

Footing the bill

Low prices boost sub shops

By Jonathan Maze

Jim Underwood, owner of eight Subway stores in Alabama, was a bit hesitant when his franchisor first introduced \$5 footlong subs more than a year ago. Lower prices make the franchisee's job tougher because they're the ones who have to squeeze a profit out of those lower prices.

Underwood isn't hesitant anymore. "I'm paying a little extra food costs, and am getting a little less on the bottom line as a percentage," he said. "But I had the best year ever, profit-wise, in 2008. So how could I really complain too much? It worked."

He's not the only one who had a good year. Subway's sales were up 17 percent last year, according to the restaurant-consulting firm Technomic—a hefty amount for such a giant chain. Much of the credit goes to that \$5 promotion, timed perfectly at the outset of a recession that would turn diners into value-conscious consumers.

There is also evidence that the promotion provided a boost to the sandwich sector as a whole. Several of Subway's competitors, including Quiznos and Blimpie, responded with their own deals, making the chains desirable destinations for the frugal diner. According to figures from UBS Investment Research, sandwich sector traffic has outpaced overall growth in quick-service dining since Subway came out with its \$5 footlong promotion last spring.

NPD Group, a market-research firm, likewise reported that the sandwich sector outpaced the QSR segment from December through February.

Companies that don't have that value proposition have suffered. Arby's, the hybrid sandwich chain that appears more like a quick-service burger chain, has seen its sales plummet in recent quarters, which it blames on its own failure to effectively communicate

its value.

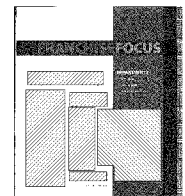
Franchisees are having to admit that the lower prices are a reality of the restaurant business right now. Consumers who move from one restaurant to the other are overwhelmingly doing so on the basis of price amid economic concerns—if they're eating out at all.

The prices could create an expectation among consumers that remains well after the economy returns, so they no longer get the higher priced items. "With the economy, you need to stay current and relevant," said Christine Specht, president and chief operating officer of Cousins Subs, a regional chain based in Wisconsin. "But it is a double-edged sword. You don't want to de-value your product."

Nevertheless, the sandwich sector has been well positioned to not just withstand the economic turmoil but to thrive in it. The chains' generally low cost of entry, combined with their ability to fit into many locations, have enabled them to grow in the past year despite credit markets that are making new units a challenge, said Darren Tristano, executive vice president of the consulting firm Technomic.

Yet even some chains that don't follow the typical sandwich script have managed success. Panera Bread recently reported a 36-percent profit increase in the first quarter, combined with a slight uptick in same-store sales.

And Jimmy John's Gourmet Sandwich Shop saw its sales grow



29 percent last year, along with a 28-percent increase in the number of units. That made it the second fastest-growing restaurant chain last year, according to Technomic, even though it hasn't jumped into the low-cost fray.

To be sure, the company's subs are hardly expensive. And the company may be benefiting from its delivery program, irreverent advertising and the fact that it's a hot brand. Jimmy John Liautaud, the chain's founder, said the company is always making improvements, regardless of the economy. "If you're not just doing continual improvement, on a daily basis, in every aspect of your business's life, you're not going to succeed, he said. "When the economy hit, we were ready to execute, ready to rock n' roll. We just did what we do every day." He added that 70 percent of the company's franchise sales are to existing owners, and the company has been "surgical" about the way it opens units.

Franchisee innovation

Despite the success of some chains, price remains the top reason consumers switch from one brand to another. "Absolutely, price is top of mind," Tristano said.

Subway's footlong promotion was started by a Florida franchisee who lowered the price on the larger sandwiches to \$5 on weekends. It was so successful other owners adopted the strategy. That caught the attention of Subway's national ad fund, which is controlled by the owners.

"We tracked it, followed it, and saw that it worked on a number of different levels," said Tony Pace, chief marketing officer for the Subway Franchisee Advertising Fund Trust. "We had a pretty good inkling it would be successful, but even those expectations

were exceeded."

Pace said Subway planned the promotion without regard to the economic environment, but by spring it was evident consumers were focused on value.

It had been something of a risk for the chain, given that the price point for value offerings is traditionally \$1, not \$5. Yet given the size of the sandwich, \$5 was considered a good deal. Traffic at Subway units surged, and the company made the promotion permanent, pricing several foot-long subs at \$5 as part of the value menu. The value menu may help Subway in regards to long-term pricing expectations by giving diners a choice of sandwiches always available for that price.

Other chains have gotten into the act. Quiznos struggled in the face of Subway's offer. And its initial foray into the cheap-sandwich world—offering a limited selection of its large subs for \$5.99—was coupled with its controversial sandwich giveaway in which many owners didn't participate, resulting in plenty of bad publicity.

More recently, the chain seems to have found its footing. Its \$4 "Toasty Torpedo" appears to be generating traffic. While many owners have been skeptical of the chain's deals in the past, there are indications that the owners believe them to be necessary in the current environment.

The \$4 Torpedo "has definitely brought traffic in," said Trevor Werner, who owns three Quiznos shops in Nebraska. "We're seeing a lot of customers we never saw before." Werner noted that Quiznos has a reputation for higher prices, even though prices haven't increased in a decade, and thus consumers believe the \$4 sub to be a higher value.

Blimpie, the 45-year-old sandwich concept based in Arizona, didn't take long to jump on the value bandwagon. The company began offering its 12-inch subs for \$5 in the summer, then added \$5 combo deals with six-inch subs combined with a chips and a drink. It also multiplied its meal deal by four, priced it at \$19.99 and called it a Family Pack.

Jeff Smit, brand president for the Kahala-owned Blimpie and a veteran of the casual diner T.G.I. Friday's, said he wondered at the end of 2007 why Blimpie didn't have a value menu.

While Blimpie's customers are loyal, Smit did say pricing is vital in the highly competitive lunch segment—as is product innovation, which is also why many sandwich chains keep adding products. Blimpie, for instance, recently added Panini Grilled Subs to its menu. "Clearly, at lunch, everybody is fighting for the same consumer," Smit said. "People like to try different things at lunch. It's a competitive segment."

Some chains have opted against giving lower prices a permanent spot on their menu, but they have opted for limited-time offers. Charley's Grilled Subs, for instance, has had to deal with a decline in the nation's malls, where most of its 381 units are located.

In response, the company has tried local print advertising and targeted discounting to attract consumers. Ed Randall, vice president of operations for Charley's, called it an "anomaly."

"We can't do much about driving traffic into malls," he said. "We don't consider ourselves a destination. But we've fought harder for the traffic that has been there. We've had opportunities to get customers in, especially on weekends.

That's helped our growth, and has brought people to the mall, specifically to us."

Randall is exploring a strategy to open stand-alone units to complement its mall strategy. "We have a very large growth goal," Randall said. "It can't be achieved through a captive audience like malls."

Cousins has used limited offers to bring in traffic. It had a two-for-\$5 promotion, and now has \$5 combo meals. One owner said that when the promotion was over, people walked out after hearing the offer was no longer available.

Traffic versus income

Value promotions can lure traffic at the expense of profits. Lower prices reduce profit per meal, which ultimately squeezes the franchisees—many of which are already dealing with increased labor costs, thanks to the increase in the national minimum wage.

"I don't know how they can maintain their margin, but we're all focusing on the top line, customer traffic," Tristano said. "Keep them coming, pay your bills. Keep the door open."

Yet the economy driving consumers toward value offerings is also reducing worldwide demand, which has eased commodity prices which at the outset of the low-price trend were hammering sandwich chains. Lower commodity prices had made it easier on local owners offering these deals.

While the lower prices increase a restaurant's food-cost percentage, they reduce the percentage of sales spent on labor because existing staff is serving more customers, Underwood said. And Subway's Tony Pace added, franchisees "still

make a profit" off a \$5 footlong.

"There is a discount, but it's still a profitable sandwich," he said. "And it's succeeded in bringing in monumental amounts of traffic. At the end of the day, the proof is in the results. Even people who were skeptical are now believers." **FT**



Christine Specht, president
and COO of Cousins Subs.



Blimpie's brand president,
Jeff Smit.



Blimpie was one of the chains that responded quickly to Subway's move to a \$5 footlong last year. The lower prices have provided a boost for the entire industry at a time when consumers are dining out less.