Wave of newcomers buoys fast-growing sub sandwich segment

BY MILFORD PREWITT

Being concentrated in different parts of the country, with different-sized chains and following different franchising philosophies, Lenny's Sub Shops, Firehouse Subs and Silver Mine Subs don't have to worry about each other when it comes to head-to-head competition.

What the three segment rivals do have to worry about is that their burgeoning brands are in a category home to the fastest-growing franchised chain concepts in foodservice, according to FRANdata.

Forty-six first-time and veteran chain operators began franchising sub sandwich concepts between 2000 and 2006, almost seven a year, according to FRANdata's "Top 10 Food Sectors by New Concepts."

Pizza came in second with 40 new franchised vehicles between 2000 and 2006, and the frozen-dessert category was third, with 31, FRANdata found.

"I think it just shows that consumers have come to identify this segment as a healthy alternative, and I think we all have Subway to thank for that," said Don Fox, chief executive of the 314-unit Firehouse Subs chain, based in Jacksonville, Fla. "There's certainly been a ton of new entrants in this business.

"But I think it's not so interesting that the numbers are going up as much as it is the underlying real estate issues behind it. That is, you have got a lot of small operators with successful, in-line units who over time have created some good unit economics that can entice people to franchise."

Determined to remain an operator so he can experience the same market and economic forces his franchisees do, Fox said the company operates 30 of the units in the system.

Interested franchise candidates need $200,000 to $366,000 to develop a unit, and there are no net-worth requirements, Fox explained, because such iron-clad clauses often discourage people who believe they are undercapitalized when, in fact, they may not be.

But based on chain history, he estimated that $70,000 liquid is a good foundation.

Aggressively franchising since 2001, Firehouse recently changed its franchising requirements to disqualify multiconcept operators who cannot devote 100 percent of their attention to the brand without a 50-percent equity partner in each unit who will be on site daily.

Memphis, Tenn.-based Lenny's Subs grew from four stores in 2002 to its current total of 150. It resumed franchising in 2004.

While not necessarily a new franchisor, Lenny's Subs, a 10-year-old Memphis, Tenn.-based chain with 150 units — all but one company-owned and used as a training center — resumed franchising in 2004 after new owners revived the concept and met their franchisees to discuss the brand's resurgence.

George Alvord, Lenny's chief executive, said the company is now poised for growth and has kept company founder, Lenny Moore, in their embrace as an advisory board member and master franchisee in the Southwest.

Alvord said just six years ago, there were only four Lenny's Subs outlets.

He does not want to open more company stores because he does not want to compete with his franchisees, who need to have a net worth of at least $250,000 to qualify for a franchise.

With two corporate stores in his 24-unit chain, Keith Dudek, president and chief executive of Silver Mine Subs in Fort Collins, Colo., is looking to accelerate franchising of its higher-end sandwich concept through a combination of both veteran players and financially sound industry newcomers.

He says even with the gloomy economic forecasts daunting investment, there are so few franchised concepts in the higher end of the sandwich segment and they are so widely dispersed, that he does not worry about saturation anytime soon. ■

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Q&A

Franchise lawyer: Federal rule changes good for both sides

On July 1 the world of restaurant franchising will change in a big way. That's the day the Federal Trade Commission will begin enforcing a rule change that governs the amount of detail franchisors must disclose in their uniform franchise offering circulars, or UFOCs. In a nutshell, franchisors will have to provide more information about their most sensitive business operations, legal matters, future prospects and present operations in a more prominent way, with some of it required to appear on the front page of the UFOC. But Michael Einbinder, a lawyer who represents both franchisees and franchisors for Einbinder & Dunn in New York, says the FTC's Disclosure Rule is a mixed bag of good and bad for both sides of the table.

Michael Einbinder

Is there a conflict of interest when a law firm represents franchisees and franchisors?

Not at all. In fact, I think when I'm representing a franchisor, my experience with franchisees gives me a unique perspective and vice versa. It really pays off when we help franchisors draft their legal documents.

If there is a contract two parties have signed, why is there so much friction between franchisees and franchisors?

No relationship is without its conflicts. That goes double, at least, for business relationships, but of the disputes between franchisees and their franchisors, many arise at the outset of the relationship. These typically involve allegedly noncompliant, improper or inaccurate disclosure.

Will this new FTC rule fix anything?

Well, it's not a bad thing for the franchisor, but it's a good thing for the franchisee. It' s not going to complicate anything, but it could be expensive for some chains to re-write their UFOCs and make them compliant.

Why this new rule change anyway?

The world of franchising has changed a lot in the last 30 years, and as an industry it has grown phenomenally, and regulators came to believe that there needed to be significant changes in the amount of disclosure to make it more helpful for potential franchises to know what they are buying.

Without using the word, I see the FTC really wants franchisors to be more open about encroachment.

They want franchisors to make it clearer. Do you offer exclusive territories? Do you intend to sell ice cream in the supermarket across the street from a franchisee? Can other franchisees move down the block? Make a clear statement, if that's the case.

There's also more disclosure required about lawsuits between the franchisor and the franchisees.

Yes. That's a good thing for the franchisee. A lot of lawsuits in the system can be a sign that the concept is not working. If franchisees are failing or not paying royalties and there's a ton of litigation, it says something about the business. Lawsuits did not have to be disclosed before. You as a prospective franchisee didn't know about other litigation until the franchisor went to court.

— Milford Prewitt