

## Case 5

# The Battle to Be Top Dog—PetSmart vs. Petco: *PetSmart and Petco Have Adopted Different Strategies as Each Seeks the Dominant Position in the Animal Care Industry*

- 1 The news hit the Phoenix offices of PetSmart on a Friday afternoon: The U.S. Food & Drug Administration was recalling tainted pet food manufactured in China. PetSmart's Chief Executive Philip Francis told his team to pounce. The company ripped recalled products from shelves, put up informational signs at stores, staffed up at its customer-service call centers, and gave refunds to folks returning tainted products. In some cases, PetSmart paid vet bills for sick animals.
- 2 Francis didn't stop there. He had the company mine its customer database and send warning notices to folks who'd recently bought recalled products. The move prompted grateful letters and e-mails from customers. "For the first time in my life, a company has sent me something of value," one wrote. Says Francis: "I'd prefer the recall hadn't happened, but from a customer loyalty standpoint, you just can't spend enough on advertising to accomplish what it did for us."
- 3 Francis has to move quickly these days because he has someone nipping at his heels: His San Diego-based archrival, Petco Animal Supplies. PetSmart and Petco are the two top dogs in the \$41 billion animal care industry. Petco is the older of the two, founded in 1965. It was the first retail chain to take the pet food businesses out of dark, smelly mom-and-pop stores and into a modern category-killer format. Today, both companies operate in about as many locations: 908 for PetSmart, 850 for Petco. But they often have different approaches.
- 4 Petco's stores tend to be smaller and more ubiquitous, almost replacing the neighborhood pet store. They're located in strip malls. PetSmart stores are bigger and tend to be in the larger "power centers," alongside other discount chains. According to a recent analysis from JPMorgan retail analyst Nancy Hoch, PetSmart's prices were on average 8% higher than those of Wal-Mart Stores but 11% below Petco's.

## SHIFTING STOCK AND SERVICES

- 5 A former supermarket executive, Francis joined PetSmart when the company was suffering a crisis in 1998. In much the way Toys 'R' Us and Tower Records struggled in their niches, PetSmart's stock-'em-high warehouse format was no longer working as discounters such as Walmart and Target loaded up on pet supplies, particularly the higher-end products such as Iams dog food that only vets and pet stores had sold previously. Francis shrunk the stores, cutting the typical store size from 28,000 sq. ft. to 20,000 sq. ft. He kept the same assortment of product but stocked less on shelves, sending trucks from central warehouses more frequently to restock and thus avoiding the warehouse look.
- 6 Most important, he added services: adoption, training, veterinary, grooming, day care, and pet hotels. Last year the company groomed 7.5 million dogs, a 16% increase over the year before. It provided 378,000 training classes, another 16% increase. Overall, services are expected to generate \$450 million in sales this year, about 10% of the company's \$4.5 billion total, but representing 26% annual growth since the strategy was hatched in 2000.



## ROOM AND BOARD

- 7 Today, the inside of the store looks a lot homier, with a little blue shingled area inside with brick and siding that houses the hotel and day care area. Inside the hotel section, visitors are greeted to slate tiles and wooden reception desk. In the dog area, owners can choose between regular boarding, where dogs congregate in a big room and then sleep alone in kennels, or private suites with raised platform beds and televisions airing the Animal Planet cable network and other pet programming. Since the stores are in strip malls, the company developed a porous pebble floor where the dogs could urinate. There's also a "bone phone" that allows owners to call in and talk to their pets. Cats have quarters with separate air filtration systems so their smell doesn't drive the dogs crazy. The cats also get to watch a live fish tank.
- 8 Francis says he can add a pet hotel to an existing location for less than half the cost of building a similar standalone location. Plus, the hotel shares the cost of the heating and air conditioning system, parking lot, employee break area, armor car pickups, and other overhead. Overnight stays start at \$21 a night, \$31 for a suite. Day care starts at \$14 a day. After five years the hotels can help boost a store's sales by 29% and double its profitability, both because the hotels are a high-margin business and because customers come more frequently and buy other things when they do. A typical PetSmart store with a hotel earns \$879,000 on sales of \$7.1 million.
- 9 Even with numbers such as those, Francis says he's rolling out the hotel concepts slowly. They're in just 62 of the stores today, although Francis says they could ultimately be in 435 stores, or 40% of the chain, by 2010. He's taking it slow because "people get angrier about bad service than a bad product. It's more personal. We have to make sure we get it right."

## GROSS-OUT PETS

- 10 Petco has a different approach. The \$2.2 billion company still does two-thirds of its business in dog and cat products, but Petco features a broader selection of goods for other animals, everything from hamsters to tarantulas. The company recently featured a "Reptile Rendezvous" at 200 stores. The events included "in the terrarium" photo contests and demonstrations for products such as a new clay that reptile owners can mold into small hills and caves. Snakes, iguanas, and turtles remain very popular with teenage boys, says Petco's CEO James Myers: "Anything that grosses your parents out."
- 11 Petco has not embraced the services strategy quite as aggressively as PetSmart. Its stores do prominently feature grooming services, and the company provides doggie day care at some locations. But Petco stores, at about 14,000 sq. ft., aren't as large as PetSmarts and for now Myers is holding back on overnight pet-sitting. "I'm not sure that plays everywhere in America," he says.
- 12 There is another difference: Petco is privately held. It was bought last year by private equity firms Texas Pacific Group and Leonard Green & Partners. Ironically, it was the second time Los Angeles-based Leonard Green had taken the company private. PetSmart's Francis says he gets calls from time to time from people interested in a buyout. So far he's been against the idea. "I've got all the money I need," he says. "Our goal is to keep our stock price up so nobody can afford to take us private."

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