After nearly two years of recession, we are starting to see signs of a turnaround. As we head into the holiday period, we expect negative growth trends to reverse, and are forecasting GAFO growth for the season of 0% to 1% over last year. Retailers are better prepared for the holidays than they were in 2008: Inventories are leaner, value trends are no surprise, and savvy marketers are basing decisions on the needs, wants and behaviors of local shoppers. The purpose of this newsletter is to provide relevant information about holiday sales trends and strategies for success in this critical period. Updates will be distributed every two to three weeks throughout the holiday season to help you monitor both trends and results as the season unfolds.

It’s hard to stick to a diet during the holidays

Holiday 2009 comes at the end of a tough year for retailers, and follows last year’s record-breaking holiday sales declines (Chart 1). We have been through one of the deepest and longest recessions in modern times, and many fundamentals in the economy remain weak. But there are a few encouraging indicators that are very apparent to consumers: The Dow Jones Industrial Average climbed over 10,000 this month, a level not seen since October of last year. Housing prices appear to be stabilizing, even showing modest increases for the first time since 2006. Household wealth was up in the second quarter. And consumer confidence and sentiment generally are trending upward.

All of this has translated into a modest improvement in retail sales. Although September GAFS\(^1\) growth was close to flat at −0.1%, that’s the best it’s been since August 2008, and it has many retailers expressing an optimism we haven’t heard for a while. We are forecasting GAFO growth of 0% to 1% over the holiday season (November-December). Other holiday forecasts range between −2% and +1%, although not all are directly comparable because they cover different periods and sector mixes (Chart 2).

\(^1\) See Chart A in the Appendix for definitions of GAFS and other sales measures.
**Chart 1:**

November and December GAFO* sales growth, 1968-2008

*1968-1978 annual growth rates shown are for GAF excluding miscellaneous shopping goods stores; 1979-1992 growth rates shown are for GAF; 1993-2008 growth rates shown are for GAFO; average difference between Nov-Dec growth rate for GAF and GAFO excluding miscellaneous shopping goods is 0.6 percentage points; average difference between GAF and GAFO is 0.4 percentage points.

Source: US Census Bureau

**Chart 2:**

Forecasted holiday sales growth, 2009

Note: GAFO forecasts are unadjusted; 2008 actuals are specific to each forecast; same-store sales are sales in stores that have been open for more than one year.

Source: International Council of Shopping Centers; Retail Forward; Deloitte; National Retail Federation; Bank of America-Merrill Lynch; Bain analysis
Of course 0% to 1% growth may not seem much to cheer about compared to historical averages. But compared to last year’s −5.3% growth, it is an encouraging sign. And 0% to 1% growth will keep us on par with the absolute GAFO spending levels we saw in the 2005 holiday season, at close to the peak of the housing bubble. This was also a profitable year for GAFO retailers, who netted an estimated $65 billion in operating profit in 2005, exceeding the $57 billion earned in 2007. This suggests ample opportunity to improve profits over last year’s levels.

Retailers are also better prepared for this holiday season. Many have taken entry price points lower to give price-conscious consumers more options. Savvy retailers are also localizing assortments and services, a strategy we’ve seen lift sales by 2 to 3 points. And to avoid the margin-eroding discounts that were needed to sell off last year’s excessive inventories, they are approaching this holiday season with leaner stock levels (Chart 3). This may present consumers with an interesting dilemma: If they hold out for the big discounts, will they miss out on what they want?

**Chart 3:**

Inventory as a percentage of sales, January-August 2007-2009

Note: Includes general merchandise, clothing and clothing accessories, furniture and home furnishings, and electronics and appliances

Source: US Census Bureau

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2 Based on US Census Bureau data for GAFO sales and operating expenses; 2005 operating expense data was not available and was estimated based on the percentage of sales observed in 2006 and 2007 (which differed by only 16 basis points)
Rays of sunshine are poking through the storm clouds

Bain & Company’s Macroeconomic Dashboard, a compilation of the 27 economic indicators that have been most reliable as a basis for economic forecasts, suggests the economy is getting back on track. For example, GDP contraction slowed to −0.7% in the second quarter of 2009, compared to −6.4% in the first quarter. Household wealth grew by $2 trillion in the second quarter of 2009, a first step toward recouping the $14 trillion lost during the recession. And the debt service ratio for households is falling.3

Although these signs suggest the crisis may have bottomed out, they are by no means a guarantee that the economy is bouncing back. That many of the economy’s fundamentals are still weak tells us that this will probably be a long, slow recovery. For example, default rates are expected to stay high, and banks remain hesitant to use increased liquidity to fund new loans. And credit markets are likely to remain tight as banks reassess risk and build Tier 1 capital.

Another fundamental, unemployment, is expected to continue climbing beyond 10% in 2010. What does this mean for retail? It means that many consumers will remain on shaky footing. But the good news is that unemployment does not have to return to “normal” levels before retail spending starts increasing. During the last three recessions, GAFO growth has recovered faster than unemployment (Chart 4). There is no single driver, though GAFO growth acceleration often coincides with the first signs of improvement in unemployment. Nevertheless, historical comparisons may not tell the whole story. Has the Great Recession changed consumer behaviors like never before?

Chart 4:

Employment and GAFO growth:
Months to recover to prerecession levels

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<th>Year</th>
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</thead>
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<td>1981</td>
<td>23</td>
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<td>6</td>
<td>47</td>
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</tbody>
</table>

Note: The employment bars show the number of months it has taken to recover the absolute number of jobs lost from the peak of employment; the GAFO bars show the number of months it has taken to get back to prerecessionary levels of GAFO monthly year-over-year growth

Source: Bureau of Labor Statistics; US Census Bureau

3 The household debt service ratio compares a household’s debt payments to its disposable personal income.
Shoppers will shop, but what (if anything) will they buy?

Despite glimmers of good economic news, most shoppers this holiday season will still have to make choices. Although the implications of this will vary by sector, retailer and category, clearly retail sales growth this holiday season will be tempered by consumers’ readiness to spend, ability to spend, and buying choices.

Over the last two months, Bain has worked with Communispace, a market research company that builds and runs online consumer communities, to better understand how consumers are feeling and what they are thinking about shopping this season.4

Are consumers ready to spend?

Most consumers have been holding back for almost two years: trading down, postponing purchases or eliminating them altogether. Many consumers have chosen to save more: The US savings rate is currently nearing 5%, up from just over 1% in early 2008, largely in response to tighter credit and the worry engendered by the recession. And some have been paying down debt: Total household debt is down slightly to $13.7 trillion from its peak of $13.9 trillion. Our Communispace panelists are no different. Approximately three-quarters of them indicate that they have been tightening their belts in some way.

Panelists who have cut back fall into two groups. Roughly two-thirds of them say that consumption is out and conservation is in. These consumers have adjusted to their new, more conservative shopping habits and are feeling good about it. One panelist summed up this segment’s feelings this way: “I do feel good about myself learning to conserve and not shop quite as much.” And another added: “I am a believer in being conservative and preserving natural resources. Being less wasteful and more mindful of spending has been positive for me personally.”

The other third, however, are unhappy that they have had to give up things that they enjoy. They are suffering from what some are calling “frugal fatigue” and are itching to break their shopping diets. As one panelist explained: “I am ready to shop and give to others. I’m glad to do it, and somehow, some way, I’m going to come up with some extra holiday money. I am so sick and tired of cutting back. This holiday I’m letting go!” Added another panelist: “[I am] excited, happy and ready to shop!”

Are consumers able to spend?

Even if consumers would like to spend, many will not be able to spend as much as they’d like. Not surprisingly, our research indicates that consumers feel less financially secure than they did before the recession. In one of our recent Communispace surveys, we asked consumers to select from a variety of images to explain how they are feeling financially heading into the holidays. Over 60% of consumers selected images that reflect a lack of

4 A Communispace community, or panel, is a private online site where up to 400 invited prospects and customers regularly spend time brainstorming, sharing feelings and experiences, and discussing trends to help a company figure out its marketing and business strategies. These private communities are facilitated by Communispace to keep the “conversation” relevant and insightful.
money and concern about bills (shown here), up from just over 40% heading into the holidays two years ago. As one of our panelists explained: “I would love to give everyone on my list something wonderful, but I cannot afford a huge Christmas bill since we are not putting any gifts on credit cards this year.”

Bain’s Consumer Spending Model shows the largest drivers of consumer spending to be jobs, wages, wealth, credit, savings, and taxes. The good news: Wealth is starting to recover as housing prices and the stock market climb. And while tax increases are expected, they will be most noticed by the wealthy and likely not until the New Year. However, unemployment remains high and continues to increase, and credit is still extremely tight.

We examined the impact of each of these drivers on different demographic and psychographic segments. For example, young families and baby boomers, historically the two largest spending groups in retail, have been hardest hit by the downturn, and are least likely to return to previous spending habits in the near term. As a panelist in his 40s told us: “Why should I keep giving my hard-earned money away? I need to save for the future.” Many young adult consumers, although affected by the downturn, have had an easier time of it. As one young panelist explained: “I’m having to decide what’s most important to me. . . . But I’m still willing to spend a little more to get good quality.”

Retailers have limited influence on unemployment, wealth and taxes, but some are looking to help consumers tap credit or find alternatives. For credit, retailers continue to promote store credit cards, frequently offering initial purchase discounts for signing up. As for alternatives, we’ve seen an increase in the number of layaway programs this year, often backed by significant advertising support. Sears and Kmart brought this tool back last year, and this year they are being joined by retailers like Toys “R” Us, Burlington Coat Factory, T. J. Maxx and Marshalls.

How are consumers choosing what to buy?
There have been headlines galore about the “flight to value.” Consumers have grown accustomed to deep discounts. Holding out for bigger and better deals, comparison shopping and using coupons have become commonplace, even fashionable. Although the jury is still out on the long-term impact of the value trend, retailers can expect a focus on value this holiday season.

For some consumers, value will always be about price. A number of retailers have responded to this by adjusting assortments toward lower price points. For example, average prices at Nordstrom were down 10% in the first two quarters of 2009 through an expansion of its entry-level offerings. And this summer Container Store permanently lowered prices by 16% on one-tenth of its stock. Even Neiman Marcus has jumped on the bandwagon: Close to 50% of the items in its fantasy catalog this year are priced under $250, compared with only about 30% to 40% in each of the past five years. Others have responded by highlighting lower prices for the holidays. Walmart, for one, has announced plans to cut prices each week on thousands of items through the holidays. We expect to see other companies offering aggressive holiday price promotions as well, but not to the extent seen last year due to retailers’ leaner inventory positions.
For other consumers, value has more to do with quality for the price. After resorting to 70% discounts last year, Saks has slashed its stock levels by 20% this season. The company’s CEO, Steve Sadove, recently said that the upscale retail chain would not be discounting as steeply as it did last holiday season: “That’s what luxury retailing is about—limited distribution (and) limited availability.” And of course many consumers will continue to line up for the innovative new products such as the iPhone or the latest Nike footwear technology.

Some consumers will continue to prioritize the shopping experience. A number of fashion retailers are using marketing events to lure shoppers in and entertain them. Macy’s Shoe Diva events, for example, offer shoppers the opportunity to buy their shoes while listening to a DJ, getting fake tattoos or having their fortunes told. And the Event Marketing Institute estimates that almost half of the shoppers that turn out for such events end up purchasing sponsored products. Walmart’s Project Impact—which improves the “shopability” of its stores by clearing the aisles to create a more upscale feel—also focuses on the shopping experience in hope of converting consumers who trialed the chain during the downturn into loyal shoppers. Key to this is its Win, Play, Show merchandising strategy, which shrinks lower priority categories while expanding those with the greatest opportunity for profitable growth. Although some of these changes have the potential to hurt sales as well, Walmart says it is pleased with results. And of course the chain continues to push its price leadership. Other retailers are taking advantage of vacant retail space and using pop-up stores to create a buzz around the experience. Rachel Roy opened a pop-up store in SoHo to highlight the launch of her Rachel Rachel Roy diffusion line during Vogue’s Fashion’s Night Out. And American Eagle Outfitters recently opened a 77kids pop-up store, the first time that the online 77kids brand will be available in a brick-and-mortar store . . . but only for 77 days.

Convenience will continue to be the key for some shoppers, and retailers are upgrading their multichannel offerings as one way to address this. The combination of reduced in-store inventories and a growing propensity to comparison-shop is pushing more and more consumers to shop online. A recent survey of multichannel shoppers found that 26% of them are planning to purchase more gifts online this holiday season, up from 21% last year. Some retailers are doing more to integrate their websites with their stores, such as enabling consumers to check store stock online. And though not a new feature, some retailers have been adding “buy online, pick up in store” functionality to make shopping more convenient for consumers. Once common mostly among big-box retailers like Walmart, Sears, and Best Buy, even upscale retailer Nordstrom added in-store pickup last year. Best Buy is adding to the convenience by reserving several parking spaces for customers who are picking up merchandise ordered online.

Some pockets of spending are more open than others

Year-to-date GAFO sales have dropped a total of 4.4% over last year. Monthly sales growth lagged last year’s levels every month until September, when GAFO growth came in almost flat, at −0.1% (Chart 5). Some sectors of GAFO have been hit harder than others (Chart 6), and there will be plenty of differences in sales results this holiday season. Some segments have dropped for cyclical reasons and are more likely to see a
bounce back driven by pent-up demand. Others may have experienced more structural shift and will continue to see sluggish sales growth.

**Chart 5:**

Change in YOY January-September GAFO, 2007-2009

- 2007 average
- 2008 average
- 2009 average

Note: September data based on advance GAFO
Source: US Census Bureau

**Chart 6:**

Absolute GAFO Changes, 2007 versus 2009
(12-months ended September)

Note: Data for the office supplies sector are 12-months ended August; the September 2009 data are not yet available
Source: US Census Bureau
The furniture and home furnishings segment has been hardest hit over the last two years, both in terms of absolute sales, which were down approximately $21 billion since 2007, and in terms of the percentage drop (see Chart 6). These sharp declines, which were precipitated by the collapse of the housing market, slowed significantly in September—likely in response to news that home values were stabilizing and to home sales spurred by tax credits for first-time home buyers. And because durables purchases are often deferred rather than diminished, the end of the recession may spark some pent-up furniture shopping.

The clothing and clothing accessories segment has lost approximately $14 billion in total sales during the recession. But comparable store sales are stabilizing, and the segment also fared relatively well last month, dropping just 0.4% year over year, compared to an abrupt drop of 4.8% in September 2008. Still, we continue to expect a wide disparity of results within the segment, as shoppers seek out retailers with on-trend fashion at the right price.

Electronics and appliance stores, the third worst sector in terms of absolute sales dollars lost, have dropped a total of approximately $7 billion in sales since 2007. This sector is also continuing to show the steepest declines in monthly year-over-year growth as consumers are still delaying, reducing or eliminating discretionary purchases. Further, there are few attention-grabbing new products to excite consumers this holiday season. And while some retailers in this segment may post strong holiday results, Circuit City’s liquidation will send substantial sales from this channel to general merchandise stores, dragging down the growth of electronics and appliances stores.

Although sales in the general merchandise segment have been down slightly in the last year, the sector is still up approximately $20 billion since 2007. Growth rates turned positive again for this segment in September. We anticipate holiday traffic to be healthy for general merchandise stores, but only time will tell how pricing strategies and inventory investments translate into growth. Still, even modest growth in this very large segment over the holidays would provide a significant boost to overall GAFO (general merchandise accounts for over half of overall GAFO sales).

Let the holidays begin!

There is no doubt this is going to be an exciting holiday season. Retailers are entering it much better-prepared than last year. And consumers, though still battered by the recession, are beginning to emerge and spend. With forecasted growth of 0% to 1%, this season brings with it the possibility of establishing a more solid platform for 2010 growth, if retailers manage it smartly. We will continue to report on those retailers who are succeeding and to examine the practices that are most important in driving their success.
Newsletter schedule

Our next newsletter will be released in mid-November, with a new issue roughly every two to three weeks after that 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 need additional analysis.

Chart 7:

Indicator and forecast update schedule

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## Appendix

### Chart A:

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Source: US Census Bureau; analyst reports
Selected References

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Carpenter, Susan. “Out and About; Party while you shop; Retailers large and small are bringing in customers with in-store events: cocktail nights, art shows and movie screenings.” Los Angeles Times (http://www.latimes.com/features/image/la-ig-shoputainment18-2009oct18,0,2481333.story), October 18, 2009.


