

RETAIL

Why zero-inventory showrooms such as Bonobos and Nordstrom Local are important to retail's future

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Nordstrom Local store on New York's Upper East Side. Image credit: Nordstrom

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Retail is facing a paradigm shift, defined as "an important change that happens when the usual way of thinking about or doing something is replaced by a new and different way."

I cannot think of a more appropriate description of what is happening in retail today.

The old ways of doing retail clearly are not working.

The retail landscape has been decimated by more than 8,500 store closures through the first nine months of this year, with another 3,500 closures predicted before year's end, according to Coresight Research.

Further, this downsizing trend is likely to continue unabated for the next 18-to-24 months, reports investment bank B. Riley FBR, resulting in some 30 percent of current retail space ceasing to exist in its current form.

BDO's David Berliner, who leads its restructuring and turnaround services practice, said, "It doesn't mean retail is going away. It's a repositioning of retail," and added, "It's the survival of the fittest."

The fittest retailers poised to survive are those with the most robust digital presence, most especially the digitally native ones that are unencumbered by old ways of thinking about, and doing, retail.

But while legacy retailers shed the weight of their unproductive store fleets, their survival will require more than simply moving sales online.

Retailers need to think in radically new ways about the role of their physical stores and how to leverage them more effectively.

Time to think about zero-inventory stores

Researchers from Wharton and Harvard propose such a radical new idea, called zero-inventory stores (ZIS), or retail showrooms.

The appeal is obvious.

No dollars are tied up in unsold inventory across a chain of stores. Less inventory means smaller store footprints and more money saved. And, most importantly, the retail staff is freed from unpacking, arranging and freshening in-store inventory to devote more time to serving the customer.

The physical store becomes a showroom where customers can touch, see and experience the products with customers' orders fulfilled via ecommerce. This showroom strategy is one that mostly digitally native retailers are moving forward with, such as Walmart-owned menswear label Bonobos and Suitsupply, MM. LaFleur for women's workwear, Interior Define for furniture, and Casper mattresses.

However, legacy retailer Nordstrom is proving the concept works with its five Nordstrom Local locations and IKEA is testing a showroom concept in New York.

What the research shows is that the ZIS showroom strategy not only is more cost-effective for retailers, but results in what is called "supercharged customers," who place larger average orders, shop more frequently and buy across a wider product range. And, as an added bonus, these supercharged customers return fewer high-priced items.

Santiago Gallino, Wharton professor of operations, decisions, and information, explained how he and fellow researchers David Bell, former Wharton marketing professor now with Idea Farm Ventures, and Antonio Moreno, Harvard professor of business administration, worked with transaction data from a digital-first men's apparel retailer unnamed, but we can guess for years 2007-2018. More than 2 million transactions from nearly 600,000 customers were analyzed to compare orders generated online with those from the company's then ~50 ZIS showroom locations in the United States.

This rich data set enabled them to study what happened when those original customers who transacted online moved over to the physical locations.

"We were able to support the hypothesis of a supercharging effect," Mr. Gallino said. "It turns out those customers who visit a physical store after that visit, they return fewer products. They buy more and not only do they spend more money, but they also tend to purchase more expensive products."

The supercharging effect they documented includes:

- Spending up to 60 percent more on an average order
- Shopping at a higher velocity, showing a 28 percent reduction in inter-purchase times
- Buying across 20 percent more products categories and trading-up to more expensive items
- Fewer returned items overall, and disproportionately lower returns for more expensive items

In effect, the research shows that retailers who disaggregate the in-store shopping experience from the fulfillment process gain the best of both physical retail and online ecommerce, what the authors describe as "offline-online complementarity."

They conclude: "Thus, an experience-centric' offline format designed to deliver customer service and brand interaction while leveraging online fulfillment, provides significant value creation as customers not only generate more demand, but also do so more efficiently."

In other words, this ZIS showroom model supercharges customers and retailers alike.

Getting the best of physical and online retail models

While this study is immediately applicable to digitally-native retailers wanting to cross over into bricks-and-mortar retail JLL, the commercial real estate firm, estimates 850 stores from the top 100 online retailers will open in the next five years the implications are more profound for traditional retailers trying to find a way forward in an increasingly complex retail environment.

This research offers retailers a reason to consider a completely or partially inventory-less format where the focus is on enhancing the customer experience, not just moving more product.

"As many stores and malls struggle and close, the ZIS offline format coupled with centralized fulfillment offers a revolutionary way forward," the authors write.

"In simple terms, the traditional store seeks to accomplish two functions, service experience and fulfillment under

one roof," they said. "In contrast, the ZIS elevates the experience function while outsourcing fulfillment entirely to ecommerce."

Caveats to consider

However, there are some caveats in the research that need to be addressed.

First, it focuses primarily on male shoppers, who behave differently than women.

That said, men tend to avoid rather than gravitate to stores, so the fact that visiting a ZIS showroom store also increases men's level of engagement with the brand is notable.

Second, the study was conducted with a higher-priced men's clothing brand, so the supercharging results may not apply to other categories of retail. But for retailers that serve more affluent customers who have higher service expectations, the ZIS showroom model is most definitely worth testing.

Nordstrom Local results are confirming the results that Gallino et. al. found.

"We're seeing higher customer engagement and spend at our Nordstrom Local neighborhood service hub," said Nordstrom co-president Erik Nordstrom in the [second quarter earnings call](#). "Customers spent 2.5 times more on average."

Third, some customers simply want instant gratification and do not want to be forced to wait.

"It's a managerial call," Mr. Gallino said. "They [retailers] can decide that for certain categories or products, they can move into more of a showroom concept. For other products, they're going to carry those in the store."

IN CLOSING, Mr. Gallino stresses the need for retailers to think more strategically about how the physical store can be leveraged to provide more of what customers want today and, in many cases, that is more service.

"One big message is that the physical store is alive and doing well," Mr. Gallino said.

"But now this research presents the option of how when you think carefully about the experience and how to engage with the customer and hopefully supercharge the customer you can do that with new and old tools alike," he said.



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