# Franchisors and the Fast Food Industry

**Franchisors share employment responsibility with franchisees**

The fast food industry is structured around a franchising model in which the franchisor corporations at the top – McDonald's, Burger King et al. – demand adherence to a highly detailed operating and supply system which controls the determinative aspects of franchisees business models.

Franchisors control franchisee's inputs and outputs by setting supply costs, specifying HR practices, designating advertising budgets and demanding royalty fees and advertising fees paid weekly or monthly.[1] The sum of these obligations amount to a highly standardized retail arrangement where franchises are required to adapt an entire business format from corporate parents rather than just a product or a tradename.[2] Franchisors control compliance through a strong stick; any non-adherence to the format allows franchisors to cancel the franchise agreement. This tightly scripted model leaves franchisors in control of wages; as NELP Policy Analyst Jack Temple notes, "The Corporations set wages by setting everything but wages."[3] A recent example involving McDonald's shed light on fast food corporations' firm hand in low wages and labor management. In July 2013, McDonald's Corporate pulled the plug on a website it had set up to advise employees on setting monthly budgets after its sample budget sparked an uproar. The sample budget advised employees to get at least two jobs to meet basic expenses, estimated employee health costs as $20 a month, and failed to take into account heating costs.[4]

**Fast food revenues, profits & CEO pay**

Fast Food CEOs are among the country's most highly compensated individuals, while fast food workers are the lowest paid.[5] By way of example Subway President Fred DeLuca's net worth is estimated at $3 billion.[6]

| Corporation | Total Revenue ($) | Total profit ($) | CEO | Total CEO Comp ($) | CEO to worker pay ratio [7] |
|---|---|---|---|---|---|
| McDonald's | 28,106,000,000 | 5,586,000,000 | Donald Thompson | 9,496,664 | 503 : 1 |
| Burger King | 1,146,000,000 | 234,000,000 | Daniel Schwartz | 4,770,787 | 253 : 1 |
| Wendy's | 2,487,000,000 | 46,000,000 | Emil Brolick | 7,607,230 | 403 : 1 |

[1] Freedman, Josh. 'Big Whopper Economics.' Washington Monthly, May 2014.
[2] Klein, Benjamin. "The economics of franchise contracts." Journal of Corporate Finance 2 (1995) p 11.
[3] Freedman, Josh. 'Big Whopper Economics.' Washington Monthly, May 2014.
[4] http://www.forbes.com/sites/laurashin/2013/12/27/mcdonalds-pulls-plug-on-widely-ridiculed-employee-advice-site/
[5] Ruetschlin, Catherine. 'How CEO-to-Worker Pay Disparity Undermines the Industry and the Overall Economy.' Demos, April 22 2014
[6] Forbes, http://www.forbes.com/profile/fred-deluca, accessed 5/22/14.
[7] Companies don't disclose average pay so ratios were calculated based on the U.S. government's industry-specific averages for pay and benefits for fast food workers. Occupational Employment Statistics available at http://www.bls.gov/oes/current/oes353021.htm

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|---|---|---|---|---|---|
| Yum! Brands | 13,084,000,000 | 1,091,000,000 | David Novak | 10,007,393 | 530 : 1 |
| Domino's | 1,802,000,000 | 143,000,000 | J. Patrick Doyle | 9,548,617 | 506 : 1 |
| Papa John's | 1,439,000,000 | 70,000,000 | John Schnatter | 3,276,878 | 174 : 1 |

*Source: company filings*

**What's contained in franchise agreements?**

Franchise agreements typically prescribe a comprehensive restaurant format and operating system including hours of operation, menu prices, staffing levels and restaurant design. Agreements also designate supply specifications by requiring that food, packaging, promotional items, cleaning tools and other supplies be sourced from a corporation approved distributor. Corporations maintain the right to audit and enforce these agreements.[8]

- Burger King Corporate requires franchisees to purchase from approved suppliers that represent approximately 40 to 60 percent of the non-occupancy expenses required to operate a Restaurant.[9] Burger King Corporate requires a royalty payment of 4.5 percent of monthly gross sales and an advertising fee of 4 percent of monthly gross sales.[10]

- Subway Corporate pairs each franchisee with a dedicated business consultant who monitors the implementation of operating standards and procedures. Subway Corporate may terminate the franchise agreement if franchisees fail to comply with procedures specified in their Operations Manual.[11] Subway Corporate requires a royalty fee of 8 percent of weekly gross sales from franchisees and levies an advertising fee of 4.5 percent of gross weekly sales.[12]

- McDonald's franchise agreements empower the McDonald's Corporate to select a site for the restaurant premises and negotiate the purchase of a lease. This means that on top of royalty payments and advertising fees, franchisees often have to pay rents to the franchisor amounting to 8.5 – 14 percent of monthly sales. McDonald's Corporate also conducts visits by operations consultants who monitor the implementation of business practices and policies.[13] McDonald's Corporate collects a 4 percent of gross sales royalty payment monthly and requires a 4 percent of gross sales advertising contribution.[14]

[8] Subway, Burger King, and McDonald's Franchise Agreements, submitted to Minnesota Department of Commerce.
[9] Item 8, p. 38, Burger King Franchise Agreement, submitted to Minnesota Department of Commerce.
[10] Item 6, p. 23, Burger King Franchise Agreement, submitted to Minnesota Department of Commerce
[11] Section 5b, p. 3-4, 2013 Subway Franchise Agreement, submitted to Minnesota Department of Commerce.
[12] Subway Franchise Agreement, p. 35. Submitted to Minnesota Department of Commerce
[13] McDonald's Franchise Agreement, p. 45, submitted to Minnesota Department of Commerce.
[14] Ibid.

## Franchisors direct franchisee personnel policies

Franchisors enforce uniformity of service and product standards through detailed operating manuals that designate cleaning and maintenance procedures, grooming and uniform standards, as well as training requirements. Noncompliance with corporate operating procedures can result in the stiff penalties for franchisees including termination of their franchise agreement.[15]

- Burger King Corporate's Manual of Operating Data Manual (MOD Manual) details staffing procedures around opening and closing, lunch changeover, and even overall labor scheduling guidelines.[16]
- After visiting a franchisee's store, a Burger King Corporate inspector's report instructed the franchisee to "ensure appropriate staffing levels using accurate sales projections to meet business needs," with a deadline of "now." The report also noted failures to meet Burger King Corporate cleanliness standards and directed the franchisee to improve "assignment and completion of tasks."[17]
- A McDonald's Corporate inspector told a Florida franchisee to add staff to the drive through, cross-train employees and improve maintenance. The inspector emphasized that consistent, satisfactory ratings on McDonald's Corporate standards are "not merely a goal or target" but rather "a requirement of your McDonald's franchise contract."[18]
- Domino's Corporate promulgated compensation policies and implemented them through its proprietary "PULSE" software system, which tracks franchisee employee hours and wages and payroll records and to which Domino's corporate has access.[19]

## Regulators confirm franchisors exercise functional control over franchisees

Regulators are increasingly holding franchisors accountable for the labor practices of franchisees. A 2010 study for the U.S. Department of Labor's Wage and Hour Division found that if a franchisor retains sufficient operational control it should be held liable as a joint employer under the Fair Labor Standards Act (FLSA).[20]

- Most recently, 61 Domino's delivery workers in New York won $ 1.28 million in a back pay from Domino's Corporate after a wage theft lawsuit found Domino's Corporate liable based on joint employer theory. The plaintiffs argued that corporate Domino's controlled key functions of their jobs, including hiring, management policies, training, staff equipment, uniforms, supplies, delivery areas and methods and procedures for delivery. Crucially, since Domino's Corporate controlled the record-keeping systems used by the franchisee, Domino's Corporate had the

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[15] Subway, Burger King, and McDonald's Franchise Agreements, submitted to Minnesota Department of Commerce.
[16] Burger King Franchise Agreement, p. 49, submitted to Minnesota Department of Commerce.
[17] *Burger King Corp. v. Duke and King Acquisition Corp. et. al*., 10-cv-20992 (S.D. Fla. March 29, 2010), Exhibits to defendant's memo in opposition to BK's motion to enjoin the franchisees from continuing operations, Doc 22-12, p. 8 and Doc. 22-13, p. 6.
[18] *Cano et al v. DPNY et al*., 1:10-CV-07100 (ALC (JCF) (S.D. N.Y.), Memorandum and Order, Document no. 104, pp. 15-16.
[19] *Cano et al v. DPNY et al*., 1:10-CV-07100 (ALC (JCF) (S.D. N.Y.), Memorandum and Order, Document no. 104, pp. 15-16.
[20] Weil, David. 'Improving workplace conditions through strategic enforcement' A report to the wage and hour division, 2010.

information necessary to determine that the plaintiffs had worked certain hours and had not been paid for all of that time.[21]

- In March 2014, McDonald's workers in three states sued McDonald's Corporate charging that Corporate shares responsibility with its franchisees for practices such as shaving hours form time cards, requiring off-the-clock work and not paying overtime.[22]

**Corporate chains & franchisees can adjust to a higher-wage, higher-demand environment**

Franchisors have the capacity to adapt franchise agreements to higher-wage, higher-demand environments. For instance, Burger King Corporate recently offered franchisees royalty rate reductions to accommodate increased costs due to required restaurant remodels and has also worked with struggling franchisees to restructure their financial obligations in a way that makes their restaurants viable.[23][24]

- Minimum wage increases do not necessarily lead to significant price hikes: a recent study found that in Santa Fe, which saw a 65% minimum wage increase from its recent minimum wage ordinance , fast food stores in the city only experienced increased business costs of 3%.[25]
- Despite the 28% difference in the minimum wage across the Washington/Idaho state line, fast food prices are essentially identical. (Minimum wage is $9.32/hour in Washington, and $7.25 hour in Idaho)[26]
- Higher pay across Seattle under Mayor Murray's minimum wage proposal will boost Corporate and franchisee revenue by supersizing consumer demand at fast food and other businesses – Seattle consumers will be able to buy a lot more burgers if they are paid $15/hour instead of $9.32.[27]
- Mayor Murray's proposal phases in franchise businesses at approximately 18% wage increases each year. This is in line with national minimum wage phase-ins in cities implementing minimum wage increases, as the average phase-in nationally is 16.7% each year.[28]

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[21] Richard Blum and Hollis Pfitsch. 'Domino's' Challenges Joint Employer Liability for Franchisors.' New York Law Journal,February 26 2014.
[22] Greenhouse, Steven. 'McDonald's Workers File Wage Suits in 3 states'. New York Times, March 13 2014.
[23] Burger King Franchise Agreement, p. 24, submitted to Minnesota Department of Commerce.
[24] *Burger King Corporation v Elizabeth Sadik et al* 07-20181-CV-MGC
[25] The Cost to Fast-Food Restaurants of a Minimum Wage Increase to $10.50 per Hour. Jeanette Wicks-Lim and Robert Pollin, University of Massachusetts, Amherst, September 2013. Accessed at: http://www.peri.umass.edu/fileadmin/pdf/research_brief/PERI_fast_food_wages.pdf. Pages 13 and 14 compile data from several minimum wage increases ranging from 10% to 65%.
[26] For example, Big Mac Value meals have identical pre-tax prices in Liberty Lake, WA and Post Falls, ID, despite a minimum wage difference of more than $2/hour. Source: Raising minimum wage doesn't seem to affect employment, in 3 charts (and 2 McDonald's meals). Jeff Simon, 1/8/2014, Washington Post. Accessed at: http://www.washingtonpost.com/blogs/govbeat/wp/2014/01/08/raising-minimum-wage-doesnt-seem-to-affect-employment-in-3-charts-and-2-mcdonaldsmeals/
[27] A 2011 study by the Chicago Federal Reserve Bank found that minimum wage increases raise incomes and increase consumer spending, especially triggering car purchases. Source: The Spending and Debt Responses to Minimum Wage Increases. Daniel Aaronson, Sumit Agarwal, and Eric French, Federal Reserve Bank of Chicago. Accessed at: http://www.chicagofed.org/digital_assets/publications/working_papers/2007/wp2007_23.pdf
[28] Michael Reich, Ken Jacobs and Annette Bernhardt. Local Minimum Wage Laws: Impacts on Workers, Families and Businesses, p 6. March 2014