CASE 1
Subway Sandwich Shops

Success in the sandwich segment requires operators to work significantly harder than they did just a few years ago. There was a noticeable slowdown in the opening of new submarine sandwich shops in 1992, although the growth rate still exceeds most other restaurant segments. Competition has intensified, with hamburger chains such as Hardee's and Burger King experimenting with sub sandwiches as menu additions. Subs seem to be a category anyone can participate in. Subs offer easy entry into the foodservice business and a simple, low-cost route to menu expansion, plus health appeal. Market data indicates that the sandwich is firmly established as a nationwide food item and there is plenty of room for growth in all areas. Many operators also see opportunities for sub-like concepts. For example, one variety of sandwich shop that continues to expand specializes in Philadelphia-style cheese-steak subs.

For sub shops, the Subway chain is the undisputed market leader, with 10 times more locations than any other competitor and more than 75 percent of all United States sub chain outlets. As of mid-1993, Subway operated 7,825 units worldwide, with about 7,750 units in North America. When it reached 8,400 stores in 1993, Subway was the No. 2 fast-food chain in the United States. By opening its small sandwich shops at breakneck speed, Subway grew from $360 million in sales in 1987 to $2.2 billion in sales in 1992 (Figure 1–1), while income increased substantially (Fig. 1–2). The former No. 2 was Pizza Hut, which operated 7,929 units in North America and expected to have 8,355 by the end of 1992, However, in terms of sales, Subway ranks 12th among chains nationwide. Sales are about 15 percent of McDonald's.

Subway is also looking to expand its nontraditional sites. The chain has about 150 outlets in colleges, convenience stores, hospitals, bus terminals, railway stations, and convention centers. Other future areas of emphasis include improving business during the dinner hour and late night and more marketing to children. About 4,000

"Subway Sub Shops," by William J. McDonald, reprinted from *Cases in Strategic Marketing Management*, 1998, Prentice-Hall, Inc.

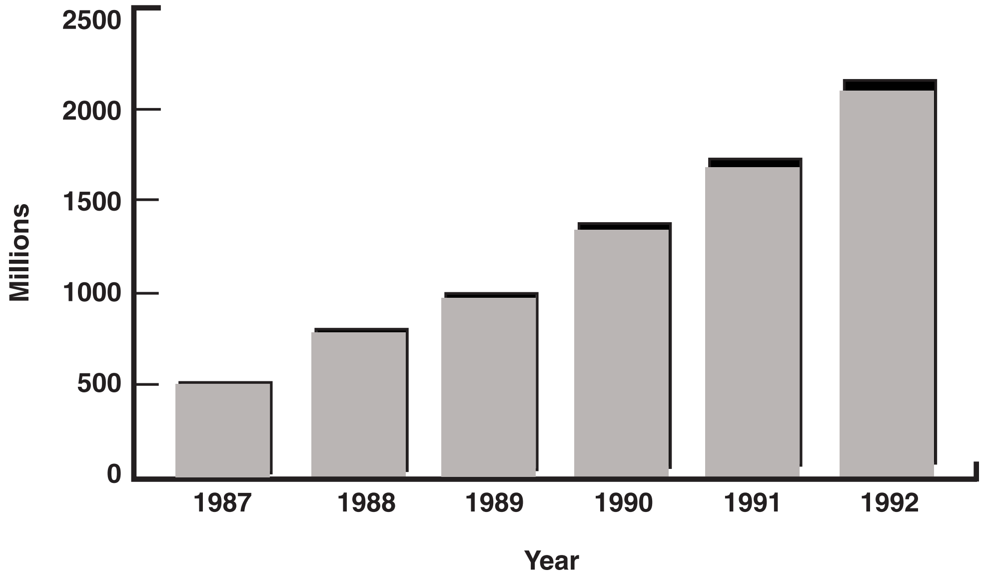

FIGURE 1–1 Worldwide Sales of Subway Sandwich Shops
Source: Estimated from various sources

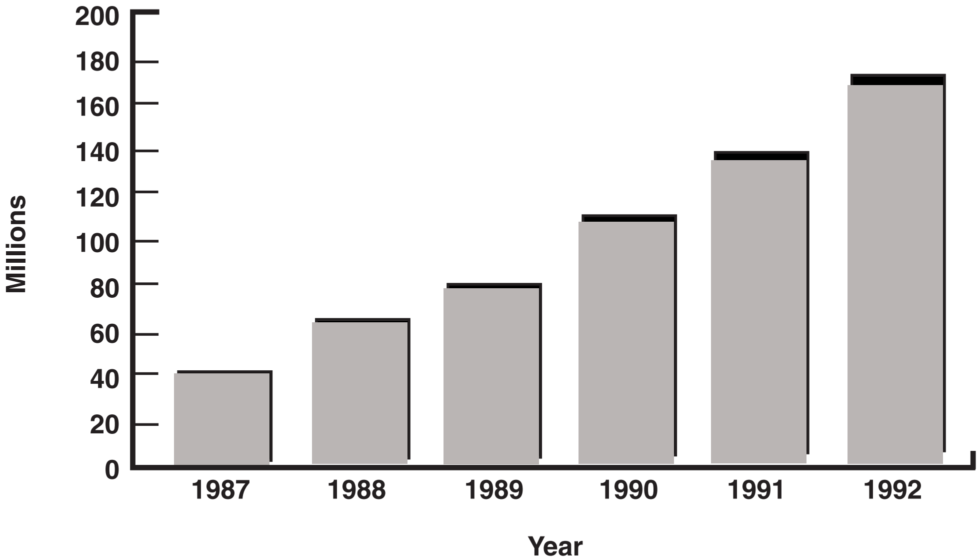

FIGURE 1–2 Worldwide Income from Subway Sandwich Shops
Source: Estimated from various sources

outlets now feature kid's packs, which include food items and a premium gift. In 1994 Subway also made a concerted effort to spend marketing dollars against teens and pre-teens.

However, Subway's rapid expansion has brought with it some problems. Franchises are upset about the location of many new stores, claiming that these additions are cannibalizing sales at existing units. Some disgruntled franchises have also charged the chain with making unrealistic financial projections during sales pitches. The Federal Trade Commission is looking into the complaints.

Among sub operators, Blimpie is running second to Subway in both unit totals and expansion plans. The New York-based firm opened about 100 restaurants in 1992, for a total of 575. It planned to reach 1,000 units by 1995. Blimpie has broken out of the Northeast over the past three years, with stores now open in 32 states, and it has begun to focus on international development.

Virtually all of Subway's competitors agree that the chain's main vulnerability is its product quality. Whether their version is an upscale, quasi-deli restaurant operation, or a more traditional, basic sub shop such as Blimpie, these other operators stress quality advantages over Subway in their efforts to attract customers and prospective franchises.

THE SANDWICH RESTAURANT INDUSTRY

Although sub and sandwich shops offer some of the best growth opportunities in fast food today, there are signs that the category is not what it used to be. Subway's rapid growth in recent years put sub sandwiches on the fast-food map and served to attract tremendous attention as well as investment dollars into the category. In part due to the increased competition, fewer operators and franchise prospects today view the name-brand sub shop as the easy way to success, compared with a couple of years ago.

Growing Competition

Competition is growing not just from other subsandwich places, but from numerous other sources. Seeking to take advantage of their rising popularity and the public perception of subs as lighter, healthier alternatives to hamburgers and fried foods, the burger chains, McDonald's and Burger King, are experimenting with sub sandwiches as menu additions. Arby's, a veteran competitor in the sandwich market with 2,570 restaurants and $1.6 million in annual sales, has also aggressively pushed into the sub business. It launched a four-item cold sub shop line, augmented with a new hot sub offering. Subs are also a popular item at a growing number of supermarkets and convenience stores because they are easy to prepare and serve, require little investment in expensive equipment, and generate good profits.

However, for traditional sub shop operators whose primary business is strictly sub sandwiches, there are questions about profitability. The low start-up costs, typically ranging from as little as $50,000 to $130,000, are matched by generally low store sales. Segment leader Subway's annual unit volume is between $250,000 to $260,000, although the company claimed sales at mature units averaged closer to

$280,000 in 1992. Then, even with the units' low operating costs, it is a close call as to whether such modest sales volumes provide a decent return on investment (ROI).

Neither Subway nor competitors with similar volumes are satisfied with their numbers, and many operators are focusing their attention on ways to boost unit sales. Common efforts include adding more higher-priced hot sandwiches and some non-sandwich items, expanding beyond lunch into other dayparts, and marketing office and party catering services.

Upscale Shops

There is a growing trend toward upscale sub sandwich shops. Rather than remaining a stripped-down location designed primarily to provide working people with a quick take-out lunch, some shops, such as Quizno's Classic Subs, are styled as casual deli restaurants that aim to attract substantial eat-in business, including families.

Most Quizno's units seat 70 to 80 and average 65 percent of sales as eat-in traffic. The menu, which features a wide selection of fresh-made, oven-warmed subs, is augmented by chef salads, pasta dinners, extras such as soups and desserts, plus special QuizKidz meals. These additions have contributed to a 20 percent gain in unit sales and boosted evening business from 10 percent of volume to 30 percent. They have also helped Quizno's substantially increase weekend business.

Togo's Eatery, with 155 locations, manages higher volumes, in the $450,000 per year range, by highlighting quality ingredients in its menu of 30 hot and cold sandwiches, salads, fresh soups, and homemade chili. Also, it features an upscale decor package, including touches such as Italian tile, marble, and oak furnishings.

Nontraditional Sub Offerings

Outside the traditional sub category, some sandwich chains are planning aggressive growth. One example is Miami Subs, which despite its name offers a broad-based menu of gourmet burgers, gyros, and chicken and shrimp platters, as well as hot and cold subs. The latter account for about 40 percent of sales.

Miami Subs sees itself as positioned somewhere between Chili's and McDonald's. Its service style is that of a fast-food shop, but in terms of food quality, quantity, presentation, and the fact that everything is made fresh puts it closer to a Chili's or other similar casual theme restaurant.

Schlotzsky's, which after struggling for a few years, plans to completely revamp its concept. Originally conceived as a fast-food outlet featuring a distinctive sandwich based on New Orleans' Muffuletta, Schlotzsky's recast itself as The Original Schlotzsky's Deli, serving an expanded menu of sandwiches, pizza, and salads, in a noticeably upscale, deli/market atmosphere.

Schlotzsky's customers perceive the chain as offering a quality product at a convenient location, and they are willing to pay for that difference. Schlotzsky's also upscaled its offerings and raised prices by 33 percent, increased the quality and quantity and broadened the menu. The strategy paid off, with converted locations boosting annual sales from an average of just $300,000 to $450,000 today.

Another variety of sandwich shop that continues to expand specializes in Philadelphia-style cheese steak subs. With their higher product and operating costs, most concentrate on developing mall units, sites in transportation centers, downtown office complexes, and selected other locations where they are guaranteed high pass-by traffic.

The cheese steak purveyors and other shops that feature hot, grilled sandwiches are reaching for ways to build stronger evening business. One chain that has been successful is Jerry's Subs & Pizza, which features Philly cheesesteak sandwiches and other subs for lunch and draws dinner business with a full pizza operation. Unit sales average in excess of $550,000.

This is a concept that many other sandwich chains are exploring. Schlotzsky's began offering pizza several years ago and kept it an integral part of its revised concept. Blimpie and D'Angelo's are currently testing pizza, and Quizno's offers it as part of its kids' menu.

New Dayparts

A growing number of sandwich chains are also following fast food's move into breakfast in an attempt to build unit volumes. Subway now offers breakfast in 500 stores. Blimpie, D'Angelo's, and Great Steak & Fry are among the chains testing this concept.

Value Pricing

With its intention of going head-to-head against McDonald's and Taco Bell, Subway committed itself to offering value items. It started by introducing a line of 79-cent Rounds sandwiches. Arby's is also focusing on Value Melts priced at 99 cents: roast beef sandwiches with melted cheddar or Swiss cheese.

Likewise, Jerry's Subs finds it's impossible not to address value pricing. Jerry's main value offering is a new $1.99 Philly Double Cheesesteak Junior, targeted at price-conscious customers. Blimpie, too, offers a value menu of Quik Bite sandwiches priced 99 cents to $1.69, credited with attracting some new business. However, as with several other sandwich chains, Blimpie's main focus is building value perceptions with specially-priced meal combos. Taking a different strategy, most of the more upscale chains have sought to avoid price competition completely by positioning themselves above standard fast food.

FRED DELUCA'S SUBWAY

When Fred DeLuca, the founder of Subway, opened the first Subway Sandwiches & Salads shop in Bridgeport, Connecticut in 1965, his primary goal was to just stay in business. When he managed to make it through his second year without declaring bankruptcy, he became more ambitious. By 1982, DeLuca was planning to open at least 5,000 Subways by 1994. When he hit that mark early, in 1990, he upped the ante. When the chain approached its next goal of 5,000 stores, it thought its growth would begin to slow, but that has not happened, expansion has been very steady.

However, a chain with thousands of stores does not just happen by accident. Since Subway last topped the *Entrepreneur* list of top franchises in 1991, the company has taken a more aggressive approach to international franchising. Although most of Subway's stores are located in the United States, there are nearly 400 locations in Canada. People in countries as far afield as Australia, Japan, Israel, Ireland, Mexico, Portugal, and South Korea are also discovering the all-American taste of Subway's submarine sandwiches.

DeLuca's most important goal is to increase average sales volume per store, while decreasing operational costs. Thus, although growth is still a priority, Subway is placing an even greater emphasis on each individual store's volume and profitability.

CUSTOMER ANALYSIS

A surprising 78.7 percent of all adults have patronized a fast-food or drive-in restaurant in the last 30 days (Table 1–1). And, some 31 percent of those same adults went 14 or more times to such a restaurant during that same time period (Table 1–1), making heavy users of the category. Demographically, heavy users are also more likely to be male, young, single, and live in the Northeast (Table 1–2).

In general, fast-food or drive-in restaurants appeal to a younger crowd who are single or young adults with children (Table 1–3). Subway has some unique customer demographics in comparison with Arby's, McDonald's, and the other fast-food or drive-in restaurants. These demographics skew much younger and single than those of major competitors (assuming that Arby's and McDonald's are competitors). In contrast to Arby's and McDonald's, Subway also has a much stronger franchise in the western United States. Both Arby's and Subway are more skewed toward middle to upper income customers than McDonald's. However, McDonald's does much better with adults who have children (Table 1–3).

The fast-food category has four main eating occasions each day: breakfast, lunch, dinner, and/or snack times (Table 1–1). Lunch is the most popular occasion for heavy users. Among all those who go to these restaurants, many go alone or with a spouse (Table 1–3). Eating with friends is also popular, as is taking the children.

Subway is low on the list of major fast-food or drive-in restaurants patronized in the last 30 days (Table 1–4). McDonald's, Burger King, and KFC are each several times more likely to be visited than is a Subway location.

PROMOTION

Advertising plays an important part in the success of any business and Subway is no exception. In addition to individual location efforts to increase sales, all Subway franchises contribute 2.5 percent (some markets elect to contribute more than this percentage) of weekly sales to the Subway Franchisee Advertising Fund Trust (SFAFT).

SFAFT is governed by a Board of Trustees consisting of 12 elected franchise owners from across the chain. The SFAFT Board meets each quarter to discuss all aspects of future chain-wide advertising.

The owners of stores located in the same market work together to purchase advertising that benefits the entire group. Each market also elects an Ad Chairperson to preside over all local meetings and to provide input on chain-wide SFAFT proposals.

To help develop the chain's advertising campaigns, SFAFT retains an advertising agency. That agency produces all the materials needed by franchises to get consis-

TABLE 1–1 FAST-FOOD AND DRIVE-IN RESTAURANTS *(respondents are all adults)*

User of	*%*
Yes	78.7
No	16.0
Don't know	5.3
Total	**100.0**

FREQUENCY OF USE IN LAST 30 DAYS

Number of Times	*(%)*
14 or more	30.9
10-13	13.2
6-9	17.6
5	4.2
4	4.7
3	2.9
2	2.5
1	1.0
None	1.7
Total	***78.7***

FREQUENCY OF USE IN LAST 30 DAYS BY OCCASION

Number of Times	Breakfast (%)	Lunch (%)	Dinner (%)	Snack (%)
14 or more	3.1	6.7	4.8	4.2
10-13	2.0	4.4	3.6	3.0
6-9	4.3	8.6	8.2	5.3
5	3.5	7.9	8.1	4.4
4	5.0	9.6	10.5	5.1
3	7.6	10.9	10.8	6.9
2	10.7	13.4	13.0	9.8
1	12.1	7.9	9.2	9.1
None	30.3	9.1	10.4	30.9
Total	***78.6***	***78.5***	***78.6***	***78.7***

Source: Simmons Market Research Bureau, Inc., 1991

tent messages to consumers. Agency representatives attend all SFAFT Board meetings to propose campaigns and communicate with the SFAFT office. To inform consumers about Subway's advertising messages, SFAFT has commercials on the national television networks.

Spending Level

Some 99 percent of Subway advertising is on television, with the rest spread over radio, outdoor, newspapers, and magazines. The advertising budget for 1992 was about $38.7 million. In comparison, Arby's budget was $26.3 million and Blimpie spent a total of $0.2 million; McDonald's spent about $413.5 million.

TABLE 1-2 **Fast Food and Drive-in Restaurants Category User demographics**
(respondents are all adults)

	ALL USERS		HEAVY USERS 14 OR MORE	
	%	*Index*	%	*Index*
TOTAL	**78.6**	**100**	**30.9**	**100**
Gender				
male	79.7	101	35.5	115
Female	77.7	99	26.7	86
Age				
18-24	80.6	102	34.7	112
25-34	84.7	108	32.2	104
35-44	85.4	109	32.3	104
45-54	80.4	102	31.0	100
55-64	73.9	94	29.1	94
65 and older	60.8	77	25.1	81
Marital Status				
Single	79.7	101	34.0	110
Married	80.3	102	30.1	97
Divorced, etc.	72.2	92	29.8	96
Parents	86.2	110	31.6	102
Region				
Northeast	69.8	89	39.4	127
Midwest	84.4	107	34.6	112
South	80.1	102	29.6	96
West	78.5	100	19.9	64
Income				
$75+	80.8	103	29.7	96
$60+	80.0	102	30.2	98
$50+	81.6	104	30.8	100
$40+	81,6	104	31.6	102
$30+	82.0	104	31.7	103
$30-$39	83.1	106	32.1	104
$20-$29	80.1	102	32.0	104
$10-$19	75.2	96	31.1	101
Less than $10	64.5	82	24.9	80
PRESENCE OF CHILDREN				
Under 2 years	86.2	110	32.3	104
2-5	87.4	111	30.4	98
6-11	85.2	108	31.6	102
12-17	84.2	107	34.0	110

NOTE: Index values above are computed by dividing the proportion in a particular grouping by their proportion of the population. For example, if an age group has 20.2% of the products users and represents 18.3% of the population, the index value for the grouping is 110. Index values over 100 signify above average usage and index values below 100 signify below average usage. However, values over 110 or under 90 are the most significant.

Source: Simmons Market Research Bureau, Inc., 1991.

TABLE 1-3 Fast-Food and Drive-In Restaurants *(respondents are all adults)*

With Whom Do You Usually Go to These Restaurants?

	Total (%)	Breakfast (%)	Lunch (%)	Dinner (%)	Snack (%)
Alone	26.3	11.6	15.0	7.8	8.3
With husband/wife	29.6	9.5	13.8	21.3	6.3
With children under 12	17.1	4.6	8.7	11.7	3.9
With children 12-17	7.9	1.7	3.3	5.4	119
With friends	20.4	5.6	11.4	11.9	6.3
With coworkers	11.2	1.8	9.2	1.7	1.2
Other	7.8	2.4	3.7	4.5	2.4
Don't know	4.3	26.2	21.0	23.8	51.6
TOTAL	**124.6**	**63A**	**86.1**	**88.1**	**81.9**

Restaurants Visited in the Last 30 Days (selected firms)

	All (%)	Sole (%)	Primary (%)	Secondary (%)
Burger King	28.6	1.8	21.7	5.1
Domino's Pizza	9.2	0.1	6.4	2.7
Godfather's Pizza	1.7	0.0	1.2	0.5
KFC	19.8	0.6	14.3	4.9
McDonald's	44.0	5.2	34.1	4.7
Pizza Hut	19.6	0.4	13.9	5.3
Subway	4.6	0.1	3.1	1.4
Taco Bell	15.9	0.3	11.9	3.7
Wendy's	15.9	0.6	11.8	3.5
TOTAL	**159.3**	**9.1**	**118.4**	**31.8**

Source: Simmons Market Research Bureau, Inc., 1991.

Campaigns

Subway Sandwich Shops broke a new campaign in 1993 that summed up the chain's rapid rise to the top of the sub market. The promotion, called the "No. 2¢ Sale," symbolized the submarine sandwich chain's claim that it will soon be the second largest fast-food chain in North America.

The campaign, which featured black and white visuals with color product shots, starred Subway franchises. It helped drive Subway's best sales year ever, while spurring a few copycat campaigns from other chains. The four-week "No. 2¢ Sale" offered game-card winners sandwiches and other items for 2¢. The campaign ran on network and cable prime time, as well as on sports and syndicated programs, carrying Subway's new theme: "Subway is the place where fresh is the taste."

The campaign was followed by a tie-in with the Paramount Pictures film "The Coneheads" and a "Consume Mass Quantities Meal Deal" promotion. Subway's most popular sandwich, the turkey sub, and chips and a Coneheads collector cup were offered at a special price, varying by markets.

TABLE 1-4 **Fast-Food and Drive-In Restaurants by Firm User Demographics**
(respondents are all adults)

	SUBWAY %	SUBWAY Index	MCDONALD'S %	MCDONALD'S Index	ARBY'S %	ARBY'S Index
TOTAL	**4.6**	**100**	**44.0**	**100**	**10.7**	**100**
Gender						
Male	5.0	109	44.3	101	11.0	100
Female	4.2	92	43.8	99	10.4	97
Age						
18–24	8.1	177	49.3	112	12.4	116
25–34	5.7	124	51.3	117	12.2	114
35–44	5.4	117	48.9	111	11.7	109
45–54	3.7	80	43.8	99	10.4	99
55–64	2.3	51	37.2	84	8.9	83
65 and older	1.2	26	27.1	61	7.0	65
Marital Status						
Single	7.8	170	46.2	105	12.8	120
Married	3.6	79	44.9	102	10.1	94
Divorced, etc.	3.9	86	38.7	88	10.2	95
Parents	4.9	107	53.3	121	11.4	107
Region						
Northeast	1.7	38	42.4	96	5.6	52
Midwest	5.3	116	51.2	116	13.9	130
South	4.5	98	41.0	93	11.5	108
West	6.8	148	42.2	96	10.9	102
Income						
$75+	5.1	111	46.3	105	13.2	123
$60+	5.5	119	46.8	106	13.6	127
$50+	5.4	118	48.2	109	13.0	121
$40+	5.5	121	47.7	108	12.2	114
$30+	5.3	116	47.8	108	12.2	114
$30–$39	4.7	103	48.0	109	12.1	113
$20–$29	4.2	92	42.7	97	9.5	88
$10–$19	3.6	78	41.2	94	10.0	93
Less than $10	2.8	61	31.0	70	6.0	56
Presence of children						
Under 2 years	5.1	112	55.5	126	10.6	99
2–5	5.0	109	58.1	132	10.2	95
6–11	4.8	105	53.3	121	10.9	102
12–17	5.3	115	47.6	108	12.6	118

Note: Index values above are computed by dividing the proportion in a particular grouping by their proportion of the population. For example, if an age group has 20.2% of the products users and represents 18.3% of the population, the index value for the grouping is 110. Index values over 100 signify above average usage and index Values below 100 signify below average usage. However, values over 110 or under 90 are the most significant.

Source: Simmons Market Research Bureau, Inc., 1991.

PROBLEMS IN FRANCHISE LAND

Charges of broken promises and hidden costs are just some of the problems plaguing franchising today. Throughout the $246 billion industry, defined to exclude auto dealers and gas stations, franchisees are battling franchisors for more control over their businesses. The franchisors are fighting back to preserve their profits. At stake is the 12.7 percent of retail sales accounted for by franchises.

Anything these days can be, and is, a franchise, from steel bungee jumping towers (Air Boingo) to gun shops (Strictly Shooting). For small-business owners, franchising offers an alternative way of raising capital, which speeds growth. For more laid-off managers and early retirees, it is a way to pursue the American dream of owning a business.

Bad management and poor locations have resulted in many franchises failing in past years, And, the recession, over saturation in many markets, and huge debt loads from leveraged buyouts put new pressures on franchisors to squeeze franchisees. As franchisors burrow into new markets, they are also increasingly vying for the franchisees' customers.

The industry claims are that fewer than 5 percent of franchises fail or close annually. In comparison, the U.S. Small Business Administration says that 63 percent of new businesses fail after six years. Most experts would agree that more franchises survive than other new businesses. The actual franchise annual failure rate is probably between 10 and 12 percent.

DIFFERENTIAL ADVANTAGE

Even with a recession and intense competition, the fast-food and drive-in restaurant category has a bright future. It is popular with consumers mainly because it satisfies their needs for convenient, value-oriented products that taste good. While they may change the mix of the fast foods they consume (pizza versus subs versus burgers), there is not any indication that consumers are about to descend on the supermarkets in mass so that they can go home and cook from scratch.

The real questions for firms in this category revolve around marketing issues: how to develop and keep a differential advantage in a highly competitive and dynamic market, while maintaining sales growth and, above all, profitability. What marketing strategy would you recommend to Subway? What specific price, distribution, promotion, and product elements would you propose and why? How would you deal with the growth competition in the sub market?

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