BAIN & COMPANY

Issue 1 | 2017–2018

BAIN RETAIL HOLIDAY NEWSLETTER

2017 HOLIDAY OUTLOOK: RINGING IN THE SHOPPING SEASON!

By Aaron Cheris, Darrell Rigby and Suzanne Tager

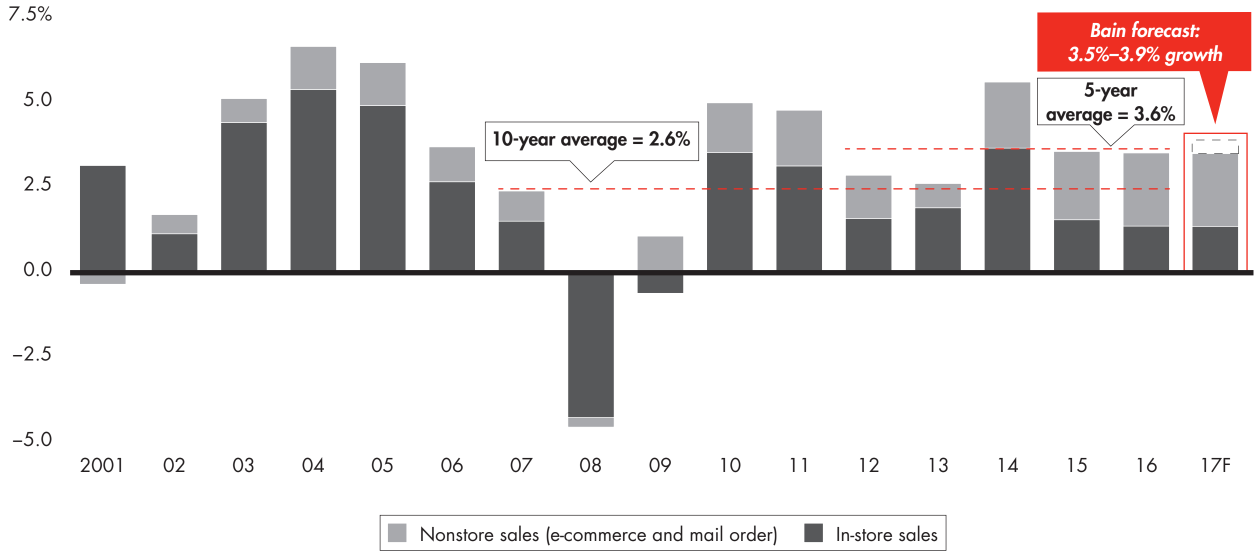
Bain & Company is forecasting 3.5% to 3.9% growth in US retail sales this holiday season, slightly above last year's 3.5% growth and well above the 10-year average of 2.6%. Our optimism stems from positive macroeconomic indicators across the board, including rising wages, increasing employment and a strong stock market. We also see above-average growth in housing-related expenditures. The forecast is tempered, however, by sluggish in-store sales, deflationary pressures in a few key retail categories and a continued shift toward spending on services, a segment we don't include in our analysis of retail sales. In this issue we also look at preseason customer advocacy. As the holiday shopping season unfolds, we plan to track and report changes in that advocacy and identify the innovations that will have the greatest impact during this high-stakes season and beyond.

Unwrapping the forecast

Bain expects total US retail sales to grow 3.5% to 3.9% this holiday season, slightly above last year's 3.5% growth and well above the 10-year average of 2.6% (see Figure 1). We define *holiday retail sales* as in-store and nonstore (e-commerce and mail-order) sales during the months of November and December, excluding sales by auto and auto parts dealers, gas stations and restaurants (see Exhibit 1 in the Appendix).

As usual, in-store retail sales will be critical to the holiday season: They represent more than 80% of holiday retail sales. Bain forecasts in-store sales growth of 1.7% to 2%. The low end of the range is in line with last year's growth of 1.7%; the high end mirrors current year-to-date growth

Figure 1: Growth in holiday omnichannel sales, 2001–2017F



Notes: Holiday season is November and December; growth rates are based on the most comparable data available at the time; 2017 growth rates are Bain's forecasts (F)
Sources: US Census Bureau; Bain analysis

of 2%. Meanwhile, e-commerce continues to show strong momentum year to date, with 15% to 16% growth over the first half of 2017. We expect that momentum to continue into the fourth quarter.

Macroeconomic indicators support prospects for a healthy holiday shopping season. Most consumers have more money to spend on holiday gifts this year, a function of favorable employment and wage trends. Several other positive forces are at play too:

- **Consumer confidence at a 13-year high.** Consumer confidence, as measured by both the Consumer Confidence Index and the Michigan Index of Consumer Sentiment, has reached levels not seen since the early 2000s. Even after the hurricanes in Texas and the Southeast, the Michigan Index of Consumer Sentiment measured 101.1 in October, up from 87.2 last October. Consumers seem optimistic heading into the holiday shopping season.

- **Favorable macroeconomic tailwinds across all household segments.** We expect holiday spending from all household segments (affluent, aspirational and lower half) to show strong growth this season (see Figures 2 and 3). Stock markets have performed very well this year: The S&P 500 Index is up more than 12% since January, rising to an all-time high. The housing market has shown stable growth: The Case-Shiller Home Price Index has been growing at 5% this year, slightly above last year's 4.6%. Finally, unemployment is down 0.7 percentage point over last year, to 4.2%, its lowest level since 2001. All of these trends combine to put more money in the pockets of US households.

- **Increase in housing-related expenditures.** In-store home-furnishing sales grew 7.5% between the first half of 2016 and the first half of 2017. A contributing factor here is a strong housing market, with increases in both home sales and apartment rentals. We expect to see further growth in these categories after recent wildfires

Figure 2: Overview of three household categories

	Lower half	Aspirational	Affluent
Annual household income	<$50,000	$50,000–$108,000	>$108,000
Proportion of US population	50%	30%	20%
Proportion of US consumption	29%	32%	39%
Spending is most affected by	Wages	Housing assets	Financial assets
Holiday sales growth outlook	In line with last year	In line with last year	Greater than last year

Sources: US Census Bureau; Bureau of Labor Statistics; Bain analysis, October 2017

Figure 3: Indicators of holiday sales growth

	Leading indicator	Measure	2016	2017	Implication for 2017 retail sales
Wealth and income metrics	Unemployment rate (reported)	Unemployment rate, September	4.9%	4.2%	◐
	Total nominal personal savings	Savings rate, Q2 average	5.9%	4.9%	●
	S&P Case-Shiller Home Price Index	Percentage growth, January—July	4.6%	5.0%	◐
	National home sales (new and existing)	Percentage change in annual sales, September—August	3.8%	4.2%	◐
	S&P 500 Index	Percentage change, July 10—October 10	1.2%	5.1%	●
	Nominal wage growth	Percentage growth from September of previous year	2.8%	2.9%	◐
Retail performance	YTD in-store retail sales growth	YOY growth, January—August cumulative	2.6%	2.0%	○
	YTD omnichannel retail sales growth	YOY growth, January—August cumulative	4.1%	3.5%	○
	Walmart Q4 sales (international consensus estimates)	YOY growth, Q4	1.0%	1.8%	●
	US sales of top retailers (consensus estimates)	YOY growth, Q4	2.4%–3.9%	4.0%–7.4%	●
Other	Michigan Consumer Sentiment Index	Sentiment Index, October	87.2	101.1	●
	Consumer Confidence Index	YOY change in CCI, September	0.9%	15.7%	●

● Implies higher growth than last year ◐ Implies growth in line with last year ○ Implies lower growth than last year

Note: Nominal wage growth represents year-over-year change in private-sector nominal average hourly earnings
Sources: US Census Bureau; Bureau of Labor Statistics; S&P Capital IQ; Yahoo! Finance; Bloomberg; Economic Policy Institute; S&P Dow Jones Indices; Federal Reserve Bank of St. Louis; The Conference Board; University of Michigan; Trading Economics

and hurricanes. Harvey and Irma put a small dent in September's macroeconomic numbers, decreasing available jobs and increasing gas prices. But we predict that rebuilding efforts will lead to greater expenditures in the home-building and home-furnishing categories over the coming months. Also, this increase in volume will likely deter price discounts, giving nominal sales an extra lift.

- **A favorable holiday calendar.** This year Christmas falls 32 days after Thanksgiving (versus 31 days last year), which means an extra day for shoppers to ring up holiday purchases. Also, Christmas falls on a Monday, giving last-minute customers a full weekend to fill their carts, which could be a boost to in-store sales.

Offsetting these positive indicators are deflationary pressures on televisions, toys and other key holiday items, along with geopolitical uncertainty. In addition, a strong dollar (currently slightly below last year's value) and more restrictive visa policies continue to constrain tourism. Although the shopping outlook is good, clearly there are headwinds at play:

- **Sluggish in-store sales momentum.** Year-to-date in-store sales growth is a strong predictor of holiday sales. This year in-store sales increased just 2% through August, down from 2.6% over the same period last year. Retail sales can change significantly month to month. For example, February's in-store purchases were down almost 2% from last year, in part because of a delay in sending out some tax refunds. Sales also slowed in June (2.2% compared with 3.7% in 2016), in large part a reflection of drop-offs in office supply, sporting goods, hobby, book and music stores. The good news for retailers: August saw a bump in growth, with in-store sales growing by 3.3% over August 2016.

- **More spending on services.** Services make up nearly 70% of consumer spending and represent 72% of the growth in consumer spending over the first half of 2017. Consumers are spending more on housing: Rents continue to rise in many cities across the country. Consumers also are spending more on financial services and insurance, which pushed growth in the category to 7% year over year during the first half of 2017. One factor driving this segment is individual life insurance sales, which grew 4% over the first half of 2017 compared with the same period in 2016. Other services categories that saw high growth were healthcare, and telecommunications and Internet services, which were up around 5% in the first half of 2017. This shift toward services means consumers have less disposable income to spend on the goods they traditionally add to their holiday baskets.

- **A highly promotional season?** The SPDR S&P Retail ETF, which tracks a broad range of stocks in the US retail industry, has dropped 9% since January 2017, and many retailers are feeling the heat. That distress, coupled with the high-profile bankruptcies of retailers like Toys "R" Us and strong competition from Amazon.com and Walmart, could set off a frenzied pricing race, as retailers try to improve top lines and move inventory over the holidays. Across the retail industry we've heard much speculation about a highly promotional holiday season. We intend to watch promotions carefully and report back. Stay tuned!

The gift of customer advocacy

The holiday season presents extraordinary opportunities to shift consumer loyalty and drive advocacy. New customers are experimenting, trying new places both for themselves and for gifting. Current customers are hoping their loyalty will earn them valuable benefits. All of this comes at a time when peak utilization is stressing the system and competition is at fever pitch. The stakes for meeting shoppers' demands, both physical and emotional, are higher than ever. If shipments arrive late, products don't look or fit the way they're described or customers' questions are left unanswered, shoppers take note ... and they tell their friends.

The solution for retailers may well lie in customer advocacy. After all, in many ways, gift-giving is the highest form of advocacy. We have the starting positions on that advocacy for a lot of retailers and will track how things change throughout the season. Bain's 2017 Advocacy in US Retail study, conducted in collaboration with ROI Consultancy Services, shows a wide spectrum of preseason performance. Looking at top retailers, Net Promoter Score®, a measure of customer advocacy and satisfaction, ranges from –26 to 57.[1] Bain research also has shown that advocacy leaders in retail outperform their competitors by two to three times in terms of organic annual growth, and that many of them outperformed their competitors within their price tier and segment last holiday season. As the season unfolds, we'll share our observations of retailers that are delivering the "wow factor" to improve the lifetime value—and the holiday value—of their customers.

On our list this holiday season

Over the next three months, in addition to tracking US sales data and broader trends impacting retailers globally, we will closely follow several hot topics ranging from how Amazon has continued to expand its reach to the latest technological and promotional strategies retailers are employing this holiday season.

Here's a preview of our upcoming newsletters:

Issue #2 (mid-November): What's on Amazon's Christmas List?

Issue #3 (late November): Holiday Half-Time Report and Technology in Retail

Issue #4 (mid-December): What's the Deal with Pricing and Promotions?

Issue #5 (mid-January): Post-Holiday Recap and Outlook

Please let us know if you have other topics you would like to learn more about by emailing us at *RetailHolidayNewsletter@bain.com*. We look forward to sharing holiday headlines with you and hearing from you throughout the holiday season.

1 The Net Promoter Score® is derived by asking consumers, "On a scale of zero to 10, how likely would you be to recommend this company (or this product) to friends and colleagues?" Ratings of 9 or 10 indicate promoters; 7 and 8, passives; and zero through 6, detractors. The score is simply the percentage of promoters minus the percentage of detractors. Net Promoter®, Net Promoter System®, Net Promoter Score® and NPS® are registered trademarks of Bain & Company, Inc., Fred Reichheld and Satmetrix Systems, Inc.

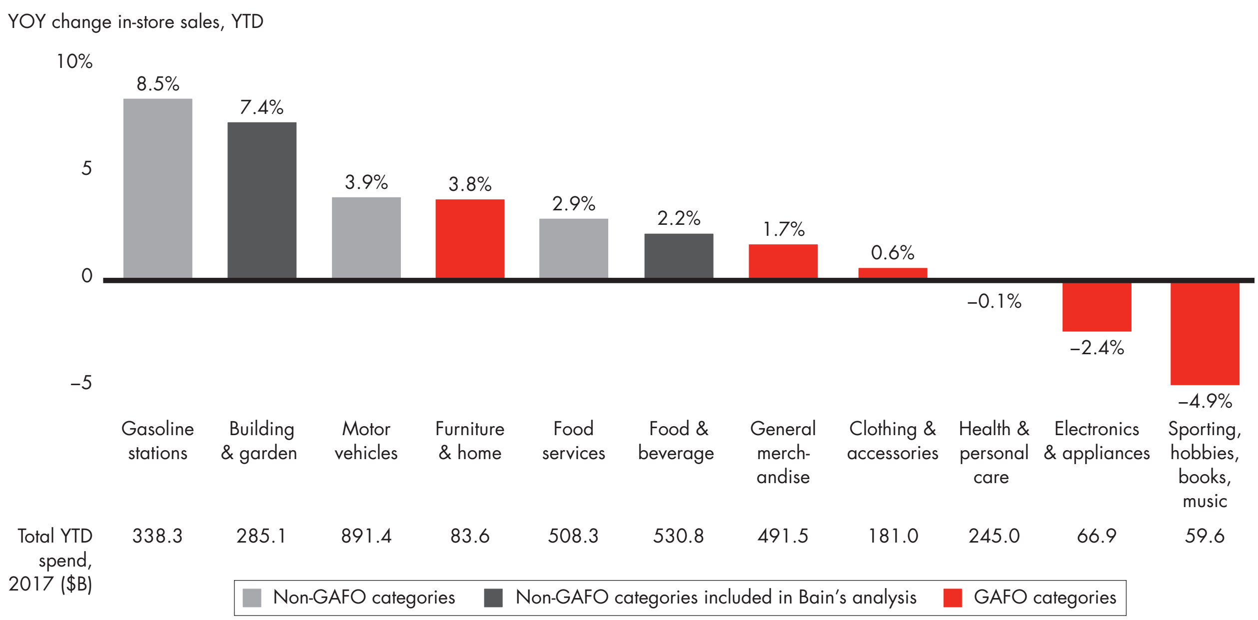
APPENDIX

Exhibit 1: Definitions of retail sales measures

	Omnichannel		Traditional in-store	
	Scope of Bain holiday forecast	Total retail sales	GAFO	GAFS
General merchandise stores	✓	✓	✓	✓
Clothing and clothing-accessories stores	✓	✓	✓	✓
Furniture and home-furnishings stores	✓	✓	✓	✓
Electronics and appliance stores	✓	✓	✓	✓
Sporting goods, hobby, book and music stores	✓	✓	✓	
Office supplies, stationery and gift stores*	✓	✓	✓	
Building materials and garden equipment and supplies dealers	✓	✓		
Food and beverage stores	✓	✓		
Health and personal care stores	✓	✓		
E-commerce sales in categories above	✓	✓		
Mail-order houses	✓	✓		
Auto and auto parts dealers		✓		
Gasoline stations		✓		
Food and beverage services		✓		
Other non-store retailers		✓		

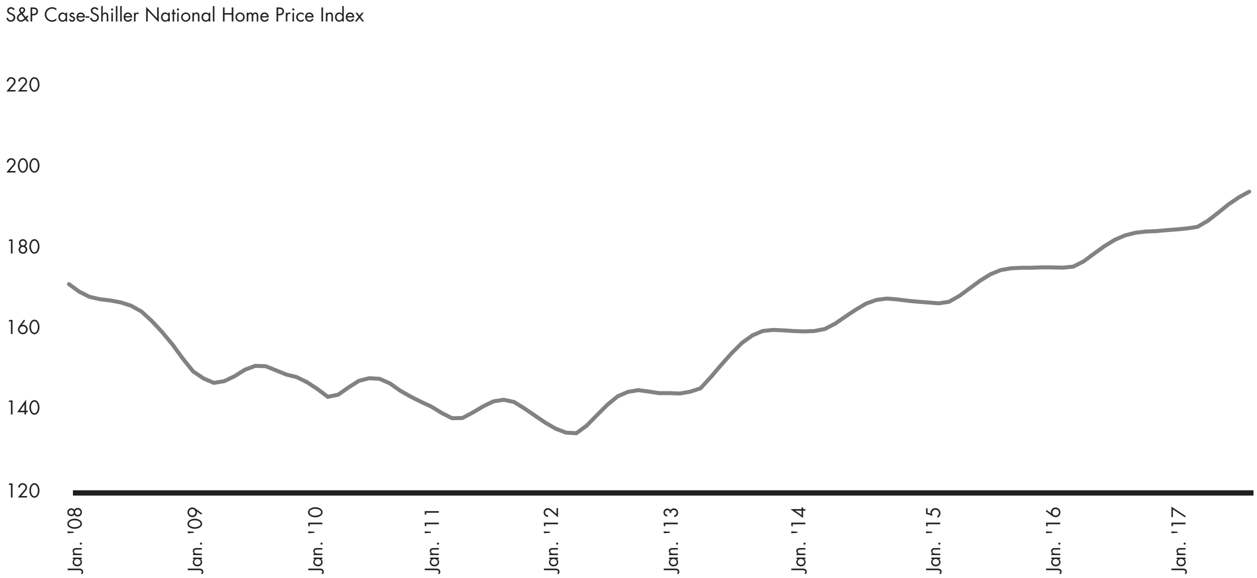
*US Census Bureau includes these sectors in GAFO as "miscellaneous store retailers"; all miscellaneous store retailers are included in both Bain's forecast and total retail sales
Notes: Omnichannel sales include in-store and e-commerce sales for both omnichannel and online-only retailers; traditional in-store sales do not include sales of online-only retailers or the e-commerce sales of omnichannel retailers that report their e-commerce sales to the US Census Bureau in a separate filing; GAFO=general merchandise, apparel and accessories, furniture, and other sales; GAFS=goods available for sale

Exhibit 2: In-store sales growth, January 2017–September 2017



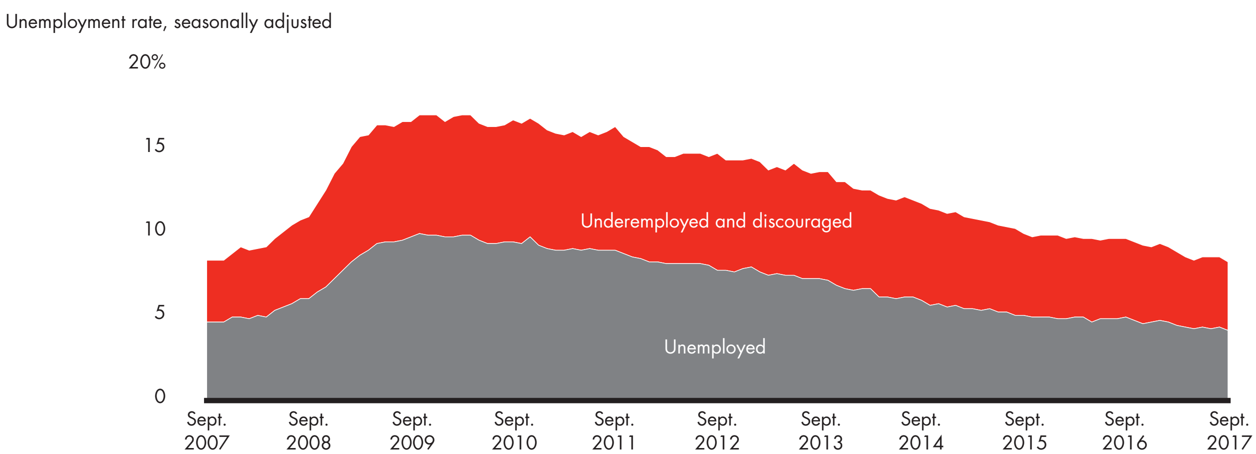
Notes: Data not seasonally adjusted; 2017 September sales estimated
Source: US Census Bureau

Exhibit 3: US housing market, January 2008–July 2017



Note: Indexed to 100 in January 2000, seasonally adjusted
Source: S&P Dow Jones Indices

Exhibit 4: Unemployment and underemployment rates, September 2007–September 2017



	Sept. 2007	Sept. 2008	Sept. 2009	Sept. 2010	Sept. 2011	Sept. 2012	Sept. 2013	Sept. 2014	Sept. 2015	Sept. 2016	Sept. 2017
Total unemployment YOY change (basis points)		260	570	10	–40	–160	–110	–190	–180	–30	–140
Reported unemployment YOY change (basis points)		140	370	–30	–50	–120	–50	–130	–90	–20	–70

Source: Bureau of Labor Statistics

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