

What Took Costco So Long to Dump AmEx and Embrace Visa?

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Costco will be replacing American Express with co-branded Visa cards from Citi.

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Costco ([COST](#)) breaking up with **American Express** ([AXP](#)) last month [wasn't a surprise](#) , but it still raises the question of what took the big-box warehouse operator so long to part ways.

On Monday, Costco announced it signed an exclusive agreement with **Citi** ([C](#)) to provide warehouse club members with Costco-branded **Visa** ([V](#)) credit cards starting on April 1, 2016. Like their AmEx predecessor, the credit cards will also serve as the discount club's membership card while also providing members with significant reward opportunities. The exact nature of those benefits, however, weren't revealed.

A lopsided relationship

It's obvious what the benefits were to American Express for having an exclusive arrangement with Costco -- Costco cards account for 20% of the credit card processor's loans and 10% of its cards, according to *BloombergBusiness* -- what's not so clear is why the warehouse club was willing to seemingly limit itself by not previously having an agreement with either Visa or **MasterCard** ([MA](#)) sooner.

With some 281.4 million cards in circulation, Visa has more than five times as many cards circulating than AmEx, which has less than 55 million cards outstanding.

Global Retail Electronic Payments Networks				
Company	Cards Outstanding (in millions)	Total Volume (in billions)	Total Transactions (in billions)	Share of Amount Spent at Merchants (2014)
Visa	2,219	\$6,970	89.7	27.30%
MasterCard	1,281	\$4,103	52.7	13.67%
American Express	107	\$952	6.4	15.41%
Discover (NYSE: DFS)	64	\$136	2.2	2.91%

Data: Figures as of 2013, except where indicated. Visa 2014 annual SEC filing; The Nilson Report.

Pinpointing a difference

While Costco does accept debit cards issued by Visa and MasterCard, they were of the sort that require a PIN number to be entered at the time of the transaction, versus signature debit cards that would have allowed members to sign for their purchases. Signature debit cards, however, far outnumber PIN cards by almost two to one.

Discover sued Visa last November for anti-competitive practices, alleging the payment processor is offering

financial incentives to merchants that generate a lot of debit card sales to send all of their transactions to its Visa transaction processing network.

In reality, there were several benefits for Costco from having AmEx as its co-branding partner:

- Bounties paid to Costco for every new customer signed up.
- Fee rebates from AmEx.
- Revenue sharing for purchases made with the card outside of the warehouse.
- Increased spending benefits.

The breakup of the 16-year partnership occurred because Costco wanted even sweeter terms than AmEx was willing to pay.

The benefits of affluence

The typical Costco customer is more affluent than the one who shops at **Wal-Mart** (WMT), and the increased sales were probably an attractive lure to keeping the partnership together for so long.



Membership has its privileges at warehouse membership club Costco, though what they'll actually be under its new agreement remains to be seen.

It had 42.5 million member households as of the end of November, but 77.5 million cardholders at the end of its fiscal first quarter. Executive members, Costco's highest level of membership, grew to 15.2 million, and although they represent a little more than a third of its membership base, they account for over two-thirds of its sales and operations.

Costco's average shopper has an average annual income of \$85,000 compared to the medium- to low-wage income earned by Wal-Mart's customers, which is reflected in how much each retailer pays its employees: The average Costco employee earns around \$20 per hour versus the \$12.83 per hour paid by Wal-Mart, and even the \$12.20 per hour national average for retail employees.

Bigger, faster, stronger, better

Volume may trump size at this point. Sales at Costco have doubled over the past decade, growing from \$52.9 billion in 2005 to \$112.6 billion last year, an 8.75% compounded growth rate. Over more recent periods, however, the growth rate has been slightly below that average.

In its fiscal 2015 first-quarter report issued in December, net sales grew 5% year over year, but analysts are looking for 6% growth this year and 7% over the next two years. The new deal with Visa and Citi could allow Costco to cast its net more broadly and attract even new members.

The new co-branding agreement means any Visa card will be accepted at Costco, but Citi, which has most of its cards processed through MasterCard's network, may not make out as well since most of those cards won't be accepted at the warehouse club.

Maybe the end of the American Express relationship should have occurred sooner, but now that it's here, investors should see the new agreement pay dividends very soon.

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Rich Duprey has no position in any stocks mentioned. The Motley Fool recommends American Express, Costco Wholesale, MasterCard, and Visa. The Motley Fool owns shares of Citigroup Inc, Costco Wholesale, Discover Financial Services, MasterCard, and Visa. Try any of our Foolish newsletter services [free for 30 days](#) . We Fools may not all hold the same opinions, but we all believe that [considering a diverse range of insights](#) makes us better investors. The Motley Fool has a [disclosure policy](#) .

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