Three Circles Analysis: Costco

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Costco is a membership-based warehouse store offering consumer products and services. Costco is well known for its Kirkland store-brand label but offers other popular brand names as well on a wholesale basis. Costco opened its first store in Seattle, Washington in 1983, with headquarters in Issaquah (Costco, n.d.), and has grown into a sprawling business ranking fourteenth on the list of the largest companies in America by Fortune magazine. Costco was able to distinguish itself from its competitors by selling its products wholesale to consumers enrolled in a subscription-based membership. While Costco is known for its food selection, the company has substantially expanded its line of products to include other commodities including home appliances, software, alcoholic beverages, jewelry, pharmacy products, and even solar panels. Costco also offers a line of services at its warehouse stores with some examples including optometry, insurance agency, photograph printing, and payment processing services. When describing how Costco has developed its competitive advantage, the three-circles method of analysis can be useful. This powerful tool can assist companies with visualizing where distinct advantages lie based on consumer’s needs, the organization's offerings, as well as the offerings of competitors as a group of three overlappings circles. Areas where the circles overlap with each other paint a compelling picture in where the company finds the strategic advantage.

**The Circle of Consumer’s Wants and Needs**

The first area we will examine is that of the wants and needs of consumers. All humans have the same basic needs including food, water, sleep, clothing, and shelter. Maslow’s (1943) famous publication *A Theory of Human Motivation* calls these physiological needs, and they form the foundation of the pyramid that all higher-order needs can be built on. In the early days of Costco, the company’s target market consisted of strictly business owners and other commercial entities looking to supply their own ventures but has since opened membership to individuals (Costco, n.d.). Today, the typical Costco shopper tends to be a person who is relatively affluent and educated, based in part on the requirement of recognition that the store's relatively high membership fees provide a worthwhile economy of scale. Costco selected locations for its stores in suburban enclaves of large metropolitan areas where homeownership is common, and as such, many of the store’s patrons are homeowners (Best, 2016) who prefer to buy in bulk. Therefore, we will place products and services that are of value to typical American homeowners and their families inside the circle of consumer’s needs.

**The Circle of Competitor’s Offerings**

Costco’s main competitors are Amazon, Wal-Mart, and Target. None of these competitors require an annual subscription to do business with. The closest similarity to Costco’s membership model is an optional subscription to Amazon Prime that provides its customers with free two-day shipping on many goods as well as other benefits such as a digital streaming service, two-hour delivery for grocery orders from their partner Whole Foods, and Prime Wardrobe which is a service where customers can try on clothing items without actually purchasing them. Wal-Mart is (in)famous for its meagerly paid employees, and relatively low caliber of customer service that paying poor wages will inevitably entail. Wal-Mart is America’s largest retail store with thousands of brick and mortar stores, as well as a formidable online presence. Target is another general merchandise seller that competes with Costco. Target differs substantially with Costco in that they sell products at retail prices as opposed to wholesale. Faith and Edwin (2014) describe this type of retailer’s practice of using product price markup in order to generate more substantial profits. Convenience, it seems, is Target’s greatest value. While the products offered by Costco’s competitors are substantially similar to their own, Costco is able to differentiate itself significantly and is able to use that differentiation as a competitive advantage.

**The Circle of Costco’s Offerings**

While Costco may offer similar typical consumer products to its competitors, the experience of shopping at Costco is anything but typical. Customers will notice the large warehouse layout of the stores as sonn as they walk in the door. A patron of the store “may be going to stock up on cereal or wine, but to get there they need to walk past large aisles packed floor to ceiling with new inventories of cool stuff. When you walk into a Costco, you never know what you are going to find.” (Best, 2016) Costco is also able to differentiate its customer service from its competitors by paying a relatively high hourly wage compared to its competitors, with the lowest-paid employees making $14 per hour with some employees making as much as $24 per hour (Glassdoor, 2019) depending on their specialization. Having well-paid employees has tangible benefits in the customer’s interactions with staff who are willing to give their services with a better attitude than if they were only making minimum wage. Costco is able to afford to pay these wages thanks in-part to their sound business model. Costco’s paid memberships represent a substantial portion of the company’s business model. For $55, one gets the privileges of a basic membership, simply granting them entry to shop in the store. Approximately one-third of members elect for the $110 executive membership which grants a two percent reimbursement bonus on all Costco purchases. If the member spends $230 per month, the executive membership pays for itself, and if the member spends $37,500 per year he or she would be eligible for the store’s maximum reimbursement of $750 cashback (Best, 2019). It is no surprise that executive members represent around two-thirds of the company’s revenue each year. Columbia University’s School of Value Investing (n.d.) explains how the prevalence of online shopping platforms can actually bring benefits to Costco. “The advent of e-commerce platforms are more of an opportunity than a threat as the expanded distribution channels and consolidation of market share towards larger players offsets the disruption potential from new entrants such as Amazon.” (Columbia University, n.d.) Costco has managed to differentiate itself so substantially that its competitive advantage is not easily disrupted, even by global leaders in the wholesale retail industry.

**Where the Circles Join**

The three-circles analysis tells us the most about Costco’s competitive advantage where the circles overlap with each other. The area in the center of all three circles, there exists parity between consumer’s needs, Costco’s offerings, and its competitor’s offerings. When we look at the intersection between consumer’s needs and Costco’s offerings, we are able to see the points of differentiation that make Costco unique. Conversely, in the intersection adjacent, where competitor’s offerings overlap with customer's needs, we are able to discern what makes Costco’s competitors unique. With the example of Wal-Mart offering sub-par customer service, we can see that this is not always a good thing for the competitors. Every executive knows that for his or her organization to succeed, it must strive to build a competitive advantage. An important, straightforward, and effective way to learn what that advantage may be, is to simply draw three circles and start filling in the details. (Urbany & Davis, 2010)

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