

Financial and Market Performance Analysis of an International Chain of Member-owned Warehouses Costco

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Abstract. The first in the United States and the third-largest chain retail, members-only warehouse store in the world is Costco. The operation description, SWOT analysis, investment competition analysis, and summary and explanation of Costco's overall condition are covered in this study. The business did well in the marketplace and made adjustments to improve performance. The business may develop smart future plans, grow Costco to new heights, and engage in fierce competition with rivals. The analysis discovered that Costco and Walmart's Sam's Club had quite distinct competition effects from the other two major retailers. The study focuses on the question of how international retailers like Costco may prosper in established foreign economies while pleasing local customers. This study attempts to further our understanding of the various business methods used by foreign retailers to influence domestic consumers in a developed market. According to the research for this essay, Costco's business plan is to offer its products at a discount, and all customers have to do to benefit from this approach is sign up for an annual membership card. The strategy works in China. Building shops rapidly is also crucial for Costco to succeed in China since its cheap price strategy depends on scale impact. They also have a consistent company philosophy and exceptional managerial skills.

Keywords: Costco; Wholesale; Investment.

1. Introduction

1.1 Background

An American multinational corporation called Costco Wholesale Corporation runs a huge retail shop network that is owned by its members. Costco was the third-largest retailer in the world as of 2020, and as of 2016, it dominated the markets for select and premium cattle, organic groceries, grilled chicken, and wine.

In addition to offering warehouse sales, Costco makes money by offering high-quality products at competitive prices across tens of thousands of product categories. The company also carefully selects and stocks only a small number of name-brand products that are in-demand and have a short shelf life. By buying these products in bulk, the company can keep retail prices low. The primary source of income for them comes from a minor yearly membership fee. Small company owners and average families that purchase in bulk are effectively catered to by the high service standards and rewards prices [1]. Analyzing Costco Wholesale Corporation's distinctive items and discounts is important for this successful business. In a manner that no other brand can, the membership model encourages consumer retention and loyalty. Beyond preserving a favorable brand image, the firm has also looked for methods to minimize purchasing costs and be environmentally friendly. Due to its limited product variety and global reach, it remains trails the competition.

1.2 Related research

According to research by Courtemanche & Carden (2014), Sam's Club from Walmart and Costco have quite distinct competitive effects. We discover that the entry of Costco is associated with higher grocery prices at incumbent retailers, and that this effect is strongest in cities with smaller populations and higher grocery store densities. We do this by comparing city-level panel grocery price data with unique data sets on Walmart and warehouse club locations [2]. The subject of how a multinational retailer like Costco can thrive in a foreign mature market and please the local consumers is addressed

by Baek & Wang (2018). The goal of this study is to advance our knowledge of how overseas retailers affect domestic consumers in a developed economy with diverse business models [3]. The strengths, weaknesses, opportunities, and threats (SWOT) that the company, Costco Wholesale Corporation, which runs a global chain of membership warehouses, faces are highlighted in a business analysis of the corporation. While its limitations are its restricted product selection and low cost operating approach, strengths include price positioning that increases consumer loyalty. Growing online retail sales and rising demand for private label goods present opportunities for improvement [4].

An overview of Costco Wholesale Corp., a chain of membership warehouses that operates globally, is provided. A description of the business is provided, along with pertinent information including contact details, headcount, and earnings. Strengths, weaknesses, chances for progress, and threats are listed in a SWOT analysis [5]. One of the key requirements for the management of financial resources is the financial analysis of any firm. Based on a thorough financial analysis, the report seeks to determine Costco Wholesale Corporation's financial strengths and shortcomings [6]. The goal of this essay is to do a financial study of Costco's success in the UK market. The following three KPIs—total sales, gross margin, and net margin KPIs—will be used in this study to do both historical and comparative financial analysis over a five-year (2013-2018) period. Findings: Over the past five years, Costco UK's financial situation has shown stable rise in profitability but significant growth in sales, reaching approximately 60% growth sales [7].

Despite posting 5% increase in December 2014, the article discusses potential difficulties Costco Wholesale Corp. in Issaquah, Washington, may experience. Discussion topics include Costco's strongest December results in the Midwest, Northeast, and Southeast, as well as the company's apparent poorest performance since February 2014, as assessed by John Heinbockel, managing director for Guggenheim Securities, New York [8]. The article states that Wal-Mart Stores Inc. and Costco Cos. will begin carrying the jointly produced Wire Rope Lubricant (WRL-191s) by Jaymor Enterprises Inc. In July 2012, Inc. outlets opened in Clovis, California. The item, now known as Jaymor's 191s, is available in lesser quantities for domestic uses. By summer of this year, according to Gerald Moreno, president of Jaymor, a new biodegradable degreaser will be released [9].

In order to boost profitability, it examines how Costco manages sales. Its suggested course of action is for Costco to reduce membership dues by 35%. Online purchasing should be expanded and funded. Opening new stores domestically or abroad can be quite lucrative. Changing the membership fee is a good strategy to boost membership, which is directly correlated with sales [10]. It says that on March 3, Costco Wholesale Corp. easily above Wall Street projections, achieving a 25% profit increase in its most recent quarter on top of a 14% increase in sales. Even the warehouse club increased its projected earnings for the remainder of 2004. by causing a 4% decline in the Issaquah company's shares. The fact that Costco pays its employees significantly better than its rival Wal-Mart Stores Inc. does is one issue for Wall Street, and analysts are concerned that Costco's operating costs may spiral out of control [11].

1.3 Objective

This research's aim is to examine Costco's business environment. Based on a thorough financial research, the goal of this study is to identify Costco Wholesale's financial advantages and disadvantages. Through financial analysis, this essay will make an effort to evaluate Costco's success in the UK market. The following are the precise goals of this study:

Analyze Costco's overall performance in relation to the internal and external environments.

Utilize the three major performance metrics listed below, do financial analysis of historical and comparative performance; key performance metrics for the five-year period (2013-2018) of gross sales, gross margin, and net margin.

Explain whether Costco's performance in operation can be used for reference.

2. Operating Description of Costco

Customers in Costco can complete all the family life related purchases. Customers can find a wide variety of products and services at Costco, all of the best caliber and value. Middle-class customers can get lifestyle solutions from Costco. Costco makes a lot of money from its members while providing excellent service. Nearly 75% of Costco's operating profit comes from membership fees. With this ticket, you can get inside and enjoy all its services.

Despite having very enormous stores, Costco doesn't truly have a wide variety of products since it strictly regulates the SKUs for each category. Only 4,000 SKUs total, including around 3,000 basics and about 1,000 impulsive purchases, are available at Costco. There are 35 times as many SKUs in Walmart's U.S. locations as there are in Costco. This ultra-low SKU strategy provides three benefits, the first of which is the reduction of transaction costs. And Costco only for consumers to provide the best two or three kinds of explosive. The purchase quantity of each SKU will naturally be much larger, which also gives Costco more bargaining power when negotiating with suppliers. The second is to guarantee the caliber of the goods. External suppliers can only perform to the best of their abilities if they want to earn a profit, and the price will be maintained as low as possible due to Costco's category, SKU, and stringent control. The third is to reduce the time for consumers to choose. In the selection of products, open customer has a huge procurement department, all merchants of the goods must go through layers of audit, will appear in front of consumers.

Costco's average gross profit margin is just 11%, compared with more than 25% at rival Wal-Mart. In fact, Costco not only doesn't care how to make more money from customers, but also strictly rules that the gross profit margin of the products on the shelves cannot exceed 14%. The way Costco makes money is not by selling goods, but through membership fees as we mentioned earlier. As long as the members feel value for money, will continue to come back to consume, and Costco to do is to maximize the value of their members to provide.

As a Costco member, if you are not satisfied, you can apply for an unconditional refund at any time and get a full refund. This is a good service Costco gives its members. In addition, Costco stores are full of various tasting activities, and Costco salespeople will recommend a large number of tastings for you enthusiastically. Just to get more people to eat. As soon as there is a tasting event, sales of the product can increase by two to three times that day. To further enhance the brand's influence, Costco also launched its own brand Kirkland, which includes health products, food, kitchenware, clothing and other categories. In this highly competitive category, the Coker, quality assurance endorsement of Kirkland is naturally popular among consumers. Now Kirkland as a brand has been accounted for 30% of revenue. With the continuous increase of the number of stores and members, Costco can further improve its premium ability when negotiating with suppliers, to bring better and cheaper goods to consumers, so as to complete a positive business cycle.

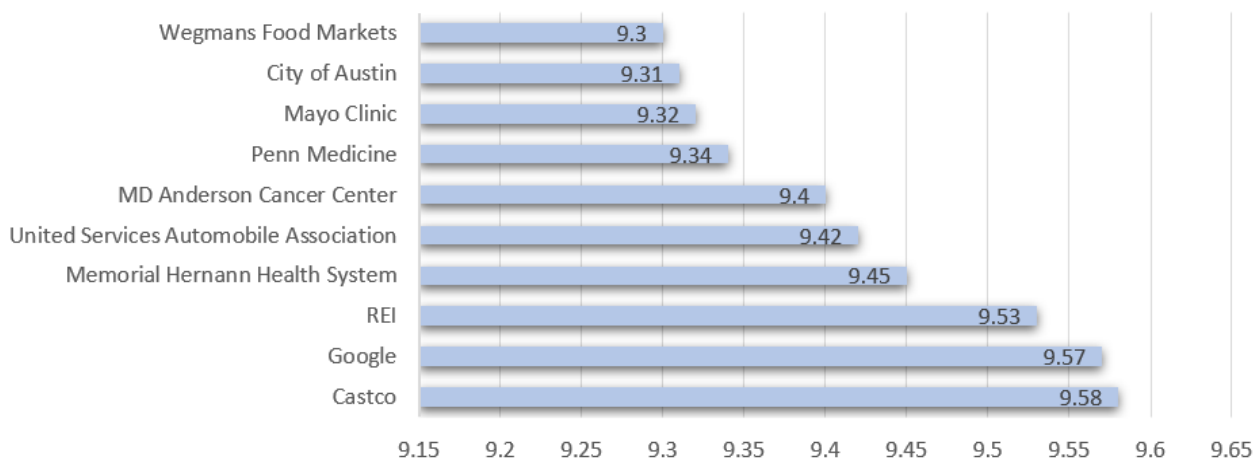


Fig 1. America's Best Large Employers.

Costco's employee satisfaction is also very high. For a very typical cashier position in a supermarket, the average wage for a Costco cashier is \$16 an hour. The average hourly wage for cashiers at Walmart and Target, the two main competitors, is just \$12. Costco is nearly 35 percent higher. Costco pays its employees well because its corporate culture and business model are different from traditional supermarkets. Costco is not relying on low product costs to earn the difference. The secret of successful haggling is the growing membership ecology, whether it is a selection of products or one-stop service, Costco's purpose is to make members stick to the consumption here, charging more and more membership fees. So, the membership fee is the basis of Costco.

3. SWOT

3.1 Strength

Costco offers attractive low prices on almost any item or service in its stores and online. Fast inventory turnover, high sales, increased revenue. Despite the lower prices, sales have maintained high growth. High sales volumes help improve operational efficiency. Costco reduces variable costs and improves operational efficiency.

3.2 Weakness

One of Costco's main flaws is its member-owned warehouse retail business model. Although this strategy limits the total number of consumers, it promotes shopping at Costco locations. Non-members are not permitted to make purchases at Costco. One drawback of Costco is its small range of goods and services. Customers might make purchases from other retailers, such as Walmart, which has a larger assortment of products and services.

3.3 Opportunity

Costco has a chance to get into developing countries like Asia. The possibility exists for Costco to broaden the audience for its online store. Currently, the business provides online services to shops in the US, Canada, the UK, Australia, Mexico, Taiwan, South Korea, Japan, Spain, and Iceland. In order to boost the appeal of Costco locations to a wider range of customers, Costco also has the potential to broaden the selection of products and services offered.

3.4 Threat

The ability for Costco to prosper in international markets is threatened by the emergence of new warehouse-branded businesses. In foreign markets, the number of new warehouse subscriptions is rising. Costco is also under danger from the aggressive marketing of competing retail businesses.

4. Investment Analysis

4.1 Competition

4.1.1 Industry rivalry

There are numerous huge grocery chains in China, such Auchan in France, Metro in Germany, and Wal-Mart in the United States. Large supermarket chains have currently basically reached a mature stage following years of continuous development, with modest increase in market demand and strong rivalry. Large grocery chains face particularly tough competition since their items are consistently good and rarely different, which makes brand loyalty among customers less strong.

4.1.2 Threat of new entrants

Economies of scale start to take effect when the major supermarket companies get older. Potential newcomers are hampered by its existence, and it presents a problem for recent arrivals. It is not particularly encouraging for new competitors to battle with established players in order to obtain

market share. Large sums of money and unclear returns on investment significantly reduce the threat. Existing businesses will still be threatened by potential competitors. Existing businesses will employ specific strategies and tactics to keep their hegemony. Because the large grocery chains provide a more reliable product, it is challenging to reject.

4.1.3 Threat of substitutes

Existing businesses will unavoidably face a serious threat from the entry of replacements. The easiest thing for customers to be drawn to is alternatives because they are so simple to obtain. The customer's decision will be influenced by price, quality, performance, and switching costs. The cost performance ratio is what clients value most. Customers have minimal switching costs as a result of the excessive consistency and lack of significant variances in products found in large grocery chains. The risk of substitution is therefore very high for the large grocery chains.

4.1.4 Bargaining power

When a huge supermarket chain is involved, the products that the supermarket sells are supplied by a supplier. In this case, the supplier is the seller. The seller always seeks to increase the price to increase profit and impact the competition, but since the buyer is also the seller, he should be able to negotiate the price increase. Both are at distinct angles and are about to come up with various solutions in order to maintain cost competitiveness.

Buyers typically haggle to lower the purchase price, and this buyer bargaining power is certain to impact some of the competition between already-existing businesses. Large supermarket chains have considerable negotiating influence with their suppliers, but because they primarily deal with consumers, they have weak negotiating strength with one another because of their average buy volume. Additionally, in major chain stores like this one, the prices of the goods are plainly displayed, reducing the likelihood of overt client haggling.

4.2 Fundamental Analysis and investment recommendation

Costco's expansion of 20 new stores in previous years was slowed by the pandemic, but it also opened 13 stores. Costco's 2020 sales hit an all-time high of \$163 billion. In 2020, Costco's comparable store sales climbed by 8%. Acquired INNOVEL to improve its ability to go the extra mile. Costco planned to have 795 locations worldwide by the year 2020. 22 more outlets are expected in 2021. Costco generates \$3.5 billion in yearly membership fee revenue from its 59-million-member homes and 107 million membership cards worldwide.

On August 27, 2019, Costco opened its first physical location on the Chinese mainland in Shanghai. More than 200,000 paying members had already signed up before and within a few days of the store's debut, and there was a lively scene there. By February 2021, Costco decided to open a second store in Shanghai and stores in Suzhou, Hangzhou and Shenzhen. The pandemic in 2020 and the Chinese New Year of the Ox in 2021 allowed Sam's CLUB and Costco WHOLESale to lead the brick-and-mortar retail growth in the retail format of the Chinese market, supported by a strong supply chain. The moves of these two warehouse membership giants reflect the long-term development opportunities of this retail format in the Chinese market. Although Costco entered the Chinese mainland market late, it seems that the consumer demand in China's first and second tier cities at this stage is more suitable for the development environment of this retail format.

Costco (COST) released its operating results for the third quarter ended May 8, 2022 and the first 36 weeks of fiscal 2022 after the market closed on Thursday, May 26. Unlike Wal-Mart (WMT), which reported weaker-than-expected first-quarter results, Costco's higher-than-expected results came on continued strong consumer demand for its food, household goods and fuel amid a surge in inflation. But Costco shares, which closed 5.65 percent on Thursday, fell more than 2 percent after hours as its gross profit margin fell 0.99 percent in the third quarter, bringing its year-to-date loss to 17.95 percent.

Table 1. Costco Wholesale Corporation Consolidated Statements of Income.

	12 Week Ended		36 Week Ended	
	May 8, 2022	May 9, 2021	May 8, 2022	May 9, 2021
REVENUE				
Net sales	\$51,612	\$44,376	\$151,966	130,611
Membership fees	984	901	2,897	2,643
Total revenue	52,569	45,277	154,863	133,254
OPERATING EXPENSES				
Merchandise costs	46,355	39,415	135,824	115,951
Selling, general and administrative	4,450	4,199	13,743	12,870
Operating income	1,791	1,663	5,296	4,433
OTHER INCOME (EXPENSE)				
Interest expense	(35)	(40)	(110)	(119)
Interest income and other, net	71	27	138	75
INCOME BEFORE INCOME TAXES	1,827	1,650	5,324	4,389
Provision for income taxes	455	417	1,287	1,004
Net income including noncontrolling interests	1,372	1,233	4,037	3,385
Net income attributable to noncontrolling interests	(19)	(13)	(61)	(48)
NET INCOME ATTRIBUTABLE TO COSTCO	\$1,353	\$1,220	\$3,976	\$3,337
NET INCOME PER COMMON SHARE ATTRIBUTABLE TO COSTCO				
Basic	\$3.05	\$2.75	\$8.96	\$7.53
Diluted	\$3.04	\$2.75	\$8.94	\$7.51
Shares used in calculation (000s)				
Basic	443,700	443,043	443,567	443,043
Diluted	444,866	444,127	444,802	444,336

Table 2. Costco Wholesale Sales channel.

	12 Week	12 Week	36 Week	36 Week
		Adjusted		Adjusted
U.S.	16.6%	10.7%	15.8%	10.7%
Canada	15.2%	12.8%	16.1%	11.2%
Other International	5.7%	9.1%	8.3%	9.6%
Total Company	14.9%	10.8%	14.8%	10.6%
E-commerce	7.4%	7.9%	11.4%	11.3%

Core financial measures include: Membership revenue was \$984 million, up 9.2% year over year, while third-quarter net sales grew 16% year over year to \$51.612 billion from \$44.376 billion last year. The first 36 weeks of fiscal 2022 had a 16.4% increase in net sales, from \$130.61 billion to \$151.97 billion. The third quarter's profit increased from \$1.22 billion to \$1.353 billion. Analysts had predicted adjusted earnings of \$3.04 per share, up from \$0.09 per share in the same period last year. Compared to the same period last year, the profit for the first 36 weeks of fiscal 2022 was \$3.98 billion, up from \$3.34 billion. Adjusted earnings per share for the first 36 weeks of fiscal 2022 were \$8.94, compared with \$7.51 in the same period last year.

5. Conclusion

Costco's business model is to retail at a wholesale price, and consumers only need to apply for an annual card to enjoy the wholesale price. This low price attracts not only many home shoppers, but also many business users. Costco's core competency is that it offers consumers prices so low that they can hardly resist them, making it difficult for competitors to do so. Costco and other large supermarkets and even some e-commerce platforms have much lower prices and profit margins relative to their products, which is simply too difficult for competitors. Not only does it fail to make money with such low prices, it will also lose money without cost control, and Costco will also manage its cost of goods sold to the extreme. Costco's superior cost management will also be hard for competitors to replicate.

In addition to their consistent business philosophy and excellent management experience, Costco's model works in China. However, for Costco to be successful in China, they must also open stores quickly enough to take advantage of the scale effect, which makes it difficult to implement their low-price strategy. The first low-cost strategy successfully occupied the region in the process of urbanization, but the market is large enough, a lot of can't eat the whole market for a period of time, the timing of the Costco to enter the Chinese is perfect, it can be different ways to compete with e-commerce. Costco was developed against the backdrop of the era of urbanization in the United States. Naturally, there are some drawbacks to Costco. For instance, it chooses all of its products independently, which results in a very small number of SKUs. The coverage of individuals is also constrained because it is an offline store, which is inferior to e-commerce.

The investment prospects for Costco are impressive, thanks to Costco's high dividend payout in recent years and a far higher return on equity (ROE) than its peers (24%), as well as Costco's solid moat to withstand the impact of e-commerce and its ability to compete with e-commerce platforms. Costco can succeed in China and drive overall growth.

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