COSTCO'S SUCCESS AND IMPACT IN JAPANESE MARKET

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Introduction

While the success or failure of foreign entries depends on the appropriateness of the firm's not only post- entry decisions but also the strategic entry choices made at the time of entry (Green et al., 1995), specifically, Gielens and Dekimpe (2001) suggested that the strategic decisions made at the time of entry continue to influence the future performance in foreign markets. There are simultaneously several strategic entry decisions such as scale of entry, mode of entry, order of entry, the adaptation of retail format to local market condition and the familiarity of the store format to the parent company. Given this variability in entry strategic choices, we focus on especially the adaptation of retail format to local market condition.

Foreign retailers are still struggling to develop the competencies needed to compete in the local markets where the retailing industry is maturing and competition is stiffening, to avoid a market share game in increasingly competition-stiffened emerging markets. Actually, few global retailers realize comparable returns in their host maturing markets as in their host emerging markets or in their home market. Some global retailers like Wal-Mart, Carrefour, Tesco lost money in many of their maturing markets like Japan or Germany (Arnold and Fernie, 2000; Fernie and Arnold, 2002; Berggoetz and Laue, 2004; Ghehard and Hann, 2005; Talaulicar, 2009, etc). As most literatures pointed out, global retail companies have differed in their approaches by the rapidity and progress of development in the country's retailing industry, because retail formats has already diversified and competition between similar retail formats has considerably intensified in their maturing markets, compared to their emerging markets constituted by pulling factors for the entry of global retail firms.

However, Costco was the first major entrant, having a success outside their home market with their same strategic decision, regardless of the rapidity and progress of development in the country's retailing industry. We seek to answer in this paper questions such as: Does Costco have their different strategic choices from their emerging market when entering their maturing country? Unless their entry or post-entry strategy is different, how can Costco have a success which is said to be quite harder in their maturing markets than their emerging markets? Specifically, we focus on simultaneously the foreign player's retail mix, resources and the host market's condition and even the impact on host market.

Literature review

The internationalization of retailing is considered an ongoing process (Whitehead, 1992; Dawson, 1994; Vida and Fairhurst, 1998; Alexander and Myers, 2000; Dawson and Mukoyama, 2006), in which retailers have rich opportunities to learn how to expand successfully their operations in foreign markets (Palmer and Quinn, 2005; Palmer, 2006). The selection of foreign market is influenced by the similarity of country characteristics as well as growth opportunities.

Many studies of international retailing are presented around the concepts of "standardization" and "adaptation" (Salmon and Tordjman, 1989; Treadgold, 1990/91; Helfferich *et al*., 1997; Alexander and Myers, 2000). For example, Salmon and Tordjman (1989) generalized two types of internationalization strategies. The first is called "Global

Strategy", with which retailers replicate its core business concept in other countries. The second is called "Multinational Strategy", with which retailers modify their core business concept (or format) to fit local market conditions while keeping the basic elements of its core concept. Treadgold (1990/91, pp.24-25) proposed a concept of "Transnational Strategy" as a type of "Hybrid Strategy (Douglas and Wind, 1987, p.27)." It is similar to the concept of "AdaptStandation" in the field of global marketing (Vrontis, 2003). "Glocal Marketing" is based on those point of views (Svensson, 2002, p.579).

Researchers have different views on the respective merits of standardization and adaptation (Burt and Carralero-Encinas, 2000; Burt and Mavronmmatis, 2006). Some believe that a retailer with unique offerings can expand its business opportunities in new markets in a standardized manner (Salmon and Tordjman, 1989; Treadgold, 1990/91), because standardization is considered to be the easier approach than adaptation. As well, standardization could be achieved without making many efforts or incurring great cost. Others argue that when operating in a standardized manner across national borders, retailers are placed in different social and economic contexts from their home market. That is, by adopting the standardization approach, retailers may not be able to achieve the same level of performance as in their home market due to diverse factors such as consumer preference and retail competition.

Some international retailers adopt a hybrid strategy that combines elements of both standardization and localization so as to maximize the value of offerings. To implement hybrid strategies, global retailers must adopt flexible organizational arrangements that permit the use of country-specific knowledge (Sashi and Karuppur, 2002). Leknes and Carr (2004) have pointed out that there are more subtle distinctions in terms of geographic expansion, entry mode, international integration, and standardization of operations than a simple distinction between global or adaptive retail strategies.

Regardless of the strategies, the performance of a global retailer can be viewed as a continuum of the internationalization process. Performance is often described with either of the two keywords: success and failure, and the choice of strategies lead a global retailer to ascertain the success or failure of its operations in foreign countries.

With regards to failure, much has been written about global retailers' withdrawal from a foreign market, which has been evaluated not always in negative, but often also in positive, terms. Even if a global retailer's withdrawal from a foreign market is described as a failure in adapting to local market conditions, it can still be seen as a lesson that leads to revised strategies for entering a new market. Indeed, when a company's withdrawal from one of its foreign markets is seen as a failure, the lessons learned can benefit the company for setting up future operations in other foreign countries (Palmer and Quinn, 2007). In this sense, failure can also bring about a positive contribution to the internationalization process. At least, the experience of a retailer's withdrawal can be an important step leading to development of new internationalization strategies (Alexander and Quinn, 2002; Palmer, 2004; Jackson et al., 2004; Toba, 2006, etc.)

Methodology

While many Japanese domestic retailers were watching Carrefour closely, none of them paid enough attention to the entry of Costco as a serious contender. Costco, the largest company in the wholesale membership club sector in the world, entered Japan at almost the same time as Carrefour, but has been making steady inroad, with a markedly different business model from not only that of other foreign retailers but also those of the domestic food and general merchandise retailers. This raises an important research question: how has Costco been able to win the Japanese consumers with a business model unfamiliar to them, whose shopping behaviours were said to be difficult, if not possible, to be changed. Through a case study of Costco Japan, this paper aims to promote our understanding of how foreign retailers influence local consumers in a mature market with differentiated business models. In particular, we focus on Costco's operational methods in a mature foreign market and its appeal to well-educated and well-informed consumers.

Our study suggests that there are different types of localization strategies for a global retail company when operating in a foreign market. Information and data used in this study are obtained from both secondary and primary sources. Secondary sources include the Costco annual reports and reputable Japanese-language newspapers and business journals.

Food retailing in Japan

Food retailing in Japan is much more developed and more resistant to foreign competition. Carrefour, Costco, Wal-Mart and Tesco all attempted to introduce changes to the Japanese food market. Carrefour brought its hypermarket format to Japan in 2000, but from the Japanese consumers' viewpoint, it was not much different from the Japanese general merchandise stores. In fact, the domestic food retailers were so advanced that they made it difficult for the Western retailers to penetrate the Japanese food market. It is no exaggeration to say that domestic retailers have been dominating the Japanese food market. Not being able to achieve expected results, Carrefour had to exit Japan in 2005.

The Japanese domestic retailers have more sophisticated handling technology and know-how of "three perishable foods" such as fishes, fruits & vegetables, and meat, compared with the Western retailers, because they have to satisfy the needs of Japanese consumers who are sensitive to the "freshness". Wal-Mart realized through Carrefour's being in trouble that the procurement capabilities and reinforcement of handling know-how in three perishable foods would be keys to the success in the Japanese food market. At that time, Seiyu which is one of the largest retail chain stores, developed "Muji" as their private label in 1980 was finding some advantageous business partners, since the financial situation at its entire group has worsened. Wal-Mart judged that Seiyu which has been operating the Japanese traditional retail format, general merchandise stores for a long time understand better the Japanese retail environment and customer and has more highly handling know-how of perishable foods. In 2002, Wal-Mart acquired a 6.1% stake in Seiyu, and after, in 2005, they acquired a majority interest, making Seiyu a Wal-Mart subsidiary. Wal-Mart proceeded with additional steps to acquire all of the remaining shares, and in 2009, Seiyu became a wholly-owned subsidiary of Wal-Mart. Japan is the seventh entering country in Wal-Mart which operates in 26 countries around the world outside home country (http://corporate.walmart.com/our-story/our-business/international/walmart-japan,29 October, 2014).

Although even domestic retail companies operating general merchandise stores at the mature stage are forced to have a hard fight for market positioning competition, Wal-Mart Japan is striving to enhance store operations and product procurement capabilities fully leveraging the global networks in order to acquire the competitive advantage.

In recent years, domestic retailers have a tendency to reduce their business size, whereas Wal-Mart expands their business scales. Tesco as one of the world's largest retailers in 12 countries, in 2014, entered Japanese market in 2003 through the acquisition of 75 discount supermarkets in Japan from Tsuru Kame Land. They continued to acquire small-sized of discount stores in 2004 from Frec's and in 2005 from Super Tanekin. After that, Tesco Japan was operating a small-sized retail format of Tesco Express at the difference from some other Asian countries but could not acquire their market positioning between supermarkets and convenience stores until the last. Although Tesco wanted to provide the Japanese consumers who go shopping frequently with more highly valuable shopping experiences, finally they announced their decision to sell their business in Japan in 2011.

However, Tesco Japan could not find any players to buy their business for around one year since the announcement of withdrawal, because most Japanese players could not feel the attractiveness about the small-sized stores of Tesco Express. Later that year, Aeon, domestic retailer in Japan became a new buyer of Tesco Express.

The Costco Business Model in Japan

The first Costco store in Japan opened in 1999 as a key tenant of a large shopping centre in Fukuoka (Hisayama). More openings followed in subsequent years. As of June 27, 2014, Costco operates 20 stores across Japan. From the beginning, Costco Japan attracted the attention of a large number of Japanese consumers, with more than 260, 000 member sign-ups in its first year (including free memberships). This initial success occurred despite the fact that its business concept and operating system were ridiculed in the media and condemned by academia.

Indeed, Costco was facing a big challenge at the time of its entry in the Japanese market. Its operation was based on a business concept that had already disappeared in Japan. Basically, the business concept was characterized with transactions in the form of "Cash and Carry", limited to paid members. This was the same concept that the domestic Daiei Group used to operate its Kou's stores. The Daiei wholesale club called "Kou's"as the first membership club had opened their first store in Habor Land, Kobe, in 1992. After the big earthquake in Osaka-Kobe in 1995, that store moved to Port Island as an artificial island of Kobe, but closed in 2002, when the financial situation at its entire group has worsened (*Nihon Keizai Newspaer*, 24 April, 2009).

The core elements of the concept were to offer their members low prices similar to retailers' buying ones on a limited selection of brands (about 5,000 SKUs) but in a wide range of merchandise categories, and to eventually achieve high sale volumes such as one case of apples (about 10 kg). Daiei hoped to achieve high operation efficiencies in their Kou's stores through high volume sales and low-cost handling of merchandise in a no-frills and self-service warehouse environment, allowing the Kou's stores to make a profit despite lower gross margins. Kou's had a markedly different business model from that of GMS (general merchandise stores) of their main retail format in the number of items and employees, display and selling way and so on. For example, Kou's had only 5,000 items compared to GMS with 45,000 items and made the number of employees around a one-third of GMS (*Nikkei Marketing Journal*, 20 October, 1992). Also, Kou's simplified a work procedure by using the forklift in the product display way so that even a part-time job and a part timer having low skill could easily perform that work. Kou's strived to enhance their store operations and product procurement capabilities in order to provide customers with products 40 % more cheaply on the average than a manufacturer's recommended price. This was supported by goods purchases without returns in difference from other

As stated above, the Kou's format was quite specific one for the Japanese consumers for several reasons. First, the Japanese consumers were not used to purchasing daily goods and food stuff in large packages. Second, the other important characteristic of Kou's business concept was to provide a continuing source of membership fee revenue, and to reinforce member loyalty. Kou's had two primary types of members such as Business and Individual, and members could utilize their membership at any Kou's six store locations like Costco. Both members pay an annual membership fee of \3,000 (approximately US$ 29.6) each, but have to pay more \500 (approximately US$4.9) as card cost for the first time, which includes one additional card used by family members.

Kou's tried to overcome the way not being familiar with the Japanese by suggesting the new consumption- style to buy the large packages with much lower prices at a time in four people, because it could be accompanied to three people in one member (*Nikkei Industry Newspaper*, 02 November, 1992). At the beginning of their doing business, it seemed as having succeeded because it became a topic in the media including the achievement of more sales and memberships than expectation. For example, the number of members was 38,000 people, and 5 months later, the membership increased 3 times (*Nikkei Marketing Journal*, 13 March, 1993). Also, they were striving to enhance their product procurement capabilities in order to provide customers with goods 40% more cheaply on the average than a manufacturer's recommended price. Actually, they introduced the way of goods purchases without returns from most manufacturers directly for only their wholesale club distinguished from other formats which Daiei group was operating (*Nikkei Marketing Journal*, 13 March, 1993). Even if the number of memberships continued to increase in 1997, they opened their price information and published the ticket of entry for non-members through their homepage (*Nikkei Marketing Journal*, 22 January, 1998). Daiei group kept off opening new stores due to their managerial deterioration, but they decided to actively open new stores of membership wholesale club because only some Kou's stores showed a 40% increase in the sales of as compared with that of last year (*Nikkei Newspaper*, 27 July, 1998). And also they tried to carry on the renewal of existing stores and on the adoption of selling their goods not only by cartons or in cases but also by each item, and of looking around the entire store by shortening the racks (*Nikkei Marketing Journal*, 28 July, 1998).

The membership fee must be the most fundamental and important factor in membership wholesale club, the total number of members was more 300 thousand in the second half of 1998. Kou's kept with the policy of member satisfaction and was earning \900 million (approximately US$8.9 million) every year by taking membership fee and that policy made Kou's low cost operation passible (*Nikkei Newspaper*, 16 November, 1998). At that time, the depression by deflation made the membership wholesale club of the lowest price policy root in the Japanese market, but at the same time, badly hit Daiei group as a whole. They decided to separate the department of membership wholesale club and to found Daiei Wholesale Corporation for a full-dress expansion in 1999 (*Nikkei Marketing Journal*, 19 November, 1998).

Due to their changing membership policy, shoppers did not need to pay a membership fee any more from September, 2001 and it was changed to discount 5% off on all bills for existent members. Kou's which had been in the red since 1996 because of depression and reducing of members could not avoid changing their membership policy. However, Kou's changing membership policy was considered the abandonment of warehouse business and produced bad results for them. Even though membership fee and member service must be the most fundamental and important factor in membership wholesale club, Kou's did not keep with the policy of member satisfaction.

They tried to embark on the reconstruction of the entire group through the discount store sector such as Kou's, but in last, Kou's shut down their six stores in August, 2002. The Daiei, Inc. used to be the largest retailer in Japan their total sales declined by nearly a quarter in the five years leading up to 2003, and was under the process of debt restructuring and support given by financial institutions in 2005. While Costco Japan follows the same concept, its business model is considerably different. According to the President of Costco Japan, Kou's is not really a wholesale club; the only element that is common to both retailers is the membership requirement, designed to both reinforce customer loyalty and provide a continuing source of revenue from membership dues. The differences between Costco and Kou's are summarized in Table1.

Element	Costco	Kou's
Store format	Warehouse-style, cash & carry, membership wholesale club: offering two types of membership such as business and individual being possible to use at any locations in the world	Likely similar to Costco
Product offering	Limited brands with wide assortments of merchandize; high proportion of merchandise are imports	5,000 SKU's compared to Costco with 3,500 to 4,000 SKU's
Pricing	Discount: everyday-low-price	40% more cheaply on the average than a manufacturer's recommended price
Selling method	Large/bulk package	High volume sales, low-cost handling of merchandise selling their goods not only by cartons or in cases but also by each item
Store configuration	Using high racks and industry-standard palettes for product display and stock	Product display by using the forklift, looking around the entire store by shortening the racks, using more boxes and carts sitting on the floor, instead of tall racks and the industry-standard palettes like Costco
In-store amenities	Food court, pharmacy, optician, print of a photograph, tire change (only for members)	Food court (non-member is available), optician, vending machine for CD
Store location	Suburban	Likely similar to Costco
Marketing	In-store promotion; free tasting/testing; no printed fliers	Likely similar to Costco
Customer service	Easy refund (including refund of the unused portion of the membership), no extra charge for membership card	Locker, telephone call to the person in charge in the sales floor

Table 1: Elements of the Costco Business Model, in comparison with Kou's

Costco is the first membership warehouse club in the world that provides its members the best possible prices on brand-name products. Its operating system is to keep costs low and pass the savings on to its members. Membership card is accepted at any Costco store in the world. It offers two primary types of members: Business, and Gold Star (individual). Businesses (including individuals with a business license, retail license, or other evidence of business existence) may become Business members. Business members pay an annual fee of \3,765 (approximately US$37) for the primary card plus one household card. Additional cards are available for an annual fee of \2,625 (approximately US$26) each, up to six employees. Many business members also shop at Costco for their personal and family needs. Gold Star membership is available to individuals who do not qualify for a Business membership, for an annual fee of \4,200 (approximately US$40), which includes one additional card used by family members.

Costco offers its members low prices on a limited selection of national-brand and private-label products in a wide range of categories. At Costco, the range of merchandise is limited be 3,500 and 4,000 SKUs, as opposed to 45,000 or more SKUs at GMS leading to the Japanese retail industry. Costco seeks to limit specific items in each product line because merchandise is stored on racks above the sales floor or displayed on palettes containing large quantities of each item. Costco is much more efficient in merchandise handling and inventory control. It buys the majority of its merchandise directly from manufacturers and routes the merchandise to a cross-docking consolidation "depot" or directly to its warehouse stores. With industry-standard pallets, deliver of goods from manufacturers to warehouses and stocking of merchandise in stores become much more efficient and economical. Rapid inventory turnover, when combined with the operating efficiencies achieved by volume sales, efficient distribution, and reduced handling of merchandise in no-frills, self-service warehouse stores, enables Costco to be profitable, despite with significantly lower gross margins than traditional supermarkets and supercentres.

The Costco stores enhance their attractiveness by carrying imported goods of international brands, including such well-known apparels as Tommy Hilfiger, Polo, and Lacoste. Imported goods account for one third of all merchandises that go through Costco's distribution centre in Japan (*Toyokeizai Weekly Magazine*, Feb. 10, 2001). Its premium private label products, Kirkland Signature, are also sold in its Japanese stores at prices lower than comparable domestic products, and are well liked by Japanese consumers. It is reported that many seniors are very pleased when their children bring to them imported goods purchased at Costco as presents.

Even the ordinary food court at the Costco store is a popular attraction. Japanese consumers have a tendency to enjoy leisure time with family. On a shopping trip to Costco, children and adults often spend a good amount of time in the food court. To many Japanese consumers, shopping at Costco is an exciting event.

Costco is good at listening to customers' suggestions and adjusting its selling methods accordingly. Many Japanese customers bring their friends and relatives to Costco, who do not have a membership card, and share the bulk purchases with them. For one example, Costco changed its 2.4 kg- package of "Sakura Chicken" from two 1.2 kg component packs to four 0.6 kg packs, to make sharing easier. After passing a cash register, shoppers share their bulk purchases with each other in the food court or parking lot (*Trendy*, April, 2011, p.38).

In order to sell new products to the conservative Japanese consumers, Costco needs to do active and aggressive in-store promotions to "educate" the shoppers. Japanese consumers are typically shy to try a product in a retail store, because they feel that they would be obligated to purchase the product after a free trial. Costco hired a local marketing firm, known as Club Demonstration Services, to do in-store promotions, offering "two free bites" to each customer. This made consumers feel comfortable to try out the new products. Consequently, long lines began to form in front of the sampling tables. The best-selling item called "Bulgogi Beef Yakiniku (Korean grilled beef)" has resulted from active in-store promotion.

It puzzles many observers that the Japanese consumers do not reject Costco's selling method, which has been used by almost all foreign discount retailers that have operated in

Japan. The foreign retailers either ended up with modifying their selling method to be similar to the Japanese methods, or withdrew from Japan. When Dairy Farm, a large discount retailer from Hong Kong, brought the same selling method to the Japanese market, many researchers warmed that it would not align with the Japanese shopping behaviour. Indeed, it was not long before Dairy Farm withdrew from Japan.

The Impacts of Costco on Japanese Producers, Retailers, Developers, and Consumers

Costco continues to open stores in Japan since its entry 15 years ago. In 2013 alone, it opened five stores. So far, it has not closed any stores, as did Carrefour and Wal-Mart. Besides, it continues to enjoy a high membership renewal rate, currently at 87%. These should be taken as evidence of its success in Japan. Its impacts extend to manufacturers, suppliers, retailers, developers, and consumers alike.

Despite that one third of its merchandize offers are imports, Costco sources large quantities of goods from domestic producers and suppliers. That means that some Japanese manufacturers are using Costco as a platform for their market expansion. For one example, the company named Japan Green Tea Co. Ltd., which imports “Crazy Salt” as a popular product for Costco Japan, always sells its new products for the first time in the Costco stores. It is reported that about 60% of Japan Green Co. Ltd’s new products are sold the rate of sales through (*Trendy*, June, 2013, p.109).

Costco often acts as a complement, instead of rivals, to the established Japanese retailers, and develops a cooperative relationship with local developers. “Power Mall Maebashiminami” is a huge shopping centre developed by the Beisia group in Maebashi-minami, Gunma, opened in December, 2010. Both Costco and a large Beisia supermarket co-tenant the shopping center (*Trendy*, June, 2013, pp.110-111) . Mitsui Real Estate Development, which developed the surroundings of JR Shinmisato Station, also chose Costco to cotenant with Ito Yokado’s general merchandise store the Lalaport Shimisato shopping center (*Nikkei Business*, Aug/Sep. 16, 2010, p.27).

Costco even works with shopping agents to reach far-away consumers. The shopping agents provide shopping services to consumers whose community does not have a Costco Club yet. For example, the shopping agent service, Town Tsukimino, buys some goods from Costco (but in damaged cartons) and retails them to consumers in single items. “costcost21” is an online agent that buys goods from Costco and re-sells them with a 30 percent markup (*Trendy*, April. 2009, p.29; June, 2013, p.113, http://costcost21.jp, the date of access, June 30, 2014). “Resell Town”, another shopping agent service, provides free delivery service. Some Japanese consumers purchase small amount of goods from the shopping agents for testing a product before going to Costco to buy in large packages. Even if the prices at the agent services are usually higher than at a Costco store, it is not that expensive if one considers the other components of the total shopping cost, such as transportation cost and travel time.

With the variety of new products introduced by Costco, particularly the imported products, many Japanese consumers developed new recipes. The spread of these recipes online and the desire to try these recipes induce more consumers to purchase ingredients from Costco.

Result and conclusion

According to Nikkei Business, the smart and careful Japanese consumers are undergoing self-change (*Nikkei Business*, April 6, 2009, p.86). 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 does not have to change the core business concept except for minor adjustment, but it could succeed by stimulating consumers to change their own purchasing behaviour.

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 consumer needs and adapted themselves to the change in social consciousness.

We could also examine that foreign retailers should be focused on their own differentiated advantage in order to success in mature market such as Japan, because they have to compete with local retailers in maturity-stage general merchandise store market, and to satisfy with more informed consumers. Product differentiation from local retailers gave Costco a competitive edge. When local retailers as well as foreign retailers attached importance to “core competence”, a smart and careful consumer would be stimulated to enjoy higher satisfaction.

But the theoretical significance of the interaction with more informed consumers has led some to wonder if the data requires further analysis for showing 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.

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