Costco Seeks to Lift Margins By Tightening Return Policy

Kris Hudson — Feb 27, 2007

Costco Wholesale Corp. has altered its return policy, aiming to alleviate the squeeze put on its profit margins by customers bringing back electronics for full refunds.

The Issaquah, Wash., retailer yesterday introduced the revamped policy in its 109 California warehouses and plans to roll out the changes in the rest of its 372 U.S. locations over the next five weeks, Chief Financial Officer Richard Galanti confirmed. The change limits to 90 days the time frame in which customers can return various consumer electronics for a full refund.

In general, Costco allows its customers -- who pay annual membership fees of $50 to $100 to shop at its warehouses -- an unlimited grace period to return purchases for a full refund. The only exception has been a six-month deadline after the date of purchase for returning desktop and laptop computers. That unlimited time frame still applies to Costco merchandise other than consumer electronics. And electronics goods bought before the implementation of the new 90-day policy still can be returned at any time.

Merchandise that will be subject to the 90-day limit includes televisions, computers, cameras, camcorders, iPods, other MP3 players and cellphones. In turn, Costco will extend the manufacturers' warranties on TVs and computers to two years from one. Those products represented about 5% -- or roughly $3 billion -- of Costco's $59 billion in sales for its fiscal year ended Sept. 3.

"Our view is, even with these changes, we still have the best return policy in the retail industry," Mr. Galanti said in an interview, adding that Costco doesn't impose a restocking charge on returned items.

Returns of consumer electronics -- flat-panel TVs, in particular -- squeezed Costco's profit margins in its latest fiscal year. Costco has posted strong sales of the TVs, including a 50% rise in November at stores open for at least a year, but many have been returned as customers encountered difficulty installing them at home. As well, the policy of giving a full refund of the purchase price allowed for some opportunism, as prices on flat-panel TVs have fallen precipitously in the past year.

J.P. Morgan Securities analyst Charles Grom estimates that returns of consumer electronics pared eight cents a share from Costco's earnings last year, when the company reported earnings of $2.30 a share. In August, Costco cited the returns, along with price reductions on furniture, in reining in its fourth-quarter earnings outlook.

"Provided the margin and [earnings] drag caused by the [previously] lenient policy, the change is a positive development for the stock and will begin to cap margin dilution going forward," Mr. Grom wrote in a research note distributed to his firm's clients yesterday. Mr. Grom owns no Costco stock. J.P. Morgan has done business with Costco in the past year.

Costco has attempted other methods to stem returns and avoid changing its return policy. It introduced an 800 number that customers can call to get answers to technical questions about their purchases. It also began offering on a limited scale a third-party service for installing high-definition TVs in homes.