



# THE STATE OF AMERICAN RETAIL STORES

## THE WAL-MART EFFECT

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**THE BASICS.** So much has been said about Wal-mart in the popular news and business media that it is challenging to find something new to add to the dialogue on Wal-mart. It is sufficient to say, as an introductory remark, that Wal-mart is substantially larger than any comparable retailing and distribution firm to such a degree that further study of this difference in scale is required. The purpose of this study, The Wal-mart Effect, is to provide evidence that the disproportionate size of Wal-mart relative to its rivals in the distribution and retailing of finished goods represents a fundamental imbalance in the macroeconomy for the consumption of finished goods on a global basis. This imbalance is highly systemic in nature; that is, it operates through the macroeconomy and not through any set of specific monetary risks to any investor or lender. Wal-mart continues to be an excellent credit risk over both short- and long-term scenarios. The risk from these systemic imbalances is that a large number of retailing and distribution firms will be forced to either merge or to file bankruptcy and in some instances these firms will terminate their operations. The imbalance, therefore, is a systemic risk factor in evaluating the credit risk of any retail or distribution firm that should be considered along with specific risk factors.

The short-term monetary benefits of large mergers are often elusive, outside of non-recurring non-cash benefits to cash flow. The primary goal of the larger mergers, typically, is to create a consolidation of fixed assets in an attempt to reduce any redundancy of fixed assets relative

to a larger revenue structure. In this scenario, the break-even point for unit sales in retailing and distribution is favored by a restrained fixed expense quantity. During times of stable prices for labor and energy, variable expenses are constrained and the combination is often favorable to an improvement in the ratio of fixed assets to sales. When two firms of similar scale and product-mix combine their firms, the immediate improvement to the fixed asset ratio does not always lead to a concurrent and immediate improvement in earnings. The recent combination of Albertsons and American Stores is an example of this. Albertsons, the surviving parent company, is not reporting immediate improvements in earnings and their debt ratings may be affected by this condition.

In contrast to this situation, Wal-mart was developed according to a business model inherently designed to support a gigantic organization of unrivaled internal coherence. Instead of testing vertical marketing channels early in its development, Wal-mart evolved through an apparently two-tiered approach to retailing: a distribution firm at the center and a mass merchandiser at the end of its own supply chain. Wal-mart, in this sense, is the supreme disintermediator of the supply chain.

This method is joined to what may be the most effective store location strategy ever deployed by a retailing firm in U.S. history. It appears that Wal-mart's early penetration into rural counties across the U.S. was designed to take full advantage of the lack of existing competition in these markets, the improved mobility of its

