Subway making headway

This case study requires knowledge of Section 3.1 – business growth.

The free-market economic system in most parts of the world has led to a dynamic business environment, with huge numbers of firms competing to get ahead. In the last few years, few businesses have grown as successfully as the American fast-food restaurant Subway.

Subway operates a franchise model. This is when the parent company sells the right to use their business model to independent third parties. In practice, the owner of each Subway restaurant pays Subway an upfront fee and a certain portion of their earnings, and keeps the rest. This can be a good deal for potential entrepreneurs who want to run their own business, backed up by the support of a large, well-established company. It also benefits Subway, as if these stores are unsuccessful, they only incur part of the cost. If the store is successful, Subway can reap the rewards from the royalties.

Some of the milestones Subway has reached include opening stores in over 110 countries, and opening its 40,000th store worldwide in 2013 (up from 35,000 in 2011) – this is more than McDonald’s. In terms of annual revenue, however, Subway trails its US rival McDonald’s (and Starbucks, as of 2015).

Along with the popularity of the franchise model, one reason for Subway’s growth is that Subway offers far more customisation of its meals to customers than its rivals, a feature which has proven popular. Subway restaurants also tend to be small and cheap to build, allowing for rapid development of stores and growth in brand recognition. In addition, Subway has benefited from the perception that its food is healthier than that of its traditional rivals such as McDonald’s, at the same time as many consumers seem to be becoming more conscientious in their eating habits. Figure 1 shows how average calorie consumption among Americans is beginning to fall, after decades of steadily rising:

![Figure 1: Average daily calorie consumption in the USA](chart.png)


Note: falls in average calorie consumption have yet to result in a fall in obesity, possibly because people are not exercising often enough.
However, as of 2015 there have been signs of a slowdown in Subway’s relentless growth as competitors in the market adapt to changing consumer habits. Rivals such as Chipotle have been offering food with fewer additives, better anticipating trends in consumer tastes. The sheer number of competitors in the market has also eaten away at Subway’s market share, with many Americans switching to pizza places. Subway also suffered a blow from a child pornography case involving a very senior figure, although it is too early to tell whether this will have a material impact on sales.

**Use the data**

1. Using Figure 1, calculate the percentage change in average calories consumed between the 2003–2004 period and the 2009–2010 period.

2. Explain how the ‘principal-agent problem’ might apply to Subway’s businesses.

**Test your knowledge...**

1. Name one advantage and one disadvantage of business growth. (2)

2. Explain the term ‘organic growth’ in the context of Subway. (2)

3. Which of the following objectives is Subway most likely to pursue in 2016?
   A. Sales maximisation
   B. Satisficing
   C. Profit maximisation
   D. Revenue maximisation

**Extended-response question**

1. Assess two ways in which Subway’s rivals could try to increase their sales. (10)