October 2019

FEATURE

The Buck Stops Where?

Dollar stores continue to encroach on c-store territory.

BY JERRY SOVERINSKY

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With its incalculable resources, Amazon has been the Darth Vader of sorts for the convenience store industry these past few years. Every NACS State of the Industry Summit (SOI) presenter, no matter the industry gains or innovations, always tempered attendees' enthusiasm with warnings of Amazon's invasion into the c-store space, whether the threat was real (Amazon Go) or hypothetical (drone-delivered chips and sodas).

In the meantime, other seemingly less-imposing competitors have been acknowledged but dismissed—or at least deemed to be minor annoyances. See for example this magazine's initial assessment of dollar stores in the October 2012 article, "The Buck Stops Here."

"While the dollar store may be in the race for the long term, you're well equipped to meet the challenge, with the endurance, stamina and execution necessary to continue to set records," the writer (myself) concluded, citing dollar stores' difficulty in offering foodservice and fuel ultimately as prohibitive distinctions.

While the former has played out more-or-less to plan (see nearly every recent SOI Summit, where sales records were announced), the latter distinction has been erased, with dollar stores moving past those seemingly impenetrable barriers, adding not just fresh food and gasoline but also tobacco and alcohol to their ever-expanding product portfolio.

Yet the news has not damped c-store industry assessments of its own progress. "The [convenience store] industry strategically resumed its trek toward an improved, more sustainable business model and away from the commodity-driven, fuel-focused model of the past," NACS wrote in its 2018 State of the Industry report.

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"It's little wonder that dollar general has reported same-store sales growth for 29 years running.

Still, the threat looms. The incursion of dollar stores on the c-store space "represents the greatest immediate threat to the convenience industry," the 2018 SOI report concludes. Here's how—and why—things have progressed to this point, and what convenience retailers need to do to protect their turf and grow market share.

BY THE NUMBERS

Since we first covered dollar stores in 2012, their collective footprint has grown 35%, from 23,421 to 31,620. Two brands dominate the channel, with Dollar General, based in Goodlettsville, Tennessee, operating more than 15,500 locations in 44 states, and Chesapeake, Virginia-based Dollar Tree (which recently acquired Family Dollar) operating about 15,200 stores in 48 states and five Canadian provinces.

Both brands have announced plans to grow their store count, with Dollar General on track to open 975 locations in 2019 amid a long-term goal of operating 28,000 stores.

During the past year, the channel was one of only two in the retail brick-and-mortar universe that registered an increase in store units, jumping 7.7% (liquor stores were up 0.4%). By contrast, the convenience store unit count contracted 1.1% and 2.3% when looking at just single stores, according to Nielsen TDLinx data.

The trends are startling, especially if one also considers that the dollar store shopper demographic is nearly identical to the convenience store shopper, with modest separation only at the highest income bracket. (See the "Convenience Store and Dollar Store Customers" sidebar.)

IT LOOKS LIKE A C-STORE

These dollar store shoppers are motivated by retail value, not necessarily shopping experience, though the channel is aggressively modifying its merchandising to mirror convenience retailing.

Dollar General recently completed a pilot of its DGX concept, which offers a compact footprint (half the size of a traditional Dollar General store) and a product selection that includes pastries, grab-and-go sandwiches and energy drinks—offerings directly targeting younger shoppers (especially as the majority of the DGX selections are priced at a buck or less). The brand operates 10 DGX stores and plans to add three more by the year's end.

The company also is expanding its cooler door count across its footprint, a move that has produced generous returns. "Our cooler expansion continues to be an important sales initiative, particularly in mature stores," CEO Todd Vasos said on a conference call last year. Through the third quarter of 2018, the company had installed 20,000 cooler doors at its stores, an expansion that it planned to continue through 2019. Building on that success, the company has begun converting locations to its Dollar General Traditional Plus (DGTP) format, which offers the expanded cooler section. Commensurate with the DGTP renovations is the introduction of fresh produce to its stores, which the company now offers in

CONVENIENCE STORE AND DOLLAR STORE CUSTOMERS

(by annual income)

$29,000 or less
Convenience stores **40%**
Dollar stores: **43%**

$30,000–$69,000
Convenience stores **32%**
Dollar stores: **34%**

$70,000
Convenience stores **28%**
Dollar stores: **23%**

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more than 400 locations. It's little wonder that Dollar General has reported same-store sales growth for 29 years running.

Meanwhile, Dollar Tree has implemented its Snack Zone, which offers snack foods and cooler-chilled beverages, immediate consumption items that are staples of the convenience store offering. The company is renovating many of its Dollar Tree and Family Dollar Stores into its H2 format (an internal designation), which includes a $1 merchandise section (Dollar Tree) and enhanced merchandise. The company announced plans to expand the number of cooler doors in 400 stores, while adding alcoholic beverages to about 1,000 stores into early 2020.

> "The expansion of cooler doors in the dollar space has boosted beer sales, which have grown an average of 32.2% since 2015."

The expansion of cooler doors in the dollar space has boosted beer sales, which have grown an average of 32.2% since 2015. "It is likely that some portion of those sales came directly out of the convenience industry's tills and will continue to do so in the future," the NACS SOI report concluded. (See Category Close-Up on page 196 for more on beer's performance in the convenience channel.)

In addition to aggressively selling snacks and drinks ("Cokes"), dollar stores complete the iconic triad of traditional c-store offerings by also selling gas and smokes. In 2013, Dollar General began selling fuel at one of its larger format stores in Hanceville, Alabama, partnering with Mansfield Oil on the project. Today, the company has expanded its fuel offerings to nearly 40 stores in the Southeast. Collectively, dollar stores are actively engaged in selling tobacco, accounting for 2% of nicotine product sales in the U.S. for the 52-week period ended in the fourth quarter of 2018, according to Management Science Associates Inc. (MSA). Still, the convenience industry holds the largest share of the U.S. tobacco market, accounting for 71% of tobacco product sales volume during the same period, according to MSA data. Although tobacco sales at dollar stores are modest, to be sure, closer inspection reveals inroads into this important c-store category. Between January 2016 and November 2018, tobacco sales volume jumped 10.7% at dollar stores, while remaining relatively flat at c-stores, according to MSA. These trends coincided with a 13.3% drop in tobacco sales volume at drugstores for the same period as some retailers exited the tobacco sales market.

FITTER ...

And did we mention healthier offerings? It's no secret that the convenience store industry has been evolving to recruit health-conscious shoppers, adding produce and better-for-you options. Right behind is—you guessed it—Dollar General, which announced plans to self-distribute perishable food to 5,000 stores by the end of fiscal 2019.

Dollar General launched its "Better-For-You" initiative last year, selling fresh produce as well as healthier snacks, including those marketed under its Good & Smart private brand. "We launched 'Better-For-You' ... in response to feedback from our customers who are starting to look for healthier food options at affordable prices," Vasos said. Through 2018, the company offered BFY products at 2,700 stores.

SMARTER ...

In 2012, dollar stores lagged far behind c-stores in tech adoption, but today the channel is leveraging technology to build on the convenience proposition. Last year Dollar General introduced its DG GO! App, allowing shoppers to scan products on their phones, keeping a running total of their basket as they progress through the store. When they finish, they skip the checkout line, instead proceeding through a special kiosk. To date, the app can be used in thousands of the chain's stores.

"Having a user-friendly and helpful suite of digital tools is becoming increasingly important to our customers," said Dollar General's CEO on a conference call last year, noting that app-equipped shoppers spend roughly double the amount of "non-digitally engaged shoppers." Earlier this year, Dollar General expanded the app to enable customers to purchase products online and pick them up in stores. "We believe that could be another leg of convenience for our core customer," Vasos said.

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NACS estimates that 24 dollar stores at $250,000 each can open for the same cost that it takes to build and open a new convenience store with fuel $6 million.

CHEAPER …

While convenience store units far outnumber those in the dollar store space, the cost of entry for the latter makes growth much more attainable. NACS estimates that 24 dollar stores (at $250,000 each) can open for the same cost that it takes to build and open a new convenience store with fuel ($6 million). Collectively, the corporate-owned stores maintain considerable purchasing power, carrying a limited number of items in smaller sizes exclusive to the channel, giving consumers the perception of lower cost.

And as we noted in 2012, dollar stores operate with limited staff (paid $8 an hour on average, according to Glassdoor, versus nearly $11 an hour for c-stores, according to the *NACS Compensation Report of 2018 Data*), incur modest overhead and lease their properties, which enables them to recognize a positive cash flow "generally" during the first year of operations, while paying back capital in less than two years. "Our stringent market analysis, real estate site selection and new store approval processes as well as our new store marketing programs help us optimize financial returns and minimize the risks of opening unprofitable stores," Dollar General noted in a 10-K report.

The limited overhead allows a dollar store to be profitable where a traditional convenience store cannot—hence, the dollar store's expansion in rural America's food deserts. Dollar stores serve as grocery stores in these low-income areas that lack access to other retail outlets.

REVISED THREAT ANALYSIS

All of this underscores the channel blurring between dollar stores and convenience stores, which portends a real threat to convenience store sales. And it's one likely contributor to the convenience store industry's contracted single-store count for 2018, its first decrease since 2008. As dollar stores expand in underserved retail areas, "this likely affects our single-store members that were successfully operating in these areas where the large convenience chains didn't go," said Chris Rapanick, NACS director of business development.

Despite Dollar General's 15,000+ store count—currently more than Walmart, Kroger, Costco and Target combined—its total channel unit count is just 20% of the convenience store channel. Convenience retailers still maintain prime locations, especially along commuter routes, a physical advantage that will continue to hold significant sales advantages.

And whereas the convenience store channel has spent decades cultivating an image of community involvement and integration with existing businesses, dollar stores have, in many cases, forced local businesses to close, especially in underserved areas where choice is limited. As a result, some communities have maintained a not-in-my-backyard stance against the dollar store channel. "Communities are standing up and raising red flags—saying it may be good in the short term, but perhaps not in the long term," said Marie Donahue, author of a brief, "Dollar Store Impacts," published by the Institute of Local Self-Reliance. Donahue cites five primary ways that cities and towns have sought to restrict the activity of dollar stores, including setting a limit on the number of locations, establishing a dispersal policy and expanding financing for local grocery.

> "Hospitality is a core principle, one that convenience store retailers are especially suited to deliver.

Finally, convenience retailers must consider whether, beyond offering those tangible items that convenience shoppers seek in a safe and clean environment, they are delivering a retail experience that breeds loyalty, a motivation unrelated to rewards (though the latter certainly helps). For that, we turn to the "Playbook for Success," a report developed by the NACS/Coca-Cola Retailing Research Council, which has studied the convenience store shopping experience for more than a decade.

As an integral component of the report's "defend your turf" mandate, "hospitality" is a core principle, one that convenience store retailers are especially suited to deliver:

- Is the atmosphere in your store warm, bright and inviting?
- Is your service friendly and engaging?
- Are your customers greeted with a smile?
- Are regular customers greeted by name?
- Does your staff go above and beyond to make customers feel welcome?

All of these are foundational principles of the neighborhood convenience store. And no matter how close the dollar store comes to replicating the "look" of a modern convenience store, it still lags woefully behind when it comes to the "feel."

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