Case 12-4

Anita's Apparel

> For 88 years Nordstrom has been guided by its founder's philosophy: offer the customer the best service, selection, quality and value.
>
> —*Nordstrom Philosophy*

Anita Lamont, founder and CEO of Anita's Apparel, a retailer of high-end women's business apparel, had just opened her fourth retail store in the Midwest. While Lamont was pleased with the company's progress, she was concerned by the growing number of customer complaints and the low sales per square foot compared to some of her better-known competitors.

When it was just one store that she individually owned and operated, she was able to control most of the details of the business. While she worked with a few employees, she always knew what they were doing. As the number of stores and the size of the stores increased, the number of employees grew more than proportionately. When she was running the single store, she rarely heard a customer complaint, her pilferage costs were very low, and her sales per square foot were $250, compared with $220 today. This concerned Lamont greatly as her expansion plans for Anita's Apparel had slowed down because the stores were not producing the returns that she expected.

When she opened the second store, she added a store manager at each location. While both managers seemed to be doing well, the number of customer complaints increased. Lamont assumed that this would happen when she had more stores and more customers. By the time that she had opened the fourth store, the number of customer complaints had grown by eightfold from when there was only one store.

The store managers were also complaining to Lamont because of the high training costs of bringing on new employees. The turnover rate seemed to be very high and Lamont could not understand why. She was paying one of the highest wages in the area to the sales clerks and store managers, yet they were leaving to go work elsewhere. The customers were also complaining about the lack of helpfulness of the sales clerks. Even after extensive employee retraining, Lamont was still hearing many complaints.

Lamont knew that there had to be a better way. Many of her competitors were well known for customer service and high sales per square foot. One of her best-known competitors that had appeared to have solved these problems was Nordstrom, Inc. In a visit to Seattle, Lamont had the opportunity to shop at a Nordstrom and she was impressed by the level of service provided by the cheerful and helpful sales clerks. Lamont could tell that there was a large difference between the level of service that she had received at Nordstrom and the level of service that sales clerks were providing at Anita's Apparel stores.

A few days later, Lamont received in the mail a handwritten thank-you letter from the Nordstrom sales clerk who had helped her in Seattle. Lamont decided right then that she had to find out more about what Nordstrom was doing

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that was so different from Anita's Apparel. She began by getting a copy of Nordstrom's 1995 Annual Report. Next she read *The Nordstrom Way* by Robert Spector and Patrick McCarthy. Then she found a few magazine articles that discussed Nordstrom and its success. The following is some of what she discovered about Nordstrom and the secrets of its success.

History

Nordstrom was founded in 1901 as Wallin & Nordstrom shoe store by Carl F. Wallin and John W. Nordstrom. On their opening day, their total sales were $12.50. In fiscal year 1995, Nordstrom had sales of $4.1 billion (see Exhibit 1 for financial information going back five years). During the intervening 94 years, Nordstrom had become the largest independently owned fashion specialty retailer in the United States, offering a wide variety of fine quality apparel, shoes, and accessories for men, women, and children.

In 1995 the third generation of the Nordstrom family stepped down from the day-to-day management of Nordstrom. Six members of the fourth generation were promoted to co-presidents. The fourth generation has inherited one of the 50 largest retailing chains in the United States and one of the seven largest department stores.

Nordstrom operates 93 stores in 15 states, and is expanding into other states. Its 1996 plans called for new stores in Philadelphia and Dallas. Beyond 1996 Nordstrom planned to open stores in Detroit, Denver, Cleveland, and Atlanta.

Nordstrom stores have consistently performed well, often at the expense of its competitors. Nordstrom captured one-third of the southern California market in 10 years. The Tyson Corner, Virginia, Nordstrom is credited with driving Garfinckels into bankruptcy.[1] Nordstrom stores average sales of $382 per square foot compared with Federated's $190 and May Department's $183.[2] Nordstrom has one of the lowest shrinkage costs in the industry at 1.5 percent versus the 3.0 percent average.

Creating a Customer Service Environment

Nordstrom has developed a number of specific systems that are designed to create the Nordstrom customer service environment:

- Inverted pyramid management
- Commissions
- Unconditional returns
- Rewards
- Recognition
- Heroics

[1]Dori Jones Yang and Laura Zinn, "Will 'The Nordstrom Way' Travel Well?" *Business Week*, September 3, 1990, pp. 82–83.

[2]Seth Lubove, "Don't Listen to the Boss, Listen to the Customer," *Forbes*, December 4, 1995, pp. 45–46.

EXHIBIT 1 Selected Financial Statements 1992 to 1996
(Dollars in Thousands except Square Footage and per Share Amounts; Year Ended January 31)

	1996	1995	1994	1993	1992
Financial Position					
Customer accounts receivable, net	$ 874,103	$ 655,715	$ 565,151	$ 584,379	$ 585,490
Merchandise inventories	626,303	627,930	585,602	536,739	506,632
Current assets	1,612,776	1,397,713	1,314,914	1,219,844	1,177,638
Current liabilities	832,313	690,454	627,485	511,196	553,903
Working capital	780,463	707,259	687,429	708,648	623,735
Property, buildings and equipment, net	1,103,298	984,195	845,596	824,142	856,404
Long-term debt	439,943	373,910	438,574	481,945	511,000
Shareholders' equity	1,422,972	1,343,800	1,166,504	1,052,031	939,231
Total assets	2,732,619	2,396,783	2,177,481	2,053,170	2,041,875
Operations					
Net sales	4,113,517	3,894,478	3,589,938	3,421,979	3,179,820
Cost and expenses:					
Cost of sales and related buying and occupancy	2,806,250	2,599,553	2,469,304	2,339,107	2,169,437
Selling, general and administrative	1,120,790	1,023,347	940,579	902,083	831,505
Interest, net	39,295	30,664	37,646	44,810	49,106
Service charge income and other	(125,130)	(94,644)	(88,509)	(81,140)	(87,443)
Total costs and expenses	3,841,205	3,588,920	3,359,020	3,199,860	2,962,605
Earnings before income taxes	272,312	335,558	230,918	222,119	217,215
Income taxes	107,200	132,600	90,500	85,500	81,400
Net earnings	165,112	202,958	140,418	136,619	135,815
Dividends per share	.50	.385	.34	.32	.31
Sales per square foot for company-operated stores	382	395	383	381	388

Source: Robert Spector and Patrick D. McCarthy, *The Nordstrom Way* (New York: John Wiley and Sons, 1995), p. 98.

Inverted Pyramid Management

Nordstrom draws its organizational chart as an inverted pyramid. The inverted pyramid shows the customers on top and the salespeople as the top level of the company. Each level below is responsible for supporting the salespeople and the customers. As co-chairman Raymond Johnson stated, "The only thing we have going for us is the way we take care of our customers and the people who take care of the customers are on the floor."[3]

As part of the pyramid, Nordstrom promotes strictly from within. Every manager and buyer started as a salesperson, including the current six co-presidents who are all Nordstrom family members. As James F. Nordstrom, former co-chairman, stated, "One of the reasons our system has continued to work is that all of us, including the family, have served at every level from stock person to buyer. We've all been salespeople for a long time."[4]

[3]Robert Spector and Patrick D. McCarthy, *The Nordstrom Way* (New York: John Wiley and Sons, 1995), p. 99.
[4]Ibid.

Commissions

Since the 1950s, Nordstrom salespeople have been paid on commission. Standard commission rates in 1995 ranged from 6.75 percent for apparel to 13 percent for children's shoes.[5] Each salesperson receives a draw against his or her commissions up to $11 per hour. Nordstrom monitors sales per hour: If an employee's draw rate is $10 per hour and the employee is selling women's shoes at a 10 percent commission, then the employee would need to sell $100 per hour to cover his or her draw. Before computing sales per hour, any returns are subtracted from an employee's total sales.

At Nordstrom each department has a minimum hourly sales target. Salespeople who consistently fail to meet the sales per hour quotas receive coaching from their department managers. Salespeople are let go if they miss quota for three consecutive months.[6]

The commission system enables Nordstrom sales associates to earn almost twice what they would be able to make at a competitor's store. As a result, Nordstrom's selling expense is one of the highest in the industry.

Unconditional Returns

At Nordstrom a customer can return any item for any reason and receive his or her money back. Former co-chairman Bruce Nordstrom explains the return policy to sales people as follows: "If a customer came into the store with a pair of five-year-old shoes and complained that the shoes were worn out and wanted her money back, you have the right to use your best judgment to give my money away. As a matter of fact, I order you to give my money away."[7] Nordstrom returns are legendary: shoplifted items and a set of tires (Nordstrom does not even sell tires) have been taken back, no questions asked.

Rewards

Nordstrom's general manager of its Southern California region, Jammie Baugh, states that at Nordstrom, "We tend to manage by contest. When we have something we want to improve on, then we have a contest."[8] These contests include monthly "Make Nordstrom Special" contests, which reward good suggestions; daily sales contests, which reward top sellers for the day; and fourth quarter 1993's "$250,000 Super Service Challenge," which awarded individual and team prizes for the best customer service.

Recognition

Nordstrom uses a number of different methods to recognize the accomplishments of its employees. Nordstrom management acknowledges employee "Pacesetters" and "Customer Service All-Stars"; morning announcements and monthly meetings are opportunities for managers to praise the sales and customer service efforts of the salespeople. The Pacesetter program recognizes the

[5] Ibid., pp. 113–14.
[6] "Nordstrom: Respond to Unreasonable Customer Requests!" *Planning Review,* May/June 1994, pp. 17–18.
[7] Spector and McCarthy, *The Nordstrom Way,* p. 100.
[8] Ibid., p. 119.

top 8 to 12 percent of each division's sales force based on exceeding a yearly sales target goal (targets which now top $350,000). Pacesetters receive certificates, increased store discounts, events, and trips. The Customer Service All-Stars are selected according to sales volume, customer service, and service to co-workers. The Customer Service All-Stars are selected monthly by store managers. The winners are given increased Nordstrom discounts and priority for selecting work shifts. Every morning, the store manager also praises departments and individuals during the pre-opening announcements for customer service and sales. At the monthly meetings, managers read letters from customers and employees celebrate sales achievements.

Heroics

An additional piece of employee recognition is the stories of customer service "heroics." Salespeople who consistently perform customer service heroics are recognized by their department and store. They are often selected "Employee of the Month" and have their deeds printed up in a weekly collection of heroics by the sales associates. The following is one example of a heroic deed:

> A Nordstrom's sales associate discovered that a customer had left her airline tickets at the counter. After calling the service representative for the airline, who refused to help, the sales associate took a cab out to the airport, found the customer, and gave her the tickets.[9]

Union Dispute

In November of 1989, Locals 1001 and 367 of the United Food and Commercial Workers Union (UFCW), which represented about 1600 Nordstrom sales associates in the Seattle-Tacoma area, filed a complaint with the Washington State Department of Labor and Industries Employment Standards Section (ESAC). The complaint charged that Nordstrom required or encouraged employees to attend meetings, perform stock work, and attend to customer service activities, such as hand-carrying items to customers or writing thank-you notes, outside of normal business hours without compensation. UFCW felt that the policy of ranking employees and managers on sales per selling hour caused managers to encourage or coerce employees into underreporting their hours worked.

On February 15, 1990, ESAC concluded that Nordstrom's work practices violated the state's Minimum Wage Act and that Nordstrom had to change these policies and retroactively compensate employees for time worked. Joe Peterson, the president of Local 1001, suggested that claims could be as high as $40 million in Washington State and $300 million in California. Based on this news, poor revenue projections, and the threat of a class-action lawsuit being filed by Peterson covering Nordstrom employees nationwide, Nordstrom's stock price fell by almost 10 percent in one day.

On February 20, 1990, *The Wall Street Journal* printed a front-page article describing horrendous working conditions.[10] The story opened with a discus-

[9]Ibid., p. 125.
[10]Susan Faludi. "Sales Job: At Nordstrom Stores, Service Comes First—But at What Price," *The Wall Street Journal,* February 20, 1990, pp. A1, A16.

sion of a former Nordstrom employee alleging that he was unlawfully discharged when Nordstrom discovered that he had AIDS. It followed with employment counselor Alice Synder describing how she regularly received visits from Nordstrom employees, "suffering from ulcers, colitis, hives and hand tremors," because of the stress of working at Nordstrom. A series of former employees were interviewed for the article. Patty Bemis, former Nordstrom employee, said, "The managers were these little tin gods, always grilling you about your sales. You felt like your job was constantly in jeopardy."

Over the next week, Nordstrom announced that it would change its timekeeping procedures and established a $15 million reserve for back-pay claims. Joe Peterson called the reserve "Wholly inadequate. It won't even cover claims of employees in Washington state."[11] After that the union filed more unfair labor practice lawsuits. The AIDS Coalition to Unleash Power (ACT UP) protested at Nordstrom's downtown San Francisco store. A class action lawsuit was also filed on behalf of shareholders.

As the dispute grew, *60 Minutes* did a segment on Nordstrom which changed some minds. As Marti Galovic Palmer, producer for *60 Minutes,* stated, "A lot of what I was looking for in terms of hard complaints turned out to be from people who just wanted a job that didn't demand a whole lot."[12]

Bruce Nordstrom gave Nordstrom's perspective on the conflict:

> Freedom is the issue, not just freedom to belong or not belong to a union, but freedom to wait on customers in the best way, freedom to go the extra mile, freedom to pursue a career in sales or in management, freedom to make customer service decisions right there on the sales floor without a lot of silly rules and interference, and freedom from being called "clock-punchers" as they have been by this union's management.[13]

In his comment about the freedom not to belong to the union, Bruce Nordstrom was referring to a request that had been made to Nordstrom by employees to have the union become an open shop where employees could choose to belong to the union or not. Nordstrom had a closed shop in the Seattle area stores where all employees had to be members of the union.

Nordstrom made this request in the 1987 contract negotiation and again in the 1989 contract negotiations. In 1989 Nordstrom would not remove it from the proposed contract. In addition to the contract negotiations, a group called Nordstrom Employees Opposed to Union Representation (NEOUR) began a campaign to have local 1001 decertified. The NLRB disallowed NEOUR's first petition for decertification because of the outstanding charges of labor practice violations by the union. In July of 1990, however, the union was decertified by over a five-to-two margin.

In the end, the class-action lawsuit by the union was settled out of court. Employee claims from the settlement totaled about $5 million, far less than the $300 million that Peterson predicted for California. The union reportedly received $6.6 million in the settlement.

[11] George Tibbits, "Earnings Fall 34 Percent in 4th Quarter; $15 Million Charge for Back Pay," Seattle Priority: Rush, February 26, 1990, Associated Press.
[12] Spector and McCarthy, *The Nordstrom Way,* p. 175.
[13] Ibid., p. 176.

Anita's Decision

As Anita Lamont considered what she had learned about Nordstrom, she focused on the fact that while she paid her employees good wages, they were still paid by the hour. Anita's Apparel had few incentive plans for the sales clerks and a very strict return policy. Also, about the only heroics that she had ever heard come out of Anita's Apparel were from her own days when she had started. Many of these heroics had become the basis for some of the current policies.

While she recognized the many merits to the Nordstrom approach of commission compensation and incentive pay, Lamont was concerned that the costs and risks associated with Nordstrom's commission-based compensation system would be greater than any benefits that Anita's Apparel might derive. In addition, if she did decide to change her compensation system, what else would need to be changed at Anita's Apparel in order to really improve the level of customer satisfaction and the sales per square foot?

Questions

1. How do you evaluate Nordstrom's compensation and other systems in support of its strategy?
2. How would you advise Anita Lamont about compensating her employees?