

The Walmart Crapshoot

BY CHRIS HOYT
HOYT & COMPANY LLC

One of the most important criteria used by retailers to evaluate a proposed shopper-marketing initiative is the extent to which it is designed to benefit all stakeholders — meaning the retailer and its customers — as well as the sponsoring brands. As everybody knows, this is called a “win-win-win.”

It goes without saying that Walmart is especially insistent on this. As a result, most suppliers pull all stops to ensure that everything they present to Walmart is structured to be a win-win-win — and perhaps even a little overboard on the “win-win” segments meant for Walmart and its customers.

Project Impact does not appear to be the “win” that Walmart expected.

Now let’s flip the coin and take a look at Walmart’s Project Impact through the same lens. To what extent is Project Impact a “win-win-win” — for Walmart, its customers and suppliers? To what extent did Walmart consider its suppliers when it blocked-out the objectives and strategies for Project Impact?

To put this in perspective, one first needs to know a little bit about what Project Impact is and how it came about.

Between 1999 and 2003, Walmart’s fierce determination to be the low-price leader enabled it to operate profitably on gross margins (read: “retail sales prices”) that were actually lower than the *operating expenses* of its leading grocery competitors — Kroger, Safeway and Albertson’s.

In other words, regardless of the number of hi-lo pricing machinations these competitors conjured-up, the bottom line is that they were mathematically unable to compete with Walmart on price — which is no doubt why millions of shoppers during these years migrated to Walmart and why Walmart enjoyed consistent double-digit growth.

Then, for the first time in 2004, Walmart’s gross margin nudged above Kroger’s operating expenses. From then on, in what turned-out to be a steady pattern every year for the next six years, Walmart had to increase its gross margins to cover higher and higher operating expenses while Kroger was able to reduce its margins as it became more and more effective at getting its costs under control.

The result is a significant reversal of the advantage that Walmart enjoyed in the early years: Now at 24.8 percent for Walmart versus 23.2 percent for Kroger, Walmart’s gross margin is at a serious 1.6 percentage point *disadvantage* versus Kroger’s — a difference just too big for recession-pressured competing shoppers to ignore for long.

The object lesson of the Walmart-Kroger pricing scenario is that, for whatever reason, Walmart allowed itself to deviate from its core strategy (“Always Low Prices”) and thereby enabled a major competitor to get its nose under the tent.

The bottom line, after six years of a steadily widening margin gap, is that in FY 2010 (which ended at the end of January for both Walmart and

Kroger), Walmart's US same store sales *declined* by -0.7 percent — the first decline in Walmart's history — while Kroger's *increased* by 2.1 percent.

Walmart attributes this decline to “deflation in certain merchandise categories” — and gives various other explanations as to why Wall Street and stockholders shouldn't really be concerned. But, as we will see, the jury is still out.

In any case, Walmart has not been unaware of its issues. In fact, it is precisely because of Walmart's dissatisfaction with its US supercenter performance that it unveiled Project Impact in the fall of 2008 with the following objectives:

- Improve traffic, same-store sales and margins in Walmart US supercenters while simultaneously reducing operating costs and — specifically — inventories.
- Upgrade Walmart's shopper base to include middle-class moms, boomers and “aspirational” while continuing to attract and hold Walmart's core customers.
- Better leverage Walmart's power and scope (*i.e.*, global reach) in all activities, including sourcing and supplier negotiations.

Walmart intends to achieve these objectives through the simultaneous implementation of three strategies, which — again — call for significant departures from traditional approaches, specifically:

“Save Money. Live Better.” Walmart has replaced “Always Low Prices” with “Save Money. Live Better” as its mantra and messaging platform. This enables Walmart to broaden its message beyond price to talk about the quality of life that its lower prices make possible — and ensure relevance by varying its message to touch upon the environmental, health and wellness issues that are most relevant to its customers (and potential customers) at different points in time.

Additionally, it allows Walmart to leverage the legacy of “Always Low Prices” by making claims like, “Undisputed Price Leadership” and “Unbeatable” without, however, actually having to gut its margins to guarantee absolute across-the-board low-price leadership.

Another facet of “Save Money. Live Better.” is Walmart's determination to make its Great Value private label brand a major factor in each of the categories in which it competes. This is because Walmart believes

that Great Value is key to achieving its margin objectives while also building customer loyalty by providing reliably consistent high quality at low cost.

As a first step, Walmart began to reformulate approximately 750 Great Value SKUs last March — mostly food items — and is now extending this to HBA as we write this. Although Walmart has not yet done much in the way of significantly increasing merchandising support for Great Value since the start of Project Impact, one can safely assume that such a push will be substantial and inevitable.

“Win/Play/Show.” Walmart now uses “Win/Play/Show” as a matrix to assign category roles or make decisions about which brands/SKUs to keep and which to delist. Walmart calls this “a more strategic approach to merchandising” and freely acknowledges that not all categories will be treated equally in the application of these criteria.

In fact, the role that Walmart assigns to a category based on this matrix will no longer be dependent on purely “objective” analytics: What Walmart is doing is combining objective and subjective criteria in order to “place bets” on certain categories based on “growth potential, scale advantages and alignment with Walmart's image.” These are factors that suppliers can “enhance” depending on the degree of support they are willing to provide.

How does one know why (or why not) one's category is placed in the Walmart “Win” quadrant? That's exactly the point. While Walmart does publish the criteria for its “Win” quadrant, it leaves this relatively open-ended, couched in subject-to-interpretation phrases like, “Consumers see Walmart as a credible destination” or “Volume contributes to price leadership position,” and so forth.

In other words, there is no longer a fact-based approach upon which one can rely. While there are obviously certain basics that must be in place even to be considered for Walmart's “Win” quadrant, by leaving the final decision open to certain subjective evaluations, Walmart cleverly sets-up a competition among suppliers.

In this environment, “winning” will almost certainly include the extent to which category suppliers are willing to go “over and above” to help Walmart achieve its objectives. Translation: When all else is equal, adding incremental marketing or merchandising support can make the difference between being assigned to the dark-and-damp “Show”

quadrant versus the sunny-and-eternally-productive “Win” quadrant.

Where one lands is critical because Walmart is using its “Win/Place/Show” criteria to achieve its inventory reduction and margin enhancement objectives. To this end, Kantar Retail estimates that since the start of Project Impact, Walmart has delisted approximately 12 percent of its total SKUs, which, based on an average of 142,000 SKUs per store, translates to more than 17,000 items.

Importantly, it should be understood that these delistings did not just include tangential or redundant SKUs that flanked core brand offerings. In some cases, they included entire brands—like Hefty One Zip Food Storage Bags—and even entire departments (e.g., fabrics).

“Fast/Friendly/Clean.” This third component of Project Impact is primarily focused on improving the in-store shopping experience to improve loyalty, increase basket size and upgrade Walmart’s shopper base to include middle-class moms, boomers and “aspirationalists.”

To achieve these objectives, Walmart has implemented its version of Target’s “Clean Store” policy—meaning that it has eliminated all displays and point-of-sale materials in all areas of all Project-Impact-converted stores that would in any way impede traffic flow, visibility or access to any department or any part of any shelf.

As Bill Simon, EVP & COO of Walmart US notes, “The net effect is you open up the customer space, you improve the shopping experience, you provide access to and visibility to departments that were previously difficult to shop—like apparel.”

In Walmart’s case, this “clean sweep” includes—literally—millions of square feet of pallet displays that used to populate Action Alleys. This includes displays that traditionally comprised high-volume impulse or elastic items like salty snacks, beverages, cereals, candy, cookies, diet products and DVDs.

Additionally, although Project Impact was “officially” implemented in only 32 percent of stores by the end of March of 2010, many store managers did not wait and took the initiative to clean out their Action Alleys before their stores were converted.

While there is a great deal more to Project Impact than what we are able to discuss here, the net of the above is that Walmart appears to have adopted a course of action based more on imitating competitors than on capitalizing on its intrinsic strengths.

In fact, much of this has the aura of being outsider-driven—e.g., the “cuteness” of barely adequate “Win/Play/Show” criteria—that flies in the face of Walmart’s rock-solid and dependable traditional approaches. Specifically:

- Whereas Walmart has been traditionally known as a “house of brands,” it is now gearing up to provide record support for the relaunch of its Great Value private-label brands which it sees as crucial to achieving its profit and differentiation objectives.
- Whereas Walmart has traditionally positioned itself as a “one stop shop”—wherein busy shoppers could get everything done for their entire family in one stop at a Walmart supercenter on a Saturday morning—Walmart appears to be subordinating this positioning to its objective of reducing inventories via the elimination of SKUs and in-aisle displays. These actions may so anger its traditional customers that they may actually begin to explore other alternatives.
- Whereas Walmart built its reputation (and its business) via an unwavering determination to always be the lowest price competitor in a market, the indications are that Walmart has made a conscious decision to relinquish this lead. This is suggested by the fact that Kroger has had lower gross margins than Walmart for the past three years—something we are 100 percent confident that Walmart follows intensely.
- Lastly, whereas Walmart has always been known as the beacon of fairness and fact-based decision-making in manufacturer/retailer collaboration, this injection of constantly moving subjective elements into the “Win/Play/Show” equation appears to have transformed what used to be a reliable process into a virtual crapshoot—a process that Walmart itself describes as “Placing Bets.”

So, given all of this, how does Project Impact stack up as a “win-win-win” proposition—for Walmart, its customers and suppliers?

Walmart: Project Impact *does not* look like the “win” that Walmart expected. After eight consecutive quarters of same-store sales *increases* through recessionary times—a record equaled by almost no other retailer—Walmart’s sales began to slow soon after it converted 600 Project Impact stores in the spring of 2009.

In its second quarter, ending July 31, 2009, same-store sales fell -1.5 percent; third quarter dropped another -0.5 percent; and fourth quarter (the holiday season!) to -2.0 percent.

Overall, for the first time in history, Walmart's US same-store sales dropped to -0.7 percent for its fiscal year ending 1/31/2010 (versus +3.2 percent year ago) — and then dropped again to -1.4 percent in Q1, 2011. Finally, despite its draconian delistings and display elimination, Walmart US's FY2010 operating expenses actually increased 0.4 points.

Other, separate, confirming data indicate that, over the past 12 months, Walmart's US dollar sales growth did not keep pace with the industry in total and, in fact, grew more slowly than all other major channels. In other words, Walmart US lost share.

Walmart's response to these numbers is that they are fundamentally a product of price deflation and recession — certainly not the result of any bad decision-making having to do with the implementation of Project Impact.

In support, Walmart points to the fact that during the 12 months ending January 31, it was able to reduce inventories by 7.6 percent or \$1.8 billion and — most important — grow operating profits by 5.2 percent to a record \$19.5 billion.

While these latter results *are* impressive, we have a long-standing belief that one has to be effective before one can afford to be efficient. So, until Walmart's same store sales turn around for two consecutive quarters, all else is conversation.

Walmart's Customers: Based on Walmart in-house surveys, Project Impact is reported to be a hands-down “win” for customers who shop in the converted stores. In 2009, Walmart US customer traffic rose 1.3 percent.

Even at these higher traffic levels, Walmart achieved “the highest customer satisfaction scores ever” in its converted stores during the critical 2009 fourth-quarter holiday-shopping season.

Walmart's recent actions, however, lead one to suspect things may not be as rosy as claimed:

The Chicago Tribune reports that Walmart is counting on sharp price cuts—such as \$1 bottles of ketchup and cases of soft drinks for under \$4—in essential food categories as it looks to regain the upper hand when it comes to a low-price reputation. At the same time, as previously

reported, the retailer is restoring some items that it previously eliminated in its SKU rationalization effort that was designed to streamline stores and make them more profitable... but instead sent a lot of its customers to the competition looking for products they could no longer find at Walmart.

(Source: *Morning Newsbeat*, 6/1/10).

Bottom line on Walmart's customers: The jury is still out.

Walmart's Suppliers: Project Impact has been a “worst nightmare” scenario for any supplier who lost distribution or whose growth is primarily dependent on Action Alley displays.

Even for the big guys, this has been hard. For example, in the second half of calendar 2009, Kraft noted that it had experienced declines in biscuits, Chips Ahoy, Triscuits and Maxwell House “*due to reduced merchandising at a key customer.*”

One customer whose actions can determine the success or failure of a national brand. Maybe we need a Robinson-Patman for retailers.

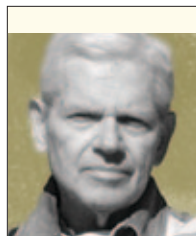
Think about it.

Beyond these specifics, we can hardly imagine that the infusion of agenda-driven subjectivity into the “Win/Play/Show” product selection or category merchandising criteria is conducive to building trust and confidence in the supplier community.

Just wait until Walmart delists your products — and then tells you eight months later that perhaps they were too hasty — or that you might get back in if you were to pony-up some advertising dollars proportional to Walmart's share of your business.

Meanwhile, what *did* you do with all of those employees you had sitting around in the middle of a recession with little or no hope of finding another job? Do you now have to hire them back?

No — Walmart's tinkering is definitely not a win for most suppliers. ■



CHRIS HOYT is president of **Hoyt & Company**, a Scottsdale, Arizona-based marketing/sales consulting and training organization that specializes in shopper marketing. Chris may be reached at (480) 513-0547 or at chrishoyt@hoytnet.com.