# Wal-Mart Stores, Inc.

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## A. Introduction

In the last couple of years, a number of major changes took place in the global hemisphere. Countries, earlier committed to tight governmental control of their economies, have redirected their political concepts and initiated drastic reforms in order to facilitate trade. The world has arrived in the global market place, at least in some terms. Not least because of new technologies like the Internet that is about to mark the beginning of a new era of international business relations. The challenges an entity faces by forming a strategy to participate in 21st century's global economy, that is, to be competitive at a worldwide stage, are intriguing to discuss and shall be the objective of this paper. Both authors share the opinion that the world's largest retail chain at present, the Wal-Mart Stores, will be a very interesting company to examine, since Wal-Mart already took a few steps, i.e. countries, towards its global appearance. To begin with, let us take a closer look at this famous company's profile.

## B. Wal-Mart Stores Inc.

1. *The Adolescence of Wal-Mart*: The company was founded in 1962 as a single Discount Store in Rogers, Arkansas, by a visionary and by the time legendary man named Sam Walton. Since then the chain had been growing at an unrivaled rate, starting with 9 stores and total sales of $ 1.4 million, now about to finish the fiscal year 1998 with total sales of US $118 billion and 2,136 stores. The company consists of discount stores, SAM's Wholesale Club (introduced in 1983, Midwest City, OK), Wal-Mart Supercenters (1988, Washington, MO) and deep discount warehouse outlets (Bud's Discount City). Having written a unique success story in the history of retail industry, thanks to the rousing leadership of Sam Walton, the company internationally came off the ground by opening its first store abroad in Mexico City in 1991. Since then Wal-Mart has extended its international presence to Puerto Rico (1992), Canada (1994), China (1996), Brazil (1995), Argentina (1995), South Korea (1996) and Germany (1998) (Wal-Mart History). Today Wal-Mart operates more than 600 stores in international arena with a revenue of $7.5 billion [1].

The major merchandise lines include house wares, consumer electronics, sporting goods, lawn and garden items, health and beauty aids, apparel, home fashions, paint, bed and bath goods, hardware, automotive repair and maintenance items, toys and games, and grocery [1].

The company is one of the major job generators in America, it has created more than 825,000 jobs and also supports thousands of U.S. manufacturing jobs, especially by its ongoing “America First”-Campaign [1].

2. *Channel of Distribution:* Wal-Mart has got over 3,300 company owned truck that carries its shipment from suppliers to warehouses and stores. Approximately 83% of the company’s Discount Stores and Supercenters’ purchases were shipped from its 51 distribution centers and rests of them are shipped directly from suppliers to its stores. Each distribution center serves the distribution needs of approximately 80-100 stores, depending on the size of the center. The size of these distribution centers varies from 600,000 – 1,700,000 square feet.

3. *The Financial Facts and Figures*: (Amounts in millions except per share data)

| | fiscal 1998 | 1997 | 1996 |
|---|---|---|---|
| a) Net Sales | $ 119,299 | $ 106,178 | $ 94,773 |
| b) Net Income (NPAT) | $ 3,526 | $ 3,056 | $ 2,740 |
| c) Net income per share – Basic & Dilutive | $1.56 | $ 1.33 | $ 1.19 |

According to [4], the revenue in 1998 was 139.6 billion up 17% from $119.3 billion. Net income $4.43 billion or $1.98 a diluted share, an increase of 26% from previous year, or $1.56 in fiscal 1998.

*I) Profitability Ratio*

| | | |
|---|---|---|
| i) Return on total assets = NPAT*100/Total Assets | 8.5% | 7.9% |
| ii) Return on Shareholders fund = NPAT * 100/ Shareholder’s Equity | 19.06% | 17.83% |

Return on total assets has increased substantially over the years, NPAT have also increased over the years. Return on shareholders funds has also shown a constant improvement over the years. After observing the profitability ratios we can say that company is constantly improving its efficiency and utilization of its resources.

II) *Efficiency Ratio*

| | | |
|---|---|---|
| i) Asset Turnover = Sales*100/ Total Assets | 260% | 264% |
| ii) Inventory Turnover = Cost of sales/ inventory | 5.66 times | 5.25 times |

Asset turnover almost remains the same but inventory turnover has improved giving better performance.

III) *Liquidity Ratio*

| | | |
|---|---|---|
| i) Current Ratio = Current Asset/ Current Liability | 1.34 times | 1.64 times |
| ii) Quick Ratio = Quick Asset/ Current Liability | 16.75% | 15.77% |

As the company has invested in its new operations overseas therefore it is showing decrease but still its well over critical ratio of 1. The quick ratio is significantly low but that is due to the fact of using JIT and inventory turnover and looking at the size and influence of the company, it is very well in the position to take care of any short liability arising in near future.

IV) *Financial Stability Ratio*

| | | |
|---|---|---|
| i) Equity Ratio = Shareholder’s fund/ Total Assets | 41% | 43% |
| ii) Debt Ratio = Total Liabilities*100/ Total Assets | 59% | 57% |
| iii)Debt Equity Ratio = Total Liability/shareholders fund | 1.45 | 1.31 |

Equity ratio expresses the relationship of assets, which are finance by shareholder’s funds. We observe that it has decreased and is mainly due to investments made overseas in relation to increase in shareholder’ funds. Debt Equity ratio, which shows the proportion of liabilities, financed by assets and we observe that it is less than one but on the increasing trend. The increase came because of considerable increase in total assets in 1998 because of acquisitions. Debt to equity ratio shows the proportion of debt financed by shareholders fund. It is well over critical level of one and is still on increasing trend, which may not be a good sign for a firm but with Wal-Mart resources and economic muscles, they are still in very good position to cope with it.

*V) Market Ratio*

| | | |
|---|---|---|
| i) Earning Per Share = NPAT/ No. of share issued | | |
| Basic & Dilutive | 1.56 | 1.33 |
| ii) Dividend per share = dividend/ shareholder’s fund | 0.27 | 0.21 |

4. *Unique Expansion Strategy*: Sam Walton had served in the army, and had employed military strategy of winning post by post and strengthening it before moving to another post, he applied same strategy in the retail industry. Instead of expanding to the main metropolitan cities to quickly gain national coverage, Wal-Mart has been expanding itself to adjoining territory (within 200 miles of the existing stores) and covering the small towns by opening up stores before penetrating the next big territory [2]. This concept kept marketing and advertising costs significantly low 0.20% of the total sales in 1998, compared to its competitors' average of 1.5% of total sales.

   The hallmark of Walton's strategy, however, was to become "Best Cost Provider", selling at everyday low prices. This could be realized by the continuous implementation of the latest available information technology and distribution control systems at a time. The Retail Link computer system is one of the secrets of Wal-Mart's success. Furthermore, due to its unique geographic expansion strategy, the company is able to operate its own distribution centers with a truck fleet to supply its stores.

   Wal-Mart has a tremendous distribution cost advantage over its competitors (0.9% of total revenue whereas Sears had incurred 3.8% and Kmart 2.9% in 1998 [3]).

5. *Corporate and Management Culture:* Wal-Mart founder Sam Walton, was an ardent believer in frugality, hard work, constant improvement, and dedication to customers and genuine care for employees. He had incorporated the same strong ideologies in Wal-Mart culture. The company over a time has developed a shared vision that is simple, clear and understood till the lowest level in the company. The company put lot of stress towards developing its human resource. Employees for management posts are very carefully recruited mostly from within the company and once the appropriate candidates are chosen they are provided with the necessary training [2].

   The leaders lead by an example for their employees. David D. Glass, President and CEO 1998 worked as a People Greeter in one of the stores as promised by him to the team on achieving 15% earning growth. The same commitment is shown by employees towards customers by going way beyond call of duty to help customers. The company has a very informal environment where ideas of every employee are taken seriously and management decisions are open for discussions. He developed corporate ideologies through traditions and sagas.

Wal-Mart corporate mission “Growth by design with a strategy for improving returns on our investment base, Wal-Mart focuses on customer and shareholder value”[1].

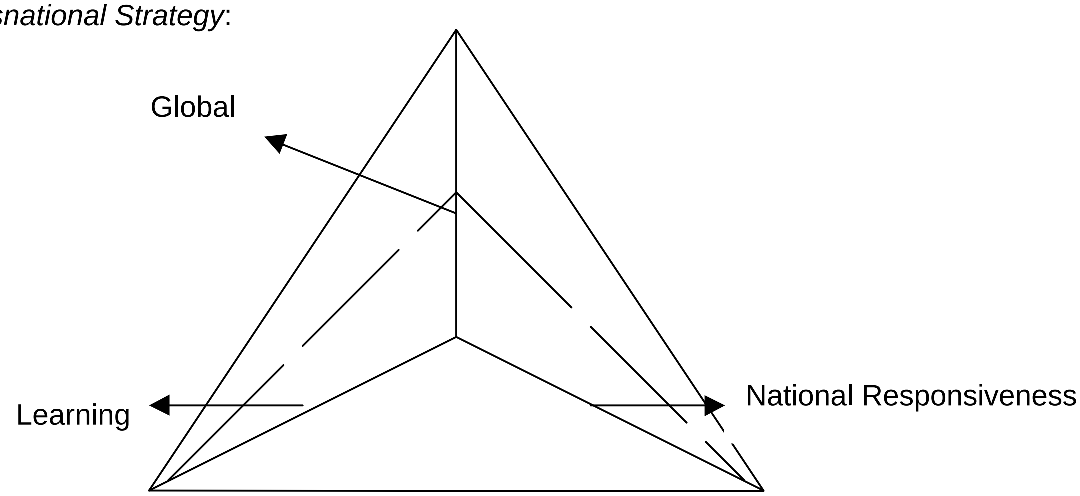
## C. The Competition in the United States

Sears Roebuck and K-Mart were considered to be Wal-Mart’s main competitors, but according to recent figures of the retail industry [5], K-Mart is the only big chain that might be able to keep Wal-Mart’s fast pace.
K-Mart is the second-largest U.S. retailer (total sales in 1998 of $33 billion) and recently has initiated an image brand initiative for 1999. By yearend, almost the entire chain of about 2,000 stores will be converted to the Big K format, similar to Wal-Mart's Supercenter concept [6], K-mart's new store format has been boosting sales, "contributing to a 90% jump in fiscal fourth quarter net income." [7]. With the adaptation of a concept that Wal-Mart already proved successful, K-Mart is giving the evidence that Wal-Mart at present is the undoubted industry leader.

Therefore, according to [8], Wal-Mart's toughest rivalries are overseas; global competitor Carrefour (France) originated the hypermart concept, and Metro AG, which operates department and specialty stores, is the #2 retailer worldwide (neck-and-neck with Sears Roebuck) and the leader in Europe. In 1997 Wal-Mart acquired German hypermart chain Wertkauf, bolstering its push to conquer Europe as well as the US.

## D. Wal-Mart's Global Expansion Strategy

*Transnational Strategy*:




Transnational Model/ Strategy:

Wal-Mart has been trying to integrate its Multinational strategy more towards Transnational Strategy, including National responsiveness, international operations and learning from its worldwide operations. Through this approach the company wants to become best low cost goods provider not only in USA, but globally. Wal-Mart puts much more emphasis on customer orientation since it is in retail industry, acquiring and distributing goods at low cost and worldwide learning through decentralization, shared knowledge, and competitiveness across borders. Since Wal-Mart is very new to International Business it is still in process of becoming a global player. Emphasis on National Responsiveness has led to a decrease in efficiency of its operations, as it can't achieve the economy of scale that one enjoys in standardized products.

Wal-Mart formulates a blueprint of all the strategies for managers to follow. The company stays near to its market and adapted itself to the need and culture of people, it acted very sensitive and responsive to a distinct nation's needs. The company works very close with the Government of a State/Nation, so when government make any rules or pass any legislation they take their concerns into account. The company works for the community, giving sponsorships to students and contributing to welfare in the countries it operates.

## E. Expansion Target: *France*

### GENERAL OVERVIEW

France, the largest country of Western Europe (about four-fifths the size of Texas), is inhabited from about 58.5 million people. Most of them are from Celtic and Latin origin with Teutonic, Slavic, North African, Indochinese and Basque ethnic groups as minorities. Traditionally, France has had a high level of immigration, especially from North Africa. At the end of 1994, about 4 million Muslims were living in France. Although the church is separate from the state, 90% of the French are Roman Catholic. France has been a founding member of European Union, and also is an active member of the G-7 club of nations, the United Nations (one permanent seat in the Security Council), the World Trade Organization and the OECD, that way ensuring its influence is a leading player on the globe, both economically and politically. 60% of its trade is settled with the other EU member nations, then follows the U.S. In recent years France has been able to run an increasing current account surplus of US $ 1.6 billion (as of 1998) [9, 10, 11].

### RETAIL INDUSTRY OVERVIEW

Marketing products and services in France is much like marketing them in the U.S., notwithstanding some significant differences in cultural factors and the legal framework. As reflected in the growth of supermarkets and hypermarkets, direct marketing and franchising, American sales concepts influence French marketing practices and distribution channels. While use of the Internet is rapidly increasing, electronic commerce in France is still dominated by the huge installed base of France Telecom Minitel units [10].

### MACRO ENVIRONMENTAL ANALYSIS

***External Factors***

1. *Political Structure*: With the constitution of 1958, the French announced their Fifth Republic. The President is the head of the executive, elected for seven years. The

President names the Prime Minister who is the nominal head of the executive. The legislative consists of two houses, the National Assembly (deputies are elected for five year terms) and the Senate. The Assembly, however, has the last word in any disagreements. Various political groups build France's political spectrum, the most important among them are the neo-Gaullist Rally for the Republic, the moderate Union for French Democracy and the Socialist Party. The current President, center-right-winger Jacques Chirac (elected in 1995) cohabits with a government of the left, elected in 1997, under Prime Minister Lionel Jospin, due to a mixture of presidential and parliamentary elements in France's political system. Nevertheless, both are strong advocates of the EU and support the EMU (European Monetary Union) which has implemented the new European currency, the EURO, for its eleven initial members on January 1, 1999 [9, 10, 11].

2. *Economic Factors*: By exploiting its vast agricultural resources, France is, behind the U.S., the number two exporter of agricultural products in the world. Similar to the U.S., the two other important export sectors are defense products and services, which give France its rank as the fourth largest exporter worldwide. Furthermore, in terms of transportation and communications, France operates one of the most sophisticated infrastructures in the world. Among other factors, all this contributes to France's position as the fourth largest economy with a GDP of US $ 1.5 trillion as of 1998 (one-fifth of U.S.), having grown at 3% in real terms compared to 1997. The GDP per capita in 1998 was at a well off US $ 24,165 and the inflation rate of 1.3% in 1998 was one of the lowest in the European Union (EU) [9, 10, 11].

3. *Effect of EURO on Economic Structure in France*: The EURO, adopted on January 1, 1999, by France and 10 other European countries, is the new single currency of the European Union (EU). A major economic factor for its implementation was to create one single European market in order to ease the large trade among its member states and to end the competitive devaluation within the market. The expected benefits are price stability, monetary stability, new trade opportunities within the single market and sound economic growth. However, companies, which operate in the member

states, face some constraints. During a transitional period of 4 years the old currencies and the new EURO coexist and each company has to decide when and how to switch to the EURO. The modification or installation of computer systems, which are capable of dealing with the EURO, has to accompany that. Furthermore, commercial relations are to be redefined, as far as prices are concerned. The benefits for those companies will be reduced financial costs due to fluctuations of exchange rates [12].

Euro also posses difficulty for retail industry as it makes it difficult for consumers to see differences in prices and determine whether an item is expensive or not. Therefore, retailers needs to quickly take actions to clear their image and to make buyers feel that they are not been cheated [37].

4. *Social and Culture Factors*: France has rich heritage of art and culture, and is famous for its fashion, perfumes, and cuisine worldwide. An average French consumer is quiet sophisticated and very brand oriented and believes in levish lifestyle. Lately, an increasing interest in American culture, younger consumers, and changing lifestyles are contributing to France’s import demand for food products from the United States. Generally, high quality food products with an American image can find a niche in the French market, particularly if they can gain distribution through stores and supermarkets that specialize in U.S. or foreign products [10].

5. *Legal Factors:* The tax system is higher in France. France’s mandatory national social insurance system covers health, retirement, family allowances, housing benefits and occupational accidents and illness. The system is financed by employees (16% of gross pay) and employers (45% of gross pay) [13].

6. *Labor Laws*: Sources of Labor Law in France include statutes and regulations, most of which are included in the Labor Code which provides minimum legal protection for both employers and employees. Other sources are case law, custom, collective bargaining agreements and companies’ internal regulations. Employment contracts are strictly regulated. Limited-term contracts are possible, but restricted. An employee may be dismissed for economic as well as disciplinary reasons but this

includes obligatory negotiations involving the employee and the third party and sometimes it can be more expensive than firing US employee (Doing business in France. No. 1). There is also a significant difference about social charges between France and US. In US, the employer pays social charges, whereas in France social charges are paid by the government [13].

7. *Labor*: France has a diversified modern industrial landscape and a highly skilled 25 million labor force of which 66% are employed in services, 28% in the industrial and commercial sector and 6% in agriculture. Employees have 35 working hours in a week, and employers must pay overtime to non-executive staff for hours worked in excess of that. Full-time employees are entitled to five weeks vacation and up to four special vacation days each year. The legal minimum wage also applies [9, 13].

## MICRO ENVIRONMENTAL ANALYSIS

### Porter's Five Forces Model

1. *Competition between the rival companies*: The French retail industry is highly competitive and in the past few years major acquisitions had taken place. The top retailers are Intermarche, the world's 6th largest retailer (1998 Sales: US$ 32.5 billion, Number of stores: 3,819, with presence in Belgium, Germany, Italy, Portugal and Spain), Promodes, number 7 worldwide (1998 Sales: US$ 28.6 billion, Number of stores: 4,921, with presence in Belgium, Dubai, Germany, Greece, Italy, Mauritius, Morocco, Taiwan, Turkey, Portugal and Spain), and Carrefour, which is the eighth largest global chain (1998 Sales: US$ 28.3 billion, Number of stores: 4,921, with presence in Argentina, Brazil, China, Colombia, Hong Kong, Indonesia, Italy, Malaysia, Mexico, Poland, Portugal, Singapore, South Korea, Spain, Taiwan, Thailand and Turkey) [14].

   Especially Carrefour and Promodes are considered to be close to being global companies. Carrefour, for instance, has introduced its hypermarket (big stores with an average area of 250,000 square feet) concept to Spain as early as 1973 [15]. In 1997, Carrefour had total sales of USD 28 billion and a net income of USD 595 million. The return on equity for that year was 18.8%, the current ratio 0.69 and the quick ratio 0.36. Carrefour strength is that it pursues international expansion with such strong determination than few other retailers. It operates 369 hypermarkets in 20 countries and 600 supermarkets. Carrefour also owns discount and convenience stores and frozen food outlets [16].

Promodes had total sales of USD 18.4 billion and a net income of 269 million.

The return on equity was 19.87%, the current ratio 0.82 and the quick ratio 0.53 [16]. Daniel Bernard, chairman of Carrefour, believes market share and volume are the keys to future success. Metro AG, a German company, the second largest retailer in the world, with $ 32.6 billion in sales, also has entered France [36].

Food retailer Promodes has been acquiring food chains for nearly two decades. A leading food retailer in France and Europe, it operates more than 4,700 hypermarkets, supermarkets, convenience stores, and discount stores [17].

2. *Threat of new entrants*: France is a big market experiencing significant growth in retail industry in recent years. Strong economy, stable government, favorable government policies for foreign investment and well-developed infrastructure and with introduction of EURO as a common currency and same international laws, makes France a very attractive place to be in. But at the same time the entry and exit levels are high and it is getting mature quickly and have low profit margins.

3. *Substitute products*: As the retail industry sells products of daily common use, there is no direct substitutes, the only substitute products that can be threat are the products from gray market, which can harm the sales of branded products. Department and discount stores also faces stiff competition from specialized retail shops such as garments, electronics etc. [11].

4. *Suppliers*: Because of the diverse product range that is distributed by retailers there are many different suppliers. Suppliers includes both domestic and international

manufacturers and as the products are more or less standardized in nature, retailers and wholesellers have low switching costs, the power of supplier are moderate to low.

5. *Buyers:* The consumers are now more sophisticated and mature. As said by Carrefour, ”they want it now and they want it with the best service and the best quality”. Consumers enjoy increasing choice of products and increased price competition, and they demand better and wider choices. They also exert pressure on manufacturers and retailers to give more relevant product information.

## SWOT ANALYSIS

**Strength:**

1. *Financial Strength*: Wal-Mart is the world's largest retailer with a turnover of more than $137 billion in 1998. CEO of Carrefour, Mr. Bernard said that, "but now, to be global you need money. Not only to invest in new markets, but to keep up with the competition at home [15].

2. *Computer System*: Wal-Mart has one of World's best Retail Link computer system to keep in check inventories, that have provided it a definite edge over its competitors over the years.

3. *Culture*: Strong work ethics and commitment towards consumers made every employee an asset for the company.

4. *Buying power*: Wal-Mart enjoys huge economy of scale as it has tremendous buying power, most of its suppliers are working on international scenario like P&G, therefore, the company can have even more bargaining power when whole operation netted into one.

**Weakness**

1. *Liquidity Ratio and Financial Stability Ratio:* Due to recent acquisitions in Germany, South Korea, Canada, expansion of operations in USA and other countries and $ 2 billion share buyback have resulted in very low quick ratio, also Debt Equity Ratio is well above the critical level of 1 and is still going up.

**Opportunities**

1. *Growing American Economy:* Recently American retail industry is experiencing very high rate of growth that can act as a growth engine for investments in other countries.

2. *Introduction of EURO:* On January 1, 1999, France and 10 other European countries introduced EURO as their common currency and are trying to create one single market. As Wal-Mart has already entered the German market, and France shares borders with Germany, it is just a normal step to expand to the French Market.

**Threats**

1. *Hidden Legal Barriers*: As the France government have imposed significant legal barriers to control the growth of department stores and hypermarkets to save traditional small shops and for saving beauty of the environment caused by sign boards (what are they called). These Trade barrier poses significant treat for Wal-Mart to grow in France.

2. *Economic and Political Turbulence in Europe*:

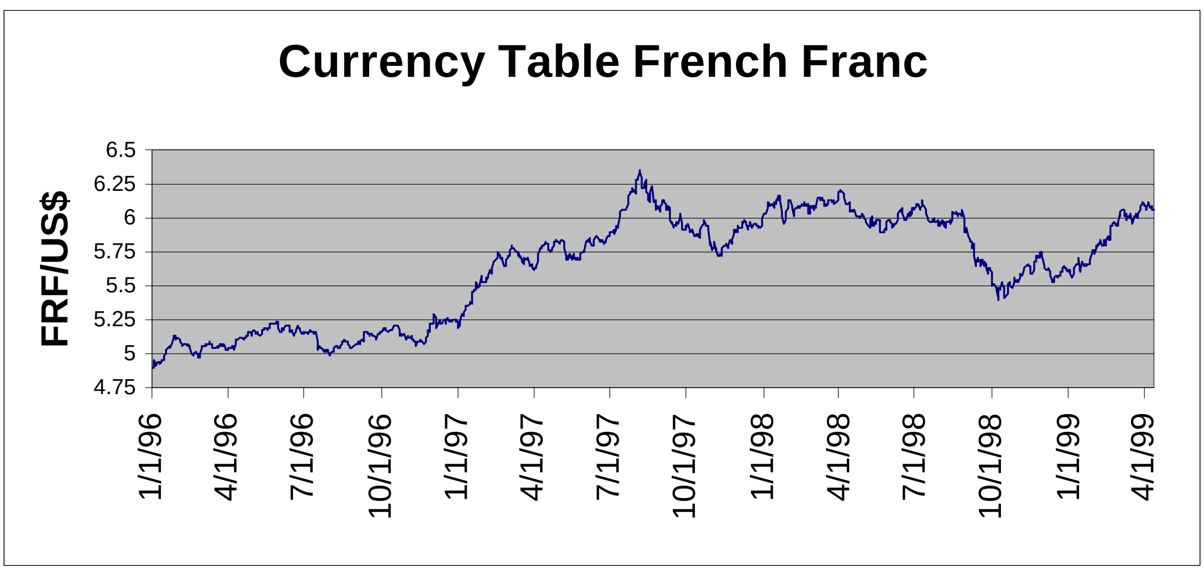
a. *Banana war*: The ongoing economic war between European Union and USA popularly known as Banana War, have lead to increase in import tariffs for more than 200 items including daily use consumer items, both by European Union and US government. It can lead to significant rise in cost for Wal-Mart, for the products they import from their traditional suppliers in U.S.

b. *War in Kosovo*: The recent turn in events like war with Yugoslavia can pose a regional threat, the war is still in very early stage and nobody knows what shape it can take in the near future.

c. *Political Turbulence in Germany*: Germany which is the entrance point of Wal-Mart in Europe, is politically not very stable right now, its Finance Minister Mr. Oskar Lafontaine resigned on 14th March 1999 Germany is also on the verge of getting into recession and it would depend upon the economic reforms that would be passed on 1st April 1999. It is still not clear what reforms would be passed and how effective they would be. As Germany was expected to act as a search engine in Europe for Wal-Mart, recession in Germany can hit hard on company's ambition in Europe.

3. *Change in Currency Exchange Rates*: Since the introduction of Euro on 1st January 1999, the initial exchange rate was 1 against $1.15 but EURO has declined ever since and it stands as 1.0751 as on 28th March 1999. There is still no fixed sentiment in which way EURO will go in near future. Once Wal-Mart invests in France, any more devaluation in EURO can result in loss of millions of USD for the company.

   1 Euro is fixed to 6.559 FRF [18].




| | |
|---|---|
| Average (1198 days): | 5.63667 |
| High: | 6.3802 |
| Low: | 4.881 |

From 1996 to 1997 the French Franc devalued continuously against the US Dollar, but in late 1998 it stabilized at about 6 FRF/US$.

**FEASIBILITY STUDY:**

The government is stable and determined to continue its support for the further unification of Europe. The France plays an active and important role in Europe as well as world's political scenario. With its well build infrastructure, strong economy, favorable government policies for foreign investments it's a good market place to be in [20].
France also have certain trade agreements and tax treaties with US government and its labor laws are also almost similar with few exceptions.

However, French government is also often influenced by strong domestic interest groups, which can result in limiting the market access of U.S. products [9]. France government have imposed many legal restrictions to open up new supercenters and hypermarkets to safe guard its traditional small corner shops, beauty and heritage of the country and other environmental factors. This can leads to significant barrier of growth for supercenters and hypermarket segment of retail industry.

The domestic market has also have become *saturated* for supermarkets and the slower economic growth and presence of some of worlds largest supermarket chains, with some strong local companies has lead to *fierce competition* in this sector. With arrival of Euro competition will increase in near future.

France is known for its fashion, perfumes and stylish People have quality of life and enjoys high living standards are often driven by brands names instead of prices.

**RECOMMENDATION:**

After evaluating the Macro and Micro Environment of France with regards to its retail industry and doing feasibility study, the authors have found out that even when France seems to be a very attractive market to be in, it has certain hidden legal barriers for retail industry and especially in superstore segment and fierce competition exists and that will increase more in near future with introduction of Euro. Moreover buyers attitude and purchasing habits are not strategically fit for Wal-Mart concept of “Low Cost Leadership”.

Therefore, the authors holds the opinion that its not the right moment for Wal-Mart to expand its operation right away in France, especially when it has just entered into Europe through acquisition of another retailing company. Wal-Mart needs to see and access how competitors would going to react to the situation as the company would have to face same competitors in France also.

Therefore Wal-Mart should take Germany as not only its entry point to Europe but also as a testing point for its performance in the European Market. After carefully looking and evaluating the performance, the company can make its strategic move for its further expansion depending upon its level of success not only in short term but also on long term basis. Thus, Wal-Mart should first strengthen its operation in Germany and then use Germany as a search engine for its expansion to other big countries in Europe.

Later after the company have strengthened its operation in Germany and evaluated its performance it can again aggressively expand its business. That could be done through acquisitions, the way company is doing now or through joint ventures or alliances, in term of logistics or market distribution.

## F. Expansion Target: *Israel*

### GENERAL OVERVIEW

The State of Israel was created in 1948 to establish a sovereign nation as a homeland for Jews and is located on the Southeastern shores of the Mediterranean Sea at the crossroads to the three continents Europe, Asia and Africa. The country has often been likened in size and shape to New Jersey and is populated by 6 million people, of which 4.7 million are Jewish and 1.3 million are non-Jewish. The major religions are Judaism, Islam, Christianity and Druze, the major languages are Hebrew, Arabic, Russian and English [22].

After the end of World War II international support for a independent Jewish state led to the UN partition plan of 1947, which required the dividing of the Mandate of Palestine into a Jewish and an Arab state, leaving Jerusalem separately as an international city under UN administration. Once, however, the State of Israel was proclaimed, armies from neighboring Arab nations immediately engaged Israeli military forces. This 1948-49 war for Israel's independence resulted in a 50% increase in Israeli territory and armistice agreements were reached with some of its neighbors. Unfortunately, no general peace settlement was achieved, leading to many conflicts, terrorist actions from a group called PLO, dedicated to "free" the Palestinian people and several wars between Israel and a number of its neighboring states ever since.

Eventually, in 1991, under lead of the United States and the Soviet Union a historic meeting of Israeli, Lebanese, Jordanian, Syrian and Palestinian leaders took place in Madrid, which became the foundation for an ongoing process for peace and economic development in the region [22, 23].

In 1993, Israel and the PLO signed a Declaration of Principles (DOP), relating to a transfer of authority from Israel to an interim Palestinian authority. Yitzhak Rabin, Prime Minister at that time, was determined to maintain the peace process. Tragically, he was assassinated by a right-wing Jewish radical in 1995 and a bitter debate over the future of the peace process erupted. In May 1996, early elections took place, but they were overshadowed by a series of suicide bombing attacks by Palestinian terrorists. As a result, right-center Likud-member Netanyahu was elected who, once in office, slowed down the peace process. He has been committed to pursue its gradual implementation, though, but his emphasis is on security first and reciprocity. As a consequence there has been little progress in the Israeli-Palestinian negotiations since then, although in October 1998 another agreement was reached, which was, among other issues, dedicated to the further redeployment of Israeli troops from occupied territory [23].

## RETAIL INDUSTRY OVERVIEW

The retail industry is one of Israel's fastest growing industries. Food sales in the large retail stores increases in the two-digit range every year, due to ongoing immigration by Russian Jews, higher income levels and a change in consumer habits towards buying in discount stores rather than buying at the small neighborhood grocers [33].
Analysts believe that this market remains very attractive and is far from saturated. This is also fueled by an expected growth in Israel's population at an annual rate of 2.5 percent.
In fact, Israel is considered to be one of the fastest growing areas in the global retail industry [22].

## MACRO ENVIRONMENTAL ANALYSIS

### *External Factors*

1. *Political Structure:* The State of Israel's Government is a parliamentary democracy. Its executive consists of the president (currently Ezer Weizman) who is the chief of state and elected by the parliament for a five-year term, and the prime minister, acting as the head of government and, for the first time, in the May 1996 elections directly voted for by the Israeli people, not from the parliament. Binyamin Netanyahu from the right-center Likud party won this election.

   The legislative is formed by the Knesset, Israel's 120-member unicameral parliament, usually elected for a period of 4 years. The most important parties are the ruling center-right Likud and the center-left Labor party, now in chief opposition.

Because of the turbulence in the peace process, Prime Minister Netanyahu called for early elections (of the 15th Knesset), held on May, 1999, about one year earlier than scheduled [22, 23].

2. *Economic Factors:* Israel's major industrial sectors include metal products, processed foods and chemicals and it also has a substantial service sector.

   In the first 20 years of the nation's being, its strong commitment to economic development and its talented workforce led to strong economic growth (over 10% annually), but after the Yom Kippur War of 1973 Israel suffered from stalled growth and triple-digit inflation until, in 1985, a economic stabilization plan was successfully implemented that eventually laid the ground for renewed rapid growth in the 1990's. After the end of the cold war many new immigrants have come to Israel from the countries of the former U.S.S.R., now accounting for 16% of Israel's 6.0 million population. Most of them are highly educated and their successful absorption into Israeli society and its labor force, and their added demand as consumers have given the Israeli economy a strong upward push.

   Furthermore economic reforms, initiated by the government, contributed to the opening to greater international competition, and resulted in the development of the financial markets and in a reduction of governmental control of the economy.

   The level of governmental involvement, however, remains high, as do the public's expectations for government assistance. Despite a commitment to reduce taxes, the country's tax burden remains high by U.S. standards, at roughly 40 percent of GDP [22, 23].

   According to *The Economist*, GDP will amount to $97.6 billion, while per capita product will reach $16,138. The weekly's economists expected political and diplomatic difficulties to affect the Israeli economy and to intensify economic uncertainty.

   Israel and the United States are bound closely by historic and cultural ties as well as by mutual interests. Relations between the two countries have been strengthened in recent years by the establishment of cooperative institutions in many fields, such as the Joint Economic Development Group.

Another development benefiting the Israeli economy is the Middle East peace process, which led to the signing of accords between Israel and the Palestinians and a peace treaty between Israel and Jordan. A process of regional economic integration has begun that will help stabilize the region. The peace process has stimulated an unprecedented and increasing of foreign investment in Israel, as companies that formerly shunned the Israeli market now see its potential contribution to their global strategies [22, 23].

Economic growth slowed over the last 2 years, to 1.9% in 1997 and 2.0% in 1998. The slowdown is mainly due to setbacks in the peace process, the waning of the beneficial effects of immigration, labor shortages in high-tech industries, tighter fiscal and monetary policy, and the Asian financial crisis which began in late 1997 [22].

Citing the slowdown from an average annual growth rate of 6 percent during the first half of the decade to the current 2%, and unemployment's rise from roughly 6% four years ago to its current 8.6%, the IMF's annual report on the Israel's economy attributes the economic contraction to "the effects of setbacks to the peace process and the fading impetus to growth provided by the large immigration from the former Soviet Union earlier this decade."

The report compliments the government's effective reversal, through budgetary and monetary discipline, of its predecessor's "excessive fiscal laxity".

The IMF projects that this year's growth rate will climb to 2.5%, while the current-account deficit will narrow further toward 2% of GDP.

As for monetary policy, the report says that it should "balance the need to sustain the disinflationary process and, as long as that process is not compromised, to support activity."

Israel's gross domestic product will increase by 2.3% in 1999, while inflation will amount to 4.4%. This estimate comes from *The Economist*, in a special survey on economic forecasts for various countries for 1999.

The United States is Israel's largest trading partner; bilateral trade accounted for some US$ 13 billion in 1997. Computers, defense equipment, wheat, and automobiles are the main goods exported from the U.S. Israel's chief exports to the U.S. include diamonds, integrated circuits, printing machinery and telecommunications equipment. The two countries signed a free trade agreement (FTA) in 1985 that progressively eliminated tariffs on most traded goods.

Together with trade agreements with the EU and some other countries, this proves the commitment of the Israeli government to a liberal trading regime.

In fact, Israel is the only nation in the world that has free trade agreements with the U.S., Canada, and the European Union, making it a "trade bridge" between three continents [24].

3. *Social Factors:* With people from more than 100 countries on five continents, Israeli society is rich in cultural diversity. Conflicts and terrorist encounters, however, arise from the yet unsolved Israeli-Palestinian tensions in their relationship, and the Israeli society has to integrate the large number of Russian immigrants that have been coming to the country in recent years [22, 23].

4. *Legal Factors:* The independent judicial system includes secular and religious courts. The highest court in Israel is the Supreme Court, whose judges are approved by the president. The country's legal and regulatory regime is based on European commercial law.

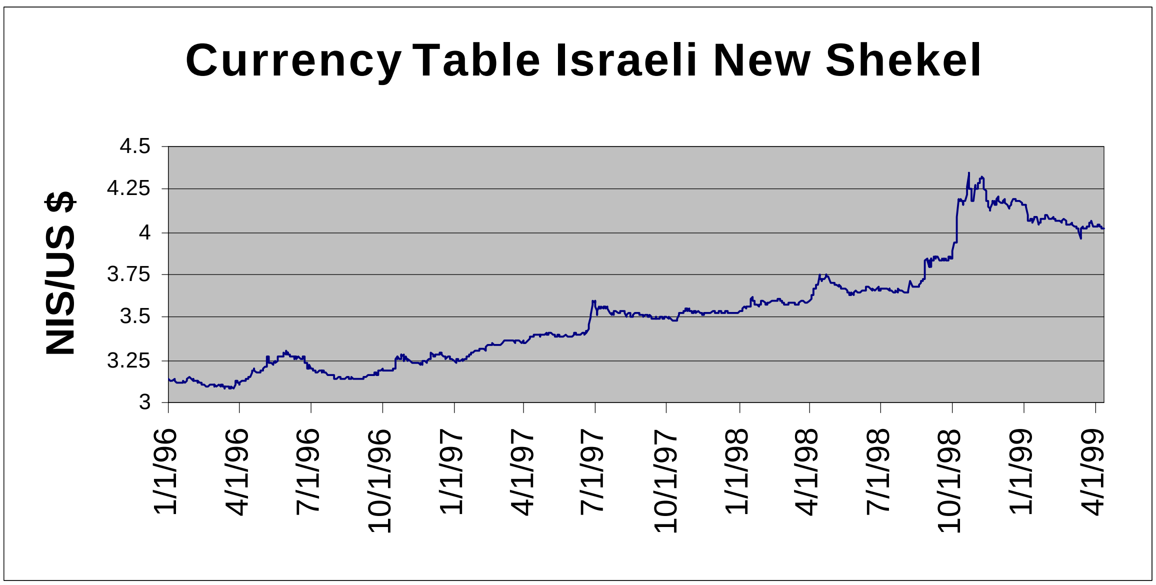
5. *Labor:* The average Israeli employee works 37.8 hours per week. 87% of the total employed are Jews. The unemployment as of 1998 had been 8.7% [38]. The most important holidays are Independence Day, Giving of the Torah, New Year, Atonement Day, the Holocaust Memorial Day, and the Fest of 9Av [39].

6. *Currency:* According to [25], a fortnightly magazine of the *Economist Intelligence Unit*, the Israeli government has made the currency, the New Israeli shekel, fully convertible to coincide with celebrations of the 50th anniversary of the formation of

the state of Israel. This move is part of the strategic goal of integrating Israel into the world economy. It is also part of Israel's preparations for the effects of European economic and monetary union, which were considered to have an important impact on the Israeli financial system in the next five years. The EIU has long held that the shekel would slip slightly once it became fully convertible. But it also believed that any depreciation would be constrained by the central bank's tight monetary policy.

Given the recent decline in Israel's inflation rate, there is "room for a further easing of interest rates in the period ahead," the International Monetary Fund's annual analysis of Israel's economy recommends.

Concerning the currency markets, the report hails last year's easing of capital flow and the central bank's refraining from intervening in trading, even when the shekel was fast depreciating following October's global emerging-market crisis. It says the shekel's initial drop last fall, since then largely undone by the markets, stemmed primarily from "a major reassessment of exchange-rate risk by domestic and foreign investors".




| | |
|---|---|
| Average (1198 days): | 3.52438 |
| High: | 4.4145 |
| Low: | 3.075 |

Until the end of 1998, the Shekel has also continuously lost value against the Dollar, but the peak was reached in late December and in recent months the Shekel seems to recover.

## MICRO ENVIRONMENTAL ANALYSIS

### Porter's Five Forces Model

1. *Competition in the Retail Industry:* Israel's largest retail stores are Blue Square and Super Sol. They dominate the Israeli supermarket market with about 40 percent market share each. Both groups have begun to target the neglected ultra-orthodox Jewish community, which counts for about 10 percent of the population.

   Of both, Blue Square is the leading retailer. A pioneer of modern food retailing in the region, Blue Square in early 1999 was operating 161 supermarkets and specialty stores under different formats, each offering varying levels of service and pricing. According to [26], Blue Square's 60-year dedication to value, quality, and customer service, along with its innovative marketing vision, has contributed significantly to Israel's current consumer revolution. Revenues for the year ended December 31, 1998 rose 10.6% to NIS 4,628.5 million (U.S. $1,112.6 million) from NIS 4,186.1 million in 1997. Operating income for the year increased by 24.5% to NIS 247.9 million (U.S. $59.6 million) from NIS 199.2 million last year. Net income for the year before discontinued operation increased by 17% to NIS 138.3 million (U.S. $33.2 million) [26]. Moreover, it successfully launched a frequent-buyer/customer-loyalty program. In 1999, the second year of its multiyear expansion plan, Blue Square plans to open 15 new stores in about 30,000 square meters, improve logistics and introduce new product lines.

   Said Blue Square's CEO Gelbard, "To reach the widest possible range of customers, we continue to refine our segmentation strategy. We have recently opened four experimental convenience store franchises designed to compete with mom-and-pop stores. At the same time, our innovative programs in the areas of marketing and logistics continue to increase customer loyalty and improve our margins. We are especially excited by our Buy & Bonus customer loyalty program, the most successful of its kind in Israel, which has reached more than a million families - more than half of all the households in Israel. In 1999, we plan to extend Buy & Bonus to offer other innovative services, and to extend our use of data mining to refine and extend our marketing strategies" [35].

According to [27], Super Sol, which is controlled by Discount Investments, currently takes 40% of Israel's retail foodstuffs chain stores market, with the chain stores taking 42% of the entire foodstuffs market in Israel. Mizrahi Bank points out, for the sake of comparison, that, in the US and Europe, the chain stores take 60-85% of the whole foodstuffs market. Analysts conclude from this that the chain stores (headed by Super Sol and Co-op Blue Square) may be expected to increase their market share in the next few years. Selected ratios show the company's financial strength:
Quick Ratio 0.94 (Industry average: 0.26), Current Ratio 1.40 (1.09), Total Debt to Equity 0.29 (0.86), Gross Margin 24.91 (26.00), Net Profit Margin 2.41 (2.35), Return On Investment 6.69 (10.71), Return On Equity 8.18 (20.89) and an Inventory Turnover of 12.71 (11.05) [28].

The described companies mainly operate in the food retail market, so for Wal-Mart as a wholesaler competition would also arise from two other entities in the segment of home improvement retailing, Home Centers and Ace Israel. Home Centers in 1998 owned 13 stores and had a market share of 8.6%. The second largest, Ace Israel, was able to gain share of 7.3% of the market. Total sales in this segment summed up to $1.5 billion for 1997 [29].

2. *Competitive Pressures From Substitute Products:* As the retail industry sells products of daily common use, there is no direct substitutes, the only substitute products that can be threat are the products from gray market, which can harm the sales of branded products.

3. *The Power of Suppliers:* The suppliers do not have a great influence, as according to the [30], the activities of the retail chains have been under investigation, both from the economic and legal aspect of the restraint of competition, searching for monopolistic or other activities, which prevent the entry of new suppliers into the market and harms end consumer prices. In the meantime, it has been found that the logistic centers set up by the marketing chains permitted the entry of suppliers who did not previously have access, due to the lack of independent transportation.

4. *The Power of Buyers:* As mentioned earlier, the Israeli customers tend to be much more price-oriented and buy more and more in large discount stores, rather than in the local grocery stores. But since the Israeli society is so rich in diversity, some religious issues determine the buying habits of the different customer groups, and the retail chains have to put high emphasis on serving their local customer base.

5. *The Competitive Force of Potential Entry:* There are, however, hidden entry barriers to Israel's retailing market, mainly in terms of religion. Says one analyst at UBS Global Research, "*It is easy to forget that Israeli eating habits are very different to those of the rest of the world*". Therefore this sector is likely to remain a duopoly for a number of years [31].

   On the other hand, American food products or products from U.S. brands attract more and more Israeli customers and are now permanent fixtures on Israeli supermarket shelves. This is supported not only by events like the "Discovering America" festival [34], but also by the fact, that a relatively high number of expatriate Americans live in Israel and that many Israelis have traveled to the U.S.

## SWOT ANALYSIS

**Strength:**

1. *Financial Strength*: Wal-Mart is the world's largest retailer with a turnover of more than $137 billion in 1998.

2. *Computer System*: Wal-Mart has one of World's best Retail Link computer system to keep in check inventories, that have provided it a definite edge over its competitors over the years.

3. *Buying power*: Wal-Mart enjoys huge economy of scale as it has tremendous buying power, most of its suppliers are working on international scenario like P&G, therefore, the company can have even more bargaining power when whole operation netted into one.

**Weakness**

1. *Liquidity Ratio and Financial Stability Ratio:* Due to recent acquisitions in Germany, South Korea, Canada, expansion of operations in USA and other countries and $ 2 billion share buyback have resulted in very low quick ratio, also Debt Equity Ratio is well above the critical level of 1 and is still going up.

**Opportunities**

1. *Growing American Economy:* Recently American retail industry is experiencing very high rate of growth that can act as a growth engine for investments in other countries.

2. *Israel is a growing market for retailers:* The retail market is projected to grow at about 16% in the near future [31] and analysts believe that the market is far from saturated.

**Threats**

1. *Culture:* Even though Israeli is considered to be the 51st state of the U.S., with "Israeli customers who have come to know that if it is American, it is synonymous with an unprecedented variety of products and services" [40], and traditionally enjoys very close ties to the United States, Wal-Mart has to keep in mind that significant cultural differences in terms of religion and social respects exist, and that any attempt to enter this market has to be accompanied by a truly commitment to serve this distinct need.

2. *In the middle of May early elections are to be held*: Because of the ongoing, highly emotional discussion of whether or not to continue the peace process with the Palestinians, the elections for the 15th Knesset will be held earlier than scheduled. The outcome of this election is an uncertainty factor because the future government may take some repulsive actions that might have an impact on Israel's economic development.

## FEASIBILITY STUDY

As regional instability and terrorism are the two major political issues affecting the business climate in Israel, analysts believe that the real key to Israel's economic take-off, that is, to become the engine of growth for the whole Middle East, will be its ability to accomplish a peaceful settlement with the Palestinians and other neighboring countries.

Israel remains well positioned to compete in the knowledge-intensive industries of the 21st century, and its economy has the potential to grow at some 4% - 5% per year.

Israel's retail distribution network offers scope for increased penetration by U.S.-style retail chains, which are making their mark on Israel's marketing system.

Israel spends large investments to upgrade its infrastructure, besides some major construction projects improvements to its ports, railways and the road network are also planned. Israeli government has also had a very favorable policy to attract foreign investments. Already, many of the US firms like Microsoft, IBM, Home Depot, Book Depot, and many other major food firms are successfully operating their business in Israel.
Israel is also a very popular tourist country as millions of tourists visiting every year.

## RECOMMENDATION

The mentioned threats notwithstanding, the Israeli retail market offers opportunities for Wal-Mart in terms of growth potential, and Wal-Mart could extend its global appearance by entering the Middle East.
Only two major players, Blue Square and Super Sol that together account for about 80% of the market, compete against a large number of small retailers.
In its earlier expansion into international markets, Wal-Mart followed the strategy of acquiring a chain in the particular country or setting up a joint venture. The “Direct Foreign Investment Decision Sequence” explains why Wal-Mart has come to use that strategy:

The company has a competitive advantage because it uses a cutting-edge retail link system that allows to offer its products to the consumers at a lower cost than its competitors. Since the U.S. market is characterized by a high level of penetration, Wal-Mart refocused its efforts and decided to exploit its existing advantage abroad. Being a retailer, branches had to be set up abroad, but the question was whether to control a company's assets abroad or license its retail system to local chains. Wal-Mart committed itself to control assets, in some cases by joint ventures (i.e., China). In most cases, however, the company preferred to wholly own an affiliate. Greenfield investment usually is more expensive than an acquisition, therefore Wal-Mart's concept has been to "purchase" an existing chain. This concept has been proven to be very successful, since, according to [32], 1998 Wal-Mart's international operations had an operating profit of US$ 551 million, more than double from the previous year.

Wal-Mart faces no critical legal or political obstacles in applying this concept for its entry to Israel, and it also has the necessary financial resources to acquire even one of the big players. Blue Square appears to be the better target because with its 60-year tradition of outstanding customer service it has already implemented a corporate culture that is very similar to Wal-Mart's.

The crucial factor in this scenario is, whether Wal-Mart is able to continue the company's dedication and focus to its local, religiously influenced customer base. The religious hidden entry must not be underestimated, even if the Israeli customers are willing to buy in discount stores.

Once a chain is acquired, Wal-Mart can take advantage of its tremendous bargaining power and achieve economics of scale for certain products of its Israeli retail operations.

Furthermore, the company can implement its superior IT systems which lead to reduced item prices that are passed on to the customers. As important, though, is that with these systems the product palette for each store can be tailored according to the local taste of the customers.

## G. Conclusion

Wal-Mart has changed its course of action from being an organic growing company to an acquiring company. Since Wal-Mart reached its objective of being the number one retailer in the U.S. in early 1991, it had been shifting its focus on becoming a global chain, starting to expand into the international market. This expansion has proven to be overwhelmingly successful, and therefore Wal-Mart in the long run can maintain this strategy and ensure the continuous growth of its businesses.

The company is present in Asia, South America, and recently started to conquer the European market by purchasing a German 100-stores chain.

Yet the company should not overexaggerate its pace, and wait for one or two years, before it enters the French market as well. In fact, it will face though competition there.

In terms of Israel, however, the fundamental data is promising and Wal-Mart would build a perfect base for a future penetration of the markets in the Middle East, once the tense situation eases and business obstacles in the Arabic countries begin to diminish.

An Evaluation Tableau contrasts the two countries:

| | Political Barriers | Competition | Cultural Differences | Economic Factors | Required Resources |
|---|---|---|---|---|---|
| Israel | 2 | 2 | 4 | 3 | 2 |
| France | 4 | 5 | 3 | 2 | 4 |

1: lowest resistance
2: lower resistance
3: middle resistance
4: higher resistance
5: highest resistance

Israel appears to be the more favorable one as an expansion target than France is in the short run.

The Market-Portfolio Matrix (Harrell, Kiefer) supports this decision. According to this matrix, Israel has more growth potential than France:

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