Teaching Note

**Walmart Stores: Gaining and Sustaining Competitive Advantage**

**Teaching Objectives**

This case is intended to be used as the first case in an introduction to strategy course or as a case to discuss cost advantage. The purpose of this case is for students to examine Walmart’s strategy using the framework outlined in the textbook that defines strategy as a plan to achieve competitive advantage that involves making four strategic choices:

a) markets to pursue/compete in,

b) unique value (low cost or differentiation) the firm will offer in those markets,

c) the resources and capabilities required to offer that unique value better than competitors, and

d) ways to sustain the competitive advantage by preventing imitation.” (see Real World Strategy, Chapter 1: What is Business Strategy?)

The case offers multiple reasons that Walmart has achieved a cost advantage but what students typically miss is the fact that many aspects of Wal-Mart’s cost advantage stems from Sam Walton’s early decision to compete in rural markets where labor, rent, advertising costs were low (and where Walmart could price higher because of no competition from competitor discount stores because they avoided such markets because they weren’t deemed large enough to support a discount store).

The Decision portion of the case is introduced towards the end of the case with the primary question being: How should Walmart respond to the growth of online purchases, and specifically to Amazon.com as a competitor? Is the acquisition of Jet.com enough to help Walmart successfully respond to the Amazon threat, or are more actions needed? This discussion allows for an examination of whether the resources and capabilities that Walmart developed to succeed in brick and mortar retail are transferable to online success (including a discussion of what new resources and capabilities Walmart must develop to succeed on line).

**Teaching Materials**

Case, Wal-Mart Stores: Gaining and Sustaining Competitive Advantage

Real World Strategy, Chapter 1, What is Business Strategy?

PowerPoint, Wal-Mart Case

Chapter 1, Real World Strategy, Comprehensive Quiz Questions

**Study Questions**

1. Why has Walmart been successful? What is the single most important factor that has contributed to Wal-Mart’s phenomenal success?
2. Why exactly are Wal-Mart’s costs lower than its competitors? *Examine each element of the cost structure (e.g., COGS, labor, rent, advertising, distribution, technology, etc. as a percentage of total sales) and assess where Wal-Mart’s costs are lower than competitors—and why.*
3. Why can’t Wal-Mart’s competitors (e.g., Sears, K-Mart) imitate Wal-Mart and realize similarly high profits? If you were running Sears-Kmart what would you do differently? What, if anything, from Wal-Mart would you want to imitate?
4. Why do you think Wal-Mart has had difficulty succeeding in foreign markets, especially in emerging markets like Brazil and South Korea?
5. What should Walmart do to respond to the emerging trend of online purchases, and more specifically to the threat of Amazon.com as the dominant online retailer?

**Teaching Plan**

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| I. Aspects of Wal-Mart’s competitive advantage | 15-20 min |
| II. Sources of Wal-Mart’s competitive advantage | 20-25 min |
| III. How Should Walmart respond to Amazon? | 15-20 min |
| IV. Summary of Key Ideas | 10-15 min |

*I. Aspects of Wal-Mart’s competitive advantage*

*Question: Assume that you are hired by Sears/Kmart to identify the key elements that drive Wal-Mart’s success. What is the single most important aspect of Wal-Mart that you would recommend that Sears/Kmart imitate in order to experience similar success?*

**Examples of Facilitating Questions:**

*How does (\_\_\_\_) help lower Wal-Mart’s cost?*

*How much lower is Wal-Mart’s cost because of (\_\_\_\_)?*

*What does (\_\_\_\_) have to do with Wal-Mart’s success?*

*Wal-Mart spends less than the competition on advertising. How do they get away with that?*

While students may or may not identify the key aspects of Wal-Mart’s strategy initially, the instructor should help students identify and quantify the varying aspects of Wal-Mart’s competitive advantage. A summary of Wal-Mart’s advantages, as well as questions to help facilitate discussion, is found below.

**Distribution:** Each distribution center serves roughly 150 stores within a 150-mile radius. Technological innovations enable Wal-Mart’s efficient distribution. *Analysts estimated in the mid 1990s that Wal-Mart’s inbound logistics expenses were roughly* ***1 percent less*** *as a percentage of sales than its direct competitors.* In 2011, Wal-Mart was the world leader in cross docking procedures.

**SupplierRelationships:**Wal-Mart’s ability to put a supplier’s product on the shelves of over 10,900 stores gives it tremendous leverage with suppliers. Wal-Mart’s ‘Worldwide Sustainability index’ uses various methods to track all stages of the product life cycle, from raw materials to disposal, and holds suppliers accountable for any unnecessary costs added to the supply chain. Wal-Mart’s Electronic Data Interchange and RetailLink systems provided all of its suppliers with up to the minute, point of sale data from all Wal-Mart locations worldwide. Wal-Mart’s Scan ‘N’ Pay system made it possible for each product to be owned by the supplier until the product was actually sold by Wal-Mart.

**InformationTechnology**: *Wal-Mart spent* ***.1-.3% more on information technology****, as a percentage of revenues, than competitors (****5 to 10 times more*** *than competitors in absolute dollars).* Walmart was known to invest more in information technology to facilitate effective communication between its stores, distribution centers, and suppliers, thereby leading to more efficient distribution, fewer stock-outs, and lower inventories.

**HumanResourceManagement:** *Wal-Mart’s* ***labor costs were 10.1% of sales*** *compared to 11.2% of sales for its direct competitors. Wal-Mart had* ***no regional offices****, which was estimated to* ***save Wal-Mart .5-1% of sales*** *each year.* Regional managers were located at Wal-Mart’s headquarters and spent roughly 200 days a year visiting stores. Members of the top management team typically earned more than 90% of their compensation from incentives based on their performance, and less than 10% as salary. Walmart’s lower labor costs were possible in part because a large percentage of stores were located in rural markets where labor costs were lower than in suburban markets. In addition, Walmart worked actively to prevent its labor force from unionizing. In one example, Wal-Mart simply closed its meat cutters division and outsourced the entire operation to an external supplier rather than allow a meat cutters union to form.

**Marketing and Merchandising:** Wal-Mart started with almost no investment in advertising which was unnecessary in small rural towns where advertising was unnecessary because EVERYONE in the town new Walmart had come to town. It was such a big deal , and ***advertising costs in 2010 were only 0.6%*** *while Target’s were 2.0%.* To ensure prices were low every day, Wal-Mart conducted weekly price checks in nearly 99% of its competitors’ stores. *In rural locations where Wal-Mart was the only discount retailer in town, Wal-Mart’s prices were* ***6% higher*** *than in locations where a direct competitor was nearby.*

**Store Costs:**  A much larger percentage of Walmart’s stores were located in rural towns where land is cheaper than in suburban areas. Thus, Walmart’s cost of stores (land/rent) has been roughly .4% lower than for competitors.

**Benchmarking Wal-Mart’s Cost Advantage:**

|  |  |
| --- | --- |
| Inbound Logistics | +1% |
| Information Technology | -.1% to -.3% |
| Labor Costs | +1.1% |
| No Regional Offices | +1.5% to +2% |
| Advertising Costs | +1.4% |
| Higher Rural Prices\* | +2.9% |
| Store Cost/Rental Rates | +0.4% |
| **Total Cost Advantage** | **8.0%** |

\*’Higher Rural Prices’ advantage was calculated by multiplying the average price increase in rural Wal-Mart stores (higher by 6%) by the percentage of total Wal-Mart stores in rural areas (48.6%).

*II. The key sources of Wal-Mart’s competitive advantage*

The purpose of this section is to help students see that even though there are many aspects to Wal-Mart’s competitive advantage, the main source of these advantages has come from Wal-Mart’s choice of rural markets and its distribution system that supports its stores in those markets. The line of questioning below is meant to help students arrive at that conclusion.

*Question: Assume that I am the owner of Wal-Mart and that you are the senior management of Sears/Kmart. As owner, I am willing to give you some of the things that you identified. If I gave you ( ) would that be sufficient to effectively compete against Wal-Mart?*

*Question: If I gave you ( ), why or why not would you be comfortable in your ability as Sears/Kmart to successfully compete against Wal-Mart?*

*Question: What else would you need to be able to effectively compete against Wal-Mart? Would ( ) be sufficient?*

(The previous two questions may be repeated as students prioritize which of Walmart’s resources and capabilities are most critical to success. The teacher may also volunteer resources to the students, such as offering the Wal-Mart brand, to help facilitate the discussion)

*Question: What have I not given you?*

*Question: Why would Wal-Mart’s stores and distribution centers be the key to its competitive advantage?*

At this point, it will be beneficial to show how the source of many of the cost advantages Wal-Mart enjoys can be traced back to their choice of markets. Below are examples using each of the quantified advantages listed in the *Benchmarking Wal-Mart’s Cost Advantage* section above.

*Rural Markets vs. City Markets*

In a typical large city market (such as Atlanta, Dallas, Philadelphia, Los Angeles), one would expect to find multiple discount retailers (an illustrative example of such a market is below).

*\*Each shape represents a different retailer such as Target, Sears, K-Mart, CostCo, Kohls, etc.*

Compare this to a smaller rural city market where Wal-Mart decided to locate, such as Rogers, Arkansas (its first store) or Sikeston, Missouri and Claremore, Oklahoma (its first stores outside of Arkansas).

*Question: Which of these looks markets looks closest to perfect competition? To a monopoly?*

After establishing the generic benefit of operating as a monopoly compared to operating in a competitive market, it should be much easier to see how many of the cost advantages Wal-Mart enjoys comes from its decision to operate in these smaller markets.

***Labor Costs:*** Because Wal-Mart is one of the largest, if not the largest, single consumer of labor in rural markets, it has significant bargaining power and can offer lower wages than it would be able to in large cities. It can also offer lower wages because the cost of living is lower in rural markets than larger cities.

***Advertising Costs:*** When a retailer builds a new store in a large market, they would typically need to not only signal to consumers that they are in that market, but also that they are better than the competition. For Wal-Mart in rural markets, the store itself is most likely sufficient in letting consumers know that Wal-Mart has arrived. There would also be less need, if any need, to signal to consumers that Wal-Mart has lower prices if they are the only large retailer in the market.

***Prices:*** When there is significant competition and competitors are selling relatively homogenous goods, rivals will most likely compete on price. This leads to lower operating margins in the large city market. In the rural market, where Wal-Mart is the only large discount retailer competing with a group of “mom & pop” retailers, they can raise prices without the worry of losing consumers to competitors which do not have the scale to offer lower prices.

***Store/Rental Costs:*** Real estate is cheaper in rural markets than it would be in large cities.

*III. How Should Walmart Respond to Amazon and the growth of online?*

*Question: what is the current situation with regard to the online retailing market and Walmart’s position in that market?*

Walmart’s success in the future will require that the company respond effectively to the growing trend towards online purchases and the emergence of Amazon.com as a major competitor. The online retailing market, 11.7% of total retail sales in 2016, is expected to grow from roughly $390 billion in 2016 to over $1 trillion by 2026. According to Internet Retailer, the problem for Walmart, and other companies trying to compete online, is that Amazon.com drove 65% of e-commerce growth in 2016. Walmart is losing to Amazon online in a big way.

In response to this trend towards online purchases, and to attempt to better connect with millennials, Walmart decided to purchase Jet.com for $3.0 billion. Like Amazon.com, Jet.com was an online discount retailer but one that focused on more price sensitive customers by attempting to provide better pricing than Amazon.com using a dynamic pricing model. One of the first things that CEO McMillon did after the acquisition was make Jet.com founder Marc Lore President of Walmart’s U.S. e-Commerce business. But the acquisition of Jet.com—and putting Lore in charge of Walmart’s e-commerce business—raised a number of questions going forward.

Question: If you were running Walmart, what actions would you take to compete more effectively online?

* Would you continue to run Jet.com as a completely separate site from Walmart.com? If so, for how long?
* Should Walmart.com adopt some of the innovative pricing approaches used by Jet.com?
* What other suggestions do you have for Walmart increasing its ability to compete effectively with Amazon.com?

*IV. Summary of Key Ideas*

It may be useful to use PowerPoint associated with this case as the key ideas are summarized in this section.

**Wal-Mart’s Strategy: The inter-relatedness of Walmart’s 4 strategic choices.**

1. Choice of markets to serve
   1. First to locate stores in cities with less than 50,000 population
   2. 1762 stores in rural America vs 476 stores for Kmart and 48 for Target
   3. Higher prices in small markets
   4. Lower costs in small markets
2. Wal-Mart’s Unique Value (Value Proposition): Every day low prices for a broad range of goods that are always in stock in convenient locations; this explains WHY customers choose Walmart over other discount retailers.
3. Resources and capabilities to deliver that unique value
   1. Large footprint of rural stores
   2. Distribution capabilities
   3. Bargaining power over suppliers
   4. Fewer layers of management
   5. Culture of cost reduction
   6. All these things are important, but the key to Wal-Mart’s strategy is the choice of Wal-Mart’s markets which allowed all of these things to become a success
4. Sustainable competitive advantage; what prevents imitation by competitors
   1. Competitors rationally refuse to enter Wal-Mart’s towns
   2. First mover advantage which created a barrier to entry through a natural geographic monopoly
   3. Success was initially driven by its choice of markets and its ability to offer lower prices than local competitors in those markets due to a more efficient business model

NOTE: Walmart has struggled globally because much of Walmart’s strategy/ business model is hard to replicate in international markets, especially the small-town strategy. For example, this has not worked well in countries like Brazil an S. Korea due to:

* + Lack of income in small markets in most countries
  + Lack of vehicles for customer to drive to shop at a Walmart store
  + Distribution is difficult w/ poor infrastructure in rural areas
  + Managing in a foreign market is difficult, but even more difficult to find capable management in small towns