Great brands don't chase customers: Why Costco limits consumer choices

The following is an excerpt from the new book, Extraordinary Experiences: What Great Retail and Restaurant Brands Do, by Denise Lee Yohn.

Millions of people do something every day that seemed unimaginable 25 years ago: They pay $55 or more for the privilege of walking through the doors of a Costco warehouse club.

Although it seems commonplace today, getting people to pay to shop at a store was a ludicrous idea back in 1976 when Sol Price founded the company that would become Costco. But Price suspected that certain people would gladly pay for the opportunity to shop at a store if it provided them with great value. He set out to attract small business owners to a members-only warehouse store using a customer strategy that Costco still uses today.

In 1990, Price explained how he targeted a specific type of customer and built what has become a more than $113 billion, 670-plus unit retail powerhouse. “The membership concept is very important to us. First, membership provides a way for us to pre-select the demographics of our customer base without having to do all the extensive research that would otherwise be required. Business owners and managers, licensed professionals, and people who work for governments, utilities, hospitals or banks tend to be more stable than many others. We take less risk in accepting their checks,” he said.

“Second, dealing exclusively with selected groups makes it possible to communicate with your customers effectively. Instead of communicating with the whole world, you communicate one-on-one with the people you want to reach. Finally, someone who pays for a membership in an organisation makes a form of commitment. They have a built-in reason to come back,” he added.

Today, Costco continues to attract business customers as well as shoppers from affluent households, having amassed a membership of nearly 80 million Costco cardholders. Despite appearances, though, the store’s low prices and great deals aren't a mass market strategy intended to appeal to everyone. They're part of a shopping experience specifically designed to appeal to certain people with certain sensibilities.

Costco exemplifies the brand-building principle that **great brands don't chase customers.** The warehouse club keeps its focus on its ideal member and refuses to chase customers who aren't a good fit. As a result, its business practices are somewhat surprising and definitely different from most other retailers and even other warehouse clubs.

Costco isn't afraid to limit customers' choices

With a membership retention rate that’s greater than 90 percent, there's no doubt Costco is a customer favourite. Yet, some of its practices seem quite unfriendly to customers.

For one, it deliberately limits the number of product choices offered. A typical Costco store stocks 4,000 types of items, including, say, just four toothpaste brands, while a Wal-Mart typically stocks more than 100,000 types of items and may carry 60 sizes and brands of toothpaste.

Instead of turning off customers, the limited selection actually works in Costco's favour. Studies have consistently shown that customers buy fewer products when faced with too many choices, a dynamic that's probably magnified when shopping in a no-frills warehouse environment.

By limiting its product selection to those sold in bulk, Costco can keep costs down. The greater the sales volume of each product, the deeper the bulk discounts Costco can squeeze from suppliers.

That's why co-founder and former CEO Jim Sinegal doesn't make any apologies for carrying Advil in only a 360-count bottle, whereas drug stores and other retailers stock the more common 50- or 100-count sizes. "That's what we refer to as the intelligent loss of sales," Sinegal explained. "If we had all of those sizes, I could do the math and show you where you would do less business as a result of having all of those sizes available."

Costco's credit card strategy also doesn't demonstrate much customer empathy. For 16 years, American Express credit cards were the only ones accepted. That was a rare policy among retailers which are typically more than eager to accept any form of payment just to make a sale.

Then in February 2015, Costco announced it was discontinuing its relationship with American Express. Instead of switching strategies and offering its customers more payment options, however, it signed a deal with Visa to use Citigroup as its exclusive provider of co-branded credit cards. As a result, many current customers will have to apply for new Costco branded/store-accepted credit cards, while others will have to continue to accept limited payment options at the chain.

To the company, limiting payment options and directing all perks through a single partner is yet another way of delivering lower prices and more benefits to customers. So, like other great brands, Costco embraces a customer strategy that might alienate some while attracting many more.

When attracting customers, less can actually be more

The principle of not chasing customers has also fuelled the success of Southwest Airlines, which knows open seating and lack of premium class service won't endear its brand to travellers who want to be pampered -- and Apple, whose closed operating system deters users who prefer more flexibility. By not chasing customers, great brands usually end up attracting more profitable, loyal ones.

Costco founder Price explained it this way: "A store that tries to be all things to all people will end up being nothing to anyone. A retailer reflecting honesty, credibility, and a definite direction that can be understood by its customers and vendors will have a good chance to make it."

Denise Lee Yohn is a brand-building expert, author and speaker. Her latest book, Extraordinary Experiences: What Great Retail and Restaurant Brands Do, profiles seven great retail and restaurant brands and shows how they earn customer love and loyalty by creatively designing and consistently delivering great retail customer experiences. Learn more at http://deniseleeyohn.com/extraordinary-experiences.