A Case Study of Costco: from Business and Financial Perspective

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Abstract. Costco is one of the four leading retailers in the world, offering customers a wide range of products at low prices and with high quality. As a low-cost leader, Costco still achieved amazing growth despite the impact of the epidemic. The purpose of this paper is to explore the business model and financial analysis of retailer Costco. This paper adopts the method of case study to discuss Costco's existing business model, strategic and competitive advantages and financial indicators. Provides Costco with a detailed analysis of its business activities relative to industry competitors in order to generate profits and maximize shareholder value. Data is collected from multiple secondary sources to ensure the authenticity of the information. In terms of business model, Costco is significantly affected by the macro environment, mainly due to COVID-19. Secondly, with the rapid economic development, online shopping is becoming more and more popular among young people, so the competition is becoming more and more fierce. Costco shows a flexible business model in its financial analysis. This article provides help for corporate managers, other retailers in the industry and researchers.

Keywords: Costco, Swot, Pest, Porter ’s Forces, Dupont analysis.

1. Introduction

Retail supermarkets have evolved from traditional street grocery stores to today's retail chains. Over time, the structure, scale, innovation and operations of the industry have changed significantly in many ways [16]. From a business perspective, new business models and strategies are adopted. For example, discount model, product differentiation, membership. But growth in global consumer spending and low inflation make the outlook for the retail sector uncertain. And with the growth of e-commerce, consumers' shopping preferences are becoming more and more important. The impact of COVID-19 has further exacerbated these uncertainties. Since 2019, the COVID-19 pandemic and the resulting government restrictions have hit the retail sector hard. Although total retail sales have almost recovered so far, the composition of total retail sales has changed dramatically as the Internet has replaced traditional sales [16].

Costco, as the largest membership-based warehouse and wholesale store in the world by sales volume, is still experiencing phenomenal sales growth despite the impact of COVID-19. 2020 annual report shows that Fiscal year 2020 net sales totaled $163 billion, up 9%. 2021 annual report shows that Net sales for fiscal year 2021 totaled $192 billion, up 18%. Costco has been able to keep growing at a time when many retailers have been hit by the economy. So how does Costco maintain its sales growth in the midst of the global economic downturn? In all decisions, corporate managers must strive to understand the sources of the company's competitive advantage and critically evaluate these strategies. Therefore, the goal of this paper is to conduct a comprehensive critical qualitative analysis of Costco from a business and financial perspective, and try to study how the company maintains sales growth under the epidemic. At present, few studies can combine business analysis and financial analysis to analyze Costco. Therefore, this paper can play a helpful role for enterprise managers, companies in the same industry or scholars.

The following is the structure of this article. The second part shows the analysis of Costco's business decisions, including PEST, SWOT and Porter five forces. This paper combines the macro environment with Costco's competitive advantages for analysis. The third section presents an analysis of Costco's financial reports, including the 2019 to 2021 financial statements and DuPont analysis.
2. Business Analysis

2.1 PEST

PEST analysis is to analyze the macro environment of an enterprise, including politics, economy, society and technology [11]. Table 1 shows the analysis of Costco's macro environment.

| Political Factors | Economic Factors |
|-------------------|------------------|
| National policies after the COVID-19 outbreak. | Declines in per capita disposable income. |
| National policy of host Country. | economic growth in general and specific industries. |
| Social Factors | unstable changes in currency exchange rates. |
| Technical Factors | |
| Host country marketing strategy. | Big data analysis. |
| | Artificial intelligence. |
| | More advanced information systems. |

2.1.1 Political Factors

In recent years, two major political factors have affected Costco’s economic growth. On the one hand, the country has introduced a series of policies after the outbreak of COVID-19. Since the outbreak of COVID-19, government actions have forced the retail sector to adopt new financial and strategic combinations [3]. Government policies limit the distance people can travel to entertain themselves and buy products, which reduces Costco's customer traffic and thus its sales revenue. In addition, Costco food Court had to close because of the policy.

Second, the policy of temporary store closures has led consumers to increasingly choose online shopping, leading to a boom in e-commerce [3]. Costco's net sales from e-commerce grew from about 4% of total net sales in 2019 to 7% in 2021. This is a good opportunity for Costco to expand its business.

On the other hand, Costco is subject to the national policies of the host country. Costco's cross-border retail business needs to adjust its strategy according to the policies of the host country so as to adapt to the enterprise's development [6]. Such as tariffs, economic regulations, etc.

2.1.2 Economic Factors

Costco is affected by several economic factors, including a decrease in per capita disposable income, economic growth in general and specific industries, and unstable changes in currency exchange rates [19]. Because Costco is a global company, it needs to adjust its supply to fluctuations in consumer demand around the world. However, the disruption of the global supply chain in the context of the pandemic has put Costco's domestic and international supply chains under a lot of pressure.

In addition, according to Costco's 2021 annual report, as Costco's product line is diversified and large, it is not only affected by changes in the retail industry as a whole, but also affected by changes in individual markets for its products.

2.1.3 Social Factors

Consumer social behavior plays an important role in retail chains like Costco [13]. The response of consumers in the host country will be influenced by factors related to the foreign firm, such as whether the marketing methods of the foreign firm can be adequately adapted to the market of the host country. Costco's marketing in the American market relies heavily on coupons and discounts as promotion methods, but in Australia consumers generally do not use coupons to buy groceries [14]. Costco needs to adjust its marketing strategy according to the preferences of consumers in different countries. As a result, Costco needs to re-examine their business model in the host country.
2.1.4 Technical Factors

Costco has been upgrading its technology in order to face the increasing competition of e-commerce. First, Costco applied big data analysis and artificial intelligence to improve inventory management and supply process and speed up inventory allocation [7]. Secondly, because the products provided by each country are different, Costco employees can increase their understanding of customers' shopping preferences through a more advanced information system so that the company can produce differentiated products and improve customer satisfaction [6].

2.2 SWOT analysis

SWOT analysis is an analysis of Costco's internal (strengths and weaknesses) and external (opportunities and threats) competitive environment and conditions [10]. Table 2 shows the SWOT analysis of Costco.

| SWOT Summary | Strengths | Weakness |
|--------------|-----------|----------|
| **Membership business model.** | High quality goods at low prices. | low operating margins |
| **No advertising.** | Costco employees are well paid. | Bulk purchase of goods. |
| **Opportunities** | E-commerce. | Logistics problems. |
| **Health conscious clients.** | | Network information security. |

2.2.1 Strengths

Membership business model. Costco's business model is based on the membership warehouse model, which not only provides most of their profits, but also helps keep customers loyal [13]. To shop at Costco, consumers must first become members and pay an annual fee [14]. Costco members also receive discounts from business partners. Like the $1,000 discount on Ford cars in North America. Other services are also offered, such as car purchase plans, insurance and telecommunications services [13].

High quality goods at low prices. Costco's strategy is to sell low-priced, high-quality goods in bulk at low margins in warehouse stores. Costco's product costs are reduced by reducing complexity. Costco has reduced product items, which means fewer products, less duplication, more efficient use of shelf space, faster turnover, and lower inventory carrying costs [6]. It also allows consumers to quickly find what they want to buy when shopping without spending a lot of time comparing brands. No advertising. For Costco, publicity means cost. Costco has minimized marketing expenses, including media advertising and human resources-related expenses [13]. Costco's senior management also believes that word of mouth is the company's best publicity method to date [13].

Costco employees are well paid. Costco raised its starting pay to $15 an hour in 2019, with more than half of its hourly workers making more than $25 an hour, according to Yahoo Finance. In addition, a large proportion of Costco employees have health insurance [14]. As a result, staff turnover is low.

2.2.2 Weakness

Costco's main weakness has been low operating margins [19]. First, the 2021 annual report shows that it relies heavily on U.S. and Canadian operations to support global growth. By the end of 2021, Costco had a membership renewal rate of 91% in the US and Canada and 89% worldwide. That means the company lacks global reach. Secondly, Costco has been keeping its product prices low to maintain its competitiveness among retailers. However, this also reduces the profitability of enterprises [19].
Bulk purchase of goods. When consumers shop at Costco, they need to take into account the storage space of their household items and the shelf life of the products. It takes customers to get used to this new way of shopping. Therefore, some consumers prefer to shop at local grocery stores in their daily life [14].

2.2.3 Opportunities

E-commerce. The growth of global consumerism has provided Costco with an opportunity to expand. Consumers in developing countries are increasingly using e-commerce sites [7]. According to Costco’s 2019 to 2021 annual reports, its e-commerce revenue grew from 4% to 7% of total revenue. For Costco, expanding online sales will help increase its brand presence around the world.

Health conscious clients. People in The United States and around the world are eating more and more healthily. Costco could sell more healthy foods in its food courts and stores.

2.2.4 Threats

The logistics of online shopping is outsourced to a third party company. According to Costco’s 2021 annual report, Costco outsources all of its e-commerce logistics to third parties, which not only poses a huge challenge for warehousing and distribution, but also a huge cost for the business. In addition, transportation costs are a major obstacle to cross-border online sales [7].

Network information security. According to Costco 2021 annual Report, Costco’s current supervision of network information is not perfect, and customer information is easy to be leaked. Therefore, companies need to strengthen the maintenance of networks that collect, store and process sensitive information about their business, members, suppliers and employees.

2.3 Porter's Five Forces analysis

Porter's Five Forces analysis brings together five different factors to analyze Costco's basic competitive situation [21]. Table 3 shows the analysis of porter's five forces on Costco.

| Force                     | Level of Threat to Profits |
|---------------------------|----------------------------|
| Internal Rivalry          | Medium to High             |
| Entry                     | Low                        |
| Substitutes and Complements | Low to Medium              |
| Supplier Power            | Low                        |
| Customer Power            | Low                        |

2.3.1 Competition in the industry

The level of competition between existing competitors is moderately high. While competition between Costco and Walmart is fierce, smaller brands also pose some competitive threats. Target and Best Buy, for example, are also influential in the retail space. This competition will have an impact on Costco's long-term profitability.

Costco can invest more in technology, improve product differentiation and improve customer experience. For example, robots could be developed to help customers quickly find the product they have in mind.

2.3.2 Power of customers

Buyers have low bargaining power. Costco's buyers are usually members who buy products in bulk. Although customers have an indirect influence on Costco's pricing, as far as individual members are concerned, they don't have enough bargaining power. And the loss of a few customers won't have a significant impact on Costco's finances.

Costco can introduce a new product mix or discount to limit the bargaining power of buyers and reduce the loss of existing customers.
2.3.3 Power of suppliers

Suppliers have low bargaining power. Since Costco is a large retailer brand, it buys in bulk from suppliers. So Costco has enormous influence and bargaining power over them [19]. But, most companies in the retail industry buy raw materials from a variety of suppliers. In this case, Costco as a brand with high influence, has more important rules for suppliers [7]. All these factors will reduce the bargaining power of suppliers, and Costco will have better bargaining power.

In order to have lower prices, Costco can try to establish efficient supply chains with multiple suppliers. In this case, if the price of raw materials from one supplier goes up, Costco can switch to another.

2.3.4 Threat of substitute products

The substitutability of substitutes ranges from low to medium. Because Costco offers a limited selection of products and services compared to other large retailers [19]. In addition, with the boom of e-commerce, consumers have more product choices and online prices are much lower than those in retail stores, thus reducing Costco's ability to compete on low prices.

Costco can be service-oriented, not just product-oriented. With "customer satisfaction" as the business goal, Costco provide members with the highest standard of service, such as quality merchandise, 2-day delivery service, professional delivery drivers, etc. [6].

2.3.5 Potential of new entrants into the industry

New entrants pose little threat to Costco. Although new entrants have innovative marketing methods. For example, by lowering pricing strategies and offering new value propositions to customers. But Costco has a strong brand reputation, its competitive advantage and responsible brand image are not easy to be surpassed [20].

3. Financial Analysis

Many important business decisions in enterprises are made based on the analysis of the company's financial statements [1]. Financial statements reflect the overall operation of the company in a certain period of time, to internal or external users more intuitive embodiment. This paper mainly analyzes the profitability ratio, working capital ratio, efficiency ratio, liquidity ratio and Dupont analysis.

3.1 Financial ratio analysis

3.1.1 Profitability ratios

| Profitability ratios                  | 2019    | 2020    | 2021    |
|--------------------------------------|---------|---------|---------|
| Gross profit cost of sales           | 12.977% | 13.086% | 12.885% |
| Operating profit Margin              | 3.102%  | 3.259%  | 3.424%  |
| Net profit Margin                    | 2.396%  | 2.3998% | 2.556%  |
| Return on Equity(ROE)                | 24.004% | 21.888% | 28.507% |
| Return on Capital Employed(ROCE)     | 23.258% | 21.068% | 27.655% |
| Return on Asset                      | 10.434% | 9.783%  | 11.318% |

Gross profit margin reflects the overall performance of the company [20]. As shown in Table 4, the gross margin showed a trend of first rise and then decline in 2019-2021. From 13.09% in 2020 to 12.89% in 2021. This represents a decline in the profitability of the company's products. This could be due to intense competition, disloyal members or overstocking. The higher the gross margin ratio, the better. Ideally, a gross margin ratio of 30% or more is considered good [1]. In this regard, Costco should take further measures, such as raising product prices and accepting cash discounts from suppliers, to improve its gross profit margin.
Costco's operating margin (OM) in 2021 was 3.42%. It shows that Costco spends 96.58 cents of every dollar it sells to cover variable costs. That leaves 3.42 cents to cover all non-operating expenses or fixed costs. OM shows the profitability and operational strength of the company [9]. As shown in Table 4, although Costco's operating profit showed an upward trend from 2019 to 2021, the change was not significant. An OM above 25% indicates financial stability and efficiency, while an OM below 25% indicates financial vulnerability [1]. This indicates that Costco should take further measures, such as reducing labor costs, improving production efficiency, and reducing operating expenses.

As shown in Table 4, Return on assets (ROA) decreased first and then increased from 2019 to 2021. The main reason for the decline in 2020 is that cross-border business is affected by the epidemic. Costco's ROA in 2021 was 11.32%. This represents an 11.32% return for Costco shareholders on their investment in assets. The higher the ROA, the better, because it shows that the company manages its assets more efficiently and is able to generate more net income [17]. ROA of more than 5% is considered satisfactory [5]. Costco's ROA ratio has been good from 2019 to 2021, therefore, Costco should keep its current ROA.

### 3.1.2 Working Capital Ratios

| Table 5 Working Capital Ratios |
|-----------------------------|
| Ratio          | 2019     | 2020     | 2021     |
|----------------|---------|---------|---------|
| Working Capital Ratios |         |         |         |
| Inventory days   | 31.2988 | 30.829  | 30.398  |
| Receivable days  | 3.669   | 3.393   | 3.359   |
| Payable days     | 32.0789 | 35.689  | 34.8098 |

Costco's receivable days did not change significantly from 2019 to 2021. Costco will collect receivable approximately every 3.36 days in 2021. Receivable turnover days, which measures a company's ability to effectively collect accounts receivable [2]. This shows that Costco has a fast collection speed, and the company can continue to operate effectively and has strong competitiveness. Therefore, Costco should maintain the current receivable turnover days for a long time.

Costco's payable days rose from 32.08 days in 2019 to 34.81 days in 2021. This shows that Costco paid its bills to other companies and suppliers in an average of 34.81 days in 2021. Costco is doing well at the moment, neither high nor low. A higher payable day means the company takes more time to pay its suppliers. Companies with high payable days are more liquid than those with small payable days, and they have more cash to invest in the short term. However, a high payable days value could jeopardise its relationship with creditors and suppliers, who may refuse to extend credit in the future [2]. Costco therefore needs to be careful not to increase or decrease its current payable days.

As shown in Table 5, Costco's inventory turnover days did not change significantly from 2019 to 2021. Costco sold inventory every 30.40 days in 2021. According to the CSI market website, Costco's inventory turnover days is 12.1 times. The higher the inventory turnover, the better. Because it shows how easy it is for companies to turn inventory into cash [12]. Walmart Stores Inc., Costco's main competitor, had an inventory turnover days of 9.4 as of Jan. 31, 2021, according to Finbox. Costco is in a better position than Wal-Mart. Therefore, Costco should maintain the current inventory turnover days for a long time.

### 3.1.3 Efficiency Ratios

| Table 6 Efficiency Ratios |
|---------------------------|
| Ratio                     | 2019     | 2020     | 2021     |
|---------------------------|---------|---------|---------|
| Efficiency Ratios         |         |         |         |
| Non-current Asset turnover| 696.797%| 607.818%| 658.297%|
| Asset Turnover            | 336.350%| 300.167%| 330.581%|
| Cash Turnover             | 1821.362%| 1358.32%| 1740.353%|
| Equity multiplier         | 2.978   | 2.970   | 3.278   |
Costco's asset turnover ratio showed a clear downward trend from 2019 to 2020, from 3.36 to 3. This means that for every $1 Costco invests, it loses $0.36 in sales. This could be due to higher transportation costs, lower sales revenue and inventory build-up due to the global pandemic. The higher the asset turnover, the better, because it measures how efficiently a business uses its assets to generate sales [8]. As shown in Table 6, Costco's turnover of assets was 3.31 in 2021. Costco uses its assets more efficiently and should maintain its current asset turnover over the long term.

### 3.1.4 Liquidity Ratios

| Liquidity Ratios | 2019  | 2020  | 2021  |
|------------------|-------|-------|-------|
| Current Ratio    | 1.011 | 1.132 | 1.002 |
| Quick Ratio      | 0.5202| 0.639 | 0.519 |

The current ratio measures a company's ability to repay maturing current and long-term liabilities. It reveals a company's cash level and its ability to convert other assets into cash to pay down debt [4]. As shown in Table 7, the current ratio of Costco showed a trend of rising first and then declining from 2019 to 2021, and the range of change was not obvious. Costco has a current ratio of 1 in 2021. Indicates that Costco has 1 dollar of current assets for every 1 dollar of current liabilities. A satisfactory current ratio in the retail sector is between 1.5 and 2 under normal conditions [20]. The highest current ratio of Costco from 2019 to 2021 is 1.1. Since Costco's Current Ratio has always been below this range in the past three years, it shows that it does not have good short-term financial strength. Therefore, Costco, the manager, should take further measures, such as accelerating the conversion cycle, receivables, paying off current liabilities, increasing shareholders' funds, etc., to improve its liquidity ratio.

Costco's quick ratio rose slightly to 0.64 in 2020. The reason may be that in 2020, under the impact of the pandemic, there is a backlog of survivors. Costco can't pay off all of its quick liabilities with quick assets. For retail, the quick ratio should be 1:1 or higher [15]. Therefore, Costco managers should take further measures, such as increasing sales and inventory turnover, increasing invoice recovery period, and paying off debts as soon as possible to improve its quick operation rate.

In general, when the current ratio increases, the quick ratio also increases, and when the current ratio decreases, the quick ratio also decreases. Costco's current ratio and quick ratio change in the same trend.

### 3.2 Dupont analysis

Dupont analysis to return on equity as the core of the financial indicators, through several major financial ratios of the internal relationship to systematically, comprehensive analysis of the financial situation of the enterprise [18].

Return on Equity (ROE) is revenue as a percentage of book value of shareholders' equity. In general, the higher the ROE, the better, but there are other factors to consider. So ROE can be broken down into three different ratios: net profit margin, asset turnover, and equity multiplier. In other words, DuPont formula is: \( \text{ROE} = \text{NPM} \times \text{Asset Turnover} \times \text{Equity multiplier} \)

From 2019 to 2021, the ROE of Costco decreased first and then increased. The company's ROE declined from 24% in 2019 to 21.89% in 2020 due to lower asset turnover and equity multiplier. Although the decrease of asset turnover is small, it also indicates that the company's control over assets has weakened in 2020.

The increase from 2020 to 2021 is due to higher equity multipliers and net margins, which is a positive sign for Costco. The increase in asset turnover is mainly due to the increase in the company's net profit. In addition, the increase in equity multiplier also shows that corporate debt increased, with the corporate debt ratio rising from 66.33% to 69.50%. Enterprises should be careful to prevent excessive rise in equity multiplier, resulting in excessive leverage, resulting in the stock discount [18]. As can be seen from the table 4, net profit margin also rose slightly, indicating that the company is making good use of its assets.
To sum up, after analyzing the financial ratio and DuPont analysis, Costco's profitability from 2019 to 2021 is on the rise, but it still needs to focus on financial and operational risks. Take effective measures to improve sales net profit margin and total assets.

4. Discussion

From a business point of view. The macro environment for Costco is not good because of the severe political and economic downturn around the world caused by the COVID-19 pandemic. So Costco's operating profit is low. Secondly, Costco is not leading in the development of e-commerce, which is the main gap between it and other competitors and the main threat of being replaced. Finally, because Costco's membership business model brings a large number of users and a strong brand image, it has more advantages in selling goods than other competitors.

From a financial point of view. In 2019-20, Costco was affected by the COVID-19 pandemic, which led to a decline in profitability, inventory build-up and weaker control over assets. However, from 2020 to 2021, Costco's ROA and asset turnover increased, indicating that the company timely adjusted its strategic policy to improve the efficiency of asset management. Therefore, In the face of emergencies, Costco's ability to respond quickly is also its great competitive advantage.

5. Conclusion

To sum up, the qualitative research in this paper is built on the basis of case study analysis using secondary data. And achieved the goal. Firstly, Costco is critically analyzed from a business perspective, including macro environment, SWOT analysis and competitive advantage analysis. Secondly, it analyzes Costco from a financial perspective, analyzes its financial performance from 2019 to 2021 and gives suggestions. Finally, based on the above analysis, this paper gives some suggestions based on comprehensive considerations. In addition, Costco is a leader in the retail industry and should better integrate the development of e-commerce. The inspiration from Costco to the retail industry is that in the case of economic instability, the retail industry should maintain high-quality service and stable pricing, improve its asset utilization rate and change business strategies flexibly. The limitation of this paper is the lack of primary data, such as the interview survey of Costco employees. Due to the rapid economic development, in order to improve work efficiency and give customers a better sense of experience, the future research direction can be AI business intelligence operation efficiency.

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