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## **PRI QUARTELY RETAIL ANALYTICS**

“BRINGING RESEARCH TO RETAIL”

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PRI's mission is to initiate and secure the funding of studies on specific retail business issues. PRI functions as a conduit, bringing together retail executives with leading researchers. The genesis of the Retail Institute is the recognition of the wealth of knowledge being produced at the University level, on the one hand, and the need for more advanced yet practical business research and insight at the retail level, on the other. It is, therefore, the Retail Institute's main objective to serve as a knowledge bridge between the University and retail industry and its related vendors. It will achieve this objective through the commercialization of the resources of its Research Fellows and University relationships.

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# I. BUSINESS OUTLOOK

## BUSINESS INDICATORS

Look for moderating economic growth during the first-half of 2006. The anticipated slowing in consumer spending could be offset by continued strength in capital spending, as well as improving overseas economies. Corporate profits, capital spending, and job growth will be the key economic drivers during the first-half of the year.

Fourth Quarter GDP illustrates this trend, growing by a disappointing 1.1%, versus 4.1% during the Third Quarter. This is the slowest pace since the Fourth Quarter of 2002. Overall, 2005 GDP grew by 3.5%, versus 4.2% in 2004 (see Chart A).

Corporate cash flow (internal funds available for investment) rose 4% in the Third Quarter. Chart B illustrates the strength in operating profits, which could fuel capital spending and hiring into 2006. On the other hand, Alliance Capital forecasts a -4.0% decrease in corporate operating profits during the Fourth Quarter, as “the economy is transitioning to a more moderate pace of growth”.

Chart A:

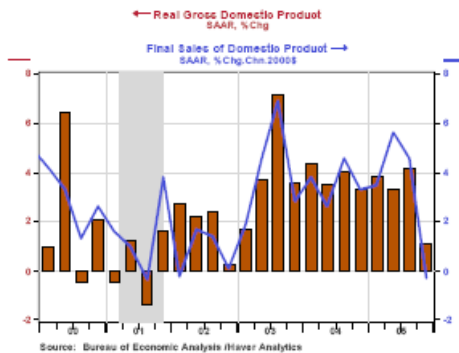
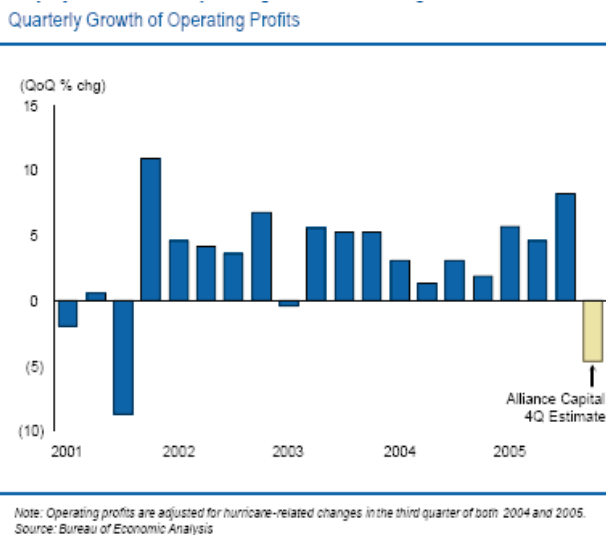


Chart B:



source: Alliance Capital

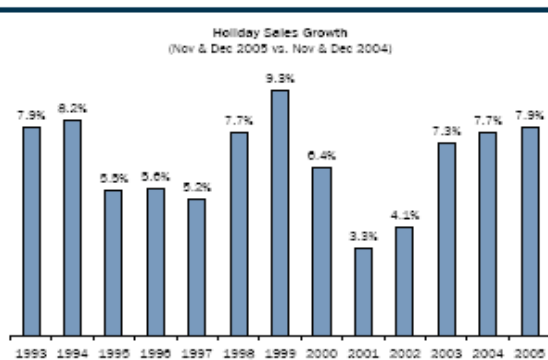
Capital spending slowed in the Fourth Quarter to 3.5%, versus 10.6% in the Third. For 2005, capital spending rose a healthy 10.8%, versus 11.9% in 2004. Strength in capital spending should hold-up, as orders and shipments remain strong. BMO Nesbitt Burns forecasts an 8.4% rise in capital spending for 2006. Supporting this, Durable goods orders rose 1.3% in December, 0.9% excluding the transportation sector. November's results were also upwardly revised. Orders for non-defense capital goods excluding aircraft rose 3.5%. Shipments of durable goods increased 3.5% in December, following a 0.6% gain in November. On a Quarterly basis, inflation adjusted shipments of non-defense capital goods excluding aircraft increased at an annual rate of 15.1% in the Fourth Quarter vs. a 1.7% gain in the Third Quarter.

On the job front, initial jobless claims rose by 11,000 to 283,000 during the Third week of January. On a year-to-year basis, seasonally unadjusted jobless claims fell 12.1% during the week ended January 21, following a 6.0% drop in the previous week. By some accounts, the current economic expansion could end with the fewest number of new jobs created during an economic cycle in the post-war period. On the other hand, other economists advance that a reasonable correlation exists between job growth and capital spending. By this view, job growth could outpace expectations. We don't think so, and are hopeful that that employment will grow in line with 2005.

## **RETAIL INDICATORS**

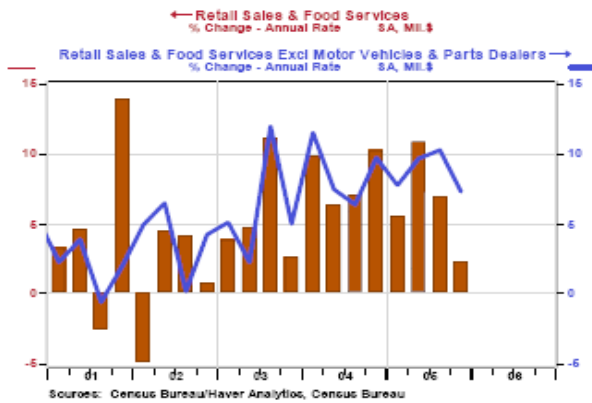
Year-on-year holiday sales held-up nicely, rising by 7.9% versus 7.7% the prior year (see Chart 1, which excludes auto, food and drink, and gas sales). However, in our Third-Quarter 2005 report, we foresaw that retail sales for the holiday selling season would be softer than the consensus view. In fact, November and December retail sales (excluding autos, gas and building materials), grew by a less than stellar 0.3% and 0.2% month-on-month, substantiating our view. As regular readers of the PRI Quarterly Retail Analytics know, we tend to highlight our prior opinions on the rare occasion when we are close to being accurate; noticeably absent are all the misses. Yet the handwriting foretelling moderating holiday sales seemed apparent. Rising gas prices and interest rates; a natural disaster here, a war there; a slowing housing market and a tapped-out consumer and, guess what? Retail sales are slowing, as Chart 2 illustrates.

Chart 1:



source: Wachovia Corp.

Chart 2:

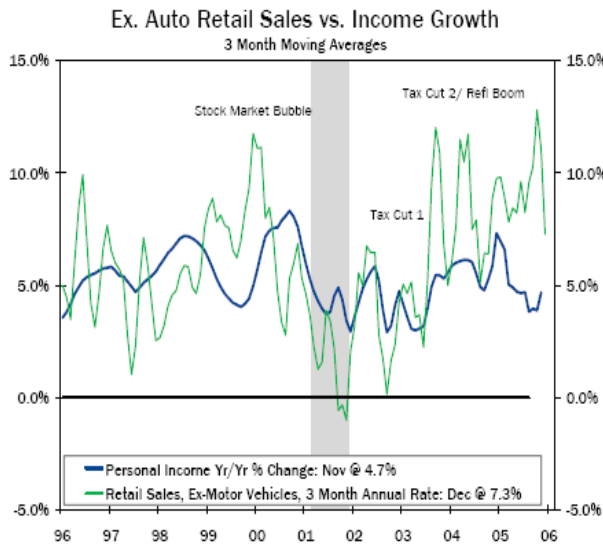


Overall, retail sales for 2005 grew 6.1%, versus 7.0% in 2004. Look for this slowing trend to continue into 2006. For example, the National Retail Federation looks for 4.7% growth in 2006. Consumer spending and income trends further buttress this view.

Consumer spending grew at an annualized rate of 1.1% in the Fourth Quarter, versus 4.1% in the Third Quarter (versus 3.5% in the first, and 3.4% in the second). Real consumer spending is estimated to grow 2.8% in 2006, versus 3.7% in 2005. Increased energy and interest costs, a slowing in mortgage refinancing, a negative savings rate, and slowing job creation underlie this.

For December, disposable personal income increased 0.4%. For 2005, real disposable income rose 1.4% versus 3.4% in 2004. Readings on consumer income, which drives spending, have been trending down. Inflation adjusted earnings are anticipated to have dropped 1% for the year. Total income rose 5.9% in the Third Quarter, slowing from 7.1% earlier in the year. Chart 3 illustrates the relationship between retail sales and income growth, as well as the direction both are taking.

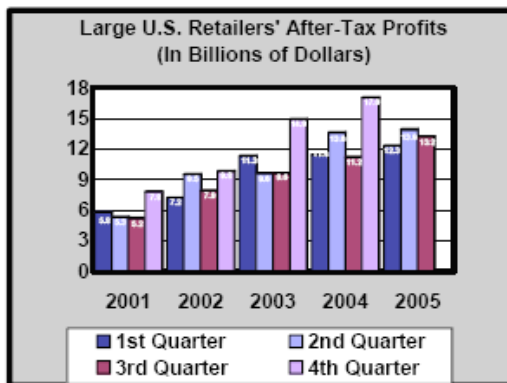
Chart 3:



source: Wachovia Corp.

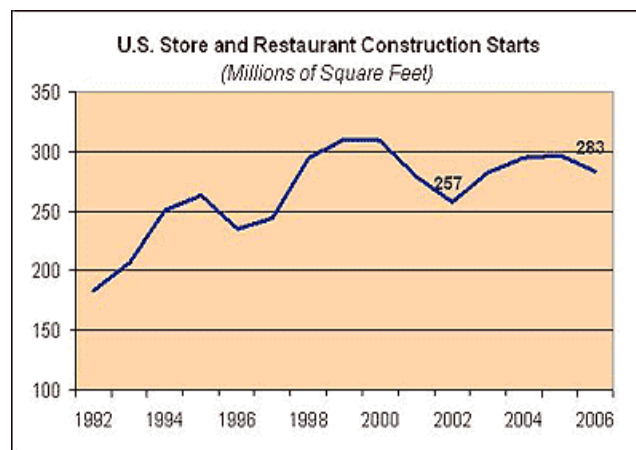
Another indicator of the direction of the retail industry comes from observing sales and profits for large retailers. Sales for large retailers rose by 0.9% in the Third Quarter of 2005 versus the second Quarter; and by 8.7% versus the Third Quarter of 2004. As Chart 4 illustrates, after-tax profits for these retailers was 3.0% for the Third Quarter of 2005 versus 3.1% in the second; and versus 2.7% for the Third Quarter of 2004. While Third Quarter profits were up in dollar terms, margins were reduced. Notwithstanding, increased profits could bode well for reasonable capital investments by these retailers into the first half of 2006. The outlook for new retail construction is not as favorable. According to McGraw-Hill Construction, following a 1% increase in new retail construction last year, they forecast a 5% decrease in new retail construction starts in 2006, which reflects the related anticipated slowdown in housing starts (see Chart 5 and Chart 6). Less new stores results in less need for capital equipment.

Chart 4:



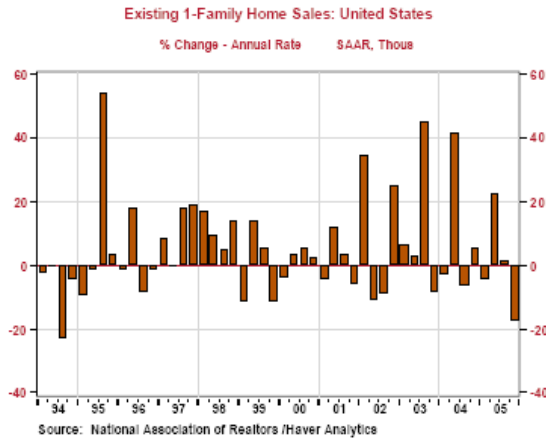
source: Census Bureau

Chart 5:



source: McGraw-Hill Construction

Chart 6:



## **II. MAJOR RETAIL SECTOR TRENDS:**

### **BUILDING MATERIALS, GARDEN AND SUPPLY STORES**

Sales fell -0.6% in December. On an annualized rate, sales are up 8.7% for the trailing 3-months and are up 9.7% for the trailing 12 months.

### **FOOD AND BEVERAGE STORES**

Sales rose 0.3% in December. On an annualized rate, sales are up 2.5% for the trailing 3-months and are up 3.9% for the trailing 12 months.

### **HEALTH AND PERSONAL CARE (DRUG) STORES**

Sales rose 0.3% in December. On an annualized rate, sales are up 5.3% for the trailing 3-months and are up 7.6% for the trailing 12 months.

### **CLOTHING AND ACCESSORY (APPAREL) STORES**

Sales were flat in December. On an annualized rate, sales are up 10.8% for the trailing 3-months and are up 7.1% for the trailing 12 months.

### **GENERAL MERCHANDISE STORES**

Sales fell -0.3% in December. On an annualized rate, sales are up 2.7% for the trailing 3-months and are up 5.1% for the trailing 12 months.

### **DEPARTMENT STORES**

Sales fell 1.5% in December. On an annualized rate, sales are up 0.8% for the trailing 3-months and are down -2.3% for the trailing 12 months.

## **AUTOS**

Sales rose 2.6% in December. On an annualized rate, sales are up 28.8% for the trailing 3-months and are up 0.8% for the trailing 12 months.

## **III. RESEARCH NOTES**

### **UNSEEN IS UNSOLD: ASSESSING VISUAL EQUITY WITH COMMERCIAL EYE-TRACKING DATA**

INSEAD Working Paper, available at:  
[http://faculty.insead.edu/chandon/personal\\_page/resume.htm](http://faculty.insead.edu/chandon/personal_page/resume.htm)

By Pierre Chandon, Insead, J. Wesley Hutchinson, University of Pennsylvania, and Scott H. Young, Perception Research Services, Inc.

This study examines the effect of POP advertising upon a brand's purchase consideration in-store. For a brand to be purchased, it must first be considered by a consumer. Brand consideration in-store is influenced by two elements: pre-store memory and in-store visual effects. Memory-based brand equity encompasses pre-store marketing such as brand awareness, knowledge and image. Visual equity, the focus of this study, is defined as marketing effects attributable to in-store visual attention, with the goal of attracting shopper's in-store to gain consideration of a brand. The study used eye-tracking technology to measure visual attention to products on shelf displays. In one category tested - orange juice - consumers' considered the category for 25.1 seconds, noted 10.9 brands, and considered 2.5 brands of 16 offered. In a second category tested - laundry detergent - consumers' considered the category for 18 seconds, noted 7.1 brands and considered 2.3 brands out of 10 available. In the two categories studied, the researchers found that the effect of in-store visual attention on brand consideration was approximately equal to that of pre-store memory. To reach this conclusion, a model was used to separate the effects of memory (i.e., the probability of consideration before fixating on the package), and the effects of visual attention (i.e., the added consideration that results from looking at the package one or more times in-store). For example, for a brand that had 20% consideration overall, it was estimated to get approximately 10% from the memory-based effect and another 10% from noticing the product on the shelf. This research is significant because it illustrates that brand consideration can be influenced by visual elements at the store level, and that the impact of POP is estimated to approximate that resulting from brand-based marketing activities.

LINKING RETAIL STRATEGY, ATMOSPHERIC DESIGN  
AND SHOPPING BEHAVIOR

Journal of Marketing Management, Volume 18, 2002

By L.W. Turley, formerly of Western Kentucky University, and Jean-Charles Chebat,  
Hautes Etudes Commerciales de Montreal

In this article, the authors discuss the importance of, and impact upon, consumer shopping behavior attributable to a store's environment. They note that most retailers have adopted an approach to store design similar to that of consumer package goods companies; that is, that a store's environment is a package that surrounds a product for sale and is designed accordingly. They further conclude that academics have also failed to link facility design to managerial and strategic issues such as corporate and marketing objectives, using design to attract specific segments of shoppers, and using atmospherics to create a differential advantage. They address this by advancing an approach that integrates store design into the strategic planning process. The approach involves formulating a consumer orientated retail strategy into a store's design, such that specific outcomes relative to shopping behavior are achieved. These outcomes include: sales effects, approach-avoidance behavior, impact on store image, a differential tool, a segmentation tool, uniformity issues, implementation problems, employee impact, entertainment aspects, and as a counter to e-tailers.

DEPLOYMENT AND TEST OF A RETAIL DIGITAL COMMUNICATIONS  
NETWORK BY THE UNITED STATES POSTAL SERVICE

Platt Retail Institute Working Paper #4, January 2006

By Steven Keith Platt, Platt Retail Institute, Dr. Kamel Jedidi, Columbia University Graduate School of Business, and Margot Myers, United States Postal Service

Issues surrounding retail digital communication networks ("DCN") revolve around strategy, deployment, and measurement. Prior research in this area has focused upon these issues, but has been limited in terms of correlating strategy with measurement over extended test duration. While such prior research has yielded valuable insights, it has been inhibited in terms of the size and scope of the underlying data sets. This Working Paper contributes to the study of retail DCN in various ways. First, it is the most extensive report of a major DCN field test published to-date. Second, it provides intricate knowledge into the testing methodologies applied and the results achieved therefrom. Third, it demonstrates how various analytic models are integrated and interpreted relative to a stated strategy. Finally, it draws implications from this research for wider retail industry application.

The conclusions reached from the test by the USPS of its DCN, known as the Post Office Channel, in video markets are summarized as follows:

**Observation 1:** The Post Office Channel had a positive, quantifiable impact on Postal Service revenue.

**Observation 2:** Customer basket size was positively impacted by the presence of digital signs.

**Observation 3:** Consumer awareness of products/services did not have a high observable correlation with changes in revenue.

**Observation 4:** The data is inconclusive as to whether the Post Office Channel increased immediate (impulse) demand.

**Observation 5:** Consumer intent to purchase products/services three months following their interview did not have a correlation with revenue over a two-, three-, and four-month test period.

**Observation 6:** Consumers were aware of the digital signage at the Post Office.

**Observation 7:** Overall, the Post Office has a high-rate of advertising recall. Moreover, digital signage had a positive impact thereon.

**Observation 8:** Consumer awareness of products/services advertised on the digital signs was increased.

**Observation 9:** Digital signage had a noticeable impact upon product/service purchase intent.

**Observations 10:** The data is conflicting as to whether retail digital signage had a clear impact on overall reported customer satisfaction. Notwithstanding, retail digital signage had a positive impact on customer wait-time perceptions.

**Observation 11:** Digital signage had an impact in shifting consumer purchases to in-store, self-service options.

**Observation 12:** The Post Office Channel had an impact upon redirecting consumers to alternative out-of-store access points to purchase products/services.

From these and other observations, we advance the following related considerations for an entity studying the merits of adopting a DCN:

1. A well-designed strategy and linked-metrics are critical to the success of a DCN.
2. Revenue gains derived from the sale of anesthetic products/services will be less than that realized from the sale of other products/services.
3. Promotional ads have a greater impact on revenue than general, informational type messages.
4. Retailers should aspire toward customized DCN solutions that best communicate their brand in-store.
5. Consumer behavior can, within certain tolerances, be impacted by digital signage.
6. Awareness is only the first step in creating relevant content.
7. Content refresh will contribute to long-term, sustainable sales growth.
8. Screen placement and customer dwell time are critical considerations.
9. Cost/benefit analysis should incorporate all tangible and intangible elements as they interact with specific goals and objectives of a particular system.

(Our research notes are published monthly, and can be found on the National Retail Federation's website at: <http://www.nrf.com/RetailResearch/View.aspx>).

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