by Dick Meyer

Strategies to drive profits

This is Dick Meyer's seventh year of providing his commentary on industry trends and dynamics. Meyer has earned a reputation for his annual interpretations in his "meat-and-potatoes" terms and "no-holds-barred" approach. His company, Meyer & Associates, Neenah, Wis., has developed proprietary financial-based models that help chains identify the operating potential and alternatives of each profit center and the company's overall financial strength. Meyer can be contacted at dmeyer@dickmeyer.com.

Unfortunately, the convenience store industry's operating results for 2002 validated this writer's earlier prognostications. This past January, I estimated last year's pretax profits would decline about 25% per store and then rebound 50% this year. Since data from the National Association of Convenience Stores shows profits down 28% to $20,400 per store, let's hope my 2003 optimism will prove on target.

In my last two annual critiques on industry trends, my themes to retailers reaping average or below-average profits were on the order of "wake-up calls" and "jumping ship or changing course." I'm comforted to see substantial evidence over the past 18–24 months that companies have embraced

aggressive initiatives to identify alternatives to underperforming stores and maximize profits in core sites.

Sadly, however, ineffective management at other companies triggered multiple Chapter 11 reorganizations and an industry first: Last October, Swifty Serve closed its 500-plus stores, followed by a store-by-store auction. The impact on employees and suppliers was a tragedy for our industry!

A pseudo class system continues to exist in our industry: Those who know how to make money do, and those who don't make money have some serious work to do. Last year, I added the words "and need to begin now" to the prior phrase, but I fear it may be too late for some with severely lopsided balance sheets. Yet no one should have been surprised by the restructurings of Dairy Mart, Fas Mart, Clark and others. Their symptoms of stress were as obvious as the symptoms of *strength* in top-performing retailers.

I've listened to mega-c-store/fuel marketers' stories for a quarter century and am comforted that there are multiple ways our industry can make money. However, the primary ingredients for success are frequently absent or unexploited in too many companies. Accordingly, I'll provide my Holy Grail profit-enhancement philosophy for c-stores.

Economic backdrop

In the 1990s, we witnessed wealth accumulation as never before experienced in our country's history. The technology "bubble" and bullish fervor on Wall Street helped to double many personal 401(k) portfolios. Average workers began to command above-average compensation plans, and too many companies riding the wave of historical stock-price growth paid more than logic would suggest. In retrospect, much of the growth was artificial while companies' productivity remained the same or declined.

Meanwhile, despite our industry being taught many lessons from the consolidation craze of the late 1980s and early '90s, directly followed by record bankruptcies when buyers couldn't service their acquisition debt, some of the same nightmares resurfaced over the past five years. Huge lenders handed in their rose-colored glasses and optimistic guesstimates when they folded their tents to retreat from our market. The only benefit of their downfall was that current lenders necessarily have sharpened their due-diligence procedures.

There are many who blame our industry's profit pressures on hypermarkets. As one example, Wal-Mart is a given reality in the survival and growth plans of almost every retailer in the country. Wal-Mart and every other mass marketer/niche outlet are after share of customer, so we have to learn how to deal with all competitors or exit retail.

SOI—Where do you fit?

NACS 2003 State of the Industry (SOI) operating results reported for each year are based upon the participating companies that shared their data that year. NACS concedes that reporting com-

Marketing is the centerpiece of this article.

To illustrate its importance, here's the "Convenience Store Vehicle for Increased Profits." Here's the manufacturer concept:

▶ Its foundation is four strong wheels. Without the fundamental strengths of leadership, administrative prowess, operations/facilities management and people development, the profitability car would break down. Each of these disciplines is integral to each other and any one allowed to be ineffective hinders the engine of the car, which is fueled by marketing.

▶ The marketing-fueled engine accelerates store profits. When all is said and done—and assuming the car's chassis is supported by the four strong wheels that must be "givens" to have a chance at profits—it's up to marketing whether a company makes it down the profit road. I'm confident it's why Nordstrom, Wal-Mart, Starbucks and Subway stand out in their sectors. I'm equally convinced it's the same Holy Grail that makes many of the c-store chains you and I admire top profit performers in our industry.

panies may be dissimilar between years and, to the extent that the "mix" of retailers is materially different between years, certain data trends could be misleading. With this background, I concluded that the best benchmarking tools for my analysis are industry averages for 2002, same-store sales performance, and NACS data by top performer and other quartiles.

The form at the end of this article provides a convenient format for retailers to compare their 2002 performance to NACS industry averages. It helps you evaluate your per-store sales volumes, margin percentages and dollars, plus your pretax profitability. NACS reports that pretax profit per store is $20,400, down 28% from 2001. It also reports that EBITDA (earnings before interest, taxes, depreciation and amortization) was $66,300 for 2002, down 14% from prior year.

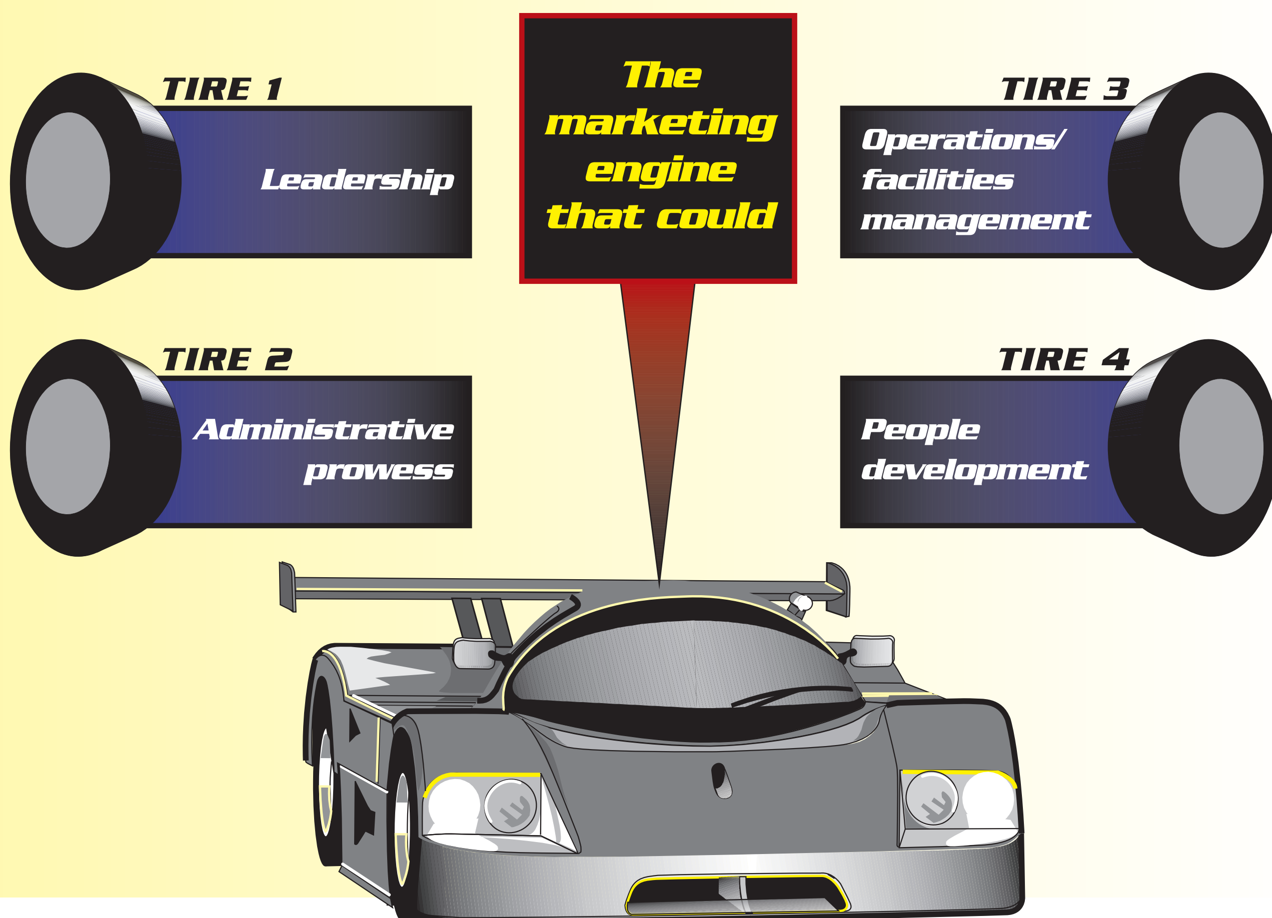
Our industry is data-handicapped because we don't have a vehicle for the timely reporting of same-store sales performance. The NACS annual survey, however, does report some same-store volume data, against which retailers should compare their per-store percentage changes between 2001 and 2002.

The takeaways I surmise from the same-store data include:

Cigarette trends. While reported industry shipments declined 3.7% in 2002, our industry didn't lose share of market (SOM) to other retail sectors. Secondly, the consumer price index for cigarettes rose 8.8% in 2002. However, with cartons per week declining, essentially we have a bigger share of a product whose overall consumption has just declined more than any prior year. This is very, very concerning.

Total inside sales. Don't be fooled by the overall 3.6% improvement in total inside sales. Inflation on foodservice and other merchandise increased 1.6% in 2002, making the net change in those categories almost flat, plus total inside sales are artificially higher because of the 8.8% inflation factor on cigarettes, albeit from increasing state excise taxes.

Gallons sold. This approximate 1% volume slide may be the tip of the



iceberg as related to future trends. Hypermarkets apparently have 20% and 16% share of the fuel market in Washington and Texas, respectively. I join all other "experts" who project that hypermarkets will continue to adversely impact our industry's fuel SOM for years to come.

The winning proposition

A few years ago NACS introduced a "top performers" analysis to its SOI Report. I've embraced this amplified data and have spent considerable time trying to discern the best modus operandi for higher profits.

Top performers might include a six-store chain in Podunk, perceived "best in class" retailers, or a single 7-Eleven franchisee in Southern California; we can't identify these winners because NACS data is confidential. Regardless, you can often recognize a winner when you see one. So study that operator and evaluate what aspects of its go-to-market strategies apply, if any, to your company. See the NACS 2003 SOI Report or the joint NACS/CSP SOI Handbook for additional food for thought.

Profit opportunities

How many companies already rank their stores by controllable income, contribution to overhead or in quartiles? How many would like to? I am confident that more than 75% of our industry's chains do not have timely and/or meaningful analyses that document their major opportunities and challenges on an aggregate basis, much less by store (which I believe is mandatory).

Just as you can't afford to *not* have the best doctor to diagnose a loved one's health, especially in today's economy you can't afford to *not* have a current internal or externally developed analysis of your company's financial foundation.

If this is nonexistent and/or not current, I suggest that you plan for this diagnosis ASAP. It's hardly a big deal compared to the risk of not knowing the symptoms of all of your stores and their impact on your development plans. I offer these three promises:

1. If you're already profitable, you'll make more money after this review.
2. If profits are hurting, at least you'll better define the culprits and alternatives.
3. This initiative will provide the company's owners and top management with more peace of mind than any other strategy.

Marketing to success

High performers in our industry are companies that, first of all, are very efficient with the four fundamental disciplines that support our marketing vehicle. Having these attributes on quasi-cruise control, they differentiate themselves with a passionate and endless commitment to marketing.

Ask yourself what impresses you about heralded c-store operators. You don't hear of top management exoduses in these chains or question their commitment to store personnel. Also, their track records in upgrading facilities and systems are as clear as their reputation for customer service. But typically, their most compelling and distinctive attribute, which is very difficult to replicate, is their tenacious sales execution.

They religiously examine and re-examine their product offerings and pricing strategies, which they supplement with a determination to not only meet their customers' obvious expectations, but also exceed them. That takes hard work every day! Assuming you concur, these are my "culture" priorities for success in this arena.

Commitment to marketing. A marketing-driven "culture" must be evident from all top management. Let the "control freaks" (I use that term respectfully) do their thing because you can't survive if excessive labor dollars, overhead or inventory shrink is allowed to frustrate corporate efficiency and profits.

Passionate marketing leader. This individual needs to live and breathe deal-making; understand the pulse and unique clientele of each of the company's stores; have a thirst to maximize product turns and gross profit dollars; and lose sleep if this goal is not accomplished. When this leader reads or hears about same-store-merchandise sales improving at another chain, at a rate higher than he is achieving, his gut has to motivate him to find out why the company hasn't earned similar results. What programs or deals are we missing and how can we get them into our stores tomorrow?

Indifference is a killer. No chain can afford "pride of authorship" that stifles the introduction and implementation of innovative sales ideas in its stores. This is non-negotiable and as much a recipe for profit disappointment as keeping a controller that isn't fluent on Excel or Lotus. If your marketing leader lacks the passion and commitment to improve the company's gross profit dollars, encourage him to join your competitor. Then invest in an energetic team player who does what's right for the company, not what is comfortable.

Improving EBITDA

I'm providing my marketing sugges-

tions to increase EBITDA (earnings before interest, taxes, depreciation and amortization) the most in the shortest period of time. I recognize these are standard operating procedures for many chains, so I welcome feedback on omitted items and/or which items you might prioritize differently.

Center stage is critical. If your counter and back bars remain cluttered or "tired," then you are telling the public and your competitors that you're up for sale or should be. This is where you sell your No. 1 in-store category (cigarettes) and high-impulse items. Your MVPs (most valuable patron, the single-pack smokers) visit this space almost daily, and that's where they develop their first impression of your store. Modernize your center stage ASAP—this investment is mandatory. The good news is that it will be one of your highest returns on investment.

"Market" cigarettes. I heartily agree with manufacturers that profess your counters should "communicate" your message to smokers. Timidity and selling cigarettes don't reconcile. Cigarettes remain about 40% of inside sales, on average, and it's a legal product; hence, sell it! Promote the popular brands, lest you give up MVPs, plus their fuel and other merchandise revenue. Lastly, take daily cigarette inventories, monitor your turns, and never "stepchild" this No. 1 traffic-generating category.

Foodservice area. When customer traffic allows, the solo or second employee should be surveying the foodservice area for cleanliness, product appearance and content. Not many customers will buy coffee or fountain drinks when the area is unkempt or the coffee smells burned. And who wants to buy hot dogs when they are as wrinkled as a year-round Miami tan? Finally, rethink how this area is promoted, including the potential for cereal and soup offerings, grain (energy) bars, etc.

Merchandising "stuff." Many good marketers concede that merchandising products (excluding cigarettes) takes a lot of attention, yet they also agree it offers some of the highest potential. Our retail sector desperately needs education in the sales of such products as packaged cereals, soups, frozen pizza, etc., because we must sell more "stuff." For more than five years we've been going backward in this broad category, and that trend is not acceptable or healthy.

> Ask yourself what impresses you about heralded c-store operators.

Scanning analysis. Many companies have taken on scanning, but if their scan rates are less than 98% then I'm confident that they're probably not using this investment properly. Scan rates should exceed 99% per store, and I've seen one company average less than $10 per store per week of non-scanned items. Once you get over that hurdle, the magic is viewing the reports on top-selling SKUs by store and company average, and studying the differences. Take this further and identify product mix (by number of units, sales dollars and gross profit dollars), plus by different types of stores: e.g., interstate, neighborhood, rural, college, etc. This is powerful marketing intelligence!

Marketing benchmarks. On average, our stores are marketed so informally that I cringe when someone proposes microscopic-type studies that allocate total operating costs by category and calculate linear facings to get the profitability per square foot of each product. My prejudice is to assure the "basics" of marketing are firmly in place, as suggested herein, then later evaluating potentially higher levels of sophisticated data analysis. I'd begin by measuring same-store sales and gross profit dollars by store, separating cigarette and non-cigarette sales data; equivalent cartons sold per week; and per-store growth (sales and gross profit dollars) by each major vendor, comparing Coke vs. Pepsi, Bud vs. Miller, etc. Then, celebrate the top supplier for each category and, likewise, acknowledge and reward your top selling store for candy, prepaid items, groceries, dairy, etc.

New products. Adopt an idea I heard from Sheetz a few years back: Measure the percentage of sales increase in the current year that emanated from items you didn't sell the prior year. This is a great motivation for touring competitors and other retail venues. Start by informing your suppliers of your desire and expectation to be part of future first-to-market initiatives so you can capitalize on their new product's introductory fanfare while consumer awareness and excitement is high.

Will your company drive profits in 2003 or will you be pulled aside because of one or two defective tires? My parting plea is that your executive committee, board and/or outside consultant immediately help you define strategies to fix the easy problems, i.e. the four wheels of your marketing vehicle. Then, harness all your focus on supporting and celebrating your new and/or improved, much faster marketing engine. Enjoy the ride! ■

Your company's performance vs. SOI

Fill out this form and analyze your company's posture vs. the rest of the industry. If your company averaged profits approximating or less than the industry average in 2002, it's time to consider some changes.

OUR COMPANY'S OPERATING RESULTS FOR 2002 VS. NACS STATE OF THE INDUSTRY DATA—Note 1

LINE #	STATISTIC	OUR COMPANY	INDUSTRY AVERAGE	FAVORABLE /–UNFAVORABLE	
				AMOUNT	% DIFF
	Volume Data per Store with Fuel				
1	Average cigarette sales per store		$306,400		
2	Average foodservice sales per store		$104,400		
3	Average other merchandise sales per store		$440,200		
4	Average inside sales per fuel store		$851,000		
5	Average motor fuel sales per gas c-store		$1,820,000		
6	Average total sales per c-store with fuel		$2,671,000		
7	Average gallons of gas sold per store		1,297,200		
8	Average selling price per gallon		$1.403		
	Product Mix & Gross Margin per Store with Fuel				
9	Cigarette sales % of total inside sales		36.0%		
10	Foodservice sales % of total inside sales		12.3%		
11	Composite merchandise sales GP% (note 2)		29.4%		
12	Motor fuel margin (cents per gallon)		12.7 cents		
13	Total gross profit $—inside sales		$250,200		
14	Motor fuel gross profit $ per gas store		$165,200		
15	Average total GP per gas store (note 3)		$415,400		
	Profitability Analysis Per Store				
16	Pre-tax profit $ per store—prior year (note 4)		$28,300		
17	Increase (decrease) in total GP$ vs prior year (note 5)			–$4,700	
18	(Increase)/decrease in store admin expenses &/or other income, net of other expenses (note 6)		–$3,200		
19	Increase (decrease) in pre-tax profit vs. prior year		–$7,900		
20	Pre-tax profit $ per store—current year (note 4)		$20,400		

Source: NACS 2003 State of Industry Report

Notes:

1. This form presents NACS industry averages and allows retailers to compare their 2002 operating results for stores with fuel with the NACS volumes, margins and profits per fuel store for 2002.
2. NACS advises that margin on Line 11 reflects buy-downs and retail display and other vendor allowances as part of the composite gross profit percentage.
3. Line 15 excludes sundry gross profit from commissions, ATMs, car washes and other similar income.
4. Pre-tax profit on lines 16 & 20 is traditional (GAAP) accounting, i.e. the income left after all charges for G&A costs, interest expense and other income-net. It's the net profit before income taxes.
5. Line 17 is the change in gross profit dollars between years for c-store with fuel; gross profit dollars are the only money available to absorb higher costs (Line 18) and improve profits.
6. Line 18 is a composite of net (increase) in store expenses (including salaries & wages), as well as net (increases) in general and administrative and/or interest costs.
7. If you would like a free copy of this Excel worksheet email Meyer & Associates: dmeyer@dickmeyer.com