

流通科学大学 リサーチレター No.18

**“How Do We See the Success of  
a Foreign Retailer in a Mature Retail Market?  
:Interaction between Costco  
and Japanese Consumers”**

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2014年3月

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# How Do We See the Success of a Foreign Retailer in a Mature Retail Market? :Interaction between Costco and Japanese Consumers

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Costco has never changed the home country style of operation, but it could succeed by stimulating consumers to change their own purchasing behavior. This research aims to increase our understanding of how the clearer business model affects the mature market based on the interaction between Costco and Japanese consumers.

Key words: Costco, interaction, Japanese consumers, mature market

## **I. Overseas Entrants in the Japanese Retail Market**

Entering the Japanese market is the single largest issue for overseas retailers. Even though many seem to fail in operating in Japan, European and American retailers have attempted to enter the second largest market until now. This is evident by the large number of Western formats and store fascia that have been imported into Japan over the past one hundred years. One of the most famous examples is the convenience store sectors; stores like Seven-Eleven which is all imported purely as fascia with only minor input of know-how from America. Over the years, since their introduction in the 1970's, that format has become "Japanized" and has been made successful by their Japanese licensees.

However, what about the overseas companies directly entering the Japanese market without a local firm in Japan to assist with entrance? In general, the Japanese retailing market has long been seen as a relatively closed and, very costly market to enter. Many overseas entrants tended to leave the details to Japanese companies acting as licensees, franchisees, or in joint venture in which the Japanese partner took the lead. However, an increasing number of overseas retailers with an innovative discount concept have operated in Japan with Japanese suppliers or Japanese partners since the economic bubble burst in Japan.

At the beginning with the entry of Toys"R"Us in 1990, Western retailers were seeking to break the Japanese traditional distribution system in order to establish their own business system in the Japanese market (Larke, 2003). Toys"R"Us was able to succeed in penetrating the Japanese Market partially because of the effectiveness of its American-style operating system.

However, this also reflects the fact that the Japanese toy market was still a developing sector that had

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many small players but no powerful competitors at that time. In such a case, it was easier for an innovative overseas retailer to penetrate into the developing toy industry in Japan. So what about the overseas retailers entering the developed Japanese food market?

Carrefour, along with possible new entrants such as Costco, Wal-Mart and Tesco were seeking to introduce more changes in the food market. Moreover, retailing companies that have been categorized as a general merchandise store have a difficulty in finding competitive advantages that can be translated into overseas operations. While Carrefour brought its hypermarket format to Japan, from the Japanese consumer's point of view it is not much different from that of the Japanese retailing format, a general merchandise store. The advance of domestic retailers in these categories made it more difficult for Western retailers to penetrate the Japanese food market. Indeed, it is no exaggeration to say that domestic retailers have been dominating the Japanese food market.

If Carrefour was seen as one which a company that domestic retailers were watching for its entry into Japan, none of them paid attention to the entry of Costco as a serious threat to the Japanese market. However, the largest company in the membership wholesale club sector Costco, is realizing results in Japan, a market difference from Carrefour. So how should we understand the penetration of an American company's business system into the Japanese market? Even if Costco entered the Japanese market at the similar time as Carrefour, why is the result so diametric?

Costco's business model might be clearer in order to succeed in Japan, but more important thing is the interaction between Costco and the Japanese consumer through a clearer business model. As a result, it might have changed behaviors among the Japanese customers which has been said to be impossible until now.

This research suggests that there are different types of localization strategies for a global retail company, even researchers focusing specifically on retail internationalization have stressed the international retailers' ability to affect or impact the local consumer behavior. The aim of this paper is, therefore, to increase our understanding of how the clearer business model is introduced and how it affects the local market based on the interaction between a foreign retailer and the local consumer.

The following section discusses research on Costco's making as a global giant not only in some mature retail markets but also in some emerging retail markets. The information offered here was gathered from annual reports of Costco and from homepages of the countries involved.

## **II. COSTCO: The making of a global giant**

Costco opened in 1976 under the Price Club, as of December 2, 2012, operated a chain of 622 warehouses in 41 states and Puerto Rico (448 locations), nine Canadian provinces (85 locations), Mexico (32 locations), the United Kingdom (23 locations), Japan (13 locations), Korea (9 locations), Taiwan (9 locations),

through a 55%-owned subsidiary) and Australia (3 locations)<sup>1)</sup>. The company also operates 4 Costco Online websites in U.S., Canada, UK and Mexico<sup>2)</sup>.

**Table1: 622 Locations as of December 31, 2012**

U.S.A*.	CANADA	AUSTRALIA	JAPAN	KOREA	TAIWAN	U.K.	MEXICO	Total
448	85	3	13	9	9	23	32	622

Source: *Annual Report 2012*, pp.6-7

Note:\* Including 4 locations in Puerto Rico

Net sales for the 53-week fiscal year ended September 2, 2012 were up 11.5%, to \$97 billion, from the prior 52-week fiscal year sales of \$87 billion<sup>3)</sup>. Costco is now the seventh-largest in the world, and especially, increasing sales in abroad is critical to Costco's success. As of a letter to shareholders in the annual report 2012, this company reported that a more global perspective would be in its future, and committed to embracing a larger, more complex global landscape with the same keep-it-simple philosophy that has driven their success over the years<sup>4)</sup>. The following table sets forth certain information concerning Costco's financial condition and operating results.

**Table2: Results of Operations (dollars in millions)**

As of the year ended	Sept. 2, 2012	Aug. 28, 2011	Aug. 30, 2010
Net sales	\$97,062	\$87,048	\$76,255
Increases in net sales	11.5%	14.2%	9.1%
Merchandise costs	\$86,823	\$77,739	\$67,995
Gross margin	\$10,239	\$9,309	\$8,260
Gross margin increase	10.0%	12.7%	9.4%
Gross margin as a percent of net sales	10.55%	10.69%	10.83%
Membership fees	\$2,075	\$1,867	\$1,691
Membership fees increase	11.1%	10.4%	10.3%
Membership fees as a percent of net sales	2.13%	2.15%	2.22%
Operating income	\$2,759	\$2,439	\$2,077
Selling, general and administrative(SG&A)expenses	\$9,518	\$8,691	\$7,848
SG&A expenses as a percent of net sales	9.81%	9.98%	10.29%

Source: *Annual Report 2012*, pp.25-31

The following table indicates the approximate percentage of annual net sales accounted for by major category of items, and their membership was made up of the following.

**Table 3: The Annual Net Sales by Major Category of Item and the Number of Cardholders**

Category of Items	2012	Type of Membership	2012 (in thousands)
Sundries(1)	22%	Gold Star	26,700
Hardlines(2)	16%	Business	6,400
Food(3)	21%	Business, Add-on Primary	3,800
Softlines(4)	10%	Total primary Cardholders	36,900
Fresh Food(5)	13%	Additional cardholders	30,100
Ancillary and Other (6)	18%	Total cardholders	67,000

Source: *Annual Report 2012*, pp.10-11

Notes:(1) Including candy, snack foods, tobacco, alcoholic and nonalcoholic beverages and cleaning and institutional supplies

(2)Including major appliances, electronics, health and beauty aids, hardware, office supplies, cameras, garden and patio, sporting goods, toys, seasonal items and automotive supplies

(3)Including dry and institutionally packaged foods

(4)Including apparel, domestics, jewelry, housewares, media, home furnishings and small Appliances

(5)Including meat, bakery, deli and produce

(6)Including gas stations, pharmacy, food court, optical, one-hour photo, hearing aid and travel

The next section considers the interaction between Costco and Japanese consumers as a brief example that sheds light on the answers to the research questions mentioned above. The information offered here was gathered from mass media sources and from annual reports of the companies involved.

### **III. The Japanese Business of Costco**

The first location in Japan was open in 1999 as a key tenant of a large shopping centre in Fukuoka (Hisayama), one in Chiba (Makuhari), one in Machida city (Tamasaki), two in Hyogo (Amagasaki and Kobe Seishin), one in Yokohama (Kanazawa seaside), two in Kawasaki (Kawasaki and Zama), one in Sapporo (Sapporo), two in Saitama (Iruma and Shinmisato), one in Kyoto (Yawata Kyoto), one in Gunma (Maebashi Gunma)<sup>9)</sup>. Costco Japan was heralded with a lot of consumers, and acquired more than 260 thousand member

sign-ups in its first year (including free members)<sup>6)</sup>. This occurred despite the fact that its business concept and operating system were ridiculed in the media and condemned by academia.

Costco's entrance into the Japanese market had a big challenge at that time. It was a business concept which had already failed there before. The business concept of Costco is the membership wholesale club operating "Cash and Carry", that is the identical business concept which the Daiei<sup>7)</sup> group had operated 1994 to 2002 (Photo1). Costco does not have to repeat the same mistake as the failure of Kou's operation by that domestic retailer. Costco, which has a competitive advantage in the clearness of business concept which is different from Kou's, has a higher likelihood of success in Japan.

**Photo1: Kou's Port Island in Kobe**



Source: Ryutsu Museum in University of Distribution and Marketing Sciences

So what is the clear business concept of Costco? This is quoted from "Annual Report 2012 (pp.8-9)" by Costco Companies, Inc. Costco operates membership warehouse based on the concept that offering its members low prices on a limited selection of nationally branded and selected private-label products in a wide range of merchandise categories will produce 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 us to

operate profitably at significantly lower gross margins than traditional wholesalers, mass merchandisers, supermarkets, and supercenters. Costco buys the majority of its merchandise directly from manufacturers and routes it to a cross-docking consolidation point “depot” or directly to its warehouses.

The president of Costco Japan says to be considerably different from Kou’s, he underlines its only common point, which is using a membership format but Kou’s is not a wholesale club. Costco’s merchandising strategy is to offer its members a limited selection with 3,500 to 4,000 SKU’s, as opposed to 10,000 SKU’s or more at Kou’s in spite of a similar store size, 12,000 to 14,000 m<sup>2</sup>. Costco seeks to limit specific items in each product line, because merchandise is stored on racks above the sales floor and displayed on pallets containing large quantities of each item.

Costco is the first membership warehouse club in the world that provides its members the best possible prices on quality brand-name merchandise. Its operating system is to keep costs low and pass the savings on to its members<sup>8)</sup>. Member sign-ups through opening day were more than 47,000 in the ninth depot of Japan, Shin Misato in 2009. The interpretation of the Japanese consumers’ taking a great acceptance in the business model of Costco seems possible in view of the fact the members per warehouse is an average of approximately 45,000.

It might be strange that Japanese consumers do not reject Costco’s selling way, even if many consumable products are offered for sale in case, carton, or multiple-pack quantities only. Such a selling way is similar to not only Costco but almost all discount retailers from Western countries that ever have operated in Japan. They ended up modifying their way in Japanese ways, or getting back their home countries. When even Dairy Farm, as a large discount retailer of Hong Kong brought the same selling way as Costco to the Japanese market, many researchers pointed out it would not be aligned with Japanese shopping behavior, and actually, it was not long before Dairy Farm withdrew from Japan.

So why does it not matter for Costco? The answer to this question is very simple: even if its merchandise is thoroughly limited and offered in multiple-pack quantities only as mentioned above, Costco has overcome this due to its merchandise strategy by providing its members with a wide range of high quality merchandise at prices consistently lower than they can obtain elsewhere.

According its internet website<sup>9)</sup>, Costco’s membership format is designed to reinforce customer loyalty and provide a continuing source of membership fee revenue, which allows it to offer lower prices. Members can utilize their memberships at any Costco warehouse location in any country. It has two primary types of members: Business and Gold Star (individual). It continues to experience strong member renewal rates, currently at 87%. Businesses, including individuals with a business license, retail sales license or other evidence of business existence, may become Business members. Business members generally pay an annual membership fee of 3,765 yen for the primary and a household card, with add-on membership cards available

for an annual fee of 2,625 yen up to six employees (including a household card). Many business members also shop at Costco for their personal needs. Individual memberships (Gold Star membership) are available to individuals who do not qualify for a Business membership, for an annual fee of 4,200 yen, which includes a household card.

Costco also purchased selected private label merchandise, as long as quality and customer demand are comparable and the value to its members is greater as compared to name brand items<sup>10)</sup>. Its premium private brand, Kirkland Signature products were also offered to its Japanese members at prices that are generally lower than those for national products, and are now welcomed in Japan. Imported goods account for a third of all merchandises of the Japanese depot<sup>11)</sup>.

Costco Japan is aimed at consumers who spend one thousand yen for their shopping a day while purchasing once or twice a month. At the same time they consider shopping a leisure activity. Costco's specific business concept, a mix of discount retailing type of operation and a warehouse type of operation, has being generally accepted by consumers in Japan.

How would the Japanese consumers accept the characteristics of the Costco business model? Which changes would happen in the interaction between Costco and the Japanese consumers?

The next section considers the interaction between Costco and the Japanese consumers as a brief example to answer the research questions as mentioned above. The information offered here was gathered from mass media sources and from interview of the consumers involved.

#### **IV. Interaction between Costco and Japanese consumers**

The Japanese consumers have a tendency to enjoy non-daily life, for example, children and adults spend a good amount of time in food courts, as well as purchasing daily goods on the sale floor. It is said that the food court is more popular than the sale floor in Costco Japan.

The original imported goods would be taken up here in light of an increase in Costco's attractiveness as a company replacing local retailers. For example, there are some famous apparel products in the world like Tommy Hilfiger, Polo and Lacoste etc. It means going shopping at Costco is very exciting event to them. Even if Costco sells the bulk of goods similar to the Japanese wholesale market, it is too different from the Japanese wholesale market so the Japanese consumers are more entertained. Also, one of the reasons why the Japanese consumers like to go shopping at Costco is its original brand called to Kirkland.

Costco is known as doing active in-store promotion of its original brand. That in-store promotion in Costco is needed to sell their original products, not available in other local supermarkets. However, Japanese consumers hesitate to try new products, even if they would like to try them before they purchase. This is, because they believe that they are obligated to purchase an item after a free trial. This Japanese consumer



behavior is being modified by “two bites” strategy implemented by Club Demonstration Services being solely responsible for free food sampling. This strategy promoted an environment which made consumers feel comfortable try out and enjoy new products. As a result, long lines begin to form in front of the free sample booth where the new original foods went on sale (Photo2). The No.1 item called “Bulgogi Beef Yakiniku(Korean grilled beef)” which got good reviews by Japanese consumers also is the result of active in-store promotion.

**Photo 2: Long Lines in front of the Free Sample Booth**



Source: Shooting in Costco Warehouse Kobe (February 25, 2012)

Most of the Japanese customers usually bring their family and friends without membership card to Costco, and so, share the bulk of commodities with them. It is said that their parents are very pleased if they bring imported goods made in Costco as a present to their parents when they visit their parents in their home town where no warehouses of Costco are in operation yet. Costco’s customers are developing many recipe ideas which manufacturers do not usually imagine in order to use all such a large quantity of products. As mentioned above, at the start-up, the Japanese consumers refused to purchase such a bulk of commodities, because they had gone to the store and purchased only one each item before. As a result, the Japanese

consumers amuse themselves shopping time in Costco by covering the matter of a large volume of products with inventing the various kinds of recipes to take advantage of high quality of materials.

The interaction between Costco and Japanese consumers would make it possible first for the smart Japanese consumer to invent how to share a large volume of things instead of asking Costco to change its own selling way. Costco aligned itself to customer's suggestions, for example, by changing the packaging in order to allow purchasing products without hesitation and sharing more easily. For example, "Sakura Chicken 2.4kg" previously came in two 1.2kg packages but after listening to customer's suggestion, Costco changed the design to four 0.6kg packages. In addition, consumers often purchase Ziploc bags together when they purchase a larger amount of perishable goods. Even if this practice is not followed in the US, younger Japanese consumers as a group shop at Costco's warehouse and share the merchandise with each other in the parking lot or food courts.

In such a case, it is reported that Seikyo named to the Japanese co-op in the past, even if the present Japanese co-op have a delivery personally, was similar to Costco now<sup>12)</sup>. The concept of the Japanese co-op in the past was the low price by sharing the merchandise with each other, but now, it is changed to the high quality and safety by having a delivery personally.

Secondly, the interaction between Costco and Japanese consumers would make it possible for the Japanese manufacturer to increase its sales even while creating brand loyalty for existing customers. For example, the company named Japan Green Tea co., ltd. which imports "Crazy Salt" as a popular product in Costco Japan always sells new products for the first time in Costco. It is said that the rate of sales in Costco accounts for about 60%.

Thirdly, Costco would already become co-operators not rivals for the established Japanese stores through its interaction with Japanese consumers. "Power Mall" which is located in Maebashi-minami, Gunma, opened in December, 2010 and is a huge shopping mall of the Beisia group. There is Costco as well as Beisia operating in the typical Japanese supermarket. Beisia said it would be possible to co-exist with Costco in the supermarket sector as the ability to attract customers is strong. Also, Mitsui Real Estate Development which has developed the surroundings of Shinmisato station of Japan railways, chose two foreign retailing companies, that is, Ikea and Costco as key tenants. Even if Itoyokado which has grown to be one of the leading general merchandise stores in Japan has been already selling mainly groceries in that shopping mall, the 8<sup>th</sup> warehouse of Costco Japan was opened with Mitsui Outlet Park.

Costco's ability to attract consumers might make it possible for the development of the entire shopping mall by cooperation as well as competition among them. Those two opening stories would prove Costco's ability to attract consumers and its rise within the Japanese market.

Finally, that interaction would attract shopping agent services. The shopping agent services exist for

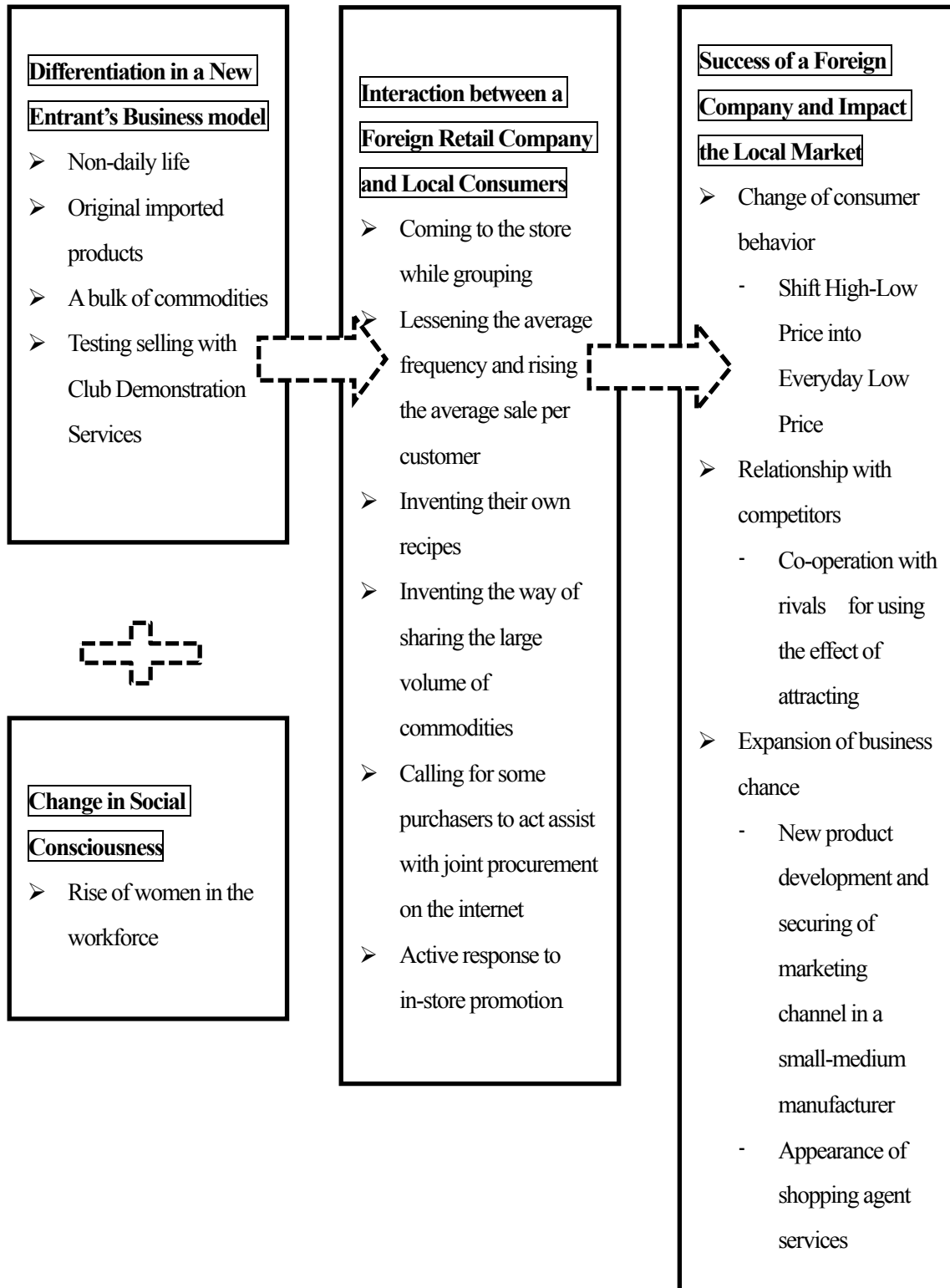
people of whom the region has not yet had a warehouse of Costco. The shopping agent service such as recycle shop, Town Tsukimino sells the single article after buying the damaged cartons included normal goods from Costco, and Resell Town as a website buys goods as a gold member of Costco every Thursday and re-sells them at the premium charge of 20% to 30% . The smart and careful Japanese customers purchase some goods from the shopping agents for testing before going to Costco, or visiting it for purchasing goods again. Even if the price of those agent services is higher than that of Costco, it is not that expensive if you consider the total cost, because some customers would have to pay a transport fee to travel large distances to the nearest Costco. In addition, Resell Town provides them with free delivery service.

We need to find out how a foreign retailer should establish a relationship between consumers in a mature market, refer to figure 1. According to Nikkei Business, it is reported that the smart and careful Japanese consumers are undergoing self-change<sup>13)</sup>. The smart and careful consumers in a mature retail market have invented recipes for using the specific products and services offered by Costco more efficiently. Also, they have even called for some purchasers to act assist with the joint procurement on the internet, because they could not afford to accept the policy of the bulk purchase of the same merchandise in Costco. As a result, Costco has never changed the home country style of operation, but it could succeed by stimulating consumers to change their own purchasing behavior.

In addition, the change of social environment has enabled the success of Costco in Japan. The Japanese consumers cannot any longer spend as much time to go out shopping as it used to be. The rise of women in the workforce has required them to choose a store where all necessary items are available instead of having to shop multiple times for different items. It is also due to this trend that Everyday Low Price had a chance to spread in Japan recently. High-Low Price was preferred in Japan previously, and so shoppers used to go around to several stores in order to get the cheapest item. At this time, Costco appeared to the Japanese consumers who had many difficulties in their retail environment and was equal to the challenge of satisfying consumers needs and adapted themselves to the change in social consciousness.

This research is theoretically significant in the sense of focusing not on the emerging market but on the mature market. However, the data requires further analysis to determine interactions between Costco and local market. The result of that analysis would verify the flow chart figure1which outlines the factors contributing to success of a foreign retail company in a mature market. Further, it would be possible to compare internationally with other Asian countries where Costco has seen success also such as in Korea and Taiwan.

**Figure 1: The factors contributing to success of a foreign retail company in a mature market**



**Acknowledgements**

This research was supported in part by a grant-in-Aid for Scientific Research from Japan Society for the Promotion of Science (Term of Project: 2011~2013, Project Number: 23330144).

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### Footnotes

- <sup>1)</sup> *Annual Report 2012*, Costco Wholesale (Year Ended September 2, 2012), p.2
- <sup>2)</sup> <http://www.costco.com> (October 22, 2013)
- <sup>3)</sup> *Annual Report 2012*, Costco Wholesale (Year Ended September 2, 2012), p.2
- <sup>4)</sup> *Annual Report 2012*, Costco Wholesale (Year Ended September 2, 2012), p.5
- <sup>5)</sup> <http://www.costco.co.jp/eng/costco.htm> (December 2, 2012)
- <sup>6)</sup> *Gekiryu Magazine*, 2000-January and 2000-March
- <sup>7)</sup> The Daiei, Inc. is one of the largest supermarket chain stores in Japan which was open for the first time in 1957.
- <sup>8)</sup> <http://www.costco.com/Membership/MembershipPopup.aspx?lang=en-US> (September 30, 2010)
- <sup>9)</sup> <http://www.costco.co.jp/eng/membership.htm> (September 30, 2010)
- <sup>10)</sup> *Annual Report 2009*
- <sup>11)</sup> *Toyokeizai Weekly Magazine* 2001.2.10
- <sup>12)</sup> *Nikkei Business*, 2010.8/9.16, pp.27-28
- <sup>13)</sup> *Nikkei Business*, 2009.4.6, p.86

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