Retail

Don't Get Grinched:

A Holiday Spending Outlook

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The Wall Street grinches have borne not-so-glad tidings about the upcoming holiday shopping season. While consumer spending will be affected by current realities – falling home values, high gas prices, product recalls – the answer is not to close up the cash registers in resignation. An informed assessment of the current environment and of consumer trends can help retailers make sound business and planning decisions.

For 22 years, Deloitte & Touche USA LLP has been monitoring consumer sentiment through an annual survey that gauges shoppers' expectations and intentions for the holiday season and offers key findings for retailers. Over the years, these results have allowed Deloitte to uncover and reconfirm important consumer trends critical to retailers when developing strategies. From consumers' expected spending changes due to economic events, to their use of online product/store reviews, their multi-channel preferences, and their choices around "green" buying, this year's holiday survey results can help retailers better respond to today's empowered consumers.

One key finding from this year's survey was that respondents were indeed being buffeted by various economic headwinds, and that spending on nonessential holiday goods and services would likely be curtailed. However, gift spending in particular was expected to be nearly even with last year's level. Consumers expect to spend $569 on holiday gifts, compared with $584 in 2006. Households with lower incomes reported a sharper deterioration in spending from last year than did upper income households.

The Federal Reserve's recent rate cuts have eased marketplace hesitancy somewhat, but given the downturn in housing and higher gas/food prices, consumer spending growth this holiday period will likely be the lowest in several years. Deloitte currently expects retail sales, excluding motor vehicles and gasoline, to increase in the 4.5% - 5% range this holiday season. This would be below the prior holiday period's increase of 5.1%. Our expectations cover the months of November through January. We include January in the holiday period because of the strong growth in gift cards.

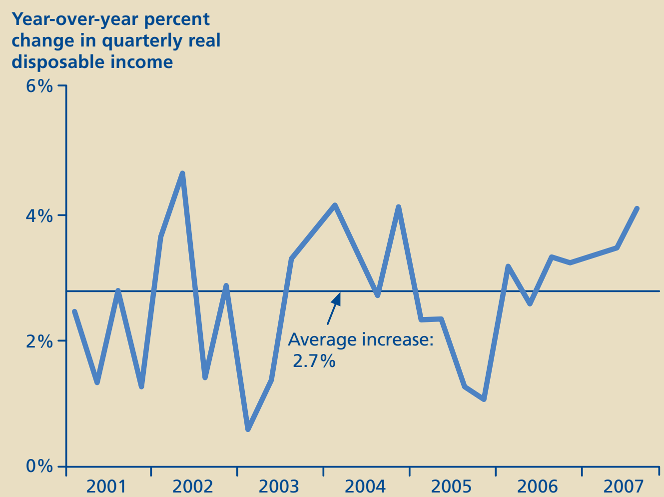
The following is a look at some of the top economic issues that will impact consumer holiday spending, relevant survey findings that discuss consumer sentiment and purchasing trends, and strategies retailers can employ in response. The bottom line is that while the season undoubtedly will be difficult for some, there are many steps that retailers can take to help improve the consumer's desire to spend.

The Positives for Holiday Spending

Spending will likely not be characterized as robust this season, yet there are some positives in the economic backdrop that suggest that the selling environment could hold up for certain retailers. Importantly, consumers' incomes have continued to increase, even after accounting for the effects of inflation. Growth in income is perhaps the strongest indicator of the consumer's ability to spend.

Income growth is being helped by the fact that employers are continuing to hire, albeit at a slightly slower pace. Employment in October 2007 was up by 1.6 million workers from a year ago. Although this pace is down by about a million from mid-2006, it remains sufficient to keep real (inflation-adjusted) incomes buoyant. By year-end, higher gasoline prices could cut into growth prospects, but it is not yet clear how steep those price increases will be in the coming months.

Figure 1. Growth in real disposable income has been healthy this year



Source: U.S. Commerce Department

Another positive is that consumers' net worth continues to improve, even as housing prices ease. In the second quarter, net worth was 8% higher than it was a year ago, according to the Federal Reserve. Consumers' real estate holdings were up a slight 4% for the year, but the value of their corporate equities and mutual fund shares were 11% higher and cash deposits had risen by 9%. Net worth likely did not grow as strongly in the third quarter, due in large part to the deterioration in the housing sector. The healthy growth in equity values, however, suggests that luxury goods retailers will see relatively good gains, although the increases may not be as strong as in previous years since "aspirational" luxury buyers will likely cut back somewhat. Ultra-luxury should continue to do well.

The other bit of good news for holiday spending is that consumers who have responded to surveys have indicated that their holiday budgets will likely be impacted only minimally by the credit crunch and housing slump. A poll conducted by the International Council of Shopping Centers in mid-August found that only 18% of respondents were worried about the financial turmoil and were "thinking twice" about spending. In late September, respondents to Deloitte's holiday survey also showed low levels of concern in these areas. Only about one in ten felt that declining home values or higher mortgage payments would negatively impact their spending. In contrast, higher energy and food prices were the biggest concerns for respondents.

The Negatives for Holiday Spending

Look no further than the housing recession. Existing home sales have plummeted 30% from their 2005 peak, and the pace of new home sales has been cut almost in half, according to the National Association of Realtors and the US Census Bureau. The pullback in lending will continue to keep home sales subdued over the near term. Mortgage availability was reportedly improving in late October, but it will likely take until early 2008 before home sales benefit.

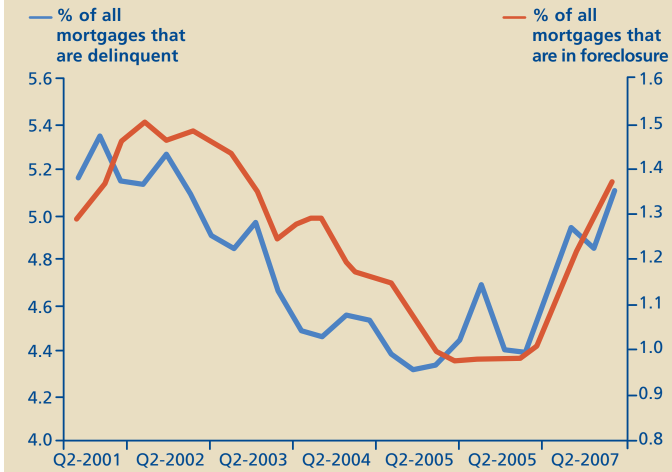
Housing-related issues are impacting consumers in other ways. In particular, decreased mortgage refinancings are depleting that source of extra cash consumers had been relying on in recent years when they extracted cash from their home's equity.

Housing's problems are beginning to flow through to other sectors of the economy. Construction employment is down, prices for home construction materials remain soft, and even the home remodeling industry is reporting weakening sales.

More importantly, if financial institutions continue with their stricter lending standards, corporate lending could soften, causing a pullback in hiring or investing in buildings and equipment. If capital spending weakens, other sectors of the economy will likely be impacted.

Another concern for the economy is rising housing-related delinquency rates and foreclosures. Both are expected to continue to increase, in part because variable-rate mortgages are now being repriced at higher rates and taking a bigger chunk of consumers' paychecks. While these percentages, relative to all mortgages outstanding, are quite small, they do represent a threat to spending, given the other negative headwinds.

Figure 2. Mortgage payment problems are rising

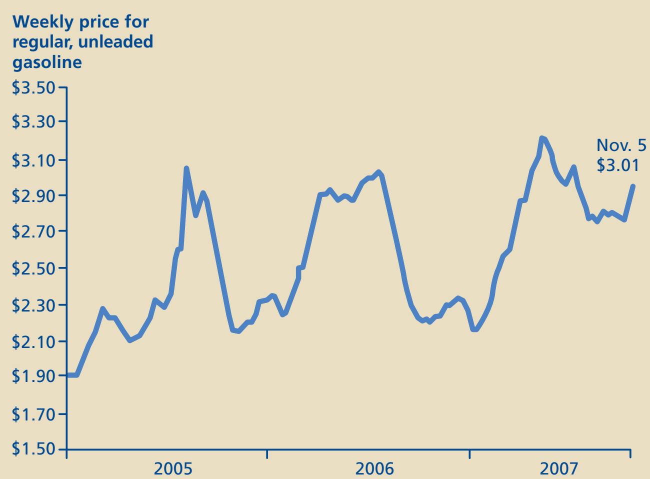


Source: Mortgage Bankers Association

On the inflation front, higher energy and food prices are cutting further into consumers' spendable cash. As noted earlier in this report, these higher bills were the top reasons why consumers in our holiday survey felt they would be slowing their spending this year.

The government's inflation data show that other sectors experiencing stronger pricing increases include medical care, educational books/supplies, tobacco and lodging. Retail sectors catering to lower-income households will likely be impacted more by these higher prices than will the luxury segment.

Figure 3. Retail gasoline prices are headed back up



Source: U.S. Energy Department

 As used in this document, the term "Deloitte" includes Deloitte & Touche LLP, Deloitte Consulting LLP, Deloitte Tax LLP, and Deloitte Financial Advisory Services LLP

What Retailers Can Do

The less-than-cheerful tone of the holiday spending outlook should encourage retailers to assess consumer attitudes and trends carefully in order to select strategies that may support and strengthen sales efforts.

Improve Customer Conversion

Customer conversion tactics offer perhaps the best option for Web- and store-based retailers. There are ample opportunities to boost conversion by offering a better customer experience, either through improved staffing in the store, or by tweaking navigation and ordering on the Website.

Conversion rates can also be increased through service improvements such as better merchandise organization, and informed, interactive sales personnel. A simple "How can I help you?" to store browsers can influence conversion even more than when the same is asked of destination shoppers. Additionally, a 2007 survey conducted by Deloitte & Touche USA LLP on conversion found that assistance in the dressing room strongly influenced conversion.

Other factors that drive conversion include merchandise availability, improved store navigation and merchandise presentation, and a selling style that focuses on offering personal experiences, suggestions and testimonials. And thanks in part to the Internet, consumers are quick to spread the word about store experiences, both negative and positive. In the Deloitte holiday survey, one-third of respondents said they often read consumer-generated reviews of stores or products on the Internet. As these types of online activities continue to grow, retailers will benefit by converting more shoppers into buyers and helping to create a longer-term affinity with customers.

Many of these conversion opportunities can be implemented in time for the holidays and involve only minimal costs, other than a reorientation of staff and a review of store/Website operations.

Offer a Seamless Multi-Channel Experience

E-commerce has altered the retail landscape and the ripple effect from the Internet on in-store sales continues to grow. Retailers are continuing to make their websites more user-friendly with features such as faster page loads, online chat capabilities, personalized information and easy ordering processes.

In the Deloitte holiday survey, 63% of respondents said that they completed at least one type of multi-channel purchase over the past year. Nearly half, 46%, made an in-store purchase after viewing/researching the product on the retailer's Website. One quarter purchased on the retailer's Website after viewing the product in the store, and 16% purchased through the catalog after viewing the product on the retailer's Website or in its store. As an overall comment about shopping, 48% said they liked the convenience of shopping with multi-channel retailers.

To improve the seamless multi-channel experience for shoppers, retailers can better integrate their direct selling efforts (online, catalog, call center) with the in-store experience. Improved inventory visibility techniques, for example, are allowing retailers to view and reserve inventory across their consumer touchpoints. A shift as simple as implementing an in-store return policy can increase appeal to online shoppers. In a related area, newer media channels such as mobile marketing and the introduction of blogs on a retailer's Website can improve customer interactions and purchases.

In order to align channels throughout the enterprise, organizational structures, multi-channel accountability, and IT support need to be considered. Success in this area by the holiday season may be difficult, but improved coordination efforts between Websites and stores and the introduction of in-store returns can help grow sales.

Tout the Corporation's Sense of Responsibility and the Product's Integrity

Shoppers today are more emotionally involved with brands. Ethical retailing practices such as good-for-you products, worker conditions in overseas manufacturing plants, and environmentally-friendly operations are just a few of the topics that concern consumers.

In Deloitte's holiday survey results, 27% of consumers said they would be using fewer plastic bags this holiday season; 18% would purchase more eco-friendly products, and 17% would seek out more "green" retailers. Further, 58% said that the recent news stories about product recalls would influence some of their purchase decisions this holiday season. The products that would be most closely monitored by consumers are toys and food.

With product sourcing such a hot issue, retailers might want to let shoppers know that they sell "Made in the USA" products. Companies may also want to advertise planet-friendly practices such as energy-efficient stores, green freight operations or the reduction of the retailer's carbon footprint. Other options: Hook up with charities for certain sales events. Initiate more safety checks on the products sold. Create consumer-friendly labels or signage that let time-pressed consumers know about better-for-you benefits. Offer recyclable and minimal product packaging. The list is long and the benefits can be many.

Make Gift Cards Easily Available for Shoppers – It's Their #1 Gift Choice

For four years running, gift cards have topped the list of what shoppers say they'll be buying as presents. In 2007, 69% of respondents in Deloitte's holiday survey said they'd be buying gift cards. They plan on buying 5.5 cards, on average, and spending a total of $199 on them. While overall holiday spending may be soft in 2007, this is one area that remains red hot with consumers, due mostly to the convenience aspect of the cards.

So why not make it easy for them to buy? Prominently display them. Promote them in communications to customers. Incorporate them into Websites, making them easy to purchase. Personalize them – some retailers are allowing purchasers to include voice messages or pictures. Others are providing additional incentives with the purchase of the card, such as "% off" promotions or free items. Package them with a small stuffed bear or a two-piece box of chocolates, to make them more appealing.

Be creative about getting consumers to redeem those cards. In Deloitte's holiday survey, consumers told us they were walking around with nearly two unused gift cards in their wallets, on average. Eight percent had five or more unused cards. Since gift card redeemers typically spend more than the face value of the card, it's to the retailer's benefit to get those cards out of shoppers' wallets. At a minimum, make sure the stores are stocked with fresh merchandise starting December 26 to entice recipients into buying.

Gift card redemption is particularly important to retailers because, from an accounting perspective, revenue can't be recognized on the financial statements until the card is redeemed. This is an issue for many retailers, particularly since a 2006 Deloitte consumer survey found that 18% of respondents owned at least one card that was more than two years old.

Protect Customers' Data – and Assure Them That It's Being Done

Identity theft is the fastest growing crime in the US according to the FBI. More than ever, retailers today are vulnerable to inappropriate exposure or outright loss of data, and, importantly, loss of customer trust and damage to brand reputation. Nearly one in five respondents to our holiday survey said they had changed their shopping behaviour because of concerns around identity theft. Two-thirds of those said they no longer give out personal information to store employees as easily as they used to.

The key for retailers in minimizing the destructive impact from identity theft is to be proactive. When a security breach does occur, an established, strategic response plan will enhance a retailer's ability to respond. Relative to operations, departments that store credit card and other shopper/loyalty card information require close monitoring. Point-of-sale systems need to be examined, along with the expanding Internet channel. As consumer awareness of identity theft grows, an appropriate privacy protection program can allow a retailer to gain a sustainable, differentiated advantage in the marketplace.

Make Sure You Get All That's Coming to You

We're talking about optimizing the corporation's tax position, especially with regard to certain tax credits and incentives that may lower the retailer's tax bill. For example, there are "green" tax incentives that can benefit companies that have adopted environmentally-friendly business practices. Incentives are often available at both the federal and state levels.

Tax credits for training, proper accounting for vendor allowances, gift card revenue deferrals and tax-efficient import strategies are additional ways that companies can unlock potentially sizeable tax savings opportunities.

The bottom line is that retailers have at their disposal a myriad of marketing, operational and pricing strategies to respond to any Grinch-like behavior from consumers. As happened to the Grinch, behaviors can be coaxed into changing.

About the Survey

The holiday survey was commissioned by Deloitte & Touche USA LLP and conducted online by an independent research company between September 24 and October 4, 2007. The survey polled a sample of 14,135 consumers and has a margin of error for the entire sample of plus or minus one percentage point.

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Retail Growth Challenge Framework Series

The Retail practice of Deloitte & Touche USA LLP is proud to produce a unique eight-part series about key issues that retailers should be thinking about now to achieve sustained, profitable growth in the years ahead. To help retailers adapt their competitive strategies and put a new transformative growth model to work, Deloitte created its Retail Growth Challenge Framework, a series of forward-thinking articles that focus on customer conversion, the changing customer, growth strategies, cost reduction, the multi-channel brand experience, and precision retailing. Together, these reports span all levels of management activity—strategic, administrative, and operational—to ensure that the right resources, organization, processes, and culture are in place to embrace new growth initiatives and meet existing growth objectives. To access these articles, visit www.deloitte.com/us/RetailGrowthSeries.

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