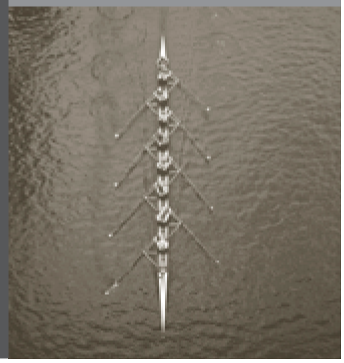
case 5

Wal-Mart Stores Inc., 2007



If you don't want to work weekends, you shouldn't be in retail.

SAM WALTON (EXPLAINING THE SATURDAY CORPORATE MEETING)

At the beginning of 2007, Wal-Mart's status as the world's biggest retailer was unassailable. It was more than three times the size of the world's no. 2 retailer (Carrefour). It earned about as much profit as the next five largest retailers combined. During the financial year ending on January 31, 2007, it appeared that Wal-Mart would achieve sales growth of 11% – above its average for the previous five years and a creditable performance during a year of unprecedented fuel costs.

Wal-Mart's transformation from a small chain of discount stores in Arkansas, Missouri, and Oklahoma in 1970 to the world's largest retailer was one of the most remarkable corporate success stories of the 20 century. Its founder, Sam Walton, had combined folksy charm and home-spun business wisdom with cutting-edge information technology and supply chain management to create the world's most efficient retail organization.

However, as Lee Scott prepared for his eighth year as CEO of this icon of American capitalism, he realized that sustaining Wal-Mart at the pinnacle of success would be increasingly challenging. Already the stock market was signaling doubts over Wal-Mart's ability to maintain its trend rate of profit growth. The stock price had peaked in March 2002; by the beginning of 2007 it was trading 32% off its peak. Maintaining sales growth meant that Wal-Mart was forced to explore new markets. By 2007, Wal-Mart was operating in 13 countries outside of the US. Within the US, Wal-Mart was continually seeking to broaden its range of offerings. During 2006, Wal-Mart moved heavily into prescriptions drugs (offering generic prescription drugs at a flat $4 price) and also expanded the range of financial services it offered.

Wal-Mart was facing stiffer competition everywhere. In its traditional area of discount retailing, Target was proving an increasingly formidable competitor, while several of the rivals that Wal-Mart had believed it had crushed – Kmart, Sears, and JC Penney – were undergoing revivals under revitalized management. In warehouse clubs, its Sam's Clubs ran a poor second to Costco. While Wal-Mart could seldom be beaten on cost, it was continually facing competitors that sought to be more stylish (TJ Maxx), more quality-focused (Wholefoods), or more service oriented (Lowe's, Best Buy). As Wal-Mart reached a scale that was unprecedented in the history of retailing, could it maintain its drive for efficiency, responsiveness, and innovation?

Of particular concern to Scott, was the need to compete on completely new and unfamiliar fronts. For years Wal-Mart had been a target for organized labor seeking to unionize Wal-Mart's million and a half employees. More recently, "The Beast of Bentonville" has attracted the ire of environmentalists, antiglobalization activists, women's and children's rights advocates, small-business representatives, and a growing number of legislators of varying political hues. The result was a series of senior appointments to new executive positions – a head of global ethics and a new executive vice president of government relations – plus a heavier commitment of time by Scott and his top management team in Washington and with the media.

Wal-Mart's success had been based on a strategy that emphasized a few key components: commitment to "everyday low prices," responsiveness to customer needs, matchless logistics supported by leading-edge IT, committed employees, and unremitting cost cutting founded on a culture of frugality. As Lee Scott looked ahead to the new financial year, two concerns filled his mind. First, could Wal-Mart sustain its leadership in costs, innovation, and flexibility? Second, would these traditional competitive advantages of Wal-Mart be sufficient for it to meet the new challenges that it would be facing in the coming years?

History

Sam Walton opened his first store – a franchised Ben Franklin variety store – in 1945. Over the next 15 years, Sam together with his brother, Bud, developed a chain of 15 Ben Franklin stores throughout rural Arkansas. During this period, Sam Walton became aware of the increasing price competition from discount retailers – large format stores that offered a broad range of products that included apparel, appliances, toiletries, household goods, and sometimes groceries as well. This new category of retailer emerged in the US following World War II. Discount stores were located within large towns – it was generally believed that a minimum population of 100,000 was necessary to support a discount store. Sam Walton believed that discount stores could be viable in smaller communities: if the prices were right, the stores would attract customers from a wide area: "Our strategy was to put good-sized stores into little one-horse towns that everyone else was ignoring."[1] Walton opened his first Wal-Mart in 1962 and within eight years had 30 discount stores in small and medium-sized towns in Arkansas, Oklahoma, and Missouri.

Distribution was a problem for Wal-Mart:

> *Here we were in the boondocks, so we didn't have distributors falling over themselves to serve us like our competitors in larger towns. Our only alternative was to build our own distribution centers so that we could buy in volume at attractive prices and store the merchandise.*[2]

In 1970, Walton built his first distribution center, and in the same year took the company public in order to finance the heavy investment involved. With this structure of large distribution hubs serving a group of 15 to 20 discount stores. Wal-Mart began its rapid expansion across the country. At the end of 1980, Wal-Mart had 330 stores in 11 states (Arkansas, Oklahoma, Missouri, Texas, Kansas, Kentucky, Tennessee, Mississippi, Louisiana, Alabama, and Illinois). By 1995, Wal-Mart had stores in all 50 states. Wal-Mart's geographical expansion was incremental. It moved into a new area, first, by building a few stores that were served by extending Wal-Mart's distribution lines from a nearby cluster; eventually, when a critical mass of stores had been established in the new area, Wal-Mart would build a distribution center to serve the new cluster. Expansion brought Wal-Mart into closer competition with other discount chains. In the small towns of the southwest and south, Wal-Mart faced few major competitors. As Wal-Mart became a national retail chain it entered more developed retailing areas, including larger cities. By 1993, 55% of Wal-Mart stores faced direct competition from Kmart and 23% from Target.[3]

Diversification

Wal-Mart has continuously experimented with alternative retail formats. Some, like Helen's Arts and Crafts and Dot Deep Discount Drugstores, were unsuccessful. Others – Sam's warehouse clubs and the Supercenters – grew rapidly to become important components of Wal-Mart's business.

Sam's Clubs imitated a distribution concept established by Price Club. The warehouse clubs were not retailers since they were not open to the public. They were clubs where access was through membership. They carried a small number of lines and most items were available in multipacks and catering-size packs. The clubs were literally warehouses with products available on pallets and minimal customer service. The rationale was to maximize economies in purchasing, minimize operating costs, and pass the savings on to members through very low prices. Competition among warehouse clubs was ferocious, resulting in rapid consolidation of the sector. Wal-Mart acquired The Wholesale Company in 1991 and Kmart's PACE clubs in 1993, while Costco Wholesale and PriceCo merged in 1993.

Supercenters were Wal-Mart stores with larger floor space (averaging 187,000 square feet, compared with 102,000 square feet for a Wal-Mart discount store and 129,000 square feet for a Sam's Club). Supercenters were modeled on the European concept of the "hypermarket" that had been pioneered by the French retailer Carrefour. A Supercenter combined a discount store with a grocery supermarket: in addition, a Supercenter incorporated a number of specialty units such as an eyeglass store, hair salon, dry cleaners, and photo lab. The Supercenters were open for 24 hours a day, seven days a week. The Supercenter stores and Sam's Clubs were supplied through a separate distribution network from the Wal-Mart discount stores. In 1990, Wal-Mart acquired McLane, a Texas-based wholesale distributor, that became the basis for Wal-Mart's distribution to Supercenters and Sam's Clubs throughout the US.

In 1998, Wal-Mart opened the first of its Neighborhood Markets. This chain of supermarkets had an average floorspace of 42,000 square feet.

International Expansion

By the end of the 1980s, Wal-Mart was concerned that it might be running out of new territory and began looking for opportunities abroad. In 1992, Wal-Mart

TABLE 5.1 Wal-Mart stores by country, November 2006

Country	Stores	Notes
USA	3,960	Included 2,176 Supercenters, 1,100 discount stores, 574 Sam's Clubs, and 110 Neighborhood Markets
Mexico	853	Entered 1991: JV with Cifra. Chains include Wal-Mart, Bodegas, Suburbia, Vips and Mercamas
Puerto Rico	54	Entered 1992
Canada	279	Entered 1994: acquired Woolco
Argentina	13	Entered 1995: greenfield venture
Brazil	299	Entered 1995: JV with Lojas Americana. Includes Todo Dias, Bompreço, and Sonae stores
China	67	Entered 1996: greenfield venture
UK	330	Entered 1999: acquired Asda. Operates Wal-Mart superstores and Asda supermarkets/discount stores
Japan	391	Entered 2002: acquired 38% of Seiyu. Mainly small stores but some superstores.
Costa Rica	135	Entered 2005: 51% acquired from Royal Ahold*
El Salvador	59	Entered 2005: 51% acquired from Royal Ahold*
Guatemala	125	Entered 2005: 51% acquired from Royal Ahold*
Honduras	38	Entered 2005: 51% acquired from Royal Ahold*
Nicaragua	37	Entered 2005: 51% acquired from Royal Ahold*
Total	**6,640**	

* 30% stake in CARHCO acquired from Royal Ahold; this later increased to 51%.

SOURCE: WWW.WALMART.COM

established a joint venture with Mexico's largest retailer, Cifra S.A., and began opening Wal-Mart discount stores and Sam's Clubs in several Mexican cities. In 2000, the joint venture became a subsidiary of Wal-Mart when Wal-Mart acquired 51% of Cifra. By 2003, Wal-Mart Mexico was the country's biggest retailer.

In 1994, Wal-Mart entered the Canadian market by acquiring 120 Woolco stores from Woolworth and converting them to its own discount stores format. By 1999, Wal-Mart took 40% of total discount store sales, establishing itself as Canada's largest retailer.

In Europe, Wal-Mart established itself through acquisition: first in Germany, then in the UK. In Asia, Wal-Mart began with cautious scale entry into Korea and China. Table 5.1 shows Wal-Mart's international development.

Wal-Mart's performance in overseas markets was mixed. Its strongest performance was in adjacent countries – Mexico and Canada. Elsewhere Wal-Mart's performance has ranged from moderate to poor. Its biggest overseas presence is its Asda subsidiary in Britain. Since acquisition, Asda's market share has increased only modestly. In Hong Kong, Indonesia, South Korea and Germany, Wal-Mart's poor performance caused it to withdraw.

Sam Walton

Wal-Mart's strategy and management style was inseparable from the philosophy and values of its founder. Until his death in 1992, Sam Walton was the embodiment of Wal-Mart's unique approach to retailing. After his death, Sam Walton's beliefs and business principles continued to be the beacon that guided Wal-Mart's development. As Harry Cunningham, founder of Kmart Stores, observed: "Sam's establishment of the Walton culture throughout the company was the key to the whole thing. It's just incomparable. He is the greatest businessman of this century."[4]

For Sam Walton, thrift and value for money was a religion. Undercutting competitors' prices was an obsession, as was the never-ending quest for cost economics that would permit continuing price cutting. Walton established a culture in which every item of expenditure was questioned – was it necessary? Could it be done cheaper? He set an example that few of his senior colleagues could match: he walked rather than took taxis, shared rooms at budget motels while on business trips, and avoided any corporate trappings or manifestations of opulence or success. For Walton, wealth was a threat and an embarrassment rather than a reward and a privilege. His own lifestyle gave little indication that he was America's richest person (before being eclipsed by Bill Gates). He also felt uncomfortable about the wealth of his associates: "We've had lots of millionaires in our ranks. And it drives me crazy when they flaunt it. Every now and then somebody will do something especially showy, and I don't hesitate to rant and rave about it at the Saturday morning meeting. I don't think that big mansions and flashy cars is what the Wal-Mart culture is supposed to be about."[5]

His attention to detail was legendary. As chairman and chief executive, he was quite clear that his priorities lay with his employees ("associates"), customers, and the operational details through which the former created value for the latter. He shunned offices in favor of spending time in his stores. Most of his life was spent on the road (or, in his case, in the air flying between stores piloting his own plane), making impromptu visits to stores and distribution centers. He collected information on which products were selling well in Tuscaloosa; why margins were down in Santa Maria; how a new display system for children's clothing in Carbondale had boosted sales by 15%. His passion for detail extended to competitors' stores as well as his own: not only did he regularly visit competitors' stores, he was also known to count cars in their parking lots.

Central to his leadership role at Wal-Mart was his relationship with his employees – the Wal-Mart associates. In an industry known for low pay and hard working conditions, Walton created a unique spirit of motivation and involvement. He believed fervently in giving people responsibility, trusting them, but also continually monitoring their performance.

Since his death, Sam Walton's habits and utterances became hallowed principles guiding the values of the company and the behavior of its employees. For example, Wal-Mart's "10-foot attitude" pledge is based on Sam Walton's request to a store employee that: "I want you to promise that whenever you come within 10 feet of a customer, you will look him in the eye, greet him and ask if you can help him."[6] The "Sundown Rule" – that every request, no matter how big or small, gets same-day service – has become the basis for Wal-Mart's fast-response management system.

Sam Walton's ability to attract the affection and loyalty of both employees and customers owes much to his ability to generate excitement within the otherwise sterile world of discount retailing. Sam Walton brought a sense of unpredictability and fun to the business. He engendered a positive attitude among Wal-Mart employees and he reveled in his role as company cheerleader.

Sam Walton's contribution to the management systems and management style of Wal-Mart is reflected in Wal-Mart's website's description of "The Wal-Mart Culture" (see the Appendix).

Wal-Mart in 2004

The Businesses

Wal-Mart described its business activities as falling into four segments:

- *Wal-Mart stores*. Wal-Mart's core area of business was its US retail stores; these accounted for almost two-thirds of its total sales. Over time, Wal-Mart's traditional discount stores have increasingly been replaced by its Supercenters, much larger stores that combined a discount store with a supermarket. Superstores were based on the European "hypermarket" concept – pioneered by Carrefour. Superstores allowed Wal-Mart to expand its range of product offerings. In groceries, Wal-Mart had established itself as US market leader, with a 20% share.
- *Sam's Clubs*. Wal-Mart's entry into warehouse clubs in the mid-1980s demonstrated its ability to transfer its retailing capabilities to a very different distribution format. These wholesale outlets offered a narrower range of products – typically around 4,000 stock-keeping units (SKUs) as compared with the 50,000 SKUs for most Wal-Mart discount stores – at prices significantly below those of discount stores. The development of Sam's Club also demonstrated Wal-Mart's capacity for continuous improvement and innovation. From the stark, austere warehouses of the 1980s, Wal-Mart had created a unique wholesale distribution experience. During 2002–6, Wal-Mart upgraded its Sam's Clubs to include more up-market products and services – principally in response to competition from Costco.
- *Wal-Mart's international operations*. These comprised a number of separate national subsidiaries, each attempting to interpret the basic Wal-Mart business principles and underlying approach to retailing within a distinctive economic structure and national culture. Wal-Mart's differentiated approach to different countries reflected the different retailing environments of these countries and the different entry opportunities that had presented themselves. Wal-Mart's joint ventures in Mexico and South America reflected its desire to access local knowledge and utilize the resources and capabilities of strong local players. Its acquisition of Asda in the UK was the result of the strong affinities that the two retailers felt for one another. In China and Argentina, Wal-Mart had entered in start-up mode, in the belief that these countries' retail markets were sufficiently underdeveloped as to allow Wal-Mart to develop a market presence. In Japan, Wal-Mart acquired a minority stake in a struggling local retailer in order to explore the opportunities to transfer Wal-Mart's retail concepts to a very different retail environment. Wal-Mart's international expansion had been a process of learning and adaptation where senior

TABLE 5.2 Wal-Mart: performance by segment

	2000	2001	2002	2003	2004	2005	2006
Sales ($ billion)							
Wal-Mart Stores	108.7	121.9	139.1	157.1	174.2	191.8	209.9
Sam's Clubs	24.8	26.8	29.4	31.7	34.5	37.1	39.8
International	22.7	32.1	35.5	40.8	47.6	56.3	62.7
Other	8.8	10.5	13.8	0.0	0.0	0.0	0.0
Sales increase							
Wal-Mart Stores	14.0%	12.1%	14.1%	12.9%	10.9%	10.1%	9.4%
Sam's Clubs	8.4%	8.1%	9.7%	7.8%	8.8%	7.5%	7.3%
International	85.6%	41.4%	10.6%	14.9%	16.7%	18.3%	11.4%
Other	23.2%	19.3%	31.4%	0.0%	0.0%	0.0%	0.0%
Operating income ($ billion)							
Wal-Mart Stores	8.70	9.70	10.30	11.80	12.90	14.20	15.30
Sam's Clubs	0.85	0.94	1.03	1.02	1.13	1.30	1.40
International	0.82	1.11	1.46	2.00	2.40	3.00	3.30
Other	(0.26)	(0.29)	(0.71)	(1.57)	(1.39)	(1.30)	(1.50)
Operating income/sales							
Wal-Mart Stores	8.0%	8.0%	7.4%	7.5%	7.4%	7.4%	7.3%
Sam's Clubs	3.4%	3.5%	3.5%	3.2%	3.3%	3.5%	3.5%
International	3.6%	3.5%	4.1%	4.9%	5.0%	5.3%	5.3%
Other	–3.0%	–2.8%	–5.1%	0.0%	0.0%	0.0%	0.0%

SOURCE: WAL-MART STORES INC. 10-K REPORTS.

executives openly acknowledged the difficulties. John Menzer, head of the international division, observed: "It wasn't such a good idea to stick so closely to the domestic Wal-Mart blueprint in Argentina or in some other international markets we have entered. In Mexico City we sold tennis balls that wouldn't bounce right in the high altitude. We built large parking lots at some of our Mexican stores only to realize that many of our customers there rode the bus to the store, then trudged across these large parking lots carrying bags of merchandise . . . We're now working smarter internationally to avoid cultural and regional problems on the front end."[7]

- *McLane Company Inc*. This company distributes to Sam's Clubs and Supercenters. It is the main component of the business segment denoted "other" in Wal-Mart's accounts (see table 5.2).

Table 5.2 shows sales and profits for the different business segments.

Performance

Table 5.3 summarizes some key financial data for Wal-Mart during the period 1994 to 2004. Table 5.4 shows Wal-Mart's recent performance compared with other discount retailers.

TABLE 5.3 Wal-Mart Stores Inc.: financial summary 1994–2006

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Income ($ billion)													
Net sales	67.3	82.5	93.6	104.9	118.0	137.6	165.0	191.3	217.8	229.6	256.3	285.2	312.4
Net sales increase	21.0%	22.0%	13.0%	12.0%	12.0%	17.0%	20.0%	16.0%	4.0%	5.0%	12.0%	11.3%	9.5%
Same-store sales increase	6.0%	6.0%	4.0%	5.0%	6.0%	9.0%	8.0%	5.0%	6.0%	6.0%	4.0%	3.0%	3.0%
Other income – net	0.6	0.9	1.1	1.3	1.3	1.6	1.8	2.0	2.0	2.0	2.4	2.9	3.2
Cost of sales	53.4	65.6	74.5	83.5	93.4	108.7	129.7	150.3	171.6	178.3	198.7	219.8	240.4
SG&A expenses	10.3	12.9	15.0	16.9	19.4	22.4	27.0	31.6	36.2	40.0	44.9	51.2	56.7
Interest costs:													
Debt	0.3	0.5	0.7	0.6	0.6	0.5	0.8	1.1	1.1	0.8	0.7	0.9	1.2
Capital leases	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.2
Provision for income taxes	1.4	1.6	1.6	1.8	2.1	2.7	3.3	3.7	3.9	4.4	5.1	5.6	5.8
Minority interests	(0.0)	0.0	(0.0)	(0.0)	(0.1)	(0.2)	(0.2)	(0.1)	(0.2)	(0.2)	(0.2)	(0.2)	(0.3)
Net income	2.3	2.7	2.7	3.1	3.5	4.4	5.4	6.3	6.7	8.0	9.1	10.3	11.2
Financial position ($ billion)													
Current assets	12.1	15.3	17.3	18.0	19.4	21.1	24.4	26.6	28.2	30.7	34.5	38.9	43.8
Inventories (replacement cost)	11.5	14.4	16.3	16.2	16.8	17.5	20.2	21.6	22.7	24.4	26.6	29.8	32.2
Net PPE and capital leases	13.2	15.9	18.9	20.3	23.6	26.0	36.0	40.9	45.8	51.4	58.5	68.1	79.3
Total assets	26.4	32.8	37.5	39.6	45.4	50.0	70.3	78.1	83.5	94.8	104.9	120.2	138.2
Current liabilities	7.4	10.0	11.5	11.0	14.5	16.8	25.8	28.9	27.3	32.5	37.4	43.2	48.8
Long-term debt	6.2	7.9	8.5	7.7	7.2	6.9	13.7	12.5	15.7	16.6	17.1	20.1	26.4
Long-term lease obligations	1.8	1.8	2.1	2.3	2.5	2.7	3.0	3.2	3.0	3.0	3.0	3.2	3.7
Shareholders' equity	10.8	12.7	14.8	17.1	18.5	21.1	25.8	31.3	35.1	39.5	43.6	49.4	53.2
Financial ratios													
Current ratio	1.6	1.5	1.5	1.6	1.3	1.3	0.9	0.9	1	0.9	0.9	0.9	0.9
Return on assets*	9.9%	9.0%	7.8%	7.9%	8.5%	9.6%	9.5%	8.7%	8.5%	9.0%	9.0%	9.3%	8.9%
Return on equity**	23.9%	22.8%	19.9%	19.2%	19.8%	22.4%	22.9%	22.0%	20.1%	21.0%	21.0%	22.6%	22.5%
Other year-end data													
No. of US discount stores	1,950	1,985	1,995	1,960	1,921	1,869	1,801	1,736	1,647	1,568	1,478	1,353	1,209
No. of US Supercenters	72	147	239	344	441	564	721	888	1,066	1,258	1,471	1,713	1,980
No. of US Sam's Clubs	417	426	433	436	443	451	463	475	500	525	538	551	567
No. of US Neighborhood Markets	–	–	–	–	–	4	7	19	31	49	64	85	100
International units	24	226	276	314	601	715	1,004	1,071	1,170	1,272	1,355	1,587	2,285
Employees (thousands)	528	622	675	728	825	910	1,140	1,244	1,383	1,400	1,400	1,600	1,800

* (Net income before minority interest, equity in unconsolidated subsidiaries and cumulative effect of accounting change)/Average assets.

** Net income/average shareholders' equity.

SOURCE: WAL-MART STORES INC. 10-K REPORTS.

TABLE 5.4 Wal-Mart and its competitors: performance comparisons ($ billions except where noted)

	Wal-Mart			Target			Dollar General			Costco		
	2004	2005	2006	2004	2005	2006	2004	2005	2006	2004	2005	2006
Income												
Sales revenue*	258.7	288.1	315.6	48.2	46.8	52.6	6.9	7.7	8.6	42.5	48.1	52.9
Gross profit	60.0	68.3	75.2	16.4	15.4	17.7	2.0	2.3	2.5	5.3	6.0	6.6
Gross margin (%)	23.2%	23.7%	23.8%	34.0%	32.9%	33.7%	29.0%	29.9%	29.1%	12.5%	12.5%	12.4%
SG&A expense	44.9	51.2	56.7	11.5	10.5	12.0	1.4	1.5	1.7	3.7	4.2	4.6
Depreciation and amortization	3.9	4.3	4.7	1.3	1.3	1.4	0.2	0.2	0.2	0.4	0.5	0.5
Operating margin (%)	4.3%	4.4%	4.4%	7.5%	7.7%	8.2%	6.5%	8.3%	7.1%	2.7%	2.9%	2.8%
Net income	9.1	10.3	11.2	1.8	1.9	2.4	0.3	0.3	0.4	0.7	0.9	1.1
Net margin (%)	3.5%	3.6%	3.5%	3.8%	4.1%	4.6%	4.4%	4.5%	4.1%	1.7%	1.8%	2.0%
Financial position												
Cash	5.2	5.5	6.4	0.7	2.2	1.6	0.4	0.3	0.2	1.5	3.1	3.5
Net receivables	1.3	1.7	2.7	5.8	5.1	5.7	0.0	0.0	0.0	0.6	0.3	0.6
Inventories	26.6	29.8	32.2	5.3	5.4	5.8	1.2	1.4	1.5	3.3	3.6	4.0
Total current assets	34.4	38.9	43.8	12.9	13.9	14.4	1.7	1.7	1.8	5.7	7.3	8.1
Total assets	104.9	120.2	138.2	31.4	32.3	35	2.7	2.8	3.0	13.2	15.1	16.5
Short-term debt	6.2	7.6	8.4	0.9	0.5	0.8	0.0	0.0	0.0	0.0	0.3	0.1
Total current liabilities	37.4	43.2	48.8	8.3	8.2	9.6	0.7	0.8	0.9	5.0	6.2	6.6
Long-term debt	17.1	20.1	26.4	10.2	9.0	9.1	0.3	0.3	0.3	1.3	1.0	0.7
Total liabilities	61.8	70.7	85	20.3	19.3	20.8	1.1	1.2	1.3	6.6	7.5	7.6
Shareholders' equity	43.6	49.4	53.2	11.1	13.0	14.2	1.6	1.7	1.7	6.6	7.6	8.9
Financial ratios												
Total asset turnover**	2.5	2.4	2.3	1.5	1.4	1.5	2.6	2.8	2.9	3.2	3.2	3.2
Receivables turnover***	199.0	169.5	116.9	8.3	9.2	9.2	227.0	309.2	722.7	76.5	143.6	94.7
Inventory turnover****	7.5	7.4	7.5	6.0	5.8	6.0	4.1	3.9	4.1	11.2	11.6	11.5
Debt/Equity	1.4	1.4	1.6	1.8	1.5	1.5	0.7	0.7	0.8	1.0	1.0	0.9
Return on assets	9.0%	9.3%	8.9%	5.9%	5.9%	6.9%	11.1%	12.3%	11.7%	5.5%	5.8%	6.4%
Return on equity	21.0%	22.6%	22.5%	14.5%	17.0%	18.0%	20.4%	20.4%	15.0%	11.6%	11.1%	11.0%

* For Wal-Mart, calculated as Net sales + Other income.

** Sales/Total assets.

*** Sales/Receivables.

**** COGS/Inventory.

SOURCES: HOOVERS.COM; VALUELINE.COM

Wal-Mart Stores' Operations and Activities[8]

Purchasing and Vendor Relationships

The size of Wal-Mart's purchases and its negotiating ability means that Wal-Mart is both desired and feared by manufacturers. Being accepted as a Wal-Mart vendor offers access to a huge share of the US retail market. At the same time, Wal-Mart buyers are well aware of their ability to take full advantage of economies of scale available to their suppliers and to squeeze their margins to razor-thin level. Purchasing is centralized. All dealing with US suppliers takes place at Wal-Mart's Bentonville headquarters. Would-be suppliers are escorted to one of 50 cubicles on "Vendor Row." Furnishings comprise just a table and folding chairs – sometimes no chairs. Suppliers regarded the experience of selling to Wal-Mart as intimidating and grueling: "Once you are ushered into one of the spartan little buyer's rooms, expect a steely eye across the table and be prepared to cut your price."[9] Another vendor commented: "All normal mating rituals are verboten. Their highest priority is making sure everybody at all times in all cases knows who's in charge . . . They talk softly, but they have piranha hearts, and if you aren't totally prepared when you go in there, you're in deep trouble."[10] The requirements that Wal-Mart imposes on its suppliers extends well beyond low prices. Increasingly Wal-Mart involves itself in its suppliers' employment policies, including workplace safety, working hours, and absence of child labor.

All negotiations are directly between manufacturers and Wal-Mart: Wal-Mart refuses to do business with manufacturers' representatives and agents. To avoid dependence on any one supplier, Wal-Mart limits the total purchases it obtains from any one supplier. The result is an asymmetry of bargaining power. Thus, Wal-Mart's biggest supplier, Procter & Gamble, accounts for about 3% of Wal-Mart's sales – but this represents 18% of P&G's sales.

International expansion has allowed Wal-Mart to increase its purchasing muscle through global procurement. By 2003, Asda was sourcing over 2,000 products from Wal-Mart's global network. This network included 23 procurement offices in 23 countries.[11]

During the past ten years, Wal-Wart established closer collaborative arrangements with its biggest suppliers. Wal-Mart's cooperation with Procter & Gamble provided a model for these relationships. The companies began electronic data interchange (EDI) at the beginning of the 1990s, and by 1993 there were 70 P&G employees working at Bentonville to manage sales and deliveries to Wal-Mart.

By the mid-1990s, Wal-Mart had extended EDI to cover about 70% of its vendors. Through Wal-Mart's "Retail Link" system of supply chain management, data interchange included point-of-sale data, levels of inventory, Wal-Mart's sales forecasts, vendors' production and delivery schedules, and electronic funds transfer.

Through collaboration with Cisco Systems, Retail Link was moved to the internet during the mid-1990s allowing suppliers to log onto the Wal-Mart database for real-time store-by-store information on sales and inventory for their products. This allows suppliers to work with Wal-Mart company's buyers to manage inventory in the stores – forecasting, planning, producing, and shipping products as needed. The result is faster replenishment, a product mix tuned to the needs of local customers, and lower inventory costs for Wal-Mart. A key benefit to suppliers is their ability to match production scheduling to Wal-Mart's sales.

Warehousing and Distribution

Wal-Mart was regarded as one of the world's leaders in logistics. It distributed a higher proportion of goods to its own stores than any other discount retailer. While most discount retailers relied heavily upon their suppliers to undertake distribution to individual stores, 81% of Wal-Mart's purchases were shipped to Wal-Mart's own distribution centers from where they were distributed in Wal-Mart trucks. The efficiency of the system rested on Wal-Mart's "hub and spoke" configuration. Distribution centers ("hubs") spanned over a million square feet, operated 24-hours, and served around 150 stores within a 200 mile radius. Deliveries into distribution centers were either in suppliers' trucks or Wal-Mart trucks, then deliveries were made to Wal-Mart stores. Grouping of Wal-Mart stores allowed trucks to deliver partial loads to several Wal-Mart stores on a single trip. On backhauls, Wal-Mart trucks would bring returned merchandise from stores and also pick up from local vendors. As a result, trucks were more than 60% full on backhauls. Unlike most retailers, which outsourced trucking, Wal-Mart owned some 3,500 trucks and some 14,000 trailers.

Wal-Mart was continually seeking ways to make its distribution system cheaper, faster, and more reliable. It was an early adopter of "cross-docking" – a system where goods arriving on inbound trucks were unloaded and reloaded on outbound trucks without entering warehouse inventory. In 2005, Wal-Mart introduced its "Remix" system designed to reduce inventories, speed deliveries to stores, and eliminate stock-outs. The new system created a new tier to Wal-Mart's distribution system. Third-party logistic companies were made responsible making smaller, more frequent pick-ups from suppliers, establishing "consolidation centers" throughout the US, then making frequent deliveries to Wal-Mart's distribution centers. The new system would allow Wal-Mart to order from suppliers on a five-day rather than four-week basis and would lead to lower inventories in both distribution centers and retail stores.

In 2005, Wal-Mart extended its tightly controlled logistical system to embrace products from overseas suppliers. Its "direct import" initiative involved, first, purchasing directly from overseas suppliers rather than through importers and, second, taking control of import logistics. Covering 4 million square feet, its import distribution center in Baytown, Texas was America's largest distribution facility devoted to a single company's products. Not only did the new distribution center give Wal-Mart the opportunity to exert greater control over its supplies of imports, it allowed it to avoid the delays and congestion of west-coast ports such as Long Beach.[12]

In-Store Operations

Wal-Mart's management of its retail stores was based upon its objective of creating customer satisfaction by combining low prices, a wide range of quality products carefully tailored to customer needs, and a pleasing shopping experience. Wal-Mart's management of its retail stores was distinguished by the following characteristics:

- *Merchandising*. Wal-Mart stores offered a wide range of nationally branded products. Although Wal-Mart also sold its own brand – especially in clothing – it gave less emphasis to own-brand products than other retailers (e.g., Sears). Under its "Store of the Community" philosophy, Wal-Mart sought to tailor its selection of merchandise to the characteristics of the local market. Point-of-sale data for individual stores greatly assisted responsiveness to local needs (see below).

- *Decentralization of store management*. Individual store managers were given considerable decision-making authority in relation to product range, product positioning within stores, and pricing. This differed from most other discount chains where decisions over pricing and merchandising were made either at head office or at regional offices. Decentralized decision-making power was also apparent within stores, where the managers of individual departments (e.g., toys, health and beauty, consumer electronics) were expected to develop and implement their own ideas for increasing sales and reducing costs.
- *Customer service*. Discount stores were open 9 a.m. to 9 p.m. weekdays, with shorter hours on weekends. Supercenters were open continuously. Despite the fanatical emphasis on cost efficiency, Wal-Mart went to great lengths to engage with its customers at a personal level. Stores employed "greeters" – often retired individuals – who would welcome customers and hand out shopping baskets. Within the store, all employees were expected to look customers in the eye, smile at them, and offer a verbal greeting. To encourage customer loyalty, Wal-Mart maintained a "Satisfaction Guaranteed" program. This program assured customers that Wal-Mart would accept returned merchandise on a no-questions-asked basis.

Marketing

Wal-Mart had been founded on Sam Walton's belief that: "There is only one boss: the customer." For Wal-Mart, the essence of customer service was low prices. Hence, Wal-Mart's marketing strategy rested primarily upon its slogan "Everyday Low Prices" – the message that Wal-Mart's price cutting strategy was not restricted to particular products or to particular time periods, but was a basic principle of Wal-Mart's business.

As a result of its customer-focused, value-for-money approach, Wal-Mart was able to rely on word-of-mouth communication of its merits, and was able to spend comparatively little on advertising and promotion. Advertising spending was limited to one advertisement circular per month per store and some television advertising. During the early 1990s, Wal-Mart spent only 0.5% of every sales dollar on advertising, compared with 2.5% for Kmart and 3.5% for Sears. In 2006, Wal-Mart's advertising sales ratio was 0.5%, compared with Target's 2.0%.

In its attempt to identify itself with its local communities and build relationships with customers, Wal-Mart had always placed strong emphasis on patriotism and national causes. However, as it became a target for politicians and pressure groups, Wal-Mart was forced to put more effort into refining and projecting its image. In November 2005, CEO Lee Scott announced Wal-Mart's commitment to environmental sustainability and set ambitious targets for energy and waste reduction.[13]

Information Technology

Wal-Mart was a pioneer in applying information and communications technology to support decision-making and promote efficiency and customer responsiveness. In 1974, Wal-Mart was among the first retailers to use computers for inventory control. In 1977, Wal-Mart initiated electronic data interchange (EDI) with its vendors. In the following year Wal-Mart introduced bar code scanning for point-of-sale and inventory control. To link stores and cash register sales with supply chain management and inventory control, Wal-Mart invested $24 million in its own satellite in 1984. By 1990, Wal-Mart's satellite system was the largest two-way, fully integrated private satellite network in the world, providing two-way interactive voice and video capability, data transmission for inventory control, credit card authorization, and enhanced EDI.

By the end of the 1990s Wal-Mart was pioneering the use of data-mining for retail merchandising:

> *At Wal-Mart, information technology gives us that knowledge in the most direct way: by collecting and analyzing our own internal information on exactly what any given shopping cart contains. The popular term is "data-mining," and Wal-Mart has been doing it since about 1990. The result, by now, is an enormous database of purchasing information that enables us to place the right item in the right store at the right price. Our computer system receives 8.4 million updates every minute on the items that customers take home – and the relationship between the items in each basket.*
>
> *Data analysis allows Wal-Mart to forecast, replenish, and merchandise on a product-by-product, store-by-store level. For example, with years' of sales data and information on weather, school schedules, and other pertinent variables, Wal-Mart can predict daily sales of Gatorade at a specific store and automatically adjust store deliveries accordingly.*[14]

Point-of-sale data analysis also assisted in planning store layout:

> *There are some obvious purchasing patterns among the register receipts of families with infants and small children. Well-thought-out product placement not only simplifies the shopping trip for these customers – with baby aisles that include infant clothes and children's medicine alongside diapers, baby food and formula – but at the same time places higher-margin products among the staples . . .*
>
> *Customers who buy suitcases are likely to be looking for other items they might need for traveling too – such as travel alarms and irons, which now, logically enough, can be found displayed alongside luggage at many Wal-Mart stores.*
>
> *The common thread is simple: We are here to serve the customer; and customers tend to buy from us when we make it easy for them. That sounds like a simple idea. But first you must understand the customer's needs. And that's where information comes in.*[15]

Most important was the role of IT in linking and integrating the whole of Wal-Mart's value chain:

> *Wal-Mart's web of information systems extends far beyond the walls of any one store. Starting from the basic information compiled at the checkout stand, at the shelves, and gathered by associates equipped with hand-held computer monitors, Wal-Mart works to manage its supplies and inventories not only in the stores, but all the way back to the original source. Wal-Mart has given suppliers access to some of our systems, which enables them to know exactly what is selling, and to plan their production accordingly. This not only helps us keep inventories under control, but also helps the supplier deliver the lowest-cost product to the customer. With sales and in-stock information transmitted between Wal-Mart and our supplier-partners in seconds over the internet, buyers and suppliers are privy to the same facts and negotiate based on a shared understanding – saving a*

significant amount of time and energy over more traditional, low-tech systems. Our buyer benefits from the supplier's product knowledge, while the supplier benefits from Wal-Mart's experience in the market. Combine these information systems with our logistics – our hub-and-spoke system in which distribution centers are placed within a day's truck run of the stores – and all the pieces fall into place for the ability to respond to the needs of our customers, before they are even in the store. In today's retailing world, speed is a crucial competitive advantage. And when it comes to turning information into improved merchandising and service to the customer, Wal-Mart is out in front and gaining speed. In the words of Randy Mott, Senior Vice President and Chief Information Officer, "The surest way to predict the future is to invent it."[16]

Early in 2004, Wal-Mart pioneered the use of radio-frequency identification (RFID) tags embodying electronic product codes for tracking pallets and cases of merchandise throughout its system. Trials showed that RFID allows sharp reductions in stockouts, faster replenishment, reduced inventory, and allowed manual orders from stores to be replaced by automated ordering.

Human Resource Management

Wal-Mart's human resource policies are based closely on Sam Walton's ideas about relations between the company and its employees and between employees and customers. All employees – from executive-level personnel to checkout clerks – are known as "associates." Wal-Mart's relations with its associates are founded on respect, high expectations, close communication, and clear incentives.

Although Wal-Mart's employees receive relatively low pay (in common with most of the retail trade), Wal-Mart offered strong profit incentives for employees and encouraged them to share in its wealth creation through its stock ownership scheme. Numerous employees have retired as millionaires as a result of their participation in the plan. Most of these were managers; however, in 1989, the first millionaire hourly associate retired from the company.

Wal-Mart resisted the unionization of its employees in the belief that union membership created a barrier between the management and the employees in furthering the success of the company and its members. Despite strenuous efforts by unions to recruit Wal-Mart employees, union penetration remained low. Between 2000 and 2004, the United Food and Commercial Workers together with AFL-CIO fought a concerted campaign to recruit Wal-Mart workers, but to little effect.[17]

Associates enjoyed a high degree of autonomy and received continuous communication about their company's performance and about store operations. Every aspect of company operations and strategy was seen as depending on the close collaboration of managers and shop-floor employees. To control "shrinkage" (theft), the company instituted a system whereby a store's cost savings from reduced shrinkage were shared between the company and the store's employees. Wal-Mart's shrinkage was estimated to be just above 1%, versus an industry average of 2%.

Wal-Mart's approach to employee involvement made heavy use of orchestrated demonstration of enthusiasm and commitment. The central feature of Wal-Mart meetings from corporate to store level was the "Wal-Mart Cheer" – devised by Sam Walton after a visit to Korea. The call and response ritual ("Give me a W!" "Give me an A!" . . .), included the "Wal-Mart squiggly," which involved employees shaking their backsides in unison.

Fortune suggested that the Wal-Mart cheer's mixture of homespun and corporate themes provided an apt metaphor for what it called "the Wal-Mart paradox:"

> *The paradox is that Wal-Mart stands for both Main Street values and the efficiencies of the huge corporation, aw-shucks hokeyness and terabytes of minute-by-minute sales data, fried-chicken luncheons at the Waltons' Arkansas home and the demands of Wall Street.*
>
> *Critics of Wal-Mart call the homespun stuff a fraud, a calculated strategy to put a human face on a relentlessly profit-minded corporation. What is paradoxical and suspect to people outside Wal-Mart, however, is perfectly normal to the people who work there. It reflects a deal that Sam Walton, Wal-Mart's founder, made with the people who worked for him.*
>
> *The deal was a lot more than just a matter of the occasional visit from Mr. Sam. Wal-Mart demonstrated its concern for workers in many ways that were small but specific: time and a half for work on Sundays, an "open door" policy that let workers bring concerns to managers at any level, the real chance of promotion (about 70% of store managers started as hourly associates).*[18]

The paradox of Wal-Mart's human resource practices continues. Its enthusiasm drive provides a level of involvement and empowerment that is unique among large retail organizations. At the same time, the intense pressure for cost reduction and sales growth frequently results in cases of employee abuse, from unpaid overtime, discrimination, and unfair dismissal.

Organization and Management Style

Wal-Mart's management structure and management style had been molded by Sam Walton's principles and values. As Wal-Mart grew in size and geographical scope, Walton was determined that corporate executives should keep closely in touch with customers and store operations. The result was a structure in which communication between individual stores and the Bentonville headquarters was both close and personal. Wal-Mart's regional vice presidents were each responsible for supervising between ten and fifteen district managers (who, in turn, were in charge of eight to twelve stores). The key to Wal-Mart's fast-response management system was the close linkage between the stores and headquarters. Former CEO, David Glass explained the system:

> *The idea is very simple. Nothing very constructive happens in the office. Everybody else had gone to regional offices – Sears, Kmart, everybody – but we decided to send everybody from Bentonville out to the stores Monday though Thursday. And bring them back Thursday night. On Friday morning we'd have our merchandising meetings. But on Saturday morning we'd have our sales for the week. And we'd have the other information from people who'd been out in the field. They're telling us what our competitors are doing, and we get reports from people in the regions who had been traveling though the week. So we decide then what corrective action we want to take. And before noon on Saturday the regional manager was required to be hooked up by phone to all his district managers, giving them direction as to what we were going to do or change. By noon on Saturday we had all our corrections in place. Our competitors, for the most part, got their sales results on Monday for the week prior. Now, they're already ten days behind, and we've already made the corrections.*[19]

The Saturday morning meeting is preceded by three other key corporate meetings. On Thursday afternoon is the operations meeting. This is attended by 70 senior executives and logistics, planning, and information managers. The meetings review non-merchandising matters – including inventory management, supply chain efficiencies, and new store development. The meetings are held standing to encourage brevity.

Fridays begin with the 7 a.m. management meeting, which involves Wal-Mart's 200 most senior managers. To attend these meetings Wal-Mart's 39 regional vice presidents need to return on Thursday evening from their territories to the Bentonville "home office." The meetings deal with strategic and critical operational matters. At lunchtime, in the same auditorium, the merchandising meeting takes place. Here, buyers and corporate executives meet. The purpose of the meeting is, first, to give buyers direct insights into what is selling and what is not; second, to give the regional VPs a means to get instant action to solve merchandising problems in their stores; third, to report on what the competition is doing. The meeting deals with stockouts, excess inventory, new product ideas, and a variety of merchandising errors. By the early afternoon the regional VPs and merchandisers will be emailed a "priority note" of specific actions that they should take action on by the end of the day.

It is the two-and-a-half hour Saturday morning meeting, however, that is the week's high point and the clearest representation of Wal-Mart's unique management style:

> *The meeting is the soul of this behemoth . . . It is the template for other vital gatherings that have evolved throughout the company, ranging from the daily shift-change meetings at the stores to the weekly management, merchandising, and operations meetings at the home office to the five company-wide mega-meetings each year that draw more than 10,000 participants apiece. Not only do these assemblies reinforce and personalize Wal-Mart's almost evangelical culture among its 1.5 million "associates" worldwide, but they are also largely responsible for the retailing giant's amazing agility in the aisles. The meetings enable the company to continue to operate its entire business on a weekly and sometimes a daily basis, just as the founder managed his first five-and-dime, moving quickly to outflank competition and growing almost as a matter of routine.*[20]

The Saturday meetings are a remarkable mixture of information sharing, educational inputs, and motivation recharging. They begin with a review of the week's performance data, then involve question and answer sessions targeting examples of good and bad performance. There are also presentations that focus on merchandising best practices or new product lines, and guest appearances that might include CEOs such as Carlos Ghosn, Steve Jobs, or Jack Welch, or celebrity singers or sports stars. The meetings close with a talk from the CEO.

Management development is a critical aspect of the Wal-Mart management system. Wal-Mart emphasizes internal recruitment and developing managers through moving then between line and staff positions and across functions. Most of Wal-Mart's senior managers are company veterans who have spent most of their careers in retailing. A large number of them are from Wal-Mart's mid-west and southwest heartland (see table 5.5).

TABLE 5.5 Wal-Mart's executive team

Name	Position	Joined W-M	Education
Eduardo Castro-Wright	EVP, President and CEO, Wal-Mart Stores Division	2001	Texas A&M University
M. Susan Chambers	EVP, People Division	1999	William Jewell College, Missouri
Patricia A. Curran	EVP, Store Operations	1983	N/A
Leslie A. Dach	EVP, Corporate Affairs and Government Relations	2006	Yale; Harvard
Douglas J. Degn	EVP, Food Merchandising	1983	University of Kansas
Linda M. Dillman	EVP, Risk Management and Benefits Administration	1991	University of Indianapolis
Michael T. Duke	Vice Chairman, International	1995	Georgia Tech
Johnnie C. Dobbs	EVP, Logistics and Supply Chain	1990	East Texas State University
John J. Fitzsimmons	SVP and Treasurer	1994	Notre Dame; University of Chicago
Rollin L. Ford	EVP and Chief Information Officer	1983	Taylor University, Indiana
Mark D. Goodman	EVP, Marketing, Membership & E-Commerce, Sam's Club	N/A	College of Wooster, Ohio; Tufts
Craig R. Herkert	EVP, President and CEO, Americas region, International	2000	St. Francis College; Northern Illinois University
Charles M. Holley	SVP, Finance	1994	University of Texas (Austin); University of Houston
Thomas D. Hyde	EVP and Corporate Secretary	2001	University of Kansas: University of Missouri
Lawrence V. Jackson	EVP, President and CEO, Global Procurement	N/A	Harvard
Gregory L. Johnston	EVP, Club Operations, Sam's Club	1982	N/A
Thomas A. Mars	SVP and General Counsel	2002	University of Arkansas
C. Douglas McMillon	EVP, President and CEO, Sam's Club	1984	University of Arkansas; University of Tulsa
John B. Menzer	Vice Chairman, United States	1995	Loyola University, Chicago
Thomas M. Schoewe	EVP and Chief Financial Officer	2000	Loyola University, Chicago; University of Chicago
H. Lee Scott	President and CEO	1979	Pittsburgh State University
William S. Simon	EVP, Professional Services, Wal-Mart Stores	2006	University of Connecticut
Gregory E. Spragg	EVP, Merchandising and Replenishment, Sam's Club	1998	North Carolina State University
S. Robson Walton	Chairman of the Board	1969	University of Arkansas; Columbia University
Claire A. Watts	EVP, Product Development	1997	University of Cincinnati
Eric S. Zorn	EVP and President, Wal-Mart Realty	1993	Fairleigh Dickinson University, NJ

SOURCE: WAL-MART 10-K REPORT, 2006.

Appendix
The Wal-Mart Culture

As Wal-Mart continues to grow into new areas and new mediums, our success will always be attributed to our culture. Whether you walk into a Wal-Mart store in your hometown or one across the country while you're on vacation, you can always be assured you're getting low prices and that genuine customer service you've come to expect from us. You'll feel at home in any department of any store . . . that's our culture.

Sam Walton's Three Basic Beliefs

Sam Walton built Wal-Mart on the revolutionary philosophies of excellence in the workplace, customer service and always having the lowest prices. We have always stayed true to the Three Basic Beliefs Mr. Sam established in 1962:

Respect the Individual
" 'Our people make the difference' is not a meaningless slogan – it's a reality at Wal-Mart. We are a group of dedicated, hardworking, ordinary people who have teamed together to accomplish extraordinary things. We have very different backgrounds, different colors and different beliefs, but we do believe that every individual deserves to be treated with respect and dignity." – Don Soderquist, Senior Vice Chairman, Wal-Mart Stores, Inc.

Service to Our Customers
We want our customers to trust in our pricing philosophy and to always be able to find the lowest prices with the best possible service. We're nothing without our customers.

"Wal-Mart's culture has always stressed the importance of Customer Service. Our Associate base across the country is as diverse as the communities in which we have Wal-Mart stores. This allows us to provide the Customer Service expected from each individual customer that walks into our stores." – Tom Coughlin, President and chief executive officer, Wal-Mart Stores division.

Strive for Excellence
New ideas and goals make us reach further than ever before. We try to find new and innovative ways to push our boundaries and constantly improve. "Sam was never satisfied that prices were as low as they needed to be or that our product's quality was as high as they deserved – he believed in the concept of striving for excellence before it became a fashionable concept." – Lee Scott, President and CEO.

Sam's Rules for Building a Business

People often ask, "What is Wal-Mart's secret to success?"

In response to this ever-present question, in his 1992 book *Made in America*, Sam Walton compiled a list of ten key factors that unlock the mystery. These factors are known as "Sam's Rules for Building a Business."

Rule 1. Commit to your business. Believe in it more than anybody else. I think I overcame every single one of my personal shortcomings by the sheer passion I brought to my work. I don't know if you're born with this kind of passion, or if you can learn it. But I do know you need it. If you love your work, you'll be out there every day trying to do it the best you possibly can, and pretty soon everybody around will catch the passion from you – like a fever.

Rule 2. Share your profits with all your Associates, and treat them as partners. In turn, they will treat you as a partner, and together you will all perform beyond your wildest expectations. Remain a corporation and retain control if you like, but behave as a servant leader in a partnership. Encourage your Associates to hold a stake in the company. Offer discounted stock, and grant them stock for their retirement. It's the single best thing we ever did.

Rule 3. Motivate your partners. Money and ownership alone aren't enough. Constantly, day-by-day, think of new and more interesting ways to motivate and challenge your partners. Set high goals, encourage competition, and then keep score. Make bets with outrageous payoffs. If things get stale, cross-pollinate; have managers switch jobs with one another to stay challenged. Keep everybody guessing as to what your next trick is going to be. Don't become too predictable.

Rule 4. Communicate everything you possibly can to your partners. The more they know, the more they'll understand. The more they understand, the more they'll care. Once they care, there's no stopping them. If you don't trust your Associates to know what's going on, they'll know you don't really consider them partners. Information is power, and the gain you get from empowering your Associates more than offsets the risk of informing your competitors.

Rule 5. Appreciate everything your Associates do for the business. A paycheck and a stock option will buy one kind of loyalty. But all of us like to be told how much somebody appreciates what we do for them. We like to hear it often, and especially when we have done something we're really proud of. Nothing else can quite substitute for a few well-chosen, well-timed, sincere words of praise. They're absolutely free – and worth a fortune.

Rule 6. Celebrate your successes. Find some humor in your failures. Don't take yourself so seriously. Loosen up, and everybody around you will loosen up. Have fun. Show enthusiasm – always. When all else fails, put on a costume and sing a silly song. Then make everybody else sing with you. Don't do a hula on Wall Street. It's been done. Think up your own stunt. All of this is more important, and more fun, than you think, and it really fools the competition. "Why should we take those cornballs at Wal-Mart seriously?"

Rule 7. Listen to everyone in your company. And figure out ways to get them talking. The folks on the front lines – the ones who actually talk to the customer – are the only ones who really know what's going on out there. You'd better find out what they know. This really is what total quality is all about. To push responsibility down in your organization, and to force good ideas to bubble up within it, you must listen to what your Associates are trying to tell you.

Rule 8. Exceed your customers' expectations. If you do, they'll come back over and over. Give them what they want – and a little more. Let them know you appreciate them. Make good on all your mistakes, and don't make excuses – apologize. Stand behind everything you do. The two most important words I ever wrote were on that first Wal-Mart sign, "Satisfaction Guaranteed." They're still up there, and they have made all the difference.

Rule 9. Control your expenses better than your competition. This is where you can always find the competitive advantage. For 25 years running – long before Wal-Mart was known as the nation's largest retailer – we ranked No. 1 in our industry for the lowest ratio of expenses to sales. You can make a lot of different mistakes and still recover if you run an efficient operation. Or you can be brilliant and still go out of business if you're too inefficient.

Rule 10. Swim upstream. Go the other way. Ignore the conventional wisdom. If everybody else is doing it one way, there's a good chance you can find your niche by going in exactly the opposite direction. But be prepared for a lot of folks to wave you down and tell you you're headed the wrong way. I guess in all my years, what I heard more often than anything was: a town of less than 50,000 population cannot support a discount store for very long.

Source: "The Wal-Mart Culture" from www.walmartstores.com (includes "Sam's Rules for Building a Business", from Sam Walton and John Huey, *Made in America*, Doubleday, 1992).

Notes

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