Discount Retailing Battlefield: Kmart vs. Wal-Mart

In June 1995, Floyd Hall took over as the CEO of Kmart Corporation. His predecessor, Joseph Antonini, who ran the company for seven years, was forced to resign three months earlier due to continued lukewarm performance of the company vis-à-vis its archrival Wal-Mart. A winning strategy for the company must now be chalked out.

DISCOUNT RETAILING ARENA

For seven years, Joseph Antonini led a discount store to battle against what appeared to be its twin. The two chains looked alike, sold the same products, and sought each other's customers. The competition, however, was over: Sam Walton's Wal-Mart Stores Inc. had won.

So bleak were the prospects for Kmart Corp. that in February 1995 an advertising agency bidding for its business, N.W. Ayer & Partners, recommended that it stop competing against Wal-Mart and transform itself into a big convenience chain where customers could go for milk and cigarettes. "It seems that the only way for [Kmart] to survive is to find a different niche," summarized the N.W. Ayer's presentation. Kmart, of course, rejected the idea.

Though the new leader could spark high hopes for ringing cash registers, Kmart still had major operational and managerial issues to deal with.

While an air of inevitable defeat had recently settled over Kmart, a short look back found many observers believing deeply in Kmart and Mr. Antonini. In fact, many of the investors who demanded his ouster as president and chief executive officer had gambled on him to outfox his counterparts at Wal-Mart not so long ago. They questioned some of the strategies of Mr. Walton, Wal-Mart's founder. They also thought Mr. Antonini had more pizazz, better locations, and a solid turnaround plan.

"He's taken a tired, dispirited company and revived it," declared a prominent retail analyst in a 1991 *Forbes* magazine article that described Wal-Mart's stock as overpriced and Kmart as a good bet.

Considering the similarity of their stores and missions, analysts attributed the different fates of Kmart and Wal-Mart primarily to management. Sam Walton, they said, was smarter than Mr. Antonini.

When Mr. Antonini took the reins of Kmart in 1987, he had his hands full. He inherited some stores that were as old as 17 years, with water-warped floors, broken light fixtures, shelves placed too close together, and cheap displays set in the middle of aisles. Also, his predecessors had neglected to implement the sophisticated computer systems that were helping Wal-Mart track and replenish its merchandise swiftly and efficiently.

Overall, however, Kmart was way ahead. It had nearly twice as many discount stores, 2,223 to 1,198. The Troy, Michigan, chain also had sales of $25.63 billion, compared with $15.96 billion for Wal-Mart. Thanks to advertising and its large urban presence, Kmart and its red "K" logo also had greater visibility.

Although Wal-Mart had a more consistent record of earnings and revenue growth, in the eyes of many experts it had never played in the major leagues. Unlike Kmart, whose stores sat on expensive urban real estate and competed against other big discounters, Wal-Mart sat in pastures outside

This case was prepared by Juan M. Florin, doctoral student at the University of Connecticut, and the author as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

small towns and picked off the customers from aging mom-and-pop shops.

Like the minor leaguer admiring a star in the bigs, Mr. Walton regarded Kmart with awe. "So much about their stores was superior to ours," Mr. Walton said in his autobiography, "that sometimes I felt like we couldn't compete." On the other hand, Mr. Antonini was heard by company insiders to dismiss Wal-Mart executives as "snake-oil salesmen."

So rapidly was Wal-Mart multiplying across the rural landscape that an invasion of urban America—and a confrontation with Kmart—became inevitable. To prepare for the encounter, Mr. Antonini focused on his own strengths: marketing and merchandising. A self-promoter with a boisterous voice and a wide smile, Mr. Antonini invested heavily in national television campaigns and glamorous representatives such as Jaclyn Smith, a former "Charlie's Angels" television star who had her own line of clothes for Kmart.

That effort only widened a public-awareness gap between the two retailers. Even before the successful campaign with Ms. Smith, Kmart's "blue-light special" was famous around the country. Meanwhile, as recently as the late 1980s, most Americans had never seen a Wal-Mart advertisement, not to mention a store.

Mr. Walton did little to change that. He avoided publicity. Instead of marketing, he became obsessed with operations. He invested tens of millions of dollars in a companywide computer system linking cash registers to headquarters, enabling him to quickly restock goods selling off the shelves. He also invested heavily in trucks and distribution centers, around which he located his stores. Besides enhancing his control, these moves sharply reduced costs.

That was a gamble. While Kmart tried to improve its image and cultivated store loyalty, Mr. Walton kept lowering costs, betting that price would prove more important than any other factor.

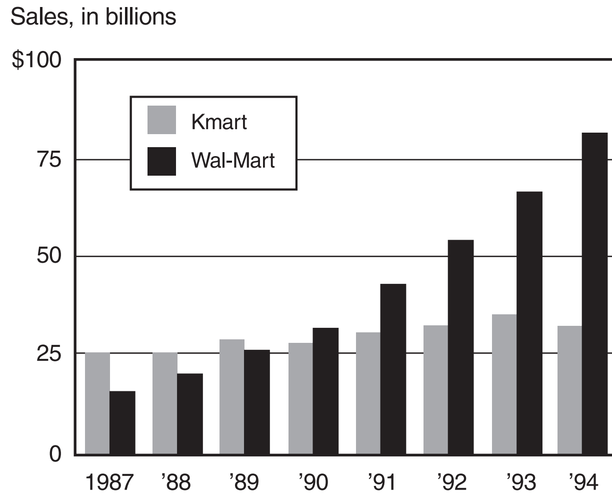
As discounting fever deepened across America, analysts and shareholders came to expect huge growth from these retailers. In trying to meet these expectations, Messrs. Antonini and Walton once again trod different paths. Mr. Antonini tried bolstering growth by overseeing the purchase of other types of retailers: the Sports Authority sporting-goods chain, OfficeMax office-supply stores, Borders bookstores, and Pace Membership Warehouse clubs. Besides additional revenue, these chains would decrease dependence on profits from discounting. "It's the way of the future," Mr. Antonini declared of such diversification.

In Bentonville, Arkansas, meanwhile, Mr. Walton was taking precisely the opposite tack—betting everything on discount retailing. He started Sam's Club, a deep-discount, members-only retailer that was modeled after California-based Price Club, which devised the concept. Then, Mr. Walton tried a brand of discounting that Kmart had already tried and abandoned in the 1960s—groceries. His first experiment, a massive Hyper-mart more than 230,000 square feet in size, suffered. Customers complained that the produce wasn't fresh or well-presented—and that they were having trouble finding things in stores so big that stockers wore roller skates. The Hypermart, Mr. Walton conceded, didn't work. Undaunted, he launched a revised concept: the Supercenter, a combination discount store and grocery that was smaller than the Hypermart.

By 1991, three years after Mr. Antonini took charge of Kmart, Wal-Mart surpassed it. For the retail year that ended in January 1991, Wal-Mart had sales of $32.6 billion, compared with Kmart's $29.7 billion. (See **Exhibit 1**.) For Kmart, the scary part was that Wal-Mart still had fewer stores—1,721 to Kmart's 2,330.

However, Mr. Antonini and other Kmart supporters took comfort in knowing that Wal-Mart was running out of small towns to conquer. To continue growing, it would need to invade Kmart's turf: the more expensive and competitive big city. To prepare for that invasion, Mr. Antonini launched a $3.5 billion, five-year plan to renovate, enlarge, or replace Kmart's oldest and shabbiest stores. Analysts called him a "visionary," and often joined him on tours of prototype stores.

EXHIBIT 1
Changing Fortune



Source: Company annual reports.

However, the least visible difference between Wal-Mart and Kmart was beginning to matter a lot. Wal-Mart's incredibly sophisticated distribution, inventory, and scanner systems meant that customers almost never encountered depleted shelves or price-check delays at the cash register. The halls of Kmart, meanwhile, were filled with distribution horror stories. Joseph R. Thomas, who oversaw distribution, said that, in retrospect, he should have smelled trouble when he found warehouses stuffed full of merchandise on Dec. 15, the height of the Christmas season.

Although Mr. Antonini poured a fortune into a frantic attempt to catch up, Kmart was so far behind that a November 1993 internal company report found that Kmart employees woefully lacked the training and skill to plan and control inventory. Kmart's cash registers often didn't have up-to-date information and would enter wrong prices. That led to a lawsuit by the Riverside County district attorney's office, claiming that 72 California Kmart stores had overcharged customers. In May 1994, Kmart settled for $985,000.

Consider the case of Anita Joy Winter. She went to a Naperville, Illinois, Kmart with three items on her list: underwear for her husband, contact-lens cleaner, and dish towels. The store was out of everything but the towels, and even then didn't have the beige color she wanted. After that, the register rang up a price more than 70 cents above what the shelf advertised, which took 10 minutes to straighten out. The consequence? "It's been 'Thank God for Wal-Mart' ever since," says Ms. Winter, who shops at a suburban Chicago Wal-Mart at least twice a week.

To the surprise of many, the higher cost and greater competitiveness of big cities hardly registered at Wal-Mart, now under the leadership of David Glass, the successor to Mr. Walton, who died in 1992 at age 74. The company had pared costs so aggressively in so many areas that it was passing on the high cost of, say, Long Island, New York, real estate and was still easily under pricing Kmart. Moreover, its stores were often twice as large as older Kmarts. The effect, when Wal-Mart put in a 125,000 square-foot, slick new store across from an old 60,000 square-foot competitor, was just devastating.

Of the two retailers' diversification efforts, Kmart again proved the least successful. Mr. Antonini's plan to make Kmart a combination discount and specialty-retailing empire began to unravel at the end of 1993. While the specialty stores—those offering books, office supplies, or sporting goods—had contributed 30 percent of sales the year before, they only made up 15 percent of operating profit. Kmart's discount stores were quickly losing market share to Wal-Mart. Shareholders demanded Mr. Antonini get rid of his prize jewels and focus on the discount stores. At the insistence of shareholders and against Mr. Antonini's wishes, Kmart announced, at the end of 1994, a plan to sell majority stakes in three of its specialty retail chains.

Wal-Mart, meanwhile, couldn't roll out its new Supercenters fast enough. The concept of buying

general merchandise and groceries in one store—at a discount—was proving successful around the country, prompting Kmart to start a similar chain. However, the cost of opening Super Kmarts only detracted from the continuing, and largely disappointing, effort to renovate general-merchandise Kmarts. Though the stores were all supposed to have a new look by 1996—with wider aisles, gleaming floors and expanded departments—a third of them remained untouched. Those that had been renovated weren't producing the sales gains that had been expected.

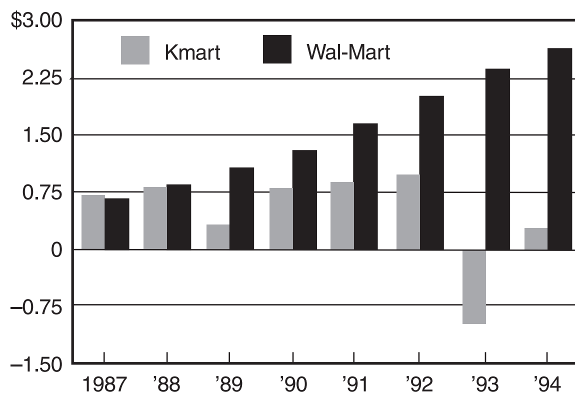
As a result, even after $1.8 billion in asset sales in 1994, Kmart's operating profit was so disappointing that the company could barely cover its 96-cents-a-share annual dividend and had to scale back capital spending to about $800 million from at least $1 billion. (See **Exhibit 2**.)

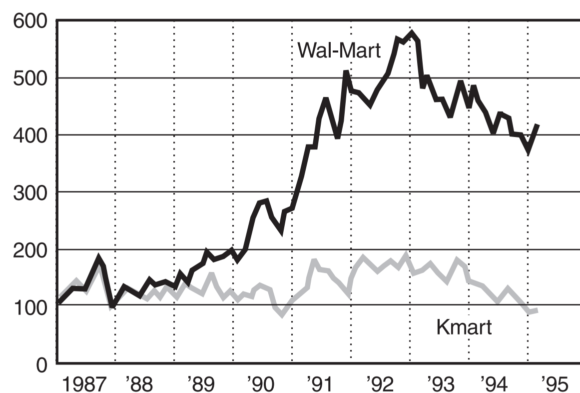
The most telling statistic: Kmart's market share of total discount sales in 1995 had dropped to 22.7 percent from 34.5 percent in 1987, when Mr. Antonini took over as chairman, president, and chief executive officer. Wal-Mart had soared to 41.6 percent from 20.1 percent.

In the end, attitude may have made a bigger difference than strategy. In Bentonville, Mr. Walton and Mr. Glass asked subordinates what wasn't working, and chided them for failing to deliver any bad news. Executives were expected to spend much of their week visiting stores, actively soliciting proposals from subordinates. Mr. Walton always acted as if a fierce competitor was just behind him and gaining. Even publicly, he and Mr. Glass were more likely to discuss Wal-Mart's weaknesses than its strengths.

In Troy, by contrast, Mr. Antonini didn't think others could tell him much about the business. A Kmart employee since 1964, when he started as an assistant manager, he bristled at criticism and was known as a "Teflon-coated" boss because

EXHIBIT 2
Diverging Paths: Wal-Mart vs. Kmart





Sources: Company annual reports, *Baseline.*

suggestions for change slid right off. Insiders say he didn't do much hiring of managers from outside the company who might challenge him, and he flayed or fired consultants who recommended everything from management changes to targeting a narrower consumer market.

In fall of 1993, munching a sandwich in a shiny new Super Kmart store, Mr. Antonini expressed the possibility of following the lead of Mr. Walton and writing a book detailing a retail success.

KMART CORPORATION

Company History

A new concept in merchandising, backed by thousands of dedicated men and women, changed the S.S. Kresge Company from a fledgling newcomer in the variety store field to a multi-billion-dollar chain of general merchandise and specialty retail stores.

In 1899, Sebastian Spering Kresge opened his first store in downtown Detroit. By 1912, Kresge had 85 stores with annual sales of more than $10 million. Kresge stores appealed to shoppers with the stores' low prices, open displays, and convenient locations. Inflation in the World War I era forced Kresge to raise prices to 25¢, and in the mid-'20s, Kresge opened "green-front stores" to sell items at a dollar or less, often next to the red-front dime stores. Kresge went into the first suburban shopping center—Country Club Plaza in Kansas City, Missouri—in 1929. By 1930, variety-store chains had become commonplace because they provided a wide array of goods at low prices. Meanwhile, supermarket chains were introducing the public to self-service shopping. The Kresge Company launched its newspaper advertising program in the early 1930s. Radio promotions followed 20 years later, and television was added in 1968. Today, print ads still dominate Kmart's advertising program, with 72 million circulars weekly for insertion in 1,500 newspapers nationwide.

With the opening of America's first discount stores in 1953, a new era in retailing had dawned. The Ann and Hope Mill Outlet in Rhode Island, which manufactured tinsel and corsage ribbons, sold discounted ribbons and greeting cards as well as women's house dresses for $2.19 each. Several other discount houses emerged in the 1950s, leading Kresge President Harry B. Cunningham to study a similar strategy for his organization. The result was the opening of the first Kmart discount department store, in Garden City, Michigan, in 1962. In Kmart's first year of operation, corporate sales topped $483 million. By 1966, Kresge registered its first billion-dollar year with 162 Kmart stores in operation. The name of the company was changed to Kmart Corporation in 1977 to reflect the fact that more than 95 percent of sales were generated by Kmart stores. By 1994, Kmart was the nation's second-largest general merchandise retailer with $34 billion in sales. Today, there are more than 2,400 Kmart stores in the United States, Puerto Rico, Canada, the Czech Republic, Slovakia, Mexico, Singapore, and Australia. Kmart employs some 300,000 individuals worldwide. Loyalty and long service are common; thousands of Kmart associates have worked for the company for 25 years or longer. Store management teams are responsible for the profitability of their own units and have the authority to make certain independent decisions about their operations.

In the early '70s, the company pursued an aggressive expansion plan that included opening 271 stores in 1976. In 1981, the company shifted toward refurbishing existing stores. For almost 80 percent of the American public, Kmart is the nearly complete one-stop shopping center. Still, the company is working to prompt customers to think of Kmart for even more of their shopping needs. In the 1980s, Kmart had the highest shopper traffic in the nation.

Today's Kmart differs greatly from its forerunner of the '60s. Kmart emphasizes top brands and a strong program of private-label products for the value-conscious customer. These merchandise lines include the Jaclyn Smith apparel line, Fuzzy Zoeller golf apparel, designer jeans for men and women, name-brand athletic shoes, Martha Stewart

fashions for the home, prestige cosmetics and fragrances, and many respected names in home improvement and health and beauty care. The company adheres to a "satisfaction always" policy, which means that customers receive refunds and exchanges with ease. The Kmart Price Promise gives each store manager and associate the power to match competitor's prices. This policy ensures Kmart remains America's price leader. The company has made strides toward more efficient operations. Kmart Information Network (KIN) is an electronic system that connects all stores, distribution centers, and headquarters and streamlines various office procedures. Point-of-sale equipment is in all 2,400 stores. In 1986, Kmart and GTE established a satellite-based communications network. Thirteen distribution centers supply stores with a substantial amount of their basic stock; most stores are less than one day's drive from a distribution center.

Diversification and Modernization

The acquisition of the nation's largest retail bookstore chain, Walden Book Company, Inc., was completed on August 9, 1984. In addition to books, Waldenbooks stores also carry video and music selections and computer software. Average stores occupy 3,000 square feet and are located primarily in regional shopping malls and strip shopping centers. Kmart Corporation completed the acquisition of Builders Square, Inc. (formerly Home Centers of America) on September 27, 1984. A typical Builders Square store occupies approximately 80,000 square feet and features name-brand merchandise at discount prices. Assortments include lumber, building materials, hardware, paint, plumbing and electrical supplies, and garden and home improvement goods. In 1987, the company celebrated the 25th anniversary of Kmart stores and announced a partnership with Bruno's, Inc., of Birmingham, Alabama to develop American Fare, combination concept stores, in the United States. The company also moved to streamline operations, closing its Central Regional Office in Plymouth, Michigan and realigning its five remaining regional offices. The company also established a marketing department to strengthen communication to its customers about the Kmart store.

In 1988, Kmart announced two new retailing concepts to be developed by its Builders Square subsidiary—Sports Giant, a chain of sporting goods superstores, and Office Square, a warehouse-type office supply store. In February 1990, Kmart announced an accelerated five-year, $3.5 billion new store opening, enlargement, and modernization program. This aggressive program involved building approximately 280 new full-size Kmart stores, enlarging 700 existing stores, relocating 300 others, and refurbishing 670 to bring their fixturing and layout up to the new store standards. The early 1990 acquisition of The Sports Authority allowed the company to move forward in the sporting goods mega-store arena. The company's Sports Giant stores were converted to The Sports Authority stores. In September 1990, Kmart acquired 22 percent ownership interest in OfficeMax, an office supply superstore chain. OfficeMax agreed to acquire the Office Square business of Kmart's subsidiary Builders Square. Kmart acquired the remaining interest in OfficeMax in November 1991.

A new, bold Kmart logo was unveiled in September 1990, signaling change and innovation for the chain. The new symbol keeps Kmart in step with the times and reflects the dynamism and excitement of the company's commitment to renewal. In 1991, Kmart raised $1 billion in equity through a Preferred Equity Redemption Cumulative Stock offering (PERCS), ensuring the completion of its modernization program in 1996. At year end 1991, approximately 30 percent of the chain's Kmart stores sported the updated look.

Kmart's subsidiary operations, which in 1992 included Builders Square, OfficeMax, The Sports Authority, Waldenbooks, and Borders, were under the Specialty Retail Group. By year-end 1993, Kmart had completed more than half of its comprehensive store renewal program. Kmart also stepped up the roll-out of combination stores called

Super Kmart Centers. In 1993, Kmart sold its Pace Membership Warehouse subsidiary. Kmart also announced the sale of Payless Drugstore Northwest to Thrifty Drugs. By the end of 1994, there were 67 Super Kmart Centers nationwide. Borders-Walden, Inc. announced a corporate restructuring, renaming the entity Borders Group, Inc. Kmart sold its 21.5 percent interest in Coles Myer Ltd. and announced plans for Initial Public Offerings (IPOs) in Sports Authority, OfficeMax, and Borders Group, Inc.

Kmart initiated a productivity improvement process to reduce expenses by $600 to $800 million by the end of 1996. This process included the review of all aspects of the business to ensure growth in sales and earnings. A merchandise flow task force also was formed to focus on inventory flow, especially high-velocity consumable items. Financial information on the company is summarized in **Exhibit 3**.

International Expansion

Kmart made its initial entry into the European market when it purchased its first store in the Czech Republic in May 1992. Later that year, Kmart finalized the purchase of 12 additional stores in the Czech Republic and Slovakia. Kmart also announced plans to expand global operations, through joint ventures, in Mexico and Singapore. In 1994, Kmart opened its thirteenth distribution center in Brighton, Colorado, and stores in Mexico and Singapore.

Corporate Culture

The thirtieth anniversary of Kmart in 1992 marked the celebration of an institution deeply ingrained in the fabric of American life. Since its beginnings as Kresge, Kmart has successfully met the challenge of serving the changing needs of the American family.

Three savvy merchants, leaders of their generations, have played significant roles in the history of Kmart. The first was the founder, Sebastian Spering (S.S.) Kresge, who built not only a successful retailing chain, but more important for its future, a flexible and responsive organization; the second, Harry Cunningham, emerged from the ranks to transform Kresge into Kmart; and until June 1995, Joe Antonini, the president and CEO who spearheaded Kmart's renewal for today's customer. Of all the great variety stores founded at the time of Kresge, only Kmart has maintained its leadership of American retailing.

Kmart was founded by a traveling salesman from Pennsylvania, Sebastian Spering Kresge. Kresge's variety stores spread throughout urbanizing America. Later, there were larger stores expanding the product lines and broadening the customer base. Through all this, S.S. Kresge was a man of vision deeply in tune with the dynamics of a growing America. Despite his personal frugality—and to the shock of his colleagues and associates—he borrowed heavily to invest in store expansion to go where his customers were.

Kresge believed that one should both entice and listen to the customer; he ran specials in his stores on a weekly basis so that each week there would be a new reason to shop at Kresge. He also left Kresge employees free to exercise their judgment and do their jobs—all who worked for him said that he never looked over their shoulders (in an age of heavy employee supervision)—an early example of the empowerment of employees.

Harry Cunningham, the next great Kresge/Kmart leader, also was known for listening to his customers. As a young manager, he asked the sales clerks to record all customer requests on little blue cards. Cunningham read the blue cards daily, ordering the merchandise requested. Within a year, Cunningham increased his store sales by 100 percent. Before he took over as president in 1959, Cunningham toured the country. He looked at his and other people's stores, he listened to the people, and he thought about the emergence of the new suburban lifestyle. He saw a sea of young families needing to furnish their homes, but, like all young families strapped by cash, they desired high quality at a low price. This post-war generation, newly

EXHIBIT 3
Kmart Corporation Consolidated Statements of Income (Dollars in millions, except per-share data)

	Fiscal Year Ended		
	Jan. 25, 1995	*Jan. 26, 1994*	*Jan. 27, 1993*
Sales	$34,025	$36,694	$33,366
Licensee fees and other income	288	296	292
	34,313	36,990	33,658
Cost of merchandise sold (includes buying and occupancy costs)	25,992	27,520	24,516
Selling, general and administrative expenses	7,701	8,217	7,393
Gain on subsidiary public offerings	(168)	–	–
Store restructuring and other charges	–	1,348	–
Interest expense:			
Debt—net	258	303	243
Capital lease obligations and other	236	192	185
	34,019	37,580	32,337
Income (loss) from continuing retail operations before income taxes and equity income	294	(590)	1,321
Equity in net income of unconsolidated companies	80	52	54
Income taxes	114	(191)	474
Net income (loss) from continuing retail operations before extraordinary item and the effect of accounting changes	260	(347)	901
Discontinued operations including the effect of accounting changes, net of income taxes of $7, $(61) and $11, respectively	20	(77)	40
Gain (loss) on disposal of discontinued operations, net of income taxes of $215 and $(248), respectively	16	(521)	–
Extraordinary item, net of income taxes of $(6)	–	(10)	–
Effect of accounting changes, net of income taxes of $(37)	–	(19)	–
Net income (loss)	$ 296	$ (974)	$ 941
Earnings per common and common equivalent share:			
Net income (loss) from continuing retail operations before extraordinary item and the effect of accounting changes	$ .55	$ (.78)	$ 1.97
Discontinued operations including the effect of accounting changes, net of income taxes	.04	(.17)	.09
Gain (loss) on disposal of discontinued operations, net of income taxes	.04	(1.14)	–
Extraordinary item, net of income taxes	–	(.02)	–
Effect of accounting changes, net of income taxes	–	(.04)	–
	$ .63	$ (2.15)	$ 2.06
Weighted average shares (millions)	456.6	456.7	455.6

EXHIBIT 3 (continued)
Kmart Corporation Consolidated Statements (Dollars in millions)

	Jan. 25, 1995	*Jan. 26, 1994*
Assets		
Current assets:		
Cash (includes temporary investments of $93 and $32, respectively)	$ 480	$ 449
Merchandise inventories	7,382	7,252
Accounts receivable and other current assets	1,325	1,816
Total current assets	9,187	9,517
Investments in affiliated retail companies	368	606
Property and equipment—net	6,280	5,886
Other assets and deferred charges	910	799
Goodwill—net of accumulated amortization of $45 and $59, respectively	284	696
	$17,029	$17,504
Liabilities and Shareholders' Equity		
Current liabilities:		
Long-term debt due within one year	$ 236	$ 390
Notes payable	638	918
Accounts payable — trade	2,910	2,763
Accrued payrolls and other liabilities	1,313	1,347
Taxes other than income taxes	272	271
Income taxes	257	35
Total current liabilities	5,626	5,724
Capital lease obligations	1,777	1,720
Long-term debt	2,011	2,227
Other long-term liabilities (includes store restructuring obligations)	1,583	1,740
Shareholders' equity:		
Preferred stock, 10,000,000 shares authorized;		
Series A, 5,750,000 shares authorized and issued at January 26, 1994	–	986
Series C, 790,287 shares authorized; shares issued 658,315 and 784,938, respectively	132	157
Common stock 1,500,000,000 shares authorized; shares issued 464,549,561 and 416,546,780, respectively	465	417
Capital in excess of par value	1,505	538
Performance restricted stock deferred compensation	–	(3)
Retained earnings	4,074	4,237
Treasury shares	(86)	(109)
Foreign currency translation adjustment	(58)	(130)
Total shareholders' equity	6,032	6,093
	$17,029	$17,504

Source: Kmart Corporation 1994 Annual Report.

affluent, produced the baby boomers and was the first generation to make shopping a vocation.

In his travels, Cunningham visited a new kind of store—the discount store. While the stores themselves were badly managed, he saw the beauty of the concept and understood how the professional Kresge organization could do better. Initially, the Kresge Board was skeptical because of the unproven success of those initial discounters, but Cunningham was persuasive in his belief that Kresge could provide value to the customer while maintaining high quality standards. Investing for the future, they spent more than $80 million. By the time the first Kmart opened in March 1962, there were 32 more locations ready to go.

Cunningham's blue index cards and S.S. Kresge's special promotions were transformed into a unique American experience—the blue light special. Its origins were humble but the blue light special has entered the vernacular and is a registered trademark.

In the spirit of Harry Cunningham and S.S. Kresge, Joe Antonini had the vision to address the needs of today's woman, the core Kmart customer. As head of apparel in 1983, he began the transformation of the Kmart organization and the Kmart shopping experience. The women's apparel section was totally revamped and the Jaclyn Smith Collection was created. He followed with many lines designed for today's "busy, budget-conscious mom," the woman who plays many roles in the life of her family and community.

Antonini's understanding of that special woman, the Kmart customer, spurred him to examine her entire shopping experience. Just as other great retailers have entered the psyche of their customers, Kmart understands theirs—the time pressures and the multiple roles, the need for convenience, the requirement of value, and the desire to translate the new fashion and home trends to enrich her life and that of her family. Respect for the customer and a desire to make the shopping experience both fruitful and fun were the catalyst for the massive organizational redesign from the stores themselves to relationships with suppliers to the information systems necessary to bring the latest fashion to every shopper. Antonini's commitment to the Kmart customer led to an investment of $3.5 billion to refurbish and build the right kind of stores.

Super Kmart Center

Ranging in size from 160,000 to 190,000 square feet, Super Kmart Centers offer customers the ultimate experience in merchandise selection as well as an array of sensational groceries. Super Kmart Centers feature in-house bakeries, USDA fresh meats, fresh seafood (delivered daily), an array of hot and cold dishes from delicatessens, cookie kiosks, cappuccino bars, in-store eateries, fresh carry-out salad bars, and "Oriental-to-Go" menu items. To ensure grocery freshness, Kmart has developed its own grocery buying and operations division. Trained grocery personnel work closely with local suppliers to make regional fresh food available to shoppers. Cross merchandising offers added convenience at Super Kmart Centers. For example, toasters are above the fresh baked breads, kitchen gadgets are positioned across the aisle from produce, and infant centers feature everything for baby from food to clothing. In many locations, Super Kmart Centers provide customers with a selection of special services such as video rental, hair salon, florist, UPS shipping, banking and ATMs, lottery, money orders, as well as faxing and copy services with one-hour photo processing in the up-to-date image centers.

The first Super Kmart Center opened in Medina, Ohio on July 25, 1991. Its success and overwhelming acceptance by customers provided the foundation for Kmart's nationwide roll-out of 67 additional Super Kmart Centers over the last three years. More than 25 Super Kmart Centers are planned for 1995, bringing the total to about 100.

A company report noted:

> The Super Kmart supercenter format is a dynamic new retail channel that builds on our core competencies and has strong potential for profitable growth. The Super Kmart format is based on a grocery-driven,

high-frequency concept that, when executed properly, yields superior sales productivity and attracts a younger and more affluent family shopper than our traditional Kmart discount stores.

We are exploring ways to improve the Super Kmart "big box" concept by increasing the ease of shopping, providing more visual excitement and coherence within the store, creating better adjacencies of related merchandise, and reducing expenses. We may also develop a smaller Super Kmart format so we can expand into communities that cannot support the "big box."

The supercenter concept is a natural extension of our traditional business, which marries the need of our time-poor customers—who want convenience, value, and one-stop shopping—with our desire for increased shopper frequency.

WAL-MART STORES

Samuel Moore Walton, the billionaire boy scout of Bentonville, Arkansas, built an empire on a fervid belief in value, pioneered by ideas like empowerment, and revolutionized retailing in the process. Dead at 74 after a long fight with cancer, he did not invent the discount department store, although it hardly seems possible that he didn't. He grabbed hold of the leading edge of retailing in 1962 and never let go, creating a value-powered merchandising machine that seems certain to outlive his memory.

In 1994, the still-young company earned $2.3 billion on sales of $67 billion. A $1,650 investment in 100 Wal-Mart shares in 1970, when they began trading, is worth $3 million today. (See **Exhibit 4** for financial information on the company.) He taught American business that the vast amount of American people want value. He saw the future, and he helped make the future. According to a retail executive, while Walton was one of the great showmen of retailing, if he had been a television preacher he'd have become Pope. As a manager he applied such concepts as a flat organization, empowerment, and gain-sharing long before anyone gave them those names. In the 1950s, he shared information and profits with all employees. He ingested as much data as he could to get close to the customer and closer to the competition. He stressed flexibility and action over deliberation.

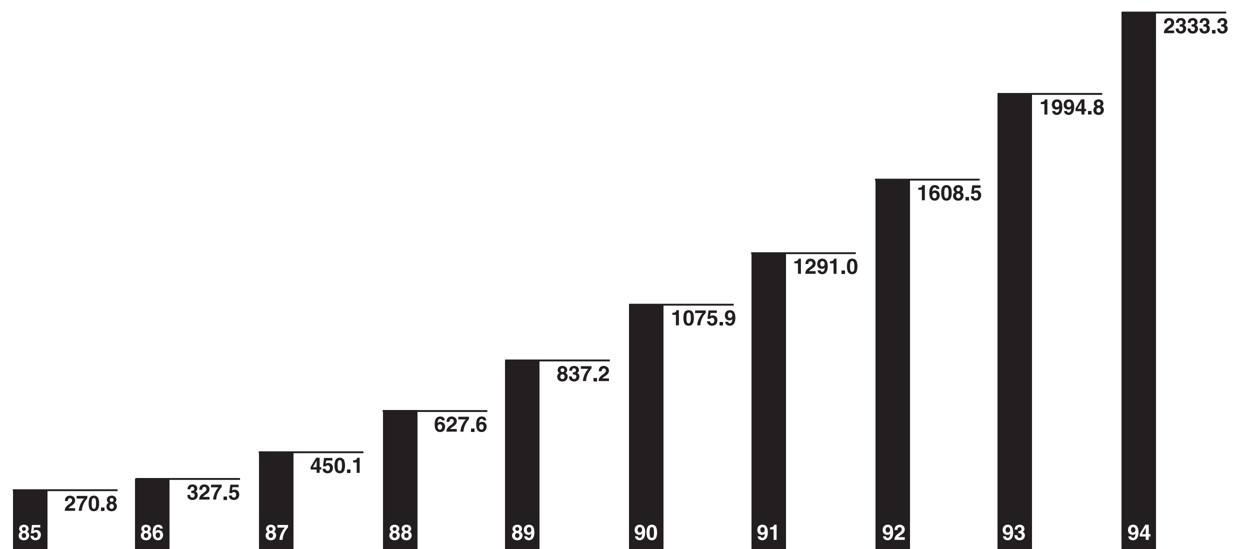
Wal-Mart is ultimately a monument to consumers: it has saved them billions. Sam Walton truly believed that nothing happens until a customer walks into a store with a purpose, buys something, and walks out. His philosophy was simple: satisfy the customer. Operating nearly 2,000 stores in 47 states, Wal-Mart remains the leader in the discount store industry. In addition, with over 400 Sam's Clubs, Wal-Mart is a major factor in the Warehouse Club industry. Combining general merchandise and groceries, Supercenters represent the company's fastest growing segment, with 65 to 70 stores planned in fiscal 1995 on a base of 68.

Walton long ago wanted manufacturers to see themselves, wholesalers, retailers, and consumers as parts of a single customer-focused process rather than as participants in a series of transactions. He personally and permanently altered the relationship between manufacturers and retailers, which has historically been, to put it politely, antagonistic. About five years ago he asked Procter & Gamble executives to view a focus group of Wal-Mart executives talking about their prickly relationship with the packaged-goods company. It was sobering. His strategy clearly was that we ought to be able to work together to lower the costs of both the manufacturer and the distributor and get lower costs for consumers. Walton got both sides to focus on distribution costs and how to cut them. Wal-Mart linked P&G with its computers to allow automatic reordering, thus avoiding bulges in order cycles. With better coordination of buying, P&G could plan more consistent manufacturing runs, rationalize distribution, and lower its costs, passing on some of the savings. This systematic approach is now in broad use throughout the industry. Walton has been described as a visionary, and he clearly was that. His vision was apparent in 1956 as a Ben Franklin variety store owner. To lure one of his first store managers, Bob Bogle, away from the state health department, Walton showed him the books and offered to pay him 25 percent of the store's net profit in addition to salary.

EXHIBIT 4
Wal-Mart Stores, Inc. Consolidated Statements of Income

(Amounts in thousands except per-share data.) *Fiscal year ended January 31,*	*1994*	*1993*	*1992*
Revenues:			
Net sales	$67,344,574	$55,483,771	$43,886,902
Rental from licensed departments	47,422	36,035	28,659
Other income—net	593,548	464,758	373,862
	67,985,544	55,984,564	44,289,423
Costs and Expenses:			
Cost of sales	53,443,743	44,174,685	34,786,119
Operating, selling, and general and administrative expenses	10,333,218	8,320,842	6,684,304
Interest Costs:			
Debt	331,308	142,649	113,305
Capital leases	185,697	180,049	152,558
	64,293,966	52,818,225	41,736,286
Income Before Income Taxes	3,691,578	3,166,339	2,553,137
Provision for Income Taxes:			
Current	1,324,777	1,136,918	906,183
Deferred	33,524	34,627	38,478
	1,358,301	1,171,545	944,661
Net Income	$ 2,333,277	$ 1,994,794	$ 1,608,476
Net Income Per Share	$ 1.02	$ .87	$ .70

Net Income (Millions of Dollars)



Source: Wal-Mart 1994 Annual Report.

EXHIBIT 4 (continued)
Wal-Mart Stores, Inc. Consolidated Balance Sheets

(Amounts in thousands.) January 31,	*1994*	*1993*
Assets:		
Current Assets:		
Cash and cash equivalents	$ 20,115	$ 12,363
Receivables	689,987	524,555
Recoverable costs from sale/leaseback	208,236	312,016
Inventories:		
At replacement cost	11,483,119	9,779,981
Less LIFO reserve	469,413	511,672
LIFO	11,013,706	9,268,309
Prepaid expenses and other	182,558	80,347
Total current assets	12,114,602	10,197,590
Property, Plant, and Equipment, at Cost:		
Land	2,740,883	1,692,510
Buildings and improvements	6,818,479	4,641,009
Fixtures and equipment	3,980,674	3,417,230
Transportation equipment	259,537	111,151
	13,799,573	9,861,900
Less accumulated depreciation	2,172,808	1,607,623
Net property, plant, and equipment	11,626,765	8,254,277
Property under capital leases	2,058,588	1,986,104
Less accumulated amortization	509,987	447,500
Net property under capital leases	1,548,601	1,538,604
Other Assets and Deferred Charges	1,150,796	574,616
Total assets	$26,440,764	$20,565,087
Liabilities and Shareholders' Equity		
Current Liabilities:		
Commercial paper	$ 1,575,029	$ 1,588,825
Accounts payable	4,103,878	3,873,331
Accrued liabilities	1,473,198	1,042,108
Accrued federal and state income taxes	183,031	190,620
Long-term debt due within one year	19,658	13,849
Obligations under capital leases due within one year	51,429	45,553
Total current liabilities	7,406,223	6,754,286
Long-Term Debt	6,155,894	3,072,835
Long-Term Obligations Under Capital Leases	1,804,300	1,772,152
Deferred Income Taxes	321,909	206,634
Shareholders' Equity:		
Preferred stock ($.10 par value; 100,000 shares authorized, none issued)		
Common stock ($.10 par value; 5,500,000 shares authorized, 2,298,769 and 2,299,638 issued and outstanding in 1994 and 1993, respectively)	229,877	229,964
Capital in excess of par value	535,639	526,647
Retained earnings	9,986,922	8,002,569
Total shareholders' equity	10,752,438	8,759,180
Total liabilities and shareholders' equity	$26,440,764	$20,565,087

Source: Wal-Mart 1994 Annual Report.

STRATEGIC ANALYSIS OF WAL-MART'S SUCCESS

Wal-Mart's Competitive Capabilities

What accounts for Wal-Mart's remarkable success? Most explanations focus on a few familiar and highly visible factors: the genius of founder Sam Walton, who inspires his employees and has molded a culture of service excellence; the "greeters" who welcome customers at the door; the motivational power of allowing employees to own part of the business; the strategy of "everyday low prices," which offers the customer a better deal and saves on merchandising and advertising costs. Strategists also point to Wal-Mart's big stores, which offer economies of scale and a wider choice of merchandise.

Such explanations only redefine the question. *Why* is Wal-Mart able to justify building bigger stores? Why does Wal-Mart alone have a cost structure low enough to accommodate everyday low prices and greeters? What has enabled the company to continue to grow far beyond the direct reach of Sam Walton's magnetic personality? The real secret of Wal-Mart's success lies deeper, in a set of strategic business decisions that transformed the company into a capabilities-based competitor.

The starting point was a relentless focus on satisfying customer needs. Wal-Mart's goals were simple to define but hard to execute: to provide customers access to quality goods, to make these goods available when and where customers want them, to develop a cost structure that enables competitive pricing, and to build and maintain a reputation for absolute trustworthiness. The key to achieving these goals was to make the way the company replenished inventory the centerpiece of its competitive strategy.

This strategic vision reached its fullest expression in a largely invisible logistics technique known as "cross-docking." In this system, goods are continuously delivered to Wal-Mart's warehouses, where they are selected, repacked, and then dispatched to stores, often without ever sitting in inventory. Instead of spending valuable time in the warehouse, goods just cross from one loading dock to another in 48 hours or less. Cross-docking enables Wal-Mart to achieve the economies that come from purchasing full truckloads of goods while avoiding the usual inventory and handling costs. Wal-Mart runs a full 85 percent of its goods through its warehouse system—as opposed to only 50 percent for Kmart. This reduces Wal-Mart's costs of sales by 2 percent to 3 percent compared with the industry average. That cost difference makes possible the everyday low prices.

That's not all. Low prices in turn mean that Wal-Mart can save even more by eliminating the expense of frequent promotions. Stable prices also make sales more predictable, thus reducing stockouts and excess inventory. Finally, everyday low prices bring in the customers, which translates into higher sales per retail square foot. These advantages in basic economics make the greeters and the profit sharing easy to afford.

With such obvious benefits, why don't all retailers use cross-docking? The reason: it is extremely difficult to manage. To make cross-docking work, Wal-Mart had to make strategic investments in a variety of interlocking support systems far beyond what could be justified by conventional ROI criteria. For example, cross-docking requires continuous contact among Wal-Mart's distribution centers, suppliers, and every point of sale in every store to ensure that orders can flow in and be consolidated and executed within a matter of hours. Wal-Mart operates a private satellite-communication system that daily sends point-of-sale data directly to Wal-Mart's 4,000 vendors.

Another key component of Wal-Mart's logistics infrastructure is the company's fast and responsive transportation system. The company's 19 distribution centers are serviced by nearly 2,000 company-owned trucks. This dedicated truck fleet permits Wal-Mart to ship goods from warehouse to store in less than 48 hours and to replenish its store shelves twice a week on average. By contrast, the industry norm is once every two weeks.

To gain the full benefits of cross-docking, Wal-Mart has also had to make fundamental changes in

its approach to managerial control. Traditionally, in the retail industry, decisions about merchandising, pricing, and promotions have been highly centralized and made at the corporate level. Cross-docking, however, turns this command-and-control logic on its head. Instead of the retailer pushing products into the system, customers "pull" products when and where they need them. This approach places a premium on frequent, informal cooperation among stores, distribution centers, and suppliers—with far less centralized control.

The job of senior management at Wal-Mart, then, is not to tell individual store managers what to do, but to create an environment where they can learn from the market—and from each other. The company's information systems, for example, provide store managers with detailed information about customer behavior, while a fleet of airplanes regularly ferries store managers to Bentonville, Arkansas headquarters for meetings on market trends and merchandising.

As the company has grown and its stores have multiplied, even Wal-Mart's own private air force hasn't been enough to maintain the necessary contacts among store managers. Therefore, Wal-Mart has installed a video link connecting all its stores to corporate headquarters and to each other. Store managers frequently hold video conferences to exchange information on what's happening in the field, such as which products are selling and which ones aren't, which promotions work and which don't.

The final piece of this capabilities mosaic is Wal-Mart's human resources system. The company realizes that its frontline employees play a significant role in satisfying customer needs. Therefore, it attempts to enhance its organizational capability with programs such as stock ownership and profit sharing geared toward making its personnel more responsive to customers. Even the way Wal-Mart stores are organized contributes to this goal. Where Kmart has five separate merchandise departments in each store, Wal-Mart has 36. This means that training can be more focused and more effective, and employees can be more attuned to customers.

Kmart/Wal-Mart Contrasts

Kmart did not see its business this way. While Wal-Mart was fine-tuning its business processes and organizational practices, Kmart was following the classic textbook approach that had accounted for its original success. Kmart managed its business by focusing on a few product-centered strategic business units, each a profit center under strong centralized line management. Each SBU made strategy—selecting merchandise, setting prices, and deciding which products to promote. Senior management spent most of its time and resources making line decisions rather than investing in a support infrastructure.

Similarly, Kmart evaluated its competitive advantage at each stage along a value chain and subcontracted activities that managers concluded others could do better. While Wal-Mart was building its ground transportation fleet, Kmart was moving *out* of trucking because a subcontracted fleet was cheaper. While Wal-Mart was building close relationships with its suppliers, Kmart was constantly switching suppliers in search of price improvements. While Wal-Mart was controlling all the departments in its stores, Kmart was leasing out many of its departments to other companies on the theory that it could make more per square foot in rent than through its own efforts.

This is not to say that the Kmart managers do not care about the business processes. After all, they have quality programs too. Nor is it that Wal-Mart managers ignore the structural dimension of strategy: they focus on the same consumer segments as Kmart and still need to make traditional strategic decisions such as where to open new stores. The difference is that Wal-Mart emphasizes behavior—the organizational practices and business processes in which capabilities are rooted—as the primary object of strategy and, therefore, focuses its managerial attention on the infrastructure that supports capabilities. This subtle distinction has made all the difference between exceptional and average performance.