Making ₵ents of the Dollar Store Threat

How much will the infiltration of the penny-profit channel cost convenience stores? By Renée M. Covino

IN THE GREAT RETAIL ARENA, DOLLAR STORES are moving from the background to the foreground, expanding rapidly and building smaller-format stores.

Two leading players, Dollar General Corp., based in Goodlettsville, Tenn., and Dollar Tree, based in Chesapeake, Va., continue to blanket North America, each now operating more than 14,000 stores.

Savvy convenience store operators are keeping close watch on the dollar channel, especially now that convenience is a solid factor in their business model.

Consider these recent news headlines:

- Dollar General cut the ribbon on a new convenience store format, DGX, in downtown Nashville, Tenn., in January 2017. At approximately 3,400 square feet, the DGX format is said to provide urban shoppers with a focused selection of consumable items and instant-consumption options.

- Dollar Tree is rolling out its "Snack Zone" initiative to hundreds of more stores after a successful launch in 214 locations. The Snack Zone encompasses cold beverages, candy, snack cakes and salty treats, and is designed to provide customers with a compelling assortment of immediate-consumption products at the $1 price point to drive incremental sales. Dollar Tree plans to add the Snack Zone to 750 more stores in fiscal 2018.

- Dollar General plans to execute approximately 2,000 real estate projects this year, comprising 900 new stores, 1,000 store remodels and 100 store relocations. Last year, the retailer bought 42 former Walmart Express small-format stores.

- For the first quarter of 2018, Dollar Tree delivered a 4-percent same-store sales increase, with growth in both average ticket and customer traffic.

- Dollar General posted a 2.1-percent increase in same-store sales for 2018's first quarter, along with a 9-percent jump in profit to $364.9 million.

Given all this buzz, should c-store operators be worried about the dollar channel?

The way industry expert Keith Daniels, a partner at corporate restructuring and investment banking firm Carl Marks Advisors, sees it, "There is a threat, but the size of the threat may not be that great." He says the core product offering is a calming differentiator: C-store assortments are typically focused on quick-service foods, snacks and drinks, while dollar store assortments are traditionally focused on general merchandise.

Where c-stores need to be concerned is if dollar stores begin selling fuel. "If the price of gas is competitive, this will likely drive customers to dollar stores, reducing c-store foot traffic and the sale of higher-margin impulse purchases of food items that c-stores enjoy," Daniels reasoned.

Looking at it from another angle, a broad assessment of the consumer packaged goods (CPG) brick-and-mortar retail landscape indicates that approximately $2 trillion of retail sales are generated across 275,000 stores annually, according to data compiled by Cadent Consulting Group in Wilton, Conn. C-stores comprise nearly 60 percent of all traditional outlets, but only about 15 percent of merchandise sales.

"Dollar stores may be attracted to the sheer number of convenience stores and the potential for fuel sales," noted Don Stuart, managing director of Cadent Consulting. "While testing fuel may be enticing, we believe it makes far more sense to leverage dollar stores' specific strength, which is price vs. grocery/mass."

Therefore, Stuart sees the biggest opportunity for the dollar channel to be food/snacks and freshness, which has the potential to hurt the convenience channel but, more so, supermarkets.

"Traditional supermarket outlet unit sales are declining, and there are significant opportunities across both dollar and limited-assortment discount stores — such as Aldi — to capture this potential," Stuart told *Convenience Store News*.

Dollar General already has a convenience store format called DGX. The inaugural DGX store in Nashville, Tenn., measures 3,400 square feet.

The Pros & Cons of Dollar Stores

Strong points of the dollar-store format:

- Provides competitive pricing in a manageable, convenient store format, essentially the intersection of value and convenience.
- Offers real value to a broad consumer group.
- Small formats cater to time-conscious consumer needs with quick and easy solutions.
- Millennials and Generation Z consumers are on the verge of conversion as the dollar channel's freshness focus continues to intensify.
- As the middle class shrinks and income disparity continues to grow, the format has greater future appeal.

Weak points of the dollar-store format:

- Low profit margins.
- Walmart, while less convenient of a shopping experience, has a broader assortment and is always in direct competition, especially in the improving economy.
- A "ho-hum" store experience, especially when contrasted with top-tier c-stores.
- No fuel and their typical strip mall locations are not conducive to fuel stations.
- Technology and internet/mobile shopping is lagging.

The Fuel Factor

Still, experts can't seem to discount the competitive match-up of the dollar channel vs. the convenience channel when considering the fuel factor.

Back in the summer of 2016, Dollar General made headlines when it bought 41 former Walmart Express locations and said it would continue to operate the gas pumps at 37 of these stores, newly rebranded as Dollar General. The chain also previously ran a test of a Dollar General location with gas pumps three years earlier.

But ultimately, does fuel really make sense for dollar stores? The consensus seems to be "not really." However, c-stores should stay on their toes, nonetheless.

"Dollar stores may be attracted to the potential for fuel sales. However, fuel is a highly visible and price-competitive commodity, which often does not generate traffic into the stores and, in the future, could fall victim to charging stations and electric cars," noted Stuart. "Dollar stores may be chasing after very few pennies of profit if they try to fuel up."

Another limiting factor is that many dollar stores are located in strip malls, making it difficult to add a forecourt. "Expansion of gas as an offering will be limited to stand-alone stores with enough land to expand, which may only be viable in certain parts of the country," affirmed Daniels.

Joseph Bona, president of New York-based Bona Design Lab, expanded on the constraining role of real estate in many of the markets where dollar chains operate.

"In the densest markets of the country, like the Northeast, most dollar stores are in strip malls in areas where drugstores and convenience stores already own the best corners," Bona said. "Because of the costs involved, it's unlikely that dollar stores would buy the kind of large, multi-acre sites they would need to accommodate their footprints, the gas pumps and the supporting parking."

He agrees that breaking into the gasoline business in such places would be quite difficult — but the same cannot be said for other locales.

"The calculus is quite different, though, in a place like rural Alabama, where land is cheap and dollar chains already operate plenty of freestanding stores," Bona told *CSNews*. "A low-price fuel strategy certainly drives traffic to Costco. In those markets where the economics pencil out, it is at least possible that dollar stores could pursue a similar strategy."

Emerging Generations

Dollar stores are poised to have a bright future with respect to today's up-and-coming generations, analysts and experts predict. The popularity of dollar stores with millennials, in particular, should be of concern to the c-store sector, according to Bona.

Dollar Tree is rolling out a "Snack Zone" initiative at hundreds of its stores. The Snack Zone encompasses cold beverages, candy, and sweet and salty snacks.

"The easiest thing to do, with respect to millennials, is to trade in stereotypes. This is where we get the images of bearded hipsters drinking out of Mason jars and clamoring for all things 'small batch,'" he said. "The truth, though, is a lot more complicated. Millennials aren't at all afraid of being seen in dollar stores, even though there's nothing particularly hip about them."

If you look at the transcripts of earnings calls from Dollar General, what you find is that "even affluent millennials are shopping at dollar stores in droves," he continued.

In fact, Bona cited findings from research firm The NPD Group that millennials now make up about 25 percent of the six-figure-income customers who shop at any of the three biggest dollar store chains.

As for Generation Z — those born from the mid-1990s to the early 2000s — "we could see them reject dollar stores for one reason or another, but I wouldn't count on it," said Bona. "It's part of the reason that differentiation is so important for c-stores, today and in the future."

According to Daniels, technology can be a key part of the differentiation equation because right now, dollar stores are lagging.

"With the middle class shrinking and income disparity continuing to grow, dollar stores remain well positioned for future growth," said Daniels. "Like other retail shoppers, the target customer of the dollar store would like to shop online, but often does not have an Amazon Prime account and are late adopters."

If and when the dollar store customer gravitates to internet/mobile shopping, particularly as the younger generations that are more tech-savvy age, dollar stores will need to play a quick catch-up.

Along with embracing technology, Stuart adds that with the proper freshness focus — which he believes should be easier to achieve for dollar stores than c-stores — millennials and Gen Zs can be converted.

Protecting Your Turf

How can c-stores protect their business from the infiltration of dollar stores?

"They need to continue offering competitive pricing on gas to drive customer foot traffic to their locations," stated Daniels. "They also need to stay true to their concept."

"Differentiation is key," according to Bona, who adds that savvy c-stores are moving away from grocery and fill-in missions and toward "foodvenience."

"That is to say, they are embracing food-on-the-go, served up in appealing store environments," Bona said, highlighting that instead of mostly selling bread, milk, eggs, cigarettes and lottery, today's c-stores are offering up the likes of Korean barbecue, pulled pork paninis, fresh salads and caramel mocha coffee with nonfat milk.

"The level of sophistication of food at top-tier convenience retailers is remarkable and helping to position these companies as destinations," he added.

Still, c-store operators would be wise to keep watch on how much innovation dollar stores are willing to undertake as they continue to expand.

"If they push the envelope in the years ahead, there is a risk that we'll see some erosion from the traditional key destination categories for the convenience channel," Bona acknowledged. **CSN**