

The
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Walmart

Thinking outside the box

As American shoppers move online, Walmart fights to defend its dominance

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THERE is little outward sign that Walmart's "supercentre" in Rogers, Arkansas differs from any other of the giant retailer's outlets. Walmart conquered America with such "big box" stores—vast concrete blocks in an ocean of parking spaces. Inside stretches



Business is picking up

aisle upon aisle of merchandise, from Patti LaBelle sweet-potato pies to Ruger rifles and ScentSationals Wax Warmers, shaped like owls. But this particular store, near Walmart's headquarters in Bentonville, is different. It is where the world's biggest retailer hones some of the new ideas which, it hopes, will help it keep its crown.

Recently the company has had lots of such brainwaves, from vegetables in plastic bins etched to look like wood, to wands that let customers scan items as they shop, thereby speeding up check-out. They are part of a multibillion-dollar bid to keep thriving as America's retail industry is upended. And for the first time in decades, it is not Walmart that is doing the upending.

Since April share prices for some of America's best-known retailers, including Macy's and Gap, have plunged by more than 25%. Some of their problems are fleeting, but one is not. Rather than driving to a big box, many Americans are shopping online instead. American e-commerce accounted for 10.4% of retail sales last year, up from 9.3% in 2014, according to Morgan Stanley, a bank. Amazon is the force behind this, with sales in North America rising by nearly 30% in 2015. The choice for bricks-and-mortar retailers is clear: evolve or decline.

Amid this tumult Walmart remains a titan. It is not just the world's biggest retailer but also its largest

private employer and company, measured by revenue. Last year it raked in \$482 billion. Walmart's empire is global, but America is its particular dominion, accounting for three-quarters of its sales. And on home turf Walmart still towers above Amazon, accounting for 10.6% of America's retail sales, more than twice Amazon's share, according to Cowen, a financial-services firm (see chart 1). Yet Amazon is still growing fast, and Walmart may be past its peak. In 2009 Walmart commanded 11.6% of American retail sales. By 2018 Cowen reckons its share will be stuck at 10.6%, whereas Amazon's will have jumped.

Walmart is spending furiously to fight back against Amazon's online onslaught. "We will win with a strategy that only Walmart can execute," Doug McMillon, its chief executive, said in his annual letter to



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shareholders, shoppers and staff. To that end, Walmart is spending \$2.7 billion to raise workers' wages, which should improve service in its shops. It will devote more than \$1 billion to e-commerce this year. Last year it poured a staggering \$10.5 billion into information technology, more than any other company on the planet, according to an estimate by the International Data Corporation, a research firm.

These investments have squeezed profits, but the firm is banking on growth. Walmart's leaders aim to

prove that an old-fashioned retailer can continue to dominate in the age of e-commerce. Walmart may show how to merge physical and online retail. It is sure to boast of its progress at its annual meeting on June 3rd: it was one of the few American retailers to post cheering first-quarter results in May. Yet its reign as undisputed retail champion is over.

Since Sam Walton opened his first shop over five decades ago, the firm has thrived with a simple strategy, zealously executed: operate with the lowest costs, sell at the cheapest prices and watch sales grow. The success of this formula has given Walmart a unique place in America's economy as well as its psyche.

Value proposition

Walmart is ubiquitous. Some 90% of Americans now live within ten miles of one of its stores. Nearly four out of five of them shopped at Walmart last year. That means its customers outnumber the voters in America's presidential election in 2012 by almost two to one. Each week 140m Americans march through its doors in search of "everyday low prices" on a vast array of goods. For the products that Americans use as freely as air—food, toothpaste, soap, paper towels—Walmart is king, ringing up sales worth about twice what its closest rivals take.

Walmart's scale has changed not just how Americans shop but also how companies in its supply chain do business. Walmart is such an important buyer that consumer-goods companies such as Procter & Gamble have offices near Bentonville. When Walmart sets a goal, companies usually find ways to meet it. In its bid to promote sustainability, for example, Walmart wanted General Mills, a big food company, to fit its Hamburger Helper noodles into a smaller box. General Mills replaced curved noodles with straight ones, which lie flatter. The switch took 500 lorries off the road each year and freed shelf space for other goods. Walmart worked with makers of detergent to develop concentrated versions, in smaller bottles. Over three years the switch saved more than 57,000 tonnes of cardboard, 43,000 tonnes of plastic resin and 400m gallons of water.

The company has its detractors. In a ranking of shoppers' satisfaction with big retailers, Walmart has usually come last, according to the American Consumer Satisfaction Index. Unions and other critics have accused Walmart of obliterating small businesses, denuding towns of local shops and encouraging suppliers to manufacture abroad. One study estimates that Walmart brought 11% of Chinese imports into America in 2013 and helped displace over 400,000 American jobs between 2001 and 2013. But China was sure to be a manufacturing powerhouse, regardless of Walmart's existence. Walmart points out that two-thirds of its products are "sourced" in America and says the study's methods are flawed.

In its home town of Bentonville Walmart seems a very American company, its culture a blend of sunny encouragement and hard-nosed capitalism. Sam Walton's legacy looms large. American town squares are often ghostly, but Bentonville's centre is cheerful, with a Walmart museum in Walton's original five-and-dime shop. At its headquarters, many employees still refer to him as "Mr Sam". Giant quotes from Walton are painted on office walls—"Get involved. Get serious. Get exercised. Get involved in

what we've got going."

Bentonville believers

When staff do good work, they may be rewarded with the company cheer, wiggling their hips to signify the hyphen that originally punctuated "Walmart". Saturday meetings are no longer weekly, as they were in Walton's day, but are nevertheless "like going to church", according to one employee. Walton's obsessive focus on efficiency remains. Most meetings begin at least two minutes early; on time is considered late. They end with each employee sure of his or her tasks, or "go-dos".

This culture has sustained Walmart's reign. Nevertheless, the low prices and broad range that made Walmart distinctive for so long seem less of an advantage these days. A growing band of competitors threaten to match or beat its prices, notes Matthew Fassler of Goldman Sachs. Aldi, a German discounter, offers rock-bottom deals by selling mostly private-label goods in bleak stores. As for choice, Amazon offers about 1.8m items of women's clothing alone, which makes a supercentre's range of 120,000 goods look paltry.

Amazon competes not only on price and range, but also on convenience. As customers shop for millions of products from the comfort of their homes, the allure of a trip to a shop that stocks both firearms and underarm deodorants is waning. What Walmart did for Americans' wallets, Amazon is doing for their time. For a \$99 annual fee, Amazon Prime guarantees free shipping in two days. Once shipping is fast and costs nothing extra, customers tend to start buying more online.

Amazon has many more ways to lure customers. It is rolling out Prime Pantry, delivering a box of household goods for a flat shipping fee of \$5.99, as well as same-day shipping or even home delivery within two hours. Amazon Dash lets consumers hit a button placed wherever they like, to buy common items, like razors or soap, eliminating the hassle of visiting Amazon's website or app. Consumers can also use a new piece of technology to scan and order items already in their cupboard. Amazon shopping could become almost as easy as flicking a light switch.

That is a dark thought for all retailers. Pharmacy chains such as Walgreens and CVS face the threat of consumers turning to Amazon for bleach, shampoo and other household supplies. Department stores are floundering as shoppers buy more dresses, shoes and jackets online. Cowen expects Amazon to overtake Macy's as America's biggest clothes seller next year.

Walmart appears less vulnerable to this assault than other retailers. Groceries account for more than half of its revenue in America. Food is hard to sell online—margins are low and logistics complex—and so far Amazon is testing grocery sales in only a few parts of the country. Nevertheless, Amazon and Walmart increasingly compete for the same customer.

Amazon customers are still on average wealthier than Walmart's, but that gap is narrowing (see chart 2). As Amazon reaches a broader swathe of consumers, the company will increasingly serve the type of shopper who goes to Walmart. In the second quarter of 2014 some 8% of those who bought household

goods at Walmart also bought them from Amazon, according to Cowen. By last year 12% shopped at both. Amazon recently said it would let shoppers pay \$10.99 a month for Prime, rather than a one-off annual fee of \$99. That may help it win customers with a wider range of incomes.



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Clicks versus bricks

The challenge for Walmart, and for all other retailers in the e-commerce era, is to protect both sales and profits. But these goals may be mutually exclusive. Retailers face pressure to offer both free shipping and competitive prices, which generally makes selling a product online less profitable than doing so in existing stores. To expand sales online, retailers must spend on technology, which squeezes margins further. Making matters even worse, retailers are often not gaining new customers but simply selling the same item to the same person online for less profit. "You pour from one bucket into a less profitable bucket," explains Simeon Gutman of Morgan Stanley.

This makes stores themselves less productive, creating yet another dilemma. America has more retail space per person than any other country and double the amount of Australia, the next-closest market (see chart 3). As e-commerce sales rise, some retailers may need to cut their networks down to size. Yet stores still account for the vast majority of retailers' sales. Closing underperforming shops may end up

sending consumers to competitors' shops—or to Amazon.

Walmart itself is bolting some doors for the last time. In January it said it would shut 269 shops worldwide, including 154 in America. That is a small fraction of the total. Most closures were not of supercentres but of

“express” shops, an ill-fated try at

running small convenience stores. Companies specialising in smaller formats, such as Aldi and Dollar General, are growing quickly. Walmart is keeping its medium-sized grocery stores but dumped its express shops this year.

Its plans, to the surprise of some investors, include opening up to 60 supercentres and 95 grocery stores this year. The addition of another 10m square feet of retail space is a slower pace of expansion, but is still almost as much as the combined additions planned by the 23 other big American retailers that Morgan Stanley monitors. Faced with a rapidly changing market, Walmart is trying to do what it has always done best: grow.

It is building more stores because, instead of reinventing itself, it wants to carry on offering more goods at low prices to more consumers, more conveniently. “The best thing you can do is always something that makes what you already do better,” explains Neil Ashe, head of Walmart’s e-commerce effort. That means making its operations more expansive and efficient by combining Walmart’s growing



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number of physical assets, including its logistics network and more than 5,200 American stores, with a growing e-commerce business and array of new digital and analytical tools.

To that end its e-commerce hub is not in Bentonville but San Bruno, California, which has more tech talent. Walmart has built a new technology platform, changing everything from how its website works to how the company manages customer payments and analyses data. The flurry of activity in San Bruno has helped Walmart.com's selection rise from 2m items less than four years ago to over 10m today.

Walmart is scrutinising the minutiae of e-commerce as closely as it monitors every aspect of its business. For example, in the past year Walmart has combed through data to learn how to pack its boxes more efficiently. Using 27 different boxes rather than the 12 they use now, the company has concluded, would lower the total volume of boxes shipped by about one-third. Packing more into each lorry could save fuel and 7.2m cubic feet of space taken up by cardboard boxes, enough to fill about 82 Olympic swimming pools.

Walmart's main differentiator online, however, may be its stores. It is combining sales figures from its shops and data from its website to discern which goods to keep where; its algorithms weigh up billions of variables. Like Amazon before it, the company is building large warehouses to serve its e-commerce business, but it is also shipping products from store distribution centres and from stores themselves. It is letting customers buy online, then collect from stores at no charge.

Some of these strategies are not unique to Walmart, but its scale and logistical skills help the company implement them better than others. For example, Walmart is already expert at the complexities of handling perishable items. It has tried delivering groceries, but is expanding a pickup service instead, betting that this will be both convenient for shoppers and profitable for the company. Such a service may work especially well in America's sprawling suburbs, where delivery would be expensive. In Rogers, online shoppers park in special bays and their Walmart app signals their arrival. Staff roll out crates of groceries, load them briskly into the waiting vehicles and send shoppers on their way.

As for the stores themselves, Walmart is trying to boost sales by making them more attractive, easier places to visit. The company raised its minimum wage to \$10 this year, as part of an effort to improve customer service. In Rogers, signs for different departments are easier to read. Customers can use an app to pinpoint this salsa or that pram, view an expanded selection online and, as of this summer, pay for them.

Store operations continue to get better. Staff are armed with hand-held devices with apps to simplify common tasks, like managing inventory. The company fretted that bakers were leaving too much icing at the bottom of tubs, so Walmart gave them new scrapers. The company reckons this will save more than 35 lorryloads of buttercream icing each year.

These efforts are likely to intensify but may not do enough to keep it in the lead. Walmart says that customers who shop both in stores and online spend more than those who shop only in stores. Yet the

e-commerce business is not growing as quickly as the company would like. Its sales in the first quarter of this year rose by 7% globally. American online sales were slightly better, but the company will not say by how much. Meanwhile, Amazon's North American e-commerce sales jumped by 27%.

Get serious

Even as Walmart pushes forward, it is in the unfamiliar position of trying to catch up. As Amazon Prime offers more functions, Walmart is still testing a \$49 annual fee for free delivery. The shipping costs and technology investments required by e-commerce may make Walmart less profitable in the long term. So would the decline of the mighty supercentre, which is showing signs of age. In the most recent quarter sales at Walmart's medium-sized, less profitable grocery stores rose seven times as fast as the broader American business.

The most troubling change would be if the company's virtuous cycle of scale and low prices were to start breaking down. In October Walmart said it would cut its prices, beginning this year. The company is confident that this will propel sales higher—as low prices have for more than 50 years. However, Mr Fassler of Goldman Sachs argues that competitors' low prices and shoppers' preference for convenience may mean that its familiar trick will not boost market share as it once did. Walmart conquered America with its big boxes. It must now contend with millions of small ones, piled high on America's doorsteps.

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