Wal-Mart Stores' Discount Operations

In October 1985, *Forbes* declared Sam Walton the richest person in the United States. With his four children, he owned stock worth $2.8 billion. That put him $1 billion ahead of the next person on the list, H. Ross Perot. By the end of April 1986, Walton's net worth had swelled by another $1.6 billion.

Walton's fortune consisted of a 39% stake in Wal-Mart Stores, a retailer that had focused historically on the Southwest. Although Wal-Mart had begun to diversify into other areas, discounting still accounted for 91% of the company's sales in 1985 and 96% of its pretax profits. Wal-Mart had consistently led other discounters in both profitability and growth. **Exhibit 1** summarizes Wal-Mart's history over the past decade; **Exhibit 2** compares its performance with that of its competitors. As a result of such comparisons, Wal-Mart's market value in early 1986 was twice K mart's, even though it was only a third as large. Analysts thought that Wal-Mart would overtake K mart as the largest discounter by the turn of the century, but they were divided over whether Wal-Mart stock remained a good buy at a price-earnings multiple of 26.

This case describes discount retailing and the distinctive features of Wal-Mart's discount operations. It also sketches the areas into which Wal-Mart was diversifying in the mid-1980s.

Discount Retailing

Discount stores emerged in the United States in the mid-1950s. They followed on the heels of supermarkets, which sold food at unprecedentedly low margins. Discount stores extended this approach to general merchandise by charging gross margins that were 10%–15% lower than those of conventional department stores. To compensate, discount stores cut costs to the bone: fixtures were distinctly unluxurious, in-store selling was limited, and ancillary services, such as tailoring, delivery, and credit, were scarce.

The discounters' timing was just right. Consumers had become increasingly better informed since World War II. Supermarkets had educated them about self-service, many categories of general merchandise had matured, and TV had intensified advertising by manufacturers. Government standards also bolstered consumers' self-confidence. Many were ready to try cheaper, self-service

Professor Pankaj Ghemawat prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

retailers except for products that were big-ticket items, technologically complex, or "psychologically significant."

Discount retailing burgeoned as a result. Discounters' sales grew from $2 billion in 1960 to $68 billion in 1985. Penetration continued: by the year 2000, discounters' sales were expected to climb to $98 billion (in 1985 dollars).[1]

But too many players had gotten into discounting at the local, regional, or national level. Industry growth peaked in the 1970s: during that decade, the number of stores increased by 64% and (undeflated) sales by 144%. Over the 1980–1985 period, the number of discount stores increased by only 8%. Several large chains—including King's, Korvette's, Mammoth Mart, W.T. Grant, Two Guys, and Woolco—failed in the late 1970s and early 1980s; many of the padlocked stores were acquired and recycled by survivors. (**Exhibit 3** depicts the average economics of discounting in 1984.)

Wal-Mart's Discount Stores

History

Although Wal-Mart Stores was incorporated in 1969, it was rooted in the variety store—franchised by Ben Franklin—that Sam Walton had opened in Newport, Arkansas, in 1945. Through 1962, Sam Walton and his brother, Bud, built up a chain of 16 variety stores in rural Arkansas that was considered Ben Franklin's most successful franchisee. But regional entry by discount stores increasingly worried Sam Walton; competitive pressure eventually led him to travel the country, scouting retailing alternatives. Despite the conventional wisdom that a full-line discount store needed a population base of at least 100,000, Walton became convinced that discounting could work in small Southwestern towns. In his words, "If we offered prices as good or better than stores in cities that were four hours away by car, people would shop at home."[2] Since Ben Franklin was unresponsive, Walton set out to build his own discount chain.

By 1970, Walton had steadily expanded his chain to 30 discount stores in rural Arkansas, Missouri, and Oklahoma. But the cost of goods sold—almost three-quarters of discounting revenues—rankled. As Walton put it:

> Here we were in the boondocks, so we didn't have distributors falling over themselves to serve us like competitors in larger towns. Our only alternative was to build our own warehouse so we could buy in volume at attractive prices and store the merchandise.[3]

Since warehouses, at $5 million or more apiece, were rather capital-intensive, Walton took the company public and raised $3.3 million.

After 1970, Wal-Mart's discount operations mushroomed. At the end of 1985, Wal-Mart operated 859 "Discount City" stores, with distribution centers in five locations. (**Exhibit 4** traces the pattern of store expansions, and **Exhibit 5** maps Wal-Mart's discounting network at the end of 1985.) In describing the pattern of expansion, David Glass (later Wal-Mart's president and chief operating

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[1] E. G. May, C. W. Ress, and W. J. Salmon, *Future Trends in Retailing* (Marketing Science Institute, February 1985).

[2] *Business Week*, November 5, 1979, p. 145.

[3] *Forbes*, August 16, 1982, p. 43.

officer) said, "We are always pushing from the inside out. We never jump and then backfill."[4] During 1986, Wal-Mart planned to add another 115 discount stores to its network.

Well over half of Wal-Mart's stores were still located in towns with populations between 5,000 and 25,000, a higher proportion than the rest of the industry. About one-third of Wal-Mart's stores were located in metropolitan areas or counties that were not served by any of Wal-Mart's competitors. The comparable figure for other discounters in the states in which Wal-Mart operated was 12%. In locations where it was alone, Wal-Mart often commanded an unmatched 10%–20% of total retail sales.

Increasingly, however, Wal-Mart had turned to more densely populated areas for growth. The average size of a Wal-Mart store had increased from 42,000 square feet in 1975 to 47,000 square feet by 1980 and 57,000 square feet by 1985. In 1985, new Wal-Mart stores averaged 63,000 square feet—about the same size as the other discount stores being opened in the same regions. Increases in average size reflected, in part, Wal-Mart's development of 85,000- to 100,000-square-foot stores in order to penetrate mid-sized cities and encircle larger ones. Wal-Mart expected that eventually a quarter of its stores would exceed 85,000 square feet.[5]

Wal-Mart's competitors had come to notice that over the 1975–1985 period, population had grown faster in the Sunbelt than in the rest of the United States, and in nonmetropolitan areas than in metropolitan ones. As a result, they had begun to encroach on Wal-Mart's sales territories; K mart, for example, competed in over half of them by 1985. In an attempt to mitigate competition, Wal-Mart was testing 30,000-square-foot stores for towns with populations between 1,000 and 5,000. Company spokespeople claimed that stores of this size would open up 1,000 locations in areas previously considered saturated.

Purchasing and Distribution

Wal-Mart, like other discount chains, had centralized purchasing. Unlike some of its competititors, however, Wal-Mart did not base orders for most stockkeeping units (SKUs) on centralized sales forecasts. Instead, it used in-store terminals to wire merchandise requests to a central computer. The central computer would either transmit the requests to the Wal-Mart distribution center that supplied the store, or, if stocking levels there were low, reorder the merchandise. Wal-Mart never filled out-of-stock areas with different merchandise.

To expedite deliveries, Wal-Mart's central computer was linked directly to several hundred of its 3,000 vendors. Wal-Mart had developed a reputation for bargaining very hard with them. Unlike some other discounters, Wal-Mart took no more than a fifth of its volume from any one vendor. In 1985, no vendor accounted for more than 2.8% of the company's total purchases.

Only 20% of the inbound merchandise—a smaller proportion than at either Sears or K mart—was shipped directly from the vendors to the stores. The rest passed through Wal-Mart's two-step hub-and-spoke distribution network. One of Wal-Mart's 400-plus truck-tractors would bring the merchandise into a distribution center, where it would be sorted automatically onto another truck and delivered to the store—usually within 48 hours of the original request. Each store received at least three full or partial truckloads a week. Because Wal-Mart stores were packed together, one truck could resupply two or three on a single trip. Any merchandise that had to be returned was carried back to the distribution center for consolidation. Since many vendors operated warehouses or factories within Wal-Mart's territory, trucks also picked up new shipments on the return trip. In the early 1980s, Wal-Mart's trucks were running 60% full on backhauls.

[4] *Business Week*, November 5, 1979, p. 146.

[5] *Discount Store News*, December 9, 1985, p. 62.

Wal-Mart opened its first distribution center—a 72,000-square-foot facility—at its headquarters in Bentonville, Arkansas, in 1970. The initial cost of that distribution center was $5 million; it was meant to serve 80 to 100 Wal-Mart stores within a 250-mile radius, and it was enlarged as Wal-Mart's store network grew. By 1978, the company's radius of operations had widened to 400 miles. In that year, Wal-Mart opened a distribution center at Searcy, Arkansas, to serve eastern Arkansas and the growing store networks in Louisiana, Mississippi, and Tennessee. Distribution centers were inaugurated in three other locations in the next seven years: Palestine, Texas (1979), to serve the southeastern part of that state; Cullman, Alabama (1983), to serve Tennessee, Alabama, Kentucky, Georgia, and the Carolinas; and Mt. Pleasant, Iowa (1985), to serve Illinois, Iowa, and Indiana. By the end of 1985, Wal-Mart operated 3.9 million square feet of distribution space in five locations. It was scrambling to add another 2.6 million square feet in 1986, primarily in three new distribution centers: Douglas, Georgia; Plainview, Texas; and Brookhaven, Mississippi. Rapid store expansion was the reason: the new distribution centers were needed to contain delivery times and transportation costs and to cope with regional differences in consumer preferences. Ultimately each center was meant to serve up to 175 stores within a 150- to 300-mile radius.

This was the same distance that Wal-Mart stores were from their distribution centers in the early 1980s. Wal-Mart's cost of inbound logistics, which it had to shoulder, had then averaged 2% of sales—about half the figure for the industry as a whole. The savings fed directly into gross margins. However, rapid expansion had nudged these costs upward: in 1984, they accounted for 2.8% of sales and in 1985, 4.0%. They were expected to drop back to 3% of sales once the new distribution centers were completed in 1986.

Store Operations

Wal-Mart leased all but 47 of the 859 stores it operated at the end of 1985. Stores were constructed or redeveloped to its specifications by independent contractors. Almost all the store leases could be renewed for 5 to 15 years at the end of their terms. Some of the leases provided for contingent additional rentals based on sales levels. Since 1979, the company had decided to stay out of locations that could not be expanded.

Building rentals accounted for 1.8% of sales in the late 1970s—the lowest level for any major discounter. Two factors had since contained them: (1) an increase in sales per average square foot from $110 in 1979 to $171 by 1985 and (2) the bargain-basement acquisition, in the 1980s, of the leases for 120 Kuhn's Big-K and Woolco stores. Despite these factors, average building rentals had probably edged upward by 0.1% as Wal-Mart moved into larger, more contested towns.

Store hours ran from 9:00 A.M. to 9:00 P.M.; most Wal-Mart stores were open seven days a week. (**Exhibit 6** sketches the layout of a relatively large Wal-Mart store.) Each store had 36 merchandise departments. Store managers were allowed considerable autonomy in allocating space among them, ordering stock, and setting up displays. The ambiance of Wal-Mart stores resembled K mart's: since the mid-1970s, both had launched expensive store-improvement programs to move slightly upscale, although they remained less luxurious than higher-priced discounters such as Caldor, Target, and Venture. More of a Wal-Mart store's gross area was available for selling space because the company's distribution network reduced back-room storage requirements. Inventory turns exceeded 4.5 in 1985—well above the levels posted by other discounters.

On average, 29% of a Wal-Mart store's sales were accounted for by soft goods (apparel, linen, and fabrics), compared with roughly 35% for the industry as a whole. Wal-Mart placed more emphasis on hard goods (hardware, housewares, automobile supplies, and small appliances): these constituted 28% of Wal-Mart's sales but only 22% of the industry's. Hard goods generated more sales per square foot than soft goods (for the industry as a whole, about $150 versus about $125), built up more traffic, and required fewer markdowns. The gross margins on them, however, tended to be lower (about 29% versus 35% for soft goods).

The other important product categories at Wal-Mart were stationery and candy (11% of sales), sporting goods and toys (10%), health and beauty aids (9%), gifts, records, and electronics (5%), shoes (3%), pharmaceuticals (3%), and jewelry (2%). Most discounters had traditionally farmed out the last three categories, in at least some locations, to in-store licensees for fees ranging from 5% to 14% of the licensees' sales. Wal-Mart was no exception: in 1975, nearly all of its shoe, pharmaceutical, and jewelry departments were handled by licensees. Over the next decade, it took over many of these specialty departments—by all accounts, quite successfully—after they failed to match sales gains in other parts of its stores. By 1985, it ran over two-thirds of these specialty departments, and licensee fees accounted for only 0.2% of Wal-Mart's discount sales. Fees from licensing averaged 0.4% of sales for the industry as a whole.

The Wal-Mart system included over 70,000 SKUs—a larger number than most other chains, because Wal-Mart was the primary source of merchandise in many of the rural communities that it served. The average store probably stocked 35,000 SKUs; that number increased with store size. Wal-Mart had led the industry in 1971 by installing a computerized system to track inventory. In 1985 each Wal-Mart store had a computer that tracked sales and performed accounting functions. Full inventories of all stores were kept in the central computer at headquarters; they were updated weekly. A $20 million satellite network was to be inaugurated in 1986 to ease real-time communications between all stores and headquarters and to cap telephone costs, which had spiraled to $10 million. Industry observers already considered Wal-Mart's reaction time in adjusting inventory to be superior to that of its competitors.

In a major drive to improve productivity, Wal-Mart, like other large discounters, was switching to electronic scanning of the Uniform Product Code (UPC) at the point of sale. This would speed checkouts, bypass paperwork, and simplify inventory management, reorders, and postaudits of merchandising programs. UPC scanning was expensive, however: equipping one store with the capability might cost up to $500,000. Wal-Mart had equipped 25 of its stores in 1983, 66 more in 1984, and another 144 in 1985. In 1986 it planned to install UPC scanning in every new store and in 200 existing ones. The goal, which it shared with major competitors such as K mart, was full conversion by 1988 or early 1989.

Marketing

Branded merchandise, most of it nationally advertised, accounted for a majority—one source said 95%—of Wal-Mart's nonclothing sales. Most of the clothing sold, in contrast, was private label. Approximately 70% of all Wal-Mart merchandise was common to all its stores; the rest was tailored to local needs.

Wal-Mart's marketing theme was emblazoned on the facade of every Discount City: "We Sell for Less." Consumers clearly agreed. According to a survey conducted in 1985 by *Discount Store News* and Leo J. Shapiro Associates, consumers shopped Wal-Mart primarily for the price-sensitive categories of health and beauty aids, housewares, and appliances. They were not as influenced by it in apparel, hardware, and consumer electronics.

Wal-Mart was very competitive in terms of prices. Its store managers had more latitude in setting prices than did their counterparts in "centrally priced" chains such as Caldor and Venture. Goldman, Sachs had compared Wal-Mart's everyday shelf prices with its competitors' in three markets in late 1983 and early 1984.[6] The most competitive market covered the eastern suburbs of St Louis: in one of the suburbs—called Belleville—a Wal-Mart and a K mart were located right next to each other. Wal-Mart's prices there were 1.3% lower than K mart's. K mart priced 9% lower in Belleville than in Fairview, eight miles away, where it competed—at a greater distance—with Venture

[6] Joseph H. Ellis, "Wal-Mart Stores, Inc.," Goldman, Sachs, May 9, 1984.

and Target. The second market, between Dallas and Fort Worth, was somewhat less competitive: Wal-Mart, K mart, and Target were each separated by four to six miles. There, Wal-Mart's prices were 7.6% lower than Target's, and 10.4% lower than K mart's. The final market studied—Franklin, Tennessee, 18 miles south of Nashville—was one in which Wal-Mart had no local competition. Wal-Mart's prices in Franklin were 6% above those in its urban location in Nashville, where it was located right next to K mart.

Wal-Mart's promotional strategy was governed by its philosophy of "everyday low prices." Many discounters, such as Caldor, Target, and K mart, cut prices 20%–30% on selected items nearly every week in order to build traffic, highlight seasonal trends, and control their sales mix. There were numerous costs, though: advertising in local newspapers or catalog mailings to prospective customers, anticipatory buildup of inventories, scheduling snarl-ups, extra payroll costs, and additional markdowns on residual merchandise. To measure the success of a promotion, items had to be counted before and afterward;[7] even this measure was imperfect because many customers deferred purchases at higher everyday prices in anticipation of sales. As a result, a few discounters, such as Hills Department Stores, ran no promotions at all. Wal-Mart fell between these extremes by running 13 promotions a year: one each month except in December, when it ran two. Promotional prices were 10%–20% below everyday ones. By one account, Wal-Mart's sales tables—jammed between regular store fixtures—generated twice as many sales dollars per square foot as those of its competitors.

Wal-Mart's advertising expenditures had averaged 1.1% of sales in the second half of the 1970s. Circulars and newspaper advertisements accounted for the bulk of this figure. Spot TV was the primary nonprint medium used. Television advertising had increased from $1.0 million (14% of the total) in 1977 to $3.7 million (29% of the total) in 1979. Wal-Mart had subsequently stopped disclosing aggregate advertising figures. In 1985, however, it spent $16.3 million on spot TV, almost entirely in major metropolitan markets. It typically advertised heavily when it entered such a market; for instance, in entering Nashville, it outspent other discounters in the area and then dropped back after it established a presence.

Wal-Mart's terms of sale, like other discounters', were primarily cash-and-carry. Although Wal-Mart did accept MasterCard and VISA, credit transactions accounted for less than 5% of its total sales in 1982. Wal-Mart had a "no questions asked" policy on returns.

In 1985, Wal-Mart was using computer-aided design to develop a program that would suggest a merchandise mix for each store, based on more than 100 factors—including climate, customers' recreational preferences, their ethnic mix, and other demographic factors. Management thought that the increasing diversity of the communities Wal-Mart served made such a program essential.

Human Resources Management

At the end of 1985, Wal-Mart employed over 100,000 full-time and part-time employees. None of them were unionized. Company spokesmen invariably emphasized their importance to the company. The annual report for the fiscal year ending January 31, 1986, was typical. Its cover highlighted the word *people*; the report went on to add, "Wal-Mart's `Our People Make the Difference' explanation for past success is more than a slogan or a philosophy—it's the very heart of Wal-Mart." Almost all Wal-Mart managers wore buttons that said, "We Care About Our People."

Wall Street analysts agreed that there *was* something different about Wal-Mart's human resource management policies. Top management spent the bulk of the week within Wal-Mart's stores.

[7] UPC scanning was alleviating this particular problem, because it allowed automatic tracking of sales.

Employees (officially called associates) were polled for their views on what merchandise to include and how to display it. Several incentives had been installed, including profit sharing and encouragement of employee stock purchases. Store managers' base salaries were supplemented by a percentage of their unit's pretax profits if they exceeded corporate targets. But the program with the most tangible impact on the bottom line dealt with "shrinkage"—a euphemism for pilferage or shoplifting. Shrinkage, which was embedded in the cost of goods sold, dissipated over 2% of most retailers' sales revenues. In the mid-1970s shrinkage ran at 2.2% in Wal-Mart stores as well. Wal-Mart then began passing on half of any reductions in shrinkage in a particular store to the employees there. By mid-1980s, this program and tight inventory control had reduced shrinkage to 1.3% of sales.

Wal-Mart had been named one of the 100 best companies to work for in the United States. This was in spite of rather than because of its pay scales, which were considered tightfisted. Salary and wage expenses accounted for roughly 11.5% of sales in the late 1970s. This figure had declined to 10.1% of sales by 1985. Capital investments to improve labor productivity—such as UPC scanning—were one of the major reasons for the drop.

Administration

Wal-Mart's administrative style emphasized frugality. Corporate offices were cramped and, according to *Business Week* (October 14, 1985, p. 142), "Visitors to Bentonville often mistake Wal-Mart's office building, with its lobby decorated in Early Bus Station, for a warehouse." The administrative style also differed from competitors' in its very heavy emphasis on communication within the company.

Wal-Mart's 12 regional vice presidents were the cornerstones of this communication network; each of them lived in or around Bentonville. Those at K mart or Target, in contrast, would have overseen geographic areas three to four times as large, lived in the field, and, with their regional offices, cost perhaps an extra 2% of sales. Every Monday, each of Wal-Mart's regional vice presidents was flown out to the region in which the 75-odd stores each supervised were located. Through Thursday, these vice presidents visited their stores to gather feedback from store management, employees, and customers. They were flown back to Bentonville for a day-long merchandising meeting on Friday in which they reviewed the week's performance.

On Saturday, the regional vice presidents and 250 other employees, including the chairman or vice chairman, met at 7:30 a.m. to discuss the previous week's results and settle on directions for the coming weeks. One observer described this meeting as "an amalgam of nuts-and-bolts merchandising set against a backdrop of almost religious fervor.8 The meeting usually wound up by 11 a.m.; each vice president then got on the phone with seven or eight district managers to relay plans for advertising and merchandising and other pertinent information. District managers, in turn, held a conference call with all their store managers. Before the end of the day, each store manager would have apprised his or her department managers of the latest programs. Once the satellite network was installed, the Saturday morning meeting would be beamed directly to all stores.

As chairman and chief executive officer, Sam Walton continued to play a very active role, at the age of 68, in running Wal-Mart. His days typically began at 6:00 A.M. and stretched into the evening, although he had been known to drop into a distribution center at 4:00 A.M. for coffee and doughnuts with his employees. He still spent three or four days a week on the road visiting stores, and he also met with each new supplier. Sam Walton doubled as chief cheerleader: at store openings, he delivered pep talks from atop a table, and in 1984 he kept a pledge to put on a grass skirt and dance a hula on Wall Street to celebrate the achievement of 1983's profit targets. In April 1986 *Financial World* named him its CEO of the year.

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[8] *Discount Store News*, December 9, 1985, p. 44.

Diversification

Before the 1980s, Wal-Mart had made only one attempt at diversification: it opened two do-it-yourself hardware and lumber stores in the mid-1970s, then quickly closed them. But in 1983 and 1984, it started three new ventures: dot Discount Drug, Helen's Arts and Crafts, and Sam's Wholesale Clubs. By the end of 1985, two dots and three Helen's had been opened. Helen's appeared to be on hold. Although Wal-Mart officials announced that dot had made the transition from an experimental chain into a full-fledged venture, analysts did not think it would contribute significantly to investment, sales, or earnings in the coming decade.

The venture that the analysts *were* excited about was Sam's—a warehouse club. Warehouse clubs had been in existence only a decade but were being hailed as the most exciting retail format since discounting. Warehouse clubs limited their gross margins to 9%–10%, implying prices 20% below those of conventional discounters and supermarkets. Clubs stocked only 3,500 items and tried to unload their merchandise before the payment for it was due—usually within 30 days of receipt. To generate such high turnovers, they located in areas with populations of 400,000 to 500,000, stocked only top-selling items (including food), packaged items in large quantities, and targeted the owners of small businesses and prescreened, low-risk groups of individual customers. Business customers typically had to pay a $25 annual membership fee; individual customers could either pay a $25–50 annual fee and receive the same prices, or forgo the fee and be charged 5% higher prices. The stores themselves were large warehouses—often the size of two football fields—with rudimentary fixtures, limited signage and marking of merchandise, and no salesclerk service, credit, or delivery.

In 1985, warehouse club sales had reached $4.4 billion. They were expected to exceed $20 billion by the early 1990s. Over a dozen companies had jumped into the business; in total, they operated over 100 warehouses at the end of 1985, compared with 43 at the end of 1984. Each warehouse cost between $5 million and $10 million to start. Only two companies had yet seen any return on their investment: (1) Price Company, which had pioneered the concept in 1975, turned its inventory 20 times a year and held a 40% market share, and (2) Wal-Mart's Sam's Wholesale Clubs, which turned inventory about 12 times a year and held a market share slightly under 20%. The other large competitors included affiliates of Kroger, Zayre, and W. R. Grace, and three "independents": Costco, Pace Membership Warehouse, and Wholesale Club. All of them had started by focusing on different geographic areas; none yet matched Sam's warehouse volumes or inventory turnovers, let alone Price's.

In 1985, companies for the first time began to compete in the same locations for warehouse business. This trend was expected to intensify because there were only about 100 metropolitan areas in the United States with populations of half a million or larger. The impact of competition was still a matter for conjecture. As one analyst put it:

> It is not yet clear whether two or more competitors can exist profitably in a single market, or how severely profitability is affected. Because warehouse clubs, as currently structured, depend on memberships—solicited directly to wholesale customers and to "group" members through savings and loan clubs, credit unions and employee organizations—being the first warehouse club to solicit and introduce the concept in a market can be a major competitive advantage.[9]

Wal-Mart had opened its first Sam's Wholesale Club in April 1983 in Oklahoma City. It added 2 more that year, 8 in 1984, and 12 in 1985. (**Exhibit 7** lists the locations in which Sam's Wholesale Clubs operated by the end of 1985.) Although Wal-Mart did not disaggregate its financial data, one analyst pegged Sam's sales at $43 million in 1983, $222 million in 1984, and $777 million in

[9] Joseph H. Ellis, "The Warehouse Club Industry: An Update," Goldman, Sachs, January 17, 1985.

1985; the corresponding estimates of pretax income were $0.3 million, $5.7 million, and $26.0 million.10 In 1985, Sam's had lowered Wal-Mart's gross margin by 1.0% of sales and its selling, general, and administrative expenses by 0.6%. In 1986, Wal-Mart expected to add another 18 warehouses to Sam's network.

Sam's mix differed from the mix in Wal-Mart's discount stores, and it bought its merchandise independently of them. Wal-Mart spokespeople acknowledged that they had built up Sam's in the image of the Price Company. They were quick to point out, however, that Sam's did have several distinctive features. It leased its warehouses, trimming the initial investment in each by about $4 million, emphasized soft goods, had begun to promote itself by mailing seasonal flyers to members, and was broadening its base by offering memberships to all Wal-Mart stockholders. Wal-Mart also claimed that because of the company's discounting experience, Sam's was more viable in smaller areas than competing warehouse clubs: as evidence, it cited 1986 openings in Greenville, South Carolina (with a population of 125,000), and Jackson, Mississippi (with a population of 175,000). In mid-1986 management reported that in the three markets in which Sam's operated side-by-side with Wal-Mart discount stores, operating results had been above average because of greater customer traffic.

By 1985, Sam's had built up a broader national presence than any of its competitors, including the Price Company—which was still concentrated in California and Arizona. Analysts projected that Sam's locations would expand to 100 by 1990, its revenues to $6.5 billion, and its pretax income to $260 million.

[10] Joseph H. Ellis, "Wal-Mart: Updated Statistics and Projections," Goldman, Sachs, March 21, 1986.

Exhibit 1 Corporate History ($ in millions)

	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Operating Flows										
Net sales	$479	$678	$900	$1,248	$1,643	$2,445	$3,376	$4,667	$6,401	$8,451
License fees and other income	5	8	10	10	12	18	22	36	52	55
Cost of goods sold	353	504	661	919	1,208	1,787	2,458	3,418	4,722	6,361
Operating, selling, general and administrative expenses	95	135	182	252	332	495	677	893	1,181	1,485
Interest cost	5	7	10	13	17	31	39	35	48	57
Taxes	15	20	27	33	44	66	100	161	231	276
Net income	16	21	29	41	56	83	124	196	271	327
Balances										
Current assets	99	151	192	267	345	589	721	1,006	1,303	1,784
Property, plant, equipment, and capital leases	68	101	131	191	246	333	458	628	870	1,303
Current liabilities	43	75	99	170	178	340	347	503	689	993
Long-term debt	19	21	26	25	30	105	106	41	41	181
Long-term obligations under capital leases	41	59	72	97	135	154	223	340	450	595
Common shareholders' equity	$64	$96	$127	$165	$248	$324	$488	$738	$985	$1,278
No. of Stores at End of Period										
Discount stores	153	195	229	275	330	491	551	642	745	859
Sam's Wholesale Clubs	0	0	0	0	0	0	0	3	11	23

Source: Annual reports.

Note: Numbers may not add due to rounding, deferred income taxes, etc.

Exhibit 2 Financial Performance of Selected Discounters, 1974–1984 (%)

	Return on Equity	Sales Growth	Earnings-per-Share Growth
Dayton-Hudson	20.6%	17.0%	18.8%
Heck's	14.1	11.7	NM[a]
K mart	15.9	14.3	13.9
Rose's Stores	14.1	11.2	22.5
Wal-Mart	33.0	40.3	38.8
Zayre	13.1%	11.5%	21.2%

Source: *Forbes.*

[a] NM indicates *not meaningful*.

Exhibit 3 The Industrywide Economics of Discounting in 1984 (% of net sales)

Net sales	100.0%
License fees and other income	1.1
Cost of goods sold	71.9
Payroll expense	11.2
Advertising expense	2.3
Rental expense	2.2
Miscellaneous expense	7.6
Operating income	5.9
Net income	2.7%

Source: *Operating Results of Self-Service Discount Department Stores* (National Mass Retailing Institute, August 1985).

Exhibit 4 Geographic Distribution of Wal-Mart's Discount Stores at Year-End, 1976–1985

State	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	% of Total Discount Stores (1985)
Alabama	0	0	0	1	9	37	40	42	47	51	23%
Arkansas	47	50	54	57	64	69	70	71	70	71	45
Colorado	0	0	0	0	0	0	0	0	0	2	2
Florida	0	0	0	0	0	0	1	8	23	37	9
Georgia	0	0	0	0	0	6	7	16	28	39	17
Illinois	0	6	11	16	20	24	30	33	37	47	12
Indiana	0	0	0	0	0	0	0	1	2	6	2
Iowa	0	0	0	0	0	0	0	2	6	13	8
Kansas	7	8	9	10	16	19	20	24	28	31	21
Kentucky	2	2	3	4	7	28	28	35	40	43	22
Louisiana	4	6	6	7	12	20	26	43	44	49	22
Mississippi	7	12	13	18	20	25	27	28	28	34	27
Missouri	44	57	61	64	71	76	78	79	82	90	40
Nebraska	0	0	0	0	0	0	1	1	4	8	9
New Mexico	0	0	0	0	0	0	0	1	2	11	17
North Carolina	0	0	0	0	0	0	0	1	1	1	0
Oklahoma	29	34	42	46	48	56	59	66	69	71	36
South Carolina	0	0	0	0	0	18	18	18	23	25	19
Tennessee	7	10	10	17	18	54	56	59	67	67	30
Texas	6	10	20	36	45	59	90	114	143	160	27
Virginia	0	0	0	0	0	0	0	0	1	1	1
Wisconsin	0	0	0	0	0	0	0	0	0	2	2
Total	153	195	229	276	330	491	551	642	745	859	18%

Source: Annual reports.

Exhibit 5 Wal-Mart's Discounting Network at End of 1985

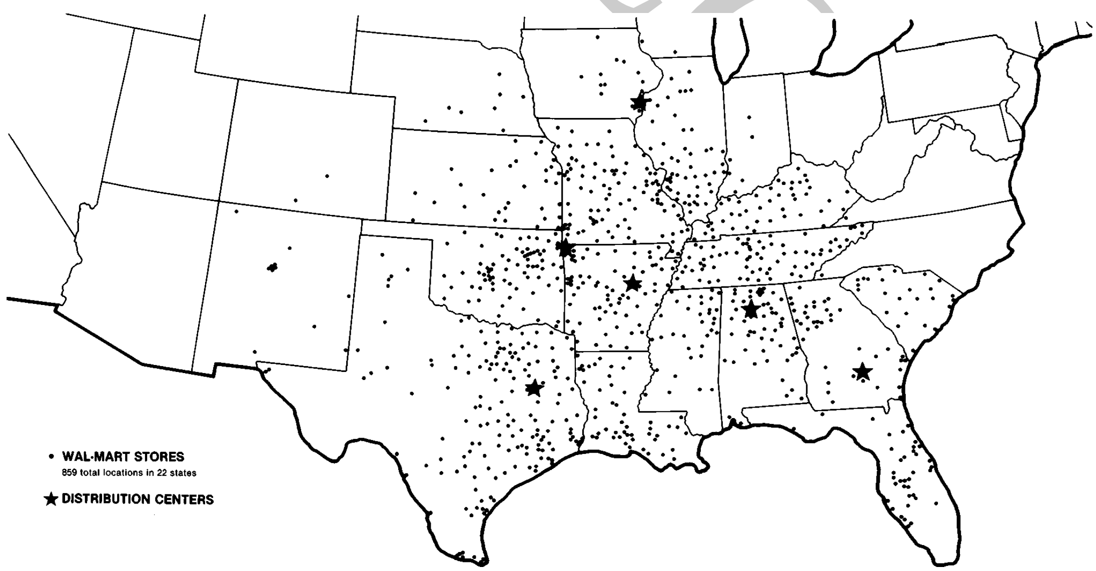
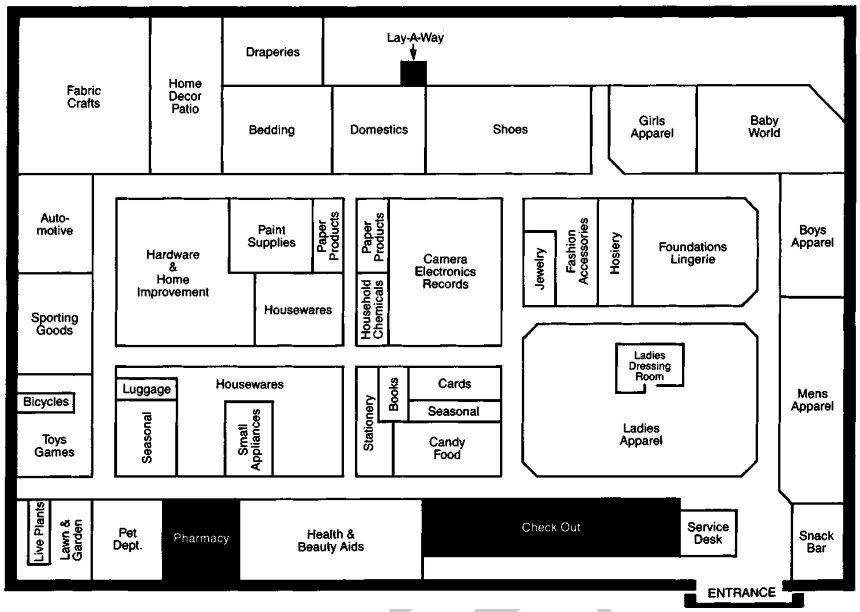


Exhibit 6 Layout of a Large Wal-Mart Store in Festus, Missouri



Source: *Discount Store News*, December 9, 1985.

Note: Size of store is 85,000 square feet.

Exhibit 7 Locations of Sam's Wholesale Clubs

State	Locations in December 1985	Additional Leases for 1986
Alabama	Birmingham	–
Arkansas	Little Rock	–
Colorado	–	Colorado Springs
Florida	Jacksonville	Orlando
Illinois	–	East St. Louis
Kansas	Wichita	–
Kentucky	–	Louisville
Louisiana	–	New Orleans (2)
Mississippi	–	Jackson
Missouri	Kansas City	–
	St. Louis	–
Oklahoma	Oklahoma City	Oklahoma City
	Tulsa	–
South Carolina	Charleston	Greenville
Tennessee	Knoxville	Memphis
	Memphis	Nashville
	Nashville	–
Texas	Corpus Christi	Amarillo
	Dallas–Ft. Worth (4)	Dallas
	Houston (3)	El Paso
	Lubbock	Houston (2)
	San Antonio (2)	Waco
Total	23	17

Source: Annual report.