Costco wholesale case study

Education

Stakeholders investmoneywith the intent to gain return in the future. It is important for stakeholders to gain access to information and evaluate the firm’s performance before they put money in it. On the other hand, it is the firm’s management team job to make decisions that would maximize the long term value of the firm’s common stock. The intent of this paper is to analyzeCostcoWholesale Corporation’s financial performance and to assess how efficient the business has been over a five year period as well as to provide recommendation for financial management strategy.

The problem identified in this paper is the low margins in the industry. Because margins are low, the profitability of individual companies depends on high volume sales and efficient operations. Costco Wholesale Corporation is high-growth Retail Company. The company has experienced significant growth from 1997 to 2001, which has caught the attention of the competition. However, the numbers are decreasing because return on assets, return on equity, and asset turnover ratios have declined within the same time frame. Costco Wholesale Corporation has been a major player in the retail industry.

It is the largest wholesale club operator in the US. “ The company operates about 555 membership warehouse stores serving more than 53 million cardholders in some 40 US states and Puerto Rico, Canada, Japan, Mexico, South Korea, Taiwan, and the UK, primarily under the Costco Wholesale name. ” (Hoover's, Inc, 2010) Costco’s strategy is low prices strategy. The management team has been able to pass savings to customers, keep low prices and maintain healthy margins at the same time. This has been a result of the company’s ability to become more efficient over time.

The company saves on operation costs in order to provide low price while still keeping high quality products for customers. It has been constructing warehouses with inexpensive concrete floors. Selling items in bulk has allowed for operating efficiencies. Also, carrying less variety of products than other competitors has contributed to keeping inventory costs down. High sales volume and rapid inventory turnover are very important for a firm’s financial performance. Therefore, they should not be overlooked by investors. Costco’s inventory turnover ratio of 11. 7% in 2001 is the highest compared to its competitors.

It is a result of operating principle that allows Costco to improve its working capital and operate much more efficiently than its competitors. For instance, Costco buys directly from manufacturers and routes purchases directly to customers in less than 24 hours. “ Cross-docks never stored inventory, so all of the items delivered were reloaded and shipped that same day. ” (Case study, p. 6) This has increased efficiency by ensuring the trucks are operating at full capacity. It also has allowed Costco to receive cash in hand before it has to pay for the original merchandise from the manufacturer.

This has resulted in a very high operating cash flow for the business. Cash is important to any company’s financial performance. It allows the company to pay its bills and invest in the business without having to use debt. According to Torres’s Common SizeFinancial statementInterest expense has decreased from – 0. 35% in 1997 to – 0. 09% in 2001. This has demonstrated Costco’s ability to reduce its overall amount of debt during these years. For example, the fact that short-term debts have increased from 0. 46% in 1997 to 1. 93% in 2001 and long-term debt have decreased from 16. 74% of sales in 1997 to

8. 2% in 2001, relates back to the decrease in Costco's interest expense. This is a representation of the management's team decision turn on to short-term and move away from long-term debts. In addition, the decrease in long-term debt has helped reducing total liabilities from 53. 32% of total assets in 1997 to 50. 46% in 2001. Costco's current ration in 2001 is 0. 94, which is below its competitors. This could be a sign for weak liquidity position. However, the high inventory turnover ratio analyzed earlier in this paper in combination with the low current ratio is an indicator for efficient assets management.

The competitors' higher current ratio might also be a sign for too much inventory that might have to be written-off or too many old accounts receivables that could turn into bad debts. Sears and Walmart's account receivables are a way higher than Costco and BJs, confirming that there is no significant reason for considering Costco's current ratio a weakness. Costco's gross margin has been well maintained over the five year period. Their gross margin of 10. 4% is much lower than Sears' of 26. 6% and Wal-Mart's of 21. 5%. Only BJ's has a lower gross margin of 9. 2%.

Costco's 2001 gross margin suggests ability to remain profitable and very competitive at the same time. The company has been able to provide goods to customers at a very low mark-up and at a lower per unit cost. According to the case study Costco's management team has decided to reinvest net income back into the company instead of paying dividends. This decision has resulted in earnings retention ratio of 100% as shown on Torres's sustainable growth model. Absence of dividends could lead to some investor dissatisfaction in the short term. The return on equity (ROE) also has been decreasing during the five year period.

It has dropped from 18. 6% in 1998 to 14. 2% in 2001, which could also lead to investor dissatisfaction. ROE tells how well stockholders are doing in term of return on their money. Costco's 14. 2% return in 2001 is consistent with the current average industry ROE is 11. 5%[1]. Costco's ratio is consistent with the industry average, but appears to be on the decline. A look at Costco's ROE since 1997 shows a steady decline. Consistent reinvestment into the company has occurred in the form of new store construction and efficient modifications of old stores during these years.

Such capital investments would take time to generate profits. Even though Costco's ROE in 2001 is lower than in 1997 it still remains a large positive figure. As long as Costco's management team continues demonstrates ability to successfully reinvest and improve efficiencies, stock price would most likely increase in the future and stockholder would be satisfied with long term returns on their investment. Economic factors should be considered when determining the future of the retail business. Economic factors include the economic growth, interest rates, exchange rates and the inflation rate.

Economic downturns have forced customers to cut back on expenses. . Any significant decrease to consumer spending has to be considered as a threat. In 2000/ 2001 tough economicenvironmentCostco has shown the ability to persevere and continue growing their business. Passing cost savings to customers is even more important in times of economic slowdowns when businesses and individuals are trying to do more with less. Economic constraints play a major role in wholesale business by forcing companies to be more creative and come up with higher efficiencies in order to provide lower prices.

On the other hand, economic growth provides opportunities not only to Costco but to other rivalry as well. Social factors influencing the retail industry includeculture, population growth, age distribution, and importance of safety. Costco warehouses are located further away from residential areas such as cities and older suburban areas. This creates inconvenience for customers as they would have to drive further to shop at Costco than a local grocery store. Costco has overcome this with a much better customer environment, larger discounts on bulk purchases and various incentives through their membership programs.

Ecological factors include ecological and environmental aspects. For instance, Costco has been offering boxes to customers instead of plastic bags. Such green initiatives are necessary to address environmental concerns. They could also contribute to increased market share. Other factors that should be considered are customer demand, cultural changes, andtechnology. Today’s advanced technology provides opportunities for higher efficiencies as well as cultural changes. For instance, the internet has been a great shopping resource lately.

It gives retailers the ability to offer lower prices and customers the convenience of shopping from their own homes. Costco’s management team should continue to work closely with customers in order to identify their needs and behavior. Costco's mission is " To continually provide our members with quality goods and services at the lowest possible prices. " (Costco, 2010). The management team should ensure that systems and processes are in place to carry on the mission. Ensure opencommunicationchannels between employees and management.

Employees should be considered when the strategy is being implemented because successful strategy implementation requiresmotivation. The company should clearly communicate its vision and mission to all levels throughout the organization. Communicating the company's vision and employees involvement in the decision making process would give them a stronger sense of job satisfaction. That would increase motivation and contribute to creativity enforce. Also to increase motivation the executive team should review management's compensation and rewards. As part of trategy implementation theleadershipteam should develop support among stakeholders. One aspect of that is to establish global network of strong suppliers and ensure availability of strong partners who share technology, development cost, and speed to market Costco's goal is to " Reward our shareholders. " (Costco, 2010) This analysis proves that Costco remains one of the industry's leading players and there seems to be no reason for Torres to sell her shares. References Brigham, Eugene, & Houston, Joel. (2008). Fundamentals of financial management. South-Western Pub. Brigham, & Houston, 2008) Carpenter, M. A. , & Sanders, Wm. G. (2009). New Jersey, NY: PearsonEducation, Inc. Costco wholesale corporation . (n. d.). Retrieved from http://www. hoovers. com/company/Costco_Wholesale_Corporation/rkfjif-1. html Costco, Initials. (2010). Costco wholesale corporation. Retrieved from http://www. csrglobe. com/login/companies/costco_wholesale_corporation. html Jun, J. (2009, January 19). Taking stock in costco. Retrieved from http://www. oldschoolvalue. com/featured/taking-stock-in-costco/

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