Consumers chased bargains, now discounters chase the affluent

BY MARINA STRAUSS
RETAILING REPORTER

When Bargain Shop features a $20 sweater on the front page of its flyer later this month, it will be a departure that marks a shift in the strategy of many discounters.

Known more for touting staples such as paper towels and detergent for under $3, it may seem odd for that type of discounter to advertise a sweater at $20. But the move reflects the rising fortunes of such chains in the recession, underlined last week by Dollarama Group LP's plans for an initial public offering.

The shift to pricier products signals the changes at **Bargain Shop Holdings Inc.** as it broadens its offerings to draw a wider – and more affluent – customer. The strategy has helped the privately held chain more than double its sales over the past three years to almost $500-million at 250 outlets.

It's not alone among smaller-format discounters and dollar stores as they profit from budget-conscious consumers in the downturn, even as other retailers are pinched.

Once considered down-at-the-heels chains, so-called "value retailers" have prospered by differentiating themselves from giant discounter Wal-Mart Canada Corp.

They have located in smaller, neighbourhood stores and stocked more high-profile brands such as Tommy Hilfiger. Others have bolstered their high-margin private labels, knocking off popular styles at low cost. And they've added more food – and in some cases fashions – to their shelves.

Now Bargain Shop may follow soon with its own IPO, Michael Roellinghoff, its chief executive officer, hinted in relation to Dollarama filing documents for an IPO that would raise more than $250-million.

"Nothing is impossible," he said in an interview.

"The climate in our industry has certainly been quite bright."

But the value chains' recipe for growth will be tested as the economy recovers and consumer confidence returns. Will customers ditch discounters for their previous retail haunts?

"There's going to be a continued focus on discount retailers," predicted Rick Pennycooke, president of retail-real estate consultancy Lakeshore Group.

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High-profile private equity groups bet on discounters

"Even as the economy improves, I don't think their fortunes will diminish ... People are not just going to go back to their previous ways of spending. And there's a bit of an entertainment factor. People will go in just on the basis of wanting to see what's new there this week. That's part of their appeal."

He himself now shops at Dollarama and discounter Giant Tiger, neither of which is his client. At Giant Tiger, he recently snapped up three pairs of copycat Croc shoes for his three children at $3.50 each.

"If the price is right, I will go," said Trudy Hamlyn, 56, who has become a regular at Giant Tiger over the past year. She shops for herself, her husband and nine grandchildren for everything from groceries to apparel. "It's very convenient; it takes me two minutes to get there. It's more of a small-town atmosphere than Wal-Mart."

Moe Glazer, 75, a retired life insurance salesman, is a relative newcomer to Dollarama. He discovered one recently when heading to a hardware store for electrical tape; instead, he tried the nearby dollar store. Now he goes there for items ranging from greeting cards to wine glasses – and to browse. "I don't have to shop at a dollar store to save money," he said. "But I don't feel like throwing money away if I don't have to."

High profile private equity groups have also bet on discounters. Bain Capital LLC took an 80-per-cent stake in Dollarama in 2004; Genuity Capital Markets acquired a majority interest in Bargain Shop in 2006.

The bid by the chains to appeal to higher-end consumers has won them new business. Dollarama started to raise its prices to as much as $2 last February. Today, 24 per cent of its goods are priced at more than $1, according to its prospectus.

It also began courting bigger spenders several years ago by allowing customers to use a debit card. Now, almost 30 per cent of purchases are made with a debit card, it said; even better, those purchases are worth 2.5 times more than those made with cash. The retailer is gunning for more: it's testing Visa cards in 74 of its 585 outlets. Altogether, they generate $1.16-billion in annual sales, nearly twice the revenue – and the number of stores – since Bain took its position in 2004.

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At Bargain Shop, average purchase size jumped about 10 per cent in the past year alone, to between $17 and $18, from $16 last year, Mr. Roellinghoff said. Privately owned Giant Tiger's average sale size has grown about 2 per cent in the past two years, to $20.26 from $19.82, its president Andy Gross said.

"Customers who might not have shopped in our stores previously are darkening the doors of discount stores in general, and the Bargain Shop in particular," Mr. Roellinghoff said. "Newer customers are willing to pay a little more as long as they're getting great value."

In the tough times, the chains have been able to stock a wider array of merchandise partly because suppliers are more open to dealing with discounters after losing some of their traditional retailer customers, he said.

"Manufacturers who wouldn't in the past have considered stores like the Bargain Shop have knocked on our door recently and sharpened their pencils to the extent that we're offering values that two years ago we would have never been able to offer the consumers," he said.

Suppliers now consider the burgeoning discounter segment as mainstream, he said. It allows the chain to trumpet coffee makers and sweaters for $20 when the same products are priced at $80 and $45, respectively, at traditional mall merchants, he said.

Part of the allure is creating a "treasure hunt." Bargain Shop purchases about 40 per cent of its stock from suppliers' excess or abandoned inventory. It woos customers back to see what new products they might find, hence the treasure hunt.

There are other ways that discounters have profited from the pain of others. They've been able to pick up new store sites at attractive lease rates from mall owners scrambling to fill empty spots left by failed retailers, consultant Mr. Pennycooke said.

The discounters count on cheap leases: They tend to pay half the rate that conventional retailers do, but are ready to compromise by moving into oddly shaped or less prominent spaces.

Bargain Shop has benefited from the woes of discounter Saan Stores, which collapsed in late 2007. Last year, Bargain Shop snapped up 74 Saan outlets for about $8-million in cash and $7-million in debt.

Other discounters are drawing customers with more up-to-date private labels. Giant Tiger has focused on fast fashion; it replenishes its stores daily with new styles to keep them fresh, and keep shoppers coming back.

This season the aisles are filled with plaid clothing, borrowing from a hot look in conventional apparel shops, Mr. Gross said. Last spring his product purchasers spotted the plaid trend on their trips to New York and Los Angeles, and quickly asked their manufacturers to copy and produce the styles for the discounter.

"Part of our strategy is to see what the amazing trends are and to work with our vendors to get them into our stores at Giant Tiger price points," Mr. Gross said.

Beyond fashions, the discounters have bulked up on groceries. Giant Tiger added more fresh produce and bakery items to its shelves – items that have better margins than packaged foods. Over all, it beefed up its food offerings by about 5 per cent in the past year from the previous one, he said.

Still, moving into new areas can be risky. Giant Tiger comes more directly into the crosshairs of Wal-Mart when it stocks more groceries, observers said.

And fashion can be high stakes because it's a discretionary purchase – one of the first that consumers drop in a downturn – "and we're not immune to that," Mr. Gross acknowledged.