

NORDSTROM: EXPANSION INTO CANADA¹

Won-Yong Oh and Duane Myer wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

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In August 2016, Blake W. Nordstrom, co-president of Nordstrom, Inc. (Nordstrom), an American high-end fashion retailer, needed ways to make the recent Canadian expansion successful. In September 2014, Nordstrom entered the Canadian market by launching its first store in Calgary, Alberta. Calgary's prosperous economy, fueled largely by the oil and gas industry, made it the ideal place for Nordstrom to try to break into Canada. The company opted for a conservative, store-by-store approach to entering the Canadian market, which it identified as a US\$1 billion² opportunity. The strategy entailed opening a second Nordstrom store in Vancouver in 2015, with a third store to follow in Toronto in 2016.³

Nordstrom's cautious approach to the Canadian expansion strategy suggested that it anticipated some financial losses in the near future, though it also anticipated that the opportunity in Canada's luxury retailing market would prove profitable in the long term. In addition to its immediate financial losses, Nordstrom found that the competition in Canada's luxury retailing market was intense. Much of the industry's market share was dominated by competitors such as Holt, Renfrew & Co., Limited (Holt Renfrew) and Harry Rosen Inc. The Hudson's Bay Company (HBC) also had shown interest in expanding into the market with the acquisition of luxury American retailer Saks Fifth Avenue (Saks), which HBC planned to bring to Toronto.⁴ In a crowded Canadian industry with several well-established retailers and an influx of entering competitors, how could Nordstrom find success?

COMPANY BACKGROUND

John W. Nordstrom, a Swedish immigrant who made his fortune in the Alaskan Gold Rush, and Carl Wallin, a friend of Nordstrom's, founded Nordstrom in 1901 as "Wallin & Nordstrom," a small downtown Seattle shoe store. By 1960, the business had expanded to eight locations in Washington and Oregon, and had become the largest independent shoe store chain in the country. In 1963, the company expanded into women's apparel, and by 1966, it had expanded into menswear and children's wear.

The company renamed itself Nordstrom, Inc. in 1971, became a publicly traded company, and continued to expand throughout the country. Another milestone came in 1973, when it launched the first of its Nordstrom Rack stores, which operated as a clear-out outlet store for unsold merchandise from the main stores. The

new millennium saw Nordstrom enter into strategic partnerships and acquisitions to further establish itself as a dominant player in the competitive upscale retailing industry. For example, in 2012, Nordstrom entered into an agreement with British high street fashion label Topshop to become the only North American retailer to sell the line's clothes in its stores.

As of August 2016, Nordstrom operated 329 stores in the United States and Canada, in addition to 200 Nordstrom Rack stores (the lower-cost retail division of Nordstrom). The company also had an extensive online retailing presence, serving customers through nordstrom.com, nordstromrack.com, and hautelook.com. In 2015, it had net sales of \$14.1 billion (see Exhibit 1).⁵

CANADIAN EXPANSION

Nordstrom realized its Canadian expansion plans by opening its first store in the country in Calgary in 2014. In 2015, Nordstrom opened two more stores in Canada—one in Ottawa and the other in Vancouver. The first of its three stores in Toronto was planned for a September 2016 opening. The company hoped to operate eight to 10 Nordstrom stores in Canada, and up to 20 Nordstrom Rack outlet stores.

Company spokesman John Bailey stated, “We think we can do a lot of business in Canada.”⁶ Despite hopes that the Canadian market would prove lucrative in the future, executives acknowledged that the significant capital expenditures associated with the launch would result in considerable financial losses in the first year; Nordstrom anticipated a \$35 million loss from its Canadian operations, and closed 2014 with a \$32 million loss. The company predicted losses of \$60 million for fiscal years 2015 and 2016, which reflected the increased level of financial investment in its Canadian expansion.⁷

Nordstrom took a particularly conservative and careful approach to its entry into the Canadian market after observing the plight of Target Corporation (Target) in trying to crack the budget retail market in the country. Target launched an ambitious entry into Canada in 2013 by opening dozens of stores at once. Within months, the chain was operating more than 120 stores across the country, but its business was hampered by a multitude of problems, ranging from supply chain issues to product availability.⁸ In January 2015, Target Canada filed for bankruptcy protection following losses of billions of dollars.

Nordstrom correctly identified that Target had attempted to enter the market too broadly, and so chose to take a store-by-store approach to launch its brand. It deliberately overstocked its Calgary location to ensure that customers would never experience the empty shelves that had been encountered at Target. And Nordstrom consistently emphasized the excellent customer service for which it had become known in the United States.⁹

Target’s failure in the Canadian market also contributed to Nordstrom’s decision to delay the opening of its Rack stores—from their original intended introduction in 2015, to 2018.¹⁰ The decision was made to limit the complexity and capital expenditures associated with the Canadian expansion, despite the outlet stores being an important stream of profit for Nordstrom in the United States. Rack stores generated \$553 in sales per square foot, as opposed to the \$372 in sales per square foot generated by their full-service counterparts. Nevertheless, Rack’s introduction to Canada would have meant more issues for Nordstrom to manage. For example, Rack had flourished in the outlet and strip malls that were easy to locate in the United States. These enormous outlet malls, which often drew Canadian shoppers across the border in search of better deals, were few and far between in Canada, which presented logistical challenges in bringing Rack to Canada.¹¹

CANADIAN RETAIL MARKET

After the 2008 financial crisis, the Canadian retail sector experienced slower-than-expected recovery rates. Despite optimistic projections of consumer willingness to buy things such as new vehicles and appliances, growth in Canada's retail sector remained below expectations. Retailers, especially in the clothing industry, resorted to offering record discounts to improve sales volumes. However, the volume of sales did not increase significantly even with the reduced prices, which contributed to even greater losses.¹²

In 2014, plummeting oil and natural gas prices further slowed the growth of the country's retail sector. The falling natural resource prices heavily affected the economies of provinces such as Alberta and Saskatchewan. The impact of decreasing prices was particularly significant for Alberta, which had been a wealthy province fuelled by a profitable oil and gas industry, and steady growth in its retail sales. The economic downturn in Alberta and Saskatchewan that came with the falling commodity prices affected the entire country. Projected growth in the retail sector fell to 2 per cent for 2015, as opposed to the 4.6 per cent increase that had been projected for 2014.¹³

The slow growth in Canada's retail sector coincided with an influx of American retailers in the market. While Canadian retailers such as Jacob, Le Château, and Reitmans struggled to remain profitable, American companies such as Aéropostale, American Apparel, and American Eagle Outfitters continued with their aggressive expansion plans into Canada. Many U.S.-based companies struggled in the Canadian retail market, but these struggles failed to stop more American companies from expanding into the country.¹⁴ Canada escaped the financial crisis of 2008 in a relatively better economic position than the United States, and American retailers saw Canadian consumers as a potential new market to offset stagnating domestic sales.

Since the financial crisis, however, projected growth was stronger in U.S. markets than in Canadian ones. For example, Canada had a debt-to-disposable income ratio of 152.14 per cent in 2014, compared to 135.6 per cent in the United States. This percentage indicated that Canadians, relative to Americans, had higher levels of personal debt and were unwilling to take on more to spend, representing a market that was "shopped out."¹⁵

CHALLENGES FOR U.S. RETAILERS

U.S. retailers viewed Canada as a natural market for international expansion plans. The two countries had no language barriers, which made expansion plans seem less daunting. And the shared border and frequency of Canadians crossing it to shop in the United States made the risks seem minimal.

The Canadian market seemed even more appealing coming out of the 2008 financial crisis, when many U.S. companies struggled to recover from the economic downturn. The impact of the economic recession was less significant on Canadians. Nevertheless, there were considerable challenges for an American retailer entering the Canadian market.

Real Estate Market

In Canada, the real estate market was less diversified than it was in the United States. There were smaller numbers of shopping malls, outlet malls, and plazas, and ownership of these buildings was concentrated among a small number of institutional landlords. In addition to this concentrated ownership, there were fewer planned future developments for more shopping malls than in the United States, making competition for existing retail space fierce. The result was a real estate market that heavily favoured landlords rather

than potential tenants (i.e., a seller's market). This market was in stark contrast to the U.S. market, where large retailers had greater influence as tenants than landlords did.¹⁶

Employment and Labour

Canadian labour laws were stricter and substantially different from U.S. labour laws, making this one of the most significant challenges for U.S. retailers wanting to expand into the country. Each province had its own set of labour laws that companies had to comply with. Further, there was a statutory law for all companies in Canada that mandated severance pay of one week of pay for each year of an employee's service. Canadian labour laws also emphasized successor rights, which had implications for the inheritance of pre-existing collective bargaining agreements with employee unions for new buyers of a business. While U.S. employment laws did not explicitly state that a new owner of a given business was bound to the terms of a pre-existing collective bargaining agreement with the business's union, new ownership was bound to any existing agreement in Canada.¹⁷

Business Logistics

Canada's expansive size made logistics a challenge for any business operating in the country. For U.S. companies, logistics became even more challenging because of the difference in population density distribution. Unlike in the United States, the majority of Canadians lived in few major urban centres (Toronto, Montreal, Vancouver, Calgary, Ottawa, and Edmonton). This population concentration created challenges for distribution, operational efficiency, and supply chain management.

For example, Target's expansion into Canada was hampered by severe mismanagement of its supply chain. The company found it difficult to keep its stores adequately stocked, and customers complained of empty shelves and an oversupply of goods that were less popular. Target struggled to control the high transport costs from its warehouses to its stores, and found that response time was significantly slower than it was in the United States. It also struggled with bringing its existing logistics systems from the United States to Canada. Its supply chain was further hampered by product codes that were different between the two countries, different stocking systems that employees struggled with, and carrying inventory control systems between Canada and the United States.¹⁸

Taxes and Price Differences

Canada had a different tax structure than the United States, something that companies entering the country had to adapt to. In Canada there was a federal sales tax and, with the exception of Alberta, a provincial sales tax on all retail goods sold. Sales taxes were added to the retail price of goods and were borne by the consumer, which resulted in a higher price charged for goods. Companies transporting their retail goods over the Canadian border had to pay customs duties—a percentage of the assessed value of the goods moving across the border. This additional cost also increased the price of goods for U.S. retailers selling their wares in Canada.¹⁹ The North American Free Trade Agreement (NAFTA) provided tariff preference for some products; however, in order to have products exempted from tariffs, the goods had to have originated in the NAFTA region (i.e., Canada, the United States, or Mexico) and be accompanied by a certificate of origin form.²⁰ For example, women's handbags and shoes from Europe, typical products sold in Nordstrom stores, were not eligible for favourable tax treatment.

These taxes, which necessitated that retailers charge a higher price for certain goods in Canada than in the United States, proved to be another significant factor in Target Canada's demise. Due in large part to increased taxes, the cost of goods on Canadian shelves was up to 25 per cent more than for the same goods in the United States, which disappointed Target shoppers in Canada. Shoppers were particularly disappointed when they compared prices of goods not necessarily with prices at Target Canada's competitors, like Walmart Canada or Real Canadian Superstore, but rather with prices in Target's American stores, which were lower for the same goods. Unfavourable price differentials between the United States and Canada also proved challenging for a number of other retailers who made the expansion across the border. J.Crew was another notable American retailer that irked Canadians with higher prices for identical goods.²¹

COMPETITION

The Canadian luxury apparel market was valued at \$1.6 billion in 2014, which did not take into account the substantial number of Canadians who went to the United States to do their luxury shopping. To American retailers, this commonplace practice indicated that there was an unmet need for upscale retail shopping in Canada. However, the luxury retailing sector in the country was characterized by a small number of retailers with customer bases with deeply entrenched loyalties.²²

The long-held loyalties of Canadian consumers to certain luxury retailers represented a challenge for some new foreign retailers entering the market. Douglas Porter, an economist at the Bank of Montreal, predicted that because of increased competition within the sector, some new players could leave Canada "licking their wounds."²³

Holt Renfrew

Holt Renfrew was a high-end Canadian department store selling many luxury brand products. The retailer was recognized as the iconic Canadian luxury store, and the dominant player in the market. It had cultivated consumer loyalty through exclusive rights to certain luxury brands and a history of strong customer service. There was significant overlap in the brands carried at Holt Renfrew and Nordstrom, putting the two retailers in direct competition with each other. In preparation for Nordstrom's Canadian expansion, Holt Renfrew began initiating new business strategies to protect its market share, such as expanding jewellery, leather goods, footwear, and menswear collections, and planning a bigger and even more luxurious store environment.²⁴

Holt Renfrew closed down underperforming stores in Ottawa and Quebec City at the end of January 2015, and was investing \$300 million into renovating and expanding its top-performing stores in Vancouver, Calgary, Edmonton, Toronto, and Montreal.²⁵ The renovations that took place at existing Holt Renfrew stores were designed to capitalize on current market trends and encourage more spending from existing customers. For example, at its Yorkdale Shopping Centre location, Holt Renfrew expanded the size of its changing rooms to be able to fit up to five or six women, which catered to the increasing number of women who shopped at the store in groups (e.g., shoppers with friends). The store also invested in things like more luxurious footwear sections, designed to evoke exclusive stand-alone designer boutiques.²⁶

To capitalize on the growth in demand for luxury menswear, Holt Renfrew expanded its in-store offerings and opened its own stand-alone menswear store in 2014. The store, which opened in the upscale shopping district of Toronto's Bloor Street West, featured traditional offerings like clothing and accessories, but also sold things like Ferrari cars and Canadian artwork.²⁷ According to Mark Derbyshire, president of Holt Renfrew, the company's men's fashion business increased from 15 per cent in 2012 to 20 per cent in 2014.²⁸

In addition to capitalizing on the increased demand for luxury menswear, Holt Renfrew capitalized on the online retail trend by improving the shopping experience on its website. The company redesigned its website, holtrenfrew.com, as “an omni-channel digital program, which includes an e-commerce website.”²⁹ The decision to overhaul its online presence was supported by shopping patterns of consumers in Canada and the United States, where customers increasingly sought the convenience of online shopping. Howard Davidowitz, a retail industry consultant based in New York, said, “E-commerce in luxury is growing like crazy in the United States. It’s wise to do it.”³⁰

HBC and Saks

HBC rebranded itself as Hudson’s Bay Company from its former name, the Bay, in 2014 as part of its repositioning efforts. Canada’s oldest retailer made the strategic decision to reposition itself as an upscale, affordable luxury brand to capture the underserved Canadian retail luxury market. The company’s chief executive officer, Richard Baker, acquired Saks in a bid to crack the upper echelons of luxury retailing.³¹ HBC purchased Saks for \$2.9 billion (including the assumption of debt) in 2013, and opened its flagship Canadian store in Toronto in 2016.³²

HBC was the most direct competitor for Nordstrom’s Canadian efforts. The chain carried the greatest number of brands that Nordstrom carried, and had the same target of meeting the demand for affordable luxury. While Holt Renfrew and Saks carried more higher-end luxury brands, including Chanel, Prada, and Christian Louboutin, HBC and Nordstrom carried more affordable luxury lines. As part of its repositioning efforts, HBC had moved away from its former mid-line retailer image, accurately assessing the troubles of mid-market retailers like J. C. Penney in the United States.³³

Despite Nordstrom and HBC competing for the same market segment, HBC executives viewed the American retailer’s arrival in Canada as a potential benefit to HBC’s reinvention as an upscale retailer. “It’s our kind of customer. It’s bringing better retail to the mall. . . . We want to be where the customer wants to be,” HBC Chief Executive Officer Richard Baker said of Nordstrom’s impending arrival.³⁴

Saks announced plans to open seven stores in Canada, beginning with a Toronto location in the city’s Eaton Centre shopping mall. The move came in tandem with Nordstrom entering the same shopping mall, putting the two competitors in close proximity to one another.³⁵

Saks downsized the number of its U.S. locations from 55 to 38 as it focused on international expansion. Like they had done with Target, Canadian shoppers compared the Saks offerings in Canadian stores with the prices in American counterpart stores; Saks, unlike Target, impressed Canadian consumers. One Toronto shopper said, “There is more variety here [in Toronto] than in the Saks in New York.”³⁶

Much like Nordstrom, Saks tailored its Canadian experience to provide additional benefits to shoppers. While Nordstrom offered its customers extensive personal shopping options, Saks integrated its shopping service, Saks at Your Service, into its Toronto store. The location featured a “Saks Food Hall,” mirroring the cafes and restaurants that accompanied Nordstrom locations.³⁷

LOOKING AHEAD

By August 2016, it had been almost two years since Nordstrom opened its first Canadian store in Calgary. The company continued its expansion plan, intending to introduce two more full-line stores in Toronto, and Rack stores were set to open in Calgary, Toronto, and Edmonton by 2018.³⁸ However, expansion into Canada was challenging, and far more complex than Nordstrom had anticipated. The Canadian market had different real estate markets and tax schemes, employment and labour law issues, and logistics difficulties. How could Nordstrom make its entry into Canada successful?

EXHIBIT 1: NORDSTROM KEY FINANCIALS

	2015	2014	2013	2012	2011	2010
Earnings Per Share Data (\$)						
Tangible Book Value	2.51	10.55	9.96	8.82	8.58	9.03
Cash Flow	6.19	6.34	6.01	5.33	4.84	4.22
Earnings	3.15	3.72	3.71	3.56	3.14	2.75
Dividends	1.48	1.32	1.20	1.08	0.92	0.76
Payout Ratio	47%	35%	32%	30%	26%	24%
Prices: High	83.16	80.54	63.72	58.44	53.35	46.22
Prices: Low	49.34	54.90	52.16	46.27	37.28	28.44
P/E Ratio: High	26	22	17	16	17	17
P/E Ratio: Low	16	15	14	13	12	10
Income Statement Analysis (Million \$)						
Revenue	14,437	13,506	12,540	12,148	10,877	9,700
Operating Income	1,723	1,813	1,780	1,685	1,620	1,445
Depreciation	576	508	454	366	371	327
Interest Expense	112	120	137	134	132	127
Pretax Income	976	1,185	1,189	1,185	1,119	991
Effective Tax Rate	38.5%	39.2%	38.3%	38.0%	39.0%	38.1%
Net Income	600	720	734	735	683	613
Balance Sheet & Other Financial Data (Million \$)						
Cash	595	827	1,194	1,285	1,877	1,506
Current Assets	3,014	5,224	5,228	5,081	5,560	4,824
Total Assets	7,698	9,245	8,574	8,089	8,491	7,462
Current Liabilities	2,911	2,800	2,541	2,226	2,575	1,879
Long-Term Debt	2,795	3,123	3,106	3,124	3,141	2,775
Common Equity	871	2,440	2,080	1,913	1,956	2,021
Total Capital	3,676	5,571	5,193	5,042	5,591	4,802
Capital Expenditure	1,082	861	803	513	511	399
Cash Flow	1,176	1,228	1,188	1,101	1,054	940
Current Ratio	1.0	1.9	2.1	2.3	2.2	2.6
% Long-Term Debt of Capitalization	76.0	56.1	59.8	62.0	56.0	57.8
% Net Income of Revenue	4.2	5.3	5.9	6.1	6.3	6.3
% Return on Assets	7.1	8.1	8.8	8.9	8.6	8.7
% Return on Equity	36.2	31.9	36.8	38.0	34.4	34.1

Note: Data are based on the calendar year; all dollar amounts are in US\$.

Source: S&P Capital IQ Report, June 18, 2016.

ENDNOTES

¹ This case has been written on the basis of published sources only. Consequently, the interpretation and perspectives presented in this case are not necessarily those of Nordstrom Inc. or any of its employees.

² All dollar amounts are in US\$ unless otherwise specified.

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