

The Impact of Minimum-Wage Increases on SME Survival Risk

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Abstract. The idea behind a minimum wage is to raise the income of those who earn it, but it also changes the costs faced by small and medium enterprises. This article reviews evidence on how increases in the wage floor affect the survival of smaller firms and how they respond. It synthesizes firm-level and worker-level evidence from the United Kingdom, Hungary, China, Germany, South Korea, and the United States, with emphasis on studies from 2022 to 2026. The evidence is organized around wage-cost exposure, prices, revenue, employment, productivity, profitability, business exit, and business entry. The review finds that the immediate impact is strongest for labour-intensive, financially constrained firms, where a large share of payroll is affected by wage increases and limited reserves restrict adjustment. However, not all effects are negative. Some firms offset higher costs through higher prices, retention, productivity gains, or revenue. Productivity, finance, demand, and the ability to pass costs to customers shape survival outcomes. In some contexts, less productive and very small firms are more likely to exit, while U.S. evidence suggests that reduced firm entry may matter more than incumbent exit. Higher wages can raise household income and demand, but high exit or low entry may weaken entrepreneurship, competition, and regional resilience. Minimum-wage increases therefore redistribute income and reallocate workers and market shares across firms. Policy should combine clear wage trajectories with measures that improve productivity and access to finance without supporting chronically unproductive enterprises.

Keywords: Minimum wage, Small and medium-sized enterprises, Survival risk, Business entry, Business exit

1. Introduction

The role of minimum wages is to set a legal bottom line for hourly wages. They safeguard the working poor, but wages are a significant expense for employers, thus affecting the income of the working poor, as well as employer finances. This link becomes all the more crucial for small and medium enterprise (SMEs). Ayyagari et al. reveal that small enterprises are responsible for employment and job creation in developing economies [1]. This therefore has an impact on jobs, competition, entrepreneurship and local resilience. It is not possible to understand the nature of wage regulation by looking at workers or at aggregate employment; the situation of employing firms is directly involved as well.

SMEs are not small companies! Small firms are more dependent on internal funds and have more financial constraints, find Beck et al. [2]. A higher wage floor is shown to have a greater impact on employment adjustments in constrained firms, as shown by Arabzadeh et al. [3]. Smaller businesses lack supplier leverage, fewer products or sites to spread costs over and less ability to fund technology. It is a particular problem in labour-intensive restaurants, retail, care and personal services, where wages are close to the minimum and a large proportion of the expenses is payroll.

The current notion that a higher minimum wage will inevitably lead to a loss of life is simply wrong. It increases the wages of covered workers, can help to lessen inequality and can decrease the cost of recruiting when workers stay longer. Coviello et al. demonstrate that productivity can be enhanced with higher wages [4]. There may be other local income sources that help to satisfy local demand. Firms can offset costs by reducing turn over, increasing their efforts, improving their services, increasing their outputs and/or increasing their sales. But benefits might come more slowly than payroll responsibilities. But if the firm cannot offset the rise he/she can increase prices, decrease hours, delay recruitment, decrease investment, or use working capital or exit.

This variation is shown in evidence. According to Draca et al. the minimum wage in Britain caused a rise in wage levels, but lowered the profitability of the exposed firms [5]. According to Harasztosi and Lindner [6], the Hungarian companies mostly shifted the price rise to the consumer and employment was only slightly affected. Mayneris et al. find a higher productivity and a greater exit rate for the weaker producers [7]. Dustmann et al. demonstrate that the German minimum wage drove low-paid workers out of smaller [8], less productive firms towards larger, more productive firms and contributed to the exit of smaller firms. Instead, Rao and Risch discover that independent business in the United States kept making profits despite an increase in revenues, but saw a decline in entry in exposed industries [9].

This paper is a review article and does not estimate an effect so there is no need to provide a comparison. It queries about the impact minimum wage hikes have on SME survival, finance, prices, employment, productivity, profits, entry/exit, and how firm reactions impact on the overall economy. The review fills a gap in the literature that focuses on either the aggregate level of employment or on the impact of the firm itself, potentially blurring the consequences of the transfer of workers and market share from smaller to larger firms. Section 2 categorises evidence by mechanism, outcome. Section 3 covers variations between companies and assesses impacts on income and job creation, competition and local resilience. The argument is that consequences will depend on the ability of the SMEs to absorb, transfer or offset the cost, and who are kept out of or stopped from entering the market.

2. Review of existing research

2.1. Review approach

A structured narrative review is used in the paper. It is recommended by Snyder when different types of evidence from different methods and settings have to be integrated conceptually [10]. In the spirit of transparency as advocated by Xiao and Watson [11], it emphasizes peer-reviewed research that is able to identify a change in the minimum wage or some other related wage-floor and report firm- or worker-level outcomes relevant to smaller firms. Outcomes are wages, finance, prices, revenue, employment, productivity, profits, entry and exit. The research of the last three years (2024-2026) has given special attention; older studies are kept for influencing causal evidence. Given the diversity of national definitions of SMEs, the review also takes into account small establishments, independent businesses and self-employed employers, albeit acknowledging that they cannot be

compared perfectly. This structure enables the comparison of mechanisms and not the country-by-country description.

2.2. Costs of wages and financial risks

A binding increase is one that provides a higher rate of pay to workers that are under the threshold. Cengiz et al. report significant increases in wages in jobs close to the new minimum wage [12]. Cost is based on number of employees covered, hours covered and the amount of the increase. When significant portions of the payroll are close to the minimum wage, labour-intensive SMEs are at risk. An extra few dollars that is small compared to a chain's turnover can eat up a lot of an independent restaurant's profit margin.

Direct coverage is an underestimate of wage pressure. Employers can increase rates for those that are above the minimum wage to maintain pay differentials for skill, tenure or responsibility. Harasztosi and Lindner report on wage impacts above the Hungarian minimum wage [6], and Rao and Risch report payroll impacts beyond the minimum-wage earning independent workers [9]. While this effect can help fairness and retention, the spillovers expand the wage-bill increase in size and require it to be dependent on the pay structure within the firm.

The key factor in the bill's threat to survival is its liquidity. Restricted small-firm finance is mentioned by Beck et al. [2], and employment adjustment is more pronounced for constrained employers, according to Arabzadeh et al. [3]. Chava et al. demonstrate how a uniform rise in minimum wages can produce stress on small business in the local context where the minimum wage is binding [13]. Wages come first before prices, productivity or sales generate cash, and fragile reserves might be an incentive for viable SMEs to cut hours, delay purchases or even raid owners' pockets.

Draca et al. [5] identify lower profits in the affected UK firms that do not immediately fail as do Mayneris et al. who identify higher exit rates in the less productive Chinese firms [7]. So lower profits are a consequence, not, necessarily, closure. Persistence of the shock, initial margins, liquidity and alternative responses are key to survival. In general, larger companies are more likely to have more reserves, more diverse product lines, better credit, and the financial resources to fund labor-saving equipment. However, as the adjustment space shrinks, SMEs might be more inclined to fall into cost exposure and thus financial vulnerability.

2.3. Firm adjustment strategies

Any wage bill increase is passed on to consumers as prices. The conclusion of Harasztosi and Lindner is that prices bore the brunt of adjustment in Hungary [6]. Link similarly reports that German companies responded with both price and employment adjustments [14]. Pass-through is easier when there is a same rule with strong demand and the competition is present. This is difficult for SMEs selling standardised products and/or which are in competition with chains and/or with price-sensitive customers. Hence, limited pricing power will lead to more absorption through profits or operational savings.

There is a possibility that higher prices will lead to higher revenues. Overall, Rao and Risch conclude [9], incumbent U.S. independent firms paid higher, increased revenues and maintained profits. Revenue can be a result of prices, sales volume and improved performance and a higher wage bill does not necessarily result in lower owner returns. But that's the result of survivors – not all weak or potential businesses. Firms that do not make money can either close, or not open, which accounts for some of the positive incumbent averages.

When it comes to employment adjustments, it's not just headcount. Companies can cut back on hours, overtime, unfilled positions, postponing hiring or altering positions. Cengiz et al. conclude that losses below new wage thresholds had a wide offset by gains at and above new wage thresholds [12]. Kunaschk reports negligible total employment effects [15], but movement from marginal to regular jobs in German hairdressing. This can therefore result in restructuring going unnoticed, as it is underpinned by stable employment. Less time spent or quicker hiring saves cash and better retention as reported by Rao and Risch saves the cash for repeating recruitment [9].

Productivity shifts happen at the firm level and via reallocation of firms. Coviello et al. report that in a large retailer [4], the individual productivity was higher after wage increases, which might not be the case for SMEs. Mayneris et al. and Dustmann et al. document positive productivity effects among Chinese survivors and a shift towards more productive German establishments, respectively [7, 8]. In SMEs retention helps to hold on to experience and can enhance service. Owners can redistribute work, re-educate staff or automate repetitive work, but smaller, less financially well-resourced businesses might not have the funds for technology.

There are further margins from profit and non-labour costs. Draca et al. present evidence that firms start absorbing wages by reducing their profitability [5]. Alternatively SMEs can reduce marketing, maintenance, hours, investment or owner income. Such options maintain existing activities, and may compromise future productivity. Working capital may be able to fill the gap for a short time, but not for an ongoing expansion. Link and Rao and Risch suggest that firms engage in a combination of responses, with immediate absorption, pricing, redesign and, for some, exit [9, 14].

2.4. Survival, entry and exit

The distribution of exit risk is concentrated in firms with low productivity, thin margins and poor finance. Mayneris et al. report that Chinese firms with below-average productivity levels were more likely to exit after the minimum-wage hikes [7], and increased their productivity levels after surviving. A wage floor can thus eliminate firms whose revenue per worker is less than the required wage.

Dustmann et al. find related German reallocation [8]. Low paid workers shifted from less productive small establishments to larger more productive establishments and very small establishments had higher exit in the exposed regions. As an industry changes business structure, aggregate employment may stay unchanged. Workers can benefit from growing local ownership.

Ahn finds that overall, there was little effect on self-employment in South Korea, although the effect was more powerful for owners employing workers than for own-account workers [16]. Lu et al. report that higher Chinese labour costs drove a higher rate of exit of foreign firms that were motivated to produce at low costs but not market linked firms [17]. Lu et al. confirm the significance of business model and pricing power, though it's not SME-specific.

Exit differs from reduced entry. There is little average impact on incumbent United States business exit but a 1.5-2 per cent decrease in the number of firms, primarily due to a reduction in entry in exposed industries, according to Rao and Risch [9]. Kuroki finds a negative relationship with non-employer entrepreneurship that is delayed [18]. Entrants do not have customers, revenues and experience, and anticipated payrolls can hinder opening even if incumbents make adjustments.

Restaurants, retail, hairdressing and personal services are characterized by low paid work and immobile production and competition. Kunaschk indicates that changes in job composition do not necessarily result in a reduction in the total employment [15], and Chava et al. indicate that changes in the local exposure affect stress [13]. An increase in the wage floor can make the productive survivors stick around, and can increase their revenues, but can also push the less productive firms

out and act as a deterrent to new entrants. These outcomes and channels for adjustment are compared in Table 1. It also distinguishes between a quick closure and the postpone of the discounting of potential competitors.

Table 1. International evidence on minimum wages and firm outcomes

Country / setting	Study	Main firm response	Survival implication
United Kingdom	Draca et al. [5]	Pay increased; profits fell	Pressure absorbed by affected incumbents
Hungary	Harasztosi and Lindner [6]	Prices carried much of the cost	Limited employment loss
China	Mayneris et al. [7]; Lu et al. [17]	Productivity adjustment and selective exit	Weaker or cost-driven firms were more vulnerable
Germany	Dustmann et al. [8]; Link [14]; Kunaschk [15]	Pricing, job restructuring and worker reallocation	Greater pressure on very small establishments
South Korea	Ahn [16]	Different effects by self-employment type	More closure among owners with employees
United States	Rao and Risch [9]; Kuroki [18]	Revenue and retention among incumbents; lower entry	Entry effects stronger than average incumbent exit

2.5. Cross-study synthesis

The studies fail to make a blanket assumption that a higher minimum wage will kill SMEs or that it will have no impact on them. Draca et al. find profit absorption [5]; Harasztosi and Lindner and Link find price adjustment [6, 14]; Mayneris et al. and Dustmann et al. find productivity-enhancing reallocation and selective exit [7, 8]; and Rao and Risch find revenue, retention and lower entry [9]. The common conclusion is that the initial wage shock is shared among owners, customers, workers and potential entrepreneurs. The financing and productivity, competition and demand, it is borne most of by which group?

3. Discussion

3.1. Why survival effects differ

There is no one SME survival effect when the minimum wage is raised. Risk is dependent upon exposure and adaptive capacity. The more employees that can be moved toward the lower end of the wage spectrum, the more exposure will be gained, and their wage and hour exposure will extend beyond the threshold level. Productivity, reserves, credit, pricing power and demand are the factors that affect adaptive capacity. Finance and local situations are important as the same legal rate can be a different proportion of revenue, and it may only be one business with the resources to make the adjustment, as demonstrated by Arabzadeh et al. [3] and Chava et al. [13].

Apparently contradictory results are explained by timing and measurements. Unlike the results of Draca et al. who find that profits fall but firms do not immediately exit [5], Mayneris et al. detect selective disappearance of weaker firms [7]. Later on, perhaps, short-run profit absorption will be replaced by prices, investment or closure. Rao and Risch report fairly stable incumbent survival and less entry [9]. This can result in adaptation in a study of employers, and market data may report fewer new employers. Employment can also stay stable while Dustmann et al. witness workers

relocating from small firms to large firms. Headcount, ownership and concentration are different results [8].

Quality of firm is key, however must be done with care. Failing or unproductive businesses may free up workers and capital to be used more productively, increasing efficiency. However, low productivity may be due to location, customers or a labour intensive service and not poor management. A rural retailer might add value not reflected in revenue per worker, such as a local care provider. The evidence is not in favour of providing blanket protection to SMEs nor is it showing that the loss of SMEs is not of importance. Policy needs to differentiate those firms that are viable but constrained from the firms that are not viable to pay the required wage.

3.2. Effects on the broader economy

Workers are the first to feel the effects of a wider. An increase in the hourly wage increases the income of those who keep their jobs and can help to decrease inequality. Going by Dube minimum wage boosts the incomes of the poorest families on the family-income distribution and lowers the poverty rate at the bottom of the distribution (among non-elderly) [19]. As Ralph and Risch have pointed out, extra expenditure can boost the demand for local products and services [9], thus providing some of the wage cost to SMEs as revenue. The amount of the gain, however, is contingent upon employment, hours, and price and household expenditures.

SMEs link the household income with employment and entrepreneurship. They offer entry-level jobs, local services and opportunities to own. With better wages, companies get more experienced workers and households get more stable incomes, and retention and effort are better. When adjustment causes a decrease in hours, hiring or survival, the distributional gain is reduced. Cost of entry is important as it adds up. Rao and Risch and Kuroki suggest a decrease in the number of potential employers [9, 18], less experimentation and fewer jobs created even if the size of closures is restricted.

The other trade-off created is reallocation. Dustmann et al. propose that workers who move to firms with higher productivity could lead to higher efficiency and worker/firm matches [8]. Mayneris et al. also relate the wage floor to an increase in productivity of the survivors [7]. However, markets may become more concentrated and competition may decrease if market participants and workers concentrate in large chains. Large companies are able to amortize compliance and technology costs across more sales and have an edge that is independent of service. Independent stores, supply chains and job opportunities are lost to the community, especially if replacement positions are located elsewhere or different skills are needed.

3.3. Policy implications

The wage objective should be protected by policy, with a focus on minimizing failures in the transition process that would otherwise be avoidable. Phased increases allow companies time to make changes to prices, contracts and staffing and investment levels. Temporary working-capital finance can be used to provide a lifeline for viable SMEs as they wait for increased payrolls to match improvements in their revenue, and productivity support can enhance their scheduling, training and appropriate technology. The assistance must be targeted, and time limited, in order to avoid a permanent subsidy for permanently unproductive models and to ensure the legal wage is not undermined.

Beyond employment counts must be included in the evaluation. The hours, earnings, retention, SME profits, arrears, entry and exit and concentration by size, sector and region should be tracked

by governments. The difference between Ahn and Link illustrates the national average masking vulnerable types of employers [14, 16], while the difference between Ahn [16] and Lu et al. [17] and between Link [14] and Kuroki [18] illustrates the same about the masking of delayed effects. Assessment should include such questions as: What companies are available for jobs that remain, do new companies emerge, are wages paid for by productivity and demand, or by working capital depletion?

4. Conclusion

The idea of minimum wages is an income policy as well as a change in firms' costs. There are not one single employment figure that can represent their impact on SME survival. The wage bill grows the most in labour-intensive industries and there are pay spillovers to workers not covered. SMEs are at risk if low productivity, low margins, limited reserves and restricted credit are not able to soak up the adjustment in prices, productivity and sales.

The evidence, however, refutes two assumptions about closure: that higher wages automatically result in widespread closure. There are a number of ways in which firms share the costs: they can increase prices, redesign jobs, cut hours or delay hiring or firing, or keep people on their payroll, which can lead to increased productivity and revenue. Draca et al. conclude that the profits of lower British companies are lowered; Harasztosi and Lindner stress the Hungarian price adjustment; Mayneris et al. and Dustmann et al. take a stance on selective exit and reallocation; and Rao and Risch find that the United States incumbents maintain their profits and that the entry decreases. When incumbent exit is stable, entry reduction is of importance for survival.

At the macroeconomic level, rising earnings can lead to a decrease in inequality, an increase in household spending and an improvement in job quality. However, high levels of exit or low levels of entry can lead to less entrepreneurship, competition and resilience in regions and the movement to larger firms. Viability of SMEs can be supported by predictable implementation, and temporary finance and productivity support. Research has to be continued in the future, with a longer time frame for firms, and with a distinction between closure and reduced entry, and a comparison of the results by size, sector and region. The connection between worker gains and firm dynamics is crucial to determine when an increase in wage floors is in the service of inclusive growth and when it is not without risk, or is so risky that it cannot be sustained.

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