

Zappos Finds the Perfect Fit*

INTRODUCTION

Can a company focused on happiness be successful? Zappos, an online retailer, proves that it can. Tony Hsieh, Zappos's CEO, says, "It's a brand about happiness, whether to customers or employees or even vendors." Zappos's zany corporate culture and focus on customer satisfaction has made it both successful and a model for other companies. Zappos has built a culture of integrity in all of its activities. The company provides an incredible example of managing ethics and social responsibility by addressing challenges and responding to stakeholder issues.

This case examines how the company's focus on stakeholder happiness contributed to its success. First, we examine the history of Zappos, its core values, and unique business model. Next, we analyze its corporate culture and how it influences its relationships with employees, customers, the environment, and communities. We then look at some of the challenges the company faced and how it plans to move into the future.

THE HISTORY OF ZAPPOS

Nick Swinmurn founded Zappos in 1999 after a fruitless day spent shopping for shoes in San Francisco. After looking online, Swinmurn decided to quit his job and start a shoe website that offered the best selection and best service. Originally called ShoeSite.com, the company started as a middleman, transferring orders between customers and suppliers but not holding any inventory. The website was soon renamed Zappos, after the Spanish word for shoes (zapatos).

In 2000, entrepreneur Tony Hsieh became the company's CEO. Hsieh, 26 at the time, was an early investor in Zappos, having made \$265 million selling his startup company to Microsoft in 1998. Hsieh wasn't initially sold on the idea of an Internet shoe store. He told *Inc. Magazine*, "It sounded like the poster child of bad Internet ideas ... but I got sucked in." After becoming CEO, Hsieh made an unconventional decision to keep Zappos going, even selling his San Francisco loft to pay for a new warehouse and once setting his salary at just \$24.

*Harper Baird, Bernadette Gallegos, Beau Shelton, Jennifer Sawayda, and Jordan Burkes developed this case under the direction of O.C. Ferrell and Linda Ferrell, © 2022. It is intended for classroom discussion rather than to illustrate effective or ineffective handling of administrative, ethical, or legal decisions by management. All sources used for this case were obtained through publicly available materials.

Zappos struggled its first few years, making sales but not generating a profit. The dot-com crash forced Zappos to lay off half its staff, but the company recovered. By the end of 2002, Zappos had sales of \$32 million but was still not profitable. In 2003, the company decided that to offer the best customer service, it had to control the entire value chain—from order to fulfillment to delivery—and began holding its own inventory. Zappos moved to Las Vegas in 2004 to take advantage of a larger pool of experienced call center employees. The company generated its first profit in 2007 after reaching \$840 million in annual sales. Zappos also started to be recognized for its unique work environment and approach to customer service.

In 2010, Amazon bought the company for \$1.2 billion. Although Hsieh rejected an offer from Amazon in 2005, he believed that the buyout would be better for the company than management from the current board of directors or an outside investor. Many Zappos customers were confused by the unexpected move and expressed concerns about the future of the company's culture and customer service. Most CEOs would not have felt any obligation to address customer concerns over the merger, but Tony Hsieh valued the support of Zappos's employees and customers. Hsieh said, "With Amazon, it seemed that Zappos could continue to build its culture, brand, and business. We would be free to be ourselves." Amazon agreed to let Zappos operate independently and to keep Hsieh as CEO (at his current \$36,000 annual salary). Hsieh made \$214 million from the merger, and Amazon set aside \$40 million for distribution to Zappos employees. After the merger, the company restructured into 10 separate companies organized under the Zappos Family. Zappos was able to keep its unique culture and core values.

A CUSTOMER-FOCUSED BUSINESS MODEL

Zappos has 10 core values that guide every activity at the company and form the heart of the company's business model and culture:

- Deliver WOW through service.
- Embrace and drive change.
- Create fun and a little weirdness.
- Be adventurous, creative, and open-minded.
- Pursue growth and learning.

- Build open and honest relationships with communication.
- Build a positive team and family spirit.
- Do more with less.
- Be passionate and determined.
- Be humble.

Zappos's core values differ from those of other companies in a couple of ways. In addition to being untraditional, the core values create a framework for the company's actions. This is exemplified in the company's commitment to their customers' and employees' well-being and satisfaction.

The Zappos business model is built around developing long-term customer relationships. Zappos does not compete on price because it believes that customers will want to buy from the store with the best service and selection. The company strives to create a unique and addicting shopping experience, offering a wide selection of shoes, apparel, accessories, and home products, free shipping to the customer, free shipping and full refunds on returns, and great customer service.

Shopping and Shipping

Zappos strives to make the shopping experience enjoyable. The website is streamlined for an easy shopping experience. Products are grouped in specialized segments. Customers can view each product from multiple angles thanks to photographs taken at the company's studio, and Zappos employees make short videos highlighting the product's features. Zappos uses feedback provided in customer reviews (e.g., if a shoe fit true to size) to improve its listings. Zappos analyzes how customers navigate the site to improve features, adapt search results, and plan inventory.

This spirit of simplicity, innovation, and great service extends to Zappos's inventory and distribution systems as well. Zappos has a live inventory management system. Once the company sells out of an item, the listing is removed from the website. This helps to reduce customer frustration. Its inventory and shipping systems are linked directly to the website via a

central database, and all its information systems are developed in-house and customized to the company's needs. Their warehouses operate around the clock, which allows them to get a product to the customer faster. Fast shipping creates an instant gratification that is similar to shopping in a physical store.

During the COVID-19 (coronavirus) pandemic in 2020, Zappos updated its website to address customer concerns. Due to an influx of orders, they alerted customers that deliveries could take longer than usual to arrive. The company also detailed how Zappos gave back to the community during the crisis. For example, customers were urged to nominate a "hero" to receive a \$250 gift card. Additionally, the company provided Crocs shoes to healthcare professionals. Zappos merchandised its site to address shifting consumer behavior and preferences, highlighting slippers, athleisure, and leggings.

Most companies have a negative view toward returns, but Zappos's mentality is the complete opposite. It sees returns as the ability to maintain customer relationships and to increase its profits. Zappos offers a 100% Satisfaction Guaranteed Return Policy. If a customer is not satisfied with a purchase, he or she can return it within 365 days for a full refund. The customer can print a prepaid shipping label that allows all domestic customers to return the product for free. This return policy encourages customers to order several styles or different sizes and return the items that do not work out.

While this strategy seems expensive, it actually works to Zappos's advantage. The average industry merchandise return rate is 35 percent, but Zappos's most profitable customers tend to return 50 percent of what they purchase. The customers who have the higher return percentages are the most profitable because they have experienced Zappos's customer service and return policy, which create loyalty to the company. These customers are likely to make purchases more often and to spend more on each purchase. This is what makes Zappos so successful.

Customer Service

What really makes the Zappos business model unique is the company's focus on customer service. The company has established a method of serving customers and handling their issues that is distinctive from the rest of the industry. Zappos believes great customer service is an

opportunity to make the customer happy. Customers are encouraged to call Zappos with any questions. The number is displayed on every page of the website. Hsieh says, "... At Zappos, we want people to call us. We believe that forming personal, emotional connections with our customers is the best way to provide great service." Customer service representatives also actively use social media sites such as Facebook and Twitter to respond to customer issues.

Another key aspect of Zappos's customer service model is that nothing is scripted. Employees have free reign in their decision-making and are expected to spend as much time as they need to "wow" customers. They help customers shop, even on their competitors' websites, encourage them to buy multiple sizes or colors to try (since return shipping is free), and do anything it takes to make the shopping experience memorable. Zappos's customer service representatives try to develop relationships with their customers and make them happy. Stories about great customer service include customer support calls that last for 11 hours, sending flowers to customers on their birthdays, and surprise upgrades to faster shipping. Some extreme cases have included Zappos hand-delivering shoes to customers who have lost luggage and to a groom who forgot the shoes for his wedding. Zappos has even sent pizzas to the homes of customers who have tweeted to the company about being hungry. During the COVID-19 pandemic, Zappos created a customer service line to allow customers to call and chat about anything from travel plans to pandemic worries. Employees came up with the idea, and Zappos, which experienced lower than average call volume as consumers spent less on nonessentials, wanted to make use of its customer service team.

Zappos believes that great customer experiences encourage customers to use the store again. In addition, Zappos's long-term strategy is based on the idea that great customer service will help them expand into other categories. While around 80 percent of Zappos's orders come from shoes, the markets for housewares and apparel are much larger. The company says it will expand into any area that it is passionate about and that meets their customers' needs. The company also considers word-of-mouth marketing to be the best way to reach new customers. With over 75 percent of purchases made by repeat customers, it is evident that Zappos's mission to "provide the best customer service possible" is working well for the company.

CORPORATE CULTURE

The corporate culture at Zappos sets it apart from nearly every other company. As Amazon's CEO, Jeff Bezos, says, "I've seen a lot of companies, and I have never seen a company with a culture like Zappos." Zappos's unorthodox culture is the work of CEO Tony Hsieh, an innovative and successful entrepreneur. Hsieh built the culture on the idea that if you can attract talented people and employees enjoy their work, great service and brand power will naturally develop.

Zappos is famous for its relaxed and wacky atmosphere. Employee antics include Nerf ball wars, office parades, ugly sweater days, and donut-eating contests. The headquarters features an employee nap room, a wellness center, and an open mic in the cafeteria. Other quirky activities include forcing employees to wear a "reply-all" hat when they accidentally send a company-wide e-mail. This environment isn't just fun; it's also strategic. According to Zappos, "When you combine a little weirdness with making sure everyone is also having fun at work, it ends up being a win-win for everyone: Employees are more engaged in the work that they do, and the company as a whole becomes more innovative."

Hiring and Training

The key to creating a zany work environment lies in hiring the right people. Zappos looks for people with a sense of humor who can work hard and play hard. Potential employees go through both cultural and technical interviews to make sure they will fit with the company. However, even Hsieh admits that finding great employees is tough. "One of the biggest enemies to culture is hyper-growth. You're trying to fill seats with warm bodies, and you end up making compromises," says Hsieh.

New employees attend a four-week training program, which includes 2 weeks on the phones providing customer service and a week fulfilling orders in a warehouse. To make sure that new employees feel committed to a future with the company, Zappos offers \$2,000 to leave the company after the training (called the "The Offer"). Amazon has since adopted a similar practice. Even after the initial training is over, employees take 200 hours of classes—with the company covering everything from the basics of business to advanced Twitter use—and read at least nine business books a year.

Benefits

Another aspect of Zappos that is unique is the benefits that it provides to its employees. The company has an extensive health plan, where it pays 100 percent of employee's medical benefits and on average 85 percent of medical expenses for employees' dependents. The company also provides employees with dental, vision, and life insurance. Other benefits include a flexible spending account, prepaid legal services, a 40 percent employee discount, free breakfasts, lunches, and snacks, paid volunteer time, life coaching, pet insurance, nap rooms, and a carpool program.

Zappos determined that the pay structure and the process for employee shift sign-ups were inefficient for the company's needs. With Hsieh's encouragement, the company adopted scheduling software called Open Market. Under this new system, call center employees would be given 10 percent time flexibility to pursue their own projects. Employees could decide when to work, but the compensation system was revamped to mimic the surge-time pricing of popular ride-sharing service Uber. With this compensation system, call center employees working during periods of high demand would receive higher pay. In other words, Zappos hourly compensation for its call center employees would be based on demand. Zappos hopes to expand this system to all departments eventually. For seniority-based jobs, this system holds risks. For instance, seniority-based incentives also take into account company loyalty, camaraderie with co-workers, and dedication that are also important to work productivity. However, Zappos believes the system works well for its call center employees because many are employed for shorter periods.

Work–Life Integration

One of Zappos's core values is "Build a positive team and family spirit," so the company expects employees to socialize with each other both in and out of the office. In fact, managers spend 10 to 20 percent of their time bonding with team members out-side of work. Zappos outings include hiking trips, going to the movies, and hanging out at bars. Hsieh says that this increases efficiency by improving communication, building trust, and creating friendships.

Along with creating friendships, employees are encouraged to support each other. Any employee can give another employee a \$50 reward for great work. Zappos employees compile an

annual “culture book” comprising essays on the Zappos culture and reviews of the company. The culture book helps employees to think about the meaning of their work and is available unedited to the public.

This positive work environment comes with the expectation that employees will work hard. Employees are evaluated on how well they embody the core values and inspire others. Zappos will fire people who are doing great work but don’t fit with the culture of the company. Hsieh says, “We definitely don’t want anyone to feel that they’re entitled to employment for life. It’s more about us creating an environment and growth opportunities for our employees such that they want to be employees for life.”

Transparency

As with its customers, the foundation of Zappos’s relationships with its employees is trust and transparency. The company wants its employees, like its customers, to actively discuss any issues or concerns that may come up. Hsieh does not have an office; he sits in an open cubicle among the rest of the employees. He believes that “the best way to have an open-door policy is not to have a door in the first place.” Zappos’s management is very open with employees by regularly discussing issues on the company blog. Employees receive detailed information about the company’s performance and are encouraged to share information about the company. Zappos believes that employees should develop open and honest relationships with all stakeholders with the hope that this will assist in maintaining the company’s reputation.

CORPORATE SOCIAL RESPONSIBILITY

Zappos also takes an unconventional approach to corporate social responsibility and philanthropy. Many companies have CSR programs that are dedicated to a certain area or cause such as education, but Zappos prefers to support a variety of programs based on the needs of communities and the interests of employees.

Zappos is involved in a variety of philanthropic efforts. Programs include donating shoes and gifts as well as giving gift cards to elementary school students. Zappos is known for teaming up with celebrities for philanthropic events. The company worked with Michael Ray and Imagine

Dragons to create limited edition sneakers with Puma and Superga. All the proceeds from the shoe sales went to charity. Zappos also worked with Shaquille O'Neal and the Boys & Girls Clubs of America for a Shaq-a-Clause event that helped more than 2,000 underprivileged kids. Zappos for Good, the charitable arm of Zappos.com, launched a Prom Closet program, a prom shop that offered prom dresses, tuxes, shoes, accessories and hair and makeup services for teens in need. The company has other projects such as Pawlidayz, a pet adoption promotion, and Closets for Good that builds closets full of clothing and food in schools. In 2019, Zappos created a platform called Goods for Goods which allows customers to shop for purpose-driven products. The platform is separated into five different categories: recycled, vegan, organic, sustainably certified, and Give Back. The website supports more than 150 brands including Native Shoes, which converts used shoes into playground equipment, and Birkenstock who is committed to environmentally friendly operations and sustainability.

Zappos also started a campaign to improve the company's impact on the environment. A group of employees created the initiative, which is known as Zappos Leading Environmental Awareness for the Future (L.E.A.F.). The campaign focuses on several environmental efforts, including a new recycling program, community gardens, and getting LEED certification for the company. Additionally, the company's Las Vegas campus was redesigned to be more energy efficient. The company also uses renewable energy sources such as solar panels.

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ZAPPOS'S STRUCTURE

In 2014, Tony Hsieh made a controversial decision to completely change the structure of the organization. The company transitioned toward an organizational structure that abandoned the top-down managerial hierarchy in favor of a redistribution of power. Called a Holacracy, this organizational structure places empowerment at the core of the organization. Every employee

becomes their own leader with their own roles. To be effective, a Holacracy requires periodic governance meetings where each employee understands his or her roles and responsibilities. Teams hold tactical meetings to discuss key issues. While governance meetings focus on clarity and role structure, tactical meetings are used to “sync and triage next actions.” It is believed that this distributed authority increases clarity and transparency and decreases cognitive dissonance by recognizing tensions before they become a problem.

As Zappos continues to grow, there is a risk its expansion will make it harder to manage employees and control productivity. Hsieh cites statistics that demonstrate how growth often causes innovation and productivity per employee to go down. However, he also claims that when cities double in size, productivity and innovation per resident increases by 15 percent. Hsieh believes that the key to sustainable growth at Zappos is to operate more like a city than a business. He feels the best way to handle growth is to become a Teal organization, starting out by using a Holacracy structure and evolving from there. In his book *Reinventing Organizations*, Frédéric Laloux uses a color scheme to describe the development of human organizations, with Teal representing an evolved level. The concept of a Teal organization is based on three premises: self-management developed through peer relationships; involving the whole person in the work; and allowing the organization to grow and adapt instead of being driven. A Teal organization is structured under the premise that all units will work “together to support the whole.” For Zappos, this involves adopting a new structure promoting self-organization and self-management.

The transformation of Zappos’s organizational structure started off slowly. However, Hsieh believed this slow transition was hindering the company’s transformation toward self-organization and self-management. Hsieh sent an e-mail to all 1,500 employees in 2015 to inform them that the organization was going to take immediate action to transform Zappos into a Teal organization. This involved eliminating bosses and the traditional functions of finance, technology, marketing, and merchandising to create task-oriented circles structured around specific businesses. Managers became employees and no longer engaged in traditional management functions. Hsieh praised traditional managers for their past contributions but stated they are no longer required for a Teal organization. He realized there was likely going to be much resistance from managers and other employees who did not agree with the new system. To

address these concerns, Hsieh extended “The Offer.” Zappos agreed to provide employees who wanted to leave severance pay for 3 months. Approximately 14 percent of employees chose to take the package.

In 2016, however, Zappos fell off the *Fortune* magazine’s 100 Best Companies to Work For list for the first time in eight years. Employee surveys showed that scores had gone down on 48 out of 58 questions. However, Hsieh chalked the problem up to growing pains, saying he believed employees must be committed to the changes and that it will pay off in the long term. Since 2017, Zappos has continued to evolve its Holacracy model. While the company has retained a circular hierarchy, they also reintroduced the manager role. Holacracy has received criticism in the past for being too internally focused which is at odds with Zappos’s customer focus. John Bunch, an executive at Zappos who co-led the movement towards Holacracy, said the company is veering employees to focus on the customer by implementing a marketplace system where teams operate like small businesses. They manage their own financials rather than stressing on the scope of their Holacratic authority. These small business-like structures are encouraged and incentivized to create new product lines and services for customers. While this is still a decentralized system that comes with a high degree of autonomy and self-sovereignty, it isn’t a pure Holacracy.

THE FUTURE OF ZAPPOS

Zappos remains committed to serving its customers and employees. So far, the company has retained its unique culture and continues to expand into new product categories. In one interview, Hsieh talked about the growth of Zappos and how he believes that expanding into the clothing and merchandise market will help the company to grow. Hsieh says that “the sky is the limit” for Zappos, and that growing and expanding into many different types of businesses is Zappos’s future. Hsieh continues to look for talented and creative individuals. He has pledged \$1 million in partnership with Venture for America to bring at least 100 graduates to the Las Vegas area over a 5-year period. As Zappos expands, it will have to work harder to hire the right people, avoid ethical issues, and maintain its quirky culture. The company’s new organizational structure and compensation system for its call center employees are major steps to expand without compromising Zappos’s unique culture. Although many employees ended up leaving the

company, Zappos believes these moves are the right ones to make and will enable the firm to continue growing both in employees and productivity.

Ethical leadership is a key factor in the success of any company, and for Zappos, having Tony Hsieh as a leader is a strong indicator for future success. Hsieh has expressed that he will do whatever it takes to make his employees, customers, and vendors happy. The future for any company looks bright when its leadership is committed to such strong values. However, Zappos needs to make sure that it continues to focus on its stakeholders and its long-term vision with or without Hsieh.

Ultimately, Zappos intends to continue to deliver happiness to its stakeholders. Hsieh says, “At Zappos, our higher purpose is delivering happiness. Whether it’s the happiness our customers receive when they get a new pair of shoes or the perfect piece of clothing, or the happiness they get when dealing with a friendly customer rep over the phone, or the happiness our employees feel about being a part of a culture that celebrates their individuality, these are all ways we bring happiness to people’s lives.”

Zappos’s success and innovative business model have caught the attention of many other companies. The company has appeared on several prestigious lists including *Fortune*’s “Best Companies to Work For,” *Fast Company*’s “50 Most Innovative Companies,” *BusinessWeek*’s “Top 25 Customer Service Champs,” and *Ethisphere*’s “World’s Most Ethical Companies.” Zappos’s business model is so successful that the company offers tours and workshops. Its 3-day culture camp costs \$6,000 and teaches participants about the Zappos culture and how to develop their own successful corporate cultures. The company also created Zappos Insights, an online service that allows subscribers to learn more about Zappos’s business practices through blogs and videos. These programs have high profit potential for the company because they are built on what Zappos already does best. As the company continues to gain recognition for its efforts in creating a vibrant and transparent corporate culture and business model, Zappos’s success among its varied stakeholders looks promising.

QUESTIONS FOR DISCUSSION

1. Does Zappos effectively focus on stakeholder happiness, and how does this approach affect the ethical culture?
2. Has Zappos developed long-term relationships with customers and employees that provide a competitive advantage in the purchase of shoes and other products?
3. Has Zappos effectively managed ethical risk, and what are potential ethical risks in the future?

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