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# Wall-to-Wall Wal-Mart

Bruce Upbin, 04.12.04

## The retailer conquered America and made it look easy. The rest of the world is a tougher battleground.



With 3,550 stores in the U.S. and 1,000 Supercenters to be added in the next five years, all that's left for Wal-Mart is mop-up. It already sells more toys than Toys "R" Us, more clothes than the Gap and Limited combined and more food than Kroger. If it were its own economy, Wal-Mart Stores would rank 30th in the world, right behind Saudi Arabia. Growing at 11% a year, Wal-Mart would hit half a trillion dollars in sales by early in the next decade.

But its mesmerizing success in the U.S. masks this fact: Overseas, Wal-Mart has won some--and lost a lot. Just a few victories have been swift: Canada, Mexico and the U.K. More than 80% of its international revenue comes from these three countries.

In Europe it has proven at times adept, at times inept, at acquiring. In China it struggles with a dauntingly primitive supply chain. In Japan it is taking rice-grain-size steps so as not to damage a powerful but backward retail ecosystem. It has achieved runaway success in Mexico, but stumbled among stronger competitors in the huge markets of Brazil and Argentina.

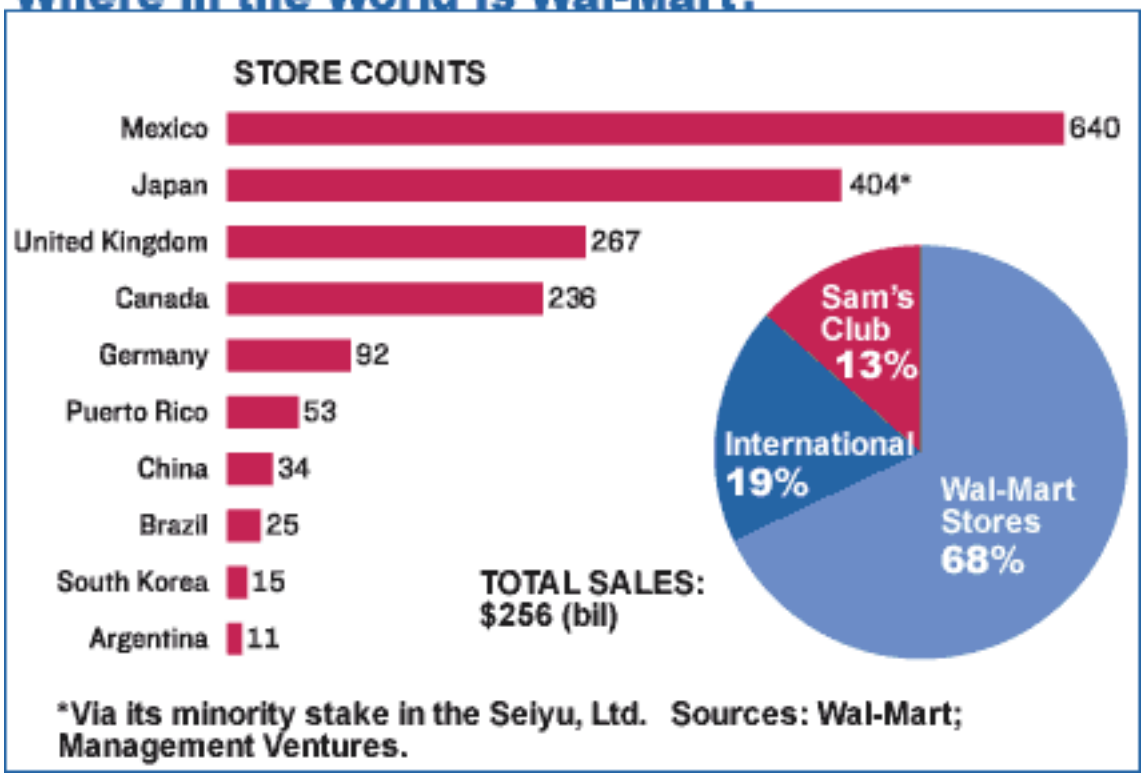
Some big blunders are behind it. Wal-Mart entered Hong Kong in 1994 and left two years later after screwing up merchandise selection and location. It entered Indonesia in 1996, but tucked tail soon after a Jakarta store was looted and torched during the 1997-98 riots. Wal-Mart lost hundreds of millions of dollars in Germany after trying to force its systems on two acquisitions. It has yet to click in South Korea, where its Supercenters misread local tastes and sit too far outside city centers.

One thing Wal-Mart has going for it--beside the fealty of suppliers and an $11 billion capital budget--is a distaste for making mistakes twice. Operations staff from 36 regions fly into Bentonville, Ark. to attend its famed 7:30 a.m. Friday meetings, which perform hours-long postmortems on what went right and wrong that week. The international crew joins that grueling powwow, too. "We're still very young at this, we're still learning," says John Menzer, chief executive of Wal-Mart International.

International is already the fastest-growing division, accounting for a fifth of revenue, or $47.5 billion--the size of Target--and a fifth of operating income (earnings before interest, taxes and minority interest), or $2.4 billion. Over the next three to five years, company Chief Lee Scott insists, sales from abroad must contribute a third of earnings and sales growth. It missed both targets last year, adding $6.8 billion to the company's overall increase of $26.7 billion in revenue and $372 million to the total $1.8 billion lift in operating income.

The Wal-Martization of the world is changing commerce around the planet, for good and ill. By importing so many goods from low-wage countries like China, it eliminates manufacturing jobs and depresses wage growth in the U.S.--and has the same effect in any country where it achieves significant density. But by selling goods for less, Wal-Mart raises living standards. It will create 800,000 jobs worldwide over the next several years, not to mention the labor needed to build the stores, parking lots and distribution centers. Yin and yang.

## Where in the World Is Wal-Mart?




**Sales Growth by Region**

| | Sales 2003 ($mil) | Annualized growth 2001-03 |
|---|---|---|
| **Argentina** | $122 | 2% |
| **Brazil** | 388 | 13 |
| **Canada** | 7,165 | 15 |
| **China** | 673 | 30 |
| **Germany** | 2,743 | -7 |
| **Mexico** | 10,659 | 17 |
| **Puerto Rico** | 2,413 | 30 |
| **South Korea** | 836 | 30 |
| **United Kingdom** | 21,740 | 14 |
| **USA** | 209,509 | 11 |

Bentonville has gotten a lot of flak for squeezing its U.S. suppliers to the point of asphyxiation. But for every casualty, there are successful upstarts like Orange Glo International. The family-run household products company in Greenwood Village, Colo. got picked up by Wal-Mart in 1998 and two years later went overseas. Wal-Mart gave Orange Glo a few pointers, urging it to make its tubs of OxiClean stain remover two inches shorter to fit on Japan's lower store shelves and to hire a full-time employee for floor demonstrations at the Sam's Club in Shenzhen, China. Orange Glo now ships U.S.-made goods to 11 countries; its sales have more than quadrupled to $400 million since 1999.

Sam Walton wasn't one to stare at a map on the wall and dream of conquest. He died in 1992, when Wal-Mart's global ambitions consisted of two Sam's Clubs in Mexico City. A year later Rob Walton, chairman, and David Glass, chief executive, asked Bob L. Martin, chief information officer, to forge abroad.

Martin went on a wild ride, mixing franchising, acquisition, virgin development and joint venture. When he retired in 1999, International had $12 billion in sales and $550 million in operating profit--and became the largest retailer in Canada and Mexico.

Time for a numbers wonk. John Menzer had been Wal-Mart's chief financial officer since 1995 and brought a passion for precision and planning. The 1999 acquisition of ASDA, then the U.K.'s third-largest grocer, was followed by two and a half years of careful technology integration and employee training. He wasn't about to repeat the chaos of the rushed acquisitions in Germany. Armed with four years' worth of studies and outlines of the Japanese market, Menzer took only a sip, spending $51 million for a 6% stake of the Seiyu chain in 2002. Seiyu's stock price more than doubled after the news broke, but Menzer had secured warrants to up its interest to 67% at a fixed price. He remembered how Wal-Mart had paid ever higher prices to add to its stake in Mexican retailer Cifra in the 1990s.

Menzer has ordered all his country presidents to make their own decisions in order to enact them faster. Each handles his own sourcing, merchandising and real estate. "Over time all you really have is speed. I think that's our most important asset," he says.

Some of Wal-Mart's labor problems have dogged it overseas. The largest union in Germany tried to get Wal-Mart to sign an industrywide collective bargaining agreement, but the retailer refused to sign any omnibus contract because it says its stores already had the terms in place. In China, where unions have little clout, Wal-Mart has refused to kick in the customary 2% of wages to the state-run labor councils, paying it instead into a fund for employees.

Competitors everywhere are bracing for a fight. Tesco, the U.K.'s biggest grocer, has opened superstores and added merchandise space faster than ASDA. The two largest retailers in China, Lianhua and Huilan, merged last year into one state-owned firm called the Bailian Group, with annual sales of $8 billion.

Where Wal-Mart goes next is a well-kept secret. Rumors swirl of buyout overtures to Italy's Esselunga chain, France's global giants Carrefour and Auchan, Japan's Daiei or Aeon. In plans kept hush until now, 40 Wal-Mart managers are convening in Russia in April to study trucking routes, distribution points, rival store locations, shopping habits. With stumbles along the way, this retail revolution will be exported to all corners of the globe.

**Sidebars**

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# China: The Slow Boat

Russell Flannery, 04.12.04



If any nation can sustain a scale replica of the U.S. Wal-Mart operation, it's China, home to 170 cities with populations above 1 million. But despite some early successes, the building of a great Wal of China is plagued by problems that defy quick solutions. Chief among them are a spotty supply chain, strong local and foreign competition and lots of red tape.

After eight years Wal-Mart's China operations gross only $670 million. The company expects to open 7 stores this year, bringing its total to 41.

The Communist government has boxed foreign retailers into designated territories to limit competition. Even though it has had outlets in China since 1996, Wal-Mart has yet to open a store in booming Shanghai and has only one in Beijing. By year-end 11 of its stores will be in the southern city of Shenzhen.

Despite a decade of effort Wal-Mart executives admit they still haven't created a strong supply chain. Under national law Wal-Mart can't buy from many of the same suppliers that feed its massive $15-billion-a-year export operation in Shenzhen. Centralized purchasing is also crimped by rules that require liquor and tobacco to be bought locally. A lot of the leafy vegetables the Chinese love must be bought nearby, too. Even for nonperishable goods, the limited road network and choked rail lines make sourcing and distribution unpredictable.

Yet Joseph Hatfield, president of Wal-Mart Asia, has reason to be patient. "If you want to look for an opportunity five or ten years down the road, China will be an extremely important place to be. So much for my bandwagon," he laughs.

Wal-Mart's effort to win over shoppers in this far-off, complex country would startle even the company's biggest detractors. Whole pigs hang from hooks. Deli cases display chicken feet, fresh-cut pig ears and cow lung. The smell of yellow grouper wafts from freshwater tanks nearby. L'Oréal women's face masks that tint Chinese skin white were one of last year's biggest hits.

The retailer wants to win customers like Xu Hui, a housewife who lives near a Shenzhen Supercenter. On a recent day she was picking through a veggie selection that's almost twice as big as those in the States: "We've lived here for two years, and this is the only place I shop," she says, nudging along a shopping cart as Julie Andrews belts out "The Sound of Music" over the speaker system.

Partial liberation from red tape may be near. Up until now Wal-Mart and other foreign retailers had to offer a 35% stake in each store to a Chinese joint venture partner and were restricted to a territory of 40 or so cities each. But after this December, as part of China's admission to the World Trade Organization, the government will allow foreign retailers to own their own stores outright in any city they choose, assuming they can get government building permits. With clearer rules and freedoms Wal-Mart may acquire existing retail outlets to scale up fast. "They're behind the locals in their knowledge of local taste, but they can buy that knowledge," says Dennis Chung, an analyst at DBS Vickers in Hong Kong.

"I think there will be opportunities in consolidation," Hatfield says, especially of state-owned retailers. "We're not opposed to looking at things like that."

Many Chinese retailers, like Hong Kong-listed WuMart, are hampered by regional focus and limited sourcing. Shanghai's

Bailian Group, the country's number one retailer with $8 billion in sales, has great aspirations but is state-run and focused on its home city.

Metro, a German chain with $60 billion in world revenue, has said it plans to invest $700 million to add 40 Chinese stores to the 18 it already has. Like Wal-Mart, France's Carrefour has moved its global purchasing center to China and is rapidly adding to its 43 stores there.

A bigger threat to Wal-Mart might be Du Sha, one of China's richest entrepreneurs, who operates a privately run hypermarket chain, the Home World Group, in northern China. He plans to increase the number of stores from 26 today to 150 in the next four years, funneling $750 million, in part from a planned public offering. His sales are accelerating at the pace Wal-Mart's did in the U.S. in the 1980s, up 43% in 2002.

"Ten years from now the retail industry in China will be dominated by Chinese companies," says Du. Perhaps. But Wal-Mart is just warming up.

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# Europe: Gold Mines and Quicksand

Joshua Levine, 04.12.04



It took Wal-Mart International five years to invade Europe. When it did, making three acquisitions in two years, one foot landed in quicksand, in Germany. The other touched a gold mine, in Britain.

Wal-Mart spent wisely when it acquired ASDA for $11 billion. The British chain had been modeling itself for years on Wal-Mart, right down to the rah-rah philosophy and everyday low prices. "When we were acquired, it was like acquiring a clone," says Tony DeNunzio, who runs ASDA from a modest, two-story office building in Leeds.

After Wal-Mart's arrival the clone got even better, expanding sales from $16.8 billion in 1999 to $21.7 billion last year, despite annual store growth of only 3%.

The reinvigorated ASDA undercut rivals' prices, added general merchandise and unleashed Wal-Mart's inventory prowess without mucking up its flair for selecting food and apparel. In some ways ASDA is better than Wal-Mart. Sales per square foot go as high as $2,000, four times higher than even a Sam's Club. Last Christmas nine out of the ten top-selling Wal-Mart stores worldwide were in the U.K. Sales in DVD players were so brisk that ASDA chartered a jet to bring in 30,000 more at the last minute.

The blindingly white aisles of the ASDA/Wal-Mart Supercentre in Sheffield were humming on a recent chilly Wednesday afternoon. Newly retrofitted, the store is a model of how to squeeze a vast Supercentre into a nation where planning councils make expansion extremely difficult. The Sheffield store built a second floor under the existing roof. For eight months grocery shoppers moved to a tent in the parking lot while it constructed a mezzanine, increasing selling space 60% to 90,000 square feet. Since then it has boosted weekly volume from $1.5 million to $2.2 million by adding such merchandise as $1,000 diamond rings and ASDA's George line of cheap-as-dirt private label clothing which, it claims, has become the second-largest clothing brand, by volume, in the U.K. ASDA also packed in an optical center, a health and beauty department and a film-processing station.

In groceries the expertise runs the other way. ASDA knows food, particularly house brands, which account for 50% of grocery sales. ASDA's Extra Special Chocolate will likely be sold in the U.S.

The problem for ASDA will be where to go from here. It expressed interest in bidding for the Safeway supermarket chain, which would have made it the second-largest U.K. grocer. Britain's Competition Commission instead approved a Safeway merger with the smaller Morrison's to maintain four strong players.

What a contrast to Wal-Mart's $2.7 billion German operation. Six years into it, it still loses money, say analysts; same-store sales are stubbornly negative. Things went badly from the outset, when Wal-Mart purchased Wertkauf and Interspar, two small German chains, in 1997 and 1998. (Interspar, a dog, had already been sold five or six times before.)

To make matters worse, "We moved the head office, rebranded, repriced--all within 12 months," says DeNunzio, chief financial officer of European operations 2000-01. "In hindsight, it was much too fast."

Germans were caught off-guard by cashiers bagging their stuff. "People said, ‘What are they doing with my merchandise?'" says a company spokeswoman. Nevertheless, Wal-Mart still offers to help pack customers' groceries. One big hit: singles

day. At designated spots throughout stores--"flirt stations," if you will--unattached shoppers can pick up free samples of products and foods--and romantic prospects.

For decades German law forced stores to close at 4 p.m. on Saturdays and all day Sundays, Wal-Mart's busiest days. Some restrictions have been relaxed. Now stores can open from 7 a.m. to 8 p.m. six days a week. (Sunday is still verboten.)

Wal-Mart predicts positive cash flow by year-end, but that may be a stretch. The retail colossus almost seems in retreat. There are no openings planned for 2004. In an almost unprecedented move, it closed a store in the Esslingen mall near Stuttgart, then chose not to rebuild a Cologne store that burned down. It stepped back from a projected store in Berlin. Thomas Lindau, a marketing consultant with Research International, holds out scant hope for a turnaround: "For years they've tried and tried and didn't succeed. It's going to be tough."

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# Japan: The American Revolution

Benjamin Fulford, 04.12.04



Wal-Mart's entrée into Japan is Seiyu, the country's fifth-largest grocer, a 400-store chain with $8.9 billion in sales. When it agreed to sell Wal-Mart a 6% stake, the company was nearly bankrupt and had little to distinguish itself from its competitors, says Seiyu President Masao Kikuchi. Two years later it still seems to be struggling. Revenue fell 17% as it posted a loss of $65 million in 2003. Walk around a Seiyu store and you will be hard-pressed to notice any difference from before.

Look closer, though, and you see a revolution in the works. Fifty-three Wal-Martians have converged to move Seiyu's point-of-sale and inventory tracking systems over to the standard Wal-Mart setup. It will take three years for them to switch over all 400 stores, and then they'll move on to Seiyu's distribution centers. Store managers will know how many items of each individual brand were sold, how many are on the shelf and how many are in the warehouse.

The future of Japanese shopping as Wal-Mart sees it lies in the Futamatagawa store, near Yokohama. First, the company moved most general merchandise upstairs and put all the food onto the first floor. The entrance has been turned into a wide, inviting funnel crammed with fresh fruits and vegetables. A greeter hands out baskets to arriving customers and answers questions. Wal-Mart has made the elevators to the parking lot big enough to hold shopping carts and has radically increased the number of cash registers. Sales of food at the store are up 50% from last year.

But not everything is going according to plan. On the second floor, even though clothing prices have been cut by 20% as generics replaced brand items, sales have fallen 10%. The Japanese, apparently, like their brands. Still, overall revenue at the Futamatagawa store has risen 17% since Wal-Mart made its changes.

The real challenge for Wal-Mart will be dealing with the convoluted and opaque Japanese distribution system. Realizing that many manufacturers will sell only through their traditional wholesalers, Wal-Mart has decided to work with them when necessary and help educate them in how to cut their own costs. To wean suppliers away from middlemen, Wal-Mart holds out the carrot of access to its 5,000 outlets around the world. At the same time it's trying to encourage Seiyu buyers to turn to Wal-Mart's global partners like Procter & Gamble, Nestlé, Johnson & Johnson and Kellogg.

Wal-Mart is learning from Seiyu, as well. Its systems will have to adapt to the rigor of Japanese shoppers, many of whom can tell just by tasting a piece of fish whether it has ever been frozen; prices can drop five times a day as the fish ages.

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# Latin America: Bumps in Brazil

Kerry A. Dolan, 04.12.04



Wal-Mart entered Brazil in 1995, raring to replicate its success in Mexico. Walmex, as it's known, had succeeded in part because it started out being so big. By the mid-1990s Wal-Mart had gradually acquired 62% of Cifra, the largest retailer in Mexico. Cifra brought with it a thorough understanding of the Mexican consumer. With revenue of $10.7 billion Walmex last year achieved a 4.5% net margin, besting the 3.5% of Wal-Mart overall.

Brazil looked like a snap. Weeks after the first Supercenter opened in São Paulo, the parking lot was full by 9:30 a.m. on a Saturday and people were waiting two hours to buy a roasted chicken for $2.80, 30% less than at nearby supermarkets. Over in Argentina similar crowds were turning out in Buenos Aires. But the crowds soon thinned, as a price war ensued between Wal-Mart and French chain Carrefour, which opened hypermarkets in Brazil in 1975 and Argentina in 1982. In a blatant salvo, Carrefour built a hypermarket right next to Wal-Mart's first São Paulo Supercenter. The store sells two times what Wal-Mart does, says a former Carrefour executive. Last year Wal-Mart's same-store sales in Brazil were modestly negative.

Its biggest mistake: not making large acquisitions. After nine years, combined sales for Brazil and Argentina were just over $500 million in 2003, says consultancy Management Ventures. In Brazil, Wal-Mart has 25 stores and is the sixth-largest retailer. Rival Companhia Brasileira de Distribuicão, the country's largest retailer, has 499 stores and $3.7 billion in sales. In Argentina, Wal-Mart has just 11 stores; Carrefour has 24.

The company made other mistakes in South America. Store layouts were initially carbon copies of those in the U.S. The head of Wal-Mart in Argentina, who didn't speak Spanish, held meetings with suppliers in English, even though nearly all of them were Argentinean.

Wal-Mart Brazil President Vincent Trius, a Spaniard, concedes errors. "We've learned through the years to adapt to the local market," he says. New stores in Brazil and Argentina devote twice as much selling space to food as the U.S. stores and now have one entrance, instead of two, to reduce confusion--and theft. Country heads are fluent speakers of either Spanish or Portuguese.

One thing Wal-Mart Brazil has successfully imported is Walmex's low-priced Bodega stores, renamed Wal-Mart Todo Dia. While stocking up on fresh rolls in the bakery department, housewife Adelaide da Silva das Freitas rhapsodizes, "My kids even did a price comparison and found the school supplies were cheaper here than anywhere else."

On Mar. 1 Wal-Mart bought the 118 Bompreço stores from troubled Dutch retailer Ahold for $300 million. They are in the poorer northeastern part of the country; the acquisition does little to strengthen Wal-Mart's foothold in wealthier southern Brazil.

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