Costco case study critique essay

Education

What isCostco's business model? Is the company's business model appealing? Why or why not? The centerpiece of their business model involved generating high sales volumes and rapid inventory turnover by offering club members low prices on a limited selection of name brand and private label products. The Club members pay an annual fee, which was a very important aspect of their business model. These fees provided enough revenue to increase the company's overall profit.

Costco was also able to sell and receive cash for their inventory before it had to pay many of its merchandise vendors; even when vendors' payments were made just in time for vendors to take advantage of early payment discounts. High sales volumes and rapid inventory turnover allowed the company tofinancea large percentage of its merchandise inventory through payment terms provided by vendors rather than by maintaining large working capital to ensure timely payments of suppliers.

Yes, the company's business model is appealing because the company's increased inventory turnover and low operating costs allowed it to maintain a profit, despite their significantly lower gross margins compared to the industry (traditional wholesalers, mass merchandisers, supermarkets and supercenters). What are the chief elements of Costco's strategy? How good is the strategy? The chief elements are pricing, product selection, maintaining low operating costs and expansion. Pricing/Product Selection-The companyphilosophywas to provide high end quality product and/or services to club members but maintain low prices.

Stores carry approximately 3, 600 items, whereas, 85% is name brand and 15% Kirkland brands. These items range from perishables (food/drinks) to nonperishable household items. Costco also offers several services such as: one-hourphoto, gasoline, pharmacy, optical, hearing aids, and travel services. Although the services remained constant, approximately 25% of its product offering were always changing. Buyers for Costco were making one-time purchases of items based on consumer taste and trends. These items would sell out quickly and were higher prices items such as: big screen TV’s and diamond rings.

Costco purchased these “ treasure hunt” items on the gray market from retailers and/or wholesalers who were looking to get rid of excess or slow selling inventory. Club members eagerly looked for these “ treasure hunt” items because it was rare the items would be available again. For many years the company even had a 14% markup cap on name brand products compared to the industry at 20-50% markup prices. There was a 15% markup cap on their private selection of products (Kirkland Signature), which was 20% below to comparable name brands.

Costco’s prices were slightly above break-even levels and sales revenues barely covered operating expenses. The company makes up for the modest contribution to operating profits with the membership fees, which attributes to over 70% of operating profits. Revenues from membership fees outweigh net income annually. Low Cost Leader/Company Expansion-Costco’s ability to maintain low operating costs is key to being able to offer club members with consistently low prices. They did not invest in amenities within their warehouses such as: shopping bags, decor, salespeople, billing, and accounts receivable.

The building were strategically placed in high traffic areas but avoided prime real estate to avoid excessive land costs. The large metal buildings were designed for economy and efficiency. In addition to keeping overhead low, Costco had shorter hours of operation to reduce labor expenses as well. Costco's growth strategy is to increase overall company sales by 5% and to open new stores within and outside of the U. S. The company spent 1. 3 billion to open 20 new stores and the average annual sales per warehouse was 103 million, which more than covers the company's initial start-up costs.

Do you think Jim Sinegal has been an effective CEO? What grades would you give him in leading the process of crafting and executing Costco's strategy? What support can you offer for these grades? Refer to Figure 2. 1 in Chapter 2 in developing your answers. Mr. Sinegal has been an effective CEO by being fully committed to the Costco vision and business strategy. In this aspect Mr. Sinegal would receive an A because he was very much " hands-on" which ensuring that each facility operated according to Costco's business model/strategy, mission, and philosophy.

Sticking with the company's present strategic course creates opportunities for growth and increased profitability as displayed in the opening of 20 new locations. The company does not engage in extensive marketing or sales campaigns and the CEO would receive a B. Communications are sent by flyers, via Costco website/email, in-store product sampling, occasional direct mailers to potential new members, and special campaigns for new store openings. This process works well for keeping expenses minimal, however, implementing effective marketing practices would greatly benefit the company.

Marketing can help Costco grow their business by focusing on their best customers (Executive members) and attracting more club members, in order to, boost their sales and increase profit margins. Mr. Sinegal refuses increased customer prices to increase company marginal profits or to provide senior management with salaries comparable to other executives within the same industry. He found it unnecessary for executives to make 100 times more than employees and insisted on paying employees higher wages and increased benefits, than the industry standards as well.

This greatly reduced employee turnover and increased consumerloyaltywith Costco, which would earn him an A. The company has some of the most affluent customers with incomes ranging from $75, 000 to over $100, 000 annually. There are Gold and Executive memberships of which 38% are Executive members. Executive members generally spend more than other members and they had an 89% membership renewal rate. The membership format facilitated strictly controlling the entrances and exits of warehouses, resulting in limited inventory losses of less than 2/10 of 1% of net sales-well below the industry standard.

Although Executive members provide a substantial amount of sales, the company should get in line to service potential club members who do not have annual incomes within the $75, 000 to $100, 000 (median range $50, 000 to $75, 000), as well as, continue to market to the Executive club members. This will strengthen the company’s future prospects and increase competition, in order to reach the projected 5% increase in sales. Managers are delegated additional responsibilities and were held accountable for store operations, product selections and promotions.

These individuals had to prove that they could function within a fast paced retailenvironmentand be able to promptly find resolutions to multiple issues. They also had to stay in tune with their customer needs and/or wants (consumer trends), in order to, maximize sales and quick turnover. For the most part, the company promoted from within, which earns the CEO letter grade C. Approximately, 98% of management is selected from within and that can cause conflicts with the organization. There is no opportunity for innovation and/or change (fresh ideas) from the outside.

Employees can feel entitled to certain positions because of their length of tenure with the company, instead of whether or not they can effectively do the job. It can also cause “ hostile work environment” by increasing competition among employees. It can hinder the company from focusing on top senior level technical talent. They targeted local universities for new hires, in order to, engage educated and hard-working individuals whom had not chosen a specificcareerpath yet. The company needs to find a balance between promoting from within and outside of the company.

For items that were not practical to stock at the warehouses, members are able to obtain a wider variety of value-prices products and services on the company website. Yes, the company is being impacted growing technological advances and the CEO would receive a D. The company is being affected by their inability to provide Apple products and/or services to club members due to online restriction. Costco needs to seek resolution for the online restriction. Apple is a popular high end product that Costco would generate increased revenues for the company and the website can only be accessed within the U. S. and Canada.

The company is faring well against their direct and indirect competitors with expansion (within and outside of the U. S.) and increased sales growth. The company buys majority of its merchandise directly from the manufacturers which allowed the company to have sufficient inventories to meet demand. The CEO would earn a C because management is not being proactive. They are “ assuming” that if they were to encounter any issues with supply, the business could just switch manufacturers without disruption.

If Costco is going to pursue overall company growth, the supply chain should be aligned with its core business strategy and value proposition such as their competition (Wal-Mart). Costco should continue with the companygoalsto expand international and needs to ensure their website is capable to service their consumer demand in these other countries. It will make the organization more competitive, considering many of Costco’s competitors have global operations setup already. With the market share Costco already has within the industry, Costco has an opportunity to capitalize on their expansion.

What core values or business principles has Jim Sinegal stressed at Costco? He stressed five business principles: obey the law, take care of our members, take care of our employees, respectour suppliers, and reward stakeholders. Obey the law-Mr. Sinegal put strong emphasis on abiding by the laws of every community where Costco conducted business, which consists of any state or government laws and/or regulations. He had a strict code of ethics. Take care of our members-Sinegal believes in customer satisfaction period.

This was displayed not only in the superior products and services being offered but with the company’s efforts within their local communities as well.

Take care of our employees-In addition to providing higher wages and great benefits, Costco provides their employees with opportunities for advancement, volunteer activities, and a safe/healthy work environment. Respect our suppliers-Costco honors all commitments and protected supplier property. They did not engage in situations that would cause conflicts of interests such as not accepting gratuities of any kind from a supplier.

The company also reserved the right to utilize their better ethical judgment when in doubt regarding what course of action to take. Reward our stockholders-Costco is publicly traded and depends on shareholders (investors) to be successful. They are treated as business partners and it is essential the company provides a good return on their investments. What is the competition like in the North American wholesale club industry? Which of the five competitive forces is strongest and why? Complete a five forces analysis of competition in the North American wholesale industry?

The competition is fierce to strong in the North American wholesale market. Costco largest direct rival is Wal-Mart but there are also significant indirect rivals such as Amazon. com and Target. Rivalry can be considered fierce to strong when the battle for market share is so vigorous that the profit margins of most industry members are squeezed to the bare minimum. The industry is growing 15-20 percent faster than retailing as a whole. Costco had 57% share of warehouse sales across the U. S. with Wal-Mart having approximately 35%.

We believe the threat of new market entrants is the strongest of the five forces because Costco is not just in competition with other warehouse clubs but other types of retailers Dollar General, Lowe’s specialty chains, gas stations, Internet retailers such as Amazon. com and Barnes and Noble whom hold substantial market share Strengths •3rd largest retailer •Has 57% share of warehouse sales across US •No one manufacturer supplies a significant percentage of merchandise that Costco stocks •Provide high end products and services at low prices •Rapid inventory turnover •Minimal overhead expenses

Weaknesses •Profits (low profit margins) dependent on card membership fees otherwise operating costs barely covered •Websites only operate in US and Canada but company has expanded internationally/website also unable to carry certain products such as Apple –technological advances •Price caps 14-15 percent on name brand and Kirkland Signature products •Promotes more than 98% from within Opportunities •To gain new memberships for potential customers with median incomes between $50-$100K annually •To open additional stores in other countries besides Japan •Increase marketing efforts Threats

•Entrance of other retailers whom adopted the low cost strategy and have significant market share -increased competition •Lack of supply management How well is Costco performing from a financial perspective? What is happening to net sales, total revenues, and net income? What are their profitability and expense ratios? The company has been consistently improving company performance from years' 2000-2011. Without the sales from the memberships, sales would not be enough to cover the operating expenses for Costco.

Net sales, net income, and total revenue have increased from the years' 2000 to 2011. Net profit margin is 16. 8% and company collects almost 17 cents for each dollar of sales. So while the company increased its net income, it has done so with diminishing profit margins. Merchandising costs are high and account for at least 89% of operating expenses. The CAGR performed on total revenue displays an approximately 11% increase in total revenue and 11. 5% increase to stockholders' equity shows that investors are receiving substantial returns on their investments with Costco.

Long term debt has more than doubled over than last 10 years, the calculation for long-term debt and capital clearly show that less than 15%. The company has established their creditworthiness and can borrowmoneyif necessary. The company's current ratio is 1. 14 which is stable because it is over 1. 0, however, ratios of 2. 0 or more are better. The return on assets and equity have fluctuated over the years. ROA was actually higher in the past compared to the most recent calculation. For example in 2005, ROA was 6. 4% and 7. 3% in 2000.

The total assets accumulated over the years have increased but the return on those assets have not. ROE was 14. 9% in 2000 and 14% in 2008. Overall, Costco is doing well but the company could be doing better. Gross profit margin= 87, 048 - 77, 739/ 87, 048 = 0. 1069 (10. 7%) Operating profit margin= 2439 / 87, 048 = 0. 02801 (2. 8%) Net profit margin= 1462 / 87, 048 = 0. 01679 (16. 8%) Total Return on Assets= 2439 / 26, 761 = 0. 091140092 (9. 1%) ROA = 1462 / 26, 761 = 0. 052663809 (5. 3%) ROE = 1462 / 12, 573 = 0. 116280919 (11. 63%) EPS = 1462 / 443. 1 = 3. 299948093 (3. 30)

Long Term Debt to Capital Ratio = 2153 / 14, 726 = 0. 146203993 (14. 62%) Current Ratio = 13706 / 12050 = 1. 137427386 (1. 14) CAGR -10 year total revenue (88, 915 / 32, 164) = 2. 764426066-2. 77 rounded 1 / 10 = 0. 1 2. 77 ^ 0. 1 = 1. 107255833- 1. 1072 1. 1072 – 1 = . 1072 (10. 72%) CAGR- 10 year stockholders' equity 12, 573 / 4240 = 2. 965330189 – 2. 97 rounded 1 / 10 = 0. 1 2. 97 ^ 0. 1 = 1. 115001996- 1. 1150 1. 1150 – 1 = . 1150 (11. 50%) Based on the data in case Exhibits 1 and 4, is Costco's financial performance superior to that at Sam's Club and BJ's Wholesale?

Costco has a larger share of the wholesale club sales in the United States. In fact, they have over half. Sam's Club is next in line and BJ's Wholesale is much smaller. Costco is efficient and utilizes its resources in order to remain more successful and have a greater impact than other wholesale clubs. Even though their profit margin may not be as high, they prove to have a stronger customer base and greater sustainability overall. Does the data in case Exhibit 2 indicate that Costco's expansion outside the U. S. is financially successful? Why or why not?

This data does show that Costco's expansion outside the U. S. is financially successful. Sales and operating income continue to rise on a regular basis for the warehouses. This proves stability and consistency. Revenue also continues to rise enabling growth and success. How well is Costco performing from a strategic perspective? Does Costco enjoy a competitive advantage? Does Costco have a winning strategy? Why or why not? From a strategic perspective, Costco is performing well. They have evaluating their strengths and weaknesses and are able to accentuate their strengths.

They look for opportunities and focus on making the most out of what they have. They are not afraid to venture into new opportunities and stray away from threats. Market share is consistently on the rise and they are increasing their customer base. Customers are aware of the care they get from Costco and the good reputation is reflected in their success. The continuous growth in memberships displays loyal customers. Costco certainly does enjoy a competitive advantage of consistently providing low prices, customer service, increasing market share, and maintaining a profitable reputation.

This is also why they do have a winning strategy. They align their business strategy with their mission and push forward. Are Costco's prices too low? Why or why not? Costco's prices are not too low. By evaluating their financial statements and review customer satisfaction, they are on target. They are meeting their goals and making a difference while still pleasing their customers. This is a happy medium that is hard to reach. Because these prices are part of their competitive advantage, it would not be a good idea to change this.

What do you think of Costco's compensation practices? Does it surprise you that Costco employees apparently are rather well-compensated? The compensation package provided by Costco is essential to the way they run their business. It is much better than those of its competitors, creating an advantage. This is another way that Costco aligns their strategy with their mission and values. While executives are offered a smaller compensation package, regular employees can take advantage of a larger package. This shows that they are all working together and one is not better than the other.

It takes all of them to successfully run the company. Again, this is an advantage because employees can make Costco their career reducing the turnover. While competitors go through many employees in a short amount of time, Costco has the same staff. It did surprise me before reading this case, but based on their strategy and focus, this is the right thing to do and they prove that it really does pay off in the long run. What recommendations would you make to Costco top management regarding how best to sustain the company's growth and improve its financial performance?

While Costco remains successful at this time, it is important that they maintain engagement from customers and employees. It could be beneficial to look into untapped markets within the United States and overseas. As times change, they may need to update processes and goals. One suggestion would be online shopping. The transition to online shopping abilities could enhance their overall success. This could also benefit customers overseas and will increase the market of Costco. They must remain one step ahead of the competition in order to stay on top. By focusing on their strength of customer care overall they will sustain their advantage.