



To: US Retail Partners
From: Darrell Rigby, Kris Miller and Josh Chernoff

Retail sales generally are improving. Although November GAFS sales were down 0.6% from last year, growth rates for all segments have been trending upward over the last several months. Hope remains for a strong December: Consumers, retailers and analysts alike are showing signs of optimism. To create and sustain momentum, retailers are testing and implementing creative ways to drive traffic, conversion and repeat purchases. Those strategies will continue to be critical as we head into January, a month that is increasingly important to ending the holiday season and starting the New Year on a positive note.

Despite the occasional setback, sales are trending upward

GAFS sales were down 0.6% in November, yet growth last month was the second strongest since August 2008 (*Chart 1*).¹ General merchandise was the only segment that grew over last year, up 1.2% (*Chart 2*). Although all other segments saw year-over-year sales fall, several posted November growth rates that ranked among the highest of the year. Based on three-month rolling averages, all categories continue to trend upward (*Chart 3*).

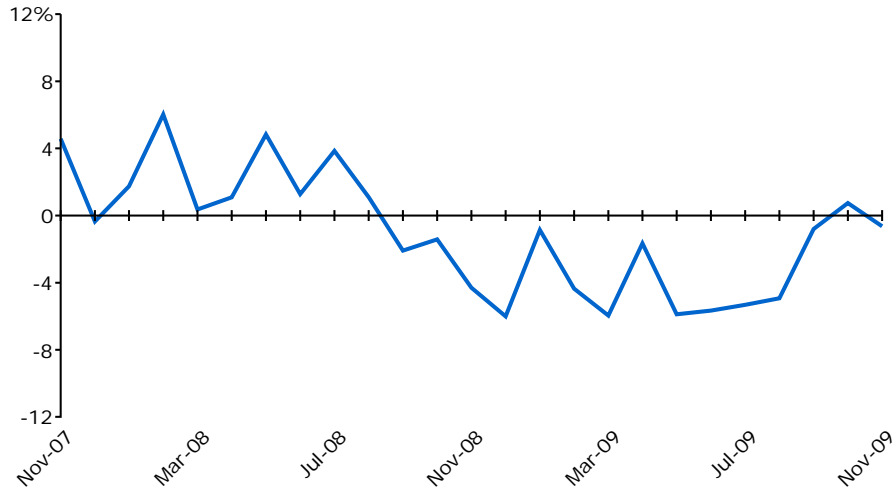
December may be well on its way to the 0.5% to 2.2% increase needed to achieve overall holiday sales growth of 0% to 1% this season. According to estimates from ShopperTrak, sales in the first week of December were almost flat (-0.3%) but then rose 1.1% over last year in the second week of the month. There is also hope that procrastinating shoppers will boost sales in the final two weeks of the season. According to the National Retail Federation, consumers on average had completed just 47% of their shopping by the end of last week.

Momentum is also building online: comScore reported sales growth of 3% and 4% in the first and second weeks of December, respectively. The market researcher is also predicting the first online sales day over \$900 million between now and Christmas. Among the factors driving this growth is the increasing availability of free shipping. A news item at InternetRetailer.com reported that 73 of the top-100 online retailers offered free-shipping deals last week, up from 68 last year.

¹ See Chart A in the Appendix for definitions of GAFS, GAFO and other sales measures.

Chart 1:

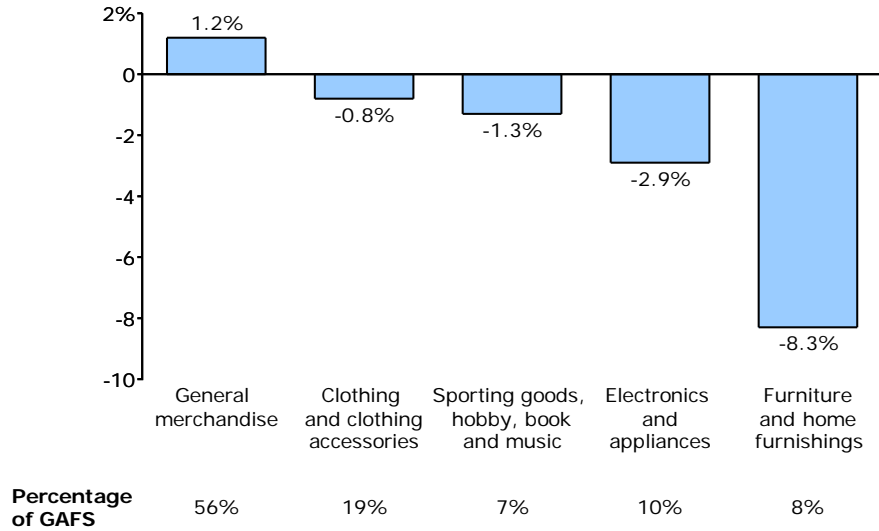
Monthly GAFO sales growth year over year,
November 2007-November 2009



Note: Data are not seasonally adjusted; November number is based on GAFO growth
Source: US Census Bureau

Chart 2:

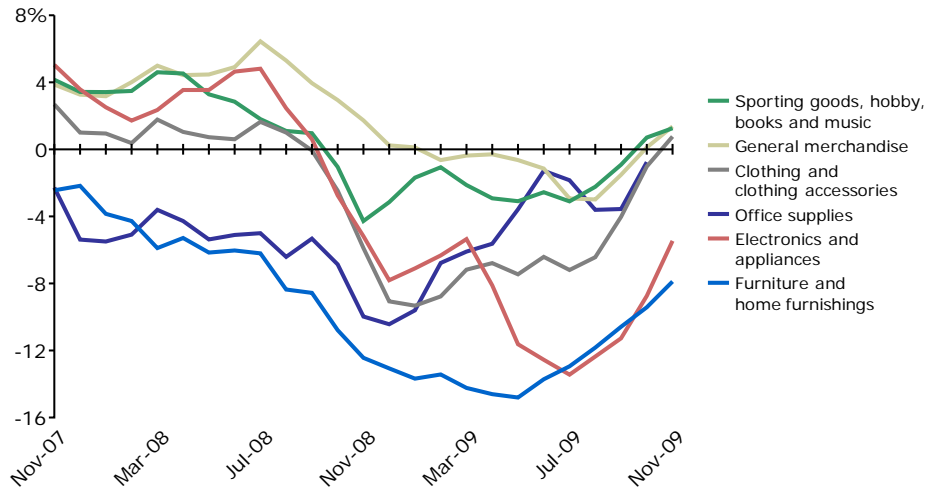
GAFO sales growth by segment,
November 2009



Note: Data are not seasonally adjusted
Source: US Census Bureau

Chart 3:

GAF0 sales growth by segment, three-month rolling average, November 2007-November 2009



Note: Data are not seasonally adjusted; office supplies data have not yet been reported for November
Source: US Census Bureau

Several other indicators also point to a positive December. Improving economic factors are helping to drive up consumer sentiment; retailers are increasingly optimistic about December sales; and many analysts continue to hold high expectations for the month.

Consumers are more upbeat as the economy shows signs of improvement

The preliminary Michigan Consumer Sentiment Index rose to 73.4 in December – its second-highest level since January 2008 – up from 67.4 in November. Personal-consumption expenditures also were up in October, another indication that consumers are feeling hopeful.

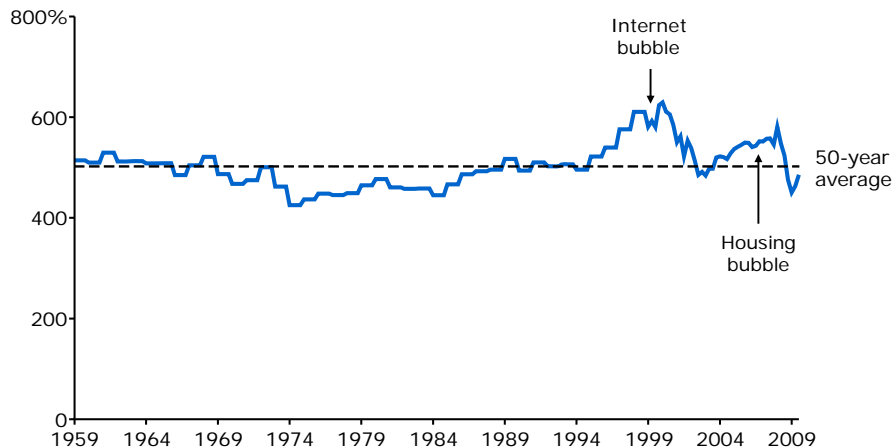
A number of economic indicators support consumers' optimism. The Bureau of Economic Analysis reports that seasonally adjusted personal income edged up in October with a 0.2% increase over September, although it lagged last October's absolute level by 1%. The Federal Reserve reports that after being devastated by falling housing and stock prices, household wealth as a percentage of disposable income has been on the rise for two quarters.² The measure is still significantly below the levels reached during the housing bubble, but it is inching closer to its 50-year average (*Chart 4*). There's been positive news in the housing market too: Existing-home sales hit their 2009 high in October, likely driven by the first-time homebuyer tax credit, which had been scheduled

² Household net worth, also known as household wealth, is the difference between the value of assets and the value of liabilities.

to end in November.³ There also have been notable improvements and overall stabilization in the stock market. The Dow jumped nearly 10%, to 10,437, between early October and mid-November, closing at its highest level in over a year. Since then the index has become less volatile, consistently closing within a relatively comfortable 200-point range.

Chart 4:

Household net worth as a percentage of disposable personal income, 1959-2009



Note: Data from 1959 to 1998 are reported annually; 1999–2009 data are reported quarterly
Source: Federal Reserve

These data may explain, at least in part, why consumers are feeling better, but they by no means indicate that the economy is bouncing back. Some fundamentals remain weak, pointing to a slow recovery. For example, credit markets are still extremely tight: Consumer lending shrank for the ninth consecutive month in October, down 1.7%. Also, the unemployment rate sits at 10.0%, a level last seen in 1983 (*Chart 5*). Although the measure fell 0.2 percentage points in November, this downward movement is more an artifact of lower labor force participation than it is a sign of increased hiring.⁴ In fact, the economy still shed 11,000 jobs last month (*Chart 6*). The *Wall Street Journal* Economic Forecasting Survey reports that economists expect unemployment to increase to 10.1% in December.⁵

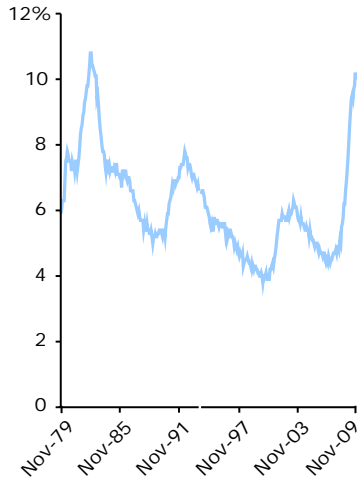
³ On November 6, President Obama approved the extension of the homebuyer tax credit into 2010 and expanded the pool of eligible buyers. In October, however, consumers were still under the impression they had to purchase a home by November 30 to qualify for the credit.

⁴ As discouraged workers stop looking for work, the pool of unemployed workers gets smaller.

⁵ The *Wall Street Journal* Economic Forecasting Survey was conducted December 4-December 7, after November's unemployment data were released. Last month's survey had originally reported an expected unemployment rate of 10.3% for December.

Chart 5:

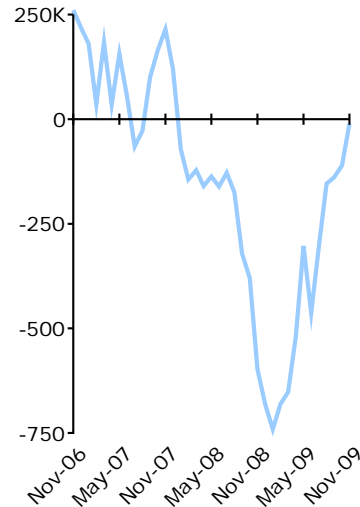
Monthly unemployment rate,
1979-2009



Note: Months seasonally adjusted at annual rates
Source: Bureau of Economic Analysis

Chart 6:

Monthly change in nonfarm payroll,
2006-2009



Note: Months seasonally adjusted at annual rates
Source: Bureau of Economic Analysis

Retailers are optimistic about the remainder of the holiday shopping season

Several retail executives are feeling good about the rest of the season. In a CNBC interview on December 7, Macy's CEO Terry Lundgren stated: "We are starting to see a little optimism in our stores, and starting to see the consumer come out. . . . I am counting on the consumer spending a little more than they did last year; not disproportionately more, but a little bit more." Similarly, Best Buy CEO Brian Dunn recently said of the holiday shopping season that it is "where we historically have achieved our peak market share during the year. I am confident that will be the case [this year]."

One indication of retailers' optimism was the 0.3% increase in wholesale inventories in October versus the 0.5% decrease that economists had expected. This could point to retailers feeling the need to increase inventory levels to meet upcoming demand. Positive sentiment is also reflected in the retail industry's hiring numbers. The Kronos Retail Labor Index's seasonally adjusted hiring numbers in November were the highest of 2009, up 6.5% over October and up 8.9% over November of last year. Among the retailers that have announced hiring increases are Best Buy, which reported in September that it was planning to increase seasonal hiring this year, and Jo-Ann Fabric and Craft Stores, which hired more than 4,000 seasonal employees for its 750 stores this year, 1,000-plus workers more than the company hired in 2008.

Analysts have a positive outlook for December

Industry analysts also are feeling optimistic about December. Credit Suisse recently announced that it expects strong gross margins along with a 1% increase in sales for the Christmas season. Similarly, Jefferies stated in a December report that it expects upward revisions of earnings per share in the fourth quarter for the specialty retail sector and

remains “positive on the . . . sector and would continue to add to long positions.” As we reported in our [previous newsletter](#), the International Council of Shopping Centers (ICSC) is holding its holiday same-store sales forecast at 1% growth, and it expects December growth to reach 2% to 3%.

Value is necessary, but not sufficient

In a recent survey by the NPD Group, over 60% of respondents stated that “overall value” is one of the most important factors in deciding where to go holiday shopping. Most retailers have responded by highlighting value in their messages to consumers. But many of them are doing more, applying innovative approaches to influence key drivers of sales growth (*Chart 7*). Here we look at some of the season’s more interesting examples.

Chart 7:

High-level drivers of sales growth



1. Building awareness and driving traffic

Retailers have worked hard to give recession-battered shoppers good reason to head into stores and onto Web sites.

- *Reaching out to a broader audience.* On December 13 and 14, e-commerce solutions provider GSI Commerce helped 37 retailers mount a cooperative friends and family sale. The goal: to multiply the effect of each company’s marketing reach. Specialized retailers – among them Bath & Body Works, Sports Authority, RadioShack and GNC – promoted the event via e-mail to their own customers, directing them to a special Web page where they found offers from all the participating retailers.
- *Taking advantage of new (and old) media.* Many retailers are turning to social networking to drive instant traffic and engage with consumers. According to BDO Seidman, more than half of retailers now include social media in their marketing strategies, up from 4% in 2007. Target, for example, is using Twitter to tell shoppers about daily deals this season. Even Dolce & Gabbana has been using YouTube to solicit feedback from customers on clothing and shoe design. Such efforts are starting to pay dividends: Dell just announced that the company’s Twitter-based promotions have

generated a total of \$6.5 million in sales for the company.⁶ But it's not just about new media. Some online retailers are investing in traditional media this holiday season. Zappos.com recently mailed 750,000 catalogs to consumers, acknowledging that "different people respond to different media." So far the move seems to be working: The catalog has increased purchases from lapsed customers, and the average catalog order is twice that of the typical online order.

- *"Screaming" discounts.* Many retailers have been relentless in communicating their holiday discounts. Wal-Mart, for one, has offered a series of promotions since the season began, setting off price wars on CDs, DVDs and books early on, slashing toy prices and offering a promotion this week on certain video and gaming products. Retailers also have stepped up e-mail communications about sales. Sears and Staples, for example, have been sending e-mail alerts roughly every 1 to 3 days since early November; and Lillian Vernon sent 10 e-mails in the 10 days from December 7 to December 16. George Zimmer, CEO of Men's Wearhouse, explained the company's sale strategy this way: "Until we have clear signs that the consumer is spending freely without promotion, we are guaranteeing that we'll get our business by promoting heavily."
- *Creating urgency with limited-time offers.* Limited-time offers are a tool to get consumers to spend immediately, without overthinking their buying decisions. On December 1, online retailer Overstock.com announced "25 Deals, 25 Days," a one-day promotion on a new heavily discounted product each day until Christmas. CEO Patrick Byrne said that "promotions have been good for us [and] we've never done this much discounting before." Williams-Sonoma also has been offering a series of one-day promotions this month, alongside its traditional two- to five-day sales.
- *Helping consumers get into the shopping mood.* According to the ICSC, about 60% of malls will offer special amenities for holiday shoppers this year, including family events, valet parking, refreshments, shopper shuttles and gift wrapping. These efforts initially help drive traffic, but they also can improve conversion by making the shopping experience more festive. One example is Beverly Center in Los Angeles, where shoppers are being treated to the mall's biggest Christmas production ever, including aerial performers. Some 20% of the stores in Cameron Village, a shopping center in Raleigh, North Carolina, are using live models in their windows as part of an annual holiday contest. And at the Neiman Marcus store in Dallas, kids can crawl into the decorated window displays and play in a fantasy factory while their parents watch from outside.

2. Increasing conversion and basket size

Once shoppers have arrived, providing unique offerings and services can significantly influence their purchasing. In today's competitive environment, these points of differentiation are especially important to a retailer's success.

⁶ Between the time Dell launched its Twitter effort in 2007 and June of this year, the company earned an estimated \$3 million from those promotions.

- *Delivering a superior customer experience.* There is no shortage of ways in which retailers can improve on the customer's experience. Sometimes the solution is as simple as opening more checkout lanes. A recent *Consumer Reports* poll shows that more holiday shoppers – 72% of respondents – complain about closed registers than anything else. To “have every single customer leave [its] stores happy this holiday season,” Borders is offering an in-stock guarantee, free shipping on any item that a customer can't find in the store as long as it's available online. Other retailers are looking to more sophisticated tools to stay closer to the consumer and so increase basket size. According to the National Retail Federation, Macy's is planning to use GPS tracking to send relevant messages to customers once they enter a store.
- *Creating excitement with product bundles.* This is a tactic most often used to sell electronics, but it has potential in any segment. Steve Koenig, industry analysis director for the Consumer Electronics Association, expects “bundling will be in abundance [this holiday season] to get that higher ticket.” Best Buy recently offered entertainment bundles – a Sony high-definition television and a PlayStation3 with savings up to \$1,100, for example – and a computing bundle that included a desktop, monitor, laptop, netbook, router and in-home network setup for a total cost of \$1,199.
- *Offering additional value with exclusive products.* Many retailers are turning to private brands to give consumers better value. The private brand not only functions as a differentiating factor; it also gives the retailer control of pricing and promotions, and often bolsters margins. Saks's newly launched Men's Collection has reportedly grown to around 15% of the company's men's business. After just three seasons, Lord & Taylor's Black Brown 1826 collection accounts for 20% of the store's men's business; company representatives call it their “number-one growth business.” Other stores are offering exclusive product lines to attract customers with items they can't find elsewhere. JCPenney, for example, recently announced a deal to sell MNG by Mango, a casual sportswear and accessories line.

3. *Generating repeat purchases*

Although many of the measures above ultimately may lead to repeat purchases, some retailers are taking specific steps to bring customers back to their stores or Web sites.

- *Giving away “bounce-back” coupons.* Gift cards increasingly are being used as a tool to stimulate repeat shopper visits. Abercrombie & Fitch offers a \$25 gift card for every \$100 spent; Hollister does the same for every \$75 spent; and Saks offers a \$100 gift card for online purchases of \$450 or more. For shoppers, the cards are additional value and guilt-free money equivalents to give as gifts or to spend on themselves on their next store or site visit. The upside for retailers: Historically when customers redeem gift cards, they spend an estimated 40% more than the original card value. Moreover, some buy full-price merchandise after the holiday sales are over, providing a welcome boost to both revenues and profits.
- *Running unadvertised specials.* One way retailers are ensuring that consumers come back often is by offering frequent unadvertised specials. Toys “R” Us recently launched “Deals of the Day”: Every day in December, the toy retailer offers new

unadvertised deals in its stores. To learn what's on sale on any given day, customers have to make another trip to a store, where they also will find other holiday discounts on hundreds of toys, including brands like Playskool, Mattel, VTech and Fisher Price.

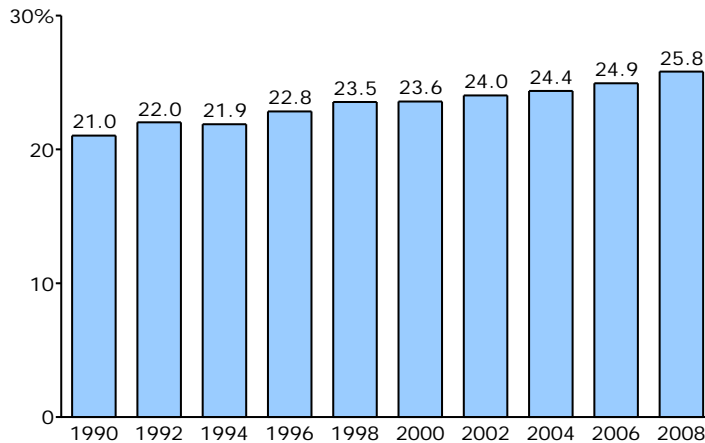
- *Putting a new twist on loyalty programs.* Some retailers are offering unique incentives to their loyalty program members. Food retailer Kroger recently launched a program that rewards shoppers with 20 minutes of free wireless phone service for every \$100 they spend in a Kroger store.⁷

With the new year comes new opportunity

With the end of the traditional holiday season less than two weeks away, we turn our attention to the new year. January continues to emerge as a powerhouse month for retailers and now contributes 25.8% of total GAFO sales in the November-January period, up nearly 5 percentage points since 1990 (*Chart 8*). The 0.9 percentage point increase from 2006 to 2008 alone represents almost \$3 billion in sales.

Chart 8:

January sales as a percentage
of November-January sales, 1990-2008



Note: November and December sales are sales in the given year; January sales are sales in the following year
Source: US Census Bureau

There are at least two likely reasons for this upward trend. First, value-conscious consumers may be delaying some major purchases – gifts for themselves or even for others – hoping that postholiday sales will bring even greater discounts. According to the latest American Express Spending and Saving Tracker survey, 10% of shoppers are

⁷ The service, i-wireless, is Kroger's own. The program does not work with other wireless providers.

waiting for after-holiday sales to buy holiday gifts this year. One consumer we spoke to explained that “we are going to make it a holiday tradition that when my sister and I return home, our gift is a shopping spree and girls’ day out with our mom . . . after Christmas or early in the new year. We shop the sales, have a nice lunch and save a bundle.” The second important factor is gift card redemption: An estimated 40% of holiday gift cards are redeemed in January. Although the National Retail Federation expects holiday gift card sales to fall this season by more than 5%, to \$23.6 billion, redemption of “bounce-back cards” – gift cards that are given away rather than sold – may help offset that drop if shoppers spend more than the full value of their cards.

For retailers, the growth of sales in January means it is increasingly important to attract postholiday shoppers. That consumers tend to see the new year as a fresh start also has implications for retailers. They may be able to enhance growth and profits by combining the “survival” skills honed over the last two years (e.g., tighter controls on selling, general and administrative expenses, SKU rationalization, vendor collaboration and Black Friday operational management) with what they’ve learned from strategies this holiday season (e.g., the breadth and depth of promotions and the frequency of communications with consumers).

Newsletter schedule

Our next newsletter, the last of the season, will be released in mid-January. It will include a report of holiday sales results as well as a look ahead at what we expect to be some of the key retail trends in 2010. Please let us know if you have any questions or need additional analysis.

Appendix

Chart A:

Definitions

	GAFO	GAFS	GAF	General merchandise	Retail excluding auto
• General merchandise stores	✓	✓	✓	✓	✓
• Clothing and clothing accessories stores	✓	✓	✓		✓
• Furniture and home furnishing stores	✓	✓	✓		✓
• Electronics and appliances stores	✓	✓			✓
• Sporting goods, hobby, book and music stores	✓	✓			✓
• Office supplies, stationery and gift stores	✓				✓
• All other retail trade sales not included in GAFO (excluding auto and auto parts)					✓
• Auto and auto parts sales					

Source: US Census Bureau; analyst reports

Selected References

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