

# *PROPOSING PRICE DIFFERENTIATION STRATEGY FOR COSTCO*

**MGMT 63800: Pricing Strategy and Analysis**



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## *Team 1*



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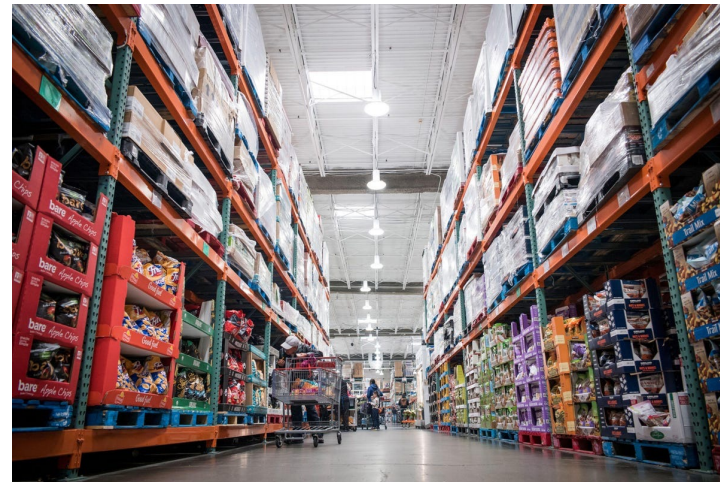


Manmeet  
Walia

## Introduction



- Costco offers a diverse range of products in one trip
- Unconventional product placement with wooden pallets and limited brand selection
- Annual membership fee required for entry
- Despite unconventional approach, Costco is a \$225B juggernaut and second-largest grocery retailer in the US



## *Significant economies of scale advantage vs. traditional grocers*



Costco Pricing Flywheel



### Markups: Costco vs. traditional grocer

#### COSTCO

PURCHASE PRICE  
\$100

SALE PRICE  
\$111

MARKUP  
11%



1 LB. WAGYU BEEF

Costco's markup is 56% less – and its shoppers pay 20% less.

#### GROCER

PURCHASE PRICE  
\$112

SALE PRICE  
\$140

MARKUP  
25%

## *Losing on margins to organized competitors but high loyalty*



**815 Stores**  
As of 2021



**\$ 220 B**  
Revenue  
As of 2021



**12.1%**  
Profit Margin  
As of 2021



**118.9 M**  
Members  
As of 2021

**90%  
Renewal**



**10,586 Stores**  
As of 2022



**\$ 573 B**  
Revenue  
As of 2021



**25.1%**  
Profit Margin  
As of 2021



**11.5 M**  
Members  
As of 2021

## *Multifold strategy to create niche and entice customers*



**Membership Psychology**



**Store Layout**



**(No) Paradox of Choice**

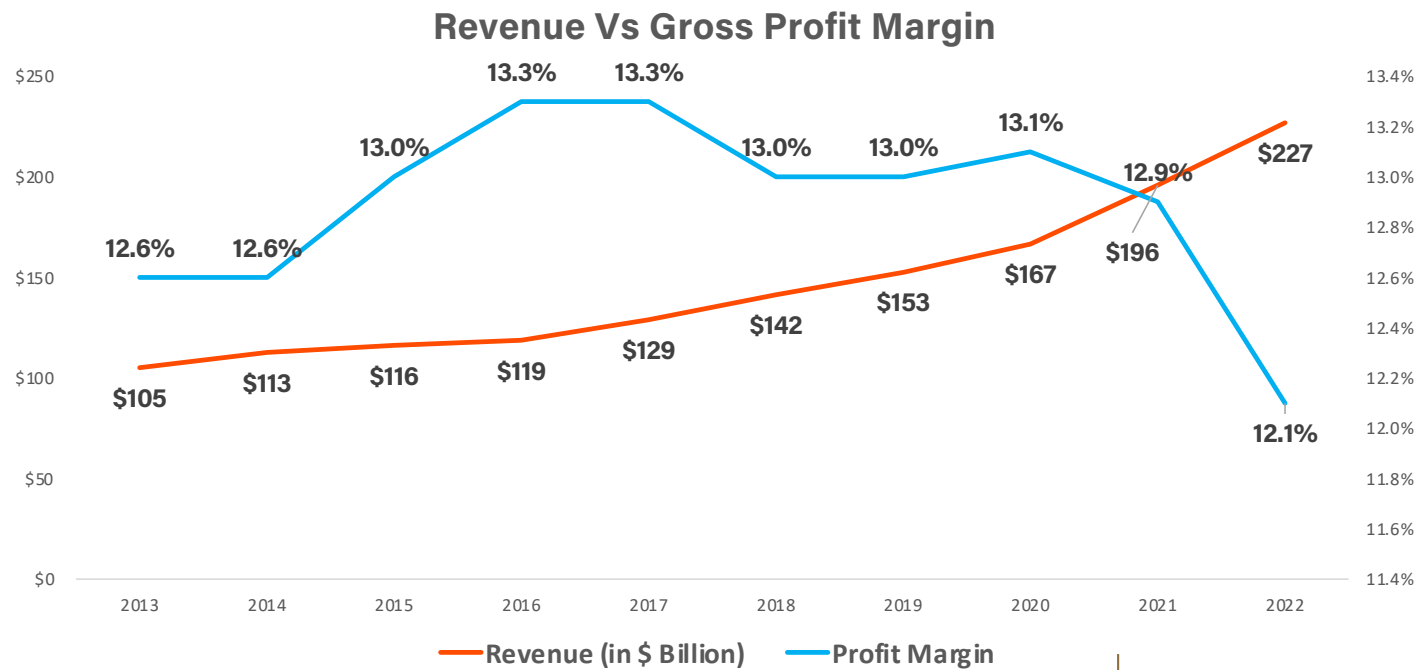


**Barebones Appearance**

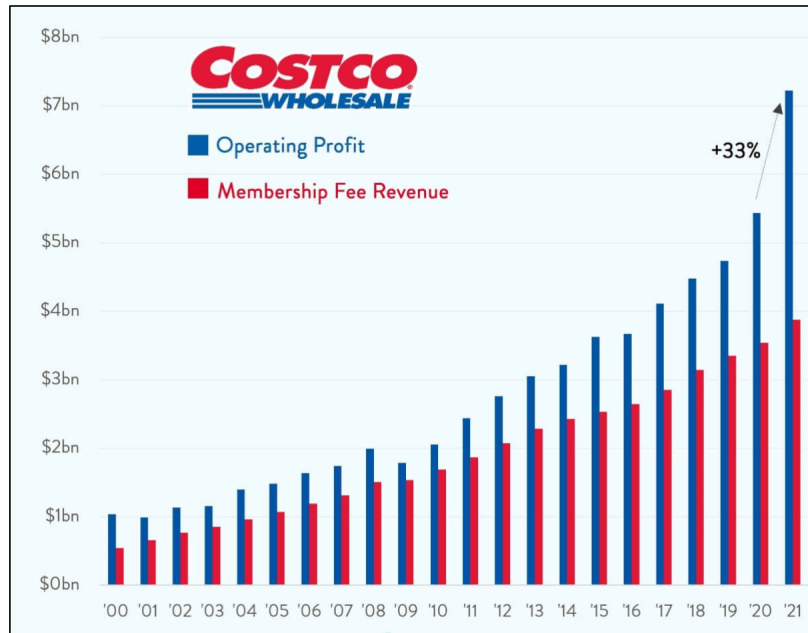


**Samples**

## *Revenues rising but margins stagnant*



## *Cause of problems (and opportunities at hand)*



- Over-reliance: More than 50% of profits from membership fees
- Lower profit margins compared to other retailers
- Can Costco leverage merchandise sales to increase profits?

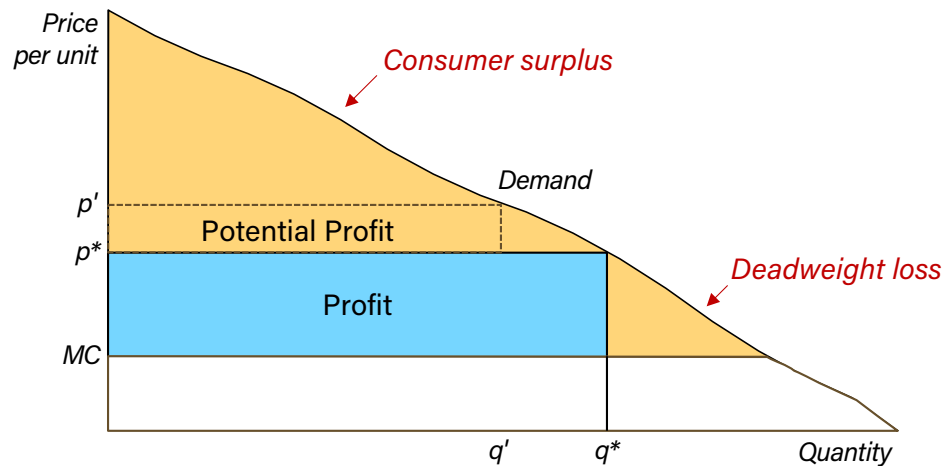
Operating Profit	~ \$7.25B
Profit from membership fees	~ \$4B



## *Opportunity for more profits by reducing sizes*



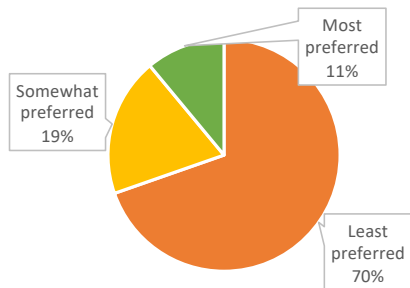
The scope of our analysis is to identify whether there exists a market potential for smaller unit SKUs that Costco can introduce to attract new customer segments and reduce lost sales to ultimately increase revenue and profits.



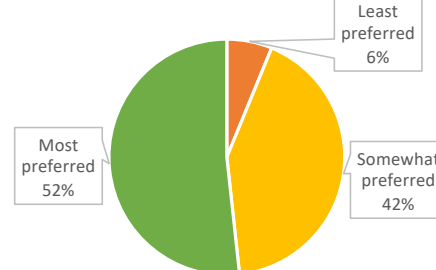
## Overview of the survey results

- Responses from 38 individuals were collected who either have the membership and experience of shopping at Costco and Walmart
- Respondents were asked to rate SKUs of same type but of different pack sizes and price points, belonging to different brand options (hidden to avoid bias). For e.g.: Walmart's [Tomatoes, 1 lb, \$5.88]; Costco alternative (suggested) [Tomatoes, 1.8 lb, \$7.99]; Costco original [Tomatoes, 2 lb, \$8.45]
- We chose 3 Perishable items (Banana, Tomatoes and Bacon) and 2 non-perishable items (Toilet Paper and Diapers)

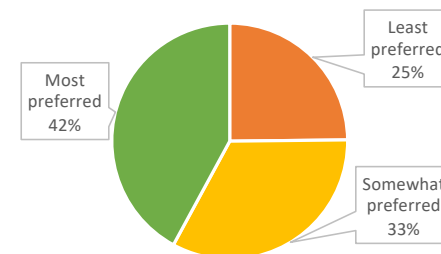
Walmart SKU Options



CostCo Alternative (Suggested) Options

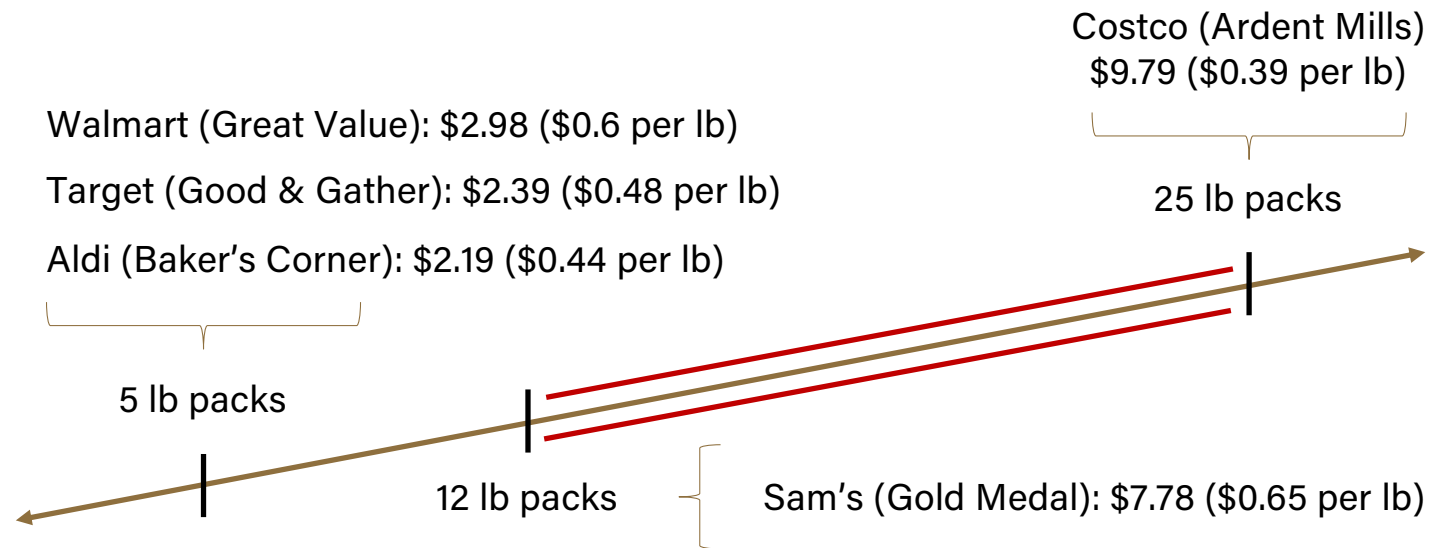


CostCo Original Options



## Rationale behind survey options

Let's consider flour: Considerable **white space** for sizes between Costco's and competitors' (for certain SKUs)



## *Considerable gain in mid-to-high volume market share*

**Price differentiation** is suggested as Costco alternative's gain in share is significant versus Walmart/Sam's share for similar price and size

Currently*	<b>37%</b>	-	<b>63%</b>
	Walmart/Sam's Medium Priced Medium Sized	Costco alternative Medium Priced Medium Sized <sup>#</sup>	Costco original Large Priced Large Sized
Projected	<b>23%</b>	<b>35%</b>	<b>42%</b>
	38% decrease	22% overall increase	

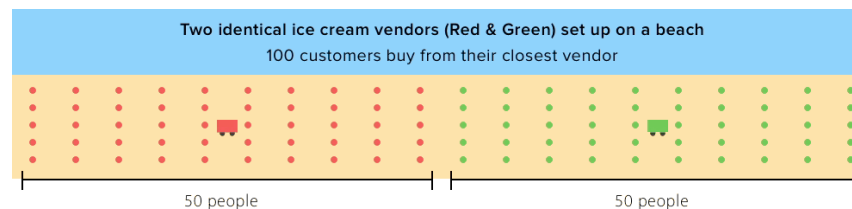
\*Actual reported to be 39% and 61% respectively as on Sep 14, 2021  
#At approx. 70% of Costco's current size with 5-10% additional markup

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## *Benefits and recommendation*

- Avoid losing customers having WTP for medium sizes (particularly for perishables)
- Tiered pricing reminds customers buying large sizes of the value they're getting
- Anchoring effect from large sizes could promote sales for medium sizes
- Identify SKUs (such as flour) that would benefit from this strategy and implement for A/B testing in some locations to validate if overall sales increase



*THANK YOU*



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## ***Appendix:***

Survey outcomes:

<https://docs.google.com/spreadsheets/d/1n2iggeT3NmIJJ338lm1FtsieMKH96LfFIUmDfK36oCQ/edit?usp=sharing>

Spreadsheet link:

[https://purdue0-my.sharepoint.com/:x/g/personal/mrahi\\_purdue\\_edu/EVL9PvJ-YgdGjWGHuGGhSD0BX7G-gExi4eBsgxJIVpf2ug?e=XG6aCA](https://purdue0-my.sharepoint.com/:x/g/personal/mrahi_purdue_edu/EVL9PvJ-YgdGjWGHuGGhSD0BX7G-gExi4eBsgxJIVpf2ug?e=XG6aCA)

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