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Against the Wall-Mart: Does Market Power Condone Bad Behavior?

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Against the Wall-Mart: Does Market Power Condone Bad Behavior?

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WHEN COMPETITIVE ADVANTAGE DEVOURS THE COMPETITION

John D. Rockefeller epitomizes an extreme form of competitive advantage that leaves the landscape bare of competition. It is a type of advantage where competitive firms cannot survive other than on the periphery. At its heart, it is a destructive force where only a monopoly is left standing.

John D. Rockefeller was a driven and extremely acute businessman. He wished to dominate the oil industry in its infancy and concentrated on refining. He knew that if he controlled refining, he could set the price of the raw material crude oil and the price of refined products, which in his day were kerosene and lubricating oils (lubes). He acquired his first refinery in an industry populated with approximately 250 competitors. In ten short years, 90 percent of them were gone. He accomplished this by achieving a competitive advantage that few could withstand.

The refiners of the day made kerosene and lubes, burned what was left at the bottom of the barrel and threw the naphtha (today's gasoline) away. Rockefeller, extremely adverse to waste, developed new markets in lubes such as for railroad locomotives and burned the naphtha for fuel. Thus, he was selling more of a barrel of crude than his competitors. He concentrated his refining in three refineries, achieving economies of scale and a level of operational proficiency unmatched by his competitors. Whereas some of his competitors would try to spike kerosene with naphtha that could lead to explosive situations killing people and setting fires, Rockefeller assured his buyers that his product was standardized (hence the reason for naming his company Standard Oil) and that this adulteration would never occur. Consumers trusted his product. In a way, he anticipated the quality revolution.

He expanded his market to cover the United States and Europe. He achieved an overwhelming competitive advantage when, through his business associate Henry Flagler, he negotiated a secret 50 percent rebate from the railroads to move his product to market. At that point, he was unstoppable. No one could match his costs. To take over the industry, he would identify his next victim to be given a "sweating," which meant that the price of kerosene in the victim's marketing area would be dropped to a point that would bankrupt the refiner. Rockefeller could bring any refiner to heel with his low operating costs and logistical advantage. Moreover, he had a much larger marketing area that could sustain losses, if there were any, in the targeted market. His only redeeming "virtue" is that he would offer his erstwhile competitor cash or stock in Standard Oil. The crushed competitor, enervated in his dealings with Rockefeller, almost invariably accepted cash – a big mistake.

Not only did Rockefeller capture 90 percent of the refining market but he also expanded into other areas of the oil business and into other industries. He never lost a penny in any of his ventures; the true Midas Touch. He became the world's richest man and spent his last years giving away a portion of his fortune (Segall, 2001).

In contrast to Rockefeller, Sam Walton started his business life with two small department stores. He realized that a competitive advantage could be achieved if he had the lowest prices in town. His version of Rockefeller's unbeatable competitive advantage of a 50 percent rebate from the railroads was sole sourcing his goods from China. Once he reached a critical mass, he could tell his American suppliers that if they wished to continue having his business, the next shipment would have to come from China. Substituting labor costing a dollar or two per day for labor costing $15 per hour easily lowered the prices of Walmart goods.

The Walmart paradigm of funneling everything through China played a major role in stripping the United States of its consumer product manufacturing base. However, substituting cheap Chinese goods for relatively expensive American goods was just the start. At some point, Walton no longer negotiated on price; he dictated the price. He could negotiate lower shipping rates than his competitors by virtue of being one of China's largest exporters, far larger than individual nations. He developed an extremely efficient warehouse-distribution system including cross-docking where trucks filled with suppliers' goods would meet empty Walmart trucks. Goods would be exchanged between trucks using only the docking facilities rather than the storage capacity of the warehouse. Walton forced inventory carrying costs to the supplier by not paying the supplier until after the goods were sold. This reduced Walmart's need for vested capital by having the supplier finance goods while Walmart waited for customers to buy them. Slow moving goods were lowered in price without much discussion with suppliers.

Walmart's information system allowed suppliers to know their inventory of goods in various Walmart stores to forecast demand and replace goods before they stocked out. In this way, Walmart passed the reordering process and its associated costs to the suppliers and generated more savings. Of course, any unsold merchandise was the supplier's problem, not Walmart's. Walmart's information system kept track of turnover and culled products as soon as sales began to weaken. In one way, Walmart was a commission house, not a retailer in the conventional sense. With regard to labor, Walmart depended heavily on part time workers paid the minimum wage without benefits while its full-time employees worked for modest salaries with minimum benefits.

It is well-known anecdotally that an opening of a Walmart store is preceded or quickly followed by the closure of neighborhood department stores which are at a decidedly competitive disadvantage for every cost factor associated with retailing. A more quantitative analysis of this phenomenon shows that exit and entry rates for new stores change in the sense of fewer new entries. In other words, the presence of a Walmart store has less to do with the closing of existing stores versus as a barrier to new stores. Stores reluctant to enter an area served by Walmart include both department stores of general merchandise and food stores. Some stores benefit from a Walmart presence if their merchandise complements rather than competes with Walmart. Many believe that very little good comes to local retailers from a Walmart entering a neighboring community (Paruchuri, Baum, Potere, 2009).

Walmart has been able to take advantage of retail trends that favor its marketing philosophy. One trend is customers being more guarded as to the information that influences their buying decisions. But if customers conclude that a particular store, such as Walmart, can present them with low cost products, they may favor Walmart at the expense of other retailers. Another trend is internet shopping where Walmart probably does not have a decided advantage other than trust incurred in buying products at Walmart. Still another area where Walmart excels is mega-retailers breaking the boundaries that constrain them through aggressive expansion of stores, formats and categories, blurring the boundaries between traditional industry segments such as general merchandise and food. Mega-retailers are anticipated to simply take over the market as a group. Another trend where Walmart excels is in partnering with suppliers and customers, forming a smooth chain of movement from suppliers' factories to distribution centers and on to stores and customers with a minimum of unwanted interruptions or inventory buildups. The last trend, and perhaps the most important, is the acceleration of competitive Darwinism that will lead

to either big winners or big losers. Undoubtedly, Walmart will be the last retailer standing (Gagnon and Chu, 2005).

The business strategy of Sam Walton, expertly crafted and carried out, has made Walmart not only the nation's largest revenue generator (all without manufacturing anything), but also the nation's largest employer. As with Rockefeller's commanding control over the nation's oil business, Sam Walton's commanding control over the nation's retail business made him exceedingly rich. His four siblings are each worth over $20 billion. This means that the original Walton fortune was $80 billion, nearly the combined fortune of Bill Gates and Warren Buffet. But unlike Rockefeller who was the most hated individual in America, Sam Walton is considered a benign businessperson deserving of our respect and admiration.

While Walmart is the largest company in the United States both in terms of revenue and number of people employed, expressing these facts differently reinforces the magnitude of the company's marketing presence. Walmart's revenue in 2010 of nearly $422 billion dwarfs its "rival" Target's revenue of $68 billion by a factor of over six. Its revenue is a bit less than that of the GDP of Taiwan and a bit more than the GDP of Norway, making Walmart the 25th largest economic power in the world. Of the world's nearly 200 nations, Walmart's workforce outnumbers the population of nearly half. Walmart's retail space, not counting distributions centers or its parking lots, is 1.5 times the area of Manhattan Island. Walmart's truck drivers have logged enough miles annually to encircle the earth 30,000 times (Berlin, 2011).

Although Walmart has been charged with unfair competition, anti-trust violations in the sense of Standard Oil will be hard to prosecute (Anonymous, 2004). Standard Oil had a practice of "sweating out" the competition that was well-documented, although it took over a decade for the Justice Department to finally prevail with the break-up of Standard Oil into nearly three dozen separate companies.

The inability to pursue anti-trust violations does not make Walmart invulnerable. Walmart's model of low priced goods depends on Chinese labor rates remaining depressed and the continuance of the current exchange rate between China's and the U.S. currency. Changes in one or both of these business factors could drastically affect Walmart's future. Of more immediate concern is the manner in which Walmart manages its employment practices.

EMPLOYMENT PRACTICES: PAY EQUITY, BENEFITS AND DEVELOPMENT

In June of 2011 and after almost a decade-long legal battle, the U.S. Supreme Court, in a 5-4 decision, ruled that female employees could not sue Walmart in a class action lawsuit that alleged wage discrimination. In 2004, U.S. District Judge Martin Jenkins granted class-action status to this sex discrimination lawsuit against Walmart Stores Inc., stating that the attorneys for the plaintiffs "present largely uncontested, descriptive statistics which show that women working in Wal-Mart stores are paid less than men in every region, that pay disparities exist in most job categories, that the salary gap widens over time even for men and women hired into the same jobs at the same time, that women take longer to enter into management positions, and that the higher one looks in the organization, the lower the percentage of women" (Ackman, 2004, p. 1). At that time and according to the plaintiffs, women comprised more than 70% of Walmart's hourly workforce but less than one-third of its store management. Today, 86% of Walmart's managers are men, even though two-thirds of Walmart's employees are women.

When the class was given class-action status in 2004, Joseph Sellers, a lawyer at Washington, DC's Cohen, Milstein, Hausfeld & Toll, which represented the women in the case, noted that "certification of this class shows that no employer, not even the world's largest employer, is above the law" (Ackman, 2004, p. 2). During the recent Supreme Court arguments, Mr. Sellers was asked to explain the "pattern

and practice" of discrimination – a legal standard for liability. He argued that the company gave local managers unbridled discretion to underpay women, and that this behavior was engrained in the centralized corporate culture of the company. In addition, more than 100 women gave depositions telling similar stories to the named plaintiffs. "We talked to hundreds more, but many were too scared to stand up," said Betty Lawrence, another attorney for the plaintiffs (Bravin and Zimmerman, 2011).

Although liberal justices were more amenable to the plaintiffs' claim based on statistical evidence of pay and promotions that favor men over women, Justice Samuel Alito posed a provocative question during the arguments. He asked whether statistical evidence of discriminatory pay and promotion practices meant "every single company" in the country could potentially be in violation of the Civil Rights Act of 1964, which prohibits employment discrimination. Mr. Sellers answered, "Possibly so" (Bravin and Zimmerman, 2011). Perhaps this exchange explains why so many large employers wrote testimonials praising Walmart as a model employer.

A key ruling in this case allows corporations to use arbitration clauses to prevent employees from using class actions to hold them accountable, requiring individual litigation instead. An attorney who unsuccessfully defended litigants in a class action lawsuit in which AT&T Inc. was charged with sales tax fraud, responded to the Walmart decision with the following, "…the U.S. Supreme Court dealt a crushing blow to American consumers and employees, ruling that companies can ban class actions in the fine print of contracts. So whenever you sign a contract for a cell phone, bank account, credit card, employment, or other purpose, you may be giving up your right to hold companies accountable for fraud, discrimination or other illegal practices." He went on to say that these decisions "…will shield corporations from accountability, making it harder for people to litigate civil rights, labor, consumer, and other (type) claims by joining together to obtain their rightful compensation" (Marshall, 2011, p. 1).

Walmart prevailed in this class action case; however, it has not been spared from other employment-related issues that have surfaced before and since that decision. In Walmart's favor, South Africa's Competition Commission announced that Walmart's acquisition of a majority stake in Massmart Holdings did not pose competition problems, although it did note concerns by various labor unions regarding labor relations and local sourcing of products. To date, the acquisition will not be confirmed until Massmart's discussions with the South African Commercial Catering and Allied Workers' Union (SACCAWU) are concluded (Anonymous, 2011). In contrast to this potential "win" for Walmart, the New York City pension funds, owner of a small percentage of shares in Walmart, announced its intention to ask the company to require its vendors to publish annual reports on working conditions in their factories. Kalpona Akter, a Bangladeshi labor organizer who will present the proposal, asserts that many Bangladesh factories that produce goods for Walmart mistreat their workers and "…when the auditor goes to the factory, the worker is coached by the management to tell lies in front of the auditors – that they are being paid living wages, that they are not being harassed" (Clifford, 2011). In response, Walmart notified the Securities and Exchange Commission (SEC) that it planned to strike the proposal; the SEC declined its request. Michael Garland, executive director for corporate governance at the city comptroller's office, hopes to persuade the board that human rights are an integral component of Walmart's supply chain standards.

Another source of controversy occurred almost a year ago, when Walmart announced the replacement of its profit-sharing contributions with matched contributions up to six percent of eligible employees' pay. David Tovar, a spokesperson for Walmart, did not disclose the percentage of Walmart's 1.1 million eligible employees who contribute to the 401(k) plan (Boyle and Stanford, 2010). Regardless of this nondisclosure, it must be noted that many benefits – notably, retirement benefits – have eroded over time. For over three decades, the number of traditional pension plans has declined as defined contribution plans such as 401(k)s increased to 67 million from 11 million (U.S. Department of Labor). Across all industries, employers are shifting the responsibility of retirement benefits to individual employees. In

Walmart's case, however, it is questionable whether its employees – commonly known to be paid among the lowest in and beyond the retail industry – will be able to "afford" this benefit.

Following the same lines of affordable employee benefits, a year ago, Walmart started offering its U.S. employees discounted online college degrees through a partnership with American Public University, a for-profit school in Charles Town, West Virginia. Employees who have been on the job for at least one year full-time or three years part-time are eligible to receive a 15 percent price reduction on tuition (Quinn, 2010). Neither the cost of tuition nor the financial relationship between Walmart and this university were divulged, leading one to question whether a low-paid workforce will be able to afford 85 percent of a higher education, excluding associated expenses. In addition, the value of a degree from this university also may be debatable in the broader and increasingly competitive employment market.

"EVERY DAY LOW PRICES" FOR WHOM?

As recently as late April of 2011 and in spite of its commanding retail presence, Walmart posted seven straight quarters of sales declines in its stores (Kavilanz, 2011). Post-recessionary factors such as the continued high rate of unemployment, underemployment, and fluctuating fuel prices have had an impact on consumer spending. Regardless of these forces, many of Walmart's business practices will determine whether it continues to retain its dominance in future years.

During the late 1980s and early 1990s, Walmart urged its customers to "buy American." However, the company pressed its suppliers to continually drop their prices to such an extent that the only recourse was to close U.S. plants in favor of outsourcing overseas. In addition and from that point forward, Walmart insists that prices for basic products that do not change must drop, year after year. These pricing demands have placed incredible pressure on both U.S. and Chinese suppliers to concede or risk the chance of extinction. Even for the largest consumer goods companies, *not* doing business with Walmart can be equally disastrous. For example, in 2007, Dial Corporation obtained 28% of its business with Walmart. If Dial had lost its one account with Walmart, it was estimated that it would have to have doubled its sales to its next nine customers just to stay even (Fishman, 2007).

Walmart pressures its suppliers but it also forces them to be more efficient and focused. To its credit, Walmart is known for keeping its word and paying its bills quickly. According to Peter Campanella, who ran the business that sold Corning kitchenware products, both at Corning and then at World Kitchen, "they [Walmart] are tough people but very honest; they treat you honestly. It was a joke to do business with most of their competitors. A fiasco" (Fishman, p. 6, 2007).

In 2005, two executives from IBM's Business Consulting Services division examined how the global consumer marketplace would evolve by the year 2010. The following is a summary of their five prophetic factors that continue to affect the nature of retail competition:

- Customer value drivers will fragment. Diversity in the composition of households and shifts in values are complicating the ability to define, categorize and reach customers.
- Customers will become more guarded. Increasingly, the public abhors unsolicited contact and as a result, companies will need to find ways and situations where their messages are most relevant.
- Information exposes all. Retailers must unobtrusively utilize electronic media to engage customers in productive ways.

- Mega-retailers will break the boundaries. These outlets will raise the bar for the rest of the industry, but they must find ways to differentiate themselves in order to survive.

- Partnering will be pervasive. Market leadership will be defined by how quickly and efficiently a retailer responds to shifting customer demands (Gagnon and Chu, 2005).

Interestingly, one value driver that has garnered attention from customers is the importance of personal opinions about corporate and social ethics. These opinions may include but not be limited to the ways in which an organization deals with employment practices, environmental issues, and world trade. Therefore, it may not be enough for a retail giant such as Walmart to offer unbeatable prices and convenience features. At any point in time, stakeholders – including investors – may demand greater social accountability that transcends traditional, profit-centered expectations.

MANAGERIAL IMPLICATIONS

As mentioned previously, the business model developed by Walmart is unique and, thanks to the expansion of its resources, has enabled the company to benefit various stakeholder groups – notably, many local and global communities in which it conducts business. For example, in the fiscal year ending 2009, the company and the Walmart Foundation gave more than $378 million in cash and gifts in the United States; globally and in the same year, both entities distributed $423 million (Anonymous, 2010). However, do customer-centeredness and community-based philanthropy offset questionable – and, some would say, hostile – employment practices and a lack of consideration of employees from its top leaders?

In spite of its achievements, Walmart increasingly has been questioned about its labor practices which include but are not limited to non-liveable wages, making employees work "off the clock" without overtime pay, and repeated violations of federal labor laws associated with unionization. In 2008, Walmart agreed to pay $640 million to settle 63 lawsuits alleging it underpaid employees around the country; in addition, the National Labor Relations Board ruled that the company has engaged in illegal activities such as confiscating union literature, interrogating employees, and firing union sympathizers (Bustillo, 2008). To these authors' knowledge and at this writing, there are no unionized Walmart sites.

According to its most recent annual report, Walmart continues to focus on customer satisfaction but fails to mention how its own employees are important members of that stakeholder group. In his opening letter to shareholders, Michael T. Duke, President and Chief Executive Officer, speaks about sustainability and "…how associates all over the world are involved," and how "the retailer that respects individuals puts customers first, strives for excellence, and is trusted, will win the future" (Walmart 2011 Annual Report, p. 3). Although the end of this letter communicates Mr. Duke's appreciation for "the hard work of our 2.1 million associates" (Ibid., p. 3), the company's responsiveness to and respect for employees – or "associates," as they are known within WalMart – has been negligent.

Finally, while Walmart is not alone in its underrepresentation of women and minorities on its board of directors, as the largest American company, it should consider setting an example for others to follow. The current board consists of 15 members, three of whom are women and two of whom are African American males.

DISCUSSION

For seven years within the last decade, Walmart has retained the number one spot on the annual list of *Fortune's* 500 largest American companies, and it employs 2.1 million people (Berlin, 2011). Unquestionably, the company dominates the retail landscape. However, the question remains: does its domination of the market justify its questionable managerial and ethical behaviors?

Anti-trust legislation notwithstanding, cheaper prices – Walmart's hallmark promise – have consequences. Steve Dobbins, the former president of Carolina Mills, said, "We want clean air, clear water, good living conditions, the best health care in the world – yet we aren't willing to pay for anything manufactured under those restrictions" (Fishman, 2007, p. 12). The contradictions that lie between these ideals and Walmart's pricing strategy may become more pronounced over time. For example, many of Walmart's competitors state that they will match prices found elsewhere. Over time, this type of action may further erode and possibly bankrupt many of these businesses and, perhaps, many of their suppliers.

The consumer packaged goods (CPG) industry is undergoing rapid change. Several years ago, one author noted that Walmart is the best known example of an oligonomy – a combination of an oligopoly (a market that has few sellers) and an oligopsony (a market with few buyers) (Hannaford, 2005). By setting low prices, Walmart wields its power over both retail and business markets. Recently, two business strategy ideas – "bigger is better" and "consolidation is inevitable" – dominated the industry. Neither of these ideas is as critical as they once were, especially in mature markets and mature companies such as Walmart.

Admittedly, a small and agile company can benefit from a strategic alliance with Walmart because "…simply be getting accepted at Wal-Mart, a CPG company with one or two popular products can gain access to 30 percent of the U.S. market overnight. With another one or two big retail distribution wins, the company can reach 50 percent or more of its target market" (Lausler, Hartley and Sharma, 2011, p. 4). However, both the small company and Walmart must be vigilant of consumers who are intrigued by smaller brands in niche markets and swayed by perceived quality versus price and availability.

Walmart is a dominant and immensely profitable business force within the retail sector. It is a model of lean supply chain management and it forces its business partners to follow suit. As management experts have seen throughout history, businesses are inventions and, as such, their inventors will determine whether they are living up to their increasingly demanding economic, legal and ethical potentials.

There is constructive and destructive competition. An example of destructive competition was the Standard Oil Trust because it had acquired a set of competitive advantages against which no refiner could compete. Standard Oil as a monopoly was becoming lethargic and bureaucratic at the time of its breakup. The proof of this was seen in the invigorating spirit that accrued within the oil industry when Standard Oil Trust shares became thirty-odd oil companies. The growth of these companies in market value made Rockefeller the richest man on earth – far richer than if Standard Oil remained the monopoly that it was.Constructive competition is epitomized by Toyota. Before Toyota, American made cars were mediocre in quality. Today, American made cars are far superior in quality than they once were. This is the benefit of constructive competition: improve the product or service or go out of business. The consumer gains by constructive competition. Walmart is like Standard Oil – all competition is simply wiped out. What this means in the future is difficult to forecast, but managerial lassitude is a consequence of monopolistic control.

At this point in time, Walmart is extremely vulnerable to changing worker conditions in China and the value of the dollar as an international currency. The company is also vulnerable to the growing populist movement to "Buy American" that would be fatal to the Walmart paradigm of having goods manufactured by workers who can't buy what they make and sold to workers who have lost their jobs to outsourcing. Lastly, if left unchecked, the company's persistent managerial problems associated with employee relations issues could affect future expansion efforts. Therefore, Walmart will not be broken up into competing companies as was Standard Oil, but its potential demise may well be the events that will destroy the economic basis of its paradigm for making money.

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