





Zeynep Ton is a visiting assistant professor in the operations management group at MIT Sloan School of Management.

PHOTOGRAPHY: STEVE WEBSTER



Some companies are investing in their workers and reaping healthy profits.

by Zeynep Ton

Almost one-fifth of American workers have bad jobs. They endure low wages, poor benefits, schedules that change with little—if any—notice, and few opportunities for advancement. The conventional wisdom is that many companies have no choice but to offer bad jobs—especially retailers whose business models entail competing on low prices. If retailers invest more in employees, customers will have to pay more, the assumption

goes. Indeed, it is easy to conclude that employee-friendly Wegmans and the Container Store can offer great jobs only because their customers are willing to pay higher prices.

I have studied retail operations for more than 10 years and have found that the presumed trade-off between investment in employees and low prices can be broken. Highly successful retail chains—such as Quik-Trip convenience stores, Mercadona and Trader Joe's supermarkets, and Costco wholesale clubs—not only invest heavily in store employees but also have the lowest prices in their industries, solid financial performance, and better customer service than their competitors. They have demonstrated that, even in the lowest-price segment of retail, bad jobs are not a cost-driven necessity but a choice. And they have proven that the key to breaking the trade-off is a combination of investment in the workforce and operational practices that benefit employees, customers, and the company. This article explains those practices.

Although my research has focused on retailing, I believe that the model these retailers have created can be applied in other service organizations where there are large fluctuations in customer traffic and employees perform both production and customer service tasks. These include hospitals, restaurants, banks, and hotels.

The United States needs better jobs, not just more jobs. Service businesses—including low-price

retailers—that currently don't invest adequately in their workers could be part of the solution.

Why Do Retailers Underinvest in Labor?

If investing in retail labor is such a good idea, as my research suggests, why isn't everybody doing it? The main reason is that labor is often a retailer's largest controllable expense and can account for more than 10% of revenues—a considerable level in an industry with low profit margins. In addition, many retailers see labor as a cost driver rather than a sales driver and therefore focus on minimizing its costs. Accordingly, they often evaluate store managers on whether they meet monthly (or weekly) targets for payroll as a percentage of sales. These managers don't have much control over sales (they almost never make decisions on merchandise mix, layout, price, or promotions), but they do have a fair amount of control over payroll. So when sales decrease, they immediately reduce staffing levels. The pressure to reduce payroll expenses is so high that store managers at several large chains, including Walmart, have been widely reported to have forced employees to work off-the-clock, paying them for fewer hours than they put in.

Moreover, the financial benefits of cutting employees are direct, immediate, and easy to measure, whereas the less-desirable effects are indirect, long

TOO MANY U.S. RETAIL WORKERS HAVE BAD JOBS

WAGES

In 2010, an American cashier made an average of

\$9.52
an hour,

55%

below the average for all occupations.

At

40

hours a week, that translates to only

\$19,801
a year.

FULL-TIME

But there is no guarantee that store employees are even that fortunate:

94%

of retailers call anyone working more than

30

hours a week a full-timer.

PART-TIME

41%

of retail workers are part-timers. Their hourly wages are 35% lower than those of full-time employees.

Moreover, they often do not receive health benefits and are scheduled too few hours to earn a living.

SOURCE FRANCOIS J. CARRÉ, CHRIS TILLY, AND LAUREN D. APPLEBAUM

Idea in Brief

Retailers have long believed that the only way to compete on price is to offer workers low wages, poor benefits, constantly changing schedules, and little opportunity for advancement.

But a growing body of research—including the author's studies of Borders, Home Depot, QuikTrip convenience stores, Mercadona and Trader Joe's supermarkets, and Costco wholesale clubs—suggests that there is an alternative to providing “bad jobs.”

Retailers can break the trade-off between low prices and investing in employees by adopting a set of operational practices:

OFFER FEWER SKUs and promotions in order to reduce complexity.

CROSS-TRAIN WORKERS so that they can perform multiple tasks instead of varying the number of employees to match changes in customer traffic.

ELIMINATE WASTE everywhere except in staffing in order to increase labor productivity.

EMPOWER EMPLOYEES to make small on-the-spot decisions.

term, and difficult to measure. Home Depot is a well-known example. When former GE executive Robert Nardelli became CEO, at the end of 2000, he cut staffing levels and increased the percentage of part-timers to reduce costs and boost profits. Those moves achieved both goals immediately, but they eventually caused Home Depot's excellent customer service—the company's claim to fame and, arguably, primary source of competitive advantage—to suffer, customer satisfaction to plunge, and same-store sales growth to drop and even go negative in some years.

What happened to Home Depot is common. Many store managers at various retailers told me that the pressure to meet short-term performance targets led them to reduce employees even though they knew that the workers who remained would cut corners and make mistakes. And they suspected

that this could hurt sales and profits. Indeed, my research suggests that understaffing retail stores amounts to a missed opportunity: In my analysis of data from 1999 through 2002 from more than 250 stores of Borders, a major bookstore chain at the time, I found that a one-standard-deviation increase in labor levels at a store increased profit margins by 10% over the course of a year. Research by Marshall Fisher, Serguei Netessine, and Jayanth Krishnan supports my findings: Their analysis of 17 months of data from a large retailer shows that for every \$1 increase in payroll, a store could see a \$4 to \$28 increase in monthly sales.

Of course the relationship between staffing levels and profitability is not linear: After a certain point, increasing the former will reduce the latter. But instead of responding to short-term pressures by automatically cutting labor, stores should strive to find the

SCHEDULES

In addition to poor wages and benefits, retail employees have unpredictable work schedules.

In an effort to match staffing levels to customer traffic, retail chains schedule employees only

1 week in advance, and even those schedules can change at the last minute.

3- to 4-

hour shifts are common, and employees are often asked to be on call.

Changing shifts on such short notice can make it difficult, if not impossible, for workers to meet family commitments, perform other jobs, and arrange for child care. It also can wreak havoc on increasingly fragile family budgets.

EFFECT ON SOCIETY

Employers' underinvestment in retail employees is costly for society. Retail employees receive disproportionately more public assistance than employees in other industries. They are clearly on the losing end of the large income gap in the United States.

RETAILING'S
VICIOUS CYCLERETAILING'S
VIRTUOUS CYCLE

staffing level that maximizes profits on a sustained basis. In many cases, that will mean adding workers.

Retailers do not just underinvest in the quantity of labor. They treat the quality of labor the same way—paying low wages, offering insufficient benefits, and providing inadequate training. The short-term pressures are just too difficult to resist. The inevitable consequences are understaffed stores with high turnover of low-skilled employees who are often part-timers and have little or no commitment to their work.

The Effect on Store Operations

Let's look closer at what happens when, say, a supermarket manager cuts staffing to meet a payroll or profit target. A typical supermarket is a complex operating environment. It carries close to 39,000 SKUs, ranging from an Idaho potato to a 6.4-ounce tube of Crest fluoride anticavity toothpaste with tartar protection. The store receives multiple deliveries every day from manufacturers and its own distribution centers, and store employees shelve much of the merchandise. It has about 100 promotions a week and serves close to 2,500 customers a day. Customer traffic fluctuates throughout the day and week and on holidays, but the fluctuations are fairly predictable.

In this environment, it takes a lot of operational expertise to get the right product on the right shelf at the right time. Like most retailers, supermarkets carry more goods than they can display. So there is not only a constant unloading of deliveries but also a constant shifting of items from backrooms to the selling floor and back again. It also takes a lot of logistical effort to get the wrong product off the shelf: For example, items move to storage when promotions end. Store employees are also supposed to remove damaged or expired goods—generally more than 1% of what is on the shelves.

In my field visits, I consistently found that with so many products, promotions, and storage areas, a task that ought to be simple—such as shelving toothpaste—is not. Such a surprisingly complex operation requires something uniquely human: judgment. Poorly paid, poorly trained, and poorly motivated employees have to monitor which products have sold, decide what to keep on the selling floor and what to move to and from backrooms, and remember which backrooms contain which items.

All the while, shoppers are asking questions, which requires employees to use their judgment

to make trade-offs between dimensions of performance: Should they answer a customer's question if that keeps them from restocking a popular product? Should they go looking for something a customer can't find if that prevents them from putting up next week's promotion?

When these nitty-gritty, ongoing operational issues are handled by low-paid employees at understaffed stores, the consequences for operational execution can be severe.

Retailing's Vicious and Virtuous Cycles

Extensive research in operations management links employee turnover and poor training to poor performance, especially in manufacturing settings. The same is true in retailing. When my colleague Ananth Raman of Harvard Business School and I first started working with Borders, we found that there was a huge variation in operational performance among stores that used the same information technology and offered the same incentives to employees. The performance of the best store was a whopping 43 times better than that of the worst store. Part of this variation, we found, could be explained by labor practices. Stores in which employees had less training, greater workloads, and higher turnover performed worse.

That is not surprising. Operational execution requires people. So stores with a gap in people—too few employees or unmotivated or incapable employees—will have a gap in operational execution. But few retailers realize the seriousness of operational problems and how much money they lose by underinvesting in employees.

In grocery retail, for example, close to a third of stockouts are so-called phantom stockouts—the supply chain gets the products to the right store, but customers cannot find them because the products are in the wrong place. For a specialty retail chain we looked at, the figure was 60%. Two surveys at Borders stores showed that one out of six customers who asked a salesperson for help finding something had experienced a phantom stockout. Misplaced products obviously lead to lost sales. We estimated that the company's profits would have been 25% higher without phantom stockouts. Misplaced products also frustrate customers and reduce employees' productivity.

Underinvestment in employees also helps explain retail stores' poor compliance on agreements with manufacturers about promotions. Manufacturers spend millions of dollars planning promotions, but



a 2008 study by the In-Store Implementation Sharegroup, an industry organization, found that about half are executed either late or not at all.

Less obvious but hardly less serious is the way such problems distort point-of-sale data, which results in poor inventory and promotion planning. For example, when a customer experiences a phantom stockout, inventory records show positive inventory for the product, and point-of-sales data show that the product did not sell. The forecasting system then concludes that there is no demand and reduces the forecast of future demand, so the retailer will stock less or even none of that product. Today's operational problems affect not only today's sales and profits but also tomorrow's.

Even Walmart, the poster child of big-box retailing and supply-chain management, has struggled with these problems, which is one reason it began putting RFID tags on some merchandise. But such technologies are often an expensive way to solve people and process problems. Because labor budgets at many retail chains are set as a percentage of sales, they take a hit when sales drop. When the labor budget is low, store managers cannot increase staffing levels, even when they know it will make the store more profitable. And retail chain managers are hesitant to invest in employee training or other benefits that increase retention—and boost sales. The vicious cycle continues.

Operating in a Virtuous Cycle

When retailers view labor not as a cost to be minimized but as a driver of sales and profits, they create a virtuous cycle. Investment in employees allows for excellent operational execution, which boosts sales and profits, which allows for a larger labor budget, which results in even more investment in store employees.

I recently studied four low-price retailers that operate in a virtuous cycle: Mercadona, the largest supermarket chain in Spain, with more than 1,300 stores and €16 billion in sales; QuikTrip, a U.S. convenience store chain with more than 540 stores and \$8 billion in sales; Trader Joe's, an American supermarket chain with more than 340 stores and \$8 billion in sales; and Costco, a wholesale-club chain with more than 580 stores and \$76 billion in sales. These retailers are highly regarded by customers and industry peers. In addition to healthy sales and profit growth, they have substantially higher asset and labor productivity than their competitors.

COSTCO

MODEL PRACTICE
Dead-end jobs are the norm at most retailers, but Costco provides employees with advancement opportunities: Around 98% of store managers are promoted from within.

Sales per employee at Costco are almost double those at Sam's Club.

\$986

COSTCO
SALES PER
SQUARE FOOT

\$588

SAM'S CLUB
SALES PER
SQUARE FOOT

SOURCE COSTCO AND WALMART
2010 ANNUAL REPORTS;
WAYNE CASCIO, ACADEMY OF
MANAGEMENT PERSPECTIVES, 20(3)

Employees of these retailers have higher pay, fuller training, better benefits, and more-convenient schedules than their counterparts at the competition. Store employees earn about 40% more at Costco than at its largest competitor, Walmart's Sam's Club. At Trader Joe's, the starting wage for a full-time employee is \$40,000 to \$60,000 per year, more than twice what some competitors offer. The wages and benefits at QuikTrip are so good that the chain has been named one of *Fortune's* "100 Best Companies to Work For" every year since 2003. All of Mercadona's employees are permanent, and more than 85% are salaried full-timers.

These model retailers make an effort to provide advancement opportunities. For example, about 98% of store managers at Costco and all store managers at Mercadona, QuikTrip, and Trader Joe's are promoted from within, and many executives at these companies started out in the stores.

Not surprisingly, employee turnover is low. QuikTrip's 13% turnover rate among full-time employees is substantially lower than the 59% average rate in the top quartile of the convenience store industry. At Trader Joe's, turnover among full-time employees is less than 10%. At Mercadona, it's a mere 4%. Turnover for employees who stay at Costco for more than a year is 5.5%.

In addition to offering the lowest prices in their industries, these retailers also provide better customer service than their competitors. The University of Michigan's American Customer Satisfaction Index ranks Costco as high as Nordstrom—a department store chain known for outstanding customer service—and consistently higher than Sam's Club. QuikTrip performs better than its competitors in evaluations by mystery shoppers. Customers get in and out of QuikTrip stores quickly because merchandise is always where it is supposed to be, and employees have been trained to ring up three customers per minute (often by not having to scan merchandise and by calculating change in their heads).

American retail customers have become resigned to the notion that if they want the lowest prices, they can't expect much, if any, sales assistance. Trader Joe's and Mercadona don't accept that. Their employees constantly engage shoppers in conversation and inform them about new products. Many Mercadona employees know customers by name and can make personal recommendations. Trader Joe's employees are known for suggesting products and recipes. In fact, *Consumer Reports* ranked Trader Joe's

TRADER JOE'S

MODEL PRACTICE
The starting wage for full-time employees at Trader Joe's is \$40,000 to \$60,000 a year, more than twice what some competitors offer.

Sales per labor hour are more than 40% higher than those of an average U.S. supermarket.

TRADER JOE'S
SALES PER
SQUARE FOOT ARE
MORE THAN

3X

THOSE AT AN AVERAGE
U.S. SUPERMARKET.

as the second-best supermarket chain in the United States after Wegmans, which is known for outstanding labor practices but does not compete on the basis of low prices.

Breaking the Trade-Off

Mercadona, QuikTrip, Costco, and Trader Joe's do not expect the virtuous cycle to operate on its own. They complement their investment in employees with operational practices that make the execution of work more efficient and more fulfilling for employees, lower costs and improve service for customers, and boost sales and profits for the retailer. These practices allow retailers to break the presumed trade-off between investing in employees and maintaining low prices.

Offer less. In an effort to offer more to customers, retailers tend to make choices that increase the complexity of their operations—sometimes without realizing it. One such choice is high product variety. A typical supermarket carries myriad types and sizes of toothpaste, for example. From an operations perspective, high product variety adds costs up and down the supply chain. It increases manufacturing costs and supply-demand mismatch costs: The more types of toothpaste retailers stock, the harder it is to predict demand for any particular type and the more inventory retailers end up holding. And as I mentioned above, high product variety makes the operating environment more complex for store employees. For all that, it doesn't necessarily increase sales.

Stores also can offer too many promotions. Variations in customer demand caused by promotions and forward buying (the purchasing by retailers or wholesalers of promoted products that they hope to sell at full price, after the promotion has ended) lead to inefficiency and waste in the supply chain. Promotions also increase employees' workloads and reduce labor productivity, as we have seen.

Retailers that operate in a virtuous cycle, by contrast, make choices that simplify their operations. They consistently offer “everyday low prices” rather than a kaleidoscope of promotions, and they carry fewer products. Mercadona, for instance, carries around 8,000 SKUs and Trader Joe's and Costco only about 4,000 (compared with the supermarket industry average of approximately 39,000). Although Mercadona has positioned itself as a one-stop shop with a broad array of categories and Trader Joe's competes only in certain categories,

QUIKTRIP

MODEL PRACTICE
While most retailers try to make do with fewer workers, QuikTrip does the opposite and maintains a force of hundreds of floaters who can fill in for employees who get sick, are on vacation, or have an emergency.

QuikTrip's sales per labor hour are 66% higher than those of an average convenience store chain and 50% higher than those of the top quartile convenience store chain.

\$804

QUIKTRIP
SALES PER
SQUARE FOOT

\$522

AVERAGE
CONVENIENCE
STORE CHAIN
SALES PER
SQUARE FOOT

\$719

TOP QUARTILE
CONVENIENCE
STORE CHAIN
SALES PER
SQUARE FOOT

ries, both offer fewer choices within their chosen categories than rivals do. QuikTrip offers only high-demand products.

Do customers mind limited options? Sales per square foot at these stores suggest that they do not.

With fewer products, employees can be familiar with everything the store sells and make knowledgeable recommendations to customers. Trader Joe's is famous for this. At Mercadona stores, each section is managed by a specialist who will gladly explain to shoppers why Mercadona does or does not carry particular products. This is one reason the company felt it could further reduce product variety to cope with the recent economic crisis. Its confidence was borne out: Sales went up because simplifying operational execution allowed Mercadona to reduce prices even more and allowed employees to explain to customers why they were getting a better deal.

Achieve flexibility by cross-training employees. At retail chains that operate in a vicious cycle, changes in customer traffic lead to changes in the number of employees. These retailers follow what Harvard Business School's W. Earl Sasser Jr. dubbed a “chase-demand strategy” in a November 1976 HBR article, “Match Supply and Demand in Service Industries.” But although fluctuations in customer traffic tend to be fairly predictable (at one retailer, I found that more than 90% could be explained by day of the week, time of day, weather, and holidays), employees' schedules are not. Workers get very short notice of changes and are often asked to shorten their shifts.

A lot of retailers consider this to be an efficient approach but do not take into account its true costs. Home Depot's “flexible” approach in the early 2000s involved replacing knowledgeable full-time employees with part-timers who did not know as much about home improvement and the store's products and so could not help customers effectively.

Not surprisingly, I found that unpredictable schedules, short shifts, and dead-end jobs take a toll on employees' morale. When morale is low, absenteeism, tardiness, and turnover rise, increasing the variability of the labor supply, which, of course, makes matching labor with customer traffic more difficult. In addition, retailers with high turnover cannot afford to invest in employee training; average training per new retail employee is a mere seven hours in the United States. Untrained or poorly trained employees are less productive and make more errors.

MERCADONA

MODEL PRACTICE
Most retailers inflict unpredictable schedules on their employees, but Mercadona trains workers in a variety of tasks (managing a section, performing inventory checks, ordering merchandise, replenishing products) so that they can vary what they do with changes in customer traffic.

Mercadona's sales per employee are 18% higher than those of other Spanish supermarkets and 46% higher than those of an average U.S. supermarket in 2008.

~\$1,250

MERCADONA
SALES PER
SQUARE FOOT

\$800

CARREFOUR
SALES PER
SQUARE FOOT

Instead of varying the number of employees to match traffic as much as other retailers do, QuikTrip and Mercadona vary what employees do. They achieve this by training employees to perform a variety of tasks. At QuikTrip, part-time employees receive 40 hours of training and full-time employees receive two weeks—not just in checking out customers but also in brewing coffee, ordering merchandise, sweeping floors and the parking lot, cleaning bathrooms, and stocking coolers, freezers, and grills. At Mercadona, every new employee receives four weeks of training, during which they learn how to manage a particular section (meat or cosmetics, for example), perform inventory checks (for data accuracy), order merchandise, replenish products from backrooms, and check for product defects or other problems. When customer traffic is high, employees at QuikTrip and Mercadona focus on customer-related tasks; when traffic is low, they focus on other tasks. QuikTrip employees also can move from one store to another, because all stores have the same design.

As a result of this cross-training, employees have more-predictable schedules and are always busy (that is, more productive), and customers get faster service from more-knowledgeable employees.

Eliminate waste in everything but staffing.

Retailers that invest in employees are by no means easygoing about what people do. Rather, they are obsessed with eliminating waste and improving efficiency. At Costco stores, products are shelved on pallets, which eliminates the need to unload and shelve them. At Trader Joe's, many perishable products are sold already packaged instead of loose, which speeds up checkout. Costco and Trader Joe's also work hard to eliminate waste in the supply chain—by, for example, purchasing most products directly from manufacturers and moving them to retail stores via their own highly efficient distribution centers.

QuikTrip and Mercadona apply world-class manufacturing practices to their store operations. Every in-store logistics process—from receiving merchandise to moving products within the store—is timed and standardized, and compliance with the standards is constantly monitored. Employee feedback is incorporated into process design and improvement. At QuikTrip, employees from every position regularly discuss problems and identify opportunities for improvement. At Mercadona, managers at headquarters in charge of specific processes routinely visit stores and talk to employees. The company

also has field employees whose main job is to relay employee and customer feedback to purchasing and marketing departments.

In contrast to retailers that constantly strive to make do with fewer employees, retailers that operate in a virtuous cycle often err on the side of overstaffing. They want to make sure that employees are not too rushed to serve customers well and finish their logistics tasks. QuikTrip goes even further, maintaining a force of hundreds of employees who do not report to a specific store but are ready to fill in for people who get sick, take a vacation, or have an emergency.

Let employees make small decisions. In most retail stores, merchandise planning is centralized and only managers can make decisions about product returns and customer complaints. But at companies that operate in a virtuous cycle, employees constantly make decisions. QuikTrip, Trader Joe's, and Mercadona employees decide how many units of each item to order for their stores. How can large chains trust thousands of people to make inventory decisions? Every decision is small, corporate IT is designed to assist, and the decisions are monitored. Because empowering employees in these ways makes companies more responsive to local needs and preferences, it increases customer as well as employee satisfaction.

We've Seen This Before

Several decades ago, there was an intense debate about whether it was possible for low-cost products to be high quality. Many academics and practitioners argued that investing in quality would increase costs. But some companies, starting with Toyota, showed that this was a false trade-off: Investing in people and processes actually drove quality up and costs down.

Today many retail managers believe that there is a trade-off between investing in employees and offering the lowest prices. That, too, is false. Retailers that persist in believing in it forgo the opportunity to improve their own performance and contribute the kind of jobs the U.S. economy urgently needs. When backed up with a specific set of operating practices, investing in employees can boost customer experience and decrease costs. Companies can compete successfully on the basis of low prices and simultaneously keep their customers and employees happy. ▀



Harvard Business Review Notice of Use Restrictions, May 2009

Harvard Business Review and Harvard Business Publishing Newsletter content on EBSCOhost is licensed for the private individual use of authorized EBSCOhost users. It is not intended for use as assigned course material in academic institutions nor as corporate learning or training materials in businesses. Academic licensees may not use this content in electronic reserves, electronic course packs, persistent linking from syllabi or by any other means of incorporating the content into course resources. Business licensees may not host this content on learning management systems or use persistent linking or other means to incorporate the content into learning management systems. Harvard Business Publishing will be pleased to grant permission to make this content available through such means. For rates and permission, contact permissions@harvardbusiness.org.