

What is the Role of the Membership Model and Warehouse Model in Attracting and Retaining Costco Customers

Xinyue He (Evelyn)

Abstract

While substantial research has been conducted on Costco's unique business strategies and models, few researchers have taken an in-depth look into Costco customers. As one of the most famous retailers in North America, Costco's mission is "to continually provide members with quality goods and services at the lowest possible prices (Costco.com)." This statement reflects Costco's essential competitiveness in keeping its member pricing as low as possible. Costco chose a novel business model to achieve a low price and profit from membership fees instead of pricing the goods too high. Meanwhile, their warehouse model reduced labor costs and increased the quantity offered for a single product. Costco created a new business model integrating memberships and bulk sales, reducing product prices and attracting more customers. With the increasing development of the economy, especially in North America, various novel business models have been used; however, their essential working principle is rarely emphasized. This paper aims to find out what the roles of warehouse and membership are in gaining more customers and benefiting the company. This study surveyed 30 respondents living in Toronto with Costco stores to determine members' attitudes toward these two business models. The study also used the quantitative method using secondary data sources such as Costco's website, annual reports, and various financial websites. Results indicate that by uniquely positioning itself as a paid-membership and warehouse model, Costco's strategies brought massive attention through the invisible advertisements implicitly found in that positioning.

Keywords: Costco Marketing Strategy, Membership, Warehouse, Advertising

Background

Origin and Market

In October 1993, Costco merged with The Price Company, which had pioneered the membership warehouse concept in 1976; together, they formed the brand new Costco corporation (Costco.com). Despite its relatively short life span, in 2019, Costco was ranked #14 on the Fortune 500 rankings of the largest United States corporations by total revenue, a mere 26 years after its inception (Fortune.com). The rapid increase in brand influence has become inseparable from its sales model: a membership warehouse supermarket. The first time this novel concept was spread in North America, it immediately attracted much attention from local populations. Conversely, Costco Wholesale also brought their new business model to open in the Asian market. The first Costco store opened in Shanghai, China, in 2019 (Ren & Wang, 2020), and Ren & Wang discussed the transformation Costco's business model underwent from the U.S. to China. The new policy for the first Chinese Costco store was "Membership cards return," a system whereby customers could return membership cards and receive a refund. Costco updated its membership model by this measurement to adapt to a different market.

However, the Annual Report of Costco (2019) admitted their failure to maintain worldwide membership growth, loyalty, and brand recognition could adversely affect their operations. This means the initial customer curiosity promoted the membership system and warehouse-style effect, but customers' impression of Costco faded through familiarity. The Annual Report warned that Costco's customers might turn to other companies with the same business model, such as Sam's Club and B.J.'s Wholesale Club (Costco Annual Report, 2019).

Exclusive Brand

The product's price and quality have always been customers' focus. "Costco generally offers few brands of each item, often merely one brand of each product, usually high-quality products, sometimes in addition to its brand, Kirkland Signature, which usually are high-quality products" (K. & W. M., 2017). Although the choices of goods and services are limited, the product's high quality and low prices are guaranteed, which is a highlight for customers. Costco Annual Report (2019) also mentioned that "maintaining consistent product quality, competitive pricing, and availability of these products is essential to developing and maintaining member loyalty." Costco highlights the importance of a product's price and quality

to retain customers.

Furthermore, it confirmed the significance of membership and warehouse strategies because these two models are essential to achieve low pricing while maintaining higher quality goods. On the other hand, the report stated if the Kirkland Signature brand experiences a loss of member acceptance or confidence, Costco sales and gross margin results could be adversely affected. Therefore, an exclusive brand was included as one of the membership-only benefits in hopes of attracting more people to purchase memberships with this exclusive offer.

Risks

With Costco's rapid economic and market growth, many potential risks and challenges arise. As Costco Annual Report (2019) mentioned, "We compete on a worldwide basis with global, national, and regional wholesalers and retailers, including supermarkets, supercenters, internet retailers, gasoline stations, hard discounters, department and specialty stores, and operators selling a single category or narrow range of merchandise." Costco covers many other retailers' services, meaning it cannot specialize in one product type. To compete with other major merchandise retailers like Walmart, Target, Kroger, and Amazon, Costco's main calling card is its membership and warehouse models.

Literature Review

Membership Model

Costco can offer attractive lower prices on every good and service in its stores (and on its website) as customers pay for their membership. Since instigating this model, Costco's membership numbers have seen progressive growth (more details in Table 1). Furthermore, the current trend is that more customers are willing to pay for the Executive membership, which is twice as expensive as the ordinary membership. Costco's official website offers three types of membership: Executive, Business, and Gold Star. Costco differentiated membership types to create tiers, so customers have advantages in the higher membership ranks. This encourages them to pay more money and gain a higher-ranking membership. The membership component is critical to Costco's experience and intrinsic to its business model and growth strategy. As an effective strategy for stores to attract consumers, memberships have since been used by lots of other companies, but Costco is the pioneer of the concept. Therefore, it has successfully created a great impression in the eyes of the public as being distinctly related to a membership and warehouse strategy. In the research regarding customer choice, Kim (2019) found that Costco

members considered the membership benefits as essential when choosing this retail store.

Conversely, the non-member group considered accessibility, close travel distance, and in-store amenities the most important in their decision-making. Based on Kim's research, most Costco members were attracted by the lower prices offered to members, indicating price as an essential point for consumers. Under the membership system, Costco has satisfied customer needs very well in the past few years. Several empirical studies have focused on how Costco wins customer satisfaction (Yu et al., 2015) and its marketing strategy (Chen & Green, 2011), which show membership policy is a significant part of both.

Costco's 2019 annual report states, "Our member renewal rate was 91% in the U.S. and Canada and 88% worldwide at the end of 2019. The majority of members renew within six months following their renewal date." This shows that North Americans are more willing to pay for the renewal membership fees than other regions. The proportion of Costco's sales in the U.S. was 74% worldwide in 2020 (NRF, 2020). These statistics show that although its total population is only 4.73 percent of the world population (Worldometer.com), North America is the most suitable region for a membership warehouse supermarket system. Furthermore, North America's 2019 per capita GDP is approximately \$63,182, while the world's GDP is only \$11,429 (Data.worldbank.org), indicating that Costco attracts people with higher incomes. Simultaneously, Costco members have strong loyalty, as only 9 percent refuse to renew their membership. Another reason for Costco's high renewal rate is that it only offers annual memberships, which can help customers easily acclimate to Costco's consumer model. This is similar to Kim's (2019) statement; unlike conventional hypermarkets, which operate diverse amenities inside, Costco only accepts cash or one specific credit card for payment, and people who accept this are Costco's main customers. This is also mentioned by investopedia.com (2020), when it states, "Its customers return to get the full advantage of their membership dues." Costco utilizes customer psychology, which believes consumers will not want to waste the membership fee they have already paid, so they will spend more in their supermarket. Therefore, it is easier for Costco to grab existing customers. However, there are some downsides to this consumer strategy. For example, Gregory (2017) states, "Costco's membership-only club retail business model encourages customers to consume at Costco stores but also limits the total number of customers.

Moreover, it might cause non-member consumers to feel unwelcome at Costco stores." In this way, the membership

policy can be seen as a weakness instead of a strength. Especially for non-members, if they do not enjoy the privilege of membership, they have no other reason to shop at Costco.

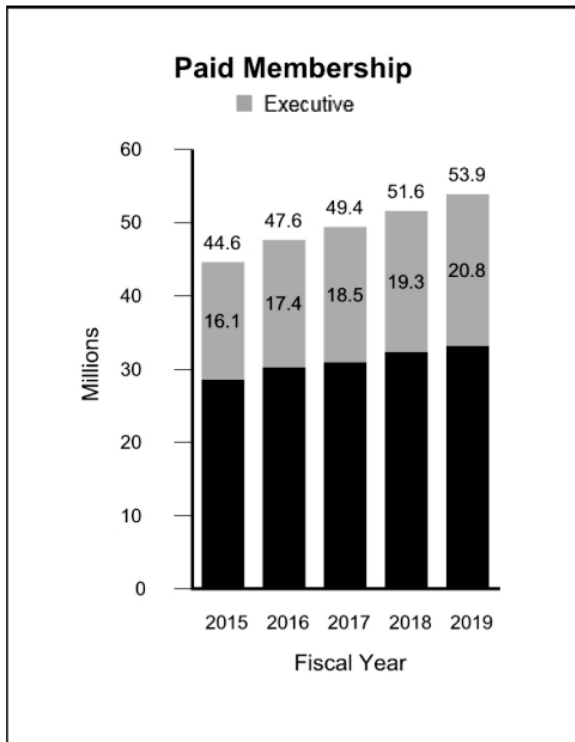


Table 1
(Costco Annual Report, 2019)

Warehouse Model

Traditionally, warehouses are defined as large buildings that store goods; Costco merged with supermarkets and created a novel retailer concept. Costco offers a more limited range of products than a traditional supermarket and aims to attract shoppers who wish to save money by buying in bulk. However, as Costco chose the warehouse model, the array of goods and services is inevitably limited (Gregory, 2017). Customers might go to other retailers like Walmart, which has a wider variety of goods and services and does not require them to buy a mandatory bundled Family Pack. For example, Costco’s shampoo cost is the lowest around, but shoppers typically have to buy a three-pack. Multiply that by any number of products shoppers add to their carts, showing why the average transaction total is so high (Best, 2020). A large part of Costco’s profit is generated from the warehouse model, and customers are willing to pay for it, which means this model creates a win-win situation. According to the warehouse model analysis, it has rapid inventory turnover and high sales volume, contributing to higher

revenues.

Moreover, the high sales volume contributes to high operating efficiency. Higher operating efficiency is achieved through minimizing variable costs; these costs are lower when volumes are higher, which is the working principle of Costco’s warehouse model (Gregory, 2017). As Table 2 shows, Costco can spend much more on employees’ annual revenue than Wal-Mart, as its warehouse model does not need many employees. The money Costco saves in hiring fewer employees can be passed on to the customers in reducing the price of goods and services, a virtuous circle for this company’s operation. This gap in employees’ revenue between competing companies also influences their reputation. Costco is considered more of a high-end supermarket with a different market position than Walmart, which might increase appeal. From the research of Best (2020), “the typical Costco shopper has a family income of about \$93,000 a year. They like a bargain as much as anyone else, but they also have the means to buy in bulk, which is the only way to buy for most of the products it stocks.” The family income mentioned above mostly represents the middle class in the U.S., who like to buy products because of the preferential price and bulk packaging. The warehouse model reduces friction and competition with other retail stores because of its fame in having invented a new field and market for warehouse clubs.

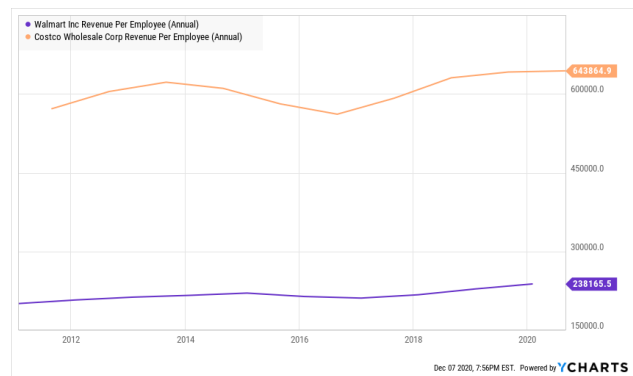


Table 2
(Ychart.com)

Advertisement

Costco’s membership and warehouse models essentially are cost leadership. “In this model, consumers pay a membership fee to access the low-cost products available at Costco stores” (Gregory, 2017). Costco positions itself as a “Members Only” warehouse store, attracting customers with a low price and relying on word-of-mouth advertising at no cost. Most retailers spend vast sums of money on marketing to bring new customers into their stores: for example, “Wal-Mart spends about 0.5%

of its revenue on marketing expenses, which is about \$2.4 billion, making Wal-Mart one of the world’s largest advertisers” (Investopedia.com). Its high popularity proves the success of its advertising strategy; however, Costco essentially spent nothing on advertisements while its popularity is similar to Walmart’s. “If Costco spent the money on advertising by using 0.5% of its revenue too, that spending would erase nearly 70% of Costco’s operating profit.” (Investopedia.com) This would lead Costco to eliminate its low prices, eradicating its most attractive feature for customers. This “membership-only” and “warehouse” concept has exploded in terms of popularity during the last few decades, with Costco opening 214 new wholesale stores around the world since 2010 (Costco Annual Report, 2019). By engraving the concept in people’s minds, “membership” and “warehouse” have become synonymous with Costco and advertised the brand to the public.

Methodology

In this research, 30 respondents were surveyed, and non-members of Costco were excluded to ensure the answers’ objectivity. It aims to investigate Costco’s customers’ leading group, their attitudes towards membership and warehouse models, and how they think of Costco’s advertisement with these strategies. Moreover, to eliminate any biased responses by region, sex, and financial condition, this survey used a proportionate quota sampling method. There are six questions in total in this questionnaire. Costco’s membership is only available for adults (costco.com), so there is no option for people under 18. These 30 respondents are between 18 and 70 years old, with the highest concentration being 26 to 50. Most respondents buy food or products for 3 to 5 people, and only one of the respondents pay Costco’s membership fee to buy things for him/herself (Table 3).

Regarding why they became a Costco member, 93.3% of the respondents were interested in the warehouse pricing, and only 36.7% chose Costco because of the membership services (Table 4). Meanwhile, old members’ recommendations also account for one of the main reasons customers pay for membership (Table 5). Furthermore, 66.7% of the respondents agree that Costco does enough advertising to promote its brand (Table 6). The survey findings were useful in identifying the role of Costco’s membership and warehouse models based on a comprehensive analysis conducted to determine members’ experience and attitudes towards Costco.

How many people are you typically buying for?
30 responses

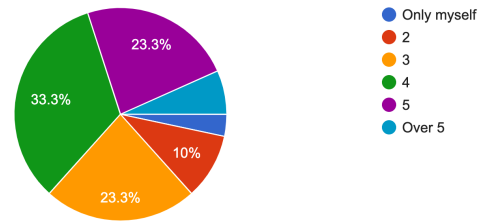


Table 3

Why did you become Costco's member? Check all that applies.
30 responses

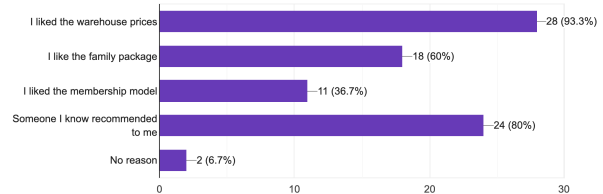


Table 4

What do you dislike about being a member? Check all that applies.
30 responses

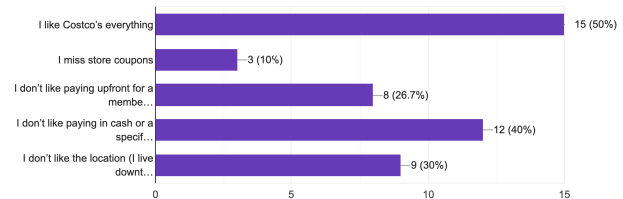


Table 5

Do you think Costco does enough advertising?
30 responses

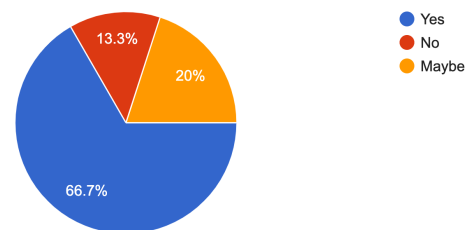


Table 6

Findings

Customer Group

Based on the research statistics, 22 out of 30 respondents are 26 to 50 years old, which shows that the age group of Costco members is mainly in the working class, from 26 to 50. Based on Table 3, 80% of respondents buy for 3 to 5 people, which means the warehouse model sells goods in bulk, which is very suitable for them. These statistics indicate that Costco attracts more middle-aged

customers who typically buy as a membership warehouse supermarket for 3 to 5 persons. Therefore, according to this information, it is safe to assume Costco's leading customer group is people who live with a family.

Customer Attitude

By asking respondents whether they will renew or have ever renewed their memberships, 25 out of 30 answered that they would like to or have already renewed. It confirms what is mentioned in the Literature Review: Costco's members have brand loyalty, and only 16.7% believe a membership is not worthwhile. As Kim (2017) stated, "the 'price' and 'bulk buying' and 'membership benefits' were considered more significant for the member group than the non-member group, whereas 'potential price bargaining' was considered more important by the non-member group." In this research, 93.3% of respondents like the low-price warehouse model, which shows Costco's pricing is the most crucial factor in attracting customers. 60% of them were attracted by the family package, which the warehouse model invented. The old members' influence is also significant, as 80% of respondents were recommended by friends or family members (Table 4). This implies that after the customers are attracted by the membership and the warehouse being members, they would like to recommend to their friends to join Costco's membership to enjoy together. Customers are invisibly advertising Costco because of the low price, rooted in membership and warehouse models. Although half of the respondents are Costco's loyal fans who like Costco's everything, there are still many shortcomings customers dislike about these two models. 40% of respondents do not like only paying in cash or a specific credit card, which is the payment that a membership model created (Table 5).

Invisible Advertisements

As Table 6 shows, 66.7% of the respondents believe that Costco does enough advertising despite Costco spending nothing on advertising. Costco's most impressive keywords for customers are "membership" and "warehouse," and old members would like to recommend Costco to others because of this. This shows that the advantages of these two strategies are already engraved in customers' minds and advertised through word of mouth.

Conclusion

In this study, membership and warehouse models are the invisible advertisements for Costco to attract and retain customers. Namely, Costco currently wins customers' support by advertising itself as a "members-only warehouse" retailer in today's competitive market. This study also has limitations.

It generalizes the analysis results only from one region, Toronto, without considering all Costco locations in Canada. All Canadian areas where Costco is located must be inspected for a comprehensive analysis. The research only conducted the questions for Costco members and did not analyze the attitudes of non-members towards Costco's membership and warehouse models. There are only 30 participants, a small sample size, which may lead to inaccurate data being collected. Although this analysis found the membership and warehouse model play the role of advertisements, there is a limitation to reaching a more profound analysis that provides various insights. Considering these limitations and optimizing the research process in further studies is significant. Nevertheless, with retailers' gradually increasing interest in membership and warehouse models, this study can provide useful implications for today's retail industry.

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Appendix 1 - Questions of the Questionnaire

Below is an outline of the interview questions asked by the 30 respondents.

1. How old are you?

2. Will you renew, or have you ever renewed your membership?

3. How many people are you typically buying for?

4. Why did you become a Costco member?

5. What do you dislike about being a member?

6. Do you think Costco does enough advertising?