

Flexible Leadership Theory Application: Costco

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Abstract

Flexible Leadership Theory (FLT) is a management related theory that proposes a firm's future and long term success can be identified from management's ability to adapt and innovate, in management's use of efficiencies, and most importantly management's effective use of labor, or human capital, as an integral part of increasing sales. This paper will apply the ideas of FLT to Costco as a case study to show how the use of FLT in a large organization can reap benefits.

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Costco Wholesale Corporation is a company that owns and runs a series of warehouses across primarily the United States and Canada. These warehouses sell goods, both ‘private label’ and branded, to members who purchase their memberships on an annual basis. Due to a combination of strict limits on price mark-up (15% mark-up maximum) and well-stocked stores, Costco has seen a great deal of success even in an era of economic downturn (Chu and Rockwood, 2008). This is helped in large part to the high quality items in Costco’s inventory which attracts affluent, well-to-do customers (Boyle, Mero, and Castillo, 2006). Interestingly, a limited variety of inventory (much more limited than their competitors) does not seem to drive customers away since one of the benefits of a lack of variety is being able to price more competitively (Boyle, Mero, and Castillo, 2006). In fact, despite running what seems to be a business model completely contradictory to the norm (Chu and Rockwood, 2008, Boyle, Mero, and Castillo, 2006) and having very tight margins (a 1.6% profit margin according to Yahoo! Finance, <http://finance.yahoo.com/q/ks?s=COST+Key+Statistics>), Costco has managed to carve out for itself a very sizeable business with year after year increases in income and, in 2011, total net income of over \$1.4 billion (<http://finance.yahoo.com/q/is?s=COST+Income+Statementandannual>).

Despite the anomalous nature of Costco’s success, there appear to be examples in many industries of “rogue” businesses that buck the trend, compete head on with “standard” businesses and business models, and manage to not only compete successfully, but also outperform their competitors: Southwest Airlines in the airline industry and Dell in the personal computing industry are two such examples (Yukl and Lepsinger, 2005). In light of a similar market, similar

competition and similar demands, it is a legit question to ask why some firms are more successful than others.

Flexible Leadership Theory (FLT) provides a framework with which to answer that question. According to Rubina Mahsud, FLT “explains how top executives influence organization-level processes that determine a firm’s financial performance” (Nalevanko, 2011). The theory states that a firm’s performance is affected by three predominant variables:

- “Human capital or talent”
- “Efficiency and process reliability”
- “Innovative adaptation and flexibility” (Mahsud, Yukl, and Prussia, 2011, p. 230).

FLT is a leadership theory, not a systems theory; it does not concern itself with the interaction of these three variables in and of themselves, but instead focuses more on how leaders and executives influence a firm’s performance through the use of these three variables (Mahsud, Yukl, and Prussia, 2011). We can see this in action by applying FLT to Costco’s leadership style.

Innovative Adaption and Flexibility

At first glance it would appear that Costco warehouses are very turn-key in their operation: warehouses all look the same, they carry the same goods, and all have very similar processes and procedures for stocking, selling, and assisting customers. However, then-CEO Jim Sinegal explained in a 2006 article that Costco warehouse managers are given plenty of latitude in how to display many items. Warehouse managers are much more than a keeper of the keys; they are also expected to know their local clientele and adapt accordingly. Managers of the larger warehouses can, in fact, be described as mini-CEO’s in their own rights (Boyle, Mero, and Castillo, 2006). Further, it needs to be re-emphasized that FLT is a leadership theory, not a sales

theory and, as such, “innovative adaption” must be looked at from the perspective of the top: what is, in this case, Jim Sinegal doing to lead his company in an innovative and adaptive way? What is he doing to be innovative?

The list is long and strikes at the heart of the very Costco model itself. Costco not only offers inexpensive staple goods at prices lower than their competitors, but they also offer luxury goods in the same store. Though they do not offer the breadth of available goods that their competitors do, shopping at Costco has been described as a ‘treasure hunt’ due to a continually changing variety of perhaps a quarter of their inventory, inclusive of a very eclectic variety of goods: food, clothing, luxury jewelry, alcohol, gasoline, and even coffins (Boyle, Mero, and Castillo, 2006). Their variety of goods can easily be seen as innovative, in and of itself.

Interestingly, there are many ideas that Jim Sinegal has tried to implement that have failed: “You don’t have enough space ... to talk about all the things that we’ve tried that didn’t work out,” Sinegal explained (Chu and Rockwood, 2008). Learning from one’s mistakes (and failures) shows a strong penchant toward adapting and being flexible. Failure is a part of business and, indeed, a part of life. Learning from failing is a measure to succeed (CNBC interview with Alison Levine, 2012).

Efficiency and Process Reliability

Costco’s low prices and limited selection of brands and variety leads to very quick inventory turnover. This quick turnover requires a good process to ship and handle physical goods. Costco is able to begin shipment of goods to the warehouses typically within 24 hours (Datamonitor, 2010). Each Costco warehouse is set up in the same format, with the same high ticket items in the same location, and the same format of aisles to maximize the user browsing

experience (Boyle, Mero, and Castillo, 2006). These processes, from a business standpoint, work.

From an executive perspective, Jim Sinegal likes to visit each warehouse as often as possible; he also likes to answer his own phone and wears a name tag. He visits the warehouses to keep them on their toes (and to gather critical feedback on what is working and what is not) and he answers his own phone because it works for him. (Chu and Rockwood, 2008, Boyle, Mero, and Castillo, 2006).

In regards to efficiency it is worth noting that Costco does not carry as many different types of items as their competitors. While a Wal-Mart might carry 125,000 different product, Costco will carry only 4,000 (Datamonitor, 2010). Further, that small breadth of variety is further limited in variety of sizes: cases of Advil, for example, might be available only in sizes of 325 tablets and no others (Boyle, Mero, and Castillo, 2006). While this might seem to limit variety and choice, having only one size available eases purchasing, shipping, storage, display, and product placement. From order to sale the process is as simple and efficient as possible.

Human Capital

Perhaps one of the most intriguing aspects of the Costco business format is how Costco treats it's employees. In answer to why Costco has higher than industry average expenditures on employee wages and benefits, Sinegal had this to say:

“We're trying to build a company that's going to be here 50 and 60 years from now. We owe that to the communities where we do business. We owe that to our employees, that they can count on us for security. We have 140,000 employees and their families; that's a significant number of people who count on us” (Chu and Rockwood, 2008).

Sinegal further explained how his warehouse managers do what they can to encourage car pooling by building schedules around the locations where people live, and by looking into a 4x10 workweek to allow employees to save on fuel and give them a long weekend every week (Chu and Rockwood, 2008).

It may seem contradictory to expect “the bottom line” to be improved by extra expenditures into labor; there are, however, theories and ideas that a happy and well-cared for workforce improve sales (Blanchard, 2010) and the numbers for Costco seem to bear this out. Not only are their sales increasing annually, but they have a very low turnover rate which leads to less need for training new employees, they have a policy to promote from within, encouraging loyalty, and each warehouse has daily meetings with employees designed to find ways to improve efficiencies and customer service (Yukl, 2010).

Summary

FLT as applied to Costco appears to hold true: upper management’s flexibility, successful process and a wealth of human capital appear to be driving a successful company with annual growth. Scientific research backs this up: a 2011 study by Mahsud, Yukl, and Prussia found evidence that “all three performance determinants were related to overall firm effectiveness” (Mahsud, Yukl, and Prussia p. 239). A happy workforce is a productive workforce.

Appendix 1

Personal Application

The application of FLT in most modern corporations looks promising, though it may not always be the right method of running a business: some businesses may have no need for one or more of the variables presented in FLT, such as an art gallery, which might not have as strict a need for processes or efficiencies.

The immediate implementation of FLT must be pursued by top management and for an organization that has not seen FLT in use before, a new implementation of it would become almost immediately visible: organizations that once might not have placed much of an emphasis on the welfare of the employee which suddenly do would be seen very quickly by the employee, and could result in an almost instant boost of morale which would impact personal performance. Similarly, environments that were originally static and void of change which suddenly were vibrant and alive with energy from new ideas could result in additional brainpower and ideas being generated due simply to the increase in excitement.

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