

Research on the Application of Membership System in Market Management: Evidence from China

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Abstract. Under the strong competition in the retail industry, large warehouse membership supermarkets have a stable and large consumer base in the market with strong competitiveness. This paper selects two case studies, Costco, which is the world's leading warehouse membership supermarket, and Freshippo, which has newly emerged in the Chinese market, for comparative analysis to explore the industrial structure behind the membership system in the development process and special innovations made by local membership supermarkets in China to satisfy consumers. The Chinese retail market is significantly different and requires localized transformation and innovation in order to attract local consumers to join. The paper also explores Freshippo's attempts to increase the brand's competitiveness in the face of the enormous convenience of online shopping in China, namely, the innovation of an online + offline model and the addition of several consumer benefits to attract more consumers to join the membership family. Through the integration and analysis of the development strategies of two membership supermarkets, we offer specific advice on the next development of membership supermarkets.

Keywords: Retailing; membership; Warehouse club.

1. Introduction

The global retail industry has undergone significant changes with the rise of the Internet and the rapid development of logistics. The widespread emergence of large retailers has increased market concentration. Large retailers have a pivotal position in the market by virtue of their dominant position in the chain and innovative formats. In the late 1990s, foreign retailers in the Chinese market have achieved considerable success in the last 20 years. To a large extent, foreign cutting-edge retailing theories have been introduced into the domestic market. However, the emergence and growth of e-commerce has dealt a heavy blow to the traditional retail industry. It has led to the closure of brick-and-mortar stores in China of several large foreign retailers such as Walmart and Carrefour [1]. However, membership-based supermarkets still possess vitality in the market. The reason for the great success of membership supermarkets is the customer loyalty attached to the good experience brought by the good quality and low-price products and marketing model. Another paper shows that the warehouse club's membership fee is an optimal competitive reaction to the supermarket's promotional activity. The more frequent the promotion is, the lower is the membership fee [2]. Consumers always favor the option that is most beneficial to them. While membership supermarkets and supermarket promotions bring about a gradual convergence of benefits on goods, other rights and benefits of membership supermarkets and good service experience will become a strong support for consumer choice. There are also research papers that propose a framework for retail formats that suggest two paths to either reduce friction in the customer journey or enhance the customer experience [3]. The success of membership in the Chinese market will require specific changes and innovations based on local consumer habits. Membership models that are well developed in international markets cannot be copied in China, but need to be adapted to local conditions. The market needs to establish a membership system with Chinese characteristics in order to harvest public trust [4]. One study found that the trend of retail upgrading is not an increase in its value-added rate, but a shortening of the length of the value chain, meaning that the efficiency of the retail distribution function is increasing based on the simplification of the chain [5]. As a representative of China's new retail industry, Freshippo, nurtured under good local soil, has been developing rapidly in China with the concept of membership and "online+offline", and has become an emerging local representative of membership

supermarkets. Existing literature suggests that due to the higher channel costs in offline stores, every price for new retail companies is higher than the corresponding price for online companies [3]. The combination of online and offline is based on the membership system, and the benefits of being a member can attract consumers to join the membership to a greater extent and save the company's cost to achieve profit revenue. This paper will take Costco as an example to analyze the marketing model and industry chain support behind the membership system. Secondly, through a specific introduction of Freshippo, a representative of China's new retail industry, we will explore the development journey of Freshippo and the driving force behind it. Then, we will compare Freshippo X member stores with traditional member supermarkets and explore the specific changes made by member supermarkets in the Chinese market according to the consumption habits of domestic consumers.

2. Case description of Costco

Costco was the first supermarket in the world to introduce the concept of membership. This innovative approach to sales has been a huge success in the middle of the market, enabling the large warehouse supermarket to gain a long-lasting, high-quality customer base and to explore a high-quality, inexpensive supply chain around the world. As a traditional retail enterprise in the United States, its main business is medium and high-end brands. Its customer group is positioned as consumers with strong consumption power. In 1983, the first Costco warehouse location was opened in Seattle. When Costco and Price Club merged in 1993, the combined company, operating under the name Price Costco, had 206 locations generating \$16 billion in annual sales. Today, the market has reached nearly 218.36 billion market capitalization. Costco has transformed the retail world. Aimed at providing consumers with the best consumer experience and cost-effective products, Costco has created its own brand Kirkland Signature to attract customers. This exclusive Costco brand also allows for maximum quality and price protection, while saving on supermarket shipping costs and warehouse operations.

By analyzing Costco's data, the author can see that membership provides a major source of motivation and benefit for the Costco brand. Compared with the other companies, the weighted average cost of capital of Costco can almost cover all-equity expected return on assets. In the real market, the return on market have achieved 29.32%. This is because of Costco's unique marketing strategy. With membership fees as the main source of profit, Costco provides high quality products to customers at cost price, meaning the main source of revenue is not the commodity itself. Costco has approximately 120 million members worldwide, which will be an important pillar in Costco's profit structure. Costco mainly targets middle class families with higher economic level in the United States. As a result, they are more willing to pay for services and more accepting of the advance payment of membership, so membership has been promoted very smoothly.

In order for consumers to pay additional membership fees, businesses must first create value for consumers. Costco's size allows it to get lower prices than its competitors in the supply chain [6]. Through various means, Costco keeps its gross profit margin extremely low. The back-end support of Costco to ensure the uniqueness of its SKU portfolio lies in its huge supply chain, which can ensure the volume is large enough, while lowering the price to the level of other competitors. Costco warehouses carry about 4,000 SKUs compared to the 30,000 found at most supermarkets. This means that Costco offers customers only two to three choices in each category, thus reducing their cost of choice [7]. It saves consumers' time in choosing, while attracting them with a larger number of packages and lower prices. But to a certain extent in China, it cannot satisfy families with simpler family structures. At the same time private label Kirkland Signature can provide a better product at a lower price. KS product sales of \$52 billion and \$59 billion in fiscal 2021. In 2022, Costco's KS merchandise penetration was approximately 28%, said Costco CFO Richard Galanti on the earnings call. This is similar to historical trends, where it's growing slowly but steadily over time. It also reduces its own cost to the maximum extent. The supply chain behind Costco's own products is unique and the most efficient in the world.

3. Case description of Freshippo

Established in March 2015, Freshippo is a representative of Ali's new retail innovation model, which has achieved significant and rapid growth in the Chinese market with its novel sales model. Freshippo is committed to using the core technology of big data. It has adopted a membership model to increase customer stickiness. At the same time, Freshippo has built its own modern logistics system to provide an integrated online and offline fresh food consumption experience for its customers, based on the characteristics of the Chinese market. As of January 2023, the number of Freshippo stores reached 337. As shown in Figure 1, Freshippo mainly covers the four first-tier cities such as Shanghai, Beijing, Shenzhen, Guangzhou and new first-tier cities such as Nanjing, Hangzhou.

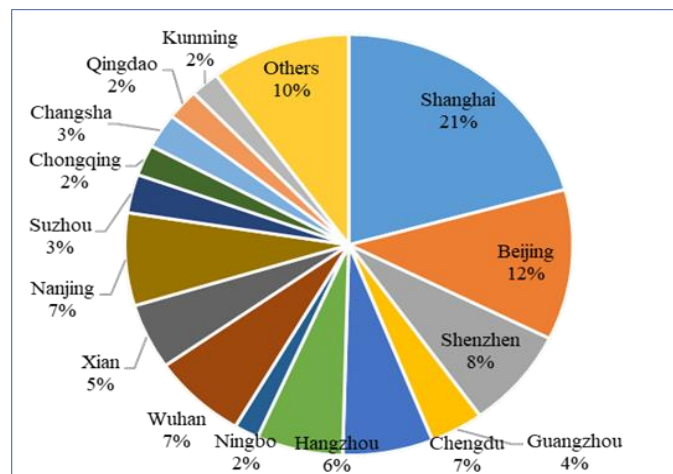


Fig 1. Distribution of Freshippo stores.

The localized, large warehouse-type member supermarket Freshippo X member stores, which are bench-marked against Costco, are also doing well. As of January 2023, Freshippo x-member stores have opened nine stores around China. There are six in Shanghai, one in Beijing, one in Suzhou and one in Nanjing. The results as shown in Figure 2.

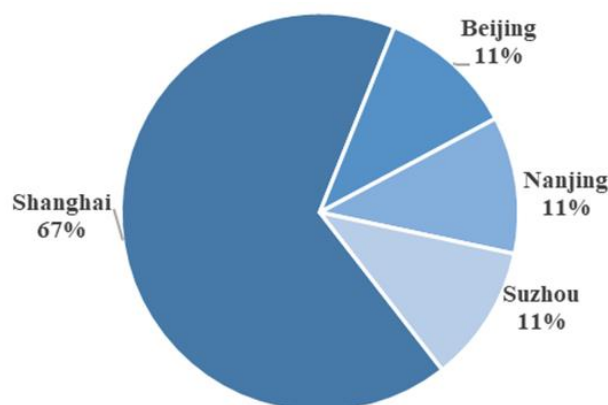


Fig 2. Distribution of Freshippo X stores.

In 2022, Freshippo sales grew by over 25% year-on-year, Freshippo X Member Stores grew by over 247%, and AOL and Neighborhood grew by a whopping 555%. The set of data announced by Freshippo CMO Jiayu Zhao reflects that the overall development of Freshippo remains strong and powerful under the synergistic development of different business formats. With the elevated positioning of Freshippo X member stores within Freshippo, Freshippo's strategic intent is gradually emerging. Freshippo hopes that through the parallel development of multiple formats, it will be able to segment in terms of categories, customer groups and scenes, so as to precisely align with the target.

4. The role of membership in the retail industry

4.1 Membership system

New retail requires stores to come up with new and better ideas to attract customers with their own uniqueness [6]. The membership system uses the annual membership price as the main income of the store to provide customers with good quality products at low prices to attract a steady stream of customers. This is one of the reasons why Costco has been able to make its membership system a stable, quality customer source worldwide. The same better service experience and the best value for money products have also gained the absolute trust of customers. As a result, membership has created a wave in the retail industry around the world. The total number of Freshippo X members is now close to 2.5 million. Based on the membership fee of 258, Freshippo's revenue in this area has exceeded 750 million. There is also a clear indication in Freshippo 2022 financial results that wholesale commercial revenue in China for the six months ended September 30, 2022 was RMB9,167 million, an increase of 13% compared to RMB8,098 million for the same period in 2021. The increase was mainly due to the increase in revenue from value-added services provided to wholesale buyers and paying members. And with a Costco membership card at 299 a year, Costco has 59 million-member households and 107 million membership card holders worldwide, generating \$3.5 billion in annual membership fee revenue for the company. A comparative analysis of the data shows that both companies use membership fees as one of their main revenues. The strong vibrancy of Freshippo can be reflected in the growth of its own strong profits.

4.2 The supply of the products and the package selection

Simplifying product selection by reducing the number of SKUs, Freshippo x member stores have introduced numerous Freshippo x products. Costco is also known for its large packaging and reduced SKUs. This form of family pack meets the demand of people's one-time purchase under the fast pace. At the same time, the concentration of categories can bring a higher value of efficiency.

In the supply side, fresh food e-commerce companies can take advantage of the scale of procurement to purchase goods directly from the source, which not only reduces the cost of products, but also facilitates quality control. In the distribution side, fresh food e-commerce companies can add front warehouses between the central warehouse and end users, and expand the coverage of users with intensive deployment.

The gross margin of own goods is higher. So large membership supermarkets will continue to increase the proportion of own goods with the aim of increasing gross margin and gaining more profit margin. The main goal of membership supermarkets is to create their own brands and provide high quality goods with low price strategies to capture the hearts of consumers.

4.3 Consumer targeting and mall location

The target group of Freshippo X member stores and Costco is the middle and upper class, and Freshippo X member stores in China are mainly found in four cities. This is also tied to traditional Chinese consumption habits. People are used to finding those vegetables and fruits at good prices at the community's vegetable market, which saves time for city dwellers with busy lives to travel to the more distant supermarkets. Large warehouse membership supermarkets, on the other hand, offer a better service experience and a unique product mix that appeals to people with longer shopping times and a desire for a broader range of goods, which are typically middle and upper class. By choosing the location we can also find out the choice of two stores for consumers. Costco has followed its usual style in the Chinese market, choosing to be on the outskirts of the city. With the idea of opening a store that allows families with cars to purchase everything at once. With a large enough footprint and sufficient parking spaces to meet the needs of consumers' family shopping. However, the desire to expand the reach of the customer base and to allow consumers who do not drive to shop at the Freshippo X member stores is a desire to meet the needs of most Chinese consumers even more. Parking environments are usually bundled with shopping malls.

4.4 Combination of online and offline

Offline retailers have been facing numerous challenges. Since the advent of e-commerce, the intensity of these challenges has increased as consumers have adapted to shopping online [7]. In the era of the epidemic, the offline economy is developing slowly and consumers' desire to shop online has become stronger, making good use of the Internet to develop itself has become one of the strategies that many supermarkets are focusing on researching and developing. The future competition between enterprises is ultimately the competition of business models, of which the offline advantage is to provide personal experience, shopping guide services, scenario-based consumption, which complements the online advantages of price transparency, fast payment, and home delivery [8]. At the same time the Chinese market online shopping, express delivery industry is very developed, how to attract customers to walk into offline stores with their own unique and innovative model has become one of the hot topics. We can find dining areas in both supermarkets, which can provide customers with cooked food and food processing places. Freshippo offers some snacks in addition to seafood processing places, which can handle fresh seafood even for customers. The freshness of the food is ensured and the same attracts customers.

4.5 Differences in marketing approaches

Due to the differences in markets and marketing approaches, the two companies have made many different decisions in the face of competition to attract customers.

Based on the characteristics of the Chinese market while adopting two improved measures to increase the breadth of its customers, Freshippo is a combined online and offline approach. Based on the "online+offline" dual-channel layout, Freshippo continuously strengthens customers' service identity and enhances their trust in the Freshippo brand by integrating data portraits. In this way, it increases customer stickiness. Improving modern information infrastructure can help to allocate the portraits. Empowering retail enterprises to improve their overall operation is also important [9]. Through "store-warehouse integration" and emerging technologies, instant logistics realizes the upgrading and iteration of logistics speed from "days" to "minutes", providing a strong support for new retail [10]. The rapid development of logistics industry provides a strong support for fresh videos to reach customers. Secondly, through the partial membership system, customers can purchase and experience at a different price without joining the membership, which gives them more space to choose after a good experience and also gives them the opportunity to counter-select. The third is the difference caused by the Chinese shopping culture. As a local brand, Freshippo X understands Chinese tastes better and will produce special snacks and food according to the diet of each place. The Shanghai Freshippo X has introduced Chinese specialties such as BBQ pork, Shanghai small wontons and butterfly puffs, which are more in line with Chinese consumers' tastes. In terms of imported food, Freshippo also actively brings in better sources to complement its own products. Thus, to meet the needs of consumers' global shopping, the Freshippo X has searched for good suppliers throughout the region to provide consumers with a diverse selection of seafood and red wine. The global supply chain of Freshippo X has been highly integrated, and the imported direct-picked goods have increased by 2.4 times compared with the same period last year, and the layout of imported food and imported goods will also be further accelerated in the future.

The goal of the products of Freshippo X member stores is to "understand life", especially fresh food-related products, and most of the bases and sources of Freshippo have precipitated localized characteristics to differentiate from foreign giant member store brands. As most foreign families are large in size, and Costco's food products are also packaged in large portions. Chinese families usually have a family of three, so the size of the goods in the Freshippo has been changed with localized specifications to better suit the consumption rhythm of Chinese consumers.

5. Conclusion

With the development of e-commerce and many forms of innovative business models, the traditional retail industry has become less competitive in the Chinese market. The emergence of large warehouse line membership supermarkets among others has brought a new dynamism to the market. Membership supermarkets also face challenges as they enter the Chinese market. These include differences in consumer spending habits, different welfare needs of the market, differences in the geographical environment in which the membership supermarkets are established, and differences in family structure. All of these require specific changes and innovations by decision makers based on local consumer habits. In this paper, a comparative analysis of the traditional U.S. membership supermarket Costco and the strong local growth brand Freshippo X member stores are used to derive localized innovations made by membership supermarkets in the Chinese market.

The analysis in this article finds that Freshippo X member stores uses big data to locate consumer groups, chooses to build malls out of transportation hubs, and categorizes Freshippo stores to attract consumers at all levels and lay a solid foundation for the promotion of its own membership system. At the same time, it broadens the rights and interests of consumers and gives them logistics as a benefit, enhancing its competitiveness with e-commerce. However, Freshippo X member stores needs to expand deeply in shortening the industry chain and the creation of its own brand of goods. Costco's own brand, Kirkland Signature, brings most of the profits to the company by shortening the supply chain and reducing the costs associated with logistics and inventory. Self-production and sales also ensure the quality of its own products, which can fundamentally gain the trust of consumers. The lack of models and quantitative analysis of in-depth research in this article brings certain shortcomings. Next will be an exploration of the factors influencing consumer loyalty to membership.

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