

Dollar Stores' Growth Opportunities—and Challenges

Still a growth story when it comes to store count

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As major department store and apparel retailers shutter outlets, dollar stores are going gangbusters, at least in terms of new store openings.

Dollar General, which has more than 13,600 stores, on Thursday reported better than expected Q1 profit and reiterated its target to open about 1,000 new stores this year. Rival Dollar Tree, which also owns Family Dollar chain, said last week that it sees an opportunity to operate more than 25,000 Dollar Tree and its acquired Family Dollar locations combined in the US, up from the current total of about 14,200.

“We continue to see tremendous runway for growth,” said Dollar General Chief Executive Todd Vasos on a conference call Thursday.

While Sears, Macy’s, JC Penney and many other retailers are shutting stores, dollar stores have been a segment of the market seeing one of the fastest store count growth. Between 2005 and 2016, dollar stores have increased their count by 58% to more than 29,400, according to Nielsen data. The only segment that saw faster unit growth (76%) during that time is supercenters, Nielsen data showed, as retailers like

Walmart converted more of their discount mass merchandise stores to supercenters including grocery sections.

The sector also looks to have outperformed the broader market by sales. Sales at variety stores, which include dollar stores, rose 6.8% to \$57.9 billion on average each year between 2011 and 2016, more than double the 2.6% growth rate of the overall retail industry, according to Euromonitor data.

“We are well positioned in the most attractive sector of retail,” said Dollar Tree CEO Bob Sasser in the company’s earnings call last week, echoing the point that it has “many years of growth opportunity ahead.”

Dollar stores, with much smaller stores than mass discounters or supermarkets, have traditionally benefited from targeting consumers seeking to quickly fill some of their weekday needs and from targeting more lower income shoppers and locating stores in markets, including rural areas, that may not have been as well penetrated by other store formats. During the economic downturn, the sectors also have attracted some higher income consumers trading down.

Nielsen data showed that among customers with household income of \$29,000 or less, 43% said they shopped at dollar stores last year, more so than at convenience stores or any other retail format Nielsen tracks. Meanwhile 23% of those earning more than \$70,000 said they shop dollar stores.

There may also be an unintended benefit of targeting lower income shoppers. As most physical retailers fret about the Amazon effect, dollar stores look to still be relatively immune. Dollar General CEO Vasos said Thursday, in response to a question about online competition, that only about 70% of its core customers have smartphones. He conceded that, over time, they’ll “probably start to gravitate toward online purchasing,” but for now they are still lagging on that front.

“I don’t see today our core customer spending a lot more of her disposable income online than before,” he said. “We just don’t see that.”

The typical demographic of a dollar store shopper doesn't have "significant overlap" with the online shopper, said Laurie Rains, group VP of Retail Consumer & Shopper Analytics at Nielsen.

"The majority of transactions at dollar stores are cash transactions," she said in an interview, adding that many dollar store shoppers don't have credit cards. Still, "any retail channel should worry about" online competition.

Indeed, both Dollar General and Dollar Tree said they are focusing on a digital strategy. Dollar Tree's Sasser, for instance, said that while online sales remain small, he's "pleased" with the trend in both ecommerce traffic and sales.

However, some of what has worked well for dollar stores so far could turn into problems under different circumstances. For instance, lower income shoppers, more than the other segments of the market, are "more sensitive to any kind of economic change," Nielsen's Rains said.

A case in point, both Dollar General and Dollar Tree said delayed tax refunds hurt discretionary sales in Q1. On top of that, Dollar General's Vasos said Thursday its consumers have been holding back on spending as the company has seen consumers consolidating trips across the board and buying less and at fewer retailers.

"She's in an economic cycle right now where there's a bit of uncertainty," he said, adding that its customers are waiting to see if the job and wage growth are sustainable. "Our core customer doesn't have a large bank account to fall back on."

To drive traffic and purchases, not unlike convenience and drug stores, dollar stores like Dollar General also are adding more fresh foods to satisfy demand. Dollar General, for instance, said it's adding more coolers in stores to stock perishable items and is testing selling fresh produce, a move that it said has benefited sales.

In another challenge to the segment, larger rivals from Walmart to Target are opening smaller format stores and promising to cut prices and make "price investments" as part of their "everyday low" price strategy. Jefferies analyst Dan Binder said its pricing analysis showed that Walmart's prices are lower than Dollar General's. Binder also noted

that as wages rise among lower income shoppers, it'll lead to less fill-in purchases and more stock up trips at other retailers.

This past fiscal year marked Dollar General's 27th consecutive year of same-store sales growth, but the gain was fairly slender, slowing to a 0.9% gain, compared to a 4.7% increase five years earlier. Q1 comparable sales this year rose 0.7%.

“Dollar stores in general are suffering from a slight loss of momentum,” said GlobalData Retail’s Neil Saunders. “This does not mean the format is falling out of favor or that there isn't scope for future expansion, but it does mean that growth is now harder to attain.”