

GRAVITY PAYMENTS: MINIMUM WAGE IS A HEAVY LOAD

Dan Price of Gravity Payments hit the headlines in April 2015 when he announced that he was introducing a minimum wage of US\$70K for all staff. Seventy of the 120 employees at the Seattle credit-card processing company got a raise. At the same time, he reduced his salary from US\$1.1M to the same level, and mortgaged his house, putting the money into the company.

While the majority of those affected were presumably happy, and few people doubted that Price's motives were good, there were wider implications. More senior employees with salaries already above the minimum received no raise: how did they feel? Given that money paid as salaries could go into other areas of the company, what were the implications for the future as the company tried to expand or raise funding? What were the effects, positive and negative, on competitors and customers? What other ways could Price have considered to motivate and improve the well-being of his employees, while enhancing the company's future?

Praised by some and ridiculed by others, Price's simple action raised complex questions about wage inequality and the best way to hire, motivate and retain staff.

A Surprise Pay Raise

At a staff meeting in April 2015, Price made the kind of announcement that few employees hear in their lifetimes: "Effective immediately... we're gonna have a minimum US\$70K pay rate for everyone who works here."¹ Price said of his decision, "To me, once you know the right thing to do, and it's the right thing for everybody involved and it's going to be beneficial to everyone, it becomes a moral imperative to actually do it."² Price added: "It's a big struggle for the middle class.... I think part of that is things are getting more expensive and the wage growth just isn't keeping up."³ The figure of US\$70K was derived from a 2010 study by Nobel Prize-winning economist Daniel Kahneman, which, setting out to answer whether money can bring happiness, gave the figure as being the approximate level below which lack of money would

¹ Q13fox, (2015) "Local CEO on why he is giving all his workers \$70K a year and what he hopes to happen next (VIDEO)," <http://q13fox.com/2015/05/19/local-ceo-on-why-he-is-giving-all-his-workers-70k-a-year-and-what-he-hopes-to-happen-next-video/> (accessed 25 Nov 2015).

² Time Magazine (2015) "Why This CEO Pays Every Employee \$70,000 a Year," <http://time.com/money/3831828/ceo-raise-70000-dan-price/> (accessed 25 November 2015).

³ NBC News (2015) "Seattle Business Owner Raises His Workers' Minimum Pay to \$70,000," <http://www.nbcnews.com/business/seattle-business-owner-raises-minimum-pay-70-000-n341546> (accessed 27 November 2015.)

Dr Tim Summers prepared this case under the supervision of Dr Tao Lin for class discussion. This case is not intended to show effective or ineffective handling of decision or business processes.

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cause "emotional pain."⁴ So, while the decision was at heart a moral one, it had a qualitative basis.

There were other rational reasons for the raise. Price claimed that previous pay raises had caused a surge in profits, and also, more cynically, thought that the publicity would increase business. The announcement was indeed covered extensively by the *New York Times* and NBC News.⁵

Coming from a conservative, religious background, Price was an ambitious entrepreneur who worked hard to build a successful and profitable business. He realized that the single most important aspect he needed to get right was nurturing client relationships: "If we can improve our quality, if we can improve how we serve our clients, that's gonna show up in our financials long term."⁶ He had no intention of turning his company into a charity for his employees, but wanted to experiment with a radical payment structure to drive the company forward. Price would probably not call himself a socialist. However, the concept had similarities to state-supported welfare, where the state ensures that citizens have food and housing at a basic level, leaving additional needs up to the individual.

Seventy of the 120 employees got a raise; 30 employees doubled their salaries. (The minimum rate for new employees was US\$50K, rising to US\$70K with service.) The majority of these were presumably happy, although a new administrative assistant at Gravity commented, "Am I doing my job well enough to deserve this? I didn't earn it."⁷

Reducing Income Equality One Step at a Time

Leading up to his announcement, Price had serious misgivings. He would be taking a huge pay cut himself and renting out his home, and told himself he'd be "better off if I don't do this" and "to forget this horrible idea." Several years of annual salary around US\$1M had certainly helped him lead a comfortable life. However, costing the idea with his financial manager convinced him that it was possible, though it was clear that there would be no room for error and no contingency for unexpected costs. In addition to Price's sharply reducing his own salary, the previous year's US\$2.2M profit would be used to finance the new pay scale. He had drastically decreased his short-term financial outcomes, although he said, "It helps that I'm 31 and don't have any kids... and no girlfriend," so giving up a high salary was probably easier for him than for someone with more commitments.⁸ He had no mortgage payments either: his house, which cost US\$900K in 2012, was bought with cash.

Price claimed he was surprised that the announcement got so much attention. However, the action seemed to enforce a debate already underway about wage inequality, and tap into a national Zeitgeist. The ratio of median to mean pay in the USA had been falling steadily since at least 1989, as the huge salaries of the highest earners raised the mean but left the majority

⁴ Kahneman, A. D. (2010) "High income improves evaluation of life but not emotional well-being," *Proceedings of the National Academy of Sciences of the United States of America*, 107(38), pp. 16489 - 16493.

⁵ Bloomberg Businessweek, 2015. "The CEO Paying Everyone \$70,000 Salaries Has Something to Hide," <http://www.bloomberg.com/features/2015-gravity-ceo-dan-price> (accessed 5 December 2015).

⁶ Q13fox (2015) "Local CEO on why he is giving all his workers \$70K a year and what he hopes to happen next (VIDEO)," <http://q13fox.com/2015/05/19/local-ceo-on-why-he-is-giving-all-his-workers-70k-a-year-and-what-he-hopes-to-happen-next-video/> (accessed 25 Nov 2015).

⁷ New York Times (2015) "A Company Copes With Backlash Against the Raise That Roared," <http://www.nytimes.com/2015/08/07/business/a-company-cope-with-backlash-against-the-raise-that-roared.html> (accessed 25 November 2015).

⁸ *Ibid.*

unchanged.⁹ Coming on the back of the financial crisis in 2008, which saw rapid rises in unemployment across regions and professions, and negative GDP growth in 2008 and 2009, the perception was that middle-class working Americans were struggling to improve their living conditions, while the very richest continued to get richer.¹⁰

The debate was as strong in Seattle as anywhere. On May 1, 2014, Mayor Murray announced that the city would introduce a sliding scale of minimum wages, starting at US\$11 per hour on April 1, 2015 and rising to US\$15 per hour on January 1, 2017.¹¹ (US\$15 per hour corresponds to approximately US\$31K annually.)

Despite Price's claim that he was surprised at the reaction, one of his motivations was definitely to make a statement to other companies. His announcement was professionally filmed and discussed on the company's blog, and widely shared with news outlets. He thought that, after the announcement, the company would "just kinda move on. But I was struck at the interest of people outside, and how people thought this might be the start of a movement."¹² When asked whether the pay raise would help pave the way for wider pay equality, Price answered, "I hope so. My goal when making this decision was for other business leaders to recognize you can pay a living wage and not only survive, but thrive."¹³

The actions of a single small company will not change income inequality. However, the effect is amplified if such actions influence a number of others. The impact on media was certainly huge, with interviews in the national press, several business magazines and TV shows. In the context of rising concern about increasing inequality, much of the coverage praised Price for his actions. Left-wing comedian and activist Russell Brand and socially concerned website Upworthy were impressed.¹⁴

Effect on Employees

The publicity was certainly good for customer leads. Gravity noted the number of new customers increased by 75% in the month following the announcement, although it was too soon to tell how many would turn out to be long-term, profitable customers. Gravity hired a dozen more employees to cope with the workload.¹⁵ They received 4,500 résumés in the week following the announcement, mostly for lower-level jobs, but also from a senior executive from Yahoo, Tammi Kroll, who joined the firm, reportedly for a pay cut of at least 80%.¹⁶

⁹ United States Social Services Administration (2015) "Measures Of Central Tendency For Wage Data", <https://www.ssa.gov/oact/cola/central.html> (accessed 26 November 2015).

¹⁰ World Bank (2015) "GDP growth (annual %)", <http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG> (accessed 26 November 2015).

¹¹ Office of the Mayor of Seattle, 2015. "\$15 Minimum Wage," <http://murray.seattle.gov/minimumwage> (accessed 26 November 2015).

¹² New York Times (2015) "A Company Copes With Backlash Against the Raise That Roared," <http://www.nytimes.com/2015/08/07/business/a-company-cope-with-backlash-against-the-raise-that-roared.html> (accessed 25 November 2015).

¹³ Gravity Payments (2015) "Would You Give 90% Of Your Salary Away?" <http://gravitypayments.com/would-you-give-90-of-your-salary-away/> (accessed 25 November 2015).

¹⁴ Brand, R. (2015) "Should You Be Paid As Much as Your Boss?" <https://www.youtube.com/watch?v=shnLrSU2H90> (accessed 25 November 2015.) Upworthy (2015) "A CEO raised everyone's salary to \$70,000/year. The backlash against him doesn't make sense." <http://www.upworthy.com/a-ceo-raised-everyones-salary-to-70000year-the-backlash-against-him-doesnt-make-sense> (accessed 25 November 2015).

¹⁵ New York Times (2015) "A Company Copes With Backlash Against the Raise That Roared," <http://www.nytimes.com/2015/08/07/business/a-company-cope-with-backlash-against-the-raise-that-roared.html> (accessed 25 November 2015).

¹⁶ inc.com, 2015. "Here's What Really Happened at That Company That Set a \$70,000 Minimum Wage," <http://www.inc.com/magazine/2015/11/paul-keegan/does-more-pay-mean-more-growth.html> (accessed 25 November 2015).

Anecdotally, some existing customers worried that a consequence of the pay raise would be increased fees. Competitors fretted that they would face internal pressure to raise their own salaries.

The publicity certainly raised Price's profile. His picture adorned front pages, including the NYSE magazine and *Entrepreneur*, which had previously named him "Entrepreneur of 2014," and he was featured in the online magazine *Inc.*, Fox TV and the *New York Times*.¹⁷ Reportedly, he was offered a US\$500K advance to write a book. In fact, his external commitments are now so time-consuming that he only comes into the office one day a week.¹⁸

The effect on Gravity's employees was largely positive, as would be expected. One said, "We've been happy to stay later and maybe work through lunches, things like that, and that's fine."¹⁹ At least two made important life decisions, starting a family and spending money on visiting far-away relatives.²⁰ On the other hand, a web developer at Gravity decided to leave, despite having his salary increased from US\$41K to US\$50K, worried that he would get too comfortable with the extra money, distracting him from his longer-term career goals.²¹

However, there was one unpleasant external shock. Dan Price's brother Lucas Price, co-founder and 30% shareholder in Gravity Payments, issued a lawsuit shortly after the announcement, demanding that Dan buy out his shares and pay damages. Although details weren't revealed, he apparently felt he had been mistreated as a minority shareholder.

Effect on Customers and Peers

Although employees and employee advocates were largely positive about the new pay scales, other businesses were less so. In the wake of the announcement, Price received negative letters from customers: "I had three people who were clients of Gravity, who said, 'Price, you just made my job harder.' To hear that from those three people was really tough."²² Customers were predominantly small business owners who used Gravity to connect them to banks and large credit-card companies. This is a competitive, low-margin industry where new, small entrants constantly have to justify to customers why they should be loyal. Customers want a super-reliable, low-cost, no-worry solution. If there is concern that their processing company will raise fees, or worse, shut down, that constitutes a risk.

Competitors in the Seattle small-business community also felt the pressure. One local business owner described a conversation with Price at a social event, where he accused Price of "trying to bring in some political and aspirational beliefs into the compensation structure of the workplace." Price responded by accusing him of treating workers unfairly.²³

¹⁷ *Entrepreneur* (2015) "Meet the Winners of Our Entrepreneur of 2014 Awards," <http://www.entrepreneur.com/slideshow/240844> (accessed 27 November 2015).

¹⁸ *inc.com*, 2015. "Gravity Payments' \$70,000 Founder Scores \$500,000-Plus Book Deal," <http://www.inc.com/christine-laurin/dan-price-fuses-of-gravity-book.html> (accessed 25 November 2015).

¹⁹ Q13fox, 2015. Local CEO on why he is giving all his workers \$70K a year and what he hopes to happen next (VIDEO), <http://q13fox.com/2015/05/19/local-ceo-on-why-he-is-giving-all-his-workers-70k-a-year-and-what-he-hopes-to-happen-next-video/> (accessed 25 Nov 2015).

²⁰ *New York Times* (2015) "A Company Copes With Backlash Against the Raise That Roared," <http://www.nytimes.com/2015/08/02/business/a-company-cope-with-backlash-against-the-raise-that-roared.html> (accessed 25 November 2015).

²¹ *Ibid.*

²² *Ibid.*

²³ *Ibid.*

A Pause to Reflect

Towards the end of 2015, eight months after the surprise announcement, Price found time to reflect on what had gone well and what could have been improved in the change in policy. Both his lifestyle and his company had changed: he was now spending the majority of his work week at speaking engagements and interviews, and had delegated much of the day-to-day working of the company to his senior management team. Yet, recently, they hadn't seemed so motivated, and admittedly they were being asked to take on more responsibility without the pay raise that lower-ranking employees had been given. One had recently told him that, as soon as he mentioned that he worked at Gravity, he also had to explain that he had not had his pay doubled. Price caught another employee looking at a competitor's job posting.

As for the lower-ranking employees, they were still happy, enthusiastic and hard-working, and Price always enjoyed hanging out with them. They never failed to tell him how they appreciated his generosity and how it had changed their lives for the better. But Price wondered how he could persuade the next generation of managers to step up and take on more responsibility. All he could offer them for their extra time and effort were peer respect and management experience, rather than a significant wage raise. Also, he was concerned that some of the more recent hires did not have the same level of commitment to the company, but were just looking to make a quick buck. He remembered a friend describing how in Japan workers rarely change employers, but frequently stay with a single employer for their working lives, knowing that their compensation will rise as their needs do.

Price wondered what other ways he could motivate his entire workforce, if he had another opportunity: possibly something that bound them to the long-term good of the company, rather than the next paycheck. Maybe more flexibility could reward the people who truly went the extra mile to bring back uncertain customers, or fix a security bug that everyone else had missed. One possibility was to reward performance with cash or stock bonuses, but Price was concerned that employees would leave right after any such award, and also worried when he would find the time to do performance reviews.

The publicity had brought in many new customers. That at least was a definite positive, though the revenues wouldn't flow through to the bottom line until initial set-up costs had been paid off. The office was getting crowded with new hires, however, and Gravity needed to expand. Given that the company now had little spare cash, one option was to approach a venture capital firm to take an equity stake. Price was shocked, though, at how low they valued his company compared to a year earlier.

One other option was to off-shore some operations to a cheaper location, perhaps Mexico or the Philippines. Price knew of several local companies that had done just that and were enthusiastic about the service they got at a fraction of the cost of employing locals.

Price also misses his old lifestyle. It was exciting to have all the publicity at first, but it was sad being less involved in day-to-day company issues. And despite the highly paid speaking engagements and the book deal, they weren't as certain as the regular bumper salary he used to draw.

Was there another way he could compensate his workers in a way that was fair, but still rewarded the hardest working and most talented, and encouraged them to see their long-term futures at Gravity?