

NORDSTROM'S LABORATORY



No department store chain has been more aggressive than Nordstrom in embracing and experimenting with technology. But will all the tinkering entice fickle customers to keep coming back?

BY PHIL WAHBA



THE NORDIES HAD WAITED DECADES for this day, and they were taking a few final moments to savor it.

On a damp morning in April, dozens of Nordstrom employees formed a long greeting line just inside the entrance to the upscale department store chain's new location, on West 57th Street in Manhattan. The 117-year-old, Seattle-based company is one of American retail's most respected names, but this men's emporium, just a block from Central Park, would be its first full-service store in the nation's fashion capital.

The party mood intensified with the arrival of Bruce Nordstrom, the octogenarian chairman emeritus affectionately dubbed "Mr. Bruce" by employees ("Nordies" is their shared nickname). When he led Nordstrom, Mr. Bruce had helped the company go nationwide; now he earned an ovation as he walked along the receiving line. The onlookers included his three sons, Blake, Erik, and Pete—now Nordstrom's copresidents, and the fourth generation of the family to run the company.

As the 10 a.m. opening neared, the store manager hushed the room to give the employees a final pep talk. "Have fun out there, and focus on that one customer in front of you," she said. The salespeople converged in a circle, pumped their hands, and shouted a Nordstrom mantra: "Let's get

ready for our world-class day!" The doors opened, and with that, Nordstrom finally had a horse in New York City's high-end retail race, competing with stores like Saks Fifth Avenue, Bloomingdale's, and Bergdorf Goodman.

But the 47,000-square-foot emporium is also a sophisticated shopping-tech laboratory—one of several where Nordstrom is urgently experimenting with ways to make upscale, high-touch retail more competitive in an e-commerce-driven era. The maze-like layout, spread over three floors, showcases subtle but important technological enhancements. Some are super-practical—such as self-service bins where shoppers can drop off returns (including online purchases) and get credit almost immediately. Others have a wow factor: In the suits section, customers can see how bespoke jackets would look on life-size avatars of themselves, projected on screens, a digital take on the adage, "Measure twice, cut once." And yet others pamper you: If you've "reserved" a product online to try on before you buy, there'll be a fitting room waiting for you—with your name on the door.

The Manhattan store illustrates just how much faith Nordstrom has in physical stores—and how crucial tech is to its vision of making them work. No department store has been more successful at embracing technology—30% of sales for Nordstrom's full-service store division now come online—and that success has helped Nordstrom dodge much of the drama buffeting retail. The company's revenues in 2017 topped \$15.5 billion, up from \$9.1 billion in 2007, a stretch of steady growth during which its closest competitors saw sales flatline or fall. And growth hasn't tarnished its reputation for attentive customer service, an approach so legendary that it inspired one of the last century's classic business books, *The Nordstrom Way*.

Still, there are unignorable clouds on the horizon. Nordstrom is very much a mall-based retailer, and the steady dwindling of mall traffic has taken its toll: Sales at full-service stores have been declining for five years. The company has become increasingly dependent for growth on its discount Nordstrom Rack chain, an off-price gravy train that some experts fear could threaten the cachet of the main brand. And big investments in technology and new stores, valuable though they may prove to be, have eroded profits and spooked Wall Street: Shares are down 40% from their all-time highs of early 2015.

Nordstrom's response: a redoubled effort to test new initiatives—not just in New York, but online and nationwide. "Sometimes to change, you have to let go of what's been successful for a long time," copresident Erik Nordstrom tells *Fortune*.

Letting go is particularly challenging because the transformation is unfolding under the sharp eyes (and short attention spans) of public-market shareholders. "Right now the things that are necessary to grow are not profitable," says Tom Gehani, a strategist at digital consultancy L2. Other retailers have gone private to reinvent themselves, and members of the Nordstrom family, including the copresidents, recently tried to do the same. But their offer to buy the 68% of Nordstrom they don't already own was rejected by the board in March as too low. (The three brothers, who each hold board seats, recused themselves from the talks.)



KEN WORZEL: CHIEF DIGITAL OFFICER, NORDSTROM

IF WE DON'T GET [CUSTOMER SERVICE] RIGHT, NO AMOUNT OF TECHNOLOGY OR WHIZ-BANG FEATURES WILL BE ENOUGH."

Still, if Nordstrom's digital experiments play out as its leaders hope, shareholders should see the earnings they crave. The chain's tech push aims to update a business model centered on close and profitable relationships with customers. In an earlier era such close ties might have meant home delivery, or giving a customer a call to say a new dress she might like has arrived; today it's connecting salespeople to customers via a messenger app, or deploying "geofencing" so Nordstrom knows a loyalist is nearing the store to try on an item he ordered online.

When service and technology harmonize, executives say, they create a virtuous cycle where e-commerce drives traffic to

HAUTE AVATAR
The Custom Suit Visualizer, in Nordstrom's New York men's store, lets shoppers see how different suit cuts and fabrics look on a digital projection of themselves.

stores, leading to more sales at higher margins. That's a recipe for 21st-century retail survival—but it works only if the service ethos remains strong. "If we don't get those things right," says Ken Worzel, Nordstrom's chief digital officer, "no amount of technology or whiz-bang features will be enough."

NORDSTROM was founded in 1901 by Swedish immigrant John W. Nordstrom (its stock ticker is JWN, in his honor) and a business partner, after Nordstrom struck gold in the Klondike and opened a shoe store in downtown Seattle with his winnings. The company built a reputation for quality goods and

good customer service early on. During World War II, when leather was rationed, Nordstrom paid vendors upfront, enabling the chain to get its hands on better merchandise.

In the 1960s Nordstrom moved beyond shoes and into fashion; by the late 1980s it had expanded its footprint from its Pacific Northwest and California roots to the East Coast. Management added stores patiently and deliberately, and only when they were confident that local economics supported them. Such caution is one reason Nordstrom has reached its present size—122 full-service department stores and 239 Racks—without piling on the debt. What’s more, Nordstrom says, all of its stores are profitable.

Nordstrom gradually gained credibility as a high-end destination, upper-middle-class if not glamorous, its atmosphere epitomized by the live piano music that still graces some of its lobbies. Loyal customers basked in attentive service and a liberal return policy. “The key to

Nordstrom is to treat people of above-average income the same way the highest-end people get treated at Bergdorf’s,” says longtime shareholder Bill Smead of Smead Capital Management. That approach was well served by a culture of corporate humility. To stay in touch with the experience of workers and customers, new executives for decades started by working the store floor (a tactic later borrowed by fellow Seattle retailer Starbucks, among others). To this day, top execs answer their own phones.

The company remains a family business, run in an unusual arrangement by the Nordstrom brothers. The publicity-averse trio took charge in 2000 and adopted the copresident title in 2015; there is no CEO. Each has his main bailiwick: Erik focuses more on e-commerce, Blake on Nordstrom Rack and tech, and Pete on merchandising and brand partnerships. Their Seattle headquarters keep them in touch with their roots and also with their biggest existential threat. From

THE FAMILY HOME
From left: Copresidents Blake, Erik, and Pete Nordstrom at the Seattle flagship store.



their offices, they can see the many cranes erecting Amazon's towering new buildings, a few blocks away.

BUT NORDSTROM has a long tradition of embracing technology rather than cowering before it. It was experimenting with online sales and home delivery as early as the mid-1990s. In 2002 it was among the first retailers to deploy systems that monitored sales minute by minute, helping it make better decisions about which merchandise to stock. The tech savvy extends to the Rack chain too; it was one of the first retailers to deploy line-busting tech by equipping staff with mobile devices that can ring up a sale anywhere in the store.

In recent years Nordstrom has taken stakes in e-commerce companies to broaden its understanding of digital retail, buying or investing in such brands as Bonobos, Shoes of Prey, and HauteLook (and, less happily, stylist service Trunk Club, an investment of which it had to write down more than half). "They've proven to be innovative in an industry that lacks innovation," says Rick Caruso, whose company owns The Grove in Los Angeles, home to one of Nordstrom's top stores.

Many of those innovations are proudly store-centric. In a modest mall near Seattle's airport, Nordstrom operates a branch that it dubs its "Experience Concept Store"—a living lab where it tests new initiatives with real-world customers. Here it fine-tuned the now-popular feature that lets customers reserve clothing online but try it on in stores; the location was also a proving ground for curbside pickup. (Nordstrom is likely to offer that in congested Manhattan. *Godspeed, Nordies!*)

When *Fortune* visited the store in May, shoppers were trying out a feature designed to beef up Nordstrom's app. Scan and Shop helps customers use a QR code scan to find products on Nordstrom.com when, say, a shoe they like isn't available in-store. The feature complements the app's Style Board feature, which allows a customer's personal stylist to send her "look" suggestions, for items that might match something she just bought—the updated version of having a favorite salesperson call you with a hot tip. "They're

THREE AT THE TOP

Nordstrom's copresidents



BLAKE NORDSTROM

[AGE 57]

He served as president from 2000 until 2015, when his brothers joined him as copresidents. Today he specializes in Rack stores and tech.



PETE NORDSTROM

[AGE 56]

His responsibilities include merchandising and brand partnerships. In the latter arena, he has helped persuade "digital-first" brands to sell in Nordstrom's stores.



ERIK NORDSTROM

[AGE 54]

Erik focuses on e-commerce, where the chain has been an aggressive investor and innovator. One key goal: luring more online shoppers into stores.

not just chasing shiny objects," says Kathy Gersch, a longtime Nordstrom executive who now works at consulting firm Kotter International. "They're picking things that are really close to their heritage."

Nordstrom's guiding ideal is that innovations that build loyalty will more than offset their costs—especially if they lure e-commerce customers to brick-and-mortar locations, where they might shop more. "How are they going to drive traffic into the stores? That's their battle now," says PwC consumer markets leader Steve Barr.

Shoppers who dislike malls could someday wind up in a place like Nordstrom's Local test store, which opened last fall in West Hollywood. The 3,000-square-foot service hub (about the size of a convenience store) holds almost no merchandise; it's more of a spoke in a regional network. Customers can pick up online orders and try on items pulled from nine nearby full-line stores. They can meet a stylist or get an alteration (Nordstrom is the largest employer of tailors in the country, with 1,300, and alterations encourage more store visits). Or they can just have a drink.

Local is a concession to new shopping habits: "It's a way to introduce the brand to people who may not go to the mall," says Shea Jensen, Nordstrom's SVP of customer experience. It's risky, since it means creating physical locations that don't directly generate revenue. But industry veterans like it and expect Nordstrom to expand it. "They have to throw all kinds of retail orthodoxies out the window," says Forrester Research analyst Sucharita Kodali.

Nordstrom has wiggle room for such experimentation, in part, because current customers are as loyal as they come. Data compiled for *Fortune* by research firm Prosper Insights & Analytics show that 65% of Nordstrom shoppers are likely to strongly recommend the store, compared with 41% of Macy's shoppers. Another firm, Coresight Research, found Nordstrom's average shopper is 43 years old and has a household income of \$101,000, skewing younger and wealthier than many of its peers. Still, even loyalists shop around these days—Prosper says 60% of Nordstrom regulars also are Amazon Prime members—and that keeps the company on an evolve-or-die footing.

Evolution means leveraging data to lure top brands. Nordstrom's loyalty program (which accounts for 51% of revenue) lets it glean information about the buying habits of many of its 33 million shoppers, which can help brands zero in on which products sell well. "Some competitors are retreating, and others don't have this tech, so we think we have an advantage if we do this right," says Blake Nordstrom. Combined with the chain's customer-friendly reputation, the data play has helped it partner with digital-first names that want the exposure a department store can provide, including apparel brand Everlane and sneaker-maker Greats.

Just as important, the tech-plus-touch formula is helping Nordstrom move further upscale. Management avoids the word "luxury," but Pete Nordstrom says "designer" is the fastest-growing part of the company's business. The category now accounts for about 20% of sales in stores that carry it, and Nordstrom is a top seller of Chanel couture in the U.S.

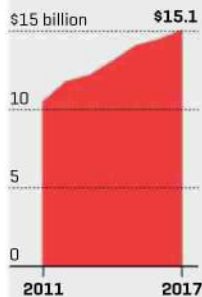
Olivia Kim, who joined the company five years ago, has helped Nordstrom climb those rungs. As VP of creative projects, she's in charge of its "pop-ins," monthly installations that feature unusual and sought-after brands. The New York men's store, for example, features a pop-in by edgy designer Comme des Garçons, and previous installations have included Allbirds, the eco-friendly shoe favored by Silicon Valley elites, and Goop, Gwyneth Paltrow's lifestyle brand. The idea is to showcase custom pieces or quirky items that help Nordstrom shed what Kim says was formerly a "beige" image. "They want to be pushed. They want to be educated," Kim says of customers—whether they're shopping for special-occasion Valentino or workaday Vans.

IN NORDSTROM'S SEATTLE boardroom, a digital clock slowly counts down to a looming milestone: the fall 2019 opening of a women's megastore in New York, across the street from the men's store, in a 320,000-square-foot space second in size only to Nordstrom's Seattle flagship. The store will bring together all the tech and store innovations that Nordstrom has been developing. But

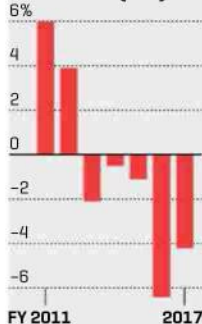
UPSCALE UP TO A POINT

Nordstrom owes much of its recent growth to its discount Rack stores.

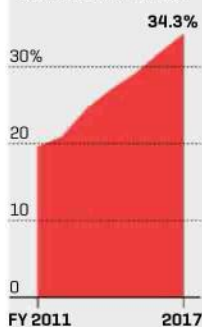
NORDSTROM TOTAL SALES*



SAME-STORE SALES CHANGE AT "FULL-LINE" STORES (YOY)



SHARE OF U.S. SALES FROM "RACK"



SOURCE: NORDSTROM FILINGS
* EXCLUDING CREDIT CARD REVENUES

the year-plus between now and then will test how well that experimentation fits in today's insanely tumultuous retail climate.

You can't visit a designer pop-in, or grab a drink while trying on clothes with a stylist, if you're doing all your shopping online. That's why a healthy Nordstrom requires a healthy fleet of department stores. The company thinks Canada, where it now has six full-line and three Rack stores, can become a \$1 billion market, and analysts say the New York megastore alone could yield \$500 million a year in sales. The Rack business generates 34% of the company's U.S. sales, up from 20% in 2011. But Nordstrom believes Rack can grow bigger without cannibalizing the full-price stores; one-third of Rack customers eventually shop at Nordstrom proper, executives say.

In recent years, the company's capital spending was heavily skewed toward tech. But in the near future, with much of the digital heavy lifting done, Nordstrom plans to spend roughly equally on tech and store improvements. To insulate itself from declining traffic at malls, Nordstrom is building out more entrances at its mall-based stores so shoppers can walk directly to the store from the parking lot. It's also relocating some stores away from malls. It plans to shut a shop in a mall in Overland Park, Kans., for example, and move it to the glitzier Country Club Plaza in nearby Kansas City, Mo.

In general, Nordstrom plans to be less aggressive about capital spending, holding it near its historical average of 4% of sales, down from a peak of 7% in 2015. Fans of the company's laboratory-driven daring see that as a concession to Wall Street. Being private, they note, would allow Nordstrom to do more of the experimentation that has kept it at the top of its field. Many observers expect the founding family to try going private again—while the brothers decline to discuss the issue, the family and its allies left the possibility open in a recent regulatory filing.

Asked whether his namesake company is currently able to be as inventive as it wants to be, Blake Nordstrom smiles and skirts the question: "We think we can be innovative as a public company." That, it seems, will have to be enough for now. ■