SOME HOLIDAY SHOPPING ISSUES

Lars Perner, Ph.D.
Assistant Professor of Clinical Marketing
Department of Marketing, Marshall School of Business
University of Southern California, Accounting 306K
Los Angeles, CA 90089-0443
Phone: (213) 740-7127   Cell: (213) 304-1726
perner@marshall.usc.edu
http://www.LarsPerner.com   http://www.ConsumerPsychologist.com

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An early Thanksgiving this year. Since November 1 was a Thursday this year, Thanksgiving falls on November 22, the earliest date at which the fourth Thursday of the month can occur. This is good news for retailers, since this will leave more time in between Black Friday—the day when many people begin their holiday shopping—and Christmas. Even if Thanksgiving occurred toward the end of the month, this would hardly prevent many shoppers from getting the time to buy gifts for people on their list. However, when more time is left between Thanksgiving and Christmas, shoppers may buy more gifts for some of their recipients. In addition, with more time to shop, some may be more comfortable in buying more expensive items knowing they have had the time to shop around.

Still, a large number of people do tend to leave holiday shopping to the last minute, so many online merchants are offering next day and second day delivery at a modest cost or even for free with purchases of a certain size.

Availability of bargains. As retailers face increasing competitive pressure, in part because Walmart and other merchants are seeking out a more prominent space in the online market, it is likely that an abundance of deep discounts will be offered this year. Retailers such as Target and Best Buy are reported to be coming out with exceptionally large advertising circulars this year.

Although certain special bargains will be in short supply, it is likely that many Black Friday deals will still be available for those who arrive at stores late in the afternoon. Although retailers historically bore the cost of limited supply special "loss leader" items that would tempt customers to visit their stores rather than those of competitors, many bargains today result from the low prices offered to retailers willing to place large orders sufficiently early—possibly as far as ten months or more in advance. Thus, retailers are actually able to make a modest profit on many of these bargains and are motivated to stock a large supply.

Consumer spending outlook. With the relatively strong economy and early occurrence of Thanksgiving this year, consumer spending on holiday items will likely be high. Although consumer confidence appears to have recently decreased slightly, the overall outlook appears reasonably optimistic. Consumers whose income taxes have decreased will also have more money available to spend, especially if motivated by attractive holiday bargains. It is widely expected that inflation rates will be increasing significantly in the near future. If this issue is discussed widely in the news, it is possible that this may spur buying in advance of expected price increases.

With increased tariffs on many products either made in China or reliant on imported Chinese components, retailers that have not struck price agreements in advance will likely face somewhat higher prices. However, there is often a lag after the time a tariff is imposed before it is passed onto consumers, so the entire effect will probably not kick in this holiday season. In addition, some of the costs of these tariffs may be masked by the current strength of the U.S. dollar.

Early Black Friday sales. During the last recession, a number of retailers attempted to open on Thanksgiving Day. This, however, resulted in considerable backlash as many consumers felt it inappropriate that retail employees should be asked to sacrifice time with their families during this holiday that often brings families together. In more recent years, many retail chains have started their sales on the days *before* Thanksgiving and even earlier. Amazon.com has been labeling what it normally calls its "Daily Deals" as "Early Black Friday Deals," although the deals offered so far have, for the most part, not been particularly impressive. In the days before Thanksgiving, Amazon will likely increase the number of aggressive deals they will be offering.

As brick-and-mortar chains increasingly emphasize online sales, they can offer customers the chance to shop that way on Thanksgiving Day without having to have retail employees work.

Cyber Monday is largely a historical relic. One might have predicted that Cyber Monday would eventually fade away as an event. It is really a historical remnant from the "dark old days" in the late 1990s and early 2000s when many families did not have high speed Internet access at home. As a result, large scale online sales with bandwidth hogging photos had to wait until people got back to their faster Internet connections at work. With online sales starting a week or more before Thanksgiving and lasting through the Thanksgiving week-end, one might have predicted a loss of interest in a Cyber Monday. Yet, Cyber Monday sales abound today since the event provides an "excuse" for merchants to provide value conscious customers with an additional round of deals. Come Cyber Monday, online merchants will also hold an edge as it becomes less convenient to go shopping in malls and other brick-and-mortar stores. In the long run, Cyber Monday could potentially fade away as consumers develop shopping "fatigue" from more than a week of sales.

Impact of online merchants on brick-and-mortar retailers. Online shopping is clearly a growing trend, and one benefit for consumers is that the market online changes to a national one as opposed to a local market where fewer merchants compete. There is a widely mistaken belief that online merchants generally have lower costs than brick-and-mortar stores. After all, online merchants can locate their distribution centers in areas with low real estate and labor costs. Some merchants such as Amazon have also used automation to become highly efficient. Many other online merchants, however, face a very labor intensive process. When customers go shopping in retail stores, they do a great deal of the work: They pick up the items desired from different areas of the store, bring them up to the cashier, and haul the purchases away. These tasks, in the online setting, have to be done by merchant employees and delivery services such as UPS and FedEx. Thus, for run of the mill type merchandise, online sellers often face *higher* costs in reality than brick-and-mortar competitors.

Online selling does, however, lend itself well to products that have a high "value-to-bulk" ratio—that is, where a high price is squeezed into a small size—and a high "absolute," or dollar margin. That is, the percentage margin does not necessarily have to be large so long as the dollar margin is. If a $1,000 notebook computer carries a ten percent gross margin of $100, that leaves a fair amount of money to handle costs even though the percentage margin is lower than it might be for other, lower priced, products. Many holiday gifts involve electronic products that fare well under these criteria, making brick-and-mortar merchants vulnerable. Merchants that operate both retail stores and online sales can benefit from the "bricks-and-clicks" effect whereby certain products can be efficiently shipped to consumers while returns can be made at retail stores.

It should be noted that only a modest amount of "diversion" from brick-and-mortar stores to online sellers is needed to dramatically affect profitability. Retailers have large fixed expenses—such as the cost of real estate and utilities—that stay relatively constant regardless of sales volumes. As a result, they need to rack up considerable sales volumes before they can even cover these fixed costs. In fact, the term "Black Friday" refers to the historical date at which retailers had fixed costs covered so that the gross margin on anything sold from thereon could go to profits. With increasing competition today, many merchants may not reach this "break-even" point until later. As evidenced by large scale retail bankruptcies, and some will not even cross that threshold.

The potential of lower prices is not the only motivation for shopping online. Some customers value the convenience and potentially greater selection available. Another benefit is that stock-outs are less likely as fluctuations in demand that would happen at the store level tend to cancel out each other when a distribution center serves a large area and, by extension, a large number of customers.

Economists say that as demand goes up, prices should *rise*. Why, then, do we end up with elaborate *sales* and exceptional *deals* during the holidays? Economists choose their words carefully. The need to buy a large number of gifts does not necessarily translate into an increased demand—a willingness to pay higher prices. One factor here is that there is a tremendous potential for *substation* among many different gift possibilities. In some cases, one's children might have asked for a very specific toy, but in other cases, a DVD, a book, or a shirt may all be suitable gift ideas for a given individual. For off-holiday shopping, opportunities for substitution are much less.

Retailers may offer *loss leaders*, deeply discounted items intended to get the customers in the door so that they will buy items with larger margins. Increasingly, however, many of the deep discounts are funded by large discounts by manufacturers in return for large orders placed early. For this reason, certain very attractive deals may be available in abundant supply.

In addition, there is a fundamental change in the nature of the market during the holidays. Because of the intense competition among retailers, there is an increasing pressure to focus on *volumes* of sales rather than margins on each sale. Given what a retailer expects about the competitive strategy of its competitors, it seems to be better off making a lot of sales that each carry a small margin rather than attempting to make larger margins on what will likely be very limited volumes. U.S. public policy strongly favors competition among firms with laws prohibiting sellers from colluding with each other to maintain higher prices. With the sheer number of competitors in the U.S. retail market, is also doubtful that that collusion could actually be maintained even if not prohibited by law.

A large portion of the merchandise retailers have bought for holiday sales will decline dramatically in value after the holidays, further creating an incentive for retailers to heavily discount if sales run behind expectations.