

# Petco Develops Successful Stakeholder Relationships

## BACKGROUND AND HISTORY

Petco Animal Supplies Inc., one of the nation's largest pet supply specialty retailers, boasts over 950 stores nationwide. Its pet-related products include food, supplies, grooming supplies, toys, novelty items, vitamins, small pets (excluding cats and dogs), and veterinary supplies. Petco aims to offer its customers a complete assortment of pet-related products and services at competitive prices along with superior customer service on location and through its company website. While Petco is one of the largest pet stores in the country today, it began as a much more specialized business. Walter Evan founded the company in 1965 under the name United Pharmacal Co (UPCO) as a mail-order veterinary-supply store. In 1976 UPCO opened its first bricks and mortar retail store in La Mesa, CA—selling quality pet and veterinary supplies at discounted prices directly to animal professionals and the public. In 1979 UPCO became Petco. Today, the company's vision is to promote the well-being of companion animals and to support the human-animal bond. Today the company aims is to provide a broad array of premium products, companion animals, and services along with a fun and exciting shopping experience with the help of its 22,000 employees.

Petco stores offer a broad merchandise selection, convenient locations, and knowledgeable customer service. Petco believes this combination makes its stores stand out and provides a competitive advantage. The principal store format is a 12,000 to 15,000 square foot building, located near local neighborhood shopping destinations such as supermarkets, bookstores, coffee shops, and dry cleaners. Each store contains approximately 10,000 pet-related items and offers grooming, obedience training, veterinary services, and pet adoptions for cats and dogs in conjunction with local animal welfare organizations. Petco has long felt that its stores are well positioned, both in terms of product offerings and location, to benefit from favorable long-term demographic trends: a growing pet population and an increasing willingness to spend money on pets. However, the 2008-2009 recession has forced many pet owners to pare back their pet-related expenses. Nevertheless, Petco's main competitor, PetSmart, has actually seen an increase in business since 2008, some of which appears to be at the expense of Petco.

Petco made history in 2006, becoming one of the largest public companies to be re-privatized. The company was purchased by private equity group Leonard Green & Partners and Texas Pacific Group for \$1.8 billion. This is the second time these buyers have taken the firm private. Petco privatized in 2000, only to be taken public again in 2002. The company announced that the privatization would help it achieve its goals in an environment of tough competition and rising costs.

## THE PET INDUSTRY

Petco does business in a highly competitive industry where it is up against other major companies such as PetSmart and Wal-Mart. This competition may be categorized into three different segments: (1) supermarkets, warehouse clubs, and mass merchants; (2) specialty pet store chains; and (3) traditional pet stores and independent service providers. The principal competitive factors

influencing Petco are product selection and quality, convenient store locations, customer service, and price. Petco believes it competes effectively within its various geographic areas. However, some of its competitors are much larger in terms of sales volume and have access to greater capital and management resources.

Over the past couple of decades, the pet food, supplies, and services industry has benefited from favorable demographic trends, including a steadily growing pet population. The U.S. pet population has now reached close to 400 million companion animals, with an estimated 63 percent of all U.S. households owning at least one pet and three-quarters of those households owning two or more pets. It is widely believed that the trend will continue, driven by an increasing number of children under 18 motivating the purchase of family pets and a growing number of empty nesters whose pets have become like replacement “children.” Pet owners spend around \$41.5 billion annually on their pets. Industry analysts have predicted that growth will continue into the future. However, owners have become less likely to indulge in luxury items, focusing instead on high-quality necessities. This back-to-basics mentality has hurt Petco and other major pet supplies retailers, especially since discount giant Walmart also offers pet products and services, sometimes at lower prices. Nevertheless, pet owners today are more likely to treat their pets as family members; this means that, even in tough economic times, many pet owners are prepared to spend considerable sums on pet products.

## THE RISKS ASSOCIATED WITH THE PET INDUSTRY

Every industry carries with it unforeseen risks such as the chance that the public or a special interest group might uncover some questionable activity. Many times, critics and mass media, competitors, or simply skeptical stakeholders can blow problems out of proportion and can use the information to undermine a firm’s reputation. Therefore, an ethical risk assessment is a critical component of most companies’ ethics initiatives. A single negative incident can influence perceptions of a corporation’s image, tarnishing its reputation and making recovery difficult. Particularly in the pet products industry, large groups such as PETA are always on the lookout for ethical fumbles.

Not all ethical concerns are of a company’s making, and there are certainly those disgruntled antagonists who will distort the truth for their own self-interests. Since many people have strong emotional reactions to issues related to pets, assessing risk in this industry is especially important. For all companies selling pets, the question is not *if* there will be accusations but rather can the companies—when accusations are made—respond rapidly enough to explain or correct questionable practices or to alter negative perceptions. The focus should be on a commitment to making appropriate ethical decisions and to constantly assessing and handling the risk of operating such a business.

Petco claims to be committed to pets and to animals in general. However, that does not mean that Petco has escaped criticism. Between 2000 and 2005, People for the Ethical Treatment of Animals (PETA) alleged cruelty and neglect to animals in its care and filed a complaint with the Securities and Exchange Commission (SEC). In particular, PETA was concerned about the sale of large birds; specifically, the fact that large birds were being denied the space to move around and to exercise. When kept as companions, large birds require a great deal of socialization and attention—at least eight hours a day; which Petco was not providing them. Additionally, most parrots were dying from diseases such as obesity, high stress, and too little exercise. PETA alleged that about 70 percent of the parrots kept by Petco were suffering from “miner’s lung” disease (pneumoconiosis) due to living in dry, stuffy indoor environments.

On April 12, 2005, PETA and Petco announced an agreement to advance animal welfare nationwide. PETA agreed to end its campaign against Petco, all references to “PETNO,” and its “PetcoCruelty” website. Petco agreed it would no longer sell large birds. It also agreed to continue working with shelter partners to assist in the adoption of homeless birds of all sizes as part of its “Think Adoption First” program. Petco promised to make changes to be more sensitive to the needs of other animals as well. For example, the company began to separate rats and mice by gender to prevent breeding. Although Petco was not required to respond to PETA, it did. This response to a special-interest group indicates Petco’s desire to cooperate, to resolve issues and misunderstandings, and to improve operations.

In May 2004 Petco paid nearly \$1 million dollars to settle two precedent-setting California lawsuits involving the mistreatment of animals in Petco stores located in five California counties. PETA had released undercover footage of North American Pet Distributor, Inc. (NAPD), supplier of at least 55 Petco stores, engaging in extreme neglect. Petco halted its business with NAPD immediately. This illustrates Petco’s ability to quickly respond to potentially negative situations that could adversely affect the company. Because of the risks involved with the pet industry, Petco has a response system that rapidly deals with any supplier abuse of animals. When an organization such as Petco has developed standards of conduct, it can more readily resolve any activities not in compliance with those standards.

Additional problems have plagued Petco. In 2002 inspectors and customers found sick finches, a moldy dead turtle, dead birds, and a toad “cooked to death” at two San Francisco Petco stores. The stores were also overcharging customers on sale items. In 2004 Petco settled this case, agreeing to pay more than \$900,000—most of which would be spent on new store scanners. Petco also agreed to increase manager and employee training regarding the care of animals. The company again appeared willing to acknowledge and correct mistakes made by its employee, which is an inevitable issue in a corporation with 22,000 employees. Petco’s ability to expose and correct these issues indicates the effectiveness of its ethics program. Because many of its ethical dilemmas involved pets, Petco sells only a limited number of small animals and no dogs and cats in an effort to reduce risk. Animal sales make up a small portion of the company’s revenues, but avoiding risk in this way ensures that Petco keeps its customers and investors happy and also protects the animals in its care from abuse.

In 2007 the pet industry experienced a pet food recall crisis. The FDA discovered widespread melamine contamination in pet food imported from China, prompting large-scale recalls. However, the problem was not discovered soon enough and many recalls were not issued in time to save a large number of pets from falling ill or dying. Petco’s response to these recalls, according to company press releases, was to promptly remove all tainted products from its shelves. The company continues to react quickly to any recall notices.

In the summer of 2008, the FDA asked U.S. Marshals to remove pet food products from a Petco supply warehouse in Illinois due to unsanitary conditions. During two FDA inspections conducted in April and May, inspectors found the warehouse infested with rodents and birds. Petco became a private company in 2006, and did not issue a response to this problem.

## **PETCO ETHICS PROGRAM**

Petco has a comprehensive code of ethics, emphasizing that animals always come first. It is critical for the success of Petco that all employees adhere to the code and promote the health, well-being, and humane treatment of animals.

The code of ethics also addresses other stakeholders such as employees, customers, and businesses. It emphasizes that employees should treat customers with the utmost care and that they should respect customer privacy. Petco also addresses its selling practices, advertising policies, pricing practices, and buying practices in the code of ethics. For example, it is against the code to promote one brand over another; associates are expected to interact honestly with customers and to clearly explain the purposes and benefits of all products and services. Petco makes efforts to ensure that advertisements are clear and minimize misunderstandings, and that pricing decisions are made without influence from vendors, contractors, or competitors.

The matter of courtesy, dignity, and respect among associates is also taken seriously. The code of ethics addresses harassment, stating that any harassment complaint will be treated with confidentiality and appropriate corrective action will be taken. Petco also addresses drug abuse, asset protection, and violence in the workplace. The company has implemented measures aimed to increase associate, vendor, and customer protection with the goal of providing everyone with a safe working environment.

Petco associates are expected to avoid conflicts of interest, meaning that Petco employees must not place themselves in situations in which they might be forced to choose between their own personal or financial interests and the interests of the company. Associates are encouraged to promptly relay potential conflicts of interest to management to determine whether or not a conflict actually exists. Petco associates are also prohibited from accepting gifts or gratuities from vendors or potential vendors. Associates offered gifts are required to contact their supervisors or the Petco Hotline for guidance and to ask vendors to refrain from future gift giving.

Associates who are looking for employment with suppliers, vendors, or others doing business with Petco are expected to do it at their own discretion and using non-work time, and supervisors must be contacted. Associates and their immediate families may not invest in vendor companies without prior approval from Petco's ethics committee. Employees are compelled to agree not to interfere with business by directly or indirectly soliciting the business of Petco customers. Former associates are not allowed to encourage other associates to quit as well. Trade secrets and other proprietary information must also be kept confidential while employed with the company, as well as after.

The code of ethics also addresses concerns such as workplace safety, wage laws, and reporting time worked. Neither political contributions nor payments to government personnel may come from Petco funds. A section concerning managers and supervisors encourages them to act as role models. When dealing with the media, Petco asks managers and supervisors to consult any parties involved to devise an appropriate media message.

The code of ethics also offers a chain of command to follow in the face of an ethical dilemma. If an associate suspects that he or she is being given false or misleading information, he or she is encouraged to phone the Code of Ethics Hotline or to consult a supervisor. The company also operates an internal ethics committee overseeing compliance and continually monitoring related practices.

## **PETCO FOUNDATION FUNDRAISERS**

In 1999 Petco established the Petco Foundation, allowing the company to directly promote charitable, educational, and other philanthropic activities of its choosing. The Petco Foundation supports the "Four R's"—Reduce, Rescue, Rehabilitate, and Rejoice—focusing on the welfare of companion animals and the importance of the human–animal bond. The Petco Foundation is a

nonprofit organization that has raised more than \$49 million since its inception. Through a combination of fundraisers, support has been offered to thousands of non-profit grassroots animal welfare organizations. The foundation is also responsible for the donation of in-kind goods and services to worthwhile organizations with the same mission. Through an exclusive, long-term agreement with Petfinder.com, the foundation also supports over 10,000 additional animal welfare agencies.

#### ROUND UP PROGRAM

Every year, U.S. shelters euthanize between five and 10 million pets. Overpopulation due to unwanted animals sends millions of potential pets to shelters each year. In 2000 Petco launched an annual “Spay Today” initiative addressing the issue of pet overpopulation. “Spay Today” funds come from customer donations; customers are encouraged to round up their purchases to the nearest dollar or to give more. Each Petco store selects one or more spay/neuter-focused charitable partners and donates the funds to these organizations. In addition, 10 percent of all funds raised are donated to the Petfinder.com Foundation to assist its spay/neuter efforts. During 2007 the Round Up program raised over \$10 million.

#### THINK ADOPTION FIRST

Launched in 2005, the Think Adoption First program combines the efforts of Petco, the Petco Foundation, and Petfinder.com to offer second chances to companion animals that have been sent to shelters after being rescued from abuse, neglect, or disaster. The program provides access to animals through its network of rescue groups and then works with these partners to make companion animals available for in-store adoption. The program has strengthened its relationship with Petfinder.com. Each year the Petco foundation works with over 5,700 local welfare partners to save over 200,000 animals. This program reinforces Petco’s commitment to both social responsibility and financial success.

#### SPRING A PET

The “Spring a Pet” fundraiser encourages pet lovers to donate \$1, \$5, \$10, or \$20 to animal welfare causes. Each Petco store selects an animal welfare organization as recipient. In the past, the money has been used to provide veterinary care for homeless and abused animals and to fund outreach programs helping handicapped and disadvantaged individuals care for their companion animals. More than 900 Petco stores collect donations. Pedigree also donated \$1 for each Pedigree purchase of \$10 or more. The event raised \$1.95 million. Pedigree also funded the costs, saving the foundation about \$35,000.

#### TREE OF HOPE

Customers visiting one of Petco’s 950 stores during the Christmas season can purchase card ornaments for \$1, \$5, \$10, or \$20. The foundation raised a record \$4 million during the 2009/2010 holiday season. Petco also partnered with Iams in 2008 to run the Home 4 the Holidays adoption drive. Iams donated \$1 for every bag of Iams pet food purchased along with about \$110,000 in operating costs. Over 1.2 million animals were adopted.

## THE “KIND NEWS” PROGRAM

The Petco Foundation sponsors “Kind News,” a program educating children about the proper humane treatment of companion animals and fellow human beings. It features training on taking care of pets and issues information on all types of animals. It contains learning tools reinforcing the need for compassion and concern for all living things. The program is currently available in 1,000 elementary schools nationwide.

## WE ARE A FAMILY TOO

During the 2008/2009 economic recession, Petco established the “We are a Family Too” fund. The company aims to aid families struggling to stay together with their pets while facing foreclosure, eviction, or a lack of funds. It also aims to help shelters deal with an increase in incoming animals. The program assists organizations already set up to deal with these issues by offering funding.

## PETCO’S CHALLENGES AND ACCOMPLISHMENTS

While most companies focus specifically on customers, Petco is also concerned about its impact on society. While providing quality products, information, and advice, it also addresses important issues related to animals in society. For example, foundation fundraising programs illustrate important contributions to society. “Kind News” is designed to educate children. Petco, like any organization, experiences risk associated with doing business and has developed a comprehensive ethics program to manage relationships with stakeholders.

All retail organizations are subject to criticism and must work to maintain internal control and high ethical standards. Petco accomplishes this through its ethics office and by developing an ethical corporate culture. Petco’s code of ethics is comprehensive, addressing risks related to human resources, conflicts of interests, and behavior in the workplace. Large organizations know that misconduct exists somewhere in their organizations; therefore, discovering, exposing, and addressing issues before they cause reputational damage is critical. For Petco, the desire to do the right thing and to train all employees to make proper ethical decisions assures not only success in the marketplace but a significant contribution to society.

In 2011 Petco changed its tagline to read “where the healthy pets go” to emphasize what Senior VP and Chief Marketing Officer Elisabeth Charles describes as the company’s “healthy, active and contemporary” brand image. Petco also underwent significant companywide changes, including remodeling many of its existing stores, introducing smaller store formats, emphasizing natural and organic products, and changing the previously capital Petco logo to lower-case letters. Petco is the largest provider of natural and organic pet food selections of any pet store. According to Petco CEO Jim Meyers, the company is “committed to helping pets live the healthiest and longest lives possible.”

Additionally, in spite of economic uncertainty, Petco continues to expand and to open new stores. As mentioned previously, its fundraisers continue to succeed as well. The company has begun offering low cost clinics, such as one providing vaccinations, so that pet owners can afford to continue caring for their pets. In February 2009, the company hired its first Senior VP and Chief Marketing Officer, Elisabeth Charles. The gist of Petco’s reaction to the economic uncertainty within the United States seems to be one of optimism, given the fact that analysts do predict a continued increase in pet owner spending.

## QUESTIONS

1. How has Petco's ethics and compliance program helped it to deal with ethical misconduct?
2. How do you think re-privatizing the company will help Petco's performance? Or do you think it could hurt the company overall?
3. Should pet supply companies like Petco be held responsible for the conditions at pet breeders and suppliers? How do you think exposés on poor breeder conditions have affected Petco's reputation?

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