

COSTCO

Local Merchants Finding Ways to Compete With Retailing Giant Costco

by Joel Moreno

With merchandise stocked to the ceiling and aisles like wide cement corridors,

Costco Wholesale has settled into the city of Santa Cruz.

County residents looking for bargains inundated the new outlet and drove sales revenues up into record levels for a warehouse club's opening day. Costco's Santa Cruz general manager David Aue wouldn't give exact numbers, but said sales receipts in the first three weeks were at least 40 percent over company projections.

Some consumers say Costco is a godsend, helping them live better on the same budget. But some small business owners say Costco will shut them down. These merchants add that the normally slow-growth Santa Cruz City Council is doing everything it can to help drive in the coffin nails.

"The biggest reason I opposed it was because I had a lot of small merchants ask me to do that," said Bob Thomas, owner of Outdoor World. "Somebody needed to step forward and speak in their behalf, and I chose to do that."

Thomas led a coalition of small business owners opposing Costco when the warehouse chain began seriously courting the area last year. The group, the Committee to Save Downtown Santa Cruz, conducted their own analysis on the overall impact of bringing Costco to the area.

Thomas and the committee determined that the presence of Costco would seriously hamper efforts to attract new businesses to rebuild the earthquake-damaged downtown retail area.

However, whether Costco is a gruesome Goliath intent on undercutting competition or simply a good-natured, misunderstood Gulliver in a Santa Cruz-style Lilliput, the fact is that the ware-

house club is here and local business owners must adapt or perish with the new heavyweight on the block.

Money Isn't Everything

Costco specializes in no-frills commodities, so trying to confront Costco on its own terms is suicidal for small merchants, say business executives. Keeping competitive with a giant discount store in terms of dollar values isn't possible for most small businesses, but value is not relegated solely to the realm of the dollar, they add.

Consumers appreciate other services which Costco is not designed to offer. For personal attention, technical assistance and a neighborly atmosphere, some shoppers are always willing to pay a little more, one local shop owner noted.

"My years of experience tell me I can't compete with them and win on their level so I have to proceed on a different level," said Steve





Bob Thomas, owner of Outdoor World.

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Mendelson, owner of Santa Cruz Optics.

Costco is a musclebound player on the economic landscape because it can sell goods at cost and survive off the profit margin of its membership fees. According to Standard and Poor's, Costco stores average \$1-1.2 million in pre-tax net profit per store, which roughly equates to their average membership at each outlet.

Another way to stay ahead of the "box industry" is to diversify the merchandise and not stock the same items that Costco carries. Switching to a manufacturer of a similar product will give consumers more of a choice, so a small business owners won't find themselves completely undercut.

Chris Casey, manager for Books Inc. in the Capitola Mall, figures to see some loss in sales to the discount chain but is confident the bookstore will retain its core of repeat customers.

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But, even without charging customers to shop, shop owners say they have many weapons in their arsenal to defend their turf. Among these defenses are a good selection of merchandise at good prices and good service.

"There are some people who don't even consider the personal touch that makes a business successful, and they will make a purchase based on the dollar being the ultimate decision," Mendelson said. "Then there are a lot of people who do business based on the service that they get—and that's the only chance the little person has—is to offer that extra service."

"People need to get value for what they're paying for," said Julia Walker, general manager at the Capitola Mall. "It's not necessarily the lowest price that they pay, it's value for what they're paying."

"Although Costco covers the current hot books at the higher discount, we have a much broader availability of titles in stock," Casey said. "Our staff is very skilled and knowledgeable in the literature that we do service. Hopefully that will be what the customer is looking for."

Even some of the larger stores which in the past were considered "discount" are feeling the affect, but they seem a little more capable of handling it.

Longs Drug Store on 41st Avenue, which is just one of 320 Longs retail stores in the western United States, has already felt Costco cutting in on sales of promotional goods, paper products and food products. But store manager Neil Wolfe said the Capitola Longs will recover quickly.

"Costco has limited varieties,

their hours are limited, their service is limited, and their location is not the best," Wolfe said. "What we're doing is trying to accentuate our strengths and play on their weaknesses."

If there's a common thread about Costco that all small business owners have spun, it's the lack of customer service and technical assistance warehouse employees offer with their products.

Costco Vice President of Operations John Booth said that is slowly changing.

"In the sales departments for major appliances, computers, that type of thing, we have on-going training programs for people associated with those sorts of areas, but it's really a cash and carry, self-selection atmosphere," Booth said.

Still, it's inevitable that in increasing the city's sales tax revenues to the amounts Costco officials claim, some existing local businesses will succumb to the competition and close their doors.

"There's absolutely no doubt in my mind that the chains are going to put stores out of business," local

business owner Mendelson said.

Boutiques Spared, but Some Businesses Sure to Go

The businesses Costco will hurt primarily are the tire stores, television stores and food stores. The Santa Cruz Costco contains a tire center, bakery, pharmacy, one-hour photo center and food court, in addition to the regular aisles of produce, meat, frozen food, books, clothes and electronics.

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I'm not sure what those people will do," Thomas said, predicting that the city could lose between 15 and 50 local businesses because of Costco's arrival.

The city manager said this wasn't necessarily the case. Wilson said certain small businesses in the community could benefit from the addition of Costco.

"Our expectation is that whatever is lost in the redirection of sales to Costco will be more than

"Our expectation is that whatever is lost in the redirection of sales to Costco will be more than made up for by sales to people who have come into town to shop Costco and who will go elsewhere in town to do things they otherwise wouldn't have done . . . We're hoping overall that it will balance out."

*—Dick Wilson,
Santa Cruz City Manager*

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"Costco itself won't require significant improvements that wouldn't otherwise have been needed," Santa Cruz City Manager Dick Wilson said. "It isn't like there were no traffic issues there before Costco."

Costco officials have been meeting with city heads to determine the short and long term solutions to the unfolding traffic nightmare. For now there will likely be some changes in



Bicycles—one answer to traffic congestion.

Costco has exacerbated the problem.

A traffic signal is due to be installed at Highway 9 and Encinal Streets, and should be completed in six months. Other improvements include adding right-turn lanes from Encinal onto Highway 9 and left-turn lanes from Highway 9 onto Encinal.

But Bob Thomas, owner of Outdoor World and an outspoken critic of how the city of Santa Cruz has handled its courtship with Costco, said he will keep a vigilant watch to make sure the warehouse club doesn't get any breaks at the expense of local tax payers.

"What I'm looking for now is that the city may have to spend more dollars in widening River Street and other streets in the vicinity in order to handle the traffic which could be at the taxpayers' cost rather than Costco's cost, and that is not fair," Thomas said. □

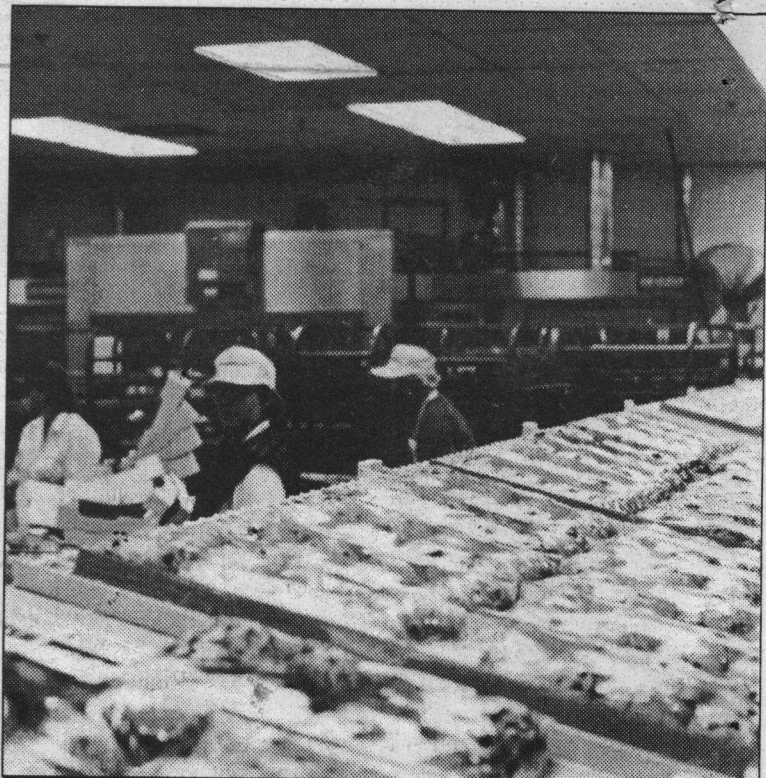
of the Santa Cruz City Redevelopment Agency, said those sales tax figures could go up to \$700,000 annually if Costco reaches its projections of \$68 million a year by 1999.

Some merchants feel that Costco is overstating their benefit to the community, and worse that city officials are buying it.

Merchants like Bob Thomas dispute the city's projections of \$400,000 annual sales tax revenue, saying other estimates put it closer to \$100,000.

Undoubtedly, county residents have been spending their money at the Costco in Sand City and the Price Club in Sunnyvale, and the Costco facility here in Santa Cruz can recapture that. Costco's own estimates put the amount of county resident dollars going to outside stores at about \$22 million annually.

Thomas says there is an "insidious" way large discount stores like Costco or Wal-Mart come in and court city councils and provincial governments, promising them huge windfalls in sales tax each year. Backed by



The in-house bakery at Costco.

phony promises, Thomas said company officials find it easy to wrest concessions like tax credits and special building considerations from city leaders which wouldn't be available otherwise.

"That's the way they started out with the city council here," Thomas said. "Six months in advance of the hearings, it was being reported that they would generate \$1 million in sales tax. When it got to the hearings, it was down to \$300,000. My studies show that the net gain is probably closer to \$100,000 [per year]."

Thomas said the city initially was prepared to cover the costs of new stoplights, sidewalks and other improvements totalling close to \$300,000 to pave the way for Costco's arrival. Thomas thinks community opposition put a stop to local taxpayers' dollars going to help a conglomerate.

"Costco did initially ask for a contribution from our Redevelopment Agency, and we talked about it for a while and said we'd be happy to recommend it," city manager Wilson said. "The local Chamber of Commerce took a position that it supported the Costco application, but absent the local contribution. So Costco withdrew its request for support. The issue never came before the city council."

Another matter which obscures Costco's overall contribution to the city is if the company will merely suck sales revenues away from local merchants and transfer them to their box warehouse. It assumes a zero sum game where one's benefit is

another's loss, and Thomas said it probably isn't too far off the mark.

"All you're doing is shifting retail sales tax dollars to Costco from other merchants," Thomas said.

The Santa Cruz City Redevelopment Agency estimated a modest first year diversion of \$90,000 in sales being redirected away from local businesses and into Costco. There are other estimates putting the loss of local businesses much higher.

Opponents add that nothing new will be sold at Costco that isn't sold in the county already. It will just be cheaper.

Costco's Ironic Premise

It's ironic that small business owners are among those bemoaning the arrival of Costco when the entire concept of the warehouse club is designed with small businesses as its primary focus. Costco is the kind of business where other small businesses purchase products at wholesale prices for their own business needs. By presenting their sales tax permit number, merchants pay no sales tax when purchasing items from Costco for resale in their own stores.

"If they are declaring an item for resale and it's a resalable item within their business according to the tax laws of the state, then we would not charge them tax," Booth said. "They would charge the tax to the end user."

During a span of one week in September, untaxed resale sales figured in at five percent of the Santa Cruz outlet's total sales. □