

# BAIN RETAIL HOLIDAY NEWSLETTER

## THE STRATEGY, SCIENCE AND PSYCHOLOGY OF HOLIDAY PROMOTIONS

By Aaron Chervis, Darrell Rigby and Suzanne Tager



*Holiday sales are exceeding expectations, thanks to strong growth of in-store sales and continued double-digit growth in e-commerce. In this issue, we examine the role promotions might be playing in this growth, reviewing the holiday promotional landscape and sharing how retailers can tap into the science behind customers' behaviors to get more out of their promotional strategies.*

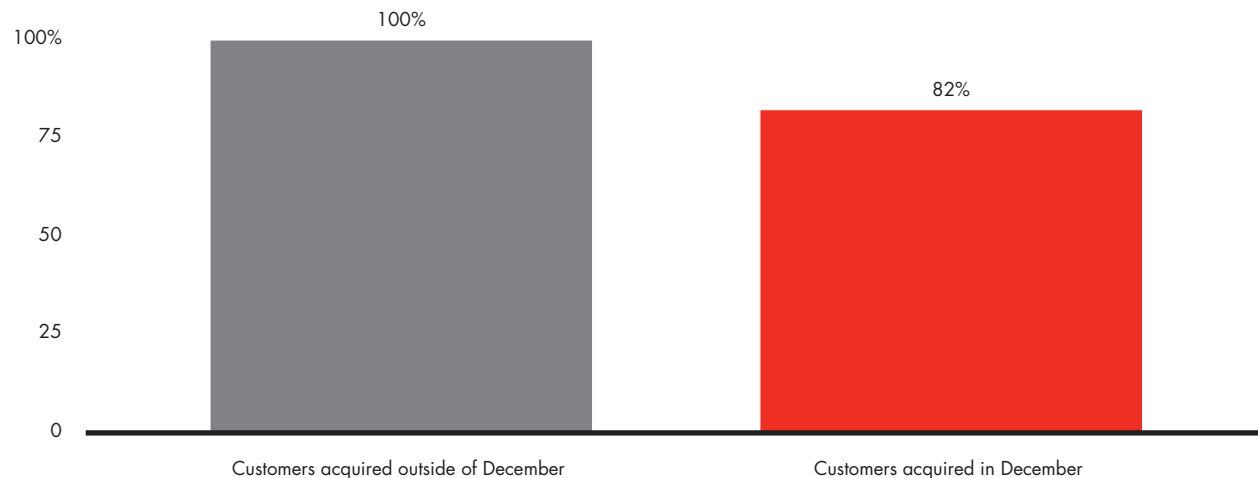
### **Holiday sales are surpassing expectations**

This November, Bain-defined retail sales grew by 6% over last year, the highest growth in November since 2010. Much of the growth came from physical stores, where sales grew 5% over last year. The highest growth categories were building materials (up 11.2%) and furniture and home furnishing stores (up 8.6%), perhaps linked to post-hurricane rebuilding and rising home sales. Electronics and appliances stores also posted big gains, growing at 7.3%. E-commerce continues to outpace the overall market, up 16% year over year according to Adobe Analytics. Sales through mobile devices (smartphones and tablets) are growing as a percentage of overall e-commerce, accounting for 32% between November 1 and December 10. Meanwhile, Amazon.com continues to outshine its competitors. The company reported its highest one-day sales in history on Cyber Monday, and estimates suggest it accounted for more than 60% of all US online sales that day (versus just under 40% on average for the year to date).

Underpinning this impressive sales growth are some strong macroeconomic drivers: The Conference Board

**Figure 1:** Customers acquired in December spend less than customers acquired during the rest of the year

Annual spending of customers in 12 months following acquisition (indexed)



Notes: Data reflects customers acquired both online and in store; includes first-time spenders who were first acquired from January 2014 to October 2016; samples derived from a consistent subset of approximately 1 million anonymous US consumers in a broad consumer panel; analysis includes nine retailers (Macy's, JCPenney, Kohl's, Nordstrom, T.J.Maxx, Sears, Ross, Best Buy, Dick's Sporting Goods)  
Sources: Earnest Research panel data as of October 2017; Bain analysis

Consumer Confidence Index remained at a 17-year high (129.5), and the S&P retail stock index is up 15% since the start of November.<sup>1</sup> That said, retailers capitalized on more than macroeconomic good fortune. They significantly increased advertising to pull in customers and delivered better experiences when shoppers arrived in stores:

- **Retailers are reminding customers to shop.** Retailers have ramped up their paid advertising, especially on mobile devices. Our research with Market Track shows that advertisement spending from mid-October through Cyber Monday for Amazon, Best Buy, Walmart and Target was up 9% year over year. This increase was propelled by a 141% increase in mobile web advertising.
- **Shoppers are more satisfied with their in-store experiences.** In-store shoppers are reporting greater satisfaction with their shopping experiences. The group's Net Promoter Score<sup>®</sup> rose from 36% in October to 43% in November, according to Bain's 2017 Holiday Shopper Pulse survey (conducted in partnership with Research Now).<sup>2</sup> Over the same period, shoppers' satisfaction with Amazon and other online retailers stayed around 52% and 42%, respectively.

While our partnership with Earnest Research suggests customers acquired during the holidays are not as valuable as customers acquired during the rest of the year (*see Figure 1*), this season's spike in holiday sales bodes well for retailers that can keep delighting shoppers in 2018.

## What's the "deal" with pricing and promotions this holiday season?

In 1861, legendary retailer John Wanamaker opened his Oak Hall store in Philadelphia. The store, which sold men's and boys' clothing, grew rapidly based on its "one price and goods returnable" policy plus a revolutionary new concept—the price tag. No more confusion or haggling. The price you saw was the price you paid.

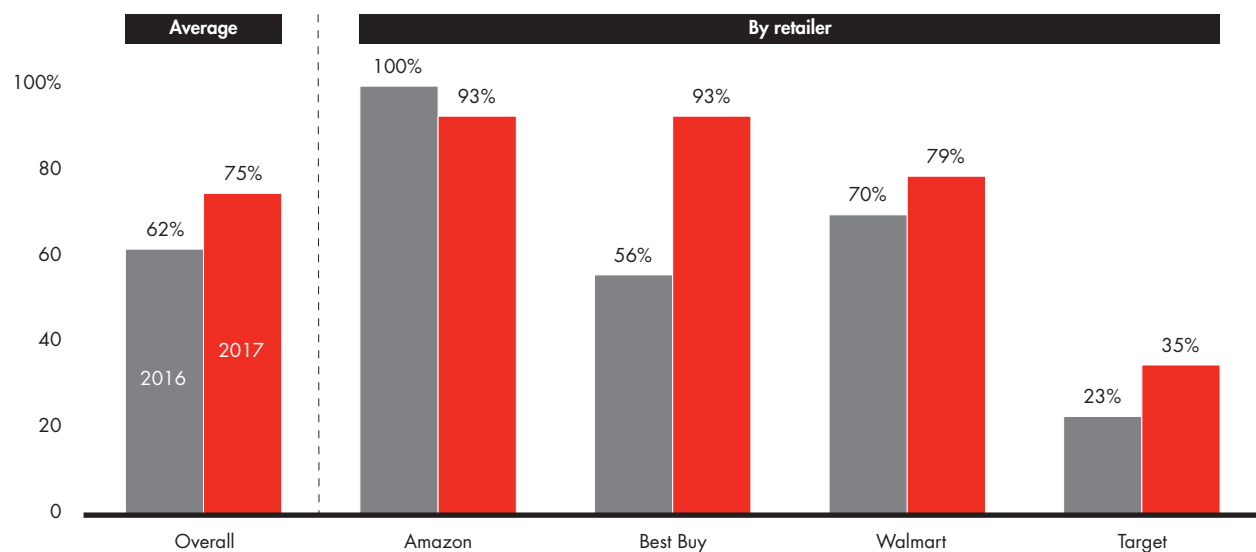
About 25 years later, Coca-Cola introduced its namesake beverage along with an innovation called the “coupon.” The regular price of a glass of Coke was 5 cents, but the coupon entitled bearers to try one glass for free. People flocked to their favorite pharmacies for samples. Experts estimate that by 1894, one in nine Americans had tried a free Coke, making Coca-Cola a household brand. The use of coupons exploded during the Great Depression, and retailers have never looked back.

Today, deals are a staple—especially during the holidays. And despite this year’s healthy economy, the duration, depth and breadth of deals continue to be as strong as ever. Many retailers, including Amazon, Kohl’s and Target, launched their holiday promotions well before Thanksgiving. The deals leading up to and after Thanksgiving remained deep. In partnership with Market Track, we found that discounts in circulars averaged 42% between October 22 and December 11, much like last year. And working with Wiser, we found that discounts in email promotions averaged 36%—slightly higher than last year’s 34%. Beneath these averages lie some interesting details.

- Following in Amazon’s footsteps, retailers are changing prices more frequently.** Amazon’s proprietary algorithms change prices many times a day, matching competitors’ lowest prices on select items and pricing on a per-SKU basis with different prices for variations (like color or size) of the same item. This season Amazon brought dynamic pricing to its Calvin Klein pop-up shops, where customers use a mobile app to scan barcodes and see an item’s current price. Meanwhile, Walmart has increased its use of machine-learning algorithms that allow it to make quick price adjustments. According to Gartner, 70% of the retailers it surveyed in April 2017 planned for significant investments in promotion optimization and pricing intelligence tools in the next 1 to 2 years. Our work with Market Track shows that on average, Amazon, Best Buy, Walmart and Target changed their prices for televisions on 75% of the days between October 15 and December 11, versus 62% in 2016 (see Figure 2). For more details, see Exhibit 1 in the Appendix.

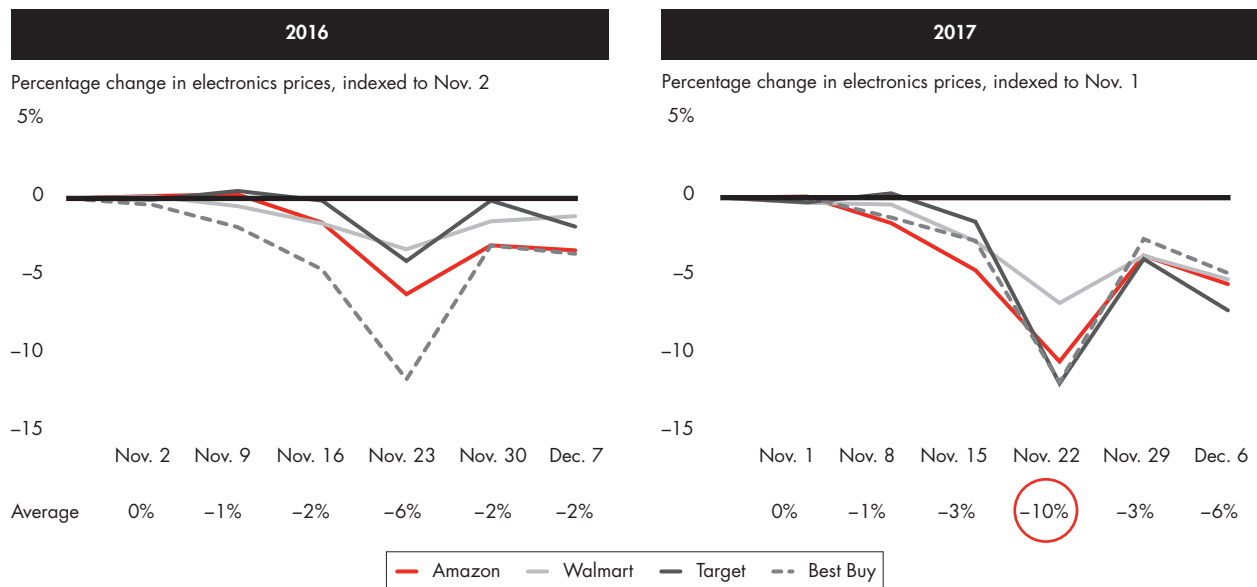
*Figure 2:* Retailers changed prices on televisions more often in 2017 than in 2016

Percentage of days with price changes on televisions from mid-October to mid-December



Note: See Exhibit 1 in the Appendix for a chart showing the percentage of televisions that changed price at each retailer each day from mid-October to mid-December in 2016 and 2017  
 Source: Market Track (n=213 for 2016, 262 for 2017)

**Figure 3:** Consumer electronics price changes in November and December 2016 and 2017



Notes: Data spans November 1 through December 11 and reflects weekly averages; includes online prices of TVs, tablets, video games, wearables and headphones; product assortment varies by retailer and year; analysis adjusted for shifts in product mix; prices do not include overlay coupons or promotions  
 Source: Market Track (n=993 for 2016, 1,030 for 2017)

- **Retailers heavily discounted electronics.** With Market Track, we traced daily online electronics prices at four major retailers between November 1 and December 11 (see Figure 3). On average these retailers ran deeper promotions in 2017, with prices dropping up to 10%, compared to only 6% in 2016.
- **Retailers offered more free-shipping promotions earlier in the season.** Retailers offer many types of promotions beyond price discounts, and free shipping continues to grab holiday headlines. This season, retailers offered more free-shipping promotions earlier in the season. In partnership with Wisser, we found that 56% of promotional emails sent this October included free-shipping offers, compared to just 40% in October 2016. Retailers’ incentives: fewer peak-volume surcharges from shipping companies and less stress on their own fulfillment centers. Retailers also reduced or removed minimum thresholds to qualify for free shipping.

### Unwrapping the long-term impact of price promotions

Americans redeemed more than 2 billion coupons in 2016. Why has the use of promotions increased so dramatically since Wanamaker opened his first store and Coca-Cola offered its first coupon? Partially because they produce such rapid results, partially because technology is making coupons easier to issue and redeem and partially because everyone assumes that someone else is bearing most of the cost. Customers believe they’re getting great deals from desperate retailers. Retailers aren’t terribly worried because they plan to go back to vendors to recover substantial markdown money. And vendors expect to raise future prices to fund the markdowns. When that happens, retailers raise prices to recover increased costs, ultimately pegging deeper discounts to rising list prices in a seemingly never-ending cycle of promotions.

But there are a few important by-products of this cycle. First, although retailers’ gross margins have stayed relatively stable, the gap between list prices and sale prices is growing, reducing consumers’ trust in original list

prices. Second, shoppers have learned to wait for deals. Third, technology is making it easier for customers to cherry-pick the best offers from multiple retailers.

Perhaps the greatest consequence of this cycle has been the rise of low and off-price retailers. Off-price retailers like Ross Stores and T.J.Maxx “price-compare” their goods to high-list-price goods at traditional stores, creating the perception of great bargains. Dollar stores and deep discounters steal customers from traditional retailers through consistent, ultra-low prices. And Walmart’s improving performance shows how advertising and delivering everyday low prices (EDLP), a strategy harkening back to Wanamaker, can improve growth while reducing complexity and operating costs. These disruptive strategies have paid off: T.J.Maxx’s stock price has jumped about 80% over the last 5 years, Aldi is set to grow its US store footprint by 25% in 2018 and Walmart’s same-store sales have increased for 13 quarters in a row.

## **Tapping into the science and psychology of holiday promotions**

Some statistics surrounding promotions are relatively easy to track, but they tell us nothing about the effectiveness of those promotions. Are promotions capitalizing on what we know about the science and psychology behind shoppers’ behaviors?

Used effectively, special offers should do four things:

- Spur strategic innovation
- Strengthen a brand’s image
- Create happier and more loyal customers
- Grow long-term sales and profits

The funny thing is that we seldom hear retailers talking about these objectives as they prepare their holiday promotions. Their primary objective seems to be hitting their holiday plan (even though that plan might involve a drop in sales) and the safest way to do so is to repeat previous promotions (even if they are producing diminishing returns).

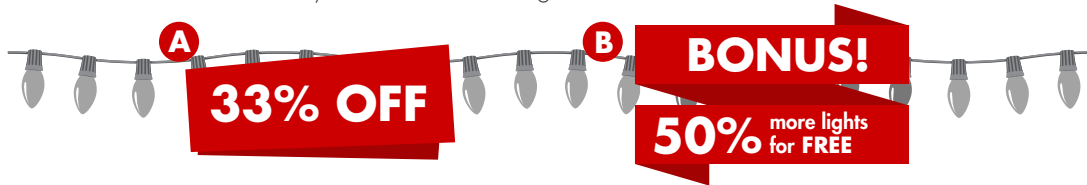
### **Spur strategic innovation**

It’s so easy to slip into incremental thinking: “We’ll do the same things we did last year, but a little bit more.” There’s not enough understanding of what drives customers’ behaviors and how to influence them in more creative or economical ways. Often, even small strategic changes can convert more shoppers into customers and boost bottom lines. Consider the science and psychology within our [Holiday Shopping Quiz](#) (see answers on page 7).

# Holiday Shopping Quiz: Customer Behavior

## Question #1:

You would like to boost holiday sales for Christmas lights. Which deal would be more attractive to customers?



## Question #2:

This season, you're hoping to increase sales for a cosmetic gift set. It's priced at \$40 and includes both eye shadow and a special applicator brush. Which tactic would be most effective?



*(No option to purchase the applicator brush alone)*

## Question #3:

Sally's birthday is December 15, and she has left an item in her online shopping cart. Which email offer would likely result in a greater increase in conversion rates and sales?



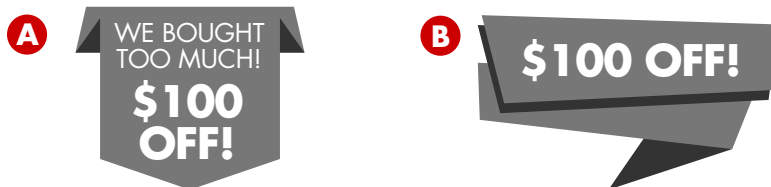
## Question #4:

It is Black Friday and you're updating your overall promotion messaging. What would be the best way to display one of your price tags?



## Question #5:

You want to get rid of last winter's excess inventory by putting it on sale. Which sign would likely yield better results?



# Holiday Shopping Quiz: Customer Behavior

## ANSWERS:

Answer #1:

**BONUS!**

50% more lights

**B. (Concept: value of free)**

While both offers yield the same price per unit, customers overwhelmingly prefer option B and assume it is a better deal. Studies show that customers attribute disproportionately high amounts of value to free products. The impact is big: In one study, researchers sold over 70% more hand lotion when they offered it with a bonus pack than when they offered it at an equivalent discount. At the same time, retailers also sell more product and get better margins on the incremental sales. For more, see "When More Is Less: The Impact of Base Value Neglect on Consumer Preferences for Bonus Packs over Price Discounts" by Chen et al. in the *Journal of Marketing*.

Answer #2:



**B. (Concept: decoy effect)**

Customers are more likely to select the gift set in option B because it looks like a better deal when compared to the equally priced applicator brush. Clearly, buying the applicator brush alone for \$40 is suboptimal. However, in option A, removing the choice to buy the applicator brush alone makes customers more likely to opt for the cheapest choice and purchase just the eye shadow. For more, see *Predictably Irrational: The Hidden Forces That Shape Our Decisions* by Dan Ariely.

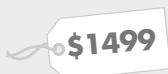
Answer #3:



**A. (Concept: implicit egotism)**

Customers prefer offers that contain letters and numbers corresponding to their names and birthdays. For example, studies show that shoppers are more likely to purchase an item when its price contains the digits found in their date of birth. In addition, personalized email subject lines that include words such as "just for you" generate an above-average open rate of 22%, a trend that holds true across price points. For more, see "Name-Letters and Birthday-Numbers: Implicit Egotism Effects in Pricing" by Coulter and Grewal in the *Journal of Marketing*.

Answer #4:



**B. (Concept: minimizing syllables)**

Most customers read option A as "one thousand four hundred and ninety-nine" and option B as "fourteen ninety-nine." The key difference? Option A has 10 syllables and option B has 5. Visually, option B also looks smaller and shorter. Studies show that even though shoppers don't say prices out loud, the number of syllables matters. People perceive prices to be smaller when they contain fewer syllables. We falsely infer that if a number is easier for our minds to process, the overall magnitude must be smaller. For more, see "Comma n' Cents in Pricing: The Effects of Auditory Representation Encoding on Price Magnitude Perceptions" by Coulter, Choi and Monroe in the *Journal of Consumer Psychology*.

Answer #5:



**A. (Concept: providing a reason for the discount)**

To increase the effectiveness of a discount, explain why you are offering it. Why? Because when customers see a reason for a lower price, they view it as temporary. When they return to your store in a few weeks, customers will be less likely to expect sale prices. For more, see "Reference Price Research: Review and Propositions" by Mazumdar, Raj and Sinha in the *Journal of Marketing*.

## **Strengthen a brand's image**

All too often promotions hurt a brand's image. But they don't have to. Take Coca-Cola: The company gave away free sodas to earn consumer loyalty and build its brand image without devaluing Coke's price. Sometimes retailers are better off offering "free" once instead of "20% off" forever.

Winning retailers align holiday promotions with their long-term brand strategies. That's why a number of luxury retailers choose to highlight the quality of their products rather than the depth of their discounts. Louis Vuitton, for example, doesn't hold sales over the holidays. It draws in traffic with special campaigns, like its partnership with renowned artist Jeff Koons. Koons created Louis Vuitton holiday window displays that situate luxury bags against the backdrop of his famous white sculptures. These displays emphasize the brand's beauty and creativity—and reinforce its high-end image. On the other hand, it makes sense for Dollar General to offer a special holiday promotion where customers can take advantage of up to \$200 in additional savings. This strategy reinforces (and exaggerates) the company's image as a retailer that saves its customers a lot of money.

## **Create happier and more loyal customers**

Happy customers make for happy retailers. Bain's research shows that advocacy leaders in retail—those that delight their customers and receive the highest Net Promoter Scores—outperform competitors within their price tier and segment by two to three times in terms of organic annual growth.

Price discounts are often a short-term fix for delighting customers, but they usually need to be offered over and over again to keep or regain shoppers' interest. Better promotional strategies create loyalty over the long term. They draw on motivating factors that extend beyond just a price cut, such as rewards, entertainment or the avoidance of hassles. Take rewards programs as an example: Few shoppers would find a 1% to 5% off sale very enticing and yet, many would happily change their behavior to get rewards benefits that are of equivalent (or lesser) value. Macy's, for example, introduced its new Star Rewards program this fall, which offers its top shoppers 5% back in store credit for all purchases.

## **Grow long-term sales and profits**

Promotional strategies too often are viewed through a short-term lens. Retailers calculate short-term price elasticities and 14-day ROIs. They focus on how price changes impact quarterly results and neglect longer-term behaviors, new customer acquisitions or the lifetime value of their customers. That's a mistake. Meaningful innovations can take 5 to 7 years of testing and learning to deliver significant results. For example, many retailers would have scoffed at the idea of a membership program such as Prime given its high costs. Yet Amazon considered the benefits of higher traffic and increased share of spending that would come with shopper enrollment. The company figured out ways to make it sticky and lower churn, while continuously adding features and increasing member value. All the while, many competitors watched and tried to figure out Prime economics, as well as ways to copy small parts of the Prime value proposition, without creating something unique and compelling of their own. As a result, Amazon now has a meaningful and durable competitive advantage.

One reason we see companies—at least public companies—take a short-term view is that they are under the scrutiny of shareholders, analysts and the markets. But imagine this: Your company goes private and you are no longer under a microscope each quarter (let alone each day). What would you do differently with your promotional strategy? Would you examine the impact on customer behavior and sentiment rather than on next quarter's bottom line? Why not start now? Five years from now, your investors will likely be happy that you did.





Changing pricing and promotional strategies is risky business. Several retailers have learned this lesson the hard way. If you hope to reduce discounts, the three biggest tips we can offer: First, find other ways of meeting the four objectives mentioned above. Retailers that do this well invest in other sources of value beyond discounts—unique merchandise, customer rewards, added services, engaging in-store experiences—that help build loyalty and sales. Second, listen to customers and measure their behaviors throughout testing and scaling. Keep an eye on longer-term trends versus just short-term reactions. Lastly, tackle the change—from design to messaging, technology requirements, and training—with cross-functional teams rather than hand-offs across silos. This boosts both results and very importantly, speed.

## Looking forward: Post-holiday recap and outlook

We hope you have a wonderful break over the holidays. We'll be back in the new year with our final issue of the 2017–2018 holiday season, “Bain’s Post-Holiday Recap and Outlook.”

Please let us know if you have any questions or would like to arrange a follow-up discussion on the issues addressed in this newsletter or any other retail topics by emailing us at [RetailHolidayNewsletter@bain.com](mailto:RetailHolidayNewsletter@bain.com).

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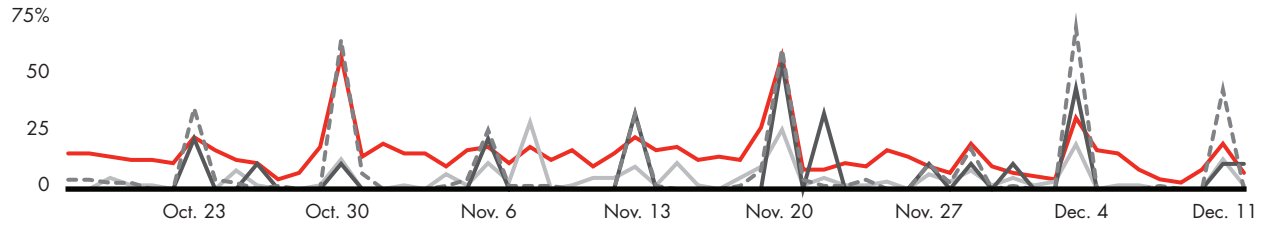
<sup>1</sup> The SPDR Standard & Poor Retail ETF tracks a broad range of stocks in the US retail industry.

<sup>2</sup> The Net Promoter Score<sup>®</sup> is derived by asking consumers, “On a scale of zero to 10, how likely would you be to recommend this company (or this product) to friends and colleagues?” Ratings of 9 or 10 indicate promoters; 7 and 8, passives; and zero through 6, detractors. The score is simply the percentage of promoters minus the percentage of detractors. Net Promoter<sup>®</sup>, Net Promoter System<sup>®</sup>, Net Promoter Score<sup>®</sup> and NPS<sup>®</sup> are registered trademarks of Bain & Company, Inc., Fred Reichheld and Satmetrix Systems, Inc.

# APPENDIX

*Exhibit 1:* Price changes on televisions from mid-October to mid-December 2016 and 2017

Daily percentage of televisions with price changes, 2016



Daily percentage of televisions with price changes, 2017



Source: Market Track (n=213 for 2016, 262 for 2017)

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