Workforce MANAGEMENT

Compensation, Benefits & Rewards

Feature: Welcome to the Club

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Welcome to the Club

Costco pays generous wages and benefits in accord with CEO Jim Sinegal's maxim: "Taking care of your employees and turning inventory faster than your people is good business." The chain is experiencing booming growth and surging revenue and profits.

By Michelle V. Rafter

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Before Costco Wholesale Corp. opened a location in suburban Detroit late last year, managers at the warehouse discount club calculated they'd need a staff of 220. Costco typically fills about a third of the jobs at a new store with transfers. At the store in Green Oak Township, Michigan, that left 160 open spots.

In all, 5,000 people applied.

"Costco is like the Marine Corps of the retail industry. The elite, the finest," writes an anonymous RetailWorker.com poster, a former Wal-Mart and Kmart employee. The Web site, run by the International Workers of the World union, is peppered with inquiries from people wanting jobs at the warehouse club.

The same thing happened in Des Moines, where Costco opened its first Iowa warehouse in December: 180 jobs, 2,600 applications. In Mount Prospect, Illinois, where a Costco opened in October, more than 2,100 people applied for 140 positions.

They're not isolated incidents. Since Costco erected its first warehouse 22 years ago, the $48.1 billion-a-year retailer has become an employer of choice, a company that is immediately associated with good benefits and decent pay. Costco workers earn an average of $16.72 an hour, far exceeding the U.S. retail industry average of $10.99 an hour as estimated by the Bureau of Labor Statistics.

In addition to offering some of the best wages and benefits in the retail industry, Costco rewards employees with bonuses and other incentives. It promotes from within, encourages workers to make suggestions and to air grievances and gives managers autonomy to experiment with their departments or stores to boost sales or shave expenses as they see fit.

The result: People line up to work there, and once hired, they stay. Annual turnover for full- and part-time hourly workers on the job more than a year is 6 percent, compared with an industry average of 59 percent, according to the National Retail Federation. It's the same story for executives. The 13member senior management team, headquartered in Issaquah, Washington, an upscale suburb 13 miles southeast of Seattle, has stayed virtually unchanged since its birth in 1983.

"What they're doing is creating a competitive advantage through people," says Fred Martels, president of People Solution Strategies, a St. Louis retail industry consultancy. "It lowers costs and increases productivity."

Mike Donaldson, now manager of Costco's Des Moines location, has been with the company 19 years, first in San Francisco, then Kansas City, Missouri. He says store managers have a friendly rivalry to outperform one another.

"That's a big reason we're so successful," he says. "We're trying to be the best. It's a great company." Treating employees well is as much as part of the Costco way as the concrete floors and unadorned cinder-block walls of its warehouses and the fresh salmon fillets it sells by the truckload. It's a philosophy that got Costco in trouble last year with Wall Street analysts who preferred heftier shareholder returns over fatter employee paychecks, a situation that has eased somewhat as the company's stock price has climbed.

It's also made Costco the antithesis of Wal-Mart, which recently launched a $100 million image campaign to battle the perception that it is an unfriendly employer.

So far, the Costco way is working. While other retail sectors stagnate, the warehouse club niche is booming, and according to industry watchers, Costco accounts for the lion's share of that growth. Since opening its first warehouse in Seattle in 1983, Costco has grown to 451 locations in the United States and abroad and has seen its workforce mushroom to 110,000--including 83,700 U.S. employees, half of whom work full time.

The publicly traded company opened 23 new stores during its fiscal 2004 year, which ended August

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31, and is on track to open 25 more in the current fiscal year.

The "people first" philosophy comes directly from Costco CEO and president Jim Sinegal, a blunt-spoken retail veteran who has been the company's alter ego and chief taskmaster from its inception. The 68-year-old executive oversaw Costco's merger with Price Club a dozen years ago, and since then has shepherded it to become the biggest player in the $101.1 billion warehouse club industry, and America's sixth-largest retailer.

Paying good wages is a no-brainer, says Sinegal, a grandfatherly gentleman who looks like former Quaker Oats pitchman Wilford Brimley, favors shirt sleeves over a tie and jacket and wears an ID badge like every other Costco employee.

His corner office at Costco headquarters is a mess. In keeping with the company's open-door policy, it's really more of an alcove with no door or window. The desk is littered with reports; the wall behind is plastered from floor to ceiling with snapshots of family members and store openings. An oversized metal table is stacked with bottles of wine and other merchandise samples.

"Taking care of your employees and turning inventory faster than your people is good business," says the peripatetic Sinegal, who's on the road more often than not. "In the final analysis, that's what it comes down to. You can have the loftiest goals in the world, but they're meaningless if you don't make a profit. If you can't deliver on the bottom line, you'll disappear."

Costco shows no sign of disappearing. In fiscal 2004, the company's net profit jumped 22 percent to $882.4 million on a 13 percent increase in revenue to $48.1 billion. That revenue included $47.1 billion in sales and about $1 billion in annual membership fees. In all, Costco has 42.4 million cardholders who pay $45 for a regular membership or $100 for an executive membership that pays them a 2 percent annual rebate on accumulated purchases. Costco's 1.9 percent net profit is razor thin, typical in the warehouse club business. However, Costco aspires to be the highest-quality, lowest-cost provider of the merchandise it carries, limiting markups to 14 percent over wholesale, or 15 percent for its Kirkland Signature private-label items ranging from coffee to cashmere sweaters. So to maintain or boost net profit margins, Costco has to compensate for low markups with high volume, which means selling--or turning--inventory as fast as possible.

When shoppers walk into Costco, they're faced with an amalgam of disparate merchandise: home electronics, small appliances, furniture, sports equipment, jewelry, books, fresh, frozen and packaged foods, as well as seasonal items and unexpected products, such as baby grand pianos and caskets.

That puts the onus on employees to produce, and they do. For fiscal 2003, Costco averaged $379,090 in sales per employee, considerably outstripping worker productivity at the country's four larger retailers: Wal-Mart, Home Depot, Target and Kroger, the grocery and supercenter chain.

Shrinkage--merchandise that's lost, damaged, broken or stolen--is another standard industry indicator of a retailer's health and employee loyalty. Costco's shrinkage runs about 0.2 percent of sales per store per year, company officials say. That compares with a retail industry average of 1.65 percent of sales per year, according to the 2003 National Retail Security Survey, the most recent data available.

However, warehouse stores' shrinkage rates are "always much lower than (other retail) stores," says Richard Hollinger, the survey's director and a criminology professor at the University of Florida.

Fast-paced environment

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In a relatively short time, Costco has become one of the country's top wine purveyors, selling more than $620 million worth last year. During 2004, Costco also filled 18 million prescriptions from its in-house pharmacies, pumped $2.3 billion in gas from its 211 on-site stations and sold 67,000 carats' worth of diamonds. In January, the company's six-year-old online division, Costco.com, sold an original Picasso crayon drawing for $39,999.

Making the sale is priority No. 1. The Costco basic training manual instructs workers to, among other things restock stray items as quickly as possible so as not to lose a sale. Last year, the company added a second worker at every checkout stand, a move that initially increased labor costs but ultimately is helping to boost sales.

Now if a shopper can't find the precooked bacon he wanted, the extra checker can get it for him, "and there's an extra $10 on that sale," says Judy Vadney, Costco human resources director. The result: an average purchase of $115 to $120.

The pressure on workers can be extreme. Turnover is highest in the first 180 days. "Not everyone loves to work for Costco," Vadney says. "It's hard work. It's a great place for people who like a lot of activity and energy and go-go-go. It doesn't take a rocket scientist to do most of the jobs at our locations. What people find difficult is the pace, the intensity."

Those who stay are well-compensated. Hourly pay starts at $10 and goes up to $18.03. Hourly workers receive twice-yearly bonuses based on length of service and hours worked. Part-time employees are guaranteed at least 25 hours a week and receive many of the same benefits as full-time workers.

Eighty-nine percent of Costco workers are eligible for health insurance, and 97 percent of them elect for the plan. After 90 days as an employee, workers are eligible for a 401(k) program. In a year, or after 1,000 hours, Costco matches up to 9 percent of their annual pay. In a new program, employees hired after January 1, 2005, will automatically be enrolled in the 401(k) program and have 3 percent deducted from their pay. Costco employees don't get merchandise discounts, but they do receive free Costco membership cards.

Entrepreneurial thinking is encouraged. Employees who come up with money-saving ideas that the company institutes can earn up to 150 shares of Costco stock. Store managers are free to experiment with what they stock and how they display it. In return, they receive rewards based on performance, including bonuses and stock options.

Options fell out of favor at some companies after new accounting rules stipulated that they be expensed. Costco still grants them and hasn't cut the number of nonhourly employees eligible to get them, even though options decreased pretax income by 1 percent in fiscal 2002, the last year the company broke out that data.

Of 2,000 nonhourly management employees eligible for options in fiscal 2004, about half were the beneficiaries of the 8 million options the company issued. "Senior management's philosophy historically has been having some skin in the game is positive," Richard Galanti, Costco's chief financial officer, told Workforce Management in September.

"We can do better"

Despite generally positive employee relations, there are some trouble spots. Costco has about 14,000 union workers in California and four other states, the vast majority inherited through the Price Club merger. Contract negotiations mostly have been amicable, but "they're not union-friendly," says Rome Aloise, a union representative for the Teamsters, which represents Costco's union workers. "They're just as bad as any other employer trying to prevent people from joining the union."

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--Judy Vadney, Costco human resources director

Also, because store managers have so much autonomy, "if you have a store manager that allows favoritism or hires more within one ethnic group, they may never hear about it at the corporate office," Aloise says.

True to its entrepreneurial roots, Costco promotes from within. Officials claim that about 90 percent of management jobs are filled in-house. Except for some white-collar specialty jobs, such as in legal and accounting, most managers work their way up from the warehouse floor. Vadney, the human resources director, was a Costco store manager in Olympia and Tumwater, Washington, before taking a corporate job.

But just who gets those top jobs has been called into question. In August, an assistant warehouse manager in Colorado filed a sex discrimination lawsuit against Costco claiming that she and other women have been denied promotions. Costco has no job posting or application process for manager and assistant manager jobs, which acts as "an invisible glass ceiling" for women, says Brad Seligman, executive director of the Impact Fund, the nonprofit group representing the plaintiff.

Seligman, who is also representing Wal-Mart workers in a suit against that company, is seeking class-action status for the Costco suit, claiming that the number of women eligible for management jobs at Costco could be as high as 650. The suit is pending, and a hearing on the class status is expected in the fall.

Sinegal maintains that Costco hasn't done anything wrong, and that it won't settle. At the same time, he admits that the presence of women in manager and assistant manager jobs is low--16.2 percent and 17 percent, respectively.

"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 labor and benefit costs are high, roughly 70 percent of its operating expenses, so the company offsets that by cutting out other common retail niceties. The company doesn't advertise on TV or radio or in newspapers. It doesn't take Visa or MasterCard, so the company doesn't have to pay those transaction fees.

Hours are shorter than the typical grocery store or supercenter to cut down on overhead such as lights and other utilities and labor. Warehouses are plain concrete boxes with merchandise stacked on pallets.

Costco also is low-budget when it comes to hiring. The company doesn't retain outside recruiters, and the human resources staff does no hiring. That's left to regional managers and warehouse managers, who put up tents on site when a new warehouse is being built to take applications and buy help-wanted ads in local papers.

However, Costco recently began to post openings on its corporate Web site, integrating automated recruitment and hiring software from outside vendor Unicru.

Local managers hold interviews in ballrooms, generally hiring one of every 15 people they interview.

All new warehouse employees go through a four-hour training session and are paired with a mentor. New workers go on a "scavenger hunt" for information on their location, their fellow employees, customers and Costco in general--data they have to turn in to a supervisor within the first 30 days on the job.

Before a new warehouse opens, the staff attends a four-hour orientation conducted by a regional manager on Costco's mission, ethics and customer relations. Training emphasizes treating customers with kid gloves.

"Most employees don't understand that those membership dollars are really vital to how we operate," Vadney says.

If current trends continue, Costco managers could be holding a lot more of those orientation meetings in coming years. The number of warehouse clubs in the United States and internationally could comfortably double before the sector is saturated, says Michael Clayman, publisher of Warehouse Club Focus, an industry newsletter.

One reason: Companies such as Costco and Wal-Mart's Sam's Club division are going into smaller markets, cities of 200,000 that previously weren't thought to be able to support the type of store that brings in $115 million a year in sales, Clayman says.

Sinegal has no problem imagining a time 10 years from now when Costco runs 900 warehouses, twice as many as it has today. He also has no problem seeing himself running the company for the foreseeable future.

"I have no plans to retire," he says. "I feel very good, very healthy, and will continue as long as the board is satisfied with me." And if warehouse club trends and employee-friendly policies continue, it's a safe bet that Sinegal can look forward to seeing hundreds of job applicants enthusiastically lined up at new stores.

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