

## **P**ricing Strategies and Tactics

“Differentiate your products, provide great service and don’t even think about trying to compete with Wal-Mart on price.”

If it seems impossible to compete directly with big-box retailers like Wal-Mart on price, the unvarnished truth is, that it is! The combination of their buying power of big brands, private-label programs, off-shore manufacturing, distribution efficiencies, incredible technology, culture, expense structure, company-owned truck fleet, and low paying non-union jobs provide a vise-like grip on costs no competitor can match. By putting all of these competitive advantages together, Wal-Mart is able to roll back its prices to the lowest possible levels.

A 200-plus-billion-dollar company, which also focuses on squeezing a nickel, gains considerable leverage from its economies of scale and by doing so creates still another competitive advantage. By consciously and culturally focusing on cutting costs and slashing expenses, Wal-Mart is able to rain cost saving dollars to the bottom line. Whoever said that in business you can’t save your way to prosperity never met the likes of Wal-Mart.

I can’t think of any industry over my lifetime that has been so dominated by one company without the Federal Trade Commission’s antitrust laws kicking in. I guess if you build a company from scratch and develop it primarily through internal expansion and new concept stores, rather than through acquisition, you avoid the Fed’s involvement. It also doesn’t hurt that Wal-Mart’s overriding and advertised goal is to charge consumers as

little as possible for their products. If consumers were complaining en masse the story would be different. The fact that competitors are the only ones who are upset about alleged unfair trade practices falls on deaf ears. There isn't a politician in his or her right mind who would risk upsetting the ranks of middle America, who most benefit from the low-priced product offerings of Wal-Mart. That's what the American free-enterprise system is all about, isn't it?

So retailers small and large need to suck it up and develop strategies to compete the best way they can. Inefficient retailers with high prices, who have taken their customers for granted, have learned some tough free-enterprise lessons of their own as Wal-Mart has crushed them with the powerful one-two punch of their "smiley-faced" customer service and great prices. Contrary to conventional wisdom and everything I've read, Wal-Mart's competitors still attempt to go toe-to-toe with the 800-pound gorilla on price. That's not the right strategy. The key to price competition with Wal-Mart is to attempt to avoid it altogether, if you possibly can.

**L**et me illustrate the power of Wal-Mart's low prices on consumers. Several years ago, one of the TV news exposé programs did a feature on Wal-Mart and sweatshops. I remember seeing David Glass, the CEO of Wal-Mart at the time, being bushwhacked by the interviewer concerning child labor in a third-world country. He was asked to watch a videotape of a child manufacturing a shirt while the camera zoomed in on his face capturing his reaction. At the end of the video, the news reporter handed David the actual shirt made by the child with one of Wal-Mart's labels in it and challenged him to explain Wal-Mart's stance on child labor. Cool as a cucumber, David explained that Wal-Mart had strict manufacturing guidelines against the use of child labor and the company did not knowingly work with manufacturers who employed children.

As a Wal-Mart home office employee at the time, I remember being worried about the potentially negative change of perception of customers as a result of this story. Wal-Mart was in the middle of its "Buy American" promotion at the time and this type of negative publicity could have had a devastating impact on sales. The story aired with customer reactions included. They asked customers what they thought about the use of child labor to manufacture products for American companies at a cheaper price. Customers responded that they were appalled children were working in manufacturing facilities overseas but they would not change their shopping patterns as a result of those concerns. They preferred to purchase cheaper, comparable quality items manufactured offshore, rather than purchasing the same quality goods manufactured in the USA, if this choice meant cheaper prices at the register.

I thought customers would vote with their feet following that story and they did. But interestingly enough, not the way I thought they would. Not only did sales not go down following the broadcast, they went up! More customers were attracted to Wal-Mart stores as a result of the free advertising provided by the news story. What consumers heard was that Wal-Mart has low prices. They did vote with their feet and their checkbooks. It seems low prices are more important to the consumer than a perceived child labor problem in a third-world country. Any concerns, on my part, about the negative impact of this story on company sales, was much ado about nothing.

I've worked directly for several public companies in my career. I don't believe there is another Fortune 1000 Company in America which would allow a nationally televised interview of their CEO without meticulous preparation and a copy of the interview questions in advance. David Glass did not rehearse and he was candid when confronted with the information for the first time. I'll never forget how David Glass conducted himself in that interview. He had to know what the interviewer was about to do and he had no fear.

David Glass had used an old-fashioned Wal-Mart strategy called *telling the truth!* I was told by Don Soderquist, the former COO, Wal-Mart never rehearses anything. They don't rehearse Saturday morning meetings, stockholder meetings, analyst calls, or press interviews. Although that's shocking in this day and age, I think that makes them better able to move more quickly than their competitors, who get bogged down in "posturing, positioning or spinning" stories to respond to questions from the media, customers, shareholders, or even their own employees. In his book entitled *Leadership*, Rudy Giuliani said it best, "A leader who fails to act until every group has been heard from, every concern addressed, every lawsuit resolved, is a leader who's abdicating their responsibility."<sup>1</sup> That's exactly what happens to many executives when they are faced with scrutiny by the media. By being refreshingly unrehearsed Wal-Mart is able to concentrate on "substance" rather than "form." It would appear our litigious American society has forced companies to choose their words carefully out of fear their own openness and honesty will be used against them in a court of law.

Wal-Mart's straightforward way of dealing with customers, employees and the news media is seldom seen in our society today. I have to say it is a refreshing approach and at least at Wal-Mart it works! Employees, customers, and the public in general really respond to open and honest communication! On the other hand, when you spin stories it's easy to get caught telling half truths. Who would have thought by being honest Wal-Mart would create a "new wave" and "cutting edge" concept in business called "telling the truth"!

**W**e sell for less” is one of the guiding principles of Wal-Mart. This philosophy involves buying low and, in the end, providing customers with the lowest possible prices. The question at Wal-Mart isn’t how much it can get for an individual product, but how little. They don’t use sales gimmicks to draw customers into the store. With respect to product pricing, I heard one of the Wal-Mart executives say, “Our merchandise is on sale every day.” Wal-Mart works diligently to find great deals and then to pass the savings on to their customers. Thanks to Sam Walton’s Philosophies, Wal-Mart is a customer-focused store in which consumers can count on value for their hard-earned dollars. The goal is to never be undersold by a competitor.

In the article *Wal-Mart, After Remaking Discount Retailing, Now Nation’s Largest Grocery Chain*, the authors talk about the radical changes occurring in the grocery business because of Wal-Mart:

The fight for the carts and minds of customers is already having an impact. Shoppers in competitive markets are seeing prices fall as Wal-Mart pushes rivals to match its low costs. Among the tactics the chains are using: improving their inventory-tracking systems, doubling or tripling discount coupons, and boosting customer loyalty with discount-card plans. Grocery chains are feeling the pinch of low prices and are enacting strategies as best they can in order to try to survive.<sup>2</sup> Wes Ball, the President of the Tennessee Grocers Association said grocers need to, “Be lean and mean and believe there is life after Wal-Mart.”

Unlike K-Mart and other competitors, which put items on sale constantly, Wal-Mart lets its everyday low prices speak for themselves. Recently, its national advertising campaign has focused on its price rollback strategy—sending the consumer a clear message Wal-Mart is doing everything possible to keep prices low, always. It even has a low-price guarantee. To the consumer, the bottom line is the bottom line. Over 100 million customers a week prove that low prices are king by shopping at their local Wal-Mart stores. According to the Seifert Group at Barrett Associates, “Wal-Mart’s prices are the lowest amongst all discount retailers, yet operating margin is the highest at around 6 percent, proving they are the lowest cost operator in retail.” Compete with Wal-Mart on price? As my New York friends say, “Fughedaboutit!”

**S**o if you can’t compete on price, what is the answer? The key is to find a niche or what I call a “pocket” within your area of expertise, with products and services not offered by Wal-Mart. In a study called *Small-Town Merchants are Not Using the Recommended Strategies to Compete Against*

*National Discount Chains: A Prescriptive Versus Descriptive Study*, the author discusses retail pricing strategies to use when big-box retailers come to town:

In the middle of this price war among national chains are smaller independent retailers. Typically unable to purchase in large quantities to receive lower prices like their larger competitors, ma-and-pa retailers have either learned to use other strategies to compete or gone out of business. For instance, to compete with Wal-Mart's low prices, small retailers have developed niche strategies by providing a broader assortment of merchandise within a given product category and better service. Wal-Mart may have the lowest average price on the few athletic shoes and clothing that it carries. A good sporting goods specialty store, however, might have a larger assortment than Wal-Mart and would be willing to special-order merchandise so that its customers could get exactly the shoes they're looking for."<sup>3</sup>

Some companies are able to carve out a niche by providing unique products and services not offered by Wal-Mart. I spoke to John Musil who is the president and owner of 10 community-based independent pharmacies in Scottsdale, Phoenix, and Payson, Arizona. Musil, who is also the president of the Arizona Pharmacy Association, a state chapter of the National Community Pharmacists Association, has 17 pharmacists employed by his company, Apothecary Shops. Arizona is a chain-dominated pharmacy market and Dr. Musil has been able to compete successfully by developing a successful niche strategy.

Approximately 50 percent of his business is generated through specialized compounding of medications. His pharmacies routinely receive referrals from area Wal-Mart Pharmacies because they don't offer services which he provides. Musil's pharmacies specialize in infertility treatment, natural hormone consultations and pain management, with an emphasis on providing traditional personalized service to his "customers."

Musil talked about his views on customer service stating, "I don't have any customers, everybody who comes to me is a patient because they require my services as a health care professional. More and more independent pharmacies are realizing we serve a specific need in the community and people rely on us for expertise as health care professionals. Wal-Mart has customers, we have patients."

**T**he idea behind Wal-Mart's pricing strategy is startlingly simple to understand. In Sam's autobiography, *Made in America*, he describes Wal-Mart's discount pricing philosophy, he said:

Here's the simple lesson we learned . . . say I bought an item for 80 cents. I found that by pricing it at \$1.00, I could sell three times more of it than by pricing it at \$1.20. I might make only half the profit per item, but because I was selling three times as many, the overall profit was much greater. Simple enough. But this is really the essence of discounting: by cutting your price, you can boost your sales to a point where you earn far more at the cheaper retail than you would have by selling the item at the higher price. In retailer language, you can lower your markup but earn more because of the increased volume.<sup>4</sup>

Sam Walton's discounting principle is that the less you are able to charge, the more you'll sell and in the end the more you'll earn. This is the "stack-it-high-and-let-it-fly" philosophy, which, at the time it was introduced, challenged the existing product-pricing and merchandising beliefs of retailers and wholesalers alike. Historically, product was sold with supply-and-demand philosophies at whatever price the market would bear. This pricing strategy alone has turned Wal-Mart into a destination store by creating the perception in the mind of the retail consumer of significant value. It is for this reason that millions of consumers flock to Wal-Mart every day. Pricing is one of Wal-Mart's many towering strengths and has to be considered its single most important competitive advantage.

Wal-Mart has three pricing strategies: Everyday low prices (EDLP), rollback, and special buy. Here is how Wal-Mart describes them on its corporate web site:

- **Every Day Low Price (EDLP).** Because you work hard for every dollar, you deserve the lowest price we can offer every time you make a purchase. You deserve our Every Day Low Price. It's not a sale; it's a great price you can count on every day to make your dollar go further at Wal-Mart.
- **Rollback.** This is our ongoing commitment to pass even more savings on to you by lowering our Every Day Low Prices whenever we can. When our costs get rolled back, it allows us to lower our prices for you. Just look for the Rollback smiley face throughout the store. You'll smile too.
- **Special Buy.** When you see items with the Special Buy logo, you'll know you're getting an exceptional value. It may be an item we carry every day that includes an additional amount of the same product or another product for a limited time. Or, it could be an item we carry while supplies last, at a very special price.

Pricing is instrumental in the creation of an exciting low-price shopping experience for the consumer. Everyday low pricing of groceries and

general merchandise makes the Supercenter a unique and attractive one-stop shopping experience for consumers.

Wal-Mart's pricing strategies provide customers with an incentive to drive long distances to shop. This can help retailers in proximity to Wal-Mart but may hurt retailers in surrounding towns. In a story entitled, "Category Killers Stalk Small Towns," Editor Jim Cullen wrote:

Wal-Mart moved into Storm Lake, Iowa, a county seat of approximately 8,500 population in northwest Iowa, in 1990. A music store, a variety store and two smaller discount stores have gone out of business in Storm Lake since then, but many local merchants report that their businesses are doing well. In fact, local business operators say the impact is probably greater on smaller businesses in surrounding communities as residents of nearby Sioux Rapids or Rembrandt drive to Storm Lake rather than shop at local stores.<sup>5</sup>

A well known study, *The Impact of Wal-Mart Stores* by Kenneth Stone found the opening of a discount store in small to medium-sized towns may help to expand local retail trade because it reduces the amount of "outshopping" by local consumers and brings more shoppers from the surrounding areas. "Unfortunately, the discounters usually saturate the market with their stores, which causes some towns' trade areas to shrink to a smaller size than before," he wrote. Nearby towns without a discount store suffer sales losses and shopping habits change, as consumers buy more from discount mass merchandisers and less from local merchants."<sup>6</sup>

Cullen goes on to say:

Wal-Mart has not run any of the five independent pharmacies in Storm Lake out of business. "Ever since they've moved in our business has gone up," said pharmacist Tony Bedel, whose father opened the drive-in pharmacy in 1955. "Once people figured out that they (Wal-Mart) don't do after-hours prescriptions, they don't deliver and they don't let you charge, they came back to us. If an independent pharmacy still keeps full service, it can make it."<sup>7</sup>

**P**harmacies are a good example of a retail specialty that feels the pinch when a Wal-Mart store opens in town. Many experience soft sales of their front-end general merchandise items. Fortunately, independent and chain drug stores for the most part have been able to maintain strong sales of prescription drugs due to the convenience of their locations, personalized service, and low consumer price sensitivity. Stephen L. Giroux, R.Ph., a board member of the National Community Pharmacists Association

(NCPA) and an owner of five independent pharmacies, stated, "In 80 to 90% of the pharmaceutical marketplace the price is controlled by an outside force, i.e. third-party insurance, so 80% to 90% of the people walking in have a prescription card dictating what they will pay in terms of co-pay. Therefore the price competition is a bit removed from the marketplace and we are more focused on service. An independently owned business can survive and in fact thrive in a service environment where you are only competing on the basis of service level and you can compete against the big boxes very, very effectively."

The good news is that successful competition with Wal-Mart is not only possible, it is highly probable if your store is more convenient, and you provide good old-fashioned service. You may also be able to increase your business by attracting new customers to your store by siphoning off some of the additional customer traffic coming into town. For this reason, some retailers even look forward to Wal-Mart's entry into the market.

The bad news is that internationally, competitors are forced into the realization that their past success in dealing with their own customers isn't necessarily going to allow them to hold on to all of their previously loyal customers. When the market conditions have changed and products are available at lower prices elsewhere people aren't going to be sentimental or blindly loyal to a local business if they have the option to save money shopping elsewhere. Unfortunately, some of the businesses in towns around the world that are affected by Wal-Mart's arrival the most are family owned and have been in business for generations. Many have failed and will fail under the pressure of everyday low prices.

Like a moth to a flame some businesses actually set up shop in the shadow of Wal-Mart Supercenters. Tempting fate they attempt to compete in close proximity to the big box in order to take advantage of their drive-by traffic. As one example, I've noticed "dollar" stores opening just off the parking lots of Wal-Mart Supercenters. In visiting these stores, my wife has pointed out many of the items offered for a dollar are available at a Wal-Mart Supercenter for 79 or 89 cents. Trust me when I tell you this is not going unnoticed by the Wal-Mart buying team. There will come a point in time when a section of a Supercenter will be devoted to similar items in order to tap into this market. The lesson is: Even if you think you've found a niche, don't ever become complacent.

Some retailers can not only survive the onslaught of Wal-Mart's entry into the market but even thrive during downturns in the economy. Stephen L. Giroux stated, "We have 5 independent drug stores with large front ends with general merchandise. Our biggest store is about 7,500 square feet and our smallest store is about 3,500 square feet. We have traditional front ends with card and gift shops. In a bad economy, because

of a lot of factors, we tend to do well, if not better than normal. We are in a climate presently where prescription volumes are exploding exponentially. They predict the number of prescriptions to double in the next five years with the aging of the baby boomers. From that perspective our business tends to succeed in tough economic times and one would potentially argue that when the economy is bad, people are stressed out so they need more stuff to help them deal with it. In a bad economic climate people tend to not necessarily go big ticket at the malls, but they still need to give gifts, so they are more apt to come to a lower end gift retailer such as a drug store for the card and gift because they still need to give everybody a gift; it's just that they can't spend as much money as they might have otherwise. Our business model with a strong front end, with lower ticket items serving a niche need, tends to survive and thrive. The real big thing is service, I know practically everyone who walks in the door, by first name, that's pretty difficult to compete with on any level including price." Even though every Wal-Mart has its own pharmacy, many local drugstores have been able to compete successfully by offering superior personalized service.

I asked a former Wal-Mart manager about the flexibility each store manager has regarding the setting of prices locally and he said, "They have what they call the Wal-Mart Sale Price. As an example they would work out a deal to buy Scope mouthwash at a certain cost, put a markup on it they wanted and set the Wal-Mart Price on it at say, \$4.97 a bottle. The store could never sell it above \$4.97 because the computer will not allow you at the store level with that bar code to go above \$4.97. If one of the competitors was pricing less than that you had the ability to drop it down below that. If they were running it at \$4.50 you could go to \$4.50 regardless of whether or not you were still making money on it."

As described in this example, pricing below cost is sometimes referred to as "predatory pricing." Wes Ball, president of the Tennessee Grocers Association, describes predatory pricing as "the practice of coming into a market and losing money in the location that you are lowballing [prices] to run competition out. Say I have six locations around town and I lower all my prices at all six locations until the other folks fold up. The competition bankrupts themselves trying to meet that price. The way you recover is to charge anything you want to afterwards. It's a variation of a monopoly. When you have umpteen stores around the country, that allows you to operate in that manner. If the last company standing is a single company, they can charge anything they want. Our friends from Wal-Mart are extremely competitive when they come into town. Three years later you're not going to find anything like the disparity [in prices] you did when they came in."

John Morrison, the state director of the Missouri Grocers Association, said, “Wal-Mart is our next-door neighbor here in southern Missouri, we are basically at ground zero. David Glass comes from this area and managed a chain of local grocery stores prior to his Wal-Mart employment. Wal-Mart’s competitive strategy comes in many shapes and sizes from EDLP (Every Day Low Prices), to potentially “over storing” the marketplace, in which case the deepest pockets usually win. We have witnessed severe erosion in some of our business communities. Within the Supercenter, our local town’s main-street business area has been recreated and departmentalized under one roof. The synergism of this marketing approach has both positive and negative consumer appeal. Many consumers just aren’t into buying a gallon of motor oil and then running across several hundred feet to buy a gallon of milk. Obviously others do not feel this way.”

I asked Morrison what type of grocery store was most vulnerable to the entry of a Wal-Mart Supercenter into the area and he answered, “Many independent neighborhood grocers have survived several generations and some pretty bleak times. True, they are not accustomed to this type of completion, but don’t sell them short. When a new Supercenter rolls in some businesses quit without a fight and others have done an excellent job in evaluating how to compete. The impact of a Supercenter is different in every town. In some, Wal-Mart has dominated, and in others the fight is on! Our job must be to educate our consumers on the value of the shopping experience, products, promotion, service and convenience we offer. The historic problem, or opportunity, as the case may be, with many companies like Wal-Mart, is the bigger they get the less flexible they become, a true advantage for the hands-on local merchant who can successfully take advantage of it.”

You may or may not consider Wal-Mart a direct competitor. If you are a retailer fortunate enough to not be in direct competition, thank your lucky stars! But remember, that could change. It wasn’t that long ago Wal-Mart wasn’t in the gasoline, banking, or grocery businesses.

**S**teve Sheetz, chairman of Sheetz Convenience Stores, discussed with me the changing world of gasoline retailing as more and more grocery stores, Sam’s Club, and Wal-Mart Supercenters are getting into the gasoline business. He said, “In the ‘70s we began to see a switch from gasoline retailing from the service station to the convenience store and now we’re seeing a huge segment of gas purchasing change moving from convenience stores over to the so-called big box or supermarkets and Wal-Mart who have a different model. They all of a sudden see the combined purchase potential

of gasoline. In essence they are subsidizing that to increase the inside. I don't know that it is predatory pricing, it's more of a different model.

"On the inside of our store we really don't have much in the way of economies of scale because our volumes per location are so small on a lot of those items compared to Wal-Mart that none of us really on the inside can compete with their pricing. They're geared more towards the restocking of home and we're geared more to an on-the-go customer. The only real significant price-sensitive items to us, in the convenience-store business, are gasoline and cigarettes, the two commodities that are really price-driven more than the rest of our offer. We know we can't compete on the inside with them and we don't attempt to."

Convenience stores have been able to thrive in the curl of the Wal-Mart wave until recently. The introduction of gasoline at Wal-Mart stores has changed everything. According to the National Association of Convenience Stores, 75 percent of its membership is single-location retailers. Mom and pop stores have no leverage in purchasing fuel. Sheetz says, "With gasoline there is a purchasing advantage: As you get bigger and buy more gallons, then you can begin to go under contract with refiners and that offers obviously some competitive advantage on purchasing." Unfortunately, the vast majority of convenience-store operators aren't large enough to take advantage of volume discounts. Adding insult to injury, Wal-Mart promotes low-cost cigarettes at their fuel pumps, directly affecting both of the convenience store's two primary business drivers. The resulting tsunami is having a devastating affect on the convenience-store industry as a whole.

Kerley LeBoeuf who is the president and CEO of the National Association of Convenience Stores said, "We do a statistical report for the convenience-store industry and if you take the top quartile, the top performers in the channel trade, they on average have less gasoline margin percentages and a higher proportion of their margins from merchandise sales from food service. The signal that sends is that those operators in the top quartile are relying less on cents per gallon for their basic profitability and they are relying more on the higher-margin food-service products."

Sheetz says, "If you segment the convenience-store industry, I think the bottom 25 percent of the convenience stores need 12 cents or more a gallon just to survive and we're saying you're not destined to be here, that's an old model and you've got to have a stronger inside offer because this gasoline retail environment is going to dictate over time that everybody moves to a much lesser margin. It's a different model and you better have a strong business outside of gasoline in order to make it. The bottom 25 percent is going to go away, I think the next 25 percent may take a little longer, they need up to 10 cents per gallon, but they are going to go away too."

It's not just Wal-Mart affecting convenience stores by selling gasoline and cigarettes out on their parking lot. Many grocery stores are getting into the business as well. It's service they can provide viewed as a convenience for their customers. Wal-Mart uses gasoline as a way to expand its customer-service concept of one-stop shopping. It also prices gasoline in keeping with its every-day-low-prices strategy.

I asked Kerley LeBoeuf why Wal-Mart hasn't aggressively gone directly into the convenience-store business and here is his response, "I'm not really sure that is their core competency. If you think about their core competency it seems to me it is to be able to purchase products for resale pretty much cheaper than anybody based on their enormous clout and buying power. They deal in extremely high volumes and convenience stores tend to not do that, they tend to deal in lower volumes. It seems their whole concept is designed for low price and is generally 'pile 'em high and sell 'em cheap.' Convenience stores have a whole different business philosophy and business model." Wal-Mart may yet enter the convenience-store business in the future and in the process could reinvent convenience-store retailing as we know it.

**W**al-Mart has experience turning other retail markets upside down. Look at the impact they've had on college bookstores. Local bookstores, on or near college campuses, used to be the only source of college textbooks for students. They had a virtual monopoly on setting prices, because there was no competition. This led the small campus bookstore to have complete pricing freedom and market dominance, but not anymore. Wal-Mart as well as other web-based book sellers have aggressively moved into the college textbook market via the Internet in a big way. Students can buy brand-new college textbooks on the Internet, from the comfort of their dorm rooms, at the same price charged for used books in the campus bookstore. It seems no market is considered safe from potential competition with the world's largest retailer.

Not only does Wal-Mart compete in selling pharmaceuticals, automotive, books, jewelry, garden, groceries, toys, sporting goods, clothes, candy, magazines, crafts, pet, flowers, office supplies, swimming-pool accessories, paint, video equipment and DVDs, etc., it owns many of these markets, having garnered huge market shares. The logistics of running so many diverse businesses under one roof and doing them well is mind-boggling. All of these unique businesses have to be executed in a 24/7/365 business environment while utilizing average people interchangeably to achieve above average sales results. It seems logistically impossible to perform such a diverse and difficult task so well but Wal-Mart does it around the world every day.

**T**o begin to understand the purchasing power and price advantage provided by big-box retailers like Wal-Mart, we need to explore how they do it. Let's go back to Purchasing 101. The vast majority of retail companies are forced to purchase the goods they sell from wholesalers or distributors of their specific line of products. The wholesaler or distributor, in turn, acting as a "middleman," buys product directly from the manufacturer in larger quantities than an individual retailer could handle and this process enables it to negotiate a better price. The wholesaler/distributor then sells the product to a variety of retailers in the quantities they demand, at a marked-up price. Historically, this symbiotic relationship has served the retailer and the wholesaler/distributor well. The retailer was able to take advantage of the buying power of the wholesaler/distributor and both benefited handsomely. Over the years, this process has kept the retail-purchasing playing field level among competitors. This purchasing balance worked just fine until Wal-Mart came along and changed all the retailing rules.

I remember hearing discussions about eliminating the third party in the purchasing process when I worked at Wal-Mart. As the company was getting larger and larger it was becoming more critical to expedite direct communication between Wal-Mart and its vendors for automatic-replenishment purposes. Elimination of third-party intermediaries was also a way of reducing cost. Wholesaler commissions sometimes added as much as three percent to the cost of goods with little perceived value added. Wal-Mart decided to buy directly from the manufacturer wherever possible. Because of the sales volume generated through its stores Wal-Mart sometimes purchases all the products some of its manufacturers can produce. In most cases, Wal-Mart buys even more products than a single large wholesaler/distributor can buy. This allows it to pay even less for its product than a manufacturer would charge its existing wholesaler/distributor network.

Because of its buying power, Wal-Mart can sell product at retail for less than the price at which most wholesaler/distributors can buy the same product from the same manufacturer. Talk about a competitive advantage in the marketplace. Other retailers can and do buy products at Wal-Mart for resale in their stores for that reason. Therein lies the problem for competitors. Retailers who are trying to compete with Wal-Mart by selling the same merchandise get blown away on pricing. It's scary to think small retailers might get better prices by purchasing directly from a Wal-Mart store than it can from its own distributor/wholesaler network. Not exactly a level, competitive playing field.

One example of this phenomenon involves small independent bookstores located in a shopping mall or a downtown area. When a new hot-

selling book comes out, a small store may order a few dozen copies while Wal-Mart will buy many thousands of copies of the same book. Because of its buying power Wal-Mart can then sell the books at retail for a lower price than that at which the small store can purchase them from the publisher. Once local customers figure out how inexpensive books are at Wal-Mart they simply stop shopping at the small independent bookstore altogether. At that point Wal-Mart becomes the only source of books in town, supply and demand takes over and consumers may ultimately be forced to pay higher prices for books. With little or no competition left, Wal-Mart is able to raise the price on the books it sells due to lack of local competition. This same aggressive pricing scenario plays out in every retail category in a Wal-Mart store. This phenomenon forces all kinds of local retailers out of business due to their loss of customer traffic.

There are variations of this scenario, but the bottom line remains the same because regardless of what Wal-Mart sells, you can bet it sells it cheaper than any other local retailer in the immediate market area. Everything from gasoline, flowers magazines, candy, jewelry, plants, tires, shoes, paint...well, you get the message. No matter what the product line, its pricing power puts its competitors at a distinct disadvantage. That is a direct result of the way it buys and its pricing philosophy. Sam Walton always told the buyers, "You're not negotiating for Wal-Mart, you're negotiating for your customer, and your customer deserves the best price you can get. Don't feel sorry for a vendor... he knows what he can sell for and we want his bottom price."<sup>8</sup>

In the study *Small-Town Merchants are Not Using the Recommended Strategies to Compete Against National Discount Chains: A Prescriptive Versus Descriptive Study*, author Christopher Achua surveyed small-town merchants to identify retail-pricing strategy changes they had made when big-box discounters arrived on the scene:

To determine how local merchants were dealing with intense price competition from the discount chains such as Wal-Mart, K-mart, and Lowe's respondents from the local market area were asked to describe what actions, if any, they had employed to stay competitive. Responses are as follows:

- No change in pricing strategy 42%
- Lowered price to match discount chains 37%
- Did not make major changes in original pricing strategy 16%
- Consciously moved away from price competition 3%
- Brought in new product lines for price conscious consumers 2%

Interestingly enough, contrary to the common-sense notion that small retailers need to promote product and change their merchandising

mix and avoid direct-price competition a full 79 percent of those participating in this study either didn't change prices at all or lowered their prices to match the discounters'. The study also noted that a high percentage of retailers who attempt to engage directly in price competition end up paying the ultimate price, which is the failure of their business.<sup>9</sup>

**W**hen Wal-Mart's company-owned prop planes were not available, I would fly on commercial flights packed with vendors flying in or out of the Fayetteville, Arkansas airport who were coming from or going to Wal-Mart. In those days you had to fly through Memphis, Kansas City, Dallas, or Tulsa to get to northwest Arkansas. I remember overhearing conversations between vendors complaining about their experiences with Wal-Mart buyers or simply grouching about the crummy flights and low-end hotels, or the fact that Bentonville was located in a dry county. I had heard some of Wal-Mart's vendors traded dollars selling to Wal-Mart and in some cases even lost money. The reason they continued to sell to Wal-Mart was because it provided a tremendous showcase for their brands and kept their manufacturing facilities operating at full capacity.

I'll never forget seeing the New York apparel merchants setting up their wares in the Wal-Mart parking lot. They would ship their samples ahead and then fly to Fayetteville and rent a car for the 25 mile trip to Bentonville. Early in the morning, the vendors put clothes on their clothing racks out in the middle of the parking lot, steaming out the wrinkles, and then rolling the racks into the main lobby of the Home Office building.

Those vendors that sold gas grills, picnic tables or swing sets were out there too, with their screw drivers and socket sets assembling their samples. I can still picture them, wearing their suits and ties while building their samples, and to me, they looked out of place and unhappy. Sometimes Wal-Mart's buyer would have to go outside to look at the larger product samples out on the parking lot. I guess some of the unhappiness I sensed from the manufacturer's sales representatives stemmed from the fact that every other company's retail buying team went to the show rooms of manufacturers to see products displayed, but not the Wal-Mart buyers.

Adding insult to injury, when suppliers entered the Sam's Club buying area, their neckties were unceremoniously cut off with scissors by company buyers, knot and all. On a wall near the plywood vendor-negotiation cubes, just off the lobby in the Sam's Club headquarters, is a permanent display of hundreds of neckties removed from the necks of vendors who were not in touch with the company's informal dress code and values. I always thought the display had to be a bit intimidating to their suppliers and manufacturer's sales people.

The wall of ties and the Sam's Club plywood negotiating cubicles symbolized and reinforced the casual culture of the warehouse-store environment and the low-price cost structure. Sam's Club and Wal-Mart had two distinctly different cultures. Historically, they intentionally operated out of separate headquarters buildings and had separate buying staffs to insure each brand stood on its own merit. Although neckties were taboo at Sam's Club, they were commonplace at the Wal-Mart Home Office just across the parking lot. Recently the two buying teams have started working together to take advantage of the negotiating power provided by combining their purchases.

**T**he negotiating prowess of Wal-Mart buyers is renowned in buying/vendor circles. They are trained to be tightfisted hardnosed negotiators known in industry buying circles for not leaving money on the table. Wal-Mart buyers are not allowed to take gratuities from the vendors such as free meals, or even a free baseball cap. The business is set up strictly on volume, timely delivery and price. Vendor relationships are important but the only guarantee of product continuity for vendors is to sharpen their pencils and to provide the best price, the first time it is requested. Failing to do so will lead to replacement in favor of a lower-cost provider. Competitive bids are encouraged and it is normal operating procedure for vendors to be pitted against one another.

We negotiated everything in every department. We were trained to negotiate by the famous negotiating-skills expert, Chester Karass, who taught us, "In business, you don't get what you deserve; you get what you negotiate." With the negotiation training we received, no one was embarrassed to push back on suppliers' published, advertised, or quoted prices. That included things like health- and welfare-benefit suppliers, temporary-employment services, office supplies, and even drug-screening services. Company pricing contracts were in place for travel expenses like rental cars, hotels and airlines. When I worked for Wal-Mart, I can't remember a time that I questioned a proposed price for anything and didn't immediately get a price reduction. We didn't care what everyone else in the business world was paying for a product or service, we demanded the lowest possible *Wal-Mart* price.

Being a present supplier of products or services to Wal-Mart is no guarantee of future business. The best advice I have to suppliers is to offer your best and lowest price the first time it is requested. Game-playing, posturing, and positioning is not only frowned upon, it is viewed as at least a lack of integrity and at worst out-and-out dishonesty. For those vendors not used to honest and open communication, operat-

ing with integrity was a real challenge. Dishonesty is the fastest way to have your products pulled from Wal-Mart's stores. Lacking integrity or being dishonest will also prevent you from getting your products into their stores in the first place.

Understanding this total integrity standard is critical to the success of vendors and Wal-Mart associates alike. Situational integrity or ethics are not tolerated. I once heard Sam Walton say he would walk a million miles with someone who had a job-performance problem but he wouldn't take the first step with someone with an integrity problem. Good old-fashioned integrity, honesty, and business ethics are required if a vendor wants to do business with Wal-Mart or if a job applicant wants to work there. Employees are held to the highest ethical standards and anything less is unacceptable.

Rob Walton, son of the founder and chairman of the board since 1992, talked about ethics and integrity in Wal-Mart's 2003 annual report. "First and foremost, a culture of ethical behavior underlies all that we do at Wal-Mart. All of us who worked with my father remember the many talks he gave stressing the importance of honesty, integrity, and fairness in our dealings with our customers, suppliers, associates and the communities in which we operate. David Glass, your former chief executive officer, and Lee Scott, your current chief executive officer, have continued that commitment. Setting the right ethical tone at the top is the first step towards good corporate governance at Wal-Mart." Whether you are a buyer, a job applicant, or an associate, operating with honesty, ethics, and integrity is a condition of employment at Wal-Mart. It's also a requirement if you want to be a supplier of products for their stores.

**W**al-Mart gets better pricing from vendors than its competitors do. This won't change unless a competitor buys more product from that vendor than Wal-Mart does. This is rarely the case. Wal-Mart's lower purchase prices lead to higher sales and higher profitability. Other retailers are truly at a competitive disadvantage in buying from their own vendors when Wal-Mart purchases from them also. This is the capitalist system at its best if you are Wal-Mart and at its worst if you are anybody else trying to compete and survive.

Grocery retailers have really felt the pinch of Wal-Mart's buying power and incredible expense control in its aggressive pricing. Those who compete in the grocery or convenience-store businesses must diligently track how they compare in shopping-cart comparisons of staples like milk, eggs, bread, coffee, soft drinks, ketchup, mustard, motor oil, cigarettes, and gasoline. Consumers have excellent pricing intuition when

it comes to staple items and for this reason pricing them competitively is critical. Grocery store staple items include bread, ice cream/cones, chips, baby food, baking powder, candy, cereal, cocoa, chocolate, coffee, corn-starch, crackers, cookies, ketchup, mustard, eggs, flour, bananas, apples, oranges, lettuce, honey, jams, orange juice, pasta, hamburger, fryer chicken, milk, peanut butter, pickles, popcorn, rice, salt, tuna fish, vegetable oil, baking soda, soft drinks, soup, sugar, maple syrup, tea, canned vegetables, vinegar, yeast, motor oil, gasoline, and cigarettes.

A general rule of thumb is to always price staples within ten to 15 percent of Wal-Mart's price structure, if you possibly can. Retailers have to do what they can to remain as competitive as their cost structures will allow on staple items, without giving away the store. John Morrison said, "An average supermarket will carry around 25,000 items and at any time I can select a cart full of products that we are at a price advantage over Wal-Mart on and at the same time I am sure Wal-Mart can make that same statement. It all depends who is doing the shopping cart comparison. Wal-Mart appears to move from the "lowest price" to "lower price" in their advertising message, based on those comparisons. If you check your best food day ad prices, with your local grocer, against Wal-Mart's every day low price, you will see what I mean. They spend an awful lot of time in our stores checking prices for some reason. The truth is on some products we are lower and on others they are." His point is that Wal-Mart doesn't have the lowest prices on everything, unfortunately, because of Wal-Mart's extensive EDLP (Every Day Low Prices) advertising, consumers perceive their prices are the lowest on everything.

One of Wal-Mart's former managers shared this insight with me regarding shopping-cart comparisons. "If we went into a town and opened a store or in the case of a Supercenter expansion, you went in to start competing with the grocery stores. You pick the top 30 or 50 items in a department or a category and you'd go to the competitors and find out what they were selling it for and you'd price it at Wal-Mart for 10 percent less. In some cases they would even price it less than that.

"In a shopping-cart comparison of 50 or 60 top items you'd then want to be 15 to 20 percent below what your competitors were. You were able to do that better at Wal-Mart, even on the general-merchandise side of it, because you were making more money than the other stores were and you could absorb some of the extra costs of the markdown. When you get into that situation, a grocery store is doing good to run a two- to three-percent profit, where now all of a sudden you're throwing in a combined store like Wal-Mart with general merchandise and groceries where as a store manager if you weren't running eight- to nine-percent profit margins you weren't doing your job. That gives you an awful lot of

money to play with to drop prices on the grocery side to knock your competitors out of business.

“That’s what I considered more of a predatory-pricing thing, where you’d go in and use the fact that you’re the biggest company in the world and can absorb some losses temporarily. As soon as these other stores go out of business Wal-Mart actually has a plan of how to raise prices back up to the Wal-Mart retail or up to wherever they want them over a 90-day or 120-day time frame so the public won’t really notice what is going on.

“If we were selling that Scope mouthwash for \$4.50 and all of a sudden that store closes we wouldn’t just all of a sudden bring that price up to \$4.97, we would do it in three or four increments over a period of time. Predatory pricing is just a way to put the other company out of business or it’s a way for your customer to discover it is cheaper here.

“The store managers were under constant pressure and scrutiny by upper managers to keep prices low. One of the district managers or regional vice presidents would come in, and there were some who would just go to the local Target and buy 30 or 40 items and bring them over to your store and ring them up and if you weren’t priced less than what your competitors were, if there was very much difference at all, you’d be in trouble. This was one of the biggest things they did. We were supposed to send our department managers, in every department, out once a week to check prices.”

**L**ocal grocers have the advantage of catering to local tastes and preferences in selecting products for their customers. They also have a better handle on catering to ethnic customers in the local area. Knowledge of the local market is a competitive advantage for the local merchant in the selection of products and services desired by local consumers. Private-label offerings are clearly another way to provide low-price alternatives to price-conscious consumers while at the same time improving margins. Customer-loyalty programs, product sampling, and double-coupons are additional strategies for retaining existing customers and attracting new ones. Wes Ball stated, “When you’re looking at a grocery store, as much as anybody would like to believe differently, you have to have cleanliness, friendliness, and variety, all of which precede price as a reason for someone buying from you. If you’re in your store, you’re keeping it stocked, you’re speaking to the people, you are relating to the community, and you are keeping your product fresh, you are very likely to survive.”

If you compete with Wal-Mart on the general-merchandise side of the store, be aware of the price structure offered in the categories within

which you compete. Intimately understand their product mix versus yours. Develop within your assortment some products at higher quality and price points to clearly differentiate your store from Wal-Mart. You can also cater to local preferences and tastes. The good news is not every consumer wants the cheapest-quality item at the lowest price. There is a wide array of customers out there, many of whom are interested in higher-quality products and willing to pay a higher price for them. Find that niche and cater to it.

Remember, your vendors have a vested interest in your success. Partner with them in developing your strategy to compete. Leverage their experience and knowledge of the marketplace. They understand as well as you do consumers are savvy and have an excellent feel for how your products compare on both quality and value. Ask your vendors to help you compete as best you can on price and everybody wins. You don't have to match or equal Wal-Mart's prices, just be in the ball park.

Webster's Dictionary defines juggernaut as "a massive inexorable force that crushes whatever is in its path." Using that definition Wal-Mart truly is a "retail juggernaut" on the offensive when it opens a new store in an area previously devoid of big-box competition. Stories abound of small retailers who simply close their shops and go out of business when Wal-Mart comes to town. Lacking a clearly defined game plan, some competitors look like a deer in the headlights. Some competitors appear confused as to whether the best defense is a good offense or the best offense is a good defense! Undoubtedly, one way or the other, you have to have a strategy to compete and survive. Unfortunately, in the "ready, shoot, aim" world of retailing the term "retail strategy" is almost an oxymoron. Most retailers err on the side of tactical activity, rarely stepping back to evaluate that activity against a predetermined plan of action. When price is the perceived driver of consumer purchasing preference and Wal-Mart is the destination of choice, it may seem futile to some to develop competitive strategies they perceive are destined for failure regardless of the quality of execution. "Oh woe is me" is not a strategy and that attitude will surely lead to a retailer's demise against the onslaught of the Beast from Bentonville.

**S**trategy for most retailers begins with the realization you can't compete directly with Wal-Mart on price. The list of those who have tried is long and their demise was painfully slow and tortured in some cases. Because of its size and the leverage it has with its suppliers, Wal-Mart has the ability to sell its product at retail for less than you pay wholesale. So don't try to compete on price. Some retailers, believe it or not, still

foolishly believe they can. As Mark Twain once said, "Denial ain't just a river in Egypt."

When Wal-Mart enters the picture it only takes one trip to the Supercenter to prove Wal-Mart's prices on the same items are lower. When that discovery is made, loyalty may rapidly become a secondary consideration for the consumer interested in saving a buck. It's easy enough to run your own price comparisons in your community. Interestingly enough, your shopping-cart comparisons will prove Wal-Mart's prices are not the lowest on all items. There is, however, a perception in the mind of the consumer that they are. This perception has been strategically planted there by targeted advertising and marketing messages focused on Wal-Mart's "everyday low prices" campaign. Consumers begin to believe that Wal-Mart has the lowest prices on everything, so they stop doing comparison shopping.

The simplified retail-pricing formula has always been  $Price = Cost + Markup$ . Traditionally the one-size-fits-all approach to pricing may have worked when competition was minimal. According to basic economics, if there is demand for a product and you are a single source of supply, prices can be set based on what the market will bear. In a big-box world everything is different and low prices drive the shopping patterns of the masses. Pricing strategies are instrumental to maintaining an existing customer base and attracting new customers. If individual prices aren't set appropriately price-sensitive, consumers will shop elsewhere. For grocers, I believe the best pricing strategy for competing in a big-box world focuses on developing price formulas for individual products based on solid market intelligence, varied assortment, private label products, and courage and commitment to buy enough inventory.

For retailers that sell general merchandise, pricing strategy begins with differentiating your product selection. Don't be afraid to purchase higher-quality merchandise to sell at higher price points. Customers are willing to pay a premium for product of higher perceived quality. Depth of quantity of that product purchased allows you to merchandise as if you are serious about your business. To determine the appropriate markup, a competitive pricing analysis of the same or similar products in the local market area will give you the confidence of knowing that the prices of your products are positioned properly in the marketplace. Unlike in the past when prices were set based on "cost plus," in this day and age appropriate prices are market-driven.

Competitors are clearly at a disadvantage with big-box retailers when it comes to price. You will lose if you try to square up on the likes of Wal-Mart by selling the same products at the same prices. Price war in this context isn't a fair fight; it's more of a lopsided aerial dogfight ending

predictably for you in a self-inflicted death spiral. So don't go there, you can't win. Remind your vendors in price negotiations partnering with you is in their best interest. By keeping you in business, with the best possible prices for your customers, everybody wins. Don't be blindly loyal to your vendors. If your suppliers won't work with you then negotiate prices with two or more suppliers to ensure you are always getting the best prices possible. Give your business to the supplier who acts like a true business partner.

The success of your business is directly related to the tailoring of the products and services you offer to the interests of your targeted customer. You need to recognize that to one customer a product may be a convenience, to another a necessity, and to another a potential impulse buy. All customers aren't motivated to buy for the same reasons. Ask your customers what they like about the items they buy and why they don't buy other items in your assortment. The differences in what people look for in products and services, and the insights they provide you, represent an opportunity for your business to tailor its product selection.

Your pricing strategy will depend on numerous factors including target market, location, competition, expense structure, and the types of products/services you offer. The key to setting your prices correctly is striking a balance between price and quality that creates a perceived value in the mind of your customer. The bottom line on pricing is that it ultimately leads to profitability.

Many retailers use a cost-based approach to pricing their products. The simple formula they use is cost of goods plus some percentage of that cost. It is important to remember a one-size-fits-all pricing strategy won't work. Individual products need to be competitively priced within the market where you do business. In other words, markup on individual products will be affected by the price structure of your competitors as well as what the market will allow. One strategy for pricing is to price items that are the same as or similar to those of your competitors comparably. This will require you to periodically shop competitors' stores for the items you sell to stay on top of changes in their strategies. For those items unique to your store, pricing may be established by what the market will bear.

You may be surprised to find your prices on certain merchandise are actually lower than those offered at Wal-Mart. That's because in the Wal-Mart assortment, certain price-sensitive items will always be priced the lowest. Wal-Mart checks its competitors' ads and shops their stores, and store managers are directed to always have the lowest prices on those products. Ask most Wal-Mart shoppers about prices and they'll tell you Wal-Mart has the lowest prices on everything. They have stopped com-

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parison shopping and simply load their shopping carts to the brim with all types and varieties of items, confident they're getting the best possible prices. Wal-Mart's marketing and advertisement of low prices have been very effective in that regard.

By leveraging what you do best, differentiating your product selection, and delivering knock-your-socks off service, you will create a niche within which to compete. As a discounter, Wal-Mart isn't able to do what you can do on a local level. You know your community and your customers better than it does, and you know the kinds of products and services that appeal to local tastes and preferences. Have the courage to buy to those local tastes and preferences. With a differentiated merchandise assortment you can survive and thrive in the shadow of big-box retailers.

Hand-to-hand combat with an 800-pound gorilla may seem like an exciting and challenging exercise, but unless you are a thousand-pound gorilla, the outcome of the confrontation is absolutely predictable. Those with delusions of grandeur who knowingly choose to compete directly with Wal-Mart on price, as they say in Arkansas, "ain't thinkin' quite right." In the end, you're only fooling yourself with the mistaken perception you are that thousand-pound gorilla. When and if you do attempt that kind of competition, you've chosen a path that will surely lead to financial disaster and the demise of your business. Remember the path to success: "In niches there are riches."

### **Pricing Checklist**

**Review this pricing checklist of success strategies and tactics designed to help you compete with big-box retailers like Wal-Mart and not only survive, but thrive.**

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- ✓ Avoid selling the same products Wal-Mart sells
- ✓ Don't try to match Wal-Mart's prices
- ✓ Ask your vendors for competitive product/pricing ideas
- ✓ Provide higher-quality products at higher price points
- ✓ Price a consumer shopping cart of comparison staples competitively (within 10 to 15 percent)
- ✓ Broaden your overall selection of price/product choices: good, better, and best
- ✓ Talk to your vendors about partnering with you on lowering their prices
- ✓ Shop competitors' stores for ideas and an understanding of their price strategy
- ✓ Ask your suppliers for special-buy and sale merchandise for your customers
- ✓ Make certain shelves or inventory are clearly marked with accurate prices
- ✓ Advertise product guarantees and service after the sale