



Subway founder Fred DeLuca talks about

Hank Armour: How did Subway get its start, and how has it evolved over the years?

Fred DeLuca: Subway got started in 1965. I was just a kid, and I needed money for college. I told a family friend that I needed money for school and asked him if he had any good ideas, kind of hoping that he might just want to loan me a few bucks. And he said, 'I think you should open a submarine sandwich shop.' I asked him how it worked, and he said, 'It's pretty easy. You get a little store, you build a counter, you buy some food, customers come in and give you money, and you'll have all you need for college.'

He said, 'If you want to do this, I'd be willing to be a partner.' Since I didn't have any better opportunities, I grabbed the idea. He stressed that it was a business and said, 'The goal is 32 stores in 10 years.' He gave me a check for \$1,000, and that's it. I was off to seek my fortune.

I found a little store. I built it without any guidance or training. I had this vision that I needed a counter and a cash register and two bowls for vegetables. The first day of the business, the neighborhood people came to see us, but we weren't able to sustain the sales. We suffered through the first week and almost closed the store.

the company's unique approach to pleasing customers.





Hank Armour interviewed Fred DeLuca for NACS Magazine.

I've known Fred DeLuca for almost a decade. We first met in the early 1990s when I put a Subway into one of my convenience stores and we continued to interact over the subsequent years as I built a chain of both traditional and non-traditional Subways. Most recently, I had the pleasure of interviewing him for the *NACS Magazine* in Las Vegas, Nevada, where the company was holding its franchisee meeting.

Fred reminisced about starting the company as a college student. We talked about Subway's unique business model relative to its fast-food competitors and his analysis of the consumer outcry for healthy alternatives. And, as we always do in these interviews, we talked about leadership. His views on the Subway culture -- and the role he plays in it -- are of particular interest. Read on, and I think you'll come to see that Fred DeLuca is a passionate and decisive entrepreneur with a gut instinct for making foodservice work.

*Hank Armour
President & CEO
Epoch Corporation
NACS Past Chairman*

But you didn't close it. You opened more stores.

That's right. We thought, we can't close because we've failed. We hadn't met our goal of 32 stores. We decided to open up a second store, even though the first one was not successful. By our second winter, we had three stores. But there was a very bad seasonal effect, so when winter came, instead of having one low-volume store, I had three extremely low-volume stores, but I had sympathy.

In the wintertime, unfortunately, sales go south?

Yeah. But I didn't have big expenses. I just had to pay for college. So, I worked a lot of hours. I kept working on improving every aspect of the business, and over the course of nine years, actually, developed a pretty good system, and I built 16 stores. The only problem was that I couldn't imagine getting to 32 stores unless we did something different, and that's how we got into franchising. So that original goal triggered the decision to franchise.

How did you start franchising?

One of my friends was our first franchisee. Then we put an ad in the newspaper. We opened a few stores in Connecticut, then New York and Massachusetts. At some point, we realized that it was hard to serve the stores from a central location. So, we set up a system where some of our franchisees were trained to be development agents — DAs — and promoted within through the system of franchisees. This system caused us to grow quite nicely. By 1982, we had 200 stores.

You've grown quite a bit since then as well.

We did an analysis of the market, and I said, 'You know what? I think

we can have 5,000 stores.' Everybody thought I was a little crazy, but everybody got behind it. The growth began to accelerate to the point where, in 1990, we changed the goal to 8,000 stores by 1995.

How did you decide to make the jump to convenience stores?

In the early 1990s, I visited a convenience store in Portland, Oregon that had a Subway counter in the corner. The employees working on the 'C' side had a lot of interesting and positive things to say about the setup and how many stores we had. I met with Chris Girard, who gave me a quick overview of the economics of the c-store.

I realized that convenience stores are all selling pretty much the same stuff: the same cigarettes, [soft drinks], coffee, beer; differences really boil down to the location, the operating systems and so forth. Placing Subways in the stores creates differentiation and additional revenue that make a big difference.

Is Subway looking at alternative retail channels for nontraditional growth?

Right now, we have a category called nontraditional. The biggest components are the convenience stores and truck stops. We have about 3,000 of those locations in North America. We also have locations in airports, college campuses, hospitals. We recently made a deal with Wal-Mart.

About how many traditional Subway locations are there worldwide right now and how many nontraditional ones?

There are about 21,000 Subway stores worldwide — 17,000 in the United States, 2,000 in Canada and the rest in other countries. In terms of nontraditional sites, we have 3,500 at convenience stores and truck stops.



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How does the nontraditional venue fit into Subway's future strategies?

It's a big part of our growth in the future. I think there will be quite a bit of business in the nontraditional arena.

What are your concerns, challenges and priorities over the next three or five years?

Right now we're going through our strategic planning process and working on store profitability. We want the average

store to be more profitable, because it's very exciting for the franchisees, who then want to build more stores. Our top focal points are sales, food and labor costs. Those are the big numbers that are controllable.

Our big focal areas are increasing our food offering, improving our advertising and improving our operations in the field. In terms of the food offering this year, we have two new product lines, low-carb wraps and a terrific line of salads. We also have new toaster ovens that do a fabulous job.

On the food cost side, we've got a buying co-op that works for the franchisees. We use them to buy better and decrease the cost of moving the food from the manufacturer to the store.

You just mentioned your low-carb wraps and your salads. Consumers say that they want healthy alternatives today, but sometimes what they say and what they do are two different things. Do you think consumers are really ready to embrace the healthy alternatives that are in food-service now?

The answer is yes and no. About a third of consumers really care about eating right, but the other two-thirds eat what they want to eat, either because they want to or they don't know what the options are or how to even think about food. But that one-third that is interested in eating correctly is a much bigger set than it was five or 10 years ago. I think more people will be concerned about eating correctly and learning about the foods they chose. What's great about Subway is, for anybody who cares about the food that they eat, they can choose what goes on those sandwiches.

It's a big point of differentiation. Our food is all custom made, and it's one of the few chains where you can get food made like that. It's an advantage and also a disadvantage. The advantage, of

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course, is that people get fresh food, and exactly what they want. The disadvantage is that we can't process as many customers as [the fast-food chains] that make food in advance. But overall, I think the position that we're in is very, very good for the future.

Do you see any demographic trends out there that Subway is particularly paying attention to as it develops and markets its product?

We're interested in people who are interested in wellness. If you look at how consumers rate us, they look at us as pro-

viding a healthier alternative. We want to make sure that we provide food that sells properly in that wellness category.

What are the leading indicators that you watch to monitor the continued viability of your strategic direction?

There are two big broad numbers that we look at, and we synthesize that into a single number: the number of stores that we have in operation and the average volume. [The second number] is cents per capita. That is how much is being spent on Subway each week by the average person. If the store growth is strong, the cents per capita will also be strong.

What are some of the ways Subway helps convenience stores drive traffic in the store?

With the differentiation and the additional improvement, you get more traffic in the store — and more than just the traffic that's coming in to buy the sandwiches. It changes the character of the store.

Subway is testing a morning day part offer, but you aren't known as a breakfast destination. What's the thinking behind that strategy?

We've got a couple of thousand stores that are open for breakfast. But even in stores that have high breakfast dollar sales, the majority of sales are actually submarine sandwiches being purchased in the morning. People come in and purchase them and take them to work.

But this toaster oven that we have coming out in the stores is an amazing piece of technology. It makes fabulous breakfast sandwiches. We're test marketing a new breakfast program in Tucson, Arizona. Over the course of a year, we plan to bring it to additional markets; and I think by the middle of next year, we'll have a very good breakfast offering.

I think the convenience store side of the business will benefit because a lot of our



convenience stores are open early already and have traffic. People are in there in the morning, so this offering will likely benefit our convenience stores before it benefits our traditional stores.

Are there scenarios where a proprietary program makes the best sense?

Some convenience store chains have a great proprietary food offering, but I think that's probably more the exception than the rule. For the typical convenience store operator, the best way to assure that they're going to get a return on their investment is to go with a known brand.

How can convenience stores successfully make that transition to foodservice?

There are two ways. In some cases, the convenience store operator simply says, 'I don't want to run it. I want you to run it,' and one of our franchisees builds the store and operates it. So, the convenience store operator just receives rent revenue and doesn't have to think about the details, and that's a very successful way to go about it. But a lot of operators want to get the return on the investment for themselves. They're willing to make the investment in personnel to run the store. So, they hire a dedicated manager, or if they have a bigger operation, they've got district managers and managers. Doing it like that — thinking of themselves as a franchisee of the brand as well as the owner of a convenience store — usually gets the best results.

Can you talk to us about your leadership philosophy and the culture of Subway?

I don't normally talk in those terms, but I know what you mean. It's a combination of things, and it's fairly entrepreneurial. It's a company made up of regular people who are all trying to accomplish their personal dreams. We don't attract big business people with \$1 million to open up 10 stores. The people that start

with us are traditional store owners; for many this is their first business. They had a small amount of money to invest, and some of them are happy to have one store, while others have 40 or 50 stores. We don't really press anybody to go in any particular direction.

What about the culture at your corporate headquarters?

People say it's a very cooperative culture. It's not a big hierarchy. People tend to work together. We do things to help foster employee communication. For example, hardly anybody ever goes out for lunch at the headquarters, because we designed the building with a cafeteria and we serve lunch for free. That's because we wanted people to be able to see their friends and communicate. We also open in the morning for breakfast so they can catch up with each other instead of going to the bagel shop somewhere. We don't have individual offices, so it's very easy for everybody to visit and check in with each other and get things done.

What skills do you consider to be most important in your management team?

I think it's really important for someone who's got a responsibility to be able to carry the ball over the goal line with it, just to take the job and work at it, and get to the destination in a fairly timely fashion.

What's the most important thing that you do in your role at Subway?

The most important thing I do is teach people what's possible. There's a goal that we set, but a goal in and of itself doesn't tell anybody that it's possible. If I say I want to add 50 stores in a certain market, there's no credibility to that necessarily. So, I create reports that benchmark markets against each other, DAs against each other, even different counties and cities against each other. I take examples from those reports to teach people what's being

done, what is possible. But I don't only give them select examples. I give them the entire report.

Every week I talk with my development agents about what's being done and how it affects overall growth. I believe people have to understand what the goal is, then they have to assess the goal and ask, 'Can this be done? And can I do it?' Then they have to internalize it, realizing 'Yes, it can be done, and I can do it, and I will do it.' Once I've got them to that point, it's just a matter of helping them understand the speed that they can move at.

Their speed is often dependent on their own personal organization strength. They may have all the ability and the desire, but they can't move as fast as they would like to. So, my challenge is to make sure that people really understand what's possible, so that they can work on their own to get the job done. But it's also important for them to learn limitations — to see where the challenges are and avoid the pitfalls on their way to getting what is possible.

What can today's business leaders learn from consumers?

They should learn what the consumer wants. Are you bringing value to the consumer or are you doing something that's not relevant or material? Taking the time and effort to do something that people don't care about is not going to be so helpful to your business.

What can a leader never do enough of?

You can never do enough development of your people. In every organization, there are people that really care about the organization. You have to appreciate the people, make sure they're in the right job slots, help them, give them some inspiration, some guidance, and realize everybody is not going to work the same way or at the same pace. As long as everyone on your team is working in the same direction, anything can be accomplished. ○