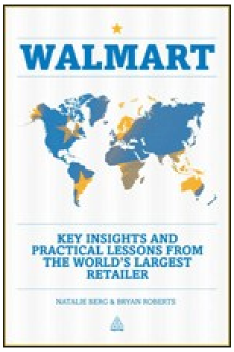

Walmart: Key Insights and Practical Lessons from the World's Largest Retailer

by Bryan Roberts and Natalie Berg
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Chapter 7: Removing the Margin-Takers: Walmart and Global Procurement

Overview

The globalization of the economy is a hefty topic and one that is better left to economists to discuss. What we can discuss here, though, is Walmart's role in this globalization process and how just one retailer's procurement has reshaped – for better or worse – the pattern of global trade and the economic well-being of countries as diverse as the United States and China.

The Chinese imports issue is one of the most frequently used sticks with which to beat Walmart. The *Guardian*, for example, in 2010 reported that Walmart gets many of its products from low-cost Chinese suppliers (and, as we shall see elsewhere in this book, many of Walmart's leading suppliers themselves get their products manufactured in China and other low-cost economies). The pressure group China Labour Watch estimates that if it were a country, Walmart would rank as China's seventh-largest trading partner, just ahead of the UK, spending more than $18 billion annually on Chinese goods.[1]

That Walmart sources a great deal of merchandise from China and other low-wage economies is in no doubt, and there have been frequent allegations that Walmart suppliers flout a wide variety of basic regulations on working conditions, pay and welfare.

In 2010, the *Guardian* quoted Michael Bride, deputy overseas organizing director at the United Food & Commercial Workers Union in Washington DC, as stating that: 'With the scale the company has, the economies of scale it can command, it basically extracts every last nickel out of its suppliers. If you're a Chinese supplier and Walmart is pressing you down, you probably can't go and negotiate your electricity rates or your rent down. But you can cut costs when it comes to labour.' An investigation by China Labour Watch of five factories supplying Walmart found 'illegal and degrading conditions', according to a report released in November 2009 by the New York-based human rights group. At one plant in Dongguan, which supplies candles and Christmas tree lights, it found that workers were required to work 24-hour overtime shifts during busy periods and painted a bleak picture of pay as low as 44 cents per hour, bathrooms without running water and unsanitary canteens. Although Walmart uses independent auditors to check on ethics at its suppliers, the *Guardian* added, the group found evidence of workers being obliged to sign false pay receipts. Walmart responded to the report by saying it had begun an immediate probe into the factories: 'We take reports like this very seriously and we will take prompt remedial action if our investigations confirm any of the findings.'[2]

Walmart/Asda was also targeted in a 2009 War on Want 'Let's Clean Up Fashion Campaign' which included some not altogether unexpected conclusions, such as: textile workers in Asia are not paid a great deal of money; retailers pressure suppliers to reduce their prices; and retailers make a great deal of margin on each garment.

Among the retailers highlighted in the report was Asda, which received a two out of five rating (meaning, according to the report's authors, that Asda acknowledges that minimum and industry benchmark wages are not sufficient, but has made no real efforts to apply a living wage).

The report stated that:

> It is extremely disappointing that a company as large as Asda/Walmart is still failing to seriously address an issue as important as wages and judging by its submission is falling well behind its closest competitors in regard to the quality of its work in this area. Although it's good to see that Asda's audit programme picks up on shortfalls, the case study they supplied makes clear that Asda is applying minimum wage standards to its work in this area. In Bangladesh this equates to just under 1,700 Bangladesh taka. This is well below a living wage. The Asia Floor Wage campaign sets this as over 10,000 Bangladesh taka in Bangladesh. Their work on productivity also offers no guarantee of improving wages for workers. Although some workers may gain greater potential for increasing their earning through becoming more skilled it is unclear how the project intends to raise wages across the board. The benefits of productivity projects can fall straight into the pockets of suppliers and result in additional stress on workers. Without worker involvement and input into the process, a key element of any credible project on wages which is not mentioned anywhere by Asda, it is unclear that workers themselves will see any benefit.[3]

Asda, for its part, stated in its submission to the campaign: 'Suppliers need to take ownership of compliance in their factories. They need to demonstrate that they are regularly and rigorously auditing their own factories... Our code addresses both wage and freedom of association considerations.' And, following the publication of the report, an Asda spokesperson told the *Guardian*: 'As the report itself states, the methodology isn't perfect, which in our view makes comparisons between retailers meaningless. At Asda, we're committed to doing the right thing for our customers, colleagues and suppliers. We believe the most sustainable solution to this complex issue is to align worker pay with productivity improvements. That's why we're working directly with factory owners to improve conditions and improve production techniques.'[4]

The issue of working conditions in Asian factories is a complex and thorny one, but it does seem puzzling that, in the never-ending discussion over retailers and their sourcing in low-wage economies, it is nearly always positioned as the retailers' fault that employees in Asian factories get a raw deal in terms of wages and working conditions. Somehow, it never seems to be the fault of suppliers or, indeed, the governments of the countries in question. And it is never the responsibility of shoppers who seem to have an insatiable desire to pay as little as humanly possible for anything. Walmart could (and probably should) do more to make sure that its vendors are not mistreating their labour forces, but surely the onus should be on governments to enact monitoring systems and living wage requirements for their own citizens.

It is worth pointing out here that, ever since the unfortunate Kathie Lee Gifford incident in the 1990s, Walmart has been more vigilant than most in making sure that its reputation in terms of sourcing is not plunged into controversy. (The Kathie Lee Gifford incident, in 1996, saw the TV celebrity and Walmart become mired in controversy after some items sold under her name at the retailer were revealed to have been sourced from a Honduran sweatshop.) In 2008, it conducted 11,502 factory audits, and over the past two years it has conducted training sessions attended by more than 14,000 supplier and factory employees, covering topics such as best practices sharing or on-site practical training. The company has stated that 'Walmart's Ethical Standards team works collaboratively with government and non-government agencies as well as other global retailers to develop, implement, and monitor programmes that make a difference.'

The other anti-Walmart sentiment derived from global sourcing is due to the perception that, by sourcing from China and other Asian markets, Walmart is somehow destroying US manufacturing jobs. We would argue, however, that the US manufacturing industry was already in decline before Walmart initiated any sort of serious global sourcing capabilities and that Walmart is merely the biggest example of a general trend in US retailers sourcing most of their products from overseas, benefiting from the lower costs to be found in Asia and elsewhere.

Some examples would be useful here: Abercrombie and Fitch states that it sources from 209 vendors located primarily in Asia and Central and South America. Rival fashion chain Gap notes that only 1 per cent of all items that it sells (representing approximately 2 per cent of total cost) are produced in the United States. Approximately 27 per cent of merchandise units were produced in China. Electronics market leader Best Buy states that its private label range is manufactured under contract by vendors based in South-east Asia. Leading discounter Dollar General, meanwhile, states that 'In 2009, we imported approximately $629 million of goods, or 8 per cent of total purchases at cost. We believe we have the potential to directly source a larger portion of our products at significant savings to current costs. We are currently increasing our direct foreign sourcing efforts, which we believe offer significant opportunity for gross profit enhancement in the future.'

Another issue with any sort of reliance on China as a source of imported product is that Walmart can be seriously affected by rising costs in that market. When asked at a 2011 investor conference whether increasing prices from Chinese suppliers were impacting Walmart, Walmart US CEO Bill Simon stated that:

> prices are coming up from Wisconsin, so dairy prices, cheese prices, I mean, we're starting to see inflation in lots of different places, not just from Asia. Our job as Walmart and as merchants at Walmart is to find ways to pull cost out of the system, work with the suppliers where we can, engineer the costs and the price to the place where we get the lowest possible we can. And then if we can't, we have to pass them through because that's EDLP. We can't just absorb it. I do believe if you look back historically what you'll find out is that in inflationary periods, we do really well because of our size and our scale. We have the ability to hold prices down longer with the size of the buys that we will make and the influence it will have on our supply chain and our ability to move it pretty quickly through the system much more efficiently than others. And if we can get – hold prices down longer, go up last, what we will have is a very big opportunity in the marketplace.

[1]http://www.guardian.co.uk/business/2010/jan/12/walmart- companies-to-shape-the-decade

[2]As above

[3]http://www.waronwant.org/campaigns/supermarkets-and- sweatshops/extra/inform/16683-lets-clean-up-fashion- 2009

[4]http://www.guardian.co.uk/money/2009/oct/07/retailers- factory-workers-asia

The evolution of global sourcing at Walmart

Walmart, like virtually all retailers that started out in the middle of the 20th century, sourced virtually all of its products from distributers, wholesalers or direct suppliers located in their domestic market, in Walmart's case, the United States. Not that all of the products it sold were manufactured in the United States, by any means, but it was certainly the case that they were sourced from US agencies. As we discuss elsewhere, it took Walmart a while to gain the scale and clout to cut out the middlemen and start sourcing directly from manufacturers, and it took longer still for Walmart to start sourcing directly from overseas.

In its fiscal 1977/78 annual report, Walmart stated that it had developed a direct import programme from what it quaintly referred to as 'the Orient' that saw its buyers visit the region six times a year. The company noted that less than 8 per cent of its merchandise was sourced directly from Asia, with those products mainly comprising those that involve 'intricate labour'.

In 1981, the retailer established a buying office in Hong Kong to provide greater opportunities in the retailer's direct import programme, a move that was augmented later that year by the addition of a buying office in Taipei to supplement the Hong Kong base.

At the same time as Walmart was establishing its procurement infrastructure in Asia, concerns over sourcing from Asia and the impact it was having on US manufacturing and US jobs became a big news story. In response to these concerns, Walmart initiated its 'Buy America' programme in 1984, with the aim of supporting US manufacturing and preventing the flow of jobs abroad. The retailer stated that it was encouraging US manufacturers and retailers to mutually consider the programme, whereby they support the purchasing of products manufactured in the United States in order to help address the issues of the trade deficit and prevent the erosion of US manufacturing jobs. In 1985, in an update on the Buy America programme, Walmart reported that $200 million in merchandise purchases had been returned to the United States, creating or retaining 4,500 jobs. By the following year, Buy America was described as no longer a mere programme but part of Walmart's philosophy. The retailer reported that it had converted or retained $693 million in purchases (at retail) – equivalent to 10,554 jobs – in the United States.

The Buy America programme continued apace in the late 1980s, with Walmart noting in 1988 that it was trying to offer the same terms and conditions to US suppliers that it offered to overseas vendors. The retailer stated that it was trying to offer US suppliers longer lead times and more predictable orders in terms of quantity. The programme was said to have created or retained more than 41,000 jobs since its inception in 1984. Tellingly, 1988 was the last time that Buy America was referenced by the retailer in its annual reports, although 1992/93 saw the initiation of short-lived 'Buy Mexican' and 'Buy Canadian' programmes in each market. Several high-profile PR disasters in the 1990s (Bangladeshi-made textiles merchandised under Buy America banners and some infamous TV appearances by David Glass and Kathie Lee Gifford) rendered the Buy America programme something of a poisoned chalice, with Walmart beginning to pick up its (largely unjustified) reputation as the poster child for importing from low-wage economies.

The following decade saw a change in tone from Walmart, with the Buy America programme safely swept under the carpet and the retailer seemingly happier to acknowledge the benefits of international procurement. In 2001, Walmart told its investors that, in the preceding few years, it had improved the quality of its goods – as well as its supply logistics and retail prices – by acquiring certain products for all of its stores around the world from a single source, a process Walmart referred to as 'global sourcing'. Walmart added that the concept works with items that are global in scope and need, whether they're items for sale or for use by employees. Items like copy paper, light bulbs, hangers, fabric or clothing zippers were cited by Walmart as typical candidates for global sourcing.

In 2002, Walmart assumed responsibility for global procurement from a third party that had been acting as Walmart's agent. This allowed the retailer to better coordinate the entire global supply chain from product development to delivery. In addition, the global procurement programme was said to allow Walmart to share its buying power and merchandise network with all of its operations throughout the world.

Three years later, with regard to global procurement, Walmart reiterated the old maxim that 'knowledge is power', and that its in-depth knowledge was critical when it came to choosing merchandise suppliers from around the world to deliver the right mix of quality and value to Walmart shoppers:

> That's why Global Procurement is establishing groups of technical experts – specialists that focus on the many important dynamics of a particular category purchase. For example, in apparel, Global Procurement has brought together individuals who have a specialized understanding of various apparel manufacturing techniques, screen printing, finishing, etc – as well as individuals who have an extended understanding of different fabrics such as cotton, synthetics, knits and wovens. These specialty groups work closely together with our team members

responsible for ethical sourcing and logistics. It's all to make certain that every day we bring our customers quality products at unbeatable prices.

New global sourcing strategy unveiled in 2010

In January 2010, Walmart unveiled a new global sourcing strategy that involved the creation of Global Merchandising Centers, a change in leadership and structure, and a strategic alliance with Li & Fung, a global sourcing organization. Walmart Vice Chairman Eduardo Castro-Wright said at the time that the moves were 'important elements in the company's strategy to deliver even greater value to its customers and shareholders'.

Walmart first announced its consolidated global sourcing structure centred around new Global Merchandising Centers (GMCs) in October 2009. The new structure was designed to leverage the company's global scale in both general merchandise categories and global food sourcing. 'The newly-established Global Merchandising Centers represent the largest and most important element of our new sourcing strategy', Castro-Wright noted. 'These centres will create alignment between sourcing and merchandising and drive efficiencies across various merchandise categories.'

The core of the company's overall global sourcing strategy will be to continue increasing direct sourcing for the company's private brands, which represented more than $100 billion in purchasing annually at the time. 'Our new strategy and structure should drive significant savings across the supply chain', Castro-Wright said.

Walmart was hoping to cut billions of dollars of costs from its sourcing operations by aggregating some components of its purchasing across its operating markets. The overall objective of this process is to increase the share of total buying that it purchases directly from manufacturers instead of through third-party wholesalers or procurement agencies – the recurrent theme of eradicating the middlemen. Less than $20 billion of the $100 billion that Walmart spent each year on procuring private label merchandise, for example, was bought directly from manufacturers.

As part of this new strategy, Walmart also finalized a series of agreements with Li & Fung. The agreements were non-exclusive and did not include volume or shipment commitments. The strategic alliance between the two companies has allowed Walmart to 'realize the benefits of consolidating a portion of its sourcing portfolio'.

Does global buying really exist?

Global buying power and the notion of global procurement are oft-touted concepts and they have been used as a justification of sorts for much of the internationalization of retailing that has taken place over the past couple of decades. By becoming bigger and more international, the argument goes, retailers will gain greater leverage over international suppliers and will secure better deals across different markets. A fine theory, but slightly flawed when it comes to tangible results.

Where global buying power has actually gained traction is in non-resaleable products (shopping trolleys, point-of-sale (POS) equipment etc) and also in services such as IT systems for labour scheduling, warehouse management, merchandising and such like. These types of products and services can be bought centrally for global usage by Walmart employees and genuine global buying power can be exploited.

To a lesser extent, the same is true for certain non-food categories such as toys, apparel and household products, particularly those that are sourced as private labels. Indeed, Asda has often commented that it is able to sell its George brand of clothing so cheaply because it buys fabrics by the mile rather than by the yard – a benefit of being part of the Walmart global family.

That said, it's worth remembering that idiosyncratic features of Walmart's different operating markets mean that the 'one size fits all' approach to buying apparel – both literally and metaphorically – would not work for supplying shoppers in the US and Japanese markets, for example.

Theoretically, the same level of scale could be achieved by Walmart in categories such as entertainment and electricals, but again there are obstacles to making this a reality. From the huge variances in national tastes in music and cinema to the different voltages and plugs used in each country, there are a number of reasons why Walmart will find it difficult to achieve genuine scalability in its purchasing.

There has been some progress in this regard, however. As early as in 2001, Walmart's Global Sourcing Team discovered that stores in Argentina were selling an entry-level microwave oven at twice the price of those sold by the company elsewhere in the world. The situation was quickly rectified when the Argentine Walmart stores contacted the company's global microwave supplier. Global sourcing also helped the company negotiate prices for fans and air conditioners, allowing its Asda stores in the UK to cut prices on the items by 50 per cent, tripling sales of the products. According to Walmart at the time, global sourcing was not just about US suppliers helping out stores in other countries; Walmart stated that it also procured items from Europe and other regions of the world for sale in the United States and elsewhere.

Grocery is still a national business

On a number of occasions, various Walmart personnel in several international markets have told us that being part of by far and away the world's largest retailer is all well and good, but really cuts no ice when it comes to sourcing groceries in each market.

Senior individuals at Asda have remarked over the past few years, for example, that they are consistently charged more than Tesco by suppliers. That Asda is able to claim to offer equal or lower prices than its arch-rival in the UK is testament to the welcome fact that Asda is the UK's lowest cost to operate (ie most efficient and cost-effective) supermarket but also testament to the less welcome fact that its margins are typically much lower than Tesco's, a product, at least partially, of less favourable general terms and conditions from suppliers in the UK.

Despite theoretically being able to say to suppliers in the UK 'we are Walmart, please give us your best prices', the reaction will be 'you might be Walmart, but in the UK you are a third the size of Tesco and we negotiate on a national basis'.

Walmart will have experienced a similar situation in its ill-fated sojourn in Germany (where many local retailers 'encouraged' suppliers to be less than collaborative with Walmart) and perhaps encounters similar issues in grocery categories in Canada.

Retailers including Walmart have hitherto been unable to engineer global, or even regional, deals because of the fact that it is national retail hierarchies that determine suppliers' attitudes towards doing business with major retail customers. Despite the fact that Walmart accounts for 14 per cent (or $6.6 billion) of Kraft's sales, this will have little impact on Kraft subsidiary Cadbury's dealings with Tesco and Asda.

There are other, more mundane reasons why negotiations or buying are likely to remain national in scope, such as: linguistic issues; different regulations on formulations, genetically modified ingredients and food safety; and the simple fact that – despite the best efforts of businesses such as P&G and Unilever – the world of branded FMCG is still extremely fragmented and country-specific.

Global buying for FMCG is therefore something of a phantom menace, in that consumer goods procurement is still very much a national procedure for a number of reasons:

- It is national retail leaders that command the best terms and conditions.
- The world of branded FMCG is still extremely fragmented and country-specific. Some of the big brands that Walmart sells in the United States are simply unheard of in Brazil or the UK.
- Many global brands are manufactured, processed or bottled locally. Different cost bases and tax regimes make the possibility of common pricing across markets extremely problematic, if not impossible.

When we asked a Walmart director about his thoughts over the likelihood of making much progress on global promotions, for brands in general, he told us: 'There has been no real progress on promotions at all; certainly no success stories that I've heard of. There have been a few attempts, but the thought of global promotions is more of a fantasy than a vision at the moment. We simply do not have the resources to execute.'

In terms of establishing global agreements for brands, the director in question expressed a slightly more optimistic outlook: 'It really depends on the category. Depends on the supplier, too. It won't happen in food. Ninety per cent of food is produced locally and negotiated locally: branded groceries will remain a national game. Non-food is a different matter to grocery. We've some big global agreements coming on stream in 2011/12 – some centrally negotiated deals that will be rolling out in all markets.'

Walmart's quest for leverage

However, what Walmart is hoping is that, over time, its global scale and importance to large multinational FMCG vendors will actually begin to translate into tangible progress in establishing genuine regional and/or global buying. Walmart terms this 'leverage'.

The list below shows how Walmart is hoping to positively impact its bottom line around the world by leveraging a number of key attributes such as size, processes and, perhaps most importantly, relationships with brands and manufacturers:

- leveraging scale and expertise;
- process consistency;
- global brand relationships;
- global supplier relationships;
- price communications;
- merchandising;
- sustainable thinking;
- integration.

Walmart's Vice President for International Purchase Leverage Hernan Muntaner featured in a 2011 *Business Week* report, which set out Walmart's aspirations to piggyback on their suppliers' own sourcing activities. The report noted that Walmart had approached PepsiCo with the suggestion of buying potatoes jointly for a lower price than either company could get on its own. *Business Week* reported: 'So far, Pepsi isn't playing along. But with sales slowing in the United States and the price of sugar, meat, and wheat on the rise, the world's largest retailer is jointly purchasing a growing share of raw ingredients with manufacturers of food and household products sold in its stores. Products already being purchased with suppliers include sugar, which goes into the company's store-brand soda and paper, used in Walmart's back-office printers.'

'Around the world, we found we were buying the same raw materials that Walmart suppliers buy,' Muntaner told *Business Week*. 'When you put the volume together of what we bought and what [suppliers] bought, and buy from just one supplier, you can reduce the cost.' As of early 2011, *Business Week* reported that only makers of private label goods sold under Walmart's house brands have joined in its so-called collaborative sourcing programme. Manufacturers of branded products have taken a pass because they're loath to share pricing data and product formulas, say executives at three companies approached by Walmart.

Business Week went on to state that Muntaner's primary job is to travel the globe helping Walmart's international divisions, from China to Japan to Brazil, find ways to use the company's massive buying muscle to lower what it spends on everything from copier paper to store-branded bottled water. Increasingly, that means selling the benefits of sourcing collaboratively. Muntaner says a soda maker, which he declines to name, has teamed up with Asda in Britain to buy sugar. The soda company paid 14 per cent less, he says. Asda's sugar costs also fell, savings it used to lower the price of bags of its own house brand of sugar.[5]

While Walmart might find it difficult to engineer global deals with suppliers, it is seeing some success in using its scale (in particular its scale in the United States) to positively impact its global operations. When we asked a senior Walmart associate active in procurement if Walmart's global buying abilities were limited, his answer was fairly frank: 'For the time being yes. It's very hard to get Walmart US to care much about it, as they don't get anything out of it. They already have all the scale and buying power they need. Adding in the UK or Brazil would make no difference to them. For private label it's happening, but for brands it feels like a bit of a non-starter.'

But, that's not to say that, in more general terms, 'global leverage' is not being achieved. The Walmart procurement director told us that: 'The way that global leverage has been working has been through the US guys helping International out. These are not global deals as such, but different Walmart countries leveraging our strong US presence.' A good example told to the authors was related to Item X and the allocations that Supplier X was giving countries. Asda requested a certain number of units, but were allocated only a third of that amount. Brazil wanted another amount but was allocated only 15 per cent of the total requested. A source told us how the buyer of

Item X in the United States came down hard on Supplier X: pretty soon after, both Asda and Walmart Brazil got their full allocation. The procurement director added: 'The system is basically Walmart International leveraging American contacts to get more muscle.' (The identity of the item and the supplier has been excised by the authors.)

Another way that Walmart is achieving greater leverage is through technology. One technique is through e-auctions, using its own internal resources. A Walmart spokesperson described the process as follows:

> an e-auction is where you go ahead and you write a very specific specification. You find out who are the people who would like to sell you that specification. You organize it on a computer and then there's a certain time period.

> Let's just say it's a couple of hours. All those manufacturers or suppliers of that product get to see the bids of themselves and the other competitors at the same time. And what winds up happening is it gives an opportunity for them to say, hmm maybe I'd like to change my bid. Now one of the interesting things is we've done over 60 of these in the last six months. The majority of the time the incumbent actually wins but there is a very meaningful saving. So this isn't like a way to make the supplier relationship a very short-term way. This is a way of getting price transparency so that we're able to see are we paying the right amount for what it is we're looking for.

Walmart has also established an internal online product catalogue that enables merchants from all over Walmart's global operations to see over 1,000 items that are being bought by their counterparts in other Walmart countries. According to the retailer: 'They can click on it. They can get their specifications and eventually they could actually order it, a great facilitator.'

[5]http://www.businessweek.com/magazine/content/10_42/b4199023758279. htm

Global Brands Imports gaining traction

Global leverage is a fine notion, but there are signs that Walmart is taking physical steps to make it reality. In an internal e-mail from May 2010 seen by the authors, we learnt of Walmart International's appointment of Fernando Serpa to its Purchase Leverage team. He was appointed as the Vice President for Global Brands Imports and took on responsibility for progressing Walmart International's efforts to facilitate access, supply chain efficiencies and cost advantages on branded products for its markets around the world.

Scott Price, EVP, President and CEO of Walmart Asia, described in 2011 how one example worked, with Walmart selling Canadian Nestlé water in its stores in Japan. Answering his own question of 'how can you ship water from somewhere else in the world and sell it cheaper?' he answered: 'Two things: one, the Japanese beverage industry is terribly inefficient and the second is that there are a lot of empty containerships that are coming back from the United States or North America empty on their way back to Asia. We're able to get really great prices.' Price described how Walmart loads up those ships in Canada with Nestlé water and gets them to stop in Japan on their way back to wherever they're headed in Asia. The bottles are augmented with a Japanese language sticker and then sold for 50 per cent cheaper than any other bottled water in Japan. Price added that 'the margin is significantly higher for us than any other of our beverages, again, the idea being that our Japanese customers like the idea of these value products. They trust the Nestlé brand. They're quite surprised at the value we can get. Our sales in terms of the particular category are great. Nestlé loves it, of course, because they're now breaking into the water industry in Japan, in which they hadn't had a position.'

GMCs yielding results

Walmart's aspirations towards global leverage and global sourcing form part of Walmart's virtuous circle general business model (below) with which the retailer is seeking to use its undoubted scale and global presence in order to generate efficiencies, reduce prices for consumers, improve product quality and drive profitability. Walmart's revamped global sourcing strategy was formally unveiled in January 2010, although it is worth remembering that a number of its global sourcing strategies and mechanics were already under way several years before the announcement was made.

The Walmart business model: → Operate for less → Buy for less → Sell for less → Grow sales → Operate for less → etc.

A key feature of the enhanced global sourcing structure was the formation of GMCs. The motivation behind the formation of the GMC structure was to eradicate billions of dollars of costs for Walmart by cutting out the agents, brokers, wholesalers, importers and exporters that have historically dominated the often complex processes that have enabled products to make the journey from producer to end consumer. As the model below shows, Walmart neatly (and accurately) describes these middlemen as 'margin- takers' – entities that add cost and complexity throughout the value chain. Through centralizing procurement through its GMCs, Walmart is endeav-ouring to increase the share of total buying that it purchases directly from manufacturers instead of through third-party wholesalers or procurement agencies. As Asda's Andy Bond noted in 2010: 'Thanks to Walmart, we have a unique opportunity to remove middlemen from the global supply chain to lower costs. We believe that the creation of global merchandising centres, be that in food, non-food or apparel, will enable us to save our customers money.'

Walmart's global procurement model: → Leverage scale → Remove margin-takers → Consolidate volumes & activities → Leverage scale

While there is a long, long way to go before Walmart can dream of leveraging its global scale in areas such as branded groceries in any meaningful sense, the retailer, through its UK arm Asda, has already made genuine strides in this direction through one of its UK GMCs, International Produce Limited (IPL). IPL is set for a period of rapid growth as Walmart seeks to exploit its expertise and scale, with the intention of enabling Walmart to reduce prices for imported produce such as melons, stone fruit, apples, pears and grapes. IPL is now buying in greater volume on behalf of Walmart stores (and shoppers) in markets as diverse as the United States, Canada and Japan.[6]

Formed in 2004, IPL was acquired by Walmart/Asda at the end of 2009 and is now a wholly owned subsidiary whose sole purpose is to 'cut out the middleman'. As the two models below reveal (the first flow depicts the traditional produce supply chain, the second flow represents the IPL scheme), the IPL business model removes at least three 'margin-taking' layers from the traditional value chain that links grower to shopper, delivering on IPL's objectives of controlling the supply chain, improving product freshness and quality, developing grower/manufacturer relationships and developing shopper advantage through points of difference.

Traditional produce supply chain: Grower → Pre-packer □ Agent exporter → Agent importer → Supplier/packer → Regional distribution centre → Walmart store

Walmart produce supply chain: Grower → Pre-packer → Regional distribution centre → Walmart store

In a little over six years since its inception, IPL has become the UK's largest produce importer, sourcing fruit from South Africa, Latin America, Europe, Morocco and New Zealand and employing 1,000 people globally. Following its success in fruit, IPL has successfully expanded its remit to include corned beef from Brazil, cooked meats from Italy, cheese from Italy and Greece, fresh pasta from Italy, olive oil and wine. Nick Scrase, the MD of IPL, told us that, while it tends to have 'very hard negotiations' and 'tough discussions' with its suppliers, the opportunities for both IPL and its suppliers to leverage volumes are substantial, also offering both parties the opportunity to increase the quality of the products under discussion and enhance margins following the removal of the middlemen in the process.

Feta cheese is a good example. Asda had been using the same feta cheese supplier for some 15 years, sourcing the product through a third-party agent and a third-party transportation provider. Following the intervention of IPL and the removal of these third parties, Asda was able to secure a 13 per cent cost saving, immediately benefiting consumers in the UK through lower prices and also providing Asda with enhanced margins. Other benefits cited by IPL of this more direct procurement method include greater visibility into the provenance of food and drink and fairer prices for suppliers as well as enhanced levels of food safety and food security.

Over the next five years, Walmart is planning to grow IPL fivefold, making it one of the 10 largest food companies in the UK. While one growth generator will be an acceleration of direct procurement for Asda itself, another avenue of growth will be through the ongoing expansion of IPL's reach to service other Walmart markets around the world, with plans already afoot for it to become the sourcing arm for Walmart globally in certain categories (it already supplies South African fruit to Walmart in Japan, the United States and Canada).

IPL claims that, thanks to its evolution into a large-scale specialist organization, it has developed the most efficient logistics and transport function of any UK retailer, due in part to its strong relationship with shipping line Maersk and logistics provider Damco, enabling it to get produce off the tree and into stores in a relatively short space of time.

Once picked on a broad variety of South African farms and orchards, produce is pre-cooled to zero degrees centigrade before being loaded onto temperature-controlled 40-foot containers. These are trucked (for anywhere between two hours or one day) to Cape Town, Durban, Port Elizabeth or Maputo Port (in Mozambique) where they are plugged in at the port and may be stored at the port for between one and three days. The containers are then loaded on a boat for their 14-day journey to the UK, during which they are still chilled (although the chillers might be turned off early for stone fruit to 'stimulate ripening'). Once the containers arrive in the UK (Tilbury, Felixstowe or Sheerness), it takes two days to unload and clear the containers from the port. They are then taken by truck or train to IPL's storage and packing facility in Yorkshire. The combined processes involved mean that it takes less than seven days for fruit to hit the stores after arriving in the UK, and up to a total of 28 days to travel from 'field to fork'.

In 2011, we visited one of IPL's key South African produce suppliers, DuToit, a Ceres-based company that produces around 130,000 tons of fruit (apples, pears, nectarines, peaches and cherries) and more than 50,000 tons of onions, potatoes and salads each year. It has a major position in the apple market in South Africa – accounting for around 12 per cent of the market – and also accounts for nearly 7 per cent of pear production. IPL is DuToit's largest single customer, supplying Asda with 750,000 cartons of apples and pears (10,000 tonnes), although DuToit also supplies local South African retailers Woolworths, Pick n Pay, Shoprite/Checkers, Fruit & Veg City and SPAR (noting that only 60 per cent of produce is sold through organized trade in South Africa). DuToit spoke very highly of IPL's systems and cited the positive impact of IPL on driving range, value and availability.

DuToit had supplied Asda since 1997 through importers, moving to a direct relationship when IPL was formed in 2004.

While all of DuToit's sales to IPL have traditionally been exported by IPL, DuToit told us that it was 'very excited' about the possibility of supplying Massmart's food retail and wholesale activities when Walmart took control of the South African retailer. Pieter du Toit, the managing director of marketing for DuToit, said that, since becoming a supplier to Asda, the firm had to integrate its planning with Asda's planning to cut packaging costs in the UK. It also had to adhere to audits on food and people safety and ethical standards. DuToit director Gysbert du Toit told us, 'The relationship with Asda creates stability in our business.'

IPL has been aggressively broadening its remit into wine. In South Africa, Asda already sources between eight and nine million litres of wine each year and IPL sees great potential in taking control of the bottling process, enabling it to negotiate directly with wine producers rather than importers/exporters. Furthermore, by transporting wine in vast 24,000-litre 'wine boxes' for bottling in the UK, Asda is able to benefit from cheaper bottling and also generate substantial environmental benefits and cost savings, as transporting wine in bulk 'wine boxes' uses 50 per cent fewer containers than transporting actual bottles of wine.

While in South Africa, we visited Fairhills, a Fairtrade wine producer and bottler based in Stellenbosch, which is a joint venture between Origin Wine, Du Toitskloof Winery and its worker community. Origin Wine is a provider of logistical services to the South African wine-making industry. Founded in 2002, Origin processes more than 40 million litres of wine per annum. The Fairhills project collaborates with local vineyards to bottle Fairtrade Wines that are mainly sold into the UK, including private label ranges for retailers such as the Co-operative and Asda. In fact, the premium private label range wines supplied to Asda under the Extra Special brand also sell well in Japan, where the Extra Special range has become a best-selling line through Walmart's Seiyu network of stores. The relationship is now handled by IPL.

Asda's early involvement with direct sourcing through IPL, it is worth remembering, was met with a degree of derision from competing supermarkets and also from within the fresh produce industry at the time. Just six years later, IPL is the largest produce importer in the UK, with turnover thought to be in the region of £1 billion. Not only has it grown rapidly, but IPL has realized that its produce-sourcing model is a very portable concept that can be replicated across many other product categories. Indeed, a similar company has already been set up for pork and pork products and, as we have seen, the model also suits dairy, wine, oils and cooked meats. IPL has told us that its long-term ambition is not to become a food processer or manufacturer in its own right, but instead to broaden its presence across different commodities, different geographies and different aspects of the value chain.

With Walmart's geographic presence expanding (it seems to be completing one major international acquisition each year), the long-term potential for IPL – and therefore its suppliers – is substantial. With consumers across the world enthusiastically embracing the concept of permanent global summertime (ie the almost constant availability of products once only available on a seasonal basis), the ability to source a broad variety of produce at low cost and in high volumes is a key cornerstone of success for grocery retailers. Thanks to the innovation and scale of IPL, Walmart is – as in so many aspects of retailing – a step or two ahead of many competitors.

Having the scale and reach to exert such an impact in the world of procurement is one thing: having the means to distribute the products to stores with incredible efficiency is another. So, we now turn to look at Walmart's leadership in distribution – one of the very foundations of its global retail supremacy.

[6]The rest of this chapter is based on Bryan Roberts' trip with Asda to visit South African produce and wine suppliers. Originally published as an article on www.kantarretailiq.com