

# Costco: internal external analysis essay



**ASSIGN  
BUSTER**

## Costco: Internal / External Analysis Table of Contents INTERNAL ANALYSIS:

- About Costco •Mission Statement •Corporate Governance & Stakeholder Management •Locations •Strategic Objective •Primary Activities •Support Activities •Costco Membership •Financial •Net Income •Net Sales
- Membership Fees •Gross Margin •Selling, General & Administrative Expenses •Cash Flows •Expansion Plans •Conclusion EXTERNAL ANALYSIS
- Demographics •Socio-cultural •Political/Legal •Technological •Economic
- Global Environmental Scanning •Environmental Monitoring •Competitive Intelligence •Environmental Forecasting •Competitive Environment •Porter's Five Forces •Threat of New Entrants •The Bargaining Power of Buyers •The Bargaining Power of Suppliers •The Threat of Substitute Products and Services •Intensity of Rivalry •Value Net •Strategic Groups Within an Industry Appendix A Financial Reports, Financial Highlights & Company Time Line Map of Locations & Photos Internal Analysis About Costco

Costco Wholesale Corporation operates an international chain of membership warehouses, mainly under the “ Costco Wholesale” name, that carry quality, brand name merchandise at substantially lower prices than the merchandise typically found at conventional wholesale or retail sources. The warehouses are designed to help small-to-medium-sized businesses reduce costs in purchasing for resale and for everyday business use. Individual consumers may also purchase for their personal needs. Costco's warehouses present one of the largest and most exclusive product category selections to be found under a single roof. Categories include groceries, candy, appliances, television and media, automotive supplies, tires, toys, hardware, sporting goods, jewelry, watches, cameras, books, house wares, apparel, health and beauty aids, tobacco, furniture, office supplies and office equipment.

Costco is known for carrying top quality national and regional brands, with 100% satisfaction guaranteed, at prices consistently below traditional wholesale or retail outlets. Members can also shop for private label Kirkland Signature products, designed to be of equal or better quality than national brands, including juice, cookies, coffee, tires, house wares, luggage, appliances, clothing and detergent. The Company also operates self-service gasoline stations at a number of its U. S. and Canadian locations. Additionally, Costco Wholesale Industries, a division of the Company, operates manufacturing businesses, including special food packaging, optical laboratories, meat processing and jewelry distribution.

These businesses have a common goal of providing members with high quality products at substantially lower prices. According to Jim Sinegal, the Company's President and Chief Executive Officer, " Costco is able to offer lower prices and better values by eliminating virtually all the frills and costs historically associated with conventional wholesalers and retailers, including salespeople, fancy buildings, delivery, billing and accounts receivable. We run a tight operation with extremely low overhead which enables us to pass on dramatic savings to our members. " (7) Costco Mission Statement To continually provide our members with quality goods and services at the lowest possible prices. In order to achieve the mission they conduct business with the following Code of Ethics in mind: 1. Obey the law.

2. Take care of their members. 3. Take care of their employees. 4. Respect their suppliers.

Costco believes that if they do these four things throughout the organization, then they will achieve their ultimate goal, which is to:

5. Reward the shareholders
- (8) Corporate Governance & Stakeholder Management There are 13 Directors and Officers, 34 Executive and Senior Officers and 80 Vice Presidents in Costco's corporate management.
- 9) Costco Locations As of December 2005, Costco operated a chain of 471 warehouses in 37 states and Puerto Rico (346 Locations), nine Canadian providences (66 locations), the United Kingdom (17 locations), Korea (5 locations), Taiwan (4 locations), Japan (5 locations), and 28 warehouses in Mexico.

**Strategic Objective** The strategic objective of Costco is based on the concept of offering members very low prices on a limited selection of nationally branded and selected private label products in a wide range of merchandise categories while producing high sales volumes and rapid inventory turnover. This rapid inventory turnover, when combined with the operating efficiencies achieved by volume purchasing, efficient distribution and reduced handling of merchandise in no-frills, self service warehouse facilities, enables Costco to operate profitably at significantly lower gross margins than traditional wholesalers, discount retailers and supermarkets.

(1) **Primary Activities** Costco buys the majority of its merchandise directly from manufacturers for shipment either directly to Costco's selling warehouses or to a consolidation point where various shipments are combined so as to minimize freight and handling costs. As a result, Costco eliminates many of the costs associated with multiple step distribution channels, which include purchasing from distributors as opposed to manufacturers, use of central receiving, storing and distributing warehouses,

and storage of merchandise in locations off the sales floors. (1) Merchandise is generally stored on racks above required for handling and stocking. In addition, sales are processed through centralized, automated check-out stands. Most items are not individually price marked: rather, each item is bar coded so it can be scanned into electronic cash registers.

This allows price changes without remarking merchandise. Substantially all manufacturers provide merchandise pre-marked with the item numbers and bar codes and many provide special, larger package sizes. Costco seeks to limit specific items in each product line to fast selling models, sizes, and colors. Therefore, the company carries an average of approximately 4, 000 active SKU's per warehouse in its core warehouse business, as opposed to discount retailers and supermarkets that normally stock 40, 000 to 60, 000 SKU's or more. Many consumable products are offered for sale in case, carton or multiple-pack quantities only.

Appliances, equipment and tools often feature commercial and professional models. One of Costco's cardinal rules is that no branded item can be marked up by more than 14 percent, and no private-label item by more than 15 percent. In contrast, supermarkets generally mark up merchandise by 25 percent and department stores by 50 percent or more. (6) Costco saves 2 percent a year in costs because it rarely spends money on mass-media advertising. Marketing and promotional expenses are usually limited to new warehouse openings. Costco effectively targets small business owners as its primary target audience.

Operating largely under the radar of the general public, Costco has many marketing representatives who are attached to each store and whose continual task is to network with business owners. (2) Costco has direct buying relationships with many producers of national brand name merchandise. No significant portion of merchandise is obtained by Costco from any one of these or any other single supplier. Costco has not experienced difficulty in obtaining sufficient quantities of merchandise, and believes that if any of its current sources of supply became unavailable, it would be able to obtain alternative sources without experiencing a substantial disruption of its business.

(1) At the end of 2005, Costco's warehouses contained over 59 million square feet of operating floor space; 46 million in the United States, 8. 4 million in Canada and 4. 2 million in other international locations. Costco's typical warehouse format averages approximately 139, 000 square feet. Floor plans are designed for economy and efficiency in the use of selling space, in the handling of merchandise and in control of inventory. Costco believes that shoppers are attracted principally by the availability of low prices on brand name and selected private label goods, hence, Costco's warehouses need not be located on prime commercial real estate sites or have elaborate facilities.

(1) Costco's ancillary business continues to draw members into their warehouses for more frequent shops, generating increasing revenue for the company. Warehouse ancillary sales increased by more than 20% in 2005 to more than \$6. 5 million. Costco's pharmacies have been featured in primetime news programs in nearly every major U. S.

market where they operate, showcasing that Costco's prices on generic prescription drugs are on an average 80 percent to 90 percent less than other stores. With 331 pharmacy locations, Costco filled 21 million prescriptions in 2005. Costco sold 25 million rotisserie chickens (500, 000 chickens a week) in the U. S.

in 2005. Costco also sold over 1 million legendary \$1. 50 hot dog/soda combos weekly. With 225 gas stations Costco boasted the lowest priced gas in nearly every market where they operated and had sales of \$3 billion in 2005 which was a 32 percent increase from 2004. Costco also offers a one-hour photo lab, hearing aid, optometry and print shop services.

(1) Support Activities Costco considers their employees to be their best asset and therefore offer their employees competitive wages and great benefits. Labor costs account for 70 percent of the company's total cost of operations. Costco's average pay is \$16 an hour, 42 percent higher than its fiercest rival.

6) Costco's health-care benefits are available to most of its employees. Costco covers about 92 percent of health care costs, and is considered generous by industry standards.

(4) Due to its great wages and benefits, Costco has extremely low rates of turnover at 23 percent, while the industry average for full-time sales staff is 66. 1 percent, according to the national Retail Federation. (4) Costco can pay its employees more and therefore save on turnover costs and maintain an experienced staff because its operations are efficient. Costco employs approximately 118, 000 people. Approximately 45 percent of the employee

base is part-time. (1) Costco utilizes SPS hosted internet service to conduct electronic commerce with its nationwide network of suppliers.

SPS Commerce allows Costco to place orders electronically with their suppliers. Costco and their suppliers gain maximum administrative efficiency, reduce shared expenses and improve system accountability from using SPS commerce technology. (3) In 2005 Costco spent a considerable amount of time and effort evaluating and upgrading their internal controls to be in compliance with regulations such as Sarbanes-Oxley 404 Internal Controls. Costco was able to enhance and streamline many of their policies and procedures as they met the extensive requirements of these regulations. (1) One of Costco's greatest senses of satisfaction is with the management team they have assembled.

Costco's management team is considered to be the most stable and skilled management team in the retail industry. Many of the executives have been with Costco for more than 20 years. Costco Membership Costco is open only to members and offers three types of membership: Business, Gold Star (individual) and the Executive membership. Business members qualify by owning or operating a business, and pay an annual fee (\$45 in the U. S. ) to shop for resale, business and personal use.

This fee includes a spouse card. Business members may purchase up to six additional membership cards (\$35 each) for partners or associates in the business. A transferable company card may also be purchased. Gold Star members pay a \$45 annual fee (in the U. S. ).



This membership is available to those individuals that do not own a business. This fee also includes a free spouse card. The third membership level is called the Executive Membership. In addition to offering all of the usual benefits, this membership allows members to purchase a variety of discounted consumer services (auto and homeowner insurance, real estate and mortgage services, long-distance telephone services, auto buying, personal check printing, financial planning) and/or discounted business services (merchant credit card processing, health insurance, business lending, payroll processing, communication solutions, check and forms printing) at substantially reduced rates. Executive Members also receive a 2 percent annual reward (up to \$500) on most of their warehouse purchases. Executive Members pay an annual fee of \$100.

(7) Financial See financial statements in Appendix A Net Income Net income for 2005 increased 20.5% to \$1,063,092 from \$882,393 in 2004. Net income has increased by more than 20 percent for the past two years. The increase has been attributed to income tax benefits resulting primarily from the settlement of a transfer pricing dispute between the United States and Canada; a cumulative pre-tax, non-cash charge to pre-opening expenses related to a correction to Costco's method of accounting for ground leases that did not require rental payments during the period of construction. 1) Net Sales Net sales increased 10 percent to \$51,862,072 in 2005 from \$47,145,712 in 2004. Approximately 71 percent of the increase was due to an increase in comparable warehouse sales in warehouses open for at least a year.

The balance of the increase was due to opening 16 new warehouses during 2005 and 20 new warehouses in 2004. (1) Membership fees Membership fees increased 11.6 % to \$1,073,156 in 2005 from \$961,280 in 2004. The increase was due to additional membership sign-ups at the 16 new warehouses opened in 2005. (1) Gross Margin Gross margin increased 9.1 percent to \$5,515,111 or 10.

3 percent of net sales in 2005 from \$5,053,696 or 10.72 percent of net sales in 2004. The nine basis point decrease in gross margin as a percentage of net sales reflected a decrease of three basis points in gross margin in Costco's merchandise departments. The three basis point decrease in merchandising is largely due to changes in the sales mix, with higher penetration of lower margin departments.

Costco uses LIFO method of accounting for Gross margin. (1) Selling, General & Administrative Expenses (SG&A) Selling, General and Administrative expenses increased 9.73 percent to \$5,044,341 or 9.73 of net sales in 2005 from \$4,597,877 or 9.5 percent of net sales in 2004. (1) Cash Flows Costco's primary sources of liquidity are cash flows generated from warehouse operations and existing cash, cash equivalents and short term investment balances which were \$3,459,857 and \$3,129,882 at August 28, 2005 and August 29, 2004 respectively.

Higher net income and a decrease in net merchandise inventories year-over-year increased cash flow from operating activities by \$391,571. A significant component of net cash used in investing activities continues to be the purchase of property and equipment related to Costco's warehouse

expansion and remodel projects. 1) Expansion Plans Costco's primary requirement for capital is the financing of the land, building and equipment costs for new warehouses plus the costs of initial warehouse operations and working capital requirements, as well as additional capital for international expansion. Costco intends to spend approximately \$1, 100, 000 to \$1, 250, 000 during 2006 in the United States and Canada for real estate, construction, remodeling and equipment for warehouse clubs and related operations; and approximately \$100, 000 to \$150, 000 for international expansion, including the United Kingdom, Asia, Mexico and other potential ventures. These expenditures are expected to be financed with a combination of cash provided from operations and the use of cash and cash equivalents and short-term investments. Expansion plans for the United States and Canada during 2006 are to open 28-30 new warehouse clubs on a net basis, inclusive of two to three relocations to larger and better-located warehouses.

Costco expects to continue its review of expansion plans in its international operations, including the United Kingdom and Asia, along with other international markets. Costco is planning to open three additional warehouses in the U. K. uring 2006. Costco Mexico plans to open two to three new warehouse clubs in 2006. (1) Conclusion Costco's most critical issues in the internal analysis that we have found are the following:

Strengths 1.

Costco has an extremely high sales volume per warehouse. It leads the industry at nearly double that of their nearest club competitor and with higher sales volume per store, Costco benefits more from economies of scale

than its' competitors. 2. Control over the inventory is crucial for success. In order to stay competitive, Costco needs to maintain high inventory turnover and low inventory shrinkage. .

Operating profit margin is less than 3 percent, which means that Costco could raise prices if needed. 4. Costco has a “ fanatical” management focused on value for the customer and management for the long term. 5. Costco has growth potential and is rapidly expanding and increasing its' customer base not only nationally but internationally. 6.

Costco has virtually no debt and has more than \$3 billion in cash. 7. Costco has a very low employee turnover rate, which creates a seasoned and efficient workforce. Employees are compensated generously with pay and benefits.

Weaknesses 1. Generous health care plans and rising compensation costs can eventually pinch profits. 2. In supplier relationships, Costco tends not to have loyalty to just one supplier. 3. Costco only marks up their products 14 - 15 percent.

Opportunities 1. Costco has been successful in ancillary businesses and Costco has the capability of adding to the number of services it offers in its' warehouses. 2. Costco could increase its' product offering in its' warehouses.

Threats 1. Sam's club has recognized the need to offer better or competing merchandise comparable to Costco.

External Analysis Demographics Costco is known as the \$99 dollar store, i. . the average customer will spend \$99 on every visit to Costco. (22) The

warehouse clubs attract the largest portion of affluent shoppers, who account for 54% of Costco's traffic.

The quality of its goods and great customer service are the reasons why it serves a larger affluent portion of the retail industry. Costco members average 11.4 visits a year at \$99 spent per visit, while Sam's Club has 8.5 visits at \$78 spent per visit respectively. It has a more upscale reputation than Sam's Club, helping it to attract shoppers with higher incomes.

(24) Socio-cultural Marketing and Advertising If you take a Costco cake to a bridal shower and there are 15 women there, 14 of them will tell their friends about this great cake for \$15 that serves 40 people," says Cathy Wanklin, Midwest regional marketing manager for Costco, who is based in Oak Brook, Illinois. " That's why one in ten Americans now has a Costco card in their wallet. " (23) That's exactly the way Costco was drawn up. " It was intentional from the beginning that Costco wanted to create this kind of effect with its marketing and, really, with how it ran and grew the whole company," says Paul Latham, Vice President of Marketing for the Issaquah, Washington-based retailer. 23) Costco figures that it saves a good two percent a year in costs because it rarely shells out money for mass-media advertising.

What it does do effectively, is target small-business owners as its primary target audience. Operating largely under the radar of the general public, Costco has cadres of marketing representatives who are attached to each store and whose continual task it is to network with business owners. (23) In other words, one to two people are working the phones all day calling

prospective members and setting up appointments, and others are out calling on businesses. These work leads that Costco gets are from business lists and networking, i. e.

unions, credit unions, church affiliations and more. (23) Outsourcing Costco turned to offshore services after it had trouble hiring programmers in 2000, during the height of the dot-com boom. The retailer is using Aliso Viejo, Calif.-based U. S. Technology Resources LLC, which operates an offshore center in Kerala, India.

(25). Costco executives weren't looking at offshore outsourcing as a way to save money. The offshore developers primarily do maintenance work, although they have been integrated into Costco's workforce and are treated as part of its development teams. Despite the outsourcing, management thinks it's essential to keep development expertise in-house and not become dependent on the outsourcer. It's also part of Costco's culture to ensure that any outsourcer the company works with pays above the prevailing wage, offers health benefits and uses full-time employees. (25) Food Safety According to Craig Wilson, Asst Vice President at Costco, food safety is part of the culture at Costco.

26) Costco's food safety program is divided into four distinct areas: Food safety operations in the warehouse club buildings, which involves a unique use of sanitation standard operating procedures (SSOPs) and Hazard Analysis & Critical Control Points (HACCP) developed to work in a retail setting; knowledge-building food safety vendor audits; a company-wide food safety training program; and a proactive quality assurance function that

focuses scientific and technical expertise on both the food safety and quality of foods manufactured, repackaged or supplied to the company. This is the four-legged foundation that provides a very solid footing for all of our programs, which are implemented on a daily basis,” notes Wilson. “ The elegance of our total food safety program is its simplicity. ” (26) It is no wonder why Costco has the reputation it has in the retail industry.

Political/Legal Costco is usually closely compared to Wal-Mart and Sam’s Club. Costco has to stay on its toes in regards to union influence, like was seen for Wal-Mart.

With an average hourly wage of \$16, Costco has been able to keep the unions satisfied so far. Only 18% of Costco’s total workforce is unionized. Union representation creates a ripple effect and helps determine labor standards in all stores. “ The agreements lock in wage and benefit packages that are the highest in the grocery and retail industry.

” (27) Costco passes on similar compensation packages to its non-union workers; the contracts act as templates for the other stores’ employee handbooks. Strong union representation isn’t the only reason Costco employees are so well compensated; the company itself has a forward looking corporate philosophy. Costco CEO Jim Senegal has said: “ We pay much better than Wal-Mart. That’s not altruism.

It’s good business. ” (27) Technology Strengths Costco, being one of the largest retailers in the U. S. , is trying hard to maintain its’ competitive competencies.

Costco has gone from once hand counting individual pieces of inventory to a new system called the AS-400, which updates the store inventory to the management every 10 to 15 minutes. This system is very important to Costco as it keeps the inventory level constant and much easier to maintain. Scheduling has been a problem for many retailers. Costco has a system which automatically schedules their employees for work, i. e.

if it is a busy season, the program will increase employee hours automatically, instead of management or human resources having to figure out which employees should work and when. The management never has to worry about being short handed or over staffed. (22) Costco's intranet is efficient and very user friendly, especially for their vendors. The fresh food section in Costco is now computerized, which reduces the manual labor hours required and increases efficiency and since these are perishable goods, their shelf life is very short and therefore food can not be over stocked or it will just be wasted. Costco always tries to offer their members fresh produce. (22) Costco has a fraud check system for every personal check written out to their company.

Costco keeps track of all checks written by a member to Costco. In the event that somebody got a hold of a checkbook that was not theirs and tried to use it at any of the Costco stores would be bound to be apprehended. It is always good for a retailer to instill customer assurance and safety. (22) Costco has a new technological rapid check-out system. With this new system, there are scanners by every product, so as the customer picks up things that they need, they just simply scan their member card by that item.



This keeps a running tally for all of the items that the member will purchase at that time. When members are finished shopping, they will give the cashier their member card and the cashier will charge the member with what has been previously scanned onto the card. This new rapid check-out system mainly takes place during the peak season right now, but they are hoping to have it become a permanent feature for members. 22) The gas pumps at Costco stores are a benefit for customers due to the lower prices charged for the fuel. How does Costco come up with the lowest price? The gas attendant has to drive around an hour before the store opens to all neighboring gas stations to check on the various gas prices being offered. The competitors' prices get entered into Costco's database, which helps them come up with the price of fuel for that day.

(21) Weaknesses On the other hand, most retailers now have sensors by their doors to help reduce shoplifting in their stores. Costco actually has two employees (depending on the period) standing by the exit door, checking everything that leaves the store, item by item, by using each customer's receipt to verify what they purchased. This one by one item check can take too long, especially during busy seasons when there are usually long lines for members. Costco can increase efficiency by coming up with a new method to help prevent any shoplifting. There are also no security cameras in the warehouses.

Members' knowledge of this could help increase theft. 22) Another weakness that members come across is the fact that Visa debit cards and American Express cards are the only two cards permitted by Costco. As a popular retailer, Costco should not limit the payment types accepted to just these

two; this may detract some important members from shopping at Costco.

(22) Returns are still done manually despite the fact that Costco has the software like other large retailers which enables the scanning of the receipt to give credit or cash back. Costco should use their system to eradicate this weakness and increase efficiency.

Economic Despite the fluctuating economy, Costco's net income rose 20.5% and sales in stores open at least one year grew 6%. Costco captured 50% of the \$70 billion U. S. wholesale club market share and boosted sales so that warehouses generate an average \$101 million annual volume, nearly double that of its nearest rival. (19) How competitive competencies does Costco use to grow so well yet keep their prices so low? •Cutting costs: " We have one mission," Costco President and CEO Jim Sinegal said, " to sell top-quality merchandise to our members at the best possible prices.

" (19) •Sells private label and branded merchandise: Costco sells private label and branded merchandise (Kirkland Signature) to businesses and individual shoppers. (19) •Sells very large volumes of merchandise and achieving high inventory turnover. (19) •Costco is open to members only. •Costco has extremely loyal members; they have renewed their membership at an 86% renewal rate. From Wall Street, Costco's kindhearted philosophies of good employee wages and great health benefits have been under fire by investors and analysts.

Analysts are more pro for the shareholders first against Costco's employee and customer first policy. Despite all the unfavorable remarks from Wall Street, Jim Sinegal stands by Costco's philosophy of putting customers and

employees first. (24) Global Costco is not just looking to expand its customer base and market share in the United States, but is always looking internationally as well. Costco understands that the market here is already retail saturated and that the most explosive growth will be internationally, in countries where big box stores are a new and novel concept. Costco operates (as of December, 2005) 66 locations in Canada, 17 in the United Kingdom, five in Korea, five in Japan, four in Taiwan (through a 55%-owned subsidiary), and 28 locations in Mexico (through a 50%-owned joint venture). The international expansion is accelerating, for instance in 2002, 11.

5% of all new Costco locations which opened were outside the United States. In 2003, that number grew to 15. 8% of all new Costco locations. For fiscal year 2004, Costco expected to spend up to 12% of its real estate, construction and remodeling budget for international expansion. While this number seems proportionally small, it is important to remember that the price of land and construction in many foreign markets may be significantly less than those in the United States. (9) While it is true that Costco is opening more and more stores internationally, the growth is not just from new stores.

For same-store sales in June of 2003, the company as a whole reported a 7% increase over the previous June. However, in the United States, that number was only 5%, while its international division ran up an 18% growth over the same period. (9) So clearly, Costco is not only opening new stores abroad, but is also ncreasing its market share and customer base at its' existing international stores. Environmental Scanning “ During a slow economy,

customers turn to wholesale clubs for everything from gasoline to fresh meats, which can be as much as 40% cheaper than at supermarkets.

When the economy picks up, many consumers figure they can easily offset their annual club fees of \$30 to \$100 through hefty savings on staples such as toilet paper or cereal. The result is that clubs are posting memberships gains even as the economy slowly rebounds. ” (10) At the moment, the economy is making a steady recovery from its recent recession in 2001. According to the U.

S. Department of Labor, the unemployment rate is the lowest it has been since August, 2001. Over the last ten years, this percentage peaked at 6. 3 percent in August of 2003. It is currently down to 4. 7 percent.

(11) This is a good indication of where the country is at economically. What this means for Costco is that they can focus marketing on such staples as toilet paper and cereal and do quite well since people are already familiar with the club and have memberships. The challenge will be getting those people to renew their current memberships. With the success of Costco’s expansion into Canada and other parts of the world, it has slowly been developing plans for further global expansion, mainly into China and Australia.

(12) China is obviously attractive in terms of its population size. It has also experienced rapid economic growth since 1999. Its gross domestic product growth rate as of 2005 was an astonishing 9. 7 percent. (13) Australia is a country that has also been steadily growing.

Its industrial development has flourished in the last twenty years and the standard of living has remained fairly high. 14) As long as the perceived benefits outweigh the possible uncertainty of entering these markets, they are appealing to the wholesale club industry. (20) Because Costco has entered foreign markets and is looking into entering more, it is important for the company to know what is going on in those countries. The U. S.

economy has an affect on how Costco does its business and how successful it is. Likewise, Costco needs to look at the economies of the countries it has entered and continues to enter. Environmental Monitoring The economy was looking pretty healthy back in the eighties and nineties when he idea of wholesale clubs started to take hold. Small businesses were thriving and Price Club took advantage of that by offering discounts on items that these small businesses couldn't find anywhere else. As the economy remained stable, Price Club, which later became Costco, slowly grew as word spread.

During the recession in the early 2000's, Costco's earnings dropped a bit, but still managed to dominate the competition. Since then, the company has only seen steady improvement. (15) Costco opened its first Canadian unit back in 1985 in Burnaby, British Columbia. Between then and 2002, they have opened 59 more. At that point, growth slowed down and they only opened 5 more stores in the years following. Competition has slowly begun to follow this trend.

Sam's Club currently owns 6 clubs in the Toronto market and plans to continue expansion there, but is still far behind the lead of Costco. Growth in Europe and Asia has not been as steady. There are currently 28 clubs

residing between the two continents. Costco plans to continue expanding into Asia, but not any time soon.

(12) These are only a couple of the environmental factors that have affected Costco and its success. As it continues to find trends in the environment and how those trends impacted its business, it can do a better job at forecasting and making future decisions. These decisions would include things like what products to bring in and where to further expand not only globally but locally. Competitive Intelligence Costco was the father of the wholesale warehouse industry, and as such has managed to always lead its game. They lead the way in providing gasoline to members and were also the first to offer a two-tiered membership program. (15) Competition, such as Sam's Club and BJ's Wholesale Club Inc.

have managed to mimic these competencies of Costco, and have been somewhat successful at it. There are multiple examples of this mimicking. The first week of January this year, Sam's Club unveiled a new health insurance offering for its small-business owner customers, a feature which Costco has been offering for some time. While the offer will not provide additional revenue for Sam's Club, it is hoped that this feature will be a justifying factor for the company's planned membership fee increase, which is being raised from \$35 to \$40 in order to closer match that of Costco's \$45 fee. BJ's Wholesale Club Inc. is also planning a \$5 fee increase.

(16) Sam's Club also brought aggressive competition to Costco with its own "dream packages" and "treasure-hunt items." These range from items such as a \$198, 000 Camaro or \$8, 000 Suzuki grand piano to fancy cookware and

fine wine. They are mostly rare items that shoppers learn to track down. One Costco executive called Sam's Club's Dream Packages a "schtick," suggesting that Sam's Club is "a copycat that yearns to draw more high-income customers, but still acts too much like its cost-conscious parent. Everything that has been done in this business has been introduced by Costco," says the company's President and Chief Executive Jim Sinegal, who is credited with pioneering the treasure-hunt strategy by sticking Rolex watches, Louis Vuitton luggage, Cannondale racing bikes and Zodiac inflatable boats at Costco's cavernous stores.

"This statement may have been presumptuous of Costco, since the "schtick" seemed to work for the benefit of Sam's. (17) BJ's Warehouse Club Inc. has taken somewhat of a different route than Costco. Some of these unique differences include aisle markers and acceptance of major credit cards and manufacturer's coupons worldwide. BJ's sees the benefits of this strategy while Costco sees benefits of the opposite. "At Costco, the larger size and absences of aisle markers creates more of treasure-hunt shopping mentality.

Rival BJ's promotes itself as a user-friendly warehouse that accepts coupons and credit cards. Traditional warehouse clubs have steered clear of accepting credit cards to avoid paying transaction fees. Costco's executive VP and CFO had this to say about the differences between his company and BJ's: "I think we've both found our respective niches. Our niche is fewer items and larger sizes for a more affluent customer. You're more likely to find '98 French Bordeaux here, as well as Tide detergent.

We've spent 25 years catering to a more upscale clientele. " BJ's has definitely found its niche in offering a broader assortment of goods in smaller locations (nearly 50 percent more SKUs than the competition), and still being able to mark up prices at a higher percentage than Costco. While its net sales per warehouse aren't nearly half of what Costco's are, its break-even point is substantially lower than Costco's: \$17 million compared to \$45 million. (15) It is extremely important with such a close rival as Sam's Club for Costco to know exactly what its competition is doing.

It must be aware of the copycatting that is taking place so that it can continue to innovate and find new distinctive competencies to set it apart from the competition. If Costco wants to maintain its leadership in the industry, it must keep a close eye on Sam's Club and BJ's and any other new entrants that may find their way into the industry. Environmental Forecasting The Washington Post stated in a February 14, 2006 article that, " White House economists said yesterday that the U. S. economy should continue to grow at a healthy pace in the years ahead.

" The article quoted the Council of Economic Advisors who said, " The economy has shifted from recovery to sustained expansion. " The CEA also mentioned that the United States' gross domestic product is likely to increase by 3. 4 percent this year, which is higher than the overall average growth rate of 3. 2 percent. 18) Costco currently has 66 units in Canada, and with Sam's Club approaching the market, must make some decisions on how much more effort it is willing to put into continued expansion there.

Executives are currently familiarizing themselves with markets such as Australia and Europe through hands-on experience.



As they become more comfortable with the culture and economy, they can better assess the benefits of entering those markets. Asian markets, like Japan, are going to be more difficult to enter due to higher costs. This market is, however, not completely undesirable since operation in Japan, particularly distribution, is improving. 12) We have seen that Costco's greatest competitors, especially Sam's club are right behind it as far as technology and innovation. As the industry proceeds in maturation, these competitors are bound to have the ability to catch up with Costco.

As long as Costco stays a step ahead in forecasting and continues to innovate, it can continue to stomp the competition. Competitive Environment In order to get a real feel for the competitive environment, we must take a look at the things that make this industry what it is. This is an industry of large quantities and even larger volume. Costco is doing business in an environment that makes a living with a three to five percent margin. In order to show profits in such a tight industry, the company must be aware of what the competition is doing at all times. This can be done on a very large scale and at the grass roots of business, meaning that each store must be able to analyze the market in which they are operating.

At the industry level it means that Costco must stay vigilant to stay ahead. Porter's Five Forces Threat of New Entrants We would rate this threat as low. This is an industry that requires a very high capital investment. It also takes time to build up relationships such as the ones that Costco has already nurtured. The company has been in business many years and is not about to let a new competitor come in and take away its key suppliers. The Bargaining Power of Buyers This could also be classified as a low threat as

there are really no buyers that Costco relies so heavily that they can demand prices lower than those offered.

This is an industry that does not have a lot very large buyers. A vast majority of the shoppers in this industry are consumers no different from you and I.

We do not have the bargaining power to demand lower prices. The

**Bargaining Power of Suppliers** Here again we find ourselves looking at an industry that is not at the mercy of its suppliers. Many of the products that are carried by large retailers have many substitutions. For example, there are televisions or cereals or shampoos made by so many suppliers that the industry is not compelled to give in to demands made by said suppliers.

**Competitors** in this market have the ability to tell suppliers what is demanded and if the suppliers are not willing to deliver the industry will go elsewhere. **The Threat of Substitute Products and Services** Now we find a threat that could be classified as high. There are really only a handful of competing firms in this market but they will fight for every customer that comes through the door. One advantage that is held in the industry is the fact that most of the firms require a membership to shop. In this way many consumers are loyal weather they like it or not.

Take this away and consumers will most definitely go to what ever store can offer the lowest prices in the most convenient manner possible. Substitutes are everywhere in this industry and without proper monitoring of competition it would be very easy to lose sales to the guy across the street. **The Intensity of Rivalry** This industry is probably one of the more fiercely competitive in the market. What makes this so prevalent is the fact that there is almost no

room for differentiation among rivals. All the companies have nearly the same product mix and if membership fees are in line then all you have left is a price war. As has been stated by professor after professor the last thing that should be fought over is price.

It makes it difficult for any one of the companies to make economic profits, thus making it even more daunting to do as any company desires to do and maximize shareholder value. Value Net This industry has made a shift in the past several years to include many complementing products in or at the stores. This has allowed the firm to grow its business exponentially. For example, Costco has added gas stations and tire centers to most of its warehouses. Offering this type of service creates much more value to the customer and makes for more revenue generating operations for the firm.

Costco is not alone in these offerings, Sam's club has similar complements and even Wal-mart (who we are not counting as a direct competitor) has made these products and services available to customers. In an industry that continually evolves itself to its surroundings there will no doubt be other services offered to improve convenience for customers. Strategic Groups Within an Industry Any large group of businesses will undoubtedly find a need to come together at some point or another to form some type of partnership that will benefit them as a whole. This is no different in the industry of shopping in bulk. Costco and other warehouse stores have a need to find suppliers that can handle the large volume that is necessary to satisfy customers. This can be a problem or it can prove to be a firm's distinctive competency.

Many of these stores could come together to form a buying conglomerate that can go into the market place and drive down costs for everyone. There is no reason for a firm to stay out on its own if there is a way to find middle ground with others long enough to create a value adding alliance. The automobile industry is a fantastic example of an industry that relies on these groups. This industry forms groups of competitors that have similar bundles of attributes. By doing so, they can all gain with higher revenues and greater market share.

It has been said that no man is an island; the same is true of industries.

Works Cited 1. Annual Report 2005. Costco Wholesale. August 28, 2005.

<http://library.corporate-ir.net/library/83/838/83830/items/177682/CostcoAnnualReportFY2005.pdf> 2.

Buss, Dale. Branding, a Job well Done.

[http://www.brandchannel.com/print\\_page.asp](http://www.brandchannel.com/print_page.asp). October 24, 2005.

3. Costco Integrates Supply Chain with SPS Commerce. <http://www.spscommerce.com/news/pr/2003/030505.shtml>.

4. Frey, Christine. Costco's love of Labor: Employees' well-being key to its success.

[http://seattlepi.nwsource.com/business/166680\\_costco29.html](http://seattlepi.nwsource.com/business/166680_costco29.html) 5. Goldberg, Steven.

Costco: Growing Giant. [www.kiplinger.com/personalfinance/columns/picks/archive/2006/pick0123.htm](http://www.kiplinger.com/personalfinance/columns/picks/archive/2006/pick0123.htm), January 23,

2006.

6. Greenhouse, Steven. How Costco Became the Anti-Wal-Mart. <http://www.nytimes.com/2005/07/17/business/yourmoney/17costco.html>, July 17, 2005

7. Investor relations. Costco Company profile.

<http://phx.corporate-ir.net/phoenix.zhtml?c=83830&irol-homeprofile> 8.

Investor Relations. Costco Code of Ethics.

[http://media.corporate-ir.net/media\\_files/NSD/cost/reports/our\\_mission.pdf](http://media.corporate-ir.net/media_files/NSD/cost/reports/our_mission.pdf)

9.

Investor Relations. Costco Corporate Governance. [http://media.corporate-ir.net/media\\_files/irol/83/83830/FinalCorporateGovernanceGuidelines.pdf](http://media.corporate-ir.net/media_files/irol/83/83830/FinalCorporateGovernanceGuidelines.pdf) 10.

Stringer, K. (2004, November 3) Wall Street Journal, p.

B. 3. Retrieved February 13, 2006, from ABI/INFORM Global database. 11.

U. S. Department of Labor; Bureau of Labor Statistics. (2006). Labor Force Statistics from the Current Population Survey. Retrieved February 14, 2006, from [http://data.bls.gov/PDQ/servlet/SurveyOutputServlet?data\\_tool=latest\\_numbers=LNS14000000](http://data.bls.gov/PDQ/servlet/SurveyOutputServlet?data_tool=latest_numbers=LNS14000000). 12.

Duff, M. (2005, December 19).

Worldwide Warehouse. DSN Retailing Today, 44(23), 40-41. Retrieved February 13, 2006, from ABI/INFORM Global database. 13.

<https://assignbuster.com/costco-internalexternal-analysis-essay/>

The great Fall of China? 2004, May 13). The Economist. Retrieved February 14, 2006, from [www. economist.](http://www.economist.com)

[com/opinion/displayStory. cfm? story.](http://www.economist.com/opinion/displayStory.cfm?story) 14. Economy.

(2005). Retrieved February 14, 2006, from [www. infoplease.](http://www.infoplease.com)

[com/cele/world/A0856772. html.](http://www.infoplease.com/cele/world/A0856772.html) 15.

Clark, K. (2001). Two Strategies, One Popular Segment. Chain Store Age, 77(11), 56-57.

Retrieved February 13, 2006, from ABI/INFORM Global database. 16. Sam's to Sell Health Plans to Some Customers. (2005, December 30). Wall Street Journal, p. A. 13. Retrieved February 13, 2006, from ABI/INFORM Global

database. 17. Hudson, K. (2005, November 11). Warehouses Go Luxe;

Costco, Sam's Club Stock Wine Coolers, Grand Pianos to Tempt Holiday Shoppers. Wall Street Journal, p. B. 1. Retrieved February 13, 2006, from

ABI/INFORM Global database. 18. Henderson, Nell. (2006, February 14).

Healthy Economic Growth Predicted. The Washington Post, p. D01. Retrieved February 14, 2006, from [www. washingtonpost.](http://www.washingtonpost.com)

[com/wp-dyn/content/article/2006/02/13/AR2006021301904. html](http://www.washingtonpost.com/wp-dyn/content/article/2006/02/13/AR2006021301904.html) 19. Costco

Wholesale. Retrieved February 21, 2006 from [http://www. priceviewer.](http://www.priceviewer.com)

[com/costco/costco. htm](http://www.priceviewer.com/costco/costco.htm) ([http://www. infoplease. com/ce6/world/A0856772.](http://www.infoplease.com/ce6/world/A0856772.html)

[html](http://www.infoplease.com/ce6/world/A0856772.html)) 22. Branding a job well done. [http://www. brandchannel.](http://www.brandchannel.com)

[om/features\\_effect. asp? pf\\_id= 286](http://www.brandchannel.com/features_effect.asp?pf_id=286) 23. Costco's Dilemma: Is Treating

Employees Well Unacceptable for a Publicly-Traded Corporation?

[http://reclaimdemocracy.](http://reclaimdemocracy.org)

[org/articles\\_2004/costco\\_employee\\_benefits\\_walmart. ht](http://reclaimdemocracy.org/articles_2004/costco_employee_benefits_walmart) 24. Sidebar: Costco

<https://assignbuster.com/costco-internalexternal-analysis-essay/>

Aims to Avoid Offshore Dependency: <http://www.computerworld.com/printthis/2005/0,4814,100972,00.html> 25. CASE STUDIES IN FOOD PROTECTION Costco Wholesale: Culturing Food Safety Success: <http://www.foodsafetymagazine.com/issues/0302/feat0302-1.htm> 26. The Costco Challenge: An Alternative to Wal-Martization? (July 5, 2005) by Moira Herbst: [www.laborresearch.org/print.php?id=391](http://www.laborresearch.org/print.php?id=391)