



WAL★MART**WATCH**

# WAL-MART IN CRISIS

How the World's Largest Retailer Lost Its Way

A Wal-Mart Watch Report  
June 2007

# SEEMINGLY OVERNIGHT,

Sam Walton's discount retailer from the Ozarks grew from a regional five-and-dime to being America's biggest company.

Wal-Mart's attempts to sustain its growth during the past few years, however, have been met with enormous challenges and setbacks. Its same-store sales numbers are down, its stock is flat, its growth has leveled off and it is continuously plagued by self-inflicted public relations problems. While other large U.S. retailers like Target and Costco are prospering, Wal-Mart is floundering.

*"If you have one takeaway from this meeting I hope it is our growth has just begun."*

*Wal-Mart CFO Tom Schoewe at the 2005 annual shareholders meeting<sup>1</sup>*

In a presentation to shareholders in 2005, Wal-Mart CFO Tom Schoewe boasted there was room for 4,000 Supercenters in the U.S. market.<sup>3</sup> However, by late 2006, Wal-Mart conceded that it could not continue growing in the same way.<sup>4</sup>

In 2007, Wal-Mart is scaling back its expansion plans, failing to enter key markets such as New York City<sup>5</sup> and facing numerous lawsuits, including the largest gender discrimination class-action lawsuit in the nation's history.<sup>6</sup> Unfortunately, even after significant public criticism of its business practices, Wal-

Mart refuses to change its ways. With issues like wages caps, health benefits, and discrimination coming to the forefront, Wal-Mart is in serious trouble.

*At a retail-industry convention, Wal-Mart's boss, Lee Scott, was asked whether his firm was trying to take over the world. "I don't think so," Mr. Scott replied with a smile on his face. "All we want to do is grow."<sup>2</sup>*

A recent Wal-Mart Watch poll shows just how much Wal-Mart's reputation has fallen in recent years. "More than a quarter (27%) of respondents report developing

a more negative opinion of Wal-Mart over the past year – more than twice the percentage of respondents who report more negative perceptions of Target (11%) or Costco (4%) over the same period of time."

This special report from Wal-Mart Watch, "Wal-Mart in Crisis: How the World's Largest Retailer Lost Its Way," provides insight into the dilemma Wal-Mart faces as it attempts to turn its massive ship around. It examines the immediate and long-term growth problems of the company and offers evidence that Wal-Mart must re-examine its business model to sustain itself and adequately address upcoming challenges.

# Wal-Mart's Same-Store Sales Flat Lining

Despite Efforts to Improve Shopping Experience and Broaden Its Customer Base, Same-Store Sales Are Not Meeting Expectations

Same-store sales measure the change in sales, over a defined period of time, for all stores open at least one year. While many consider overall revenue and stock growth to be indicators of a company's success, same-stores sales are a decent gauge for performance over a given year. In fact, Wal-Mart lists same-store or comparable sales as one of four "company performance measures,"<sup>7</sup> along with increasing operating income growth compared to net sales, slowed inventory growth when compared to net sales growth, and returns on average assets.<sup>8</sup>

During their enormous growth in the 1990's same-store sales were humming along at a high rate - hitting 6%, 7%, 8% - now they are below 2%.<sup>9</sup> In another troubling sign, Wal-Mart recently "posted its worst monthly same-store sales results in at least 28 years."<sup>10</sup> These figures worry Wal-Mart's leadership because they realize their most recent innovations have not had the results they have been seeking.

## Blame it on the weather?

When same-store sales have failed to meet projections, Wal-Mart has no shortage of excuses. Rather than blaming policy decisions for poor sales growth, Wal-Mart must reach for external factors. One of the most popular excuses is to blame weather conditions around the country. It is interesting to note; however, that other retailers, like Target, do not seem to be having problems with the weather. Listed below is a compilation of weather-related excuses from Wal-Mart, dating back to 2001:

**2007: Bad April Weather Hurt Us.** "Wal-Mart Stores Inc. posted its worst monthly same-store sales results in at least 28 years, tallying a 3.5% decline in April... In a recorded phone message Thursday, Wal-Mart blamed bad weather last month in most U.S. regions and the early Easter on April 8, which pushed many Easter sales into March."<sup>11</sup>

**2007: Cold February Hurt Us.** "Retailers like Wal-Mart Stores Inc. and Federated Department Stores reported weak February sales on Thursday, saying the month's cold temperatures and stormy weather hampered results. But upscale department stores and Wal-Mart rival Target Corp. bucked the trend, posting stronger-than-expected comparable-store sales figures, and some retailers said they expected the Easter holiday to help their March results."<sup>12</sup>

**2006: Cold, Late Easter Hurt Us.** "Rising fuel expenses are hurting Wal-Mart's lower-income customers, and Easter's shift to April and unseasonably cold weather caused shoppers to delay purchases."<sup>13</sup>

**2005: Cold Spring Hurt Us But Not Target.** "Wal-Mart said unusually cold spring weather and higher gasoline prices were to blame for the disappointing quarter, but retail analysts said something more fundamental is afoot. After all, both retailers had to endure poor weather; yet Target's same-store sales increase - a key retailer yardstick - were more than double those of Wal-Mart in the quarter."<sup>14</sup>

**2005: Maybe It's Not The Weather After All?** "Wal-Mart can talk about the weather, about high fuel prices, but it's becoming very evident that they aren't executing the way they should," said Joseph Beaulieu, a retail analyst at Morningstar, a mutual fund research firm based in Chicago."<sup>15</sup>

**2004: Cold May Hurt Us.** "Wal-Mart Stores Inc. lowered its forecast yesterday for June sales growth at stores open at least a year to a range of 2 percent to 4 percent, citing low temperatures and disappointing Father's Day results. The world's largest retailer said that key categories were flat this year compared to last year, when it had its best week of the summer. A week ago, Wal-Mart had indicated that June comparable-store sales were tracking at the low end of its earlier estimates of 4 percent to 6 percent growth for the month. Wal-Mart said sales this past week were hurt by unseasonable weather."<sup>16</sup>



## The Columbus Dispatch

Wal-Mart blames weather for woes

Thursday, June 29, 2004, 3:54 PM

Wal-Mart Stores Inc. lowered its forecast yesterday for June sales growth at stores open at least a year to a range of 2 percent to 4 percent, citing low temperatures and disappointing Father's Day results. The world's largest retailer said that key categories were flat this year compared to last year, when it had its best week of the summer. A week ago, Wal-Mart had indicated that June comparable-store sales were tracking at the low end of its earlier estimates of 4 percent to 6 percent growth for the month. Wal-Mart said sales this past week were hurt by unseasonable weather.

**2003: Cold November Hurt Us.** "Or could it be that two other factors are affecting sales? The poor weather on the East Coast surely discouraged some shoppers. And Hanukkah comes late this year, which may have kept some buyers on the sidelines in the weeks before and after Thanksgiving. But Wal-Mart draws a relatively small portion of its sales from the Northeast, and neither weather nor the calendar seems to have taken a toll on high-end retailers in the region."<sup>17</sup>

**2003: Bad Weather And Iraq Hurt Us.**

"Wal-Mart recently reported the worst same-store sales in two years. Bad weather, the war and a late Easter were cited as some of the factors in the poor performance."<sup>18</sup>

**2003: Cold September Helped, But Warm October Hurt.** "From a sales perspective, August was the strongest month, with September declining from that level and October weaker still. I think August benefited from the last of the child care tax credits, and the heavy clearance. September benefited from the cold weather that happened early in the month. And October was slower due to the unseasonably warm temperatures that we had throughout much of the United States."<sup>19</sup>

**2002: Cold April Hurt Us.** "Wal-Mart, the world's largest retailer, said cold, wet weather in late April was largely to blame for a monthly same-store sales gain of 3.3 percent, slightly below expectations."<sup>20</sup>

**2001: Cold December Hurt Us.** "Weather did hamper our sales in some parts of the country," said Wal-Mart spokesman Rob Phillips. The beginning of the holiday season proved to be rough for Wal-Mart, which failed to meet its projected sales results for three consecutive weeks in December."<sup>21</sup>

# Is Wal-Mart's Store Remodeling Project Causing Same-Store Sales Problems?

While Wal-Mart may be full of excuses, policy decisions are also to blame for poor same-store sales performance. Wal-Mart's ineffective store remodeling project is one example of a project that has



*One of Wal-Mart's newly-remodeled stores in Joplin, MO.*

hurt same-store sales. In early 2006 "in its effort to broaden the appeal of its stores and improve the shopping experience,"<sup>23</sup> Wal-Mart decided to begin a partial remodeling program for 1,800 stores in the United States. The company hoped the highly touted remodeling project would improve the ambiance of its cluttered and unimaginative stores. Wal-Mart's internal polling also showed that remodeling bathrooms and apparel areas were the best way to head off negative views of the company.

Initial projections anticipated the project's completion by the end of 2006, but Wal-Mart executives feared the impact on individual stores sales. "The total process for this remodel is about eight to 10 weeks," said vice chairman John Menzer at the Credit Suisse Consumer and Retail Conference in June. "The areas specifically that are [affected by] these special remodels are electronics, apparel, home, signing, upgraded bathrooms, along with better adjacencies throughout the store."<sup>24</sup>

Initially most analysts and investors agreed, "Wal-Mart sales could benefit from its planned store remodeling, which includes better product displays, signage and merchandise assortment."<sup>25</sup> However, as fall sales floundered, observers abandoned their optimistic position and publicly reassessed their predictions for the remodeling project and Wal-Mart made excuses.

In addition to the remodeling efforts, Wal-Mart blamed low same-store sales growth on hurricane-related restocking efforts and gas prices. Despite these excuses, "investors have interpreted recent weakness from Wal-Mart as a sign that its effort to target more upscale shoppers by remodeling its stores and remaking its image is falling flat."<sup>26</sup>

## **CONAN O'BRIEN:**

"Wal-Mart's in the news. Wal-Mart announced it is remodeling its stores to attract more upscale customers. Yeah. That's right. Step one to attract upscale customers is take down the signs that say 'Wal-Mart.'"<sup>22</sup>

- "Over the past year and a half, though, Wal-Mart's growth formula has stopped working. In

2006 its U.S. division eked out a 1.9% gain in same-store sales—its worst performance ever—and this year has begun no better. By this key measure, such competitors as Target, Costco, Kroger, Safeway, Walgreen’s, CVS, and Best Buy now are all growing two to five times faster than Wal-Mart.”<sup>27</sup>

- Adrienne Shapira, a New York-based Goldman analyst, has this to say about Wal-Mart’s prospects for 2007. “...We expect 2007 to be at best a transition year and at worst a year characterized by further missteps and strategy shifts.”<sup>28</sup>
- “A research report by HSBC holdings PIC, a financial-services company, called Wal-Mart’s beefed up remodeling plans ‘botox,’ designed to ‘arrest decline but not relaunch growth.’”<sup>29</sup>

Attracting upscale shoppers with new products and designs is proving to be difficult and although remodeling efforts are not yet complete; analysts are skeptical that these changes will make much of a difference in same-stores sales.

<b>Wal-Mart Comparable Store Sales</b>						
	<b>FY2002</b>	<b>FY2003</b>	<b>FY2004</b>	<b>FY2005</b>	<b>FY2006</b>	<b>FY2007</b>
1st Qrt (Feb-Apr)	3.70%	8.10%	2.20%	6.40%	2.80%	3.80%
2nd Qrt (May-July)	5.70%	6.40%	3.20%	4.10%	3.50%	1.70%
3rd Qrt (Aug-Oct)	6.70%	3.50%	6.10%	1.70%	3.80%	1.50%
4th Qrt (Nov-Jan)	6.90%	2.70%	4.80%	1.50%	3.10%	1.60%
<b>Target Comparable Store Sales</b>						
	<b>FY2002</b>	<b>FY2003</b>	<b>FY2004</b>	<b>FY2005</b>	<b>FY2006</b>	<b>FY2007</b>
1st Qrt (Feb-Apr)	1.70%	5.20%	(-0.1%)	6.60%	6.20%	5.10%
2nd Qrt (May-July)	2.00%	3.00%	1.50%	3.90%	6.70%	4.60%
3rd Qrt (Aug-Oct)	1.50%	0.10%	4.30%	4.50%	5.90%	4.60%
4th Qrt (Nov-Jan)	4.60%	(-2.2%)	2.90%	5.30%	5.60%	4.80%

Sources: Wal-Mart Financial Releases; Target Corp. Financial News

## Wal-Mart’s Failed Attempt to Attract Upscale Customers Leads to Week Same-Store Sales

What type of customer shops at Wal-Mart? Are they poor? Are they rich? Are they rural or urban dwellers? Realizing they had to reach out to other customers segments if they wanted to expand sales domestically, Wal-Mart began pushing fashionable clothing lines, organic foods, and expensive electronics. These types of goods would be a departure from normal products its customers usually buy.

Business Week accurately describes Wal-Mart's customer base by saying, "low prices still define the chain's appeal to its best customers, the 45 million mostly low-income Americans who shop its stores frequently and broadly."<sup>30</sup>

Everyday low prices has been the main goal for Wal-Mart since its inception; however, after years of increased competition from rival Target, (who many view as being more stylish than Wal-Mart), the world's largest retailer began to panic.



Its loyal shoppers, dubbed Karla, would shop for certain products, like groceries, but would rarely cross the aisle to buy things like electronics and clothing and were not susceptible to fads. These lower income loyalist shoppers are also greatly impacted by higher gas prices, which tend to decrease buying power.

Wal-Mart's search for another type of shopper leads them to Gracie. Gracie is a shopper "who has more disposable income and is more financially resilient."<sup>31</sup> These shoppers also "go to Wal-Mart less than once a week and spend only 28 percent of

their grocery budget at its stores."<sup>32</sup> A Gracie shopper is looking for quality over low prices when compared to a Karla shopper.

In an effort to appeal to upper income shoppers, Wal-Mart opened an experimental store in Plano, TX, which features expensive wine, high-end electronics, and sushi.<sup>33</sup> They also introduced a new clothing line called Metro 7 during Fashion Week in New York City in 2005. This move was intended to make Wal-Mart look hip and along with the new higher end store, position the retailer to reach out to a new customer base.

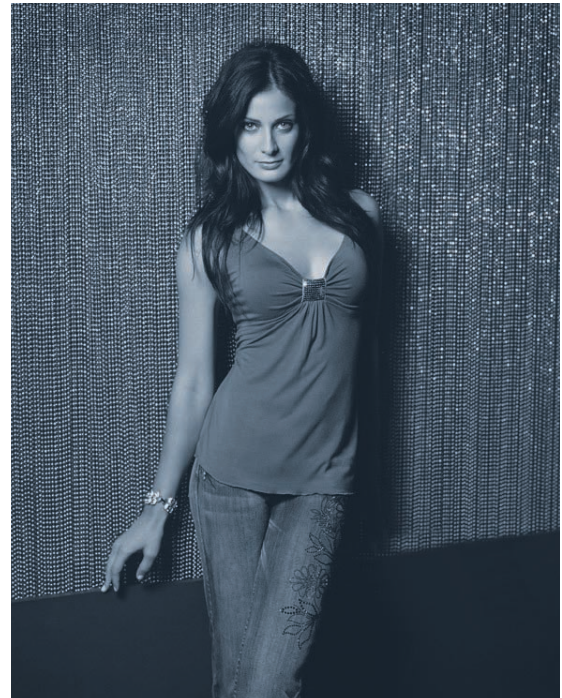
While new or existing customers might like expensive wine and sushi, the Metro 7 apparel line has proven to be a failure. Although Wal-Mart executives were initially happy about their apparel decisions, once sales figure came in, they soon realized their mistake. The following examples show how executive opinions changed over the course of 2006.

### Outlook Spring 2006:

- **Castro-Wright Praises Metro 7.** "In terms of merchandise, if you go back to where we are focusing on, Metro -- you have heard about it. We're very pleased with the results. As you can read there, we have got a 70% increase in market basket compared to other apparel brands. So very much a driver of increased basket, which is back to what I told you before that we were trying to do. We already have the customer in the store, so how do we drive basket by selling them something else? Metro, very successful. So successful, unfortunately, that we had

to scale down the expansion from what we had hoped first of 1500 stores to 1300 stores that we will have the brand name to by September 1."<sup>34</sup>

- **Schoewe Calls Metro 7 Line a Success.** "When we met her needs, we came out with a line called, 'Metro 7.' This was introduced last fall. We've only had one real problem with 'Metro 7,' and that is, we're having a hard time keeping up with the demand in our stores. We had what we thought was an aggressive rollout plan. We've had to slow that down just to make sure that when we did roll it out to a store, that we'd have the product available for Gracie or for Jen when she shopped."<sup>35</sup>
- **Clothing Line Will Match Success of Target.** "To prevent Metro 7 from encountering that fate, Wal-Mart will have a broad advertising campaign including local newspapers and national magazines, Mr. Fleming said. Metro 7 will put Wal-Mart in direct competition with Target, whose clothing lines, created by designers like Isaac Mizrahi, have become desirable brands in their own right."<sup>36</sup>



## Outlook Fall 2006:

- **Lee Scott on Apparel Choices.** "If I think about apparel, I wouldn't be so positive."<sup>37</sup>
- **Wal-Mart's Upscale Strategy Poorly Executed.** "One of Wal-Mart's main problems is that its strategy to broaden its appeal to higher-income shoppers with upscale merchandise was poorly executed. It filled its fall clothing racks with too many trendy items like skinny jeans that shoppers just didn't want. The company said it's cutting back on distribution of the clothing line Metro 7, but the move is too late for the holiday season."<sup>38</sup>
- **Trying To Be Like Target?** This holiday season, a big challenge at Wal-Mart is convincing shoppers like Portia Goodman and Karen Wade to buy fashion instead of just basics. "I buy more at Target than I do here," said Goodman, a 31-year-old graduate student from Riverside, Ill., who was recently shopping for candy at a local Wal-Mart with her son. "I think they should be more like Target." Such reluctance from these consumers comes more than a year and a half after Wal-Mart Stores Inc. has worked hard to improve its image with new fashion brands, a trendspotting office in Manhattan, and fashion shows during New York's Fashion Week. The company's fashion faux pas, such as stocking up on too many trendy items like skinny jeans, was a big factor behind disappointing sales for September and October, and is expected to weigh down business in the critical fourth quarter, the company acknowledged late last month.<sup>39</sup>

- **Wal-Mart CEO Acknowledges Mistakes.** “Just a week ago, Chief Executive H. Lee Scott told analysts that Wal-Mart needs to re-emphasize selling basic items for low prices, saying the company had put too much emphasis on higher-priced clothing.”<sup>40</sup>
- **Apparel Not Working Out At Wal-Mart:** David Abella, an analyst with Rochdale Investment Management in New York, had this to say about Wal-Mart apparel. “Well, I think there’s definitely a lot of problems specific to Wal-Mart. I know the market sort of interpreted it today as its beginning of maybe signs in the crack of very strong retail sales. Retail was pretty much down across the board as was the market. There was a lot of retailers down a lot more than Wal-Mart today. But I do think that Wal-Mart has some very specific things. They are reaching a saturation point. Also, the low-end consumer isn’t as strong as sort of the middle and upper end consumer. And you know apparel is not working out very well at Wal-Mart.”<sup>41</sup>

## Wal-Mart’s Failure to Comply With Its Own Governance Standards is Hurting Growth

Concerned with Wal-Mart’s direction and compliance with its own governance standards, F&C Asset Management PLC co-filed a shareholder resolution it hopes will bring attention to years of mismanagement by the retail’s leadership. Katrina Litvack, head of governance and sustainable investments at the firm, said Wal-Mart’s “Weaknesses in internal controls have eroded the company’s reputation as an attractive employer and are adding fuel to the fires of Wal-Mart’s critics” She also went on to say that, in light of new class action lawsuits and government investigations against the retailer, “we fear that its failure to deliver on these policy commitments is inhibiting Wal-Mart’s ability to expand into new domestic markets.”<sup>42</sup>

## Reputation Problems Slow Wal-Mart’s Growth

A report released in late 2006 by GSD&M, commissioned by Wal-Mart, highlights many of the problems the world’s largest retailer is currently facing. If Wal-Mart fails to improve its reputation, domestic growth will no longer be possible. Two of the key findings are:

- “Target is the #3 Challenge facing Wal-Mart. They [Target] feel like ‘new and improved while Wal-Mart often feels like the ‘old and outdated.’”
- “Wal-Mart is not a smart choice in categories where saving money and time are not the be-all, end-all, drivers - specifically Electronics, Apparel, Home Décor, Pharmacy, and Grocery. Our model is dependent on people wanting to buy a trusted item as quickly and cheaply as possible.”<sup>43</sup>

# Wal-Mart Strains Relationship with Developer

Wal-Mart's relationships with its developers, particularly Developers Diversified Realty (DDR), are strained. Wal-Mart and DDR share a profitable history, as Wal-Mart is consistently one of DDR's top five tenants.<sup>44</sup> Nonetheless, at the 2006 National Association of Real Estate Investment Trusts (NAREIT) conference, DDR made a number of antagonistic comments against the company:

- "[Wal-Mart is] Having a very difficult time getting communities to allow them to build stores. They are getting out positioned by Target...Target is perceived as a more upscale merchant and a more acceptable as a merchant in the town."<sup>45</sup>
- "They have a real problem with their image and that is affecting their ability to open stores around the country."<sup>46</sup>
- "Municipalities tell us if you want us to cooperate, you'll bring us a Target and not a Wal-Mart."<sup>47</sup>

## Wal-Mart's Urban Expansion Problems

Wal-Mart Has Problems Entering the Urban Markets It Desperately Needs for Success

In their own words, Wal-Mart's "expansion strategy depends upon our ability to execute our retail concepts successfully in new markets within the United States and upon our ability to increase the number of stores in markets in which we currently have operations."<sup>48</sup>

The new markets the company is targeting, (45% of their stores are located in rural and semi-rural counties and are verging on store saturation),<sup>49</sup> are in urban areas where labor has a strong presence, political tension is high, and zoning regulations are tougher to navigate.

### According to an analyst report by Credit Suisse:

To date, Wal-Mart has not entered New York City, Boston, San Francisco, or San Diego and it only operates one store each in Chicago, Los Angeles, and Philadelphia.<sup>51</sup> According to Census Bureau data, these seven cities combined account for 6.5% of the total U.S. population and 5.6% of U.S. retail sales excluding autos and gas.<sup>52</sup>

Cities like New York, Los Angeles, and San Diego have fostered resistance against the expansion policy of the world's largest retailer. City leaders, activists, and labor unions are opposed

to Wal-Mart's move into urban centers. Because of this, Wal-Mart has increased charitable giving, donated money to the various political campaigns, and created jobs and opportunity zones in an effort to improve its image.

Without much prospect of expanding in urban areas, Wal-Mart's business performance is in great jeopardy. Currently, 45% of their stores are located in rural and semi-rural counties and are verging on store saturation.<sup>50</sup>

Wal-Mart reported that it opened about 318 new stores domestically (including conversions) in 2006.<sup>53</sup>

Though they made their target rate, it was a loss from last year when they opened 320 stores and were ambitious about drastically increasing that rate this year.<sup>54</sup>

Management sees no shortage of opportunities to expand in the U.S., particularly in many urban areas where Wal-Mart has little or no presence and in filling in existing markets where returns are still attractive.<sup>55</sup> However, the response they have been getting from these cities is hardly encouraging.

## Big No from the Big Apple

Wal-Mart in New York City? It hasn't happened so far and New Yorkers have worked hard to make sure that it never becomes a reality.



*Wal-Mart opened its first store in Chicago in 2006 amidst much public debate and local protest.*

Similarly, in 2005, Wal-Mart was working to open a store in Staten Island and due to resistance from local residents, have still not build a store.<sup>59</sup>

### **DENNIS DELL'ANGELO, Staten Island resident:**

*"We need this Wal-Mart like a hole in the head because on the south shore of Staten Island we don't need any more retail whatsoever and this is a corporation that has a lot of baggage about how it treats its employees."<sup>56</sup>*

Lee Scott, who once declared, "We will be in New York,"<sup>57</sup> most recently announced that Wal-Mart was giving up its attempts to build a store in New York. Later on, Wal-Mart's public relations personnel clarified his position and said he was talking about Manhattan rather than the entire New York City area. Wal-Mart is still looking to expand into the city's other boroughs, namely Queens and Staten Island. This was in spite of past rejections from these areas of the city.

In 2004, Wal-Mart tried to open its first store in Rego Park, Queens and this move was met with opposition from a coalition of politicians, union organizers and community members.<sup>58</sup>

The demographics of neighborhoods in Queens and Staten Island are not as urban as those of Manhattan; nonetheless, they are well-informed consumers and still withhold their purchasing power from Wal-Mart as a result of the company's negative reputation.

Credit Suisse analysts confirmed this by noting, "Political pressures resulting from Wal-Mart's image and labor practices will continue to make it challenging for the company to open new stores in the largest cities in the U.S."<sup>60</sup>

## Resistance in Inglewood

Wal-Mart has always wanted to build as many stores as possible in California. With the largest population of any state, and a thriving economy, Wal-Mart was optimistic that years of store expansion and sales growth were in their future. In 2004, this optimism came to a screeching halt when Wal-Mart met fierce resistance from the residents of Inglewood, California. This suburb of Los Angeles, with its diverse, working class citizenry, fought hard, in conjunction with unions, to defeat a ballot initiative to permit the building of a 60-acre Wal-Mart shopping complex that would be exempt from state and local regulation.<sup>62</sup>

Wal-Mart invested over \$1 million dollars to garner support for the initiative, which they put on the ballot after their development plans were rejected by local officials.<sup>63</sup>

When the people on Inglewood finally voted on the measure, Wal-Mart was defeated by 3-2 margin.<sup>64</sup> This was a grave setback for the company that was attempting to build 40+ Supercenters throughout the state and was met with mass resistance from local grocers. Additionally, the Los Angeles City Council prepared an ordinance that outlawed the building of massive Supercenters in the city.<sup>65</sup>

## San Diego Bans Supercenters

Influence by the decisions of Turlock and Long Beach, in November 2006, the City Council of San Diego, the eighth-largest American city, voted to ban giant retail stores, specifically targeting Wal-Mart's Supercenters. This decision harms Wal-Mart because building supercenter is the favorite method of growth for the retailer. In Turlock, where supercenters were also banned, Wal-Mart challenged the law in state court but lost.<sup>66</sup> This derailed possible legal challenges in the future.

San Diego's measure prohibited "stores of more than 90,000 square feet that use 10% of space to sell groceries and other merchandise that is not subject to sales tax."<sup>67</sup> In voicing his support for limiting the size of stores in San Diego, City Councilman Tony Young said, "I have a vision for San Diego and that vision is about walkable, livable communities, not big, mega-structures that inhibit people's lives."<sup>68</sup>

## Local Unions Keep Wal-Mart Out of St. Louis

Wal-Mart's lack of presence in St. Louis has been astounding considering the city's close proximity to northwest Arkansas. In 2003, local St. Louis grocers and UFCW led a strike against the arrival of Wal-Mart in their city as "the companies with union employees feared that they couldn't compete with a

national giant that paid lower wages and skimmed on health coverage.<sup>69</sup> The strike was later settled but the union strength has since continued to keep the retailer at bay.<sup>70</sup> Wal-Mart has been able to build on the outskirts of the city but it has not found a place in metro St. Louis.

**MARLENE GEBHARD,  
President of Shop ‘n Save Warehouse Foods:**

“We, as business people, have an obligation to stay in business, so there’s always competition. What I’m concerned about is that customers, down the road, potentially won’t have choice.”<sup>71</sup>

While upscale urban populations have embraced Target, Wal-Mart cannot shake its image of being a low quality, budget store. Wal-Mart desperately needs to expand in urban markets to maintain its growth, but with a reputation for bad employment practices, bankrupting local retailers, and impoverishing communities, its efforts have lead to constant disruptions.

Additionally, due to heavy regulation of retailers in cities, Wal-Mart has been forced to play by a completely new set of rules. It has had to adopt new tactics, from adopting a more humanitarian image to promoting “progressive” rhetoric that embraces minorities, women and gays, in an attempt to appease urban populations and win their favor.

**Wal-Mart has used various tactics in order to increase its appeal and build stores in these urban centers:**

1. Increased marketing
2. Store of the Community
3. Charitable giving
4. Political contributions
5. Urban enterprise zones
6. Support of women and homosexuals

**Increased Marketing**

With former Target executive, John Fleming, in charge of the company’s marketing, Wal-Mart took great risks to shed their “always low prices” image and increase their desirability to a hipper, high-income crowd of consumers.

**GSD&M, advertising agency:**

“The Wal-Mart Shopper ‘hillbilly’ stereotype is alive and well (in some form or fashion). While most people know better, the time has come to rectify the stereotype so that our shoppers can feel proud to shop at Wal-Mart. As we move into departments that are more style oriented, namely apparel and home, the stereotypical rural user imagery is particularly problematic.”<sup>72</sup>

With new and increased marketing, Wal-Mart took strange steps like taking out ads in Vogue magazine, airing holiday television commercials with high-profile celebrities like Destiny’s Child and Jesse McCartney, and rolling out a line of women’s urban appeal, Metro 7, along with an exhibition in Miami’s high-fashion and trendy South Beach.<sup>73</sup>

Fleming was also given the authority to completely enhance the marketing team, bringing in young professionals from Frito-Lay and DaimlerChrysler .

But has this strategy been successful? Wal-Mart's new clothing lines have failed to impress consumers and analyst alike, and the firing of Julie Roehm<sup>74</sup> shows how her drastic changes to Wal-Mart's marketing and advertising strategy did not go over well with Wal-Mart's leadership. In general, the new marketing overhaul, it has led to more negative controversy and generally inconsistent marketing messages.

## Store of the Community

With this concept, Wal-Mart has sought to isolate one segment of the population that shops at a particular store and gear the products towards their preferences. The communities they specifically target include African-Americans, Latinos, and affluent populations.<sup>75</sup>

In Evergreen Park, IL, Wal-Mart has customized the store to fit the tastes of the predominantly African-American clientele by including a selection of ethnic hair care products, urban sportswear and gospel, rap and R&B music.<sup>76</sup>

At Plano, TX, in an effort to target affluent communities, Wal-Mart offers \$500 wines and houses a coffee shop and sushi bar.<sup>77</sup>

In El Centro, California, the Latino customers are offered a fresh selection of produce such as peppers, papaya and tortillas.<sup>78</sup>

While these are interesting new steps implemented mainly by Eduardo Castro-Wright, they are not sustainable. With over 4,000 stores, it would be virtually impossible to identify the target population of each store and customize the products accordingly. This will be a difficult strategy to implement in urban communities in particular due to the diverse nature of the potential shopping demographic.

## Charitable Giving

Wal-Mart was recognized as the largest corporate cash-giver in the U.S.<sup>79</sup> In their press releases, they laud themselves for donating to humanitarian groups like the American Cancer Society and Boys & Girls Clubs and seek to present themselves as a generous community supporter.<sup>80</sup> However, no one but Wal-Mart really knows what other organizations the company donates to and their lack of disclosure is discouraging.



When trying to build a store in Chicago, Wal-Mart would often try to pay off local leaders as well as church groups to gain their support. When Wal-Mart needed the support of Ald. Emma Mitts they sent fifty calculators to Austin High School and \$1,000 for toys and clothes for poor children in her ward.<sup>81</sup>

In the 2007 proxy, there is a shareholder proposal that urges Wal-Mart to disclose information regarding the Company's:

1. Policies and procedures for charitable contributions (both direct and indirect) made with corporate assets;
2. Monetary and non-monetary contributions made to non-profit organizations operating under Section 501(c)(3) and 501(c)(4) of the Internal Revenue Code, and any other public or private charitable organizations;
3. Rationale for each of the charitable contributions.<sup>82</sup>

Predictably, Wal-Mart's Board recommended that shareholders vote against this proposal claiming this is up to the local store and that providing additional information than what is on the website, otherwise known as responsible corporate governance, would be "unduly burdensome".<sup>83</sup> Predictably, the proposal failed at the 2007 shareholders meeting.

### **PALLAVI GOGOI, BusinessWeek:**

Wal-Mart gave a total of \$326,875 in the 2000 election cycle, \$431,017 in 2002, and \$857,179 in 2004, according to research by The Institute on Money in State Politics, a nonpartisan, nonprofit research organization based in Helena, Mont. For the 2006 election cycle, the company has given \$644,655 so far and seems to be on track to hit a record for political contributions.<sup>85</sup>

### **Political Contributions**

Over the years, Wal-Mart has steadily been increasing its political contributions to officials who make decisions on issues affecting the company like minimum wage and healthcare.

There was another shareholder proposal, which requested that the company disclose an accounting of how Wal-Mart uses its funds for political contributions.<sup>84</sup>

Wal-Mart has flexed this political and financial muscle to its use in many site

fights, most notably in Chicago. In July 2006, the Chicago City Council passed a living wage ordinance which was subsequently vetoed by Mayor Richard Daley.<sup>86</sup> The aldermen had a chance to override the veto but failed to do so, thanks to Wal-Mart.<sup>87</sup> The company, along with a partner PAC, the Illinois Retail Merchants Association, donated thousands of dollars to various aldermen's campaigns and essentially bought their vote.<sup>88</sup>

The company had a chance to set a precedent by supporting the ordinance, which demanded that the living wage be \$9.50, and supporting families and low-income communities. However, it failed to take up this opportunity and further smeared its name in the opinion of urbanites.

## Urban enterprise zones

Urban enterprise zones promote entrepreneurial development in low-income communities by offering tax breaks for companies that start a business there. Wal-Mart has appropriated this concept and renamed it as its Jobs and Opportunity Zones Initiative.<sup>89</sup> It announced recently that it had chosen nine communities as the ground to develop this project. The nine zones are Cleveland, OH, Decatur, GA, El Mirage, AZ, Landover Hills, MD, Portsmouth, VA, Richmond, CA, Sanger, CA, East Hills, PA and Chicago, IL.<sup>90</sup>

The company claims that these areas will serve as hubs “in which local businesses will be able to advertise inside Wal-Mart stores and in which the retailer will offer funding for local chambers of commerce.” While this seems rather charitable of Wal-Mart, the truth is that because of market economics, there will not be any local businesses left once Wal-Mart moves in. Additionally, this move would not seek enfranchise the blighted population of these communities nor would it uplift them out of poverty even if they worked for Wal-Mart.

## Support of Women and Homosexuals

The conservative community went into a frenzy when the traditionally Republican, conservative retailer announced that it would be partnering with the National Gay and Lesbian Chamber of Commerce to promote diversity.<sup>91</sup> The NGLCC represents the interests of over a million LGBT-owned businesses that are generally located in urban regions. Thus, establishing a relationship with them would serve Wal-Mart’s best interest as it would not only improve their image in the eyes of young, urban consumers but also, despite the temporary backlash, it would not really affect their traditional customer base.

Wal-Mart has also attempted to promote itself as the retailer for women, whether they are consumers or employees. Most recently, Working Mother magazine named Wal-Mart the “2007 Best Company for Multicultural Women.”<sup>92</sup> Despite such positive publicity, Wal-Mart cannot ignore the looming shadow of *Dukes vs. Wal-Mart*. As the largest class-action lawsuit against a private employer, *Dukes* accuses Wal-Mart of discriminating against its women employees and not providing them the same privileges it awards the males.<sup>93</sup> *Dukes* has garnered tremendous publicity and attention for the company, most of it unpleasant, and has served to portray Wal-Mart as a misogynistic company that has a lot of progress to make on gender issues.

# Wal-Mart's International Success Mixed Saturation at Home, Uncertainty Abroad

Today, Wal-Mart operates nearly 2,800 stores in 12 countries and Puerto Rico.<sup>94</sup> Sales generated by this division represent more than 20% of the company's total revenues, and its operating profits account for about 18% of Wal-Mart's total.<sup>95</sup> Wal-Mart has already considerably expanded its operations worldwide, has acquired majority stake interests in many joint venture companies, and is expanding to up-and-coming markets like India and Russia.

While Wal-Mart has grown to dominate the retail market in the Western Hemisphere, it has stumbled elsewhere. Wal-Mart is finding out that global competition is much tougher when its business model is rigid and uniform. Wal-Mart often lacks the cultural understanding in many of the areas it enters, which has created a situation that may not be sustainable for a company that will be very dependent on international expansion in the future.

## According to Bear Stearns:

"Management has made clear its desire for Wal-Mart International to account for 30% of Wal-Mart's revenues over the next few years."<sup>96</sup>

## Missteps in South Korea

South Korea has always held a special place in the psyche of Wal-Mart's leadership. "Even the hokey Wal-Mart cheer was based on one Walton heard at a factory in South Korea."<sup>97</sup> Like many other western retailers, Wal-Mart attempted to break into the competitive South Korean market, because it saw opportunity in the rapidly expanding economy. Wal-Mart opened sixteen outlets in the country but as

### **MICHAEL T. DUKE, Vice-Chairman of Wal-Mart International:**

"As we continue to focus our efforts where we can have the greatest impact on our growth strategy, it became increasingly clear that in South Korea's current environment it would be difficult for us to reach the scale we desired."<sup>101</sup>

in so many other countries, they tried to apply their western retail model to the South Korean market.<sup>98</sup> Wal-Mart entered the market with the same strategy and plan that they enter every market -- low prices.

Nevertheless, Wal-Mart's low price/big box strategy alone did not appeal to South Korean consumers. In particular, the food and beverage selection was considered unsatisfactory

to South Korean women.<sup>99</sup> South Korea is a country that requires cultural context to succeed in the marketplace. This is something Wal-Mart lacks, and this is a pattern that has been repeated in other nations.<sup>100</sup>

## Problems in the Land of the Rising Sun

Many of the problems Wal-Mart faced in South Korea, with regards to tailoring a store to the local culture and facing major distribution issues, are also reflected in Wal-Mart's Japanese retail acquisitions. Despite the retailer's best efforts, Seiyu has remained a problem for Wal-Mart even to this day. Seiyu has yet to be profitable venture for Wal-Mart for nearly six years, costing the retailer billions of dollars.<sup>102</sup>

There is a unique cultural wrinkle to Japan, which makes Wal-Mart's focus on low-priced, low-quality goods unsustainable in Japan. The Japanese culture is one where higher price is often associated with higher quality, and the Japanese are perfectly willing to pay more for a quality product.<sup>103</sup> Since space is at a premium in Japan the culture of Wal-Mart of low priced almost disposable goods does not fit the Japanese lifestyle. This has created a problematic situation for a company with a monolithic strategy for every market it enters.

"Always Low Prices" is equated with "not worth the money" or possibly insulting in the Japanese culture. It is this lack of understanding of the Japanese culture that has created significant problems for



### According to the Associated Press:

"Say sayonara to Japan. Seiyu Ltd., Wal-Mart's struggling Japanese supermarket and department-store unit, lost about \$465 million last year and hasn't been profitable in six years."<sup>104</sup>

Seiyu. Another problem for Wal-Mart is that its Japanese stores are not centrally located. In fact, they are often cited in poor locations on the outskirts of urban centers, which is problematic for a primarily urban population that is highly dependant on public transportation.<sup>105</sup>

Many successful retailers in Japan are not those that offer deep discounts of low quality merchandize, but centrally located retailers willing to distinguish themselves with specialty stores offering high quality merchandize.<sup>106</sup>

In addition to the problems regarding Wal-Mart's low price focus, Wal-Mart faces major logistical problems. The primary problem is the grocery business in Japan is significantly different than North America. Japanese consumers largely rely on regionally grown products and local food preference varies significantly throughout the country.<sup>107</sup> This means instead of relying on centralized distribution system, Wal-Mart must seek produce locally.

This means Seiyu is on the same level as the rest of the market, taking away the price advantage that

comes from the centralized distribution system Wal-Mart Stores in the Americas enjoy.<sup>108</sup> The distribution issues are not exclusive to food however, as the limited space and transportation system of Japan is not conducive to Wal-Mart's North American model for product distribution. That means Wal-Mart cannot maximize efficiencies using its North American distribution model so the cost savings for products are limited at the Seiyu subsidiary.

Even if these cost savings were present, it would not address the fact that Wal-Mart has failed to tailor Seiyu to distinguish itself in the ultra-competitive Japanese retail marketplace where discounting is viewed suspiciously.<sup>109</sup>

Wal-Mart treated Japan like every other retail environment, not the retail saturated, quality conscience market with distribution complexities that Japan has always been. While Wal-Mart is speaking about profitability in Japan, they are also contemplating a pullout in the future.<sup>110</sup>

## The Impossibility of the European Union

The European mainland is a market Wal-Mart has difficulty breaking into and may be unable to break into successfully. In the land of unionization, expensive gasoline, and smart growth policies, the Wal-Mart model simply does not fit.



Wal-Mart attempted to enter the German market, but found that the Wal-Mart model was not sustainable and did not fit the German culture or economy. Wal-Mart basically found its US business model of high saturation of stores on the outskirts of towns, massive distribution centers and an influx of foreign goods, was unlikely to succeed in the highly urban German market where public transportation is extremely important and space is at a premium.<sup>111</sup>

Wal-Mart could not dot the land with big box stores the same way it had in North America. In addition, the cultures of Wal-Mart and Germany did not blend well. Wal-Mart tried to impose many American management styles in Germany, which were either alien to the German people, or against the law in Germany. For example - Wal-Mart did not allow employees to date colleagues and were found in violation of the law for attempting to set up a hotline for employees to inform on their fellow associates.<sup>112</sup> In addition, Wal-Mart buyers were almost exclusively American, which resulted in stores not catering to the German people.<sup>113</sup>

In addition to the cultural hurdles Wal-Mart could not manage, Wal-Mart entered a well established market where German retailers and grocers, such as Metro AC, Aldi and Kaufland, were already strong.<sup>114</sup> Retailers such as Metro AC are better situated than Wal-Mart because it had the cultural context to succeed in Germany, but also well established ties to European and German suppliers.<sup>115</sup> Wal-Mart on the

other hand relied heavily on its pre-existing supplier relationships formed in Bentonville and management from the United States.<sup>116</sup>

This resulted in poor product selection and a lack of cultural context with regards to what Germans expect out of a retail experience. Wal-Mart could not compete with Metro and other retailers because it lacked the cultural understanding that was essential to running a successful business in Germany.

While Wal-Mart tried and failed in Germany, the company may not even attempt to enter the remainder of Western Europe, which is dominated by other retailers such as France's Carrefour. In addition, most of Western Europe runs under strict land use and labor laws that create significant problems considering Wal-Mart's anti-union stance and development strategy. The remainder of Western Europe may be culturally different when compared to Germany, but the significant level of retail competition, the development policies, labor policies and cultural hurdles remain similar throughout the EU or in the case of France, even more of a hurdle than Germany.

**BRYAN ROBERT,  
Planet Retail Analyst:**

Wal-Mart was not very humble when they went in... They wanted to impose their own culture.<sup>117</sup>

## Trying to Change the Face of the United Kingdom

Wal-Mart's UK subsidiary ASDA is a profitable, yet problematic venture for Wal-Mart. The number two retail and grocery chain in the UK has problems competing against its more flexible and dominant UK rival Tesco. Wal-Mart has sought changes in the UK planning policy in order to implement the same big-box strategy that it uses in North America to compete with the multi-format and ultra-flexible Tesco.<sup>118</sup>

Furthermore, Wal-Mart has lobbied heavily for the elimination of the national smart growth policies that have kept cities in the UK highly centralized and public transportation friendly affairs.<sup>119</sup>

Wal-Mart's solution was not to adapt to the UK market, but rather seek fundamental change in urban planning in the UK and force an American planning regime there that would create unsustainable land intensive development environment on an island with limited space.<sup>120</sup> With ASDA, Wal-Mart has sought to force its unsustainable practices into the UK because it has difficulties competing with the urban market conditions of the UK, where Tesco has the upper hand in terms of real estate and supplier relations.<sup>121</sup>

ASDA is also beginning to face the same types of site fights that are found in the United States with Wal-Mart when it seeks to put an ASDA on the outskirts of British towns.<sup>122</sup> Wal-Mart is facing difficulties competing in the UK with Tesco and would rather change UK planning laws than adapt to the market and regulatory system in the UK.

Wal-Mart may be realizing that its model of big-box stores do not work in the UK and may be seeking to remedy the problem by acquiring small store grocer Sainsbury.<sup>123</sup> It is likely that such a move would raise anti-trust questions.

## Where Does Wal-Mart Go From Here?

At its 2007 shareholders meeting, Wal-Mart executives cheerfully proclaimed that the state of the company is strong; however, their positive rhetoric sugarcoats major problems facing the company. The failure to attract higher income shoppers, improve its image as well as contain criticism from activists and community leaders, have led to disastrous same-store sales numbers and a flat stock price.

When Wal-Mart releases their monthly and quarterly sales figures, they are quick to point out how much they have grown over the past year. Building new stores is the quickest way to achieve high sales growth. However, over saturation has become a real problem for Wal-Mart. As stock prices continue to slump Lee Scott has been forced to undertake drastic measures to head off criticism from shareholders. Reducing supercenter growth from 270 to 200 next year is Wal-Mart's latest attempt to boost returns.<sup>124</sup>

Even though Lee Scott seems to have the support of the Wal-Mart's board and the Wal-Mart family, shareholders and analysts are wavering. "Outside shareholders won't give Scott an indefinite period of time," said Walter Todd, who helps manage \$800 million at Greenwood Capital Associates LLC in South Carolina.<sup>125</sup>

Although Wal-Mart's latest announcements may initially stop the hemorrhaging of the company and make analysts hopeful, without substantive long-term changes to its business practices, Wal-Mart will not be able to sustain growth, even at a reduced rate, and attain the necessary growth in same-store sales to stay ahead of its competition.

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