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The Effects of the Patient Protection and Affordable Care Act on the Franchise Industry

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The Effects of the Patient Protection and Affordable Care Act on the Franchise Industry

Diana Furchtgott-Roth and Amlan Banerjee
Hudson Institute[1]

Introduction

The Hudson Institute was engaged by the International Franchise Association to research the effects of the Patient Protection and Affordable Care Act on the franchise industry. Our research, grounded in rigorous economic analysis, includes four components: first, a review and analysis of existing literature on the effect of the key provisions of the law and their impact on small businesses; second, a review and analysis of data provided by IFA members, including franchisors and franchisees of different sizes and types of business; third, based on an analysis of franchise industry data, case studies to demonstrate how different franchise businesses – of varying sizes and from different industries – will be affected by the law; fourth and finally, a summary with our findings and conclusions.

The report is organized into six sections: an executive summary, key provisions of the new health care law, effects on franchising, conclusions, data appendix with case studies, and bibliography. The primary source for franchising industry data, such as the number of establishments and jobs, is a report by PricewaterhouseCoopers, *The Economic Impact of Franchised Businesses, Volume 3*, which is based on the 2007 Economic Census, the latest year for which data are available.[2]

Our report is timely as the U.S. economic recovery has stalled. Unemployment is above 9 percent, the economy created no net jobs in August 2011, GDP growth hovers around 1 percent, the housing market is depressed, consumer confidence is low, and high levels of volatility are being seen in global financial markets. Some analysts believe that the United States may already be in a recession. In light of these conditions, policymakers and business leaders across the country

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[1] Diana Furchtgott-Roth, former chief economist at the U.S. Department of Labor, and Amlan Banerjee wrote this paper when they were, respectively, senior fellow and research associate at Hudson Institute.

[2] *Economic Impact of Franchised Businesses*, Vol. 3, PwC, IFA Educational Foundation.

are debating the best ways to stimulate the economy, restore consumer and business confidence, and create jobs.

Small businesses, which research shows accounts for half of the nation's GDP and more than half of the private sector workforce, are vital in this national debate.[3] In particular, policy makers must consider how to encourage the growth of franchise businesses, which in the past have demonstrated their ability to be engines of economic growth and job creation. The Ewing Marion Kauffman Foundation has shown that most of the new jobs in the economy are generated by businesses less than five years old.[4] Many franchise businesses have the characteristics suited to high-growth businesses, to scale quickly and generate net new jobs and economic output at rates greater than small, independent businesses. From 2001-2005, job growth in franchising outstripped the growth of total jobs by 3.3 percent each year.[5]

Our report shows that the new health care law will have negative effects on the franchising industry's ability to grow and create much-needed jobs for the U.S. economy. We estimate that the law will negatively affect tens of thousands of franchise businesses, adding more than $6.4 billion in increased costs, not including the cost of regulatory compliance. Further, we estimate that the jobs of more than 3.2 million full-time employees in franchise businesses would be put at risk.

These effects can best be described cumulatively as anti-small business growth. The health care law unintentionally discourages franchisees from owning and operating multiple locations. The law creates a competitive disadvantage for franchisees who do own more than one or two locations. The employer mandate in the law provides an incentive for franchisors and franchisees to replace full-time workers with part-time and temporary workers. It imposes another layer of regulatory burden on business owners as they attempt to understand and comply with the new law. It increases the cost of doing business for tens of thousands of business owners who are struggling to recover from the deepest recession since the Great Depression. The law ultimately creates barriers to entrepreneurs who are looking to capitalize on the franchise business model to grow their business.

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[3] U.S. Small Business Administration.

[4] Timothy Kane, *The Importance of Startups in Job Creation and Job Destruction*, Kauffman Foundation, June 2010.

[5] Chad Mountray, "Linking Franchise Success with Economic Growth and Net Job Creation," International Franchise Association, April, 2011.

Executive Summary

With unemployment a major concern for Americans, the Patient Protection and Affordable Care Act of 2010 will make it more expensive for employers to hire low-skill workers when fully implemented in 2014. Companies with 50 or more workers will be required to offer a generous health insurance package or pay an annual penalty of $2,000 for each full-time worker. This penalty raises significantly the cost of employing a low-skill worker.

As workplaces around the country prepare to implement the Act, employers are considering how best to comply. Some companies are already limiting their hiring, leading to a jobless recovery from the recession.

The franchise industry will be particularly hard-hit because the new law will make it harder for small businesses with 50 or more employees to compete with those with fewer than 50 employees.

Franchisors and franchisees, who often own groups of small businesses, such as stores, restaurants, hotels, and service businesses, will be at a comparative disadvantage relative to other businesses with fewer locations and fewer employees. This will occur when a franchisor or franchisee employs 50 or more persons at several locations and finds itself competing against independent establishments with fewer than 50.

Our study shows that, when the employer mandates are phased in 2014, many franchise businesses will be motivated to reduce the number of locations and move workers from full-time to part-time status. This will reduce employment and curtail the country's economic growth. We estimate that more than 3.2 million full-time employees in franchise businesses would be affected.

Industries that have traditionally offered the greatest opportunities to entry-level workers -- leisure and hospitality, restaurants -- will be particularly hard-hit by the new law. Many of these employers do not now offer all of their employees health insurance, and have large percentages of entry-level workers, whose cost of hiring will increase significantly.

The franchise industry has offered an entry point to low-skill workers, who have some of the highest unemployment rates in America. Adults without high school diplomas face an unemployment rate of 14.3 percent, more than three times as high as rates for college graduates, and well above the national average of 9.1 percent. The unemployment rate for teens, another low-skill group, is 25 percent. These workers will be particularly hard-hit with the new penalties on franchise businesses.

Under the new law, every employer with more than 49 full-time or "full-time equivalent" employees will either have to offer health insurance or pay an annual penalty. For each block of 30 weekly hours of part-time work by one or more employees a business is deemed to have one full time equivalent employee. The penalty for full-time employees is $2,000 per worker after the first 30 employees. Businesses with fewer than 50 employees will be the big winners. If they do not hire too many workers - another government-induced disincentive for hiring in this weak labor market - and stay within the 49-person limit, these firms will not have to provide health insurance and will have a cost advantage over the others.

Such businesses will be able to compete advantageously against businesses with multiple locations and 50 or more employees.

The $2,000 penalty will amount to 15 percent of average annual earnings in the food and beverage industry and 9 percent in retail trade. This is a cost in addition to the employer's share of Social Security and Medicare taxes (7.65 percent, equal to what the employee pays), as well as workers' compensation and unemployment insurance.

When government requires firms to offer benefits, employers will generally prefer to hire part-time workers, who will not be subject to the penalty. Even though the Act counts part-time workers by aggregating their hours to determine the size of a firm, part-time workers are not subject to the $2,000 penalty. Hence, there will be fewer opportunities open for full-time work. Many workers who prefer to work full-time will have an even harder time finding jobs.

In August, 8.8 million people were working part-time because they cannot find full-time jobs. Our data show that the new health care law would exacerbate this problem.

In 2010, 50 percent of restaurant employees and 36 percent of retail employees worked part-time, i.e. under 35 hours per week. A higher percentage of women, 53 percent in the restaurant industry and 44 percent in the retail industry, work part-time.

With higher-skill jobs, employers can offer the required benefits and pay for them by adjusting the wage. But low-wage jobs in the restaurant and retail sectors leave little room for wage reductions without violating federal minimum wage law.

Consequently, firms will have an added incentive to become more automated, or machinery-intensive—and employ fewer workers. Fast food restaurants could

ship in more precooked food and reheat it, rather than cook it on the premises. Something analogous is already gaining momentum in industries such as DVD rental, where manual labor at retail outlets is being replaced by customer-activated DVD checkout. Supermarkets, drugstores and large-chain hardware stores also are introducing do-it-yourself customer checkout.

Even those employers who do offer health insurance could be penalized, according to a study by Mercer, a global consulting firm. Under the new law, health insurance premiums charged by employers to employees must not exceed 9.5 percent of their household income. As many as 38 percent of employers may be at risk of violating the unaffordable coverage provision, the study concluded. Regulations need to clarify whether the rule will apply to insurance coverage for a family, or just to the employee's own, individual coverage.

There is an unintended irony: in the name of expanding health care coverage, the Congress and the Obama administration are making it harder for workers to get started in the workforce. Clearly, the Act will have negative effects on employment.

This report concludes that requiring employers to offer health insurance raises the cost of employment, and discourages hiring. Employers should not be required to offer workers health insurance, just as they are not required to offer auto and home insurance as part of a compensation package. Franchise businesses, which employ substantial numbers of low-skill workers, will suffer the most distortions due to the new employer mandate. Entrepreneurs will be discouraged from expanding their businesses by opening additional locations or acquiring others, thus reducing the rate of growth and job creation the country so desperately needs.

Some Key Provisions of the Patient Protection and Affordable Care Act

The Patient Protection and Affordable Care Act, signed into law by President Obama in March 2010, is intended to make important changes in the provision of health care in the United States. Beginning in 2014, when the individual and employer mandates are fully phased in, individuals will be required to sign up for health insurance, or pay a $675 annual penalty (to be waived for those with low-incomes). Businesses with 50 or more employees must offer health insurance for their workers, or pay a penalty of $2,000 a year for each uncovered employee.

The Act mandates state exchanges at which insurance companies will be able to sell certain types of health insurance to the public. Those individuals and families without employer-provided health insurance will be able to buy

insurance through these state exchanges. Individuals whose earnings place them below 400 percent of the poverty line will receive subsidies.

The Act restricts the type of health insurance that can be offered by businesses and by insurance companies through the exchanges. Plans can have no annual or lifetime maximum, or cap, on benefits paid. They must not charge a co-payment for broad categories of preventive care. They must take all who apply, regardless of health history (a prohibition on denial of coverage for so-called pre-existing conditions).

Small business owners are wary of the new act for many reasons. There are the costly and confusing penalties on business. It will impose a competitive disadvantage on businesses with 50 or more full-time employees. Other concerns can be grouped into four categories: the employer mandate, free-rider provisions, excessive administrative discretion, and the ramifications of the two new Medicare taxes.

The Act imposes two types of penalties on businesses with 50 or more full-time employees or full-time equivalents. Employers must offer the right kind of health insurance or face a $2,000 penalty for each employee. In addition, if an employer offers insurance, but an employee qualifies for subsidies under the new health care exchanges because the insurance premium exceeds 9.5 percent of his income, his employer is fined $3,000. This combination of penalties gives businesses a powerful incentive to downsize, replace full-time employees with part-timers, and contract out work to other firms or individuals. For example, a restaurant might outsource some of its food preparation versus paying employees to make it on-site.

Suppose that a firm with 49 employees does not provide health benefits. Hiring one more worker will trigger a penalty of $2,000 per worker multiplied by the entire workforce, after subtracting the statutory exemption for the first 30 workers. In this case the fine would be $40,000, or $2,000 times 20 (50 minus 30). Indeed, a firm in this situation might have a strong incentive to pay a 50th worker off the books, thereby violating the law.

The interactions between the employee subsidies and the employer penalties will alter the employer-employee relationship. Currently, employers are not allowed to ask workers for personal or financial information relating to family members. For example, employers cannot ask whether an employee is married, how much a spouse earns, whether an elderly relative is living in the house, or other such questions.

Under the Act, an employee may have to submit such private information in order to receive a subsidy to purchase health care in the state exchanges. Once an employee qualifies for a subsidy, the government will send the employer monthly reports that may reveal personal financial data about the employee's spouse and other household members.

For example, once an employee receives a subsidy, each household member's employer is penalized and notified. The monthly notice reveals that the household's income is below the benchmark. For a family of four this benchmark income is $90,000 in 2011 dollars, so if an employee earns $70,000 a year and receives a subsidy, the employer can know by simple subtraction that the employee's spouse contributes at less than $20,000 to family income. This may be information that either the employee does not want the boss to know, or even information the employer does not wish to know. The provision effectively forces the employee to choose between a subsidy he may desperately need and his privacy.

Employer penalties are triggered by factors irrelevant to the business and unknown to the business owner. These penalties can generate legal disputes between employer and employee. Because of the subsidy and penalty structure, businesses may be penalized financially because of personal matters occurring in their employees' households, matters over which the employer has no control or knowledge.

Some employers will be allowed to keep existing plans, a term known as "grandfathering." A grandfathered group health plan is a plan in which an individual was enrolled on the date President Obama signed the Affordable Care Act into law. It can be a single employer plan, a multi-employer plan, or a multiple employer plan. It can also be an insured plan, one managed by an insurance company, or a self-insured arrangement in which an employer acts as the underwriter. Depending on the provision, grandfathered plans may benefit from either a delayed effective date for compliance with, or a total exception from, certain insurance market reforms and coverage mandates.

However, grandfathering does not immunize a plan from having to comply with the reforms found in other parts of the statute, including, for example, the requirement to report the value of coverage on each employee's Form W-2 (effective for employment in 2011) , the employer mandate to offer affordable coverage to full-time employees (effective January 1, 2014), the high-cost health plan excise tax (effective January 1, 2018) and the mandatory automatic enrollment requirement (effective when regulations are issued).

While the grandfather provision does not include a general expiry date for non-collectively bargained grandfathered plans, it is unlikely that these plans will be granted a permanent exception from compliance with any of the insurance market reforms and coverage mandates in the Act that do not include a delayed effective date. Given the flexibility of the grandfather rule, the federal agencies invested with regulatory authority over the new law (specifically, the Internal Revenue Service, the Department of Labor, and the Department of Health and Human Services) are likely to issue guidance that places certain limits on grandfather protection.

Restrictions on "grandfathering" could force perhaps 80 percent of small businesses to drop their current health insurance plans within three years and either replace them with more expensive new plans or go without insurance altogether and pay the penalty, according to the National Federation of Independent Business.[6]

In 2013, two new Medicare taxes will reduce earnings for high-income individuals and small-business owners who report business income on their personal tax returns. The revenues from these two taxes will fund the Act's insurance expansion. A 0.9 percent payroll surtax will be levied on wage and salary income over $200,000 for single filers or $250,000 for joint filers, and a 3.8 percent tax will apply to some or all investment income of taxpayers whose modified adjusted gross income exceeds the same income thresholds. Investment income includes rents, dividends, interest, royalties, and capital gains on the sale of real property and securities.

Beginning in 2014, the practice of "medical underwriting," a process whereby insurers can deny coverage or charge higher premiums on the basis of an insured's health history, will be prohibited. The Act requires insurers to guarantee coverage to all applicants without exclusions for health history, so-called pre-existing health conditions. Further, it requires all plans selling individual or small group coverage to participate in a risk-adjustment system that applies to all insurance sold in these markets, including those sold in exchanges.

The risk-adjustment system collects funds from plans that have a disproportionately low-risk population (typically, young adults) and transfers

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[6] U.S. Department of the Treasury, U.S. Department of Labor, U.S. Department of Health and Human Services, "Interim Final Rules for Group Health Plans and Health Insurance Coverage Relating to Status as a Grandfathered Health Plan Under the Patient Protection and Affordable Care Act, *Federal Register*, Vol. 75, No. 116, Thursday, June 17, 2010.

these funds to plans that cover a disproportionately high-risk population. As the overall risk pool becomes more expensive, most small businesses will not escape the upward pressure on premiums.

The restaurant industry, which represents 23 percent of franchise businesses by number and 50 percent of franchise business employment, provides an example of how firms with seasonal, part-time employees, competitive environments, and low profit margins will face new challenges in connection with the provision of health insurance. Some restaurant owners are likely to drop existing coverage that no longer meets the requirements of the Act. Several restaurants received waivers from the Department of Health and Human Services in 2011, but these waivers will not continue into 2014, once the Act is fully phased in. Many restaurants will be penalized because their low-wage workers will choose to get subsidized coverage on the state exchanges.

For many businesses, the provisions in the Act are likely to have unintended consequences. The requirement that employers offer health insurance to workers or pay a fine will cause some employers to substitute capital for labor and more highly skilled workers for less skilled ones. Thus, instead of employing several low-wage workers, an employer might hire one highly skilled operator and one expensive piece of equipment, leading to reduced employment of unskilled workers.

These cost pressures will be exacerbated by the indirect effects of the reform. Small businesses will experience upward pressure on health insurance premiums, and they will need to form new benefit packages. Some businesses may choose to stop providing insurance altogether. Simply learning all the rules and regulations necessary to make these decisions will be a substantial hurdle for many small businesses.

Beginning in 2014, when implementation of the mandates take effect, the U.S. economy will see fundamental changes, affecting in varying degrees firms of all sizes.

The new law will have disparate effects on businesses depending on their number of employees, and on whether they are a single location or multiple locations. The effects are expected to be profound, particularly on small and medium size businesses, as the new statute brings additional regulatory burdens.

The new healthcare law has been written with the intention of expanding affordable healthcare coverage among the American population, but it is structured to shift the cost burden to employers. This will be accomplished by mandating that employers (with 50 or more employees) pay at least fifty percent

of their employees' insurance premiums, or pay a steep penalty. If a business has fewer than 25 employees and meets certain conditions, the law offers it tax incentives for contributing to its employees' health insurance plan.

Small businesses with 50 or more workers will incur higher costs of hiring and retaining workers. The largest employers might not experience such a big rise in their operating expenses as they already frequently provide healthcare benefits to some if not all of their employees. But small businesses with 50 or more employees that do not now offer healthcare benefits would see an abrupt and significant increase in their operating costs in 2014.

Businesses with 50 or more workers will not be eligible for a new small business tax credit which is part of the Act. Small businesses generally operate under low profit margins and cash reserves. Higher operating expenses (overhead) would likely impede future growth. Given the country's low GDP growth rate, below one percent at the time this paper went to press (September, 2011), and an unemployment rate of 9.1 percent, stagnation in the small business sector will have negative implications for the U.S. economy as a whole. With the new mandate for healthcare coverage, the cost of employer-sponsored benefits is likely to rise faster than real wages. In turn, there is likely to be little or no growth in the purchasing power of newly covered employees.

Effects of Reform on Franchising

The new health care law will have particularly negative effects on the collection of small businesses that make up the franchise industry. Many franchise businesses have total employment exceeding the 49-worker ceiling. Yet they compete against other businesses whose employment levels do not require them to offer health insurance. The law will result in fewer well-paying jobs in the industry as employers increasingly automate or change to part-time work.

With higher-skill jobs, employers can offer the required benefits and pay for them by adjusting wages. But low-wage jobs in some sectors, such as the restaurant and retail sectors, leave little room for cuts in wages. So firms will have an incentive to become more automated, or machinery-intensive - and hire fewer workers. For example, some retailers are already replacing cashiers with self-scanning machines.

Businesses must absorb temporary workers in the insurance pool, or they have to pay penalties, with the amount depending on the number of workers purchasing health insurance at the state exchange.

An estimated 828,000 franchise establishments in the U.S. accounted for more than $468 billion of GDP and more than 9 million jobs, based on PwC's report of 2007 Census data. When factoring the indirect effects, these franchise businesses accounted for more than $1.2 trillion of GDP – or nearly 10 percent of total non-farm GDP. Of franchise businesses, an estimated 77 percent were franchisee-owned and 23 percent were franchisor-owned.

Franchise businesses can be organized in many ways. In some cases the franchisor, or parent company, will own and operate locations while franchising others. In other cases, a franchisee will own a single location or "unit." In a third set of cases, a franchisee will own multiple locations, referred to as a "multi-unit franchisee". More than half of all franchise establishments are owned by multi-unit franchisees. In the cases where the franchisor and the franchisee own and operate multiple locations, these firms are treated as one company for tax and health care purposes. The new health care law would put many franchise businesses at a disadvantage relative to non-franchise competitors by driving up their operating costs. Many of these businesses would be subject to the $2,000 health care penalty if they do not provide health insurance. The multi-unit franchisees will have a particularly difficult time operating in this uneven business environment.

Suppose a multi-unit franchisee owns four establishments with 15 full-time employees each. Under the new health care law, this multi-unit franchisee will be treated as a single firm with 60 full-time employees, and the employer will be required by law to provide healthcare benefits for all employees or pay a fine of $2,000 per full-time employee per year.

However, if these four establishments were owned and operated separately, they would be exempt from the requirement of providing healthcare benefits. If these four separately-owned businesses choose to offer health insurance, they would in many cases be entitled to a tax credit.

On average, each franchise establishment employs nearly 10 workers. For purposes of this study, we estimate that multi-unit franchisees who own more than five establishments will be affected by the new law. As Table 1 shows, more than 5,000 multi-unit franchisees and more than 77,000 establishments would be affected by the healthcare law's employer mandate. It is very likely that the numbers are higher, because in many cases franchisees with only a few establishments have more than 50 full-time employees.

Table 1 Breakdown of Multi-Unit Franchises

Range of Establishments per multi-unit franchisee	Number of establishments	Average number of establishments per multi-unit franchisee	Number of multi-unit franchisees
2-5	65,800	3	21,900
6-10	28,800	8	3,600
11-25	21,000	18	1150
26-50	14,000	40	350
51-100	5,600	75	75
100+	11,200	149	75
Total	**146,400**		**27,150**

Source: IFA Educational Foundation

Hudson used survey data from the International Franchise Association from 15 franchise businesses for this report. These data were provided by IFA. The survey questionnaire had two parts. The first part asked questions in order to gather information about employment numbers, (number of full-time, part-time, and hourly employees), wage rates, extent of participation in the employer-sponsored healthcare plan, and employers' annual expenditure on healthcare benefits.

The second part sought attitudinal information, such as employers' perceptions about the effects of healthcare reform on the cost of running their business, their future business plans, and their post-2014 plans to offer healthcare benefits (or pay the penalty). The findings of the attitudinal survey are remarkable. The following section summarizes the survey responses.

Of the questionnaires sent to 20 franchise businesses, IFA received 17 responses, of which 15 were complete and were usable for the analysis. Among the 15 responses 6 businesses are franchisors, 8 are multi-unit franchisees, and one is a single-unit franchisee. The survey respondents were either owners of the businesses or primary decision-makers within the management.

To assess the effects of healthcare law on a particular business, we need to consider various operational characteristics of the business. Under the new law, the size of an establishment and average annual wage of the full-time employees are the two most important characteristics. Based on these two characteristics, all businesses can be categorized into three broad groups.

Group 1 – This group is made up of businesses with fewer than 25 full-time or full-time equivalent employees (120 hours per month of part-time work is considered a full-time employee). This group is eligible for

health care tax credits and to purchase subsidized plans through the state exchanges. To be eligible for the tax credit, the annual average earnings of the full-time employees must be less than $50,000 and the business must subsidize at least 50 percent of an employee's cost of coverage.

Group 2 – This group consists of businesses with 25 or more employees but fewer than 50 full-time or full-time equivalent employees. This group is not eligible for health care tax credits but these employers may purchase subsidized plans through state exchange.

Group 3 – This group, businesses with more than 49 full-time employees, is subject to the employer mandate (described below). Businesses in this group are not eligible for health care tax credits but may be eligible to purchase some group contracts through state exchange.

The new law's employer mandate and its effect on employment costs is our main focus in this paper, because this provision is likely to have the most significant effect on many franchise businesses. Businesses with more than 49 employees will be subject to penalties if they don't choose to offer healthcare benefits or if one or more employees receive subsidized insurance from state exchanges. Here is a summary of the conditions that will determine the size of any penalty.

A business will owe a penalty if it meets one of the following conditions:

1. If the business employs 50 or more full-time employees or full-time equivalent and it does not offer the right type of insurance. Each 120 hours per month of part-time labor will be counted as one full-time equivalent. The business owes $2,000 per worker on each full-time worker over 30 workers.
2. If the business offers suitable insurance, but the cost of the insurance is greater than 9.5 percent of the worker's household income. The business owes $3,000 per worker per year.

An employee is eligible to receive a premium credit if he satisfies two conditions:

1. The employee's household income is less than 400 percent of the federal poverty level (FPL), which is determined by income and household size.

Table 2 Health and Human Services (HHS) Poverty Guideline, 2011

Household Size	FPL	400% of FPL
1	$10,890	$43,560
2	$14,710	$58,840
3	$18,530	$74,120
4	$22,350	$89,400
5	$26,170	$104,680
6	$29,990	$119,960
7	$33,810	$135,240
8	$37,630	$150,520
For each additional person, add	$3,820	$15,280

Source: Federal Register, Vol. 76, No. 13, January 20, 2011, pp. 3637 - 3638

2. The employee's portion of the insurance premium exceeds 9.5 percent of the employee's household income.

If a business owes a penalty, the size of the penalty is calculated as follows:

1. If the business does not provide health insurance, its annual penalty equals the total number of full-time employees minus 30, multiplied by $2,000.
2. If the business does provide health insurance, its annual penalties equal the lesser of the number of subsidized employees multiplied by $3,000 or the total number of full-time employees – 30, multiplied by $2,000.

Seasonal employees, who work less than 120 days in a year, are excluded from the calculation of the employer mandate.

The Act's effect on the operations of a franchise business depends on the number of full- and part-time workers. Our analysis, set forth in detail in the Appendix, based on survey data from the franchise industry, shows that the Act offers incentives to hire fewer workers, particularly fewer full-time workers. Below are a few examples.

Consider a single-unit franchisee with fewer than 25 full-time equivalent workers. Details are given in Table A1 in the Appendix. The amount of money that the business receives as a tax credit under the Act increases if the business lowers the number of full-time workers and increases the number of part-time workers, keeping total hours of work unchanged. A business can keep wages and insurance premiums low and benefit from higher tax credits while keeping

the same level of productivity. The design of the tax credit in the Act gives small businesses an incentive to cut full-time positions and add part-time workers.

Even if small businesses were to take the tax credit, it does not provide employers with sufficient funds to offer health insurance to their employees. Table A2 shows that in the case of a firm with 11 full-time employees, thus qualifying for the credit, the available tax credit per employee would only be $177 per year. That is less than 2 percent of an average employer contribution for health insurance, $8,861 per year. Even with the tax credit, the employer's labor cost would increase by 20 percent.

If a business with over 49 workers drops health insurance coverage and chooses to pay the penalty, as is shown in Table A3 for a 60-worker firm, its costs decline. Using franchise industry data, the total cost per worker can be reduced by over $11,000, or 92 percent, by dropping health insurance.

What's surprising is the disincentive in the Act to hire additional workers. This is illustrated in Table A4. If a business does not offer health insurance, then, beginning 2014, it will be subject to a penalty if it employs more than 49 workers in all its establishments. For 49 workers, the penalty is 0. For 50 workers, the penalty is $40,000; for 75 workers, it is $90,000; and for 150 workers, the penalty is $240,000. Each time a franchise business adds another employee, the penalty rises.

On the other hand, as is shown in Table A6, businesses can reduce costs by hiring part-time workers instead of full-time workers. A firm with 85,000 full-time workers and 7,000 part-time workers that does not offer health insurance would pay a penalty of $170 million. By keeping the number of hours worked the same, and gradually reducing full-time workers and increasing part-time workers, until the firm reaches 17,000 full-time workers and 92,000 part-time workers, the penalty is reduced to $34 million. If the firm abandons full-time workers altogether, the penalty is reduced to zero.

Some single-unit franchisees could minimize cost by increasing part-time hourly workers, reducing the number of full-time workers, and dropping employer-provided health insurance. Even if businesses choose to offer health insurance to their full-time employees, the Act gives them an incentive to employ more part-time hourly workers than full-time workers in an effort to maximize tax benefits. If Congress leaves these incentives in place, the reduction in full-time employment would be costly to the economy.

In Table A7 we show the costs of the new health care law to the multi-unit franchise business. The multi-unit franchisees would face more than $3.5 billion

in penalties—penalties that could be reduced if firms switched from full-time to part-time workers. The costs would be highest in the quick service restaurant industry, with total penalties of more than $1.6 billion. More than 1.7 million full-time jobs are at risk in multi-unit franchisee businesses, with 820,000 jobs in the quick service industry.

Conclusions

Franchise businesses employ millions of full- and part-time workers. Only two of our sample of franchisors and franchisees interviewed in 2011 offered employer-sponsored health insurance to all their employees, including full-time and temporary workers.

The responses by the franchisors and franchisees participating in our study to questions about the effect of the healthcare law on their businesses were overwhelmingly negative.

Seventy-five percent of respondents expect the number of enrollments in employer-sponsored health care plans to increase when the Act takes effect. Twenty-five percent reported that it is likely that they will cut employer-sponsored health care coverage and the rest were either undecided or reported that it was not likely that they will drop the coverage. However, all respondents uniformly think that the health care law will significantly increase operating costs. This expectation has created significant uncertainty in their long-term growth and business planning. The results of our sample group were also mirrored by a survey of IFA members conducted in mid-August. The IFA survey found that four out of five executives (81.3%) have a "negative" or "very negative" view of health care reform and nearly four out of five (79.1%) believe their business costs will increase "significantly" or "very significantly".

Here are a few comments made by our survey respondents.

"There is a right and a wrong way to make corrections to any situation needing attention. However, the new reform laws are not what I would consider to be a concise, collective solution to meet the needs of the situation as a whole."

"Uncertainty of the cost impact of the reform on our business is unsettling. We voluntarily provide 50 percent premium benefit today to employees who choose to participate. The unknown of costs and mandatory participation in a plan where the effectiveness and efficiency will not be as strong as our current plan creates anxiety."

"Concerned with administrative and financial burdens on Employers."

"We unfortunately fall into the category of already doing things right - pay solid wages and pay large portions of premiums and get ZERO help from government. We get no reward for doing the right thing."

"Without knowing the costs or requirements we cannot plan for future growth."

"Healthcare reform will have a disproportionate impact on franchisees in our system."

The new healthcare law will encourage franchise businesses to reduce employment and to hire part-time rather than full-time workers. The sector will have incentives to stop expanding due to increased penalties. This is the wrong direction for our economy and for millions of unemployed Americans.

The mandate for businesses to offer health insurance should be repealed, along with the penalties for not doing so. In that way, franchise businesses can continue to grow and offer Americans products and services in an efficient manner.

What is clear is that the new health care law imposes additional cost and regulatory burdens on many franchise businesses, while creating a disadvantage compared to businesses with fewer than 50 employees. Many franchise businesses will react by employing fewer full-time workers and hiring more part-time workers in an effort to reduce their costs. This will have negative effects on employment in America, effects which America cannot now afford.

Table A1: Tax Credit Encourages Dropping Full-time Employees

	Avg. Annual Wage
Full-time Employees	$42,000
Part-Time Hourly Employees	$15,000
Average Premium Paid	$8,861

	Scenario 1*	Scenario 2	Scenario 3
Full-time Employees	15	11	3
Part-time Hourly Employees	3	8	18
Tax Credit in 2014 Per Participating Full-time Employee	0	$177	$2,658

*Base scenario

This case presents the effects of tax credit on the operating cost of a small business that offers health insurance coverage only to its full-time employees. Scenario 1 is the base scenario, which is based on the survey reporting. We vary the mix of full- and part-time employees in each scenario so that the level of total weekly labor hours stays at 522 hours.

By comparing the three scenarios, we observe that the amount of the tax credit in 2014 increases if the business lowers the number of full-time workers and increases the number of part-time workers. Thus, a business can keep its total contribution to insurance premium and average wage per worker low, while at the same time it can gain from the higher tax credit without compromising labor productivity. The new healthcare law gives them an incentive to cut full-time positions and hire more part-time hourly employees in an effort to maximize tax benefits. If full-time employment begins vanishing, this trend would prove very costly for the US economy.

Table A2: Tax Credit Not an Incentive for Small Businesses to Offer Employer-sponsored Coverage

	Scenario 1*	Scenario 2
Full-time Employees	11	11
Part-time Hourly Employees	8	8
Average Annual Wages Paid per Full-time Employee	$42,000	$42,000
Employer Contribution per Participating Full-time Employee	$0	$8,861
Tax Credit Per Participating Full-time Employee	$0	$177
Cost (Wage + Premium - Credit) per Participating Full-time Employee	$42,000	$50,684
Change of Cost per Participating Employee from the Base Scenario	-	$8,684
Percent Increase in Cost per Employee from the Base Scenario	-	20.1%

*Base scenario

Table A2 demonstrates that the tax credit would not provide small business employers with enough incentives to offer healthcare benefits to their employees. In this case the available tax credit per participating employee would only be $177, which is less than 2 percent of the additional cost of providing health care coverage for employees. This would not be sufficient incentive for employers to increase their labor cost for full-time employees by over 20 percent.

Table A3: Employer Penalty Provides Incentive to Drop Employer-Sponsored Coverage

	Scenario 1*	Scenario 2
Full-Time Employees	60	60
Employer Contribution per Participating Employee	$12,384	0
Total Premium	$743,040	0
Total Employer Mandate Penalty (2014)	0	$60,000**
Change in Total Cost (2014)	-	- $683,040
Change in Cost per Employee (2014)	-	- $11,384
Percent Change in Cost Per Employee (2014)	-	-91.93

*Base scenario

**The calculation is 60 full-time employees minus the exempted 30 full-time employees, and then multiplied by the $2,000 employer mandate penalty, for a total employer mandate penalty of $60,000.

Table A3 presents two scenarios for a business that has 60 employees and is deciding whether to offer health insurance to all employees. Scenario 1 is based on actual reporting in the survey.

Scenario 2 demonstrates that if the business drops employee health coverage completely and instead opts to pay the penalty, the business can save a substantial amount of operating costs compared to Scenario 1. The total cost per worker is reduced in this case by about $11,000, or 92 percent, by dropping the private health insurance. This decision is compounded when the employer faces increasing insurance premiums.

The data presented in this table suggest that in the face of rising insurance premiums, the Act will give an incentive to many businesses to drop employer-sponsored health insurance and pay the penalty instead.

Table A4: Disincentives for Growth

	Avg. Annual Wage
Full-time Employees	$40,000

	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Full-Time Employees	49*	50	75	100	150
2014 Penalty	$0	$40,000	$90,000	$140,000	$240,000
Change in Cost per Employee (2014)	$0	$800	$1,200	$1,400	$1,600
Percent Cost Increase Per Employee (2014)	0.0%	2.0%	3.0%	3.5%	4.0%

*Base scenario assumes that there are no part-time employees and therefore the employer mandate does not apply.

Table A4 presents the example of a business that employs full-time workers and does not offer employer-sponsored health insurance benefits to its employees. Under the new healthcare law, if a business does not offer health insurance coverage, it will be subject to a penalty if it employs more than 49 workers in all establishments. In 2014, such businesses employing 150 full-time workers will face a penalty of $240,000, which will contribute to an increase in costs per employee of 4 percent, without considering the additional administrative costs incurred.

Scenarios 2 through 4 demonstrate how, for firms that do not offer health insurance, the cost differentials increase with additional full-time workers through the $2,000 per worker penalty. Scenario 2 shows that adding one employee will cost a multi-unit franchisee with 49 employees a $40,000 penalty. Beyond this threshold, hiring of each full-time employee will add a penalty of $2,000. If we compare the scenarios, we find that the percentage increase in cost per employee rises with the number of full-time workers. Hence, the Act has created a substantial disincentive for businesses to expand their full-time workforce.

Table A5: Cost Savings from Dropping Employer-sponsored Coverage

	Scenario 1*	Scenario 2
Full-Time Employees	107,000	107,000
Premium per Full-Time Employee	$6,389	0
Number of Participating Employees (2014)	100,000	0
Number of Employees Receiving Subsidized Coverage on the State Exchanges (2014)	7,000	0
2014 Employer Mandate Penalty	$21,000,000**	$199,880,000***
Total Cost (2014) Premium + Penalty	$659,900,000	$199,880,000
Change in Total Cost (2014)	$21,000,000	- $439,020,000
Change of Cost per Employee (2014)	$196	- $4,103
Percent Change in Cost per Employee (2014)	0.47%	-9.75%

* Base scenario

** The calculation is 7,000 full-time employees multiplied by the $3,000 employer mandate penalty, for a total employer mandate penalty of $21,000,000.

*** The calculation is 107,000 full-time employees minus the exempted 30 full-time employees, and then multiplied by the $2,000 employer mandate penalty, for a total employer mandate penalty of $199,880,000.

In Table A5, scenario 2 demonstrates the cost outcome if the employer stops offering insurance all together and opts instead to pay the penalty. The cost per worker declines by about 10 percent, consistent with the previous cases.

Table A6: Cost Savings from Moving Workers from Full-time to Part-time

	Scenario 1*	Scenario 2	Scenario 3	Scenario 4	Scenario 5	Scenario 6
Full-time Employees	85,000	68,000	51,000	34,000	17,000	0
Part-time Hourly Employees	7,000	28,250	49,500	70,750	92,000	113,250
2014 Employer Mandate Penalty	$169,940,000	$135,940,000	$101,940,000	$67,940,000	$33,940,000	0
Change in Total Cost (2014)**	$169,940,000	-$113,593,500	-$397,135,500)	-$680,653,000	-$964,231,000	-$1,247,679,750
Percent Change in Cost per Employee	6.64%	-8.66%	-22.67%	-35.55%	-47.42%	-58.40%
Cost Per Labor Hour (2011)	$19.60	$19.60	$19.60	$19.60	$19.60	$19.60
Cost Per Labor Hour (2014)	$20.91	$18.73	$16.56	$14.39	$12.21	$10.04

* Base scenario

** The calculation is full-time employees minus the exempted 30 full-time employees, and then multiplied by the $2,000 employer mandate penalty.

In Table A6 we show, consistent with previous cases, that large businesses can dramatically minimize costs by increasing the number of part-time hourly workers and by reducing the number of full-time workers. The mix of employees in different scenarios is determined in such a way that the weekly labor hours stay the same in all scenarios. The presence of higher number of part-time workers is associated with a lower penalty, because penalties are not levied on part-time workers. Scenario 6 demonstrates that if all full-time workers are replaced by an equivalent number of part-time hourly workers, the business would not have to pay any penalty. That would decrease labor costs by 58 percent compared to Scenario 1 in this table. Moving from 7,000 to 113,250 part-time workers reduces labor cost per hour by over half, from $20.91 to $10.04.

Table A7: Estimated Effect of Healthcare Reform on Multi-Unit Franchise Businesses

Business Category	Jobs	Establishments	Employer Mandate Penalty	Full-time Jobs at risk
Quick service restaurants	1,174,957	62,404	$1,631,664,898	820,057
Table/Full Service restaurant	350,648	12,467	$557,958,133	279,746
Business services	306,658	49,474	$228,654,370	113,692
Lodging	318,159	11,976	$501,453,723	250,048
Personal services	294,945	66,584	$166,025,405	90,595
Retail food	159,901	19,961	$129,928,679	65,043
Real Estate	189,104	48,429	$102,037,036	52,421
Retail products and services	150,626	40,618	$80,171,475	40,025
Commercial and residential services	124,603	35,004	$65,120,442	32,619
Automotive	72,398	13,453	$42,741,404	21,360
All Multi-Unit Franchisees	**3,141,999**	**360,371**	**$3,505,755,565**	**1,765,607**

Source: IFA Educational Foundation, 2007 Economic Census, and Hudson Institute calculations.

Table A7 presents the estimated effect of healthcare reform on multi-unit businesses by industry. Our cost calculations show the total penalty faced by franchise businesses if they do not choose to offer health insurance when it becomes mandatory in 2014. The entire multi-unit franchise industry would face more than $3.5 billion in penalties. The costs would be highest for the quick service restaurant industry, the largest in the franchise industry in terms of both the number of workers and the number of establishments, encountering total employer mandate penalties of more than $1.6 billion.

As we have discussed earlier, under the new healthcare law, small businesses with 50 or more workers have an incentive to substitute part-time workers for full-time workers. The businesses might keep only 30 full-time workers, and supplement these positions with part-time workers. In order to estimate the overall effect on full-time employment in the multi-unit franchisee businesses, we calculate how many full-time positions are potentially at risk in each franchise industry. We find that more than 1.7 million full-time jobs are at risk across the entire industry, with 820,000 full-time jobs in the quick service restaurants industry.

Table A8: Estimated Effect of Healthcare Reform on IFA Franchisor Members

	0-2 Company Owned Locations	3-10 Company Owned Locations	11-50 Company Owned Locations	51-100 Company Owned Locations	101-250 Company Owned Locations	Over 250 Company Owned Locations	**Total**
No. of Members	628	188	127	37	38	63	**-**
Percent of Membership	58.1	17.4	11.7	3.4	3.5	5.8	**-**
Range of Employer Mandate Penalties per Franchisor	N/A	$42,000 - $280,000	$314,000 - $1.6 mil.	$1.7 mil. - $3.3 mil.	$3.4 mil. - $8.4 mil.	More than $8.5 mil.	**-**
Estimated Total Penalty Cost	None	$21,852,213	$99,146,867	$ 9,603,563	$206,824,837	$2,511,191,656	**$2,928,619,136**
Full Time Jobs at Risk	None	10,926	49,573	44,802	103,412	1,255,596	**1,464,310**

Source: IFA Educational Foundation, 2007 Economic Census, and Hudson Institute calculations.

Table A8 presents the estimated effect of healthcare reform on franchisor members of the IFA who have multiple company owned establishments. The modeling is based on IFA members only, which represents 81% of the total 108,340 franchisor owned establishments. Although this underestimates the effects on franchisor owned establishments it was done because there are no reliable estimates for the number of company owned establishments for franchisors that are not IFA members. We have found that the IFA franchisor members could pay over $2.9 billion in employer mandate penalties associated with the new Act, assuming they did not provide health insurance benefits. We find that approximately 1.5 million full-time jobs will be at risk.

Table A9: Estimated Effect of Healthcare Reform on the Franchise Industry

	Cost of Penalty	Jobs at Risk
Effect on Franchisees	$3,505,755,565	1,765,607
Effect on IFA Franchisor Members*	$2,928,619,136	1,464,310
Total Estimated Effect for Franchise Industry	**$6,434,374,701**	**3,229,917**

Source: IFA Educational Foundation, 2007 Economic Census, and Hudson Institute calculations.
*This is based on IFA members only, which represents only 81% of franchisor owned establishments (see Table A8 for a greater explanation).

Table A9 shows the estimated effect of healthcare reform on the entire franchise industry, which combines all multi-unit franchisees and franchisors. According to our estimation, the entire franchise industry could face approximately $6.4 billion in employer mandate penalties and could find more than 3.2 million full-time jobs at risk.

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