



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

GAFS sales increased 2% in October, marking the ninth straight month of growth. Furthermore, recently released e-commerce figures show that online sales continue to grow at a rate well above GAFO sales. Consumers are flocking online to shop for the holidays. Once there, they are wowed by digital innovations that enable them to shop the way they want to shop. Pureplays have been at the forefront of these advances, but traditional retailers are catching up. The savviest of them are creating omnichannel strategies that seamlessly bring together the best of both worlds for a superior shopping experience.

Upward momentum continued in October

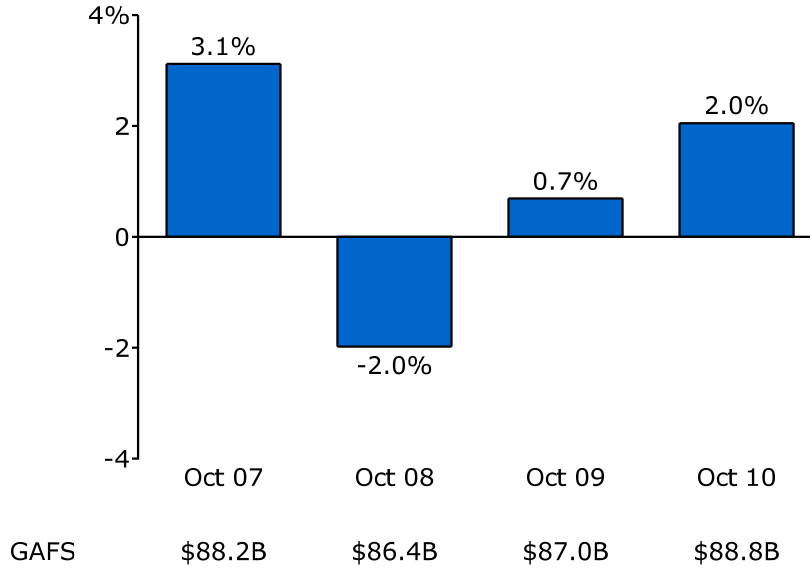
October GAFS sales increased 2% over 2009.¹ Although the rate was down from September's 3.6% growth, it was on top of the toughest comparison so far this year. Last October's GAFS sales increased 0.7%, the first positive year-over-year growth in 13 months. GAFS sales in October 2010 also reached a new peak – \$88.8 billion – edging out the previous October high of \$88.2 billion set in October 2007 (*Chart 1*).

October growth was positive in all GAFO segments (*Chart 2*). Sales in the general merchandise segment, which make up over half of GAFO sales, were up 2% over last year – slightly below the segment's 12-month average growth of 2.3%. Warehouse clubs and luxury department stores continue to drive growth in this segment. The clothing and clothing accessories segment posted growth of just 1.4%, largely a function of weather. This was the warmest October in 15 years according to Weather Trends International, and cold-weather apparel categories suffered. Consumers likely delayed some of these purchases rather than deciding entirely against them, which should bolster November's numbers. Sales growth in more discretionary segments also slowed as at least some shoppers chose to wait for holiday discounts. This effect was most apparent in two segments. Sales of electronics and appliances grew just 2.3% in October, the segment's lowest growth since February. That came as no surprise to Best Buy CEO Brian Dunn, who expected shoppers to "take a just-in-time approach" to holiday

¹ See Chart A in the Appendix for definitions of GAFS and other sales measures.

Chart 1:

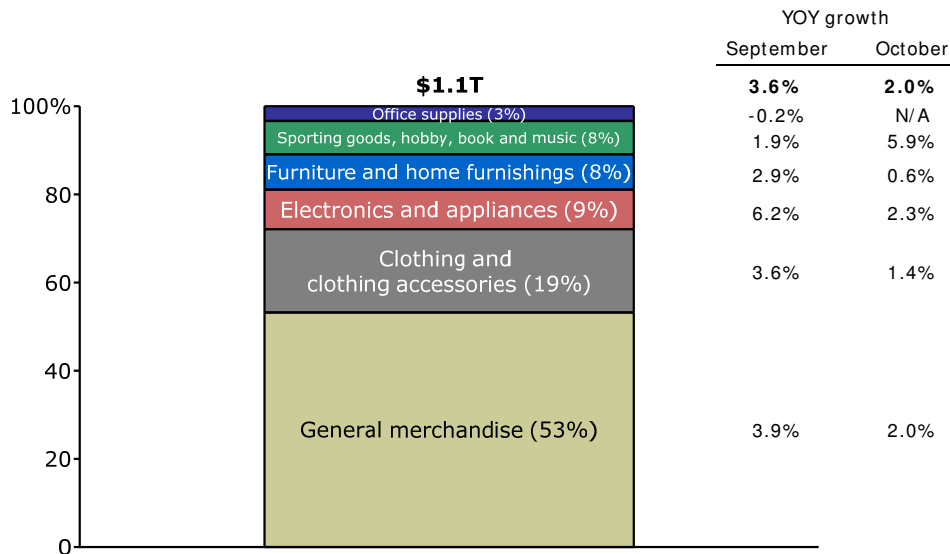
Year-over-year GAFS sales growth,
October 2007-October 2010



Source: US Census Bureau

Chart 2:

GAFO sales by segment,
November 2009-October 2010

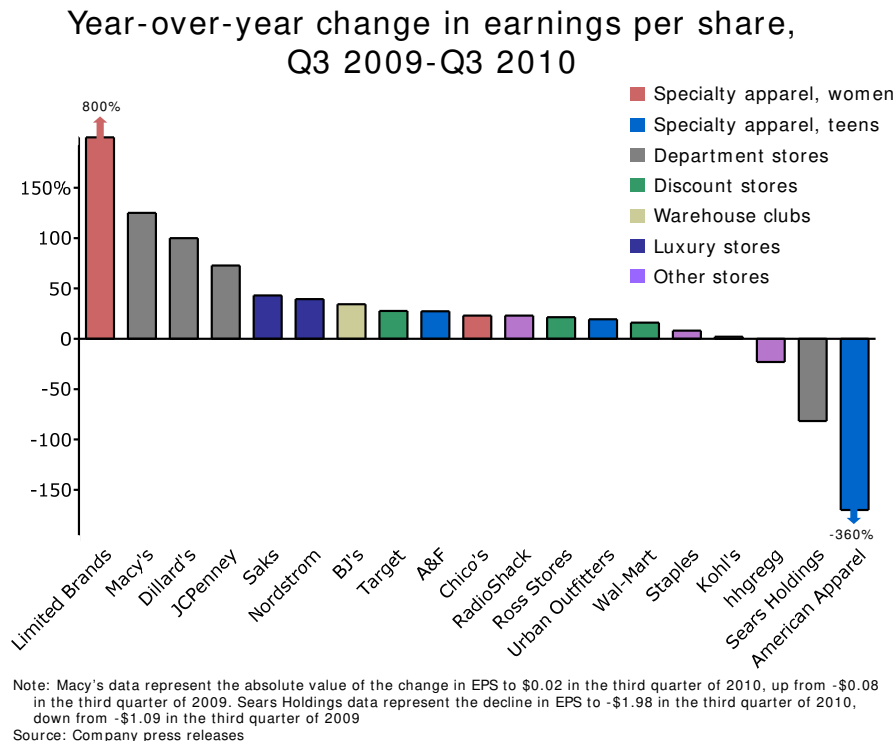


Note: October overall growth rate is for GAFS; office supplies data have not yet been reported for October; September data are based on preliminary numbers, and October data are based on advanced data published November 15, 2010
Source: US Census Bureau

spending this year. And sales of furniture and home furnishings rose a modest 0.6%, the segment's lowest gain since June.

The rebound in growth has been good news for profits. Most of the retailers that recently reported third-quarter results continue to show healthy earnings growth. In fact, 16 of 19 (84%) posted a year-over-year increase in earnings per share (*Chart 3*).

Chart 3:



E-commerce will be the guest of honor at this holiday party

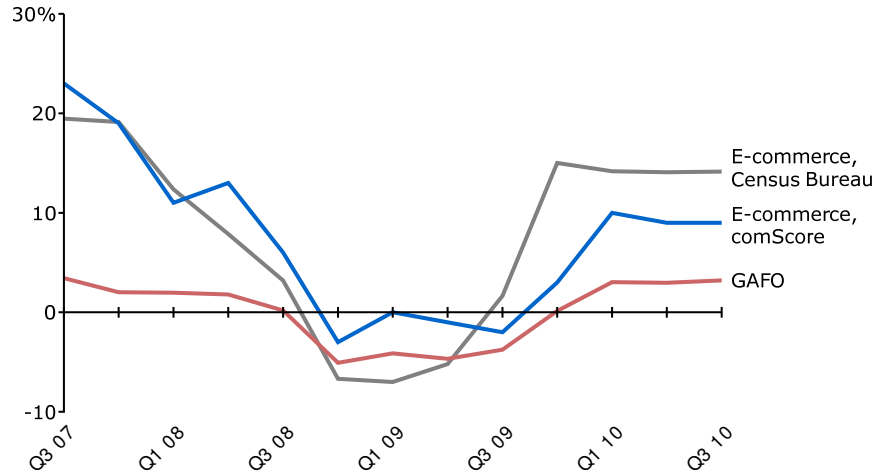
E-commerce is reclaiming its position as the shining star of retail growth. Since the third quarter of last year, online sales have rebounded with growth that has outpaced GAFO sales by at least three times in each quarter this year (*Chart 4*). comScore estimates that online sales rose 9% in the third quarter, and the Census Bureau estimates an even more impressive 14.1% increase, though the numbers are not directly comparable.²

This impressive performance is expected to continue and even accelerate through the holidays. Analysts are predicting e-commerce growth as high as 16% this season (*Chart 5*). Retailer sentiment supports these estimates. BIGresearch and Shop.org found that 64% of retailers surveyed, up from 46% last year, expect year-over-year sales growth of 15% or higher this holiday season.

² See Chart B in the Appendix for details of e-commerce tracking methodologies and definitions.

Chart 4:

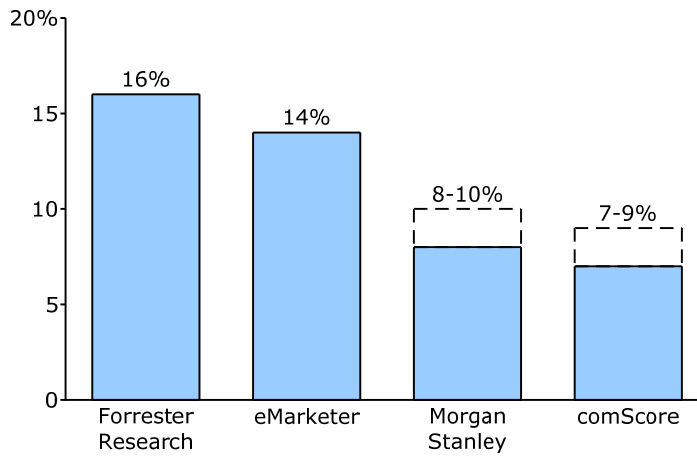
Year-over-year e-commerce and GAFO sales growth, Q3 2007-Q3 2010



Source: comScore; US Census Bureau

Chart 5:

Forecasted holiday e-commerce sales growth, 2010



Note: Holiday is defined as November and December; comScore defines e-commerce as online retail spending excluding travel, autos and auctions; other sources do not specify which components of online retail sales are included in their forecasts
 Source: Forrester Research, eMarketer, Morgan Stanley, comScore

"Digital disruption" is fueling e-commerce growth

Since the mid 1990s, e-commerce has offered consumers more convenience, access to a wider range of products, and better product and pricing information. But recent advances in technology and bursts of innovation have revolutionized e-commerce, enabling consumers to shop the way they want to shop:

- *Ubiquitous access.* E-commerce made 24/7 shopping a reality many years ago, but the recent surge in smartphone and tablet adoption coupled with new mobile shopping applications now allows consumers to shop anywhere, anytime. According to a National Retail Federation survey, over 25% of smartphone owners plan to use their phones for purchases this holiday season. In addition, the base of smartphone users is skyrocketing: comScore estimates today's smartphone penetration at about 25% of mobile users, and Nielsen expects this to reach 50% by mid-2011.
- *An inspiring shopping experience.* Shopping from a computer, let alone a phone, used to be boring: a few fuzzy pictures, generic product descriptions and little or no service. Today's digital technology has vaulted the experience to new levels. Innovations like enhanced photography with 360-degree views, video demonstrations, click-to-chat, click-to-call and in-store pickup are wowing consumers. And more revolutionary features, including webcam-enabled virtual dressing rooms, are just around the corner.
- *Connectedness.* Shopping online used to be lonely compared to a visit to the mall. No more! With just a few clicks shoppers can share ideas with friends and get their opinions instantly, and read reviews from other like-minded people. They can even buy directly via Facebook or "group-shop" for volume-driven deals.
- *Personalization.* It can be a daunting task to browse retailers' vast online offerings. Today, advanced search functionality makes finding that perfect item much easier. Looking for a dress? Just a click on a size, a silhouette and a color produces a custom "rack" filled with items that are suited to the shopper's body type and style. If shoppers still can't find exactly what they are looking for, there are a growing number of options for customizing products to meet any need. More and more online retailers also now offer product suggestions based on the shoppers' browsing and purchase histories. But this approach is not without flaws. Patterns during the gift-giving season may not indicate future buying behaviors. Additionally, some consumers are concerned about privacy. As one of our Communispace members noted: "At some point, I feel my privacy is compromised."³

³ Bain continues to work with Communispace in its proprietary IdeaSpace communities to better understand how consumers are feeling about the holidays and what will motivate them to shop. Communispace is a marketing research company that builds and manages custom online consumer communities. A Communispace community is a private online site where up to 400 invited customers and prospects regularly spend time brainstorming, sharing feelings and experiences, and discussing trends to help guide a company's marketing and business strategies. These custom private communities are facilitated by Communispace to keep the "conversation" relevant and insightful, and bring to life the voice of the consumer.

- *Great deals.* Everybody loves a good deal. But many of today's consumers pride themselves on finding the best deal. That's easier than ever now, thanks to price-comparison engines and coupon-aggregation websites that put pricing information and deals at shoppers' fingertips. comScore reports that total visitors to price-comparison sites jumped 24% year over year in September, and that total time spent on the sites went up 38%.

The rate of technological advance is rapidly accelerating, and that will continue to fuel dramatic improvements to the shopping experience, particularly via mobile devices. According to IDC, revenue from smartphone applications and services is expected to grow an average of 28% a year through 2014. And ABI Research reports that shoppers will increase mobile spending from \$2.4 billion in 2010 to \$119 billion by 2015.

Pure plays are leading the parade

While traditional retailers fretted about whether websites would dilute their brand image or online sales might cannibalize in-store sales, pure plays — online retailers without physical stores — knew they had to revolutionize the online experience to compete. Without the heavy burden of capital in physical stores and distributed inventories, pure plays soon realized that they could deliver superior returns on capital while investing more aggressively in website functionality, search engine marketing, customer communities, free shipping and even compensation packages to attract star performers. In the end, they have ushered in the waves of innovation that define what e-commerce is today.

Amazon leads the pure-play world with annual sales that now top \$24 billion. Its name is synonymous with extensive product reviews, purchase suggestions and a mix of new and used offerings. More recently they blazed new trails with Amazon Prime, providing unlimited free two-day shipping for an annual fee. Membership-only flash-sale sites have combined community and urgency in a winning formula. Witness Rue La La and Gilt Groupe: Their September year-over-year traffic was up 153% and 124%, respectively, according to comScore. Zappos, now owned by Amazon, couldn't offer in-store returns, so it instead set a new standard in customer service with two-way free shipping, a 365-day return policy and a 24/7 call center whose goal is to "deliver 'WOW' through service." In just over 10 years, the online retailer grew from inception to a valuation of \$1.2 billion. More recently, collective-buying sites Groupon and LivingSocial have put a new spin on time-sensitive offers, an approach that has contributed to more than 800% growth over last year (admittedly off a very small base). For the holidays, eBay is suggesting Group Gifts, a program that allows two or more people to chip in to buy gifts for their friends, pulling from Facebook for personalized gift ideas. The company's objective: encouraging shoppers to bring their networks onto the auction site.

As digital boundaries blur, nontraditional players are moving into e-commerce, further changing the nature of retail. Search engines, social networks and new media sites are introducing new sources of influence and purchase options. Google's most recent unveiling, Boutiques.com, is a destination for searchers and shoppers alike. The site

allows consumers to “build” a boutique, a wish list of products they’ve selected themselves or from a celebrity’s suggestions. According to Google, the site “uses computer vision and machine learning technology to visually analyze [users’] taste and match it to items [they] would like.” Social networking and new media sites are providing instant input and information that consumers trust and follow. Before they buy, shoppers are now checking their friends’ “likes” on Facebook or their favorite fashion icons’ must-haves on Polyvore or Fashionista.

The innovation investments are paying off. Not only have individual pure plays been enjoying triple-digit growth, but pure plays as a whole have been gaining share from their multichannel competitors. Since 2008, pure-play retailers have seen their portion of e-commerce sales increase year over year in every quarter (*Chart 6*).

Omnichannel will shape the future of retail

Digital technology promises to disrupt the retail industry over the next few years more than anything has for decades. Retailers that fail to respond to that disruption risk becoming tomorrow’s forgotten brands. But matching pure plays’ online innovation is only a first step. To reap rewards, traditional retailers will have to move from multi-channel operations – stores and websites in silos – to omnichannel strategies that seamlessly bring the best of both these worlds together. The transformation is under way, and winning strategies will be evident this holiday season. Omnichannel innovation is helping retailers:

- Become a “must shop” holiday tradition.
- Help Santa stuff the stockings.
- Put a bow on it...fast and free.
- Earn a year-round spot on wish lists.

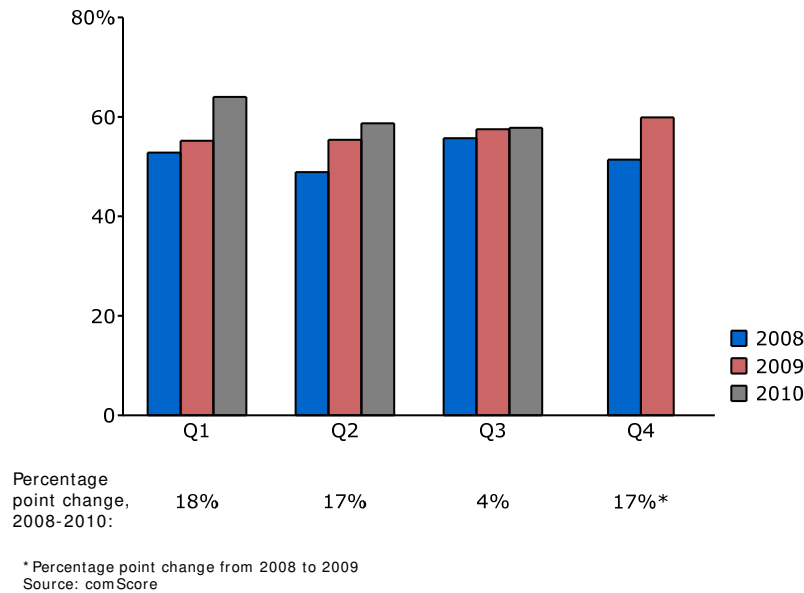
Become a “must shop” holiday tradition.

Attracting shoppers during the holidays has always been a competitive sport, and this season is no exception as marketing, discounts and special events continue to escalate in scale and pace. Retailers are looking for new ways to engage customers, and omnichannel approaches are helping.

Best Buy, Macy’s and other retailers have partnered with shopkick, a rewards program that automatically registers shoppers for personalized messages and special offers when they walk into stores. Users of mobile application foursquare can “check in” when they arrive at stores like JCPenney and RadioShack to receive exclusive rewards and discounts. While many of this year’s holiday windows delight viewers with digital displays, Bergdorf Goodman is taking it one step further: Consumers who scan the barcodes on the retailer’s window displays with their smartphones are directed to a gift-giving website.

Chart 6:

Pure-play share of quarterly US e-commerce sales, 2008-2010



Help Santa stuff the stockings.

By offering meaningful product recommendations, relevant information and excellent service, omnichannel strategies are helping retailers fill shopping baskets with more products at higher price points. Noted one Communispace community member: “The reason I shop online is to get instant information and read reviews. . . . I like shopping in stores to touch and feel the product.”

Today, more and more retailers are giving shoppers the best of both worlds by combining online information with in-store experience. Two days before Black Friday, Target plans to post store maps to its website for download to mobile devices. Sam’s Club now offers a smartphone application that allows customers to scan in-store products and read product details and reviews. JCPenney’s in-store FindMore fixture – a 52-inch touch screen – lets consumers browse the retailer’s full range of merchandise (on- and offline), read reviews and e-mail themselves product information. Other retailers, including Kohl’s, give shoppers access to the company’s full inventory plus special sizes and more with in-store kiosks where they can order online and have merchandise shipped to them at no cost. And this year, Neiman Marcus’s Christmas Book will hit more than mailboxes. Customers can access the retailer’s catalog of extravagant gift suggestions in stores through an iPad application.

Put a bow on it...fast and free.

Customers always want fast and efficient checkout, payment and delivery options. But the added complexities of holiday shopping, including crowded stores and longer lines, heighten the importance of these services. Digitally savvy retailers are offering a variety of options to increase the speed and flexibility of purchasing, both online and in stores.

About 200,000 US merchants have installed readers that accept contactless payments via mobile phones. Self-checkout options are nothing new, but Magic Beans – a small Boston-based chain of children’s goods stores – now offers shoppers self-checkout on their mobile phone. Apple has upped the ante even further with its recently updated Apple Store iPhone application. Customers can “reserve” a product through the application and then check in on their iPhone when they enter the store. A sales representative will come to them, product in hand and ready to check them out.

Making it easy is just one piece of the puzzle. According to the NRF, the number one reason shoppers don’t spend even more of their holiday budget online is shipping charges. A comScore survey revealed that 55% of shoppers are at least “somewhat likely” to abandon their digital shopping cart if shipping isn’t free. Retailers are responding with free-shipping offers or free-pickup-in-store options. A full 85% of retailers will offer free shipping at some point this season according to the NRF. Wal-Mart and Best Buy recently announced free shipping on thousands of holiday items with no minimum purchase. And many retailers, from Wal-Mart to Nordstrom, continue to offer a free-ship-to-store option for items ordered online.

Earn a year-round spot on wish lists.

Innovative retailers are turning to more sophisticated loyalty programs – well beyond the traditional store credit card – to give shoppers even more reason to come back. Chico’s loyalty program spans their channels. Shoppers who sign up for the Passport Program and spend more than \$500 in stores, online, or by phone are entitled to everyday discounts and are invited to private sales, parties and events. For retailers, the holy grail would be knowing who their best customers are while they’re still shopping. With smartphones and applications with geolocation, we can imagine a day when retailers’ most loyal customers, who may only have shopped online to that point, are identified as frequent buyers the moment they walk through the door.

There is no doubt that omnichannel innovations will continue to enhance the shopping experience. At the same time, they will challenge retailers by forcing them to rethink inventory models, evolve organization structures and develop a willingness to test new capabilities.

Black Friday is starting early this year

As we discussed in our [previous newsletter](#), a number of retailers are touting Black Friday savings throughout the month of November. Still, eager shoppers are counting down the days until November 26. As it turns out, they had better rest up and remember to set their alarm clocks a little earlier this year. Macy’s, Target, Kohl’s and The Home Depot are all opening an hour earlier than last year. And a number of retailers plan to open their doors for Black Friday much earlier: Wal-Mart at midnight and Toys “R” Us at 10:00 p.m. on Thanksgiving Day. In our next newsletter, we will report initial Black Friday results, our first real indicator of performance this holiday season.

Newsletter schedule

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

Chart 7:

Indicator update and newsletter schedule

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

Appendix

Chart A:

Definitions

	GAFO	GAFS	GAF	Nonauto retail sales
General merchandise stores	✓	✓	✓	✓
Clothing and clothing accessories stores	✓	✓	✓	✓
Furniture and home furnishings stores	✓	✓	✓	✓
Electronics and appliances stores	✓	✓		✓
Sporting goods, hobby, book and music stores	✓	✓		✓
Office supplies, stationery and gift stores	✓			✓
All other retail trade sales not included in GAFO (excluding auto and auto parts)				✓
Auto and auto parts sales				

Chart B:

E-commerce tracking methodologies and definitions

	comScore	US Census Bureau
Methodology	Based on data from a consumer panel of 1 million US residents	Based on a sampling of 12,500 retail companies that are representative of the industry
GAFO segment sales	✓	✓
All other retail trade sales not included in GAFO (excluding auto and auto parts sales)	✓	✓
Auto and auto parts sales		✓
Auction sales		✓
Event ticket sales	✓	
Online travel sales		

Note: US Census Bureau e-commerce sales are sales of goods and services where an order is placed online by the buyer, or price and terms of sale are negotiated online; payment may or may not be made online
 Source: comScore; US Census Bureau

Selected References

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