7-Eleven Inc.: The Fine Line Between Franchise Independence and Interdependence

Case

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Region: Northern America | State:

Industry: Retail trade, except of motor vehicles and motorcycles

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Abstract

On June 17, 2013, federal agents from the Immigration and Customs Enforcement Agency (ICE) seized fourteen 7-Eleven franchised stores that were responsible for running what the authorities described as a “modern day plantation” ring. The owners of these franchises were suspected of recruiting more than 50 illegal immigrants, working those employees approximately 100 hours a week, siphoning their pay, and forcing them to live in “unregulated boarding houses.” The case focuses on 7-Eleven Inc.’s response and how the company sought to distance itself from individual franchise holders.

Case

The Raids

On June 17, 2013, federal agents from the Immigration and Customs Enforcement Agency (ICE) seized fourteen 7-Eleven franchised stores that were responsible for running what the authorities described as a “modern day plantation” ring. The owners of these franchises were suspected of recruiting more than 50 illegal immigrants, working those employees approximately 100 hours a week, siphoning their pay, and forcing them to live in “unregulated boarding houses.” In response to the raid, 7-Eleven Inc. declared that they would “take aggressive actions to audit the employment status of all its franchisees’ employees (and) pledged full cooperation with the federal probe.”

On January 11, 2018, ICE agents conducted a second raid on approximately 100 7-Eleven stores, resulting in 21 additional arrests. According to CSP Magazine, a prominent trade publication for the convenience and petroleum retailing industry, the second raid was a:

“Round of notices intended as a follow-up to ensure proper steps are taken toward more responsible hiring and employment practices, ICE said. Neither Irving, Texas-based 7-Eleven Inc. nor its parent company, Tokyo-based Seven & i Holding Co. Ltd., was charged in that case. 7-Eleven has more than 8,300 c-stores in the United States.”

In response to the 2018 raid, 7-Eleven Inc. “issued a statement saying that the company is not responsible for individual franchise owners’ hiring decisions.”

These raids are two of the largest federal cases brought against 7-Eleven franchises in recent history, and are two symptoms of a conflicting relationship between 7-Eleven Inc. and 7-Eleven franchises.

Seven & i Holdings, Co. Ltd.

Formerly the Southland Ice Company, 7-Eleven Inc. was established in 1927, at which time they primarily sold block ice for food preservation. Following the Great Depression, the company emerged from bankruptcy with a new emphasis on food and drink. A licensing agreement with a Japanese affiliate further expanded their purview to the automobile industry.

After years of successful expansion through franchising, Southland Corporation faced major threats of a ru-
mored corporate takeover. This prompted the then-CEO to complete a buyout of the company that plunged the firm into crippling debt. A decade of downsizing ceased when Japanese entities Ito-Yokado and Seven-Eleven Japan provided the capital needed to continue operations.\(^6\) The Southland Corporation changed its name to 7-Eleven, Inc., divesting in all operations other than 7-Eleven. In 2005, 7-Eleven, Inc. became a wholly-owned subsidiary under the holdings company Seven & i Holdings, Co., Ltd. formed by Ito-Yokado.\(^7\)

**7-Eleven Inc.**

Best known for its iconic Slurpee and Big Gulp dispensed beverages, 7-Eleven Inc. operated 8,273 stores in the United States as of 2016.\(^6\) The convenience store defines its competitive advantage as “Retailer Initiative,” allowing a store operator to align product assortment with the store’s customer preference.\(^9\) This allows customization of product mix in various stores across the nation. 7-Eleven consistently maintains a presence at the top of league tables, ranking first among the top 202 convenience stores\(^10\) and second on the Franchise 500 list in 2018.\(^11\) While the latter ranking simply looks at the store count, the former applies various considerations such as cost and fees, size and growth, support, brand strength, and financial strength and stability. Year-after-year, 7-Eleven continues to place high in various rankings and ratings for best franchises, convenience stores, brand, and global retail.

According to the 2017 financial statements, the company saw an increase in EPS between 2016 and 2017 from $9.46 to $29.83, largely due to the increase in non-operating income.\(^12\) This increase, however, came primarily from the disposal of Starbucks Shanghai. Regardless of this gain, 7-Eleven consistently sees stable income year-to-year with net income of approximately $32 million in 2017, $11 million in 2016, and $9.5 million in 2015. Year-over-year, 7-Eleven boasts steady growth in revenue and strong financial performance.

**Franchise Agreements**

Retail outlets brands such as convenience stores, quick service restaurants, and hotels traditionally operate as franchises, an arrangement in which the parent corporation provides permission for a local owner to use the corporation’s name, brand image, and products. A franchise is either owned as a corporate entity, sole proprietorship, limited liability company (LLC) or other business structure. 7-Eleven, Inc., as a sole proprietorship of Seven & i Holdings, Co., considers its franchise operators “independent contractors.”\(^13\)

Under a franchise arrangement, a person or company purchases the legal right to run a local business under a larger company’s brand. Depending on the arrangement, the local party may be required to meet certain standards and purchase products from the parent corporation. For example, a local quick service restaurant is likely owned by a local or regional company and operated under a franchise arrangement with a national or international organization. The franchisor owns the rights to the brand and experience of the franchise, such as product offerings, employee uniforms, trade dress, advertising and operations manuals.

Franchises can be owned by any type of business structure, with a corporation being the most prevalent. A corporation traditionally offers liability protection for its owners, called shareholders. Corporations must register with their state’s business registration office and file annual reports. They must also hold periodic shareholder meetings and keep records as required by state and federal law. Franchises can also be owned by other business structures, including an LLC. Such entities also offer many of the same liability protections as corporations, but generally require less paperwork. See Table 1 for a comparative list of franchises across North America.
### Table 1: Franchise Comparison

<table>
<thead>
<tr>
<th>Franchise</th>
<th># of Stores</th>
<th>Cost to open franchise</th>
<th>Scope of Operations</th>
<th>Parent Company</th>
<th>Value Proposition</th>
</tr>
</thead>
<tbody>
<tr>
<td>7-Eleven</td>
<td>66,000</td>
<td>$37,200–$1.6 Million</td>
<td>International – 17 Countries</td>
<td>7 &amp; i-Holdings, Co.</td>
<td>Availability, consistency in experience and 24/7 convenience</td>
</tr>
<tr>
<td>McDonalds</td>
<td>29,544</td>
<td>$1 Million–$2.3 million</td>
<td>International – 119 countries</td>
<td>McDonald’s Corporation</td>
<td>Availability and consistency in experience</td>
</tr>
<tr>
<td>Circle K</td>
<td>5,063</td>
<td>$211,500 to $1.6 million</td>
<td>International – 30 countries</td>
<td>Circle K Stores</td>
<td>Regional and local customization</td>
</tr>
<tr>
<td>Anytime Fitness</td>
<td>2,885</td>
<td>$78,700–$371,000</td>
<td>International – 30 countries</td>
<td>Self-Esteem Brands, LLC</td>
<td>24/7 convenience</td>
</tr>
</tbody>
</table>


7-Eleven has nearly 66,000 franchises, each of which cost between $37,200 and $1.6 Million to operate. Well established and recognized internationally, 7-Eleven prioritizes a franchise agreement that ensures consistency among the tens of thousands of franchises around the globe. This consistency includes store offerings (traditionally standardized on the national level), store hours, and branding. “Most franchise systems,” according to *Business Insider*, “require royalty payments based on a percentage of sales. With the 7-Eleven system, franchisees pay royalties based on the store’s gross profit, that is, net sales receipts less the wholesale cost of the merchandise sold.” This distinctive business and sales model has proven to be highly successful for 7-Eleven and continues to attract customers.

### 7-Eleven Franchise Agreement & Terms of Operation

The standard franchise agreement requires strict adherence to policies that assure strict internal controls of financial information and brand design equities. This includes the requirement to exclusively use 7-Eleven owned and branded IT systems to conduct operations and furnish all forms related to pertinent bookkeeping, including daily summaries of purchases, daily reports of receipts, time and wage authorizations, actuals sales, and related data. Franchisees are also required to submit to at least one audit each calendar quarter or in any other three month period. Outside of the periodic audit, the agreement places special emphasis on the preparation and service of food. Franchisees must agree to operate the Store, including the Foodservice Facility, at all times in compliance with the 7-Eleven Foodservice Standards and in compliance with all applicable laws, regulations and codes, including the U.S. Food & Drug Administration Model Food Code.

7-Eleven’s franchise agreement places clear emphasis on what franchises cannot and are not in their rights to do. Notably, the agreement forbids franchises to operate less than 24 hours a day unless prohibited by law or unique local/environmental circumstances. Keeping in line with strict internal controls regulating the compa-
ny brand, franchisees may not alter, modify, or add to the store or equipment. The agreement further forbids use or claim any right to 7-Eleven trademarks, marketing materials, or programs in addition to any proprietary claim or right to use or ownership of 7-Eleven Systems or IT systems. 

The franchise agreement does not dictate specific safety requirements (outside of food practices) or hiring practices for the franchisee. Franchise operators are left to determine individual policy around hiring and safety, and must use State and Federal law to guide decision making (i.e. minimum wage laws, and guidelines set for by the Occupational Health and Safety Administration).

In 2018, 7-Eleven Inc. revised its standard franchise agreement, which approximately 19 percent of franchisees must sign by March 2019, with the majority of all franchisees signing before the year 2025. According to the National Coalition of Associations of 7-Eleven Franchises (NCASEF), this dictates an increase in the owed amount of franchise profit to the parent company, an increase to store-level operating costs, and a requirement that stores stay open on Christmas Day. To date, the NCASEF is composed of 44 Franchise Owners Associations across North America, each representing between 15 and 400 7-Eleven franchise members.

Similar Industry Trends

Undocumented workers are fairly common across the hospitality industry, and industry experts estimate that over 10% of employees across the restaurant subsection of the industry do not have proper legal documentation for U.S. employment. Similarly, over 13% of employees in the Agricultural industry are estimated to be undocumented, which is why the industry was targeted by ICE raids in January of 2018.

These industries, among others, are known for their difficulty in retaining employees because of strenuous work requirements, often accompanied by a minimum wage salary. The United States has a Temporary Foreign Worker Program, and offers H2B visas specifically for temporary or seasonal workers in industries other than agriculture, but these visas include numerous restrictions as well as an annual cap on the number of workers. Hospitality industry specialists estimate that 7-Eleven “has (only) filed 11 labor condition applications for H1B visa and 8 labor certifications for green cards from fiscal year 2015 to 2017.”

7-Eleven Inc. is not the only franchised corporation that has had difficulty with employment processes reported in the media. They are, however, unique in that legal accountability and responsibility rests solely on the franchises. According to Reuters.com, in July of 2018, McDonald’s Corporation tried settling a case on “alleged labor law violations by franchisees across the country” and the company’s proposal was rejected by a U.S. labor board judge.

The Relationship Between Franchises and 7-Eleven Inc.

Immediately following each of the immigration raids, 7-Eleven Inc. regained control of the franchises. In a public statement issued by corporate headquarters, the company said: “7-Eleven is determined to protect our guests, employees and other franchisees by ending the relationship with franchisees that violate the law or the franchise agreement, where appropriate. The company is confident in the thorough and lawful system that it has in place to accomplish this.” Once the parent organization regained control, they assumed future responsibility for the stores, while maintaining that the franchises had sole responsibility for the original hiring decisions.
When the franchises are held responsible for their actions by federal authorities, the resulting statements by 7-Eleven corporate reflect a relationship that seemingly places all legal responsibility on the franchisees. However, according to Franchise City, “The 7-11 business model has been considered by many as an employee/employer relationship rather than franchisor/franchisee.” 26 In March of 2018, this relationship perception was taken to court in Haitayan vs. 7-Eleven Inc., with the presiding judge declaring that:

“The court concludes that plaintiffs have not demonstrated that 7-Eleven exercised the type or degree of control necessary to create an employment relationship between the parties … . In addition, the court concludes that the other factors relevant to the issue of whether an employment relationship exists under the FLSA (the Fair Labor Standards Act) weigh heavily in 7-Eleven’s favor.” 27

The Decision

By redrafting franchise agreements after major federal criminal activity continues across 7-Eleven Franchises, is 7-Eleven Inc. showing more or less responsibility for the actions of its franchises? As a key decision maker, CEO Joseph Michael DePinto has the opportunity and, perhaps, the responsibility to clearly delineate the legal relationship between franchisees and 7-Eleven Inc., and to resolve tension between franchisees and the parent company. 28

Discussion Questions

1. Who are the responsible stakeholders in this case?
2. What policies should be included or changed in the franchise agreements to hold the franchises responsible?
3. What steps should 7-Eleven take to protect their brand and reputation?
4. From a resource standpoint, is it reasonable for the 7-Eleven corporate headquarters to monitor all franchisees?
5. Does 7-Eleven have an issue with corporate disassociation? If so, how can they remedy that? If not, why not?
6. What role does the government play in this case? How should 7-Eleven manage government relations?

Writing Assignment

Please respond in writing to the issues presented in this case by preparing two documents: a communication strategy memo and a professional business letter.

In preparing these documents, you may assume one of two roles: you may identify yourself as a C-Suite executive at 7-Eleven Inc. who has been asked to provide advice to CEO Joseph Michael DePinto regarding the tension with 7-Eleven franchises. Or, you may identify yourself as a 7-Eleven franchise owner who is preparing recommendations for the upcoming National Coalition Board of Directors Meeting of the National Board.

Either way, you must prepare a strategy memo addressed to Joseph Michael DePinto, Chief Executive Officer of the company, that summarizes the details of the case, identifies critical issues, discusses their implications (what they mean and why they matter), offers specific recommendations for action (assigning ownership and suspense dates for each), and shows how to communicate the solution to all who are affected by the recommendations.
You must also prepare a professional business letter for Mr. DePinto’s signature. That document should be addressed to all 7-Eleven Inc. employees and franchises, explaining the actions the company is taking. If you have questions about either of these documents, please consult your instructor.

**References**


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