January 17, 2012

Holiday review and a look ahead to 2012

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

Holiday sales gave the retail industry a bit of cheer but also reason for concern. GAFO sales grew 3.5% to $251.3 billion, just short of the all-time record of $251.7 billion set in 2007.[1] *E-commerce sales led the season with 15% growth. Still, despite stronger-than-expected holiday sales in 2011, retailers face many challenges in the new year. We wrap up our series of holiday newsletters with a look ahead at the retail outlook for 2012 and at 10 strategic imperatives for success.*

Last-minute spending helped the holiday season beat expectations

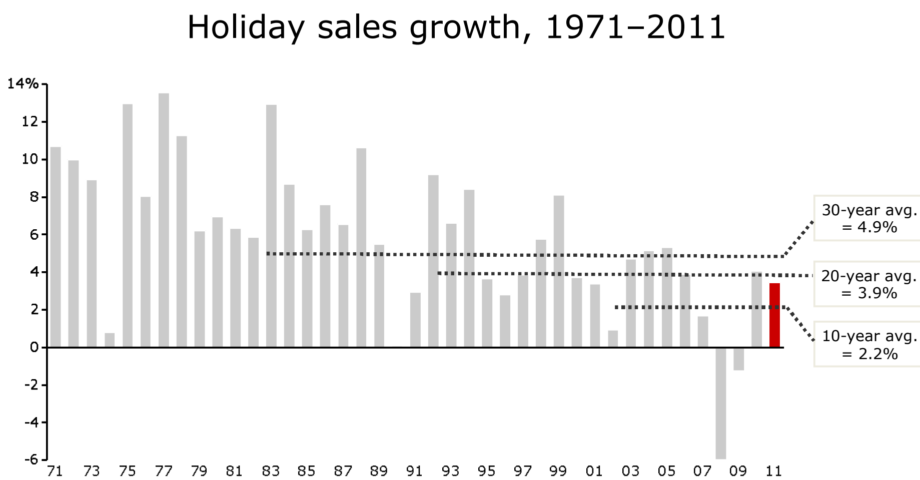
Total sales for November and December were up 3.5% over last year, significantly beating the 10-year average of 2.2% and even topping Bain's forecast of 3% (*Chart 1*). Holiday GAFO sales of $251.3 billion almost matched the 2007 prerecession peak of $251.7 billion (C*hart 2*). For the full year, GAFO sales were up 3.6% in 2011, reaching $1,173 billion and surpassing the 2007 peak of $1,149 billion.

A strong end to December capped this year's growth. According to ShopperTrak, in-store GAFO sales the week before Christmas rose 14.8% over last year, thanks in part to a Saturday Christmas Eve. All together, GAFS sales were up 3.6% in December.

E-commerce sales grew 15% during the holiday season, as Bain predicted. Consumers spent an unprecedented $37.2 billion online during November and December, including a record 10 days with online sales of more than $1 billion per day. Mobile devices played an increasingly important role: E-commerce consultant ChannelAdvisor reported that 10% of its clients' online holiday sales came through smartphones and tablets, more than double last year's rate.

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

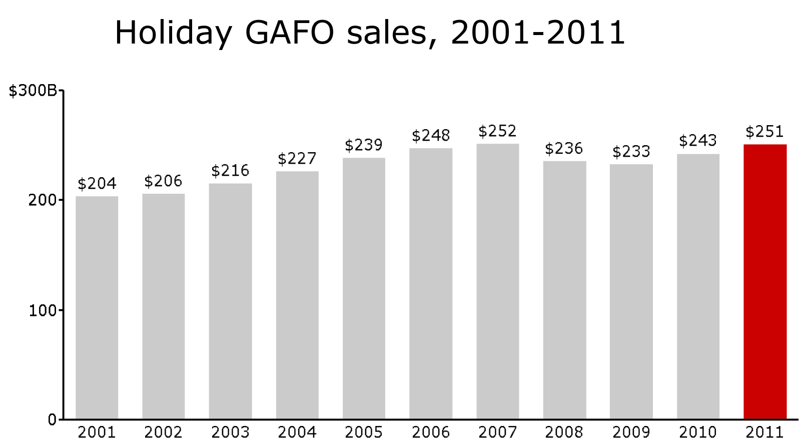
Chart 1:



Note: *Holiday* is defined as November and December; growth rates are based on the most comparable data available by time; 1971–1978 growth rates are for GAF sales excluding miscellaneous shopping goods; 1979–1992 growth rates are for GAF sales; 1993–2010 growth rates are for GAFO sales; the 2011 growth rate was calculated using growth rates for November GAFO and December GAFS sales

Source: US Census Bureau

Chart 2:



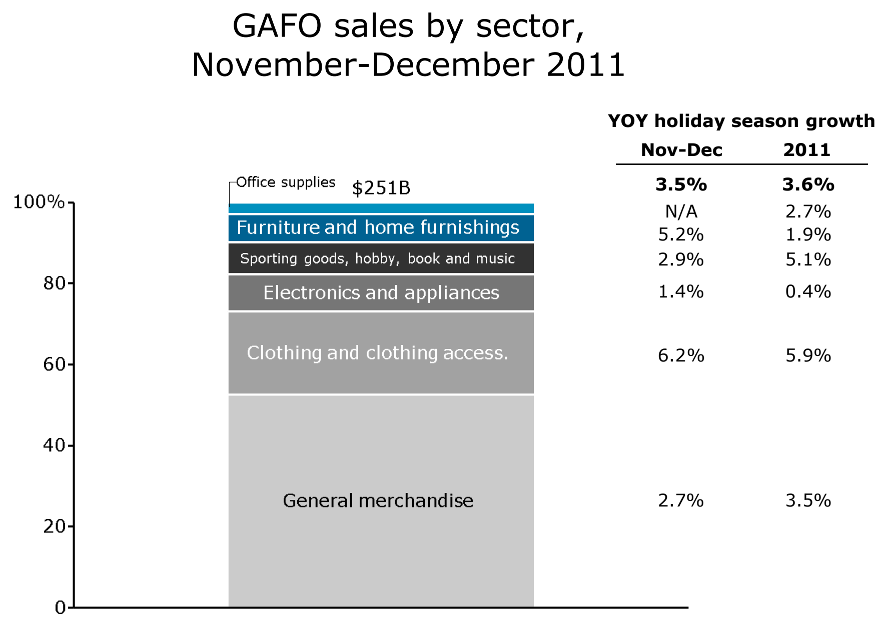
Year-over-year change:	3.2%	1.0%	4.6%	5.1%	5.5%	3.6%	1.6%	-6.1%	-1.3%	4.1%	3.5%

Note: *Holiday* is defined as November and December; the 2011 growth rate was calculated with November GAFO and December GAFS sales for both 2010 and 2011

Source: US Census Bureau

Apparel and furniture and home furnishings stores led holiday sales growth (*Chart 3*). Clothing and clothing accessories stores saw moderate sales growth in November; that growth rate doubled in December, finishing with an impressive rate of 6.2% for the season. Furniture and home furnishings stores also picked up steam in December, posting 5.2% growth for the season. Sales at general merchandise stores, which account for more than half of GAFO sales, grew by just 2.7%. Electronics and appliances stores, which saw decent growth of 4% in November, limped through December with a mild reduction in sales and finished the season with only 1.4% growth, the lowest of all GAFO categories.

Chart 3:



Note: December data are based on advanced data published January 12, 2012; office supplies data for December have not yet been released; the chart assumes office supplies will grow at the same rate as GAFS sales in December

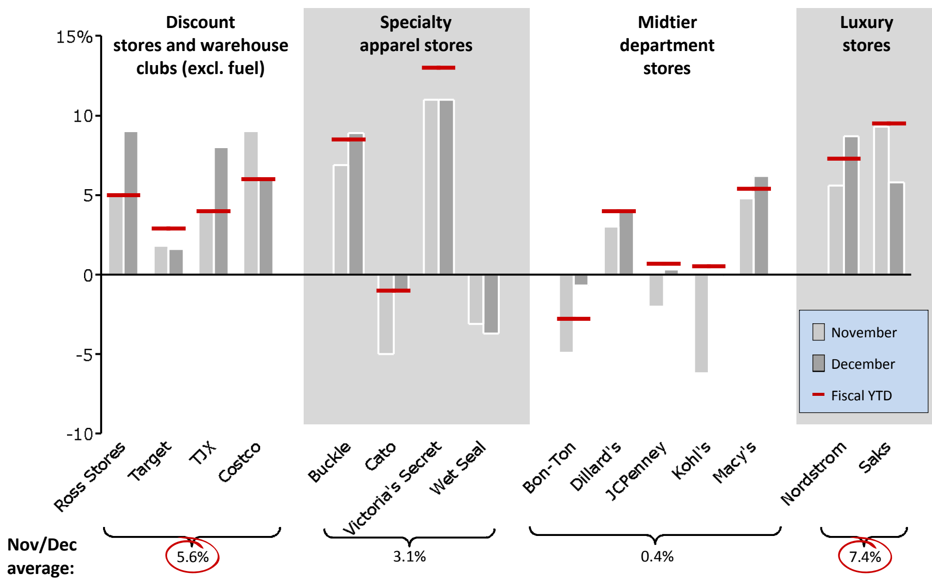
Source: US Census Bureau

Some retailers are cheering their holiday results more than others. Among broadline retailers reporting monthly same-store sales results, luxury and discount retailers tended to outperform their midtier counterparts this holiday season (*Chart 4*). Of course, every general rule has important exceptions. Macy's ended a solid year with an impressive holiday season, while Target finished below expectations. Specialty apparel retailers delivered mixed results: Victoria's Secret and Buckle posted impressive growth, while Cato and Wet Seal posted declines this holiday period. Underperforming retailers have offered several explanations for disappointing sales, including warm weather that depressed sales of winter clothing. In a holiday season filled with aggressive promotions, varying discount practices likely contributed to differences in performance as well. Shoppers opened their wallets for big discounts around Black Friday and at the end of the holiday season, but spent less whenever there was a lull in deals.

Strong sales are great, but profits and returns on invested capital are equally vital. We will not know the full story until retailers begin reporting earnings in February, but American Eagle, Target, Kohl's and JCPenney all have lowered their fourth-quarter profit forecasts since the end of the holiday season. Several retailers likely will enter 2012 with lower profits than they envisioned on their holiday wish lists.

Chart 4:

Year-over-year growth in same-store sales, November-December 2011 and fiscal year to date



Note: Fiscal year to date includes sales through December; Wet Seal does not report YTD same-store sales; Costco includes US stores only; Target, Costco, Dillard's, JCPenney, Kohl's, Macy's, Nordstrom and Saks include online sales in their same-store sales; the fiscal year ends in August for Costco and in January for all of the others

Source: Financo

What to expect in 2012

Relatively weak economic indicators raise concern about a spending "hangover" heading into the new year. Consensus forecasts suggest that real GDP will grow by only 2.2% in 2012, and Bain expects significant pressure on discretionary spending through at least the first half of the year. The National Retail Federation is forecasting retail sales in the United States for all categories except gasoline, automobiles and restaurants will grow by 3.4% this year, slower than the 4.7% growth in 2011. A number of factors are influencing the consumer-spending outlook:

> *Disposable personal income remains stagnant, with virtually no growth since March.* Adjusted for inflation, disposable personal income dropped steadily over 2011 back to mid-2010 levels. It remains nearly 2% below the prerecession peak reached in the fourth quarter of 2007.

Consumers are saving less of their income. With savings down (and earning power slipping), consumers have smaller nest eggs to tap into and larger debt burdens to pay off. The November personal savings rate of 3.5%, down from recession rates of about 6%, was the lowest in nearly four years. This drop suggests that consumers were eager to spend over the holidays but were unable to sustain their splurge without dipping into savings.

Holiday spending was "charged." Consumers relied on debt to finance much of their holiday spending: Auto loan, student loan and credit card borrowing spiked by $20.4 billion from October to November, the biggest monthly surge in a decade. By comparison, consumer debt increased by only $2.5 billion between October and November 2010. Consumers continued to use plastic through December, which saw 6.9% growth in dollar volume on credit cards over the same month last year. This level of spending on credit is not sustainable, which means some consumers are likely to start 2012 by cutting back to pay down accumulated debts.

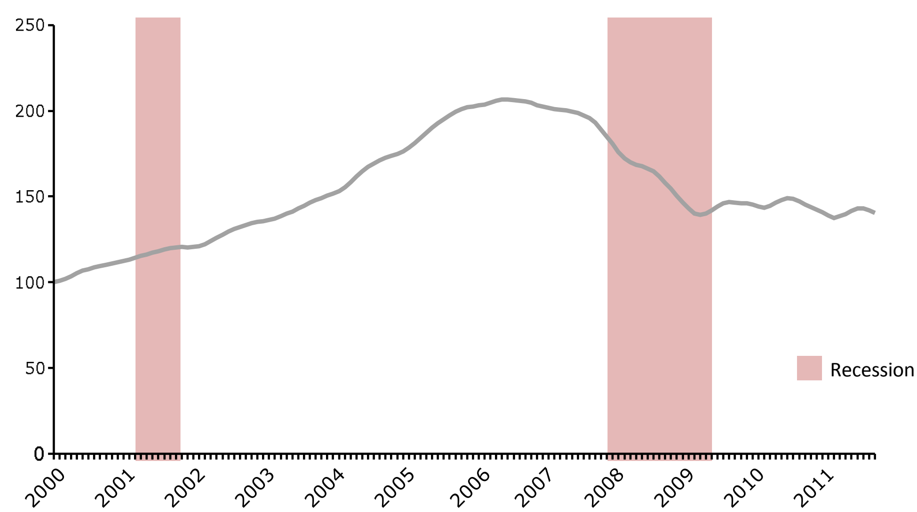
Although edging down, unemployment remains high. The unemployment rate in December was 8.5%, down slightly from November. The economy added 200,000 jobs during the month, but many of those jobs were seasonal: About 28,000 of them were in retail, and another 42,000 represented courier and messenger work for employers like FedEx. A bigger-than-expected uptick in jobless claims for the first week of 2012 suggests that strong seasonal hiring has given way to seasonal layoffs after the holidays. There are still 6 million fewer jobs in the country than there were at the prerecession peak, and the number of Americans who have been unemployed for more than six months remains at around 5.6 million. In addition, whereas fully 60% of the jobs lost during the recession were in midwage occupations, the recovery has seen low-wage jobs grow significantly faster than midwage jobs, implying that earning power is likely weaker than employment figures suggest. Recent drops in unemployment indicate the labor market at least is leveling off; but without continued and substantial improvements in the labor market, consumer spending likely will remain constrained in 2012.

The cost of living continues to rise. Essentials such as food, gas and health care are all becoming more expensive, leaving consumers fewer dollars to spend on other purchases. The Department of Agriculture expects food prices to rise 2.5% to 3.5% in 2012, above the expected inflation rate of around 2%. The national average price of $3.299 per gallon of gasoline at the start of 2012 was $.293 higher than 2011's record-setting start—and geopolitical developments in the Middle East could threaten supplies and send prices and volatility skyrocketing. The Centers for Medicare & Medicaid Services forecasts health care spending will grow 5.8% a year through 2020, a rate far above expectations for GDP and income growth.

Housing prices show no signs of rebounding. The S&P/Case-Shiller 20-City Composite Home Price Index decreased by more than 1% in October from the previous month (*Chart 5*). More than 22% of all homes with mortgages nationwide were worth less than their outstanding balance in the third quarter of 2011, a situation that is unlikely to have improved in the fourth quarter given the stagnant market. Weakness in the housing market limits homeowners' confidence in their ability to spend; it also limits the availability of home equity lines of credit. This problem disproportionately affects certain regions of the country, with former boom states like Florida, Arizona and Nevada the hardest hit. Housing prices may finally be nearing bottom—November housing starts rose to the highest level since April 2010—but Bain does not expect the market to fully recover any time soon.

<u>Chart 5:</u>

S&P/Case-Shiller 20-City Composite Home Price Index, January 2000–October 2011



Source: Standard & Poor's

Consumer sentiment remains pessimistic even after upticks in recent months. The Consumer Confidence Index increased to 64.5 in December from 55.2 in November (which saw a 15-point increase over October), but the index is still well below its 96.9 average in the five years before the recession.

Government policies create additional uncertainty. The upcoming elections in the United States add ambiguity to long-term decisions. Federal Reserve policy is another source of uncertainty: The Fed could implement a third round of quantitative easing and provide a monetary boost to the economy, but it has not announced any intention to do so. And then there is the situation in Europe. Though improbable, if government leaders are not able to stabilize the euro crisis, there could be additional pressure on the United States equity market and consumer confidence.

These shaky economic fundamentals likely will dampen discretionary spending as we enter 2012. Retailers will be competing for pieces of a pie that simply will not be big enough to satisfy everyone. Slashing prices worked for some retailers this holiday season, but they will need more-innovative strategies to continue attracting customers and their dollars in 2012 and beyond.

Top 10 imperatives for retailers in 2012

Economic uncertainty, digital disruptions, increased price competition and more-complex consumer pathways are just a few of the realities facing retailers this year. Knowing where to focus, building the right capabilities to execute and transforming strategy into action will separate winners from losers. Here are Bain's top 10 imperatives for retailers in 2012:

1. Build the best of both (digital and physical) worlds.
2. Make it easy for customers to feel better informed.
3. Be more than a brand aggregator.
4. Get personal.
5. Combine art with science.
6. Transition the store portfolio to the future.
7. Learn to cross the border.
8. Explore alliances and acquisitions.
9. Up the innovation ante.
10. Build a team to support the strategy.

1. Build the best of both (digital and physical) worlds

Digital retailing is the most dramatic change to hit the retail industry in the last 50 years. E-commerce sales are approaching $200 billion annually in the United States and eventually are expected to reach 15% to 20% of global retail sales. Online players like Amazon.com and eBay.com and new competitors like Facebook and Google are dramatically shifting industry profit pools.[2]

Digital technology is also revolutionizing in-store shopping experiences via mobile apps for product search and price checks, mobile check-out and payments, digital walls to showcase full product assortments, integrated online and in-store inventories and more. In stark contrast to online retailers, many traditional brick-and-mortar retailers face declining foot traffic, sagging sales and restrictive long-term leases. But it doesn't have to be that way.

Now what?

> *Take a "pulse check" by understanding digital density.* Digital players are especially menacing in product categories with high "digital density"—with price,

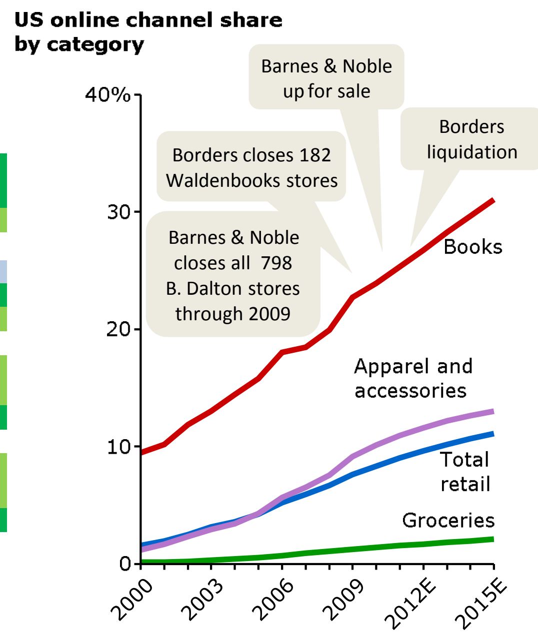
[2] Facebook is leveraging its 750-million-person network to establish its own e-commerce platform. Google offers local deals and electronic wallet capabilities, and is reportedly in discussions with major retailers and couriers to develop an online service that would deliver purchases within 24 hours.

selection, convenience and trust attributes that lend themselves to high online channel share (*Chart 6*). Knowing one's digital density and understanding where both digital and traditional competitors are heading are the first steps to prioritizing actions.

Chart 6:

Drivers of digital density and
US online channel share by category
(1 = low, 5 = high)

	Books	Apparel and Accessories	Groceries
Price			
Prices often lower online (delivered)	5	3	1
Lower-cost digitized products	5	1	1
Value of price comparisons	5	3	2
Selection			
Value of broad assortments	5	4	3
Value of customization	2	3	1
Futile searches in store	4	3	2
Convenience			
Research and information intensity	5	3	2
Web tools that trump store experience	4	2	2
Ease of delivery and returns	5	3	1
Trust			
Reliability of product descriptions	5	2	2
Frustrations with physical stores	4	4	2
Trust in online retailers	5	3	1
Total	**54**	**34**	**20**



Turn stores from liabilities to assets. Traditional retailers have an asset that pure digital players do not: physical stores. The key is to create a compelling in-store experience that customers value more than the equivalent online experience. For example, fast fashion players like Forever 21 keep customers coming back by offering daily new product flows and fashion items that will not be replenished, driving visits and creating a "buy it now" mindset. Shoppers in the United States visit department stores an average of three to four times a year, but that number jumps to one to two visits per month for fast fashion players.

Adjusting inventory freshness is not the only step that retailers can take to make the physical store experience more compelling than the online experience. Creative merchandising to suggest product combinations and bundles, personalized service and advice and locally-available inventory delivering "instant" gratification are all reasons for consumers to visit stores. Dynamic and interactive retail spaces also draw crowds: Bass Pro Shops offers restaurants, workshops, aquariums, waterfalls and even climbing walls. Shop online—pick up in-store, tailored offerings, easy returns and personalized service (more on that later) are just a few of the tactics retailers are using to help turn stores back into strategic weapons.

Identify and use the right metrics. Leading retailers have to rethink the tools they use to evaluate operational success in an omnichannel world. Relevant score-cards can help retailers track success beyond traditional measures like sales per square foot. Some non-traditional measures include sales through smartphones and tablets, percentage of customers shopping in more than one channel, Net Promoter® Score by channel, Customer Service complaints, percentage of online orders fulfilled, percentage of sales to registered users and growth in the number of registered users and the e-mail distribution list.[3]

2. *Make it easy for customers to feel better informed*

The prolonged economic downturn has turned more consumers into value shoppers – shoppers who search for coupons, visit multiple stores in person or on the web to check prices and tap trusted friends for input on major purchases. And digital technology has made it easier and faster to be a value shopper. Consumers are using digital search engines to check inventory at local stores, scan for better services and compare prices. Winning retailers will embrace this reality and help customers feel smart and well informed about their purchases on price and other dimensions.

Now what?

Understand new consumer pathways and pain points. Consumers routinely jump across channels to do their shopping, looking for convenience, deals and speed. Understanding how and where target segments interact with one's brand—what delights and what frustrates—can help prioritize investments. Key to that understanding are robust closed-loop feedback mechanisms, mechanisms that (1) Solicit feedback from customers including loyalty measures like Net Promoter® Score, (2) Share that feedback with relevant employees and (3) Identify the root cause of any issues. The goal is twofold: to fix problems for individual customers and, simultaneously, to identify and address systemic issues. Macy's is one retailer that uses a closed-loop feedback process, reaching out to select customers to collect input for use in strategic decision making.

Offer value that builds loyalty and closes the sale. Retailers have a choice: Keep lowering prices to satisfy the growing demand for bargains, or offer value that encourages deal hunters to pause – and ultimately pay. Among the innovative approaches retailers have recently rolled out are the following:

---

[3] Net Promoter® Score is measured as the percentage of promoters minus the percentage of detractors. Consumers are asked how likely they are on a scale from 0 to 10 to recommend a brand to a friend or colleague. Promoters rate their likelihood a 9 or 10; detractors rate their likelihood a 6 or lower. Net Promoter® is a registered trademark of Bain & Co., Inc., Fred Reichheld and Satmetrix Systems, Inc. (www.netpromotersystem.com).

- *Awareness*: Zappos.com has produced more than 50,000 short videos of their staff members talking about shoes for sale on the site. The company's tests show that purchases of a shoe increase 10% when a video is included in the product description.
- *Purchase*: Nordstrom has lowered online purchase barriers with everyday free shipping and returns. The Home Depot is piloting mobile in-store payment with PayPal. Customers can pay simply by entering their phone number and PIN at checkout. Over the holidays a number of retailers, including hhgregg and Walmart, gave customers the option to buy online and pick up at a store the same day.
- *Use*: Estee Lauder's website offers how-to videos on makeup application and occasion-based makeup recommendations. Sephora's iPad app features innovative "follow along" videos on how to apply makeup. The "Lowe's on the Go" iPhone app offers images of decorated rooms for inspiration and plays how-to videos to make home improvement projects simpler.
- *Service*: The employees who staff Zappos.com's customer service Twitter account help customers track down items Zappos.com doesn't stock. While the goal isn't an immediate sale, the company understands that delivering a "WOW" experience keeps customers coming back.
- *Feedback*: My Starbucks Idea (http://mystarbucksidea.force.com/) is a website where customers can suggest and vote on ideas for the chain. Last year Starbucks implemented 70 ideas, including the Mocha Coconut Frappuccino and eGifting.
- *Retention*: Through its Angel and Angel VIP credit cards, Victoria's Secret offers $10 rewards for every $250 spent, birthday gifts, invitation-only access to events, first access to sales and more—and builds customer loyalty.

3. Be more than a brand aggregator

Customers have a seemingly unlimited number of shopping options, and simply offering them popular brands in undifferentiated environments is a recipe for price wars. The ease with which customers can comparison-shop and order from physical or digital competitors—even while in a brick-and-mortar store—places retailers at risk. Adding to that risk are vendors that are boosting investment in their own direct-to-consumer capabilities, further disintermediating the relationship between traditional retailers and customers. True Religion is increasingly selling its apparel through its higher-margin direct-to-consumer channel, growing its retail store count and attributing more than half of the brand's revenue to its US Consumer Direct business.

Now what?

> *Offer proprietary products.* Customers are drawn to stores with exclusive brands they value, brands like Whole Foods' 365 Everyday Value and Macy's INC International Concepts. Limited-time product offerings and designer collaborations—the Jennifer Lopez Collection at Kohl's or Mary-Kate and Ashley Olsen's Olsenboye line at JCPenney, for example—give customers a reason to buy from a specific retailer.

Provide valuable services and advice. Beyond product differentiation, retailers can use service and advice to stand out from the crowd. J.Crew offers complimentary personal shopping to everyone and free alterations to store credit card holders. At Apple's in-store Genius Bar, customers can get expert troubleshooting advice, technical support and repair services. Pottery Barn's Design Studio Specialists make complimentary house calls and personalized suggestions for decorating and entertaining. Good service and advice build loyalty and trust between the retailer and shoppers and help close sales.

4. *Get personal*

Retailers are bombarding shoppers with more marketing communications than ever before. Responsys reports that e-mail volume from major retailers hit an all-time high in 2011: 177 promotional e-mails sent per subscriber, up 16% over 2010. Tweets and Facebook messages from dozens of different retailers add to the communication overload. Ways for retailers to cut through the clutter and make their messages relevant include targeted messaging, curated assortments, recommendations and value-added services.

Now what?

Treat customers with familiarity, but be respectful of personal data. Everyone likes to feel special, but no one wants to feel exposed. Personalizing outreach based on prior shopping behavior helps Totes Isotoner close online sales. When customers frequently browse umbrellas on the Totes Isotoner site, the company follows up with a targeted e-mail about umbrellas, a move that increased its e-mail-driven revenue by 7,000% over a 14-month period. At the same time, it is important to be respectful when using customer data. Select US malls recently began tracking shoppers' movements from store to store via their cell phones, but soon stopped after the public and Senator Charles Schumer (D-NY) voiced privacy concerns.

Support customer individuality. Some retailers allow customers to design one-of-a-kind products. Reebok, Nike, Vans, Converse and New Balance offer custom footwear; Threadless asks for T-shirt designs; and Zazzle enables customers to personalize everything from skateboards to iPhone cases. Mass customization isn't a model for all markets, but finding economic ways to tailor products to individual consumers can be a strong differentiator.

Localize to neighborhood customers. Shoppers at stores just miles apart can have vastly different demographic profiles and shopping preferences. Savvy retailers are tailoring merchandise assortments and services within like trading areas. Macy's My Macy's initiative stocks dressy hats in areas with church-attending populations, while stores in Florida are more likely to carry light-colored linen clothing. Other retailers make items relevant by identifying local products. And eBay.com's Local Shopping tool helps consumers find what they're looking for in nearby stores.

5. *Combine art with science*

So much data, so little action. Online, social and mobile channels as well as loyalty programs and inventory systems give retailers an unprecedented amount of information that can be mined to improve assortments, allocations, services and margins. But weeding through the data and then acting on the insights collected pose enormous challenges. Science and business analytics are key, and so is the art of interpretation.

Now what?

> *Raise the role of business analytics.* Business analytics aren't just academic. Smart analysis and actionable algorithms can improve the processes of forecasting demand, managing pricing guidelines and identifying trends. Target increased its sales and gross margin by partnering with DemandTec, employing an analytical approach to optimizing merchandising decisions on range and price. And Belk worked with Oracle to improve sell-through of seasonal goods, manage margins and help performance across its department stores. Technology can help, but prioritizing action typically takes well-trained analysts on the team.
>
> *Filter data to discover useful insights.* Connecting the dots between sales results and formal surveys, click-through rates, e-mail responses, store feedback and social network chatter can generate new ideas like never before. Consumers are posting their purchase and lifestyle preferences—their favorite books, their travel choices—with unprecedented speed and frequency. Online flash-sale retailer Fab.com collects shoppers' "faves," the products they like most, and uses that information to make relevant product recommendations. Customers also are weighing in with their opinions. Walmart, Sears and Quidsi (recently acquired by Amazon.com) are just a few of the retailers who used customer feedback on items they purchased to make product and merchandising decisions during the 2011 holiday season.

6. *Transition the store portfolio to the future*

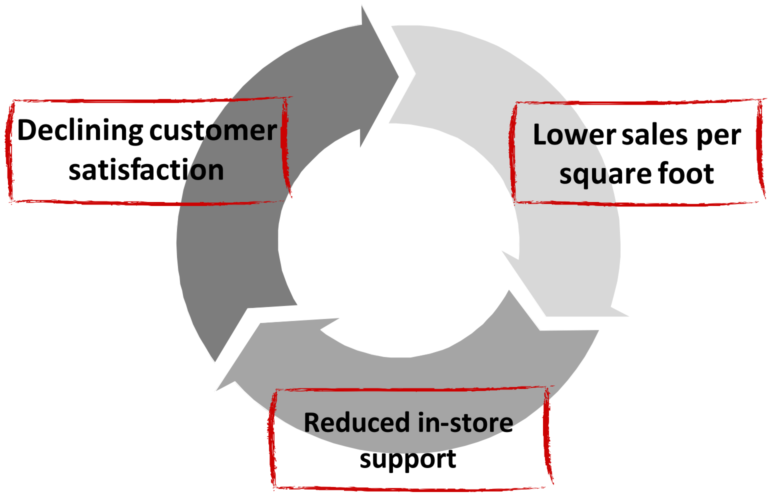
Store traffic is on the decline. Bain recently partnered with ShopperTrak to understand changes in foot traffic and found overall traffic was down 3.8% in 2011.[4] Shoppers went to an average of four to five stores per trip in 2008 but only three in 2011. Fueling this trend are increases in online research and shopping; but diminished store experience is adding to the fire. Many retailers have stumbled into a "doom loop" (*Chart 7*). As store productivity dips, retailers look to reduce costs. A prime target is store labor and other support, but cutbacks here can worsen the in-store experience. It's no surprise, then, that more consumers turn to online shopping, which further lowers store productivity. Some retailers respond by shutting down stores; many others struggle to balance unprofitable doors linked to long-term leases. Since the recession, mall vacancy rates have hovered

[4] ShopperTrak (www.shoppertrak.com) provides a 24/7 managed service that counts the number of shoppers entering and exiting retail stores in 40,000 locations in 72 countries. ShopperTrak's daily retail foot traffic analytics help set strategies for shopper conversion, store labor scheduling and marketing.

around 9.4%, an 11-year high. Neighborhood and community shopping centers face an even higher rate of 11%.

Chart 7:

The store experience doom loop



Now what?

Face the facts about the future. Retailers routinely open and close stores, but 2012 is a time to candidly evaluate economic trends. Although it is natural to want to fix the problems of failing stores, efforts to do so can slow investment in strengths. Some stores are fixable, while others are in locations that will never rebound. Doing the appropriate analysis and making hard decisions about store closings can free up capital and management attention for stores and other channels that have a chance to grow profits.

Rethink store formats. Digital retail is spurring more than online sales growth. It is changing the role of brick-and-mortar stores and forcing retailers to rethink store sizes and footprints. Ann Taylor has downsized its boutiques; both Best Buy and Kohl's are opening smaller stores than the prototypes of just a few years ago; and Sephora is getting rid of registers in favor of mobile checkout at many of its stores.

Build the store of the future. Reconfigurations and updates are important, but a wealth of new technology is available to make the store of the future a reality. Video services that connect shoppers directly to experts for advice, "magic mirrors" that let customers try on items virtually and apps that simulate a remodeled room before shoppers make major purchases are already transforming shopping experiences. Some retailers, including Tesco and eBay.com, are thinking outside the box, experimenting with virtual stores in subways and shopping windows on main streets.

7. *Learn to cross the border*

The United States remains the world's largest consumer market, but the density of stores here and slow growth are good reasons to explore international expansion. Retail sales are forecasted to grow 13.1% per year and to reach $3.8 trillion by 2016 in China, and to grow 5.8% annually and to reach $0.8 trillion in 2015 in Russia. Bain research tells us that international expansion has been one of the most frequently targeted retail adjacencies over the last decade despite the fact that more than half of these investments fail. Even major global retailers—companies like Tesco, Carrefour, Office Depot and Abercrombie & Fitch—have stumbled. But market forces make it imperative for big retailers, who have reached a maturity point in the US, to develop and implement successful international strategies.

Now what?

> *Play to learn and eventually win.* The best retailers will commit to expansion with the intent of winning, not just dabbling, in a region. They will weave local customs, shopper preferences, legal regulations and macroeconomic environment into a long-term expansion strategy. They also will plan time to learn from and react to early results, changing their approach as needed.
>
> *Deploy digital skills.* For some retailers, testing new international markets with country-specific e-commerce sites and social media pages is a cost-effective plan. Cisco has recently launched an online store and shipping capabilities throughout Europe to sell their global home networking business, Linksys®, with plans to open physical stores in the future to sell software apps and services.

8. *Explore alliances and acquisitions*

The retail environment is evolving quickly, and the capabilities and skills required to compete in an omnichannel world mean that "home-grown" solutions may no longer be feasible. Retailers must weigh whether to develop a slew of new technologies and skills in-house or to license them, establish partnerships or make acquisitions. Smart retailers are considering all types of arrangements, including international partnerships (for example, J.Crew via Net-a-Porter), merchandise alliances (Brookstone displays in Staples), lease takeovers (Forever 21 setting up shop in former Mervyns stores) and straight-out acquisitions to expand into new categories or brands (Gap Inc. buying Athleta). The key is to pursue only those alliances that are both creative and commercial, filling in priority capability gaps to win.

Now what?

> *Identify opportunities and gaps.* The first step for retailers is to screen potential licensing, partnership or acquisition opportunities to fill capability gaps within the organization. Retailers can proactively identify and maintain a pipeline of possible partners and targets to plan for opportunity long before opportunity arises. Every potential deal should be clearly linked to a retailer's growth strategy. Alliances and acquisitions are tactics for achieving strategic goals. The

primary purpose of mergers and acquisitions is not simply to make a good deal but for companies to do what they already do, better.

Build a disciplined program. Bain research indicates that frequent acquirers outperform sporadic acquirers, and that those focused on smaller deals outperform those doing larger deals. The lesson here: Programs should center on frequent, on-going deal making and at least initially focus on small acquisitions.

Integrate, learn and practice. Each new deal is an opportunity to integrate lessons learned into the process going forward. Amazon.com is a prime example of a retailer that does this well. The company has made 17 deals in the last two years, among them a $175 million investment in LivingSocial and the acquisitions of Quidsi (the company behind Diapers.com and Soap.com) and streaming video provider LOVEFiLM.

9. *Up the innovation ante*

Leading companies routinely find themselves outpaced by more-innovative competitors: None of the top 10 retail profit leaders in 1970 remain on the list today (*Chart 8*). As the rate of change accelerates with digital retail, developing and flexing innovation skills isn't a choice. With so many intriguing options, it's important not to get lost in gimmicks that don't do enough to really matter to customers. Retailers can start with filling customer needs and demands to achieve real results, not just good public relations.

<u>Chart 8:</u>

Top 10 retail profit leaders in the United States, 1970-2010

1970	1980	1990	2000	2010	2020
1. Lucky	1. Tandy	1. Walmart	1. Walmart	1. Walmart	?
2. Winn-Dixie	2. Walmart	2. Food Lion	2. The Home Depot	2. CVS	
3. JCPenney	3. Lucky	3. The Limited	3. Sears	3. The Home Depot	
4. Albertsons	4. Melville	4. Rite Aid	4. Target	4. Target	
5. S. S. Kresge	5. Albertsons	5. Giant Food	5. Safeway	5. eBay.com	
6. W. T. Grant	6. American Stores	6. Melville	6. Gap	6. Walgreen	
7. Giant Food	7. Winn-Dixie	7. JCPenney	7. Kroger	7. Lowe's	
8. Borman's	8. Dayton Hudson	8. Albertsons	8. May Dept. Stores	8. TJX	
9. Zayre	9. Supermarket General	9. Service Merchandise	9. Lowe's	9. Publix	
10. Federated Dept. Stores	10. Revco	10. The Home Depot	10. Walgreen	10. Gap	

Source: Fortune

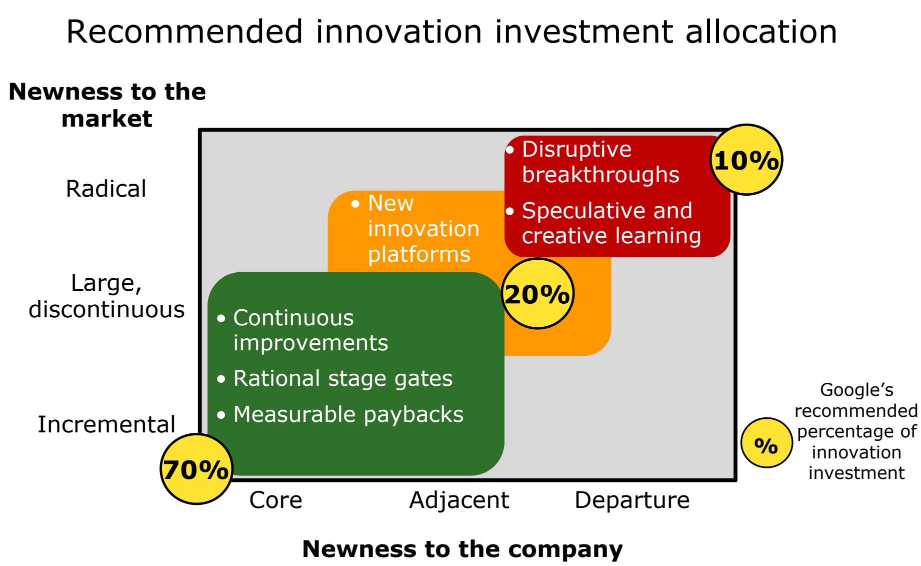
Turbocharging innovation takes new skills and resources. Some innovative companies devote significant amounts of their budgets to technology and research and development. Amazon.com plows about 5% of sales into R&D spend, while eBay.com spends 10% of revenue on product development.

Now what?

Continually improve, impress and create buzz. True trendsetters apply innovation principles to their interactions with customers at every step along the customer pathway. Dell reported success with its recent mobile app. The average size of a mobile order exceeded that of online carts by 25%. Stop & Shop is streamlining shopping and checkout with an innovative iPhone app. Customers use the app to scan their groceries as they shop, stopping only to pay when they're done. The app also delivers targeted coupons to customers as they shop.

Pursue a portfolio of innovations. Leading retailers dedicate abundant resources to growing and pursuing innovative ideas. The most cutting-edge retailers invest in a full-portfolio approach, pursuing a mix of investments from the incremental, which align closely with their core business, to the radical, which tend to be riskier and potentially disruptive (*Chart 9*). The percentage investment split reflects Google's famous innovation mix, allocating as much as 30% of resources towards developing new innovation platforms and disruptive breakthroughs. Though companies with weaker financials will be less able to meet this target, a similar mix is about right for most healthy companies. These retailers also may look for ways to trim excess operating costs to free up investment capital for innovation.

Chart 9:



Improve testing and learning. When building testing and learning capabilities, it is important to balance speed and deliberation. Moving too quickly can lead to costly mistakes; moving too slowly just opens the doors for competitors. Successful innovators settle in the middle, taking just enough time to develop clear hypotheses, conduct pilot tests and design processes to evaluate results and incorporate learning. Retailers like Chico's, Family Dollar, PetSmart, and Staples have partnered with Applied Predictive Technologies to implement APT's Test & Learn™ approach to analyzing and improving the outcomes of various initiatives.

10. Build a team to support the strategy

Digital retailing places new and uncomfortable demands on traditional retail organizations. Building new capabilities (for example, online merchandising or search engine marketing), adopting new tools to integrate systems and mine data and implementing new processes to coordinate across channels and create seamless customer experiences are just a few of the tasks facing retailers today. In response, retailers are revisiting their operating models and recruiting new talent. The war for e-commerce experts is particularly fierce. A survey by Internet Retailer indicates 55% of Web retailers plan to expand their e-commerce divisions in 2012.

Now what?

Hire, train and retain the right people, with the right digital skills. There is little doubt that the future of retail will require new and different skills. Assessing Talent and Organizational Readiness helps retailers understand where gaps in capabilities and personnel exist. It also creates a customized blueprint to address challenges from sourcing from non-traditional backgrounds (for example, computer programming) to reassessing role structures and responsibilities, or even to building a presence in a regional talent hub (for example, the Bay Area for engineers or New York City for designers). Walmart centralized its digital efforts in one technology division with @WalmartLabs, and has since spearheaded innovations in mobile use, social shopping and product personalization.

Increase decision speed. Too often progress slows when employees nod in a meeting but disagree in the hallway, or when everyone in a meeting feels that he or she should be the one making the critical decisions. Bain research has found that defining critical decisions and clarifying the roles of decision makers are essential to the decision process. The research indicates that companies with high decision-making effectiveness outperform across core financial measures. Effective decision makers have 16% five-year revenue growth and 13% five-year average return on invested capital, compared to an average of 10% and 7% for organizations with low or average decision-making effectiveness. Successful omnichannel retailers will define their critical decisions and have the right people, processes and tools in place to make them, with roles and accountability clearly defined at all levels.

Leverage the insights of different demographics within the organization. The average retail executive is not necessarily tech-savvy and does not necessarily fit the profile of tomorrow's consumers. But broad groups of employees within the organization may well have the technological know-how or consumer profile to provide valuable insights. For example, echo boomers (those ages 13 to 30) are a large and increasingly important demographic, poised to outspend baby boomers (those ages 47 to 65) by 2020; and the Hispanic population is growing quickly and has a larger lifetime spend than the US average. Retailers that employ members of these and other key populations need to improve methods for listening to them and disseminating their insights through the organization.

We recognize that 10 imperatives make for a long list. Every retailer will need to prioritize these imperatives based on its sector dynamics, market position, capabilities and capacity for change. One tool that can help is an Omnichannel Strategy Diagnostic, a snapshot of opportunities and challenges on the horizon. By evaluating channel experiences, product offerings, systems and more, it helps frame the focus and speed of change. At the core are four simple questions that individual retailers must ask themselves:

1. Does the organization have a compelling vision for a seamless customer experience across channels?
2. How well is the organization currently executing this vision?
3. What are the implications for product assortment, pricing, technology, marketing and branding?
4. What talent and capabilities are required?

We hope you've enjoyed reading our retail holiday newsletters this season. There is no doubt that 2012 will be a year of excitement and innovation in retail. We will be back later this year to report on the retail landscape. In the meantime, we welcome any questions on the content of our newsletters and your perspectives on the state of retail.

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

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.

Abelson, Alan. "Only a Holiday Pop?" Barrons.com, January 7, 2012. (http://online.barrons.com/article/SB50001424052748704330804577138671013581452.html?mod=BOL_twm_col)

Aéropostale. Official Facebook page (accessed January 12, 2012). (https://apps.facebook.com/shopaero/)

Amazon.com, Inc. "Form 10-K for the Fiscal Year Ended December 31, 2010." (http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-sec&control_selectgroup=Annual%20Filings)

Applied Predictive Technologies. "Solutions: Customer Testimonials." Web page (accessed January 14, 2012). (http://www.predictivetechnologies.com/en/index.cfm/solutions/client-testimonials/)

Bloomberg. "Corporate Actions, US Equities: Amazon.com (AMZN)." Subscription database (accessed January 11, 2012).

Bray, Hiawatha. "Stop & Shop to Launch App for Checkout." Boston.com, April 22, 2011. (http://articles.boston.com/2011-04-22/business/29463822_1_new-app-iphone-3gs)

Brohan, Mark. "Retailers Enter 2012 with Visions of More e-Commerce Technology Workers." Internet Retailer, December 31, 2011. (http://www.internetretailer.com/2011/12/31/retailers-enter-2012-visions-more-e-commerce-workers)

Bureau of Economic Analysis. "Consumer Spending Rises in November." News release, December 23, 2011. (http://www.bea.gov/newsreleases/national/pi/2011/pdf/pi1111_fax.pdf)

Bureau of Economic Analysis. "Personal Income and Outlays: November 2011." News release, December 23, 2011. (http://www.bea.gov/newsreleases/national/pi/2011/pdf/pi1111.pdf)

Business Monitor International. *China Retail Report Q1 2012*. November 18, 2011. (http://www.marketresearch.com/Business-Monitor-International-v304/China-Retail-Q1-6690664/)

Business Monitor International. *Russia Retail Report Q1 2012*. December 16, 2011. (http://www.marketresearch.com/Business-Monitor-International-v304/Russia-Retail-Q1-6734942/)

Cameron, Doug. "Fed Official Pianalto Says Inflation Outlook Is 'Pretty Good.'" *Wall Street Journal*, January 10, 2012.

Chandra, Shobhana. "Jobless Claims in U.S. Rose More Than Forecast." Bloomberg, January 12, 2012. (http://www.bloomberg.com/news/2012-01-12/first-time-jobless-claims-in-u-s-increased-more-than-forecast-last-week.html)

Cisco. "New Linksys Online Stores throughout Europe Cater to Growing number of European Online Shoppers." Press release, November 22, 2011. (http://home.cisco.com/en-us/press/releases/CISCO_CONTINUES_INTERNATIONAL_EXPANSION_BY_LAUNCHING_DIRECT_ONLINE_STORES_FOR_LINKSYS_PRODUCTS)

comScore. "U.S. Online Holiday Shopping Season Reaches Record $37.2 Billion for November–December Period, Up 15 Percent vs. Year Ago."Press release, January 4, 2012. (http://www.comscore.com/Press_Events/Press_Releases/2012/1/U.S._Online_Holiday_Shopping_Season_Reaches_Record_37.2_Billion_for_November-December_Period)

CoreLogic. "CoreLogic Third Quarter 2011 Negative Equity Data Shows Slight Decline but Remains Elevated." Press release, November 29, 2011. (http://www.corelogic.com/about-us/news/corelogic-third-quarter-2011-negative-equity-data-shows-slight-decline-but-remains-elevated.aspx)

Crutsinger, Martin. "Consumer Borrowing Surges as Economy Improves." Associated Press, January 9, 2012. (http://hosted.ap.org/dynamic/stories/U/US_CONSUMER_CREDIT?SITE=AP&SECTION=HOME&TEMPLATE=DEFAULT)

Delaney, Arthur. "Recovery Job Growth Concentrated in Low-Paying Occupations." HuffingtonPost.com, July 26, 2011. (http://www.huffingtonpost.com/2011/07/26/recoverys-jobs-pay-less-t_n_909515.html)

DemandTec. "Customers: Success Stories: Target." Web page (accessed January 12, 2012). (http://www.demandtec.com/mydemandtec/network/customers/successportal/target)

Demery, Paul. "Getting 'Lookers' to Come Back and Buy." Internet Retailer, January 5, 2012. (http://www.internetretailer.com/2012/01/05/getting-lookers-come-back-and-buy)

D'innocenzio, Anne. "Retail Group Forecasts 3.4 Pct Growth for 2012." Associated Press, January 16, 2012. (http://hosted.ap.org/dynamic/stories/U/US_RETAIL_SALES_FORECAST?SITE=AP&SECTION=HOME&TEMPLATE=DEFAULT)

Duryee, Tricia. "PayPal's First Mobile Payments Pilot Is with Big-Box Retailer Home Depot." AllThingsD.com, January 6, 2012. (http://allthingsd.com/20120106/paypals-first-mobile-payments-pilot-is-with-big-box-retailer-home-depot/)

eBay Inc. "Form 10-K for the Fiscal Year Ended December 31, 2010."(http://investor.ebayinc.com/secfiling.cfm?filingID=1065088-11-3)

Federal Reserve System, Board of Governors. "Consumer Credit: November 2011." Table G.19, January 9, 2012. (http://www.federalreserve.gov/releases/g19/current/default.htm)

Feran, Tim. "Slow Overseas Sales Hurt Abercrombie." *Columbus Dispatch,* November 4, 2011. (http://www.dispatch.com/content/stories/business/2011/11/04/slow-overseas-sales-hurt-abercrombie.html)

Financo. "December 2011 Comparable Store Sales Report." January 5, 2012. (http://financo.com/site/wp-content/themes/brain-wp/_layout/images/12-11%20Comparable%20Store%20Sales%20Report.pdf)

"First Data: Overall Transaction Growth Up 7.0% in December." *Chain Store Age,* January 11, 2012. (http://chainstoreage.com/article/first-data-overall-transaction-growth-70-december)

"Fortune 500: Our Annual Ranking of America's Largest Corporations, 2010." *Fortune,* accessed January 12, 2012. (http://money.cnn.com/magazines/fortune/fortune500/2010/full_list/)

Efrati, Amir and Stu Woo. "Google Targets Amazon's 'Prime' With 1-Day Delivery." *Wall Street Journal*, December 2, 2011. (http://online.wsj.com/article/SB10001424052970204012004577072323400561792.html)

"Housing Starts Were Up in November." *New York Times*, December 20, 2011. (http://www.nytimes.com/2011/12/21/business/economy/housing-starts-were-up-in-november.html)

Hsu, Tiffany. "Food Prices Will Continue to Rise in 2012, Says USDA." *Money & Company* (blog), December 23, 2011. (http://latimesblogs.latimes.com/money_co/2011/12/food-prices-will-continue-to-rise-in-2012-says-usda.html)

Hudson, Kris. "For Malls, Occupancy Firms Up." *Wall Street Journal,* January 9, 2012.

Kavilanz, Parija. "U.S. Will Pay for Half of All Health Care Costs by 2020." CNNMoney, July 28, 2011. (http://money.cnn.com/2011/07/28/news/economy/healthcare_spending_forecast/index.htm)

Kurtzleben, Danielle. "The Many, the Doomed, the Long-Term Unemployed." USNews.com, January 6, 2012. (http://www.usnews.com/news/articles/2012/01/06/the-many-the-doomed-the-long-term-unemployed)

Lutz, Ashley, and Matt Townsend. "Stores Pay Price for Holiday Deals." Bloomberg, January 6, 2012. (http://www.bloomberg.com/news/2012-01-05/retailers-in-u-s-post-mixed-december-sales-results-as-best-deals-prevail.html)

Malcolm, Hadley. "Walmart, Macy's, Other Retailers Stock Regional Favorites." USAToday.com, December 22, 2011. (http://www.usatoday.com/money/industries/retail/story/2011-12-22/retailers-regional-sales/52166156/1)

Marlow, Jeffrey. "Q&A: Google's Green Energy Czar." *New York Times*, January 7, 2010. (http://green.blogs.nytimes.com/2010/01/07/qa-googles-green-energy-czar/)

Moore, Randell E. Blue Chip Economic Indicators. Periodical, January 10, 2012.

Moore, Stefany. "Social Shopping Comes to Fab.com." Internet Retailer, December 16, 2011. (http://www.internetretailer.com/2011/12/16/social-shopping-comes-fabcom)

Nassauer, Sarah. "A New Sales Model: Employees." WSJ.com, March 17, 2011. (http://online.wsj.com/article/SB10001424052748703899704576204413874760334.html)

Oracle. "Belk Selects Oracle Retail Markdown Optimization to Enhance the Customer Shopping Experience and Improve Performance." Press release. July 21, 2009. (http://www.oracle.com/us/corporate/press/021624)

Peters, Meghan. "3 Examples of Stellar Social Media Customer Service." Mashable, November 23, 2010. (http://mashable.com/2010/11/23/customer-service-award/)

Rueter, Thad. "E-mail Marketing Increases 16% in 2011." Internet Retailer, January 3, 2012. (http://www.internetretailer.com/2012/01/03/e-mail-marketing-increases-16-2011)

Schumer, Charles E. "Schumer Reveals: This Holiday Season, New Technology Could Be Tracking Shoppers' Movements in Shopping Centers Through Their Cell Phones; Calls for Mandatory Opt-In Before Retailers Are Allowed to Track Shoppers' Movements." Press release, November 28, 2011. (http://schumer.senate.gov/Newsroom/record.cfm?id=334975)

Shader, Maggie. "Holiday Shopping: Buy Online and Pick Up at Store on Same Day." ConsumerReports.org, December 12, 2011. (http://news.consumerreports.org/money/2011/12/holiday-shopping-buy-online-and-pick-up-in-store.html)

ShopperTrak. "Experts Predict More Retail Sales, but Fewer In-Store Shoppers This Holiday Season." Press release, September 21, 2011. (http://www.shoppertrak.com/news-resources/press-releases/2011-09/experts-predict-more-retail-sales-but-fewer-in-store-shoppers-this-holiday-season)

ShopperTrak. "Late Retail Shoppers Increase December Sales." Press release, December 28, 2011. (http://www.shoppertrak.com/news-resources/press-releases/2011-12/late-retail-shoppers-increase-december-sales)

Siwicki, Bill. "Yes, Virginia, Consumers Will Buy Big Ticket Items via Mobile." Internet Retailer, December 27, 2011. (http://www.internetretailer.com/2011/12/27/yes-virginia-consumers-will-buy-big-ticket-items-mobile)

"Something Is Working." *Free Exchange* (blog), January 6, 2012. (http://www.economist.com/blogs/freeexchange/2012/01/americas-economy?fsrc=scn/fb/wl/bl/americaseconomysomethingisworking)

Standard & Poor's. "Home Price Index Levels." December 27, 2011. (http://www.standardandpoors.com/indices/articles/en/us/?articleType=XLS&assetID=1221192472066)

Standard & Poor's. "The Fourth Quarter Starts with Broad-Based Declines in Home Prices According to the S&P/Case-Shiller Home Price Indices." Press release, December 27, 2011. (http://www.standardandpoors.com/servlet/BlobServer?blobheadername3=MDT-Type&blobcol=urldocumentfile&blobtable=SPComSecureDocument&blobheadervalue2=inline%3B+filename%3Ddownload.pdf&blobheadername2=Content-Disposition&blobheadervalue1=application%2Fpdf&blobkey=id&blobheadername1=content-type&blobwhere=1245326665736&blobheadervalue3=abinary%3B+charset%3DUTF-8&blobnocache=true)

The Conference Board. "The Conference Board Consumer Confidence Index Improves Again." Press release, December 27, 2011. (http://www.conference-board.org/data/consumerconfidence.cfm)

True Religion Apparel, Inc. "Form 10-Q for the Fiscal Quarter Ended September 30, 2011." (http://biz.yahoo.com/e/111102/trlg10-q.html)

US Census Bureau. "Estimated Monthly Sales for Retail and Food Services, by Kind of Business." Table, January 12, 2012. (http://www.census.gov/retail/marts/www/download/excel/table1.xls)

US Census Bureau. "Estimates of Monthly Retail and Food Services Sales by Kind of Business: 2011." Table, January 12, 2012. (http://www.census.gov/retail/mrts/www/data/excel/mrtssales92-present.xls)

US Energy Information Administration. "Gasoline and Diesel Fuel Update." January 2, 2012. (http://www.eia.gov/petroleum/gasdiesel/)

Webb, Tom. "Warm Days, Tepid Sales." TwinCities.com, January 5, 2012. (http://www.twincities.com/markets/ci_19679742)

White, Ronald D. "Gasoline Prices Start the Year at a High—and Rising." LATimes.com, January 6, 2011. (http://www.latimes.com/business/la-fi-gas-prices-20120106,0,2326955.story)

Wilson, Marianne. "Sephora to Unveil Totally Mobile Checkout in Manhattan." *Chain Store Age,* September 12, 2011. (http://www.chainstoreage.com/article/sephora-unveil-totally-mobile-checkout-manhattan)

Wiseman, Paul, and Christopher S. Rugaber. "Nation Adds 200,000 Jobs in December Hiring Surge." Associated Press, January 6, 2012. (http://hosted.ap.org/dynamic/stories/U/US_ECONOMY?SITE=AP&SECTION=HOME&TEMPLATE=DEFAULT)

Woo, Stu. "U.S. Web Sales Sparkled for Holiday Season." *Wall Street Journal*, December 30, 2011.

Zibel, Alan. "Goldman: Housing Market Bottom Is Really, Finally (Almost) Here." *Developments* (blog), December 5, 2011. (http://blogs.wsj.com/developments/2011/12/05/goldman-housing-market-bottom-is-really-finally-almost-here/)