

THE HUB



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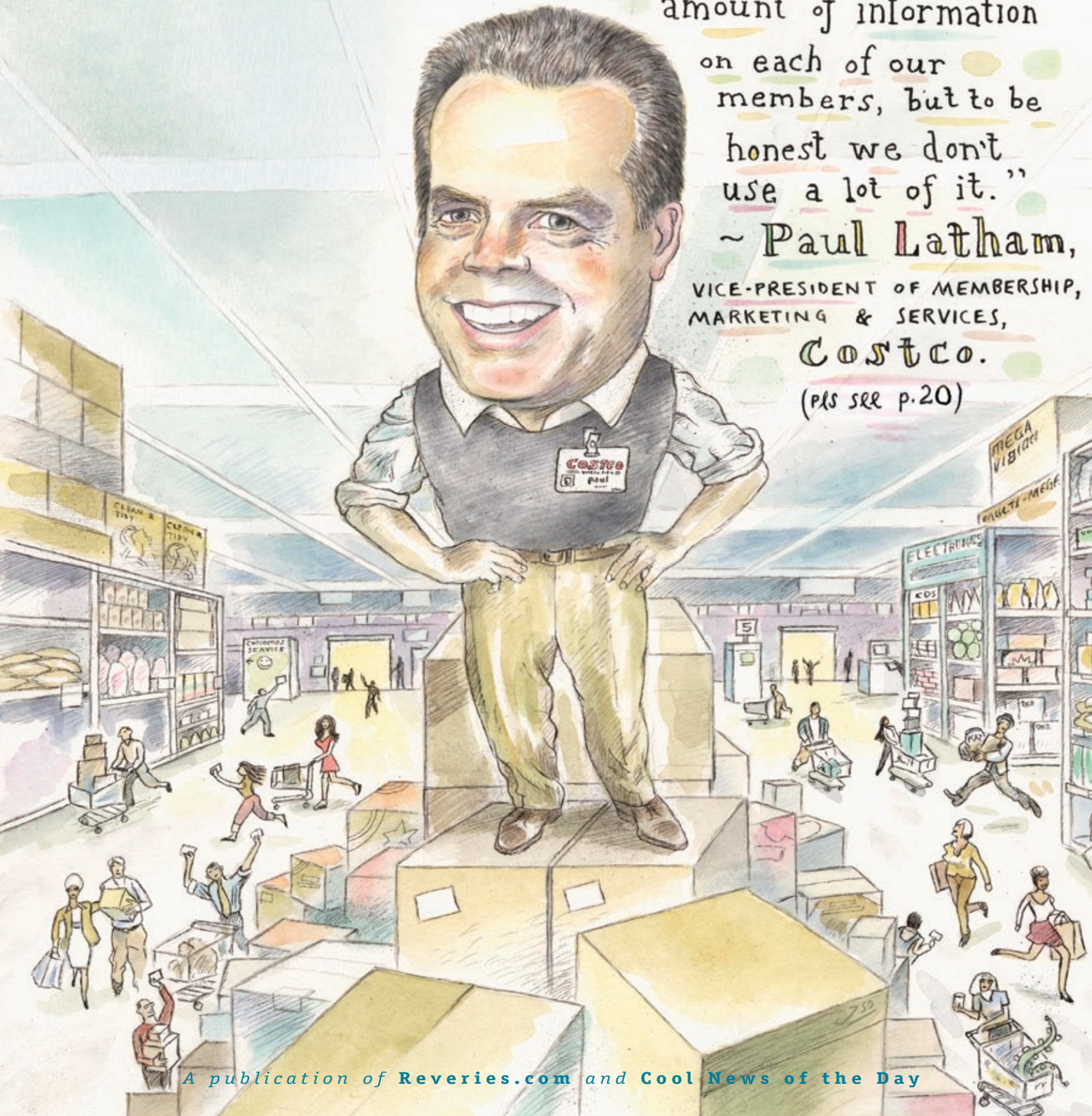
"Costco has a tremendous amount of information on each of our members, but to be honest we don't use a lot of it."

~ Paul Latham,

VICE-PRESIDENT OF MEMBERSHIP,
MARKETING & SERVICES,

COSTCO.

(PLS SEE P.20)



Crazy for Costco

Paul Latham had no idea what he was getting into when he took a summer job at a newfangled members-only warehouse club back in 1979. He thought he was just looking for a little part-time work to help pay for tuition at San Diego State before launching a career in sports medicine.

Well, Paul never left that newfangled members-only warehouse. He's now held a total of 16 different jobs there over the past 28 years. He's been a merchandise manager, an assistant warehouse manager, a director of tires and a vice president of gasoline. He's run the photo, optical and pharmacy departments.

Today, Paul Latham is vice president of membership and marketing for Costco — by most measures the most successful warehouse club store in the world. “It was probably at the assistant warehouse-manager level that I recognized that this was a good model,” he says. That was about 22 years and 12 job titles ago.

Paul's first job was actually with Price Club, which later merged with Costco. At the time, the enterprise was doubling in size nearly every few years. Today, Costco has more than 500 club-stores and is expected to top \$65 billion in revenues.

Who would've guessed? Whoever heard of selling items in bulk — and requiring customers to pay a membership fee for the privilege of shopping? Who would've thought that running a store out of an old airplane hangar would earn the enduring loyalty of America's most affluent and well-educated shoppers?

Who would've predicted that a part-timer Costco hooked 28 years ago would be in charge of hooking Costco shoppers today? Having been there since almost the beginning — and having worked up and down the Costco ladder — Paul Latham has more than his share of front-row insights into the answers to those questions, and more.

Marketing chief
Paul Latham
doesn't just create
loyalty to **Costco**.
He personifies it.





What makes Costco tick?

It starts with our discipline on the number of items we have in the building. Because we're able to maintain that discipline, we really are focused on weeding out those items that may be marginal and concentrating on the items that we believe have the potential to sell big.

So, for example, if we're going to carry a blender, we're not looking for three, four or five different kinds of blenders. We're looking for what's going to be the best-selling blender.

If we do that, then we're going to appeal to the bulk of our members, because we can leverage the cost down by the quantity of the purchase. We're also going to bring added value by offering features that may not be available at that price point on other blenders.

There are a lot of things we don't do as well as we'd like to, but we're not afraid to try things. For a company that's as large as we are, we're pretty nimble. We can try things, and if they don't work, we try something else.

We don't feel like we need to do a lot of analysis on every concept because by the time we'd have completed the analysis, we could've tried two or three different scenarios and seen which one worked best. Ultimately, we listen very closely to what our members tell us.

Is that what makes Costco members loyal?

It does, but ultimately it's because we stay true to our mission. We have a mission statement that's not dissimilar from that of a lot of other companies—to provide our members with quality goods and services at the lowest price. A lot of companies make that claim.

But we have a discipline at Costco that starts right at the top—with our CEO, Jim Sinegal—that maintains that we are constantly searching and fighting for ways to reduce our costs so that we can pass along savings to our members.

For example, we will not take more than 14 percent gross margin on any product that we sell, except for Kirkland Signature, our private label product, on which we'll take 15 percent.

That sense of discipline permeates the company, and our members now have come to recognize that even if we have the opportunity to make a little extra margin on something, we don't do it.

What that gives us is pricing authority. Our members feel like they don't have to shop an item competitively to see if we have the lowest price. They trust that we will always have the lowest price.



For a company that's as large as we are, we're pretty nimble.

So loyalty to Costco is primarily premised on price?

Yes, although there are items where Sam's Club or BJ's can easily match us or beat us by a penny or two. So, loyalty also comes down to the experience people have in our buildings—the cleanliness of the facilities, as well as the friendly and knowledgeable nature of our employees.

Is there a typical Costco shopper?

Costco's high-quality/low-price model appeals to a wide range of people. But we also recognize that there's a demographic profile of a Costco member that is more affluent, more college-educated, higher in home ownership, with generally more kids living at home. In a lot of those affluence and education categories, Costco indexes higher than the general population.

Why does Costco attract upscale shoppers?

Because we go out of our way to carry the brands that they're looking for, and we consistently move new products into our buildings to create a "treasure hunt" atmosphere. When those members come into our buildings they're seeing something exciting, something new—high-end brands that they

recognize. That cements our relationship just a little bit more and keeps them coming back.

How do you balance your focus on both small businesses and individual consumers?

The original concept, when Price Club first opened its doors as the first warehouse club, was to limit the offering only to business members. The thought was that business members were the most affluent members of the community. So, there was an opportunity not only to supply items for their businesses, but also supply them with the everyday items they needed for their homes.

It was quickly recognized that limiting ourselves just to business owners and business members was probably not enough to sustain the model. So, we opened membership up to local, state and federal government employees, members of credit unions and members of large employers in those communities, because they were good credit risks.

How much of your shopper understanding comes from data versus intuition?

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Costco Mojo

Wall Street complains that Costco doesn't put shareholders first, but CEO Jim Sinegal says he sees a different order of priorities. "We want to obey the law, take care of our customers, take care of our people and respect our suppliers," says Jim. "And we think if we do those four things pretty much in that order, that we're going to reward shareholders."

Jim also has a ready response to those who say that giving customers a great bargain is costing Costco profits: "There are all sorts of opportunities where you can try to sneak in a little more margin here and a little more profitability there, but that's not what we're about," he explains.

"When you start suggesting that it's not important to save the customer money on this because they'll never

know the difference, you start to fool yourself. The customer trusts us. You don't want to give up on that type of reputation."

The other Costco knock is that it pays its people too much money. Says Jim: "We are the low-cost provider of merchandise and yet we pay the highest wages. Wouldn't that suggest that we're getting better productivity?"

He adds: "By the way, we sell for a pretty rich multiple." Costco, whose 514 club-stores are expected to top \$65 billion this year, "trades at 21.2 times its projected per-share earnings for the next four quarters."

(SOURCE: Kris Hudson, *The Wall Street Journal*, 8/27/07)

a lot of it. The bulk of what we do for our members is done pretty much across the board. All of our coupon programs and internal marketing efforts are pretty much targeted at all of our existing members.

We are solicited constantly with offers of tools and vehicles to try to take advantage of the intelligence we've gained from our members. But we guard that privacy and that relationship with our members very carefully.

We want to be careful that our members don't think that we're using the information we have in a way where they feel somewhat violated by it. We certainly use our member information to help us model for prospective members. But to a large degree, we rely on our intuition.

Do you have an advertising strategy?

No. We don't have an advertising budget. None at all. We do some direct mail. Our corporate marketing budget is probably a third of what a company like Microsoft might use to launch a new product. It is miniscule in comparison to other companies of our size. We literally do no advertising, and we pay for no sponsorships.

But we will do limited direct-mail solicitation for new memberships. Typically, we ride an existing coupon program. We also do a number of other mailers that are funded by our vendors.

We may also do a distribution of 12 or 13 million to our members and then carve out somewhere between one- and two-million of those to go after a particular market or demographic with a membership offer.

Are there any circumstances under which you would do advertising?

I don't believe so. We haven't done advertising in our 30 years of existence, and that's pretty steadfast. We are asked all the time to pay for placement on various TV shows but we've just found that we get enough exposure on TV, in magazines and newspapers without paying for any of it.

Our customers are accustomed to not seeing ads in the newspaper. Sometimes our suppliers or vendors will advertise a product in the newspaper and say that it's available at Costco and other places, but we're very careful to make sure that there's no appearance that Costco is involved in paying for that ad.

How does the marketing function work at Costco?

It's largely decentralized. We have local marketing teams, and the bulk of our efforts are around two things. One is driving the sales of products, and that's largely through our coupon offers. The second is driving membership. We need to sign up about 2-1/2 million new members in the U.S. every year to continue to sustain our growth.

So, the primary responsibility of our marketing teams — and each warehouse has its own marketing team — is to acquire new members.

There are two primary ways they go about doing that. One is to canvas all of the small businesses in their market area and talk to them about potential Costco membership. The second is that we get to know all of the mid-size and large employers in each of the market areas. Our local teams go out and meet with those businesses, and ask to do some sort of promotion.

What kinds of promotion?

We might host an onsite reception on a couple of afternoons during the week, where we'll sit in the break room of that employer and offer Costco memberships to its employees. Or, we might set up splash pages on their intranet sites, again offering Costco memberships.

Or it could be a reverse onsite, where we invite all the employees from that business to come to Costco for a few hours, where we'll offer refreshments and let them walk around and shop at a Costco building.

How do you choose which brand names you'll have in the store?

Our buyers rely on a lot of the intelligence that our vendors provide them to determine which products we ought to be carrying, and which features those products should have.

We pilot products and services all the time before we roll them out in a big way. That allows us to see if something is working quickly, and then react quickly if it doesn't. We can do that because we have so few items in the building.

If a buyer had to manage a category of thousands and thousands of products, each product wouldn't get the same level of scrutiny that an item does in one of our warehouses. That's simply because our buyers have such a limited number of products that

they're responsible for, and so each product receives a tremendous amount of scrutiny.

We also have a hit list among our non-foods buyers. Every year they're trying to get certain brand names that we haven't been able to buy directly from in the past.

Some of our recent successes, for example, have been in the clothing area, with Adidas. That's a brand that we've been trying to buy direct from for about 20 years now. It's only in recent years that they have decided to sell to us.

Why did Adidas decide to do that?

The opportunity at Costco was just too big for them to ignore. It's a combination of telling them openly that we're going to go out and try to find their products, but that we'd rather do business directly than have to go through that process.

Is it hard to build supplier loyalty when you don't work with them regularly?

I don't think so. They recognize that we'd like to have their brands in our buildings all the time. It's more an issue of supply — of being able to get the kind of quantities that we want and need. We also have a real limitation on the number of items that we may have in the building. Sometimes seasonality comes into play. But it would be our preference to have a brand like Adidas in our stores at all times.

Is there any product category that you wouldn't carry at Costco?

The one that comes to mind is guns and ammunition. That is something we will not sell because of the risk and our family-oriented environment. There are other things that we don't carry because of licensing or distribution restrictions — such as cars, for example. If the business model for how cars were distributed in the United States were ever to change and allow us to sell cars directly, I could see us carrying a vehicle.

Other than Costco, do you have any favorite retailers?

Yes, there are a number of them. Target, certainly. They do a fantastic job appealing to families and providing a little more upscale shopping experience at very reasonable prices. On the high-end,

I like Nordstrom's. They may have lost their way a few years ago, but I think they have found it again. They are getting back to what made a name for themselves — which is the level of service they provide.

What's your take on Tesco?

I think they're a fantastic operator. We're very familiar with Tesco because we have a number of units in the U.K. that compete against them. We've looked at them in a number of different arenas, such as how they operate in Europe and Asia, and have been very impressed with them.

I think they're going to do a bang-up job when they start opening these units in the U.S. and we're paying very close attention to the progress that they're making. We absolutely see them as competitors. It's a fallacy to think that we're only competing against other big box retailers. We have a tremendous offering of fresh products in our buildings, and in fact, we really consider those signature categories for us.

So, anybody who is coming in and is going to compete on that level, and anyone who has a reputation for already having done it — as Tesco has — certainly we're paying close attention to them.

What's it like to work for Jim Sinegal?

It's hard for me to compare because I've only worked for Robert Price, who was president of Price Club when it merged with Costco, and now Jim Sinegal. I haven't known anybody else as a leader of a company. But I can tell you that, at 72 years old now, he still outworks everybody. He's fair, honest and ethical.

You never have to question whether a decision that you made is the right decision. It's a very close-knit, casual and easy environment to work in. It's not that there aren't the stresses of dealing with the issues that a \$60 billion firm has to deal with, but you just don't feel that there are any hidden agendas. Everything is open and honest and working toward what's best for our members. ■



PAUL LATHAM is vice president of membership, marketing and services for **Costco Wholesale Corporation**. Paul began his career with the company part-time while studying kinesiology at San Diego State, and has since held 16 positions there over the past 28 years.