Zappos.com: Focus on Customer Service

This case was written by V. Namratha Prasad, under the direction of S.S. George, ICMR Center for Management Research. It was compiled from published sources, and is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of a management situation.

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“Our whole philosophy is rather than spend a whole lot of money in marketing let’s just put it back into the customer experience and let our customers generate that word of mouth and do the marketing for us.”

- Fred Mossler, Director of Merchandising at Zappos in 2008.

“Zappos has built a dot-com model specifically for dot-com and have invested a great deal of time, money and effort into combining superior shoe business knowledge with a great supply chain, business process, and retail policy.”

- Gene Alvarez, Vice President of Research at Gartner in 2008.

INTRODUCTION

In January 2009, Zappos.com, Inc. (Zappos), the market leader in online shoe sales in the US, appeared for the first time on Fortune Magazine’s ‘100 Best Companies to Work For’ list, figuring at No. 23 in the list for 2009. Jeffrey M. O’Brien, Senior Editor, Fortune Magazine, said, “Zappos is adored by employees, providing a model of how to manicure culture and treat staffers like adults, while simultaneously reassuring them that sometimes it’s okay to behave like children.”

Zappos was founded in 1999, at a time when there were few online shoe retailers. The company grew over the years, mainly by offering several customer-friendly services that other online shoe retailers did not provide such as free shipping and a generous return policy. Some of these services were offered at a considerable cost to the company. Moreover, Zappos ensured that customer service was ingrained in the company’s culture.

Strategic business decisions at the company, including the decisions to shift both its headquarters and warehouse to other locations, were always taken keeping in mind the objective of customer service. HR activities like hiring, firing, and performance evaluation were also carried out with a view to enhance its customer service. Zappos urged its customer service reps to be friendly and helpful to customers, even going to the extent of advising them to direct customers to competitors’ websites if a particular product was not available with the company.

Zappos claimed that it put in as much effort into customer service as other companies put into marketing. According to the company, it got most of its customers through word of mouth marketing, and its employees, who offered superior customer service, were the people most capable of creating a positive buzz about the company. Zappos even used media like blogs and social networking sites like Twitter to reach out to customers.

In 2003, in addition to shoes, Zappos began selling handbags, watches, and apparel. During the period 1999-2008, it was one of the fastest growing online retailers in the world. The company’s unique approach to selling shoes online resulted in its sales rising to US$ 1 billion in 2008, from almost nil in 1999.

However, in November 2008, faced with the recession in the US, the company decided to lay-off of about 125 employees. The CEO of Zappos, Tony Hsieh (Hsieh), gave a long explanation for the lay-offs on the company blog and the social networking site Twitter. He said that it was a proactive step to keep the company’s financial position sound, in light of the poor economic conditions in the US.

BACKGROUND NOTE

In 1999, Nick Swinmurn (Swinmurn), who was working as a webmaster for Silicon Graphics, was disappointed and frustrated when he could not find a pair of Vans shoes in the style, color, and size that he was looking for, while out shopping at a mall in San Francisco. He then unsuccessfully tried to buy the shoes online. However, he discovered that while there were a number of small stores selling shoes online, there were no major online shoe retailers.

Swinmurn immediately saw the business opportunity in this. He said later, “I’d worn Van’s my whole life and they just happened not to carry this certain style any more. And I started thinking that if what happened to me was a common experience, there might be a business in trying to solve it.”

In 1999, the footwear industry was worth around US$ 40 billion, and about 5% of the sales were through mail order catalogs. Swinmurn estimated that the online shoe business would be worth more than US$ 2 billion. He decided to quit his day job and start an online shoe retailing business.

By June 1999, he managed to raise US$ 150,000 in initial capital from friends and family. In July 1999, the website shoesite.com was launched. Swinmurn entered into a tie-up with a few small shoe stores in his neighborhood to provide him with the shoes to sell online.

In an effort to expand the business, Swinmurn decided to seek venture capital funding. However, he was turned down by most of the venture capital (VC) firms that he approached, because conventional wisdom had it that shoes could not be sold online, as no one would buy shoes without trying them on first. Finally, Swinmurn managed to get the attention of Venture Frogs, a VC firm founded by Hsieh and Alfred Lin (Lin). Hsieh had earlier set up a company called LinkExchange, which was sold to Microsoft Corp. for US$ 265 million in 1998. Lin used to work as the finance head at LinkExchange.

In 2000, Venture Frogs invested US$ 1.1 million in the business. In addition, Hsieh joined as co-CEO of the company, while Lin joined as CFO. The company was later renamed as Zappos.com, Inc. The name was loosely based on zapatos, the Spanish word for shoes. Later, Hsieh invested some of his own personal funds in the company, and the company managed to gain access to credit from banks, which helped fund its expansion plans.

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4 Silicon Graphics, founded in 1982 by Jim Clark and Abbey Silverstone, is a company providing a range of computing solutions for data storage and security.

5 Vans, founded in 1966, is a manufacturer of shoes and is based in California, US. It makes shoes mostly for surfing, skating, and trekking.


7 Swinmurn graduated from college in 1996. Then he worked as a group-ticket salesperson for the San Diego Padres of Major League Baseball. In 1997, he was working as a sales manager for a successful online automotive retailer called autoweb.com. In 1998, he joined Silicon Graphics and worked as a webmaster.

8 LinkExchange was formed in 1996, by Harvard graduates Tony Hsieh and Sanjay Madan. It was a web based advertising co-operative, wherein members displayed ads on other member’s website through links. It was acquired by Microsoft in 1998.

9 Microsoft is the world’s largest software company based on software sales revenues. It also has a presence in the fields of computer hardware development and video games.
In 2003, in addition to shoes, Zappos also began selling handbags, clothing items, and other accessories. In October 2004, Sequoia Capital (Sequoia)\textsuperscript{10} made an initial investment of US$ 20 million in Zappos. In June 2005, Sequoia invested a further US$ 15 million in the business. In 2006, Swinmurn left the company to form STAGR, a website dedicated to selling customized apparel.

Zappos began to turn a profit from 2006. Lin said, “After breaking even during its first six years, [Zappos] did post profits in 2006 and 2007.”\textsuperscript{11} During the period 2001-2008, Zappos became one of the fastest growing online shopping sites and enjoyed an astonishing growth in sales year-by-year (See Exhibit I for Sales Figures of Zappos). As of 2008, Zappos was the largest online shoe retailer in the world, offering over 1,000 brands of shoes in over 150,000 styles.

THE IMPORTANCE OF CUSTOMER SERVICE

According to Swinmurn and Hsieh, the Zappos website was originally conceived as a site that offered a large selection of shoes in terms of brands, styles, colors, sizes, and widths. However, they discovered soon enough that providing a large selection was not easy, as most shoe manufacturers were reluctant to work with a small company that sold shoes online, due in part to concerns about the effect of such an association on their brand image. Swinmurn and Hsieh realized that it would take them a long time to build a reputation, attract shoe manufacturers, secure inventory, and build up a large selection.

As expected, they also found that selling shoes online was extremely difficult, as most people preferred to avoid the hassle of ordering and then having to return the shoes because of bad fit. This meant that the website had to offer services that would help customers overcome their reluctance to purchase shoes online.

Swinmurn and Hsieh began by renaming the website Zappos.com. This was a somewhat risky course of action, as it was unlikely that most people would know what the name meant, or associate the word ‘Zappos’ with shoes. However, they felt that the name would help them build a brand around customer service rather than just shoes, and this would make it easier for them to offer a larger variety of product categories on the website in future. Hsieh said, “If we can get customers to associate the Zappos brand with the absolute best service, then we can expand into other product categories beyond shoes.”\textsuperscript{12} (See Exhibit II for the logo of Zappos).

Zappos started out offering several customer-friendly services, and continued to add more such services over the years. Many of these services had never been offered before in the online shoe market. For example, Zappos offered free shipping and allowed the customers to return the shoes if they were not satisfied with their purchases for any reason. In such cases, the return shipping expenses were borne by the company. Moreover, Zappos credited the customers’ accounts while the returned goods were still in transit.

About their customer services, Hsieh said, “It’s free shipping both ways. We have a 365-day return policy. We promise customers that they’re going to get their shoes in four to five business days, but actually, for almost all of our customers, we do a surprise upgrade to overnight shipping.”\textsuperscript{13}

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\textsuperscript{10} Sequoia founded in 1972 by Don Valentine, is a venture capital firm that mainly funds technology startups. Some of the companies it has funded include Cisco Systems, Oracle, and Apple.


These services, especially the generous return policies, encouraged more people to purchase shoes from Zappos, as they could now easily reverse an unsatisfactory transaction. Zappos also claimed to offer its customers the lowest prices for the products it sold. The company offered a price-protection policy wherein it guaranteed that it would refund 110% of the difference between its price and any lower price offered by a competitor.

The cost of many of these services was significant – for example, free shipping was a major drain on revenues. However, according to Hsieh, the company viewed the cost of providing these services as a long-term investment rather than as an expense.

Although Zappos initially offered discounts and e-coupons, it decided to drop these when it discovered that they tended to attract price-minded, one-time customers instead of brand loyalists. Hsieh said, “In terms of the three major areas – service, selection and price – you can really only offer two of them at the same time. Our brand [niche] was in service and selection.”

With these services, Zappos could compete with brick-and-mortar shoe retailers as well. It believed that offering these services narrowed the “convenience gap” between buying shoes online and buying them at a store. Swinmurn said, “What we’re trying to do is bridge the gap between the experiences.”

Zappos also had pictures of each shoe it sold, in all the colors it offered and taken from six different camera angles. Swinmurn said, “Whether in a brick-and-mortar store or online, customers want the same things: a large selection, the ability to view the merchandise properly, quick and courteous service when shopping or returning, and having their new shoes on their feet as quickly as possible.”

To answer customer enquiries, Zappos provided a toll-free customer service number that was available 24/7 – a first in the online retail industry. It also had a customer service team to answer every e-mail that was received. In January 2004, to further improve its customer service and find better talent, the Zappos headquarters was moved from San Francisco to Las Vegas. Hsieh said, “We were having a hard time finding good customer service people in San Francisco. Las Vegas has a lot of call centers and lots of people who want to do customer service as a career.”

The customer service numbers were displayed on every page of the Zappos website, and great care was taken to ensure that the customer service reps were courteous and helpful. Hsieh said, “You have them on the phone for 5 to 10 minutes and that’s something they’ll remember the rest of their lives, if you do it well.”

The customer service reps’ responses were not scripted, and there were no time limits on the length of calls. The reps were also given enough flexibility to respond to each customer. Hsieh said, “Most call centers have this concept of average handle time, which is all about how many customers a day each agent can talk to – and the more the better. But that just ends up translating into, “How quickly can we get the customer off the phone?” which we don’t think is great customer service.”

The customer service reps could even redirect customers to other websites, if they failed to find any item on Zappos.com. Hsieh said, “We don’t up sell the customers. Everyone is trained so that if their customer is looking for a specific pair of shoes, and we are out of stock in their size, then...”

they look at three other competitor websites. If they find that shoe in stock, they are supposed to direct the customer to that website. Every call was also rated on how helpful the customer service rep had been to the customer.

**CULTURE AND HR POLICIES**

According to Hsieh, the best way to offer a better customer experience was by investing in developing a company culture with an almost fanatical emphasis on customer service. He observed that ‘Zappos was a service company that just happens to sell shoes.’ He believed that while it would be easy for competitors to copy services like free shipping and free returns, it would be difficult to imitate its culture, and this could serve as a major competitive advantage.

Hsieh listed ten core values to be adopted for building a customer service-focused culture at Zappos (See Table I for the ten core values).

### Table I

<table>
<thead>
<tr>
<th></th>
<th>Ten Core Values for Building a Service-Focused Culture</th>
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<tbody>
<tr>
<td>1</td>
<td>Deliver ‘WOW’ through service.</td>
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<tr>
<td>2</td>
<td>Embrace and drive change.</td>
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<tr>
<td>3</td>
<td>Create fun and a little weirdness.</td>
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<tr>
<td>4</td>
<td>Be adventurous, creative, and open-minded.</td>
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<tr>
<td>5</td>
<td>Pursue growth and learning.</td>
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<td>6</td>
<td>Build open and honest relationships with communication.</td>
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<tr>
<td>7</td>
<td>Build a positive team and family spirit.</td>
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<tr>
<td>8</td>
<td>Do more with less.</td>
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<tr>
<td>9</td>
<td>Be passionate and determined.</td>
</tr>
<tr>
<td>10</td>
<td>Be humble.</td>
</tr>
</tbody>
</table>


According to Hsieh, all critical HR actions like hiring, firing, and evaluating performance were done with an eye on enhancing the customer service culture of the company. Hsieh said, “We make it (culture) part of the hiring process and we actually fire people if they’re not living up to the Zappos core values even if they’re doing their job function. It’s 50 percent of every performance review.” Potential recruits were put through a tough two-part interview to discern if their skills were up to the mark and if they were a ‘culture fit.’ All prospective candidates were carefully screened to ensure that their core values matched with those of the company. All new hires, irrespective of department, then had to spend five weeks in ‘Customer Loyalty’ training. Talking about the training, Hsieh said, “We go over company history, our philosophy about customer service, and the importance of company culture, which is actually our No. 1 focus for the company (not customer service).”

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During the five-week training period, the recruits had to work in the company’s call center, and later the warehouse, where they had to learn about the shipping process. After the first week of training, the new hires were offered US$ 1000 (later increased to US$ 2000) to leave the company if they felt that they did not fit in with the company culture. Zappos’s ‘offer’ to new hires was, “If you quit today, we will pay you for the amount of time you have worked, plus a US$ 2,000 bonus.” Around 2-3% of the new hires usually took the money and left.

This was considered an inexpensive way of getting rid of people who did not see eye to eye with its customer service principles and to have more committed people on the payroll. Hsieh said that this also ensured that each employee thought that he/she had a stake in the company culture.

Analysts commended Zappos’s commitment to company culture. Keith McFarland of McFarland Strategy Partners, said, “The ‘Offer’ suggests a rare company that believes if you really want to amaze your customers, a great way to start is to amaze your employees and inspire them to amaze everyone who comes in contact with your enterprise. Zappos is forcing itself to do a good job filtering people on the front end, and creating a place where people want to work.”

Zappos also encouraged its managers to spend time with their teams outside the office, in order to improve communication and trust at the workplace. Other unique practices designed to raise employee morale included birthday parades and nap times. Every year, Zappos also released a 300-page ‘culture’ book that carried stories and testimonials from their employees and other partners about working with the company.

A large part of Zappos’s sales was driven by word of mouth, and the way the employees dealt with customers was a major factor in creating a positive brand image. Brian Kalma (Kalma), Director of Creative Services/Brand Management, said, “We put as much energy in planning and training our employees as other companies do planning their media. That allows us to feel more comfortable having every single employee be a direct contact with the customer. Every person is an advertising vehicle; with thousands of phone calls a day, multiplied by 365, those are a huge amount of touch points with our customers.”

THE USE OF TWITTER

Zappos also connected with its customers through social media like blogs and social networking sites. It was also one of the first companies in the US to use social media extensively for this purpose.

In 2007, Hsieh started using Twitter, the social networking and micro-blogging service (See Exhibit III for more information on Twitter), where users could send each other text-based messages called ‘tweets’. By late 2007, Hsieh had around 10,000 followers, or people who regularly read his messages. In addition, he encouraged his employees also to use Twitter.

Later, the subdomain Twitter.Zappos.com was added to the Zappos website, and linked to all the other pages on the website using the phrase ‘What are Zappos employees doing right now?’. The Twitter page on the Zappos website contained information on all the tweets about the company, by customers as well as employees. In addition, it also contained a list of all Zappos Twitterers and the ranking of people at Zappos according to the number of their followers. Kalma said, “We can’t ignore that free, high-impact employee-generated media affects the broader media mix.”

Zappos encouraged employees to use Twitter as a means to promote transparency, and to reach out to customers in a friendly way. Hsieh said, “We just think Twitter is a great way to connect more deeply and personally with our customers. We’re having fun with Twitter and would do it even if there was zero marketing benefit.”

Twitter enabled Zappos employees to respond quickly to any enquiries from customers. It also provided the capability to keep a tab on all exchanges around any search term. Hsieh used the feature to keep track of all the tweets about Zappos. This helped address customer service issues faster, and facilitated more effective damage control if something happened to go wrong with an order.

Twitter was used to market Zappos products and it provided insights into market developments. It was also used as a recruitment tool to get in touch with prospective employees who knew and appreciated Zappos’s core values. Christa Foley, Recruiting Manager for Zappos, said, “A hire from Twitter is a nice bonus and we actively cultivate that relationship. It allows us get the word out that Zappos is a really great place to work and we interact with them in a way that brings the Zappos story to life.” The use of Twitter was included in the new recruits’ orientation program as well.

Zappos also maintained a company blog, did video blogging through Zappos TV on YouTube, and had a presence on the social networking sites Facebook and MySpace.

ORDER FULFILLMENT

In 2002, Hsieh shifted Zappos’s order fulfillment operations from a 30,000-square foot warehouse in California to a 280,000-square foot warehouse in Kentucky. In addition to increasing the space available, the shift was done to ensure faster delivery. This was possible as the United Parcel Service’s (UPS) largest domestic shipping hub was only 20 miles away from the new location. The new warehouse was also more centrally located in the US, with two-thirds of the nation’s population being within a radius of 600 miles.

At conventional shoe stores, about one potential sale in three would be lost due to the customer’s shoe size not being in stock. Online retailers, however, could use the time available between the order and the actual delivery to get a particular product from outside, if it was not in stock. Zappos did not have this luxury, as it tried to ensure that all ordered products were immediately shipped to the customer. Therefore, it had to stock most of the items it sold.

However, until 2003, Zappos followed a process called ‘drop-shipping’, wherein it did not stock all the shoes it displayed on its website; instead, it maintained only 80%-90% of the items in stock. For the rest of the products, it transferred customer orders to a wholesaler or the manufacturer, who then delivered the product to the customer. Hsieh said drop-shipped products accounted for 25% of the company’s revenue. However, this process caused delivery delays for customers. Zappos found out that the transfer of data from retailer-to-manufacturer-to-fulfillment center was lengthening the order fulfillment process. Hsieh said, “That means 10%-20% of our customers were finding out a couple days later that their item was out of stock, and they’d be extremely upset, creating a lot of negative word of mouth.”

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30 Zappos TV showed employees having fun at the workplace and also had the company’s ads shown on TV.
31 UPS is one of the world’s largest package delivery companies. In 2008, it had revenues of US$ 51.6 billion and delivered packages to almost 200 countries around the world.
32 ‘Drop shipping’ is a supply chain management technique in which a retailer does not maintain any goods in stock, but instead transfers customer orders to a manufacturer or wholesaler who ships it to the customer. The retailer actually earns a profit on the differences between the wholesale and retail price. In addition, the retailer saves the costs for storing the inventory.
In 2003, Zappos took what it claimed to be one its toughest business decisions, when it ended ‘drop shipping’ of shoes. Hsieh said, “Drop-shipped orders were producing 25% of our revenue, and we walked away from it because we knew it was important to be true to our brand.” At the same time, Zappos also took steps to ensure that all its displayed products were available in stock at its warehouse.

These steps gave Zappos better control over its order fulfillment process, as it did not have to wait for a product to arrive from a vendor before shipping it to the customer; neither were its product offerings subject to availability from a manufacturer. It achieved the capability to ship any product as soon as the payment transaction was completed successfully. As of 2008, Zappos claimed to have 100% of the goods displayed on its website in its inventory, which included four million items, consisting mostly of shoes from almost 1000 brands. Zappos also claimed to have a delivery accuracy rate of 99%.

The Zappos warehouse in Kentucky worked round the clock. Customers could place an order as late as 11 p.m., and still be eligible for overnight shipping. Hsieh said, “We run our warehouse 24/7, which isn’t the most efficient way to run a warehouse, but it gets the orders out to customers as quickly as possible.”

In 2008, Zappos also installed the Kiva Mobile Fulfillment System in its warehouse. The mobile robotic units that were installed as part of this system picked up and moved pallets and cases containing the ordered items. Hsieh said, “We’re always looking at ways to improve our efficiencies in the warehouse, but probably none of them are as ‘cool’ as the Kiva robots.”

OTHER STRATEGIES

In its initial stages, Zappos did some offline advertising to develop its brand image and to attract shoe manufacturers. Most of the advertising was aimed at suppliers rather than customers. Over time, after it had won over the suppliers, it shifted the focus of its advertising to customers. Initially, Zappos spent heavily on advertising (through online ads) and even purchased costly sports stadium signage to create general brand awareness. However, the company soon realized that this approach did not bring in enough customers.

Zappos then began using more cost-effective online marketing techniques, like Search Engine Marketing (SEM). It discovered that shoes were a great product for SEM for various reasons. One was that people tended to conduct online searches for shoes by brand name. This meant that the company did not have to spend on advertising to build the Zappos brand name, but only needed the prospective customers to click on an ad for a particular shoe brand to be directed to its site. In addition, the margins that could be earned on shoes — especially on high priced ones — were good. The average order size for repeat customers was about US$ 140, compared to about US$ 110 for first-time customers. The gross margins Zappos earned on shoes was around 50%. This ensured that the company had enough money to invest in SEM campaigns and its customer service initiatives.

36 With the Kiva Mobile Fulfillment System, products are stored in inventory pods at the center of the warehouse while operators stand at inventory stations around the perimeter. When an order is received, robotic drive units retrieve the appropriate pods and bring them to a worker, who picks out the appropriate item and places it in the carton for shipping.
38 SEM is a form of internet marketing that is used by online retailers to increase their visibility in search engine results pages. It includes various options like paid inclusions, paid placements and even contextual advertising on other websites. It also includes Search Engine Optimization (SEO). SEO is the use of algorithmic search results to increase the volume and quality of traffic to a web site from search engines.
Zappos also used affiliates, whom it called ‘associates’, to direct web traffic to its site. The company paid a generous commission to the affiliates for sending in first-time customers. As of 2007, Zappos had about 17,000 affiliates (see Exhibit IV for an analysis of Zappos’ affiliate program).

Zappos provided data to about 1,200 of its vendors to enable them to have an idea about their product sales. The company provided vendors with login information to access company data and see what shoes were selling, the inventory levels, and the markdowns done. Tom Austin, who managed the California and Nevada territories for Clarks Companies 39, North America, said, “I can see my business from their point of view.”

Zappos also sent the Zappos Daily Shoe Digest, an e-mail discussion list that contained various questions for discussions regarding shoes, out to its customers. The customers were asked to send their answers to an e-mail address and the best answers were selected and posted in the next issue of the digest. This was considered an inexpensive method to reach out to customers and was sent out three times a week. Adam Audette, SEO Manager, Zappos, said, “The number of subscribers has been growing at 8% year over year. It is not salesy, it provides us with tons of content, and it’s a long-term play that we are very happy with. It has an invaluable aspect of giving back and getting that personal connection. It generates its own buzz at the same time.”

Zappos invited shoe manufacturers to work with it as ‘partners’. Zappos offered its partners a service called ‘Powered by Zappos.’ As part of this service, it proposed to design, host, fulfill orders, and even own a partner’s website. Zappos also offered to provide customer service, including post-sales support, to its partners’ customers. Analysts considered this a very smart method to get possible competitors to work with Zappos.

Zappos also took many measures to bolster its public image. In 2007, the company was voted the best vegan shoe retailer by PETA 42 for its wide selection of leather-free shoes and for not carrying any products made of animal fur. Guided tours of Zappos’s Las Vegas office were offered to the public, if they wanted to learn more about the order fulfillment and delivery process at the company. Transparency was an important component of Zappos’s corporate culture and a valuable marketing tool.

In 2008, Zappos worked with Google Inc. to develop an efficient and highly customized search function on its new website called zeta.zappos.com. Zappos used a tool called Google Product Search to increase traffic to its website. Gene Alvarez, Vice President of Research at Gartner, said, “Zappos does have excellent search capabilities. Tabs allow quick and easy search narrowing and a simple click brings the precise product in front of the customer quickly.”

In 2008, Zappos began to advertise on TV. Hsieh said, “We found that a lot of people still have not heard of Zappos. We actually spend most of our paid advertising dollars online and we’ve found that when done together, TV helps improve the effectiveness of our online efforts.”

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39 Clarks Companies N.A. is a retailer and wholesaler of the brands Clarks England and Boston, in North America. The company was established in England in the 1900s. The company sells shoes in North America, Canada, the Caribbean, Central and South America.

40 “A Shine on Their Shoes,” www.businessweek.com, December 05, 2005.


42 People for the Ethical Treatment of Animals (PETA), founded in 1980 in the US is the largest animal rights group in the world, with about two million members. PETA takes action to provide protection to animals mostly in factory farms, labs, the clothing trade, and the entertainment industry.


In February 2008, Zappos changed some of its pricing and advertising policies. It removed the price-protection policy, wherein it had guaranteed that it would refund 110% of the difference between its prices and any lower price charged by a competitor. According to the company, the policy was inconsistent with its aim of making Zappos customer service-focused, as opposed to price-focused.

Zappos instead created a new website called 6pm.com to sell highly discounted products. At 6pm.com, Zappos did not offer services like free shipping both ways, and the return time was limited to 30 days. However, it claimed that the cost savings from these measures would be used to give discounts of up to 75%.

Zappos also decided to stop advertising free overnight shipping. In his blog, Hsieh said, “This means that the vast majority of our customers will still get their orders as quickly as they used to (usually overnight). The only difference is that we made the decision to not advertise or promise it, because we found that our customers were happier when they were surprised by the fast shipping.”

THE GROWTH OF ZAPPOS

Within a few years of its launch, Zappos became one of the largest shoe stores in the world, offering shoes in a wide range of designs and sizes. Miles Olson, an independent sales representative for Simple Shoes and UGG Australia, said, “The [footwear] industry was in shock when they found out the numbers Zappos is doing and how popular they are.” Zappos was featured in the list of the 500 fastest-growing private companies in the U.S. compiled by Inc. Magazine, for the years 2004, 2005, 2006, 2007. In 2006, it was one of Time Magazine’s ‘25 Sites You Can’t Live Without.’

Industry observers noted that when compared to other online retailers, Zappos spent very little on offline advertising. Print advertising accounted for just 15% of its media spend. Zappos claimed to have gained over 80% of its customers either through word of mouth or through online advertising. Hsieh said, “The primary driver of our growth has been repeat customers and word of mouth. We focus the company on providing the absolute best service and shopping experience and let word of mouth be our marketing. By doing so, we’ve historically been able to more than double sales year over year.”

Over the years, Zappos came to be one of the largest online retailers in the world. As of 2008, the company was ranked No. 27 on Internet Retailer Top 500 Guide released by Internet Retailer. (See Exhibit V for a list of the top 10 Internet retailers). Zappos also won Shopzilla’s Circle of Excellence Award five times.

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46 “A Shine on Their Shoes,” www.businessweek.com, December 05, 2005.
47 Founded in 1979, it is managed by Mansueto Ventures, LLC. It generally publishes articles in HR, technology, finance, sales, and marketing.
49 The Top 500 Guide covers the online retail industry providing data about growth, revenues, etc. The Internet Retailer is a US-based e-commerce magazine that publishes articles on internet marketing, online supply chain initiatives, online retail technology, and online retail industry issues and trends.
50 Shopzilla, earlier called BizRate.com was formed in 1996. It offers price comparison services.
51 Retailers needed to participate in the BizRate Research Customer Certified Merchant Program in order to qualify for the award. As part of this program, online buyers were asked to complete surveys to be completed at the point-of-sale and after delivery of goods.
Industry analysts praised the efforts of Zappos to provide superior customer service. For example, Pete Blackshaw, co-founder of the Word of Mouth Marketing Association (WOMMA), highlighted the superiority of Zappos’s customer service, in a table comparing it with other brands (See Table II below).

### Table II

**Comparison of Zappos Customer Service with Other Brands**

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<thead>
<tr>
<th>Key Variable</th>
<th>Typical Brand</th>
<th>Zappos</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service as marketing</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Toll-free number</td>
<td>Hidden</td>
<td>Written on forehead</td>
</tr>
<tr>
<td>Invitation to interact</td>
<td>Hard to find</td>
<td>Everywhere</td>
</tr>
<tr>
<td>Openness to talk</td>
<td>The clock is ticking; get lost</td>
<td>Stick around; let’s chat</td>
</tr>
<tr>
<td>Toll-free number hours</td>
<td>9:00 a.m.-5:00 p.m.</td>
<td>24/7</td>
</tr>
<tr>
<td>Outsourcing</td>
<td>Common</td>
<td>Unthinkable</td>
</tr>
<tr>
<td>Employees as advocates</td>
<td>Medium</td>
<td>Off the charts</td>
</tr>
<tr>
<td>Traditional media spend</td>
<td>High</td>
<td>Low</td>
</tr>
</tbody>
</table>


On any particular day, repeat customers accounted for 75% of Zappos’s orders. The company claimed that repeat customers had higher average order sizes and they made purchases 2.5 times a year. As of 2008, the online footwear market in the US was estimated to be worth US$ 3 billion, and Zappos, the market leader, had a one-fifth share. As of January 2009, Zappos claimed to have a customer base of nine million.

**CHALLENGES**

Some analysts felt that Zappos’s decision to drop competitive pricing would lead to a drop in sales. They felt that customers would be reluctant to pay a premium only for customer service, particularly when buying branded products. According to them, customers who wanted good service could always go to a shoe store, and while buying online, they would be more likely to use any extra money to go in for a better brand. Moreover, they felt that selling through two different websites would dilute Zappos’s brand image.

Some analysts interpreted Zappos’s claim that 75% of its customers were repeat buyers to mean that it had saturated its market, and was finding it tough to get new customers.

The decision to eliminate drop-shipping and keep all products in stock was also not considered to be cost efficient, as it tied up the company’s cash in inventory. Free shipping was also thought to be a heavy drain on resources. In 2007, free shipping cost Zappos US$ 100 million. These were thought to be the reasons why Zappos became profitable only by 2006.

Zappos also faced a very high return rate — it was almost three times the return rate at brick-and-mortar stores. Hsieh said, “For some brands, the return rate might be 20 percent; other brands might be 40 percent. The more expensive shoes are most likely to be returned.”

Over time, the number of websites selling shoes kept increasing. However, none of them proved to be much of a competition for Zappos. Zappos believed that exceptional customer service and a wide collection of shoes were the major reasons for its success. Swinmurn said, “It has taken us a long time to get some brands on board, and it would take someone else a long time to duplicate...

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that work." However, analysts felt that Zappos needed to remain alert to the threat from new entrants to the fast growing online shoe market, like endless.com, shoebuy.com, piperlime.com, etc., who offered similar services. (See Exhibit VI for more information on the competition).

OUTLOOK

Zappos’ sales crossed US$ 840 million in 2007, prompting the company to bring forward its goal of achieving annual sales of US$ 1 billion, from the year 2010 to the year 2008. In mid-2008, Hsieh said, “Back in 2003, we had set the goal of hitting US$ 1 billion by 2010, so we’re very excited that we’re on track to hit the US$ 1 billion milestone ahead of our original goal.”

Zappos also opened a Canadian website, canada.zappos.com. As of 2008, Zappos operated four different websites — couture.zappos.com, running.zappos.com, outdoor.zappos.com, and rideshop.zappos.com. Each of these websites had its own customer service number and specialized staff. As of 2008, in addition to shoes, Zappos sold handbags, clothing, eyewear, watches, and other articles like cookware and electronics through its main website.

However, the economic crisis in the US in 2008 took its toll on Zappos. In November 2008, Zappos laid off more than 100 people, or around 8% of its staff. This news was first announced in an internal e-mail, and later Hsieh talked about this action at the company blog as well as Twitter. In his blog, Hsieh said that this was done to ensure that Zappos remained profitable and cash flow positive in 2009. A generous severance plan, including COBRA payments for up to six months, was provided to the laid off employees.

Some analysts felt that Zappos’s strengths as a maverick organization could eventually lead to its downfall under adverse conditions, if they were not managed well. Sucharita Mulpuru, principal analyst of retail at Forrester Research, said, “Among [the] obstacles Zappos faces are a tough economy for discretionary purchases, continued growth from core customers who may be affected by the economy, a high cost structure given that they carry most of their inventory in their warehouses and they offer free shipping both ways, and a very generous customer service operation.”

As of 2008, Zappos operated only in the US and Canada. However, Hsieh stated that he had plans to expand internationally. He said, “Rather than spread ourselves too thin by trying to be in a number of countries at this stage of the company’s growth, we have decided to focus on North America and do the best possible job we can here. Once we have accomplished that, we will start expanding into other countries.”

In the future, Hsieh planned to sell several other new products under the Zappos brand. Hsieh said, “Hopefully, 10 years from now people won’t even realize we started out selling shoes. Thirty years from now, I wouldn’t rule out a Zappos airline that was just about the very best customer service and the very best customer experience.”

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55 The Consolidated Omnibus Budget Reconciliation Act (COBRA) is a group health insurance plan. For active employees, the employer usually paid all or part of the group health premiums. Under COBRA, as a former employee no longer receiving benefits, a person usually had to pay the entire premium amount (the portion of the premium that was paid as an active employee and the amount of the contribution made by former employer).
While Zappos was not the first company to build a business based on services like free shipping, a liberal return process, and a 110% price guarantee, it was exceptional in the way it incorporated customer service so deeply into its culture. It was also considered one of the few companies that truly recognized the importance of employee generated media and social media, in increasing brand awareness. Commenting on Zappos, Beth Thomas-Kim, Head of Consumer Relations for Nestlé and Chair of the Society of Consumer Affairs Professionals, said, “Zappos is touching a real nerve in the consumer affairs industry. The service is putting hard data behind what we all intuitively know and feel: great service and so-called ‘feedback moments’ are inseparable from marketing and brand building.”

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### Exhibit I

**Zappos’ Sales**

<table>
<thead>
<tr>
<th>YEAR</th>
<th>SALES/REVENUE (in millions of US$)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>Almost Nothing</td>
</tr>
<tr>
<td>2000</td>
<td>1.6</td>
</tr>
<tr>
<td>2001</td>
<td>8.6</td>
</tr>
<tr>
<td>2002</td>
<td>32</td>
</tr>
<tr>
<td>2003</td>
<td>70</td>
</tr>
<tr>
<td>2004</td>
<td>194</td>
</tr>
<tr>
<td>2005</td>
<td>370</td>
</tr>
<tr>
<td>2006</td>
<td>597</td>
</tr>
<tr>
<td>2007</td>
<td>840</td>
</tr>
<tr>
<td>2008</td>
<td>1000*</td>
</tr>
</tbody>
</table>


### Exhibit II

**Logo of Zappos**

Exhibit III
About Twitter

Twitter is a free social networking and micro-blogging service developed by Jack Dorsey, Biz Stone, and Evan Williams. In April 2007, Twitter Inc. was formed to offer the service to online users. The service enabled users to post ‘tweets’ — short messages of up to 140 characters long, mostly answering the question ‘What are you doing?’ Users could also read other users’ updates if they had signed up to receive them by becoming a ‘follower’ or by being a ‘friend’. The updates could be received through the Twitter website, SMS, RSS, email, or through applications such as Tweetie, Twinkle, TwitterFor, Twittrific, Feedalizr, and Facebook.

Twitter is so popular that it has many system crashes due to high visitor traffic. It is also considered a way to message friends about interests or to vent feelings regarding consumer products. It has a reputation of being a major source of news regarding natural disasters and political issues.

Many businesses increasingly consider Twitter to be a good market research tool to understand their consumers. They generally track what is being said about their businesses on Twitter and respond to any negative issues. It is also considered a great means to get instant feedback on proposed company policies or products.

Some prominent companies that use Twitter are Whole Foods Market, Comcast, Cisco Systems, JetBlue, Sun Microsystems, Southwest Airlines, and Zappos.

Compiled from various sources.

Exhibit IV
Critical Analysis of Zappos’ Affiliate Program

<table>
<thead>
<tr>
<th>Pros</th>
<th>Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open invitation — anyone could join the program</td>
<td>Zappos did not accept international affiliates, even if they had a website targeted at US citizens.</td>
</tr>
<tr>
<td>The program had a very high number of members about 17,000.</td>
<td>Zappos had a reversal rate of 31%, in case of which the affiliate also had to lose out.</td>
</tr>
<tr>
<td>Each associate was given US $15 per order. Given that an average sale order at Zappos was about US $100, each associate had the chance to earn about $15 for every sale.</td>
<td></td>
</tr>
<tr>
<td>The referral rate was about 15%.</td>
<td></td>
</tr>
<tr>
<td>Moreover, associates had the option of choosing to link to the Zappos site through banners, text links, or HTML.</td>
<td></td>
</tr>
<tr>
<td>Associates could choose to recommend specific shoes or the complete product line.</td>
<td></td>
</tr>
<tr>
<td>Associates could also add a Zappos search box to their website.</td>
<td></td>
</tr>
</tbody>
</table>

Exhibit V
Top Ten US Internet Retailers in 2008

<table>
<thead>
<tr>
<th>RANK</th>
<th>COMPANY</th>
<th>WEB SALES VOLUME (in billions of US dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Amazon.com Inc.</td>
<td>14.8</td>
</tr>
<tr>
<td>2</td>
<td>Staples Inc.</td>
<td>5.6</td>
</tr>
<tr>
<td>3</td>
<td>Office Depot Inc.</td>
<td>4.9</td>
</tr>
<tr>
<td>4</td>
<td>Dell Inc.</td>
<td>4.2</td>
</tr>
<tr>
<td>5</td>
<td>HP Home &amp; Home Office Store (Hewlett-Packard Co.)</td>
<td>3.4</td>
</tr>
<tr>
<td>6</td>
<td>OfficeMax Inc.</td>
<td>3.2</td>
</tr>
<tr>
<td>7</td>
<td>Apple Inc.</td>
<td>2.7</td>
</tr>
<tr>
<td>8</td>
<td>Sears Holding Corp.</td>
<td>2.6</td>
</tr>
<tr>
<td>9</td>
<td>CDW Corp.</td>
<td>2.4</td>
</tr>
<tr>
<td>10</td>
<td>Newegg.com</td>
<td>1.9</td>
</tr>
</tbody>
</table>

Source: www.internetretailer.com

Exhibit VI
Some of Zappos’ Competitors

<table>
<thead>
<tr>
<th>Endless.com</th>
<th>Shoebuy.com</th>
<th>Piperlime.com</th>
</tr>
</thead>
<tbody>
<tr>
<td>Endless.com is offered by Amazon.com and is a site dedicated to shoes and handbags.</td>
<td>Shoebuy.com claims to be one of the top internet retailers. It was founded by CEO, Scott Savitz. Also sells bags and other accessories.</td>
<td>Piperlime.com is offered by Gap Inc. and is a site dedicated to shoes.</td>
</tr>
<tr>
<td><strong>Services:</strong></td>
<td><strong>Services:</strong></td>
<td><strong>Services:</strong></td>
</tr>
<tr>
<td>• Wide Selection</td>
<td>• Wide Selection</td>
<td>• Wide Selection, brands other then Gap offered.</td>
</tr>
<tr>
<td>• 24/7 customer service</td>
<td>• Free Shipping</td>
<td>• Free Shipping</td>
</tr>
<tr>
<td>• Free Overnight Shipping</td>
<td>• Free Return Shipping</td>
<td>• Free Return Shipping</td>
</tr>
<tr>
<td>• Free Return Shipping</td>
<td>• 110% Price Guarantee</td>
<td>• 100% Price Guarantee</td>
</tr>
<tr>
<td>• 110% Price Guarantee</td>
<td>• No Sales Tax (Shoebuy pays all applicable sales taxes)</td>
<td></td>
</tr>
<tr>
<td>• 365 days return opportunity</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Compiled from various sources.
References & Suggested Readings:

21. www.zappos.com