Costco Wholesale Corporation: Part One

Costco: Join the Club

If 25 years ago a pair of entrepreneurs aspired to the ranks of Fortune 500 retailers by following unconventional and counterintuitive strategies, investors and colleagues would have likely dismissed the effort or perhaps even advised the idealistic greenhorns to consider other careers. Yet as James Sinegal and Jeffrey Brotman mark their 25th anniversary as co-founders of Costco Wholesale Corporation, the iconoclastic businessmen are the envy of retailers everywhere. By offering a limited selection of merchandise at rock-bottom prices, setting razor-thin profit margins, establishing lofty ethical standards, and rewarding workers with premium wages and healthcare benefits, the enterprising duo defied conventional wisdom and created the No.1 membership warehouse club in the world.

In the years since the co-founders opened their first low-price retail warehouse just miles from its current headquarters in Issaquah, Washington, Costco has grown to over 488 locations serving 48 million enthusiastic cardholders in eight countries. With annual sales of over $50 billion and a workforce of nearly 125,000 highly motivated and famously well-paid employees, Costco is the top warehouse club and fourth-largest retailer in the nation.

The story of Costco's rise from a single Seattle store in 1983 to a multinational chain of enormously profitable warehouses is a tale of exemplary leadership in a rapidly-changing retail world. Under the artful direction of Sinegal and Brotman, Costco Wholesale Corp. developed and perfected the warehouse-club formula pioneered in the 1970s by Sol Price, founder of California retailer Price Club. Initially a protégé to Price, young Jim Sinegal learned his mentor's high-volume low-cost trade secrets, but later left Price Club to launch a competing company—Costco. The two businesses eventually merged in 1993, and Sinegal went on to eclipse Sol Price in the art of getting the right product in the right place for the right price.

The most visible emblem of Sinegal and Brotman's retail strategy is the Costco warehouse itself. With its bare concrete floors, fluorescent lights, and pallets of merchandise piled to the rafters, the colossal 150,000-square-foot theater of retail is worthy of the "big box" appellation. Visitors are immediately struck by the conspicuous absence of signs and displays throughout the massive structures, and the self-checkout lanes and dispersed sales associates betray Costco's barebones, no-frills approach to reducing costs to the absolute minimum.

But if Costco's atmospherics are generic and uninspiring, the company's merchandising mix is anything but. While Wal-Mart stands for low prices and Target is the master of cheap chic, Costco is a treasure hunt. Among the high-end merchandise moving through stores are Waterford crystal, Coach leather goods, Fila jackets, Dom Pérignon Champagne, Apple Video iPods, and Prada sunglasses. Sinegal's quest to offer luxury goods to his characteristically upscale customers has inspired Costco merchandisers to source some unusual surprises: rare Picasso drawings and 10.6-carat yellow-diamond rings priced at $180,000. Yet in a single shopping cart, such pricy merchandise can be found alongside bulk items like 2,250-count Q-Tip packs and vats of mayonnaise—or beside the many products sold under Costco's own Kirkland Signature private label. Of the 4,000 items offered in Costco warehouses, approximately 1,000 are these upscale treasure-hunt goods that come and go at a moment's notice, creating an urgency to buy before it's too late.

Managing warehouses of ever-changing merchandise requires an organization that is flat, fast, and flexible. Sinegal fancies each warehouse a mini-corporation, and each warehouse manager a de facto CEO. These "local CEOs" make rapid, independent merchandising decisions based on knowledge of their customers' wants and needs. Likewise, lower level employees are expected to make decisions guided by the organization's mission and values and based on widely distributed inventory and sales information.

To develop a highly-trained and knowledge-driven workforce, Sinegal and other leaders atop Costco's managerial hierarchy abandon the old command-and-control mindset and emphasize coaching, motivation, and empowerment instead. Sinegal famously spends about 200 days a year visiting his company's warehouses—often dressed in casual attire. During these warehouse tours, Sinegal is at once a monitor, figurehead, leader, and disturbance handler. As the CEO strolls around the "racetrack"—the U-shaped path along the perimeter of the facility—he checks whether stocks are replenished and positioned to sell, discusses sales with warehouse managers, and observes how workers are sharing knowledge and solving problems. This "management-by-walking-around" routine creates a bond of trust and loyalty between Sinegal and his employees.

Costco's benevolent and motivational management approach manifests itself dramatically in wages and benefits paid to workers. The company pays employees an average hourly wage of $17—the highest among discount retailers—while also picking up 92 percent of health-insurance premium costs. The result is high performance and low turnover. Costco's workforce has a reputation for being the most productive and loyal in all of retail.

A winning retail strategy, flexible organization, exemplary leadership, and well-compensated ~~employees—these are~~ the unique qualities that place ~~Costco~~ Wholesale Corporation at the head of its class. As you progress through your course in management, you'll continue to read about the extraordinary leadership of Costco's founders and encounter the innovative planning, organizing, leading, and controlling methods the company uses to outstrip competitors and steer the organization toward future success.

Questions

1. Which of the three management-skill categories do you think Costco CEO James Sinegal draws upon most during his year-round visits to local Costco warehouses? Explain.
2. What aspects of Costco's business model exemplify the transition from "the old workplace" to the "new workplace," and why?
3. How does Costco's high worker-retention rate help the warehouse club maintain low prices?

SOURCES: Matthew Boyle, "Why Costco is So Damn Addictive," *Fortune*, October 30, 2006; Alan B. Goldberg and Bill Ritter, "Costco CEO Finds Pro-Worker Means Profitability," *ABC News*, August 2, 2006, *http://abcnews.go.com*, accessed November 8, 2006; Doug Desjardins, "Bulking Up Sales Through Sales in Bulk," *Retailing Today*, September 25, 2006; Daren Fonda, "Jim Sinegal: Costco's Discount CEO," *Time*, May 8, 2006; Alyce Lomax, "Most Foolish CEO: Jim Sinegal," *The Motley Fool*, September 28, 2006, *http://www.fool.com*, accessed November 6, 2006.

Costco Wholesale Corporation Part Two: James Sinegal, The Conscience of a Corporation

Entrepreneurs face enormous challenges in today's complex business world. To succeed in the 21st century, these aspiring business owners must be able to identify global trends, provide ethical leadership, develop effective corporate cultures, and manage the various environments in which they operate. Like jugglers in a circus, entrepreneurs are expected to balance the often-conflicting demands of customers, employees, shareholders, and other stakeholders to whom they are responsible. The ones that rise to the occasion make enormous contributions to society and reap rewards beyond their wildest dreams.

Transforming a startup into a multinational corporation often begins with the vision, drive, and perseverance of a single individual. The entrepreneurial impetus that catapulted Costco Wholesale Corp. from a Seattle warehouse to the nation's top warehouse-club chain originated with James Sinegal, the Pittsburgh native and grandfather-like figure who co-founded Costco and now serves as its chief executive. The son of a steelworker, Sinegal embarked on his retail journey early in life. In 1954, at the age of 18, Sinegal took a job unloading mattresses for Fed-Mart, a new San Diego discount store launched by Sol Price, an early pioneer of the warehouse-club concept. Sinegal worked hard and became Price's protégé, eventually achieving the head manager position at Fed-Mart's flagship store. In the 1970s, Price sold Fed-Mart and launched a new warehouse store, one bearing his name: Price Club. Though Sinegal followed his mentor to the new warehouse establishment, it was only a matter of time before Price's star pupil would venture out on his own. That time came in 1983 when Sinegal founded Costco with business partner and lawyer Jeffrey Brotman, the company's current chairman. Their efforts helped launch an era of "big-box retailers" typified by companies like Wal-Mart, BJ's Wholesale Club, and Target.

From the beginning, Sinegal's vision for Costco was guided by a set of values and priorities now expressed in the company's five-point code of ethics. The Costco Code of Ethics indicates that, to achieve its mission of providing members with quality goods and services at the lowest possible prices, Costco must (1) obey the law, (2) take care of its customers, (3) take care of employees, and (4) respect its suppliers. If the organization follows these four guidelines, it will accomplish its fifth and ultimate goal: reward shareholders.

To ensure that these ethical standards would become the guiding principles for all Costco busine[ss] operations, Sinegal developed a vibrant corporate culture that embodied and reinforced the co-founde[r's] values and beliefs. One of the most visible and ofte[n] discussed aspects of Costco's corporate culture is its generous-yet-proportional employee compensation. Convinced that happy workers are productive workers, Sinegal saw to it that his team was lavishly compensated with a livable wage and premium benefits[.] 2006, Costco workers made an average hourly wage [of] $17, an astounding 42 percent higher than rival Sam['s] Club. Richard Galanti, Costco's executive vice president and chief financial officer, believes the pro-wor[ker] wages policy makes good business sense: "It's impo[r]tant to pay people a fair living wage. If you do, and [...] better than everybody else, you're going to get bette[r] people—and they're going to stick around longer." Despite complaints on Wall Street that Costco's employee-remuneration program functions at the expense of profits and share prices, Sinegal is committ[ed] to the long-range benefits of a generous compensatio[n] strategy: "On Wall Street, they're in the business of making money between now and next Thursday . . . but we can't take that view. We want to build a company that will still be here 50 and 60 years from now[."]

Though Costco's employees and first-line managers are the best paid in retail, leaders atop the ma[n]agerial hierarchy earn a humble living, relative to their peers. Sinegal's salary hovers around $350,000[—] chump change compared to the greenbacks floodin[g] the wallets of most Fortune 500 bosses. Even with bonuses, Sinegal's annual compensation ranks amo[ng] the lowest ten percent of chief executives. The work[er-]centric leader is unapologetic, viewing his company['s] executive pay policy in terms of distributive justice: [...] just think that if you're going to try to run an organization that's very cost-conscious, then you can't hav[e] those disparities. Having an individual who is maki[ng] 100 or 200 or 300 times more than the average perso[n] working on the floor is wrong."

The egalitarian-minded CEO reinforces this culture of inclusion and proportionality in other ways, [as] well. Sinegal dons a Costco Kirkland Signature dres[s] shirt instead of a suit. He wears an ID nametag like other employees, answers his own phones, and spends 200 days each year visiting warehouses and teams. Even his corner office is welcoming: with no door or window, the Costco general's quarters are covered with photographs of family members and store openings. In ways large and small, Sinegal sen[ds] the message that employees are the company's most valuable commodity.

Costco's commitment to ethics and social responsibility has not been without challenges, however. In

2006, a stock-options backdating scandal tainted hundreds of businesses, forcing the ouster of dozens of top executives. When an internal investigation at Costco uncovered "imprecisions" in the company's executive options plan, officers proactively cancelled executive bonuses for the year, withholding payouts of up to $200,000. This dramatic act of self-regulation was suggested by the two leaders who had the most to lose: James Sinegal and Richard Galanti. Costco has been accused of other lapses, such as impeding the advancement of female workers to senior-level positions and displaying environmental and cultural insensitivity during its Mexico expansion, but Sinegal & Co. have thus far emerged unscathed.

Despite occasional allegations, Costco has managed to maintain its squeaky-clean reputation. And so long as Jim Sinegal continues serving as the conscience of the corporation, there is every reason to believe it will stay that way.

Questions

1. What are the motivations and personality traits that compel individuals like James Sinegal to strike out on their own, preferring the risks of entrepreneurship to the relative safety of working for others? Does Sinegal qualify as a social entrepreneur? Why or why not?
2. In what way does the carefully crafted order of Costco's five-point Code of Ethics represent a rejection of the profit-maximizing approach to evaluating corporate social performance?
3. Which of the four types of corporate cultures best describes Costco? Identify ways that James Sinegal exhibits cultural leadership to create and maintain a high-performance organization?

SOURCES: Mike Duff, "The Sinegal Factor: Thriving with a Hands-on Approach," *DSN Retailing Today*, December 19, 2005; Doug Desjardins, "Culture of Inclusion: Where Top Executives Lead by Example and Honesty and Frugality Are Valued Virtues," *DSN Retailing Today*, December 19, 2005; Chris Noon, "No Bonuses For You Two," *Forbes*, October 20, 2006; Alyce Lomax, "Most Foolish CEO: Jim Sinegal," *The Motley Fool*, September 28, 2006, *http://www.fool.com*, accessed November 6, 2006; David Pinto, "Costco Named Retailer of the Year, *MMR*, January 9, 2006; Steve Greenhouse, "How Costco Became the Anti-Wal-Mart," *The New York Times*, July 17, 2005; Mike Troy, "A Model Business: Long-term Vision Benefits Customers, Employees," *DSN Retailing Today*, December 19, 2005; Matthew Boyle, "Why Costco is So Damn Addictive," *Fortune*, October 30, 2006; "Code of Ethics," Costco Investor Relations Web site, *http://phx.corporate-ir.net/phoenix.zhtml?c=83830&p=irol-irhome*, accessed November 14, 2006.

Costco Wholesale Corporation Part Three: Costco Turns 500

November 22, 2006, marks a major milestone in the history of Costco Wholesale Corporation. On that date, in the city of La Quinta, California, the world's top warehouse-club operator opened its 500th location since pioneering the discount warehouse concept in the 1970s and '80s.

Throngs of customers, city planners, and interested observers gathered in the Southern California suburb to celebrate the store's grand opening, days before the onset of the 2006 holiday shopping season. At 8 A.M., the boxy 148,000 square-foot facility threw open its doors, welcoming hundreds of enthusiastic bargain hunters giddy at the prospect of buying the year's hottest merchandise at rock-bottom prices. As the morning hours passed, Xbox 360s, Panasonic plasma TVs, and AG brand jeans began beeping briskly through the checkouts—a sure sign that holiday stockings across the Greater Palm Springs area would soon be filled with gift-giving cheer.

The landmark opening of Costco's 500th warehouse was not only a sign of good things to come for local residents or for La Quinta officials anticipating a one-million-dollar boost to the city's annual tax revenues; for Costco CEO James Sinegal and his team of strategic planners, breaking the 500 barrier was confirmation that Costco's long-term growth plan was working. In the 25 years since Sinegal and Costco co-founder Jeffrey Brotman broke ground on their first archetypal no-frills warehouse in Seattle, Washington, Costco has consistently executed its mission to build warehouse clubs that provide quality goods and services at the lowest possible prices. The general merchandise retailer has grown at an average of 20 warehouses per year and now ranks No.1 among discount warehouse chains.

For some businesses, reaching the top might seem like a time for self-congratulation. But for Sinegal & Co., success is handled with a kind of "business-as-usual" modesty. Far from causing Costco's top brass to rest on their laurels, hitting the 500 marker has emboldened management to set even more aggressive expansion goals. During an August 2006 conference call, CFO Richard Galanti announced plans for 35 to 40 new stores, with a target of 700 U.S. locations—a sizable increase over previous goals.

Launching new storefronts is central to any major retailer's grand strategy. First and foremost, adding locations is about increasing revenues and profits. A typical Costco warehouse averages $128 million in annual sales. By raising expansion projections for 2007, the Issaquah, Washington-based retailer has set itself on track for double-digit percentage revenue growth beyond its record $60 billion achieved in 2006.

Costco doesn't throw warehouses up just anywhere, however. Sinegal's strategic planning effort involves the careful identification of sites that provide a good fit between the organization and its environment. A majority of Costco store openings target suburban commercial districts, where suburban customers like their bulk-packaged soup, toilet paper, and peanut butter under a single roof with computers, copiers, hot tubs, and grand pianos. But in Costco's urban outlets, such as the tower-complex location in the heart of downtown Vancouver, Canada, merchandise caters to downtown demographics. The club's urban-tailored product mix features upscale Louis Vuitton fashion goods and a hearty deli selection of home-ready meals—a nod to Vancouver's many downtown condo dwellers. "It is the most unique Costco in the world," says Regional Marketing Director Robin Ross, reflecting on the store's uncommon placement within big-city surroundings. "This is a place where you can buy tires *and* a two carat diamond ring for $19,699."

Though revenue generation and demographic fit are primary goals for all Costco locations, certain warehouses also serve as testing labs for new ventures. One such idea incubator is Costco's 205,000 square-foot superstore in Hillsboro, Oregon, near Portland. The store's footprint was designed 40% larger than typical stores to test out a mini-version of Costco Home, the retailer's high-end home furnishings chain store. "It gives us lots of extra space where we can test some things and it's close enough where we can keep an eye on it," said Galanti.

Management's strategy of designating certain locations for test marketing purposes has proven successful, especially in light of the fact that most of Costco's present ancillary businesses began in such warehouses before being rolled out nationwide. The company's $2 billion-in-sales pharmacy division began as an experiment in a Portland store in 1986. More recently, in 2006, Costco's drive-through Car Wash business made its test-market debut at the famous Fourth Avenue store in south Seattle.

But as Costco implements expansion plans in locations ranging from Manhattan and Mexico to Taiwan, the discounter's big box concept faces challenges from numerous forces in the external environment. Various stakeholders—including unions, local governments, and anti-globalization groups—are engaged in a contentious dispute over the rapid growth of big boxes. Though city developers and state officials typically view superstores as a preferred means of filling government coffers with millions in tax revenues, labor and anti-growth forces see the price-slashing mega-stores as detrimental to their interests. The debate is growing particularly acrimonious in California, where arguments rage over whether superstore retailers belong in a neighborhood and legislative bills threaten a severe restriction of big box expansion.

Keen to the threat from outside forces, and dedicated to his team's plan for growth, Sinegal sets course and asserts his rock-steady leadership. To Costco's seasoned founder and chief, the company's growth from one single Seattle store into a 500-warehouse retail chain is a powerful motivator for future performance. "We still take pictures of that original building and show it at our manager's meetings and then show the contrast to what our businesses look like today," Sinegal says. "If we are going to continue to prosper as a company, we had better be as creative in the next twenty years as we have been in the past twenty years. It is an imperative that you continue to be creative and build your business."

Questions

1. What strategy formulation tools might top management at Costco use to assess opportunities and threats to the company's future expansion?
2. Explain how Costco's select test-market warehouses demonstrate cooperation and connectedness between the different levels of planning and strategy throughout an organization.
3. How does James Sinegal's recounting of Costco's history using early warehouse photographs at manager's meetings illustrate the role of corporate culture in supporting an organization's strategy and performance?

SOURCES: Marcel Honore, "Valley's Second Costco Lands in La Quinta," *The Desert Sun*, November 21, 2006; Will Fifield, "500 and Counting," *The Costco Connection*, November 2006; Doug Desjardins, "Bulking Up Sales Through Sales in Bulk," *Retailing Today*, September 25, 2006; Gillian Shaw, "Costco Opens Yaletown Warehouse Store," *Vancouver Sun*, November 10, 2006; John Howard, "Big Box Debate," *Capitol Weekly*, November 16, 2006; "Ancillary Businesses Continue to Drive Through Sales," *Retailing Today*, September 25, 2006; Doug Desjardins, "Retailer's Largest Store a Learning Lab," *Retailing Today*, November 6, 2006; Mac Greer, "Is Costco Giving Away the Store?," *The Motley Fool*, November 22, 2006, *http://www.fool.com*.

Costco Wholesale Corporation Part Four: Costco's Generous Pay Yields Generous Profits

Attracting and retaining a loyal and productive workforce is essential to the success of any business. But in retailing, where employee turnover can nearly outpace rapidly churning inventories, a stable and satisfied workforce can be of critical importance. When it comes to cultivating human capital, Costco Wholesale Corp. stands heads and shoulders above its discount-retailing peers. The No. 1 membership warehouse chain boasts the highest-paid, most dependable workforce in the industry. This distinction stands in sharp contrast to prevalent labor trends, where many businesses have abandoned the lifetime-employee concept and are engaged in a lower-wages race to the bottom. When viewed against this backdrop, Costco's strategy for developing a loyal and empowered labor force is at once the most innovative and most controversial in retailing today.

Costco's unconventional approach to human resource management is immediately apparent in the recruitment of its warehouse workers. In keeping with the company's bare-bones, cost-cutting ethic that eliminates overhead and passes the savings to its customers, the big-box discounter doesn't retain outside recruiters, and the human resource staff doesn't participate in hiring. When a new warehouse is being built in a location, regional and local managers pitch office tents onsite to take applications and place help-wanted ads in area newspapers. After conducting interviews with job candidates, managers select hires and schedule training sessions, where the recruits are assigned a mentor. For their first assignment, trainees go on a scavenger hunt for information about their new company, gathering facts and reporting their discoveries to managers within the month. Once acclimated to the Costco way, the new workers finish their orientation and prepare for the store's grand opening. The entire process is carried out on a shoestring budget, in keeping with Costco's no-frills, low-budget operations philosophy.

Bolstering Costco's recruitment effort is one of the most generous compensation packages in retail. Costco's workers earn an average of $17 per hour—42 percent more than employees at rival Sam's Club and high above U.S. retail industry averages. Employees at this pay level are eligible for bonuses of between $2,000 and $3,000, and, after four years, full-time hourly employees earn $40,000 annually. Equally alluring are Costco's premium health benefits that are the envy of many American workers. Costco employees, whether part- or full-time, pay only 8 percent of healthcare costs, compared to the retail average of 25 percent. Topping it off is Costco's 401(k) program for new hires that eventually matches up to 9 percent of workers' annual pay.

The expense on such lavish compensation adds up: Costco's labor and benefit costs make up about 70 percent of its operating expenses, a lofty number that troubles some analysts who say the $60-billion-a-year retailer is showering benefits at the shareholders' expense. But CEO James Sinegal maintains that his company's investment in human capital is good business, not corporate altruism. "It absolutely makes good business sense," Sinegal states. "Most people agree that we're the lowest-cost provider. Yet we pay the highest wages. So it must mean we get better productivity . . . you get what you pay for." Costco financial chief Richard Galanti sees things in a similar light: "One of the things Wall Street chided us on is that we're too good to our employees . . . we don't think that's possible."

The numbers speak for themselves—Costco's workers stay longer and produce more than workers of competing retailers. After the first year, only 6 percent of Costco employees leave, compared with 21 percent at Sam's. With recruitment and training costs estimated at around $2,500 per trainee, a sizable retention rate means sizable savings. Moreover, Costco workers generate $918 in per square foot of retail space annually, outstripping worker productivity at other major retailers. Sam's Club employees yield $552 in sales per foot of space, and Wal-Mart and Target staffs produce $438 and $307 per foot, respectively.

Costco displays the same pro-worker mindset with the recruitment of top management. Sinegal has claimed that up to 98 percent of managerial positions are filled from within the company—in fact, most upper-level managers worked their way up the ladder starting at the warehouse floor. This official policy of promoting from within fosters loyalty and helps to develop warehouse managers, buyers, and executives who have thorough knowledge of the company. When sourcing such talent, recruiters look for leaders with people skills, smarts, and an entrepreneurial love of merchandising. The company has been accused of lacking diversity among top management, however. Sinegal admits that having 17 percent of management jobs occupied by women is low: "We don't let ourselves off the hook on that," he says. "We think we can do better. We know we can do better."

Costco's success proves that low prices for customers don't have to come at the expense of wages and benefits for workers. Sinegal chooses to save money elsewhere in the business while generating ample revenues through membership fees and high-volume sales. Reflecting Sinegal's labor-oriented values, Costco's top brass views people as a competitive advantage, not another expense to be reduced to the minimum. "Some companies control these expenses by figuring out how little they must pay their employees and how much of the health care cost they can pass on to their employees," Galanti remarks. "While we agree with the idea of cost efficiency, we believe the rest of that stuff is mostly about sacrificing the well-being of your employees in order to increase profits; we don't buy that. We believe you can do both."

Questions

1. What sacrifices does Costco make so that it may pay employees higher wages?
2. What are the benefits of promoting from within? What might be possible drawbacks to having a high internal promotion rate?
3. What steps could Costco take to foster greater diversity among its management, particularly as it relates to the promotion of women?

SOURCES: Michelle V. Rafter, "Welcome to the Club–Parts 1 & 2; Costco Employees Enjoy Some of the Most Generous Wages and Benefits Among U.S. Retailers" *Workforce Management,* April 1, 2005; Matthew Boyle, "Why Costco is So Damn Addictive," *Fortune,* October 30, 2006; S. Holmes and W. Zellner, "The Costco Way: Higher Wages Mean Higher Profits. But Try Telling Wall Street," *Business Week,* April 12, 2004; Steven Greenhouse, "How Costco Became the Anti-Wal-Mart," *The New York Times,* July 17, 2005; Nina Shapiro, "Company For the People," *Seattle Weekly,* December 15, 2004; Jim Underwood, *What's Your Corporate IQ?: How the Smartest Companies Learn, Transform, Lead,* Chicago, Ill.: Dearborn Trade, 2004, quoted in Cecil Johnson, "Treating Employees Well Is One Key to Firm's Success, Professor Writes," *Fort Worth Star-Telegram,* October 7, 2004.

Costco Wholesale Corporation Part Five: Providing Leadership in Bulk

When Costco Wholesale procured land to construct a new warehouse in Cuernavaca, Mexico in 2001, it had no idea that the purchase would spark a two-year clash between anti-globalization protesters and senior management. The leading U.S. warehouse club operator was looking to continue its international expansion, and the Mexican government's auctioning of a site occupied by a dilapidated hotel and casino known as the *Casino de la Selva* presented a strategic opportunity.

But what started out as a business-as-usual transaction for Costco soon turned into a public relations crisis. Opponents of the land development staged human blockades to stop chainsaw crews from clearing the way for the superstore and surrounding facilities. Numerous protestors were arrested, and the conflict received widespread media attention.

Despite overwhelming support in Cuernavaca for the new Costco store and its promise of new jobs and economic prosperity, accusations that Costco was paving a parking lot overtop the city's civic, artistic, and national heritage were beginning to create the perception of Costco as an insensitive multinational corporation. To demonstrate environmental and cultural sensitivity to the citizens of the region, and to offer an olive branch to anti-growth opponents, Costco set aside millions of dollars beyond its original budget to preserve much of the area's natural landscape and to restore the dilapidated murals of the *Casino de la Selva*, the site's once-thriving hotel and gaming casino. In cooperation with the Mexican National Institute of Fine Arts and Literature, the Vergel Foundation, and regional city planners, Costco built a cultural center and museum that now displays the hotel frescos as well as the esteemed Gelman Collection of Mexican art, featuring works by Frida Kahlo and Diego Rivera. Today, the site serves as a valuable international attraction for Cuernavaca, preserving the city's cultural heritage and providing a boost to the city's economy.

The Cuernavaca story illustrates the exemplary moral leadership that has come to characterize Costco's senior management. From the very beginning, Costco had a different way of seeing its own mission. While many businesses measure success in strictly financial terms—Are we profitable?—the world's leading membership warehouse chain has always gauged achievement according to broader criteria: Are we creating greater value for the consumer? Are we more efficient? Are we doing the right thing for employees and other stakeholders? This holistic approach to business has made Costco not only wildly profitable but also vitally relevant to the issues and trends shaping the future of business today.

Led by co-founder and CEO James Sinegal, Costco forged a new model of retailing that combined wholesale-styled bulk efficiencies with brand-name merchandising, delivering high-end products to club members at the lowest possible prices. As a result of Sinegal's strong leadership and vision, Costco finds itself at the forefront of big box retailing, occupying a seat among top chains like Wal-Mart, Target, and Home Depot.

On its way to becoming the No.1 warehouse club in the nation, Costco launched timely ancillary businesses that changed the way people shop. To its core warehouse club business Costco has added gas stations, home furnishing stores, pharmacies, drive-through car washes, optical centers, photo labs, fresh-food departments, and business centers. These ancillary businesses have contributed $7 billion to Costco's $60 billion in annual sales and stimulated a growing market demand for one-stop shopping.

In some instances, Costco's side ventures have risen to the top of their associated retail categories. In 2006, Costco's fast-growing pharmacy division generated sales of $2.6 billion, making Costco one of the nation's largest pharmacy chains—an astounding accomplishment that took only 20 years. With their staggering prescription drug sales and recent entry into low-priced generic drugs, Costco pharmacies are turning up the heat on category leaders CVS Corp. and Walgreen Co. and demonstrating effective positioning to meet the needs of the aging baby-boomer population.

Costco's innovative leadership has also extended to the private label enterprise. At a time when many retailers are struggling to sell private labels alongside national brands, Costco's Kirkland Signature label has evolved into one of the most successful and recognized own-brands in the country. Designed to be of equal or better quality than national brands, Kirkland Signature products make up 400 of Costco's approximately 4,000 SKUs, with items ranging from diapers manufactured by Kimberly-Clark to tires produced by Michelin—offered at a minimum of 20 percent savings compared to leading national brands. Applying high-volume leverage on the distribution channel helped to create Kirkland Signature's more-for-less reputation—Costco buyers famously exclude suppliers that fail to meet their demands. "This is not the Little Sisters of the Poor," Sinegal declares with usual dry wit. "We have to be competitive in the toughest marketplace in the world against the biggest competitor in the world. We cannot afford to be timid."

From its development of Cuernavaca to its transformational impact upon the retail industry, Costco's legacy of innovation and success is owed to the company's motivational leadership, and especially to James Sinegal, a visionary CEO that *Time* magazine named as one of the 100 most influential people of 2006.

Questions

1. What is moral leadership, and why is it increasingly important for global business?
2. What types of leadership are necessary for leading change? In what ways has Costco's management demonstrated such leadership?
3. What motivational impact might Costco's handling of the Cuernavaca expansion have on employees, both in Mexico and internationally? Explain.

SOURCES: Mya Frazier, "The Private Label Powerhouse; With Booming Kirkland Signature Line, Costco Controls National Brands Like No Other Retailer," *Advertising Age*, August 21, 2006; Mike Duff, "A Private Label Success Story," *DSN Retailing Today*, December 19, 2005; Doug Desjardins, "Presence Builds Rapidly Amid Rx Top Tier," *Retailing Today*, November 6, 2006; David Pinto, "Costco Named Retailer of the Year," *MMR*, January 9, 2006; "Costco to Match $4 Generics Price as Rx Sales Continue to Rise," *Drug Store News*, November 6, 2006; Investor Relations Web site, *http://phx.corporate-ir.net/phoenix.zhtml?c=83830&p=irol-irhome*, accessed November 21, 2006; "Ancillary Businesses Continue to Drive Through Sales," *Retailing Today*, September 25, 2006; "Mix Includes Everything From Cosmetics to Caskets," *MMR*, January 9, 2006; Alyce Lomax, "Most Foolish CEO: Jim Sinegal," *The Motley Fool*, September 28, 2006, *http://www.fool.com*; Mya Frazier, "Chic Costco beauty line displayed-in cardboard; Warehouse chain offers Borghese, undercutting department store rivals," *Advertising Age*, May 22, 2006; Steven Greenhouse, "How Costco Became the Anti-Wal-Mart, *The New York Times*, July 17, 2005; Mac Greer, "Is Costco Giving Away the Store?", *The Motley Fool*, November 22, 2006, *http://www.fool.com*; "A Culture of Commitment: The Story of Costco in Cuernavaca," Company Web site, *http://www.costco.com/Service/FeaturePage.aspx?ProductNo=11004800*; Daren Fonda, "Jim Sinegal: Costco's Discount CEO," Time, May 8, 2006.

Costco Wholesale Corporation Part Six: Costco's Whopper of a Fish Tale

Continuous improvement isn't a mere buzzword at Costco Wholesale: it's a *modus operandi*. To offer high-quality products at rock-bottom prices, the $60-billion-a-year warehouse club must manage its daily operations and supply chain with ever-increasing efficiency and innovation. Without this commitment, selling stacks of AG dark-rinse jeans and Canon high-performance digital cameras at deep discounts would be a losing business proposition.

When illustrating Costco's ongoing quest for an ever-higher standard of quality and efficiency, senior executives recount an old fish tale—fortunately, this is not about the one that got away. The story begins with a salmon fillet that Costco's seafood department once sold for $5.99 per pound. At the time, shoppers saw nothing unusual or impressive about the fish—the pinkish-orange tender fillets lined the seafood aisle, complete with skin, bones, fins, and belly fat. One day, merchandisers began looking for a way to boost the fish's $200,000-per-week sales. Their objective was to improve the product while lowering its price. In a breakthrough procurement effort, staffers located a salmon-jerky manufacturer in Japan that could deliver the fish trimmed and stripped of bones, after retaining the belly fat for its jerky product. The new leaner salmon fillet sold for $5.29 per pound, producing a 20 to 30 percent rise in sales. After additional improvements, Costco offered a fully trimmed, skinless and boneless fillet for $4.99 per pound. At this price point, sales of the salmon jumped from about $850,000 per week to $1.4 million. The higher volume sales now enabled Costco's buyers to source the product directly from salmon farms in Canada and Chile, creating even greater cost savings. The final result of Costco's fishing expedition: a $3.99-per-pound salmon delicacy generating over $2 million in weekly revenues.

This salmon story has come to symbolize Costco's unique operating philosophy—so much so that it is now tightly woven throughout the company's corporate culture. The oft-recounted tale has given rise to the Salmon Awards, the company's annual achievement program that recognizes the merchant or vendor who does the most to improve a product's quality while lowering its cost. In addition, Costco's Issaquah, Washington headquarters prominently displays a statue of spawning salmon—a shrine dedicated to the cherished Pacific Northwest fish and to Costco's value-driven merchandising.

Establishing cost-saving partnerships with suppliers requires the resourcefulness of Costco's dedicated managers, but maintaining these relationships on a day-to-day basis is made possible through cutting-edge technology. For example, coordinating the order, transport, and replenishment of inventories would be nearly impossible without computerized information systems like the Costco Collaborative Retail Exchange (CRX), a high-tech program that creates an electronic link between Costco and its vendors. The program gives manufacturers, suppliers, and other partners constant visibility of Costco's warehouse management to effectively reduce out-of-stocks, increase new product introduction success, and manage item performance. With Costco CRX, vendors gain direct, interactive access to Costco's warehouse-specific, item-level data—in real time. "The CRX program is our approach to providing our vendor community with standard, secure access to current and detailed information about their business at Costco Wholesale," said Ed Maron, executive vice president at Costco. Maron added that CRX transforms Costco's point-of-sale information into actionable business insights for retail partners.

Other Costco business operations depend on technology as well. As a result of having many retail partners, Costco must manage thousands of communications in and out of the company each day. The warehouse club operator can't afford to get bogged down in delayed responses to purchase orders, debit memos, or invoices. To streamline processing of the nearly 30,000 documents exchanged between Costco and its suppliers daily—6.7 million each year—the company employs a document imaging system that scans documents for digital storage and retrieval. The system facilitates fast, effective communication between Costco and outside firms, resulting in improved service to warehouse, depot, and vendor customers.

Though high-tech coordination with suppliers has played a vital role in Costco's past, it also holds the key to Costco's future. Nowhere is this more evident than with Costco.com, the company's e-commerce division. Costco.com offers about 4,000 items for sale online, and nearly 70 percent of products ordered through the site are shipped directly from external suppliers to the customer. By connecting outside vendors and manufacturers to its e-supply chain, Costco saves millions of dollars in warehousing, inventory, and shipping expenses. The retailer's Internet-based strategy is paying off: in 2005, Costco.com ranked 27 among online retailers, boasting sales of $534 million. Looking ahead, the e-business division is projected to generate over $1 billion annually.

Whether the objective is to offer customers the best salmon product at the lowest possible price or to implement state-of-the-art technologies that streamline daily business processes, Costco Wholesale is dedicated to keeping continuous improvement at the center of its business. After more than 25 years of retailing success, the No.1 warehouse club is as determined as ever to lead the way to the future with ever-increasing efficiency, profitability, and success.

Questions

1. How does Costco's famous and oft-recounted salmon story help management create a culture of performance and quality?
2. What role does the Salmon Awards program play in Costco's system of control?
3. How does Costco reduce its operating expenses by investing in technologies that enable outside suppliers to manage inventories and ship orders directly to customers?

SOURCES: Tim Craig, "Impressed by Costco? Join the Club," *DSN Retailing Today*, December 19, 2005; Mike Duff, "Innovation Has Its Own Reward," *DSN Retailing Today*, December 19, 2005; "Salmon Tells the Costco Story," *MMR*, August 23, 2004; "Costco Makes It Easier for Suppliers," *MMR*, December 12, 2005; "Costco Keeps Prices Low with Document Imaging," *Transform*, December 2004; Mya Frazier, "What Long Tail," *Advertising Age*, August 21, 2006.