WHAT IS A CONVENIENCE STORE?

The following information, sourced from the NACS research report *Convenience Store Industry Marketing Strategies and Store Formats* prepared by Gene Gerke of Gerke & Associates, Inc., (some minor updates were made by the editor to reflect current conditions.) describes the characteristics of the different types of convenience stores represented by the data in this report.

In the not too distant past, every convenience store looked about the same—2,400 square feet of packaged consumer items. Today, companies in the industry are approaching their markets with different store formats and different product offerings. There are mini-convenience stores under canopies, conventional size stores with expanded foodservice, and even hyper-convenience stores with an extensive variety of product offerings and in-store seating for foodservice.

The fastest growing segments of the convenience store market, "nontraditional" stores, are store formats other than 2,400 square feet, either larger or smaller.

The changes in store formats have implications for all elements of the industry. Retailing executives are concerned with the competitive impact and their marketing strategies and niches. Product suppliers need to be aware of format variations as they dictate requirements for appropriate product packaging, promotion and distribution for the stores. Equipment and systems vendors have to design their equipment and systems to fit the various types of store formats. Investors and financial analysts must understand the economics of the changes taking place and the likely impact on the convenience store industry. Local, state and federal governmental agencies also want to understand the various store formats.

Based on this research, six formats identified as representing trends in the convenience store industry, consist of Kiosk, Mini, Limited Selection, Traditional, Expanded, and Hyper.

The following is a general description of each type.

Kiosk

This format is less than 800 square feet and provides some additional revenue beyond gasoline sales. Gasoline is always the focus of this operation with the owner usually being an oil company or petroleum marketer, supermarkets, and some of the mass merchandisers. These stores sell only the fast-moving items found in traditional convenience stores (tobacco, beverages, snacks, and confectioneries). Grocery items are conspicuously absent, as is foodservice. Store sales may be only about ten percent of revenues in such locations. Parking is usually only at the pumps. Hours vary widely depending on the location and the inclinations of the owner. Typical customers are transients and locals stopping in to buy gasoline.

Mini Convenience Store

This store format, usually 800 to 1,200 square feet in size, was extremely popular with oil companies; and the emphasis was on gasoline sales. Now, however, the situation has changed to where the oil companies are more interested in building larger formats. Supermarkets today are building most stores in this format. However, in this format, the owners view store sales as an important part of the revenue and margin picture. Grocery selection is usually very thin and foodservice beyond prepared sandwiches, coffee and fountain is rare. There usually is not any parking other than that at the pumps, although some locations do have modest striped parking. These stores are open from 18 to 24 hours a day. Customers are usually people buying gasoline. However, there are stores of this size in urban areas that may or may not sell gasoline.

Limited Selection Convenience Store

These stores, which range from 1,500 to 2,200 square feet, are becoming more numerous. Often affiliated with

oil companies and in the size range of a converted two-bay service station, both gasoline and store sales are generally important parts of profitability. They differ from the "mini convenience store" in a broader product mix and grocery offering (although still somewhat limited by traditional convenience store standards). In addition, simple foodservice (hot dogs, nachos, popcorn, etc.) are options. Although gasoline buyers are normally still the main part of the customer base, traditional convenience store patrons are important. Striped parking and extended hours are common.

Traditional Convenience Store

Most of the original convenience stores now fall into this category. They are about 2,400 to 2,500 square feet in size and offer an expanded product mix. Dairy, bakery, snack foods, beverages, tobacco, grocery, health and beauty aids, confectionery and, perhaps, prepared foods to go, fresh or frozen meats, gasoline, various services, and limited produce items are typical. Most stores of this size have 6 to 12 striped parking spaces or some form of convenient pedestrian access. Extended hours are typical, compared to average retailers, with a large percentage open 24 hours per day. Convenience store chains normally own such operations, but oil companies have also built or acquired stores of this size.

Expanded Convenience Store

Growth is occurring in the number of stores in the 2,800 to 3,600 square foot range. Such stores can accommodate more shelving for additional grocery products or room for significant foodservice operations and seating. Stores using the space for more grocery items are taking advantage of the niche that has developed as supermarkets increasingly move above the 40,000 square foot range. A few large chains are using this "superette" approach. Even more are using the space to take advantage of the high profit margins in foodservice. As the number of smaller operations proliferates (largely because of the oil companies), many convenience store chains apparently view the move towards increased foodservice as essential. In terms of other products and services, such stores usually carry the traditional convenience store items. Parking is important with most having about 10 to 20 marked spaces. Extended hours are typical. Such operations not only attract the typical convenience store customer but also more families, women and senior citizens.

Hyper Convenience Store

These very large stores (4,000 to 5,000 square feet) usually offer an array of products and services arranged in departments. For example, such stores may offer variations such as a bakery, a sit-down restaurant area or a pharmacy. Many of these locations sell gasoline. The number of employees per shift can be large, particularly if a small restaurant is present.

The number of parking spaces is substantial, especially since the amount of time the average customer spends in such an establishment can be significant. Extended hours are typical. Here again, as in the case of the Expanded Convenience Store, families and senior citizens as well as traditional convenience store customers are patrons. In some locations, such stores are mini-truck stops that obviously affect product mix and the customer base.

NACS DEFINITION OF A CONVENIENCE STORE

According to NACS Constitution and Bylaws, the
NACS Definition of a Convenience Store is:

"... a retail business with primary emphasis placed on providing the public a convenient location to quickly purchase from a wide array of consumable products (predominantly food or food and gasoline) and services. While such operating features are not a required condition of membership, convenience stores have the following characteristics:

(a) While building size may vary significantly, typically the size will be less than 5,000 sq. ft.;

(b) Off-street parking and/or convenient pedestrian access;

(c) Extended hours of operation with many open 24 hours, seven days a week;

(d) Convenience stores stock at least 500 SKUs; and

(e) Product mix includes grocery type items, and includes items from the following groups: beverages, snacks (including confectionery) and tobacco.

A SHORT HISTORY OF THE CONVENIENCE STORE INDUSTRY

Convenience stores evolved from a variety of sources early in the twentieth century. They drew upon characteristics of many types of retail establishments in existence at the time: the "mom-and-pop" neighborhood grocery store, the "ice-house" (from pre-refrigerator days), the dairy store, the supermarket and the delicatessen.

Credit for the birth of the convenience store industry belongs to The Southland Ice Company as they opened a convenience store in May 1927 on the corner of 12th and Edgefield Streets in the Oak Cliff section of Dallas, Texas. "Uncle Johnny" Jefferson Green, who ran the Southland Ice Dock in Oak Cliff, realized that customers sometimes needed to buy things such as bread, milk and eggs after the local grocery stores were closed. Unlike the local grocery stores, his store was already open 16 hours a day, seven days a week; so, he decided to stock a few of those staple items. The idea turned out to be very convenient for customers.

Joseph C. Thompson, one of the founders and later president and chair of The Southland Corporation, recognized the potential of Uncle Johnny's idea and began selling the product line at the other ice dock locations of The Southland Ice Company. Further, these stores were open from 7:00 a.m. to 11:00 p.m., seven days a week.

In addition to convenience store development at The Southland Ice Company, other types of stores were emerging. There were "midget" stores in the 1920s and "motorterias" or mobile convenience stores. "Bantam" and "drive-in" markets were also around in 1929 where motorists never had to get out of their cars. The "Delmat" vending machine type of stores was also popular for obtaining milk, eggs, produce and fresh meat. Dairy cooperatives often ran "dairy stores" or "jug stores" as outlets for their operations. Sometimes supermarkets had small outlets in rural areas for people who did not travel to the city enough for eggs, milk, etc.

The pattern of the emerging "convenience" types of stores grew modestly until World War II (although they were not yet called "convenience stores"). The big factor in all of these operations was fast service. The stores were most successful in warmer climates where the open front was a big attraction.

The end of the war and the increased ownership of automobiles sparked the rapid growth of the industry in the 1950s. The automobile helped fuel the growth of suburban living—families wanting the "American Dream." With bigger cars and better roads, Americans began flocking to the suburbs where they found plenty of space to live and raise children…but too much space between shopping centers.

Additional forces continued to drive convenience store growth. The growth of the supermarket industry affected convenience stores. As grocery stores became larger and larger, they became less convenient for the customer who was in a hurry. Convenience stores filled in. Suburban families often had two cars and two incomes; both spouses working meant more discretionary income and less time for using a supermarket. Also, the increase in the number of working women reduced the amount of time available for shopping.

Stores were conveniently located. With the variety of items available, it was virtually one-stop shopping without waiting in line.

Franchising became an attractive option for opening new stores since it was getting expensive to start up a new store. They entered the northern regions of the country and continued to grow through merger, acquisition and new building.

Convenience stores continued to evolve from characteristics of the competitors: supermarkets, mom-and-pop grocery stores, specialty food shops, drug and variety stores, vending fast food chains, and gasoline service stations. Convenience stores began offering gasoline when self-serve became popular. The number of gasoline stations declined while the number of convenience stores selling gasoline increased.

Today, the main competitors convenience stores face are those mentioned above as well as chain drug stores, superettes, supermarkets, dollar stores, warehouse stores, general retail stores, home delivery services and, of course, other convenience stores.

The industry grew rapidly along with the increased consumer demand for convenience. The industry

supplanted the neighborhood grocery store and quickly established itself in new suburbs and areas too small to warrant a supermarket. Convenience store companies have been opportunistic and innovative, thriving in market niches too small for others to operate profitably.

OVER FOUR DECADES OF CONVENIENCE STORE GROWTH

In the early 1970s, convenience store operators had to cope with price and wage controls, gasoline and merchandise shortages, record inflation and interest rates, and increased competition due to longer hours and increased discounting by supermarkets. The energy crisis limited the quantity of gasoline convenience stores could sell. During the severe phases of the energy crisis, operators could sell all the gas they could get at the highest prices permissible under the price controls in effect at the time. The major factor limiting gasoline profits was an adequate source of supply.

The industry stood up to all types of competition successfully. As the size of supermarkets continued to increase to the new super store concept of 30,000 to 50,000 square feet, a number of the smaller, existing supermarkets fell by the wayside. The result was that many operators seized upon the pockets of opportunity provided by these openings.

More states began allowing self-service gasoline, so the number of convenience store gasoline outlets grew. More stores were selling gasoline and moving to owning gasoline equipment as opposed to operating on a commission basis. A higher margin per gallon was associated with a store owning its equipment.

Costs continued to go up with energy taking a sharp jump; severe competition held back margins; high interest rates affected bottom lines; more regulations were imposed by federal, state and local governments; and there was, in general, an increased cost of doing business. Store labor costs were rising due to increases in the minimum wage, wage hikes and more fringe benefits as well as other factors such as added services including gasoline, deli and prepared foods. The operators needed to attract and hold customers on a daily basis; Sunday openings were increasing. Marginal stores and marginal items were rooted out.

By 1976, stores selling gasoline were profitable and the numbers were growing. There was a competitive battle in gasoline as seen by the number of stores offering gasoline—the average margin dropped while the average gallons went up. As the major oil companies withdrew from certain locations, convenience stores were becoming more and more significant as a source of petroleum product sales.

As the number of convenience stores increased, the average number of households served by an individual store dropped. Higher saturation and increased competition led to fewer customers per store; therefore, firms remodeled stores to attract more customers rather than building new stores. Utility costs were high, but most stores continued to stay open 24 hours more often than not.

As the rate of inflation accelerated in the late 1970s, significant sales increases were necessary to maintain the trend of real growth in the industry. The growth in the number of customer visits outpaced the growth in number of stores. This trend was reflected in the frequency of foodservice sales including sandwiches, coffee and frozen novelties.

The convenience store industry continued to grow; but the impact of increased competition, higher energy costs, new store expenses and higher labor expenses reduced profits as a percentage of sales. The increase in labor as a percentage of sales absorbed the improved gross margin and emphasized the continued need for employee productivity both in the store and at the staff level.

By the end of the 1970s, most sales gains were due to inflation, gasoline, new stores and increased real volume per store. Some stores closed, primarily due to age of the physical plant, changing location and customer patterns,

and higher breakeven points due to the rise in new store investment and the increasing capital requirements in areas such as fast food equipment.

Over 80 percent of the stores constructed were equipped with the ability to sell gasoline. The increasing volume per store, coupled with the growing number of stores with gasoline, increased the importance of convenience stores as a marketer of petroleum products.

Not surprisingly, smaller chains reported significantly higher sales per customer since several were superette operations located in smaller towns with less customer traffic and, often as not, heavily promoted fast food and coffee sales. The larger chains were volume oriented. The two patterns presented opportunities for different merchandising strategies since the large chains were merchandising for increased transaction value while the smaller chains sought to increase the number of transactions.

Operators were making the stores more capital and labor intensive with the addition of microwaves, fountain drinks and fryers as they expanded into higher margin product lines. The increased gross margin dollars generated by these products offset the associated incremental capital and labor costs. The trend toward 24-hour operation reflected the need to maximize utilization of the facility. As the industry moved into more foodservice, the equipment required a high level of maintenance and servicing. Servicing and cleaning equipment could result in a third-shift person whether the store was open or not.

In 1980, the slowdown in the number of new stores was inflation related. There was less money available, interest rates remained high and stores required increased capital investment. Faced with a slowing economy, higher breakeven points made it even more difficult to justify opening new units. Instead, many operators invested in remodeling existing locations to take advantage of lower rental rates.

Higher rental rates for new convenience stores reflected the increased dollar investment in both land and building. These higher land and building investments reflected the high interest rates and inflation premium demanded by investors. Bargain rents on existing stores contributed a sizable portion of the industry's profit.

In 1981, economic recession and high interest rates dampened growth. High interest rates, high rental costs, heavy initial capital requirements and the general sluggishness of the economy all resulted in higher breakeven points and a continuing trend toward remodeling existing convenience store locations rather than committing funds to the opening of new outlets.

By mid-1982, the economy was experiencing the worst recession since World War II. Oil supplies were in excess of demand and reduced prices and profits resulted throughout the oil/gasoline industry.

In food retailing, super warehouse stores doing over $1,000,000 per week in sales were shaking up the grocery industry. Retail gasoline, grocery, and fast food chains were seeing increased activity in mergers and acquisitions and redeployment of assets.

As economic recovery progressed, gasoline usage increased but remained below the levels of the 1970s. Sales in gasoline service stations fell due to falling prices and demand that had not kept up with supply in recent years.

Food retailers continued to struggle with the influx of new store formats—super warehouse stores, gourmet stores, super convenience stores, hypermarkets, fast food restaurants inside convenience stores, gasoline pumpers with small convenience stores and more.

The convenience store industry was getting into new technology related to gasoline, checkout and banking. Industry attention moved to improve operations, margins and cost control. Merchandising became the key ingredient for the successful operation of convenience stores. Merchandising programs had the two-fold objective of increasing store traffic and increasing the average sale per customer.

There was a continued reduction in the opening of new stores and an increase in the investment required for a new store. Acquisitions continued as a way to increase store growth. The increase in the cost of land for the new rural store reflected the saturation of the urban market. Nevertheless, companies continued to look to the rural market for store growth, as land and building costs were less costly compared to those in urban locations. The

increases in the cost of both land and store construction reflected the competitiveness for prime locations. Annual sales for new stores needed to exceed the averages for existing stores by a sizable amount to ensure the recovery of the investment.

Operating costs continued to rise even faster than selling prices. Corporate acquisitions and mergers reached the highest level of activity in over 50 years. Sky-high insurance costs, underground storage tank liabilities and consumer group pressures regarding alcoholic beverages and adult magazines became important factors. Increased competition, the changing labor force and the uncertainty of the opportunities presented by new technology all affected the industry.

Labor became the largest operating expense component and was a large factor in the reduction of pretax profitability. Regional differences in labor markets became especially acute as the convenience store industry increased services offered and stayed open for extended hours. Some stores turned to increased automation—Electronic Funds Transfer, Automated Teller Machines and Scanning.

In the 1990s, several factors, such as the Gulf War, a weak economic climate and increased awareness of the environment, affected the industry. New Environmental Protection Agency underground storage tank regulations made it more costly to operate a convenience store. In addition, industry concerns, such as inventory shrinkage, employee shortages and turnover, operating regulations and an aging population, made it important to reexamine the concept of convenience and the strategies for operating in an increasingly competitive environment.

Responding to the more difficult economic environment in 1992, companies began to lower general and administrative expenses and close marginal stores. Lower interest costs, higher gasoline volumes, higher gasoline margins, increased merchandise sales per store and a strong customer focus combined to explode industry profits to a record $2.2 billion in profits in 1993. Industry profits continued to grow in 1994 and 1995, reaching $3.2 billion, respectively, for both years. Although profits dropped in 1996, they still were at a high level ($2.4 billion) compared to the early 1990s. Industry pretax profits increased only slightly in 1997 to $2.5 billion but jumped to $3.4 billion in 1998 and $4.8 billion in 1999. For 2000, total industry pretax profits fell slightly to $4.6 billion on sales of $269.4 billion. The economic recession and the events of September 11th during 2001 slowed sales growth to $283.0 billion and lowered industry profitability by 24.6 percent to $3.453 billion. The slow recovery from the recession and the buildup in preparation for the Iraq war further lowered industry pretax profits in 2002 as they fell by 24.3 percent to $2.615 billion. Total sales for the convenience store industry rose by 2.7 percent to $290.6 billion in 2002. For 2003, the emerging economic rebound clearly affected results for the convenience store industry as industry sales increased 16 percent to $337.0 billion and industry pretax profits increased by 55 percent to $4.044 billion. The economic recovery continued during 2004; industry sales increased 17.1% to $394.7 billion as both in-store and motor fuel sales enjoyed double-digit growth from 2003. Industry pretax profits during 2004 rose 23.4% to $4.989 billion from 2003. In 2005, Hurricane Katrina wreaked havoc with the petroleum refining industry in the United States and, coupled with significantly increased energy demand from China and India, pushed motor fuel prices up during the latter third of the year. Industry sales increased 25.5% to $495.3 billion in 2005. Once again, in-store and motor fuel sales realized double-digit growth from 2004. Industry pretax profits rose 18.2% from 2004 to $5.895 billion in 2005. For 2006, the convenience store industry once again enjoyed increased sales as retailers had revenue of $569.4 billion, an increase of 15.0% over 2005. Industry pretax profits in 2006 were $4.767 billion, a drop of 19.1% from 2005. Lower motor fuel margins led to the decline.

Extreme price volatility in the motor fuel segment and solid growth in the merchandise sector characterized the convenience store industry performance during 1998. During 1999 and 2000, motor fuel sales grew rapidly, rising 34.7 percent and 23.2 percent, respectively. The entire rise in motor fuel revenue during 2000 resulted from higher prices as gallon sales actually declined by 1.6 percent. However, industry motor fuel sales growth slowed dramatically during 2001 to a rise of 3.4 percent as retail prices actually fell by 3.6 percent. For 2002, there was continued volatility in the motor fuel market, however, sales of motor fuel rose by 6 percent while the price per

gallon rose by 1.4 percent. For 2003, motor fuel prices increased by almost 11 percent as worldwide demand for motor fuel rose significantly. Industry sales of motor fuel rose by 16.7 percent while motor fuel margins went up by a penny per gallon to 13.7 cents. During 2004, motor fuel sales rose 18.9% to a record $262.6 billion as prices for gasoline rose 18.2%. Competition, as usual, came from all corners, but the last five years saw heightened inroads from new motor fuel competition in the form of supermarkets, mass merchandisers, and hypermarts. These new competitors traumatized traditional motor fuel marketing networks. In addition, chain drug stores accelerated their campaign to attract consumers with products normally associated with convenience stores and enjoyed great success. For 2005, industry motor fuel sales were up 31.1% to set another record of $344.2 billion. Prices temporarily rose above the $3.00 per gallon mark in the aftermath of Hurricane Katrina. In spite of the higher prices, motor fuel gallon sales for the convenience store industry still rose but at a modest 1.6% rate for the year. During 2006, industry motor fuel sales rose 17.9% to $405.8 billion as motor fuel prices rose to an average of $2.54 per gallon for the year.

Looking to the future, many challenges remain for retailers. High motor fuel prices seem here to stay, given the worldwide demand for petroleum products and the precarious state of world affairs. There are no easy answers but retailers must continue the search. Looking backwards, the 1995 *NACS Future Study* recommended two paths to enhance future opportunities for convenience store operators: removing barriers to shopping at convenience stores and creating new value for the customer. The addition of branded or proprietary foodservice programs is one approach for creating new value for the customer. These offer the consumer a recognized name, a consistent product, convenience and a better value. The goal is to utilize the foodservice offer to attract new customers and make the convenience store a destination shopping experience.

As the industry adjusted to twenty-first century realities, findings from *The Outlook for the Convenience Store Industry Through 2005, Beyond 2005,* the most recent future study conducted by NACS, guided retailers forward. The findings indicate that the retail market place is consolidating rapidly, conventional growth strategies are topping out, the core offers of the convenience store industry are under attack, more price competition is occurring, more convenience competition exists from other formats, and online shopping presents new opportunities and threats.

What particular shopping format succeeds in the future will be a function of who can add the most value for the customer. There is, and will be in the future, stiff competition from other channel competitors for our industry's customers. The line between formats is blurring as each tries to erode the other's market share by encroaching on each other's customer base and shopping occasion. For example, convenience stores added foodservice, the mass merchandisers and supermarkets began to add motor fuel, and the supermarkets looked to home meal replacement strategies to replace lost share of the stomach. Retention of customers is an important issue, and research and development efforts by NACS have as their goal a better understanding of customer satisfaction drivers and metrics. The objective is to provide NACS members with tools and benchmarks that assist them in measuring customer satisfaction.

A major opportunity to effect positive change for the convenience store industry exists in the area of technology. In past years, NACS focused efforts to adopt and promote the utilization of technology standards germane to the convenience store industry. NACS established several committees and workgroups made up of industry participants to drive the process. These efforts, ranging from Device Integration to Payment Systems, have the potential to change the way our industry competes over the long term. For some participants, these will be radical changes. The cooperation between suppliers and retailers during this effort led to advances in several areas including XML, EDI, POS/Back Office, payment system message formats, and interoperability between disparate devices in the store. As retailers implement technology in their operations, new generations of technology equipment now incorporate many of the advances and improvements reflecting these industry standards. An important side benefit to the investments made by NACS and the supplier community has been more awareness of the importance of technology to the convenience store industry. The investments made by

NACS, retailers, and suppliers have been so successful that the entire scope of the technology standards effort has been spun off into an independent organization called PCATS (Petroleum Convenience Alliance Technology Standards). NACS will continue to be involved in technology issues but the primary work of the standards effort is now centered in the new organization.

Although labor and technology will be key focuses internally, the industry must take into account the rapid changes in the external retailing environment. This is evident by the emergence of new and aggressive motor fuel competitors who are willing to forego short-term profits for long-term gain. The business model for the convenience store industry is changing. Those companies that are able to understand today's market trends, interpret those trends and quickly apply that knowledge via technology to serve customer needs will be the successful firms of the future. Hank Armour, NACS 2001 Chairman of the Board, in his address at the 2001 NACS Show, quoted Jack Welch, retired CEO of General Electric, saying "If the change outside your business is greater than the change inside your business, you're going out of business!" That quote is even truer today. Hank further elaborated that retailers must change their business model by adding new categories, new services and new shopping occasions. New profit centers are critically important to future success. In addition, he maintained that by being innovative, expanding the core categories and driving costs out of the system, retailers would succeed.