

The impact of minimum pay implementation on small businesses operating cost and sustainability: A case of service business

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Abstract. The implementation of minimum wage requirement in Malaysia beginning mid 2016 seems to impact both employees and employers in different ways. While this implementation could increase household income and claimed to boost employees' productivity, employers or business operators, on the other hand are experiencing stringent effect on their business operating cost. The effect is more significant for small business operators, including the childcare centers. Childcare industry operates in the service sector, which represents the main contributor of Malaysian SMEs. Unfortunately for the industry, there is an increasing numbers of childcare centers have to cease their operation due to inability to comply with the minimum pay requirement. In the absence of thorough understanding of the phenomena, the small businesses, particularly among institution-based childcare, is at the risk of losing their businesses. This exploratory study intends to assess how the implementation of minimum pay requirement affects the existing operating cost structure, and consequently business sustainability of Malaysian childcare industry.

1 Introduction

The minimum pay requirement while could benefits the workforces at large could also results in a stringent job opportunity for employees in certain industries that is negatively affected by its implementation. The implementation of the minimum wage requirement, while at early stage, has been a worrying issue for small businesses, including the childcare operators. Since its implementation in July this year, many issues have been raised by the childcare operators, largely concerning changes in their operating cost. Increases in salary particularly, which represents a major components of the childcare operating expenses have causes a spike on their operating cost [1]. As a result, an increasing number of childcare centers have ceased their operations, and some others are struggling to survive by absorbing losses, which affect the sustainability of childcare industry. While this problem has been highlighted as a national issue in media, empirical findings are lacking in the literature. This study will look at how the implementation of the new minimum pay policy exerts changes on the current cost structure and affect sustainability of childcare centers operation in Malaysia. Findings from this exploratory study could offer empirical evidence towards

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better understanding of the phenomenon and to propose ways for effective cost management strategy and ensure sustainability of the childcare industry.

2 Literature Review

2.1 Minimum Wage Policy

Minimum wage is the lowest remuneration employers pay to employees, according to the governmental legislation. Minimum wage policy was long implemented in various parts of the world as a poverty mitigation tool [2]. Until 2013, many developed countries have implemented minimum wage policy, such as Australia, Luxembourg, France, Ireland, US, Japan, Canada, Korea, Turkey, Greece and many more.

2.1.1 Minimum Wage Policy in Malaysia

The second wave of minimum wage policy in Malaysia was fully gazetted on July 1, 2016, continuing from the first wave that was implemented in January 1, 2014. Under the Minimum Wage Order 2016 (MWO2016) the implementation of the policy increases the monthly minimum wage from RM900 to RM1,000 for Peninsular Malaysia and from RM800 to RM920 for Sabah, Sarawak and Labuan. On average, the affected workers are expected to receive a 13% increase in wages. The minimum wage policy is in line with government's aim to become a high income nation by 2020 [3]. Apart from improving government's labour standards, the increase of the minimum wage will enhance the wellbeing and welfare of low income bracket employees, improve their motivation, and hence, their productivity. While the policy will benefit the employees, many employers express their objection towards the minimum wage. According to Malaysia Employers Federation (MEF) executive director, Datuk Shamsuddin Bardan, the enforcement of MWO 2016 will affect 30,000 lower level employees, where they may be retrenched [4]. In addition, the vice-president of SMI Association of Malaysia claimed that most SMEs in Malaysia would not be able to absorb the cost spike as most of their profit margin is about 3% to 5%, leading to cease of operation [5]. The implementation of the policy is like a double-edged sword.

2.1.2 The Impact of Minimum Wage Policy

According to Efficiency Wage Theory (EWT) it may benefit firms to pay workers a wage higher than their marginal revenue product. The theory purports that when workers are paid higher wage, it will lead to increase in productivity. With higher pay, a worker may feel loyal and attach to the company. It is also possible that with higher pay, a worker may fears of being retrenched, and hence, he will work harder to keep his job. Although the company pays higher, it gets more employees' productivity. Riley and Bondibene [6] found that, upon the introduction of National Minimum Wage (NMW) in Britain, low-paying companies responded to the increase in labour costs from minimum wages by increases in the labour productivity. They suggested that these labour productivity increases may have been associated with decrease in employee turnover and improve in training. Further, Mayneris et al. [7] provided support that recent minimum wage reform in China forces the least productive firms to raise their competitiveness. Stronger and higher minimum wage will raise employees' salary, and hence, contribute to employees' motivation, healthier employees, attract high quality employees, and increase work effort [8] [9]. These will change the present situation of low labour productivity [9]. As the increase in wages could

be mitigated through enhancements in productivity, the overall impact on business cost will likely be insignificant.

Notwithstanding, the minimum wage policy may negatively affects both the employees and employers. A study conducted in China shows that minimum wage reduces the employment of low-skilled employees. This indicates that Chinese employees with low education level (i.e., below vocational school degrees) were directly and adversely affected by the policy. The results support prior study by Fang and Lin [10] that minimum wage increases in Eastern and Central regions of China negatively affects young adults, females and low-skilled employees. With the increase in minimum wage, firms are forced to increase their labour cost. The labour cost increases may force firms' to cut the labour hours, or to change from full time to part time, which negatively affects employees' wages [4] [11]. In developing countries, such as Colombia, increases in labour costs by 13% significantly associated with a reduction of employment rate by 6% [12]. Other firms may adjust to the increase of the labour cost by replacing low-skilled employees with high-skilled employees [13]. These worsen the poverty level of the affected workers. In fact, some firms, especially small and medium enterprises (SMEs) may force to cease their operation due to inability to absorb the cost spike. In Thailand, 110,000 SMEs was closed down due to minimum wage policy [14]. The same situation may be experienced by Malaysian SMEs too as their profit margin is around 3% - 5% only and hard for them to grip the labour cost increases [5].

2.2 Childcare industry in Malaysian SMEs Service Sector

The nation's economy is largely composed of Small and Medium Enterprises (SMEs) operations. SME contributes 65.5% to the overall employment as in 2015. Further, service sector is a major player in the SMEs establishment, which represents 90% of the overall SMEs in Malaysia. Out of 580,985 SMEs in the service sector, 79.6% consists of micro enterprises [15]. The childcare business operations is commonly categorized as a small service business with owner or known as operator employing limited number of employees. Nevertheless, changes in the current economic development offer platform for these small businesses to flourish through knowledge utilization and innovation, hence strengthening its competitiveness and presence in the market [16]. Since small businesses or micro operation play a significant role in the nation's economy, their presence should be recognized by the policy makers. From the entrepreneurial economy perspective, government should play a crucial role as an enabler, rather than a controller, to support small business survival and sustainability [16]. For instance, by reducing administrative burden and facilitating small business ability to cope with changes.

2.2.1 Childcare operation and its future in Malaysia economic development

Childcare operation provides caretaking and custody services to four or more children below the age of four with certain amount of fee to be charged. The operation of the childcare center in Malaysia is under the administration of the Social Welfare Department, and subjected to the Akta Taman Asuhan Kanak-Kanak 1984 [Akta 308]. It provides guidelines for the registration, inspection and enforcement of childcare centers to ensure the prosperity, security and overall development of the children [17].

Early care industry could contribute significantly to the nation economy development on both short term and long term basis [18]. According to The Cornell Linking Economic Development and Child Care project, childcare industry contributions can be classified into three main aspects: its impact on the regional economy or place, impacts on parents by providing social support to the labour force, and impacts on children strategic human

capital development. While the impact on children is vital, the benefits of childcare service on parents deserves similar merits.

Despite the importance of the childcare industry, the recent implementation of minimum pay seems to affect the institution-based childcare operation, in particular. For instance, media has reported nearly 70% of registered childcare centers in Pahang, one of the largest states in the country, are unable to comply with the minimum wage requirement (Sinar Harian, 16 September 2016). Out of the total 203 registered centers, 36 centers were closed due to unbearable operating cost as a result of the minimum wage pay. On the other hand, only 12 percent (25 centers) comply with the requirement, although have to absorb loss from the operation.

The child care industry is known as a low skill–low pay environment [19]. As such, constant changes in the technical requirements imposed on licensed operators, and recently the minimum pay implementation, imposed pressures to continue their operations. If the cost for childcare keep increasing, it might affect women involvement in the labour force and lead to withdrawal of professionals among female employees since accessibility to quality childcare would become an economic burden [19]. Consequently, the nation economic development could be negatively affected.

To address the issue, this study proposes the importance of cost management such as revising costing and pricing strategy, which allow childcare businesses to cope with changes and ensure sustainability of its operations, as discussed in the following section.

2.3 The Importance of Managing Effective Cost Management and Accurate Price Setting For Business Sustainability

Sound cost management is the index of the success of an enterprise, its existence and growth. Cost management makes possible the use of available resources in the form of workers, materials and machines more effectively. Thus, it helps in preparation of plans for development and expansion and their successful executions [20]. For instance, cost management permits evaluation of the business profitability in a given circumstances so that a proper decision may be taken to minimize the risk of high operating costs.

Operating costs are the cost of resources used by a business just to maintain its existence. It falls into three broad categories, which are fixed costs, variable costs and semi-variable costs. Further, a business's cost structure refers to the relative proportion of fixed and variable expenses. It is necessary to classify business expenses as either fixed or variable if the management or owner want to understand the profitability of its business. In order for a business to gain a reasonable profit, determining accurate sales per unit or price setting of goods or services is essential [21]. Many businesses are not making a reasonable profit because they do not know the basic concepts of costing and set prices. The situation is most serious in the service business because each service performed has a different cost. Frequently, the service business must bid for jobs by making a price quotation in competition with similar businesses. It is difficult to calculate the costs for services and quote a price that is competitive and returns a profit. Without realizing what they are doing, some business owners set their selling price below their total cost. This may result a loss incurred. Occasionally, a business owner who lacks a knowledge of costing will try to compensate by setting prices very high. The end result is that the business is not price competitive and does not attract sufficient customers to survive.

2.3.1 The effect of salaries and benefits of small businesses

Salaries and benefits are a large portion of any business' operational cost. This is particularly expensive for a small business, as the cost can easily take up a large percentage

of revenue. In the current situation of coping with the minimum pay implementation, business could either increase the selling price of its services or make a necessary reduction to its fixed and other variable costs in order to absorb the increment of salaries and benefits expenses. In conjunction to that, a solid understanding of accurate costing and price setting strategy is vital for business to continue generate a reasonable profit for its sustainability. Therefore, this study will assess the existing cost structure adopted in the childcare businesses to understand the impact of minimum wage implementation on their operating cost, and to develop the operating cost model for small business services.

Figure 1 below depicts the importance of effective cost management to ensure business sustainability as a result of minimum pay policy implementation among Malaysian childcare operations.

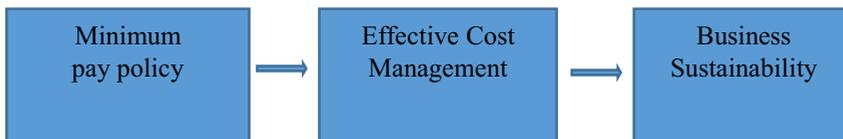


Fig. 1. Conceptual Model of the impact of minimum pay implementation on operating cost and business sustainability.

3 Conclusion

A qualitative case study is proposed to explore the phenomenon. Data gathering will involve semi structured interviews among childcare operators in Malaysia. Findings from the study could benefit both service business operators and policy makers to better understand the effects of minimum wage implementation on the small businesses' cost structure. It is hoped that findings could enlightened business operators in making improvement in their business and costing strategy; and for the policy makers to introduce a better mechanisms that could facilitate small businesses adapting with changes in relation to minimum pay requirement, hence to ensure the industry sustainability.

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