

INNOVATING TO COMPETE

Next steps for North American
convenience stores



At a glance

C-STORES ARE POISED TO STEAL MARKET SHARE

North American c-store sales are rebounding, and c-stores appear well positioned to steal share from adjacent foodservice segments. For the first time in our survey, speed and convenience have trumped price as the reasons consumers buy food at c-stores. Additionally, consumers indicated increased interest this year in purchasing ready-to-eat meals from c-stores in lieu of dining out. To take advantage of this moment, the industry must innovate on three crucial fronts: foodservice offerings and operating models, creative differentiators, and emerging threats.

1

INNOVATING IN FOODSERVICE AND OPERATING MODELS

- Foodservice remains the primary driver behind in-store purchases at c-stores.
- Grab-and-go leads in consumer interest over made-to-order.
- C-stores must focus on ready-to-eat and "better for you" platforms, and work to attract the 50% of consumers who are reluctant to try new foodservice offerings from c-stores.

2

CAPITALIZING ON CREATIVE DIFFERENTIATORS

- Loyalty programs are a very important factor in influencing c-store customer behavior, but c-stores significantly trail the restaurant industry in terms of mobility adoption and must address this.
- Progressive concepts are shifting from introducing to expanding delivery platforms, potentially including tobacco and alcohol products in markets where possible.
- Nontraditional types of locations, such as airports and college towns, are resonating with large segments of consumers and helping concepts reach new customer bases.

3

TRANSFORMING POTENTIAL THREATS INTO OPPORTUNITIES

- Several forces—automation in retail, alternative transportation, and e-cigarette regulation—are posing potential threats to c-stores.
- C-stores should adapt their long-range development plans to accommodate increased use of electric or hybrid vehicles.
- Concepts should prepare for potential significant disruptors in e-cigarette sales.

Now in its fifth year of publication, AlixPartners' North American convenience store consumer study uncovered vital insights into the shape of the industry's landscape in 2018.¹ Our findings this year point to three imperatives that industry players must meet to remain competitive in a hypercompetitive landscape: innovating in foodservice to drive growth, capitalizing on creative differentiators, and transforming potential threats into opportunities.

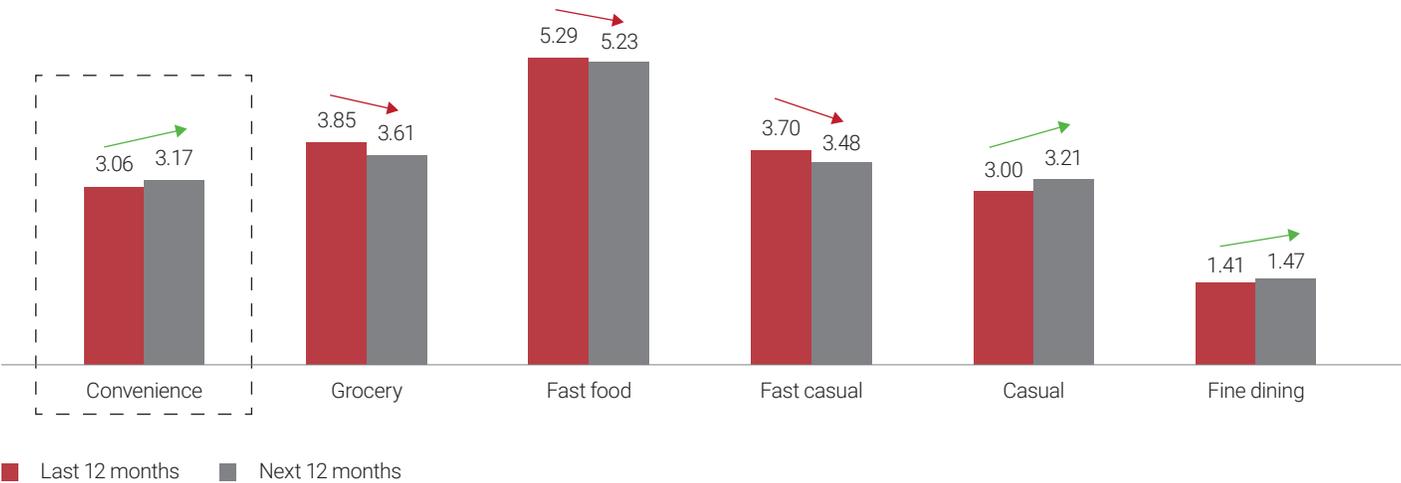
INDUSTRY SNAPSHOT

The c-store industry has been bouncing back somewhat after experiencing total sales lows in 2015 and 2016. A rebounding of US gas prices and continued growth in in-store sales, specifically foodservice, have helped. This growth in foodservice sales stands out in the context of the wider overall foodservice industry, which seems set for a somewhat flat performance moving forward, judging by this year's survey findings. Our respondents indicated even spending on dining out in the coming year versus the previous year, and only a slight dip in dining occasions.

However, c-stores seem well positioned to steal share from adjacent foodservice segments, particularly limited-service restaurants. In fact, our study suggests that the number of visits to c-stores for the purpose of buying food will rise over the next year but will decline for grocery, fast food, and fast casual (figure 1). Why? Consumers plan to buy ready-to-eat meals from c-stores and grocery stores more often in lieu of dining out. (We saw an uptick from 16% to 25% of consumers from 2016 to 2018 highlighting this strategy as a way to reduce restaurant spending.) Intended usage of all other strategies (including using promotions, eating at less expensive restaurants, and ordering fewer items) shrank year-over-year.

FIGURE 1: ON AVERAGE, HOW OFTEN DID YOU DINE/PURCHASE A MEAL OUTSIDE THE HOME AT ANY OF THE FOLLOWING TYPES OF FOODSERVICE ESTABLISHMENTS IN THE LAST 12 MONTHS AND HOW OFTEN DO YOU PLAN TO IN THE NEXT 12 MONTHS?

Average monthly visits



1. The North American convenience store consumer study reflects responses from 1,018 US-based consumers regarding their choices and preferences when visiting and shopping at c-stores. The survey was conducted in September 2018.

SPEED TRUMPS PRICE

This is the first year that we've seen convenience trump price as the rationale for buying meals at a c-store rather than a restaurant. When asked what their number-one reason was for buying ready-to-eat meals from c-stores or grocery stores more often than dining out at restaurants, 41% of our respondents said they were out shopping for gas or food already, and it was simply easier to pick up such

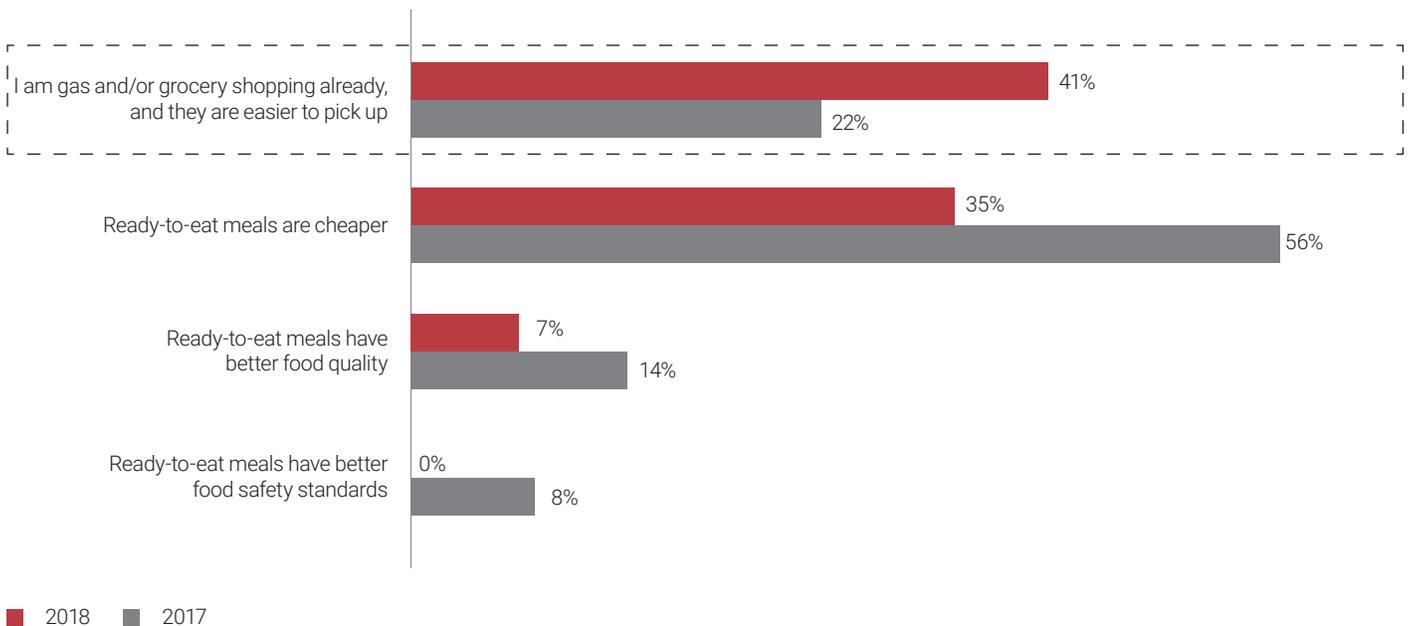
meals at these stores. This was up from 22% just last year. In contrast, only 35% of consumers suggested that their rationale for purchasing these meals was a lower price (figure 2). (This was down from 56% in last year's study.) What's more, when rating their experiences with buying meals and drinks at c-stores versus at establishments in other foodservice segments, consumers in our study gave c-stores higher grades than limited-service establishments for speed and convenience but gave similar grades on pricing.

41%

of consumers said their rationale for purchasing these meals was because they were out shopping already and they were easier to pick up.

FIGURE 2: CONVENIENCE HAS RECENTLY TRUMPED PRICE AS THE MAIN REASON TO SELECT READY-TO-EAT MEALS IN LIEU OF RESTAURANT DINING

You indicated that you plan to purchase ready-to-eat meals from grocery or convenience stores more often in lieu of restaurant meals. What is the number one reason for this?



Source: AlixPartners US Restaurant Outlook Consumer Study, 2018

INNOVATING IN FOODSERVICE

Foodservice once again features as a prominent theme in this year's survey.

Our study participants indicated that foodservice (including prepared foods and dispensed beverage) remains the primary driver behind their in-store purchases—significantly beating out packaged beverages and cigarettes. (While 28% of respondents selected foodservice as the primary driver, the numbers for packaged beverages and cigarettes were just 16% each.)

So how should c-stores further capitalize on this trend—and sharpen their competitive edge over players in other segments of the larger foodservice industry? Innovation will be essential—in food product categories such as ready-to-eat offerings, in the healthfulness of their foodservice offerings, and in their strategies for attracting a broader swath of foodservice customers.

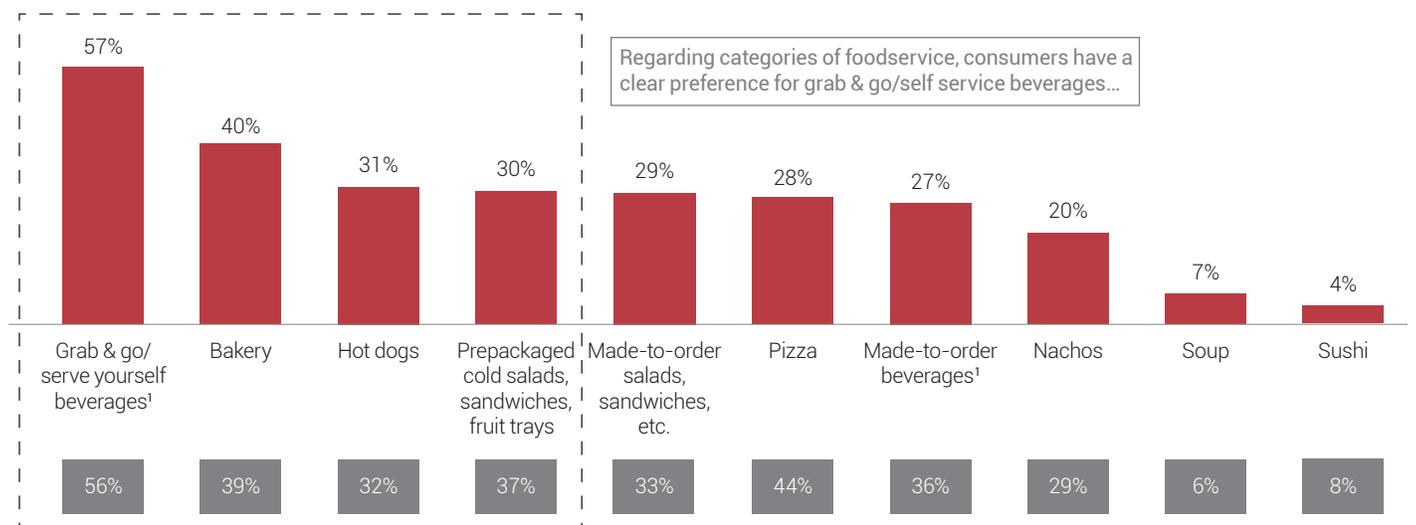
FOCUSING ON READY-TO-EAT, GRAB-AND-GO MEALS

Additional foodservice findings further underscore the importance of service, speed, and convenience (even over price) to c-store customers. When asked what most catches their interest regarding the foodservice offerings they evaluate while visiting a convenience store, their responses showed that grab-and-go/self-serve beverages and ready-to-eat offerings trump made-to-order food and beverage products (figure 3). While industry players have recently focused on customized, made-to-order foodservice offerings, we advise operators not to lose sight of the quality and breadth of ready-to-go platforms.

OFFERING HEALTHY OPTIONS

Consumers' desire for "better for you" foodservice offerings is also strongly influencing their c-store purchase choices. For consumers, the defining attributes of "healthy" options include freshly made in stores, locally sourced and fresh ingredients, and low-calorie. When asked how important "healthy" or "better for you" options are to them while they're choosing what to buy at a c-store, the percentage of our respondents who said "extremely important" jumped from 10% in 2017 to 15% in the 2018 survey—driven primarily by millennials. What's more, the percentage who responded "not at all important" to this same question dropped in that time frame (from 19.5% to 16%).

FIGURE 3: WHAT TYPES OF FOODSERVICE FOOD AND BEVERAGE ARE YOU MOST INTERESTED IN PURCHASING FROM A CONVENIENCE STORE?

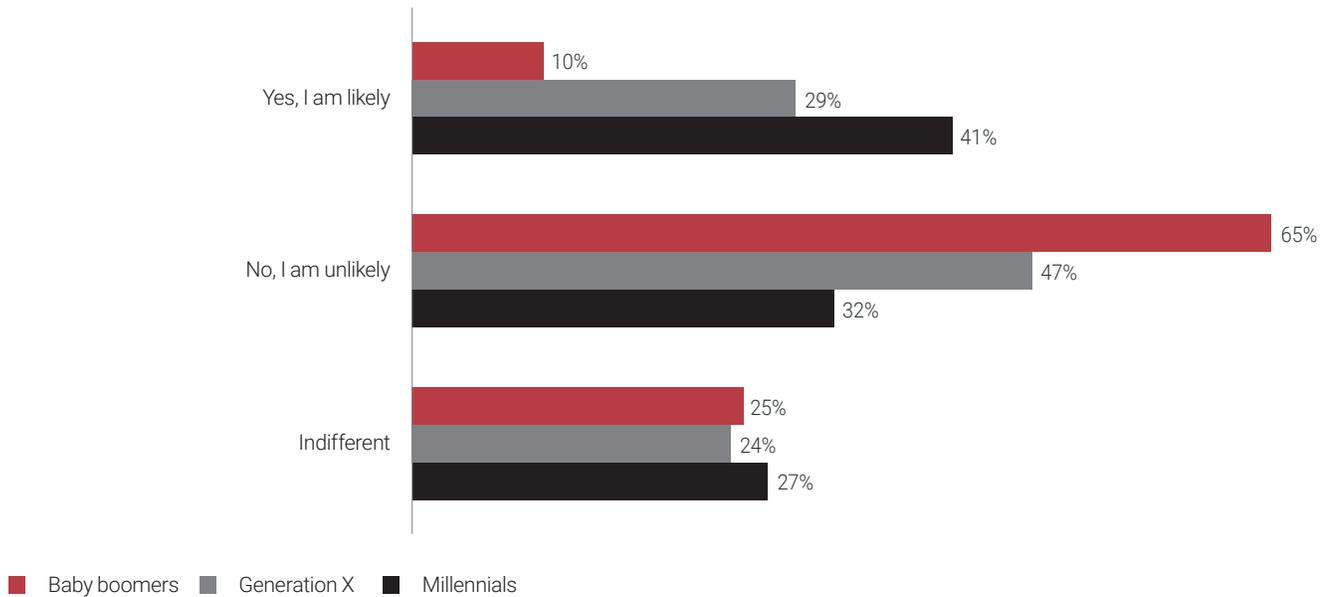


■ All respondents ■ Millennials only response

1. Includes coffee, frozen drinks, and fountain soda

FIGURE 4: ARE YOU LIKELY TO TRY NEW FOOD OFFERINGS FROM AN ESTABLISHMENT THAT HAS NOT TRADITIONALLY SOLD FOODSERVICE ITEMS (E.G. GAS STATIONS, RETAIL STORES, ETC.)?

By generation demographic



Slicing the data more finely reveals important differences across demographics. For example, baby boomers are less likely to try new items where as millennials are more likely.

ATTRACTING A BROADER SWATH OF FOODSERVICE CUSTOMERS

Half of our respondents said they're unlikely to try new foodservice offerings sold by establishments that haven't traditionally sold such items, such as gas stations and retail stores. But slicing the data more finely reveals important differences across demographics (figure 4). Specifically, consumers from the baby boomer generation are the least likely to try buying food items at these nontraditional establishments. (Nearly 66% suggested they would not.) By contrast, millennials are most likely to give these items a try. (Only 32% suggested they would not.)

Promotions linking fuel and food purchases topped the list of answers of how c-stores can best persuade consumers to try new foodservice offerings. For instance, "offering free food with gas purchases" and "offering gas discounts with food purchases" were selected as strategies by 44% and 41% of our study participants, respectively. "Providing free food samples in the store" was also selected by 41% of the respondents. These tactics won out over others including "sending promotions and coupons in the mail or online", "advertising food products at the gas pump," and "providing free food samples at the gas pump."

CAPITALIZING ON CREATIVE DIFFERENTIATORS

This year's survey pointed to several creative differentiators that could help c-stores drive top-line growth and start stealing market share from players in other segments of the industry: loyalty programs, new delivery models, and nontraditional store formats. All three of these present additional opportunities for c-stores to innovate.

LOYALTY PROGRAMS

When asked how important specific c-store service offerings were to them, our study respondents gave loyalty programs the highest ratings in importance—over made-to-order foodservice, drive-through window pickup, and in-store and outdoor dining areas. Loyalty programs even beat out high-tech services, such as curbside pickup and drone delivery.

Clearly, loyalty programs have grown from their fuel-only roots. But they vary in user experience, point value, and effectiveness as a marketing strategy. Differences in loyalty programs' maturity levels can be seen in criteria such as degree of functionality (for example, the existence of separate apps for pick-up and delivery) and quality of the user interface (including ease of use, geo-fencing, and personalization). The upper echelon of loyalty programs incorporate gamification and use of customer insights to personalize marketing campaigns. Loyalty-program leaders also leverage customer insights and stronger marketing efforts to gain advantage over their peers.

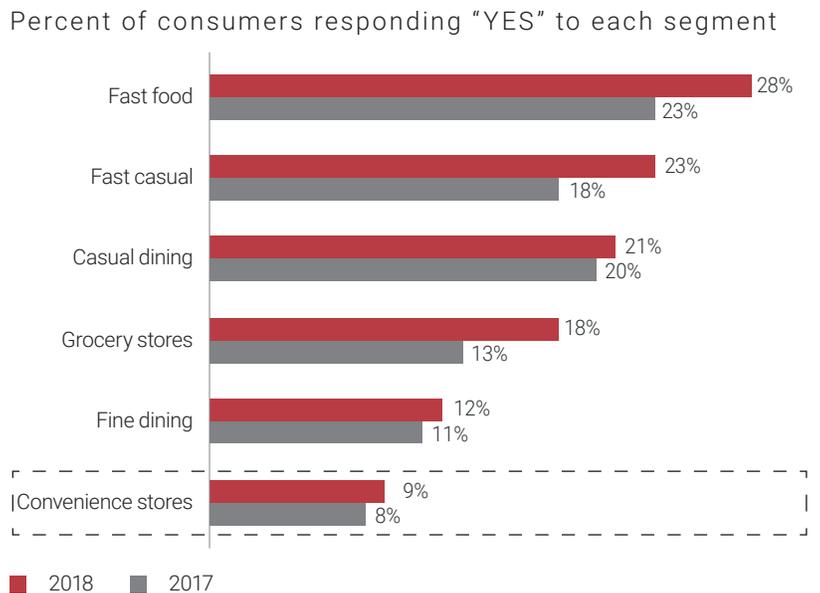
For example, some concepts have designed sophisticated loyalty programs focused on growing in-store traffic and ticket spend. Their programs are stand-alone, manifested as a mobile-first app. In-store pickup is available, along with delivery (in-app or through a third party).

Leading apps feature a high-quality design and are frequently updated to ensure a high-quality user experience. The marketing campaigns behind the program are often artificial-intelligence assisted and target micro-customer segments, such as specific age groups or even individual users. Finally, the programs show a high level of gamification; for instance, comprising tiers that lead to more free items as customers advance to higher levels.

When it comes to c-store loyalty programs, millennials stand out as the most promising customers. For one thing, they now make up the largest segment of the labor force—and they're expected to overtake baby boomers to become the heftiest demographic segment in 2019, according to Pew Research. Millennials also exhibit a stronger loyalty toward their favored brands than members of the Gen X and baby boomer generations—suggesting their greater propensity to use loyalty programs.

Given loyalty programs' central role in brands' broader mobile technology platforms, c-stores must also consider where they stand on use of mobile technology. Such technology is gaining momentum in the foodservice industry—particularly in the limited-service segments. But when we asked our survey respondents whether they've used mobile technology in different foodservice segments, convenience stores came in dead last, even behind fine dining (figure 5). For c-stores hoping to steal market share from limited-service restaurants, catching up on mobile technology will be essential.

FIGURE 5: HAVE YOU USED MOBILE TECHNOLOGY (E.G. PAYMENT, ORDERING, RESERVATIONS, APPLICATION FOR PHONE, ETC.) AT ANY OF THE FOLLOWING EATING LOCATIONS?



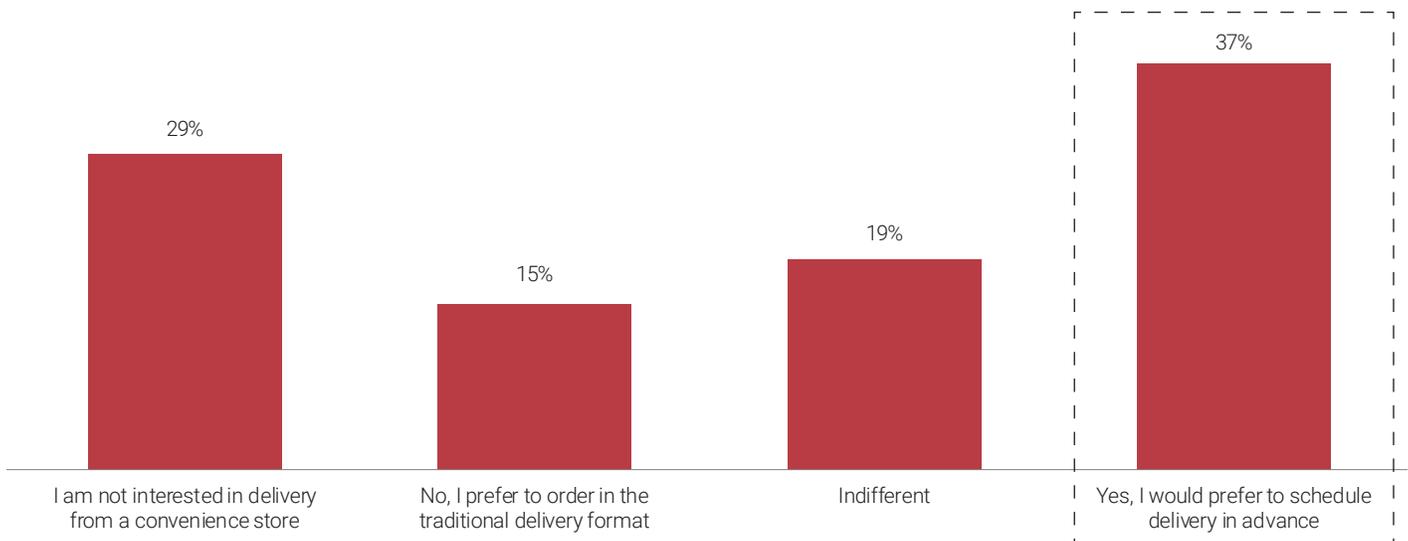
TECH-ENABLED DELIVERY STRATEGIES

Technology is enabling c-stores to craft cutting-edge delivery strategies that could help fuel top-line growth. While c-stores generally haven't forged exclusive partnerships with delivery service providers, they're testing such services locally. For instance, several concepts have been experimenting with Postmates, Doordash, UberEATS, and GrubHub. Some delivery service providers—such as goPuff—focus specifically on the c-store segment.

However, our survey findings indicate that most consumers prefer to order delivery directly from a c-store instead of through a third-party service. What's more, they want to be able to schedule delivery in advance—more akin to the grocery-store delivery model versus restaurant delivery (figure 6).

But delivery innovations are expanding beyond just c-store food and foodservice offerings. Tobacco and alcohol are cases in point. North American cities and states have become increasingly open to allowing delivery of these products. Accordingly, brick-and-mortar retail stores have begun partnering with on-demand delivery services such as Saucey and Minibar. C-stores in geographies where such delivery has been legalized may benefit from exploring these partnerships as well.

FIGURE 6: IF YOU WERE ABLE TO SCHEDULE DELIVERY FROM A C-STORE IN ADVANCE, WOULD YOU PREFER THIS VERSUS TRADITIONAL DELIVERY (E.G. ORDER IN THE MOMENT FOR THE FOOD TO SHOW UP APPROXIMATELY 45 MINUTES LATER)?



NONTRADITIONAL STORE FORMATS

This year's survey respondents indicated an increased willingness to buy from c-stores in nontraditional locations—such as high-traffic urban centers, college towns, airports, and sports stadiums. Progressive brands have already picked up on this development, with new small footprint, fuel-free locations popping up across several cities, airports, and sports venues. Often with built-in traffic, these nontraditional formats enable brands to reach new customer bases unfamiliar with the concepts, cater to captive audiences, and forge new business partnerships (such as exclusivity to sell sports team branded food products) to help strengthen competitive positioning.

TRANSFORMING POTENTIAL THREATS INTO OPPORTUNITIES

A number of forces are gathering steam that could present serious threats to the convenience store business, both in the near and longer term. C-stores that strategically assess these threats rather than shying away from them stand the best chance of transforming them into new business opportunities. We see the threats as falling into three categories: automation in retail, alternative transportation, and e-cigarette sales and regulations.

AUTOMATION IN RETAIL

Demographic trends suggest that North America, particularly the United States, is ripe for an increasingly aggressive shift toward automation in the retail industry. For example, adoption of self-checkout systems has skyrocketed, along with mobile-based scan-and-go technology, which is of particular interest to younger consumers.

Looking to the future—to the growth of fully-automated stores—the integration of mobile and self-check-out systems could create an entirely frictionless experience for c-store customers while also cutting labor costs for stores by eliminating

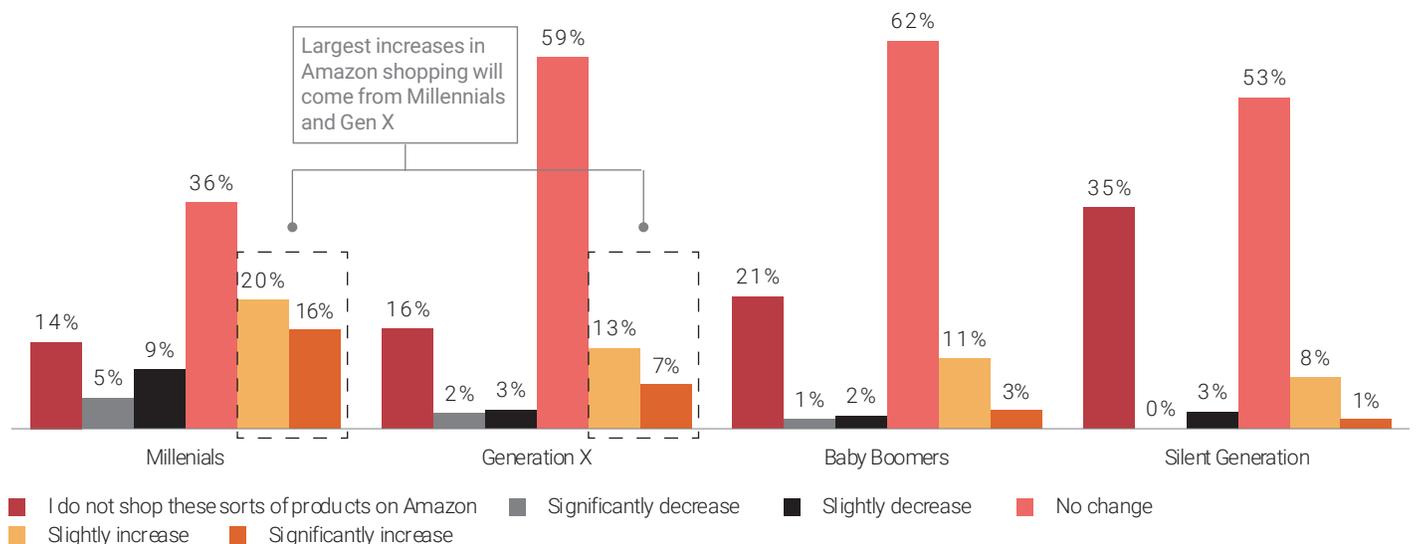
checkout lines. Technologies in scope include facial recognition, RFID, artificial intelligence, mobile payment, intelligent video tracking, voice recognition, and security solutions.

A few c-stores have begun exploring these technologies, but Amazon Go is clearly the leader in fully-automated stores. Moreover, it has made such automation a key strategic priority and is decidedly set to expand this model. With its remarkably convenient, “just walk out” in-store shopping experience, paired with its same-day delivery and pickup service (Prime), Amazon will continue to challenge the c-store segment. Indeed, analysis of this year’s survey results suggests that we’ll see an uptick in c-store-category purchases from Amazon among some demographic segments, particularly millennials and Gen Xers (figure 7).

To combat these threats, c-stores will need to proactively develop offerings and marketing strategies leveraging innovation and technology to better engage their customers. For instance, they’ll have to:

- Redefine their operating models and brand strategies to better reach customers (including where, when, and how consumers buy from them); for example, by providing drive-thru, curbside pick-up, and delivery.
- Maximize automation—in forms such as frictionless checkout and fully-automated stores, to enhance visitors’ in-store experience and make on-demand shopping easier.
- Rapidly migrate to the digital world by improving their mobility and loyalty platforms and using machine learning, virtual reality, and accelerated analytics to gain insights into customers’ behavior and better engage consumers.

FIGURE 7: THINKING ABOUT TRADITIONAL C-STORE CATEGORIES, HOW DO YOU EXPECT YOUR PURCHASES FROM AMAZON TO CHANGE OVER THE NEXT 12 MONTHS COMPARED TO THE PREVIOUS YEAR?



ALTERNATIVE TRANSPORTATION

Convenience stores must prepare for a future in which more and more people will be using alternative forms of transportation, especially electric or hybrid vehicles. Indeed, in the US alone, all future growth in the number of vehicles on the roads will come from alternative-fuel vehicles. And many of the consumers participating in this year's c-store survey who own electric vehicles (EVs) view availability of an EV charging station as important in their decision to visit a c-store (figure 8).

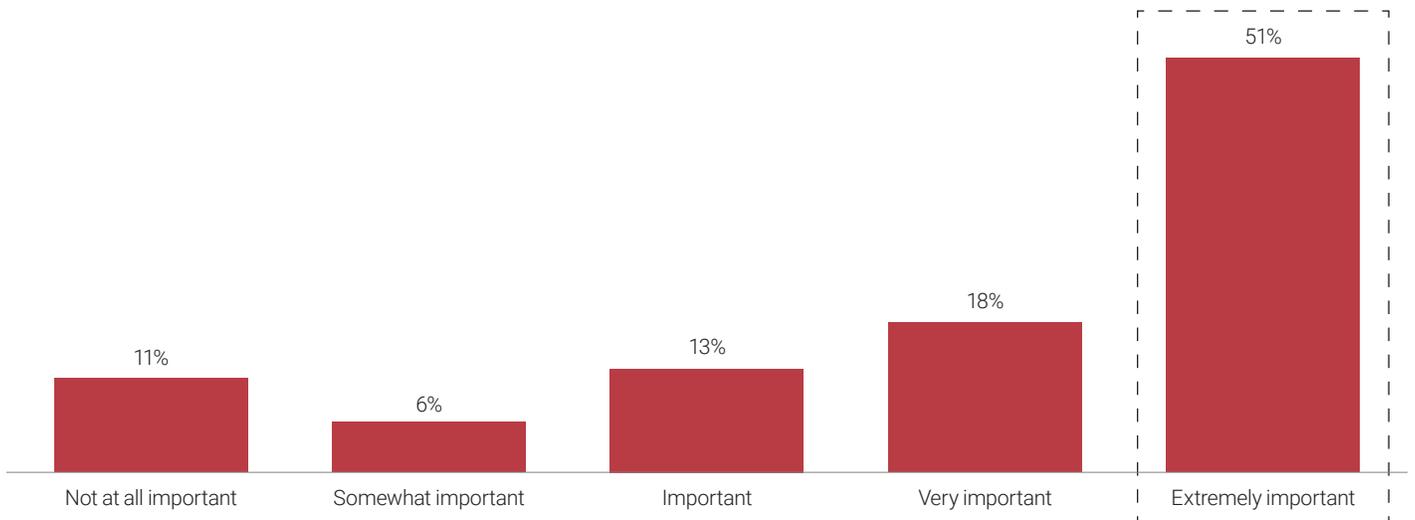
We believe that convenience stores can adapt their development plans to accommodate EVs and their comparatively longer refueling periods. For instance, they can introduce EV chargers and adjust their store layouts to provide "dine-in" occasions suiting the extended visit of EV owners who are recharging their vehicles. This approach could help c-stores generate additional revenue and enhance customer loyalty.

Ride sharing (through services such as Uber and Lyft) is hardly top of mind for c-stores. But if it becomes increasingly popular in the next 5 to 10 years, it could pose a threat. According to our survey findings, people tend not to visit convenience stores while using ride-sharing services. When we asked our respondents to indicate how likely they'd be to buy something at a c-store when using a variety of transportation modes, ride sharing came in near the bottom, after a long list topped by use of private vehicles.

Another key transportation innovation is fully autonomous vehicles. These are still far from mainstream adoption by consumers, and they won't likely affect c-store visits in the near term. However, in the long term, the picture may change. For example, if technology enables consumers to become much more passive drivers, then they may make fewer spontaneous c-store visits. On the other hand, if fully autonomous cars enable interactive experiences (such as through geo-fencing), c-store visits may not be negatively affected.

It's too early for anyone to identify the full impact of transportation innovations on c-stores. But what we do know is that these businesses can't over-rely on traditional, fuel-related visits from consumers. Instead, they must tailor their strategies to drive better customer engagement and reduce this dependence.

FIGURE 8: HOW IMPORTANT IS HAVING ELECTRIC CAR CHARGING STATIONS TO YOUR DECISION TO VISIT A CONVENIENCE STORE?



E-CIGARETTE SALES AND REGULATIONS

With c-stores selling roughly 70% of total nicotine volume in the United States, the industry has been hit particularly hard with tax and legislation to drive down overall tobacco usage. But recently, increased sales of e-cigarettes have mitigated losses in the overall category. Over the past several years, non-cigarette tobacco products led the vast majority of the sales growth of c-stores' tobacco category, reflecting a five-year growth trend that's poised to continue.

To prepare for the projected ongoing market growth of e-cigarettes, c-stores should closely monitor innovation in that channel. However, they should also keep tabs on the regulatory landscape for e-cigarettes. Following a major increase in e-cigarette use among teens and

children (for example, vaping has increased nearly 80% among high schoolers and 50% among middle schoolers over the last year), the FDA has vowed to strengthen agency policies against flavored e-cigarette products, suggesting the potential for increased federal enforcement in c-stores and other retail sites, a ban on online sales, a ban on the sale of menthol cigarettes, and a requirement that e-cigarette makers share plans to curb vaping among teens and younger individuals. The FDA has also launched its own multimillion-dollar marketing campaign to warn teens and children about the dangers of vaping nicotine. In response to FDA pressure, Juul (the e-cigarette brand boasting 70% of the market) has announced that it will remove most of its flavored nicotine liquids from brick-and-mortar stores and discontinue the use of social media marketing.

Clearly, c-stores can't take growth of e-cigarette sales for granted. They should also prepare for a future where sales of these products may not be as brisk.

SUMMING UP

C-stores are rebounding from the sales lows of previous years and appear poised to continue the recovery by stealing share from adjacent competitors. To do this, they must focus on three critical imperatives. First, innovating on foodservice by focusing on speed and convenience (e.g. grab-and-go foodservice offerings, etc.) and targeting millennials (a demographic where interest in foodservice innovation and loyalty is particularly strong). Secondly, c-stores must re-engage consumers by developing creative ways to differentiate themselves from the competition. This can be done through innovations in loyalty and mobility, delivery, and non-traditional store formats. Finally, they must turn the emerging threats of automation, transportation innovation, and tobacco regulation into opportunities.

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Our approach enables us to help our clients confront and overcome truly future-defining challenges. We partner with you to make the right decisions and take the right actions. And we are right by your side. When it really matters.

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