Growing cigarette profits

It's one thing for industry profits to suffer because of competitive pressures. It's a totally different (and sad) thing, however, to watch retailers *forfeit* profit opportunities.

Dick Meyer

Recently, a trusted colleague told me that as many as one-third of the 125,000 convenience stores in the United States still have unappealing sales counters and horrible (or absent) back-bar presentations to promote cigarettes. Still other c-store retailers subconsciously limit or reduce store profits by not examining the effect of some of their decisions related to retail display allowances (RDAs). Many of these decisions become a major determinant for the primary foot traffic in our stores: the smoker.

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Cigarettes are a legal product, and the c-store industry sells more than 60% of the total U.S. market. If smart liquor stores promote specials on Scotch and wine, we shouldn't be timid in promoting our primary category. Cigarettes are almost 40% of the average c-store's total inside sales, yet I'll bet the category doesn't take up more than 10% to 15% of the store's total selling space on average.

Further, while we'll quickly invest whatever is necessary to promote fuel, our counters and back-bars don't harmonize with our inherent marketing objective (i.e., "I want more business from you!").

If no petroleum marketer would dare to have mechanical pumps and old canopies outside the store, why would he forfeit important smoker traffic with unappealing and badly merchandised counters and back-bars?

This model doesn't compute in any return on investment (ROI) dialogue. That's especially true because remodeling the counter and back-bar areas requires a fraction of the funding that's necessary for any type of fuel-related capital improvements.

First impressions matter

We'd probably agree that our sales counters and back-bars continue to be our No. 1 prime in-store real estate. So if this area is tired-looking, nonresponsive to full or 100% non-self-service requirements, and/or limited in visible display capability to earn the smoker's perception that you care about the category, then you are forfeiting gross-profit dollars to other retailers.

In brief, the payback for modernizing our counters and back-bars has to trigger one of the highest and lowest-risk ROI vs. any other initiative competing for valuable capital.

If your chain's cigarette sales per store approximate industry averages ($356,000/year), and you generate the industry average gross profit from the category (including RDAs and buy-downs) of $69,000 per store, then a 10% to 20% improvement in those averages could provide $7,000 to $14,000 more gross profit dollars per store, plus an important ancillary sales and profit effect (because smokers buy other "stuff").

Therefore, assuming my estimates are reasonable, doesn't an increase in per-year profit potential of $10,000 to $20,000 per store suggest that you could invest at least that much to enhance your counter area? I suspect you're better off modernizing 10-20 counters in existing locations ASAP vs. building an unproven new store at $1 million to $2 million.

Counter promotions

When I think of the proposition of having a "clean counter," I think of the saying "out of sight, out of mind"—and then I add the phrase "out of business." Bottom line is, clean counters forfeit gross-profit dollars.

Because counter displays and signage offer the highest visibility for retailers to communicate their price and special-promotion messages to consumers, we can't afford to have this area void of sales information. I'm told that as much as 4% to 6% of cigarette volume is lost when the counter doesn't communicate price or special products to smokers. Limited back-bars, too (8 linear feet or less, not elevated and/or unattractive), will only encourage smokers to buy from retailers who are visually more proud of their highest-volume category.

Whether you use clear security-shielded counter displays or self-service racks when legal, you will lose profits big time if you lose even one or two of your Most Valuable Patrons (MVPs), the brand-loyal pack smoker.

Feedback from many retailers has validated my hypothesis that the MVP is worth at least $360 in gross-profit dollars per store per year to a c-store; this is their value from purchasing cigarettes, fuel and other stuff. Keep the MVP's value in mind when you evaluate any and all so-called "special" RDAs for a clean counter. I guarantee you'll lose more total gross profit dollars than any incremental RDA to an aggressive c-store competitor that is more promotion-driven.

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Low-priced brands

I've expressed a fear that consumers may ultimately perceive c-stores as places that sell "cheap" products.

This premise arose when I reflected on industry data showing a lower percentage of premium gallons sold, a decline in some premium beer products, and an increase in "fourth-tier," non-master-settlement-agreement (MSA) cigarettes.

Via roundtable discussions and subsequent dialogue with several category managers, I was told that maybe 8% to 9% of smokers will go into a store and say "give me the cheapest cigarette you got" and not care what brand it is. Further, I'm also told that smokers in that group almost never buy anything else.

I questioned marketers for some alternative ways to move these lower-priced sales in a more profitable direction. Two ideas surfaced that seem to make more sense.

First, several retailers have effectively developed (with the help of the primary tobacco manufacturers) their own private-label brand, to the extent that some of these become more than 10% of their total cigarette pack volume.

Secondly, I was informed that other retailers have elected to aggressively promote nationally recognized "top of mind" savings brands of primary tobacco manufacturers. The retailers feel they are serving the need of the "give me the lowest price" smoker while retaining an image for selling perceived higher-quality "brands."

I'm prejudiced to both these ideas vs. the sale of any non-MSA products that provide an open invitation to attorneys to someday sue the retailer for purported liability damages not covered under the MSA.

Cigarette benchmarking

On a daily basis we religiously know competitors' prices for regular and premium fuel. Regardless, we're still unaccustomed to following the same pricing awareness when it comes to cigarettes. We expect store managers to know their gallons improvement over same week last year, plus we constantly talk about cents-per-gallon margin and total fuel gross-profit dollars.

Yet we're far from fluent on our cartons sold per week or the change in volume and total cigarettes and all merchandise gross-profit dollars this week vs. same week last year.

We have to revise our weekly metrics and expectations from stores personnel to foster the importance of cigarettes alongside fuel. Cigarette sales remain an important driver for fuel customers, just as fuel customers are potential buyers of cigarettes, etc.

Monitoring only one half of these two c-store dependent consumers is no longer acceptable—or profitable. ■

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