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## Management Compensation as a Value-Added Competitive Method for Casual Theme Restaurants

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# Management Compensation as a Value-Added Competitive Method for Casual Theme Restaurants

## **Abstract**

The primary purpose of this study is to propose that the management compensation package at Outback Steakhouse is a value-adding competitive method. Specifically the research focused on a survey of general manager's attitudes in regards to their intentions to seek out new employment and the effect of the compensation plan provided by Outback Steakhouse on the managers' intentions. This research will provide insight into the use of compensation packages and programs as proactive, value-adding competitive methods in retaining good quality managers in casual theme restaurants.

## **Keywords**

Kevin Murphy, Food and Beverage

# Management Compensation as a Value-Added Competitive Method for Casual Theme Restaurants

By Kevin S. Murphy and Robin B. DiPietro

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## Introduction

The Bureau of Labor Statistics (BLS) predicts that employment of restaurant and foodservice managers will be increasing faster than the average for all occupations through the year 2010. This is due, primarily because of continued expansion in the restaurant segment. Additionally, the BLS data predict that foodservice managers will post the highest growth rate of any foodservice occupation, gaining 24.7% between 2000 and 2010. According to the National Restaurant Association (NRA), over the past few years operators have consistently identified "recruiting and retaining employees" as the top challenge for their business. The demand in the industry for competent qualified management has never been greater, according to Olsen and Sharma, "the availability, quality and motivation of the work force is of no greater importance in any other industry when compared to the foodservice industry".

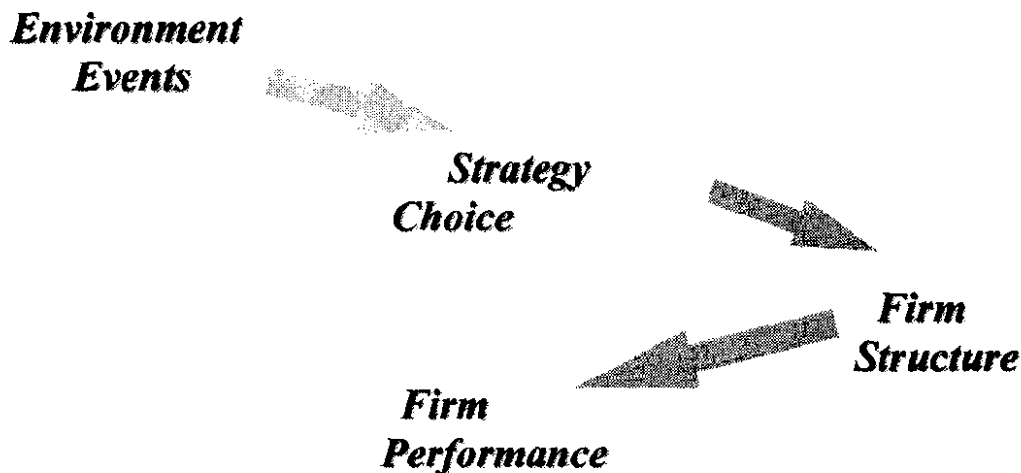
Because of this anticipated growth and demand for managers in the restaurant industry, most chain restaurants are revamping their compensation packages and incentive programs for managers, adding such items as commitment contracts, incentive bonuses, cash sign-on bonuses, profit-sharing, stock options, 401K plans and severance awards. As Dennis Lombardi, executive vice president of Technomic, stated at the 15<sup>th</sup> Annual Elliot Conference- "there is so much competition for employees out there, and we are not the industry of choice. However, some restaurant companies, including Sonic, IL Fornaio, P.F. Changs, Outback Steakhouse, Cheesecake Factory, California Pizza Kitchen and others, have done a good job with their turnover and compensation packages. Those restaurant companies that are able to provide quality unit level management, which enables the firms to operate efficiently and reduce turnover, will be the companies that can compete more effectively. The objective of this study is to explore the concept that management compensation can be a value-adding competitive method for casual themed restaurants.

## Literature Review

### Co-Alignment Theory

The theory of co-alignment refers to the ability of an organization's leadership to correctly align the organizations' strategy choice (competitive methods) and structure (core competencies) with the environmental trends that are driving change in their specific industry. "This alignment requires that management invest in competitive methods that yield the greatest overall financial value to the firm". Environmental scanning is the foundation of the co-alignment model and is the process of collecting information about an organization's environment, whether consciously or unconsciously, and attempting to discern useful intelligence from this information (see Figure 1).

## The Co-alignment Principle



**Figure 1 – The Co-Alignment Principle**  
Olsen, West & Tse, 1998

It takes extensive effort on the part of the firm to properly perceive the environment in which their organization functions. Boston Chicken is an excellent illustration of a company that had a great concept, but developed a plan that ignored the environment in which the organization operated. Boston Chicken started in the early 1990's when the management team from Blockbuster Video decided to take their business model and apply it to a restaurant company. While this was a good model for a video chain, it soon ran into multiple problems in the restaurant industry. The organization focused on rapid growth at the expense of unit economics. Growth for the sake of stock performance was the motivator. In 1993, the IPO of Boston Chicken was a high flyer, but by 1998, the company was in debt in excess of a billion dollars and shuttering 500 stores. In the end, almost 50% of the original stores closed and McDonald's bought the remainder for just over \$176 million. Boston Chicken failed to recognize that the restaurant environment could not support a video store business model and that the unit economics of stores were very sensitive to their environment, including such environmental factors as location and demographics in the various markets.

West and Olsen surveyed the hospitality industry to determine whether the relationship between environmental scanning, in support of organizational strategy, has an impact on firm performance in the foodservice industry. Further, they wanted to determine, whether high scanning activity correlates to high performance and low scanning activity correlates to low performance in firms in the foodservice industry. Ninety-two firms participated in the study by agreeing to have three members of their executive committee respond to a pre-tested questionnaire that gathered information on firm performance, environmental scanning, demographics and strategy. The dependent variable was firm performance determined by return on assets (ROA), return on sales (ROS) and unit sales growth. The independent variable was the extent of environmental scanning performed by the firm. The results indicated that higher performing firms grouped by ROS and ROA scores engaged in significantly higher levels of environmental scanning than lower performing firms. The results of this study indicate that there is a high correlation between environmental scanning and performance; high performers scan their environments at higher levels than low performers. The results of this empirical research demonstrate that companies can

improve firm performance as indicated by return on assets and return on sales through the use of environmental scanning in conjunction with organizational strategy in foodservice firms.

Previous theoretical concepts that imply an organization can be categorized into one of a small list of typologies do not mesh well with what firms are encountering in the business environment. The co-alignment model has the most relevance to the foodservice and restaurant industries because their rapidly changing environment, particularly in the realm of technology use, has forced organizations to be highly adaptive and flexible to meet the challenges of tomorrow. Some start up restaurant concepts quickly gain in popularity and grow from one store to over 500 in just a decade, while changing the rules on how to operate. Once large Goliaths in the foodservice industry that seemed unstoppable often become victims of their own success and run out of room to grow while seeing their margins strained and market share continually being pressured by new innovative competitors. What works well in today's environment are organizations that are adaptable enough to align their choice of competitive methods and core competencies with their external environment to ensure superior firm performance.

A good example of the restaurant industry aligning itself with the environment is a new breed of restaurants that are emerging. In the late 1980's, the trend in society was towards a more relaxed and casual lifestyle as baby boomers grew older and had more disposable income along with a desire to eat out more frequently, but with less formality. The restaurant industry responded with a host of casual restaurant chains that have become notable fixtures at suburban shopping malls. Now after more than a decade of long waits at casual theme restaurants, poor quality food and service at quick service restaurants, the entrepreneurs in the foodservice industry have created a new hybrid segment of fast growing restaurants: quick casual. The food is served quickly, but the quality is elevated considerably above the traditional quick service restaurants. While the segment is still small, it is the fastest growing sector of the restaurant industry today. Many of the large chains have begun to buy up the current crop of quick casual concepts with an eye on rapid expansion.

#### **Compensation as a Competitive Method**

According to Steers and Porter, the research on compensation clearly shows a link between the rewards a company offers, those individuals that are attracted to work for the company by the compensation package offered, and those employees who will continue to work for the business. In recent years the compensation available to employees has expanded both in terms of the type of compensation and the amount. Traditionally, restaurant general managers were compensated with a base pay and a business period bonus based on meeting preset goals for revenues and expenses. In general, compensation has been divided into monetary and non-monetary incentives, but with the advent of "cafeteria" style plans, where employees get to choose among a variety of options for a set price, the compensation categories have become blurred. Additionally, employees that are in high demand are increasingly acting as their own agents negotiating individual compensation arrangements, much like professional sports players, based upon their employment value to the firm.

The useful life of compensation as a competitive method is hard to determine because of many intrinsic factors. First, when dealing with people there are as many variables as there are individuals and predicting how long a restaurant manager will stay with the firm or in the industry before they burnout or decide to leave is difficult. Outback Steakhouse has done a good job of attempting to mitigate this problem so far by performing a careful screening of its' Managing Partners before they take over the management position. All of Outback's managing partners are industry veterans who have worked in the restaurant business for years. Outback does no traditional recruiting of its' managers, in contrast the managers seek them out because of the potential to be a managing partner and to receive a portion of the profits in a successful restaurant and restaurant company. Before a person can become a

managing partner they have to go through a 6-month training period as an assistant GM and are evaluated as to their potential to be successful in the Outback system and with the Outback Steakhouse culture.

This competitive method would seem to be easily duplicated, but so far no other major casual chain has attempted to duplicate the system of bringing in managing partners rather than general manager “employees” on the scale of Outback. This has enabled Outback Steakhouse to continue to recruit and retain qualified management, which is a key to the success of the concept. The high compensation and the continued ability to renew the management contracts every five years or find a replacement for the departing manager enables Outback to maintain this competitive method in the present and far into the future. With the success of this competitive method it seems that some other large casual theme restaurant organizations will realize that in order to grow and create value into the future they need to hire the best general managers and reward them well in order to continue to strive for excellence in staffing and operational performance into the future.

### **Compensation**

Ask someone to define compensation, and depending on the life experiences of that person, you will get a range of definitions. The combination of all cash incentives and the fringe benefit mix that an employee receives from a company constitutes an individual's total compensation according to Lawler. Dibble expands the definition of compensation to mean the benefits provided by employers that do not have to do with earnings or cash. Even benefits such as employee training and development, though not necessarily viewed by the employee as compensation, are a substitute for money and a major cost for employers. However, for the purposes of this study, company benefits which are mandated by law, (e.g. FICA, workers compensation insurance), and other firm benefits that are not traditionally thought of as compensation by employees, (e.g. training and development), will not be considered. The study will use a list of compensation items as defined in published literature about Outback Steakhouse, company published literature and personal interviews with managers.

### **The Outback Steakhouse Compensation Plan**

For many inside and outside observers, the compensation plan at Outback Steakhouse is the cornerstone of Outback's success: the ability to hire and retain well-qualified restaurant management by providing managing partners the opportunity to purchase a 10% ownership stake in the restaurants they operate for \$25,000 and requiring them to enter into a 5-year contract. By offering this level of commitment and by providing the managing partner with a significant stake in the restaurant (10% of operating cash flow), the company believes it can attract and retain experienced and highly motivated restaurant general managers. The company also limits most restaurants to “dinner only” service, which reduces the hours for managers and employees. Managers typically work 5 days a week with a 55 hour maximum work week. This enables the average managing partner to earn \$73,600 a year in bonuses from cash flow coupled with a \$45,000 base salary for annual cash compensation of \$118,600. The eight monetary compensation offerings at Outback are: Ownership equity stake-10%; Retirement plan; Cash flow bonus- 10%; Base salary of \$45,000; Stock option of 4,000 shares vested over five years; Deferred compensation/ end of contract cash out ( 10% of cash flow for last two years times five); Medical, dental and life insurance; Vacation/ paid time off. The five non-monetary compensation offerings are: Quality of work; Status as manager/ partner; Community association/ location; Job Autonomy; Job status.

### **The Research Question**

The purpose of the current research is to determine if the compensation plan in a casual theme restaurant company is a value-adding competitive method that can be used to help attract and retain good quality restaurant managers. More specifically the research question to be answered is: Is the compensation plan for Outback Steakhouse's managing partners an effective value-adding competitive method?

### **Methodology**

The study used a quasi-case study method that included an examination of ten years of primary and secondary public archival data, an extensive compensation survey of the unit general managers at Outback Steakhouse and interviews with unit general managers.

The population selected for this study was the U.S. managing partners/general managers/proprietors of Outback Steakhouse Inc. As of September, 2004 the company operated 853 restaurant units under the Outback Steakhouse brand in 50 states and 21 countries according to a company news release. The sampling frame for this study includes all those managing-partners at the Outback Steakhouse concepts in the U.S. listed on the company web site as of August 2000, a total of 600 managers. The questionnaire for this study was a self-administered survey, which probed work history, demographic, and compensation variables.

The survey was developed by researching other compensation, turnover and job satisfaction survey instruments that had been previously used in the hospitality field and human resources management field for data collection purposes. The survey and a letter of introduction developed for this study was sent by mail to all of the 600 general managers of Outback Steakhouse listed on the company's web site. Considering the delicate and personal nature of the questions about turnover intentions and compensation, complete confidentiality and anonymity was promised and used on the survey. The instrument contained items intended to measure general demographic information for the purpose of gaining a profile of the typical respondent and for the intention of measuring the differences between groups of respondents. The survey also contained questions designed to measure the influence of the compensation package on the general managers' intent to turnover.

Pilot testing was done to help ensure that the questions would reflect accurately the compensation package that was used by Outback Steakhouse. Two managing partners at Outback Steakhouse and two human resource management experts were given the survey as content experts and were asked during personal interviews if any relevant factors of the compensation plan of Outback Steakhouse, Inc. were not included on the survey instrument and they were asked if they understood all of the questions on the survey. The content experts did not identify any missing factors on the survey instrument, but they were able to provide additional details regarding recent developments affecting two compensation variables included in the survey instrument. The first included the second five-year contract, which is the manager's option to purchase an additional stake, up to 20%, in their unit and receive the associated cash flow. The second addition is the paid one-month break and re-indoctrination into the company at the corporate headquarters in Florida. Both of these additional benefits are designed to help retain managers for another contract period.

### **Results**

Of the 600 surveys that were sent out to the general manager's of Outback Steakhouses in the U.S., 70 surveys were returned for a response rate of 12%. Of the 70 surveys returned, 64 were usable (91%) for a final usable response rate of 10.6%. Considering the personal nature of the survey regarding compensation and turnover intentions, and the target population of very busy restaurant general managers, the response rate was considered within acceptable ranges.

Of the 64 responses, there were 6 respondents (9.4%) under the age of 30, there were 34 respondents (53%) from the ages of 30 – 39, 23 respondents (36%) were between the ages of

40 – 49, and one respondent was over 49 years old. The sample of respondents is in general older than the ages reported for restaurant managers in other surveys and by the Bureau of Labor Statistics (2003). Possible causes for the older age of respondents in this study could be that the stated philosophy of Outback Steakhouse, Inc. is to hire only experienced managers as well as the fact that the rewards associated with Outback’s compensation package could be an incentive to encourage managers to stay, while also helping to prevent industry burnout of older managers.

In response to the question, “How long have you been with your current employer” the mean response was 6.87 years with a standard deviation of 2.58 and a range of 1.5 years to 12 years. The mean response to the question “How long have you worked in the hospitality business” was 18 years with a standard deviation of 6.4 and a range of 6 years to 38 years. This question was intended to include all positions the respondents may have held in the hospitality business including part-time jobs. For the question “How long have you been a restaurant manager” the mean response was 12.42 years with a standard deviation of 6.61 and a range of .5 years to 30 years. Finally, for the question “how many other hospitality organizations have you managed” the mean response was 2.63 with a standard deviation of 2.18 and a range of 0 to 12 other organizations managed. These responses illuminate the success that Outback Steakhouse has had with hiring experienced restaurant managers and it shows the amount of experience that they have in the restaurant general manager ranks in their individual units.

Next, we asked questions related to the compensation package (see table 1).

**Table 1- Compensation Elements (Q1) & Compensation Package (Q2) Rankings**

<b>Construct</b>	<b>Mean</b>	<b>Std. Deviation</b>
Ownership Stake/Equity Interest	6.56	0.97
Compensation Plan (question # 2)	6.31	1.04
Deferred Compensation/End of Contract Cash Out	6.17	1.30
Performance Bonus	6.16	1.56
Job Responsibility*	6.05	1.24
Job Autonomy*	6.05	1.17
Quality of Work Conditions*	6.03	1.31
Status as a Restaurant Manager *	5.86	1.68
Community Association/Location*	5.80	1.25
Stock Options	5.34	1.90
Vacation/Time off	5.03	1.65
Base Salary	4.91	1.43
Medical, Dental, Life Insurance	4.56	1.66
Retirement Plan	4.47	1.92
Monetary Compensation Elements Combined	5.40	0.96
Non-monetary Compensation Elements* Combined	5.96	0.76
N=64		

In response to the question regarding the degree of influence the compensation package of Outback Steakhouse has on their desire to turnover or to stay with the company (scale item 2), 89% of the managers stated that this factor was highly influential in their desire to stay with the company. The composite mean score for item 2 was 6.31 (on a 7 point Likert-type scale with 1 being “not influential at all” and 7 being “highly influential”) with a standard deviation of 1.04, the second highest composite mean score for all 14 variables that were rated by managers. Only having an “ownership stake/equity interest” in the company ranked higher when rated as a factor in causing them to turnover or to stay with the company with a composite mean of 6.56 (on a 7 point Likert-type scale with 1 being “not influential at all” and 7 being “highly influential”) and a standard deviation of .97.



Factors influencing managers' decisions to stay or leave were collected through the use of open-ended survey items 3 and 4, which provided a descriptive rank of those variables that are most important in influencing managers to leave and those variables that are important in getting managers to stay. These rankings can be compared to the compensation attributes in item 1 to determine if any compensation attributes were missed in the survey, as well as providing a method to check on the responses from the managing partners related to items 1 and 2. For item 3, the "most important factor influencing your decision to stay", there were fourteen factors reported by general managers that influenced their decision to stay. "Ownership stake/equity" was the most frequently cited factor in manager's decision to stay with a 25% response. This was followed by "compensation/money" with 18.8%, "cash-out at end" with 10.9%, "opportunity" with 7.8%, and "quality of life" with 7.8%.

In response to item 4, what would be the "most important factor influencing your decision to leave", there were twenty factors reported by general managers that would influence their decision to leave. "Quality of life/family life" was the most frequently cited reason/factor managers cited that would influence their desire to leave with a 24.6% response. This was followed by "pay/compensation" with 16.4%, "better opportunity/growth" with 9.8%, "poor management", "company change" and "ownership" with 6.6 % each.

The results of the correlation analysis support in part the proposition that Outback's compensation plan has a significant positive impact on turnover intentions of general managers. Five of the eight compensation variables (deferred compensation  $R = .582$ , ownership stake/equity  $R = .483$ , stock option  $R = .477$ , base salary  $R = .298$ , vacation/time off  $R = .272$ ) had a significant positive relationship with the compensation plan's impact on the general manager's desire to stay with Outback Steakhouse. This is not to say that correlation implies causality, it only demonstrates the strength of the relationship between the variables.

The respondents to the survey ranked item 2 with a composite score of 6.31 on a 7-point Likert-type scale indicating that the compensation package of Outback Steakhouse is highly influential on their desire to stay with the company. Item 1 asks, "the degree to which each of the following elements (13) has a positive influence on your desire to stay with your current employer and not join another company", while Item 2 refers to the influence of the compensation package as a whole plan. Both items 1 & 2 were based on a 7 point Likert-type scale, with 1 = "not at all influential" to 7 = "highly influential". The responses ranged from a composite mean of 4.47 for retirement plan to 6.56 for ownership/equity stake. The composite mean across all variables for question 1 & 2 was 5.66. With 7 of those variables scoring an individual composite mean of 6 or higher. This would seem to indicate that the respondents as a group felt that 7 of the 14 variables were somewhat highly influential on their desire to stay with the company.

Reliability tests were run on the survey items related to compensation elements and it was determined that all items were within the acceptable range of .70 or higher.

## **Discussion**

The compensation plan for Outback Steakhouse Inc.'s managing partners has significant positive impact on manager retention; consequently reducing their intention to turnover to an annual manager turnover rate of 4-5% compared to an industry turnover average for managers of 27%. This is in accordance with some of the previous research on manager turnover that the compensation an organization provides clearly influences the decision employees make about the organization and turnover intentions. Additionally, Steers and Porter support the premise that companies which offer the greatest compensation retain the most employees. Steers and Porter have found that high reward levels lead to high satisfaction, which in turn leads to lower turnover. The results of this study would seem to add credence to the conjecture that the compensation plan for Outback Steakhouse managing

partners is a value-adding competitive method considering the low turnover rate and the industry leading financial performance of their restaurants.

Outback believes that the compensation plan they offer is effective in preventing turnover, retaining quality management while helping to attract experienced well qualified managers and gives the company a value-adding competitive method. The findings of the current study shows that Outback Steakhouse's managing partners are highly influenced by the compensation package that the company offers in regards to their intentions to stay with the company. The findings also demonstrate that the managing partners are most influenced by the non-traditional attributes of the plan (deferred compensation, stock option and ownership stake) as opposed to the more traditional attributes of compensation plans (base pay, insurance & retirement plans). The managers appear to be overall positively influenced by the compensation plan of Outback. This bodes well for Outback because these well-developed, non-traditional aspects of their compensation plan are a successful competitive method for the company.

The study also indicates the factor that would be most influential in the managing partner's decision to leave is a non-monetary element perhaps not addressed by their compensation strategy, quality of life and quality of family life. While the respondents clearly indicated that it is the monetary aspects of compensation influencing their decision to stay with Outback, they were also equally clear that it is the non-monetary aspects of compensation, quality of work and life that would most influence their decision to potentially leave. Working 55 hours a week, nights and weekend all the time can start to become burdensome for managers. The lack of time spent with family and friends can start to wear on managers as they get older. There is also the risk of burnout as managers decide that they want something more out of life than just being a successful restaurant manager. For Outback to continue to consider its' compensation plan an industry leader they will need to address these issues in the future.

### **Conclusions and Suggestions for Future Research**

In the search for competent restaurant managers that can successfully operate in today's increasingly competitive environment and help a restaurant company continue to grow, there are compensation strategies that will work in attracting and preventing turnover among the management ranks. Organizations should develop a comprehensive compensation strategy to use as a competitive method, which will help ensure job satisfaction, prevent turnover and burnout for operational management. Restaurant organizations need to make a commitment to be a leader in overall total compensation and use their company's compensation practices as a competitive method to gain a competitive advantage in the restaurant industry. In order for a company to succeed at being a leader in the restaurant industry, it should show the way with practices that will attract the best managers, produce competitive methods and create additional shareholder value for the firm.

If the restaurant industry is going to break out of the mold it has so long cast itself into, it will need to gain a better understanding of the issues that exacerbate turnover and cause burnout. More research is needed to determine the degree of influence other progressive compensation plans have on managers and competitive methods for different restaurant organizations. Additional variables should be included in future research including, quality of life, family time, growth opportunity and burnout as some possibilities. The sample size and population should be expanded in future research in order to include a broader cross section of restaurant companies and number of managers.

With the future growth of the restaurant sector dependent to a large extent on its' ability to find employees and managers to operate units, the old ideas about compensation and attitudes about the quality of life outside of work are undergoing a transformation. Several reports cited in this study imply the old ideas regarding compensation and work concepts are

under assault. Experienced managers are increasingly leveraging their value to the company and to the restaurant industry by "making a statement about whom they are, where they want to live, how they want to work". The restaurant industry has been challenged by these issues for a long time and the inability of some organizations to change continues to prolong the problem, "employers, unwillingness to increase pay, shifts with long hours and poor corporate recognition of good performance just scratch the surface on a list of shortcomings that exacerbate employee flight".

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