# Membership Wholesale Clubs: A Low-Price Alternative

Walter Epps and Judy Putnam
(202) 786-1866

Offered the choice of paying $3.29 or $2.79 for a 12-pack case of 12-ounce Pepsi's, obviously most buyers would choose the lower price. This price appeal goes a long way toward explaining the meteoric rise of wholesale clubs—fully computerized "no-frills" operations offering a limited selection of first quality, name-brand merchandise to small businesses and selected groups of consumers.

Today's clubs trace their lineage to the cash-and-carry operations started more than 50 years ago by wholesale food distributors to serve their small business customers who couldn't buy in large quantities. As the name implies, customers pay cash at these outlets and assume responsibility for receipt and delivery of their order, thus avoiding distributor service charges.

The wholesale club was born in 1976, when the San Diego-based Price Company added a new twist to the cash-and-carry industry by opening a member-only warehouse where businesses and individuals were allowed to shop. Since then, 17 other companies have started operations patterned after the Price Company outlets, creating a booming mini-industry.

In 1985, membership wholesale clubs did an estimated $4.4 billion worth of business, roughly double that of 1984. In 1986, sales will likely exceed $8 billion. By December 1986 *(table 1)*, there will be close to 230 wholesale clubs, compared with 80 at the end of 1984. The industry has attracted such heavyweights as Zayre, Wal-Mart, Kroger, and Pay "n Save, who have their own versions. Clubs can now be found in most of the 100 largest U.S. metropolitan markets.

## A New Type of Store

Clearly different from the conventional supermarket or discount store, the wholesale club is more accurately described as a retail/wholesale hybrid. These membership-only distributors straddle the line between wholesaling and retailing by offering discounted prices previously available only to larger businesses that ordered merchandise in bulk.

*The authors are agricultural economists with the Food Marketing and Consumption Economics Branch.*

**With no frills and limited variety, low prices largely explain the meteoric rise of wholesale clubs.**

The clubs have two classes of members: wholesale and group. Wholesale members include retail grocers; restaurants; professional service providers, such as accountants and lawyers; and other business establishments. Normally, these firms use the purchases in their businesses and view clubs essentially as their wholesale suppliers. Members pay an annual fee to buy products at posted wholesale prices. In 1985, the fee averaged $25.00.

Group members are individuals whose employment by banks, credit unions, public utilities, government agencies, or any other organization designated by the club qualifies them for membership. These customers usually buy food and other products for home use. The inclusion of these group members, in particular, has enlarged the customer base of wholesale clubs over that of traditional food distributor cash and carries. Some clubs charge group members an annual fee. Those that don't usually require that members pay a stated percentage above posted wholesale prices, about 5 percent in 1985.

Most wholesale clubs stock 4,000 to 6,000 items. This compares with up to 25,000 items offered by conventional supermarkets and 30,000 to 50,000 items stocked by traditional discount stores. However, a club's range of items is broad—from microwave ovens to plastic trash bags. Within any product category, clubs stock only a couple of fast-moving, well-known brands. Grocery items account for 40 to 60 percent of clubs' sales, with general merchandise making up the remainder.

Included in their food lines are canned peas, trout fillets, and frozen french fries. In short, there is the range of products, though not the variety of brands and sizes found in supermarkets. Also offered are brooms, soap, paper towels, light bulbs, and similar products typically found in grocery stores.

Clubs' food lines are geared primarily to supply restaurants and other foodservice operations. Therefore, their lines include institutional sizes and packs, such as No. 10 cans of string beans (108 ounces) and prepared trays for quick heating and service.

Clubs' general merchandise lines include hardware, appliances, auto supplies, consumer electronics, clothing, and furniture.

## Warehouse Clubs in Profile

Whether a business or consumer, members of wholesale clubs will usually find everyday prices below those charged by any other type of retailer and, oftentimes, by many wholesalers and distributors. The products are almost always purchased directly from the manufacturer, often at discounted prices, and sold to the membership from the warehouse floor. Clubs do not guarantee daily availability of any item.

Many of the "frills" that would otherwise raise overhead costs are absent in wholesale clubs. Gone are the use of advertising; catalogs; fancy showrooms or fixtures; credit cards sales; sales help; bagging groceries; delivery service for large appliances, such as refrigerators and washing machines; and after-sale service.

Although clubs lack many amenities, one central feature of all clubs is the widespread use of computers in all phases of their operations, from preparing data bases of membership sales and demographics to tracking inventory and checkout scanning.

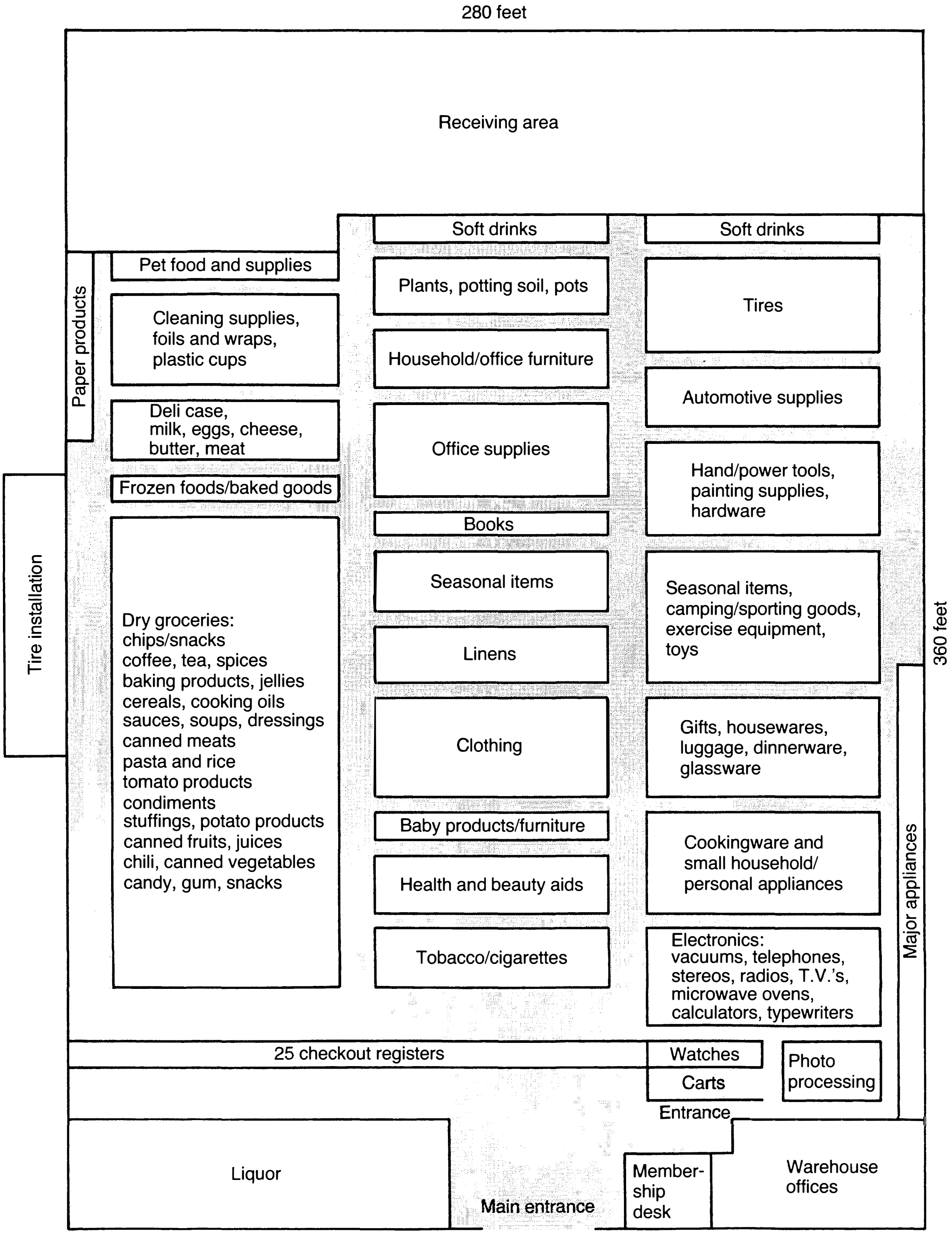
Sophisticated computer technology, the "bare-bones" format, and large sales volume form the core of clubs' operating efficiency. Price Company, the industry leader, generates annual sales of around $1,000 per square foot, but the typical club

**Table 1. Membership Wholesale Clubs Growing**

| Company | Operating as of July 1986 By region[1] NE | S | NC | W | Total | Expected by Dec. 1986[2] | Expected by Dec. 1987 |
|---|---|---|---|---|---|---|---|
| Sam's Wholesale Club (Wal-mart Stores, Inc.), Bentonville, AR | — | 31 | 4 | 2 | 37 | 45 | [3] |
| The Price Company, San Diego, CA | — | 3 | — | 22 | 25 | 30 | 40 |
| Costco Wholesale Club, Seattle, WA | — | 5 | 2 | 14 | 21[4] | 35 | 50 |
| PACE Membership Warehouse, Denver, CO | 1 | 13 | 2 | 4 | 20 | 25 | 35-39 |
| Super Saver Wholesale Warehouse Club, (A. Howard Wholesale), Monroe, LA | — | 13 | 1 | — | 14 | 21 | 36 |
| BJ's Wholesale Club (Zayre Corp.), Natick, MA | 8 | 1 | 3 | — | 12 | 15 | 25-27 |
| The Warehouse Club (Pay 'N Save Corp.), Skokie, IL | — | — | 9 | — | 9 | 14 | 19-21 |
| The Wholesale Club, Indianapolis, IN | — | — | 6 | — | 6 | 11 | 18-20 |
| Value Club (Southwest Merchandising), San Antonio, TX | — | 6 | — | — | 6 | 6 | 6 |
| Price Saver's Wholesale Club (The Kroger (Co.), Salt Lake City, UT | — | — | — | 5 | 5 | 9 | [3] |
| Makro Self-Service Wholesale (SHV Holding), Cincinnati, OH | 1 | 2 | 1 | — | 4 | 4 | |
| Buyer's Club, Aurora, CO | — | — | — | 2 | 2 | 3 | 12 |
| Club Wholesale (Elixir Industries), Boise, ID | — | — | — | 2 | 2 | 2 | 5 |
| D-Mart Wholesale Club, Salt Lake City, UT | — | — | — | 2 | 2 | 2 | |
| Member$ Warehouse, Winston-Salem, NC | — | 2 | — | — | 2 | 3 | 7 |
| Wholesale Plus, Plantation, FL | — | 1 | — | — | 1 | 1 | 1 |
| American Wholesale Club, Richardson, TX | — | 1 | — | — | 1 | 1 | |
| Save Club, Concord, CA | — | — | — | 1 | 1 | 1 | |
| Total | 10 | 78 | 28 | 54 | 170 | 228 | [3] |

[1]NE = Northeast; S = South; NC = North Central; W = West. [2]Company estimate as of July 1986. [3]No estimate available. [4]Costco operates two clubs in Canada, one in Alberta and one in British Columbia.

**Figure 1. Typical Membership Warehouse Layout**



averages between $400 and $600.

Clubs' labor costs average 5 percent of sales, compared with around 10 percent in conventional supermarkets. However, some clubs achieve a labor cost average of only 2.5 to 3 percent.

Labor-saving steps permeate every phase of operations. For example, clubs specify shipments on wooden pallets where possible, so that goods may be placed directly on the sales floor with minimum handling. Bulky items are displayed close to receiving docks. Restocking, a primary task of store labor, is accomplished using forklifts that pass up and down wide aisles.

Operating efficiencies are reflected in a minimal gross margin, resulting in prices that are hard to beat. The gross margin, or markup, is the difference between what the retailer pays for a product and its retail price. For a typical discount store, the markup is equal to about 30 percent of what the manufacturer charges for the product. Markups for conventional supermarkets are close to 20 percent, while those for department stores are 40. For wholesale clubs, on the other hand, the overall gross margins range from 8 and 11 percent, depending on the club's efficiency of operation and volume of sales. Margins on groceries range from 6 to 9 percent.

## Customer Appeal—Low Prices

Wholesale clubs operating profitably on low margins have created a niche that appeals to a legion of small businesses who use the clubs to stock their own outlets and who typically view the club as a wholesale supplier. For example, a small restaurant operator can buy one case of ketchup or even one bottle at a wholesale club. A full-service, general-line wholesale distributor, in contrast, requires larger minimum orders because of the high cost of servicing small accounts. However, there are some higher costs for the small business buyer—for example, the expense of picking up the goods from the club. Usually the large wholesale distributors deliver.

Clubs are also economical suppliers of stationery, filing cabinets, and other office supplies needed in professional offices. Considering the economy and accessibility of wholesale clubs, it is not surprising that small retailers, restaurateurs, and other businesses are the main customers, accounting for over 50 percent of all clubs' sales.

For some consumers, the discount prices offset the limited variety, drab decor, and out-of-the way locations. Clubs generally offer 20 to 40 percent lower prices than traditional establishments. For example, in the Washington, D.C., area in mid-1986, an 8.5-ounce package of Stouffer's Lean Cuisine glazed chicken with vegetables cost $3.29 at a large supermarket chain, but $2.39 at Pace Warehouse Club. Of course, customers' savings depend on the products they buy.

## The Industry Now...

Still in its infancy, the wholesale club industry is highly concentrated, with just four firms accounting for 75 percent of all sales. Price Company captured 41 percent of all club sales in 1985, Sam's accounted for 16 percent, Costco 11 percent, and Pace 7 percent.

Although sales concentration is high, the industry continues to be very competitive. Fueling the competition is rapid expansion by existing firms and entry by new firms. For example, all of the leaders scheduled new openings for the latter half of 1986, ranging from five locations for the Pace Membership Warehouse firm to 14 for the Costco Wholesale Club.

The geographical dispersion of the clubs also may figure prominently in shaping competition. Early in their development, clubs were concentrated on the West Coast. In 1983, that distribution changed substantially. The South now has 80 clubs, nearly half of the units operating in mid-1986. One result of this geographic expansion is direct competition among clubs. For example, the Makro Company was the sole firm operating in the Washington, D.C., area until Pace's entry in 1985.

Equally important in determining the state of competition in the industry is the entry of new firms. In the first half of 1986 alone, four new firms opened six clubs. Continuation of this trend will mean lower concentration in the future.

## ...And in the Decade Ahead

The success of wholesale clubs lies with their targeting a market that is not served or only partly served by existing businesses. Some industry observers estimate wholesale club sales at $24 to $29 billion by 1991, at least three times the 1986 level.

However, certain limitations could slow growth. Market saturation is one potential drag on wholesale club expansion. The population needed to support a club is estimated at 400,000. Thus, even areas with high population concentrations can support only a limited number of clubs.

Yet another possible brake on wholesale clubs' expansion is the competition from traditional wholesale establishments, supermarket chains, specialty stores, and other retail outlets that handle the same kinds of products. These firms can be expected to offer competitive prices where wholesale clubs encroach on their markets. Thus, these other outlets' lower prices, coupled with attractive decor, delivery, bagging, and other services, may limit the growth of wholesale clubs.

Profitability in a low-margin operation greatly depends on economies achieved through rapid inventory turnover and huge sales volumes. Faced with increased competition, both among themselves and from their more traditional counterparts, wholesale clubs may be tempted to loosen membership requirements, expand variety, upgrade decor, and add services to increase unit volume. The risk is that such deviations from the wholesale club format could increase the cost of operations, thereby negating their greatest strength—low prices.

For all of their similarities, clubs strive to differentiate themselves from each other. For example, Makro offers greater variety within product lines than its competitors. Sam's mails seasonal flyers to its members and is opening stores in smaller cities. Differentiation will assume greater importance as firms expand and find themselves in direct competition with each other and with traditional retailers. ☐