

January 28, 2007 Spending

24 Rolls of Toilet Paper, a Tub of Salsa and a Plasma TV

By JULIE BICK

SHOPPING at Costco often goes something like this: Customer comes to buy bulk necessities like toilet paper and dish detergent. Customer buys those items, as well as a pack of giant muffins, three cashmere sweaters and a power tool.

It's more than impulse buying. It is a calculated part of the company's business plan. Call it the Costco effect.

"We always come out with too much," said Linda Curtis Schneider, who lives in Nashville. "It's hard to get out of there for under \$200."

Even when they are on vacation, the Schneider family seeks out the nearest Costco to gas up their rental car, grab a familiar lunch and browse for local specialties to bring back home. They have bought cases of chocolate-covered macadamia nuts from a Costco in Hawaii, gallon-sized salsa in Tucson, Ariz., and a crate of ruby red grapefruits in Marina del Rey, Calif.

The <u>Costco Wholesale Corporation</u>, based in Issaquah, Wash., aims to offer an inviting mix of necessities and indulgences — bulk detergent and megapacks of yogurts, stocked along with giant <u>plasma</u> TVs and crystal stemware.

From its first Seattle warehouse in 1983, Costco has grown to more than 500 warehouse stores worldwide and finished the 2006 fiscal year with its highest-ever sales, \$58.96 billion. Costco is the largest player in the warehouse market. The rival Sam's Club, a division of <u>Wal-Mart Stores</u>, operates more than 670 warehouse clubs worldwide, with a sales volume of approximately \$40 billion.

Richard A. Galanti, Costco's chief financial officer, said that while a grocery store might stock 40,000 separate types of items, and a Wal-Mart might stock 100,000, Costco will stock only the 4,000 most popular items it can find. "We try to figure out what people really want," he said.

So, along with purchases of jumbo packs of paper towels and other supplies, impulse buying can be a big part of the Costco experience, because only the most well-liked, trendy, and fast-moving items are stocked.

Those items include iPods, individually wrapped cheese sticks to put in a child's lunch box, as well as a few of the latest fashions.

Recently, Ms. Schneider and her college-age daughter were excited to find Ugg boots, Smashbox makeup in leather cases and Seven jeans at their Costco in Nashville. "Costco seems to go for the upper crust in taste," she said.

Some offerings rotate in and out of the warehouse based on the season, sales volume and other factors. As a result, people may go to Costco more often than necessary to see what is new, said Steve Hoch, a retail professor at the Wharton School of the University of Pennsylvania. "When they see something they want," he added, "they'll be likely to go ahead and buy it, because next time they return, the item may be gone."

While most consumers become annoyed when something they expect to find at a store is out of stock, a Costco shopper is likely to think, "I should have gotten it last time," Professor Hoch said.

Other retailers may also seek to entice shoppers by setting limits and creating scarcity. For example, <u>Target</u> offers limited-edition designer clothing and home furnishings that are unique to its stores, and that are often stocked for a period of only 60 to 90 days.

And at <u>BJ's Wholesale Club</u>, customers may come for their everyday grocery items, "but if they spot some jewelry or the new capri pants at a great price they will be happier," said Teleia Farrell, a company spokeswoman. BJ's uses items like 42-inch televisions and topaz rings to turn "ho-hum shopping into an exciting environment," she said.

It is the same at Sam's Club, where "members enjoy looking throughout the club for unexpected deals," said Susan Koehler, a spokeswoman for the company.

Temporarily stocked surprises are also a calculated part of the Costco shopping experience. "We try to have hundreds of items that are different each time a customer comes to the warehouse, to create a treasure-hunt atmosphere," said Joel Benoliel, a senior vice president. "We'll always have the same staples — the cereal, the detergent — and then we add in the 'wow' items." But at the same time, there can be a comforting sameness to each cavernous location.

Psychological factors can strongly influence buying behavior, according to Pamela N. Danziger, author of "Shopping: Why We Love It and How Retailers Can Create the Ultimate Customer Experience" (2006). Shoppers can experience an emotional thrill when they spot a deep discount, or find a particular item before it disappears from the shelves, she said, and creating those kinds of feelings has

helped Costco. "Shopping is recreational there," she said. "People seek out this psychological reward."

Ted Reisdorf, 43, chief executive of Paragon Custom Homes of Scottsdale, Ariz., goes to Costco once every month or two and stocks up on household supplies, to save him more frequent trips to the grocery store. Once he is there, however, he walks up and down every aisle to see "what jumps out" at him. Mr. Reisdorf usually adds some books, DVDs or baked goods to his cart. "I always buy stuff I don't exactly need," he said.

Everyone seems to have an opinion about the Costco shopping experience. Some say they avoid going there because they always spend too much money. Others say they do not mind overspending at Costco because the company treats its workers well. A typical full-time cashier will earn \$40,000 a year plus benefits after four years with the company.

Others, however, decry the essence of Costco. Teri Franklin, a mother of two in Seattle, said that Costco fed American consumerism and waste. "Instead of a single board game, you're offered seven shrink-wrapped together," she said. "You'll probably end up playing with a couple and the rest will sit in the closet. But you really only wanted one." She said she was not tempted to buy anything beyond bottled water and diapers at Costco. "How many things do you need 42 of, really?" she asked.

FOR those who want to minimize impulse buying, consumer experts say, it is helpful to shop as infrequently as possible, to arrive at the store with a list and a budget, and to walk down only the aisles that contain an item on the list. Conventional wisdom would also say that it is a good idea not to shop when hungry.

But those are not the types of shoppers who have made Costco successful. Professor Hoch said that increasing impulse buying or the number of items bought per visit was crucial to the company's success.

Costco makes the bulk of its profit by charging an annual membership fee for access to its stores, he noted. A larger membership allows the company to buy items in bigger quantities and to pass along savings to customers. Customers who buy more items may feel that the membership fee is worth paying, because the cost is spread over all the products they buy.

Current annual membership rates are \$50 for an individual, couple or business, and \$100 for an Executive Membership, entitling the customer to other services.

"People laughed at the idea of charging someone to shop at your warehouse, but our membership fees are north of \$1 billion a year," Mr. Benoliel of Costco said. The company has more than 24 million member households in the United States and Canada.

Crucial to the company's continued growth will be people like the Schneiders, who find shopping at Costco both utilitarian and serendipitous. "I might be going in for lettuce," said Ms. Schneider, who on the spur of the moment once bought a \$2,000 baby grand electronic piano at Costco, "but if I come out

with other things, I don't mind."

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