Company Snapshots:
At Costco, Culture is King

"Culture is not the most important thing in the world. It's the only thing."

According to Jim Sinegal, founder of retail giant Costco, the company's culture drives its business strategy. Costco's success turns on its ability to recognize and respect what Sinegal calls "what we stand for in the customer's eyes, and what we mean to all of the stakeholders in our business." Those core tenets include putting the customer first, rewarding its employees, and valuing its suppliers.

Developing Corporate Values

Sinegal's education in business started in 1954, when he worked at the discount chain Fed-Mart as a bagger to help pay for his education at San Diego State University. He soon left college to rise up the ranks at Fed-Mart, eventually working under Sol Price, Fed-Mart's founder and a retail pioneer, for thirty years. Price impressed upon Sinegal the importance of trust in customer relationships—a part of the reason Sinegal insists on Costco's disciplined margins, honest prices, and great value.

Under Price, Sinegal developed his business philosophy: "We have to obey the law, we've got to take care of our customers, take care of our people, and respect our suppliers. We think if we do those four things, pretty much in that order, that we're going to do what we have to do in the long term, which is to reward our shareholders."

Sinegal's thinking dovetails with University of Virginia Professor R. Edward Freeman's concept of stakeholder theory: that businesses should create value for stakeholders (those beyond the central financial shareholders), i.e. those affected by the business, including employees, communities, suppliers, and other actors. As Sinegal puts it, "Our view is that you can reward the shareholders in a short term by not paying attention to one of those aspects, but you can't do it in a long term…You are either going to have labor problems, or you are going to break the law, or your customers are going to be turned off, or the suppliers are not going to want to do any business with you." He adds, "Sooner or later you are going to stumble very badly."

Sinegal hopes to build an organization that will be around in fifty years, and that means Costco has obligations to all stakeholders—suppliers, employees, the community, and customers. A key part of Costco's business model, Sinegal says, is its investment in its employees as the critical piece of serving its customers.

"We count on very significant productivity," he says. "We pay high wages and have a very healthy benefit plan. Of every dollar that we spend on our business, $0.70 is on people."

In her research on retail supply chain and store operations management, Zeynep Ton, an adjunct assistant professor at the MIT Sloan School of Management and the author of *The Good Jobs Strategy,* found that some retail companies often view employees as a cost to be minimized by way of poor pay and limited training. She found that this perspective depressed morale and consequently reduced the quality of customer service, ultimately negatively impacting the bottom line.

A Focus on Employees and Culture

Costco's focus on its employees, on the other hand, is a clear example of what Ton calls the "good jobs strategy" of investing in employees in order to boost bottom-line profits. Nearly 90% of Costco's employees receive healthcare and benefits, despite half its staff being employed part-time. A 2013 Businessweek story cited an average hourly worker pay of more than $20 an hour excluding overtime, which works out to nearly $43,000 a year, assuming 40-hour workweeks. This is three times the U.S. minimum wage of $7.25 and is almost double the national average retail staff pay of $25,000 annually.

It is no surprise, therefore, that Costco's turnover is a mere 5% per year for employees who have worked for Costco for over one year—compared to the national average of 67% in part-time retail employees, according to a 2012 study by the global management consulting firm Hay Group. Sinegal describes this investment in its people as Costco's "most significant expense item," and the item that is key to Costco's high volume and high revenues on low margin, high value products.

The strength of Costco's employee relationships is not simply limited to pay and benefits: Costco has also proven its commitment to its employees in times of crisis. In one example cited in Simon Sinek's book *Leaders Eat Last*, when the 2009 U.S. economic crisis caused sales to drop by 27 percent, Sinegal introduced a $1.50-an-hour wage increase for many hourly employees, spread out over three years, to help employees weather the U.S. economic crisis in 2009. Sinek writes that Sinegal told Costco CFO Richard Galanti that workers needed help during a recession, not the opposite. As Sinek explains in his book, layoffs are a last resort at Costco, rather than a routine strategy.

In another example, Sinek describes Sinegal's 2005 refusal to pass on additional healthcare costs to consumers, leading to Sanford C. Bernstein & Co. analyst Emme Kozloff to criticize Sinegal for being "too benevolent". Yet studies have shown that this benevolence is often the very quality that can build a strong, trusting relationship between the employees and employer. In one Stanford University survey of 800 MBA graduates from eleven European and North American business schools, researchers found that the graduates said they would be more committed to organizations with a “benevolent climate” that prioritizes employee and community welfare.

In line with Sinegal’s insistence on the importance of engaged employees in satisfying customers, Sinek notes that “customers will never love a company unless the employees love it first…It is usually the people at the edges, the infantry, so to speak, who are the most vulnerable to external dangers. They are also the ones who tend to have the most contact with clients and customers. If they feel protected, then they will do all they can to serve the customers without fear of repercussions from the company’s leaders”.

A study on the value of corporate culture by Luigi Guiso, Paola Sapienza, and Luigi Zingales advances Sinek’s point: the authors concluded that “high levels of perceived integrity are positively correlated with good outcomes, in terms of higher productivity, profitability, better industrial relations, and higher level of attractiveness to prospective job applicants”.

Sinek also adds that Costco promotes employees internally, allowing longtime employees to have the opportunity to rise up to executive positions. Sinek cited a Bloomberg Businessweek piece claiming that over two-thirds of Costco’s warehouse managers started out as cashiers and other hourly-pay roles. Sinek writes, “whereas people go to work for Walmart because they want a job, people go to work at Costco because they want a future and a sense of belonging as a team.”

Why Ethics Pays: “It’s Just Good Business”

Sinegal’s business approach shows that being humane and ethical can also be profitable. A grounded businessman among overpaid chief executives, Sinegal earns a salary and bonus that is only twice that of a Costco store manager’s compensation. His CEO employment contract was singularly short: one page long, and the only contract which specified that Sinegal could be ‘terminated for cause,’ according to Nell Minow, editor and founder of the Corporate Library and an expert on corporate governance.

Another aspect of Costco’s corporate ethic is its disciplined margins and fair value. One Huffington Post article titled, “11 Reasons to Love Costco That Have Nothing To Do With Shopping” cited stock analyst research that described Costco’s 15% margins as compared to the 25% markup that most supermarkets and department stores use as standard. Costco’s legendary stubbornness about prices and margins can seem excessive, but the results are impressive. Its hot dog and drink combo, for example, has famously stayed priced at $1.50 since the mid-1980s. The dependable price both drives traffic into stores and allows Costco to sell four times the number of hot dogs sold at all Major League Baseball stadiums in total each year.

While some on Wall Street have complained about low earnings on the dollar, Sinegal responds that it’s just good business. "You get what you pay for. We try to give a message of quality in everything that we do, and we think that that starts with the people." This has certainly translated into business success: as America’s second largest retailer and the seventh largest retailer in the world, Costco has revenues of over $110 billion and operates nearly 700 warehouses and stores, while earning a reputation as a fair and progressive employer.

Others on Wall Street recognize Sinegal’s genius: in an interview with The Motley Fool, Berkshire Hathaway’s Vice Chairman Charles Munger responded to a question about his favorite company outside of Berkshire: “That’s easy. It’s Costco. It’s one of the most admirable capitalistic institutions in the world. And its CEO, Jim Sinegal, is one of the most admirable retailers to ever live on this planet.” Munger noted, “When other companies find ways to save money, they turn it into profit. Sinegal passes it on to customers. He’s sacrificing short-term profits for long-term success.”

Asked about the source of his approach to business, Sinegal cites the values and integrity that he learned from Sol Price. Sinegal confides that his biggest concern is maintaining the discipline to hold those values: “I worry that we don’t lose sight of what it is that got us to where we are and continue to keep the same values.” Those values have served Costco, and its investors and stakeholders, well.

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