



January 1, 2004

Case Study: 99 Cents Only Stores' Efficient IT Infrastructure

By Janet Rae-Dupree

Avis Walton is used to being told where to go and what to do once he gets there. As a "picker" for 99 Cents Only Stores, Walton spends his 5 a.m.-to-3:30 p.m. shift cruising around a 750,000-square-foot distribution center in Katy, Texas, in an electric cart responding to a stream of spoken instructions. "Go to row 12, section 8, bin 31," an authoritative woman's voice in his ear commands, and Walton zips to row 12. Blip-blip. He scans the bin tag with a wireless handheld computer to confirm he's arrived at the right place. "Pick two cases plus four items," the voice continues. Beginning to break a sweat, 24-year-old Walton lifts two cases of vinyl tablecloths onto a pallet, rips open a third box and removes four more tablecloths. "Confirm pick," he says into his microphone, thus prompting the voice to send him zipping off on another assignment. Doesn't her bossiness get annoying? "Nah, she's cool," Walton says. "She tells me what to do and I tell her when I do it."

Perhaps if this voice were that of a human, Walton might take offense. But the "she" that he and his 15 fellow pickers interact with throughout their shifts is actually the computer-generated voice of the distribution center's warehouse-management software. Like a digital flight controller, the as-yet-unnamed voice sends squads of pickers scurrying to gather the items needed by individual stores, all the while quietly calculating the most efficient routes that will also prevent them crashing into one another. At the same time, the voice tells the pickers which bins need replenishment and where they can find the stock to do so. Roaring away overhead is a mechanized conveyor system worthy of any airport's luggage-handling operation. Pickers run along four levels of a massive series of racks, each shoving cases of product into the conveyor system; laser scanners read box tags to verify that each case is following the correct path to the waiting pallets below.

[To view this chart, click here](#)

It's not exactly what you'd expect to find behind the scenes at a retailer so frugal that it sells everything for the same rock-bottom price of 99 cents. Expensive computer gear and cutting-edge automation would seem anathema to a company totally driven by the bottom line. Yet the combination of up-to-date technology and a keen eye on expenses has been part of the secret to success for 99 Cents Only Stores. And the company has been mighty successful. Since going public in May 1996 at a split-adjusted \$3.12, the company's shares climbed as high as \$36.22 this past July, then fell below \$25 in mid-December before recouping to a recent \$27. The company consistently outranks its peers in the dollar-store retail niche in such measures as sales per square-foot and net profit margins. In 2002, net profit margins were 8.3 percent, which may not sound spectacular, but consider this: In the same period, Kroger Co., the supermarket chain, had net margins of only 2.1 percent, while margins at the super-efficient Wal-Mart Stores Inc. came in at just 3.1 percent.

Yet, even with sales of \$863 million for the fiscal year that ended December 2003 (up an impressive 21 percent over the previous year), IT investments at 99 Cents Only Stores, based in City of Commerce, Calif., are as spare as Robert Adams, vice president of information services, can make them. Even with the high-end automation installed at the new Texas distribution center—not to mention the cash registers, wireless LANs, Internet hook-ups and back-office computers needed for each of the 38 new stores it opened last year—99 Cents Only spent less than \$5 million on IT in 2003.



In fact, the prospect of doing nothing but cutting corners is what prompted Adams to turn down his current job the first time it was offered to him, seven years ago, when he was director of IS at Associated Truck Parts Inc. But when the job opened up again, two years later, 99 Cents Only asked Adams to reconsider. After some hesitation, the veteran of IT at retailers The Wet Seal Inc. and J. Crew Group Inc. decided to take the risk. "My biggest fear coming in here was that they wouldn't be willing to do a lot with technology because they would naturally be cheap," he says. "I shouldn't have worried."

How does 99 Cents manage to spend so little? Like the company's founding family, Adams knows how to squeeze every dollar—make that 99 cents—until it bleeds. When he needed ten database-management system licenses, he didn't just slap down the \$16,000 per seat that his usual supplier demanded. Instead, Adams surfed over to PriceGrabber.com and found the same software at another reseller for \$6,000 per seat. How quickly did he get approval to switch to the cheaper company? He didn't have to seek approval. It was his decision to make. "That's one of the beauties of working with a family-owned operation," Adams says. "There's a real small power base within the company, decisions are made quickly and our whole life cycle of projects is much, much shorter."

The dollar-store industry as a whole has been slow to adopt modern systems, according to senior retail analyst Mark Mandel of the brokerage firm Blaylock & Partners LP. "It's a fairly simple format, and the cost-benefit analysis has not pushed the players into investing in modern systems," Mandel says. But many chains in the industry are slowly beginning to move that way. "All of them are trying to enhance their technology so that they can improve their profitability and ordering systems," says Todd Hale, senior vice president at ACNielsen Consumer Insights. "A lot of dated material used to move through this channel, so there wasn't much incentive to modernize, but now a number of manufacturers are making products specifically for this channel."

Mandel does note, however, that 99 Cents is not a traditional single-price retailer. Other dollar stores typically sell their wares in 4,000- to 6,000-square-foot stores, each of which grosses around \$1 million a year; a typical 99 Cents Only store is about 19,000 square feet and brings in \$4.8 million. And where other dollar stores target low- to moderate-income neighborhoods, 99 Cents looks for areas with a high-income demographic. "Rich people like to save money too, and they do it in higher volumes," says founder David Gold. Case in point: The 18,000-square-foot 99 Cents Only store adjacent to Beverly Hills rakes in the chain's highest annual gross, averaging \$10 million. And, unlike competing retailers in the dollar-store industry, the company can re-order up to 60 percent of its inventory; the remaining items in each store are one-time-only close-outs.

Low-Cost Growth

Like its competitors, however, 99 Cents Only Stores has a simple, two-pronged strategy for maintaining its stellar growth rates: Open more stores quickly and push same-store sales increases hard. The 38 new stores the company opened last year brought its total to 189, and same-store sales were up 6.4 percent in the first nine months of 2003 over 2002. That, of course, is the point of the company's move into Texas from its home markets of California, Nevada and Arizona, and of its growing effort to sell food items, which made up fully 45 percent of its sales in 2003.

It's a mix that cries out for computerization. Fortunately for 99 Cents, however, everything at the company revolves around one central imperative: Create and follow the most efficient path between the customer and the sale. So choosing which IT projects to implement is relatively straightforward. Whatever decision the company faces, the final action boils down to getting those 99-cent items into the customer's shopping bag. That has been David Gold's driving principle from the moment he opened his first store, in Los Angeles, in 1982. A year or two earlier, he and his wife, who still live in the modest house in the Fairfax neighborhood of Los Angeles they bought 40 years ago, sold the family liquor store to pursue an idea that Gold, then 50, had been noodling with for nearly a decade. Was it possible, he wondered, to operate a profitable store—or even a chain of stores—if every item you sold was tagged at just 99 cents? By focusing initially on inventory close-out sales and "distressed" product lots, Gold soon discovered the lucrative answer: Yes. Gold, now 71, still arrives for work every day at 4 a.m. According to *Forbes* magazine, he has amassed a personal fortune of \$860 million.

In the early days, the operation was simple. Everything from inventory to sales records to warehouse-management was done on paper. Cashiers tallied up the number of items in a purchase, multiplied that total by 99 cents and collected the cash. Credit cards? Forget about it. But then Gold, ever the wheeler and dealer, picked up some aging Radio Shack TRS-80 computers for a debt payment in the mid-1980s. His son Jeff, still in high school but working part-time for the half-dozen stores then up and running, taught himself BASIC and created the chain's first order-entry program. He then used the TRS-80s to sort and categorize the company's warehouse inventory. Jeff Gold is now senior vice president for real estate and information systems; his brother, Howard, is the company's senior vice president for distribution. Their brother-in-law, Eric Schiffer, serves as the company's president, while David Gold remains its chairman and CEO.

Despite the efficiencies computers have brought to his company, David Gold remains leery of them. A dusty PC sits forgotten beneath stacks of paper in his chaotic office. There is no secretary to encourage him to turn it on, either; no one at the company, not even Gold, has a secretary. So what's he got against computers? "I'm not against computers," he insists. "I am against spending a lot of money and not utilizing the information you get." He's also annoyed with the average "not very personable" IT professional holding himself apart from the non-technical masses. But Adams is a different story, Gold insists. "I don't know much about technology, but I do know Robert is terrific," he says. "He's very, very bright. He wrote the entire point-of-sale system himself, and I've seen him bring in a lot of innovation. He has been a perfect fit for us."

Like Gold, Adams is a man in constant demand, his cell phone incessantly warbling Beethoven's "Für Elise." Every district manager at the company carries a Nextel phone, allowing spontaneous walkie-talkie communication between any of them at any time—no matter whether they're inside the company's gritty City of Commerce headquarters or driving between grand openings in Texas. And while Adams knows how to delegate details to one of his 18 IT team members, he also knows how to take the reins and write code for a new system himself. "I hate recurring costs," he grumbles. "I hate having to pay someone else every time I want to put a new cash register out in the field." When he decides it's time for a new system, Adams balances the cost of buying a pre-packaged solution and then customizing it, against the effort involved in developing a suitable system in-house. With roughly 40 percent of its merchandise consisting of one-time-only close-out inventory that can't be restocked, 99 Cents Only requires systems that can be updated painlessly, and on the fly, with new, previously unrecognized items. If in-house development wins out, Adams usually can be found at the project's center. "I'm a developer by nature," he says. "Most [off-the-shelf] systems out there don't work for us without a lot of customization. Why pay so much money and take so much time customizing something when you can write something yourself faster?"

When 99 Cents Only Stores decided to expand into Texas, the company set a mid-2004 deadline for finding and opening a distribution center there. A few weeks later, David Gold found an "opportunistic buy," as he puts it. Albertson's Inc. was pulling its grocery operations out of Texas, leaving behind a white-elephant headquarters and warehouse complex a few miles outside of Houston. The Golds estimated that Albertson's had poured about \$80 million into the facility since building it in 1995. For \$23 million, 99 Cents Only got everything: the building, featuring scores of truck bays, 220,000 square feet of refrigerated storage, and nearly half a million square feet of "dry side" storage, as well as dozens of forklifts, computer cabling and hundreds of office chairs and desks. Adams was given less than four months to get the whole operation up and running.

It was tempting, Adams says, to try to retool the warehouse inventory-control system he'd written three years earlier for the City of Commerce distribution center. But, even as he was coding that system, he knew it would eventually need to be replaced by something more powerful—at the time, the company was planning to triple sales within five years. So Adams decided to use a different system for the Texas distribution center. The first few warehouse-management packages he looked at were maddeningly difficult to customize. If a new category needed to be created, or if a previously unknown item came through receiving, it took a computer guru to make the necessary changes. Adams ultimately purchased a system from HighJump Software Inc.—he won't say what he paid, only that it was, of course, a steal—that has proven so efficient in Texas that Adams hopes to begin installing it in the City of Commerce distribution center in early 2004. Picking accuracy—the work done by Avis Walton and his colleagues—is up to nearly 99 percent in Texas, and picking speeds there are some 15 to 20 percent faster than in Los Angeles, where the accuracy rate is only 90 percent. But putting the new system into the fully functioning, 24-hour, three-shift distribution center in California won't be nearly as easy as it was to start from scratch in Texas. So Adams plans to bring a select group of the Los Angeles-based pickers and receivers to Texas to train them on the new system before he installs it at their home facility.

Still, getting the Texas facility up and running so quickly cost 99 Cents Only Stores more money than expected, dragging down third-quarter earnings to below Wall Street expectations and hitting the stock price hard. The company maintains, however, that the new warehouse will be profitable once the store count in Texas reaches about 30, sometime in mid-2004.

Low-Hanging Fruit

In fact, there's nothing terribly new or cutting-edge about 99 Cents Only's use of information technology; Adams himself insists the company is too small and traditional to deploy "bleeding edge" technologies. It's primarily the intelligence with which the company integrates proven technologies into its overall system that sets 99 Cents Only apart. Adams usually has at least six or seven IT projects going at the same time. How does he prioritize them? "I'm going for the low-hanging fruit," he says. "If the ROI is obvious, the implementation is straightforward, and it gets the product to the customer faster or better, I'll go ahead." But he doesn't always finish what he starts. On the contrary. "We'll get the important things out of a project," says Jeff Gold. "Say 90 percent of the planned benefit, and then we'll put it on hold because something else comes up that we decide will provide more benefit in a shorter time period. We still get our 90 percent of the benefit, and it works out great that way."

It's all part of David Gold's original over-arching mandate: Create the shortest path possible between the customer and the sale. Never knowing what new close-out items they'll discover, customers return day after day, looking for amazing 99-cent bargains—the ten-pound jar of Gulden's mustard, the leather PDA case, the highly rated bottle of wine. "It's a treasure hunt every day here," Adams says. "Our customers are excited to come here because they never know exactly what they'll find."

Resources

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Thinking Out Loud: Robert Adams

By Janet Rae-Dupree

CIO Insight: What did you expect when you came to 99 Cents Only?

Robert Adams: I was nervous about going back into hard-core retail. It takes a certain breed to do it. It's very reactionary and very impulsive. It's a competitive environment. You're always expected to know more and do more and give more. It's seven days a week. My phone rings in the middle of the night on a regular basis. You're giving something up.

On the other hand, it gives me opportunity. It's like I've been given a clean slate. You don't walk into many jobs with a clean slate. It was a bit of, "Hey, I can do it my way."

Do you have an annual budget?

No.

Then what controls your spending?

Between equipment, payroll, cash registers, it's a few million dollars a year. Probably \$4 million or \$5 million a year, which is pretty low for a company our size. We do well at making money. We believe in streamlining things. We need a little more red tape, but I don't want it to be too much more.

Why more red tape?

I would like a little more accountability, a few more procedures, a bit more keeping people focused. The problem with being able to react quickly is that people use it too often. Sometimes, I think we should step back and try to build better and keep our focus, keep on top of projects instead of going back and forth.

How does the Gold family influence the company's operations?

We're still a very tightly knit, closely monitored company. It's not a political company. That's one of the beauties of working with a family-owned operation. There's a real small power base within the company, decisions are made quickly and our whole life cycle of projects is much, much shorter. The ROIs are much easier to explain to one person than to an entire committee of people. It's a much more informal process.

But the buck stops there. If you don't make your point quickly enough, you're done. My biggest fear coming in here was that they wouldn't be willing to do a lot with technology because they would naturally be cheap. I shouldn't have worried.

How has your job evolved over the course of your career?

IS now hits every area of the enterprise. When I first started out, I was this Holy Grail kind of guy. I was the one who knew the computers, so everyone responded to anything I said with "Yes sir," and whatever I gave them they were thankful for it. This was the era when there was maybe one PC for the whole accounting area. Now I have to know everything about all aspects of the business and be able to keep the entire enterprise running smoothly. There's a new-PC mentality out there pushing up the expectation levels. All these users now have PCs at home. They think that when it's time to upgrade it's just a matter of loading up the new software and—boop!—you're done. They think it's that simple. They don't understand that when you're trying to manage an enterprise you have to manage for change. I'm not going to be able to upgrade one point-of-sale register. I'm going to have to do all 1,500 of them.

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