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Wal-Mart's Painful Lessons

Having grown in fits and starts, Wal-Mart's international unit has a new game plan. Can it master world markets?

By [Matthew Boyle](#)

It's rare that a \$100 billion business can be marginalized, but such is the case with the international arm of Wal-Mart Stores ([WMT](#)). As a stand-alone company, it would rank among the top five global retailers. Inside the \$401 billion retail giant, though, the business has traditionally received short shrift. Its Bentonville (Ark.) headquarters is underwhelming—a drab, largely windowless, one-story structure named after Bill Mitchell, a former Walmart executive whom nobody seems to remember.

Since venturing into Mexico in 1991, Walmart International has grown haphazardly. During the 1990s the retailer exported its big-box, low-price model. While that strategy worked in North America, the results were so bad in Germany and Korea that Walmart withdrew from those countries in 2006. In response, Michael T. Duke, the former international chief and current CEO, gave local managers more autonomy while instituting more stringent financial goals for each region.

The results are mixed: International sales rose 11.5% in the second quarter (before the impact of exchange rate fluctuations), while U.S. sales barely budged. But over the past few years, operating profit margins have declined on the international side, which now has 3,805 stores operating under 53 distinct banners in 15 markets. As international chief C. Douglas McMillon says, Walmart is "progressing from being a domestic company with an international division to being a global company."

A TALE OF FOUR COUNTRIES

The trick is how to get there. Four countries illustrate the challenges the world's largest retailer will face in the coming years as it seeks new sources of global growth. In Japan, managers are trying to revitalize a business that has hemorrhaged money for years—weighed down by a ho-hum brand, the country's byzantine distribution system, and cultural resistance to the discount model. In India, restrictions on foreign ownership have forced the company to team up with conglomerate Bharti, an odd coupling that has so far resulted in one store. Walmart has spent more than five years in Russia, maintaining a team of 30 executives who are still trying to plot an entry strategy at a time when other foreign retailers, like Carrefour, are bulking up their presence. And in Chile, a decade-long courtship finally led to the acquisition of the country's leading supermarket chain earlier this year, bringing with it a different business model, based in part on financial services.

All four demonstrate the perilous but potentially lucrative terrain that lies outside the saturated retail markets of Europe and North America. And Walmart's success will ultimately hinge on its ability to learn from past mistakes and adapt quickly to the shifting realities of these markets. Ahead, a look at the company's strategies.

JAPAN

It's lunchtime at a newly remodeled Seiyu supermarket in Tokyo, and shoppers are swarming around bento boxes that sell for 289 yen, or about \$3. In the back, peaches, bananas, and pears are stacked neatly in the bins they were shipped in while the front of the store houses bottles of Chianti and Burgundy from Asda,

Walmart's British chain. Nami Misawa, 26, is looking through near-empty discount bins. The recession prompted her to come back to Seiyu, and she's glad she did. "This store used to be a mess," she says, "but now it looks great."

Misawa's newfound enthusiasm is welcome news for Walmart, which has taken a beating in Japan. It entered the country seven years ago with the purchase of a 6% stake in the 371-store Seiyu chain. Despite continued losses, Walmart gradually raised its stake, making Seiyu a wholly-owned subsidiary in June 2008.

Walmart has had to confront numerous issues in Japan, from longtime Seiyu managers resisting its initiatives to a tendency among Japanese shoppers to equate low prices with inferior products.

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Bulk deals don't play well in a country where many live in small urban apartments, and the country's grocery distribution system is populated with wholesalers who broker deals between suppliers and retailers, skimming profits. Rival Carrefour abandoned the market years ago. "I have no idea why [Walmart is] still there," says Neil Z. Stern, a senior partner at consultancy McMillan/Doolittle.

TAPPED FOR A TURNAROUND

Edward J. Kolodzieski is the man in charge of turning Seiyu around. As CEO of Walmart Japan, Kolodzieski has slashed expenses, closed 20 stores, and cut 29% of corporate staff. In-store butchers were removed, with most meat now processed in a central facility. With the freed-up floor space, Seiyu bulked up meals-to-go offerings. To bypass the middlemen, Seiyu has also boosted the number of products it imports directly from manufacturers by 25% over the past year, and is also focusing on increasing sales of its own private-label brands.

The biggest change, however, is a shift away from weekly specials to "everyday low prices" in areas like baby care and pet products, and, eventually, throughout the store. Taking a page from Britain's Asda, Seiyu instead uses its marketing dollars to compare prices against competitors. With the depth of the current recession, argues Tokyo-based business consultant Ken Hasebe, Japanese consumers "have finally accepted that you can buy quality merchandise for a lower price."

One positive sign: Seiyu has been posting positive comparable store sales since last November, including a 1.3% gain in same-store sales in the second quarter. (Comparable or same-store sales is a key retail metric that tracks the results of stores open a year or more.) Still, profit margins declined in the same period, proving that progress is slow: "It's taking a little longer than any of us would have liked," says CFO Thomas M. Schoewe.

INDIA AND RUSSIA

India and Russia are widely regarded as two of the world's fastest-growing retail markets—and two of the most frustrating for foreign retailers. Walmart boasts one wholesale outlet so far in India, and it has only a 30-person development office in Moscow to show after more than five years of scouting in Russia. But through a combination of joint ventures, acquisitions, and expansion, the retailer is hoping to become a major player in both.

India's \$350 billion retail sector is composed of small family-run ventures, with organized chains accounting for less than 5% of sales. To get around government restrictions on foreign retailers selling to consumers, Walmart recently teamed up with Bharti Enterprises to open a cash-and-carry operation in the northern city of Amritsar. Best Price Modern Wholesale, as it's called, technically caters to merchants and small businesses. But with few restrictions, more than 30,000 members have signed up for the first store.

As in the U.S., the emphasis is on a wide selection of goods in one location at a low cost—everything from Castrol motor oil and sneakers to milk in large canisters that can be tied to the side of bicycles. Best Price employs 25 people to go around the region each week and check prices at mom-and-pop shops, to ensure that they're consistently offering the best value. Raj Jain, a former Whirlpool executive who now heads

Walmart's Indian operations, also opened a training institute in Amritsar last December in partnership with Bharti and the Punjab government.

HAVE TRACTOR, WILL SHOP

With so few retail chains, employees have no background in the kind of merchandising and customer service skills needed to work at a large store. They also need to learn how to help customers with goods they have not seen before, such as the Japanese guava that some restaurant owners sampled on a recent visit.

Jain is also tapping Walmart's expertise to buy from farmers directly, cutting out local distributors. About 10% to 15% of Best Price's produce currently goes right from the field to the shelves, and Jain says he wants to increase that to 40% by next year.

Though small, the venture shows promise.

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Jaideep Singh and his sister, Shalini, now drive a tractor 25 miles to pick up goods for their father's store. Jaideep says profits are up about 20% because of the low-priced goods that Best Price stocks. "We come two or three times a week," he says.

CONFRONTING RUSSIAN CORRUPTION

Walmart plans to open 10 to 15 outlets through the partnership over the next three years, eventually employing about 5,000 people. But McMillon wants to see Walmart running its own retail stores there, too. He pressed his case with commerce and agriculture ministers in New Delhi in July. "What I tried to convey is that we would invest more, and faster, if we had the opportunity to do so," he says. A representative from the Indian government declined to comment.

In Russia, the impediments to retail development are less visible but no less worrisome. Corruption is rampant with various administrative authorities capable of gumming up operations if payments are not made. Anticorruption group Transparency International ranked Russia 147th out of 180 countries on its most recent corruption perception index. In June, Swedish furniture retailer IKEA said it would halt further investment in Russia, citing the "unpredictability of administrative processes." The retailer's stores have been temporarily shut down in the past due to various questionable violations, and IKEA founder Ingvar Kamprad went on Swedish radio earlier this year to link those problems to IKEA's refusal to pay bribes in Russia. (A Russian government representative declined to comment.)

While Walmart is looking at opening its own stores in Russia, it's far more likely it will start by acquiring a local retailer. Analysts say the prime candidate is Lenta, a fast-growing, privately held chain of 34 hypermarkets and the nation's fifth-largest retailer. Lenta founder Oleg Zharebtsov is saddled with debts and sold his 35% stake to the investment group of private equity firm TPG and the private equity arm of Russian state bank VTB in early September. "There was a time when we felt that market was overpriced, and that has changed somewhat," says McMillon. With rivals such as Metro expanding their presence through new stores, and Carrefour opening its second outlet in September, "they cannot wait," says Planet Retail analyst Milos Ryba.

CHILE

Chilean shoppers strolling through the aisles of their local D&S supermarket recently came across something not usually offered by the discounter: Apple ([AAPL](#)) iPods. That's not the only change coming for the 224-store chain, which sold a majority stake to Walmart earlier this year for \$1.6 billion. (It now owns about 75% of D&S.)

In acquiring D&S (short for Distribución y Servicio), the nation's leading grocer and third-largest retailer, Walmart hopes to cement its dominance in Latin America, where it is by far the biggest retailer with \$38 billion in sales, estimates research firm Planet Retail, double that of its closest rival, Carrefour. In Chile, Walmart enters a market that has long been inhospitable to foreign retailers. Home Depot ([HD](#)), Carrefour, and J.C. Penney are among the companies that have tried, and failed, to make it in Chile, a nation of 17 million with the sixth-largest retail market in Latin America.

Rather than go it alone, as others have attempted, Walmart cultivated close ties with D&S for more than a decade: Bob L. Martin, who ran the international division in the 1990s, says he first visited Chile in 1997. D&S, in turn, modeled much of its business practices on Walmart, looking to Bentonville "as an icon," says Claudio Pizarro, a professor at the University of Chile. (Walmart also imports products like salmon from Chile.)

FINANCIAL SERVICES A DRAW

Walmart has increased D&S's expansion budget from \$150 million to \$250 million, which will go toward opening nearly 70 stores this year, many of them small stores that cater to lower-income shoppers, according to Vicente Trius, Walmart Latin America's president and CEO.

The appeal of D&S goes well beyond its stores. About 1.7 million Chileans carry a Presto card issued by its financial services unit, up from 1.2 million in 2004. "There is a saying here that large retailers generate sales with [stores] and earnings with their credit cards," says Rodrigo Rivera, a partner with the Boston Consulting Group in Santiago.

Indeed, some South American retail chains generate upwards of 70% of their profits from financial services, analysts estimate. (At D&S that figure is just 17%.) Walmart already offers financial services in Mexico and Brazil, though its attempts to launch a bank in the U.S. have failed. The retailer is keen to grow the Presto business by adding more low-risk services such as selling life insurance for outside vendors.

Achieving the right balance between local knowledge and global scale is not easy. "We're in the early stages," says McMillon. "But we know you can't run the world from one place."

With Kenji Hall in Tokyo, Mehul Srivastava in Amritsar, and Miriam Elder in Moscow.

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