

Lending to Pet Stores

By Bobby Martin

Changing attitudes toward pets mean higher spending.

The U.S. pet and pet supply store industry is an interesting field for commercial bankers to explore. Fueled by unprecedented growth in pet ownership, pet store chains and franchises have introduced superstores rapidly since the early 1990s. At the same time, changing attitudes toward pets mean higher spending. As owners treat their pets more like children, demand for premium products and services increases. Americans actually spend more on pet supplies than on toys or video games. Lavish spending has fueled growth in specialties such as gourmet pet food, deluxe pet hotels and pet photography.

Pet services currently represent a small, but profitable and growing, segment of sales for pet stores. In the past five years, retail prices rose 16 percent for pet services (such as boarding and grooming) and 25 percent for veterinary services. Services also generate store traffic, increasing the potential for sales of pet products.

The recent expansion of pet superstores has caused traditional, smaller pet stores to close because of their inability to compete with lower prices and larger inventories. As a result, pet superstores command 60 percent of sales and dominate high-traffic areas. For commercial lenders, the big-box pet stores such as PetSmart and PETCO become increasingly attractive. Big-box pet stores are a great prospect because they carry high net worth at 72 percent, stemming from a high gross profit margin at 43 percent. In addition, the larger stores carry relatively high amounts of cash and are a good source for corporate treasury management products. This article will help bank officers engage decision makers, particularly those in the big-box pet stores.

To successfully position your commercial banking products and services with a prospect or customer in the pet and pet supply industry, you need to demonstrate a clear understanding of the issues, challenges and opportunities affecting their business. Once you garner this knowledge, you can tailor your bank's products and services to address current challenges or take advantage of upcoming opportunities.

Understand the Industry

When you understand your prospect's industry and business concerns, you'll be much better positioned to connect with key decision makers and win the business. Here are a few of the basics when it comes to the U.S. pet and pet supply store industry:

- The U.S. pet and pet supply store industry includes about 7,500 stores with combined annual revenue of almost \$8 billion. Major companies include PetSmart, PETCO, Pet Supplies "Plus" and Petland. The industry is concentrated at the top but otherwise highly fragmented: The 50 largest companies hold 60 percent of sales.
- Pet ownership drives demand, and spending generally resists economic cycles. Profitability for individual companies depends on the ability to generate store traffic and on effective merchandising. Large companies offer low prices and wide selections of both products and services. Small companies compete effectively by serving a local market, selling unique products, offering spe-

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Call Prep for the Pet Store and Pet Services Industry

Asking the right questions will help you anticipate client needs and provide proactive guidance.

Financial Analysis Questions

- **Are sales seasonal? If so, how does the company manage cash flow?** Sales of gift-oriented pet products are often seasonal.
- **What plans does the company have to expand or upgrade its store(s)?** Adding services or new product lines can require capital investment.
- **If a franchise, what are the terms of the franchise agreement?** Initial investments run between \$200,000 and \$500,000; royalties between three percent and six percent.
- **What is the company doing to improve operating margins, given low growth in retail prices?** Slow growth in retail prices of pet food and pet supplies squeezes margins.
- **What issues does the company face when negotiating leases?** Initial lease terms for superstores range from 10 years to 20 years; franchise and independent pet stores may average three years to five years.

Customers, Marketing, Pricing, Competition Questions

- **Who are the company's customers?** The typical pet store customer is a family with children.
- **What types of marketing and promotion has the company found most effective?** Most companies use TV, print and radio advertising, direct mail and newspaper inserts.
- **What does the company do to drive store traffic?** Pet stores will hold events such as pet adoption drives to generate store traffic.
- **What problems does the company face regarding pet food pricing?** Mass merchandisers and warehouse clubs deeply discount pet food.

- **How does the company increase the average amount a customer spends?** Strong sales of products other than pet food are key to profitability.
- **Who are the company's major competitors?** Pet stores compete with other pet stores, grocery stores, mass merchandisers, warehouse clubs and Internet retailers.
- **What are the issues raised by Internet retailing?** Large pet stores struggle to maintain profitable Internet operations, while small specialty stores may depend on the Internet.

Business and Technology Strategy Questions

- **Where does the company see potential for growth?** Pet services, luxury pet products and specialty pets provide opportunities for growth.
- **How does the company compete with the other retailers that sell pet supplies?** Companies compete with other pet stores, grocery stores, mass merchandisers, warehouse clubs and Internet retailers.
- **How does the company compete with the expansion of superstores such as PetSmart and PETCO?** Independent pet stores generally can't compete directly with superstore prices.
- **What challenges and opportunities are raised by Internet retailing?** Specialized pet stores use the Internet to reach beyond a local market, but Internet operations are expensive.
- **What types of technology does the company use to manage product movement?** Computerized inventory management systems are needed to manage the thousands of products a typical pet store carries.

cialized services or providing pet expertise. The industry is labor-intensive, with annual revenue per employee of about \$100,000. Revenue per employee for small, independent pet stores is significantly lower than for major chains. Competitors include grocery stores, warehouse clubs, mass merchandisers, Internet retailers and some veterinary clinics.

- Major product segments include pet food, pet supplies, aquarium products and fish and pets. Pet food accounts for 40 percent of sales, pet supplies for 40 percent, aquarium products and fish for 10 percent and pets for five percent. The pet food segment primarily consists of dog and cat food. Pet supplies include pet toys, collars and leashes, cages and habitats and vitamins and supplements. Types of pets sold include dogs, cats, fresh- and saltwater fish, birds, reptiles and small animals (mostly hamsters and gerbils).

Focus on Today's Most Pressing Issues

By taking the time to understand the current business issues your potential clients are facing, you will be better able to recommend appropriate services and offer advice. Stay current and focused on timely issues and obstacles of your potential clients to quickly establish trust and offer sound advice. Before you pick up the phone, prepare yourself to talk about these critical issues impacting pet store owners:

- Low growth in key segments of pet ownership
- Slow growth in retail prices
- Competition from alternative channels

Low Growth in Key Segments of Pet Ownership

Lack of growth in dog ownership will affect overall demand for pet supplies. Dogs drive pet food consumption, and dog owners spend more on supplies than any other pet owners. Increasing urbanization, while conducive to owning cats and fish, makes dog ownership difficult, and the number of households with children, the demographic most likely to own dogs, is expected to decline through 2010.

Since you know that lack of growth in dog ownership will affect overall demand for pet supplies,

you can go into your meeting prepared to ask the question: *How have changes in the ownership of different pets affected demand?*

Slow Growth in Retail Prices

Retail prices for pets and pet supplies increased just over four percent from 2002 to 2005, well below the inflation rate. Industrywide discounting and growth of private-label products for dog and cat food have suppressed retail prices. Low-priced imports have driven overall retail prices down for pet accessories. Declining pet ownership and slow growth in retail pricing will eventually affect profitability. U.S. retail prices for pets, pet supplies and pet accessories increased 1.4 percent in June 2007 compared to a year earlier.

Once you know that retail prices for pets and pet supplies are not increasing at a fast rate, you're prepared to ask: *How has slow growth in retail pricing of pets and pet supplies affected company performance?*

Competition from Alternative Channels

Pet stores face intense competition from mass merchandisers, warehouse clubs, grocery stores and Internet retailers. Mass merchandisers and warehouse clubs offer lower prices on pet food and represent almost 40 percent of pet product sales. Grocery stores offer convenience, and Internet retailers offer a wide range of supplies at extremely competitive prices. Recognizing the profitability of pet products, even hardware stores are establishing pet sections.

So, when you meet with your prospect or client, you may want to ask: *How does the company compete with other types of retailers selling the same products?*

Asking pointed questions that address specific business issues will go a long way toward distinguishing your bank from competitors.

Key in on Trends and Opportunities

As a commercial banker, you are continually striving to become a trusted advisor and partner to all

of your business clients. Recognizing trends and sharing ideas and opportunities available in the pet industry will go a long way toward demonstrating your knowledge of a prospect's or client's business and setting yourself and your bank apart from the competition.

Key trends in pet stores and pet services include the following:

- **Rapid expansion of pet superstores, franchises.** Fueled by unprecedented growth in pet ownership, chains introduced superstores rapidly, starting in the early 1990s. PetSmart and PETCO opened about 90 stores each during 2005. Pet Supplies "Plus," the largest U.S. pet store franchise, adds between 10 and 15 locations every year. Unable to compete with low prices on pet food, smaller traditional pet stores have been forced to close.
- **More revenue from pet services.** Services represent a small, but profitable and growing, segment of sales for pet stores. In the past five years, retail prices rose 16 percent for pet services (such as boarding and grooming) and 25 percent for veterinary services. Services also generate store traffic, increasing the potential for sales of pet products.
- **More imports equal lower prices.** Cheap manufacturing costs in countries such as China allow pet supply companies to produce low-cost pet products. Imports are often trendier items, or items customers replace regularly, such as collars. Pet stores sell these imports at low prices.

Pet industry opportunities include the following:

- **Animal specialization.** With the declining number of pet stores offering live animals, opportunities exist to sell specific pets and provide expertise on pet care. Most chains don't sell exotic pets, such as pythons or bearded dragons, which have limited availability and require extensive knowledge to sell and maintain. Aqua Zoo franchises specialize in fresh- and saltwater fish and offer education in fish and aquarium care.
- **Providing medical advice.** The rising cost of veterinary care has resulted in owners turning to pet stores to help diagnose common health problems in their pets. Providing medical advice helps pet stores develop relationships with customers, and the recommended treatment

usually results in the purchase of remedies available in the pet store.

Growing market for luxury pet goods. The humanization of pets and extensive press coverage of celebrities' pets have resulted in demand for luxury brand-name products. Brands such as Chanel, Burberry and Coach make dog collars and leashes. With intense competition at the low end of the market, small, independent pet stores can differentiate from large chains by stocking unique, high-end products.

Target Top-of-Mind Issues

Aside from a high-level understanding of the industry, be sure you take the time to drill down to targeted talking points that address a specific executive's concerns within the industry. For instance:

- **Differentiating the store in a competitive market.** In addition to competition among pet retailers, pet stores face challenges from an increasing variety of channels, such as veterinarians, feed stores, grocery stores, mass merchandisers, warehouse clubs and Internet retailers. The profitability of the pet business has even led retailers such as Home Depot to add pet sections. To be more competitive, the owner or president of a pet or pet supply store is most likely interested in exploring new options to edge out the competition, such as providing superior customer service or ancillary services (grooming, training); serving a local market; or specializing in a specific type of pet. Speak to this issue by explaining just how your bank's products and services can help the store fund new products and services or explore growth opportunities.
- **Funding capital improvements.** Pet retailers require capital to expand and improve stores and facilities. Adding pet services, such as grooming, requires incremental investment to buy equipment and build a separate room for performing the service. Pet retailers, especially independent pet stores, may rely on bank financing to cover the associated costs. You may want to talk to your contact about a line of credit or other forms of financing that can help him or her fund capital improvements.

Succeeding with Clients in the Pet Industry

To capture business in the pet store and pet supply industry, employ these five simple tactics:

- **Understand the issues.** Before you take even a minute of a pet store or pet supply store owner's time and attention, make sure that you understand your prospect's business and industry.
- **Target industry niches.** If you can demonstrate how your bank's products or services can help a prospect take advantage of a niche-specific trend to grow business, you'll be more likely to close a deal.
- **Ask the right questions.** Engage customers and prospects immediately by asking questions that illustrate your understanding of their changing industry dynamics.
- **Refine your message.** Use the information contained in this article to refine your message to engage pet retailers about their critical business issues. If you can do that, you're more likely to win their business.
- **Stay on top of the industry.** Stay on top of prospects' and clients' ever-changing business issues to consistently demonstrate your understanding of their needs. Do this after they become a client to position yourself as an advisor and deliver value even after you close the deal.

The bottom line: The more you know about your prospects and clients, the more likely it is that you'll enhance your opportunities for loan production and funds acquisition while decreasing the risks for your bank.

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