Walmart Goes South

Commercial Mexicana S.A. (Comerci), one of Mexico's largest retail chains, is faced with a serious dilemma. Since Walmart's aggressive entry into the Mexican retail market, Comerci has found it increasingly difficult to remain completive. Walmart's strong operating presence and low prices since NAFTA's lifting of tariffs have put pressure on Comerci, and now management must determine if Comerci's recent participation with the purchasing consortium Sinergia will be sufficient to compete against Walmart.

What's caused this intense competitive pressure on Comerci, and what is likely to be its future? Mexico's retail sector has benefited greatly from the increasing trade liberation the government has been pushing. After decades of protectionism, Mexico joined GATT in 1986 to help open its economy to new markets. In 1990, with Mexico's economy on the upswing and additional free trade negotiations with the United States and Canada taking place, the founder of Walmart, Sam Walton, met with the president of Cifra, Mexico's leading retail store. Their meeting resulted in a 50/50 joint venture in the opening of Mexico's first Sam's Club, a subsidiary of Walmart, in 1991 in Mexico City.

It only took a couple of months after the opening to prove the store's success-it was breaking all the U.S. records for Sam's Club. The joint venture evolved to incorporate all new stores and by 1997, Walmart purchase enough shares to have a controlling interest in Cifra. In 2000, the name changed to Walmart de Mexico, S.A. de C.V., and the ticker symbol to WALMEX.

Prior to 1990, Walmart had never made moves to enter Mexico or any country other than the United States. Once Walmart started growing in Mexico, management created the Walmart International Division in 1993. By 2009, Walmart had expanded internationally to 15 countries outside the continental United States through new-store construction and acquisitions. It now operates in Argentina, Brazil, Canada, Chile, China, Costa Rica, El Salvador, Guatemala, Honduras, India, Japan, Mexico, Nicaragua, Puerto Rico, and the United Kingdom. Walmart serves customers and members more than 200 million times weekly through its international operations.

With growth stalling in the United States, Walmart is looking to international expansion for growth. It currently has over 8,000 retail units worldwide, of which 3,659 are outside the continental United States, and it employs 680,000 people outside the U.s. In December 2005 alone, it acquired 545 new stores and increased its personnel by 50,000 in Japan and South America. In fiscal year 2009, the international division increased sales over the previous year by 9.1 percent-to $98.6 billion. The international division accounts for approximately 24.6 percent sales.

Nevertheless, Walmart's success internationally has varied by country. It has struggled to match consumer preferences and work successfully with suppliers in Japan, encountered trouble in the United Kingdom, and failed to turn profits in Germany and South Korea, forcing it to withdraw completely from both markets. However, it has flourished in Canada and, most notably, in Mexico. Walmart's operations in Canada began in 1994 with the acquisition of 122 Woolco stores. It now has more than 254 Walmart stores and 58 Supercenters and enjoys strong partnerships with Canadian suppliers. In Mexico, Walmart operates 1,242 units, including Sam's Clubs, Bodegas(discount stores), Walmart supercenters, Superamas(grocery stores), Suburbia's(apparel stores), and VIPS restaurants and it has become the largest retailer in the country.

Given its hit-and –miss success rate on the international scene, it is natural to wonder how much of Wal-Mart's triumph in Canada and Mexico has stemmed from its internal processes, international strategies, and geographic proximity and how much can be attributed to the close economic ties shard by the United States with the two countries through NAFTA.

WALMART'S COMPETITIVE ADVANTAGE

Much of Walmart's international success comes from the tested practices on which the U.S. division bases its success. Walmart is known for the slogan "Every Day Low Prices." It has expanded that that internal to "Every Day Low Cost's to inspire employees to spend company money wisely and work hard to lower costs. Because of its sheer size and volume of purchases, Walmart con negotiate with suppliers to drop prices to agreeable levels.

It also works closely with suppliers on inventory levels using an advanced information system that informs suppliers when purchases have been made and when Walmart will be ordering more merchandise. Supplier can then plan production runs more accurately, thus reducing production costs, resulting in cost savings for Walmart, which then can pass on the savings to the consumer as lower prices.

Walmart also has a unique distribution system that reduces expenses. It builds super warehouses know as Distribution Centers (DCs) in central locations that receive the majority of merchandise sold in Walmart stores. It sorts and moves the merchandise via a complex system of bar codes, and its inventory information system then transports it to the various stores, using its company-owned fleet or a partner. The central distribution center helps Walmart negotiate lower prices with its suppliers because of the large purchasing volumes.

These strategies have resulted in great success for Walmart. And it even uses the second most powerful computer in the world-behind the Pentagon's-to run its logistics.

WALMART IN MEXICO

Despite its current success in the region, Walmart encountered some difficulties with its opening in Mexico prior to the passage of N/AFTA. One of the biggest challenges it faced was imported charges on many of the goods sold in its stores, thus preventing Walmart from being able to offer its "Every Day Low Prices."

Unsure of local demand, Walmart stocked its shelves with things like ice skates, fishing tackle, and riding lawnmowers-all unpopular items in Mexico. Rather than informing headquarters that would not need those items, local managers heavily discounted the items, only to have the automatic inventory system reorder the products when the first batch sold. Walmart also encountered logistics problems due to poor roads and the scarcity of delivery trucks. Yet another problem was the culture clashes between the Arkansas executives and the local Mexican managers.

Some of these problems were solved by trial and error, but the emergence of NAFTA in 1994 helped solve most of the problems. Amount other things, NAFTA reduced tariffs on American goods sold to Mexico from 10 to 3 percent. Prior to NAFTA Walmart was not much of a threat to companies like Comerci, Gigante, and Soriana, Mexico's top retailers. But once the agreement was signed, the barriers fell and Walmart was on a level playing field with its competitors-all it needed to become number one.

NAFTA encouraged Mexico to improve its transportation infrastructure, thus helping to solve Walmart's logistical problems. The signing of NAFTA also opened the gates wider to foreign investment in Mexico. Walmart was paying huge import fees on goods shipped to Mexico from areas like Europe and Asia. Foreign companies knew that if they built manufacturing plants in Mexico, they could keep cost low with Mexican labor and also ship to NAFTA's free trade zone- Mexico, the United State, or Canada.

As companies began to building manufacturing plants in Mexico, Walmart could buy these products without paying the high import tariffs. An example of this tactic is Sony's flat-screen television line, Wage. Sam's Clubs in Mexico imported Wega TVs from Japan with a 23 percent import tariff plus huge shipping costs, resulting in a $1,600 retail price at Sam's Club. In 1999, Sony built a manufacturing plant in Mexico, thus allowing Sam's Club to purchase the Wegas without import tariffs; this tactic also yields much lower shipping fees. Sam's Clubs passed on the savings to customers-with a retail price of only $600. As noted earlier in the chapter, Sony has expanded its manufacturing facility in Tijuana to produce flat-screen TVs that can be used to supply the local market or export the United States.

The benefit s of NAFTA, such as lower tariffs and improved infrastructure, helped not only Walmart but also its competitors, like Comerci. But Walmart used the advantages of NAFTA better than anyone else. Rather than pocketing the differences the lower tariffs made, Wal-Mart reduced its prices. In 1999, it closed one of its Supercenters for a day to discount up to 6,000 items by 14 percent.

Comerci and others have combated Walmart's tactics by lowering their own prices, but on many items, they can't get the prices as low. Walmart's negotiating power with its suppliers is large enough that it can get the better deal. Also most of Mexico's retailers priced goods differently. They were used to putting certain items on sale or at deep discount, a strategy known as "high and low" rather than lowering all prices. They have been trying to adjust their pricing structure to match Walmart's, but they are still frustrated with Walmart's continued cost cutting. Competitors and certain suppliers are so angry that they have gone to Mexico's Federal Competition Commission (known in Mexico as CoFeCo with complaints of unfair pricing practices.

FORMATION of SINERGIA

Unable to compete with Walmart under the new conditions, Comerci has been faced with extinction. Walmart is the largest retailer in Mexico and owns more than half of all retail sales, has captured 55 percent of the Mexican retail market, and has become the largest private employer in Mexico with 1,4000 employees.

Fear over the giant retailer's predominance and over its unexplained withdrawal from the Mexican National association of Department Stores (ANTAD) in 2004 prompted Comerci to band with two other struggling homegrown supermarket chains, Soriana and Gigante, to form a purchasing consortium that would allow them to negotiate better bulk prices from suppliers.

The collaboration, known as Sinergia, was initially rejected by CoFeCo and met resistance from the Consumer Product Council of Mexico, a 46-member organization representing major consumer goods companies, which feared that Sinergia would use its purchasing power to force unreasonably low prices on suppliers. However, after it second presentation to CoFeCo, the consortium was at last approved, provided that it issue regular reports to CoFeCo outlining the nature of its purchasing agreements and that it sign confidentiality agreements with the participating chains to prevent price-fixing and monopolistic behavior.

As a representative body with no assets, Sinergia's purchases are currently limited to only local suppliers, and its future is still uncertain.

Should Sinergia fail to improve the situation, Comerci could try to duplicate the efforts of its Sinergia partner Soriana, which is attempting, with some notable success, to differentiate itself from Walmart by offering products and a store atmosphere that appeal more to Mexicans' middle –class aspirations.

The government may give Comerci a break if it rules against Walmart's aggressive pricing, but as on analyst put it, "We do not believe the CFC will end up penalizing Walmart for exercising its purchasing power in an attempt to get the best deals available in the marketplace, which is the goal of every retailer in the world, especially when (these savings) are ultimately passed on to consumers." One thing is certain, however: Comerci cannot afford to sit still.