcement

Traditional enforcement approaches are based on investigations having two types of effects. First, an investigation changes the behavior (compliance) of the individual employer being investigated directly through the finding and correction of past violations. Back-wage findings are designed to restore wages owed to workers retrospectively. Civil monetary penalties for repeat or willful violators, and injunctive actions or settlement agreements are intended to ensure that employers comply in the future. Second, an investigation has deterrence effects on other employers who are making compliance decisions. Raising the probability of investigations—which other employers may become aware of either through the communication efforts of the DOL or through their own communications with other employers in the same industry and/or geographic region[12]—increases the incentives for an employer to comply even absent an investigation. The potential of being assessed civil monetary penalties provides further incentives to comply if such penalties impose significant costs on employers. An investigation may also have deterrence effects when, after its completion, the DOL issues a press release that includes the violations found and penalties assessed—a signal to all employers that they could also receive negative publicity for any violations found.

RECOVERING BACK WAGES

The primary recourse under the FLSA is recovery of back wages owed to workers for underpayments of minimum wage, overtime, or other statutory obligations. For many years, the WHD has been evaluated by external constituents—and indeed has measured its own success—primarily through amounts of back wages it recovers (in addition to overall numbers of cases concluded). The recovery of back wages is extremely important for workers the WHD is trying to protect. But given what we now know about preventing underpayment of wages in the first place, we argue that a focus on back wage recovery, while necessary, is no longer sufficient for a goal of sustainable improvement in FLSA compliance.

Analysis that has been done for this study focuses exclusively on compliance with the minimum wage and overtime provisions of the FLSA. We do not analyze child labor or MSPA findings, for example; we have studied industry structures as they relate to compliance with minimum wage and overtime and isolated only those WHISARD cases that have reported FLSA findings (including FLSA findings of "no violations.")

For the years 2003 to 2008, average back wages per investigation were $15,823.[13] However, this average includes only those investigations in which monetary violations were found. If, on the other hand, we include all investigations concluded in this time period, average back wages found due were $8,838 per investigation. The large difference is explained by the relatively high percentage of investigations where no monetary or record-keeping (RK) violations of the FLSA were cited. We do not illustrate how average back wages per investigation has changed over time, as this measure can be easily skewed by a particularly large case in a given year. Rather, we show in Figure 1.5 the percentage of no violation cases: Between 2003 and 2008, about one-quarter (24.6 percent) of all investigations found no violations (i.e., no monetary or RK violations).[14] This

Mart uses outside contractors for some functions, but unlike GM, those functions might be to provide services that are core to business operations. Like GM, the company relies on an enormous network of suppliers for its core business, all of which are dependent on the corporation for a significant percentage of their business. Unlike GM, however, those relations are at once arms-length (i.e., they are suppliers of products to Wal-Mart and autonomous corporate entities, as opposed to the vertically-integrated or closely-held firms within GM's historic supplier structure) and yet operate under elaborate and stringently-enforced guidelines from the retailer that dictate everything, including logistics arrangements, product identification methods, packaging and marketing decisions, and methods of floor display.

12. These could include communications with formal employer associations such as NFIB or the National Restaurant Association.

13. Cases registered fiscal years 2003 to 2008 and concluded by end of fiscal year 2009. Excludes conciliations.

14. Our estimation of "no violation" cases is a count of cases, excluding conciliations, with no back wage (minimum wage or overtime) and no record-keeping violations. Although it includes only those cases with FLSA as the registration act, it may include cases that had violations of the FLSA other than minimum wage

calculation is very close to the way the WHD characterizes and counts no violation cases.[15] The average of 24.6 percent reflects a decrease in the percentage of no violations cases over time—from 28.9 percent in 2003, to 20.5 percent in 2008, which is a positive trend.

The percentage of no violations cases differs dramatically across investigation types: While an average of 20.7 percent of complaint cases find no monetary or RK violations, almost one-third (30.7 percent) of directed investigations find no monetary or RK violations of the FLSA. One important factor that helps explain these differences is the different ways that the two types of investigations are triggered. Investigations that result from worker complaints are much more likely to find violations than directed investigations because of two "pre-screening" processes. First, a worker has stepped forward, often in the face of reasonable fears of repercussions for taking such actions, because of a perception that his or her rights have been violated. Second, the WHD has decided, through its intake process, that the claim is of significant enough nature to warrant a visit by an investigator rather than resolution by conciliation, typically a phone call.[16]

Although directed investigations often target sectors or areas where there is a belief significant violations are present, the targeting of individual workplaces within that sector or area typically benefits from less information—certainly less information than WHD has for a typical complaint investigation, before which investigators have discussed certain details of the workplace and alleged violation(s) with complainants. As a result, investigators face a higher chance that any given directed investigation will not yield back wage findings. However, it is also true that for those investigations where violations are found, average back wages per directed investigation are far higher than in comparable complaint-based investigations.[17]

A narrow reading of Figure 1.5 would be that directed investigations are less desirable because of the lower chance of finding back wages, implying that the overall predominance of complaint investigations serves WHD's larger aims. As

or overtime, e.g., those related exclusively to child labor. The modest difference between our estimate of no violation cases and WHD's estimate is likely attributable to the fact that we have not isolated and excluded those cases with CL—but no back wage or RK—violations.

15. There are other ways of characterizing "no violation" cases, however. Another way of thinking about no violation cases is to look at those cases that were found to have zero back wages due workers (i.e., they might have had only record-keeping violations). If we isolate those investigations registered under the FLSA with no back wage violations, we find that 31.4 percent of investigations find zero back wages due workers, instead of 24.6 percent cited above. If we break down these investigations between complaint and directed, we find that 25.8 percent of complaint cases and 40.3 percent of directed cases found no back wages due.

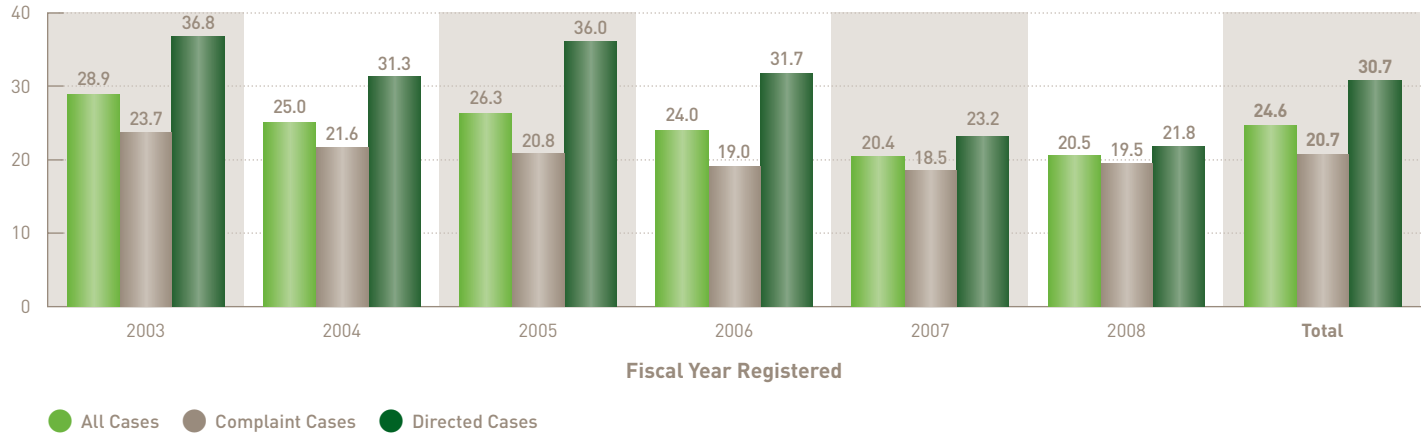
16. Between 1998 and 2008, about 55 percent of complaint investigations were handled through conciliations. These cases were often last paycheck disputes involving individual workers.

17. For example, among those cases with back wage violations, the average back wage finding for a complaint investigation in the period 1998-2008 was $5,615, versus $18,025 for a directed investigation. Even after excluding conciliations, directed investigations found, on average, $4,608 more in back wages than complaint investigations.

FIGURE 1.5

Percentage of No-Violation Cases, 2003–2008

Share of all cases (Percent)



Source: WHISARD data. Includes cases registered fiscal years 2003 to 2008 and closed by end of FY2009.
Includes cases with FLSA as registration act and with no back wage or RK violations. Excludes conciliations.

we argue below, that interpretation fails to recognize important opportunities offered by directed initiatives and indeed some advantages they have over complaint investigations for improving long-term compliance.

Making sure that workers who have been underpaid—or not paid at all—get paid is of course fundamental, so increasing back wage recovery over time is a laudable objective. But recovery of back wages per se should not be defined as the principle objective of WHD. If the factors that lead employers to decide not to comply with laws do not change, then investigators are forever cleaning up after a system that remains broken. An apt analogy would be to occupational health and safety. Although workers compensation policies provide benefits to workers who have been hurt at the workplace and whose earnings have been impacted, the ultimate objective of health and safety policy (including OSHA) is to reduce (i.e., prevent) injuries and fatalities in the workplace, not simply to ensure that those injured are compensated (as important as that objective is). Enforcement that only cleans up past noncompliance but does not alter behavior puts investigators on a hamster wheel: running very fast and working very hard, but not advancing the larger aim of protecting and enhancing the welfare of the Nation's workforce. Traditional enforcement focused on a back wage recovery objective must therefore be challenged.

Effective enforcement policies must change employer behavior so that practices that result in underpayment of wages do not occur in the first place. This requires addressing the underlying factors that lead to lost back wages and other violations of labor standards.

Enforcement Actions, Tools and Deterrence

The second foundation of traditional enforcement is deterrence. In addition to requiring the payment of back wages to employees, the FLSA provides additional enforcement tools such as monetary penalties, temporary restraining orders to prevent the shipment of "hot goods," injunctions to compel future compliance, and a prohibition against intimidating employees who complain. These tools, when uniformly and consistently used, can work to deter violations from occurring in the first place and to reduce violations by prior violators.

Due to data limitations in certain parts of WHISARD, the extent to which some of these tools have been utilized is difficult to evaluate. Improved reporting of this information by WHD and SOL in WHISARD is important to future evaluation of their impacts on compliance. However, it is important to discuss these significant enforcement tools, how they have the potential for protecting vulnerable workers and influencing employers' behavior to comply, and how they can relate to deterrence and the broader goal of improving workplace conditions.

The FLSA gives the DOL the authority to initiate civil litigation to recover back wages and to supervise the payment of back wages.[18] Therefore, an employer's refusal to pay back wages even after found by the WHD does not mean that vulnerable workers will not be ultimately be paid. The knowledge that the DOL might seek court action may influence employers to avoid costly litigation and pay the back wages owed.

The DOL also has the authority to seek injunctions in U.S. District Court to prevent future FLSA violations. Court orders compelling future compliance reduce the necessity to expend WHD's limited resources for reinvestigations and are particularly useful for multi-branch and large enterprises, which are prevalent in the industries discussed in this paper.

In addition to civil litigation, the FLSA provides for criminal prosecution for willful violations. A conviction can result in a fine of not more than $10,000, imprisonment for up to six months, or both.[19] Although the assessment of monetary penalties discussed below is less burdensome, the knowledge within the employer community of a criminal prosecution that demonstrates DOL's commitment to improving compliance can be a useful deterrent, as was proven in the New York City garment manufacturing community.

The FLSA also has a "hot goods" provision, which prohibits the shipment in interstate commerce of goods produced in violation of the FLSA. This provision is particularly useful in bringing pressure to bear not only on the violating employer but also on upstream customers of such goods to remedy violations and ensure prompt payment to underpaid workers, as we will discuss in Section III.

With respect to monetary penalties, the FLSA provides that employers can be liable for liquidated damages (LDs) in an amount equal to the back wages. Unlike civil monetary penalties, LDs are paid directly to the affected employees. These LDs are an especially important benefit to low-wage and vulnerable workers. Further, these LDs could significantly increase the employers' cost of violating the law, which for some may have the effect of swinging the pendulum towards complying with the law.[20]

Another enforcement tool that can affect deterrence is the FLSA provision that employers who repeatedly or willfully violate the minimum wage and overtime requirements of the Act may be subjected to civil monetary penalties (CMPs)

18. The law also provides for private right of action.

19. Imprisonment is only upon a second conviction.

20. Once again, limitations in WHISARD make it difficult to reliably estimate the use of LDs, where applicable, in the past. For example, for cases concluded fiscal years 2003 to 2008, WHISARD data imply that less than one half of one percent of cases had liquidated damages computed by investigators and that zero cases had liquidated damages assessed.

FIGURE 1.6a

Percentage of Re-investigations with Repeat FLSA Violations that Were Assessed CMPs

Share of all cases (Percent)

Source: WHISARD data. Cases, excluding concilliations, that: 1) were marked in WHISARD as re-investigations with repeat FLSA violations; 2) had minimum wage and/or overtime back wages found due; and 3) were sent CMP assessment letters.

of up to $1,100 for each violation. CMPs are supposed to change employer behavior in the way discussed above: By weighing the potential assessment of penalties, an employer contemplating the "benefits and costs" of complying should become more inclined to comply, even absent a visit from a WHD investigator. This is true only to the extent that the penalty is high enough to produce a deterrence effect.

The FLSA provides for CMPs only where an employer is found to have repeatedly or willfully violated the law. As a practical matter, this typically means that a prior investigation had to have occurred before a CMP can be imposed. Since the majority of employers investigated by WHD are first-time offenders, the number of investigations that assess CMPs as a percentage of all investigations is very low: Less than 3 percent of all investigations 1998-2008 assessed CMPs, but this is in part a reflection of the fact that a large percent of investigations are the first for employers.

Although CMPs are an important enforcement tool available to WHD, they are often not assessed even in the case of reinvestigations that find repeat violations: As Figure 1.6a shows, among reinvestigations where repeat FLSA violations were detected, CMPs were assessed in only about 43 percent of cases. Although that percentage increased in 2007, the majority of repeat investigations do not result in penalties even in the presence of repeat violations.

Analysis of WHISARD data for 1998-2008 also indicates that even when CMPs are assessed by the District Director, the amounts that employers agree to pay are often substantially reduced from the amount initially set. For all cases concluded by the WHD that had CMPs assessed, the CMPs ultimately determined to be collected by the WHD were only 61 percent of the total amount assessed.[21] The reductions are more striking if we look just at those cases that had CMP assessments reduced. Figure 1.6b shows that for the years 1998 to 2008, those cases that had CMPs reduced were originally assessed an average of $13,899 in CMPs and had those CMP amounts ultimately reduced by an average of $9,218, i.e., reduced by 66.3 percent. The percentage of cases for which CMPs were reduced has declined in recent years, as has the average amount of reduction, which are positive trends. Nevertheless, data from just 2007 and 2008 alone still show that CMP amounts are reduced more than 25 percent of the time and in those cases, the amounts are reduced by close to 50 percent, on average. The limited use of CMPs coupled with their reduction undermines the potential ability of the enforcement system to change employer behavior.

The enforcement trends reviewed above suggest that deterrence effects have declined over the last decade: the probability of an investigation has diminished (whether triggered by a worker complaint or part of a directed initiative) and the monetary penalties beyond back wage payments are relatively small. Given the growth in the number of workplaces and workers over the same period, these trends also suggest that simply trying to "catch up," even with additional resources available, may be difficult, particularly given that employer behavior in many industries may reflect past enforcement conditions for some time. Additionally, the traditional

21. WHD policy includes criteria for the District Director to follow in determining possible reductions in CMPs. The fact that the amount of reduction varies quite a bit from year to year, even since 2003, suggests that a review of policies for reducing CMP assessments might be warranted.

FIGURE 1.6b

		All Cases that Were Assessed CMPs				
Fiscal year registered	Total FLSA cases, excluding concilliations	Number of cases assessed CMPs	Percentage of cases assessed CMPs	Average amount of CMPs assessed per case (Dollars)	Average reduction in CMPs (Dollars)	Average reduction in CMPs (Percentage of original CMPs assessed)
1998	29,550	451	1.53	9,173	4,291	-46.8
1999	21,000	371	1.77	10,312	4,782	-46.4
2000	17,698	530	2.99	8,046	4,127	-51.3
2001	18,260	478	2.62	9,440	3,682	-39.0
2002	17,752	456	2.57	5,078	1,873	-36.9
2003	20,043	479	2.39	6,341	2,749	-43.4
2004	19,535	441	2.26	6,965	2,836	-40.7
2005	19,190	401	2.09	9,237	3,528	-38.2
2006	16,517	397	2.40	8,204	1,531	-18.7
2007	15,508	434	2.80	5,125	1,360	-26.5
2008	13,686	317	2.32	3,853	737	-19.1
Total	**208,739**	**4,755**	**2.28**	**7,481**	**2,928**	**-39.1**

	Cases that Were Assessed CMPs but had the CMP Amount Reduced				
Fiscal year registered	Number of cases that had CMPs reduced	Percentage of cases that had CMPs reduced	Average amount of CMPs assessed per case (Dollars)	Average reduction in CMPs (Dollars)	Average reduction in CMPs (Percentage of original CMPs assessed)
1998	176	39.0	15,455	10,995	-71.1
1999	104	28.0	20,441	17,146	-83.9
2000	164	30.9	16,953	13,357	-78.8
2001	187	39.1	17,343	9,411	-54.3
2002	148	32.5	9,778	5,771	-59.0
2003	158	33.0	12,748	8,402	-65.9
2004	131	29.7	13,538	9,547	-70.5
2005	138	34.4	14,368	10,252	-71.3
2006	100	25.2	12,778	6,077	-47.6
2007	121	27.9	9,375	4,877	-52.0
2008	86	27.1	6,169	2,715	-44.0
Total	**1,513**	**31.8**	**13,899**	**9,218**	**-66.3**

Source WHISARD data. Includes cases registered fiscal years 1998 to 2008 and closed by end of FY2009. Excludes conciliations.

enforcement approach focuses on the individual employer or enterprise without regard to how industry and geographic forces affect their compliance behavior. These external forces may be far more powerful than the influence even an aggressive enforcement effort can exert.

Effective enforcement requires an expanded and refined definition of deterrence. Changing behavior in a lasting manner requires changing the benefit/cost calculus (implicit or explicit) that leads employers to choose to violate labor standards. Since many of the factors underlying this assessment operate at the market- or industry-level, effective enforcement must act at higher levels than single investigation-based enforcement is often directed.

Four Criteria for Evaluating Strategic Enforcement

The central regulatory challenge facing the WHD can be succinctly stated: The WHD seeks to improve compliance with federal workplace standards in an *ongoing and sustained* way by drawing on limited organizational resources to *change employer behavior*. Enforcement policies that take into account both the underlying likelihood of problems and the capacity of the intervention to change employer behavior in significant and lasting ways have the potential of appreciably reducing the number of workers who do not receive the pay they are entitled. Achieving the overall regulatory goal suggests four central principles to guide and measure enforcement policies.

Prioritization: For many years, the WHD has focused on a core set of low-wage industries. Ranking industries and workplaces from worst to best is perhaps the most straightforward principle for managing workplace agencies in a world of limited resources. In recent years, through its strategic planning and evaluation process, the WHD has prioritized directed investigations in designated low-wage industries at the regional and national levels. However, since the vast majority of investigations arise from worker complaints, non-directed resources may not match up to those industries or workplaces where workers face the greatest problems. Prioritization gains particular salience when wedded to other core principles. For example, priorities need to be based not only on the probable severity of the problems facing an industry or workplace, but also on the likelihood that an intervention can actually affect behavior (deterrence) or have lasting effects on conditions (sustainability).

Deterrence: Evaluations of workplace agencies typically focus on the direct effects of investigations on workplaces. Yet the greatest potential impact of their activities arises through deterrence: the threat of investigation spurring on changes in compliance or practices prospectively. Deterrence is related to the perception that the expected costs of investigation (in the most simple case, the probability of investigation multiplied by the penalties associated with violations) are significant enough to lead firms to voluntarily comply. Through deterrence, the potential impact on workplaces can be magnified significantly, but only if investigations truly raise the *expected* costs of noncompliance, which arise from both the chance of being investigated and the penalties associated with failure to pay workers what they are due. This means that enforcement procedures must send the consistent message that persistent, egregious, and workplace-wide infractions of the law will be met with significant consequences.

Deterrence effects can also be present beyond the workplaces and individual employers being investigated. For example, if employers in an industry look to other employers in a local area in the process of setting their policies, including human resource practices, an investigation at one workplace can have "geographic deterrence" effects on others. We find evidence of this kind of geographic effect in the eating and drinking and parts of the hotel industry. Since investigation policies can impact how strong these effects are, WHD staff should incorporate consideration of deterrence into their investigation planning and procedures.

Sustainability: Workplace investigators, as law enforcement officials, often worry about employer recidivism—that is, the fact that a significant number of those who violate the law once tend to do so again in the future. Sustainability is the mirror image of recidivism: it represents a measure of whether past interventions affect continuing compliance in the long run. Sustainability matters both in gauging the direct impact of investigations (e.g., did the current safety inspection lead the employer to continue to use scaffolding protections on the job site after the present inspection was completed?) and in assessing deterrence impacts (e.g., does the threat of investigations create an ongoing spur to better job-site practices among area employers over time?). Like the problem of "teaching to the test," enforcement strategies are flawed if they focus employers on narrow compliance at the time of the investigation. Enforcement effects can be judged as having greater sustainability if they lead both to lasting compliance and the adoption more generally of employment policies consistent with larger policy objectives, such as internal health and safety policies that both satisfy specific standards and create a preventive injury and illness culture at the workplace. This becomes increasingly important given the greater complexity of workplace risks.

System-wide Impacts: Recovering back wages for workers is a critical goal of WHD investigations. However, more fundamental than that is changing the incentives of employers to underpay in the first place. WHD efforts should therefore aim to alter the larger, system-wide incentives for compliance, thereby encouraging all employers to follow the law. Given

the increasingly complex workplace settings described in this section, achieving more system-wide impacts on employer compliance requires investigators to examine how to achieve geographic-, industrial-, and/or, product market-effects. The WHD can do so by finding ways to influence the behavior of firms at the "top" of fissured industries in order to improve compliance at the "bottom" of those industries. The garment initiatives in the late 1990s and early 2000s are an example of this: Through aggressive enforcement and use of the hot goods provisions, the WHD changed behavior among small contractors operating at the bottom of the industry by reaching comprehensive agreements with manufacturers further up the chain.

Creating this kind of system-wide impact can be applied to other sectors with large numbers of vulnerable workers. For example, by identifying wide-scale patterns of noncompliance among different franchisees in various parts of the country, a major brand may be willing to increase its programs to encourage compliance across its outlets, thereby magnifying the effects of investigations carried out at separate franchisees. Bringing an understanding of the impact of these larger factors into the regulatory scheme potentially allows enforcement to have systemic effects going beyond the workplaces directly investigated.

Conclusion

Internal and external factors surrounding the WHD have raised the difficulties—and the stakes—facing the agency in achieving its goals. These problems will not be overcome simply with more resources or with more active application of available penalty policies (although these remain important). Instead, they require a very different framing of basic enforcement approaches. They also require evaluating success with a different set of measures than traditionally used. The next chapter describes in detail the factors driving the growth of the vulnerable workforce in many sectors of the economy. It suggests how understanding these influences can provide a map for enforcement that has more sustainable and system-wide effects on employer behavior. The sections that follow then demonstrate their application in specific sectors and in the realm of complaint investigation policy. In each case, the four strategic enforcement criteria are used to evaluate those approaches.

II

CONNECTING THE DOTS

VULNERABLE WORKERS, FISSURING, AND INDUSTRY STRUCTURE

Over the last decade, more and more workers have become vulnerable to violations of labor standards, workplace safety, and other basic rights in the workplace. The workers of greatest concern to the WHD, however, are not randomly distributed across every sector of the economy. They are concentrated in a subset of industries. In this section, we identify those sectors. We then discuss the characteristics of those industries that help explain vulnerability and identify one factor in particular—what we call the "fissuring" of the employment relationship—as particularly important. "Fissuring" of employment arises in many industries because major companies that in an earlier time period would have directly employed a large workforce, have delegated away employment and the responsibility to oversee the workforce to smaller business organizations, thereby creating more competitive conditions among the businesses who directly employ those workers. This splintering (fissuring) of employment leads to conditions that raise the incentives not to comply with workplace policies like the minimum wage and overtime components of the FLSA. But, by recognizing industries' distinctive structures and understanding the reasons why the basic employment relationship in many industries has become fissured between multiple parties, we find insights into how enforcement might be more effectively undertaken.

The Vulnerable Workforce

Workforce vulnerability can be defined in a variety of ways. In terms of employment security, it refers to the precarious nature of the employment relationships and increased risk of losing one's job. In terms of earnings, it means receiving wages that are close to (or sometimes below) the statutory minimum and subject to *de facto* reductions via being asked to work "off the clock," without being paid overtime as required by the law or, in extreme cases, simply not being paid for work performed (Shulman 2003, Greenhouse 2008).

Workforce vulnerability also relates to increased exposure to a variety of workplace and social risks. Many have written about the 'great risk shift' occurring over the last 25 years that has moved many societal risks from large institutions of the private and public sectors and placed them on the individual. In terms of occupational safety and health, vulnerability translates into exposure to hazards where there are existing regulatory protections and/or available practices to reduce risk, as well as to risks currently unregulated by health and safety standards such as musculoskeletal disorders, occupational stress, and exposure to a variety of workplace chemicals (Azaroff *et al.* 2004; Clapp *et al.* 2007).

More often than not, vulnerable workers do not receive a critical set of workplace- based benefits. According to a 2006 survey (Families and Work Institute 2006), low- wage workers—a reasonable proxy for vulnerability, as will be discussed below—have significantly lower health care coverage; more limited paid time off for sickness, vacation, or holidays; far lower pension coverage (either defined benefit or any form of retirement benefit); and less access to job training programs than middle- or high-wage workers (Families and Work Institute 2006, Table 2).

The vast majority of vulnerable workers do not receive health care benefits from their employers. Among low-wage workers, the DOL's Bureau of Labor Statistics, in its 2007 National Compensation Survey, reported that only 24 percent of workers in the bottom quintile of the wage distribution had employer-provided health coverage, compared to 62 percent in the middle wage quintile. The survey found similarly low absolute and relative rates of coverage for dental and vision

care, prescription drug coverage, and disability insurance (see Boushey *et al.* 2007).

Few vulnerable workers receive pension coverage. Across the workforce, a shrinking percentage of workers receive defined benefit pension benefits (i.e., pensions with an assured level of retirement benefits linked to a worker's final pay level). The rate of coverage is particularly low among low-wage workers: only 11 percent have defined benefits (versus 34 percent for workers in other wage brackets). Less than half of all low-wage workers have defined contribution programs (43 percent), meaning that most of these workers will be entirely dependent on government-provided Social Security benefits for retirement income (Boushey *et al.* 2007; Ghilarducci 2008).

Finally, vulnerability relates to treatment at the workplace, including not being afforded adequate protections against discrimination and capricious behavior by supervisors. This directly relates to the decreasing likelihood in most private sector workplaces that one is represented by labor unions. The rate of unionization of private sector workers over the last fifteen years fell from 10.4 percent in 1993 (less than half its rate in post World War II era), down to 7.5 percent in 2007. In industries with large concentrations of low-wage workers, such as food services and drinking, less than 1 percent of workers were union members in 2007.

Concentration of Workplace Vulnerability

How pervasive is workforce vulnerability in the U.S.? Given the many different dimensions that may be used to describe vulnerable workers, it is difficult to provide a single measure regarding its extent. One reasonable measure defines vulnerability in terms of low-wage work. Low-wage work is usually measured either in terms of earned income relative to what is required by a family to purchase basic needs, or by ranking jobs in the labor market based on the overall wage distribution. Using a definition related to the poverty level, Boushey *et al.* (2007) estimate that there were about 35 million low-wage jobs in 2006. If one uses a definition based on the broader income distribution, where low-wage work is defined as earning two-thirds (or less) of the male median wage, the number climbs to 44 million jobs.

Although either definition of low-wage work is somewhat arbitrary, both of the above estimates represent a large percentage of total U.S. employment. But the estimates mask the fact that the vulnerable workers are concentrated in certain segments of the labor market. One way to reveal this is to compare the distribution of low-wage jobs against the overall distribution of employment across industry sectors. Using a definition based on the relation of earnings to the federal poverty level, Osterman (2008) finds that retail, food services and drinking places, and health care together account for more than 40 percent of all low-wage workers.[22] Table 2.1 compares Osterman's estimates of the distribution of low-wage workers with the distribution of total employment in 2006. For example, about 5 percent of all employment in 2006 was in construction, and about the same percentage (4.7 percent) of low-wage workers were found in that sector.[23] Workers in health care segments accounted for about the same share of low-wage workers as they did in the economy as a whole, while a slightly higher share of low-wage workers (11.4 percent) were found in manufacturing than they accounted for in the economy as a whole (9.4 percent).

Table 2.1 demonstrates that several sectors accounted for a disproportionate share of low-wage workers: While retail workers constituted 10.2 percent of the workforce, they made up more than 20 percent of all low-wage workers in the U.S. Similarly, food and drinking services accounted for 6.2 percent of employment but 12.5 percent of low-wage workers; and workers in the accommodation (hotel and motel) and agriculture sectors accounted for up to twice the proportion of low-wage workers that they represented in the economy as a whole.

Sectors with significant concentrations of low-wage workers also tend to have low union density. Retail, food and drinking services, and health care all had levels of union representation that were below the average rate of unionization in the private sector as a whole. The absence of unions in this sector—though a focus of several major union organizing efforts in recent years (Lerner *et al.* 2008)—reduces bargaining pressures to raise wages and improve working conditions, and also hinders the initiation of enforcement actions arising from worker complaints.

Industries with large concentrations of low-wage workers constituted growing segments of the overall U.S. labor market (see Table 2.2). More than 20 percent of U.S. workers were employed in the retail, and leisure and hospitality sectors, the sectors employing the largest concentration of low-wage workers. These sectors combined were projected to grow by

22. Osterman uses the Current Population Survey (CPS), Outgoing Rotation Group, to make his estimates. The CPS is based on a household survey conducted by the Bureau of the Census for DOL's Bureau of Labor Statistics. The estimates, therefore, pertain to the number of workers employed in low-wage work. This contrasts with the approach used in Boushey *et al.* (also quoted in the article) that bases estimates on the Current Employment Statistics survey, which, instead of counting workers, counts the number of low-wage jobs. Since some workers may hold multiple jobs, the two measures are not synonymous. The figures for the economy as a whole that are used in Tables 2.1 and 2.2 combine both sources in presenting estimates of total employment.

23. Since the construction industry is made up of subsectors with considerably different characteristics, this figure is somewhat misleading. About 50 percent of construction employment is in the residential sector, which has a much higher proportion of low-wage workers than found in the heavy and highway, industrial, or major commercial construction sectors.

TABLE 2.1

Distribution of Employment, Low-wage Workers, and Union Density by Selected Industry Sectors, United States, 2006

Sector	Employment [a]		Low-wage Workforce Distribution [b]	Union Density [c]	
	Total employed (Thousands)	Percent of total employment	Percent of all low-wage workers	Percent members of unions	Percent represented by unions
Construction	7688.9	5.1	4.7	13.0	13.6
Manufacturing	14197.3	9.4	11.4	11.7	12.5
Retail	15319.4	10.2	20.3	5.0	5.3
Professional and business services	17551.6	11.7	9.2	2.4	2.9
Food and drinking services	9382.9	6.2	12.5	1.1	1.4
Health	14919.8	9.9	9.9	7.0	7.9
Agriculture	2138.6	1.4	2.5	2.3	2.6
Accommodation	1833.4	1.2	2.6	9.2	9.9
All other sectors	67588.1	44.9	26.9	–	–
Total	**150,620**	**100.0**	**100.0**	**7.4** (Private sector only)	**8.1** (Private sector only)

Notes:

a. U.S. Department of Labor, Bureau of Labor Statistics, Employment data for wage and salary workers from Current Employment Statistics survey and Current Population Survey for self-employed, unpaid family workers, and agriculture, forestry, fishing, and hunting.

b. Distribution of low-wage workers by Osterman using U.S. Census Current Population Survey, Outgoing Rotation Group survey. Low-wage worker defined by poverty level for a family of four (see Osterman 2008 for additional details).

c. U.S. Department of Labor, Bureau of Labor Statistics, 2008.

almost 1.8 million workers between 2008 and 2018. Food services and drinking (the major component of the leisure and hospitality sector) was projected to grow by about 740,000 jobs over the same period.

Vulnerability and the Fissuring of Employment

The sources of workforce vulnerability arise from a variety of economic and social factors that have been widely discussed (see Bernhardt *et al.* 2008 for a recent summary of this literature). These include increasing levels of global competition; a large influx of immigrant (and in many cases undocumented) workers, who are particularly vulnerable to exploitation; changes in the organization of work and in the structures of industries; and long-term declines in enforcement by federal and state government.

Although all of the above factors play significant—although varying—roles, an important source of vulnerability arises from factors rooted in the sectors where those workers are concentrated, and specifically in how those industries are structured. The interactions of firms in these markets provide important insight into the sources of workforce vulnerability, as well as how those dynamics can be changed through public interventions to improve labor standards conditions for those workers.

In many of the sectors listed in Table 2.2, the key employment relationship has been "fissured" or splintered apart. From the post World War II period through the 1980s, the critical employment relationship was between large businesses and workers in major sectors of the economy. Increasingly, however, the employment relationship has shifted away from those large employers—who continue to play critical roles in shaping competition in the market—and towards a complex network of smaller employers. These lower-level employers typically operate in more competitive markets than those of the firms that shifted employment to them. As a result, the small contractor trying to win drywall work from a national residential homebuilder competes against a multitude of

TABLE 2.2

Employment Trends in Major Sectors, United States, 1998–2018

Sector	1998		2008		2018 (Projections) [a]	
	Employment (Thousands)	Percent of workforce	Employment (Thousands)	Percent of workforce	Employment (Thousands)	Percent of workforce
Goods-producing (exc. Agriculture)	**24,273.6**	**19.2**	**21,363.1**	**15.5**	**21,390.4**	**14.0**
Manufacturing	17,559.5	13.9	13,431.2	9.7	12,225.2	8.0
Service providing	**102,351.1**	**80.8**	**116,451.7**	**84.5**	**131,053.1**	**86.0**
Retail trade	14,609.7	11.5	15,356.4	11.1	16,010.4	10.5
Health care & social assistance	12,213.7	9.6	15,818.7	11.5	19,815.6	13.0
Leisure and hospitality	11,231.6	8.9	13,458.7	9.8	14,601.1	9.6
Food services & drinking	7812.7	6.2	9631.9	7.0	10,370.7	6.8
Accommodation	1773.5	1.4	1857.3	1.3	1,956.7	1.3
Retail, health care & leisure/ hospitality (combined)	**38,055.0**	**30.1**	**44,633.8**	**32.4**	**50,427.1**	**33.1**

Note:
a. Ten year projections by the Bureau of Labor Statistics: See Woods 2009 for projections; Franklin 2007 for details on methodology.
Source: U.S. Department of Labor, Bureau of Labor Statistics (2009).

other small contractors and the fast food franchisee competes against many branded- and non-branded restaurants in a suburban market, creating intense pressure to lower costs, particularly the most sizeable cost and the one most easily controlled: labor. On the other hand, the parties that set many of the conditions of competition—the national home builder or the fast food parent company—operate in environments that afford them more options with which to pursue profitability.

Fissuring (which we sometimes also refer to as "devolution") of this kind has been accomplished via the growing use of a wide variety of organizational methods: subcontracting, franchising, third-party management, changing workers from employees to self-employed contractors, and related contractual forms that alter who is the employer of record or make the worker-employer tie tenuous and far less transparent (Carré *et al.* 2000; Ruckelshaus 2007; Zatz 2008).

Multiple motivations underlie fissuring and the growing use of non-traditional employment arrangements. In some cases, subcontracting and related forms of devolution arise from a business decision to focus on core competencies while outsourcing activities not central to the firm's operation (Quinn 2000). With the falling cost of coordination arising from information and communication technologies, productive reconfiguring of the boundaries of companies and entire industries naturally occurs (Williamson 2000). This is particularly common in industries that create intellectual capital, like software development and entertainment. (Simchi-Levi *et al.* 2003; Dyer and Hatch 2004).

In other cases, employment fissuring arises from a desire to shift labor costs and liabilities to smaller business entities or to third-party labor intermediaries, such as temporary employment agencies or labor brokers. Employers have incentives to do so for obvious reasons: As has been documented in numerous studies conducted in recent years, shifting employment to other parties allows an employer to avoid mandatory social payments (such as unemployment and workers compensation insurance, or payroll taxes) or shed liability for workplace injuries by deliberately misclassifying workers as independent contractors (e.g., Carré and Wilson 2004; National Employment Law Project 2004; GAO 2009).

But there are other, more subtle and fundamental reasons behind the devolution of employment.[24] In the three decades following World War II, employers in major sectors of the U.S. economy (manufacturing, construction, government) employed large numbers of workers directly, through what we still consider to be conventional employer-employee contracts (whether union or nonunion). Employers of such large numbers of workers needed to have unified personnel and pay

24. A detailed discussion of this issue can be found in Weil 2010 (forthcoming).

policies for a variety of reasons, including to take advantage of administrative efficiencies, create consistency in corporate policies, and reduce exposure to violations of laws. In addition, unified employment policies—particularly compensation policies—reduced frictions between workers (and their negative effects on productivity): Workers operating under one roof communicate and might quickly discover that the person sitting in the next cubicle is being paid more for the same job.[25] Paying individuals who did similar jobs different wages could have deleterious consequences on productivity, increase turnover, or even inspire an organizing drive.[26]

Imagine, however, if a large employer could find a way to pay each worker a wage exactly equal to his or her value of production (or, in economic jargon, match the worker's wage to his or her "marginal productivity"). One way to do this without the internal organizational problems discussed above would be to restructure the way the employer contracts with workers so that the marginal productivity of each worker hired is matched to his/her wage rate, and that the wage rate paid to one party has no impact on that paid to anyone else already employed (or potentially hired if production is expanded). In so doing, the employer could "capture" the difference between the individual marginal productivity and what would be the prevailing single wage rate if it set one. Such a mechanism would benefit the employer over the case where it set a single wage rate for the market as a whole.

25. An extreme case of this is monopsony, where there is only one buyer of a good or service. In the labor market, an example of monopsony is the company town where virtually everyone works for a single employer. In such a case, the monopsonist faces the entire labor supply, and must pay higher wages if it wishes to increase the number of people employed. As a unitary employer paying one wage rate, each additional worker employed not only raises its costs because of that one employee, but all employees already hired since the company must now match the wages received by existing workers with that paid to the new employee. As a result, the employer hires fewer workers and pays a lower wage to them than would occur in a competitive labor market with multiple employers. Note that this result arises from the need of the monopsony employer to pay a single wage to its workforce. See Erickson and Mitchell 2007 and especially Manning 2003, chapter 2 for a discussion of the classic model of the employer monopsonist.

26. There is a large empirical literature that shows that wages within firms vary far less than one would expect given the existence of considerable differences in productivity among workers (see Manning 2003, Chapter 5 for a summary of this literature). Firms move towards a single wage policy for workers of similarly observable skill/ability because of the negative consequences arising from having multiple rates for workers who otherwise seem similar. Seniority-based pay is one imperfect way to vary wages based on differences in average productivity that strike most as "fair." But "wage discrimination" (à la price discrimination) is rare with large firms. As Manning notes, this is hardly a recent observation. The Webbs noted in 1897 that "the most autocratic and unfettered employer spontaneously adopts Standard Rates for classes of workmen, just as the large shopkeeper fixes his prices, not according to the haggling capacity of particular customers, but by a definite percentage on cost." (Webb and Webb, 1897, p. 281 as quoted in Manning, 2003, p. 132.).

What happens, instead, if the large employer subcontracts out the task of "employing" the workers to multiple smaller parties who compete with one another to obtain the employer's business? Each small firm would offer its workers wages to perform work for the central employer, but as contractors to the employer, they would be paid a price for their production (via the subcontractor) rather than be directly paid as individual workers. As such, the larger employer engenders competition for work from different purveyors, and pays them based on its assessment of the contribution. Less efficient producers could be paid less than more efficient producers. In this way, the central employer faces a schedule of *prices for services* rather than *wages for labor,* leaving the unseemly task of compensation to the individual providers of the service or product. In effect, the big player devolves its employment activity to a network of smaller providers. In so doing, it creates a mechanism—a competitive market for services that in the past was handled internally through direct employment—in the form of a network of service providers (subcontractors).

By shifting employment to smaller parties operating in competitive markets, a large employer creates a mechanism to pay workers closer to the additional value they create, but avoids the problem of having workers with very different wages operating under one roof. In so doing, the employer captures the difference between the individual marginal productivity of each worker and what would be the prevailing single wage rate if it set one. Such a mechanism benefits the employer over the case where it set a single wage rate for the market as a whole.[27]

The above story describes the basic structure of many industries that have long been examples of "sweatshops." Major apparel manufacturers since the late 1800s drew on large networks of assembly subcontractors, who offered those larger manufacturers relatively similar services to undertake the most labor-intensive part of production (sewing). But, as we argue below, other industries have restructured to accomplish similar ends. Subcontracting out work has become common in many service industries (janitorial, hotel, landscaping). Construction in the commercial sector has changed dramatically as general contractors, who once directly employed large numbers of basic trades like carpenters, became "construction managers," who subcontracted out such work. Franchising provides a way for very large national businesses to benefit from investments in a brand (which convey larger margins), and at the same time move the problems arising from common wage policies out to a network of independent entrepreneurs.

27. Ironically, it would also remove the resource distortion introduced by monopsony since under these circumstances, they would end up hiring additional workers to the point that would be found in a competitive market. However, unlike the situation in a competitive market, the monopsonist would capture the "bonus" received by workers whose wage rate exceeded his or her marginal contribution to production (i.e., the rents of inframarginal workers).

Vicarious Liability and Further Incentives for Devolution

A second set of factors related to the law governing employment relationships compounds the incentives for devolution discussed above. In particular, common law principles governing torts create peculiar incentives regarding responsibility in situations where one party contracts with another party to undertake activities. Vicarious liability refers to liability imposed upon one party because of the actions of another. Under tort law, according to Arlen and MacLeod (2005, p.4)

> … vicarious liability hold organizations (and other principals) liable for their agents' torts, committed within the scope of the agency relationship, such as an employer-employee relationship. Organizations generally are not liable for torts by independent contracts, even if committed within the scope of the agent's authority. The central distinction between a master-servant agency relationship and a non-master-servant (e.g., independent contractor) agency relationship turns on whether the principal had the capacity to control the physical conduct of the job …

Vicarious liability affects the degree to which, in a principal-agent relationship, the principal attempts to influence behavior by asserting more direct control on the agents' activities. Imagine our large employer from the above discussion who decides, rather than directly employing its workforce, to contract with a network of small companies to undertake those activities. The question is how to manage those companies in order to meet its production goals while taking advantage of the competition between them it has created.

Option one would be to treat the individual companies (and their workers) exactly as it would if they directly worked for the major employer: set tasks, monitor progress, evaluate based on performance, and revise plans given performance. In so doing, the employer acts essentially as a joint employer with the smaller firms (in tort parlance, it establishes a master-servant relationship with the contractors). With that role comes liability—vicarious liability—for problems that may arise in the activities of the individual companies it has hired. And those problems may not be limited to potential liability for workplace issues (such as injuries, violations of workplace standards, or discrimination). The employer might also be on the hook for potential damages arising from the activities of its network of producers to other parties like consumers.

For example, imagine that an employer devolves the operation of restaurants bearing its brand and menu to a network of independent businesses who operate those businesses across the country (i.e., it decides to franchise its operations). If a consumer walks into one of those restaurants, operated by an independent franchisee, and slips on a wet floor, the major employer is potentially partly liable for damages if it can be shown that it had a hand in the day-to-day operational decisions of the outlet.

If the major employer pursues a devolution strategy to solve one set of labor market problems (the problem of paying workers closer to their marginal productivity), it might take on other ones as a result of vicarious liability. To take the above story further, if, by devolving its employment relationships to multiple small companies, it reduces its ability to impose quality or performance standards, it might make itself more vulnerable to claims from workers about discrimination or injured customers than if it managed operations itself. Because vicarious liability says an employer is often at least partly responsible for what its agents do, what an employer might gain from devolution in increased ability to pay multiple wage rates it might lose from exposure to claims.

Tort law provides a potential solution to this dilemma. If a company can show it did not have daily, operational control of the activities of its agents, it cannot be held to be vicariously liable for problems arising from the agents' actions. If a company hires another company to undertake a job in an arm's-length relationship (I will pay you to do a job, and you decide how to do it), there is no master-servant relationship implied by the contract and the principal cannot be held liable for problems created by the independent contractor.

This creates a difficult problem for the major employer. On one hand, an employer always has an incentive to have its network of contractors adhere to a set of standards, practices, and/or procedures central to its business model. On the other hand, it will want to have competition among multiple parties who do the hiring of workers to undertake the task (devolution to match payment with marginal product), while not supervising those activities to such an extent it could be held vicariously liable. Achieving such a balance is no small feat by any means.

This leads to some very complicated and sometimes contradictory incentives. As Arlen & MacLeod note, "… far from encouraging organizations to assert control, vicarious liability often discourages organizations from controlling their agents, even when it would be efficient for them to do so. Vicarious liability discourages the efficient exercise of control because organizations which exert control over agents are likely to be deemed "masters" and thus face liability for their agents' torts." (p.4).

Reluctance to monitor behavior of contracted entities can lead to unsafe streets. For example, in a study regarding the petrochemical industry, James Rebitzer found that a series of major petrochemical explosions and worker fatalities were linked to the use of independent contractors who

were hired by major petrochemical companies to undertake "turn-around" operations, which allow a plant to switch from one type of end product to another (e.g., switching from home heating oil to gasoline production).[28] Rebitzer found that major petrochemical companies who hired contractors to do this work—work in the petrochemical companies' own plants to change the mix of products produced by the facilities—sought to distance themselves from their training and supervision. Despite the potentially devastating impact of improperly performed work, major petrochemical companies sought to insulate themselves from asserting "master-servant" relationships with turn-around contractors in order to avoid tort claims arising from those contractors' activities (see Rebitzer 1995).[29]

In Sections IV and V, we will see how this complex balancing act affects labor practices among the franchisees of internationally recognized and branded companies like McDonald's or Hilton. Franchisors expose themselves to a wider set of liabilities (and potential costs) if they begin to treat franchisee employees as their own. Monitoring payroll records or imposing closer monitoring scrutiny could be interpreted as evidence of a "master-servant" relationship and therefore expose the franchisor to tort liabilities going far beyond the employment relationship itself (e.g., a suit by a customer arising from a franchisee employee who failed to warn customers of a wet floor that led to a fall and injury). In effect, franchisee noncompliance with the FLSA (and other workplace regulations) and its impact on brand reputation may be viewed as an unfortunate but necessary cost to bear relative to the costs arising from a wider range of claims under tort law arising from more stringent monitoring.

Fissured Workplaces, Vulnerable Workers

The sectors with fissured employment relationships have common characteristics for reasons described above. Rather than a single employer hiring, training, paying, and managing workers—the way that workplace regulations assume—reality looks very different. A person's paycheck may be from one party, yet the person may be managed by an entirely different company (as has become common in the hotel/motel industry). A person may produce goods or services for a nationally known company, yet be paid and managed by another entity wholly unknown to the public (common in many retail and food supply chains). Alternatively, a person may be asked to be an independent contractor (or work for another individual who acts in that capacity) and receive compensation in the form of a percentage of revenues rather than wages.

Fissured industries, for reasons described in the prior section, have distinctive product- and labor-market features. Typically, employment decisions have been devolved from major employers to a complex network of smaller employers. These lower level employers typically operate in more competitive markets than do the companies that "sit on top" of these industry structures. Hence, the small contractor trying to win residential carpentry or masonry work in a small geographic area competes against a multitude of other small contractors, which creates intense pressure for it to lower costs, particularly the cost that most dominates its income statement and is most easily controlled: labor. On the other hand, the parties that set many of the conditions of competition—for example large, national home builders—operate in environments that afford them a variety of options with which to pursue profitability.

Devolved employment plays out into four distinctive structures, depicted in Figure 2.2. The factors pushing for devolution play out in different ways related to the role that central companies play in the industry structure. For example, in the first category, where a strong buyer sources its products through a competitive supply chain, the central player (e.g., a retailer like Wal-Mart or a well-known national brand like Vlasic Pickles or Adidas) plays its role because of brand recognition. Brand plays a similarly important role in the second type of cases, however in these cases, firms provide a service (eating or hospitality services). For each case in Figure 2.2, we indicate the key player, the nature of the "devolved" relationship, the coordinating mechanisms used by central players with their network of contractors, and provide several examples.

Strong buyers sourcing products in competitive supply chains: In some sectors— for example, in many non-durable consumer product markets where retailers play a dominant role in driving supply chains—major players set the overall terms of economic relationships in the product markets (e.g., retailers like Wal-Mart), yet they have no direct employment responsibility for large supply chains that provide products. As a result, pricing policies are set by one group of players who operate in markets where they hold significant pricing power because of scale economies, brand recognition, and geographic barriers to entry. However, the markets (supply chains) providing these goods are characterized by significant competition, low margins, low barriers to entry and therefore, significant pressures

28. See also Kochan, Smith, Wells, and Rebitzer (1992) written as part of a wider investigation of the petrochemical incident for the Occupational Safety and Health Administration.

29. Findings by Jin and Leslie (2009) concerning the gap between franchisee and company-owned restaurant hygiene prior to the imposition of mandatory grade cards can be similarly understood through the lens of vicarious liability. The imposition by franchisors of stringent monitoring of outlet hygiene practices could support a claim that they exert a direct role in operational decisions and therefore expose them to liability claims. Franchisee free-riding behaviors (lax hygiene practices) were only reduced by allowing consumers to directly "see" outlet hygiene status in the form of posted restaurant grades.

FIGURE 2.2

Fissured Employment Relationships—Four Categories

Type of Fissured Structure	Central Actor(s)	Nature of Fissured Relationship	Coordinating Mechanisms	Examples
Strong buyers sourcing products in competitive supply chains	• Lead distributor of product (retailer or lead producer)	• Production supply chain with market and non-market elements	• Market transactions • IT and logistics systems • Standards	• Garment and retail supply chains • Food industry (food processor)
Small workplaces linked together by large branded organizations	• Branded entity (franchisor; brand)	• Franchising • Management/operating companies	• Franchise agreements • Brand standards	• Fast food • Hotel/motel
Central production coordinators managing large contractor networks	• Prime coordinator (e.g., general contractor; construction manager)	• Subcontracting to prime business organization	• Bidding • Site management	• Construction • Moving companies/ logistics • Entertainment (content) production
Small workplaces and contractors linked together by common/centralized purchasers	• Public sector purchaser • Primary service user	• Payer of services to network of providers	• Bidding • Payment systems • Evaluation protocols	• Janitorial services • Home health care (state provided)

for low wages and poor working conditions. Agricultural sectors driven by major food processors, as well as food retailers are examples of this type of industry structure.

Small workplaces linked to large, branded, national organizations: In a number of service providing industries—in particular in food services, and hotels and motels—work is undertaken in small, geographically dispersed workplaces. Although these workplaces often operate under the name of well-known national brands (McDonald's, Hilton), the employment relationship is usually with a different entity, such as a franchisee in the eating and drinking industry, or a complicated combination of local owners and third-party management companies in hotel and motels. Conditions leading to workforce vulnerability arise because employment policies for the workers in these sectors reflect the interdependent decisions of relatively small, local employers, who face significant product market competition yet have a lower stake in reputation than the multinational brands of which they are a part.

Central production coordinators managing large contracting networks: In this type of industry structure, large companies play a role as coordinators of production that entail large numbers of workers. Few of those workers, however, are directly employed by the coordinators. The U.S. housing market is a prime example of this type of structure, where in the 1990s and first half of the 2000s (prior to the housing bust in 2006), a small number of national home builders (e.g., Pulte) came to dominate many housing markets. Though typical national homebuilders might have built more than 10,000 homes per year, they directly employed very few construction workers. Instead, construction was undertaken by a large number of relatively small contractors who, in turn, further subcontracted work to other, smaller firms engaged in competitive markets. While the large homebuilders created and managed the plans for development, set the basic terms for pricing, and established standards for performance, terms of employment were set by the myriad of small contractors who undertook the work on site.

Small workplaces and contractors linked together by common purchasers: A final variant of this industry structure occurs where a network of employers is tied together by a common purchaser of services, or a public, not-for-profit, or private entity that disperses payments to employers in that network. Vulnerability in this setting arises because services are provided in smaller, more decentralized units whose decisions reflect the concerns of local companies or contractors engaged in far more competitive markets than the larger entities that are the source of revenues. The common purchaser here is neither a coordinator of sales or production, nor a well-known business entity. An example of this type of structure arises in the janitorial, landscaping, and related business services area, where large end users (building owners) contract out these activities to large numbers of competitive contractors. In many cases, prime contractors to building owners further subcontract work to even smaller business entities. A different, but related variant of this model occurs in child care and home health care sectors, where service is provided

by small community-based facilities or at recipients' homes, but paid for via public funds.

Implications for WHD Policy

In a growing number of industries, the employment relationship has become fissured, requiring regulators to act on webs or networks of employers, not on single, fixed organizations. Fissuring in employment relations further complicates the regulation of workplace conditions described in Section I. 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 enforcement problem in these 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 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 section, 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 workplaces. 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[30]—a strategic approach to regulation that builds on these insights provides a critical means for changing the underlying conditions driving vulnerability.

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. We investigate this by describing policies that are—or could be—built around the industry structures described in the following sections of this report.

30. Osterman (2008) usefully lays out a framework that delineates policies dealing with low-wage work that recognizes their origins in both labor supply and labor demand. This essay focuses on the nature of labor demand. However, there is a separate and important set of policies regarding education, training, and private and public efforts to enhance the human capital of low-wage workers by focusing on the supply side of the labor market (e.g., Holzer 2004).

III

GARMENTS

LEARNING FROM PAST SUCCESS REGULATING SUPPLY CHAINS

Fissured industries and the problems they create for workers operating in them are not new.[31] Garment manufacturing represents one of the oldest examples of a fissured industry, and the government has wrestled with the task of improving working conditions in garment for more than a century. In 1893, the Committee on Manufacturers of the House of Representatives released a report regarding their investigations of the "sweating system" of production. Among other conclusions, the Committee concluded that 80 percent of production originated in sweatshop production.[32] Several years later, President McKinley appointed a commission made up of members of Congress and private citizens to study the problem. Arising from their study running from 1898-1901, the commission documented extensive abuses including long hours, low pay, and unsanitary conditions.[33] Given this legacy, it is not surprising that enforcing provisions of the FLSA in the garment industry has been an ongoing area of concern since the statute was passed in 1938. The highly competitive markets for apparel and for the workers who cut and assemble products have together made enforcing labor standards a major challenge for the WHD.

Despite these longstanding forces and the long-term employment declines in the domestic apparel industry caused by growth in imports, data from WHD investigation-based random surveys suggest that WHD initiatives in the late 1990s and early 2000s had large and significant impacts on minimum wage and overtime compliance. Based on an evaluation of investigation-based surveys completed in the garment industry, this section argues that compliance was improved through a combination of private market leverage and public enforcement of monitoring arrangements that were established by the WHD in the New York City and Southern California markets.

The garment initiatives in these markets led to significant improvements in the percentage of employers in compliance with minimum wage and overtime provisions and substantially reduced both the frequency with which violations occurred within garment workplaces as well as the average level of underpayment to workers during this time. The initiatives were also associated with overall improvements in contractor compliance in those markets, over time, as well as increased incentives for compliance as perceived by the constantly changing set of contractors operating in the industry. The garment initiative provides an important and replicable example of addressing the fissured nature of an industry and improving conditions by gaining greater control over the forces acting on employers within it.

Supply Chains and WHD Approaches to the Garment Industry

Core characteristics of the product and labor markets in the apparel industry push contractors to cut corners with respect to wages, hours, and conditions. In particular, the women's segment of the industry has always been organized around a splintered production system, where different enterprises

31. This section draws on research in the following reports and published articles: Weil, Mallo, and Pyles 2003; Weil and Mallo 2003; Weil 2005; Weil and Mallo 2007.

32. See U.S. Congress, House of Representatives, Committee on Manufacturers, "The Sweating System," House Reports, 52nd Congress, 2nd Session, Vol. 1, no. 2309, 1893, pp. iv-viii.

33. Reports of the Industrial Commission on Immigration and on Education. Washington, D.C.: Government Printing Office, 1901, vol. XV. A discussion of the history of regulating labor standards in the apparel industry can be found in Abernathy, Dunlop, Hammond, and Weil (1999), Chapters 2, 10, and 15.

carry out the design, cutting, and sewing and pressing/packaging of apparel products.[34] For example, a "jobber" may sell a design to retailer, and then contract with a manufacturer for delivery of the product. The manufacturer, in turn, may purchase and cut the product, but then contract out sewing to one or more companies (which may, in turn, further contract out sub-assembly). Contractors compete to preassemble bundles of cut garment pieces in a market where there is little ability to differentiate services (i.e., sewing and associated assembly) except for some operations requiring higher levels of skill content. The structure of relations from the retailer down to contractors and subcontractors is depicted in Figure 3.1.

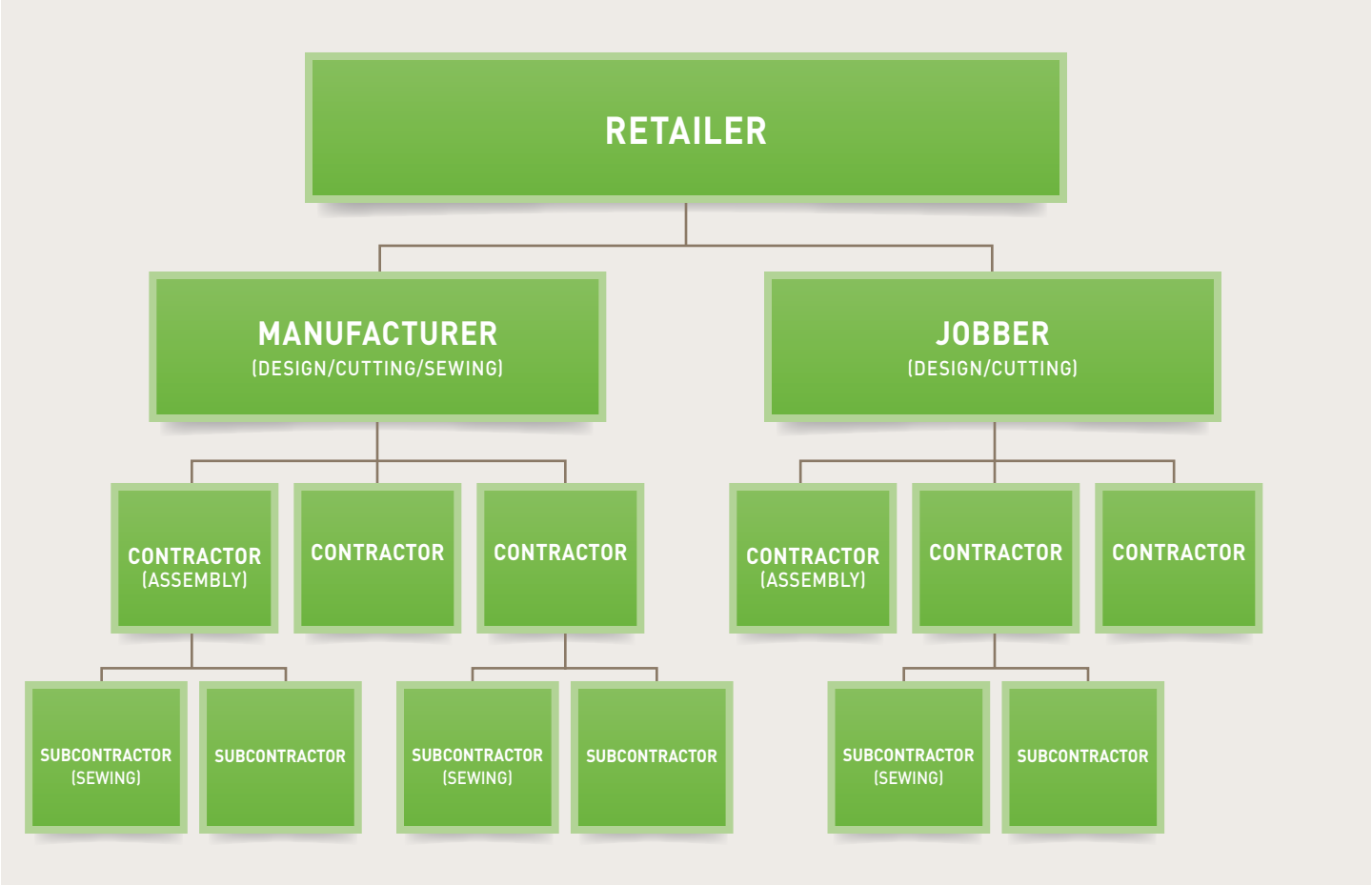
In general, as one goes to "lower" levels of apparel production (i.e., from design and cutting by manufacturers or jobbers at the top of Figure 3.1, to sewing by contractors or subcontractors at the bottom), the level of competition intensifies and profit margin per garment diminishes. Sewing contractors—often themselves former sewers/cutters and recent immigrants to the U.S.—compete in a market with large numbers of small companies (on average 25-35 workers each in the women's industry), low barriers to entry, and limited opportunities for product differentiation. This creates conditions for intense price-based competition. Because labor costs represent the vast majority of total costs for a sewing contractor, there is great pressure to strike deals with jobbers and manufacturers that would not be economically sustainable if the contractor actually complied with wage and hour laws.

Labor market conditions also tend to push wages towards the legal minimum or below. In the women's segment, many entry-level sewers can reach the standard rate for sewing in a matter of months, making it relatively easy to substitute workers in the event of turnover. Given its low skill barriers,

34. In the U.S., men's clothing—from the 1920s onward—is primarily produced in factory-type settings, with manufacturers designing, cutting, sewing, pressing, and packaging products.

FIGURE 3.1

Garment Industry Structure



the apparel industry has always been attractive to immigrants (e.g., Slovaks, Germans, and Jews at the turn of the century; Hispanic, Chinese and Asian workers today).[35] The ample supply of workers and the relatively low skill level required of sewers keep wage levels low and the incentive to work long hours—even in inhospitable work environments—high. The illegal status of many workers, language barriers, and cultural norms further undercut the bargaining power of these workers (Kwong 1997).

Market forces began to reshape the apparel industry, however, beginning in the early 1990s, particularly involving the relations between retailers, apparel manufacturers, and textile producers. "Lean retailing" takes advantage of information technologies, automation, industry standards, and management innovations to align more closely orders from suppliers with real-time sales data. This system reduces the need for retailers to stockpile large inventories of a growing range of products, thereby reducing their risks of stock-outs, markdowns, and inventory carrying costs. The companies that have adopted lean retailing principles now dominate major retail segments. In contrast to the infrequent, large bulk shipments between apparel manufacturers and retailers under traditional retailing, lean retailers require frequent shipments made on the basis of ongoing replenishment orders. These orders are made based on real-time sales information collected at the retailers' registers via bar code scanning. SKU-level sales data are then aggregated centrally and used to generate orders to suppliers, usually on a weekly basis for each store.

Retailers operating with the systems described above require frequent replenishment and demand that shipments meet standards concerning delivery times, order completeness, and accuracy.[36] Lean retailing, therefore, changes the problem faced by an apparel supplier. Suppliers must replenish products within a selling season, instead of between selling seasons, with retailers now requiring replenishment of orders in as little as three days. Lean retailers are vulnerable to disruptions to the weekly replenishment of retail orders by apparel suppliers. Such disruptions are a major problem for retailers and can lead them to penalize suppliers, cancel orders, and even drop suppliers altogether. Given that retailers drive the dynamics of the apparel markets depicted in Figure 3.1, the increasing importance of timeliness translates into a potential tool of regulatory enforcement.

35. See Commons (1901) in Part III of the Industrial Commission report entitled "Immigration and Its Economic Effects."

36. This model of retailing has also become common in many other segments, most strikingly in food retailing, where strategies such as "Efficient Consumer Response" seek to similarly reduce inventory exposure through use of point-of-sale information, efficient logistics, and replenishment programs for perishable and non-perishable products.

A New Approach to Enforcement

State and federal enforcement historically focused at the contractor and subcontractor levels of the apparel industry. The WHD and state labor agencies attempted to increase compliance with labor standards by directly investigating contractor shops and creating incentives for both investigated and non-investigated shops to comply by levying CMPs for those found in repeat violation.[37] Significant investigation resources were applied to the garment sector in the 1990s. Yet the large number of contractors still meant that the average annual probability that a given contractor shop received a WHD investigation was below 0.10.[38] CMPs incurred by a typical garment contractor during the same period were $1,086 per contractor.

Using data from investigation-based compliance surveys of randomly-selected contractors (see below), we estimate that a contractor with 35 employees owed approximately $11,850 in back wages annually.[39] Given the modest investigation probabilities and CMPs, such a contractor has a very high incentive to underpay workers, even when faced with multiple investigations over time. In fact, the incentives for noncompliance are large enough that an employer will choose noncompliance even if found in violation of minimum wage requirements in the first period and therefore facing a higher probability of investigation and CMPs in the subsequent period.[40]

In response to the agency's inability to appreciably improve compliance in the industry despite devoting to it a relatively significant amount of resources, the WHD began to alter this regulatory model substantially in the mid-1990s, partly in response to the changes in the apparel industry mentioned above and the egregious violations at a garment shop in El Monte, CA. The WHD shifted its enforcement focus from targeting individual contractors to exerting regulatory pressure by invoking a long-ignored provision of the FLSA, Section 15(a). Under this section (the "hot cargo provision"), the WHD can embargo goods that have been manufactured in violation of the Act. Although this provision had limited impact on the traditional retail-apparel relationship, when long delays in

37. Most academic studies of FLSA compliance (particularly of minimum wage) focus on this aspect of government interventions. See Ashenfelter and Smith (1979); Grenier (1982); Chang and Erlich (1985); and Yaniv (2002).

38. This is based on the following calculation: In the late 1990s, there were roughly 10,000 establishments in the segments of the apparel industry that are the focus of WHD regulation (primarily the women's and to some extent the children's industry). Given that there was an average of about 800 investigations conducted annually by WHD investigators between 1996 and 2000, the annual probability of inspection is about .08.

39. This estimate is calculated by taking the average back wage owed per worker per week for the subsample of contractors who had not been inspected prior to the time of the randomized survey by the WHD. This estimate is then annualized and applied for a shop employing 35 workers.

40. The detailed calculations behind these conclusions can be found in Weil 2005.

shipments and large retail inventories were common, invocation of the hot goods provision today (given the short lead times of retailers) potentially raises the costs to retailers and their manufacturers of lost shipments and lost contracts. The embargo of goods may create consequences for FLSA violations that quickly exceed the costs of back wages and CMPs owed. In effect, the ability to stop the flow of goods creates significant private penalties associated with the market-based costs of failing to deliver orders in a timely manner.

As a vital part of this policy, the WHD used the threat of embargoing goods to persuade manufacturers to augment the regulatory activities of the WHD. It did so by making the release of embargoed goods contingent on the manufacturer's agreement to create a compliance program for its contractors and subcontractors as well as to assure that back wages owed to workers are paid (either by the contractor or manufacturer).[41] Under the compliance program, the manufacturer agrees to sign two types of agreements: one between the manufacturer (or jobber) and the DOL; and another between the manufacturer and its contractors. The agreement between the DOL and the manufacturer stipulates the basic components of a monitoring system that will be conducted by the manufacturer.[42] The provisions of this agreement include explicit top management commitment to: uphold the FLSA; screen new contractors concerning prior history of FLSA compliance; establish a monitoring system; guarantee back wage payment and a formal remediation process; and inform and train contractors regarding their responsibilities under the law.

The second set of agreements are between the manufacturer and all of its contractors. These agreements set out the specific FLSA requirements; clearly define the terms and methods of computing wages and overtime (the subject of some ambiguity given that much of the industry uses piece rate payment); establish specific procedures for tracking payroll records, time cards, and the use of time clocks; and lay out other administrative procedures related to the contractor's compensation policies.

Measuring Regulatory Performance

Data collected over time through investigation-based random surveys provide a means to evaluate the impact of new strategies adopted by WHD specifically for improving compliance in garment manufacturing. The data for the following analysis arise from four investigation-based random surveys of apparel contractors operating in Los Angeles/Southern California (1998 and 2000) and the New York City area (1999, 2001). The surveys were conducted by the WHD using a randomly-selected set of establishments in the Southern California and New York area apparel markets.[43] Contractors selected from the list were subject to full investigations by WHD investigators that included employee interviews, a review of time cards and payroll records, and other data collection for a designated time period (typically two years).[44]

MONITORING IMPACT

Compliance program agreements entered into by the WHD at both the manufacturer and contractor levels stipulate a method of formal monitoring to be conducted by the manufacturer (or its designated third party). In a model program as described by the WHD, manufacturers would undertake unannounced monitoring visits "… at least once every 90 days." In the course of the visits, monitors would review contractors' payroll records and time cards; undertake piece counts (important for translating piece rate payments into hourly earnings); interview employees in private; advise contractors of compliance problems; and undertake training for contractors and/or their employees (U.S. DOL, 1998; 1999).[45]

41. These agreements are known as Augmented Compliance Program Agreements (ACPA). The ACPA contains within it a Program to Monitor Contractors that includes various provisions regarding contractor monitoring (discussed below).

42. These agreements, however, are entered into voluntarily by the manufacturer and their terms are therefore negotiated out between the government and the manufacturer/jobber. The terms described here are taken from the DOL's model agreement language specified in formal policy documents (see WHD, 1998).

43. Total sample sizes for the four surveys were 77 and 67 in Southern California (for 1998 and 2000 respectively); and 67 and 91 in New York (for 1999 and 2001). Apparel manufacturing and contractor firms appearing on the California and New York manufacturing registration lists for each year constituted the universe for the surveys. The registration lists for apparel consist of "… all persons or firms engaged in the business of apparel manufacturing …" where apparel manufacturing is defined as "… sewing, cutting, making, processing, repairing, finishing, assembling, or otherwise preparing any garment or any article of wearing apparel or accessories designed or intended to be worn by any individual …" See Weil, Mallo and Pyles (2003) for further details.

44. The WHD also selected a random sample among previous violators in order to see the evolution of the behavior of those who had already been found to violate FLSA regulations. The performance of prior violators (recidivists) is not our focus here (see Weil and Mallo 2003 for analysis of the recidivist group).

45. Model agreements also require that back wages are paid to workers: "Whenever the FIRM finds any act or omission by a Contractor that violates Sections 6 and/or 7 of the Act with respect to any work on any goods that the FIRM has shipped during the term of this ACPA or will ship during the term of this ACPA, the FIRM will immediately i) suspend all shipment of goods affected by such violations until all such violations affecting the goods have been remediated … and ii) cause … the payment of all unpaid back wages resulting from any violations of Section 6 and/or 7 of the Act by the Contractor … and do so in an amount approved by DOL …" The agreements may also provide for a more advanced set of monitoring arrangements and work practice agreements including the use of electronic time clocks and an agreement not to subcontract work without prior approval of the manufacturer. (WHD regional offices in New York and California frequently use the FCPA, a slightly shorter version of the ACPA.)

In the course of the Southern California and New York programs, the WHD negotiated many agreements with manufacturers, leading contractors operating in those areas to be covered by a variety of arrangements. These are depicted in Table 3.1, which lists the different provisions for monitoring and their frequency among the contractors in the random samples for both markets. Some provisions were very common among the sample (e.g., required review of time cards by the manufacturer undertaking monitoring). Others were less common (e.g., manufacturer recommendation of corrective action or conducting unannounced visits of contractors).

Although there are many potential combinations of the different monitoring activities, certain combinations of activities were found to have potentially larger impacts on contractor behavior than others. We focus below on specific combinations of monitoring activities that reflect the stringency of monitoring arrangements under which a contractor operates (lower portion of Table 3.1). First, we examine the impact of the presence of "any monitoring"—that is, contractors who report that at least one of their manufacturers is conducting at least one of the seven monitoring activities listed in Table 3.1. About 60 percent of the contractors in the New York sample in 2001 and over 70 percent in Southern California in 2000 had "any monitoring" in place.

In contrast, "comprehensive monitoring" is defined according to the presence of two specific monitoring features out of the seven: both payroll review by the manufacturer and the manufacturer's ability to conduct unannounced inspec-

TABLE 3.1

Types of Monitoring Agreements and Arrangements: Southern California 1998/2000; NYC 1999/2001

	Southern California 1998	Southern California 2000	New York City 1999	New York City 2001
Monitoring Activity Employed by Manufacturer				
Manufacturer reviews payroll	.66	.53	.43	.52
Manufacturer reviews time cards	.73	.60	.43	.54
Manufacturer conducts employee interviews	.62	.50	.30	.40
Manufacturer requires contractor to provide minimum wage information to workers	.65	.52	.28	.37
Manufacturer discloses problems with practices to contractor	.32	.42	.11	.25
Manufacturer recommends corrective action to contractor	.31	.42	.16	.27
Manufacturer may conduct unannounced visits	.55	.58	.29	.42
Type of Monitoring				
No monitoring: No monitoring activity among any of the manufacturers for which the contractor currently works	.211	.29	.443	.403
Any monitoring: One or more monitoring activities by one or more manufacturers	.789	.71	.557	.597
Comprehensive monitoring: Payroll review and unannounced inspections*	.239	.307	.241	.373
Number of observations	71	62	79	67

Note: *Because of differences in the survey questions used, comprehensive monitoring is measured as the presence of both features at all manufacturers for which a contractor currently works (Southern California) or at least one current manufacturer (New York).

tions.[46] This combination of monitoring activities provides manufacturers with the means of assessing the presence of possible minimum wage or overtime violations (payroll review) and a way of gaining a more realistic assessment of contractor operations (unannounced visits). We focus on these features because of their consistently significant impact on performance and complementary nature with one another (Weil and Mallo 2007). About 30 percent of contractors in the Southern California sample in 2000 and 37 percent of New York City contractors in 2001 reported operating under these provisions (see lower portion of Table 3.1).

46. Information about monitoring differs somewhat between the two samples. In Southern California, surveys provide information about each one of the contractor's multiple manufacturing customers at the time of the payroll review whereas in New York City, surveys only asked if any of the contractors' current customers used the various monitoring practices. As a result, comprehensive monitoring for Southern California meant all customers had both payroll review and unannounced inspections. In the New York sample, we classified a contractor as operating under comprehensive monitoring if any one customer had both practices in place.

Impact of Monitoring on Regulatory Performance

The random investigation-based surveys provide a way to see how manufacturer monitoring agreements negotiated with the WHD affected compliance. Since the workplaces selected for the survey were picked randomly, they should be representative of the cross-section of contractors operating in the two markets, and include many different monitoring arrangements. Table 3.2 provides an overview of compliance with minimum wage provisions for contractors that were not monitored by any of their manufacturers, relative to those with any type of monitoring by at least one manufacturer, and those with comprehensive monitoring. Three different measures of compliance are presented: the overall percent of compliance among contractors in that group (i.e., the percent of contractors with no violations of minimum wage provisions); minimum wage violations per 100 employees (a measure of the incidence of violations among the workforce); and minimum wage back wages owed per worker per week (a measure of the severity of violations per worker). The table shows that in both Southern California and New York City,

TABLE 3.2

Compliance: Minimum Wage Violations per 100 Workers and Back Wages per Worker per Week as a Function of Monitoring Levels

Compliance Measure	No Monitoring	Any Monitoring	Comprehensive Monitoring
California 1998			
Percent in compliance	33	54	65*
Minimum wage violations per 100 workers	52	27**	22**
Back wages owed per worker per week	$12.89	$7.21	$1.60**
California 2000			
Percent in compliance	11	57**	74**
Minimum wage violations per 100 workers	44	23**	9**
Back wages owed per worker per week	$10.26	$5.72	$0.93**
New York 1999			
Percent in compliance	54	73*	84**
Minimum wage violations per 100 workers	31	17*	3**
Back wages owed per worker per week	$16.46	$9.36	$0.77**
New York 2001			
Percent in compliance	78	92*	96*
Minimum wage violations per 100 workers	14	7	4
Back wages owed per worker per week	$4.53	$1.75	$1.53

Notes: Significance for "Any Monitoring" and "Comprehensive Monitoring" is measured against the "No Monitoring" base category.
An asterisk denotes significance at the 10 percent level and a double asterisk for 5 percent.

contractors with some form of monitoring had significantly better compliance—measured in all three ways—than those without monitoring. Comprehensive forms of monitoring are associated with particularly large improvements in compliance. For example, in Southern California in 2000, contractors operating under no monitoring by their manufacturer customers had on average 44 minimum wage violations per 100 workers; those operating under comprehensive monitoring had only 9 violations per 100 workers. Similarly, striking reductions are found in New York City in both 1999 and 2001.

However, there still might be reasons that the impressive results in Table 3.2 could have arisen from other factors related to, but not caused by monitoring. For example, contractors who operated under comprehensive monitoring might have also tended to be larger or more sophisticated. If these characteristics are also related to compliance, the results in Table 3.2 might be in part attributable to these other factors rather than monitoring.[47] In order to estimate the independent impact of monitoring programs on regulatory performance, other contractor characteristics such as size, type of products produced, and measures of contractor sophistication must be held constant. Fortunately, the investigation-based surveys also collected much of this information. We therefore estimated statistical models that separate out the effects of other contractor-related factors on compliance. In so doing, we can measure the independent impact of monitoring efforts on compliance with minimum wage provisions of the FLSA, holding constant the effects of contractor age, size, ability to affect price of goods sold, and other factors.[48] This provides a direct way to measure the impact of the new approaches to enforcement.

Table 3.3 presents the core results of these models for Southern California (upper panel) and New York City (lower panel). For each category of monitoring ("Any" and "Comprehensive"), the estimate can be interpreted as the incremental impact of that type of manufacturer monitoring of the contractor on compliance, i.e., "Any monitoring" relative to no monitoring, and "Comprehensive monitoring" relative to "Any monitoring." The total effect of comprehensive monitoring relative to no monitoring can therefore be found as the sum of the two effects.

Southern California: Monitoring programs instituted by the WHD in Southern California are associated with significant improvement in regulatory outcomes for both minimum wage and overtime violations. The upper portion of Table 3.3 presents the estimated impact on Southern California contractors of having "any" or "comprehensive" monitoring relative to no monitoring, holding constant the effects of other factors associated with regulatory performance in 1998 and 2000 and using two measures of compliance mentioned above: minimum wage violations per 100 employees and minimum wage back wages owed per worker per week.[49]

The presence of any type of monitoring by any one manufacturer ("Any monitoring") is not associated with significant improvements in compliance. Although having any monitoring is associated with a decrease in the incidence and severity of violations, the impacts are small and not statistically significant. On the other hand, manufacturer monitoring efforts that use both payroll review and unannounced inspections ("Comprehensive monitoring") have consistently large and significant impacts on contractor behavior. The incremental effect of comprehensive monitoring (relative to any monitoring) is a reduction of 8.5 violations per 100 employees in 1998, or a reduction of 19.3 violations relative to no monitoring; and in 2000, a reduction of 20.2 violations per 100 employees, relative to any monitoring, for a total reduction of 28.8 violations relative to no monitoring. Since average incidence of minimum wage violations in 2000 was 29.5, this represents a very sizeable effect attributable to monitoring. Comprehensive monitoring is also associated with a significant reduction of back wages by more than $6.00 per worker per week (and around $8.00 relative to the no monitoring case), which is almost equivalent to the average severity of minimum wage violations per contractor ($8.40 in 1998 and $7.03 in 2000).

New York City Area: Monitoring programs instituted by the WHD also were significantly associated with improved compliance among garment contractors in New York City (lower portion of Table 3.3). Contractors with monitoring in place had substantially better performance than those without monitoring. As was the case in Southern California, the presence of comprehensive monitoring by manufacturers had the greatest impact on improved compliance. Holding constant other factors affecting regulatory performance, comprehensive monitoring is associated with large and significant reductions in the incidence of violations (a reduction of 20 violations per 100 workers in 1999 and a smaller reduction of 12 violations per 100 workers in 2001, relative to the case of contractors with "any monitoring"). Similarly, contractors with comprehensive monitoring had less severe minimum wage violations, particularly in 1999 when contractors operating under comprehensive monitoring had

47. Another way of describing this problem is that while the survey of contractors is random, coverage under monitoring arrangements is not (the WHD did not randomly select manufacturers to negotiate monitoring agreements, nor was the ability to conclude those agreements independent of characteristics of those firms). As a result, we need to control for other characteristics that might be related to both the presence of monitoring and contractor compliance.

48. See Weil 2005, and Weil and Mallo 2007 for the econometric models underlying this section.

49. Monitoring also reduced overtime violations of FLSA, although less consistently than found for minimum wage violations. These results can be found in an earlier evaluation (Weil and Mallo 2003).

TABLE 3.3

Monitoring Effects in Two Apparel Markets

a. Southern California, 1998/2000

	Effect of Monitoring Arrangements [a]			
	Minimum Wage Violations per 100 Employees [b]		Minimum Wage Back Pay per Worker per Week [b]	
	1998	2000	1998	2000
Any Monitoring	**-10.79** (8.15)	**-8.63** (6.55)	**-1.96** (2.88)	**-1.73** (2.13)
Comprehensive Monitoring	**-8.47** (11.0)	**-20.15**** (8.03)	**-6.44*** (3.44) *	**-6.08**** (2.58) **
R^2	.122	.447	.155	.363
Sample Size	71	62	71	62

b. New York, 1999/2001

	Effect of Monitoring Arrangements [a]			
	Minimum Wage Violations per 100 Employees [b]		Minimum Wage Back Pay per Worker per Week [b]	
	1999	2001	1999	2001
Any Monitoring	**-5.36** (6.56)	**-3.58** (7.40)	**-2.33** (4.19)	**-2.09** (2.36)
Comprehensive Monitoring	**-20.33**** (10.27)	**-12.22** (10.53)	**-12.00*** (6.45)	**-3.44** (3.74)
R^2	.335	.523	.313	.579
Sample Size	79	67	79	67

Notes:

a. Model also includes controls for the effects of contractor size; primary product produced by the contractor (e.g., dresses; jeans); number of years of operation; pricing power (ability of the contractor to increase price if delivery time changed); and total number of manufacturer customers in the recent time period.

b. Standard errors are shown in parentheses. Estimates represent the marginal effects of monitoring, conditional on compliance being greater than zero, based on Tobit regression estimates. See Weil and Mallo 2007 for details and complete results. An asterisk after the estimate denotes significance at the 10 percent level and a double asterisk for 5 percent. R^2 based on McKelvey and Zavoina procedure for Tobit models.

back wages $12.00 lower than those with only some monitoring (and more than $14.00 lower per worker per week than those without monitoring).

Interpreting the Monitoring Effect

There are several factors important to interpreting the association between monitoring and regulatory performance. The "direct" impact of monitoring arises when manufacturer (or third-party) review of contractor payrolls and wage policies, as well as related activities during unannounced visits, lead directly to improvement in the practices of contractors—that is, contractors change their levels of compliance with FLSA as a direct result of monitoring. However, this is not the only way that monitoring might affect performance.

Manufacturers that sign monitoring agreements might also seek out contractors that are more likely to comply with the FLSA as a means of lowering risks of future embargoes. If many of the manufacturers with monitoring agreements in place undertake this kind of activity, more compliant contractors will end up sorting themselves or "matching" with manufacturers that undertake monitoring and worse contractors will end up with non-monitoring manufacturers. Figure 3.2 portrays these two effects.

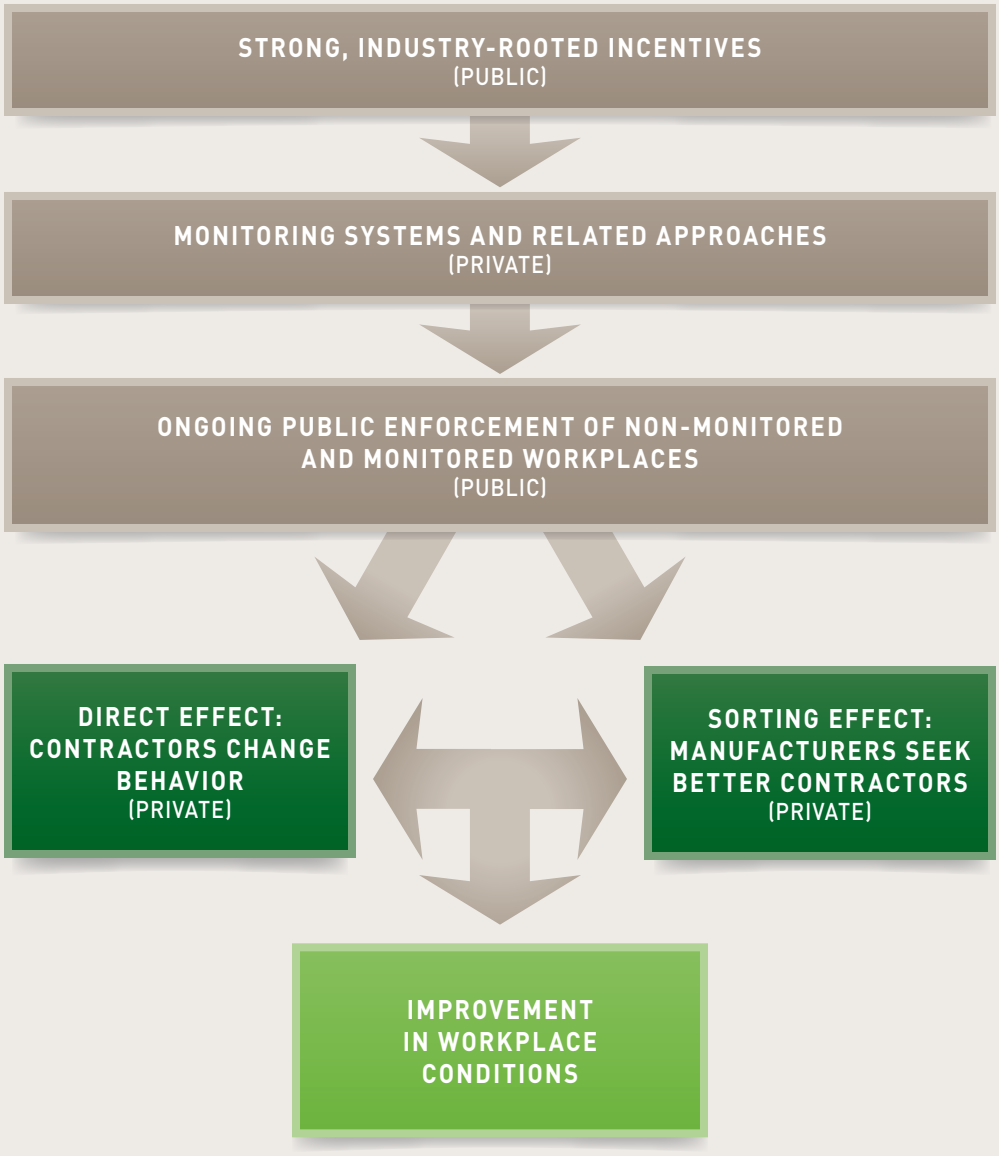
Both effects could contribute to the results depicted in Table 3.3. Because the survey data pertain to a group of randomly-selected contractors in a given year rather than the same set of companies followed over time, it is not possible to directly observe whether the measured effect arises from behavior changes induced via monitoring or sorting behavior. However,

several different analyses have allowed us to distinguish the direct effect of monitoring from those effects arising from manufacturer selection (see Weil 2005, and Weil and Mallo 2007 for details).

One method for separating out the direct impact of monitoring from the effect of selection is to compare the association between monitoring and regulatory performance for contractors with prior WHD violations to those without prior violations. Manufacturers during the survey periods had access to information about violators through government records and publications. Once provided this information, one would expect that most of the improvement in performance for the subset of prior FLSA violators would arise from direct effects of monitoring rather than from sorting. Conversely, if sorting was predominately responsible for the measured effect of monitoring, one would expect little association between monitoring and performance. In fact, in a separate analysis of survey data on prior violators in Southern California for 2000, we find that the presence of comprehensive monitoring is

FIGURE 3.2

Systemic Effects on Compliance from the Garment Enforcement Strategy



still associated with a reduction in minimum wage violation incidence of 26.7 per 100 workers and a reduction in back wages owed per worker per week of $3.44 (Weil 2005).

Another method of separating the direct effects of monitoring from sorting effects involves breaking the sample into two subgroups: recent entrants and established contractors. There is a high level of entry into and exit from the garment industries in both New York City and Southern California. New contractors (defined in our analysis as those that had been in business less than two years) have no real track record and because of this lack of information, are less likely to be sorted. An association between monitoring and performance among this group would therefore arise primarily from direct monitoring effects on behavior.

There is significant evidence of an association between monitoring and performance after separating by the contractors' years in operation. Using data from Southern California in 2000, we find strong and large associations between comprehensive monitoring and improvements in the incidence and severity of minimum wage violations. For example, among contractors that had been in business less than two years, comprehensive monitoring was associated with reductions of 22.3 violations per 100 workers. Conversely, we find strong evidence of sorting among established contractors (those in business more than two years): for these contractors, we find no statistical association between comprehensive levels of monitoring and performance (Weil 2005).

Finally, sorting itself represents a positive program effect if the prevalence of monitoring increases over time. That is, if manufacturers seek out only contractors that they believe to be compliant with FLSA provisions, and the percent of manufacturers undertaking monitoring increases over time, selection effects can drive real improvements in overall performance alongside the direct effects of monitoring. Table 3.4 presents comparative regulatory compliance for older contractors (operating for more than two years) versus new contractors. Changes in compliance over time, within each market for both groups, indicate what has driven some of the overall improvement in compliance. In Southern California (left columns of Table 3.4), regulatory compliance among older contractors improved modestly between 1998 and 2000. For new contractors, the incidence of violations actually rose slightly between the two time periods, although the severity of violations fell by $2.00 owed per worker per week—a relatively large (but not statistically significant) change.

New York City shows more dramatic changes in mean compliance levels for new contractors over time (right columns

TABLE 3.4

Regulatory Compliance Among New Contractors: Southern California 1998/2000; New York City 1999/2001

	Southern California Means (Standard errors)		New York City Means (Standard errors)	
	1998	**2000**	**1999**	**2001**
***Regulatory Compliance*—Old Contractors**				
Number of workers paid in violation of minimum wage per 100 employees	**28.5** (37.5)	**17.4** (29.6)	**17.4** (32.9)	**17.6** (34.6)
Average back wages owed per worker per week (Dollars)	**6.4** (13.7)	**4.2** (9.2)	**6.5** (16.6)	**5.4** (15.4)
N	36	34	32	27
***Regulatory Compliance*—New Contractors**				
Number of workers paid in violation of minimum wage per 100 employees	**35.6** (39.5)	**37.8** (35.7)	**26.5** (41.8)	**4.5**** (19.1)
Average back wages owed per worker per week (Dollars)	**10.8** (20.1)	**8.9** (14.4)	**19.7** (43.2)	**1.2**** (6.2)
N	41	33	59	40

Notes: "Old" contractors have been in business for more than two years; "new" contractors for two years or less. An asterisk after the year 2000 (or 2001) denotes significance at the 10 percent level of the difference in means between 1998 and 2000 (or between 1999 and 2001), and a double asterisk for 5 percent.

of Table 3.4). Although compliance changed little among older contractors between 1999 and 2001, violation incidence among contractors with less than two years of operation fell from 26.5 per 100 workers in 1999 to only 4.5 per 100 workers in 2001 and average back wages owed fell from $19.66 per worker per week in 1999 to a scant $1.18 in 2001. This major change among incoming contractors is consistent with the impact of sorting on contractor behavior. As more manufacturers in the market put in place monitoring systems, entrants will have a greater incentive to comply with labor standards in order to find customers. Given the significant turnover of contractors, these incentives can drive the market towards the higher levels of compliance observed in both areas, but strikingly so in New York.

The combined effects of monitoring and sorting help to explain the modest decrease in the incidence and severity of minimum wage violations in Southern California between 1998 and 2000 and the major decreases in New York between 1999 and 2001. The larger effects found in New York City shown in Table 3.4 may arise from the longer existence of the monitoring program there (which began some form of monitoring in 1996, versus 1998 in California). Structural features of the two markets may also account for some of the difference in effects. For example, New York manufacturers typically work with a smaller number of contractors, which might have heightened the incentives to find compliant partners.

Implications from the Garment Initiative

The garment initiative conducted in the late 1990s and early 2000s succeeds along the four dimensions of strategic enforcement discussed in Section II. In terms of prioritizing enforcement, the program focused on a low-wage industry with significant and persistent violations (and which, at the time of the initiative, still employed a relatively large number of manufacturing workers). And, while it focused within the industry on the level where those problems are most significant (contractors), rather than the endless "cat and mouse" games that historically characterized the garment enforcement strategy, its simultaneous focus on higher levels of the supply chain—the manufacturer—created greater incentive effects on those companies that drive subcontractor compliance. As a result, the strategy of using public enforcement power (the embargo) to create private monitoring systems has a powerful deterrence effect by engaging manufacturers in overseeing their contractor networks. This oversight, as well as the incentives to find more compliant contractors in the future, creates a platform for sustainable improvements in compliance.

The results from Southern California between 1998 and 2000 and particularly from New York between 1999 and 2001 indicate system-wide improvement in compliance: both the incidence and severity of minimum wage violations improved markedly during this time. What is more, the incentives for manufacturers to find partners who are less likely to cause their goods to be embargoed seems to raise the average levels of compliance of new garment contractors coming into the industry. Given the high rate of business turnover, this effect leads to compliance improvement in the industry over time. In this way, the sector-based strategy led to systemic change by altering the basic incentives to comply (or, more aptly, making them part of contracting decisions of manufacturers).

One "bottom-line" measure of the garment initiative is its impact on the overall levels of compliance in the markets during the time studied. Drawing on the random investigation survey data and extrapolating to the markets as a whole, compliance improved in both areas, as shown in the upper panel of Table 3.5. Improvements were particularly striking in New York, where the incidence of violations fell from 23 per 100 in 1999 to just under 10 per 100 in 2001, and the severity of back wages fell from $12.50 to under $3.00 per worker per week.

Use of Supply Chains as a Regulatory Tool

The decline of the U.S. garment industry has continued since the garment programs described in this section were created. Why, then, does the garment initiative remain relevant to crafting future strategic enforcement?

First, the garment initiative represents a replicable model for addressing systemic forces that push towards high noncompliance in fissured industries with multiple levels of subcontracting. The initiative did this by using public enforcement via the hot goods provision to create private market leverage. The threat of embargoes in an industry where on-time delivery had become a non-negotiable term of trade changed the way that key players in the industry—manufacturers, jobbers, and major contractors—made sourcing decisions. In particular, the threat of embargoed goods introduced substantial private penalties that easily dwarf in magnitude the CMPs available to the government. As a result, manufacturers—as part of their ongoing business decisions—became part of the effort for changing the behavior of their contractors (via monitoring agreements).

Second, retail restructuring and the growing compression of time in supply chain relations characterize a growing set of industries, from food to computers to home building supplies. At the same time, many companies are spinning off parts of their production processes and ceding them to networks of contractors and subcontractors. This trend is well-known in the manufacturing sector—for example, the spinning off of

suppliers formerly owned by the major car companies. As we have seen in Section II, the creation of multiple layers of subcontracting relationships has also become common in service sectors, from the health care industry to the provision of janitorial services in commercial buildings.

Understanding developments in industry supply chains provides a model for creating opportunities to use private incentives to achieve public ends. Establishing where these dynamics are occurring across different industries and harnessing them to serve public policy objectives, therefore, may prove a fertile means for achieving public purposes in a wide variety of regulatory arenas. The emergence, at key positions within supply chains, of powerful players that can exert pressures throughout the system also bears attention as a potential source for both education efforts and influencing adherence to labor standards.

TABLE 3.5

Regulatory Compliance Measures and Contractor Characteristics: Southern California 1998/2000; NYC 1999/2001

	Southern California Means (Standard errors)		New York City Means (Standard errors)	
	1998	2000	1999	2001
Regulatory Compliance Measures				
Percent of employers in compliance with minimum wage	**0.49** (0.50)	**0.44** (0.50)	**0.65** (0.48)	**0.87** (0.34)
Number of workers paid in violation of minimum wage per 100 employees	**32.07** (38.34)	**29.53** (34.59)	**23.08** (38.66)	**9.76** (26.99)
Average back wages owed per worker per week (Dollars)	**8.41** (16.40)	**7.03** (12.49)	**12.50** (26.02)	**2.87** (10.97)
Selected Contractor Characteristics				
Number of manufacturers that contractor worked for in past 6 months (Percent of contractors)				
1 manufacturer	31.0	48.6	55.4	61.2
2 manufacturers	33.8	22.6	25.3	22.4
3 manufacturers	16.9	11.3	13.3	16.4
4 manufacturers	9.9	6.5	3.6	0
5 manufacturers	8.4	10.6	2.4	0
Employer size (Number of workers)	29.1 (26.8)	31.9 (32.04)	27.0 (15.7)	29.1 (20.1)
Sample size	71	62	79	67

Note: Standard errors are shown in parentheses.

IV

FAST FOOD EATING PLACES AND VULNERABLE WORKERS

The eating and drinking industry—an industry that includes everything from fast food outlets to the most upscale and exclusive restaurants in the country—employs over nine million individuals. It is composed of two distinct sectors: full-service restaurants, and limited-service (or fast food) eating places. The limited-service sector accounts for about 37 percent of employment in the industry, or about 3.3 million workers.[50]

The vast majority (88 percent) of jobs in the industry are low-skilled and relate to food preparation and service. Employment is concentrated in small food establishments, which average about 17 workers per outlet.[51] In 2006, average hourly earnings for food preparation and servers were $7.23, with a median wage of $7.02 and a 10th percentile wage of $5.79—both well below the current federal minimum wage of $7.25.[52] The large number of low-wage jobs makes the industry particularly prone to minimum wage and hours of work violations.

In 2006, about 9.4 million workers were employed in the industry, accounting for about 12.5 percent of all low-wage workers (Osterman 2008). A recent comprehensive survey of 4,387 workers in the three largest U.S. metropolitan areas (New York, Chicago, and Los Angeles) found very high incidence of workplace violations in restaurants and hotels (grouped together in the study because of sample size). According to Bernhardt *et al.* (2009), an estimated 18.2 percent of workers in these sectors experienced minimum wage violations, 69.7 percent overtime violations, and 74.2 percent off-the-clock violations.[53] Estimated violation rates were similar for one key occupational group within the sector—cooks, dishwashers, and food preparers: 23.1 percent experienced minimum wage violations, 67.8 percent overtime violations, and 72.9 percent off-the-clock violations.

The high rates of violations put the sector on the list of top 15 low-wage industries identified by the WHD in 2004.

50. Full-service restaurants (NAICS 72211) are defined by the U.S. Census Bureau as, "establishments primarily engaged in providing food services to patrons who order and are served while seated (i.e., waiter/waitress service) and pay after eating. These establishments may provide this type of food service to patrons in combination with selling alcoholic beverages, providing carry out services, or presenting live non-theatrical entertainment." Limited-service eating places (NAICS 72221) are defined as "establishments primarily engaged in (1) providing food services where patrons generally order or select items and pay before eating or (2) selling a specialty snack or nonalcoholic beverage for consumption on or near the premises. Food and drink may be consumed on the premises, taken out, or delivered to the customer's location. Some establishments in this industry may provide these food services (except snack and nonalcoholic beverage bars) in combination with selling alcoholic beverages."

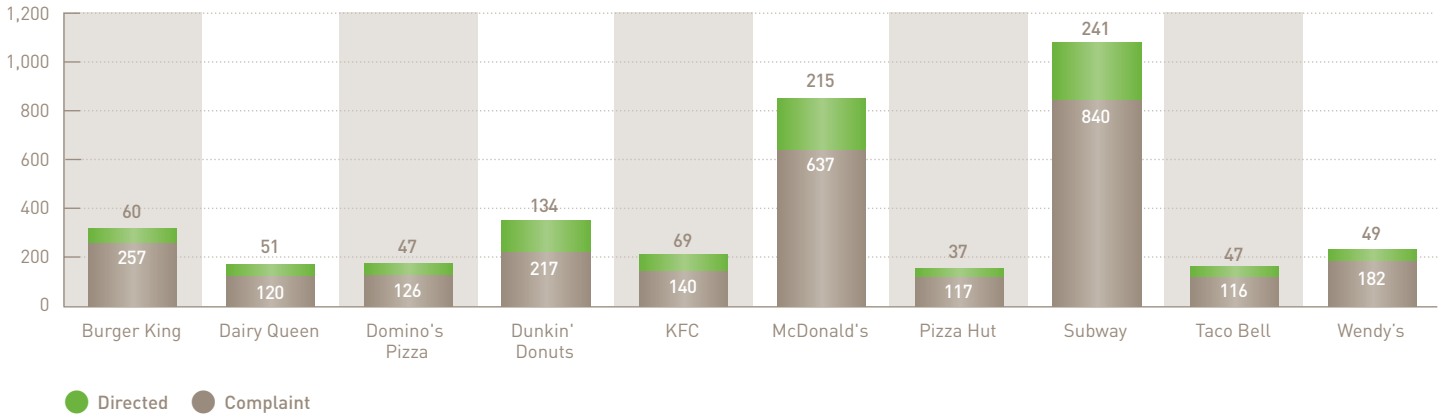
51. U.S. Bureau of the Census, *County Business Patterns: The United States.* (Washington, DC: GPO, 2004). http://www.census.gov/epcd/cbp/download/dwncbp04.html.

52. U.S. Bureau of Labor Statistics, *Occupational Employment and Wage Estimates, NAICS 722211, Limited Service Restaurants,* May 2006. The minimum wage increased to $7.25 on July 24, 2009. The minimum wage for tipped workers is considerably lower ($2.13 per hour, although employers are required to see that the total of tipped earnings and direct wages meets the minimum wage standard of $7.25). However, work at most fast food restaurants is paid on an hourly basis since there is seldom table service.

53. The estimates represent violation rates for low-wage workers in the three major metropolitan areas, based on a sampling methodology that sought to survey "… low-wage workers who may be hard to identify from official databases, who may be vulnerable because of their immigration status, or who are reluctant to take part in a survey because they fear retaliation from their employers." (see Bernhardt *et al.* 2009).

FIGURE 4.1

Cases with FLSA Findings in 10 Eating/Drinking Places, 2003–2008



Source: WHISARD data. Includes cases registered fiscal years 2003 to 2008 and closed by end of FY2008.

Accordingly, the WHD has devoted significant resources to the industry. Between 2003 and 2008, 25,056 of the 165,785 investigations (or about 15 percent) conducted by WHD were in eating and drinking.[54] The estimated amount of annual back wages owed by the industry is also sizeable: the average amount of back wages recovered during the 2003-2008 period was $12.9 million per year (or an average of $14.3 million between the years 2003-2007).

Although there are major problems in both the full- and limited-service segments of the industry, we focus on the fast food sector, and in particular on the segment of that sector dominated by large, branded national chains.[55] Given its far higher level of industry concentration (i.e., the fact that the fast food sector is dominated by a smaller number of brands than is the case in the full-service segment of the industry), findings regarding the compliance patterns among leading fast food companies may provide opportunities to affect corporate-wide compliance covering large numbers of workers. We discuss how brands and franchising—two central attributes of the sector—affect compliance. We also examine the presence of deterrence effects among the different major fast food brands operating in the same geographic area as one another. Our analysis shows that the organization of the sector leads to systemic patterns of compliance and noncompliance and, in turn, provides opportunities for WHD to influence employer behavior in a large number of workplaces because of how firms operate. In addition, the importance of national chains and the use of franchising in the fast food sector have implications for other sectors that are similarly structured.

54. This number reflects investigations in all eating/drinking workplaces, for cases with FLSA findings, registered in FY 2003 or later and concluded by the end of FY 2008. The total case numbers for 2008 are lower given that many cases were still open and therefore not included in this count at the time it was completed. If investigations initiated in 2008 are excluded, we find that 22,318 of 148,076 investigations or still about 15 percent between 2003 and 2007 were conducted in eating and drinking.

55. Although labor standards violations are common in both subsectors of the eating and drinking sector, the type of problems differ because of the nature of services provided by them. The central role of table service in the full-service subsector makes compliance with tipped wage requirements of the FLSA a central concern for enforcement. Since table service is uncommon in limited-service eating places, most workers are cooks, food preparers, cashiers, or cleaning workers, all of whom earn a set wage rate.

Branding and Franchising in Fast Food

THE IMPORTANCE OF BRANDS AND STANDARDS

The significant number of investigations and amount of back wages collected suggest that many of the major chains in this industry have been investigated repeatedly. For example, between 2003 and 2008, WHD completed a total of 317 Burger King cases (286 excluding 2008) and 231 Wendy's cases (209 excluding 2008), through a combination of complaint and directed investigations (see Figure 4.1). Some of these investigations arose from targeted investigations, but the majority arose from worker complaints (70 percent, excluding 2008).

Although the level of industry concentration (i.e., market share controlled by the top firms) is relatively low for the eating and drinking sector as a whole, the fast food subsector is much more concentrated. 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.[56]

The fast food sector in the U.S. is geographically dispersed. The establishments—about 195,000 outlets—can be found in virtually every community in the country. This should not be surprising given that eating out has become an important source of household daily food expenditures, constituting almost half of a typical family's food budget.[57]

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.[58] The investment in brand name and in the protection of its image is therefore a central part of the competitive strategy of national chains and an integral part of the way that they make operational decisions.

The importance of adhering to quality standards is key to fast food competitive strategy. This is demonstrated by provisions in agreements that franchisees sign when they become part of a national chain. Table 4.0 provides excerpts from several franchise agreements, illustrating the detailed standards (and the consent to follow them). 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:

> 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.

FRANCHISING AND STANDARDS

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 way is by 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.

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.[59]

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 moni-

56. 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.

57. Economic Research Service, United States Department of Agriculture, CPI, Prices and Expenditures: Foodservice as a Share of Food Expenditures, Table 12: Food Away from Home as a Share of Food Expenditures, http://www.ers.usda.gov/Briefing/CPIFoodAndExpenditures/Data/table12.htm (site accessed May 8, 2006).

58. This strategy was most famously pioneered by Ray Croc, founder of McDonald's, who built the national chain originally around a narrow selection of products. The strategy was followed by others who sought to both emulate McDonald's consistent customer experience, but also differentiate products (e.g., Burger King's emphasis on "flame-broiled" hamburgers) and the speed and convenience of service, including ubiquitous locations. 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.

59. 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.

TABLE 4.0

Franchise Agreement Statements Regarding Compliance with Brand Standards: Fast Food Industry—Selected Examples

Eating/Drinking Brand	Excerpt from Franchise Agreement
Dairy Queen	Your operating agreement is a contract between you, ADQ and us. You are a part of the national and international franchise system of DQ Grill & Chill and Dairy Queen franchisees and sub-licensees, and you must adhere to various system standards of quality and uniformity that ADQ establishes and modifies periodically, as well as standards and requirements that we establish and modify periodically. You will use ADQ's nationally recognized trademarks and service marks that are approved for your concept; have access to the distinctive operational and management attributes of the DQ system; participate in ADQ's national and regional sales promotion programs; and receive the benefits of association with a nationally recognized franchise system, including various forms of training, opening and operational assistance (see Item 11). [a]
Dunkin' Donuts	If you sign a franchise agreement, you will operate a franchised Dunkin' Donuts Store. Under our franchise agreement, we grant our franchisees the right (and they accept the obligation) to operate a Dunkin' Donuts Store, selling doughnuts, coffee, bagels, muffins, compatible bakery products, croissants, pizzas, snacks and other sandwiches and beverages that we approve. We may periodically make changes to the systems, menu, standards, and facility, signage, equipment and fixture requirements. You may have to make additional investments in the franchised business periodically during the term of the franchise if those kinds of changes are made or if your store's equipment or facilities wear out or become obsolete, or for other reasons (for example, as may be needed to comply with a change in the system standards or code changes). All Dunkin' Donuts Stores must be developed and operated to our specifications and standards. Uniformity of products sold in Dunkin' Donuts Stores is important, and you have no discretion in the products you sell. The franchise agreement is limited to a single, specific location and we have the right to operate or franchise or license others who may compete with you for the same customers .... The distinguishing characteristics of the Dunkin' Donuts System include, for example, distinctive exterior and interior design, decor, color and identification schemes and furnishings; special menu items; standards, specifications and procedures for operations, manufacturing, distribution and delivery; quality of products and services offered; management programs; training and assistance; and marketing, advertising and promotional programs, all of which we may change, supplement, and further develop. [b]
Einstein Bros. Bagels	Restaurants are characterized by our system (the "System"). Some of the features of our System are a specially-designed building or facility, with specially developed equipment, equipment layouts, signage, distinctive interior and exterior design and accessories, Products, procedures for operations; quality and uniformity of products and services offered; procedures for management and inventory control; training and assistance; and advertising and promotional programs. We may periodically change and improve parts of the System ... You must operate your Restaurant in accordance with our standards and procedures, as set out in our Confidential Operating Manual (the "Manual"). We will lend you a copy of the Manual for the duration of the Franchise Agreement. In addition, we will grant you the right to use our marks, including the mark "Einstein Bros." and any other trade names and marks that we designate in writing for use with the System (the "Proprietary Marks"). [c]
KFC	KFC outlets must be built to specification approved by KFCC. The KFC Operating Standards Library (the "Standards Library") explains the required standards for preparing products to be sold at the KFC outlet and operating the outlet (see Standards Library – Table of Contents attached as Exhibit I). The KFC outlets are characterized by a unique system which includes special recipes and menu items; distinctive design, décor, color scheme and furnishings; standards, specifications and procedures for operations; procedures for quality control; training and assistance; and advertising and promotional programs (the "System). [d]

Continued on next page.

TABLE 4.0

Franchise Agreement Statements Regarding Compliance with Brand Standards: Fast Food Industry—Selected Examples, CONTINUED

Eating/Drinking Brand	Excerpt from Franchise Agreement
Long John Silver's	LJS Restaurants offer a limited menu featuring fish, seafood, chicken and related items. The Restaurants are designed to serve food promptly and offer dine-in, take-out and in a significant number of Restaurants, drive-thru service. Your Restaurant must be built to LSJ's specifications and operated in accordance with LJS's standards.[e]
Taco Bell	You must operate your facilities according to methods, standards, and procedures (the "System") that Taco Bell provides in minute detail. The System is Taco Bell's sole property and is embodied in the Franchise Operations Manual, commonly referred to as the Answer System (the "Manual"). Taco Bell will furnish you with Books 1, 2, 3 and 5 of the Answer System at no cost and you may order, at your option and expense, Books 4 and 6, all of which are also currently available in cd format. The Manual is incorporated by reference into and is part of the Franchise Agreement, and has the same force and effect as other provisions of the Agreement. Taco Bell may choose to provide the Manual to you via electronic access to a confidential website, in which case Taco Bell will notify you that all or part of the Manual is posted on the website. You agree that it is your responsibility to provide access to the website to those of your employees (but no other persons) for whom the website is intended by Taco Bell. Your failure to follow the System as described in the Manual is a breach of the Franchise Agreement.[f]
Pizza Hut	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 (the "System"). A variety of trademarks, service marks, slogans, logos, and emblems that PHI designates for use in connection with the System (the "Pizza Hut Marks") identify the System. PHI has operated Pizza Hut "Red Roof" restaurants since 1958, when PHI opened its first restaurant. PHI has granted franchises for Pizza Hut "Red Roof" restaurants since 1959. PHI has operated Pizza Hut "Delivery" restaurants and PHI has allowed its franchisees to engage in delivery of pizzas since 1984. PHI has operated Pizza Hut "Express" restaurants (a concept not offered under this disclosure document) since 1987. [g]

Notes:

a. "American Dairy Queen Corporation: Dairy Queen Franchise Disclosure Document." 17 April 2009. Filed and accessed through the California franchising database. http://134.186.208.228/caleasi/Pub/Exsearch.htm

b. "Dunkin' Donuts Franchising LLC: Dunkin' Donuts Franchise Disclosure Document." 28 March 2008. Accessed through BlueMauMau.org. http://www.bluemaumau.org/ufocs_free_and_without_a_salesman_attached

c. "Einstein and Noah Corp.: Einstein Bros. Restaurant Franchise Disclosure Document." 20 December 2005. Accessed through FREEFranchiseDocs.com. http://www.freefranchisedocs.com/einstein-and-noah-corporation-UFOC.html

d. "KFC Corporation: KFC Franchise Disclosure Document." 24 March 2009. Filed and accessed through the California franchising database. http://134.186.208.228/caleasi/Pub/Exsearch.htm

e. "Long John Silver's, Inc: Long John Silver's Franchise Disclosure Document." 24 March 2009. Filed and accessed through the California franchising database. http://134.186.208.228/caleasi/Pub/Exsearch.htm

f. "Taco Bell Corp.: Taco Bell Franchise Disclosure Document." 24 March 2009. Filed and accessed through the California franchising database. http://134.186.208.228/caleasi/Pub/Exsearch.htm

g. "Pizza Hut, Inc: Pizza Hut Franchise Disclosure Document." 25 March 2009. Filed and accessed through the California franchising database. http://134.186.208.228/caleasi/Pub/Exsearch.htm

toring 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 reasons, restaurants represent the most highly-franchised industry in the U.S., making up 36 percent of all franchised establishments.[60]

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). This can lead to differences in terms of pricing, promotion, and cost control strategy.[61] 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.[62] This means franchisees may be more willing to violate the FLSA in order to reduce labor costs.

EFFECTS OF FRANCHISING ON FLSA COMPLIANCE

Table 4.1 provides background information on franchise ownership and compliance for the top 20 fast food companies in the sample.[63] 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 4.1, and implies that WHD investigations were somewhat skewed toward franchised outlets. In terms of comparative compliance, Table 4.1 indicates that in all brands except McDonald's, the average back wages per investigation 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.

Three measures of compliance among the top 20 brands in the sample are presented in the left-hand column of Table 4.2. There were a total of 1,768 full or limited investigations of the top 20 fast food outlets in the U.S. between 2001 and 2005. The mean total back wages per investigation for a given outlet were $1,350, and the average back wage per employee paid in violation was $178. Violations of minimum wage or overtime were found in about 40 percent of the 1,768 investigations. The first row, last column of Table 4.2 indicates that average total back wages per investigation were about $1,022 higher in franchisee-owned than in company-owned outlets. The second row shows similarly that total back wages owed per employee paid in violation were about $153 higher among franchises. Finally, the incidence of noncompliance (i.e., the percent of employers not complying with the law) was almost 20 percent higher in franchisee-owned than in company-owned outlets.

HOW MUCH DOES FRANCHISING AFFECT COMPLIANCE?

An objection to the comparisons in Tables 4.1 and 4.2 might be that there are many other reasons that franchisee-owned outlets might have higher noncompliance than company-owned outlets that have little to do with franchise status itself. In this view, the comparisons are unfair in that they compare outlets that might be very different in other respects leading one to incorrectly attribute the differences to franchising. For example, franchisees might be more common in local areas where there is greater competition between fast food restaurants. That competition (and only indirectly franchising) might lead them to have higher incentives to not comply. Alternatively, company-owned outlets might be in locations with stronger consumer markets, higher skilled workers, or lower crime rates, all of which might also be associated with compliance.

To adequately account for these problems, we created statistical models that allow us to include all of the potentially relevant factors in predicting compliance levels. By doing so, we can look at the effect of any one of them, holding the other factors "constant," and therefore interpret the franchise effect as representing its impact for an outlet with otherwise identical features as a company-owned outlet.[64]

60. FranData 2000, Table 4-1.

61. 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.

62. 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 Slade (1998); Lafontaine and Kaufmann (1994); Lafontaine and Shaw (1999; 2005).

63. 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.

64. Details on the statistical models created to undertake this analysis and the complete results from them can be found in Ji and Weil (2009).

TABLE 4.1

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

Brand	Percent Franchisee-Owned		Total Back Wages Per Investigation (Dollars)			
	(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.
Quiznos	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**

Note: Source for 'Percent of Franchisee (QSR)' is QSR Top 50 (2004).

TABLE 4.2

Back Wage Levels for Franchisees and Company-Owned Outlets: Fast Food Industry, 2001–2005

	N	Mean [St.D]	Mean Franchisee Owned (1)	Mean Company Owned (2)	Difference (1) – (2)
Dependent Variable					
Total back wages per investigation (Dollars)	1,768	1350.07 [5068.43]	1398.06 (126.23)	375.80 (119.58)	1022.27* (569.51)
Back wages per employee paid In violation (Dollars)	1,768	177.87 [541.67]	185.08 (13.49)	31.59 (7.49)	153.49** (60.81)
Incidence of employer noncompliance	1,768	0.40 [0.49]	0.41 (0.01)	0.21 (0.04)	0.19*** (0.05)

Notes: Standard errors in parentheses. *** Statistically significant at the 1% level, ** at the 5% level, * at the 10% level.

Table 4.3 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 good measure of the overall amount of noncompliance in a typical investigation.[65] 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 self-initiated by investigators, while complaint investigations arise from allegations of violations lodged by employees who believe an employer is violating labor standards. These different investigation types lead to potential differences in the outlet involved in an investigation.[66] 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: 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 investigations (and there is greater statistical uncertainty about the significance for that investigation type).

The statistical models underlying Table 4.3 excluded fast food outlets that were investigated using conciliation procedures.[67] The WHD undertakes conciliations in response to employee complaints typically by resolving violations via phone contacts with the employer. Conciliations, therefore, focus on resolution of an individual violation or claim where the WHD believes the incoming complaint does not suggest more serious, workplace-wide problems. Column (4) of Table 4.3 includes all investigations—directed, complaint, and the subset of complaint investigations that are resolved via conciliations. Since the latter type of investigations are handled on the phone and typically involve only the resolution of problems for an individual worker, the average back wage for that group is much lower than when an on-site investigation is undertaken. Nonetheless, the results show that franchisees still have significantly higher average back wages owed than comparable company-owned outlets.

65. 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.

66. Specifically, WHD does not include conciliations which arise in response to complaint investigations.

67. Conciliations accounted for 47 percent of all WHD enforcement cases during the sample period.

TABLE 4.3

Effects of Franchising on Employer Back Wages

Dependent Variable: Total Back Wages per Investigation

(2005 dollars)

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)
Probability 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 R^2	0.260	.655	.161	194
N	1,654	892	762	3,073

Notes: Standard errors in parentheses. *** 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 row. 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.

We also tested to see if the franchise effects varied for other measures of compliance. For example, WHD is not only concerned about overall back wages, but also the average back wages owed per worker paid in violation of the FLSA. This definition of compliance captures the relative severity of typical violations (just how much a worker who experienced a violation typically lost). Table 4.2 reported that the average level of this measure of compliance equaled $178 for the sample as a whole. Table 4.4 provides the results of the same type of statistical models used to generate Table 4.3, but using the severity of violations as the measure of compliance.

Table 4.4 demonstrates that franchisees once again owe far more back wages to workers than comparable outlets managed directly by the franchisor, even when using this alternative measure of compliance. In each case, a franchisee-owned fast food outlet is much more likely to have higher back wages owed than an otherwise similar company-owned outlet. 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.

IMPLICATIONS FOR WHD POLICY

Franchising solves a number of fundamental business problems for branded companies in the fast food industry: it allows for growth by tapping into the private capital of investors (franchisees); it creates management systems where

TABLE 4.4

Effects of Franchising on Employer Back Wages

Dependent Variable: Total Back Wages per Employee Paid in Violation

(2005 dollars)

Variables/Functional Form	(1) Overall	(2) Directed Investigations	(3) Complaint Investigations	(4) All Investigations, Including Conciliations
Franchise Ownership (Franchisee-Owned vs. Company-Owned)	$716.9***	$1,330.7***	$164.6	$159.9***
Standard error	(224.8)	(469.0)	(225.2)	(57.9)
Probability value	[0.001]	[0.005]	[0.465]	[0.006]
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 R^2	0.169	0.055	0.149	0.324
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 row. 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.

small and geographically dispersed operations have incentives to perform profitably; and it allows for the brand to respond to variations in local conditions.

But franchising does not come without costs. The challenge for franchisors is maintenance of brand image, a crucial piece for overall profitability. In the words of Rich Bachman, a KFC division director of operations, "We are running thousands of identical factories. They need to be the same because customers need to get what they expect. Since customers can see the plant and the process in real time, the details of the business are crucial." (Bachman quoted in Bradach 1998, p. 85).

The divergence in franchisor and franchisee investment in the brand has profitability implications. But as this section has demonstrated, it also has clear implications for FLSA compliance. Simply put, a typical franchisee has less on the line in complying (and more to gain from not complying) than a similar company-owned outlet. These findings have a number of implications for strategic enforcement in this sector. We go into detail on policy implications in section VI, but several key implications can be noted here.

1. Investigation priorities: In fast food chains, major problems are far more likely to be found among franchisees than company-owned outlets. Directed investigations should therefore focus on franchisees, and in particular, larger franchisees where an investigation can impact multiple outlets.

2. Include the brand in the investigation strategy: Franchisors have a stake in protecting brand reputation. In this sense, their interests can be aligned with WHD's: Franchisees who cut corners on compensation policies may feel consequences on other practices that could undermine reputation (e.g., bad pay policies result in poor service quality). Franchisees who "go rogue" may be violating other workplace policies that can be consequential to the brand. Bringing the brand to the table might provide opportunities for cooperative problem solving.

3. Wide-scale noncompliance by outlets of a franchisor, however, may indicate a "don't ask, don't tell" policy, particularly if motivated by concerns of reducing potential exposure to vicarious liability (beyond labor standards claims). If so, the WHD might be required to pursue a less cooperative approach, including compelling the creation of some form of monitoring arrangement at the brand level through a settlement arrangement or comparable chain-wide agreement.

4. Finally, the systemic nature of violations found in this section raises a more fundamental legal question that goes beyond the fast food sector. As Section II argued, in more and more industries a lead firm sets significant product, performance, quality, and/or delivery standards on a network of other, usually smaller business entities operating in competitive markets. What other obligations do the lead firms take on if they create these often very exacting standards? How does the answer to that question affect the definition of employer (or joint employer) and have implications for WHD in regard to the use of other tools like hot goods temporary restraining orders?

Deterring FLSA Violations: Prospects and opportunities in the fast food industry

To paraphrase Mark Twain, everyone talks about deterrence, but no one does much about it. Most regulatory agencies assume that their actions at one place change the behavior not only at that place, but also at other workplaces that are not directly investigated. The assumption is that rational companies compare the probability that they will be investigated and the costs of being found in violation to the costs of complying with labor standards. If the expected costs of not complying are sufficient, deterrence will lead companies to comply with standards (beyond what they would already do given their own interests) even if they are not directly investigated. Everything from income taxes to traffic enforcement depends on this logic of deterrence.

The logic of deterrence also gives rise to concern about the capacity of regulatory agencies like the WHD or OSHA to achieve compliance. If employers see the likelihood of investigation as unlikely and/or the penalties of not complying low, noncompliance will result. This problem is magnified further given that the FLSA does not levy CMPs for violations the first time an employer is found to violate.[68] The absence of CMPs for first-time violators means that a rational employer who can attract a workforce paying below the minimum wage actually should violate since the cost of doing so (the first time) is simply the amount of back wages owed to workers (i.e., what a compliant employer should have been paying all along).

GEOGRAPHY AND INDUSTRY MATTER

Deterrence implies that there is something about prior investigations that affects a company's decision. In the simplest case (the story often told), government activity at any workplace affects deterrence. From this perspective, it is easy to conclude that deterrence effects should be small in general. There are 7.3 million employers regulated by the WHD. The WHD 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.

But this is a very simplistic way of thinking about deterrence. Businesses think about key decisions in terms of competitors in their market. A market is defined by an industry and by geography. A company sets its competitive policies—the goods and services it provides, the prices it sets for them, and decisions related to costs of producing those products or services—according to conditions in its market. Deterrence should be thought of in similar terms. A company's decision to comply with laws should depend on the "threat" it feels from investigations given the perceived likelihood of investigations in its relevant markets.

For a fast food company, that means that if deterrence is present, it should be working across the other fast food companies it regards as competitors, and in the local area where it faces competition from them. We therefore measure deterrence here among a set of major, branded fast food outlets that compete at a local level (defined in terms of sharing a common, 5-digit zip code).

For WHD, deterrence effects may arise geographically, in an industry, or in an area of regulatory concern (e.g., child labor). The problem is that there have been few studies that measure the size of deterrence effects. This is because the data collected by the agency only tell us about the compliance situation of those workplaces that are actually investigated by WHD. Deterrence, however, is about how investigations in one workplace affect behavior in other workplaces—ones that are not necessarily investigated.

Since we cannot analyze compliance behavior of workplaces that weren't investigated, one way to measure deterrence is to recast it around the impacts of prior investigations in a geographic area on the behavior of workplaces subsequently investigated in that same area. For example, does a fast food outlet behave differently if there were many investigations of other fast food restaurants in the same geographic area in the prior year than if there were no investigations of other

68. The FLSA does give WHD the authority to assess liquidated damages equal to the amount of the back wages. Historically, WHD has not used this enforcement tool except in litigation cases seeking back wages.

restaurants? By reframing the analysis in this way, we can use WHD data to estimate deterrence.

MEASURING DETERRENCE EFFECTS IN FAST FOOD

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. The first two columns of Table 4.5 list the total number of investigations (not including conciliations or audits) for each of the top 20 branded restaurants in the U.S., and the calculated annual probability of investigation. Each of the brands faces less than a .02 probability of receiving an investigation in a given year.

How well do major fast food companies comply with FLSA? The answer for 2001-2005 is surprising. Table 4.5 presents enforcement and compliance information for the 20 largest fast food eating and drinking outlets in the U.S. between 2001-2005. Overall, about 40 percent of the investigated outlets were in violation of the FLSA during the period, with minimum wage or overtime violations for about 17 of every 100 workers and average back wage payments of a little under $200 per employee who was paid in violation. But compliance varies considerably across brands: Companies like Dunkin' Donuts, Domino's Pizza, and Subway had violations far above those averages and others like Burger King and McDonald's well below.

We defined a "local" area by using a 5-digit zip code, and counted the number of investigations that were done by WHD of top 20 fast food outlets in that area. These are presented in Table 4.6. There were a total of 1,890 investigations of top 20 fast food outlets in our data. For 1,301 of them (or 69 percent of all investigations), there had been no other investigations (either complaint or directed) of other fast food outlets in the prior year in the 5-digit zip code area. For 367 investigations, there had been only one other investigation of a top 20 restaurant in the prior year, for 129 investigations, there had been two other investigations of a top 20 outlet in the prior year, etc. Alternatively, in 1,575 of the investigations, there had been no prior directed investigation and in 1,559 cases, there had been no prior complaint investigation.

Categorizing the investigations in eating and drinking in this way allows us to compare the investigation findings for a workplace where other major eating and drinking outlets had not been investigated in the prior year with those where other outlets had been recently investigated. If there are deterrence effects present, a fast food outlet in an area where there had been prior investigations should have better compliance than one with fewer (or no) prior investigations.

Table 4.7 provides a top-line comparison of the effects of prior investigations on compliance. It uses three different ways to measure compliance: the percent of outlets with violations for that group; the average number of employees paid in violation of the FLSA relative to the total number of employees at the outlet; and the average back wages per employee paid in violation. It presents these averages for workplaces where there were 0, 1, 2, etc. other fast food investigations in the prior year. As can be seen, noncompliance (percent of outlets with more than 0 violations) declines steadily with the number of prior investigations, implying deterrence. The relationship is also present for total back wages per investigation, and employee violations per total employees (up to the case where there were three prior investigations). However, the relationship is not readily apparent for back wages owed per employee paid in violation of the FLSA.

Deterrence effects are more pronounced when we compare how average compliance measures change given prior directed versus complaint investigations (Table 4.8). Once again, the table can be read as the average compliance level given the presence of 0, 1, 2, etc. prior directed or complaint investigations. What is striking in Table 4.8 is that while average compliance levels increase where there were more prior directed investigations, the pattern does not seem to hold for complaint investigations. We examine this difference in greater detail below.

FOCUSING IN ON TRUE DETERRENCE EFFECTS

There are, no doubt, other differences besides a changing number of prior investigations that might account for the relationship between prior investigations and compliance seen in Tables 4.7 and 4.8. For example, areas where there were multiple investigations might have had common labor market characteristics that both drew WHD to investigate them multiple times and are associated with better compliance. As a result, it would be incorrect to conclude that a true deterrence effect from investigations led to better compliance.

We can use statistical models to try to correct for these effects. By including other possible factors that affect compliance with the FLSA and the number of investigations in a local area, we can "control" for these other potential factors and measure the true effect of prior investigations on current compliance.[69] There are a number of factors that must be taken into consideration:

- **Investigations of the same brand as the outlet under investigation:** Prior investigations of the same restaurant brand as the outlet in a geographic area may reflect that the WHD has recently found problems with that brand, or the owner of a franchise in a geographic area previously. As a result, this subset of prior investigations could

69. A technical paper is available separately (Ji and Weil 2010).

TABLE 4.5

Enforcement and Compliance with FLSA in Top 20 Fast Food Outlets, 2001–2005

Brand	Enforcement		Compliance Levels (Means across investigated outlets)		
	Number of Investigations (not including conciliations or audits)	Probability of Annual Investigation [a]	Percent in Noncompliance (Percent of brand outlets with EEVIOL > 0)	EEVIOL/ # ees	BW/EEPIV (Dollars)
Arby's	59	0.007	45.763	0.181	185.512
Baskin-Robbins	17	0.002	29.412	0.109	17.344
Blimpie	13	0.004	46.154	0.216	49.888
Burger King	127	0.008	31.148	0.121	167.837
Dairy Queen	100	0.006	45.000	0.216	211.645
Domino's Pizza	61	0.005	47.458	0.246	298.118
Dunkin' Donuts	183	0.011	37.569	0.145	376.553
Hardee's	40	0.015	27.500	0.139	33.253
Jack in the Box	20	0.003	25.000	0.096	172.018
KFC	150	0.008	38.000	0.121	221.204
Little Caesars	30	0.003	26.667	0.078	66.413
McDonald's	294	0.009	30.584	0.068	89.007
Papa John's	30	0.005	40.000	0.158	83.877
Pizza Hut	63	0.004	17.460	0.046	44.069
Popeyes	45	0.018	60.000	0.251	217.502
Quiznos	45	0.007	35.556	0.166	84.663
Sonic	85	0.012	48.235	0.221	221.200
Subway	409	0.009	50.515	0.284	246.903
Taco Bell	75	0.005	37.838	0.115	169.789
Wendy's	82	0.007	42.308	0.117	216.054
Total	**1,928**	**0.008**	**39.735**	**0.167**	**194.723**

Note:
a. Annualized number of investigations divided by total number of workplaces controlled by brand.

TABLE 4.6

Frequency of Past Investigations in Five-Digit Zip Code Area

Number of Prior Investigations [a]	TOTAL Number of Cases with this Number of Investigations in Prior Year		DIRECTED Number of Cases with this Number of Investigations in Prior Year		COMPLAINT Number of Cases with this Number of Investigations in Prior Year	
	N	Percent	N	Percent	N	Percent
0	1,301	68.84	1,575	83.33	1,559	82.49
1	367	19.42	193	10.21	267	14.13
2	129	6.83	65	3.44	44	2.33
3	48	2.54	22	1.16	14	0.74
4+	45	2.38	35	1.85	6	0.32
Total	**1,890**	**100**	**1,890**	**100**	**1,890**	**100**

Note:
a. Total investigations excluding conciliations and audits.

TABLE 4.7

Relation of Prior Investigations of All Top 20 Outlets to Compliance

(Excluding Conciliations and Audits)

Number of Investigations in Prior Year (Five-Digit Zip Code Area)	Percent in Noncompliance (Percent of Brand Outlets with EEVIOL > 0) [a]	EEVIOL/# ees [a]	BW/EEPIV [a] (Dollars)
0	41.891 (1.368)	0.177 (0.009)	190.397 (14.309)
1	37.875 (2.536)	0.153 (0.016)	238.257 (37.436)
2	32.558 (4.142)	0.131 (0.024)	73.776 (22.674)
3	29.167 (6.630)	0.181 (0.052)	111.480 (62.215)
4+	24.444 (6.479)	0.082 (0.034)	400.237 (215.202)
Total	**39.735 (1.126)**	**0.167 (0.007)**	**194.723 (13.475)**

Note:
a. Standard errors are in parentheses.

TABLE 4.8

Relation of Prior Investigations of All Top 20 Outlets to Compliance: Directed and Complaint Investigations

(Excluding Conciliations and Audits)

Number of Investigations in Prior Year (Five-Digit Zip Code Area)	Directed Investigations in Prior Period Only [a]			Complaint Investigations in Prior Period Only [a]		
	Percent in Noncompliance (Percent of Brand Outlets with EEVIOL > 0)	EEVIOL/# ees	BW/EEPIV (Dollars)	Percent in Noncompliance (Percent of Brand Outlets with EEVIOL > 0)	EEVIOL/# ees	BW/EEPIV (Dollars)
0	43.30 (1.25)	0.19 (0.01)	194.15 (13.12)	38.23 (1.23)	0.16 (0.01)	193.46 (15.05)
1	26.43 (3.18)	0.09 (0.02)	216.51 (56.93)	43.07 (3.04)	0.18 (0.02)	194.06 (32.20)
2	18.46 (4.85)	0.07 (0.03)	123.43 (72.98)	61.36 (7.43)	0.26 (0.05)	206.82 (92.09)
3+	10.53 (4.10)	0.03 (0.02)	218.15 (157.44)	65.00 (10.94)	0.44 (0.10)	275.70 (145.47)
Total	**39.74** (1.13)	**0.17** (0.01)	**194.72** (13.48)	**39.74** (1.13)	**0.17** (0.01)	**194.72** (13.48)

Note:
a. Standard errors are in parentheses.

be related to compliance. In order to create a cleaner measure of compliance, we count separately the number of prior investigations of the same brand and of other brands.

- **Characteristics of the outlet:** Certain types of outlets might be more prone to having multiple investigations and compliance problems because of their characteristics. We have seen, for example, that franchised outlets are far more likely to have compliance problems than outlets owned and managed directly by the brand. We control for franchise status and also control for outlet size (the number of employees at the outlet). Finally, we include controls for each of the major brands operating in the area.
- **Characteristics of the geographic area:** Certain geographic characteristics might be associated with both compliance and the frequency of investigations, independent of deterrence effects. We control for the number of major brand outlets in the area (where more competition might spawn greater incentives to cut costs and not comply, but also increase attention by the WHD because of larger numbers of facilities). We also control for a variety of economic characteristics of the area including population size, demographic factors, whether the zip code area is classified as a metropolitan or rural area, and other characteristics.
- **Other factors:** Finally, we include statistical controls for other factors that might potentially account for the relationship between prior investigations and current compliance levels. These include the year in which the investigation was conducted, whether the state where the inspection occurred had a state minimum wage above the federal level at the time of the inspection, and two kinds of variables to control for the region of the investigation.[70]

OVERALL WHD DETERRENCE EFFECTS

Our statistical models allow 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"

70. In order to ensure that we are identifying deterrence effects and not those associated with other local characteristics that might be associated with the number of investigations, we include controls for a 3-digit zip code region surrounding the outlet to control for other "unobserved" factors that might be otherwise measured. This represents a very strong control for the presence of unobserved factors that might be incorrectly attributed to deterrence. If we relax the control and include a dummy variable for the region in which the investigation occurred and a separate dummy variable for states with state minimum wage levels above the federal minimum wage, the estimated deterrence effects are even larger and statistically significant.

measure of how much employers in the fast food industry responded to prior investigation activities.

Table 4.9 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 any of the top 20 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 (a measure of the amount of variation around the estimated effect) 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: Referring back to Table 4.2, 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 Table 4.9 provides the traditional measure of compliance: whether there was any violation of the FLSA found in the investigation. The value of negative 0.331 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.

DETERRENCE EFFECTS BY THE TYPE OF INVESTIGATION CONDUCTED

The results in Table 4.9 combine directed and complaint investigations. Do the results look different if we separate out prior directed from prior complaint investigations? There are arguments in both directions. On one hand, the WHD procedures for investigations attempt to make both investigations look the same from the perspective of the employer: When WHD decides to conduct a site visit, it does not indicate to the employer whether the visit was initiated by a specific worker complaint or by a larger directed initiative. On the other hand, directed initiatives in many local areas are often accompanied by press releases or other communications indicating that WHD is undertaking focused activity in an area. A complaint investigation, by contrast, is not by nature associated with larger initiatives. Employers may be more likely to discuss (and therefore preemptively respond to) directed investigations, whereas a complaint investigation may not be well known beyond the employer (franchisee) or possibly the brand involved.

Table 4.10 provides estimated effects of prior directed versus complaint investigations among the top 20 eating and drinking outlets. As in Table 4.9, these estimates represent the effect of an additional directed or complaint investigation in the prior period, holding constant the effects of other factors (including the other type of investigation).

The two types of investigations have different impacts on compliance outcomes. The estimated effect of prior directed investigations on current compliance behavior increases from the effects in Table 4.9, indicating that an additional directed investigation has an even larger deterrence effect than when we combine the effects of directed and complaint investigations. 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 Table 4.9, 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 in Table 4.10, 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. What might explain these differences?

THE DRIVERS BEHIND DETERRENCE

From what we know, Tables 4.9 and 4.10 represent the first, explicit measures of the impact of WHD investigations on subsequent employer behavior with respect to compliance with the FLSA. They imply that WHD has had significant impact on behavior in the branded end of the eating and drinking industry. What might explain these significant findings? We speculate on some of the reasons, although additional analysis underway will hopefully provide further insight.

First, local geography is very important. The strong deterrence effect is measured by calculating the number of investigations in the same 5-digit zip code as an outlet. To test

TABLE 4.9

Effect of an Additional Prior Investigation on Predicted Compliance

	Total Back Wages per Investigation [a, b] (Dollars)	Total Number of Employees Paid in Violation [a, b]	BW/EEPIV [a, b] (Dollars)	Percent in Noncompliance (Percent of Brand Outlets with EEVIOL > 0) [a, b]
Effect of an additional investigation of top 20 outlets in prior year in local area, excluding outlets of the same brand (Five-digit zip code)	**-$886****	**-10.2*****	**-$98.56**	**-0.331****
Standard error	(382.3)	(3.54)	(53.64)	(0.156)
Probability value	[0.021]	[0.004]	[0.066]	[0.034]
Number of observations	1654	1654	1654	1051

Notes: *** Statistically significant at the 1% level, ** at the 5% level, * at the 10% level.
a. Total investigations excluding conciliations and audits.
b. The model used for these estimates include three-digit dummy variables to control for geographic specific effects—a more geographically detailed control variable than used in the other models.

MODEL REFERENCES:
(1) Table 8-3 (Tobit with full eating and drinking sample): 12/24/08, specification (5).
(2) Table 10-3 (Tobit with full eating and drinking sample): 12/24/08, specification (5).
(3) Table 7-3 (Tobit with full eating and drinking sample): 12/24/08, specification (5).
(4) Table 12-3 (Tobit with full eating and drinking sample): 12/24/08, specification (5).

TABLE 4.10

Effect of an Additional Prior Directed vs. Complaint Investigation on Predicted Compliance

	Total Back Wages per Investigation [a, b] (Dollars)	Total Number of Employees Paid in Violation [a, b]	BW/EEPIV [a, b] (Dollars)	Percent in Noncompliance (Percent of Brand Outlets with EEVIOL > 0) [a, b]
Effect of an additional *directed* investigation of top 20 outlets in prior year in local area, excluding outlets of the same brand (Five-digit zip code)	**-1466.27*****	**-14.0*****	**-125.44****	**-0.563*****
Standard error	(458.4)	(3.58)	(57.35)	(0.17)
Probability 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 (Five-digit zip code)	**-2.55**	**-6.37**	**-84.2**	**-0.133**
Standard error	(591.2)	(4.55)	(78.62)	(0.13)
Probability value	[0.997]	[0.16]	[0.285]	[0.32]
Number of observations	1654	1654	1654	1653

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

MODEL REFERENCES:
(1) Table 14-3 (Tobit with full eating and drinking sample): 12/24/08, specification (4).
(2) Table 16-3 (Tobit with full eating and drinking sample): 12/24/08, specification (4).
(3) Table 13-3 (Tobit with full eating and drinking sample): 12/24/08, specification (4).
(4) Table 18-3 (Tobit with full eating and drinking sample): 12/24/08, specification (4).

TABLE 4.11

Effect of an Additional Prior Investigation on Predicted Compliance Using a Wider Geographic Area for Deterrence Effects

	Total Back Wages per Investigation [a, b] (Dollars)	Total Number of Employees Paid in Violation [a, b]	BW/EEPIV [a, b] (Dollars)	Percent in Noncompliance (Percent of Brand Outlets with EEVIOL > 0) [a, b]
Effect of an additional investigation of top 20 outlets in prior year in local area, excluding outlets of the same brand (Three-digit zip code)	**-75.135**	**-0.72**	**-8.95**	**-0.039*** **
Standard error	(71.039)	(0.65)	(10.21)	(0.015)
Probability value	[0.290]	[0.273]	[0.381]	[0.009]
Number of observations	1654	1654	1654	1051

Notes: *** Statistically significant at the 1% level, ** at the 5% level, * at the 10% level.
a. Total investigations excluding conciliations and audits.
b. The model used for these estimates included three-digit dummy variables to control for geographic specific effects—a more geographically detailed control variable than used in the other models.

MODEL REFERENCES:
(1) Table 8-3 (Tobit with full eating and drinking sample): 1/25/09, specification (5).
(2) Table 10-3 (Tobit with full eating and drinking sample): 1/25/09, specification (5).
(3) Table 7-3 (Tobit with full eating and drinking sample): 1/25/09, specification (5).
(4) Table 12-3 (Tobit with full eating and drinking sample): 1/25/09, specification (5).

how sensitive our results are to geography, we recalculated these results for a 3-digit zip code area as well (i.e., including prior investigations in the last year over a much larger geographic area). Table 4.11 (which can be read in the same way as Table 4.9) shows the results: The deterrence effect fades quickly away as we "zoom out" from the immediate zip code area. The size of the deterrence effect is very small: An additional investigation of a top 20 brand outlet in the 3-digit area during prior year lowers current back wages by $75 (versus $855 in the more immediate area) and barely changes the overall likelihood of compliance (an estimated 4 percent reduction in the probability of noncompliance versus a 33 percent reduction for past investigations in a more localized area). These results show that the deterrence effect is strong, but at a very localized level.

WHD policy impacts: One reason that employers are so sensitive to investigations may be that they represent a "bolt from the blue" to an employer. Most employers rarely encounter WHD (or for that matter OSHA and other regulatory agencies). In the five-year study period (2001-2005), only 17 percent of the 5-digit zip code areas that had at least one top 20 fast food outlet located in it received one or more investigations.[71] A recent WHD investigation in a local area is an unusual event and one that employers notice. Tables 4.6 and 4.7 also show that impact is particularly large initially, and diminishes after that (i.e., going from zero to one investigation in a local area has a much larger impact than the effect of an additional investigation beyond that).[72]

Employers must also know that WHD has been conducting investigations. Although the protocols specified in the WHD handbook for conducting a workplace investigation are similar for directed and complaint investigations, the publicity surrounding them are not. In particular, directed investigations of an industry are typically preceded by a press release by the local area office, letters to area employers, and often summaries of findings by investigators after the fact. In contrast, complaint investigations are handled as a matter between the employer and the WHD office. This difference in pre- and post-investigation information is evident in the different deterrence effects shown in the prior tables.

Employer networks: The way that businesses interact with one another clearly has important implications for deterrence. Stronger networks mean that information about investigations will be communicated and, presumably, imply stronger deterrence effects. The strength of geography and industry are one example of this: franchisees operating in a com-

71. There were 14,481 5-digit zip code areas with one or more fast food outlets. 11,934 of them received no investigations; 1,798 received one investigation; 472 two investigations; and 277 three or more investigations. About 13 percent of the 5-digit zip code areas received one or more complaint investigations and about 5 percent received one or more directed investigations.

72. Other studies of workplace regulation find similar "bolt from the blue" effects. In OSHA, see Weil 1996 and Mendeloff and Gray 2004.

mon industry like fast foods interact with one another both through day-to-day market competition, but also by participating in business associations (franchise associations; local Chambers of Commerce), community groups (e.g. Rotary clubs) and other social networks. Common experiences and interests arising from competing in the same industry overlaid by those arising from operating in the same geographic market can strengthen ties between companies and, in turn, amplify deterrence effects. These ties might go beyond the deterrence effects arising from investigations of well-known brands, but may also ripple out and affect compliance among independent, unbranded fast food outlets (something we examine in greater detail in the hotel/motel sector).

Worker networks: It is also possible that information about investigation activity is transmitted via worker networks operating within local labor markets. There is significant turnover among workers in the fast food industry. It is possible that turnover facilitates information about the presence of investigations ("The guy I used to work for was investigated for paying under the table."). Community, familial, or ethnic ties may also increase information flow across worker networks. Impacts on deterrence may work in a variety of ways. An investigation at one workplace may give workers information about their right to file complaints or give them more confidence in exercising this right. This might lead to discussions with employers that in themselves lead to improved compliance.

Using Ripples: Implications from the Fast Food Industry

There are a number of policy implications arising from the significant deterrence effects found in this paper, particularly those found among directed investigations conducted by the WHD. We go into them in depth in Section VI, but several require mention here.

1. **Industry matters!** Deterrence effects are present beyond the boundaries of a workplace or even company. In planning investigations, the WHD should take into account not only their impact on the targeted employer, but on other employers in the same industry who operate under similar conditions.
2. **Geography matters!** They say that all politics is local. The same seems to be true for workplace compliance. Even though major fast food brands compete aggressively to create brand recognition at a national level, through advertising and marketing strategies, competition in the fast food industry plays out locally as outlets try to win the business of consumers. That means that the eyes of franchisees are focused on their competitors down the street, both in terms of winning business and keeping down costs. The results in this section indicate that attention to local conditions plays out in terms of awareness of WHD investigations, too, with resulting impacts on deterrence.
3. **Networks matter!** The way that businesses and workers interact within a geographic area as a result of employer associations, franchise networks, and business practices, impacts the strength of deterrence. Equally, worker networks arising from community, ethnic, and other ties, as well as through organizations like labor unions and worker centers, play an important role in influencing the strength of "ripple effects" that underlie deterrence. As a result, in making investigation decisions, the WHD should consider its impact beyond the specific workplace involved. In planning initiatives and evaluating their success, the WHD should consider not just the direct effects of investigations on employer activities, but also the effects beyond them.
4. **Not all investigations are created equally!** Complaint investigations are more likely to find violations than directed ones. However, in the eating and drinking industry, they have more limited ripple effects. The WHD should seek to emulate those features of directed investigation policies that enhance their ripples (e.g., publicizing local investigations after they have been undertaken) in their complaint investigation procedures. For example, the findings of recent complaint investigations could be summarized and announced to area employers in the industry (and potentially related industries).

V

THE FISSURED WORKPLACE

LESSONS FROM THE HOTEL AND MOTEL INDUSTRY

The hotel/motel industry employs more than 1.8 million employees in over 56,000 establishments.[73] The industry accounts for a disproportionate share of low-wage workers relative to its share of employment (Table 2.1). Hotels and motels employ vulnerable workers, many of whom are not being paid/employed in accordance with the minimum wage and overtime requirements of the FLSA. Between FY 2003 and FY 2008, the WHD found back wages of $13.6 million in this industry, for more than 28,000 workers.

Indications of the scope of the problem facing low-wage vulnerable workers were recently documented in a report published by the National Employment Law Project. As previously mentioned, the report is based on a survey of 4,387 workers in low-wage industries in Los Angeles, New York City, and Chicago. The survey of workers in these cities found high incidence and high severity of FLSA violations, especially overtime violations. The report also detailed findings about retaliation against workers who complained to their employers about working conditions and the fears that prevent workers from complaining at all. With respect to the hotel/motel industry, the survey looked at restaurants and hotels combined and found that for these two sectors, the minimum wage violation rate was 18.2 percent and the overtime violation rate was 69.7 percent. More specifically, the violation rate for "off-the-clock" violations was 74.2 percent, the violation rate for meal breaks was 75.7 percent, and the violation rate for meal breaks specifically for maids and housekeepers was 76.6 percent (Bernhardt *et al.* 2009).

Employment fissuring has taken 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.

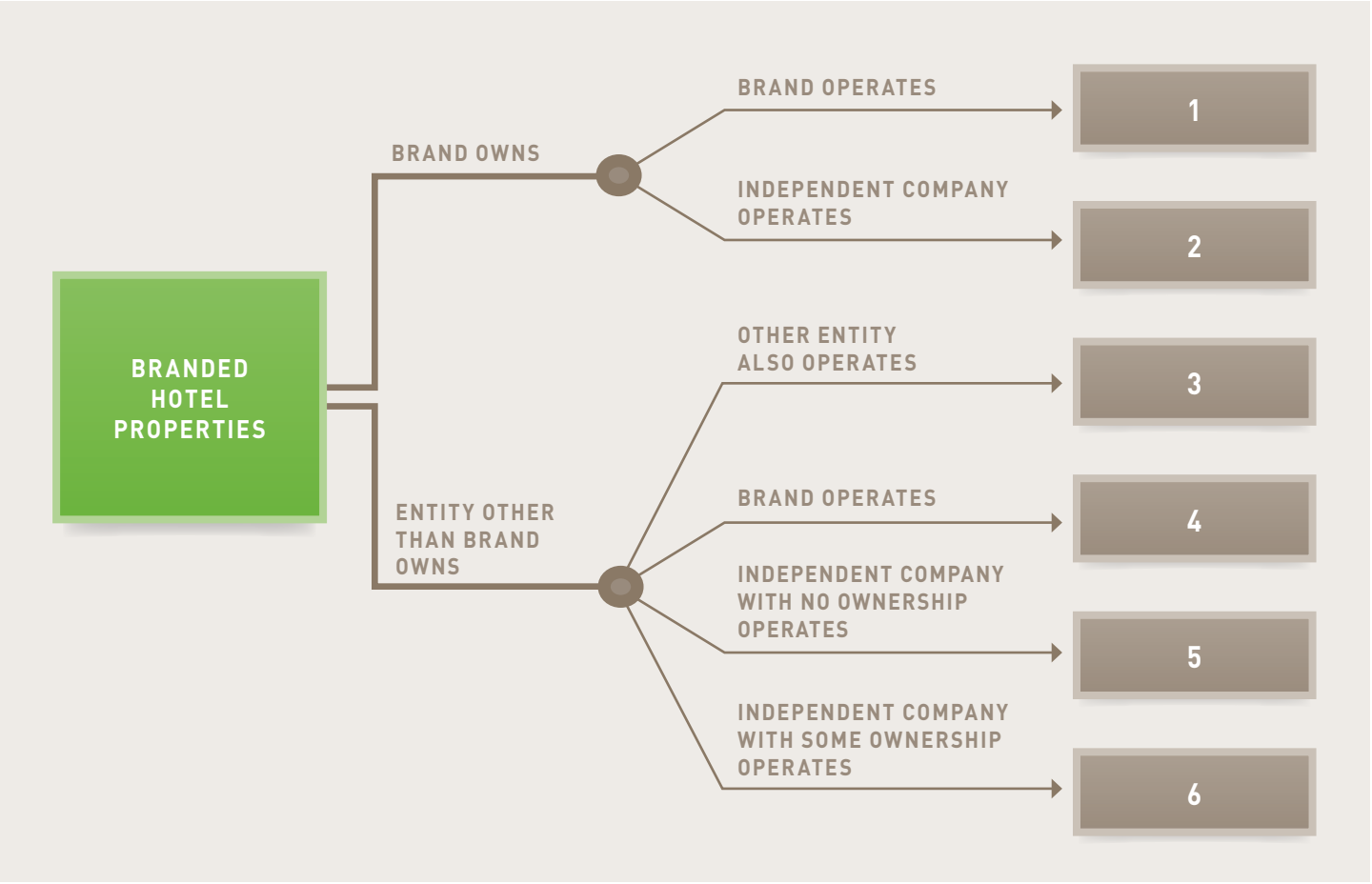
These relationships are depicted in Figure 5.1. The figure depicts the different ownership and management relationships that may be present at hotels with well-known names (Hilton, Marriott, etc.). While the name on a fast food restaurant does not indicate whether it is owned and operated by the parent 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 5.1 have very different implications on how employment policies are handled, including the incentives for compliance.

This section reviews the fissured structure of the hotel/motel industry and its consequences on labor standards compliance. It begins with a discussion of the importance of branding as a competitive strategy. It then examines the role of franchising in brand expansion and the widespread practice of splitting

73. County Business Patterns data for the accommodations industry, 2007. http://censtats.census.gov/ cgi-bin/cbpnaic/cbpdetl.pl. Accessed 10/18/2009.

FIGURE 5.1

Hotel Industry: Ownership and Operating Structure



the day-to-day management of properties from either ownership or brand. We then look at the impact of these practices on operations generally and compliance in particular. Finally, we examine how past WHD investigations affect compliance behavior of the different segments of the industry.

Branding and the Hotel Industry

Customer-based brand equity occurs when the consumer has a high level of awareness and familiarity with the brand and holds some strong favorable and unique brand associations in memory (Keller 2008, p. 53).

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 the brand name and in the protection of its image is therefore central to the competitive strategy of national chains and an integral factor in how they make operational decisions.[74]

Brands compete with other brands as well as with the large independent sector of the industry. The independent sector is composed of locally- or regionally-based hotels that are not affiliated with any brand and generally cater to specific niches, operating on a smaller scale than the branded chains.

74. 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). The forthcoming report "Improving FLSA Compliance in the Hotel/Motel Industry" discusses these chain scales in greater detail.

TABLE 5.1

Branded vs. Independent Hotels

	Top Brands and Independent Hotels: U.S. Lodging Census Database			
	Number of Properties	Percent of Total	Number of Rooms	Percent of Total
Independent Only	22,177	44.81	1,482,421	32.52
Branded Only				
Top 5*	6,398	12.93	703,906	15.44
Top 10	11,790	23.82	1,229,363	26.97
Top 25	17,937	36.25	2,020,521	44.32
All major brands	22,142	44.70	2,512,969	55.10
Non-major brands	5,167	10.40	563,697	12.40
Total	49,486	100.00	4,559,087	100.00

Top 5 STR Brands: Best Western, Days Inn, Holiday Inn, Marriott, Holiday Inn Express Hotel
Top 10 STR Brands: (Top 5), Super 8, Comfort Inn, Hampton Inn, Courtyard, Hilton
Top 25 STR Brands: (Top 10), Motel 6, Quality Inn, Sheraton Hotel, Residence Inn, Hyatt, Econo Lodge, Hilton Garden Inn, Fairfield Inn, Embassy Suites, Doubletree, Ramada, Extended Stay America, Americas Best Value Inn, Crowne Plaza, Westin

Note: *Ranked by Number of Rooms.
Source: Boston University analysis of Smith Travel Research database, U.S. Lodging Census Database. Smith Travel data current as of 12/31/2007.

Table 5.1 compares the number of properties that are branded and independent in the U.S. 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 when we look at total hotel rooms in the U.S.: About two-thirds of all hotel rooms are found in branded hotels versus one-third in independents. The table also show that a relatively small number of major brands control a large share of all available rooms: The top 25 brands account for 44 percent of all hotel rooms in the U.S.

Expanding brands into new markets (as well as creating new brands to enter chain scale segments) is a major focus of competition between brands. To accomplish this expansion, the parent companies that hold many of the major brands have to bring in other parties—first to put up additional capital, either to fund new construction or to purchase existing properties, and then to manage the day-to-day operations of the hotels in the brand's portfolio.[75] Relying on other entities often creates tension as, on the one hand, the hotel brand company must protect the brand image, but on the other hand must depend on these other parties—franchisees, equity partners, property managers—that might not be as interested as the parent company in protecting brand equity.

Brand parent companies are concerned about quality, consistency, and public image. Their reputations are important and these companies do not want them tarnished. The more that a brand invests in its public image, the more concerned it is about protecting against its potential deterioration.

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

75. There is an additional level of the branded segment of the industry composed of very large parent companies that own a portfolio of recognized brands. Some of these parent companies bear the names of leading brands in their portfolio (e.g., Hilton Hotels Corporation, which owns a variety of brands with the Hilton name as well as many others such as Doubletree, Embassy Suites, and Hampton Inn). Other parent companies are less well-known themselves (Choice Hotels, Carlson, and Starwood) but own well-known brands. The six largest parent companies account for 40 percent of branded hotel properties. We focus on the brand level for the most part in this report, although the role of the parent company as an important "background" institution will be discussed below. (See the internal document "An Examination of Independent Operators in the U.S. Hotel Industry" for a listing of the brand holdings of the major parent companies).

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."[76]

Table 5.2 presents excerpts from a number of hotel/motel franchise agreements regarding compliance with brand standards. The exacting requirements arise from the central role branding plays in business strategy:[77] Branding and public image allow a hotel chain to charge a premium for its services and create a loyal customer following. These give it a major stake in protecting the brand from threats to deterioration arising from the actions of its franchisees.

Several short excerpts from the table indicate the importance of quality standards to the core strategy of hotel chains:

- ***Microtel:*** "(W)e expect that each Microtel Hotel will comply with Hotel System standards to achieve a relatively uniform and standardized package of services and amenities that are offered to guests consistent with the economy budget sector of the hotel industry."
- ***Motel 6 Hotels:*** "To promote uniform Standards of operation under the System, we have prepared a set of confidential operating manuals … which contain mandatory and recommended procedures for operating your Motel."
- ***Omni Hotel:*** "Each OMNI HOTEL operates pursuant to unique methods, systems and programs of operation (the "Method of Operation"). These relate to the establishment, development and operation of OMNI HOTELS that offer distinctive high quality hotel services."

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) 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 (p. 307).

Assuring that franchisees maintain these brand standards is a constant concern for the branded franchisor, given the consequences of a loss of reputation.[78] But the concern over brand standards also implies a level of oversight of hotel operation (by the brand) that potentially has implications for adherence to labor standards and other workplace regulations.

Ownership: Franchising and Member Associations

Opening and operating an enterprise in the hotel/motel sector typically requires a far greater amount of capital than entering the fast food business. Consequently, ownership in the hotel industry typically involves multiple investors and alternative forms of ownership. In addition to investors with a direct interest in operating hotels, many investors are more interested in the opportunities to develop properties and then sell them to other investors. Finally, the high rates of return in the industry, most recently in the 1990s, attracted many investors with relatively little or no experience, thereby also giving rise to distinctive management problems that we discuss in the next section.

FRANCHISING IN THE HOTEL/MOTEL SECTOR

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, Wyndham, which owns the Ramada, Howard

76. "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.

77. For this reason, it is probably not surprising that the actual manuals detailing standards and procedures are regarded as proprietary trade secrets that are not released to anyone but active franchisees and are energetically withheld from wider circulation by franchisors.

78. An example of the potential impact of negative publicity on brand equity played out in Boston in August 2009, when 100 Hyatt housekeepers' jobs in Boston were outsourced. It made headlines not only because of the actual outsourcing, but also for the way it was carried out: The management had the housekeepers train replacements, telling them that they were only training temporary workers who would fill in during vacations, and then laid off the long-time housekeepers. The incident received major publicity locally and nationally, and business experts wrote about its effect on the brand's value and shareholders. http://www.boston.com/business/articles/2009/09/17/housekeepers_lose_hyatt_jobs_to_outsourcing/

TABLE 5.2

Franchise Agreement Statements Regarding Compliance with Brand Standards: Hotel/Motel Industry—Selected Examples

Hotel/Motel Brand	Excerpt from Franchise Agreement
Days Inns	When a licensee buys a franchise from DIA (Days Inns of America), he buys the "Days Inn System," a comprehensive "hotel operating system" that sets hundreds of mandatory "System Standards" that control the manner in which a Days Inn must be operated .... As the Statement of Undisputed Facts shows in exhaustive detail, the mandatory Days Inn System and DIA System Standards, which DIA can change at any time, address all aspects of the operation of a Days Inn, including: operating policies that "must be strictly observed by each property in the Days Inn System" and requirements for grooming and attire for hotel employees, employee uniforms, hours of operation of the front desk, services that must be provided to guests, the forms of payment the hotel must accept, guest safety and security, swimming pools, restaurants, free continental breakfasts, supplies and furnishings in guest rooms, the responsibilities of the hotel's general manager, employee relations, employee performance, housekeeping, and maintenance.[a]
Microtel Hotels	You operate the Microtel Hotel under the Hotel System. The Hotel System means the concept and system associated with the development and operation of Microtel Hotels. The Hotel System may be periodically modified by us. The Hotel System includes, among other things, (i) the trademarks, service marks, logos, slogans, trade dress, domain names and other source and origin designations that we or USFS periodically designate for use with the Hotel System (collectively, the "Proprietary Marks"); (ii) copyrightable materials that we periodically develop and designate for use with the Hotel System including prototypical architectural plans, designs, layouts, building designs, and a set of confidential constructions/operations manuals (the "Manual"); (iii) a central reservation system (the "CRS"); (iv) a unified platform property management system, management and personnel training, operational procedures and marketing, advertising and promotional programs; (v) all confidential information (see Item 14) and (vi) standards, procedures, policies, specifications and rules associated with the construction, operations, marketing, furnishings and equipment that we introduce and implement for the Hotel System which are described in the Manuals or in other written (electronic or otherwise) directives and which we may periodically modify. We designed the Hotel System for the operation of "super budget" and "hard budget" hotels, and we expect that each Microtel Hotel will comply with Hotel System standards to achieve a relatively uniform and standardized package of services and amenities that are offered to guests consistent with the economy budget sector of the hotel industry. [b]
Motel 6 Hotels	The terms, conditions, and obligations under which you operate the Motel are described in a franchise agreement that you and we sign before you begin operations (the "Franchise Agreement"). You must also sign a Software Agreement with Motel 6 OLP for the Software used in operating the Motel. Before signing a Franchise Agreement of the Software Agreement, you must sign and submit a franchise application (the "Application") to us. The Application, the Franchise Agreement, and the Software Agreement are referred to in Item 22 below, and copies of the documents are attached as exhibits to this disclosure document. To promote uniform Standards of operation under the System, we have prepared a set of confidential operating manuals, which may include more than one volume and periodic supplements (the "Manuals") and which contain mandatory and recommended procedures for operating your Motel.[c]

Continued on next page.

TABLE 5.2

Franchise Agreement Statements Regarding Compliance with Brand Standards: Hotel/Motel Industry—Selected Examples, CONTINUED

Hotel/Motel Brand	Excerpt from Franchise Agreement
Omni Hotels	Each OMNI HOTEL operates pursuant to unique methods, systems and programs of operation (the "Method of Operation"). These relate to the establishment, development and operation of OMNI HOTELS that offer distinctive high quality hotel services. The characteristics of the Method of Operation include exceptional décor, design, layout and color scheme; exclusively designed signage, decoration, furnishings and materials; the Omni Hotels Reservation System; hospitality service procedures and techniques; operating procedures for cleanliness and maintenance; other confidential operating procedures; methods and techniques for inventory and cost controls, record keeping and reporting; personnel management and training, purchasing, marketing, sales promotion and advertising.[d]
Red Roof Inns	You will own and operate a Red Roof Inn or Red Roof Inn & Suites lodging facility. A Red Roof Inn lodging facility offers low cost accommodations to all sectors of the traveling public. A Red Roof Inn is generally located at places that attract both business and leisure travelers, such as major highway exit ramps, major intersections, airports, tourist destinations, and business centers. You will operate the business according to our business system and standards, and under the Red Roof Inn trademarks. You will use our prototype architectural plans and drawings in building a Red Roof Inn, or in renovating an existing building to be a Red Roof Inn. A typical Red Roof Inn does not offer full service and management intensive facilities or services, such as in-house restaurants or cocktail lounges, conference rooms, room service, or banquet centers. However, to meet the needs of guests in certain markets, we offer a Red Roof Inn & Suites lodging facility with enhanced amenities, such as more spacious rooms with refrigerators and coffee makers, exercise facilities, or meeting rooms.[e]

Notes:

a. "PLAINTIFF UNITED STATES' MEMORANDUM IN SUPPORT OF ITS MOTION FOR SUMMARY JUDGMENT." *United States of America v. Days Inns of America,* Inc. 27 October 1997.

b. "Microtel Inns and Suites Franchising, Inc: Microtel Franchise Disclosure Document." 28 March 2008. Filed and accessed through the California franchising database. http://134.186.208.228/caleasi/Pub/Exsearch.htm

c. "Accor Franchising North America, LLC: Motel 6 Franchise Disclosure Document." 6 March 2008. Filed and accessed through the California franchising database. http://134.186.208.228/caleasi/Pub/Exsearch.htm

d. "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.htm

e. "Red Roof Franchising, LLC: Red Roof Inns Franchise Disclosure Document." 1 October 2008. Filed and accessed through the California franchising database. http://134.186.208.228/caleasi/Pub/Exsearch.htm

TABLE 5.3

Franchise Fees by Hotel/Motel Chain Segment, 2007

Chain scale	Average Franchise Fee (Percent of Revenues) [a]	Median Franchise Fee (Percent of Revenues) [a]	Total 10-year Franchise Fee per Available Room (Dollars) [b]	Lowest Fee in Scale Segment (Percent of Revenues)	Highest Fee in Scale Segment (Percent of Revenues)
Economy	8.3	8.7	12,700	.8 Budget Host	12.2 Days Inn
Mid-range	9.3	9.8	22,917	2.4 Best Western	11.4 Holiday Inn Express
Premium	9.5	9.9	32,110	5.2 Preferred Boutique	13.5 Westin

Notes:

a. Franchise fee includes all fees charged by franchisor including initial fee and ongoing fees (royalties, marketing, reservation and other fees), calculated for a specified number of rooms for each chain scale group for a 10-year period, given the specific policies of a sample of major branded hotels in each of the three chain scale segments. About 90% of the calculated franchise fee are made up of ongoing fees in all three chain scale categories; approximately 50% of the calculated fees arise from royalty fees to the franchisor.

b. Dollar amount calculated given assumptions about available rooms and occupancy levels for each chain scale segment over a 10-year period, and standardized per available room.

Source: Rushmore et al. 2007.

Johnson's, Super 8, and Days Inn brands, franchised all of its 6,383 properties.[79]

Franchise fees are compensation paid by the franchisee to the franchisor for use of the brand's name, logo, good will, marketing, and referral and reservation systems. Franchise fees are made up of two primary components: an initial fee paid with the franchise application and a continuing set of fees paid throughout the term of the agreement. Initial fees typically are based on a property's room count and are designed to cover the franchisor's cost of processing the application, reviewing the site, assessing market potential, evaluating hotel plans or the existing layout, construction inspection, and services leading up to the opening of the property. Continuing fees generally include the basic royalty fee (constituting the largest ongoing payment to the franchisor) as well as fees related to marketing/advertising, use of centralized reservation systems, frequent traveler programs, and other miscellaneous services provided by the franchisor.

The fees charged by franchisors vary considerably across, as well as within, chain scale categories (the segments in the industry demarking different levels of hotel quality and service). This is illustrated in Table 5.3, which compares typical franchise fees as a percent of revenues across three major chain scale categories. Median total franchise fees are lowest among economy brands (8.7 percent of revenues) relative to mid-range (9.8 percent) and premium hotel brands (9.9 percent). In absolute dollar amounts, differences in the typical fees on a per-room basis over a 10-year franchisee period are more striking: from $12,700 in the economy segment to $32,110 in the first-class brands. However, the table also indicates that rates vary considerably within chain scale segments, reflecting the premium that franchisors are able to charge for being affiliated with their brand.

Brand and Independent Operating Companies: Fissured Ownership Meets Fissured Management[80]

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 the 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 brand operating company) or by a separate company specializing in hotel management (an independent operating company).[81]

79. 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.

80. This section draws from material in Eyster, James J. and Jan A. DeRoos (2009) and an internal Boston University document prepared by research fellow Anne Klieve, "An Examination of Independent Operators in the U.S." October 2009.

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

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.[82]

Management operating companies also became common as an assurance to lenders that a hotel property would be able to earn revenues and produce profits once the project was completed or acquired. Given their stake in brand reputation, brands themselves also spurred growth in management companies for prospective owners, either through requirements that the brand itself manage the operations of the property or that the owner use a reputable independent hotel operating company.

The economic terms of most franchising arrangements in fast food and hotel are similar: the franchisor (brand company) receives a percentage of the revenues earned by the franchisee (owner). In contrast, agreements between owners and hotel management operators fall into three major groups. First, the operator may receive a fee that is a percentage of the property's revenues (much like a franchise agreement). Second, the operator may receive some form of incentive fee, typically based on a percentage of an agreed upon measure of profits. Third, if the operator holds some ownership stake in the property it manages, the operator may receive a return on equity (which might constitute only a part of its compensation, along with one of the other fees described above).

The incentives for the operator vary considerably across these contract types. Incentive fees try to more closely align operator and owner interests through profit-based compensation (versus fees based on revenues where an operator might seek policies to boost sales and minimize the costs they face, but not necessarily the costs of the owner). Requiring operators to hold at least a small stake in the property is likewise an effort to align incentives. But even these methods have limitations: definitions of "profit" may be contentious and tend to favor the party with bargaining power; and ownership stakes might be insufficient to significantly change the alignment of interests. And the inherently greater exposure to liability by owners is not directly addressed through any of the compensation mechanisms.

In addition to the fee arrangement, management operating contracts usually contain three main components: a provision providing the operator sole and exclusive rights to manage the property without ownership interference; a requirement that the owner pay for operating and financing expenses, and assume ownership risks; and some form of indemnification of the operator, with the exception of gross negligence or fraud. In essence, the contract makes it clear that the operator manages the business, while the owner owns it and assumes the attendant liability. The divisions of branding from ownership and of ownership from management create complicated cross-currents in terms of authority and accountability. Eyster and DeRoos note:

> … owners often feel they are at a disadvantage because they turn over to the operator complete operating control of their properties without having adequate leverage to affect the operator's behavior or actions. On the other hand, operators claim that they are being hired to perform a service for which they have expertise, that ownership interference would diminish their ability to perform effectively, and that it is they, and not the owners, who are creating the economic value of the project from which the owners will ultimately benefit (2009, p. 9).

The trade-off facing owners of gaining the benefits of the management expertise of the operator versus the costs implied by facing all legal and financial liability for the operator's actions is a source of bargaining between the parties in the creation of agreements. But the fun does not end there. The complications surrounding the basic question of "who is responsible for what" at the work site are further complicated by differences in the incentives facing brand versus independent operating companies.

BRAND OPERATING COMPANIES

Through management contracts to franchised hotels, brand parent companies earn fees for operating hotels that they do not own but which hold their brand name.[83] A branded operating company, such as Choice Hotels International or Marriott, provides "… management and operating expertise to lodging properties it manages, using its national and/or international trademark and reservations system as an integral part of the hotel management services it provides."[84] In effect, a franchisee using a brand operating company can gain the benefits of both brand reputation and the skills of that brand in undertaking management, while retaining ownership of the property itself.[85]

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

83. Butler, Jim and Jeff Riffer. "Hotel Operators Open Pandora's Box: From 'Agent' to 'Fiduciary' and Beyond." Real Estate Issues: Fall 2000, 25, 3, ABI/INFORM Global p. 15.

84. Eyster and deRoos, p. 5.

85. Ownership in hotel/motel is usually more complicated than in fast foods: Although properties may have a single owner, hotels are more commonly owned by a set of investors who operate through an ownership company, or by multiple investors who own shares in a set of properties. Many hotels are also owned by

Because of their ability to negotiate the terms of franchising, some brands require prospective owners to agree to a franchised form of ownership and to allow the brand to manage their operations. These arrangements are typically found at the high-end segment of the chain scale spectrum (upscale and luxury properties). Brand operating companies also manage mid-sized operations of franchisees that own multiple properties of a given brand. However, as the number and scale of independent operators have grown, brand operating companies have found themselves in great competition for services to potential owners (Eyster and DeRoos 2009, p. 179). Branded operators managed about 4,370 properties worldwide in 2006.[86]

The basic fee arrangements for brand operating companies may be based on revenues or profits. Among brand operators, the median fee for brand operating companies was about 3.25 percent of gross revenues. Incentive fees ranged from six to twelve percent, depending on the measure of profits used (or a range of 10 to 30 percent for fees based on cash flow). About 40 percent of contracts include some ownership stake in the property.[87] Agreements between brand operating companies and owners/franchisees are often fairly long-term contracts, typically lasting 15 to 20 years.[88]

The terms of contracts between owners and brand operating companies tend to favor the operator (e.g., a long contract period), reflecting the relative bargaining power of brands with respect to potential owners/franchisees. But they also create mixed incentives between the brand—which has a stake in both reputation and operational issues—and the owner, whose chief concern is profitability of the property.

INDEPENDENT OPERATING COMPANIES

The same factors that led to the growth of brand operating companies spurred on the growth of independent operating companies—companies providing management services, but unaffiliated with a specific brand. An independent operating company (sometimes referred to as a management company or third-party management company) provides management and operating expertise to branded properties that are owned by an entity other than the brand-holding parent company. An independent operating company may "operate a franchised property carrying a brand trademark, and may therefore have access to a reservations and distribution system of the brand. The operating company may be a separate and distinct entity from the owner ... a subsidiary of the owner, or [it may be that] the owner and the operating entities have common ownership."[89] In other words, independent operating companies manage hotels under someone else's brand.

Many of the companies in this sector operate on a regional and fragmented basis, owing to their origin as managers of properties in a particular geographic area. The number of entrants offering services in the independent operating company sector increased in the 1990s. Eyster and DeRoos estimate that there were about 800 companies managing about 12,000 properties.[90] The recent growth in management companies has led to consolidation of the hotel/motel industry, and the emergence of a number of large-scale independent operating companies. Table 5.4 lists the top 12 independent operating companies and the number of properties and rooms managed by each.

The top 50 management companies listed by Lodging Hospitality (a leading trade journal for the sector) operate a total of 2,270 properties comprising 380,906 rooms, which represents about 10 percent of all branded properties. The top 10 management companies manage more than half of those properties, about 1,163 hotel properties comprising almost 187,000 rooms.

A striking difference between branded and independent operators is the large number of brands managed by the latter group. The largest independent operator, Interstate Hotel and Resorts, manages close to 40 different brands; Tharaldson, the second largest, manages 17. The multiple brands do not necessarily stem from an operator working with a particular parent company, but in fact represent a mix of different parent companies.[91] The properties managed by those compa-

Real Estate Investment Trusts (REITs), a different investment vehicle for developing and operating properties. REITs are explicitly not allowed to manage the assets they hold so are required to hire a management operator (branded or independent). Finally, the brand itself may hold a minority stake in the hotel property. In fact, many investors require brands to do so as a pre-condition for investment because they want the brand itself to have some "skin in the game."

86. Assuming that about two-thirds of these properties are in the U.S., this represents about 15 percent of all branded U.S. hotels. This is a rough estimate, however, because the number includes some international operations that we cannot break out separately. See Eyster and DeRoos 2009, p. 12 and "2009 Business Travel Survey: Hotel Companies." Business Travel News, 6/8/2009, pp. 27-42.

87. These estimates are based on a survey in the late 1990s (the last survey evidence available on this issue). The ownership stake however, is relatively small: the median equity share at the time of the survey was 8 percent. Eyster 1997 ("Twelve Concerns for Operating Companies), Exhibit 1.

88. The median length of contracts among branded operators was 16 years in 2008. "Brand operators estimate that they need, on average, a term of at least 8 to 10 years to recover their start-up costs and to make their time and effort in the project worthwhile." See Eyster and DeRoos, p. 58.

89. Eyster and DeRoos, p. 5.

90. Eyster and DeRoos 2009, p. 13. There is a range of estimates of the total number of companies operating in this sector. The current estimates seem to range somewhere between 800 to 1,000 firms in the U.S. The difficulty of estimating the sector's size arises because there are a large number of very small companies offering services to one or a few hotels (including independent, non-branded hotels).

91. An analysis of the relationship between the number of properties managed by one of the major companies and the number of parent companies represented by that group indicates that by the time a typical independent operator manages 10 properties, it will already be working with four different parent companies. The

TABLE 5.4

Top 12 Independent Operating Companies, Hotel/Motel Industry, 2008

Company Name	Properties Owned and Managed		Properties Managed for Other Owners		Total Rooms Managed	Total Properties Managed
	Rooms	Properties	Rooms	Properties		
Interstate Hotels & Resorts	2,050	7	44,500	219	46,550	226
Tharaldson Lodging	14,610	222	13,162	200	27,772	422
White Lodging Services	3,035	18	16,838	123	19,873	141
John Q. Hammons Hotels	19,021	78	0	0	19,021	78
The Procaccianti Group	15,025	57	0	0	15,025	57
Crestline Hotels & Resorts	1,340	6	13,239	64	14,579	70
Pyramid Hotel Group	0	0	12,792	38	12,792	38
Sage Hospitality Resources	10,614	50	1,905	12	12,519	62
Davidson Hotel Company	0	0	9,986	35	9,986	35
Outrigger Hotels & Resorts	3,129	6	5,554	28	8,683	34
HEI Hotels & Resorts	8,632	30	0	0	8,632	30
Kimpton Hotels	2,472	12	6,035	32	8,507	44

Source: Top of the Top Ranking 2008, Lodging Hospitality, March 2009.

nies operate in many states (close to 40 states for Interstate and 30 for Tharaldson) and in a variety of chain scales (e.g., economy, mid-range, luxury). As a result, the impacts of the behavior of these companies are wide ranging.

The median fee for independent operating companies is about 4 percent of gross revenues; incentive fees range from 5 to 12 percent depending on the measure of profits used (or a range of 10 to 30 percent for fees based on cash flow). Only 20 percent of contracts include a requirement to hold equity, in contrast to branded operators where almost 40 percent of contracts require an ownership stake in the property.[92]

Other contract terms between franchisee/owners and independent operators have the same terms as among brand operating companies, but tend to favor the owner rather than the operator because of competition among independent operators (and the fact that the brand is not involved in the negotiation).[93] Reflecting this, management contracts last between 6 to 9 years (versus a median of 16 years for branded management) and often provide the owner with more rights in key operational decisions, such as the selection of the hotel's general manager, as well as a stronger position in regard to contract termination and renewal.[94] The emergence of large-scale independent operators like Interstate and Tharaldson tips the balance somewhat more in their favor, although the relatively low level of market concentration moderates this effect.

Fissuring and Compliance

How do the above factors together contribute to observed levels of compliance in the industry? As in geology, fissuring creates complex fault lines regarding compliance with labor

evidence suggests that operating companies have no problems working with many different parents and owners since the customers for their services are owners, not brands.

92. Eyster 1997 ("Twelve Concerns for Operating Companies), Exhibit 1.

93. The exception to this is where a brand has preferred independent operators that it suggests for potential franchisees.

94. For example, although in most contracts between owners and branded operators, the operator retains the right to renew the terms the contract, it is more common (although not yet for the majority of contracts) that owners retain this right in contracts with independent operators.

standards that arise from the varied interests of the parties with a hand in the management or operation of hotel properties. Recall Figure 5.1, which portrays the multiple combinations of ownership and management that may be possible for a branded hotel property. Two hotels bearing the same brand name might actually have entirely different combinations of underlying ownership and management, and therefore behave very differently, including in terms of their respective likelihood of violating labor standards.

Brands have a major stake in reputation and preventing threats to reputation in their systems. However, they also have a stake in expanding their reach by pursuing operating agreements with owners of properties, through which the brands manage properties that they do not directly own. This means that hotel properties owned and operated by the brand (type 1 in Figure 5.1) have significant incentives to comply with law, similar to company-owned outlets in the fast food industry. The incentives for compliance are less clear for a property owned by a party other than the brand, but managed through a brand-management company (type 4 in Figure 5.1). Although the brand is in a position to protect its reputation through its role as the operator, it also must negotiate with an owner, who has a lower stake in the brand's reputation and a more direct interest in holding down costs.[95]

Independent operating companies face limited incentives to uphold brand standards (except in those instances where a particular brand has a relationship with the independent operator). For hotel/motel types 5 and 6, the independent operator therefore is more likely to take steps of direct interest to expanding its own competitive position (such as by providing increased revenues for the owners for whom it works and increased fees for itself), while minimizing the costs it faces itself. Given that liabilities—including those relating to violations of workplace laws—rest with the owner, these properties might be particularly willing to play at the edge of compliance than owners who are potentially more on the hook for violations.[96]

Finally, type 3 firms are similar to the classic franchisees in the fast food industry: they own and operate their properties directly. This makes their incentives to comply higher than the properties managed by independent operators (types 5 and 6) but lower than the pure "company-owned" hotel (type 1).

EFFECTS OF BRANDING, OWNERSHIP, AND MANAGEMENT ON COMPLIANCE

In order to examine the relationships between the various structural features of the hotel and motel industry and patterns of compliance, we created a database consisting of all hotel properties investigated by the WHD between 2002 and 2008.[97] 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.[98]

Tables 5.5(a), 5.5(b), and 5.5(c) present three measures of compliance with the FLSA: total back wages per investigation; back wages per employee paid in violation; and the percent of employers that were not in compliance with the FLSA.[99] We compare compliance levels for brands, ownership, and whether a property is managed by an independent operator. As in the analysis of the fast food sector in section IV, we use the hotel/motel database to create statistical models to allow us to estimate the impact of brand, ownership, and management effects on compliance while holding constant other factors that might affect compliance and also be related to any of the above factors. The resulting statistical models include a variety of variables that might be associated with compliance levels and the factors discussed in this section, allowing us to examine the effect of any one of them, holding the other factors "constant."[100]

Branding and compliance: Table 5.5(a) 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.[101] Branded hotels also tend to

95. There are only two cases in our database of hotel/motel properties where a brand owns a property and an independent company operates it (type 2). We therefore do not consider this case.

96. The fissuring of responsibility raises interesting legal questions. Operators are not liable for violating wage and hour regulations (because of indemnification in the management contracts). However, they could be held responsible if it could be shown that the operator acted against the interest of the owner (because the operator is required to act as the owner's agent). If a management operator was found to have managed hotels by promoting or even tolerating widespread violations of the law, an owner facing major actions by the WHD might sue the operator to terminate the management agreement under agency theory.

97. 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.

98. 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."

99. Data exclude conciliations and audits.

100. The variables in the model include the size of the hotel property, the number of competitors it faces in local markets, the chain scale segment for the property, and a variety of variables related to its geographic location and demographics in the local area. Complete results are available. A detailed manuscript on the statistical models by Weil and Ji will be available in the spring of 2010.

101. 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

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.

The results in Table 5.5(a) 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 per investigation 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. Although there are clearly significant problems in both the branded and independent sectors, Table 5.5(a) might imply that WHD's time would be better spent focusing on independents, however there are reasons we think that isn't necessarily the case and it's a point we return to below.

Franchising and compliance: 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.[102] Table 5.5(b), 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.

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 small and statistically insignificant, implying that the compliance behavior for the two are fairly close in the sample.

Independent operators and compliance: 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.[103] 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 5.5(c) 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.[104]

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 per investigation 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.

IMPLICATIONS

The above analysis suggests that the range of hotel properties depicted in Figure 5.1 do behave very differently and are driven by the cross-cutting incentives of branding, ownership, and management discussed above. WHD policy must recognize that the brand on the hotel sign out front only provides limited information about what practices might exist inside the

quality, service, etc. (Ji and Weil 2010).

102. 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.

103. Specifically, we created a list of major independent hotel operators (see Table 5.4 for the top 12) 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 those companies from Internet sources. These were then matched with individual hotel properties in the database.

104. We restrict the comparison in Table 5.5(c) to branded properties since only a handful of independent properties are managed by a major independent operator.

TABLE 5.5

a. Compliance Levels for Brands and Independent Properties: Hotel/Motel Industry

Compliance Measure/Statistics	N	Overall Mean [St.D]	Mean Brand Owned (1)	Mean Independent (2)	Difference (1) – (2)
Total back wages per investigation (Dollars)	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 (Dollars)	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 errors 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.

b. Compliance Levels for Franchisees 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 (Dollars)	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 (Dollars)	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 errors 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 Americas Best Value Inn) in the U.S. hotel/motel industry.

c. 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 (Dollars)	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 (Dollars)	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 errors 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 Americas Best Value Inn) in the U.S. hotel/motel industry.

hotel property. Only then can it fashion policies that allow it to change behaviors that result in workplace violations.

Deterrence: Who Really Counts?

In section IV, we found that the top 20 fast food restaurants are very sensitive to WHD investigations conducted in their local area. It turns out that an investigation of a Subway in a 5-digit zip code area improves compliance at a nearby Taco Bell, for example, in the year following that investigation (particularly if it was a directed investigation). As in the fast food industry, hotel/motel chains have powerful national brands, but competition is fierce at the local level. How much, then, do WHD investigations at one hotel affect the behavior of other hotels in a local area? The answer depends on who is investigated and who is watching.

FOLLOWERS AND LEADERS

In the prior section, we found that the branded and independent sectors operate differently in terms of their investment in building reputations and in terms of their compliance behavior.[105] Within the branded sector, then, how do different property owners and operators behave?

Competition in the branded segment of the hotel/motel industry follows a pattern common to many industry structures in which a relatively small set of players dominate: One set of firms act as market leaders, defining pricing policies, advertising campaigns, or new customer services. Once market leaders have established new policies, other firms in the industry follow and emulate those practices. In order to test for ripple effects between branded hotels, we tested to see if hotels in a given geographic area paid more attention to investigations conducted at certain branded hotels than others. For example, did an investigation at a Marriott, at the premium level of the industry, or a Holiday Inn, in the mid-scale segment, have more influence on other hotels than one conducted at a less prominent or lower-scale brand?

By using statistical models that control for a variety of factors affecting compliance, and calculating the number of investigations conducted by the WHD at a 5-digit zip code level, we could test for the presence of ripple effects given past investigation histories for the geographic area. For example, we could see if the effect of three investigations of hotels in the top 25 brands in the prior year had a bigger impact on subsequent compliance than three investigations of the top 5 hotels in the prior year.

105. We reach this conclusion by creating statistical models where we test the impact of an investigation of a branded hotel on compliance at independent hotels in the same area in the subsequent year and similarly test the impact of an investigation of an independent hotel on the compliance of branded hotels in the area in the subsequent year. In both cases we find no statistical relationship between the investigations.

Table 5.6 provides the key results of that analysis. In column (1), we present the estimated impact of an additional investigation of any hotel property in the prior year on compliance at a hotel in the next year. The results say the impact was quite small: An additional investigation at any hotel would decrease total back wages found at another hotel in the area by about $70. In column (2), we restricted the analysis to the effect of prior investigations of branded hotels on branded hotels in the subsequent year. In this case, we found a slightly larger effect (a reduction of $111) but once again relatively small and not significant. As can be seen, the results were similar for the other categories, except in column (5). In that case, we found that investigations of properties of one of the top 5 hotel brands in the prior year in the local area had large, and, in many cases, significant impacts on subsequent compliance among all branded hotels (not just the brand investigated). An additional investigation at, say, a Days Inn (one of the top 5) lowered subsequent back wages at other branded hotels (not Days Inns) by over $450. This implies that hotels "follow the leader" with respect to prior investigations, much as they do in other areas of behavior.

The final column (6) of Table 5.6 looks at the impact of an additional investigation of an independent hotel on the behavior of brands. Although the estimate is in the negative direction, as expected, it is not statistically significant. It should not be surprising that independent properties behave differently in terms of how much they are influenced by the ripple effects of investigations in the branded segment of the hotel industry.

When we broke the sample further into prior directed and complaint investigations, we found results similar to those in eating and drinking. Branded hotels were particularly sensitive to directed investigations of the top 5 hotel brands in the prior year, more than they were to complaint-based investigations. The shadow cast by directed investigations is longer and more influential than that of complaint investigations.

RIPPLE EFFECTS AMONG INDEPENDENT OPERATORS

Just as branded hotels seem to look only at other branded hotels in reacting to investigations, the same is potentially true among independent hotels. We tested this proposition in much the same way as in Table 5.6. Using statistical models controlling for other factors affecting compliance, we examined the impact of additional investigations of different subsets of the hotel industry on the compliance behavior of independent hotels. The results are presented in Table 5.7.

Column (1) of the table presents the impact of investigations of any branded hotel in the prior year on compliance among independent hotels, holding other factors constant. The positive sign of the estimate implies that an additional investigation of a branded hotel in the prior year increases back wages owed by independent hotels. This surprising result, however,

TABLE 5.6

Deterrence Effects on Hotel/Motel Employer Compliance in the Branded Hotel/Motel Sector

Dependent Variable: Total Back Wages per Investigation

(Dollars)

Variables Included in the Model	(1) Investigations of any Properties in Prior Year [a]	(2) Investigations of Branded Properties in Prior Year [b]	(3) Investigations of Top 50 Branded Properties in Prior Year [b]	(4) Investigations of Top 25 Branded Properties in Prior Year [b]	(5) Investigations of Top 5 Branded Properties in Prior Year [b]	(6) Investigations of Independent Hotels in Prior Year [b]
Impact of an additional prior investigation of the type indicated in column (Dollars)	- 70.2 (102.4)	- 111.1 (134.2)	-91.0 (148.4)	-3.7 (172.4)	-474.4 (348.2)	-208.8 (211.8)
Statistical models include the following variables:						
Franchise ownership/ branded ownership and/or management/ member association affiliate	Yes	Yes	Yes	Yes	Yes	Yes
Independent management operator	Yes	Yes	Yes	Yes	Yes	Yes
Chain scale controls	Yes	Yes	Yes	Yes	Yes	Yes
Geographic area controls (urban, rural, resort, etc.)	Yes	Yes	Yes	Yes	Yes	Yes
Outlet size (number of employees)	Yes	Yes	Yes	Yes	Yes	Yes
Year dummy	Yes	Yes	Yes	Yes	Yes	Yes
Demographic variables	Yes	Yes	Yes	Yes	Yes	Yes
N	2,301	1,717	1,717	1,717	1,717	1,717

Notes: Standard errors of estimates in parentheses.

a. Based on entire national sample, including branded and independent hotels/motels.

b. Based on national sample, only branded hotels/motels.

MODEL REFERENCES (MWJ data runs):

(1) Table 5-1 (Tobit with entire national sample included): 7/15/09, specification (9).

(2) Table 1 (Tobit with National sample, branded H/M entries): 11/27/09, specification (8).

(3) Table 2 (Tobit with National sample, branded H/M entries): 11/27/09, specification (8).

(4) Table 3 (Tobit with National sample, branded H/M entries): 11/27/09, specification (8).

(5) Table 5 (Tobit with National sample, branded H/M entries): 11/27/09, specification (8).

(6) Table 1 (Tobit with National sample, branded H/M entries): 12/14/09, specification (8).

TABLE 5.7

Deterrence Effects on Hotel/Motel Employer Compliance in the Independent Hotel/Motel Sector

Dependent Variable: Total Back Wages per Investigation

(Dollars)

Variables Included in the Model	(1) Investigations of Branded Properties in Prior Year	(2) Investigations of Top 50 Branded Properties in Prior Year	(3) Investigations of Top 5 Branded Properties in Prior Year	(4) Investigations of Independent Hotels in Prior Year
Impact of an additional prior investigation of the type indicated in column (Dollars)	**211.18 (303.43)**	**269.32 (315.2)**	**960.22 (640.95)**	**-701.9*** (175.23)**
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 hotels/motels in local market)	Yes	Yes	Yes	Yes
Chain scale controls	Yes	Yes	Yes	Yes
Geographic area controls (urban, rural, resort, etc.)	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
Three-digit zip code dummy	Yes	Yes	Yes	Yes
N	774	774	774	774

Notes: Standard errors in parentheses. *** Statistically significant at the 1% level, ** at the 5% level, * at the 10% level. Estimate based on national data sample of all independent hotels in the U.S. hotel/motel industry.

MODEL REFERENCES (data runs):
(1) Table 3 (Tobit with independent national sample): 12/14/09, specification (8).
(2) Table 5 (Tobit with independent national sample): 12/14/09, specification (8).
(3) Table 11 (Tobit with independent national sample): 12/14/09, specification (8).
(4) Table 1 (Tobit with independent national sample): 12/14/09, specification (8).

is not statistically significant. Similarly, columns (2) and (3) focus on investigations of subsets of the branded industry on compliance at independents. Once again, in both cases the result is positive (additional branded investigations are associated with higher noncompliance in the independent sector), but once again the results are not significant. However, column (4) looks at the impact of prior investigations of other independent hotels on the subsequent behavior of other independents. In this case, the estimate is in the expected negative direction, large, and statistically meaningful. It suggests that an additional investigation of an independent hotel lowers subsequent back wages owed by other independent hotels in the area by about $700 per investigation, all other factors held constant. Independent hotels are very sensitive to WHD activities at other independent properties in their local area.

Once again, when we looked at the separate effects arising from directed versus complaint investigations, we found that both types of investigations had the expected ripple effects, but they were much larger among directed investigations than complaints. Interestingly, the ripple effects were stronger among independent hotels than between the top 5 brands and other branded hotels.

Conclusion

The desire to build a reputable brand and at the same time expand operations by tapping into investors that may not have much experience in the hotel industry has created a complicated set of forces that send contradictory signals and blur responsibility about operating practices in general and employment conditions in particular. The empirical analysis presents evidence of the impacts of fissuring, particularly with respect to the impacts of independent operators on compliance.[106]

These findings have a number of implications for strategic enforcement in this sector. We go into detail on policy implications in Section VI, but three key implications should be noted here.

First, the vast majority (two-thirds) of hotel/motel rooms available in the U.S. are affiliated with brands, in particular large national brands with a presence throughout the country. Although we document that independent hotels have worse compliance than branded hotels, our empirical findings suggest that there are high levels of violations among branded properties as well. By understanding how these major national enterprises operate, WHD can potentially have systemic impacts on their behavior—at a brand or management company level rather than restricted to a hotel-by-hotel focus.

Second, 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. A strategic enforcement strategy must act on all three levels of the industry—owners, brands, and managers—to be effective. If it can do so, it has the potential of changing behavior beyond those being directly investigated.

Third, there is evidence that past investigations have ripple effects (deterrence) in the sector. However, these effects do not ripple across the entire industry, but are restricted to subsets of the industry that tend to "watch" one another. On the branded side of the industry, investigations of the top 5 hotels seem to have the greatest effect on other branded hotels.

Ripple effects are even larger on the independent side of the industry. Independent hotels seem particularly aware of investigations conducted at other independent hotels in their area. One explanation of this might be the important role played by the Asian American Hotel Operators Association (AAHOA). The AAHOA represents more than 50 percent of hotel owners in the independent sector and may play a particularly important role as a social network among owners and operators in the independent sector. It may play a role in transmitting news about investigations along with their activities in other areas.

In a related vein, the presence of strong ripple effects and the potential role of the AAHOA in the independent sector provide the opportunity for having systemic effects on that side of the sector. Although we have shown in the prior section that independent hotels tend to have worse compliance than brands, that in itself does not imply WHD should focus its efforts on that sector. The problem of doing so is that independent hotels, for the reasons described above, do not have the same "glue" that binds together brands. Absent some other form of glue between them, a strategy focused on investigating individual independent hotels might successfully recover lost back wages for affected workers, but do little to change behavior more broadly. A successful strategy for the independent sector would need to maximize deterrence effects and at the same time try to include associations like the AAHOA in achieving more systemic changes. We turn to considerations like these in the final section of this report.

106. The forthcoming report "Improving FLSA Compliance in the Hotel/Motel Industry" provides more detailed comparisons of compliance across different chain segments, brands, and independent operators.

VI

DESIGNING AND IMPLEMENTING SECTOR-BASED ENFORCEMENT

The changing workplace environment, coupled with the experiences of WHD and other regulatory agencies over the past two decades, requires new, more strategic approaches to enforcement. Strategic enforcement policies aim to change employer behavior so that practices that result in underpayment of wages do not occur in the first place. This requires addressing the underlying factors that lead to lost wages and other violations of labor standards. Strategic enforcement also entails changing behavior of employers at the market level, rather than on a case-by-case basis. This more expansive role requires the WHD to consider new strategies as well as organizational changes to support them.

In this final section, we provide recommendations based on the findings presented in previous sections of this report. First, we discuss priorities for future investigations based on the need to focus efforts on those workers most vulnerable to violations of the FLSA and least able to protect themselves, and where there are opportunities to affect employer behavior at a sector- rather than workplace-by-workplace level. Second, we discuss four major strategies for WHD to pursue, drawing on the four criteria (prioritization, deterrence, sustainability, and systemic effects) for strategic enforcement described in Section I. Finally, we discuss organizational modifications that should be considered in preparing WHD to undertake these strategies.

I. Setting Industry Priorities

This report points to several clear principles regarding industry prioritization. WHD industry priorities at the national-, regional-, and district-levels should be guided by three criteria: (1) sectors with large concentrations of vulnerable workers; (2) sectors where the workforce is particularly unlikely to step forward; and (3) sectors where the WHD is likely to be able to change employer behaviors in a lasting and systemic manner.

First, the WHD should prioritize among those industries with large numbers of vulnerable workers—that is, workers that are likely to face violations of labor standards because of both the low-wage work that characterizes their jobs and the larger conditions that create significant pressures on employers to reduce labor costs. As we showed in Section II, restructuring of product and labor markets in many industries means that these two characteristics are often related: large and often highly-profitable employers in many sectors have shifted the place of employment outside of their corporate boundaries onto smaller employers (contractors and subcontractors/self-employed workers/franchisees) that often face more competitive conditions in their local markets. Figure 2.2 identified a number of major sectors where these conditions exist. Although some of these sectors represent problems in virtually any part of the country (e.g., eating and drinking; hotels), others are either more regionally- or locally- focused (e.g., chicken processing; logistics; agriculture) or vary in importance across regions and time because of changing economic conditions (e.g., residential housing construction, which will become active in some areas of the country long before others).[107]

Second, given the high proportion of WHD investigations driven by complaints, the likelihood of employee exercise of

107. As noted in Section II, a particularly vulnerable subset of workers are those subject to human trafficking for labor and modern-day slavery (e.g., the workers who were found to be an imprisoned workforce of an apparel contractor in El Monte, California in 1996, which provided part of the impetus of the garment initiative at that time). These highly vulnerable workers require strong enforcement response, as will be described below.

rights must be considered. It would be ideal if those workers exposed to high levels of violations were more likely to utilize their right to complain than those facing relative low levels of violations. Past evaluations of WHD data, however, reveal no such connection (Weil and Pyles 2006, 2007). This implies that there are significant factors other than being paid in violation that affect the worker's decision to complain.[108] These include immigrant status, union representation, lack of education and knowledge of basic rights, and the costs of job loss (e.g., how high is area unemployment?). As a result, the WHD should be particularly concerned about industry sectors and working groups that are unlikely to come forward with complaints, even in the face of significant violations. Those sectors with a significant number of vulnerable workers who are unlikely to complain due to immigration status, lack of education, fear of job loss, and other reasons should therefore rise particularly high on a priority list.[109]

The third criteria for setting priorities regards efficacy—the likelihood that the WHD will actually be able to change the behavior in the industry in a sustainable (little recidivism) and systemic (beyond the boundaries of the workplace and firm(s) being investigated) manner. This report has stressed the importance of understanding how the structure of an industry affects behavior of employers. There are some industries with large numbers of vulnerable workers who are unlikely to complain, but where it is difficult to change behavior of employers in a sustainable manner. One example is nail salons: a variety of stories have shown significant violations of labor standards in these typically small establishments (Greenhouse 2007). Many of those in the workforce are immigrants and non-English speakers, making complaining unlikely. Yet because employers are small, geographically dispersed, and under tremendous competitive pressure, it is hard to see how the WHD might systematically affect behavior.

Including efficacy as a criterion for selecting industries can spur creativity rather than be a barrier to innovation. The greengrocer initiative undertaken by the Labor Bureau of the New York Attorney General's Office is indicative. Labor standards violations were widespread among the small local grocery stores in the New York area. In many ways, "greengrocers" have similar characteristics to the nail salons discussed above. However, the Labor Bureau's strategy was built on the fact that most greengrocers were members of the Korean American Association of Greater New York; the agency crafted a more systemic solution via the important role the association played in its community. By focusing enforcement pressure on this group, the agency successfully negotiated an innovative code of conduct with the business association that provided a sustainable structure to allow ongoing monitoring and payroll review, as well as training of employers in labor standards.[110]

The WHD has set explicit industry priorities in low-wage industries for a number of years and incorporated the idea of prioritization in its annual strategic planning cycle. This internal structure for discussing annual priorities and then having regional and local offices propose their upcoming plans in light of those priorities is an important institutional foundation for the prioritization discussion. Sharpening the criteria for selecting targets and, in particular, bringing the issue of efficacy explicitly into that process builds directly on this existing experience.

Figure 6.1 lists a set of major industries that rank high along all three criteria. Some of the industries on this list have been priorities for WHD in recent years. All of the industries have historically high rates of labor standards violations and represent a disproportionate share of low-wage workers (see Tables 2.1 and 2.2). Workers in these industries have characteristics that undermine their likelihood to complain (low union density; high proportion of immigrant workers; and/or limited employment options due to prior work histories, or lack of education and/or mobility). Finally, the industries have fissured employment characteristics that both are a source of underlying problems but that also lend themselves to different approaches to enforcement. A strategic enforcement perspective requires a multi-pronged approach, focusing both on the workplaces where labor standards violations occur (the traditional focus of WHD investigation activity) and also at a higher level of industry structure, where "lead firms" play a key role in setting the competitive and employment conditions

108. Statistical analysis of complaint activity in the hotel and motel industry finds that one of the strongest predictors of the likelihood of lodging a complaint with WHD in the independent sector is the presence of prior complaints at the same property (i.e., workers in properties where other workers complain are more likely to complain themselves). On the other hand, prior directed investigations reduce the likelihood of future complaints. Both of these results may arise from factors that affect the willingness of workers to step forward (e.g., the feeling that an employer might retaliate against an employee who complains). The fact that past complaints lead to additional complaints might reflect that workers feel more emboldened to exercise their rights in the face of other workers doing so. In contrast, directed investigations that are not triggered by employees might cause some employers to respond by actions to discourage workers from stepping forward (e.g., pre- and post-investigation meetings with employees asking them not to speak with investigators).

109. In prior work, the authors created lists of industries based on these criteria by combining estimation of underlying likelihood of violations based on the Current Population Survey and complaint rates calculated from WHISARD. This analysis should be updated using more recent CPS data and WHISARD information regarding complaints and incorporating more detailed industry measures for certain critical sectors such as construction. We discuss this option in recommendation II.C.1 (below).

110. We are grateful to Terri Gerstein of the New York State Department of Labor for her description of the program. For a detailed discussion of the initiative see Bodie 2004a. Patricia Smith describes the strategy in an interview in Bodie 2004b.

FIGURE 6.1

Priority Industries for Strategic Enforcement

Industry	Lead Firm/Organization for Strategic Focus	Workplace for Investigation Focus
Eating and drinking **Limited service (fast food)** **Full service**	• Brands (franchisors)	• Franchisees/outlets
Hotel/motel	• Brands (franchisors) • Brand operators • Independent operators	• Hotel/motel properties
Residential construction	• Major homebuilders	• Contractors/subcontractors
Janitorial services	• Building owners/major building service providers	• Buildings where the services were provided
Moving companies/logistics providers	• Branded national moving companies	• Subcontracted local movers; interstate trucking companies; warehouses
Agricultural products—multiple sectors	• Food retailers • Major food processors	• Farms; Farm labor contractors
Landscaping/horticultural services	• Major purchasers of landscaping services in private/public sectors	• Subcontracted landscaping providers
Health care services	• Major health care providers	• Nursing homes; residential care facilities
Home health care services	• Major purchasers of home health care services	• Health care intermediaries; home health care providers
Grocery stores—retail trade	• Major food retailers	• Food retailing establishments
Retail trade—mass merchants; department stores; specialty stores	• Major retailers	• Retail establishments

for employers at "lower levels" of the industry structure. Key players at both levels are listed in Figure 6.1.

The industry list is not meant to be comprehensive or definitive. Annual planning cycles, drawing on up-to-date information regarding complaint rates, estimates of underlying violation likelihood, and efficacy evaluations related to ongoing enforcement efforts (see below) can be incorporated in ongoing revision and refinement of these priority sectors.

II. Strategies for Enforcement

The findings of this report suggest four clear strategies for the WHD to pursue with respect to new enforcement approaches. First, given the impact that product- and labor-market restructuring have had on employer behavior in many of the industries employing large numbers of vulnerable workers, the WHD must find ways to focus regulatory pressure on the lead firms in these industry structures. If the WHD is to have sustainable and systemic effects on key sectors, it must experiment with sector-level strategies in priority areas. The example of the garment initiative detailed in Section III indicates the past success of the WHD in undertaking such an effort; that lesson can be applied to many other sectors. Second, WHD enforcement policies should explicitly factor in deterrence ("ripple effects") in all stages of enforcement—initial planning, undertaking, and following up on investigations. Third, given the high percentage of enforcement activity arising from complaints, the agency should pursue programs that ensure that complaint mechanisms have impacts beyond the immediate workers involved, while also strengthening the recourse to the WHD among vulnerable workers who might otherwise be intimidated from exercising their rights. Fourth, uniting all of the above strategies, the WHD must continually seek to link its enforcement tools—whether they are methods of complaint response, targeting of directed investigations, coordination with worker

advocates, outreach to employer or business associations, CMP assessment, or larger litigation strategies—so that in the long term, they help create an environment that encourages more systemic compliance with labor standards.

II.A. FOCUSING AT THE TOP OF INDUSTRY STRUCTURES

Traditional strategies assume that enforcement efforts should focus at the level where workplace violations are occurring. Yet, as has been argued throughout this report, the forces driving noncompliance in many industries arise from the organizations located at higher levels of industry structures. 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.

II.A.1. MAPPING BUSINESS RELATIONSHIPS AND REACHING OUT TO THE TOP

One of the basic messages of this report is that strategic enforcement requires creating a "map" of business relationships. The kind of maps that are laid out in Sections III, IV, and V indicate the different players that drive employer behavior. The map, in turn, indicates which organizations ultimately must be considered in developing investigation plans. An eating and drinking initiative should, for example, include not only investigations of outlets with violations (e.g., those arising from complaints), but also of other units owned by the particular franchisee. It would 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 (as discussed in sections IV and V).[111]

An example of such outreach for the fast food and hotel/motel industries, where franchising is wide-scale, would be for the Secretary of Labor to send a "Message to Franchised Companies" directed to the major brands in those industries. In the message, the Secretary could describe her concern for vulnerable workers, the importance of the protections afforded by workplace laws and the Department's commitment to enforcing those laws and assisting employers in complying with them. The message could indicate the important role that franchisors could play in encouraging their franchisees to understand the importance of and compliance with these laws. Framed in a non-confrontational way, such a message—coupled with strategic enforcement initiatives described below—would lay the groundwork for a variety of different interventions aimed at linking workplace investigations to the upper levels of the branded organizations.

Specific outreach could be geared to major brands depending on their prior records of compliance. The WHD (or DOL[112]) could reach out to several major brands in those industries with positive employment reputations and positive records of system-wide compliance and ask them to work with the WHD to be leaders in the industry and help ensure compliance with workplace policies across their systems of franchisees.[113] A cooperative agreement could include a commitment by the brand to cascade information through its company-owned properties and outlets, and to its franchisees, as well as a commitment to review employment practices with franchisees when other franchise standards are being reviewed—with the intention that such efforts could be a model for other progressive major brands.

The flip-side would be to target several major brands that had documented histories of systemic violations among their franchisees. These brands could be identified through evaluation of past investigation records similar to the analyses presented in Section IV and V.[114] Brands could also be identified prospectively via information arising from complaint investigations (see "Special Strategic Complaint Procedure" below). Once identified, the WHD could undertake broad and coordinated investigations in multiple parts of the country and across multiple franchisees, in order to establish the level of system-wide violations, and pursue statutory penalties for those violations. As part of its process of resolving the violations, the WHD could negotiate a comprehensive agreement covering all outlets/properties, which would entail outreach, education, and monitoring.

111. 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, which typically employs a minimal number of construction workers directly, but contracts and subcontracts work. A WHD 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.

112. In some cases, these brand-level efforts could span multiple agencies in the DOL, including ETA for H2-B programs, and OSHA. We discuss this kind of opportunity in a later section.

113. This would require generating clear, replicable criteria about positive employment practices. These could include transparency in human resource policies, wage and benefit policies that exceed industry averages, and objective evidence of worker satisfaction, such as turnover levels below industry averages.

114. For example, in the fast food sector, our analysis found significantly higher back wage violations among particular brands, even after statistically holding constant other factors that might also explain noncompliance. In particular, compared to typical outlets of McDonald's (which had the best overall compliance record among the top 20 branded companies studied), Subway, Domino's Pizza, and Popeyes Chicken all had back wages per investigation that were more than $8,000 higher. Results for all brands are available from the author.

II.A.2. COORDINATED INVESTIGATION PROCEDURES

Refocusing enforcement strategy so that it includes "lead firms" (i.e., firms at the top of the industry structure) as well as the employers directly responsible for labor standards violations requires changes to a variety of investigation protocols. Individual investigations might need to be augmented by collection of information about ownership, management, and responsibility for specific activities at the work site.[115] Investigation procedures might also require upfront commitments to investigations of multiple sites of a given employer or operating under a lead firm where wide-scale violations are believed to be present. Other techniques used by the WHD in past directed efforts when there was a concern about falsified records, worker intimidation, or other impediments to determining compliance need to be more generally adopted.[116]

Since lead companies often operate in multiple states, several District Offices in one Region or in some cases multiple Regions will need to cooperate. This entails enhanced use of MODO procedures for everything from coordinating the larger investigation strategy to ensuring that WHISARD information is linked to principal companies. It also requires an integrated approach to short-term investigations and long-term settlement objectives (e.g., District Offices must coordinate decisions about when and how to close multiple cases linked to a common lead firm). Finally, coordination across cases that are associated with a common business association or an entity that might not traditionally be considered part of coordinated investigation efforts (e.g., independent management operators in the hotel industry) becomes essential.

In order to develop coordinated approaches, the WHD should consider establishing **vulnerable worker coordinated strike forces** in one or two industries employing vulnerable workers (obvious industries given this report would be eating and drinking, and hotel/motel, but the idea could be expanded in subsequent years to other industries with vulnerable workers, such as residential construction or janitorial services, as information about the structures of other industries is verified/validated). For example, the target of such a coordinated strike force could be a problematic brand (based on the review process discussed in II.A.); properties of a specific, large owner (e.g., a major, multi-unit franchisee with a history of violations); properties of a specific management company in the hotel/motel sector; businesses in a particular chain segment with persistent compliance problems (e.g., upscale resorts in the hotel/motel sector); or employers that rely heavily on a practice associated with noncompliance (e.g., misclassification of workers in residential construction or H2-B workers in hotel/motel).

Similar to WHD child labor initiatives of the past, the targeted group of firms would be pre-selected and screened and WHD offices around the country would start investigations of the targeted employers at the same time. Using one of the examples above, 24 outlets of a major franchisor would be investigated during a five-week period in multiple locations around the country. Communication releases (local, regional, and national), through traditional media and the Internet, would be coordinated at the start of the initiative as well as at its completion (to announce results). Such a coordinated effort would both create an impetus for establishing systemic agreement with the targeted "top employer," as well as have potential ripple effects on other industry players (see recommendations on deterrence in II.B).

Other investigation tools could also be modified to better support a "mapped" approach to enforcement. Reinvestigations make up a significant chunk of enforcement activity each year. For example, between 1998 and 2009, the WHD undertook 4,569 reinvestigations in the eating and drinking industry, representing 9.7 percent of all investigations in that industry, and 1,095 in hotel and motel, representing 10.4 percent. They are undertaken to serve a variety of ends: quality reviews of past investigations; check-ups on problematic employers; evaluations of recidivism. Reinvestigations could be used in a focused effort as part of a wider initiative regarding a problematic brand as described above. By tying reinvestigations explicitly to brand- or third-party management initiatives, the WHD could lay the groundwork for more comprehensive agreements with the top-level organizations (and potentially increase the deterrence effect of these interventions).

II.A.3. CLARIFYING THE BOUNDARIES OF EMPLOYMENT RESPONSIBILITY

The WHD, in consultation with the Office of the Solicitor, should seek to clarify joint employment in the many industries and sectors where the locus of employment has blurred. In more and more sectors, defining the employment relationship has become muddy. In the hotel sector, for example, a property may be owned by one group, hold a brand of another organization, and have its operations run by an independent operator. Since each of these organizations exerts some control over day-to-day operations, often with specific and detailed requirements (see Figure 5.2), the problem of defining joint employment in new contexts naturally arises.

115. For example, several of the District Offices involved in the 2008 hotel industry pre-pilot effort included in each investigation a battery of questions relating to who was responsible for hiring, daily management, review, termination, and other specific activities at the hotel property, since those tasks are often divided between management operators and owners in that industry.

116. This might include a review of the longstanding practice of WHD arranging for investigations in advance rather than conducting unannounced visits. Although advanced notice has certain advantages for logistical reasons (having the right staff present so payroll records can be reviewed and key personnel interviewed), it also undercuts the ability of WHD investigators to uncover certain types of violations (e.g., if unscrupulous employers intimidate and/or coach employees prior to the WHD visit).

The FLSA provides a broad definition of the word "employ." Goldstein *et al*. (1999) argue that the Act's definition that "employ includes 'to suffer or permit to work'"[117] not only covers direct employer-employee relationships (i.e., the master-servant relationship described in the Common Law), but is a broader definition that "… required only that the business owner have the reasonable ability to know that the work was being performed and the power to prevent it. Thus, work performed as a necessary step in the production of a product was almost always suffered or permitted by the business owner." (Goldstein *et al*. 1999, p. 984). This broader definition of employer responsibility has been used in the past as the basis for creative policies in agriculture and garment. Bringing significant cases that require courts to once again consider and clarify the boundaries of employment in other major industries employing large numbers of vulnerable workers (construction, janitorial, hotel) and involving a variety of organizational forms (franchising, third-party management, temporary help agencies, supply chain subcontracting) seems propitious.[118]

The WHD and Solicitor could also pursue litigation, based on evidence of systemic violations across different owners linked by a common brand or other higher-level entity, to establish joint employer responsibility. For example, franchisees are commonly viewed as the direct and sole employer of workers in their outlets or hotels. But as Sections IV and V illustrated, franchisees operate under specific, extensive, and demanding operational requirements. This is an essential element of successful branding: a consistent customer experience in any outlet bearing the brand name. The nature of franchisor/franchisee relationships may imply under state law a joint venture relationship, which, in turn implies more interdependence in the employment relationships between the parties.[119]

The Solicitor's Office should actively review cases involving legal issues revolving around franchising, branding, joint employment, subcontracting, and joint ventures, and consider filing amicus curiae ("friend of the court") briefs as part of its efforts to clarify the law involving employment responsibilities in fissured industries. Similarly, the Solicitor's Office should reach out to state labor standards agencies and the worker advocacy community for potential cases.

II.A.4. EXPANDING THE APPLICATION OF HOT GOODS BEYOND THE APPAREL INDUSTRY

The hot goods provisions of the FLSA, which provides the DOL with authority to enjoin the transportation, shipment, delivery, or sale of goods produced by a worker who was not paid the minimum wage or required overtime (Section 15(a)(1)), could be once again actively used as a means of extending the costs of noncompliance beyond the employer immediately responsible for the violation. There is precedent for the use of the hot goods provision beyond garments (Leonard 2000). Since the interruption of the flow of goods has become costly in a growing number of industries where employment has been devolved, the pursuit of temporary injunctions, temporary restraining orders (TROs), or simply the threat of invoking hot goods can be a means to bring key parties to the table to rectify significant cases, or, more fundamentally, to create mechanisms to prevent future noncompliance as will be discussed below.

The WHD should work closely with the Office of the Solicitor to investigate the potential application of hot goods provisions to sectors where it has not been actively used, but

117. Fair Labor Standards Act of 1938, Pub. L. No. 718, § 3(d), (e), (g), 52 Star. 1060, 1060 (1938).

118. In a related vein, the WHD, in consultation with the Solicitor's office and perhaps other DOL agencies (OSHA in particular), should pursue cases that would clarify the implications of competing doctrines regarding employment relationships on the respective responsibilities of franchisors, management operators, production coordinators, or central payment organizations. Section II, for example, discussed how the doctrine of vicarious liability compels firms at higher levels of industry structures to distance themselves from operational decisions, even though it sometimes is costly for them to do so. The conflicting incentives operating between legal doctrines and business strategies have important implications for how decisions are made in many of the industries of concern to WHD. It is not clear that the WHD and Solicitor's Office have a common view even internally of the cross-current arising from these competing incentives. For example, the WHD's Fact Sheet #13 regarding employment relationships under FLSA states that "Franchise arrangements can pose problems in this area (definition of employer) as well. Depending on the level of control the franchisor has over the franchisee, employees of the latter may be considered to be employed by the franchisor." This statement relates to common law definitions of master-servant relationships, although the definition of employee used in the FLSA arises from an economic definition of the relationship (Goldstein *et al*.).

119. This is not intended to represent a fully formed legal theory that franchising constitutes a form of joint venture. We simply want to illustrate the type of litigation that could be pursued to clarify employment responsibilities as part of a broader regulatory enforcement strategy. For example, under New York State law, the essential elements of a joint venture are: 1. an agreement manifesting the intent of the parties to be associated as joint venturers; 2. a contribution by the co-venturers to the joint undertaking (i.e., a combination of property, financial resources, effort, skill or knowledge); 3. some degree of joint proprietorship and control over the enterprise; and 4. a provision for the sharing of profits and losses." (Kaufman v Torkan, 51 AD3d 977, 979, 859 N.Y.S.2d 253 [internal quotation marks omitted]; see Tilden of N.J. v Regency Leasing Sys., 230 AD2d 784, 785-786, 646 N.Y.S.2d 700; Ackerman v Landes, 112 AD2d 1081, 1082, 493 N.Y.S.2d 59). [**104] [***111] "The ultimate inquiry is whether the parties have so joined their property, interests, skills and risks that for the purpose of the particular adventure their respective contributions have become as one and the commingled property and interests of the [*11] parties have thereby been made subject to each of the associates on the trust and inducement that each would act for their joint benefit" (Matter of Steinbeck v Gerosa, 4 NY2d 302, 317, 151 N.E.2d 170, 175 N.Y.S.2d 1 [internal quotation marks omitted])." Hamlet at Willow Cr. Dev. Co., LLC v. Northeast Land Dev. Corp., 2009 NY Slip Op 3136, 10-11 (N.Y. App. Div. 2009).

where it is potentially applicable. It should review past District and Regional Office efforts to use hot goods—even where its application was not fully invoked—to provide guidance on experience to date. Settlement of hot goods cases should draw on the larger strategy of linking in "top level" business organizations (recommendation II.A.1) as well as creation of innovative forms of ongoing oversight such as monitoring (recommendation II.C.1).

II.B. ENHANCING DETERRENCE EFFECTS AT THE INDUSTRY/GEOGRAPHIC LEVEL

The evidence in Sections IV and V suggests that all investigations are not created equal. Some investigations have very local effects, essentially limited to the worksite being investigated. But other investigations seem to have much stronger ripple effects that go on to affect the behavior of other establishments controlled by the firm, or, more interestingly, the behavior of other companies in the same industry and geographic area.

II.B.1. INDUSTRY-FOCUSED DETERRENCE

The strength of deterrence or "ripple effects" relates in part to the characteristics of the industry and the relations between employers in the industry's markets and workers in the industry's labor markets. For example, employers seem to be sensitive to investigations conducted among specific "reference" employers: Top 20 fast food restaurants are very sensitive to investigations of other outlets in their local area. In contrast, branded hotels seem to be particularly focused on local investigations at the top five national brands, but less responsive to investigations of the next tier of competitors. Similarly, independent hotels are very sensitive to investigations at other area independents, but relatively unresponsive to investigations at branded hotels. This may stem from the way that these businesses interact with one another in terms of pricing policies, customer or job referrals, and participation in industry or business associations.[120]

WHD can seek to enhance deterrence impacts by acting on these patterns, such as by publicizing its investigations of particular hotels. Alternatively, it should also explore whether there are transferable lessons that can be used to modify its policies. For example, findings reported in Sections IV and V indicate that, in general, directed investigations have larger deterrence effects than complaint investigations. Although the procedures of a full investigation are designed to be the same regardless of the trigger for an investigation, pre- or post-investigation activity may differ. Procedures surrounding complaint investigations (e.g., pre- and post-investigation communications) should be modified to more closely resemble those in directed cases in order to have similar deterrence impacts.

The general point is that the planning and evaluation of investigation strategies need to explicitly include potential deterrence effects. This builds on the need to map business relationships in priority industries as a central component of enforcement. But strategic enforcement requires that WHD consider every workplace investigation it undertakes—complaint or directed—in terms of its potential ripple effects. How it does so may vary by industry, geographic area, or the relationships that exist between the WHD and relevant worker advocates and employer communities.[121]

II.B.2. PENALTY POLICY AS A CENTRAL PART OF DETERRENCE

Deterrence only works if employers have an incentive to change behavior even before being investigated. Choosing to comply in this way reflects an employer's assessment that the benefits of complying voluntarily (without an actual investigation) outweigh the costs of not doing so. The potential costs arising from major WHD actions or hot goods TROs is one means of changing the private benefits and costs of compliance. But liquidated damages (LDs) and civil monetary penalties (CMPs) are also a means of doing so for investigations, regardless of whether they are part of a directed initiative.

Deterrence theory states that penalties should reflect the potential gains received from failing to comply (which, in the case of FLSA, are equivalent to expected back wages) and the probability that an employer is investigated.[122] As the probability of investigation decreases, the expected penalty should increase exponentially. Specifically, this means that if the typical employer in an industry underpays workers by $1,000 for the relevant pay period, the expected penalty for violation should equal $2,000 if there is a 50 percent probability of investigation; $4,000 if there is a 25 percent probability and $10,000 if there is a 10 percent probability. Given that the probability of investigation in most industries is far below 10 percent, the theory of deterrence suggests that WHD penalty polices are far too low.[123]

120. For example, one reason that WHD investigations of the top five brands seem to have greater ripple effects on the compliance of other brands may be that other brands look to these market leaders in the areas of pricing, advertising, or service innovations.

121. For example, the Asian American Hotel Operators Association (AAHOA) is an important player in the independent sector of the hotel industry, representing more than 50 percent of all independent hotels. Outreach to this group in terms of ongoing initiatives could be a critical part of enhancing the ripple effects of investigations that Section V indicated were present in the independent hotel sector. For background on the AAHOA, see http://www.aahoa.com/AM/Template.cfm?Section=About_Us (accessed October 10, 2009).

122. The economics of deterrence was famously first articulated in Becker 1968. The large theoretical and empirical literature on deterrence is nicely summarized in Winter 2008.

123. Deterrence theory also argues that it is usually more efficient to increase the expected cost of violation (which is determined by the product of the probability of investigation/detection multiplied by the expected penalty) by increasing the penalty rather than the probability of investigation, since it is less costly to

Analysis in Section I indicates that expected penalties for violations of the FLSA are modest given the relatively small percentage of cases where CMPs are assessed and the fact that they are frequently reduced after they have been assessed. Over much of the past decade, less than half of reinvestigations where repeat FLSA violations were found had CMPs assessed (see Figure 1.6). If investigations are to have greater deterrence effects, WHD must make CMPs a far more common outcome in investigations where they are warranted than under current practice. The default for investigations with repeat findings should be assessing CMPs, with the failure to do so representing the exception rather than the rule. The WHD moved in this direction in 2006 and 2007, where the percent of reinvestigations with violations with positive CMPs rose from 46 percent in 2006 to 55 percent in 2007. That trend should be continued and well publicized.

To further enhance their impact, WHD should consistently assess CMPs and review established guidelines for CMPs, including policies regarding what constitutes "repeat and willful" violations of the Act and policies regarding negotiating CMPs from the time they are assessed to when they are ultimately paid, all with an aim to increasing their impacts on repeat and recurring violations and the consistency of their application.[124] Once those guidelines have been reviewed and revised, they should be incorporated into the WHD's Field Operations Handbook, and efforts should be made to ensure consistent application across District Offices. At the same time, the WHD at all levels should aggressively seek collection of CMPs by using established debt collection procedures to the extent possible.[125]

In addition to more comprehensive and consistent use of CMPs for repeat cases of violations, investigation policies should explore administratively assessing liquidated damages (LDs) for serious/willful/repeat violations and not just in those RTP cases referred to SOL for litigation. Broader use of LDs seems permissible under the statute and would increase deterrence effects if used consistently, particularly in sectors identified in this report.[126]

While outside the purview of the FLSA provisions discussed above, but related to vulnerable worker populations, we also recommend that the WHD increase the number of debarment actions in SCA and DBA cases, especially those involving security guards, janitors, lower-skilled construction workers, and other vulnerable workers on government contracts, including those with disabilities. Similarly, WHD should pursue all available penalties for MSPA violations, which also involve vulnerable workers in agricultural industries.

Employers in the sectors studied in this report also demonstrated sensitivity to WHD activities conducted in their local (5-digit zip code) areas. WHD should develop a communications strategy to publicize the assessment of LDs, CMPs, and the use of TROs and hot goods actions at the local, regional, and national levels. As part of a broader transparency policy (recommendation II.B.4), the WHD should also consider making lists of employers who have been repeatedly assessed with CMPs or LDs, are operating under a TRO, or who have failed to pay final CMP assessments readily accessible on the web, and publicize the existence and ongoing updating of this information.

II.B.3. EXPANDED LITIGATION TO PREVENT NONCOMPLIANCE

Most employers abide by workplace standards. Market forces can drive employers to cut corners and evade compliance, particularly where a pattern of violations becomes established in an industry or geographic area. But some employer behavior goes beyond this and represents egregious, willful, and pernicious behavior. In such cases, civil and criminal litigation should be actively pursued. High-profile prosecutions in the garment industry arising from the notorious El Monte case signaled a zero tolerance policy towards such behavior. But they also provided a backdrop for the subsequent garment initiative discussed in Section III.[127] Although it should not be used capriciously and should be primarily focused on "lowest road" players, the potential for criminal litigation can act as an important deterrent well beyond those directly involved.

In this context, mention should be once again be made of the most egregious forms of labor standards violations related to cases of trafficking and similarly extreme workplace prac-

raise penalties than to increase the chance of being found out of compliance (i.e., increase the number of investigations in a way that would appreciably increase any one employer's chance of being investigated).

124. As discussed in Section II, our analysis of WHISARD data for 2003-2008 indicates that even when CMPs are computed, the amounts that employers agree to pay are usually substantially reduced from the amount initially set. For all cases concluded by WHD 1998-2008 that had CMPs assessed, the CMPs ultimately deemed receivable by the WHD were only 61 percent of the total amount assessed.

125. Other government agencies—in particular the Environmental Protection Agency—have developed sophisticated penalty procedures over the last two decades that are based on explicit consideration of the likelihood of detection and gain to businesses arising from noncompliance, along with a number of other explicit criteria tied to deterrence. WHD should carefully review the methods developed by EPA and other government agencies in reviewing its penalty policies.

126. Section 16(b) states that "any employer who violates section 6 or 7 of this Act shall be liable to the employee or employees affected in the amount of their unpaid minimum wage or their unpaid overtime compensation … and in an additional equal amount as liquidated damages …" It does not appear from this language that court action is required to assess and collect LDs.

127. Although the available data did not allow us to measure their impact, we have been told by a number of investigators involved in the garment industry initiatives at the district, regional, and national levels that contractors reported a willingness to pay back wages and comply in the future because of their fear of prosecution.

tices. In such cases, WHD staff need to recognize potential human trafficking (for labor) situations and follow established DOL/WHD policies regarding timely coordination with RSOLs, appropriate referrals to the Department of Justice and other federal agencies, and cooperation in ongoing criminal investigations, in order to ensure the successful prosecution of perpetrators of the trafficking, recovery of back wages under WHD-administered statutes, and relief for the victims of trafficking. Where those cases are related—even indirectly—to "fissured employers," lead firms (e.g., brands in fast food, independent operating companies in hotel/motel, major homebuilders in residential construction) should be included in the assessment of appropriate remediation and penalties and appropriate actions taken.

Civil litigation can also play a far greater role in enhancing the deterrence impact of investigations. A small number of cases are currently litigated by the WHD. These should be more consistently pursued, particularly as part of a larger industry-focused initiative. Civil litigation and consent agreements can have broad impacts on employer behavior. For example, a relatively modest comprehensive settlement agreement with Tharaldson Lodging in January 2007 seems to have resulted in improved compliance among a large number of hotels owned by different companies and flying the flag of a variety of brands.[128] Litigation may also spur negotiation of innovative monitoring arrangements that create sustainable mechanisms for ensuring ongoing compliance, as we will discuss below.

II.B.4. ENHANCING DETERRENCE THROUGH TRANSPARENCY

In general, the WHD should make its investigation activities in a geographic area more transparent. WHD District Offices publicize directed investigations in a variety of ways (press releases, letters to employer organizations, outreach to worker advocates). These should be evaluated to assess their comparative impact. New methods of conveying information about WHD activities, drawing on the web and social networks, should also be explored.

The WHD should also make data on closed investigations contained in WHISARD more accessible for use by the public. Geo-coded information, accessible via maps rather than search screens, is more useful to many users.[129] Lowering the costs of information acquisition and gearing information to the way that users search for and use it should be pursued. Providing information regarding particular industry initiatives to key parties can have additional beneficial impacts. For example, during the late 1990s, the WHD issued quarterly garment reports that simply listed contractors and manufacturers who had been investigated in the prior quarter.[130] This report gave manufacturers in search of contractors with better track records (and, therefore, a lower chance of being threatened by a hot goods embargo) information for future sourcing decisions, thereby furthering the systemic effects of the garment initiative.

Increasing transparency about WHD activities potentially increases deterrence effects not only among employer networks, but also through spreading the word to workers in a local area. However, getting the word out regarding WHD presence to workers—again, whether through directed initiatives or complaint activities—requires different methods of outreach that tap into relevant community organizations such as immigrant rights groups and religious organizations. We recognize that WHD staff expend considerable resources in responding to requests from these organizations and others that represent the interests of vulnerable workers. We are suggesting, however, that WHD have a more proactive and coordinated—both externally and internally—approach to its outreach efforts, in order to communicate the agency's strategic enforcement approach and to seek the assistance of these groups in furthering WHD's goals.

II.C. TRANSFORMING COMPLAINT INVESTIGATIONS FROM REACTIVE TO STRATEGIC RESOURCES

Although the focus of this report is not the role of workers in enforcement, several issues relating to this issue bear mentioning.[131] Given that complaints comprise the majority of WHD investigations now (76 percent in 2008) and for the foreseeable future, close attention must be paid to the question of "Who complains?" under workplace policies.

Complaint investigations need not, however, be simply accepted as inevitably reactive. First, complaint investigations can be better integrated with directed investigations and the larger aims of the WHD. Second, the WHD can more effectively reach out to the worker advocacy community, which plays a complementary role in securing workplace standards.

128. The short (seven-page) agreement states that the defendants are "permanently enjoined and restrained from violating the provisions of the Act" (overtime and record-keeping violations) and that they must not discriminate against the named employees in the future. The agreement also required the company to pay double back wages, totaling $24,452. In late 2008 and 2009, directed investigations at a large number of hotel properties managed by Tharaldson (27 properties in 8 states) revealed only minor violations of the FLSA, implying that even a relatively modest agreement had an impact on behavior.

129. The feasibility of doing so is demonstrated by the profusion of web sites that "mash" data from many different sources. The Boston University research team has experimented with mapping WHISARD information in the hotel and motel, and eating and drinking industries.

130. The reports were issued in paper and PDF format. Although they were downloadable for a period of time from the DOL web site, users could not search the database of past violators, but instead had to look through the quarterly reports manually. A user-friendly, searchable database would now be easy to create and vastly enhance the utility of this type of disclosure.

131. The Boston University research team has looked intensively at this issue in prior work with WHD and have published a number of studies relating to it. See in particular Weil and Pyles 2006, 2007 and Weil 2008.

II.C.1. RESPONDING STRATEGICALLY TO COMPLAINTS

A conservative estimate of the relationship between worker complaints and underlying overtime violations suggests that there are about 130 violations for every one complaint lodged overall, and that this ratio varies tremendously across industries (Weil and Pyles 2007). This indicates both the significant number of unreported violations in many places and the magnitude of the task facing the WHD were it to handle this problem alone.

Strategic enforcement should focus on workplaces where big problems exist but also where workers are unlikely to complain because of barriers they face. Enforcement policies that take into account both the underlying likelihood of problems and the capacity of workers to trigger enforcement have the potential of appreciably increasing the regulatory bang for the enforcement buck. A corollary to the above complaint problem arises in the largely non-unionized, private-sector workplace. Absent the presence of third-party representatives, workers face substantial impediments to effectively exercising their rights.

But even with closer working relationships with outside groups, the WHD must respond to incoming complaints in a more strategic manner. This requires not only taking into account the relative priority of different complaints (the kind of triage approach currently used in determining whether to conciliate or undertake a physical investigation of the workplace), but nesting incoming complaints within the larger universe of workplace problems faced by the agency.

One means of doing so at the industry level is to array workplaces according to two dimensions discussed above, namely, the likelihood of complaints (as measured by past complaint activity) and underlying compliance in the industry. Conceptually, the two dimensions can be captured in the two-by-two matrix depicted in Figure 6.2. Industries are located in the matrix based on whether they have above- or below-average levels of complaints and FLSA violations (where the former is measured by the rate of complaints per workers employed in an industry and the latter by measures of the underlying state of conditions in the industry, such as the estimated number of overtime or minimum wage infractions per worker).

Complaints arising in industries that lie in quadrants 1 and 4 will tend to point investigators in the correct direction. The industries in quadrant 1 have higher-than-average complaint rates but also higher-than-average underlying rates of violations, appropriately leading investigators to spend more time in those industries. In contrast, the industries in quadrant 4 have below-average complaint rates, thereby leading to lesser attention by regulators, which is also desirable since there are fewer problems in those industries (at least relative to others). However, to the extent that significant numbers of workplaces fall into the other two quadrants, complaint-based policies will tend either to under-investigate problematic industries (quadrant 2) or to over-investigate relatively less problematic ones (quadrant 3).

FIGURE 6.2

Strategic Complaint Response Matrix

	High Noncompliance	Low Noncompliance
High Complaint Rates	**QUADRANT 1** • High complaints • High violations	**QUADRANT 3** • High complaints • Low violations
Low Complaint Rates	**QUADRANT 2** • Low complaints • High violations	**QUADRANT 4** • Low complaints • Low violations

A strategic approach to complaint response would consider the quadrant in which a complaint case arises in deciding how to respond and therefore how many resources to allocate. For example, one might seek to use fewer resources in responding to incoming complaints from quadrants 3 and 4, given what is known about underlying conditions in those industries. Conversely, investigators should be more responsive to complaints arising in quadrant 2, and perhaps engage in more comprehensive investigations than they might have otherwise. Similarly, given the underlying compliance problems in quadrants 1 and 2, investigators should link complaint investigations in these quadrants to larger-scale industry or geographic initiatives that use programmed or targeted investigations in order to enhance the deterrence effects and systemic impacts of their efforts. This entails explicitly linking all tools available to the WHD—directed and complaint-based investigations, education and industry outreach initiatives, etc.—for priority areas of activity.

The WHD should create an updated version of the matrix depicted in Figure 6.2 based on new information from the CPS as well as more recent complaint information from WHISARD. The analysis should not only be done at the national level, but also undertaken for each of the WHD's five regions. With new analysis of both WHISARD and CPS data, a revised matrix would assign each industry to one of the four quadrants, highlighting in what industries complaints might be sending the "right signal" and where they might not. The results of the matrix should be used in setting regional and national priorities and also as a decision tool for complaint response.

II.C.2. SPECIAL COMPLAINT HANDLING PROCEDURE FOR TARGETED INDUSTRIES

To date, responding to complaints has essentially been a customer service function. The agency has not analyzed incoming complaints to uncover information such as patterns about nature of violations, linkages between workplaces or employers from which complaints originate, job classifications of workers complaining, or composition of complaints by industry and geographic area. In short, information about complaints has not been used to inform the development of WHD's directed enforcement program (or how it might adjust response to future complaints).

The central idea of the **special complaint handling procedure** is to turn WHD's *expenditure* of resources for resolving complaints into an *investment* in the longer-term, more targeted strategies based on the information received from investigating the complaints. The procedure would use incoming complaints from around the country in targeted industries as the basis of a coordinated approach to deal with many of the issues discussed in this report. For workplaces in a targeted industry, complaints would be tracked by owner, brand, brand- or independent-operating company, and/or any other relevant organizational entity that potentially ties multiple workplaces together. That information would be analyzed in an ongoing way to find systematic patterns of violations. Enforcement and outreach would be undertaken in a coordinated manner. The WHD would periodically analyze data from the special complaint initiatives to determine if additional levels of intervention—litigation, outreach to "top level" entities, public relations, or corporate outreach—were warranted.

Although the following procedure could be applied to any sector, we believe it should be piloted in one of the fissured industries discussed in this report. The following describes how it might look in the hotel/motel industry.

On average each year, WHD conducts investigations of—as opposed to conciliating—approximately 340 complaints from employees in the hotel/motel sector.[132] Rather than handling these incoming complaints as separate and unrelated to one another, the special complaint procedure would treat them as part of a common initiative. Given that the key parties in the industry operate in multiple states, this procedure requires the cooperative efforts of many parties (from the District level to the National office), adherence to existing Main Office/District Office (MODO) procedures, and additional recordkeeping, pending revisions to WHD's information systems.

132. Based on cases with FLSA findings that were registered between fiscal years 1998 and 2008 and concluded by the end of fiscal year 2009.

Procedures for district offices receiving complaints and conducting investigations: District Office management staff would assign for the conduct of full investigations all valid complaints received from employees in the hotel/motel industry except those complaints which involve allegations typically conciliated like last paycheck issues. As appropriate, staff would screen complaints to ensure their validity.

All the usual full investigation procedures such as records review, employee interviews, etc. would be followed. However, in addition to a narrative report specific to the investigation, investigators would also complete a *Fissured Industry Worksheet,* which would record information regarding hotel management structure, specific employment practices, and the entities responsible for various tasks such as hiring, termination, and daily management. Collecting additional industry-specific information is essential for determining employment responsibility, refining strategies for the industry, and making determinations about CMP assessment and litigation.[133] Final conferences would be held with the party determined to be responsible for employment. If joint employment was thought to exist, final conferences would be held with all responsible parties. At the conclusion of the investigation, DO management staff would review the information gathered and make determinations about opening then, or at a later date, investigations of other properties associated with the one investigated, which could include other properties of the same brand or managed by the same company, staffing services companies, or landscaping or other companies providing labor/services at the property investigated.

Post-investigation analysis and MODO coordination: Following completion of the investigation, management staff would review the completed investigation files in light of the known structure/practices in the industry (e.g., review the ownership type, brand, and third-party management companies, if present) as well as the past history of the ownership group. These cases would closely adhere to revised CMP policies described in recommendation II.B.2.

Drawing on information from the investigation, the DO staff would also contact all appropriate MODO(s). In some cases,

133. The Boston University team prepared a prototype of such a worksheet that was used in several hotel/motel pre-pilot efforts in 2009. Based on our assessment of pre-pilot efforts in the hotel/motel industry conducted in 2009, existing management information systems and instructions for conducting investigations and preparing narrative reports do not currently support a multi-level approach to vulnerable industries. The special complaint procedure would allow the WHD to develop more supportive worksheets, information systems, and procedures. Accordingly, in addition to completing the worksheet, DO staff should be invited to submit recommendations on how to make the worksheet and related materials more useful. The worksheet and a detailed evaluation of the pre-pilots conducted in 2009 are in the forthcoming companion report, "Improving FLSA Compliance in the Hotel/Motel Industry."

there could be multiple MODOs, for example one for the relevant brand and another for the management company. Because of the fissured nature of the hotel/motel industry, MODO offices have the potential to receive an increased number of and frequent communications involving owners, brands, and management companies. MODO offices would be responsible for maintaining records about these various contacts and the resolution of the investigations, and for making determinations about further action when a case history develops about a particular owner, brand, or management company.

In order to allow the WHD to evaluate compliance issues relating to the major companies that emerge from the MODO contacts, MODO offices would submit a report of hotel-related contacts on a semi-annual basis to the National Office. In consultation with senior Regional and District staff, the National Office would decide how to proceed in terms of communications to relevant companies (using approaches described in recommendation II.A.2), litigation strategies (II.B.3), and outreach to the worker advocacy and employer communities, and to the general public. Where appropriate, the National Office would make referrals to the Solicitor's Office for further action.

Longer-term implications of the Special Complaint Procedure: Historically, the WHD has thought of complaints as one silo and directed work as a second, separate silo. This initiative could provide a tractable means of integrating WHD's complaint program into its directed program. Once piloted in the hotel/motel industry, this special complaint handling procedure could be used in other industries, specific geographic areas, or to deal with cross-cutting problems like misclassification.

II.C. 3. REACHING OUT TO THE WORKER ADVOCATE COMMUNITY

The decline of unionization generally and low levels of representation in many of the industries with a concentration of vulnerable workers require the development of different models of outreach with community groups, worker centers, and other worker advocates to encourage the exercise of rights among vulnerable groups in priority industries. A strategic complaint-based policy requires creatively drawing on the strengths and abilities of different institutions to respond to workplace problems: that is, relying on collective bargaining arrangements (where present) to help assure compliance; working with worker centers, community organizations, and similar organizations to establish effective floors where such institutions are present; and relying on government enforcement where no other institutions can perform this function.[134] The WHD experimented with outreach to these groups in the 1990s and has recently moved towards reengaging those communities.[135]

To pursue this outreach, the Department of Labor should convene Worker Advocate Dialogues—involving not just the WHD, but also other agencies such as OSHA and EEO where such outreach is critical. (The write-up below, however, is related mainly to the WHD.) In keeping with their name, these forums would be two-way flows of communication. On one hand, the meetings would provide the DOL an opportunity to explain its priorities and new approaches to industries employing vulnerable workers. On the other hand, the meetings would afford organizations in the worker advocate community a chance to inform the WHD about emerging conditions/violations in the workplace; figure out ways to build cooperation and trust between the DOL and the "silent workforce," so that workers more freely come forward with specific information about employment practices; improve the quality of information about violations in the workplace (because even when workers do complain, the information is frequently lacking or contradictory); and work together to better map the contours of fissured employment relationships.

Together, ongoing interaction between the parties could also allow problem-solving around issues such as setting enforcement priorities, as well as how to respond to industries in the different quadrants depicted in Figure 6.2. It would also allow development of strategies for resolving problems arising in the workplace through mechanisms other than employee complaints, via the activities of worker centers with employers or employer associations, or through the creation of other innovative mechanisms.

II.C. 4. INCREASE PROTECTIONS FOR EMPLOYEES WHO COMPLAIN

Worker knowledge of rights and willingness to use them remain an important foundation for improving workplace conditions. All of the recommendations in II.C are therefore strengthened by increasing the use of rights by vulnerable workers. Collaborations between the WHD and the worker advocacy community and other educational and communication efforts should focus on rights and encouraging workers to use them where the law has been violated.

At the same time, WHD should vigorously increase protections for employees who complain. It is illegal to discharge or discriminate against an employee who has filed a complaint

134. This is not to minimize the inter-organizational tensions and mistrust that sometimes exist between governmental and non-governmental organizations in the pursuit of goals that are not completely aligned, or the tensions existing between trade unions and newer workplace institutions (see Fine, 2007; and, on this last point, Heckscher and Carré, 2006).

135. Of course, success in this regard would potentially create an even greater investigation burden for investigators. A strategic complaint-based policy, therefore, requires that the investigators work with third-party groups like worker centers, unions, and worker advocates in creating more proactive response mechanisms. This would begin with explicit discussions of the resource constraints facing agencies (as well as advocacy groups) and the resulting need to reach broad consensus on industry and workplace priorities.

under the FLSA. WHD should make it a priority to fully investigate any allegations of intimidation and discrimination. Given the reluctance of vulnerable workers to complain in the first place, the DOL's use of this provision has the benefit of encouraging employees to come forward with complaints and to cooperate in WHD investigations as well as to cause employers to weigh the costs of noncompliance and failure to cooperate during an investigation. A concerted and well-publicized effort to prohibit the intimidation of employees who complain would encourage greater use of rights as well as discourage illegal employer behavior.

II.D. ENHANCING THE SUSTAINABILITY OF INITIATIVES THROUGH MONITORING AND RELATED PROCEDURES

If the WHD is successful in bringing employers at "higher levels" of industry structures to the table, what should happen then? If the goal of strategic enforcement is to create sustainable and systemic change, the answer cannot simply be to collect back wages owed to workers. For industries that are the focus of WHD initiatives, the goal should be creating mechanisms that remain in place that promote ongoing compliance beyond the boundaries of one firm. This may mean creating monitoring arrangements through negotiations similar to those developed in the garment initiative. Alternatively, it may be using settlement agreements to create alternative accountability requirements for future behavior. Finally, improving the sustainability of enforcement efforts may be most successfully achieved if employers (e.g., brand companies in the eating and drinking, and hotel/motel industries) can be convinced to incorporate labor standards monitoring into existing systems used to oversee quality, organizational performance, or adherence with brand standards.

II.D.1. CREATING NEW MONITORING ARRANGEMENTS

The garment industry example represents a successful model of using public enforcement power (via the hot goods provisions) to create private monitoring systems. The power of that system, as described in Section III, is that it not only changed the behavior at the contractor level, but at its peak of activities in the late 1990s and early 2000s, changed the way that manufacturers made subcontracting decisions.

Another example is the previously cited code of conduct among greengrocers in the New York City area (Bodie 2004a, 2004b). The code arose from robust public enforcement by the Labor Bureau of the Attorney General's office based on the finding of systemic violations in the industry. But the agreement also reflected an awareness of the key role played by a business association (the Korean American Association of Greater New York) and tapped into worker advocacy communities and labor unions to create an ongoing monitoring system. Signatories to the agreement agreed to have unannounced inspections conducted by a monitor selected by the Attorney General's (AG's) office. The monitor's role was to assess compliance of the employer with the Code, in particular with minimum wage and overtime requirements. Violations detected by the monitor were reported to the AG's office as well as a separate, tri-partite Committee created by the agreement.[136]

The garment and greengrocer initiatives illustrate the opportunities and challenges of augmenting traditional enforcement efforts with private monitoring. By doing so, WHD's capacity to sustain changes in labor standards practices is enhanced through the ongoing work of monitors. Monitors may be able to respond more quickly to potential problems, resolve lower-level disputes more effectively, and play productive roles in education, outreach, and information provision. Monitoring can also provide "top level" organizations with information about potential business partners that have better compliance practices and potentially other beneficial qualities (reliability, quality, etc.). Our analysis suggests that this aspect of monitoring led to changes in how some manufacturers sourced their work in New York City.

But monitoring is not a simple panacea. The monitoring systems described above arose from aggressive public enforcement efforts and required the continuation of that pressure. The garment initiative changed behavior over a five-year period, but those effects receded with declining strategic enforcement in garment under the Bush administration. The greengrocer initiative improved compliance behavior during the two-year code of conduct negotiated by the parties, but that agreement was not renewed. Given the limited number of cases of true public/private monitoring efforts, it is unclear whether monitoring can ever be fully internalized into the behavior of participating employers.[137] But that does not undermine its potential utility when it is wedded to an active public enforcement presence.

II.D.2. ENHANCED SETTLEMENT AGREEMENTS

Settlement agreements can also play an important role in changing employer behavior. Given the importance of third-party management in the hotel/motel industry, settlements with other management operators—or more comprehensive agreements that go beyond traditional settlements—could

136. The case also illustrates the trade-off between collecting back wages upfront versus a longer-term solution to underlying compliance problems. The AG's office agreed not to investigate signatories to the agreement for prior violations of state minimum wage and overtime laws in exchange for future compliance with the code and living under its provisions. Back-wage settlements in the short term were therefore sacrificed for long-term changes in the compliance behavior by the sector as a whole (Bodie 2003a).

137. We do not include the more prevalent use of voluntary monitoring systems, particularly at the international level (e.g., Locke *et al.* 2007). These voluntary monitoring systems usually arise because of the absence of international regulatory institutions. Their effectiveness, therefore, depends on different forces (e.g., public pressure; moral suasion; progressive corporate leadership) than those relevant to a regulatory agency.

have wider-scale impacts on compliance beyond a single brand or owner.

Creating more comprehensive agreements is more desirable particularly in response to cases where the WHD has found systemic noncompliance. Agreements may require changes in basic payroll procedures (e.g., the creation of electronic timesheets or quality assurance procedures to protect records from being changed without the knowledge of workers) or in personnel practices that have led to repeated violations. Agreements should also require training of existing management staff and new managers about the FLSA, including training of contractors, franchisees, or other parties linked to the signatory (a frequent feature of monitoring agreements in the garment industry). Finally, agreements can require some form of ongoing site review by a corporate official or representative of a corporate official to review practices and records of contractors, franchisees, and other parties working for or with them to ensure compliance.[138]

The complex organizational relationships in industries with vulnerable workers mean that comprehensive settlement agreements can play a particularly important role in expanding the impact of enforcement actions onto a network of workplaces. But this once again requires that the WHD carefully coordinate the activities of multiple offices through effective MODO procedures and robust information systems.[139]

II.D.3. MAKING COMPLIANCE AN INTEGRAL PART OF EMPLOYER MONITORING ACTIVITY

A final means for the WHD to improve the sustainability of enforcement is by changing the compliance calculus of the parties themselves. As the fast food and hotel cases illustrate, franchisors and brands have developed their own internal mechanisms to monitor the behavior of company-owned and franchised outlets and properties. They do so because maintaining standards is a central—indeed decisive—element of a branding strategy. It is good business to create monitoring mechanisms to protect brand equity.

The results in Section IV indicate, in fact, that the top 20 brands are extremely successful at complying with the FLSA among their company-owned units.[140] The opportunity for the WHD is to change the basic calculus of companies so that they are similarly successful in their oversight of franchisees. The most sustainable means of changing employer behavior would be to ultimately convince these top-level businesses to tap into existing monitoring arrangements present in multi-tiered industry structures. Many of those industry structures already have complicated monitoring mechanisms in place that assure that lower-level businesses act within quality, delivery, product, or other standards that were created by the upper-level business organizations.

Franchisees and third-party operators follow brand standards in fast food and hotels; subcontractors follow building procedures of the national homebuilder; farmers and intermediate suppliers follow product quality and safety standards of the branded food processor. In these cases, an agreement could incorporate explicit accountability for and monitoring of labor standards into existing mechanisms, with the WHD or parties designated by them to provide supplementary oversight.[141] For example, a fast food agreement might augment the activities of franchisee consultants present in many businesses with a compliance monitoring structure developed in consultation with the WHD.[142] Alternatively, agreements might augment the role of employer associations that provide advisory and consultative services with educational and consultative roles pertaining to compliance with labor standards. Agreements might also play a role in diffusing information about successful compliance practices and models to other association members.[143]

138. Such agreements have been used in the agriculture industry, where settlement agreements specify that farmers supervise the work and review the hours worked/piece rates received of farm labor contractors working for them.

139. For example, hotel/motel management companies frequently operate in many states, making it a challenge for the WHD to consolidate information about a particular company in order to consistently assess and collect CMPs and consider further action such as a consent injunction.

140. Research by Gin and Leslie (2009) show that franchisors have similar success maintaining public health hygiene standards among their company-owned outlets, but the same difficulties in combating lower adherence with health code standards among franchisees.

141. The greengrocer agreement in New York City also provided for a separate, expedited complaint process that provided workers at any establishment an immediate means to contact the designated outside monitor in the case of violations. This provided an additional mechanism to ensure that individual employers were abiding by the agreement, along with the established monitoring procedure (Bodie 2004a).

142. Fast food companies do have different types of monitoring structures for company-owned than franchised outlets. Company-owned units operate under more hierarchical management systems with close monitoring, clear accountability, and carrots and sticks associated with adherence to brand standards. Because of their independence due to ownership, franchisees are typically monitored by a "franchise consultant." Although they still must adhere to a detailed set of quality standards, the monitoring is more episodic and of a more consultative fashion. A more aggressive monitoring structure could require the franchisor to apply its protocols from the company-owned units to franchisees.

143. For example, the Asian American Hotel Operators Association (AAHOA) discussed in Section V provides the thousands of hotel operators who form its member base with guidelines, information, and consultative services regarding a variety of business activities, such as dealing with brands and getting the most from franchise relationships. The active and productive role it plays for its members could be expanded to include ensuring that businesses improve compliance with FLSA and other workplace regulations.

III. Organizational Requirements

The changes described above in many ways build on people, practices, and experiences of the WHD. But they also require new organizational procedures or the modification of existing ones. In particular, strategic enforcement, especially in fissured industries, requires: enhancing investigation capacities, including revising investigation protocols, developing new training materials, and modifying the WHD's Field Operating Handbook; gathering new types of information about other parties related to the employer under investigation; strengthening the interactions between the Solicitor and the WHD; improving the operation of MODOs in their crucial role in coordinating across District and Regional offices; enhancing information systems, particularly WHISARD, to make them more useful as investigation and planning tools; building joint efforts with other DOL agencies in key sector initiatives such as residential housing or on an issue like misclassification; and undertaking systematic evaluations regarding program impact.

III.A. ENHANCING INVESTIGATION CAPABILITIES

Strategic enforcement changes the way that District and Regional Offices plan, conduct, and follow-up on investigations (as illustrated by recommendations. II.B.2, II.C.2). This, in turn, requires WHD investigators to have the training and support to help them undertake effective investigations in targeted sectors.

To begin with, strategic enforcement requires modifying basic investigation protocols. In essence, the purpose of investigations must not be limited to recovering back wages for affected workers, as important as that goal remains. Instead, strategic enforcement entails getting the greatest impact out of all investigation activities, regardless of what triggered them. It requires connecting the workplace under investigation to the WHD's broader efforts in that industry, geographic area, or employment problem (e.g. misclassification). It entails thinking about the impacts of that investigation on deterrence and on changing behavior. A careful review of how each of the above activities affects the planning, conduct, and follow up of investigations is therefore a fundamental organizational necessity. As has been repeatedly emphasized in this report, there is much experience from specific WHD initiatives over the years to learn from, but these lessons must be incorporated into the basic ways that investigators undertake their day-to-day work.

Investigation protocols for targeted industries also require modification in order to enhance the kind of data collected in the course of investigations—about connections between the enterprise and other business organizations and relationships; the specific use of contracting and hiring of independent contractors; and how decisions are made regarding key personnel policies. The hotel and motel "fissured industry worksheet" described in recommendation II.C.2 is one example.[144] For certain industries, protocols might need to be revised with respect to the scope of investigations (e.g., the need to investigate multiple outlets owned by a franchisee or contractor as a matter of basic policy); the steps to be taken given findings of violations (e.g. whether to settle back wage claims immediately, or seek LD remedies, where appropriate); and, given the larger industry strategy, the need to coordinate with other DOs and Regions, the National Office, and/or other parts of the DOL.

The complexity of some of the initiatives described in this report might also require District or Regional offices to create teams or task forces built around sector-focused initiatives or specific practices (e.g., misclassification). These would allow exchange of information gleaned from District Office industry initiatives across the entire agency.

Since many of the ideas about industry-focused initiatives are unconventional, the WHD should develop training materials regarding industry structure, the impact of industry structure on compliance, enhanced data collection, models of coordinating across the agency (and with other agencies), and the development of multi-pronged approaches to initiatives. The four criteria for strategic enforcement described in Section II (prioritization, deterrence, sustainability, and systemic effects) and the strategies described here represent a substantial departure from the traditional way investigators do business. Training is therefore essential to raise awareness about new ways to think about the basic tasks facing the agency.

New sections of the Field Operating Handbook regarding characteristics of fissured industries and their implications for investigation procedures should be developed to help investigators modify their activities to enhance their impacts. For example, rather than focusing on the specific property when an investigator arrives at a hotel, the approach described here requires DO staff to immediately think about the brand, owner, operating/management company, and their relationships to one another in conducting the investigation. Training is needed to open investigators' eyes to the opportunities that such a structure presents and to have them ask different questions than might arise in a traditional, "property-focused" investigation. In essence, strategic enforcement requires competencies that go beyond knowledge of the laws, interviewing techniques, ability to analyze payroll records,

144. However, our experience with pilots involving the hotel/motel worksheets indicate that simply providing investigators with worksheets or other data collection tools is insufficient. Investigators need training about the industries in which they are to be used and the investigation procedures—including the questions investigators ask; the people with whom investigators choose to interview; and the activities that occur subsequent to the investigation—that they draw upon to ensure that the information collected in those worksheets is useful for subsequent investigations and broader industry interventions.

and negotiating skills. While these certainly remain necessary, they are no longer sufficient for the approach described in this report.

Finally, the changes described above entail significant modifications of penalty, investigation, and coordination procedures, as well as other elements of the investigation. The special complaint procedure also potentially entails changes to complaint handling procedures (which are already under review because of the GAO studies of complaint handling). Many of the changes discussed in this section may therefore require significant review and revision of portions of the Field Operations Handbook.

III.B. COORDINATE ACTIVITIES OF WHD AND THE OFFICE OF THE SOLICITOR

The Office of the Solicitor has faced the same long-term decline in staffing as the WHD: From FY 1992 to FY 2009, total staff (including attorneys, paralegals, and administrative staff) decreased by about 25 percent, from 786 to 590. But this reduction in staff had an ever greater impact on the number of FLSA cases handled by the Solicitor than simply the decrease in staff might imply. The demands on the Office of Solicitor come not only from WHD, but from other agencies in the DOL including OSHA and MSHA. Litigation arising under the OSHA and MSHA are non-discretionary, i.e., employers have a right to a hearing before an administrative law judge to contest penalties levied by either agency, and such cases are handled by the Solicitor.

In contrast, the Solicitor can decline to litigate cases where an employer refuses to remedy FLSA violations found by WHD staff. Since the Solicitor can decline to litigate such cases for a variety of reasons, including lack of resources, OSHA and MSHA case load has pushed out FLSA cases. This was further intensified by revisions to the Mine Safety and Health Act in 2006, which increased penalty policies and as a result led to an increased number of appeals under that Act.[145] As a result, FLSA law suits filed by the Solicitor's Office went from 705 cases in FY 1987 to only 151 cases in FY 2007.[146]

Comprehensive strategies—more consistent application of LDs and CMPs; pursuit of hot goods TROs; injunctions barring future violations; and negotiation of comprehensive monitoring—all require a higher level of coordination and support between the WHD and the Solicitor's Office. Moving towards comprehensive strategic enforcement will require additional resources for FLSA cases and a closer working relationship between the WHD and the Solicitor in the field and at the National Office. The need for this coordination is pressing where enforcement strategies rely on novel theories or untested procedures.

The WHD and the Office of the Solicitor also need to work together in developing revised policies on pursuing CMPs in reinvestigations, computing/charging LDs, and mechanisms and model language for monitoring, as they did in the past in the garment initiatives. The WHD should provide the Solicitor with information on its upcoming programs so that the National Solicitor's Office can brief Regional Solicitors about the likelihood of referrals from targeted industries and the goals of those referrals to ensure a consistent national approach to improving compliance for vulnerable workers.

Finally, close coordination between the two groups is essential in pursuing the ambitious litigation agenda directed towards clarifying joint employment and related questions involving employer responsibility under the FLSA.

III.C. IMPROVE OPERATION OF MODOS

The strategies described in this report require high levels of coordination between District Offices within and across Regions and with the National Office. Fortunately, the WHD has created Main Office/District Office (MODO) procedures expressly to coordinate enforcement across the different levels of the WHD. To be effective, these procedures need to be made consistent and actively applied. The MODO procedure has been used primarily in the past to coordinate activities around employers operating in multiple WHD jurisdictions.

Although this type of activity will remain an important part of the policies described here, MODO procedures will also need to be applied to complex cases such as: a large franchisee of a certain brand operating in multiple states, while the same brand is operating at a national level under many different franchisees as well as at company-/brand-owned outlets; an independent operator who manages properties of multiple brands; or a web of construction contractors operating under the umbrella of a national homebuilder. The complexities of such coordination should not be underestimated.[147] The special complaint procedure (recommendation

145. The legislation, the Mine Improvement and New Emergency Response Act of 2006, came in response to a mine disaster in Sago, West Virginia. In addition to increased penalties, the legislation established new requirements that mine operators develop a "… response and preparedness plan …" for mine disasters, including providing additional breathing devices and other essential life-saving equipment under ground and available in the event of a mine collapse.

146. These figures are based on analysis by Jim Leonard, former member of the U.S. DOL Office of the Solicitor and currently a volunteer attorney for Farmworker Justice, from U.S. DOL Budget Submission to Congress in FY 2008. The authors are grateful to Mr. Leonard for discussion regarding the operation of the Office of Solicitor.

147. Problems in the MODO procedure were identified in a 2005 report by the DOL's Office of Inspector General. That report concluded that weak MODO procedures resulted in a settlement agreement with Wal-Mart that "… may adversely impact WHD's authority to conduct future investigations and issue citations or penalty assessments, and potentially restricts information to the public." See U.S. Department of Labor, Office of Inspector General, Agreement with Wal-Mart

II.C.2) can provide an immediate opportunity to pilot procedures for improving the coordinating role MODOs can play and for spreading those practices to other offices.

III.D. ENHANCE THE UTILITY OF INFORMATION SYSTEMS

Another foundation of the strategies described in this report is collecting, analyzing, updating, and evaluating information. The WHISARD system is the anchor of enforcement data for WHD. The analyses in Sections III, IV, and V built on that data, augmented by employer and industry data from other available sources.

In the last decade, WHISARD has been improved as an information system, moving it from being an electronic filing cabinet to a useful source of information for the agency. Quality control procedures have been introduced that improve the accuracy and reliability of key fields. The ability to run analyses for specific employers, industries, or geographic areas has been enhanced.

Nonetheless, WHISARD still has a long way to go to become a useful, real-time, decision support information system. Continuing efforts to ensure the accuracy and timeliness of data remain. For example, data regarding the assessment and collection of monetary penalties and the use of various litigation tools need to be improved in order to improve evaluation of how these measures affect compliance and deterrence. This will require efforts to improve data collection in both the WHD and SOL at the regional and national levels.[148]

To fully support strategic enforcement, the system needs to be modified to allow WHD leadership at all levels to link investigations by the different affiliations a work site may have—that is, to be able to link cases with a common employer, brand, management operator, production coordinator, or other business entity that might play a role in the business operation.

The residential construction industry provides a useful illustration of WHISARD's limitations in this respect. At the peak of the residential housing boom in 2005, the top 10 homebuilders in the U.S. built almost 30 percent of the new homes in the U.S. (when there were an estimated 1.7 million housing starts for single family houses).[149] Between 2000-2007, WHD conducted a total of 20,204 investigations in the construction industry (all sectors, including residential). Yet, we can only confidently identify 21 cases where one of the top builders is identified as the employer of record. Undoubtedly, a larger number of investigations were undertaken on construction sites controlled by one of the top 10 builders, but WHISARD only records the contractor directly employing workers, making it impossible to link the contractors working for one of the major homebuilders together in order to assess the presence of more systemic problems.[150]

WHISARD should also be linked with other data systems (to the extent permissible) in the DOL to allow agencies to find out about systemic violations (e.g., an employer who violates FLSA, OSHA, and ERISA requirements). It should also integrate the vast amount of information available regarding business characteristics, much as this report has done.[151] It should allow WHD staff to use the power of geographic information systems in using data, potentially "mashing" data contained in WHISARD with data sources available on the web.[152]

Finally, WHISARD can become a more useful tool for the general public as the basis for improved transparency. Changes in the DOL web site now allow users to search the database, but it is still a relatively difficult system to navigate. Enhanced transparency requires development of more user-friendly ways for the public to access information on closed cases, to "see" investigations in their local area, and to have better means of linking information from WHISARD to other sources of data on employers and industries.

III.E. BUILD STRONGER LINKAGES TO OTHER KEY DOL AGENCIES

The final area of structural change critical to undertaking strategic enforcement involves improving the linkages of workplace agencies within the DOL itself. Agencies that undertake enforcement of workplace regulations have grappled with common problems related to enforcement for decades. They have been challenged to set regulatory priori-

Indicates Need for Stronger Guidance and Procedures 5 (Oct. 31, 2005), available at http://www.oig.dol.gov/public/reports/oa/2006/04-06-001-04-420.pdf.

148. This recommendation arises from our difficulty in estimating the use of various enforcement tools using WHISARD including the frequency that CMPs were assessed in the course of investigations where they were potentially applicable.

149. The top 10 national homebuilders accounted for 28 percent of all new single-family housing. Housing start data based on U.S. Census Bureau, New Residential Construction, "New Privately Owned Housing Units Started in the United States by Purpose and Design", http://www.census.gov/const/www/newresconstindex.html.

150. Similarly, although many of the hotels studied in Section V were managed by an independent operator, only a handful of WHISARD records included the name of that company as a subsidiary employer, except where the management company held some equity in the property and was therefore listed as an owner. We were only able to link the hotel to an independent operator by matching the hotel property's address with a separate data set.

151. WHISARD could also become a more useful "spine" for investigators in linking other information relevant to enforcement in the form of digital photos, videos, and scanned images, to enhance the quantitative and qualitative information currently available. The falling cost of storage and improvements in the ability to link such files (and, more importantly the enhanced ability to search) make the creation of more flexible and expandable content feasible.

152. More and more state governments are using the capacity to mash information from public and private sources together to create additional information useful for both internal and external purposes. See NYTimes article on 12/7/09. http://www.nytimes.com/2009/12/07/technology/internet/07cities.html

ties, undertake effective enforcement actions, coordinate with the various levels within the federal agency (district, regional, and national) as well as with state counterparts, work with private sector individuals on legal strategies, interact with the labor and worker advocacy communities, and evaluate and refine approaches. There is a great deal that agencies within the DOL can learn from one another, as well as from the experience of unions, worker advocates, and state agencies. There are also significant opportunities to coordinate agency strategies that may have been overlooked in the past.

Shared strategies might result in parallel initiatives, strategies that are carried out in coordination (e.g., joint initiatives in a particular sector), or information sharing, so that information from one program informs enforcement in another program (e.g., investigation targeting decisions). The topic of opportunities for cross-agency diffusion of knowledge and experience, and opportunities for joint activity go beyond the boundaries of this report.

Opportunities for collaboration may involve specific industries that represent priorities for agencies. One clear example is the residential construction industry. During the sustained boom, residential construction employed large numbers of low-skilled workers, often through multi-tiered contractors. Many of them were undocumented workers from Mexico. These conditions led to high rates of noncompliance with labor standards (Theodore 2008; Bernhardt *et al*. 2009) as well as high rates of injuries and fatalities, particularly among Latino workers (Lowe, Hagan, and Iskander 2010; NIOSH 2009). As the residential housing market begins to recover, both WHD and OSHA should develop cooperative programs to address the effects of fissured employment in the sector.[153]

Coordinated approaches are also possible to address challenges that cut across multiple agencies, such as misclassification of workers as independent contractors. A variety of states have experience with joint task forces in some of these areas that provide guidance on both the opportunities and challenges of coordinated enforcement.[154] One objection to such efforts is that they require investigators who are used to a particular agency to break out of their standard operating procedures in working with other agencies, a transition that can prove difficult. The large number of new personnel currently being hired by the WHD, OSHA, and other agencies provides a rare opportunity to expose a subset of investigators to some of these industries or cross-cutting employment problems as part of their on-the-job training, and perhaps create a new generation of investigators more aware of workplace issues in other agencies.

III.F. STRATEGIC ENFORCEMENT AND EVALUATION

Many of the approaches advocated above are new or significant departures from established practices within the WHD. They require the agency to move into uncharted waters. Undoubtedly, some efforts will prove more successful than others, and unanticipated difficulties will inevitably arise. This raises the importance of instituting up front evaluation of these initiatives.

Expand the use of investigation-based random surveys: One of the most difficult problems in evaluation is establishing cause and effect relationships between interventions and outcomes. In regulatory agencies, this is particularly difficult because the data that agencies collect on enforcement (e.g., number of investigations) are also the data that must often be used for evaluating impact (back wages collected). They use survey results to set benchmarks at the beginning of initiatives and to gauge progress of initiatives at several set time periods (e.g., every three years). Much can be done with such data (as this report hopefully demonstrates), but there are limitations in using them for evaluating long-term effects.

WHD has been in the forefront in dealing with this problem through its ongoing use of random, investigation-based surveys. These surveys—done in multiple sectors, geographic areas, and time periods—provide a singular measure of the state of compliance in a workplace sample of interest. In so doing, they can gauge the impact of a WHD initiative as well as other factors associated with compliance (workplace size, market conditions, employer strategies), while also providing the kind of rich information on compliance that can only come from a detailed investigation by an experienced investigator.

Section III provides an example of the kind of rich and detailed analysis that can be done if data from random, investigation-based surveys are conducted. Investing in this kind of data collection is of particular importance for new initiatives if the WHD wishes to learn what approaches work and do not work. Although there is institutional reluctance to

153. During the last building boom, the industry consolidated around a set of major regional and national homebuilders. Although many of those companies built tens of thousands of homes, they employed very few construction workers directly. A strategic enforcement approach would need to carefully consider how the organization of the industry, including management of the construction worksite, bidding of work, and role of contractors and subcontractors, affects compliance with the FLSA, OSHA, and other relevant workplace policies.

154. For example, a number of states in the last five years have created "Joint Task Forces on Misclassification" that bring together labor bureaus overseeing labor standards, workers compensation, and unemployment insurance, among others. Authors' discussions with personnel in several states engaged in these efforts indicate that they require resources, attention, and most importantly, commitment by senior leadership of all organizations involved. Different agencies have procedures that often conflict with one another. But these efforts already point to some common principles of how some of these barriers might be overcome. For example, the appointment of independent leadership of joint agency task forces seems essential. The leaders would have the authority to coordinate efforts across agencies but also be accountable for those efforts.

doing surveys of this type, given the time and effort required (in particular, drawing investigators away from investigations that are part of directed initiatives or from responding to worker complaints), the long-term benefits are critical in providing the raw material for systematic evaluations. If WHD is to pursue strategic enforcement initiatives in fissured industries, it will need to use investigation-based surveys to benchmark compliance across the different layers of employers and explicitly account for their distinctive structures in designing them.

Explore other measures of gauging violations of labor standards among vulnerable workers: Bernhardt *et al.* (2009) use an innovative survey methodology drawing on social networks of vulnerable workers themselves to estimate the prevalence of labor standards violations in three metropolitan areas.[155] Although this represents the first time that the approach has been applied to a labor market survey and requires significant resources (time and money), it should be explored as an alternative approach to benchmarking the prevalence of workplace problems in industries and geographic areas with vulnerable workers. It is particularly attractive since it uses social networks to deal directly with the problem of the fear that many vulnerable workers have of answering surveys about work conditions. A pilot use of such an approach might be to pick a major industry of concern (e.g., residential construction) and integrate other agencies (e.g., OSHA) that might collectively benefit from this unique data collection method.

Generate interim measures of performance using WHISARD: At the same time that the DOL invests in long-term, random investigation-based surveys to gauge impact, the WHD needs interim measures of compliance. Investigation-based information from enforcement can be used for evaluative purposes. The evaluations in Sections IV and V illustrate the utility of using WHISARD records, matched to other sources of information about employers, geographic areas, and industries to evaluate patterns of behavior and, with care, impact. Records of back wages and the number of violations can be translated into broader measures of the incidence and severity of violations to allow comparisons across employers and over time.

Using WHISARD to generate these measures and then integrating them into ongoing planning and evaluation will be essential to the ongoing implementation of various initiatives. Once again, the WHD has experience in using WHISARD data and evaluation for these efforts. Changes to WHISARD discussed above should focus on improving the system's ability to provide real-time information on interim measures of performance to WHD staff at the District, Regional, and National offices.

The special complaint procedure (recommendation II.C.2) represents a second way that WHD can use interim measures to guide future action. By systematically responding to complaints in a sector of current or potential interest, the agency can gain a better understanding of the breadth and depth of the problem, its relation to industry and labor market features, and the impact of alternative methods of intervention. It could provide the agency with a means to refine a future directed initiative at the same time it's handling real problems arising from complaints. Finally, the special complaint handling procedure could play a role as an "early warning system" of practices that may be evolving in the industry, specific kinds of violations, and owners/operating companies that may be consistently the subject of complaints.[156]

Evaluate the impact of different tools and approaches: This report advocates a mix of tools for enhancing the impact of WHD. Evaluating the comparative impact of those tools—both established tools like litigation, LDs, and CMPs, and newer innovations such as monitoring arrangements and transparency—will be essential in refining approaches for expanding them within sectors or applying them to new industries.

Using an experimental approach for evaluation: Finally, the above recommendations require building on long-term practices in some areas and moving into untested waters in others. In areas where policies represent new or significant departures from established practice, the WHD should use pilot and experimental efforts to test new ideas. For major initiatives, it should seek to combine the use of random, investigation-based approaches with an experimental approach to evaluation. This could entail, for example, pairing district offices that are attempting new approaches to enforcement for a given industry with offices that continue to use traditional approaches. This "treatment/control" design can provide the agency deeper insight into the factors that contribute to the success or failure of an initiative.

Conclusion: Opportunities and the Need for Creativity

The central regulatory challenge facing the WHD is improving compliance with federal workplace standards in an ongoing and sustained way by drawing on limited organizational

155. This "snowball" methodology is described in Bernhardt *et al.* 2009, and in a more detailed report available from its authors. As noted in the report "(S)tandard surveying techniques—phone interviews or Census-style door-to-door interviews—rarely are able to fully capture the population that we are most interested in: low-wage workers who may be hard to identify from official databases, who may be vulnerable because of their immigration status, or who are reluctant to take part in a survey because they fear retaliation from their employers." (p. 56).

156. OSHA uses complaint investigations in this manner as an indicator of emerging safety and health problems in specific workplaces. For example, one of the early indicators of repetitive motion problems came from a worker complaint lodged in the apparel industry (Richard Fairfax, Director of OSHA Enforcement, December 4, 2009).

FIGURE 6.3

Evaluation of Recommendations on Four Strategic Enforcement Criteria

Rec. Number	Recommendation	Prioritization	Deterrence	Sustainability	Systemic Effects
I	**Setting industry priorities**	●			
II.A	**Focusing at the top of industry structures**				
II.A.1	Mapping business relationships and reaching out to the top				●
II.A.2	Coordinated investigation procedures		●		●
II.A.3	Clarifying the boundaries of employment responsibility	●			●
II.A.4	Expanding the application of hot goods beyond the apparel industry		●	●	●
II.B	**Enhancing deterrence effects at the industry/ geographic level**				
II.B.1	Industry-focused deterrence		●		●
II.B.2	Penalty policy as a central part of deterrence		●	●	
II.B.3	Expanded litigation to prevent noncompliance		●		
II.B.4	Enhancing deterrence through transparency		●		
II.C	**Transforming complaint investigations from reactive to strategic resources**				
II.C.1	Responding strategically to complaints	●			
II.C.2	Special complaint handling procedure for targeted industries	●	●		●
II.C.3	Reaching out to the worker advocate community	●	●	●	
II.C.4	Increase protections for employees who complain	●	●		
II.D	**Enhancing the sustainability of initiatives through monitoring and related procedures**				
II.D.1	Creating new monitoring arrangements			●	
II.D.2	Enhanced settlement agreements			●	
II.D.3	Making compliance an integral part of employer monitoring activity			●	●

resources to change employer behavior. Enforcement policies that take into account the underlying prevalence and severity of labor standards problems and the capacity of the intervention to change employer behavior in significant and lasting ways have the greatest potential of appreciably reducing the number of workers who do not receive the pay to which they are entitled.

This report has sought to lay out the nature of this challenge in industries where vulnerable workers are concentrated. This section has then described policies that the WHD and the DOL can employ to achieve its goals. We discussed four criteria in Section II to gauge whether enforcement policies contribute to achieving the central task. Those criteria are Prioritization; Deterrence; Sustainability; and Systemic Effects. Figure 6.3 lists the recommendations in this section and indicates their intended effect on one or more of these criteria.

The most important implication of Figure 6.3 is that no single recommendation contained in this report satisfies all four criteria by itself. The complexities of the modern workplace mean that the strategies of government agencies must be multi-pronged. In undertaking strategic enforcement, the WHD must be flexible and adaptive, learning from experience in the field, evaluating different types of interventions, and drawing on insights and experience to modify approaches.

Although the idea of strategic enforcement builds on many practices that have been a part of the WHD playbook for decades, it also requires adopting some approaches that are quite new. At its root, however, the idea of strategic enforcement entails thinking differently about how an agency like WHD attempts to create significant, systemic, and sustainable changes in the behavior of employers at a sector- rather than workplace-level. The employment world has been transformed over the past 25 years. Those changes require that all levels of the WHD "step up their game." They can do so by adding new approaches and tools in six important areas.

- First, with policies that are based on efforts to map the industries and workplaces covered by the FLSA in terms of where the major problems reside, particularly those that can be affected through government intervention.
- Second, by adjusting the way WHD responds to complaints so that it remains responsive to worker problems yet actively uses complaint investigations to help achieve larger regulatory priorities rather than being forced into a purely reactive role.
- Third, strategic enforcement involves developing integrated approaches to specific industries that allow agencies to leverage industry forces (such as the successful efforts in garment and new approaches in eating and drinking) to achieve larger regulatory goals. This entails using private incentives to achieve public ends more effectively.
- Fourth, strategic enforcement requires paying attention to the deterrence (ripple) effects of enforcement activity. This requires undertaking and following up on investigations so that they are felt not only by the employer being investigated but also by other employers in the relevant industry and area. It also requires consistently assessing real penalties for willful and repeat violations, computing LDs, and pursuing litigation against recalcitrant companies.
- Fifth, it involves working with key stakeholders (industry associations, labor unions, companies, worker centers and advocates, and other labor market institutions) whose activities at the workplace- and industry-level are natural complements to government efforts.
- Sixth, it requires combining decentralized planning and implementation so strategies reflect conditions on the ground, with centralized evaluation and deployment of the agency's resources based on overall compliance impacts.

These six elements of strategic enforcement however cannot simply be imposed on WHD as it currently operates. Instead, they must be accompanied by the six organizational requirements discussed above that build WHD capacities to operate more strategically on a day to day basis. As detailed above, these organizational requirements span from changing the way that investigations are planned, carried out, coordinated, and evaluated to the way that WHD interacts with other parts of the DOL at all levels.

Over its history, the WHD has accomplished much in the face of growing regulatory responsibilities, challenging budgetary pressures, and an ever-changing workplace. Its efforts to continue to protect vulnerable workers will require full use of all available enforcement tools, and continued focus, coordination, and institutional creativity. Continuing advancement will require maintaining an open mind to new ideas and approaches to enforcement, while continuing to draw on the experience and insights of its dedicated investigators and staff.

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