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Fast-Food Industry Profiteering: Why California Businesses Can Absorb a Higher Minimum Wage

Alí R. Bustamante and Ira Regmi

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About the Authors

Alí R. Bustamante is the deputy director of the Worker Power and Economic Security program at the Roosevelt Institute, where he focuses on how public policy can structure markets around both economic and social value and empower Americans through the provision of public goods and stronger labor protections. Prior to joining Roosevelt, he served as chief economist at the Louisiana Workforce Commission, senior research associate at the Southern Economic Advancement Project, and as faculty at Florida International University, the University of New Orleans, and Loyola University New Orleans. Dr. Bustamante earned a BA and PhD from the University of Miami, where he specialized in political economy.

Ira Regmi is the program manager for the Macroeconomic Analysis team at the Roosevelt Institute. They hold a bachelor's degree in economics from Delhi University and a master's in international affairs from Columbia University, where they specialized in gender and public policy. Prior to working at Roosevelt, Regmi worked on corporate finance issues and international development.

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Introduction

Effective April 1, 2024, California fast-food workers will be paid at least $20 per hour as part of legislation enacted last September that established an industry-wide minimum wage and created a Fast Food Council of worker, business, and state representatives to develop recommendations for industry standards, rules, and regulations (Office of Governor Gavin Newsom 2023).[1] The new fast-food minimum wage will be $4 higher than California's general $16 per hour minimum wage, a significant win for workers in one of the lowest-paid industries. Further, the new Fast Food Council will give fast-food workers a formal seat at a negotiating table with oversight over working conditions.

While the law is a win for workers and the labor unions that have long fought for improved working conditions in the fast-food industry (SEIU 1021 2023), some employers perceive the law as a financial threat (Moorcraft 2023). In the months leading up to the minimum wage increase, fast-food firms have suggested looming price increases and job cuts (see, for example, Luna 2024; Woods 2023). Yet our analysis of financial data for the past decade finds increases in fast-food industry operating profits and rising markups, suggesting that affected employers can absorb the increased operating costs associated with a higher industry minimum wage without increasing consumer prices or reducing employment.

According to Mike Konczal and Niko Lusiani's "Prices, Profits, and Power" (2022), corporate profit margins and markups in 2021 grew at the fastest annual pace since 1955. Their research finds that the recent high jump in corporate profit margins and markups—the difference between the prices consumers pay and the cost of production—is evidence that inflation is being driven, in part, by corporate profiteering related to firms' price-setting power. Corporations have accumulated significant market power over the years, enabling them to charge more than what a competitive market would allow. In effect, this means that firms are able to increase prices without sacrificing profit. This recent spike in corporate profiteering should inform how we account for the impact of California's fast-food minimum wage on corporate employers. Outsized corporate profit margins driven by increased markups throughout the industry provide evidence that now, more than ever, fast-food employers can absorb higher wage costs without raising prices or reducing employment. In response to the implementation of California's fast-food minimum wage,

[1] The law defines fast-food chains as "limited-service restaurants consisting of more than 60 establishments nationally that share a common brand, or that are characterized by standardized options for decor, marketing, packaging, products, and services, and which are primarily engaged in providing food and beverages for immediate consumption on or off premises where patrons generally order or select items and pay before consuming, with limited or no table service."

affected corporations can simply narrow the gap between prices and the cost of production and still maintain profitability.

This brief provides evidence of increasing corporate profit margins and markups in the fast-food industry and of a strong fast-food labor market in California and across the US. We find that firms in the fast-food industry increased markups during the past decade, which drove record-level profit margins in 2023. Additionally, we find that California's fast-food industry has experienced robust growth in both employment and the number of establishments over the past decade, but that the wage gains of California's fast-food workers have been undermined by inflation. We conclude that increasing the minimum wage for California's fast-food workers can offset the real wage decline caused by the brief inflationary period of 2022—23 and that the industry's operating profit margins provide sufficient room to absorb higher wage costs.

Fast-Food Industry Markups and Profit Margins

Much of the fast-food industry has drastically increased markups during the past decade, helping pave the way for record-level industry profit margins above and beyond other sectors' growth. While not all firms have followed this strategy, the largest firms have, forcing consumers to pay for their higher profits through unnecessary increases in prices. Between 2014 and 2023, fast-food prices increased by 46.8 percent compared to 28.7 percent for the average of all prices.[2] Evidence of fast-food firms' recent profiteering makes it clear that the upcoming implementation of a fast-food minimum wage of $20 per hour in California will not necessitate price hikes or employment losses, because profits in the industry are sufficiently high to absorb the greater operating costs.

In 2023 alone, the 10 largest publicly traded fast-food companies spent $6.1 billion on share repurchases.[3] To put this into perspective, if we estimate the cost of the minimum wage increase for affected employers using the most generous—and unrealistic—assumptions, employers' wage costs will increase by a maximum of $4.6 billion annually.[4] This figure is notably less than the amount the top companies spent on share repurchases, indicating that most affected employers could cover the expense of the minimum wage increase by merely decreasing their share repurchases. Further, these 10 firms made $20.9 billion in total operating profits in 2023 suggesting considerable room on their income statements to cover wage increases.

Profit Markups

Applying Konczal and Lusiani's (2022) methodological approach to estimating markups, we find that on average, markups increased by 13.9 percent across all firms during the past decade and by 14.7 percent in the fast-food industry (limited-services restaurants) (see Figure 1).[5] In 2023 alone, the average markup in the fast-food industry jumped by 8.4 percent while markups for firms across all industries grew by 6.2 percent. The recent spike in markups means that in 2023, fast-food firms charged prices that were 27 percent above the marginal cost of production.

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[2] See US Bureau of Labor Statistics Consumer Price Index series CUUR0000SA0 and CUUR0000SEFV02.

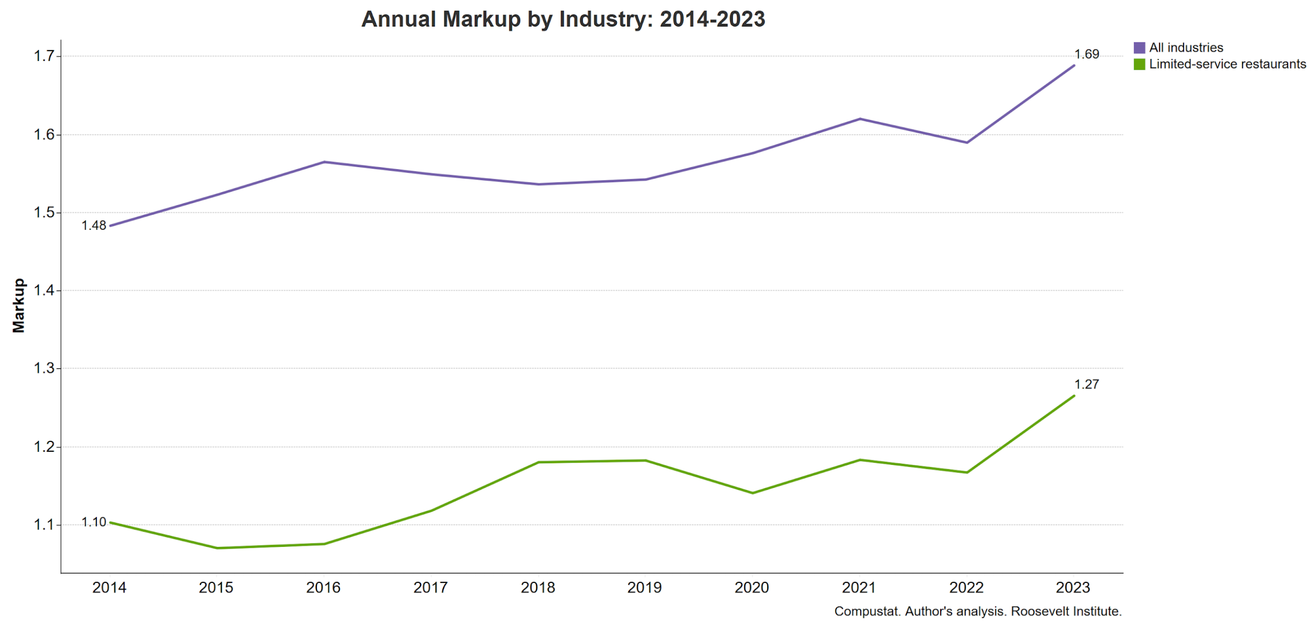
[3] The total shares repurchased includes common and preferred stocks.

[4] To arrive at this estimate, we assume that all workers in the industry (approximately 552,000) receive a $4 per hour raise (going from $16 to $20). We further assume that they all work 40 hours per week for 52 weeks per year.

[5] Firm and industry markups are derived from sales divided by the cost of goods sold multiplied by an industry- and year-specific production function and are adjusted for firm size, employing data from Compustat. The sales and cost figures are adjusted for inflation.

As with most industries, the fast-food industry has historically charged higher prices than their marginal costs. However, between 2014 and 2023, markups increased at an annual rate of 2.2 percent, faster than at any period since 1978. As a result, fast-food firms have developed an increasingly large buffer between costs and prices that has better positioned them to absorb higher operating costs now, more so than in the recent past. On average, publicly traded firms distribute all corporate profits to shareholders via stock buybacks and dividends on stock (Palladino and Lazonick 2021). This means that markups have only benefited wealthy stock owners and hedge funds. In sharp contrast, minimum wage increases have the potential to shift corporate profits inward, back into the company, rewarding the workers who drive productivity in the first place.

Figure 1: Annual Markup by Industry, 2014–2023



Our analysis of 10 of the largest publicly traded fast-food firms shows that markups have increased substantially at 5 firms during the past decade.[6] Markups increased most at Wendy's and McDonald's, by 76.2 percent and 40.3 percent respectively between 2014 and 2023. In 2023, markups were the highest among Wendy's, where prices were 91 percent above marginal costs, McDonald's (85 percent), and Restaurant Brands International (80 percent).

[6] Our analysis includes: Chipotle Mexican Grill, Domino's Pizza, Jack in the Box, McDonald's, Papa Johns International, Restaurant Brands (Burger King, Tim Hortons, and Popeyes), Shake Shack, Starbucks, Wendy's, and Yum! Brands (Pizza Hut, Kentucky Fried Chicken, and Taco Bell). We do not include firms like Darden Restaurants, CAVA group, and Wingstop Restaurants, which are among the largest firms by market capitalization but are not subject to the California minimum wage legislation or were not publicly traded prior to 2015.

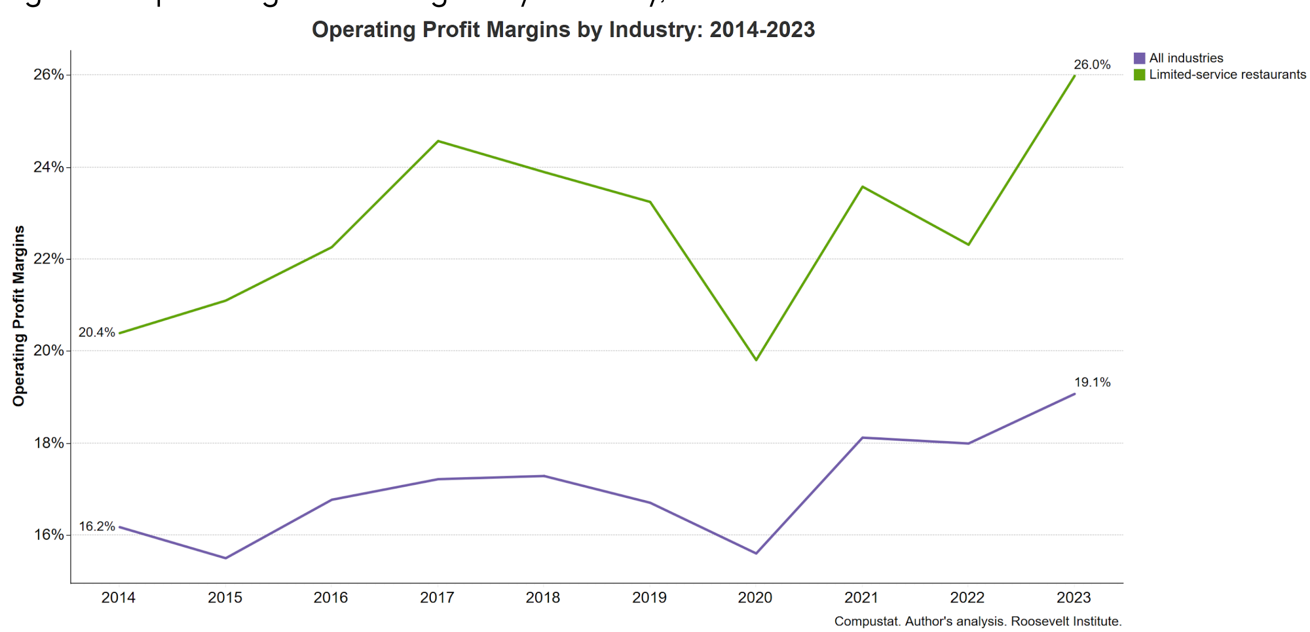
Markups at Yum! Brands and Domino's Pizza were 45 percent and 19 percent respectively, closest to the fast-food industry average of 27 percent.

Unlike most firms, markups have declined at Shake Shack, Jack in the Box, Starbucks, Chipotle Mexican Grill, and Papa Johns International—firms where markups have been relatively low for the past decade. The decline in markups does not indicate that these firms lack the capacity to absorb higher operating costs without raising prices. Rather, the data suggest a high degree of variance in how firms set prices relative to operating costs. As the next section shows, each of these firms has operating profit margins of at least 10 percent, enabling them to absorb higher operating costs without increasing prices.

Profit Margins

Higher markups have driven higher profit margins during the past decade. Between 2014 and 2023, operating profit margins across all industries increased by 17.9 percent, growing to 19 percent in 2023 (see Figure 2). During this same period, operating profit margins at fast-food restaurants grew by 27.4 percent to 26 percent. In 2023, operating profit margins in the fast-food industry, and across all industries, were at record highs. Taken together, this suggests that increases in markups have translated to higher operating profit margins at fast-food firms relative to all other firms.

Figure 2: Operating Profit Margins by Industry, 2014–2023

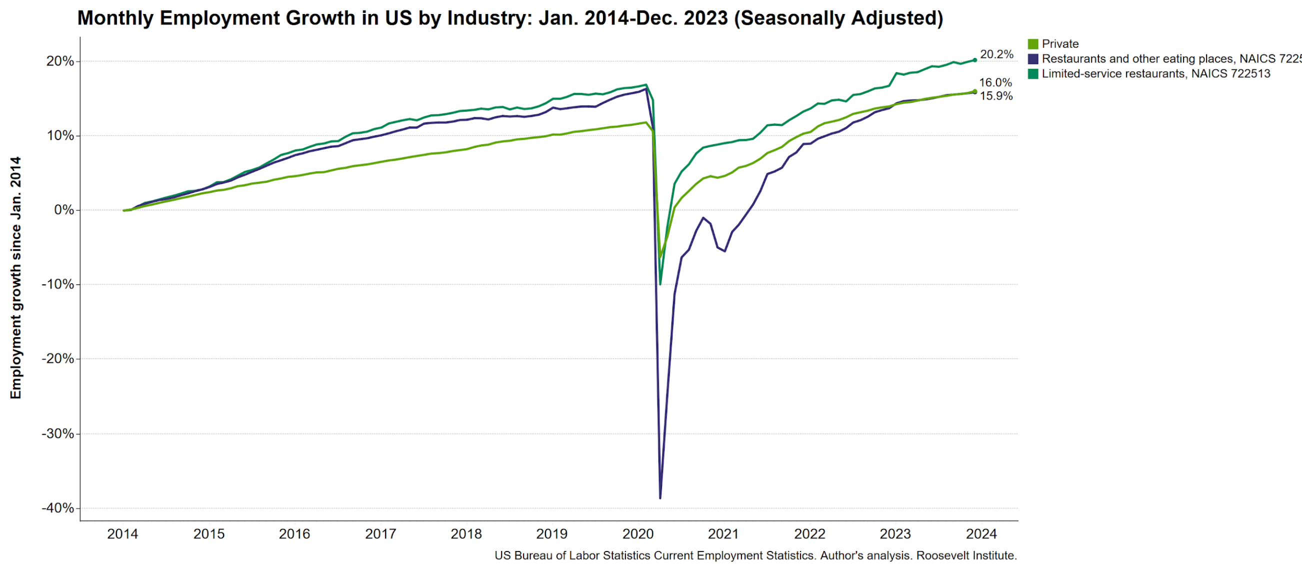


In 2023, operating profit margins among the top 10 fast-food firms were highest at McDonald's (52 percent)—the firm that experienced the second-highest growth in markups during the past decade. Operating profit margins were higher than the industry average at Yum! Brands (36 percent) and Restaurant Brands International (33 percent). Operating profit margins ranged from 19 percent to 24 percent at Wendy's, Domino's Pizza, Chipotle Mexican Grill, Starbucks, and Jack in the Box. Papa Johns International and Shake Shack had the lowest operating profit margins with 10 percent. Between 2014 and 2023, increases in profit margins led overall real operating profits to grow by 23.3 percent across these 10 firms.

California's Growing Fast-Food Industry

The fast-food labor market tells a similar story to the data on markups and profit margins. Nationally, total private-sector employment has increased by 16 percent during the past decade and by 3.7 percent since its pre-pandemic level in February 2020 (see Figure 3). Over the past decade, fast-food industry employment has grown by 20.2 percent, and by 2.8 percent since immediately prior to the pandemic—outpacing the broader restaurant industry in both periods. Robust employment gains in the fast-food industry suggest strong labor demand by firms in the industry.

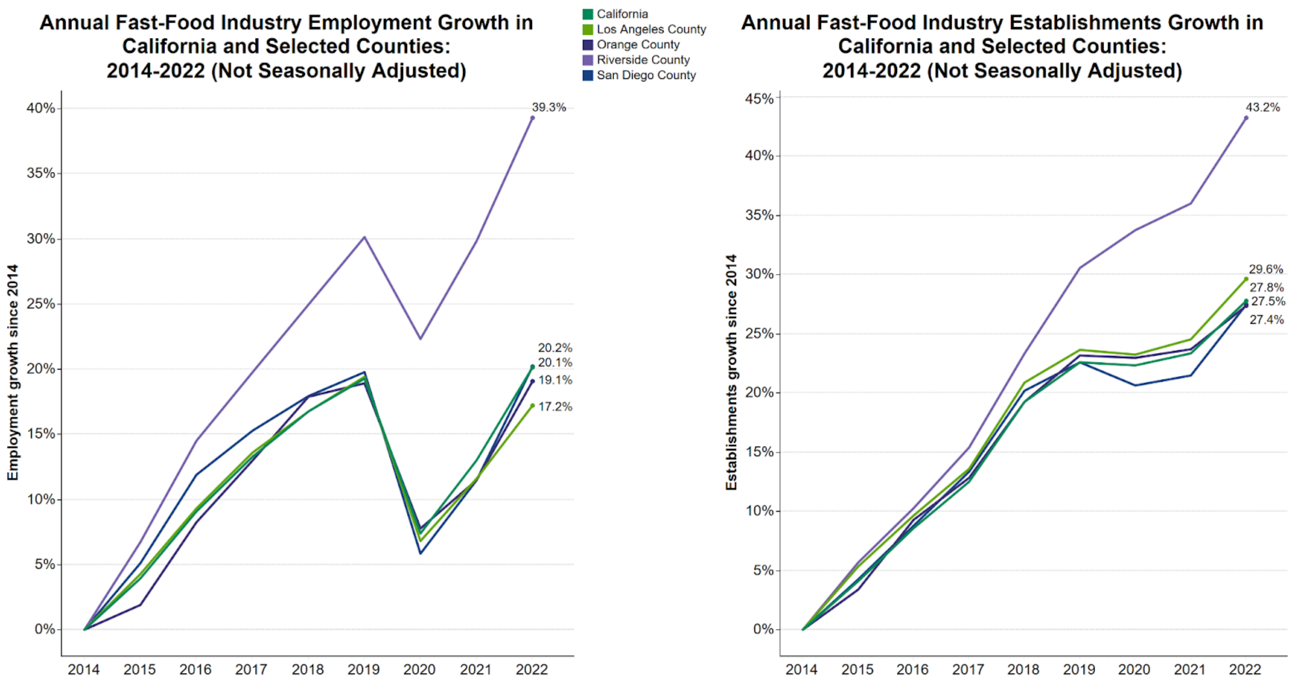
Figure 3: Monthly Employment Growth in US by Industry, Jan. 2014–Dec. 2023



Trends in the California fast-food labor market have mirrored national averages. Yet between 2014 and 2023, the federal minimum wage remained stagnant at $7.25 per hour while California's minimum wage increased from $9 to $15.50 an hour—evidence that California fast-food firms can readily adjust to minimum wage increases. In 2022, industry employment had increased to approximately 553,000, a 20.1 percent increase since 2014 (see Figure 4).

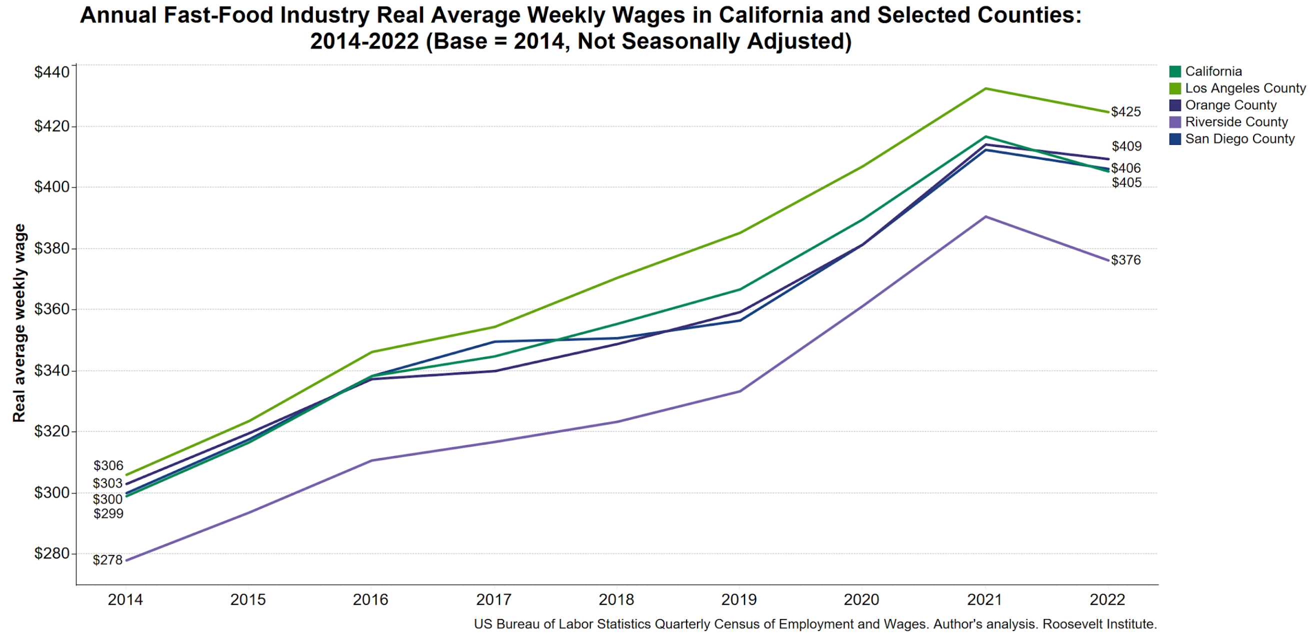
A look at the state's four largest counties show that Riverside County has experienced the fastest growth in fast-food industry employment (39.3 percent), outpacing state-level trends, while San Diego, Orange, and Los Angeles counties each grew by slightly less than the state overall. Similarly, the number of fast-food establishments in California has grown to approximately 32,300, increasing 27.8 percent since 2014 (see Figure 4). The number of establishments grew by 43.2 percent in Riverside County, and growth in San Diego, Orange, and Los Angeles counties hovered around the state-wide trend. Together, the data show a robust fast-food industry that has expanded over the past decade and recovered from the pandemic's economic shock.

Figure 4: Annual Fast-Food Industry Growth in Employment and Establishments in California and Selected Counties, 2014–2022



Growth in California's fast-food industry largely translated into robust wage growth for workers until 2022 (see Figure 5). Statewide average wages in the industry grew by 35.5 percent over the past decade, but peaked in 2021 before inflation peaked in 2022. The sharp spike in inflation during 2022 undercut wage growth and caused real wages to decline by 2.7 percent. Fast-food firms could've raised wages further in order to prevent wages from eroding, but they chose not to. Instead, firms chose to raise prices—by 14.7 percent between 2021 and 2023—and pass the profit gains to their stockholders.

Figure 5: Annual Fast-Food Industry Real Average Weekly Wages in California and Selected Counties



An increase in the industry-wide minimum wage will directly address the real wage decline of fast-food workers. Research shows that minimum wage increases affect the workers with the lowest wages but also have the effect of increasing the average wage overall (Cengiz et al. 2019). As a result, California's $20-per-hour minimum wage will enable workers in the fast-food industry to overcome the purchasing power loss associated with inflation.

Conclusion

In general, corporations within the fast-food industry and the broader economy have enough room on their income statements to comply with increased minimum wage requirements and maintain profitability and healthy shareholder returns. Growth in corporate markups and record profit margins suggest that increased production costs from changes in minimum wage laws can be absorbed without increasing prices or reducing employment. In fact, data show that wage growth is needed to keep up with recent inflation. The brief inflationary period between 2022 and 2023 did not hurt the profitability of the fast-food industry, but it did undermine the wage growth of fast-food workers.

California's $20-per-hour fast-food industry minimum wage and the creation of a Fast Food Council have the potential to supplement statewide labor policies and provide fast-food workers with a vehicle to more labor-centered policies. The Council could shore up gaps in labor policy and drastically improve labor conditions in the sector—achieving some of the promises of sectoral bargaining frameworks suggested by Kate Andrias and Brishen Rogers (2018). But the success of California's innovative fast-food industry labor legislation will largely depend on overcoming the opposition of the business sector, which as this paper shows, is very capable of absorbing higher labor costs.

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