Columbia Business School

The New 7-Eleven

I've got a great opportunity. I'm transforming a brand with 75 years of history.
- Jim Keyes, CEO, 7-Eleven

Jim Keyes, the 4-year veteran CEO of 7-Eleven, is flying his Beechcraft A36 Bonanza. He is ascending to 10,000 feet, and despite the good weather he remains vigilantly focused on the instrument panel, and on the bright skies around him. "Flying is a great distraction," he says. "You can't think about anything else when you're in the cockpit."

It is May 2004, and Keyes has a lot to think about. Since 2000, he has been leading a successful transformation of 7-Eleven, the global convenience store retailer with 5,784 stores operating across the United States and Canada and 19,501 international stores in 17 countries. (See **Exhibit 1** for a biography of Keyes.) Focusing on what he calls "Retailer Initiative," Keyes has overseen the transformation of the company's distribution model, the steady redefinition of relationships with key suppliers, and the incorporation of technology and data-driven decision-making throughout the chain. Overall, he is pleased with the successes of his strategies. Earnings have been rising, up 15.6 percent during 2003.[1] Same-store merchandise sales have increased for 29 consecutive quarters through the end of 2003.[2] As a result, the company's stock price grew from $9.14 in April 2002 to $16.91 two years later. (See **Exhibits 2 to 5** for company financials and stock price history.) "We've had quite a rebirth of the company," Keyes says, "but it's been a slow, steady rebuilding of the company, basically reinventing ourselves."[3]

Despite his many successes, Keyes continues to confront large challenges. He faces strong resistance from some of his largest suppliers to 7-Eleven's evolving re-stocking and distribution systems. He also worries about people management issues: hiring and managing a workforce in the low-paid convenience store business; and working with franchisees to ensure implementation of key corporate initiatives. In addition, Keyes must manage the chain's increasing international expansion and its efforts to reposition the 7-Eleven brand in the highly fragmented domestic convenience store industry.

This case was prepared in May 2004 by Eleanor Broad (MBA '05), Paul Kihn (MBA '04) and Steven Schneider (MBA '04) under the supervision of Professor Alan Kane as the basis for class discussion, rather than to illustrate either effective or ineffective handling of a strategic situation.

[1] 7-Eleven, Form 8-K, January 29, 2004.
[2] 7-Eleven, 2003 Annual Report; 7-Eleven Q4 2003 Earnings Conference Call.
[3] Interview with Jim Keyes; Yahoo Finance.

Keyes levels off at his cruising altitude. Despite the clarity of the day, he feels some turbulence and wonders what corrective action he should take.

Convenience Store Industry

The convenience store industry represented approximately $290.6 billion in total sales in 2002, 62.4 percent of which were motor-fuels sales.[4] The industry differentiates itself through convenience – of location and product offerings – and speed of service.[5]

Historically the industry has been highly fragmented and very competitive with low barriers to entry. Single store companies account for 60 percent of the 132,000 convenience stores across the U.S.[6] There are also 100,000 combination convenience-store/gas stations owned by major oil companies which are run by a network of independent dealers and distributors. 7-Eleven, with 4 percent of the total U.S. market, remains the largest corporate entity in the convenience store industry.[7]

Most of 7-Eleven's direct competitors are regional convenience store chains. Circle K has 2,000 stores in the South and Southwest, Casey's General Stores operates 1,800 in the Midwest and The Pantry has 1,400 stores in the Southeast.

Inefficient supply chains and "high-low pricing"[8] also characterize the industry, according to Keyes. Stores need to stock very wide but shallow product assortments. For example, an individual store may keep only four bottles of ketchup on hand at any given time.

Since 1999 the industry has been undergoing a structural transformation with consolidation occurring through acquisitions and a number of bankruptcies among the smaller regional chains. In December 2003, Circle K was sold to Canada's largest convenience store chain, Couche Tard. In 2004 the Midwestern chain Hale Halsell, the parent company of Oklahoma based 115-store convenience retailer Git-n-Go, declared bankruptcy. In March 2004, Kansas-based Sav-A-Trip announced it was entering Chapter 11.[9] Despite these changes, one-store companies continued to gain market share, up five percent from 2001 to 2002.[10]

[4] National Association of Convenience Stores.
[5] Southwest Securities, 7-Eleven Inc., June 11, 2003.
[6] National Association of Convenience Stores
[7] Southwest Securities, 7-Eleven Inc., June 11, 2003.
[8] Jim Keyes, Columbia Class Video, February 6, 2002. "High-low" refers to convenience stores charging customers above average prices for products, in exchange for convenience, while discounting other products (like gasoline, cigarettes, beer and soft drinks).
[9] *Progressive Grocer*, March 26, 2004.
[10] Southwest Securities, 7-Eleven Inc., June 11, 2003.

Overall, the convenience store industry was facing increasing challenges. According to an industry report published in May 2003:

> The convenience store sector is poised for drastic change as players respond to depressed profit margins and intensified competition. Profitability and survival will depend on the ability of convenience store operators to offer value-added benefits to their convenience services, either by targeting the emotional needs of consumers or by adopting niche operating strategies.[11]

Company Background

The 7-Eleven chain was born in 1927 as the Southland Ice Company in Dallas, Texas. From this single location it soon began operating convenience stores under the name Tote'm. In 1946, it changed its store names to 7-Eleven to reflect their new, extended hours of operation from 7 a.m. to 11 p.m.[12] The chain continued to expand rapidly, adding gas stations to its stores, opening locations across America and franchising overseas. (See **Exhibits 6 to 7** for current domestic and international store locations.)

In 1983, Southland acquired Citgo, an oil company, in an effort to pursue a vertically integrated strategy with ownership of its own dairy operations and distribution centers. Keyes, who began his career with the company at that time, recalls that the move backfired miserably. "We were great retailers but terrible refiners and dairy farmers," he says. In 1987, stymied by debt, the company sold most of its non-retail businesses and its remaining 50 percent stake in Citgo. In 1988 management borrowed heavily to buy 100 percent of Southland's stock in a leveraged buyout. However, in 1990, Southland defaulted on $1.8 billion in publicly traded debt and filed for bankruptcy protection. The company persuaded bondholders to restructure its debt and take 25 percent of its stock, clearing the way for the purchase of 63 percent of Southland in 1991 by IYG Holding, formed by Ito-Yokado (51 percent owner) and Seven-Eleven Japan (49 percent owner). From 1991 to 1993 sales declined as Southland closed stores, renovated others, and upgraded its merchandise. In early 2000 IYG raised its stake in 7-Eleven to nearly 73 percent. (See **Exhibit 8** for 7-Eleven's Board of Directors.) IYG currently owns or guarantees 80 percent of 7-Eleven's outstanding debt. The company's debt to total capital ratio is just above 91%. Also in 1999, the corporation changed its name from the Southland Corporation to 7-Eleven, Inc., in order to better reflect its primary business.[13]

In 2002 the company closed 133 under-performing stores and opened at 127 new locations in North America. At fiscal year end, 2003, domestic sales at 5,784 stores (2,457 of which also sell gasoline) was $10.8 billion ($3.4 billion in gasoline sales). (See **Exhibits 9 and 10** for sales trends.) Interestingly, 7-Eleven's percentage-of-sales ratios for merchandise (70 percent of sales) and gas (30% of sales) are the inverse of the convenience store industry's as a whole.

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[11] Datamonitor, Convenience Store Shopping, May 2003.
[12] 7-Eleven. The company changed its corporate name from Southland to 7-Eleven, Inc. in 1999.
[13] Southwest Securities, 7-Eleven Inc., June 11, 2003.

Worldwide, the company owned, franchised and licensed 25,796 stores that generated $36.5 billion in sales.[14] (See **Exhibit 11** for global store count growth.)

Company structure

There are three types of 7-Eleven stores: corporate, franchised and licensed. The company began franchising in 1964, signed its first United States area licensing agreement in 1968, and entered into its first international licensing agreement (with Mexico) in 1971.

Corporate stores are owned and operated by the corporation, and run by store managers who are employees of 7-Eleven, Inc. About 2,480 of the 5,784 stores in the U.S. and Canada fall into this category.

Franchises are run by independent contractors who enter into an agreement with 7-Eleven in order to operate one or more stores. 7-Eleven leases or owns the facilities and the store equipment, which are in turn leased by the franchisee. A typical franchisee pays a franchise fee averaging about $66,000, while the corporation retains ownership of the property, plant and equipment. **7**-Eleven then requires an initial cash payment, averaging about $83,000 depending on the area, for the starting inventory and supplies.[15] In some cases, the company will loan this amount to new franchisees. It is a franchise model, Keyes says, that provides "the best of both worlds": the capital and support of the corporation, and the initiative and sweat-equity of individual entrepreneurs. Approximately 3,300 stores in the U.S. and Canada are franchised.

7-Eleven also enters into license agreements with partners, almost exclusively in foreign countries.[16] A licensee is typically a retailing organization that owns or leases several 7-Eleven stores in areas where the company does not do business. In these cases, 7-Eleven does not own the PP&E, and imposes a set of contractual obligations on the licensee to ensure consistency of signage, store design elements and store offerings. The licensee has access to brand equity and proprietary products. Specifically, 7-Eleven, Inc., grants the license to use the 7-Eleven trademarks, trade dress, and business information system. The company additionally provides ongoing business consulting services for a fee based on a percent of monthly gross sales and a commitment from the licensee to grow the 7-Eleven convenience store business in a specific geographic area on an exclusive basis for a set period of time.

At the end of 2003, the company had 19,501 licensed stores operating internationally, an increase of approximately 1,400 locations over the prior year. In August 2003, Seven Eleven Japan, the largest international license holder, opened its 10,000th store.

[14] 7-Eleven.
[15] 7-Eleven.
[16] There are 489 stores in the U.S. that operate under license agreements, or 8 percent of the total for the U.S. and Canada.

Redefining Retailing

In the Spring of 2003, speaking to the Retailing Leadership class at Columbia Business School, Keyes described the transformation in retailing he foresaw at 7-Eleven. "In the U.S., you say 7-Eleven and people think sticky floors, surly salespeople and old product," says Keyes. "In Japan where convenience stores sell sushi and pantyhose, 7-Eleven is known for service and for fresh, high quality product." This vision of the potential for 7-Eleven stores in part drives Keyes' ideas for change across the company. He continued:

> Twenty years ago when I was an MBA student at Columbia Business School there was no Retail class nor was Retail considered a worthy profession to go into – that is all changing. Retail is undergoing a massive transformation in the US right now. Retailers are seizing control of their own destiny.

Keyes went on to explain how about 15 years ago Wal-Mart was the size of 7-Eleven. Wal-Mart has since grown to be the largest retailer in the world. "At 7-Eleven we are carrying out our own transformation," said Keyes. "We have only just started."

Working with the Japanese owners and borrowing heavily from ideas generated by Seven Eleven Japan, Keyes has been leading a major cultural shift within the company, which he is calling the "Retailer Initiative." At the heart of the initiative is 7-Eleven's use of technology to empower the store operator (the person closest to the customer) to make key decisions. Keyes explains:

> Wal-Mart is very proud of their replenishment model. It's directly intended to take the thinking out of the store. Ours is exactly the opposite. It's intended to provide easy, fun-to-use and informative tools in the hands of store personnel. It's a fascinating use of technology. We become incredibly nimble. We can put a new product on the shelf, and by tomorrow we know how the customer is responding. Within a week, we can say with pretty good confidence whether it will be successful. We can tweak it or make it bigger or change the price. It's the heart of how we differentiate ourselves.[17]

With this fresh customer data in hand, 7-Eleven is working with suppliers to develop new private label products it knows its customers want. Overall, "Retailer Initiative" works to leverage the company's scale, infrastructure and the entrepreneurial energy of its store-level operators. As Keyes wrote in the 2003 Annual Report: "[The store operators'] focus on item-by-item management – deleting slow-selling merchandise and introducing new items at every store, every day – allows 7-Eleven stores to satisfy their customers in ways that few retailers can match. In the simplest terms, we enjoy the power of a global retailer, but maintain the store-level focus of a single-store operator."[18]

Economies of scale

7-Eleven achieves competitive success in large part due to its supply chain efficiency. By concentrating its stores in tight geographic areas, 7-Eleven is able to get fresh product to its

[17] December 19, 2003. Dallas Morning News.
[18] 7-Eleven, 2003 Annual Report.

stores while minimizing inventory and transportation costs. The company utilizes combined distribution centers (CDCs) that are strategically located near concentrations of 7-Eleven stores. In all, the company uses 23 CDCs across the United States that each can serve up to 700 stores. Driving time from the CDCs to the stores is usually no more than 90 minutes.

Prior to the CDC approach, most vendors delivered directly to 7-Eleven stores at sporadic times, often no more than once per week. The cost of making more frequent stops could not be justified by single store sales. Further, 7-Eleven parking lots were frequently crowded with huge delivery trucks and more stops per week would only worsen this issue. As a result, each store needed to carry at least a week's worth of inventory at any point in time. This drastically increased both inventory costs and storage space requirements while decreasing the freshness of the products offered to customers.

7-Eleven has the majority of its fresh products now delivered directly to the CDCs. By combining the demand of 200 stores, more frequent deliveries to the CDCs can easily be justified by the improved economics of the transportation costs. These CDCs, in turn, consolidate product from different vendors and combine them all on to one truck headed for each local 7-Eleven.

The company also runs their back-end supply chain very efficiently. 7-Eleven partners with third party logistics providers to run the CDCs. Each of these centers is approximately 20,000 square feet and ships 60,000 units per day—a very high number of orders given the size of the warehouses.

Franchisees and corporate store managers make local vendor selection decisions. On average, store operators purchase 80 percent of their products from corporate recommended vendors using 7-Eleven's internal systems. The remaining product can be purchased from suppliers outside of this network. By centralizing their buying for all of its stores, 7-Eleven is able to wield its purchasing power and negotiate better pricing, further contributing to their margins.

Use of data and technology

7-Eleven takes a different approach to purchasing than traditional supply chain behemoths such as Wal-Mart. Rather than having a system decide what to order and taking the human element out of the process, 7-Eleven seeks to provide a set of tools for its local stores to make informed decisions on product ordering and assortments. The company effectively treats its local owners and operators as retailers.

The corporation has developed a technology suite for its stores that helps local stores manage their purchasing. This system allows store managers to customize their product offering by ordering online and creating a suite of reports. Each local manager can track their total progress versus other 7-Eleven stores—which helps them determine if they are not taking appropriate steps to drive traffic (e.g. assortments, price points, etc.). Specific product reports are available to help managers determine their appropriate product mix and predict demand. Weather forecasts are provided as another tool to assist in the ordering process.

In addition, the huge amount of sales data and immediate response time help 7-Eleven make improved corporate decisions. The company is able to track trends at stores to understand how customers' preferences are changing. Sales data helps the company understand the impact of opening up new stores and assists in location decisions. In addition, it allows the corporation to predict customer demand and helps in central purchasing decisions. Finally, this technology provides an immediate feedback loop for 7-Eleven on new products—within a matter of one or two days the fate of a new item becomes very clear. This information helps 7-Eleven drive key space in the store, innovate new products, and stay a step ahead of the competition. As Keyes points out, "Retailers are closer to customers than manufacturers," even though the large suppliers traditionally drove the decisions on shelf space and location.

Not all store owners and operators take advantage of this data and technology. Currently, the percent of product ordered through the online system by franchisees ranges from 100 percent to 20 percent. This raises the question of whether the right people are in place in 7-Eleven to make such localized decisions, and whether the company would be better served just ordering product for them. 7-Eleven is also faced with issues of brand consistency as a result: with different product assortments in each store, customers may be confused about what 7-Eleven stands for.

Products

Product innovation is another avenue through which Keyes is transforming the convenience retail industry. 7-Eleven tracks customers' changing product purchasing habits and Keyes' goal is to leverage this to create better quality products in the future. "We have the benefit of convenience, not price, being our main selling point. This gives us a lot of leeway to create higher quality, better products," he says.

7-Eleven stores offer a wide range of products, from beer to beef jerky and cigarettes to cereal. The average store carries 3,000 SKU's. About 70 percent of these are recommended by the head office and the remaining 30 percent are picked by local store managers to cater to specific local needs.[19] For example, the 30 percent discretion allows a manager to stock up on beer if he knows that a local football game is playing, or to stock specific ethnic products if appropriate to a neighborhood.

Merchandise mix

Overall, tobacco products represent the largest selling product category at 7-Eleven, accounting for 29.3 percent of merchandise sales in 2003. (See **Exhibit 12** for a breakdown of sales by product category.) Beverages represent 23.1 percent of sales, followed by beer/wine at 11.4 percent. Fresh foods account for 7.2 percent. Gasoline sales account for 31% percent of sales.

The stores' highest selling product is coffee – it sells thirty million cups a month.[20] This is followed closely by beer (with sales of $64.58 million per month), the unit sales of which are

[19] Jim Keyes Interview, March 23, 2004.
[20] *Information Week*, January 26, 2004.

more than half single beers.[21] The next highest selling product is the Slurpee, with over eleven million sold per month.[22]

Private label products

7-Eleven creates private label products to differentiate itself from the competition and boost its margins. The company's most famous product, the flavored, crushed-ice beverage called Slurpee, was created in 1965. The company now sells 11.6 million Slurpees a month and introduces new flavors every year. Overall, the company creates 1,500 to 2,000 private label products each year, or 10-15 percent of its merchandise mix. Approximately 22 percent of its sales are proprietary products.[23] If a product is not available in a conveniently sized package or is unknown in another country, 7-Eleven's category managers will work with suppliers to create a new product. For example, in early 2004, 7-Eleven launched a low-carb category, primarily comprised of nutritional bars and snacks. It has also recently introduced the first mentholated gum in the U.S. after spotting the success of the product in Japan. (See **Exhibit 13** for sample proprietary products.)

Not all propriety products have been successful. In 2003, the chain launched its own proprietary imported beer brand, Santiago, brewed in El Salvador by an independent subsidiary of SAB Miller. Priced at $5.99 for a six-pack, a price roughly equivalent to Budweiser, Santiago suffered from oxidization and "taste" problems and is quietly being withdrawn after 10 months on the shelves. A reformulated version with improved taste and quality will be reintroduced later in the year.[24]

7-Eleven is also launching its first premium wine brand, Regions, in 2004. Packaged in 375-ml half bottles and finished with a natural cork stopper, Regions will retail for $4.99 compared to other wine selling in 7-Eleven stores at an average price of $6.25.

Another new product 7-Eleven is launching is the EZ-D. Utilizing a new technology, this vacuum-packed DVD begins to oxidize upon exposure to the air. After 48 hours, it is no longer functional. As Keyes explains:

> We know we can sell DVDs. We know we'll never have the assortment of a Blockbuster, but if we can come up with a more unique way to sell movies, then we think there's an opportunity for us to be relevant. We're shooting for this to be priced like a rental with no returns at $5.99. It's a great example of how instead of waiting for the industry to catch up, we go to the manufacturer and say we need this.[25]

[21] 7-Eleven.
[22] *Information Week*, January 26, 2004.
[23] Southwest Securities, 7-Eleven Inc., June 11, 2003.
[24] 7-Eleven.
[25] *Dallas Morning News*, December 19, 2003.

Services

Currently, store sales from the Services category comprise 3 percent of overall sales. With new VCom Inc. terminals installed at 1,000 stores, the company provides financial services and E-retailing to in-store customers. The VCom units combine ATM capabilities with nonstandard features such as dispensing coins, cashing checks, and providing money orders. 7-Eleven also added E-retailing features allowing customers to buy products from retailers such as 1-800-Flowers, eBags.com, and TopWebBuys.com. The goal is to have two kiosks in every store, Keyes says. Other services include 7-Eleven convenience cards – chargeable cards that work like cash – and pre-paid phone cards. As an extension to these phone cards, 7-Eleven started selling pre-paid Nokia wireless phones in April 2004. Customers will only be able to purchase additional minutes for these phones at 7-Eleven stores.[26]

Gasoline & Tobacco

Product categories which may be cause for concern in the future are gasoline and tobacco sales. From Dec. 2003 to March 2004 retail gasoline prices surged more than 25 cents per gallon from $1.48 to $1.73. The winners from this hike were oil refiner retailers such as Shell, BP, Exxon Mobile whilst the losers were convenience retailers, such as 7-Eleven. Such convenience retailers are required to pay refiners the higher fuel prices yet can not pass all of these increased fuel costs onto customers and thus sacrifice their gasoline margins. According to the Oil Price Information Service (OPIS) gross retail gasoline profit margins plunged by more than 37 percent in the December, 2003-to-March, 2004 period, falling from 16.8 cents per gallon to just 10.6 cents per gallon nationally[27]. With 31% of 7-Eleven's sales coming from gasoline, the volatility in gasoline prices over the last year highlights the risks of such dependence. While quarterly volatility is a risk with most commodity based products, 7-Eleven's annual earnings stream from gasoline has been quite stable with gross profit margins of at least 13 cents per gallon in each of the past 10 years.

Along with other convenience store retailers, 7-Eleven faces an increasingly tough regulatory environment surrounding the sale of tobacco, its best-selling product category. This environment includes a potential rise in the minimum age to purchase tobacco, an increase in "sin taxes" and growing health concerns. Ultimately, these issues could put downward pressure on tobacco sales and 7-Eleven's margins.

Distribution and supplier relationships

7-Eleven has forged strong relationships with its suppliers, though many challenges still remain for the corporation. These relationships are critical elements of 7-Eleven's operational efficiency and strategy. Technology allows 7-Eleven to seamlessly integrate ordering and delivery scheduling.

Key suppliers to 7-Eleven, however, have remained resistant to participating in the company's evolving distribution system. These consumer packaged goods manufacturers have extensive

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[26] *Wall Street Journal*, April 27, 2004.
[27] *Convenience Store News*, March 17, 2004.

distribution networks of their own to deliver goods and control in-store shelf space. By controlling in-store product placement, they are able to drive sales and get a solid advantage over the competition. They are reluctant to give up such an advantage.

7-Eleven has been changing this model. The company believes that they can increase their own profitability by consolidating shipments from a variety of suppliers in their warehouses, and distributing to their own stores based on in-store sales data. While many of the smaller manufacturers have conceded and switched to this CDC model, many of the larger suppliers are still fighting. Companies such as Coca-Cola, Pepsi and Budweiser have such a vested interest in their distribution networks that they have not yet been willing to transition. They do not want to relinquish control over floor and shelf space. Keyes, however, feels that they will eventually come around as a result of pressure from key players such as Wal-Mart and 7-Eleven. Further, this centralized distribution model – which is effectively breaking down the barrier to entry of 100-year-old distribution networks – is providing opportunities for new suppliers to enter the market.

Customers

Traditionally 7-Eleven's core customer was a male, blue-collar worker purchasing coffee before work or beer at the end of the day. More recently, the 7-Eleven customer demographic has shifted as the products and services it offers have changed. Describing the relationship between demographic and product mix, Keyes explains: "7-Eleven's gasoline island today is over 50 percent female because we were one of the first with self-service, pay-at-the-pump gas pumps and it was easier for moms."

The customer base has shifted from largely blue-collar male to a broader demographic mix, including more female customers. Keyes says of this shift:

> Inside, the store isn't 60 percent blue-collar male anymore, but we don't want to run off our core customer. We still sell a lot of beer and beef jerky, and we plan to continue. Our new approach is subtle. When you know that you can get a good, healthy, fresh sandwich then we'll get you, not by advertising and telling you what a great place we are. As with most retailers, the key is having the right assortments.

This strategy involves selling a wider range of products than the traditional beer and beef jerky alongside pork rinds. Broadening the product mix encourages a demographic broadening of the customer base.

People Management

People management remains an ongoing challenge at 7-Eleven. "There are huge labor issues," says Keyes.[28] Specifically he points out: "The people represent the company." 7-Eleven has 70,000 employees worldwide, 6,000 of whom are staffing stores on overnight shifts. Keyes

[28] Jim Keyes, Columbia Class Video, February 6, 2002.

worries about the customer service provided by these front-line employees, and by franchisees who operate as independent contractors. "You cannot execute Retailer Initiative without retailers," says Keyes.

To help its store managers, both franchisees and corporate employees, 7-Eleven began a 12-week certification program in 2002. By the end of 2003, almost one-third of its store operators had been certified. In addition, more than 2,700 store sales associates had completed a two-day training module on the essential elements of the Retailer Initiative strategy.[29]

Franchisees

7-Eleven remains active in managing and supporting its franchisees. Each franchisee undergoes an initial 6-week training program in operating and managing a 7-Eleven store, and is subsequently assigned a field consultant who provides on-going support during weekly visits. In addition, the company hosts an annual "7-Eleven University" during which franchisees and corporate-store managers are introduced to new products and company initiatives.

Historically, the franchises have been more successful than corporate stores. "We think this is because they've got skin in the game," says Keyes. Now, however, the franchises have begun to fall behind corporate stores. While all corporate initiatives are immediately implemented in corporate-run stores, franchisees are not required to use the new inventory system. As Keyes has moved to change the way 7-Eleven operates, the existing group of 3,300 franchisees are proving to be a "challenge." "They think that we're trying to force them to be employees, and we're not," he says.

Specifically, franchisees have been unhappy with the gross profit "split" between themselves and the company. Under the existing franchise agreement, franchisees retain 48 percent of their gross profit margin, and give 52 percent to the corporation. In turn, the corporation has become unhappy with the rate at which existing franchisees have been converting to the Retailer Initiative and the new, company-wide SKU-picking system in particular.

In order to address these concerns, 7-Eleven has recently offered a new franchise agreement. Under this new agreement, the gross profit split is now 50-50. Under the new agreement, franchisees must now repay the corporation for advertising expenditures, equivalent to between 0.5 and 1.5 percent of the franchisee's gross profit. To address the company's concerns, the new agreement phases in a further requirement for franchisees to order 85 percent of their SKUs from recommended vendors.

The new agreement will affect the 34 percent of all franchisees whose agreements were up for renewal on December 31, 2003, along with all new franchise holders. The remaining franchisees will be eligible to sign the agreement starting in 2004.

[29] 7-Eleven, 2003 Annual Report.

Diversity

As a further effort to address 7-Eleven's human resource issues, the company has attempted to re-brand its diversity as an asset. Following the terrorist attacks on September 11, 2001, the company experienced antagonism directed at several of its front-line store employees who were thought to be of Middle-Eastern origin. The company responded to this crisis by attempting to define the diversity of its workforce as a strength.

7-Eleven produced and aired commercials that highlighted the immigrant origins of franchise-owners. In one commercial, a Thai franchisee is shown working hard to build her 7-Eleven franchise, followed by shots of her welcoming her two children to America in an airport waiting area after a long separation. Additionally, the company held its 75th birthday celebrations on Ellis Island in New York City, the former gateway to the U.S. for immigrants. "America was built by immigrants who came here to live the American Dream" says Keyes. "7-Eleven represents that opportunity to be your own boss."[30]

Differentiation

Continuing people management concerns also rest in part on the lack of training and on-going support for the hourly workers, particularly those that work in franchises where franchisees are responsible for the hiring and training of employees. According to the company, store-level employee turnover at over 100% is in line with industry norms, and 7-Eleven has seen two consecutive years of improvement.[31]

Keyes believes that 7-Eleven's front-line employee issues can be resolved in part through differentiation. Just as 7-Eleven has to differentiate products, he says, it also has to differentiate the store for employees. Why work at 7-Eleven for $8-$9 an hour, rather than at McDonalds? Currently, says Keyes, "We have people looking for an hourly wage, not a challenge."[32]

There are currently two drivers of employer differentiation at 7-Eleven. The first is staff development and ongoing training. At 7-Eleven University, franchisees and store managers are exposed to ideas for motivating and teaching employees. Keyes often visits stores and concludes that franchisees often do not work with their hourly employees to help them understand customer service. Hourly workers are told, for example, that the retail cost of an empty cup is 70 cents (a function of retail vs. cost accounting), so when customers come in and ask for a cup of water, they are told the cost is 70 cents. "They don't know that the actual cup cost is only a nickel and that it would make more sense to build customer goodwill by giving them the cup and writing it off," says Keyes. "We can turn an $8-9 dollar an hour employee into a retailer by giving them the tools, like performance-building skills."

Additionally, Keyes would like to see store franchisees and managers do more to create a positive work environment for hourly workers. You can "fire up" a group of hourly-wage employees, believes Keyes, thinking back to his own college job at McDonald's. He was

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[30] Jim Keyes, Columbia Class Video, 2003.
[31] 7-Eleven.
[32] Jim Keyes, Columbia Class Video, February 6, 2002.

enthusiastic, he recalls, both as an entry-level worker and when he was promoted to run staff training at new stores. His managers and his peers, he believes, helped to create an atmosphere where people wanted to work.

The second driver of employee differentiation is "social capitalism." Keyes attempted to differentiate 7-Eleven stores as workplaces by building up the idea that the company can give back to the communities in which its employees work and live. In 2002, 7-Eleven set up the Education is Freedom Foundation, sustained through company gifts, website donations, and collection boxes at store cash registers. (See **Exhibit 14** for the Foundation's website.) The Foundation was expressly intended to provide money for the higher education of employees and their children. This idea intended to leverage 7-Eleven's long identification with the American Dream – as a place where recent immigrants and others could run a business as a franchisee with little capital investment – into the idea that working for 7-Eleven is a good place to get an education.

Overall, the Foundation distributed $2000 scholarships to 223 students, after receiving 30,000 applications.[33] The impact on employee turnover, however, seemed negligible. "I was waiting," says Keyes, "for my HR team to pick up the ball."

Despite wanting to differentiate itself in the eyes of employees, 7-Eleven, like other players in the convenience store industries, worries about an increase in the minimum wage. Labor expense accounted for 42.1 percent of gross profit in 2002 for the convenience store industry as a whole.[34] For example, the New York Association of Convenience Stores noted that a proposed increase in the minimum wage from $5.15 to $7.10 by 2006 would increase convenience store costs in the state by 38 percent.[35]

Finally, 7-Eleven faces the challenge of maintaining security in its stores, many of which operate 24 hours a day.

A Learning Organization

Keyes would like 7-Eleven to become a "learning organization" from top to bottom. As he works to reinvent the company, and to move away from traditional methods of retailing, Keyes would like to engender an environment of continual learning in franchises, corporate-run stores, and in HQ. Recognizing that 7-Eleven is not considered an attractive place to work for newly-minted MBA's and others, Keyes wants to turn 7-Eleven into the "Procter & Gamble training ground" for the convenience industry.

Specifically, Keyes worries about creating a management team to succeed him. He talks about being in "leadership 101" as he looks back and realizes that he is so much of a hands-on person that he did not make enough effort to develop people as he was moving up through the ranks of the company.

[33] 7-Eleven news release, January 21, 2004.
[34] EDC Economics, An Overview of the US Convenience Store Industry, December 2003.
[35] New York Association of Convenience Stores (www.nyacs.org).

Search for new HR Director

In order to develop employer differentiation ideas, manage the image of 7-Eleven's front-line retailers and develop ways of making 7-Eleven's corporate side a more attractive place to work and develop as retailers, Keyes instituted a search for a new Director of Human Resources. (See **Exhibit 16** for a company organization chart.) After looking at many resumes, he remains unimpressed. "They don't go above the baseline," he says. So many of the candidates miss the point about differentiation and customer service, and do not understand that all employees must be able to fill in the blank: "I want to work for 7-Eleven because _______."

Growth

7-Eleven is expanding rapidly. In the U.S., store growth is balanced between new franchises and corporate-run stores. Internationally, the company enters into license agreements with partners in foreign countries.

Domestic Expansion

7-Eleven is adopting an urban strategy learned from successful licensees in Japan and Taiwan, ceding high-traffic corners to others and looking for more unconventional locations. These types of selections decrease the cost of real estate and, as a result, increase the company's return on investment. In addition, the company is upgrading both its technological and physical infrastructure to continue to redefine its brand image. 7-eleven spent over $500 million over the last five years to upgrade its technology platform (See **Exhibit 16** for pictures of current stores.)

In 2004, the company plans to open approximately 100 new retail outlets in the United States while continuing to close unprofitable stores. Keyes believes this is vastly undershooting their expansion potential. In Japan, the company netted over 1,000 new stores during 2003. He believes that 7-Eleven could easily add 500 to 1,000 stores per year in the U.S. market. Areas of focus include cities and airports, as well as further penetrating some of their existing markets. Questions remain, however: Can 7-Eleven justify the relatively high cost of real estate in these areas? What effect will cannibalization have on the economics of both their new and existing stores? Further, based on their highly leveraged balance sheet, can they even afford to do it?

International Expansion

Keyes also sees great opportunities in new markets. South America, Beijing and the rest of China are all examples of key markets that the company is looking to expand into.[36] 7-Eleven hopes to secure local partners that are familiar with the markets to increase the chances of success. While convenience transcends cultural differences, the definition of convenience will certainly vary by culture.

[36] Associated Press, April 6, 2004. 7-Eleven, through a joint venture arrangement between licensee Seven-Eleven Japan and two Chinese partners opened its first store in Beijing on April 15, 2004.

International expansion is facilitated through the use of license agreements. Such agreements give 7-Eleven, Inc., legal control over the use of trademarks, trade dress and business information, and attempts to establish mutually beneficial relationships in order to ensure additional control over licensees.

Japan represents 7-Eleven's greatest international success. The stores are consistently clean and well-organized, with a very wide and high-quality product line. Working closely with suppliers and providing first-class service to customers Seven-Eleven Japan has experienced phenomenal success. It now has over 10,000 stores. While the Japanese experience represents strong success, it remains to be seen whether 7-Eleven can replicate that model in other countries.

Conclusion

"It's been a fascinating experience to take a company that was an icon in an industry and transform its economic model over the last 10 years," says Keyes. He admits, however, that the transformation is on-going and not complete. He worries about the continued holding-out of his dominant suppliers like Coca Cola and Pepsi to the CDC model. Underlying these difficulties with his reinvention of 7-Eleven, the people management issues loom large. What should he be looking for in his new HR director? Why is the right person so hard to find?

"The sky's the limit in terms of what we can create," says Keyes. "As I look around the landscape of retail all of my competition are playing the same game." In his Beechcraft, as Keyes adjusts his altitude to compensate for the turbulence, he sees much blue sky in front of him. He also can't help noticing the clouds off in the distance.

Exhibit 1 Biography of Jim Keyes

Jim Keyes is president and chief executive officer for 7-Eleven, Inc., the world's largest convenience store retailer.

Mr. Keyes served in a number of senior management positions before being elected to his current role in 2000. He joined 7-Eleven stores' former subsidiary Citgo Petroleum in 1985 as general manager of marketing and business strategy. A year later, he became general manager of 7-Eleven's national gasoline, with responsibility for the company's retail gasoline business in the United States and Canada. He was named vice president of national gasoline in 1991.

Mr. Keyes served as the company's senior financial officer in 1992 and was named chief financial officer in 1996. He was elected to the company's board of directors in 1997 and promoted to executive vice president and chief operating officer in 1998.

Before joining 7-Eleven, he held various field and corporate positions at Gulf Oil Corporation.

Mr. Keyes earned a Bachelor of Arts degree at Holy Cross College in Worcester, Mass., where he was named to the Phi Beta Kappa honor society and graduated cum laude in 1977. He also attended the University of London and received a Master's of Business Administration degree from Columbia University in New York City [in 1980].

Mr. Keyes is founding chairman of Education is Freedom, a public charity dedicated to helping hard-working young people reach their full potential through higher education. He serves on the national board of directors of Students in Free Enterprise (SIFE), the Muscular Dystrophy Association, Latino Initiatives for the Next Century (LINC) and on the board of trustees for the Boys and Girls Club. Mr. Keyes also is on the board of directors for the National Association of Convenience Stores (NACS). He was recognized by the Network of Executive Women for his efforts to promote diversity in the workplace.

Mr. Keyes serves in a leadership role within the local Dallas community as well, as an executive board member of the Greater Dallas Chamber of Commerce, a member of the Dallas Citizens Council and a member of Southern Methodist University's Cox School of Business and chairman of the Dallas Symphony Association.

Mr. Keyes was born on March 17, 1955 in Grafton, Mass. He and his wife Margo live in Dallas.

Source: 7-Eleven

Exhibit 2 Consolidated Balance Sheets

(in thousands, except share data)

	Year ending December 31	
	2003	2002
Current assets:		
Cash and cash equivalents	82,423	88,129
Cash for Vcom kiosks	38,342	96,298
Total cash and cash equivalents	120,765	184,427
Accounts receivable	248,483	225,260
Inventories	114,091	105,507
Other current assets	140,837	159,904
Total current assets	624,176	675,098
Property and equipment	2,175,360	2,407,583
Goodwill and other intangible assets	140,490	140,412
Other assets	124,299	125,810
Total assets	**3,064,325**	**3,348,903**
Current liabilities:		
Trade accounts payable	260,978	270,747
Accrued expenses and other liabilities	457,623	531,700
Long-term debt due within one year	48,609	39,828
Total current liabilities	767,210	842,275
Deferred credits and other liabilities	386,995	431,116
Senior Subordinated Notes due to SEJ	—	400,000
Other long-term debt	1,366,623	1,035,490
Convertible quarterly income debt securities	380,000	300,000
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, \$.01 par value; 5,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock, \$.0001 par value; 1,000,000,000 shares authorized; 104,977,302 and 111,834,262 shares issued and outstanding	10	11
Additional capital	1,168,182	1,251,428
Accumulated deficit	(990,107	(926,013
Unearned compensation	(1,068	(796
Accumulated other comprehensive earnings (loss)	(13,520	15,392
Total shareholders' equity	163,497	340,022
Total liabilities and shareholders' equity	**3,064,325**	**3,348,903**

Source: 2003 10K

Exhibit 3 Consolidated Income Statements

(Dollars in millions)

	Year ending December 31				
	2003	**2002**	**2001**	**2000**	**1999**
Sales	10,784.7	8,607.9	9,781.8	9,346.0	8,251.7
Cost of Sales	7,516.7	7,041.1	6,852.7	6,563.2	5,680.4
Gross Operating Profit	3,268.0	3,068.6	2,929.1	2,782.8	2,571.3
Selling, General & Admin. Expense	2,845.5	2,739.2	2,558.4	2,415.6	2,234.1
Other Taxes	0.0	-1,501.8	0.0	0.0	0.0
EBITDA	422.5	329.4	370.7	367.2	337.2
Depreciation & Amortization	307.1	280.2	266.9	239.3	205.5
EBIT	115.4	49.2	103.8	127.9	131.7
Other Income, Net	97.0	103.0	112.3	105.1	97.9
Total Income Avail for Interest Exp.	212.4	152.2	216.1	233.0	229.6
Interest Expense	71.3	64.7	62.7	79.3	102.2
Minority Interest	0.0	0.0	0.0	0.0	0.0
Pre-tax Income	141.1	87.5	153.4	153.7	127.4
Income Taxes	53.6	35.0	59.8	47.2	48.5
Special Income/Charges	0.0	0.0	0.0	0.0	0.0
Net Income from Cont. Operations	87.4	52.5	93.6	106.5	78.8
Net Income from Discont. Opers.	-13.1	-11.6	0.0	0.0	0.0
Net Income from Total Operations	74.3	40.9	93.6	106.5	78.8
Normalized Income	87.4	52.5	93.6	106.5	78.8
Extraordinary Income	0.0	0.0	0.0	0.0	0.0
Income from Cum. Eff. of Acct. Chg.	-10.2	-28.1	-9.8	0.0	0.0
Income from Tax Loss Carryforward	0.0	0.0	0.0	0.0	0.0
Other Gains (Losses)	0.0	0.0	0.0	1.8	4.3
Total Net Income	**64.1**	**12.8**	**83.8**	**108.3**	**83.1**

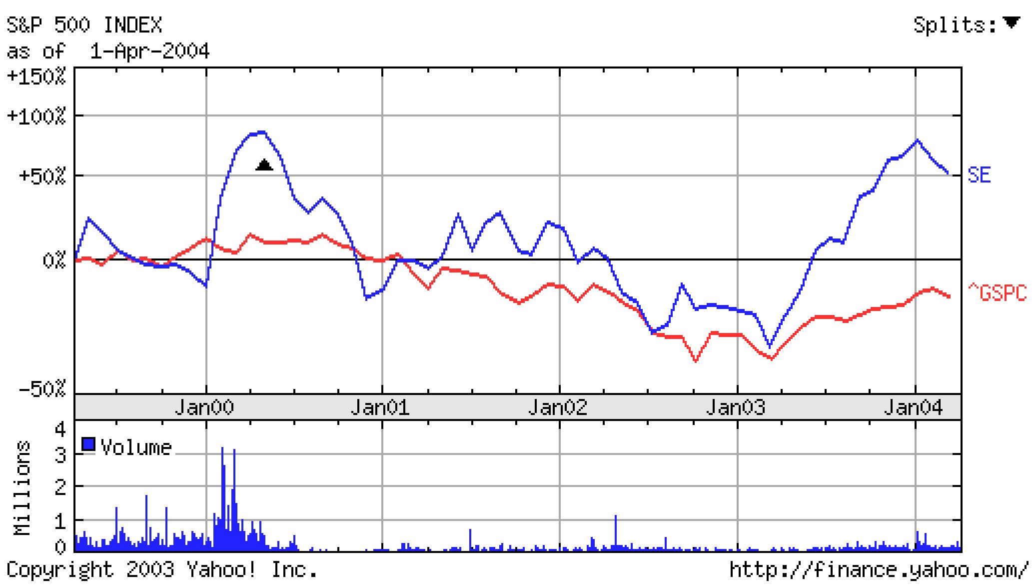
Source: MSN Money

Exhibit 4 Select Financial Data, 2003

	2003
Total Stores	5,784
Gasoline Stores	2,457
Gasoline Gallons (MM)	2,117
Merchandise Sales (MM)	$7,412.5
Gasoline Sales (MM)	$3,372.2
Total Sales (MM)	$10,784.7
Other Income (MM)	$97.0
Total Revenues	**$10,881.7**
Total Merchandise GP (MM)	$2,634.6
Merchandise GP Margin	35.54%
Total Gasoline GP (MM)	$326.3
Gasoline GP Cents/Gallon	$0.154
Avg Retail Price/Gallon	$1.59
Total Gross Profit (MM)	**$2,960.9**
Cost Of Goods Sold	**$7,823.8**
Franchise Gross Profit (MM)	$798.0
OSG&A Expenses (MM)	$2,047.5
OSG&A/Sales	18.8%
Interest Expense, Net	**$71.4**
Interest Income	$8.2
EBT & Extroadinary Items	$141.0
Income Taxes (Benefit)	**$53.6**
Discontinued Operations	**(13.1)**
Accounting Change	(10.2)
Net Earnings/(Loss)	**64**

Source: 7-Eleven

Exhibit 5 5 Year Stock Price History vs. S&P



Source: Yahoo Finance

Exhibit 6 North American Store Distribution

	Owned	Leased	Total
U.S.			
Arizona	32	51	83
California	263	950	1,213
Colorado	61	171	232
Connecticut	9	43	52
Delaware	10	16	26
District of Columbia	6	15	21
Florida	239	304	543
Idaho	6	5	11
Illinois	56	125	181
Indiana	10	23	33
Kansas	7	5	12
Maine	0	13	13
Maryland	91	211	302
Massachusetts	14	96	110
Michigan	49	82	131
Missouri	32	42	74
Nevada	87	110	197
New Hampshire	5	22	27
New Jersey	75	140	215
New York	44	212	256
North Carolina	2	5	7
Ohio	10	3	13
Oregon	42	86	128
Pennsylvania	75	93	168
Rhode Island	0	18	18
Texas	116	159	275
Utah	42	61	103
Vermont	0	4	4
Virginia	218	395	613
Washington	51	159	210
West Virginia	10	12	22
Wisconsin	0	0	0
Total U.S. Stores	**1662**	**3631**	**5,293**
Canada			
Alberta	39	108	147
British Columbia	30	118	148
Manitoba	14	35	49
Ontario	27	77	104
Saskatchewan	21	22	43
Total Canada Stores	**131**	**360**	**491**
Total Stores	**1,793**	**3,991**	**5,784**

Source: 2003 10K

Exhibit 7 International Licensed Stores, December 31, 2003

Country	Total Stores
Japan	10,080
Taiwan	3,470
Thailand	2,397
South Korea	1,277
Hong Kong	484
Mexico	421
Australia	308
Malaysia	300
Singapore	206
Philippines	195
China	150
Norway	75
Sweden	74
Denmark	44
Turkey	21
Puerto Rico	13
Guam	8
Total	**19,501**

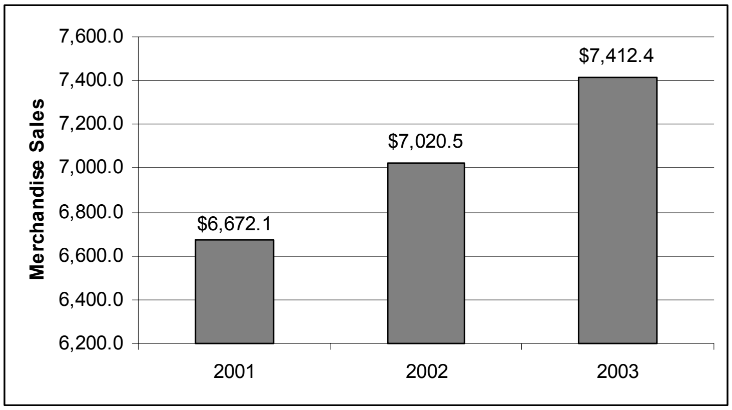
Source: 2003 10K

Exhibit 8 2003 7-Eleven Board of Directors

Name	Age	Position with 7-Eleven	Director since
Toshifumi Suzuki	71	Chairman of the Board	1991
James W. Keyes	49	President and Chief Executive Officer, Director	1997
Yoshitami Arai	72	Director	1991
Masaaki Asakura	61	Senior Vice President, Director	1997
Timothy N. Ashida	64	Director	1991
Jay W. Chai	70	Director	1991
Gary J. Fernandes	60	Director	1991
Masaaki Kamata	64	Director	1991
Kazuo Otsuka	57	Director	1991
Lewis E. Platt	63	Director	2001
Nobutake Sato	65	Director	1991

Exhibit 9 United States and Canada Sales Trends

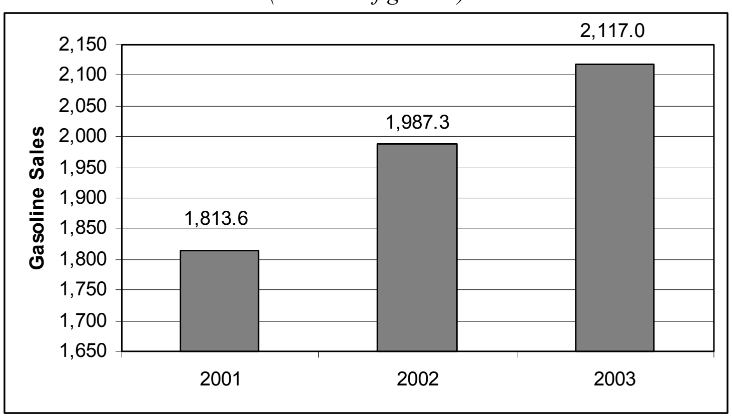
(Dollars in millions)



Source: 2003 Annual Report

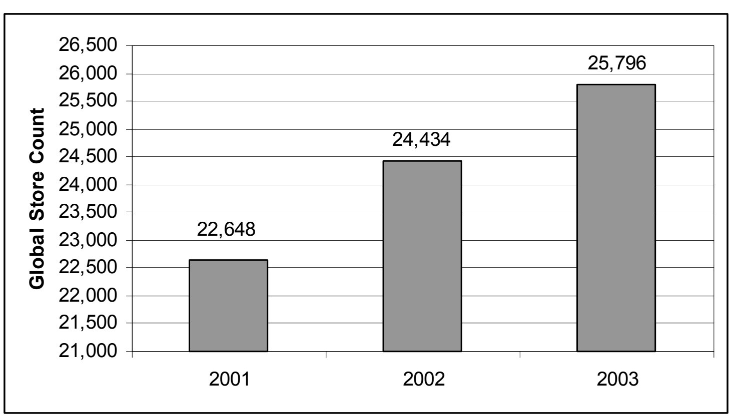
Exhibit 10 Gasoline Sales Growth

(Millions of gallons)



Source: 2003 Annual Report

Exhibit 11 Global Store Count Growth



Source: 2003 Annual Report

Exhibit 12 Merchandise Sales in the United States and Canada by Principal Product Category

	Year Ended December 31		
Product Category	**2003**	**2002**	**2001**
Tobacco	29.4%	28.1%	27.0%
Beverages	23.1%	23.0%	23.0%
Beer/Wine	11.4%	11.2%	11.3%
Candy/Snacks	10.5%	10.9%	10.9%
Non-Foods	7.0%	7.6%	8.0%
Fresh Foods	7.2%	6.7%	6.6%
Dairy	4.4%	4.5%	4.8%
Other	3.6%	4.6%	4.9%
Total Product Sales	96.6%	96.6%	96.5%
Services	3.4%	3.4%	3.5%
Total Merchandise Sales	100.0%	100.0%	100.0%
Gasoline Sales Percent of Total Net Sales	31.3%	28.2%	28.3%

Source: 2003 10K

Exhibit 13 Sample Products

¼ Pound Big Bite Hotdog	**Slurpee**	**EZ-D Disposable DVD**	**Santiago Beer**
			

Exhibit 14 Education Is Freedom Foundation Website

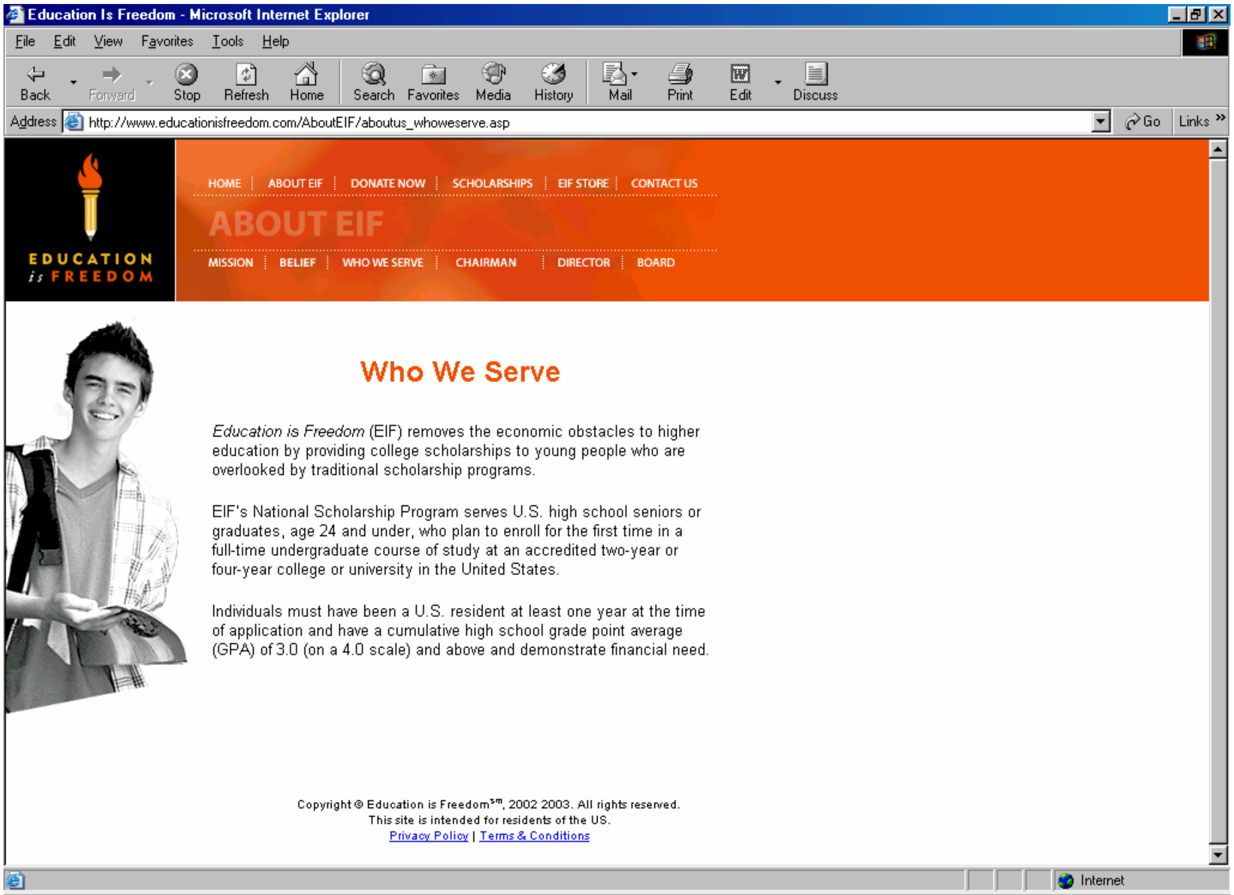


Exhibit 15 7-Eleven Organization Chart

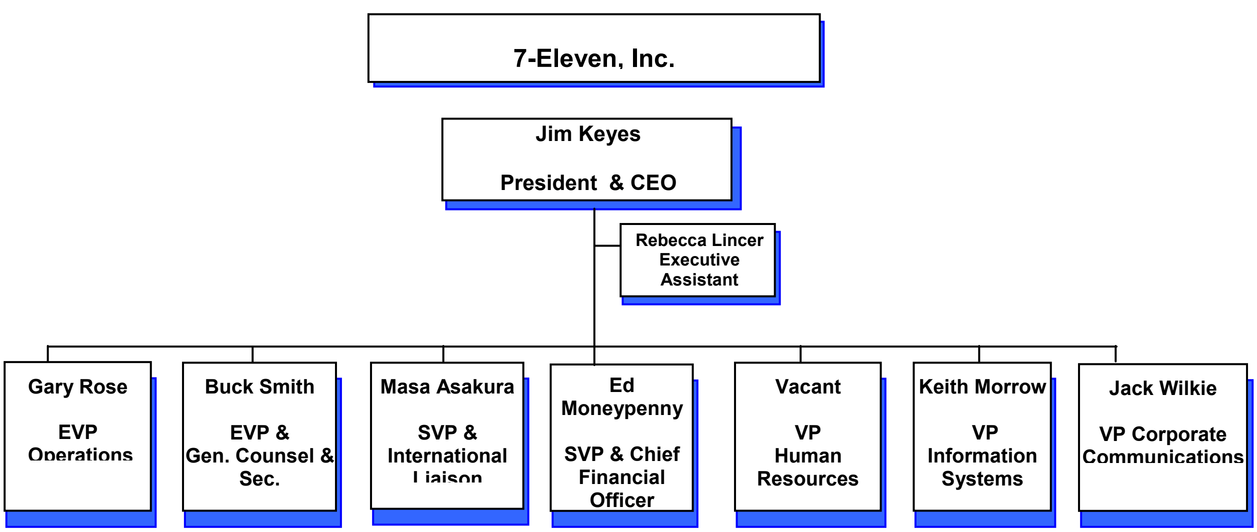


Exhibit 16 7-Eleven Stores