

# Costco Buying and Operating

The foundation of Costco's buying and operating philosophy centers on nine key concepts: quality, low prices, six merchandising rights, business members, reduced operating expenses, fresh foods, creativity, private label and organic. In addition, there are a number of specific principles that vendors need to understand to successfully sell a Costco buyer.

## Quality

Describing any business in one word is difficult, but if pushed to describe Costco's buying and operating philosophy in one word, that would be "quality". Costco believes it is easy and wrong to offer low prices on low-quality merchandise. The trick, from their point of view, is to be able to stock and sell high-quality products at lower prices than can be found elsewhere. This creates the value proposition that convinces members to continue to pay to shop.

The issue of quality is so central to Costco's purchasing decisions that buyers are rarely concerned with price point until they are satisfied a product will meet their members' expectations. With such a focus on quality, the first step a manufacturer should take before approaching Costco is to truly assess whether or not their product is distinguished from a quality perspective in comparison to competitive products.

**Quality Due to Wholesale Member** – Jim Sinegal, Costco's founder and former president and chief executive officer, was interviewed by *The Motley Fool* in July, 2012. Sinegal discussed how the company's focus on the business member led it to also focus so strongly on product quality. He said, "Our business customer is still our most important customer that we have, and so that was the type of thing that helped the evolution of the products that we carry. Because when we determined that we had an upper-scale customer, people that own businesses generally are at the top end of the demographic scale, we knew that if anybody could sell Waterford crystal, Costco could. And so it became a stimulus for us going out and trying to upgrade the quality of every product that we carry."

**Kirkland Signature Tuna** – One product that exemplifies Costco's drive for quality is its Kirkland Signature private label albacore tuna. The product is made from 100% solid albacore loins and each can contain only one solid piece of loin that is cut to fit the can. Costco mandates that the albacore must be "line caught" instead of allowing for the use of nets. The product does not contain vegetable broth or hydrolyzed protein which are ingredients used by some national brands resulting in a less expensive, diluted product containing less protein.

The end result is that Costco's private label tuna is of a higher quality than competing national brands. Costco's focus on tuna quality results in a unique situation. Instead of selling at a discount compared to competing national tuna brands, Costco's Kirkland Signature albacore tuna sells for approximately the same price to slightly higher with the difference being that quality.

## Low Prices

Costco's goal is to sell merchandise at the lowest possible price. Costco will not sell any branded item for more than a 14% gross margin and any private label item for more than a 15% gross margin. To back this up, Costco has reports that notify executives when this situation occurs so an explanation can be given. When offered rebates and allowances from vendors, Costco's philosophy is to reflect those deals in the cost of goods and lower the item's retail price.

In the Fall, 2016, club suppliers were asked what merchandise gross margins the clubs generated on their products. Respondents do not necessarily know the cost each club allocates for its cross dock and/or distribution center. Therefore, the merchandise gross margin results may be slightly elevated.

Respondents reported that Costco's average merchandise gross margins increased from 13% in 2014 to 14% in 2015 and 2016. Sam's merchandise gross margins have been increased from 16% in 2014 and 2015 to 17% in 2016. BJ's merchandise gross margins, the highest in the warehouse club industry, increased from 17% in 2014 to 18% in 2015 to 20% in 2016.

## Six Merchandising Rights

Costco's buying and merchandising philosophy is based on Sol Price's six rights of merchandising. A Costco food vendor said, "Costco has specific things they are looking for. I follow Costco's blueprint which is the six rights of merchandising. Along with understanding Costco, their member and their merchandising strategy, I know exactly how to prepare for meetings." The six rights of merchandising are dedicated to providing the:

1. **Right Merchandise** – high quality brand name and private label items.
2. **Right Place** – merchandising standards created to maximize sales, secure product and reduce handling and storage.
3. **Right Time** – maintain in-stock positions without being overstocked and transition seasonal merchandise.
4. **Right Quantity** – utilize just-in-time principles when ordering merchandise.
5. **Right Condition** – merchandise should be packaged, pre-marked and prepared for the club environment.
6. **Right Price** – assure low prices through volume buying, expense reduction and low gross margins.

## Business Members

Costco's focus on the business owner started when it opened its first club in Seattle, Washington. The company knew that by attracting business owners, they were also attracting wealthy individuals who would also shop for themselves.

Despite being a 14 year old quote, the following remains true. In a November 10, 2003 article in *Fortune*, Jeff Brotman, chairman of the board of directors at Costco, said, "We understood that small-business owners, as a rule, are the wealthiest people in a community, so they would not only spend significant money on their businesses, they'd spend a lot on themselves if you gave them quality and value."

## Reduced Operating Expenses

One of Costco's goals is to constantly improve club operations as well as search for ways to reduce costs. By reducing operating costs, Costco's philosophy is to use those savings to reduce retail prices and to help improve overall profitability.

**Limited Assortment** – Costco has consistently kept its SKU count around 3,700 to 3,900 items. This enables Costco to merchandise the majority of its items on full pallets, reducing the amount of labor needed to restock those SKUs during the day. This is especially important as items that need to be pulled down from the steel during business hours require three employees, one to drive the forklift and two on either side of the aisle to prevent members from entering. Reducing the number of times employees retrieve inventory from the steel clearly reduces expenses.

**Advertising** – Costco views advertising as a cost and it has never been part of its operating strategy. Sinegal said, "If you advertise, you have to raise the price of the merchandise, it is that simple ... We feel that the most successful type of advertising is word of mouth. When people are saying good things about you, it is much more important than when you say them about yourself."

**Salary and Benefits** – Costco's salary and benefit program is among the best in the retail industry. Costco believes that by paying well, employees stay with the company longer, learn the business and make its overall operation more efficient. Sinegal said, "It's just good business. I mean obviously anyone who is a business person thinks about the importance of people to their operation. You've got to want to get the very best people that you can, and you want to be able to keep them and provide some job security for them. That's not just altruism, it's good business."

**Milk** – The milk category in the club channel has evolved over the past 18 years. Costco was the first club to sell cardboard boxes with two 1-gallon bottles of milk. Initially, milk was sold in gallon containers merchandised on wheeled carts that could not be stored in the steel. In high volume locations, a club would need to have a lot of milk on hand, especially during weekends. Those carts took up space on the cooler floor making it difficult for club employees to maneuver inside the cooler.

Around 19 to 21 years ago, Costco began selling that two 1-gallon cardboard box. In addition to the benefits of a higher price point and the potential savings by selling a larger amount of milk, the two one-gallon boxed containers were stored and merchandised on pallets and could be easily inventoried on the steel inside the cooler freeing up space on the cooler floor.

## Fresh Foods

Costco's fresh food departments (meat, bakery, produce, deli and prepared foods) are an important part of its business model. Not only is sales growth robust with fresh food comparable sales consistently among Costco's strongest but the departments help to increase member shopping frequency.

The chart on the right shows department penetration and sales figures for Costco's most recent five fiscal years. The department penetration figures are reported by Costco in its 10K annual report.

Fresh food sales have increased an average of 7% annually (eclipsing ancillary annual growth which was flat, hardlines annual growth at 5%, sundries annual growth at 3% and food growth at 6%) from \$12.62 billion in fiscal year 2012 to \$16.25 billion in fiscal year 2016.

Fiscal Year	CAGR	2016	2015	2014	2013	2012
Sundries	3%	\$24,375	\$23,870	\$23,145	\$22,529	\$21,354
		21%	21%	21%	22%	22%
Food	6%	\$25,536	\$25,007	\$24,247	\$21,500	\$20,383
		22%	22%	22%	21%	21%
Hardlines	5%	\$18,572	\$18,187	\$17,634	\$16,356	\$15,530
		16%	16%	16%	16%	16%
Softlines	9%	\$13,929	\$12,503	\$12,123	\$11,213	\$9,706
		12%	11%	11%	11%	10%
Fresh Food	7%	\$16,250	\$15,913	\$14,328	\$13,373	\$12,618
		14%	14%	13%	13%	13%
Ancillary	0%	\$17,411	\$18,187	\$18,736	\$17,899	\$17,471
		15%	16%	17%	17%	18%

WCF Research, Costco Annual Reports

**Fresh Food Introduction** – Costco was the first club to introduce fresh foods. Ed Maron, a former Costco executive who is now retired, was given responsibility for introducing fresh foods at Costco in the late 1980s. The company was committed to the fresh food concept which helped it overcome many mistakes. Maron said, “That was really the first idea that we didn’t clone from Price Club. The general sense was that fresh foods wouldn’t work in the wholesale club format. We made every mistake that could be made, but we learned from every one of them.”

**Simplistic Philosophy** – In an interview with *Meat & Deli Retailer* (the October/November 2007 issue), Doug Holbrook, assistant general merchandise manager for fresh meat and corporate foods at Costco (at the time), said, “A limited number of SKUs enable our buyers to make sure the items they are purchasing are done right ... We don’t make things complicated. We don’t cut a thin pork chop, or a thick pork chop, or a stuffed pork chop or a butterfly pork chop. We cut a boneless pork chop. What made us successful is making sure we are right with the top items.”

## Creativity

One of Costco’s key buying strategies is to constantly “push the envelope” in terms of its product assortment. A non-food vendor said, “Costco’s buyers have full authority to do what they want. They’re given freedom to make mistakes.” Commenting on Costco’s coffin business, Sinegal said, “When somebody sees that you’re willing to take a chance on coffins, odds are they’ll come up with some other good ideas.”

Costco’s vice president and general merchandise manager of bakery, service deli and food service said, “The best method for us is to put [a new item] in a club and see if it has legs. We sometimes spend a lot of time creating items that last a few weeks. If something is not growing it needs to be changed. And we’ll also take an item that is really good and try to make it better ... Some items sell great for six months and then drop off as members tire of them, while others last two to five years. But new items are the spice that keeps people coming back. By offering different selections you get more of their attention.”

## Private Label

In 1995, Costco introduced its Kirkland Signature private label brand. Its private label strategy initially focused on premium SKUs in high volume “consumer need” categories. As members began to recognize Kirkland Signature’s quality, Costco expanded its selection to categories and items not traditionally associated with private label such as a mechanics tool set and light beer. As of February, 2017, Costco’s 584 private label items generated 25.3% of the company’s overall sales.

**Co-Branding** - An important concept in developing a strong private label program is member acceptance. One way that Costco achieves this is to co-brand its Kirkland Signature label with existing brand-name products. By associating the Kirkland Signature name with an existing known consumer brand, members associate the quality of the branded company to Costco and Kirkland Signature.

Costco has placed its Kirkland Signature label on the following products: jelly beans with Jelly Belly, aluminum foil with Reynolds, grape juice with Newman’s Own, shortbread cookies with Walker’s, cranberry juice with Ocean Spray, whole bean coffee with Starbucks and raisin bran cereal with Post.

**Gasoline** – Costco extends its Kirkland Signature brand to its gasoline business. Costco’s sells two types of gasoline: Kirkland Signature regular unleaded and Kirkland Signature premium. All gasoline is required to have detergent additives mixed in. These detergent additives are not soap. Rather, they are organic materials that help keep an engine clean. Costco’s Kirkland Signature gasoline includes five-times the government minimum of detergent additives.

As Costco’s gasoline business grew, Costco was faced with the challenge of making sure its gasoline always had the appropriate mixture of additives. Costco determined the best way to control the additive mixture was to blend it on site when gasoline was delivered. To achieve this, Costco trained its gasoline station attendants to not only handle emergencies, customer service and pump operations but to make sure the additives are blended correctly.

## Organic

Costco’s first organic item, Earthbound Farm’s organic spring greens, was stocked in 1992 and its first Kirkland Signature organic item, milk, was stocked in 2004. Today, Costco’s organic business generates approximately \$4 billion in sales annually. Costco’s focus on organic merchandise has grown over the past few years due to six benefits it accrues from these items:

1. Organic merchandise reinforces a member’s perception of Costco’s focus on product quality.
2. Organic merchandise is more expensive to produce resulting in higher retail price points helping to increase Costco’s average transaction.
3. Organic merchandise adds to the treasure hunt club buying philosophy.

4. Organic merchandise supports Costco's search for exclusive or hard to find products.
5. Organic merchandise generates the necessary sales dollars for Costco buyers to continue to purchase otherwise these items would not be stocked.
6. Costco has found that in many cases, organic merchandise sales are incremental. For example, sales of organic ground beef did not dramatically reduce sales of non-organic ground beef.

**Costco's Organic Goal** – Jeff Lyons, senior vice president of fresh foods at Costco commented on Costco's overall organic goal and its plan to secure its own organic meat supply. Lyons said, "[Our goal is] to continue to grow the organic program in every area where it makes sense, not only for our suppliers, but also for our members. And to try and bridge some of the gaps we have in weather and times of the year, because there are certain times of the year [when] it's very hard to grow organics. With organic meat, we're in the process of securing our own resources to ensure the sustainability of the program."

**Vendor Support** – For farmers, converting an operation to produce organic products is not only expensive but time consuming. Additionally, weather and pests can interfere with a crop at any time. For that reason, Costco not only works very closely with its organic suppliers/farmers but supports them for the long term.

Lyons said, "If along the way, a problem occurs with an organic crop due to weather or pest influences, then sometimes that farmer, depending on how far along that crop is, loses everything. In that case, the farmer may have to go to conventional just to save his farm ... and we would support him and buy the conventional item from him."

**Product Development** – When developing new organic items or asking a farmer to convert a conventional item to organic, Costco works closely with suppliers to determine if the club operator will be able to offer a value for the new/converted organic item. Lyons said, "We're not ever going to have a supplier plant something and then hurt them. We'd rather know upfront what the costs are going to be. If they say it's going to be five times the cost of conventional, we'd probably say ... 'Let's look at this and see if there's something else we can do.'"

**Supply** – Lyons discussed the issues farms/suppliers face regarding supply on their organic items. He said, "With organic crops, [farmers] don't have some of the tools that they would have with conventional crops, so they have to make sure they've got good weather and good everything for the crop to make it to delivery. With certain produce, such as leafy greens, it's easier to grow organic because they repopulate quickly ... In some products, such as blueberries, it takes three years for an organic blueberry plant to propagate and give off any fruit."

**Financing** – To help the company create a consistent source of organic food, Costco tested a loan program to help farmers grow organic merchandise. The company is currently working with just one supplier, San Diego, California-based Andrew and Williamson Fresh Produce (A&W). The loan will enable the company to buy equipment and 1,200 acres of land in the Mexico state of Baja California.

Lyons was visiting A&W when they explained that the farmer heard about 1,200 acres of land for sale along the Pacific Coast that would be ideal to grow organic merchandise such as strawberries, raspberries, blackberries and tomatoes. However, the company did not have the capital to purchase the land.

In return for making the loan to A&W, Costco has the right of first refusal to everything grown on the land that meets its requirements. Lyons said, "By helping them with financing, we got access to and purchased about 145,000 cases of organic raspberries that we normally would not have access to because they normally would not have done the deal or could not have done it. Or, if they could have, we may not have gotten first dibs."

## Selling Costco Buyers

In addition to the nine key buying and merchandising philosophies listed previously, there are a number of important concepts (in no particular order) that further define what Costco buyers want and need from a vendor to create a successful club item.

**Meeting Preparation** – Costco buyers expect a vendor to be an expert on their product, competitive items and marketplace trends. A food vendor said, "Be prepared to know your product inside and out. Costco buyers are the most knowledgeable buyers on products, production and ingredients." The depth of questioning from a Costco buyer is usually far more detailed than what is experienced in most other retail settings. Vendors should be prepared to discuss the following seven subjects: product components, production, market presence, quality, packaging, marketing and purchasing/ordering requirements.

**Package Sizes** – Costco buyers are more likely to purchase larger sized products in comparison to BJ's and Sam's Club buyers. In a July, 2012 interview with *The Motley Fool*, Sinegal said, "The larger sizes almost always create a better savings for the consumer. It's very rare when it doesn't create a significant savings, and so we view it from that standpoint."

In addition to potentially attaining a lower unit cost, larger packages positively affect the clubs in the following four ways: the club's average transaction increases helping to reduce payroll as a percentage of sales, studies have shown that larger packages are consumed more quickly potentially increasing sales, the club generates higher gross margin dollars and, in most cases, more product can be engineered to fit on a pallet or a truck lowering the freight cost per selling unit.

**Sustainable Buying** – Costco buyers want to purchase merchandise from suppliers who use sustainable production methods or through organizations whose goal is to support the people who produce the products. The following are two examples:

**Rwandan Coffee** – For approximately three months a year, Costco sells a Kirkland Signature private label whole bean coffee grown and processed in Rwanda. Sinegal became involved in Rwanda through a meeting with two Costco investors at Costco's corporate office in Issaquah. That conversation dovetailed into a discussion on Rwanda with the investors suggesting Sinegal meet Paul Kagame, the president of Rwanda. Sinegal and President Kagame met for lunch in New York and discussed many things including Rwanda's coffee business. Sinegal learned about Rwanda's strong coffee growing climate and the high quality coffee grown in the country.

Costco buyers were sent to Rwanda to investigate and "without any prompting from" Sinegal, created a purchasing system for premium Rwandan coffee making sure the resulting funds were paid to Rwandan farmers. Sinegal said, "They also initiated a program to enhance the farmers' production of the beans by setting up washing stations and pulling out the best beans. Today, I think we buy something like 25% of the premium coffee coming out of Rwanda."

**Flowers** – Costco only sells Rainforest Alliance roses which are certified as sustainably grown. A Costco floral buyer, said, "Costco was one of the first retailers in the country to commit to only selling sustainably grown long-stemmed cut roses. This assures the company and Costco members that the beautiful flowers they purchase in the warehouse are not causing harm to the people who grow them."

Costco's rose distribution system keeps the flowers at a temperature of 35 degrees Fahrenheit. Rose specifications include a minimum length of 19.67-inches (50 centimeters) and most varieties have slightly opened buds. In terms of distribution, Costco's goal is for the flowers to travel two to five days from harvest to the production facility and less than two more days of travel to a club location.

**IRI/Nielsen Data** – Since 2004, Costco and Information Resources Incorporated (IRI) have been providing vendors in the United States and Canada with access to sales and inventory information through the Costco Collaborative Retail Exchange (CRX) point-of-sale program. The data platform is managed by IRI. Since that time, more than 750 vendors have used the program. The program was updated in 2013. The enhancements included: category data, real-time sales, supply chain solution, seasonal and UPC data.

**Category Data** – Vendors can benchmark their product sales data against the category as well as sub-categories.

**Real-Time Sales** – Vendors can receive daily sales and inventory of their items every day of the week from all locations.

**Supply Chain Solution** – Three new inventory data metrics are now included: in transit orders, on orders and orders received. Adding these data points to the program's existing inventory information (inventory on hand and average days supply) provides vendors with a more complete view of their product's inventory situation.

**Seasonal** – The category data now includes a three year historical view of seasonal trends enabling vendors to make better decisions regarding inventory and sales planning, product demonstrations and promotional activities.

**UPC Data** – UPC-level visibility provides sales information by size and color.

**National Buying Group** – Costco's national buying committees are comprised of buyers and/or general merchandise managers from each region. The buying committees work with select items from food and sundry categories and make company-wide purchases. The national buying group's goal is to reduce product costs seeking a decline of 15% to 20%.

**MVM Coupon Program** – Costco's MVM (multi vendor mailer) coupon program is run approximately 11 to 12 times per year for approximately 25 days each. Each MVM has approximately 90 to 110 items. MVM redemption rates are extremely high. Costco and its vendors plan for those high redemption rates and order an appropriate amount of product prior to an item's MVM period. As a result, MVM coupon items typically receive a free end cap.

Costco changed its coupon program eliminating the need for the member to "clip and present" a coupon. Under its previous coupon program, Costco members were presented with three coupon types: an instant savings coupon that did not require the member to "clip and present" a coupon, a coupon that needed to be clipped and presented at checkout and an online-only coupon. The coupon program changes were introduced with Costco's August, 2013 coupon book. Items are now divided into two categories: instant redeemable coupons/discounts and online-only offers.

**Food Safety, Food Testing and Social Audits** – All vendors doing business with Costco may be subject to audits and tests. Costco buyers are up front about its quality assurance program and view it as part of its partnership with suppliers. Those audits can include:

**Food Audits** - Costco requires a food safety audit before a vendor begins shipping merchandise. There are only six Costco-approved food safety auditing companies worldwide and only BRC and SQL based food safety audits are acceptable. Audits for domestic facilities generally cost \$1,300 while overseas facilities are billed on a case by case basis.

**Social Audits** – International manufacturing facilities regardless of country (both food and nonfood) will need to complete a Costco specific social audit.

**Produce Audits** - Produce audits ensure E. coli, salmonella and other pathogens don't contaminate produce products that Costco stocks. A typical harvest crew audit costs \$195, a growing area audit costs \$550 and a processing facility audit costs \$850 to \$1,300.

**Practical Use Testing** – This occurs when Costco's quality assurance personnel purchase an item, like furniture, at a club location and assemble it adhering to the directions. The items chosen are typically among the top ten within Costco's damage and destroy list. Some of the questions this audit answers includes: whether everything that is supposed to be in the box is actually in the box, can the item be realistically assembled using basic tools and does the item perform as intended.

**Food Testing** – To test the food it purchases, Costco uses both an in-house lab and third party food testing companies. Costco's in-house testing lab employees 20 people. One of the outside companies that Costco uses to test food is IEH Laboratories (Institute for Environmental Health). IEH's first lab was created in 2001 with six employees and it now has 116 labs in the United States and Europe with over 1,500 employees.

Costco's vendors pay the cost of the food tests and Costco hears little negative response from those vendors. In terms of guidelines for vendors to follow, Costco uses the government as a base and issues its own standards that are more stringent.

One of the reasons for Costco's food testing program is to uncover fraud. Olive oil is a common target for fraud. A supplier can substitute lower grade olive oil or even canola oil which has no taste. Unless a supplier goes through the process of getting a U.S.D.A. certified sticker on their olive oil, any grade can be doctored. Costco sent an employee to Tuscany to collect leaves from Tuscan olive trees. The company now has an index of 16 different trees that their in-house lab uses to test the DNA of Tuscan olive oil that it purchases.

**Gift Cards and Out-of-Box SKUs** – Costco continues to stock a wide assortment of discounted gift cards and out-of-box services and products.

**Item Deletion** – When Costco initially buys an item, it is usually purchased as a rotational SKU. If a new item sells more slowly than a buyer anticipated, the vendor may be asked for assistance through demonstrations and markdown money to improve sales. There are times when a buyer will even delete an item even though it is selling well. This can happen due to: seasonality, SKU count focus, the product no longer offers a value or too many "like" items in a category.

There are four primary ways a manufacturer can prepare for an item being deleted: understand the buyer's intention before the product is purchased, understand Costco will not guarantee an item longer than 30 days so inventory must be managed, packaging raw materials must be conservatively managed and stay in relatively constant communication with the buyer especially within the first few weeks of the product's life cycle.

**Business Center** – Costco currently operates 16 business center locations. The locations are approximately 120,000 square feet offering both delivery and walk-in service. Business centers stock merchandise primarily for convenience and grocery store owners, vending operators, janitorial services, restaurants, professional offices, daycare centers and assisted living facilities. These business centers offer additional sales opportunities for a vendor's foodservice or wholesale products.

**Product Recalls** – In December, 2009, Craig Wilson, vice president of food safety and quality assurance at Costco, made a presentation at the USDA-FDA Traceability Hearing in Washington, DC. Despite the presentation being over three years old, it provides relevant and important information about product recalls and what vendors should do to minimize their impact.

**Immediate Reaction** – When an item is recalled, Costco's most important priority is member protection. Wilson said, "Our primary focus is to protect the member all the time, first and foremost. I don't care about cost. I don't care about anything else." Wilson immediately blocks an item from being sold and has that item immediately pulled from the sales floor at every club worldwide.

**Item Traceback** – When an item is recalled, Costco relies on its sales and inventory management system to quickly pull information in real time. Costco discovers what members purchased the recalled item and when, it pulls the item's distribution information (both through Costco and back to where the item originated from) and it pulls the item's ingredient validation form (a mandatory part of the buying process). Costco works closely with the states involved, the Centers for Disease Control (CDC), the Food and Drug Administration (FDA) and any other situation-appropriate regulatory agency.

**HACCP Plan** – Wilson said, "It's up to our vendors to know where their ingredients came from and where they were produced under a qualified HACCP plan [hazard analysis critical control point]."

**Product and Vendor Information** – While an item traceback is happening, Costco gets item information such as the item number, name, flavor, size, UPC, lot number and "sell by" date. In addition, the vendor provides Costco with contact information for its recall coordinator, media representative and the person members can contact for information. The vendor will also provide Costco with product disposition information.

**Member Notification** – On the first day of the recall, Costco is able to begin notifying every member who purchased the item. The first notification is done by phone using an electronic system that calls 870,000 people per hour. This verbal notification is followed by letters mailed to members.

**Club Communication** – Costco communicates with every location regarding item removal and/or disposition instructions as well as vendor contact information for the membership desk. Costco also provides its call center with an explanation about the recall, any member instructions and vendor contact information.

**Recall Records** – Costco is also focused on keeping accurate records about the product being recalled and tracks how many units were pulled from the sales floor, how many units were returned by members, how many units were destroyed and how many units were returned to the vendor.

**Regional Suppliers** - The December, 2012 issue of *The Costco Connection* included an article about regional food suppliers. Buyers in Costco's eight regional offices are always looking for unique regional products. Tim Rose, senior vice president of foods and sundries (at the time of the article), said, "When we search out some of these regional suppliers, we know they're not going to be able to supply the whole United States right out of the chute."

Rose mentioned one regional supplier that grew to supply the company worldwide. Rose said, "Johnny's was a small restaurant in Tacoma [Washington] that used to sell seasoning salt next to their register and now it's not only sold nationally, but globally." One rule that Costco uses when working with smaller regional suppliers is to never become too large a part of their business. Rose said, "We have a rule that we don't want to be more than 25 percent of someone's business."

**Tmall.com** – Alibaba.com, a Chinese-based online ecommerce company, is described as the largest online marketplace in the world. Its operations included consumer-to-consumer, business-to-consumer and business-to-business. Its online transactions last year at \$248 billion eclipsed the total combined sales for eBay.com and Amazon.com.

Costco opened an online store on Alibaba.com's marketplace site, Tmall.com. Costco is selling branded and Kirkland Signature private label food and healthcare products on the site, costco.tmall.hk. The advantage of selling its products through Alibaba.com is logistically, a distribution infrastructure is already in place, operationally, a payment infrastructure is already in place, and in terms of merchandising, Costco can learn about the Chinese marketplace and determine in an inexpensive way, whether opening club locations in the country makes sense.

**Books** – Costco's four person book buying team includes one buyer and three assistants: one for children's and young adult books, one for basics such as cookbooks and gift books and one for best sellers. The following are some of the strategies used by Costco's book buying team:

**Sales Requirements** – As with the rest of the club, if a book's sales do not meet certain thresholds, it will be removed.

**Planning** – The team's assortment is typically planned three months in advance.

**Packaging** – The book's jacket is one of the more important aspects of the product and it should not only represent what the book is about but also catch the member's eye so they stop and pick it up.

**Distribution** – One of the challenges for the book buying team is that decisions on what books to purchase are not just made nationally but are made regionally and sometimes by club location.

**Exclusivity** – Costco's book buying team is always looking for exclusive books that can only be found at Costco. For example, Costco may ask for a few extra recipes in a cookbook or reference books that have padded covers. Colby Lawrence, director of proprietary publishing and premium sales at Houghton Mifflin Harcourt, said, "We start with Costco's price point and our goal is to get as much as we can into the box."

**Distributor** – One of the unique ways that Costco is growing its business nationally is as a distributor. Historically, one of Costco's key strategies is to act as a distributor for business members. Costco has not only met those business member needs through its traditional club locations but also through its 16 business center locations (15 in the United States and one in Canada). Business members must shop at a traditional Costco location but the business centers enable members to not only shop at a club location but order and receive merchandise via Costco delivery trucks.

In a much more subtler strategy, Costco is expanding its role as a distributor and using third party providers to delivery merchandise to consumers which is helping Costco grow its business nationally. Costco is working with Google Express, Instacart and Shipt to deliver merchandise in one to three days throughout the continental United States. Non-members can use these services.

From Costco's perspective, working with these third party delivery companies offers five key benefits: volume, value reinforcement, membership protection, membership growth and limited downside. First, the sales volume in the locations that are acting as distribution points for these third party delivery companies is progressively increased.

Two, Costco is not damaging its value proposition by partnering with these companies. Users of these services are paying a cost to the third party (either in the form of higher prices or an up-front delivery fee) and, in return for that expense, they don't have to drive to Costco to shop. If they want to eliminate those costs and pay the in-club retail price, those users can always purchase merchandise at their local Costco location.

Third, the monetary relationship between Costco and its paid members is not affected. Since there is a cost to use the third party delivery company, the expense of a Costco membership is not questioned by existing members.

Fourth, these third party delivery companies offer their service to non-Costco members. Costco is getting free advertising/promotion for its merchandise and its company. The possibility exists that these customers like what they are purchasing from Costco and may decide to purchase a membership at Costco and avoid those third party delivery costs by shopping at a club location.

Lastly, if a third party delivery company stops using a Costco location as a distribution point or stops operating as a business entity, the only significant downside to Costco is a loss of volume. However, that potential volume loss may be partially offset by larger than normal membership growth for those locations that acted as distribution points because customers may still want to purchase Costco products but would need a membership to do so.