

Costco.com Successfully Expands into United Kingdom in Record Time

Executive Summary

CUSTOMER

Costco Wholesale Corporation

INDUSTRY

Retail

CHALLENGES

- Take advantage of high online / mobile commerce growth rates in foreign markets and meet members' burgeoning multichannel demands
- Convince senior leaders that international e-commerce opportunity was large enough to justify significant investment

STRATEGY

- Identified best practices in global e-commerce management
- Developed economic model for global e-commerce that forecasted size of online opportunity in each warehouse country
- Recommended country rollout based on existing business size and maturity of each country's e-commerce infrastructure
- Laid out global e-commerce best practices across all retail functions, along with specific success factors for each international market

RESULTS

- Launched Costco.com U.K. in October 2012, only six months after receiving management approval
- Increased sales by 30-35 percent month-over-month (incremental to warehouse sales)
- Scheduled launches of two more international e-commerce sites within next 18 months

Background

Costco Wholesale Corporation (COST) is the largest wholesale club operator and the fifth-largest retailer in the United States.¹ It is also the sixth-largest retailer in the world, with sales close to US\$100 billion and more than 620 warehouses in the United States, Puerto Rico, and seven foreign countries.² However, in 2011, Costco had e-commerce operations only in the United States and Canada.

Costco.com wanted to take advantage of the high online and mobile commerce growth rates in foreign markets and meet members' burgeoning multichannel demands. The idea, however, of expanding e-commerce globally raised many investment and management issues among the company's senior leadership and e-commerce division.

Challenges

Costco's international warehouse business is very successful and still in high-growth mode. Although local country managers recognized the importance of adding online channels, U.S. senior leadership was not convinced that the size of the international e-commerce opportunity was large enough to justify a major investment, which might come at the expense of warehouse expansion, with its predictable returns. Furthermore, senior management was concerned that creating an online operation in each country would either distract local managers from growing their warehouse business or add significant headcount and training costs.

The idea of rolling out e-commerce to foreign countries also raised many operational unknowns: What kind of online presence should Costco have globally? What are members' online shopping expectations in each country? Where should the website's management be located? How should operational issues be handled, such as number of sites, product assortment, marketing, payments, fulfillment and delivery, cross-border trade, and technology platforms?

Costco.com asked the Cisco® Internet Business Solutions Group (IBSG) to assist in developing a global e-commerce growth strategy that would size the business opportunity, analyze the key countries' online markets,



Cisco Internet Business Solutions Group (IBSG)

prioritize country rollout, and provide best practices in running a global e-commerce business.

Strategy

Prove the Potential

First, Cisco IBSG and Costco.com worked on sizing the company's global e-commerce opportunity—in total and for each international warehouse market—to prove the investment potential. The business model conservatively suggested that Costco.com could increase its online sales revenue 60 percent over five years by expanding globally.

Furthermore, IBSG pointed out that global expansion would: 1) protect Costco's market share against key Western and local competitors already online; 2) attract new members, especially from the younger generation and people unable to shop Costco warehouses due to distance or legal restrictions; 3) generate new member fees; and 4) drive warehouse sales from more engaged multichannel shoppers.

Based on the business forecast and competitive rationale—as well as the promise of a low-cost, prebuilt e-commerce platform—Costco senior management approved a proof-of-concept expansion of e-commerce to one new country.

Start with the United Kingdom

Cisco IBSG interviewed global e-commerce pioneers from six top-50 retailers and five major consulting firms and suppliers to understand best practices in global e-commerce management. As Don Burdick, senior vice president of Costco global e-commerce, observed, "Macro data from Forrester and Gartner is good, but it's 10 times more valuable to talk to people who really did it, to hear from the school of hard knocks."

These expert interviews indicated that Costco should prioritize its country rollout based first on the size of its existing business ("Go where you're already strong," said interviewees), and second on the overall size and maturity of a country's e-commerce market. Based on these criteria, Cisco IBSG recommended that the global rollout start with the United Kingdom. Costco agreed and decided to launch there on a very short timetable—only six months after approval—in October 2012.

Costco chose to go to the United Kingdom for four main reasons. First and foremost, Costco U.K. has high sales and membership. Since Costco has had warehouses in the country since 1993, a U.K. site was likely to have the highest international sales simply by attracting its existing membership. Plus, given Costco's strong brand recognition, there was the possibility of attracting new, online-only members. Britain's zoning laws restrict warehouse membership primarily to business, so less than half of the United Kingdom's population is eligible to become regular members.

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Senior Vice President
Costco Global
E-Commerce

Second, in 2012 the United Kingdom was the second-largest e-commerce market in the world and still growing at a high rate.³ At least 62 percent of the population shops online,⁴ and U.K. consumers spent an estimated £78 billion⁵ (roughly \$118 billion) in 2012. So, most of Costco's members were online anyway, and the company wanted—and needed—to build loyalty by offering another shopping channel. In addition, online sales were the only segment of U.K. retail that grew in 2012, increasing an estimated 16 percent over the prior year compared with flat U.K. retail store sales.⁶ Costco realized that it needed to supplement warehouse sales with online sales to maintain overall country growth.

Third, Costco.com U.K. could benefit from the United Kingdom's sophisticated e-commerce infrastructure, including delivery and payments, and Costco could leverage its online and in-line supplier network. The English language also allowed for an easier initial website transition.

And fourth, since Cisco IBSG's research showed that many U.K. retailers are seeing online growth from European orders, Costco saw an opportunity to use the U.K. website to enter non-warehouse countries like France and Spain through cross-border trade.

Organize Operations for Speed and Success

Based on both expert interviews and U.K. market analysis, Cisco IBSG also identified specific organizational and country best practices, which Costco implemented and enhanced with great success.

One of the most important decisions was determining which capabilities to staff locally versus centrally. Cisco IBSG recommended that Costco centralize all functions at headquarters that require standardization and scale, but to use country personnel for all functions that require local market expertise, particularly buying. So, a crucial success factor was immediately redeploying Costco's strongest local warehouse buyers to online.

Costco.com U.K. uses local personnel for buying products in all categories. "Our U.K. buyers made a big difference. Using both local and best buyers allows for a quicker startup. They already know the vendors, items, market, competition, and systems," said Burdick. The local buyers can still take advantage of Costco's global vendors. An estimated 20 percent of products are ordered through U.S. buying arrangements and shipped directly from manufacturers, which actually allowed some U.S. vendors to go global themselves for the first time.

In general, U.K. product categories mirror those in the United States. These are categories in which Costco can offer great value in both countries and include electronics, jewelry, and lawn and garden. Cisco IBSG's analysis, however, also suggested potential in food and beverage given the United Kingdom's larger, more established online grocery market. Today, gourmet foods, wines, and spirits are the website's number-three category, driving member frequency online just as grocery traditionally does in the warehouses. "We sell prosciutto on the

shoulder, gourmet seafood from Scotland, and Bordeaux new releases—all have great cachet. There is even a 33-pound cheese wedding cake,” laughed Burdick.

Another critical speed factor was the use of a prebuilt, feature-rich, hosted e-commerce platform, hybris, and an outsourced drop-ship network from GSI Commerce. Using these virtual IT and logistics partners allowed Costco.com management to commit to opening in only six months, at a total cost of just \$5.2 million over three years.

Other U.K. operations are quite similar to those in the United States. However, having been warned by Cisco IBSG that British online shoppers have high expectations of website performance, Costco.com U.K. does not sell anything that it does not have on hand, either at Costco or at a vendor. When inventories reach a certain, predetermined low level, the item automatically drops off the website within 15 minutes.

Finally, Costco.com U.K. has launched an online-only membership to allow non-business web shoppers to finally have access to Costco without paying extra for products. As Garth Morris, Costco e-commerce director, said, “Launching our U.K. website to include an Online Annual Subscription further broadens our U.K. customer base by overcoming the member zoning restriction criteria and enabling online customers to shop without incurring the 5 percent non-member surcharge. We now get the opportunity to offer an expanded selection of products and categories to a wider audience than is typically available in the bricks-and-mortar locations.”

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Results

Costco.com implemented Cisco IBSG's rollout and operational recommendations. “Market analysis, country prioritization, and staffing structures — everything Cisco recommended, we did. We are ending up right on point and where we want to be,” said Burdick.

Results achieved to date include:

- After six months in market, Costco.com U.K. sales are growing rapidly. Each month's sales are up 30-35 percent over the prior month.
- Online sales appear to be completely incremental, since warehouse sales continue to grow.
- Costco.com U.K. is expected to break even in the second year, and in three years should realize profit levels similar to those in the United States.
- The U.K. website is increasing the British public's awareness of Costco, which Burdick considers to be “the best-kept secret in U.K. retail.” The popular TV show Top Gear featured both Costco.com's £90,000 (\$138,000) full-size racing car simulator and its diamonds.

Next Steps

Senior management is pleased with the U.K. website results and has approved two more international markets for launch in the next 18 months. Costco expects to launch a Mexico website under a similarly tight timetable, using both its international e-commerce platform and all the lessons learned in the United Kingdom.

Endnotes

1. "2012 Top 100 Retailers," *Stores* magazine, July 2012.
2. "Global Powers of Retailing, 2012," Deloitte, January 2013.
3. "Ecommerce Sales Topped \$1 Trillion for First Time in 2012," *eMarketer*, February 5, 2013.
4. "The Connected Kingdom: How the Internet Is Transforming the U.K. Economy," The Boston Consulting Group, October 2010.
5. Interactive Media in Retail (IMRG), IMRG.org, March 2013.
6. "B2C Global E-Commerce Overview 2012," IMRG, May 2012.

More Information

Cisco IBSG (Internet Business Solutions Group) drives market value creation for our customers by delivering industry-shaping thought leadership, CXO-level consulting services, and innovative solution design and incubation. By connecting strategy, process, and technology, Cisco IBSG acts as a trusted adviser to help customers make transformative decisions that turn great ideas into value realized.

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