



BENTLEY
UNIVERSITY

**Center for
Business Ethics**



Costco, Cheonan, South Korea

Raytheon Lectureship in Business Ethics

Costco: How Our Ethics Evolved Over the First 30 Years

Jim Sinegal

Co-Founder and Former CEO, Costco Wholesale

March 26, 2015



BENTLEY UNIVERSITY is a leader in business education. Centered on education and research in business and related professions, Bentley blends the breadth and technological strength of a university with the values and student focus of a small college. Our undergraduate curriculum combines business study with a strong foundation in the arts and sciences. A broad array of offerings at the Graduate School of Business emphasize the impact of technology on business practice. They include MBA and Master of Science programs, PhD programs in accountancy and business and selected executive programs. The university is located in Waltham, Mass., minutes west of Boston. It enrolls approximately 4,200 full-time and 140 part-time undergraduate students and 1,300 graduate and 43 doctoral students.

THE CENTER FOR BUSINESS ETHICS at Bentley University is a nonprofit educational and consulting organization whose vision is a world in which all businesses contribute positively to society through their ethically sound and responsible operations. The center's mission is to provide leadership in the creation of organizational cultures that align effective business performance with ethical business conduct. It endeavors to do so by applying expertise, research and education and taking a collaborative approach to disseminating best practices. With a vast network of practitioners and scholars and an extensive multimedia library, the center offers an international forum for benchmarking and research in business ethics.

Through educational programs such as the Raytheon Lectureship in Business Ethics, the center is helping to educate a new generation of business leaders who understand from the start of their careers the importance of ethics in developing strong business and organizational cultures.



W. Michael Hoffman, PhD

Executive Director
Center for Business Ethics and
Hieken Professor of Business
and Professional Ethics
Bentley University

Did you know that the country's largest seller of wine is also one of the largest sellers of pizza? No, I'm not referring to the Gallo Brothers or Pizza Hut, but Costco. By essentially reinventing what a retail store could be, Costco has become the world's second largest retailer in less than 40 years. How did they do it? Part of the answer to that question can be found in our speaker, Jim Sinegal, Costco's co-founder who guided the company to become what it is today.

Jim has a well-deserved reputation as one of the great leaders of American business, up there with Henry Ford and Steve Jobs, but guided by an ethical sensitivity not usually associated with them. Coloring the long shadow of Jim's stature in business is a celebrated reputation for being a down-to-earth straight shooter. When my colleague made a phone call to arrange Jim's talk, he expected to be greeted with the words, "Mr. Sinegal's office." Instead, he heard one word: "Sinegal." Jim answers his own phone. As CEO, he was renowned for his concern for employees and attention to detail, sometimes visiting as many as 12 Costco stores in a day. When asked why he was so motivated, he replied, "Because I love it!"

"Love"... not the kind of word we hear enough in business, but Costco is no ordinary store and Jim is no ordinary leader. Enter a Costco and before long you sense that it is driven by something stronger than the time clock. The employees have a commitment that can't be faked, and the customers have a loyalty that is the envy of businesses everywhere. Again, I ask, "How did they do it?" Sinegal responds to that question in the following pages, but it seems clear that an essential ingredient in Costco's secret sauce is ethics, and with some 79 million members, Costco is living proof that good ethics is worth its weight in gold.

The **Raytheon Lectureship in Business Ethics** at Bentley University is made possible through the generous support of the Raytheon Company.

Raytheon is a technology and innovation leader specializing in defense, homeland security and other government markets throughout the world. With a history of innovation spanning 92 years, Raytheon provides state-of-the-art electronics, mission systems integration and other capabilities in the areas of sensing; effects; and command, control, communications and intelligence systems, as well as a broad range of mission support services. The company reported sales of \$22.8 billion in 2014 and employs 61,000 people worldwide. It has built a reputation for adhering to the highest ethical standards in the industry. The Raytheon Lectureship in Business Ethics series aims to illuminate and promote ethical values and conduct in business, highlighting best practices in corporations throughout the United States. Learn more about Raytheon online at raytheon.com.



(From left) Tim Schultz, Vice President, Ethics and Business Conduct, the Raytheon Company; Jim Sinegal, Co-Founder and Former CEO of Costco Wholesale; and W. Michael Hoffman, Founding Executive Director of the Center for Business Ethics and Hieken Professor of Business and Professional Ethics at Bentley.



Thomas A. Kennedy, PhD

Chairman of the Board and
Chief Executive Officer
Raytheon Company

Raytheon believes in a values-based ethics program, and we believe in the value of ethics education. We invest in ethics and provide employees with robust, award-winning ethics education to reinforce how important doing the right thing in business is to our success. We talk about ethics so our employees know it is okay to ask questions and raise concerns, to take an “ethics check,” if you will. By supporting this process, we build upon a strong ethical foundation and reinforce a culture of integrity at the company. A strong ethical culture requires work. We believe that working at ethics pays dividends, and that it gives us a competitive advantage.

Raytheon’s support for the Center for Business Ethics at Bentley University has a long history. The center has provided leadership in this important field for the academic and business communities extending now for two generations. Bentley is increasingly recognized for promoting ethical business practices and cultures not just in the United States, but internationally as well. This is especially significant as our world is increasingly interdependent, and having ethical business partners is a global imperative.

The Raytheon Lectureship in Business Ethics at Bentley has added relevance in this environment. Having respected corporate leaders share their insights and commitment to business ethics helps show the way for all of us. Promoting further dialogue and discussion about ethical business practices enlightens and inspires us to redouble our own commitment. Raytheon is proud to partner with Bentley and the Center for Business Ethics to give voice to ethical excellence in business.



Costco began under the Price Club name in 1976 in a converted airplane hangar in San Diego. Today, with revenues over \$110 billion, the company operates 672 warehouses/stores in 43 states and Puerto Rico, and nine countries. With more than 79 million members, Costco has distinguished itself for the quality of its products, its outstanding customer service, and highly loyal and dedicated workforce of 195,000 employees.

Jim Sinegal delivers the Raytheon Lectureship in Business Ethics at Bentley University.



Jim Sinegal
Co-Founder and Former CEO
Costco Wholesale

Jim Sinegal began his career in retail business in 1954 when he went to work for the legendary retail icon, Sol Price, at the discount store FedMart in San Diego. Sinegal continued working for Price for almost 30 years before striking out on his own to start Costco with his business partner, Jeff Brotman. He was named one of Business Week's "Best Managers" in 2003, and, from 2006 to 2011, he was selected as one of the 30 most respected CEOs by Barron's Magazine. Jim serves as a Trustee for Fred Hutchinson Cancer Research Center. He is a Senior Executive in Residence at Seattle University's Albers School and serves in a similar capacity at his alma mater, San Diego State University. Jim also serves as an adviser at the Mendoza School of Business at Notre Dame.

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hank you, Mike. Let me begin by giving you some background on Costco. As many of you may know, Costco does not advertise in the traditional sense.

You don't see advertisements for Costco on television, on the radio, in newspapers, or in magazines. We count on what we think is the most valuable advertising of all, which is word of mouth. We think it is much more important for other people to be saying nice things about you than for you to be saying it yourself.

Today, Costco is the second largest global retailer, 19th largest on the Fortune 500, and our company has a market capitalization value of \$64 billion.

Today there are 672 warehouses worldwide, with the bulk of them located in the U.S. There are 89 in Canada, 34 in Mexico, 26 in the U.K., 20 in Japan, 11 in South Korea, 10 in Taiwan, seven in Australia, and one in Spain, where we entered under a year ago. Our sales for the last fiscal year were \$110 billion. Our average warehouse size is 144,000 square feet and we have 195,000 employees worldwide. We have about 2.3 million transactions on a daily basis. Our strength is in

the 79 million people who are running around with Costco cards in their wallets. They are very loyal, renew at a very high rate, and pay our annual fee for shopping with us. Currently, renewal rates are at an all-time high. We think we have established "absolute pricing authority." This was a tag that was hung on us by an analyst from Goldman Sachs 15 years ago. They stated that Costco had established "absolute pricing authority," better than any other retailer in the world. When a customer saw a product at Costco, they knew it was going to be a good deal and at the best price they could get. That is the reason why stories like the price of prescriptions ranging up to \$1,700 at other retailers compared to our price of \$51 are so important for Costco. We have fantastic employees and great merchandise. We create a treasure hunt experience so when you come into our warehouse you will see new items coming in all the time. We tried to create an atmosphere where



Costco, Seville, Spain

when you see something you like, you feel inclined to buy it because it might not be there next time. We like to think like a small company and remain nimble even though it is not easy to do with some 200,000 employees. We have created a quality image; rather than one of cheap merchandise at cheap prices, Costco's image is one of high quality merchandise at a great value.

A little history: The Price Club was founded in 1976 in San Diego. It was very successful. The business was very attractive with its low prices, no advertising, low expense ratios, and an attractive rate of return for the investors. In 1982, the only warehouse clubs that existed were those of the Price Club. When the club went public, everyone saw how successful they had been and rushed to get in the business. It became one of the most attractive new businesses concepts around. Walmart was one of the first to open their version and came out with Sam's Club in 1983. Zayre, who used to operate in New England, opened up B.J.'s and several other startups, including Costco, opened up as well.

In 1982, my partner, Jeff Brotman, and I met and drew up plans to clone the Price Club of San Diego, a company I had worked for a period of time. We went out and raised \$7.5 million ourselves, which was enough money to open our first three Costcos in Seattle, Portland, and Spokane. Half of it was raised in the Northwest part of the country and the other half in Southern California. We hired our 10 founding officers at that time. Our original business plan, and the way we raised the money from our investors, was by telling them that we thought we could eventually grow to 12 Costcos in the Northwest region of the U.S. We thought that if those 12 locations could eventually average \$80 million, it would become a billion-dollar company and return a 3 percent profit.

In 1985, we decided to branch out and go into California. Also in 1985 we went into Canada. We thought that couldn't be very difficult, Canada was only 140 miles away from Seattle. We found out that since it was a different country, they acted like a different country. They spoke a different language, used a different system of

measurement, currency, and laws. We learned a good lesson in terms of international expansion there.

In 1986, we expanded to the Midwest; we went into Milwaukee and Minneapolis. In 1987, we exited the Midwest. It was a situation where we underwhelmed them, and because we were a young company we found ourselves in the classic position of spending 80 percent of our time on 20 percent of the problem. Everybody wanted to get on an airplane to fix the Midwest, but we made a very painful decision to exit that market. It was an admission of failure which made it a very difficult time for us, but we offered every employee a job with us in another city and paid every supplier. We also refunded every dollar of the membership fees that we had collected even if someone had been a member for 10 months.

In 1988, we expanded our selection to include fresh foods like meat. In 1992, we expanded into Mexico, to a suburb of Mexico City. In 1993, we went to the U.K., into a suburb of London and opened a second unit in London the following year.

In 1993, we merged with the Price Club, and, for a short period of time, we were Price Costco. However, because we were confusing everybody, we changed the name to just Costco. In 1995, we entered South Korea. One of the things that is different about doing business in Asia is that instead of having a big parking lot to handle 700 cars, we had to go vertical. One location in South

Korea has the sales floor on two floors and parking on the other five floors.

In 1999, we got involved in e-commerce and one of the hallmarks of our e-commerce business is that we have been profitable since the day we started. (We even sold a Picasso print on our e-commerce site for \$40,000, which sold in about an hour and a half.) Today, it is over a \$3 billion business for us. We operate e-commerce not just in the U.S., but also in Canada, Mexico and in the U.K.

We've engaged in a lot of packaging innovation and a lot of new products and services over the years. At first, our early merchandising efforts were fairly bare bones and not sophisticated. However, with the help of our suppliers and the ingenuity and creativity of our buyers, we have become much better at packaging and presentation of the products over the years.

Our merchandise strategy has been very unique, but very simple. We have a very limited selection of merchandise — we carry somewhere between 3,700 to 4,000 SKUs at a time. To put that in perspective for you, if you were to go into a Walmart Supercenter or a Super Target, they have essentially the same categories of merchandise that we do, but they probably have about 140,000 SKUs. We pre-select the best values in every single category of merchandise we can find. We carry high quality national brands with a selected private label program from a wide range of categories. We have to be



Costco's approach to packaging has evolved over the years.

able to show our customers savings on every item we carry. If we cannot show them a savings, we won't carry it. This doesn't mean that on a weekend someone can't beat us in terms of price on Coke for three or four days, but day in and day out we have to offer the best price for a product. Our attitude is that if we can't beat the best price, it's a chink in the armor. If a customer sees that we don't offer the best price on all items, they have every reason to believe that we don't offer the best price on the Michelin tires or the Tag Heuer watches.

If you were to go into the supermarket and go into the cereal aisle, you would probably find about 350 products available. Now, if you enter the cereal aisle in Costco, you might find 12 products. We go out to someone like General Mills, and we get them to build the biggest box of cereal that they can make. We then put it on a pallet, shrink-wrap them, and put it on the sales floor for the selection process for the customer. Think about the labor savings here, instead of having to open hundreds of boxes and hand stack merchandise onto shelves, we can go in and do this in a matter of 10 seconds, and put it in a selecting position. Not only that, we're bringing a higher ticket at the register, instead of a lower ticket. The catch is, we hope you like Cheerios because you're going to have them for a while.

As I mentioned earlier, Costco sells products from numerous categories and offers great pricing on all of them. TVs are a big category for us. Every Costco you go into has a lead electronics department. We carry name brands such as Samsung, LG, Panasonic, Sony, and Vizio. We also sell name brand clothing like Lucky Jeans and Calvin Klein, which are selling at hot prices like \$19.99 for a pair of jeans. As for our diamonds, they are the same quality you would find at Tiffany's. Last year we sold 129,000 carats of diamonds.

To our knowledge, Costco is the biggest merchant of wine in the world. We do a good job with varietals as well as very high-end wines. We source produce from 44 different countries and as a result of that, we can sell you blueberries in



Costco has a limited selection of merchandise sold in larger quantities.

November from Chile and Argentina in the larger sizes that you have grown to know. The bakery products we sell are baked on site. If you were to go into one of our warehouses two or three days before Thanksgiving, you would see employees bringing pallets of pumpkin pies out. Customers would follow them and take the pies as they passed. By the time the employees got to their destination, they would need to go back and get more pies. Our meat department is one of our signature departments. We like to think that we run our meat operations as well as any other chain operation in North America. Overall, the Kirkland Signature brand has become a trusted brand. Products like vodka, shirts, housewares items, candies, nuts, salmon, and women's athletic wear have helped make Kirkland Signature a trusted brand.

Costco pharmacies have filled 40,000 prescriptions in just the U.S. this past year. We also have pharmacies in Mexico and Canada. It is a very successful business for us. Those savings I mentioned previously are not unusual for us. TV segments have been done on our prescription savings in 40 major communities across America, with each news report tailored to the community by the local broadcaster. The only variation might have been what other drug stores we were being compared to and what type of drug. You can imagine how much you have to pay to get



Costco's pharmaceuticals are among its best values.

that type of story on the 6 o'clock or 11 o'clock news in all of the communities.

It is not uncommon for you to see long lines of cars at our gas stations. Over three million checks were done on pricing across the country and Costco has been the low provider of gasoline for the second year in a row.

Let me now talk to you about the cultural and ethical principles that have been central to the evolution of our company. When Costco opened up in Seattle and we applied for a beer and wine license through the state, we kept getting delays on the processing of the license. The first thing they said to us was, "We don't like your name," which at that time it was Costco Wholesale Club, "You can't be a club and sell beer and wine." So we dropped the word, "Club," and the name became "Costco Wholesale." Then they came in and did an intensive audit on our business, checking everything we were buying, from the Michelin tires to the mayonnaise — things that had absolutely nothing to do with the processing and selling of beer and wine. At this time we were already open, but we didn't have a license so we couldn't engage in the sale of those products. Then they came back and said, "We still don't like you name, we want you to drop the wholesale." I went momentarily insane, and had a two-word response that wasn't "happy birthday." We eventually had

some people on our board who had some connections down in Olympia and straightened things out.

I'm sharing this story because it forced us to take a look at our business at the time and to realize there was going to be a lot of questions about it. Here we have big, cavernous warehouses with forklifts running all over the place. We have cement floors and open beam ceilings. There is merchandise stacked all the way up to the roof. We charge a membership fee to shop with us. There was going to be a lot of questions about what the catch was, and if they should do business with people like this. If we could find the inspector who came in and ran the audit, we would probably owe him a big "thank you" because it really made us focus on our business and on what we were going to represent as a business. It made us a lot more resolute about our beliefs. Many of these things were part of our DNA from being in business for a long time anyway. We determined to put a lot of emphasis on our beliefs and that there was a lot more that could be said about this.

We set out to overcome any objection that people would have with shopping at Costco. We figured people are going to say that there is no guarantee on anything that you buy here, it's probably the buyer's risk. We then offered a 100 percent warranty on every single product that we sell. Satisfaction guaranteed. If you're unhappy, you come in and get a refund — we'll give it to you at the front door. We have the best refund policy of any retailer in America. Not only that, we guarantee the membership; if you are unhappy with being a member, we will give you a full refund at any time. There will be no misleading claims on anything that was sold; no high pressure, no advertising, no superlatives on the signs. We just show the product and let the customer make their determination. There is a minimum and maximum markup on goods with no loss leaders. We were going to pass savings to the customers on everything that we purchased, so that when we got a good deal from a supplier,

our customers were going to get a good deal. Hence, the disparity pricing on something like the price of generic drugs. As a matter of policy, we don't sell seconds or irregulars at our company.

In terms of salaries, we were not going to allow people to say that we are making money off the backs of our employees. We have the highest paid employees in the retail business with the best benefit plan.

Again, we probably should thank that inspector because it forced us to really look at and focus on our business. Within our established Code of Ethics, we think that as a business there are four things you have to do. You have to obey the law, take care of your customers, take care of your people, and respect your suppliers. If you do that systemically, in that order, year in and year out, you will do what you have to do as a public company, which is to reward your shareholders. We think it's possible to reward shareholders in the short term by not paying attention to all four of these aspects, but sooner or later, you're going to trip yourself up pretty badly and get yourself in trouble.

Our people are fantastic. We have always felt that if you go out and hire good people, provide good jobs and good career opportunities, then good things will happen in your business. They are our best ambassadors. We provide careers at Costco and we promote almost 100 percent from within our company and everybody is included. This is not altruistic. Do we feel good about paying good wages? Absolutely, but it is good business; you get what you pay for. If you buy for a second the premise that Costco is the low cost provider of goods and if we are also paying the highest wages with the best benefit plan, then we must be getting better productivity. We think it follows, and it's been proven over the last 30 years that we have been in business.

Our employees are all highly paid. The average hourly wage of an employee working on the sales floor is \$22 an hour. Our employee turnover rate is very low. If you know anything about the retail business, you know that it is not unusual in the

fast food business to have 250 percent turnover. I think that at Walmart the rate is in excess of 60 percent; at Costco the rate is under 10 percent and after an employee has been with us for a year that drops to below 6 percent.

We go out and recruit at colleges. In every community around the world when we open, the first place we go is to the local universities because we're looking for part-timers, people to work in the evenings, and people to work weekends. This past year, worldwide 907 Costco employees graduated from college and that is typical.

Our commitment to paying well is consistent with our operational mission, which is to constantly strive to bring goods and services to market at the lowest possible price. We continually think about that and look at products in a different way than traditional retailers. A traditional retailer might look at an item and say, "I'm charging \$10 for that, I wonder if I can get \$11?" We look at it and say, "We're selling this for \$9, I wonder if we can get it down to \$8?" If we get it down to \$8, we want to see what we can do to get it down to \$7.49. We think about every single product in that way, while aiming for cost containment in every aspect of our business.

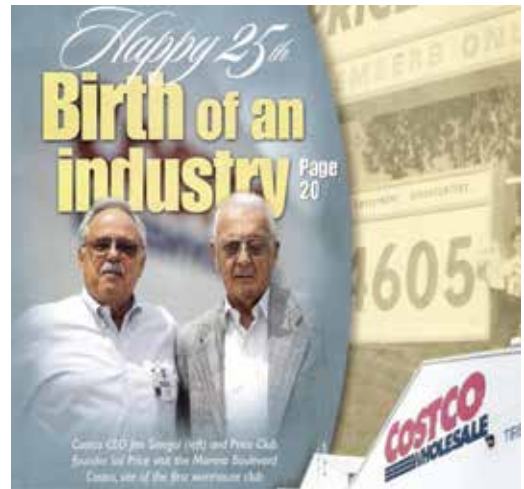
Why has Costco succeeded? We never had an exit strategy. It was never our intention to sell this business. We could have sold it a dozen times over the years. A lot of people wanted to buy our company in the early years. That was never our interest. We wanted to build a company that would be here 50 to 60 years from now. We thought that we owed that to all of the stakeholders in our business, so we operated in that fashion. We understand the discipline that is required. Anybody can sell merchandise for low prices, but you have to be disciplined in terms of your operating efficiencies to make a profit. We've assembled a great team. Many of the people we hired at the beginning of this business are still with us today. We're good merchants; we know how to buy and sell

merchandise. It's a fun place to work, people enjoy working at Costco. Last, but not least, we've had some good fortune. You would have to be a fool to not recognize that you had some luck out there. There are some people working very hard and are very smart that don't make it because they didn't get a break. We got the right breaks, and that's the reason we're still in business.

Since our company went public in 1985, our net sales have growth at a 13.3 percent compounded rate, net income at a 13.2 percent compounded rate, and our stock value grew at 16.5 percent compounded rate. So we think we've done what we set out to do, which is to reward our shareholders by paying attention to the important elements of our business.

For Costco's 25th anniversary, we asked Sol Price, the founder of the Price Club, if we could have a picture of him to be on the Costco Magazine. He said he would only do it if I would join him, so I agreed. I share this because Sol has been my mentor since I started working for him at age 18. A reporter once asked me, "Gee, you've worked for him all those years, you must have learned a lot?" and I said, "No, that's inaccurate. I learned everything." He was probably the smartest and toughest man I've ever known. If I had ever told Sol that he was my mentor he would have said something along the lines of "Cut the crap kid, and get back to work." Nonetheless, he was my mentor and we remained friends until he passed away five years ago.

I speak at a lot of different business schools, and I'm always asked the question, "What type of advice would you leave for the students here?" I always start with the first one: find a mentor. I was so lucky to have found my mentor. Each of us has someone in our lives that we admire — maybe it's a coach, teacher, neighbor, relative, but someone that you admire. Take advantage of that and use every opportunity you can to learn. With Sol, I was like a fly on the wall, I was watching him work continuously, even though he always told me to go back to



Career advice for students: "Find a mentor!" That's what he found in Sol Price (pictured above).

work. The second piece of advice is that if you are going to get involved with something, find something that you truly love. If you get yourself involved in something that you hate, my advice to you is to run for the fastest exit because you are going to make yourself miserable. You aren't doing yourself, or your company, any good if you stay. I'm going to be 80 on my next birthday, and I still go into the office every day. I still visit a Costco every day, even on Sundays. Nobody's got a gun at my head; I'm doing it because I love it. If you find something that you love, you never have to work another day in your life. That's the story of Costco.

Q&A

Below are highlights of Jim Sinegal's question-and-answer session with Bentley University students, faculty, staff, and guests.

QUESTION: *There has been a lot of news in the papers lately about plans for Costco and American Express to end their partnership next year. Could you tell us what you have learned from that partnership and why it is ending?*

JIM SINEGAL: We will be accepting American Express for another year, until March of 2016. When we first started in business, Costco did not accept any credit cards. A payment was done only by check or cash. We did not take credit cards for several reasons. At that time, the process at the front end of taking credit cards was very complicated and labor intensive. This took a tremendous amount of time, which slowed the lines. In addition, we did not get our money immediately. We had to submit the vouchers, and we were paid several days later for it. There was also a very high fee for credit cards, which at that time were in excess of 2 percent of purchases. With our pricing structure there was no way we could afford to pay the 2 percent fee for credit cards.

Subsequently, about 15 years ago, American Express came to us with an idea of a portfolio establishing a co-branded card that would be both a Costco Card and American Express Card. By this time, the process of accepting credit cards had sped up at the register and the money came in much faster. We found out that the use of credit cards at the register actually was faster than using cash or check. In addition, American Express made a package for us that was substantially below what any other credit card had, almost to the tune of 120 basis points. It was a very significant savings for us, and American Express was counting on the loyalty to Costco that would bring a lot of business to them. Customers would use their card on vacation, meals, and other items. Therefore, two of the major objections were overcome just by technology. Our relationship has been very good and very strong for 15 years. We admire them. They are a good company.

However, the market changes, and things change in the marketplace dramatically relative to technology, processing, and interest rates. As prudent business people would always do, we go out and get bids for anything we are purchasing. Just as we would for tires or the Kirkland Signature shirt, we had to get bids to see whether or not we are being competitive and to see whether or not our suppliers are being competitive. It turned out, that because of the size of the portfolio, there was heated bidding for this business. American Express was no longer willing to engage in the pricing structure that would have been necessary. We had a great relationship with them and we respect them, but like all partnerships, sometimes things change. I'm hopeful that we will be friendly with American Express forever because they are good people and we had a great relationship.

QUESTION: *You covered your ethics code, which has been provided to us. I have a few questions: You didn't talk extensively about Costco's involvement with the communities around them. Part of the ethics code indicates that Costco works very closely with them and also provides environmentally friendly products to its customers. Also, it is my understanding that Costco's pharmacies are open to customers who do not have Costco memberships. Could you talk about that as well?*

JIM SINEGAL: We explain some of our community work on our website. We are very engaged with education, children's health care, children's hospitals, and the United Way. All of the money we contribute is directed toward health and human services because they generally touch all of the communities where we do business across North America. Rather than trying to select an area that is tailored specifically to Seattle or to the Northwest, we try to get engaged in areas that will cover most of the country where we do business. We think that there are a lot of people who give money to the

arts, symphony, and other areas, but we think that our money is best spent in health and human services.

In addition, there are two other major things that we contribute to the community that I think are even more important than those just mentioned. The first thing is our pricing; our pricing is so good that it has the tendency to bring down prices for everybody in the community, including those people who don't shop with Costco. As an example, on the island of Kauai in Hawaii, when we first opened there, every gas station on the island was selling gasoline at 60 cents higher than Costco. However, as a result of our presence on the island, the prices of the other gas stations have come down to within 20 cents of our price. Everyone on that island saved 40 cents on gasoline as a result of our presence on that island. This pattern applies to every single community where we do business.

Moreover, we think one of the highest forms of social service is providing good jobs. We create jobs in communities, and as a result, the same thing occurs as I explained happened in Kauai. Since we pay the wages we do, other businesses raise their wages as well. In order to get employees, other businesses have to pay more than they had been.

You can also see the things we do relative to the environment on our website. We have installed solar panels on the roofs of our warehouses, and in about one hundred of our buildings we are generating our own electricity. We are unable to do this in Seattle because the sun does not shine enough, but we do it certainly in the Southwest, California, Arizona, Texas, and similar places. Doing so has a payoff. Anything you do in business has to have some commercial value to be successful. For example, instead of using paper bags we recycle all of the boxes that we buy the merchandise in and use them for the customers to take products home. We have skylights in all of our buildings, and in many of our buildings, during the day we have

at least 70 percent of our lights turned down. We have engaged in a lot of other areas pertaining to the environment.

In terms of prescriptions to non-Costco members, we should not get too much credit for that because in most states the law requires that if you have a license to prescribe drugs or to dispense drugs you have to allow anyone to come in and shop for it. That is not a law in every state, but because it is such a common practice we do it in all states.

QUESTION: *What sort of criteria does Costco look at when going into international markets? Does Costco look at personal income, GDP, or other qualities?*

JIM SINEGAL: The first international location where we did business in was Canada, which was close. That was perhaps the smartest thing we could have done because it taught us valuable lessons about doing business in another country. The next country we went to was Mexico. Both of them were chosen because they were close in terms of distance. From that point on, it got a little trickier. The criteria we've generally used is to look into higher priced markets. When we went into Japan, it was one of the highest priced markets in the world. We thought that even though there may be many obstacles, there was a lot of wealth from the top of the country down and another criterion was that the economy be pretty stable.

The same thing was true about South Korea. However, their economy tanked right after we went in. We felt so good about South Korea that we said this is indeed a country that is too big to fail, that the economy will come back. We felt that these are very bright and industrious people who will make this country succeed, and they did that. So as a result, we were very successful. Mexico and South Korea, on a ratio basis, are the two most profitable countries where we do business. So we look at those types of opportunities to do business.

Spain seems to be an outlier because the economy in Spain has been struggling, and their unemployment rate has been high. When we went to Spain, we did not sense that because everything felt good. Spain felt prosperous, better than the numbers were reflecting. We have always wanted to have a springboard into Western Europe and because the permitting processes are so very difficult we thought the state of the economy would give us enough opportunity to enter a country we might not be able to enter five or six years later. That is the reason we entered. We hoped that would give us the leeway for other countries in Western Europe.

Any place we go, any place in the world, our attitude is to make a long-term commitment. We are not there for the short term. We are in there to build our business; to build our business the same way we do in the U.S. — to be mindful of all the stakeholders, to ensure that they have assurances that we are going to be around a year or two or three years from now. It's pretty simple.

QUESTION: *My heart is beating really fast because you stand as an inspiration and an entrepreneur, which many people in this room are striving to become. How did you respond to those people who thought you were crazy to try to accomplish these great feats you were able to accomplish?*

JIM SINEGAL: I guess guilty as charged. One of the things you have to understand is that this is not a one-man gang. We are an organization, and the management team is the one that developed the culture, the attitude, and the way we have been running our business over the years. We were pretty resolute. We had determined that we were going to do the right things for our customers. The more we did it, the more we started thinking about, "You know, let's pull that product off the shelf. It's not worth carrying. It's not the type of quality

or image we want to present at Costco.” We thought about that relative to our people. If you are going to fire an employee, you have to consider that you are as guilty about what happened as they are. You should try to do everything you can to save them — you owe that to them. You owe it not just to them but also to every other employee. We thought about all of those aspects together, came to the same conclusion, and then developed the culture of the company. We don’t think we’re crazy; we determined that we would run the company in that fashion, and we would be satisfied with our business. We decided what was really important to us, which was to make sure our shareholders were happy in the final analysis.

QUESTION: *One of the things that I have long admired about you is your ability to stand up to analysts on Wall Street who keep saying, “Why don’t you take larger margins and why do you have to pay your people so much? Why do you give them so much health care? You’re taking away from investors when you do that.” I know you have had a different way to respond to that over time, and it is really inspiring to other public companies that often hide behind this excuse that because they are a public company, they can’t treat their people well, or they can’t provide good benefits and so forth.*

JIM SINEGAL: Standing up to Wall Street is difficult, but you have to look at it from a standpoint that they are in a different business. Wall Street is in the business of trying to make money between now and next Tuesday. I don’t mean that to be cynical, I’m not knocking the system. The system has been very good to us and we’ve prospered under the system. Oftentimes, when they ask questions, you don’t like it at that moment, but you think about it later and you ponder it and you say, “You know, that wasn’t a bad question. They have every right to ask that question as shareholders.” However, we are not in the business of trying to do something between now and next Tuesday.

We are trying to build a company that is going to be here years and years from now. We want to prosper, to be consistent, and to be trusted in the business community. My mentor, Sol Price, taught me that business was about more than making money, and you indeed have a social contract. You owe something to the communities where you do business and conscious capitalism is an extension of that. The fact that Costco and my colleagues and I are recognized for our way of doing business is great. If we encourage other people to think the same way, that’s a bonus for us, and we love it.

QUESTION: *Have you ever considered opening a Costco in the Middle East?*

JIM SINEGAL: We have had lots of inquiries, as you may imagine. We’ve looked at it and most of the countries in the Middle East could only support two or three Costcos. You need a lot of infrastructure in place to operate our business. We were concerned about Australia because we did not know if Australia would be big enough since there are only about 20 million people there. Although it is reasonably wealthy, we were concerned that it would not be enough for us to do more than about five or six Costcos. As it turns out, we now have nine Costcos there. We are learning that we will probably grow to about 20 or 25 Costcos in Australia. What happened in Australia is probably going to adjust our thinking about some of these small countries in the future. At the moment, there are some inhibitions relative to going into places like that, mostly because of the size of the country.

Thank you.



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