



December 20, 2012

Are consumers waiting for better deals?

by Darrell Rigby, Kris Miller, Josh Chernoff and Suzanne Tager

November sales results were mixed: Online sales were up, and some retailers performed well, while the general merchandise category (the massive “G” in GAFO sales) experienced declines in stores. December started slowly, but momentum is building; and retailers are counting on a strong finish. In this issue, we review performance-to-date for the holiday season and take an in-depth look at pricing – a primary lever in challenging times. Today’s consumers, armed with smartphones and other internet devices, have unprecedented access to pricing and product information. We examine how retailers are responding by redefining customer value propositions and developing high-tech pricing tools, which may forever change the ways price wars are fought.

November sales were a mixed bag, but momentum is picking up in mid-December

Consumers opened their wallets in November, but sales skewed to non-GAFO categories (GAFO includes General Merchandise, Apparel and Accessories, Furniture, and Other). Nonstore sales, which include online, grew at 12.4%. Sales of motor vehicles grew at 5.8% and building materials grew at 5.9% in the wake of Superstorm Sandy.¹ These categories spurred total retail sales growth of 4.5% year-over-year in November – above the 10-year average of 3.5% (*Chart 1*). GAFS sales (General Merchandise, Apparel and Accessories, Furniture, and Sporting Goods – the near-term proxy for GAFO sales until further details are released) grew slowly in comparison, at 2.2%, below both the 3.5% growth in November 2011 and the 10-year average growth rate of 2.6%.

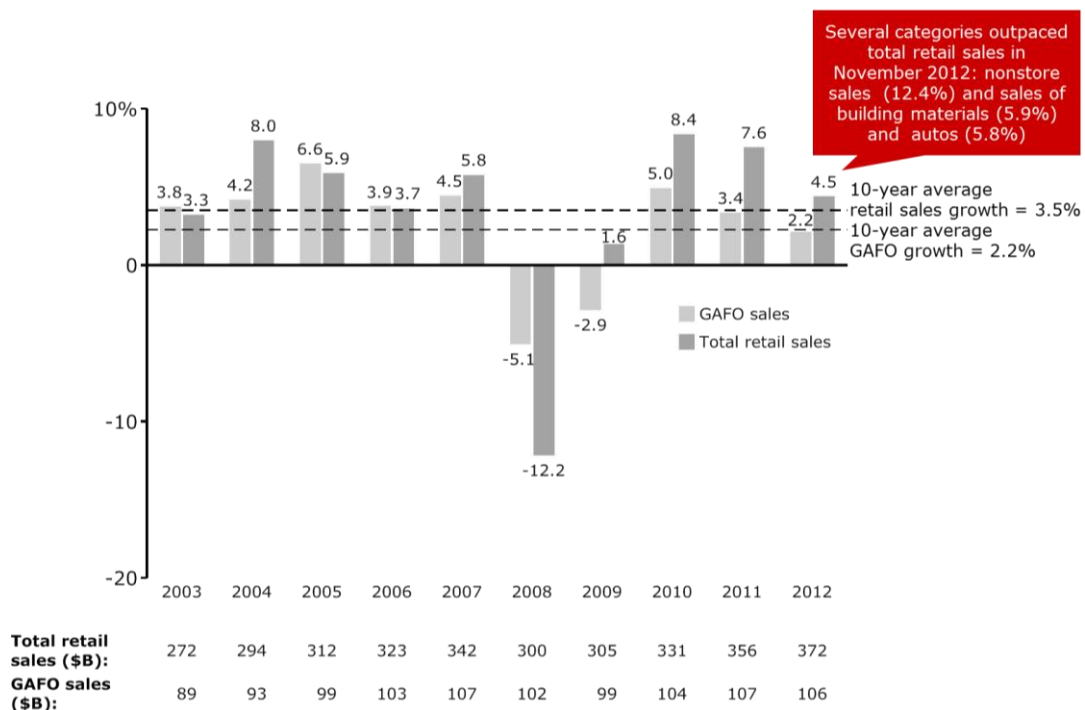
The general merchandise category was the biggest GAFS loser in November, down 1.1% (*Chart 2*). This segment accounts for 52% of GAFO sales and includes sales through

¹ Total retail sales include general merchandise, apparel and accessories, furniture and other sales (GAFO) and sales of motor vehicles, food and beverages, gas, nonstore sales, building materials and health and personal care items. See Chart A in the Appendix for definitions of GAFO and other sales measures.

department stores, mass merchandisers and warehouses. Some of the factors driving this weakness were an increase in online shopping (not included in GAFS sales) and the weather – both the detrimental effects of Sandy and warmer-than-average temperatures. The good news is that other GAFS categories fared better in November, with clothing and accessories up 8.8%, sporting goods up 7.9% and furniture up 6.5%. Sales of flat-panel TVs and Android tablets helped electronics and appliances grow at 0.2%, following months of shrinking sales.

Chart 1:

November GAFO and total retail sales year-over-year growth, 2003-2012



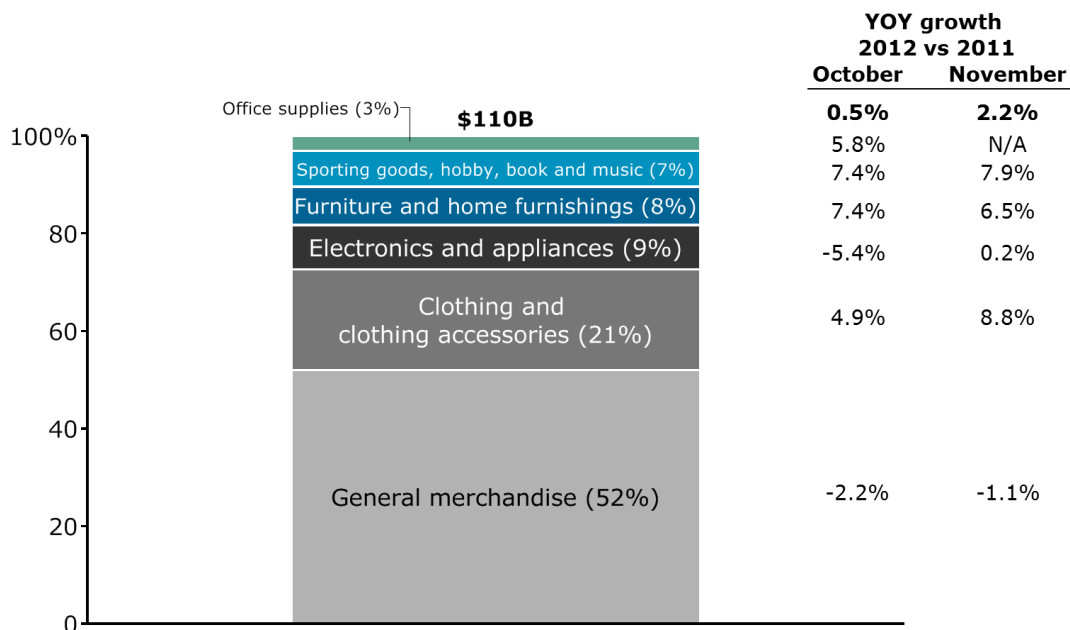
Note: The 10-year average is the compound annual growth rate from 2002 to 2012; November 2012 shows GAFS growth because the GAFO rate is not yet available; the GAFS 10-year average growth rate is 2.6%
Source: US Census Bureau

E-commerce continues to show strong growth. ComScore reports that online sales were up 13% from the beginning of November through December 16 relative to last year. Accelerated growth is likely to occur in the remaining days to Christmas, as shoppers who have procrastinated because of the extended holiday season complete their shopping. Increasingly faster shipping times will enable these shoppers to make last-minute purchases online and still have gifts delivered before the Christmas deadline. One quarter of digital gift cards, which can be sent instantaneously, were purchased over the last three days before Christmas in 2011.

Although some forecasters, including ShopperTrak, have begun to lower estimates of holiday sales, overall momentum is showing some signs of recovery as we head into the final weeks of the holiday shopping season. Weekly same-store sales have rebounded from softer sales in late November and early December. Retailers may still get the late momentum they are hoping for. The International Council of Shopping Centers estimates that same-store sales were up 3.5% in the second week of December, alleviating some concerns about the 2.5% growth in the first week of December (Chart 3). The ICSC's estimate reflects a mix of in-store and online sales, since some retailers report combined sales.² An extra shopping weekend before Christmas should also help December sales.

Chart 2:

GAF0 sales by segment,
November 2012

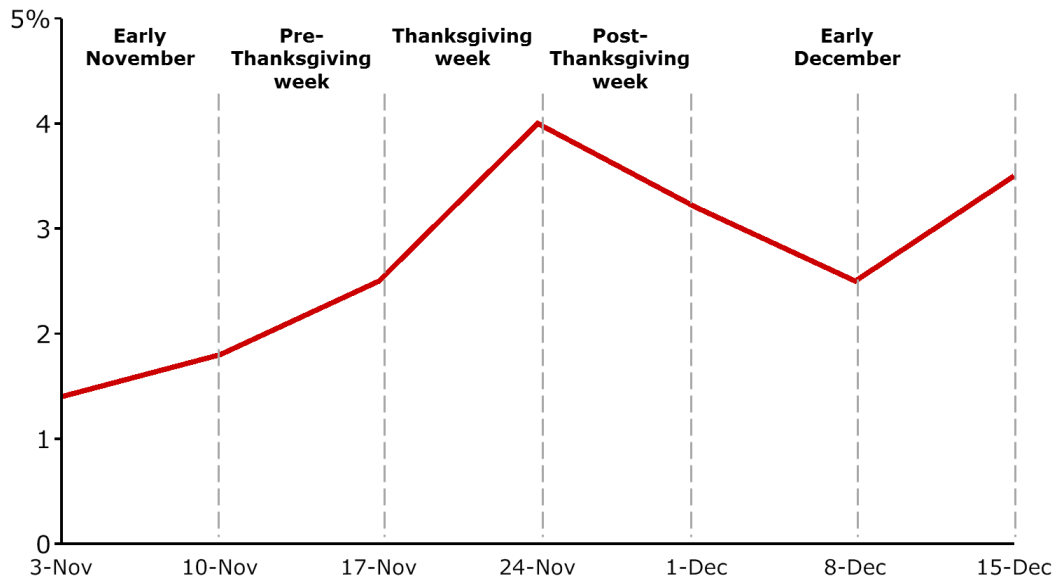


Note: November overall growth rate is for GAFS; office supplies data are from October 2012 because the November figures have not yet been reported
Source: US Census Bureau

² Some retailers include online sales in same-store sales, while others report them separately. The ICSC bases its aggregate analysis on retailers' reported numbers.

Chart 3:

Weekly same-store sales growth over the previous year,
November-December 2012



Note: Weeks end on the dates shown for 2012; the ICSC's weekly growth estimates are based on a different sample of stores than its monthly figures and so are not directly comparable to monthly totals

Source: ICSC-Goldman Sachs

Most macroeconomic indicators continue their gradual improvement and should support improving December sales.

- Unemployment showed slow improvement as November rates decreased to 7.7% from 7.9% in October. As of the week ending December 15, weekly job claims numbered 361,000, below the four-week moving average of 368,000. Including underemployed and discouraged workers, 14.4% of Americans are feeling the effects of a soft job market this holiday season versus 15.6% in 2011.
- Holiday hiring is on the upswing. Expanded store hours around Thanksgiving spurred retailers to add 610,000 seasonal workers in October and November, a 19% increase over the same months in 2011. If retailers end up hiring 150,000 more workers in December, in line with the 148,000 they added in December 2011, they will have the best year since 2000.
- Gas prices have continued to fall slowly. At \$3.20 per gallon last week, the national average price of gas was down 5% from last month.
- Equity markets remain strong. The S&P 500 Index is up 4% since Thanksgiving and 15% for the year.

Nevertheless, consumer confidence fell this month, reflecting concerns about the fiscal cliff. The preliminary reading for the Michigan Consumer Sentiment Index indicates confidence dropped from 82.7 to 74.5 points, marking the first month the index has gone down since July. If this trend persists, December sales could be impacted negatively as could sales in early 2013.

Is a “price cliff” coming?

Prices draw shoppers’ attention, close sales, and matter to margins. Priced right, inventory moves. Priced wrong, merchandise ages and profits evaporate. Inventory levels were high going into the holiday season, with total retail inventories 7.9% higher this October than they were a year ago. The month-over-month increase versus September was 10.7% for general merchandise, including 13.8% for department stores. The combination of high inventory levels, soft November sales and consumers’ search for great deals may force some retailers to price more aggressively than normal as the season ends.

Consumers are researching products and shopping online in record numbers. Excluding categories such as food, motor vehicles and gas, nearly 10% of sales are now transacted on the Web. Forrester reports that 58% of total retail spend is Web-influenced (either researched or researched and bought online). ComScore estimates that 37% of consumers have showroomed this season, checking out a product in a store and then buying it online. A Google study found that 80% of surveyed shoppers planned to do online research before buying holiday gifts. Google’s new Google Shopping platform highlights price comparisons prominently in its results, though only retailers who pay to be included in results are featured.

Online shopping tools are multiplying, especially mobile ones. According to Google, 49% of mobile phone owners use their device to compare prices; 43%, to read product reviews; 42%, to locate a store; and 42%, to look for coupons. A price-savvy mom looking to buy her child a Furby toy can use one of many price comparison apps – RedLaser, ShopSavvy, PriceGrabber, Google Shopper or Price Check by Amazon – to help her decide where to make her purchase. She can type “Furby” into her phone or scan a Furby bar code, and the price comparison engine will show her the best prices online and in nearby stores. She then can click to purchase the toy from her phone and to arrange for home delivery or local in-store pickup.

As price transparency increases, some retailers may be tempted to focus too much on pricing tactics and not enough on differentiation, risking a race to the bottom. That’s unnecessary because Bain’s research shows that shoppers are not buying on price alone: Product innovations, customer service, convenience and other aspects of the customer experience build loyalty and drive sales. Amazon is rapidly gaining market share, but shoppers and retailers might be surprised to learn that the online retailer does not always offer the lowest prices. In fact, ShopSavvy found that of the 40,000 retailers it tracks, Amazon offers the lowest price on just 6% of items. A Citigroup analysis of Amazon, Target and Walmart prices for a basket of toys also found that Amazon had the lowest, unmatched price just 6% of the time. The three retailers shared the lowest price

for 18% of products; and for an additional 41% of items, Walmart and Amazon shared the lowest price. A Deutsche Bank review of a more varied basket of goods from the same three retailers estimated that Amazon had the lowest price for 40% of items and that Walmart or Target was the price leader for 18% of items.

Furthermore, automated price comparisons are not always as straightforward as they seem. Differences in pack sizes, return policies, and promotional offers (rebates, gift cards, bundled products, volume discounts, rewards points and free shipping to name a few) and state-by-state sales tax considerations can mask full pricing. The best deal is not always obvious, making price comparisons difficult despite all the new technology in place.

Retailers respond by rethinking their differentiation and sharpening their pricing tools

The prolonged economic malaise of the last few years has altered the behavior of consumers and competitors. Most consumers (regardless of their net worth) want to feel like they are spending their money wisely. And while most retailers have tried to wean themselves from the heavy price promotions used to survive the recent recession, price cuts are addictive, and both retailers and consumers develop strong cravings.

Online price transparency has exacerbated the pricing situation, shining a spotlight on retailers' pricing strategies and, in many cases, forcing retailers to rethink those strategies. Retailers have to tell a good pricing story, but single-mindedly matching a low-priced competitor's prices is not a game many retailers can afford to play. Retailers need to rethink their broader value proposition for the consumer, and pricing is just one part of the equation.

1. Differentiation as the best armor in price wars

Price transparency does not necessarily require price parity across all products. Winning retailers must establish and communicate a customer value proposition that differentiates them from the competition – often by delivering unique products and experiences, greater convenience and superior customer service.

- *Exclusives and limited-time products.* Consumers can't directly compare prices on products that aren't for sale anywhere else. This holiday season, shelves have no shortage of exclusive items and private-label brands. Retailers also are using exclusive items and brands to create scarcity and a sense of urgency to buy. Victoria's Secret introduced its Bombshell collection for the holiday season, an assortment of limited-edition lotions, powders and lip glosses. EBay released its Holiday Collective in November, presenting designer home and fashion gift items, available for a limited time through its Fashion Vault. Target and Neiman Marcus jointly launched an exclusive gift collection earlier this month. More than 50 gifts from designers like Marc Jacobs and Tory Burch are available at either of the two retailers for the holidays.

- *Personalized products.* Consumers increasingly crave goods that reflect who they are, and technology has made customization and personalization more prevalent this holiday. Amazon allows consumers to upload photos to personalize video gift cards (with a value of up to \$2,000), which are then e-mailed to recipients. Neiman Marcus offered online shoppers personalized UGG boots and TOMS shoes, and monogrammed cellphone covers and leather coffee cup sleeves for the holidays. Wild Things Gear, an outdoor apparel company, allows shoppers to customize jackets with embroidered initials and choice of fabric, insulation, zippers and pockets. The Nike ID service helps customers personalize athletic wear and add design details such as graphics, uniform numbers and names.
- *Targeted gift recommendations.* Retailers like Walmart and Amazon hope to make finding that perfect gift easier by offering suggestions based on customers' behavioral data. Product recommendations based on prior purchases and browsing history have long been around, but the level of sophistication has increased and ties to social media sites are more prevalent. The Walmart Shopycat app suggests gift ideas for friends based on their likes, comments and updates on Facebook, and then routes shoppers to Walmart.com. Amazon launched a similar application, Friends & Family Gifting, that helps users organize and share wish lists in addition to providing gift ideas. PinPointing is a service Zappos.com offers: It makes product recommendations to users based on contacts' Pinterest activity.
- *Superior customer service.* Seamless service can turn a first-time buyer into a repeat customer. Amazon's candid customer reviews, hassle-free returns, detailed purchase history, shipping address retention and easy-to-use interface make the site a shoppers' favorite even when its prices are slightly higher than competitors' offerings. And there is often no substitute for a truly knowledgeable sales associate. Apple's sales staff receives extensive customer service training. Shoppers can trust that Apple associates will answer any questions they might have about products they are interested in as well as those they already have purchased.
- *Speed and convenience.* Procrastinating shoppers often are willing to pay more to make sure the gift is under the tree on time. The convenience of walking into a store and walking out with a product has long benefitted brick-and-mortar retailers. But online players aren't far behind. Amazon Prime members enjoy two-day delivery on millions of products, and the online behemoth now offers same-day shipping in 10 urban locations. Walmart also has started to experiment with same-day shipping in select markets. And Instacart and other startups fulfill online orders by delivering goods from the physical store to the customer's door within hours.
- *An inviting store environment.* Some brick-and-mortar retailers excel at making the physical store a place that customers want to visit. REI stores have rock walls where shoppers can pause from shopping to take a turn at climbing. Lululemon athletica offered a 12 Days of Yoga seminar this month where shoppers could

participate in complimentary yoga classes. And Starbucks is extending its concept to other stores. It has created a signature grocery store aisle where coffees are displayed in a Starbucks café environment. Stores that are testing the signature aisles are selling two to three times more Starbucks coffee than those that are not.

2. *Translating pricing strategy into holiday policies and tactics*

In Bain's experience, retailers that get pricing right manage it at three levels. They create a pricing *strategy* that fully supports their broader objectives and positioning. They set prices on individual *products* to reflect value to both customer and retailer. And they deploy disciplined *tactics* to manage the aspects of the transaction that most affect profitability. Different retailers compete with different pricing strategies: high-low for the promotional department stores; realistic tickets with selected promotions for retailers like Nordstrom; and everyday low price for big-box players such as Costco.

Winning pricing strategies embrace a few core themes:

1. ***Pricing strategy must start with the customer:*** Pricing is just one part of the overall customer value proposition. A clear understanding of what will meet and exceed your target customers' expectations is critical.
2. ***Pricing "on average" costs you money:*** Different categories, geographies and channels may attract different customer segments with different shopping missions. Recognize the differences and tailor the value proposition, including prices and promotions, to specific situations and individual customers.
3. ***Every business has its own "milk, bread and eggs":*** The only price that matters is in your customer's mind. Know what products define "value" for them and how these key value items drive the broader basket (and profitability).
4. ***Competitors don't stand still:*** Pricing strategy should be used to defend home turf from new entrants and gain share from existing competitors. Understand how your competitors are pricing and what you can do to play to your strengths while exploiting their weaknesses.

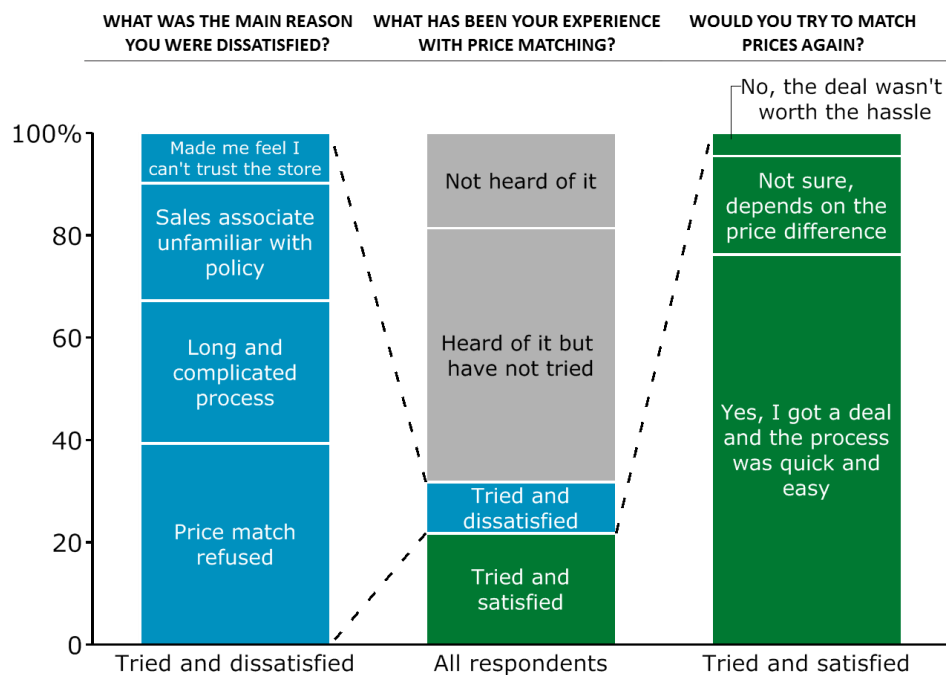
Online price transparency is forcing a rethink of most retailers' pricing strategies, with some product categories being impacted more than others. If you are a consumer electronics retailer, you are facing a very different situation than a grocery store retailer – at least for now. Depending on their merchandise mix and cost position, retailers should craft customized pricing strategies and policies to guide their tactics. Successful policies protect margins and also make consumers trust they are getting a fair deal. Some of the trickiest holiday season programs are price matching, rewarding loyalty and free shipping.

- ***Price matching.*** Best Buy, Toys "R" Us and Target are a few of the retailers advertising more aggressive price-matching programs this holiday season, with Best Buy and Target matching online for the first time. In theory, price matching sounds simple: "We match competitor's prices." In reality, many of these policies

have restrictions and requirements that risk leaving consumers confused or annoyed. Bain partnered with PollBuzzer to understand consumers' reactions to price matching (*Chart 4*).³ We surveyed 1,760 consumers and found that 32% of respondents had tried price matching. Of the 559 price matchers, about two-thirds were satisfied with the experience because they got a better deal, but nearly one-third were not satisfied. Those who were not satisfied described associates who refused to match prices, a process that was too long and complicated, or a feeling that they could not trust the retailer to offer good prices. Respondents tried to match prices across categories: consumer electronics (60%), toys (15%), apparel (7%), books/media (6%) and other (12%). Price matching will continue to be more prevalent for categories where shoppers can find a broad product assortment online, often at a lower price, along with detailed product information and reviews. However, there is a risk that for some retailers price matching may diminish consumers' trust.

Chart 4:

PollBuzzer price-matching results



Source: PollBuzzer; Bain analysis

- *Rewarding loyalty.* Retailers are working hard to increase their share of customers' wallets. They are using loyalty programs and other tactics to reward repeat

³ PollBuzzer™ (www.PollBuzzer.com) offers a real-time consumer opinion survey product. According to PollBuzzer, clients use demographic, geographic and socioeconomic filters to build customized panels drawn from PollBuzzer's proprietary national respondent pool, build their own surveys using a do-it-yourself Web interface, and receive Excel-formatted results in as little as one hour after launch.

customers. “Bounceback” promotions are one example of these tactics during the holidays: Gilt.com is one of the retailers offering shoppers e-mails with a discount on their next purchase. Williams-Sonoma also offers shoppers a credit for their next visit. Shoppers who spend more than \$50 from December 13 through December 24 receive a \$10 coupon toward purchases made December 26 to January 31. Basket-level discounts are another way retailers are trying to motivate customers to increase the size of their orders. For example, Kohl’s offered 20% off any purchase of \$75 or more online and in stores in early December. Shoppers could combine this discount with coupons from Kohl’s own bounceback program.

- *“Free” shipping.* Consumers have begun to expect free shipping over the holidays, though it can be costly for retailers. This holiday season, according to comScore, more than 50% of online transactions between November 18 and December 2 shipped for free. But ‘free’ shipping comes in many different forms.
 - *Offering membership programs.* Amazon and other retailers offer unlimited “free shipping” on many items for an upfront fee. Programs like Amazon Prime have the benefit of defraying costs while building loyalty. Why shop elsewhere if you’ve already paid for “free shipping”? Consumers come to think of Amazon as the automatic first stop, visiting other retailers only if they can’t find the product on Amazon. Retail analysts estimate that Amazon customers triple their spending after joining Prime. For certain products, Amazon further defrays expenses by offering members who opt for slower shipping a \$1 to \$3 store credit, applicable to Amazon instant videos or MP3s. The retailer also offers Prime membership to moms and college students.
 - *Building shopping baskets with minimum-purchase requirements.* Retailers that require a minimum purchase for free shipping, such as J.Crew and Lowe’s, often spur additional spending, which can help offset shipping costs. Forrester reports that 27% of consumers add unplanned items to their online shopping carts to reach free-shipping thresholds.
 - *Reducing costs and adding convenience with ship to store.* The last mile of delivery is typically the most complicated and costly leg of the supply chain. Many retailers cut this cost by shipping online orders to stores or picking from in-store inventory and having shoppers come to that location for pick up. About 50% of sales at Walmart.com and more than 40% of Best Buy online purchases are picked up at stores. The added benefits to retailers: increased in-store foot traffic and a draw for consumers who prefer to pay in cash. The downside: consumers who don’t retrieve their orders and extra labor needed to make the in-store pickup experience a positive one.

3. Adding science to the art of pricing

Setting and changing prices have always been core retail skills. Today, more and more retailers are relying on science and computing power to help collect real-time data on competitors’ prices, calculate sell-through and margin implications of pricing changes, and update their own prices frequently. These tools can be very helpful; but if used in

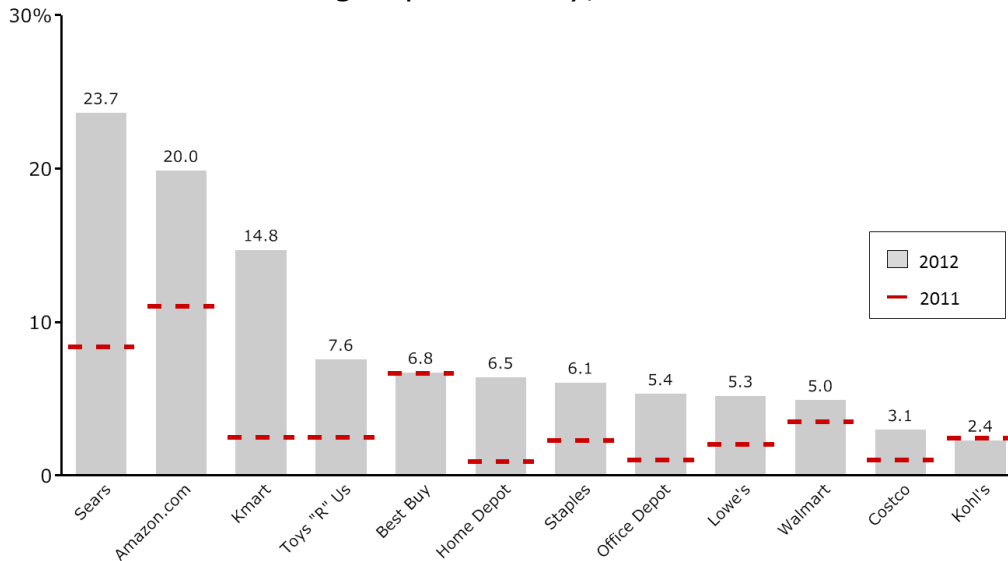
the wrong ways, they can create confusion and make customers doubt they are ever getting a good price.

- *Dynamic pricing online.* In 2010, many retailers were changing prices daily. Changes shifted to hourly in 2011. This holiday season, dynamic pricing tools allow retailers to monitor prices at three times last year's pace. In response, several companies have emerged to help consumers and retailers compare and adjust prices, among them camelcamelcamel, Decide.com, digitalfolio and Dynamite Data.

Bain partnered with Dynamite Data to analyze retailers' price movements this holiday season.⁴ Dynamite Data examined 12 retailers' online offerings and estimated the percentage of their product assortment that had daily price changes from November 1 through December 10 (*Chart 5*). Most of the retailers changed prices daily on less than 10% of their assortments, but Sears and Amazon adjusted double that range of products. And all but Best Buy have expanded their use of dynamic pricing over last year. Volatility of prices ranged significantly with Toys "R" Us having the biggest difference in prices over the six-week period. Interestingly, nearly all of the retailers we examined had higher indexed prices on December 10 than they did on November 1 (*Chart 6*).

Chart 5:

Percentage of retailer's online product assortment that changed prices daily, 2011 and 2012

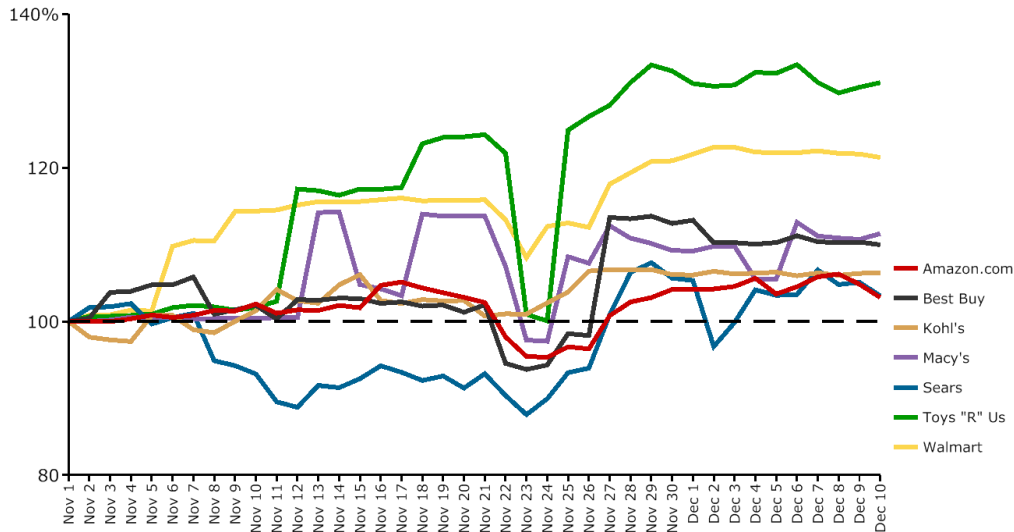


Note: Based on a select basket of items from retailers' holiday circulars; price changes were measured from November 1 to December 10 in both 2011 and 2012
 Source: Dynamite Data; Bain analysis

⁴ Dynamite Data (www.dynamitedata.com) provides retail channel intelligence for merchants, manufacturers and consumers. Through its proprietary algorithm, Dynamite Data offers data collection techniques that gather and distribute pricing, inventory, and ratings and review information from over 450 million buy pages at more than 3,000 online merchants worldwide.

Chart 6:

Retailers' indexed prices of circular offerings,
November 1, 2012-December 10, 2012



Note: Based on a select basket of items from retailers' holiday circulars; baskets vary by retailer and are based on products that are sold in common; products tracked range from 200 to 850 depending on retailer; prices are indexed to November 1, 2012
Source: Dynamite Data; Bain analysis

Dynamic pricing creates opportunities for customers to hunt for value, but it can also paralyze decision making. Bain's extensive research on complexity reduction finds that simplicity can frequently reduce costs while increasing customer confidence and willingness to spend.

- *Dynamic and customized pricing in stores.* Changing prices online is easier than changing prices in physical stores, but electronic displays and personalized promotions do offer options. Kohl's use of electronic signage enables the retailer to quickly and easily communicate promotions and other price changes. Lowe's MyLowe's loyalty program uses customers' purchase histories to offer shoppers promotions on specific products that might help with their current home improvement projects. Shoppers with Visa cards can sign up for Gap Mobile4U, a mobile service offered by Visa and Gap that tracks consumers' purchases. Based on the collected data, Gap sends customers personalized offers every week.
- *Geofencing and location-driven promotions.* Geofencing technology and transaction history help retailers offer consumers who visit stores unique and unexpected promotions. RetailMeNot's mobile apps send shoppers coupons when they approach a partner's store or a shopping mall. Macy's app delivers previously unadvertised specials and current store promotions to shoppers as they enter a specific Macy's store. Apple's Passbook app gives users access to store loyalty

and rewards membership information. Shoppers who walk by Sephora, a Passbook retail partner, may receive a push notification detailing reward points and special deals available to them.

A fresh look at pricing for the new year

The holiday season has sharpened the short term focus on pricing; the prolonged economic slump and increased price transparency will keep pricing at the top of executives' priorities in the new year. There is no single model for pricing across assortments, channels and geographies that will work for everyone, but there are a series of important questions all retailers should ask and answer:

1. Do you fully understand the *role pricing plays* for your customers and how online price transparency has amplified price comparisons?
2. Are you using other *ways to differentiate* (e.g., product innovation, customer service, in-store experience) as the best defense in the war on price?
3. Do you have a *winning pricing strategy* that conveys value to your customers while also achieving your profit objectives? Is this supported with *disciplined pricing tactics*?
4. Are you adding *science to the art of pricing*, supporting pricing decisions with more sophisticated tools (e.g., dynamic pricing, geofenced, location-based offers) and developing stronger pricing capabilities over time?

Newsletter schedule

The final issue of this newsletter will be released mid-January with a recap of the 2012 holiday season and trends retailers should expect in 2013 (*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	Dec		Jan		
	17-23	24-30	31-6	7-13	14-20
US Census Advance Retail Sales (GAFS/GAFO)					▲ (1/15)
ICSC Monthly Same Store Sales			▲ (1/3)		
Michigan Consumer Sentiment	▲ (12/21)				
Consumer Confidence Index		▲ (12/27)			
BEA Gross Domestic Product	▲ (12/20)				
BEA Personal Income and Outlays	▲ (12/21)				
Holidays			▲ <i>Christmas (Tues)</i>		
Bain Retail Holiday Newsletter (tentative)					★

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	✓			✓
All other retail trade sales not included in GAFO (excluding auto and auto parts)				✓
Auto and auto parts sales				

Selected References

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