1.0 Executive Summary

Wal-Mart's unprecedented growth to become Americas #1 retailer has created positives and negative for both Wal-Mart and its customers. Wal-Mart's main focus is to reduce costs in every portion of the supply chain plus develop inventory management software that efficiently distributes products to its stores.

Since going public over thirty five years ago, Wal-Mart has tried to enter both markets that are well suited for its model and those providing the opportunity to gain a stranglehold over its competitors. Many believe Wal-Mart's unbridled growth has become the scourge of America while others feel it is the only place to shop.

Recently it seemed Wal-Mart's markets were exploited and the company was beginning to mature with fewer growth possibilities. In 2004, Wal-Mart turned its focus on 5 areas of growth to increase sales in the future.

The growth areas are:

1. **Pharmaceuticals.** This area will grow as seniors become a larger part of the market and Wal-Mart focuses on those that are uninsured or underinsured. Wal-Mart's "everyday low prices" will draw customers into the pharmacy increasing the likelihood of purchasing higher margin items.
2. **Consumer electronics.** Wal-Mart has swiftly moved to become the #2 consumer electronics retailer in the country. Wal-Mart will continue to grow by adding higher end brands, introducing its own private label and offering greater product selection.
3. **Banking.** Wal-Mart is still on the periphery of the banking industry. It has tried to enter the banking industry on numerous occasions. However, Wal-Mart has been rebuffed every time. Wal-Mart realizes how lucrative this market is and will continue to vigorously pursue this area.
4. **Fashion.** The Fashion market has great potential for Wal-Mart. A slight tweaking of the product mix will increase margins and attract an entire new market segment who prefer a higher level of quality.

5. **Retail Gasoline.** This market has been a huge success for Wal-Mart. They have captured 3% of the market in fewer than 10 years. Wal-Mart has plans for expansion using third party vendors and also branding under the Wal-Mart name.

These new growth strategies will allow Wal-Mart to energize it revenue and earnings growth to the point where it could go from a mature retail behemoth to a growth stock.

2.0 Wal-Mart's Growth

Wal-Mart's growth over the last decade is unprecedented -- the company has gone from a successful discount retailer to a dominant force no other retailer can ignore.

Wal-Mart went public on October 1, 1970. Since then its stock has climbed from 5 cents (split adjusted) to a high of $63 in March 2002. Recently, its' stock has dropped more than 20% reaching a low price of $42.31 on September 22, 2005. With $256 billion in sales this year through January 2006, it is the largest private employer in the United States, Mexico and Canada. It has also been the world's biggest company from 2001 to 2004.

In America, Wal-Mart manages nearly 3,000 retail locations made up of discount stores, neighborhood markets, and super centers. Abroad, they continue to expand with locations in Mexico, Britain, Japan, Canada, Germany and China. Eight out of ten American households shop at Wal-Mart at least once a year. Worldwide, more than 100 million customers visit Wal-Mart stores every week.

2.1 Pro-arguments for Wal-Mart's Growth

As Wal-Mart's chief executive Lee Scott likes to points out, Wal-Mart only represents 14% of total retail sales in America. It is not unusual for dominant firms in mature industries to command market shares of 30% or more. In theory, Wal-Mart still has room to grow.

Scott also points out that Wal-Mart's attention to site selection and targeting smaller towns keeps quite a number of these communities from becoming extinct. Wal-Mart saves the citizens literally billions of dollars as well as by creating hundreds of thousands of jobs. Millions of people are better off today than they would have been if Wal-Mart had never existed. Therefore, Wal-Mart's unabated growth is bringing greater prosperity around the world.

2.2 Con-arguments for Wal-Mart's Growth

Over the years, Wal-Mart has become a target of much criticism. Critics, including community groups, grassroots organizations, trade unions, and environmental groups believe Wal-Mart's success comes at the expense of employees, local communities, the economy, and the environment.

Wal-Mart is said to be harmful to local communities and local economies. A study by Emek Basker found that within five years of Wal-Mart's arrival, individual counties had lost an average of four small retail businesses, one midsized store, and one large store. The remaining retailers that survive often experience significant declines in revenue.

Wal-Mart is often criticized for substandard wages. 2003 wage analysis reported that cashiers earn approximately $7.92 per hour and work 29 hours a week. This brings in annual wages to only $11,948 without benefits.

Additionally, Wal-Mart has a bad track record of locating its stores with little regard for the community or the environment. Wal-Mart has gone as far as building stores on ecologically sensitive areas. The long-term effects can be devastating to the environment and to humans.

2.3 Who benefits from Wal-Mart's growth?

Suppliers. Wal-Mart lowers its operating costs through economies of scale in manufacturing and logistics, high volume purchasing, and efficient stock control. Their vast purchasing power also gives them leverage to force manufacturers to change their production process (usually to create cheaper products) to suit its wishes: a single Wal-Mart order can comprise a double-digit percentage of a supplier's annual output. Suppliers who meet Wal-Mart standards are extremely profitable.

Consumers. Low to middle class consumers visit Wal-Mart every week to take advantage of their "everyday low prices". Wal-Mart's growth means continued lower cost products to feed and provide for their families.

2.4 Who gets hurt from Wal-Mart's growth?

Small stores. Many smaller stores have gone out of business because of Wal-Mart. Wal-Mart often drives smaller stores out of business by selling similar goods at lower prices and has been found to engage in predatory pricing.

Small towns. Kenneth E. Stone of Iowa State University published several studies on Wal-Mart. One 1997 study found that small towns "lose up to 47 percent of their retail trade after 10 years of Wal-Mart stores nearby."

2.5 Forces to slow down Wal-Mart's growth?

According to A.T. Kearney, Wal-Mart's three-biggest sources of cost advantage are low corporate overheads, the efficiency of its supply-chain and, above all, low labor costs. Of these three, labor issues may prove the most difficult for Wal-Mart to handle.

The eroding of Wal-Mart's labor-cost advantage may slow down their growth. Labor costs in line with the competition will help level the playing field. In February, for instance, unionized grocery-store workers in southern California agreed to wage and benefit reductions following a five-month-long strike. This strike began after local supermarkets proposed to cut wages and benefits in preparation for Wal-Mart's entry into the market.

A second labor factor which might slow Wal-Mart's growth is staff turnover. Wal-Mart struggles to renew its 1.6 million strong workforce even though staff turnover has fallen from over 60% to 44% (which is close to industry averages). Yet even at 44%, they still must hire an astonishing 600,000 people every year simply to maintain their current size. As the company grows, recruitment becomes even more difficult, suggesting that Wal-Mart must further lower their turnover rate. However, retention puts pressure on costs with pay raises and better benefits.

Another force working to slow Wal-Mart's growth is the company's mounting legal and labor-compliance problems. At any moment, Wal-Mart faces about 8,000 lawsuits. The vast majority of these are personal-injury claims from employees. More material, given the sheer number of employees, are class-action suits. Wal-Mart's most recent annual report lists 33 punitive class-action suits alleging violations of the Fair Labor Standards Act, including forcing employees to work "off the clock" and failing to provide work breaks. Eight other punitive suits allege the firm failed to pay overtime, and a one, which could prove costly, alleges discrimination against female employees. The potential size of these lawsuits is 1.5 million plaintiffs.

3. Is Wal-Mart Targeting...

3.1 Is Wal-Mart Targeting Pharmacy?

Wal-Mart is definitely targeting the retail pharmacy market. In 2004, Wal-Mart was fourth in pharmacy sales, behind Walgreens, CVS, and Rite-Aid. In 2005, they moved into the third slot behind only Walgreens and CVS.

2005 Retail Drug Sales

* Walgreens- $37.5 billion
* CVS- $30.6 billion
* Wal-Mart- 25.7 billion[1]

Wal-Mart is successful in the retail pharmacy market. In fact, last year pharmacy sales made up a significant portion (11.9%) of their $315.65 billion in total sales revenue.[5] A segment this significant warrants attention. In fact, Wal-Mart not only recognizes the importance of pharmacy in terms of sales, but also in terms of driving customers to other parts of the store. They know people trust their pharmacist and take their recommendation to purchase products from other sections of the store- Health & Beauty, Sporting Goods, Grocery, etc. This characteristic is unique to the in-store pharmacy.

Also, Wal-Mart recently announced an ad campaign promoting their pharmacies. [3] The campaign aggressively targets busy Moms and seniors. Devoting advertising dollars to pharmacy indicates Wal-Mart's belief in future profitability.

Lastly, the retail pharmacy's importance is seen in Wal-Mart's store design standards. They've added pharmacies to many of their Sam's CLUB stores and continue to do so. In fact, the pharmacy is a standard component of prototypical design for Sam's CLUB and super centers. [2] Pharmacy is definitely still a target for growth.

Strategy for Future Growth

This is a smart market to focus on given the ever growing prevalence of disease in the U.S. Global sales values for the drug retail sector were $372.5 billion in 2004 and are predicted to increase 5.5% from 2004-09. [1] However, Wal-Mart must take pro-active strategies to achieve growth.

Growth strategies we recommend include:

1. **Continue to target seniors**. This population requires more prescription and OTC drugs each year and has the money to buy them. In fact, seniors in the U.S., 55 and over, control 70% of the disposable income.[4] In other words, one third of the country controls two thirds of

the disposable income.

Also, more seniors are visiting their local retail pharmacy. With the advent of Medicare Part D coverage, almost 39 million Medicare beneficiaries are enjoying prescription drug insurance for the first time in years.[6] This means a new influx or patients for pharmacy retailers.

More customers translate into higher prescription drugs sales; however, the gross margin on these sales is now much lower thanks to Medicare Part D. These seniors are moving from the higher-paying Medicaid coverage to the frugal reimbursement practices of the privately run Medicare prescription drug plans. But lower gross margins are a small price to pay in order to get seniors into the pharmacy. Once there, they are likely to spend money on products with higher margins- vitamins, hair care products, greeting cards, and other front-end products.[6]

This population must be pursued aggressively. Wal-Mart should market to them through print, TV, healthcare events in their pharmacies, and even web sites. According to the Pew Internet & American Life Project, Americans age 65 and older now represent the fastest-growing online audience.[7] Online marketing is an effective way to reach this population and get them in your pharmacy.

2. **Control pharmacy operating costs and target the uninsured**. Wal-Mart is the master of controlling costs through supplier side management and quantity discounts. These savings are usually passed down to customers in the form of everyday low prices (ELDP). These prices make Wal-Mart an attractive provider for those who don't have medical insurance. These customers pay out-of-pocket costs anyway and are definitely interested in the lowest price on prescription drugs, if they can afford them at all. Low OTC drug prices will also attract this group into the pharmacy.

Current data tells us 43 million Americans lack heath insurance.[8] This many people can't be ignored. The private and public sectors are under increasing pressure to hold down prescription drug costs, so uninsured Americans buying power for healthcare is likely to increase. It is a market segment worth watching.

3. **Stress the convenience factor**. Eighty-four percent of Americans either shop regularly or once-in-a-while at Wal-Mart. [9] This many people come for a variety of reasons, but one major draw is one-stop shopping. You can find everything at Wal-Mart- groceries, general merchandise, banking, dry cleaning, fast food, etc.

This aspect must be emphasized in their pharmacy marketing. Messages to target groups should emphasize the convenience of meeting all of your shopping needs in one place, including filling your prescriptions. The concept is especially attractive to seniors, the most valuable target market for retail pharmacy, because they don't want to travel all over town to shop.

4. **Build consumer trust.** This is crucial to a retail pharmacy. People are more likely to conduct business with a pharmacy they trust. They want to know a pharmacy's products and services benefit them. Loyalty is built when customers perceive the pharmacy is acting in their best interest. In fact, a 2005 survey of more than 6,000 consumers in Great Britain, conducted by Carlson Marketing Worldwide, revealed that 85 percent of respondents said they would recommend a company with which they have a trusting relationship.[10] Trust builds repeat business and word-of-mouth referral.

Wal-Mart marketing messages should emphasize they carry name brand medications at the lowest cost. Wal-Mart should also organize healthcare events and information sessions to demonstrate they have the customer's best interest at heart- blood pressure screenings, education sessions over insurance benefits, preventative healthcare advice (recipes, exercise recommendations, etc.).

5. **Locate the pharmacy department to a more visible location**. The in store pharmacy can drive sales for other departments. For example, pharmacists can recommend purchases from other areas of the store- grocery, exercise equipment, health & beauty, etc. Because of the trust people usually have with their pharmacist, these recommendations are likely to lead to high margin sales. This relationship is unique to in-store pharmacies, so it makes sense for them to locate in a high profile location within the store.

6. **Market advantages of technology to customers.** Wal-Mart has improved the convenience of using their pharmacy through technology. They offer AutoPay, a quick pay system used at the pharmacy counter, and a national database ensuring customers can fill their prescriptions at any Wal-Mart.[11] They are also taking steps to make it easier to use Medicare approved discount cards.

These are important conveniences to customers and should be marketed more effectively.

Effect on Competing Retailers

As in other areas, Wal-Mart either improves everyone's efficiency or drives them out of business. Their state of the art technology system lowers distribution costs and increases supplier efficiency. USA Today recently stated that Wal-Mart's efficiency had an indirect effect on the economy because it forces competition to rethink ways to lower costs and prices.[12]

This is certainly true for Wal-Mart's retail pharmacy competition. Walgreens and CVS must offer the same products and services (and more) to stay ahead. They are successful at the moment, but Wal-Mart forces them to continually re-evaluate and trim costs wherever possible. Walgreens and CVS are large enough that they can effectively compete on cost by utilizing quantity discounts and influence over suppliers, but small shop pharmacies face a much more daunting task to stay competitive.

The small shop pharmacy must rely on a higher level of service to remain competitive. It just isn't possible to match distribution and supplier costs. In an interview with Dick Storseth, owner of Village Pharmacy in Amarillo, he outlined strategies for the small pharmacy to compete.

1. **Develop customer relationships**. Village Pharmacy takes time to counsel patients and ensure they understand the medications they are taking. They make the extra effort to provide outstanding customer service.
2. **Provide value added services**. These include compounding medications, offering immunizations, cholesterol testing, diabetes clinics, delivery, etc. Bigger chains are moving this direction, but right now the small pharmacy has first mover advantage which creates customer loyalty.
3. **Emphasize the convenience of a smaller pharmacy**. Village Pharmacy recently used commercials showing customers going through the hassle of using a big chain retail pharmacy. The commercial showed customers hiking through a huge parking lot, standing in a long line, and waiting 30 minutes to an hour to have their prescription filled. The commercial's purpose was to let customers know these hassles aren't found in smaller pharmacies.
4. **Educate customers about contracted prescription drug prices**. Patients who have an insurance card pay the same amount for prescription drugs at Wal-Mart as they would at Village Pharmacy. However, not all patients realize this. Wal-Mart and the big chains have done an excellent job convincing customers that they always have the lowest price on everything, even prescription drugs.[13]

If small pharmacies are to stay in business, they'll have to adopt these types of strategies.

3.2 Is Wal-Mart Targeting Banking?

Yes and no. Wal-Mart now says they're not targeting banking. However, their past actions and even their current actions lead critics to believe otherwise. As D. Anthony Plath, a finance professor at the University of North Carolina at Charlotte, said "It's not a question of if Wal-Mart's going to be a bank, it's a question of when".

Federal Regulations

WAL★MART®
ALWAYS LOW PRICES. Always.

Under United States banking regulation, commercial entities are prohibited from entering the banking field. The logic for this prohibition is that a commerce and banking mix would create an unfair and risky concentration of power. Conflicts of interest could arise. For instance, will credit decisions be objective? Would credit be offered to competitors? In a worst case scenario, the Federal Deposit Insurance Corp. (FDIC), the federal fund that insures each consumer's bank deposits, could be put at risk by the failure of a large commerce and banking company. According to Rep. Jim Leach (R-Iowa), "What's really at issue is the nature of the American economy. If such concentrations are allowed, you could have our largest banks combined with our largest retail companies and high-tech companies and create questions about how credit is allocated. It has enormous consequences for competition, and I think America would become less competitive in the world."[14]

Wal-Mart's Maneuverings

Despite these regulations, Wal-Mart appears undaunted.

In 1998, Wal-Mart attempted to convert Oklahoma's State Bank and Trust Company, a bank owned by the Walton family, into a national thrift. Moving from a bank charter to a national thrift would have allowed Wal-Mart to open unlimited branches. The thrift's plans were to locate these branches in Wal-Mart stores. Wal-Mart was eventually stopped in 1999 by the Gramm-Leach-Bailey Act, which banned thrift ownership by commercial entities. [15]

Three years later Wal-Mart resumed its banking aspirations with an attempt to establish a banking partnership with Toronto-Dominion Bank. This attempt ultimately failed due to Wal-Mart's failure to obtain the regulatory approval required by the Office of Thrift Supervision.

In 2002, Wal-Mart again tried unsuccessfully to enter the banking industry. Wal-Mart pursued a takeover of California's Franklin Bank; however, state laws were passed that banned non-financial institutions from owning California industrial loan corporations (ILC).

In its latest move, last July Wal-Mart filed an application with the state of Utah and the FDIC to operate an ILC in Utah. Wal-Mart claims the ILC will only process its internal credit card, debit card and electronic transactions. Wal-Mart claims the result would be that it would save millions of dollars in fees that are currently paid out to other banking institutions. However, the concern among critics is that Wal-Mart is looking to exploit a regulatory loophole – if Wal-Mart's ILC application is approved Wal-Mart only has to refrain from providing full banking services for 3 years. After a 3 year period, Wal-Mart can change its business plan and target the full spectrum of banking services without any additional scrutiny.

In light of Wal-Mart's latest attempts to enter the banking industry, concern has mounted from the Federal Reserve to the halls of Congress. No less than Alan Greenspan has said "The ILC exemption is now the primary means by which commercial firms may control an FDIC-insured bank engaged in broad lending and deposit-taking activities and thereby breach the general separation of banking and commerce." Greenspan has urged Congress to close the loophole because it "provides the corporate owners of exempt ILCs a significant competitive advantage over other types of banking institutions, and creates an un-level competitive playing field among banking organizations."[103] Congress might just be listening. On July 10, Congressman Barney Frank (D-MA) and Paul Gilmor (R-OH) introduced the "Industrial Bank Holding Company Act of 2006" which is designed to prohibit purchase of ILCs by commercial entities. According to Frank "the proliferation of new ILC applications is creating a situation where Congress must set appropriate policy to preserve the integrity of the banking system."[17]

Strategy for Future Growth

While Wal-Mart continues its attempt to push into the banking industry, it is already offering several tangent services. Four years ago, Wal-Mart began offering money orders. It has since added payroll-check cashing and money-transfer services. With just these services, one estimate suggests that Wal-Mart has entered a market worth at least $5 billion a year in fees. These services alone offer significant room for growth.

Needless to say, should Wal-Mart clear the regulator hurdles, banking will prove to be an even more lucrative growth opportunity.

Growth strategies we recommend are:

1. **Serving the under-served.** Wal-Mart's potential market includes those that aren't currently being served by the banking industry. Wal-Mart customers' average income is below the national average and more than one-fifth of Wal-Mart's customers do not have a bank account. In fact, in the United States 56 million people do not have a bank account.[18] Wal-Mart can tap these customers with affordable banking, credit cards and mortgages.

2. **Move up the ladder.** One of the big fears critics have is that Wal-Mart won't stop at

targeting low income groups. If Wal-Mart moves beyond low income groups, Rongal Ence Vice President of Independent Community Bankers of America suggests “there's no doubt in my mind they'll be able to do to community banks the same thing they've done to the local grocery store and the local hardware store and the local clothing store.” [18] Wal-Mart’s history of efficiency and low prices could be universally appealing. As Charles Fishman, author of a new book, "The Wal-Mart Effect," states: "I don't know if Wal-Mart would be good or bad for banking in the long run. But I'll bet ATM fees would come down pretty quick." [14] In addition to checking and savings, Wal-Mart will be offering credit cards, auto loans and mortgages.

3. **Compete on more than just price.** Everyone knows Wal-Mart competes on price. Currently, their wire transfer to Mexico is less than $10. A Western Union wire transfer costs $14.99. Wal-Mart’s money orders are less than $0.50 when most banks charge more than a dollar. And, Wal-Mart cashes checks for $3 without the worry of being suckered into high interest short term loans.

But for Wal-Mart to appeal to more than just low income groups, Wal-Mart must compete on more than just price. Wal-Mart must also compete in terms of convenience. In-store banking will be convenient for those already at Wal-Mart to shop. However, Wal-Mart must offer convenient ATM machines and drive through locations to serve those with the sole mission of banking.

Effects

Should Wal-Mart gain approval for a move into the banking industry, the results will be mixed.

National Banks – National banks like Wells Fargo, Bank of America and Wachovia would be forced to improve their efficiency to better compete with Wal-Mart. These national banks already have a significant infrastructure and large customer base; however, Wal-Mart’s potential entry into the market will mean new competition from a company that has a history of winning.

Local Community Banks – The reality is that Wal-Mart has a cost advantage over local community banks. Wal-Mart can offer lower cost, higher paying checking and savings accounts. Local community banks will be forced to reposition themselves or they may fall by the wayside.

Western Union – Wal-Mart is currently competing with Western Union through its partnership with MoneyGram International. Western Union has 196,000 agents in 190 countries and controls about 22% of the estimated $65 billion that flows out of the US. In contrast, Wal-Mart/MoneyGram has 75,000 agents in 170 countries and only controls 10%

of US money transfers. Western Union currently holds a competitive advantage over Wal-Mart; however, Wal-Mart has only been in the business for a handful of years.

Target – While Wal-Mart holds several advantages over retail rival Target, one area where Target is in front of Wal-Mart is banking. Target pursued and was granted a Utah ILC. While Target got out of the gates quicker, their approval might just help Wal-Mart get their foot into the banking industry.

Consumers

At the least, the forecasted in-house efficiencies of Wal-Mart processing their own 2.5 billion credit and debit card transactions may result in lower prices for consumers. In a best case scenario, Wal-Mart may force the banking industry to streamline their processes and offer more competitive services at a lower cost to consumers.

3.3 Is Wal-Mart Targeting Fashion?

Definitely. Wal-Mart's apparel offering improved dramatically in 2004. Comparing its merchandise with competitors, including Target and Kohl's, shoppers can find close parallels. In terms of its sourcing and distribution capabilities, Wal-Mart's potential to lead with well-designed apparel at rock-bottom prices is unmatched. But Wal-Mart is not complacent about its position in fashion. With a 40 to 50 percent share of all US basic apparel sales, it is striving for an even larger share and better quality merchandise.

They are not only still targeting fashion, but also stepping up in the area. The concept of Wal-Mart's fashion has greatly expanded.

2005 Retail Fashion Sales

* Target - $3.5 billion
* Abercrombie & Fitch - $1.634 billion
* Wal-Mart - $191.8 billion

Wal-Mart is developing additional fashion products for customers of its Metro 7 fashion line. The Metro 7 line will soon include shoes and jewelry along with the introduction of organic clothing.

Wal-Mart's introduction of Metro 7 Apparel, a line for women, has attracted more upscale customers, an integral component to Wal-Mart's future growth. Metro 7 is carried in 500 Wal-Mart stores and the company plans to add another 1,000 stores by September 2006. In April, the line expanded to include shoes and accessories. The clothing line did so well that Wal-Mart struggled to supply existing stores.

Strategy for Future Growth

Wal-Mart aims to grow sales by offering merchandise that appeals to higher income customers and the customers who already shop in their stores. They want customers to shop Wal-Mart for all their needs from groceries to Metro 7 apparel and accessories.

Actually, Wal-Mart has already started targeting higher-income groups by selling high-end electronics and introducing Metro 7 Apparel.

The biggest problem facing Wal-Mart's future growth in the fashion area is whether Wal-Mart's low-price, commodity approach is too restricting for a fashion brand. Wal-Mart is known for price, but that may not be the primary goal for higher end customers when buying fashion apparel.

Growth strategies we suggest include:

1. Choose the appropriate target market. Wal-Mart needs to re-define the target market clearly before adopting a new market strategy.

Women 35 to 60 years old compose a very large part of their current fashion consumers. And these baby-boomer women who battle middle-age spread do not want to shop online or via catalog, since they prefer trying clothes on. As a discount retail conglomerate, these current customers are the primary target.

But Wal-Mart's expansion plan into Metro 7 clothing line is targeting the fashion-savvy female customers with an urban lifestyle. Wal-Mart should not neglect their primary target while expanding into this new market.

2. New marketing. Their advertising and promotion strategy, which has been about price, convenience and friendly people, must be re-evaluated to appeal fashion-savvy customers.

3. Create a wonderful shopping experience for consumers. With increasing gas prices, shoppers tend to consolidate trips to do more at a single location. On the other hand, fashion-savvy shoppers are more concerned about the whole shopping experience rather than just getting the "everyday low price." These consumers compare Wal-Mart's offerings to the competition.

Therefore, less merchandise stacked at the ends of aisles, faux hardwood floors in apparel sections, and more room between racks must be made a part of a mandate for a more attractive shopping experience. Also, customers looking for upscale goods need to be able to easily find them. Better signage and more fashionable merchandise displayed closer to aisles is needed.

4. New merchandise. More-affluent shoppers still want to save money, but their higher incomes make them more sensitive to fashion trends.

Wal-Mart must keep their finger on the pulse of the fashion industry. They need to be aware of current styles, trends, and the latest fashions.

5. Committed to value. Despite the new appeal for upscale consumers, Wal-Mart must maintain commitment to value in fashion. This satisfies their core of price-conscious customers who have made them the biggest retailer in the world.

6. Integrating different brands. This could be a great challenge for them. After all, women's Hilfiger cardigans average $60, while the most expensive sweater at Walmart.com is $19.94. However, having a wider selection of merchandise brings more customers into the store.

Effect on Competing Retailers

As Wal-Mart modifies its merchandising strategy, this list of top co-tenants could very well change. Some fashion retailers, such as Cato or Fashion Bug, could retreat in some markets if Wal-Mart continues to expand its own fashion lines.

Because Wal-Mart generates an enormous amount of traffic, many competing retailers now reside around it in order to corral the overflow of shoppers seeking styles and brands not available in Wal-Mart. For example, Sally Beauty Supply offers a few products similar to Wal-Mart's, but they do offer much more selection. If someone is looking for specific beauty items not be found in Wal-Mart, Sally Beauty Supply is likely to have them.

The most frequent Wal-Mart co-tenants are listed in the following table:

Most frequent Wal-Mart co-tenants

	% in Wal-Mart centers	No. of stores	Avg. store GLA
Sally Beauty Supply	26%	303	1,600 sf
Payless ShoeSource	25	295	3,000
Dollar Tree	25	290	8,000
RadioShack	24	288	2,400
GNC	20	231	1,500
Subway	18	216	1,200
Fashion Bug	17	198	8,000
Cato Fashions	15	174	6,000
McDonald's	12	137	3,000
Friedman's Jewelers	11	133	1,800

Source: National Research Bureau/CoStar Group

However, when Wal-Mart adopts the new strategy in fashion area, those competitors who used to steal trips from them would be dramatically hurt.

On the other hand, other competitors of Wal-Mart in the fashion area would get hurt too, because of Wal-Mart's "everyday low price" and their loyal customers.

In order to survive in the competition, they need to adopt the following strategies:

1. Effective promotion. Due to EDLP, Wal-Mart doesn't put items "on sale" to generate traffic or compete with other retailers. Thus, these smaller companies should take the advantage of sales and promotion to beat Wal-Mart.

2. Greater customer service. People get more attention in small retailers to satisfy their individual needs. Outstanding customer service leads to loyalty and retention.

3. Provide value added service. In the fashion industry, customers want expert advice. For example, some customers want to know what kind of makeup is most suitable for the clothes they purchase.

3.3 Is Wal-Mart Targeting Consumer Electronics?

With a vengeance. Wal-Mart is pushing full steam ahead and making further inroads into a $100 billion industry it seeks to dominate. In 2004, Wal-Mart became the nation's No. 2 consumer electronics retailer moving ahead of Circuit City Stores Inc. With electronic sales of $12.11 billion (not including $2.07 billion at its Sam's Club chain), Wal-Mart has its sights set on industry leader, Best Buy Co (2004 sales of $20.75 billion).

Strategy for Future Growth

To catch Best Buy and compete with mass market retailers like Target, Wal-Mart is taking a new approach – moving upscale. In many ways, Wal-Mart has saturated its target market of working class, price sensitive consumers. According to Wharton marketing professor Xavier Dreze, now that Wal-Mart has conquered the value end of retailing, its options are limited. "They are going upscale. It's the only choice available," he says. "They have expanded to the point where they can't expand in the U.S. anymore. If you can't grow by reaching more people, you have to grow by selling more -- and more expensive -- [merchandise]." Wharton marketing professor David Bell elaborates "Wal-Mart is sending a signal that they are about more than price. They have played price. Now they want to play quality and broaden their image."[24] In consumer electronics, this upscale push is a key strategy.

Growth strategies we recommend include:

1. **Wide selection of top products**. Previously, Wal-Mart carried televisions from second tier manufacturers like Sceptre, Tatung, and Sampo.[22] As part of gaining greater market share, Wal-Mart has redefined its consumer electronics inventory. Thin is in and brand names abound. Not only has Wal-Mart greatly expanded its selection of LCD and plasma televisions, it has done so by adding top brands like Sony and Panasonic. In addition, Wal-Mart has introduced iLo, a cost conscious house brand. In order to compete with Best Buy, Wal-Mart must have a well rounded selection of quality products.

2. **Extended warranties**. The real profits in consumer electronics are found in extended warranties. These are the expensive protection plans offered on big ticket electronics items. And they accounted for more than one third of Best Buy's operating profit and all of Circuit City's. Wal-Mart must continue to attack this area of consumer electronics. Wal-Mart currently offers extended warranties that on average are 50% lower than Best Buy or Circuit City.

3. **Create a Buyer Friendly, Higher End Environment**. To compliment its new electronics, Wal-Mart is creating a more buyer friendly, higher end environment. These upgrades include more appealing aesthetics and more floor space devoted to consumer electronics. The entire electronics department is visible at eye level thanks to lower shelves and wider aisles. Additionally, customers will be treated to higher quality displays. When selling flat panel television with prices upwards of $2,000 to $3,000, Wal-Mart has to engage its customers and provide more than a discounter's environment.

4. **Multi-Channel Sales**. To date, Wal-Mart has largely fumbled online sales. While Wal-Mart exceeds Target in overall sales, Wal-Mart falls behind Target in online sales according to Advertising Age. In 2004, Target generated 25% growth in online sales compared to only 8% for Wal-Mart. Target also grew its online audience 83% compared to a paltry 4% growth for Wal-Mart. Additionally, Advertising Age reported that the average per-shopper sale on Target.com was $151 compared to only $59 at Walmart.com. For Wal-Mart to grow consumer electronics, it's going to have to make a commitment to maximizing online sales.

Effect on Competing Retailers

Wal-Mart's effects on the consumer electronics industry are far reaching. Wal-Mart is crushing mid to high end electronics retailers and Best Buy can hear the footsteps from behind.

Smaller electronics specialty stores like Tweeter Home Entertainment Group Inc. and Ultimate Electronics Inc. are in trouble. Both companies have suffered numerous quarters of losses and their stocks have stumbled up to 90% off all-time highs.

For electronics stores to compete they must "find the next hot product or embark on an extreme form of customer service to differentiate themselves" according to Rob Wilson, an analyst at Tiburon Research Group. [24] While these are tough times for electronics stores, many are attempting to serve a higher end audience with an augmented product. Electronic stores now find growth opportunities in services like customization, home installation and superior customer service. For instance, Wal-Mart falls short in sales associates' technical knowledge. CompUSA Chief Executive Larry Mondry points out that shoppers who want to integrate their big-screen HDTVs with their computers, install cables and cut holes in the wall "can't go to Wal-Mart." Unless a customer knows exactly what he/she wants, Wal-Mart is very unlikely to match the know-how found a specialty stores.

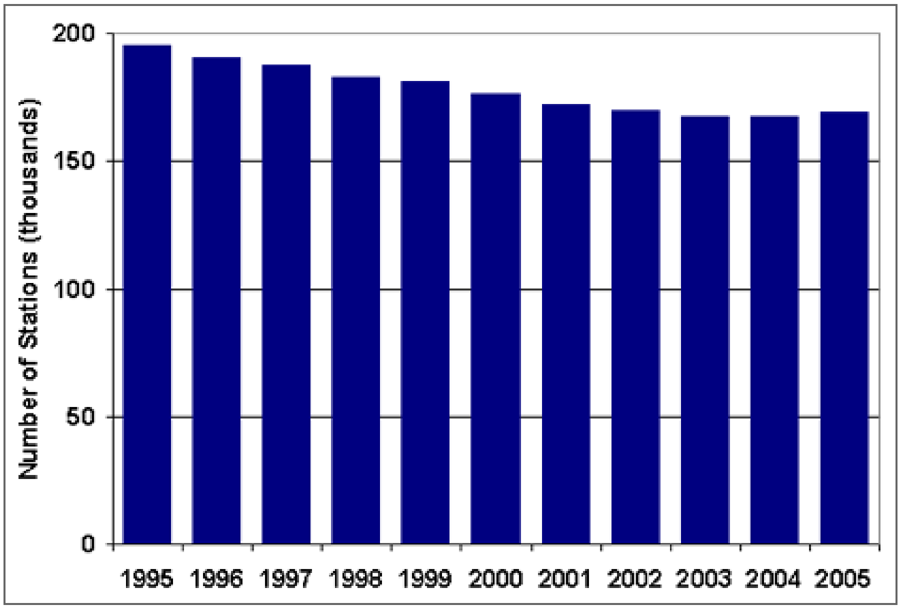
While mid to high end electronics retailers attempt to re-carve their niche in the consumer electronics industry, industry leader Best Buy has woken up to the Wal-Mart threat. When Wal-Mart moved ahead of Circuit City and into second place, Best Buy started to respond. Best Buy initiated a "customercentric" makeover of its stores. However, this effort has largely failed. On the other hand, Best Buy has found success with home installations and customer support. Plus, Best Buy already had the head start on Wal-Mart and they serve a completely different demographic. Best Buy serves a higher end market - 25.5% of Best Buy's customer made over $100,000 compared to only 8.9% of Wal-Mart's. Despite these initial advantages, Best Buy should continue to maximize their superior selection, technical knowledge and high-margin services.

3.4 Is Wal-Mart Targeting Gas Sales?

Definitely. Wal-Mart entered the retail gas business in 1996 by signing a lease agreement with Murphy USA to supply fueling stations at designated Wal-Mart and Sam's stores. By 2002, Murphy had 500 stations in 20 states operating on Wal-Mart properties. This number has expanded to 1,555 with Wal-Mart directly operating 300 of these sites for its distribution facilities. [1]

The number of retail gasoline stations in the United States rose from 167,000 in 2004 to 169,000 in 2005, although the number of station significantly decreased from 1995. The decrease in stations was caused by the mergers of many large oil companies including BP/Amoco, Exxon/Mobil and Conoco/Phillips. As the chart shows, 2004 to 2005 is the first increase in new gas stations since 1995. This reversal is due to practically every new supermarket and hyper mart including a fueling station.[2]

Gasoline Stations in the United States, 1995–2005



Strategy for Future Growth

Wal-Mart's experiment of using third party lessee's has been an unqualified success. They are now installing Wal-Mart branded fueling stations in Virginia and Missouri. The plan is to have 200 to 300 locations in the next year and 500 by the end of the decade. With Wal-Mart's distribution capabilities, adding fuel deliveries to its stores is the logical next step in its corporate growth strategy. Wal-Mart has been accused of selling gas under cost as a loss leader, which is illegal in many states. It is apparent even in the Amarillo market that Wal-Mart is willing to price gas 10¢ below the market to draw in customers.[3]
Growth strategy recommendations include:

1. **Focus on company branded stations.** Wal-Mart should follow its corporate strategy by squeezing every penny out of the retail gas business. If they deal directly with refiners they can remove the middle man and create a larger margin from this segment.
A typical Wal-Mart sells between 300.000 and 600,000 gallons per month with a high traffic store selling 1 million gallons per month.[4]

2. **Purchase a refining/marketing company.** They can retain the refining and distribution portion of the company and dispose of the exploration and production divisions. This would be a good time to do this because the refining division for Murphy is losing money and it could be acquired for a discount. Murphy's 140,000 barrel/day refining capacity would supply about half

of Wal-Mart's needs. The acquisition of a company about 50% larger than Murphy in the west allows Wal-Mart to meet future needs for refined product from coast to coast.

3**. Provide gas discounts by showing purchase receipt.** Stores could provide a 3-10 cent discount for customers buying gas after shopping at that particular location. This gets around the loss leader laws because they would not be advertised prices. Discounting gas is shown to create a bigger draw than discounting individual products.

4. **Add self serve car washes.** Car washes generate more profit than anything Wal-Mart sells. The main costs are water soap and electricity. Promotions discounting gas a few cents after a full service car wash help improve gas margins.

5. **Capture Convenience Store business.** Since Wal-Mart's are located in convenient locations and the fueling stations are placed on the outer perimeter of the stores, customers do not have to fight traffic to reach these locations. Each fueling station should include a store that has the most desirable products contained in a convenience store. With cheap gas and products most people run to the C store for Wal-Mart could add incremental sales by adding this to all stores selling gas.

Effect on competing retailers:

Wal-Mart knows gasoline sales not only provides an additional revenue stream but according to a study done by Costco, customer visit frequency was 4 times per month for locations with gas compared to one visit per month for locations without gas.[5]

Wal-Mart's pricing strategy is difficult for the traditional convenience store to overcome. Most C store locations are in high traffic areas which come with a hefty price tag. This requires the store to have higher margins to compensate for the smaller store size and hefty rent for the premium location. Also the average C Store will sell 80 to 100,000 gallons per month, 3 to 6 times less than the normal Wal-Mart.

The Convenience store business will need to do the following to help reduce eroding sales:

1. **Emphasize the C in Convenience.** Ensure stores are fully staffed with competent personnel so the customer is in and out without any hassles. A pleasant experience will always make customers return.

2. **Optimize the restaurant section.** Nothing drives business away from a C store quicker than a restaurant that takes a long time to fill orders. This keeps the parking lot full of restaurant customers driving paying convenience store customers away. The restaurant ultimately drives customers away and the C store loses the incremental business the restaurant was supposed to bring in.

3. **Consolidation.** This is least preferable, but in times of ever decreasing margins larger organizations are better equipped for competition. C Store companies are consolidating to create efficiencies with suppliers of fuel and groceries. Consolidation also allows companies to sell off duplicate sites as Toot-N-Totum is currently doing after its purchase of the Phillips Stations. This provides millions of dollars in cash which can be used to upgrade remaining locations.

4. **Additional Signage.** Most C stores do not have adequate signage to advertise specials in the stores. Large signs around the awning of the fuel island will give the visibility needed to properly display sale items.

5. **Free Gas promotions.** Have gas promotions in conjunction with your highest grossing products. An example would be $5 of free gas with the purchase of a carton of Marlboro's or buy three 12 inch subs and receive $3 of free gas.

4. Is Wal-Mart Too Big?

Yes and no. From an antitrust perspective, Wal-Mart is not too big. Sure they have 1.3 million employees and sell more products than many of the leading retailers combined. In fact, it is even hard to find companies to compare them with because they are so large. However, this size doesn't warrant antitrust legislation.

The Robinson-Patman Act of 1936 was passed to protect small retailers from the Wal-Mart of their day, the Great Atlantic& Pacific Tea Company. But today's antitrust interpretations have moved away from the philosophy of protecting the little guy. Current rulings show the courts don't view this legislation's primary purpose as to protect smaller companies from larger ones. Wal-Mart really has a lot of latitude to do what they want as long as they continue to provide low prices to customers.[14]

From a labor perspective, however, Wal-Mart's size may cause problems. With over a million employees, issues of recruitment, unionization, and management become difficult to handle.

Wal-Mart added 267 new super centers in 2005. Each of these stores employs approximately

350 people, creating almost 100,000 positions. Granted, most of these are low skills positions, but the sheer volume creates a substantial number of management and technical positions (pharmacy, IT, engineering) to support these stores. Research tells us by 2010, the U.S. will face a shortage of 12 million qualified workers, mostly in the science and engineering fields.[15] A company is only as good as the people it hires and Wal-Mart faces a huge recruitment challenge at their current growth rate.

One million plus employees also means increasing pressure to unionize. Wal-Mart has successfully fought unionization for years. But how long can they resist?

Lawsuits stemming from unfair labor accusations are not helping them in their battle. As more of these continue to surface, it will become more difficult to stop employees from organizing. However, to Wal-Mart's credit, they are fighting an effective battle so far. They recently started Working Families for Wal-Mart (http://www.forwalmart.com), a group funded primarily from Wal-Mart to combat two political-style campaigns launched by unions.[16] These union campaigns attack Wal-Mart for what they say are low wages and skimpy benefits. The Wal-Mart response to these accusations is working, because a new study released on June 29, 2006 found that most Americans like Wal-Mart and almost 80 percent of its employees do too.[17]

It is interesting to see the battle, but as the size of Wal-Mart increases, especially as they enter the urban market, the battle to keep labor unorganized will prove to be more difficult.

Lastly, the sheer number of employees has to become unmanageable at some point. Inefficiencies and layers of management will eventually eat away at profits and make Wal-Mart vulnerable to other quicker responding organizations.

Granted, no one has ever done a better job of managing size than Wal-Mart; however, there is an upper limit.

How Does Wal-Mart Affect the Competitive Arena?

The overall impact Wal-Mart has on the competitive arena is positive, especially from a consumer standpoint. Their relentless pursuit of cost-cutting in their distribution and supplier channels has resulted in lower prices for the consumer- Everyday Low Prices (ELDP).

Critics argue that these low prices are to blame for low retail wages, thousands of people driven out of work, and shoppers who are increasingly restricted to merchandise Wal-Mart chooses to sell. The jury is still out on these issues; however, there is no doubt that Wal-Mart forces businesses to compete smarter and more efficiently. It requires small business to find niches and services Wal-Mart can't duplicate. It motivates the other big box stores to continually improve and continual improvement and greater efficiency ultimately benefit our economy. In fact, New England Consulting estimates that Wal-Mart saved U.S. customers $20 billion last year alone, and when you factor in price cuts other retailers made to compete, the total savings approach $100 billion.[14]

On the supplier side, it has been a mixed blessing. For sophisticated suppliers with good data and scale, Wal-Mart as a customer is extremely profitable. Many suppliers must basically choose between their way or the Wal-Mart way. Suppliers who don't manufacture the Wal-Mart way are forced to look for other customers.

There are pros and cons of their impact on the competitive environment; however, the overall contribution is positive. Wal-Mart has made it a very tough competitive environment, but one that ultimately benefits customers, the economy, and some suppliers.

5. Competitive Strategy?

Competing and surviving against Wal-Mart is a daunting task. There is no question they are a retail force and have achieved unparalleled success. However, it is possible to compete. Many businesses have folded in Wal-Mart's wake, but many continue to succeed.

In his book, Up Against the Wal-Marts, Don Taylor outlines strategies to effectively compete with the retail giant.[1] These include:

1. **Focus on the customer**. Taylor emphasizes the importance of businesses knowing what their customers want- value, convenience, service, information, choices, and hassle-free shopping. Wal-Mart obviously has many of these covered extremely well; however, smaller retailers can exploit areas Wal-Mart doesn't excel in. For example, Wal-Mart can't provide the level of customer service a smaller retailer can. Their size prevents them from taking the time to truly listen, anticipate and meet customer needs

Also, small retailers can take the hassle out of shopping. Providing easy checkout, friendly return policies, helpful staff, clean restrooms, and help when customers need it, they take the hassle out of shopping. Retailers who effectively communicate these benefits are in much better position to compete.

2. **Hire great people**. Wal-Mart's rapid growth rate likely will cause recruiting challenges, especially for lower level positions. Many of their staff won't be skilled in customer service or product knowledge. This is a weakness the smaller retailer can exploit.

Knowledgeable, friendly, positive, dependable employees provide an advantage.

3. **Add obvious value**. Many times, smaller retailer can't compete with Wal-Mart on price because customers believe the lowest price and best value is always at the big box stores. However, this isn't always true.

Small retailers should work to change this perception. They can run sales, carry and market higher quality product lines, add service (free delivery, installation, safety checks, lessons, adjustments, etc.) and bundle value (free shirt with the purchase of a suit, free wood chips with a BBQ grill, etc.). These activities go a long way toward changing the perception that the big box stores always have the best value.

4. **Become a marketing expert**. Many small retailers have great products and services, but no one knows about them because there is no formal marketing plan. Small retailers should analyze their product, price, placement, people, promotion, and positioning strategies.

Is there a rhyme and reason behind which products they carry and the price they charge? Do customers want their products and do they associate value with the price being charged? Is there a strategy for hiring, promoting, and niche marketing? These are questions small retailers should consider in-depth.

5. **Eliminate waste**. Wal-Mart is an expert at trimming operating expenses. In fact, their operating expenses as a percentage of sales are typically half that of other big box stores (15% vs. 30%). It isn't unusual for smaller retailers to have operating expenses as high as 40-45% of sales.

It may not be possible to trim operating expenses to Wal-Mart's level; however, most businesses can improve. By analyzing their budgets and justifying every expense, businesses find areas for improvement. Smart businesses also realize the value of time and diligently find quicker ways to do things and eliminate non-productive activities.

6. **Get accurate, timely management information**. Many smaller retailers simply don't know current product, financial, customer, or industry trend information for their businesses. Contrast this to Wal-Mart who knows virtually everything about their business- sales from yesterday, last week, last year; inventory in progress, in transit, and on the shelves, etc.

Smaller business must invest in technology or develop systems to capture this type of information.

7. **Find a power niche**. The big box stores are mass merchandisers. They carry a huge variety of products and try to appeal to as many people as possible. Being all things to all

people leaves many retail and service gaps that smaller retailers can exploit.

Whether the niche is specialized service or expert product information, small retailers have an opportunity to specialize and fill needs Wal-Mart is unable to meet.

8. **Focus on improvement**. There is always a better way to do business and smart businesses constantly look for ways to improve. Take Wal-Mart for example. They continually analyze their operations, relationships with suppliers, sales trends, etc. Smaller retailers should do the same.

9. **Become results-oriented**. Smaller retailers should continually ask if their actions are creating quality results. There is a difference between busyness and productivity.

In the ultra competitive retail environment, smaller businesses must make the most of every opportunity. They should know what activities bring the most productivity (increased sales) and which one are simply busyness with adding to the bottom line.

Competing with Wal-Mart is definitely challenging, but possible for businesses who continually strive to implement these strategies.

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