

**Competitive Strategy**

# **How I Did It: Zappos's CEO on Going to Extremes for Customers**

by Tony Hsieh

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Brad Swonetz/Redux

**Summary.** In 2004 the biggest problem the online shoe retailer Zappos faced was how to staff its customer call center with dedicated, high-caliber service reps. The company's headquarters were in San Francisco, where the high cost of living—and the upwardly mobile Silicon... [\*\*more\*\*](#)

**In the 11 years since** Zappos was founded, we've had to make some

big decisions. One of the most significant came in early 2004, over lunch at Chevys, a chain Mexican restaurant in San Francisco. We hadn't expected to make a life-changing choice over a plate of fajitas, but when you're part of a fast-growing company, a lot of decisions arise at unlikely moments.

Zappos was then nearly five years old. I'd gotten involved with the company as an investor after LinkExchange, which I'd cofounded, was sold to Microsoft in 1998. At first I thought that selling shoes online sounded like a poster child for bad internet ideas. But the founder of Zappos, Nick Swinmurn, explained that shoes were a \$40 billion market in the U.S. and that 5% of them were already sold by mail order. What had started as just one of several dozen angel investments ended up as a job: By 2000 I had joined Zappos full-time. The company had survived the dot-com crash, and our gross merchandise sales were growing—up from zero in 1999 to \$70 million in 2003. But for most of those years we had been short of cash and struggling to cope with growth.

In early 2004 our biggest problem was customer service—specifically, finding the right employees to staff our call center. A lot of people may think it's strange that an internet company would be so focused on the telephone, when only about 5% of our sales happen by phone. But we've found that on average, our customers telephone us at least once at some point, and if we handle the call well, we have an opportunity to create an emotional impact and a lasting memory. We receive thousands of phone calls and e-mails every day, and we view each one as an opportunity to build the Zappos brand into being about the very best customer service. Our philosophy has been that most of the money we might ordinarily have spent on advertising should be invested in customer service, so that our customers will do the marketing for us through word of mouth.

But that requires the right staff members—and our inability to find enough dedicated, high-caliber customer service reps near our San Francisco headquarters was turning into a huge problem. It's hard to find people in the Bay Area who want to make customer service a

career. Culturally, it's not part of the Silicon Valley mentality. The high cost of living also plays a role: In San Francisco you can't afford to buy a home on a call center rep's salary. So most of the people working the phones for Zappos were temps, and they weren't always providing the *wow* experience our customers deserved.

## **How About Outsourcing?**

By late 2003 we'd started looking at different options for expanding our call center. We initially considered outsourcing it to India or the Philippines, and we met with a few outsourcing companies. We got the whole sales pitch and listened in on sample calls. You could tell on the ones from India that the people talking were from another country. Accent aside, they just didn't understand the nuances of American culture. How would they be able to help a customer who asked, say, for shoes like the ones Julia Roberts wears in *Eat, Pray, Love*?

We were reluctant to outsource the call center, because we'd had bad experiences with outsourcing in the past. In fact, one of the big lessons of Zappos's first few years was that it never makes sense to outsource your core competency, especially if your aim is to be maniacal about customer service. In its earliest days, Zappos fulfilled orders with drop shipments: We didn't carry any inventory; instead we relied on shoe manufacturers to ship products directly to our customers.

That system never worked very well. We didn't have 100% accurate information about our vendors' inventory, and because their warehouses were all over the country, delivery times weren't predictable. So we stopped drop shipping and began buying inventory from manufacturers, but we outsourced the warehousing and shipping to a separate company in Kentucky. That didn't work well either. As an e-commerce company, we should have considered warehousing to be our core competency from the beginning. Trusting that a third party would care about our customers as much as we did

was one of our biggest mistakes. If we hadn't reacted quickly by starting our own warehouse operation, that mistake would eventually have destroyed Zappos.

So we agreed that Zappos employees would staff the call center. But finding them in San Francisco remained a problem. One option would have been to set up a satellite call center, staffed by Zappos employees who were operating someplace far away. As we thought more about it, though, we realized that it wouldn't be matching our actions to our words. If we were serious about building our brand around being the best in customer service, customer service had to be the whole company, not just a single department.

### **Seven Ways to Achieve Exceptional Customer Service**

Make customer service a priority for the whole company. It's not just a department. Empower your customer service ...



We decided we needed to move our entire headquarters from San Francisco to wherever we built the call center, whose staff we had recently named the Customer Loyalty Team, or CLT. We talked about lower-cost cities where housing would be cheaper and there would be a bigger supply of workers who might think being a phone rep for a fun, growing company was a viable career choice. We did a lot of research into real estate, wages, and the cost of living in various cities, and we narrowed down the list of possibilities to Phoenix, Louisville, Portland (Oregon), Des Moines, Sioux City, and Las Vegas.

Over lunch that afternoon at Chevys, we talked through our choices. Could the company afford the huge costs associated with moving its staff? How many of our employees would be willing to relocate to a

new state? Would the potential upside be worth the disruption to our young company? What would be the best decision for our culture?

## **You Can Call Us Anytime**

If we moved, it would be only the latest effort in Zappos's drive to achieve world-class customer service—a goal that has led us to run our business in a way that sets us apart from many of our competitors. In the United States we offer free shipping both ways to make transactions risk free and as easy as possible for our customers. A lot of them will order five different pairs of shoes and then send back the ones that don't fit or that they simply don't like—free of charge. The additional shipping costs are considerable for us, but we view them as a marketing expense. We also offer a 365-day returns policy for people who have trouble making up their minds. (Originally our returns policy was only 30 days, but we kept increasing it at the urging of our customers, who became more loyal as we lengthened the returns period.) Our returns run high—more than a third of our gross revenue—but we've learned that customers will buy more and be happier in the long run if we can remove most of the risk from shopping at Zappos.

Our customer service orientation is also apparent on our website. On many websites the contact information is buried at least five links deep, because the company doesn't really want to hear from you. And when you find it, it's a form or an e-mail address. We take the exact opposite approach. We put our phone number (it's 800-927-7671, in case you'd like to call) at the top of every single page of our website, because we actually want to talk to our customers. And we staff our call center 24/7.

Looking at every one of our interactions through a branding lens instead of an expense-minimizing lens means that we run our call center very differently from others. For instance, most call centers measure their employees' performance on the basis of what's known in the industry as “average handle time,” which focuses on how many phone calls each rep can take in a day. This translates into reps'

worrying about how quickly they can get a customer off the phone—which in our eyes is not delivering great customer service. Most call centers also have scripts and force their reps to try upselling to generate additional revenue.

At Zappos we don't hold reps accountable for call times. (Our longest phone call, from a customer who wanted the rep's help while she looked at what seemed like thousands of pairs of shoes, lasted almost six hours.) And we don't upsell—a practice that usually just annoys customers. We care only whether the rep goes above and beyond for every customer. We don't have scripts, because we want our reps to let their true personalities shine during every phone call, so that they can develop a personal emotional connection with each customer, which we refer to as a PEC.

### **For Zappos Reps, Patience with Strange Customers Is a Job Requirement**

One observer who spent time inside the Zappos call center described the conversations between customers and reps as ...



When one of our reps found out that because of a death in the family, a loyal customer had forgotten to mail back a pair of shoes she'd planned to return, the rep sent her flowers; now she's a customer for life. Once, at a shoe sales conference in Santa Monica, after a long night of barhopping, a small group of us headed up to someone's hotel room to order food, but room service had closed at 11. When we couldn't find a place that delivered food after midnight, a couple of us cajoled a woman (who didn't work at Zappos) into calling a Zappos rep for help while we listened in on speakerphone. The rep was a bit

confused by the request, but she quickly recovered and put us on hold. Two minutes later she told us the five closest places in Santa Monica that were still open and delivering pizzas.

There's a lot of buzz these days about social media and "integration marketing." Our belief is that as unsexy and low-tech as it may sound, the telephone is one of the best branding devices out there. You have the customer's undivided attention for five or 10 minutes, and if you get the interaction right, the customer remembers the experience for a very long time and tells his or her friends about it.

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devices out there.**

Usually when marketing departments do their ROI calculations, they assume that the lifetime value of a customer is fixed. We view it as something that can grow if we create positive emotional associations with our brand. To that end, most of our efforts at customer service actually happen after we've already made a sale. For example, for most of our loyal repeat customers, we do surprise upgrades to overnight shipping, even when they have chosen the free ground-shipping option. Our warehouse is open around the clock every day, which is costly. The most efficient way to run a warehouse is to let the orders pile up, so that when a worker walks around picking up orders, the picking density is higher and the worker has less distance to walk. But we're not trying to maximize picking efficiency. We're trying to maximize the customer experience, which in e-commerce involves getting orders out to customers as quickly as possible.

## **What We're Learning from Amazon**

In the debate about moving our headquarters, we settled on Las Vegas. We didn't consult with our board or our investors—we just told them we were doing it. (It may have helped that Nevada has no

income tax; some of them probably figured we were moving for tax reasons.) Las Vegas wasn't the cheapest option we considered, but we thought it would make our current employees the happiest. It also made sense for other reasons. It's an all-night city where employees are used to working at any hour, which would help us find people willing to take the overnight shift at our call center. And because so much of the city's economy is focused on hospitality, Las Vegas has a customer service mentality—employees there are used to thinking of people as guests.

Two days after the lunch at Chevys, we held a company meeting and announced that we were relocating to Las Vegas. We would pay the moving costs for any employees who came along, and we'd help them find new homes. When the announcement was made, everyone in the conference room was in a state of shock. We told everyone to take a week before making a decision one way or the other.

We had about 90 employees in San Francisco at the time, and I had guessed that maybe half of them would decide to uproot and move with the company. A week later I was pleasantly surprised to learn that 70 were willing to give Vegas a shot. In their minds it was all about being adventurous and open-minded. The move cost about \$500,000 altogether, which was a significant amount of money for us at the time. It also cost us some good people: Our star software developer loved San Francisco and decided not to leave. Some of those who did move were taking a real leap of faith. One employee had been with Zappos only 10 days (and married for only 15) when we announced we were moving. He came with us—and, luckily for him, so did his wife.

Although our timing could have been better (we moved at the height of the real estate boom in Las Vegas, and subsequently property values dropped across the board), the move paid off in several ways. When we arrived in Vegas, we had no one to lean on except one another. Our company culture, which had always been strong, became even more so. As we grew, we made sure we hired only



people we would enjoy hanging out with after hours. As it happened, many of our best ideas arose while we were having drinks at a local bar.

By 2008 we had hit \$1 billion in gross merchandise sales. But the economic slowdown made for a crazy year. Even though we were still growing, we realized that our expenses were too high for the revenue we were bringing in. We had planned on faster growth, and discovered that we'd overhired. Late in the year we decided to lay off 8% of the staff. It was one of the hardest decisions we've ever had to make.

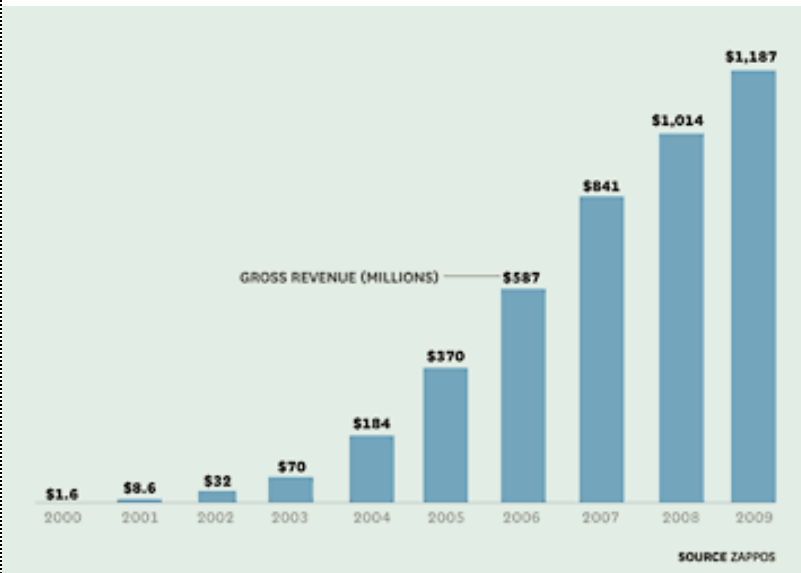
## **By 2008 we had hit \$1 billion in gross merchandise sales.**

In 2009 we agreed to sell ownership of Zappos to Amazon. Amazon has always described its goal as being the most customer-centric company in the world, but its approach is more high-tech than ours, with a focus on using web design and functionality to make the shopping experience so easy for customers that they don't have to call the company. Ours is more high-touch—we try to make a personal connection. Since the sale, we've learned from Amazon's technology: We've started to track some metrics Amazon tracks, and we're learning how it thinks about warehouse operations. We've also expanded far beyond shoes. Now Zappos sells a wide assortment of clothing, housewares, cosmetics, and other items.

Today we have more than 1,800 employees. We offer starting pay for call center reps of around \$11 an hour—typical for reps in Vegas—but because Zappos is known as a great place to work (we made *Fortune's* "Best Companies to Work For" list for the second time in a row this year), we have no shortage of applicants. Last year 25,000 people applied for jobs with us, and we hired only 250. Someone told me

that statistically it's harder to get a job at Zappos than it is to get admitted to Harvard, which says a lot about the strength of the culture we've created here.

### Smiling Customers, Steady Growth



By providing stellar service, Zappos has made steady gains in gross revenue. But its customers take full advantage ...



Looking back, I attribute most of our growth over the past few years to the fact that we invested time, money, and resources in three key areas: customer service, company culture, and employee training and development. The move to Las Vegas helped us make progress in each of the three. If you'd like to hear what our telephone reps sound like, just pick up the phone and give us a call.

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During the past 10 years, the company has grown from almost no sales to more than \$1 billion in annual gross merchandise sales, driven primarily by repeat customers and word of mouth.