

# Bain Retail Holiday Newsletter #2

November 6, 2010



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

*As the 2010 holiday season officially gets under way, the positive momentum continues, and we continue to forecast holiday sales growth of 3% over last year. In October, same-store sales were up 1.6% over last year's already respectable 2.1% increase, and other retail and economic indicators showed little change. In this newsletter we examine these indicators and then take an in-depth look at one of the holiday season's mainstay segments, clothing and accessories. We also look at key insights into women's shopping behaviors gleaned from "Why She Shops: The 2010 Fashion and Beauty Study," a study we conducted with Vogue magazine.*

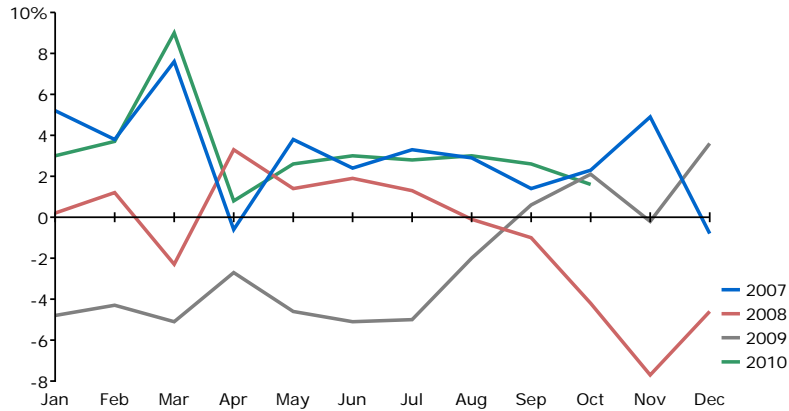
## **Positive momentum continues, despite intimidating headlines**

Recent retail indicators show little change in momentum heading into the holidays. October same-store sales increased 1.6% over last year according to the International Council of Shopping Centers (ICSC). Although this is the smallest increase since April 2010, it also is based on the toughest comparison so far this year: Same-store sales rose 2.1% in October 2009 (*Chart 1*). Moreover, the ICSC estimates that an unseasonably warm October depressed sales growth by a full percentage point. For the remainder of the holiday season (November and December), growth will be off mixed results from 2009, flat in November and up 3.6% in December, the highest-growth month of 2009.

Monthly same-store sales figures alone don't give us a complete picture of October performance. Some retailers noticed an uptick as the month drew to a close. Macy's CEO Terry Lundgren noted that "while we experienced some softness in sales early in October given the unseasonably warm weather, we ended the month with a strong trend going into the holiday selling season." Similarly, Target chairman, president and CEO Gregg Steinhafel explained that "October sales were near the low end of our expectations, primarily due to softness in the first two weeks of the month. . . . Sales trends throughout the store improved in the last two weeks of the month."

### Chart 1:

#### Year-over-year growth in monthly same-store sales, 2007-2010



Note: Excludes Wal-Mart  
Source: International Council of Shopping Centers

While some retailers saw strong same-store sales gains in October, sales for many others remained negative on a three-year stacked basis (*Chart 2*).<sup>1</sup> Luxury stores, for example, saw significant improvement last month but still have a long way to go to recover sales lost in the recession. Department stores also have a lot of lost sales to recover, but their October same-store sales growth does not show nearly the same level of improvement. Warehouse clubs saw modest sales growth in October, but this followed net increases over the last three years.

Since our last newsletter, newly released retail and economic indicators show little change or even slight improvement:

- Unemployment was unchanged at 9.6% in October.
- Real disposable personal income growth was essentially flat in September, dipping 0.3% from the prior month.<sup>2</sup>
- The Consumer Confidence Index edged up 1.6 points but remains near historical lows and its trailing four-month average.
- Housing prices have stabilized somewhat, but perhaps only as a short-term response to direct support in the form of homebuyer tax credits.
- Real GDP continued to grow at a modest pace in the third quarter, up 2.0%.
- Equity markets rose another 3.6% in the last two weeks.<sup>3</sup>

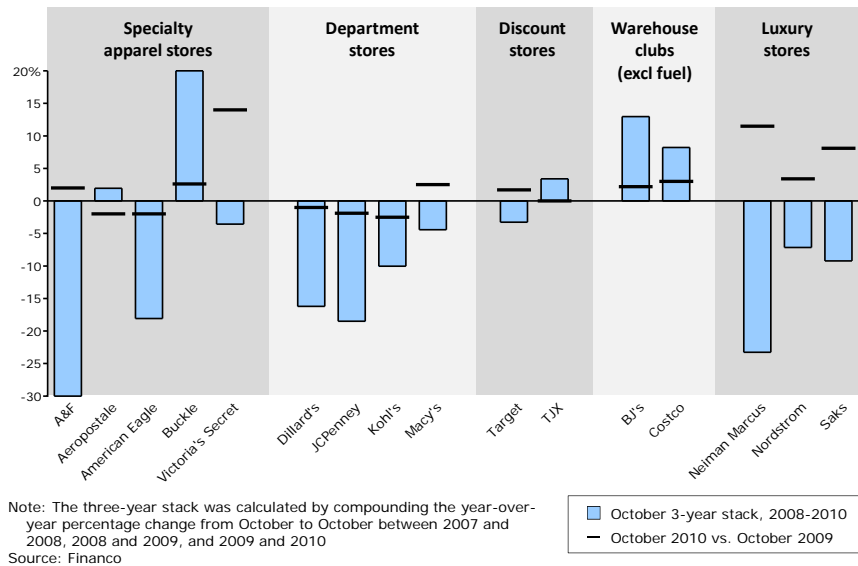
<sup>1</sup> The three-year stack was calculated by compounding the year-over-year percentage change from October 2007 to October 2008, from October 2008 to October 2009 and from October 2009 to October 2010. For example, growth of 10%, -5% and 5% compounds to 9.7% growth.

<sup>2</sup> Based on seasonally adjusted chained 2005 dollars.

<sup>3</sup> Based on the S&P 500 Index on October 22, 2010, and November 5, 2010.

## Chart 2:

### Change in same-store sales, October 2008-October 2010



- Third-quarter e-commerce sales increased at a healthy 9% over the same period in 2009, according to ComScore.
- Traffic conditions improved in October compared to both the prior month and October 2009, based on the ICSC's Shopping Center Executive Opinion Survey.
- Completion of the midterm elections may reduce the uncertainty that can cause consumers to hold back.

### Look for clothing and accessories under the tree this season

If our estimate holds true, total GAFO sales this year will increase 3.0% over 2009 – to approximately \$1,147 billion – but will still come in 0.6% below their prerecession peak in 2007.<sup>4</sup> In contrast, clothing, accessories and footwear sales will go up an estimated 3.8% over last year, reaching \$324 billion in 2010, according to Euromonitor. This represents an increase of 1.3% over 2007 sales.

Clothing and accessories will continue to be mainstays of holiday retail spending. They remain the most wanted gifts this season (after gift cards), according to a survey by the National Retail Federation. But it's not just about gifts. Sales of clothing and accessories also will get a boost from shoppers looking to update or at least freshen up their own worn-out wardrobes. This season, a full 57% of shoppers – up 4 percentage points from last year – intend to take advantage of holiday pricing to buy clothing and accessories for themselves. Classics and basics are on everybody's list. Even fashion enthusiasts are

<sup>4</sup> See Chart A in the Appendix for definitions of GAFO and other sales measures.

getting “back to basics,” mixing casual items like cardigans and button-down shirts with more tailored clothing or even formal wear.

Retailers face the challenge of making both fashion items and closet staples exciting to consumers. Apparel executives consistently cite on-trend product, and the development speed required to achieve it, as the most important issue affecting the fashion industry.<sup>5</sup> They are using a number of approaches to get new product on the racks. Some are changing the cadence of new-product infusions. Smaller orders delivered more frequently mean shoppers can always find fresh merchandise. That’s important, says Cavalli Group CEO Gianluca Brozzetti: “Loyal clients that are coming to the store frequently will get bored of not finding something new.” Other retailers focus on speed to market, in part to appeal to shoppers who can’t wait to buy what they see celebrities wearing. Fast-fashion retailers are best positioned to meet this demand. H&M is able to get new styles from design to distribution in three weeks. Inditex (Zara) is able to do so in as little as two weeks and delivers new styles to stores twice a week.

### **Style-conscious women deck the halls with fashion**

Three out of four women plan to purchase clothing or footwear over the holidays, according to Experian. What makes these consumers tick? We spoke with more than 5,000 women to find out. In September, Bain released a joint study with *Vogue* magazine titled “Why She Shops: The 2010 Fashion and Beauty Study.”<sup>6</sup> The study identifies a strong correlation between style-consciousness and spending. Style-conscious women make up less than 40% of the female population but account for almost 70% of total spending on women’s clothing and accessories and beauty.

Who is the style-conscious woman? She is not defined by age or income. In fact, she is present across age groups and income brackets (*Chart 3*). Style-consciousness is a mindset. The style-conscious woman identifies herself as average or above average on being “stylish” and following “the latest fashion trends.” She loves to shop and knows what she wants. And she is spending . . . even in the slow economy. She spends three times more on clothing, accessories and beauty than the average woman does. Although she is reluctant to pay full price, price is not her most important consideration: 80% of style-conscious women are willing to pay more for items that will last several seasons. Still, she is likely keeping a watchful eye on holiday promotions as she plans her holiday gift giving, which includes many “gifts” for herself.

The style-conscious woman is extremely loyal to the brands she loves, and is a strong advocate for them. This is especially important during the holidays, when word of mouth is by far the most influential factor for consumers deciding to purchase specific items of clothing, according to a National Retail Federation survey. So what brands does she love? To answer this question, Bain and *Vogue* created a brand index that measures a combination of brand significance and brand loyalty:

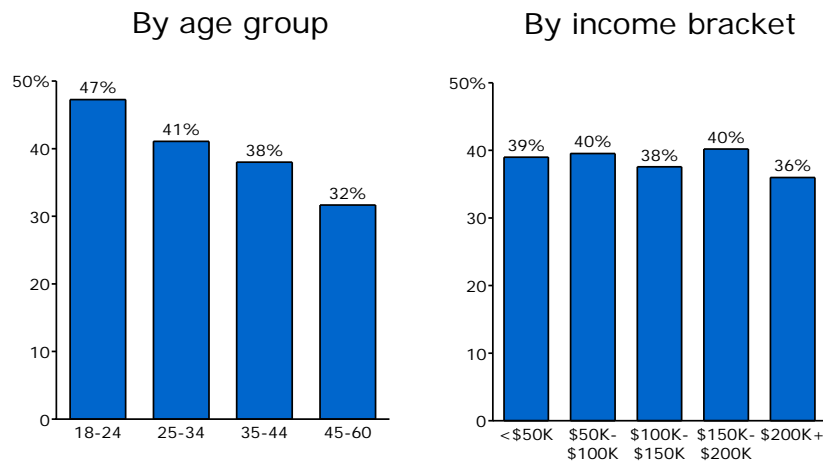
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<sup>5</sup> We recently conducted more than 65 interviews with apparel retail and wholesale executives.

<sup>6</sup> For a copy of the study, contact Cheryl Krauss at [cheryl.krauss@bain.com](mailto:cheryl.krauss@bain.com).

**Chart 3:**

Percentage of women who are style-conscious



Source: Bain and *Vogue* magazine, "Why She Shops: The 2010 Fashion and Beauty Study"

- *Brand significance.* Brands with the highest significance are those that the style-conscious woman buys more frequently and that capture a greater share of her spend. These brands typically offer her better style, fit and quality. She describes her favorite brands primarily as "making me feel good about myself."
- *Brand loyalty.* The winning brands we identified in our study have twice the number of advocates as other brands surveyed and a Net Promoter® Score (NPS) that is 20 points above the average. NPS measures the likelihood that a shopper will recommend a brand to a friend or colleague.<sup>7</sup>

The brands she loves most have a laserlike focus on their target consumers (*Chart 4*). The style-conscious woman feels they each offer her something unique. Express, for example, delivers trendy, stylish clothing for the workplace. Loyal shoppers also appreciate the brand's sales and promotions. Victoria's Secret focuses on sexy, flirty apparel that makes her feel good about herself. She likes how the brand showcases itself on television, online and in print. Chico's offers unique but comfortable styles that flatter the body. The style-conscious woman says they "just work for me."

When the style-conscious woman is deciding where to shop, quality, style, selection and environment all trump convenience and value. Although she spends a disproportionate amount of her money at midtier department stores and vertical retailers, she uses luxury department stores as a benchmark for her shopping experience. Nordstrom sets the bar high, especially during the holidays: Free personal stylists to help shoppers choose gifts,

<sup>7</sup> Net Promoter® Score is measured as the percentage of promoters minus the percentage of detractors. Consumers are asked how likely they are to recommend a brand to a friend or colleague, on a scale from 0 to 10. Promoters rate their likelihood a 9 or 10; detractors rate their likelihood a 6 or lower.

#### **Chart 4:**

### Fashion Brand Index, 2010

	Top Apparel Brands	Top Accessories Brands
1.	Express	Coach
2.	Victoria's Secret	Express
3.	Banana Republic	Louis Vuitton
4.	Ann Taylor Loft	Nine West
5.	Lane Bryant	Chanel
6.	Levi's	Fossil
7.	Ann Taylor	Cole Haan
8.	7 For all Mankind	Forever 21
9.	White House/Black Market	Marc Jacobs
10.	Ralph Lauren	Steve Madden
11.	Burberry	J.Crew
12.	Gap	Chico's
13.	BCBG	Gucci
14.	Chico's	Ann Taylor
15.	Jones New York	Dior

Source: Bain and *Vogue* magazine, "Why She Shops: The 2010 Fashion and Beauty Study"

in-store pickup for online purchases, free gift boxes and bows, and in-store Wi-Fi for customers with smartphones.

Not all style-conscious women behave the same way. In fact there are six distinct shopper segments that shop a range of styles and price points (*Chart 5*). But what all style-conscious women want is to feel special: "my style," "my fit," "my experience," "my desire to be unique." Retailers are responding with localized offerings. In its second-quarter earnings call, Saks highlighted "local business development" through "differentiated merchandise" as one of its most critical strategies. Macy's continues to see success with its "My Macy's" initiative, which the retailer says may add as much as 3 percentage points to its holiday sales at stores open at least a year. Specialty retailers are upping their efforts: In August, Talbots announced it would no longer stock stores uniformly. "We have over 4 million square feet over one brand. You can't treat every store the same way," explained CEO Trudy Sullivan.

Social networking and mobile commerce are becoming essential for reaching the style-conscious woman. She is an early adopter of digital technologies, though they have not changed her shopping behavior entirely . . . yet. Of course, online is a critical commerce vehicle for her. She already does almost 25% of her spending on clothing, accessories and beauty online, compared to just 10% to 15% for the average US woman. Online-only players are doing a better job than their multichannel counterparts at delivering newness, unique products, and breadth (*Chart 6*), which helps explain their exponential growth. But innovative traditional retailers are taking note as they develop their online assortments and improve their customers' digital experience. Burberry, for example, created an iPad application for Fashion Week in London that allowed consumers watching shows live to place rush-delivery orders instantly. Neiman Marcus has found its own new way to inspire holiday shoppers – a "Surprise Me" smartphone application that helps shoppers come up with holiday gift ideas.

**Chart 5:**

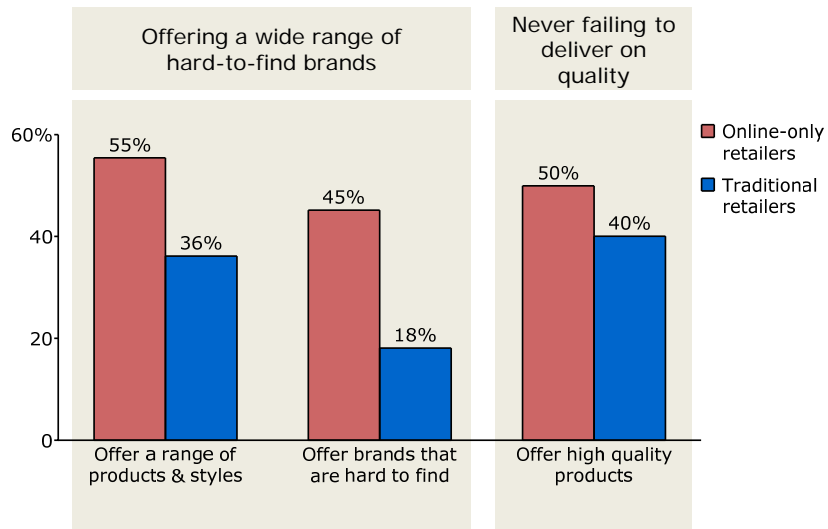
Six segments of style-conscious women

	ESTABLISHED SPENDERS		STYLE AT A PRICE		UTILITY SHOPPERS	
	Fashion maven	Classic professional	Frugal fashionista	Shopping enthusiast	Basics buyer	Necessity shopper
	Fashion expert and luxury-brand lover who is not afraid to spend to keep up with the latest trends	Older wealthy professional who buys quality classic products over the latest trends	Fun, stylish recent graduate who uses starting-level salary to look fashionable	Younger, less wealthy woman who can't shop enough and follows all aspects of fashion	Mom who doesn't have the time or energy for fashion, simply preferring comfort and ease	Older woman who doesn't love shopping and doesn't stay in touch with the latest fashions
Percentage of style-conscious population	24%	17%	15%	11%	20%	13%
Percentage of style-conscious spend	30%	20%	15%	12%	16%	7%
Average age	33	44	27	28	34	42

Source: Bain and *Vogue* magazine, "Why She Shops: The 2010 Fashion and Beauty Study"

**Chart 6:**

Percentage of style-conscious women who describe retailers as:



Source: Bain and *Vogue* magazine, "Why She Shops: The 2010 Fashion and Beauty Study"

## The margin curveball

So far this year, many retailers' EPS figures have exceeded even 2007 levels.<sup>8</sup> But retailers are facing margin headwinds this holiday season and into 2011.

One issue retailers face is sizable increases in input costs. Clothing retailers, for example, face the threat of record-high cotton prices at \$1.44 per pound, up 88% this year.<sup>9</sup> The impact could be dramatic: Textile accounts for substantially more than half of the cost of goods sold. Overseas labor costs also continue to rise. In China, for example, the average hourly wage in manufacturing has increased almost 70% in the past five years, versus about 4% in the United States. This has an important impact on domestic apparel because Chinese-produced garments now account for more than 35% of total US consumption, up from under 20% in 2002. And shipping costs are up 50% in some instances, although these typically represent a much smaller portion of overall costs.

Retailers may begin to feel these increases during this holiday season. The challenge is how to deal with rising costs. Some retailers are exploring alternative sourcing options. Talbots, for example, is evaluating new emerging markets as less expensive options for outsourced manufacturing. In its most recent annual report, it noted: "We expect to reduce the percentage of our products sourced from China." Others retailers are considering changing the material content of their merchandise. And some will simply absorb the cost increases. Hudson Jeans CEO Peter Kim said, "We do everything we can not to pass [rising costs] on. In the end, we are absorbing some of it in our margins."

Of course, one option is to pass cost increases on to consumers. The unfortunate reality for most retailers is that they probably won't be able to do so, at least during the holiday season. Consumers continue to expect big discounts, and a number of retailers are obliging them by starting holiday sales earlier and offering deeper discounts. Sears, Wal-Mart and JCPenney are all touting Black Friday sales weeks before the actual day. JCPenney CEO Mike Ullman told investors the chain will offer larger discounts this season than last. And Target is getting a jump on Black Friday this year with a four-day sale before Thanksgiving and heavy discounts on more than 170 items. Kathee Tesija, Target's executive vice president of merchandising, confirms that Target's discounts this year will be deeper, broader and focused on gift-ready items to drive holiday sales early.

Retailers that best maintain their margins will likely be those preserving profitability on high-demand items. This means offering well-thought-out item-level discounts rather than blanket markdowns. But it won't be easy. Recession-battered consumers have learned to hunt for deals and sidestep nonsale merchandise. As Robert Buchanan, a finance professor at the John Cook School of Business at Saint Louis University notes, "They are looking for the \$6 toaster [on Black Friday] and they're on their way."

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<sup>8</sup> Most retailers will release third-quarter results in the next few weeks.

<sup>9</sup> Cotton price as of November 4, 2010.



## There's a lot of holiday ahead

We are cautiously optimistic as we head further into the holiday season, our optimism buoyed by recent indicators. Again, momentum is positive, sales growth is respectable and the consumer situation is relatively stable . . . at least compared to the last couple of years.

Of course, optimism and momentum by themselves don't ensure success. We expect to see wide differences in holiday performance both across and within segments. One factor in that variation is likely to be effective use of online and other digital technologies. In our next newsletter, we will take a close look at e-commerce trends. We also will discuss some of the key innovations that are likely to capture the imagination, and spend, of holiday shoppers.

## Newsletter schedule

Our next newsletter will be released in mid-November, with a new issue every two to three weeks through the holiday season (*Chart 7*). This schedule allows us to incorporate newly released holiday forecasts and performance data in a timely manner. Please let us know if you have any questions or suggestions for additional analysis.

### Chart 7:

#### Indicator update and newsletter schedule

Data Source	November				December				January			
	7	14	21	28	5	12	19	26	2	9	16	23
US Census Bureau Advance Retail Sales (GAFS/GAFO)		▲					▲					▲
		15-Nov					14-Dec					14-Jan
ICSC Monthly Same Store Sales				▲							▲	
				2-Dec							6-Jan	
Michigan Consumer Sentiment Index	▲		▲			▲		▲				
	12-Nov		24-Nov			11-Dec		23-Dec				
Consumer Confidence Index				▲							▲	
				30-Nov							28-Dec	
Bain Retail Holiday Newsletter	★				★		★					★

## Appendix

### Chart A:

#### Definitions

	GAFO	GAFS	GAF	Nonauto retail sales
General merchandise stores	✓	✓	✓	✓
Clothing and clothing accessories stores	✓	✓	✓	✓
Furniture and home furnishings stores	✓	✓	✓	✓
Electronics and appliances stores	✓	✓		✓
Sporting goods, hobby, book and music stores	✓	✓		✓
Office supplies, stationery and gift stores	✓			✓
Nonstore sales, including traditional retailers' online sales				✓
All other retail trade sales not listed above (excluding auto and auto parts)				✓
Auto and auto parts sales				

## Selected References

Bain & Company has included in this document information and analyses based on the sources referenced below as well as our own research and experience. Bain has not independently verified this information and makes no representation or warranty, express or implied, that such information is accurate or complete. Projected market and financial information, analyses and conclusions contained herein are based (unless sourced otherwise) on the information described above, and Bain's judgments should not be construed as definitive forecasts or guarantees of future performance or results. Neither Bain & Company nor any of its subsidiaries or their respective officers, directors, shareholders, employees or agents accept any responsibility or liability with respect to this document.

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