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WAL-MART STORES: “EVERY DAY LOW PRICES” IN CHINA

China “is the one place in the world where you could replicate Wal-Mart’s success in the U.S.”

- David Glass, former CEO of Wal-Mart Stores¹

The beginning of spring 2005 must have left a mark on the corporate strategy of every retailer vying for a share in China, the world’s most populous consumer market. From this time on, foreign retailers were no longer constrained to specified regions, forced to enter into joint ventures with local partners, or hampered by a lack of distribution rights—China’s retail market had thawed and was laid open to all.

To the world’s largest retailer, Wal-Mart Stores, China had long been a strategic imperative. On one hand, nearly US\$20 billion worth of goods made in China were now travelling through Wal-Mart’s global supply chain to drive its costs down; on the other hand, China’s vast size in land and population, an emerging middle class optimistic and eager to spend, and consumers’ relentless pursuit of value all seemed to suggest that China was an ideal ground into which Wal-Mart could successfully transport its business model centring around the strategy of “Every Day Low Prices” (EDLP).

However, in the midst of proclamations of market entry or ambitious expansion plans by many major world retailers came the news that Cassian Chueng, the president of Wal-Mart China, had resigned in March 2005 to spend more time with his family. Changing the commander-in-chief the night before a major battle was, to many, no different from a public admission of the failure to live up to the retail giant’s ambition in China. Indeed, nine years after its market entry in 1996, Wal-Mart ranked only twentieth in sales among all chain stores in China, compared to the fifth place taken by its world rival, the French Carrefour, which had entered the market at more or less the same time as itself. Wal-Mart had 43 stores nationwide, far behind Carrefour’s 62 [see **EXHIBIT 1** for top 25 chain stores in China]. But most

¹ Gilman, H., “The Most Underrated CEO Ever”, *Fortune*, April 5th 2004.

Hong Iris Wang prepared this case under the supervision of Dr. Ali Farhoomand for class discussion. This case is not intended to show effective or ineffective handling of decision or business processes.

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Ref. 06/297C

importantly, whereas Carrefour had started generating positive returns from its stores in China, the annual numbers sent back by Wal-Mart China to its home office in Arkansas, US remained in the red. The fate of successfully duplicating its domestic business model in other parts of the world was further shadowed by the company's complete retreat from Germany in 2006 due to its failure to generate any profit after struggling bitterly for nearly a decade.

The Wal-Mart Way

From Backwater Retailer to the World's Number One

The first Wal-Mart store was opened on July 2nd 1962 in Rogers, Arkansas by Sam Walton,² a 44-year-old man from Oklahoma. Walton believed that the future of retailing lay in discounting. To avoid head-on competition with giants such as Sears and Woolworths which dominated big cities, Walton opened stores in "one-horse", rural, backwater towns ignored by other retailers. The stores aimed to serve customers who, up until then, had to travel long distances to save money. Now they could buy the same goods cheaply at home.³ This positioning proved to be critical to Wal-Mart's success in the years to come as it grew outside competitors' radar screens to a substantial size to command economies of scale.

When sceptics doubted the purchasing power of a small population to support a big store, a retail miracle was in the making which would revolutionise the old, slumbering industry. In the first year of operation, sales at Wal-Mart stores were US\$975,000. Ten years later, when the company was listed on the New York Stock Exchange in 1972, revenues had reached US\$78million. The public listing provided the company with ample resources to finance a more rapid expansion, and by 1979 sales had surpassed US\$1 billion. The powerful growth engine seemed unstoppable. In 1990, the company topped the list of major retailers in the US. And five years later, Wal-Mart stores could be found in all 50 American states, and in Mexico and Canada. In 2002 it became the world's largest company in terms of sales. On January 31st 2005, Wal-Mart Stores reported net sales of US\$285 billion, had a presence in nine countries with 5,289 stores and 1.6 million employees worldwide, offered multiple store formats including discount stores, supercentres, warehouse stores and neighbourhood markets, and was not only the largest company in the world but also the most admired company in the US according to Fortune magazine⁴ [see **EXHIBIT 2** for a timeline of major milestones, **EXHIBIT 3** for a history of growth at Wal-Mart Stores and **EXHIBIT 4** for store formats].

Many attributed Wal-Mart's success to its well-known model of selling brand-name products for less, but Wal-Mart's founder and its executives did not invent the rules of discounting. When Sam Walton opened the first store, this powerful idea had already been around, and had attracted many players. Kmart and Woolco had opened discount chains in the same year as Wal-Mart. Four decades later, Woolco was no longer there, and Kmart in bankruptcy. Many of the prominent names had vanished, while Wal-Mart continued to grow. The secret of success lay in a unique combination of culture and strategies at Wal-Mart that set it apart from its competition.

² Samuel Moore Walton was born on March 29th 1918 and died on April 6th 1992. He was the founder of Walmart and Sam's Club, and stepped down as CEO in 1988.

³ Slater, R. (2003) *The Walmart Decade*, Penguin Books: London.

⁴ Figures have been collected from Walmart's annual reports.

The Wal-Mart Value

*I've yet to meet a customer who came to a store because we're Number One:
If they come it's because of the value we give them.*

- Lee Scott, CEO of Wal-Mart Stores Inc.⁵

There were many reasons why a customer chose to shop at one store instead of another. These generally ranged from the quality of merchandise, assortment of goods, price level, store environment, customer support, to store hours and even to the availability of free parking. For an average customer, the value of shopping was maximised when he or she could select the desired products of the best quality from a wide variety of goods, at the lowest possible price, with friendly and knowledgeable staff and in a pleasant surrounding. To give customers what they wanted, Wal-Mart rightly focused on two major value drivers—price and service.

Every Day Low Prices (EDLP)

“Every Day Low Prices” was the unshakeable crux of the value that Wal-Mart offered to its customers. Its advertising materials proclaimed: “Wal-Mart is a store you can count on every day to bring you value for your dollar. And that’s why at Wal-Mart, you never have to wait for a sale to get your money’s worth!”⁶

Every day low pricing proved to be a successful innovation in retailing. On the demand side, it successfully addressed customers’ disappointment in constantly changing shelf prices and ensuing frustration in buying an item at the wrong time, for example, just before a sale or promotion was offered. Wal-Mart’s motto “Always Low Prices, Always” helped to drive home the concept of EDLP, but it was Wal-Mart’s credibility in keeping this promise that had drew millions of customers to its door.

Anecdotes had it that the founder, Sam Walton, would often sneak into his competitors’ stores wearing sunglasses and having removed his signature baseball cap to inspect their prices. If he saw an item priced lower than at a Wal-Mart store, he would call the nearest store manager and have him immediately reduce the price. More recently, each Wal-Mart store monitored the prices of about 1,500 items in their competitors’ stores. If it was found that a competitor had a lower price on one of these items than Wal-Mart, the store manager would immediately lower the price to be the lowest in the area.⁷ The objective was to offer the same merchandise as other local stores, but at 20% less. Experts estimated that Wal-Mart saved shoppers at least 15% on a typical cart of groceries.⁸

Wal-Mart also mixed other philosophies into its pricing. One of these was the “roll-back” philosophy. This was an on-going program to lower prices even further when there was an opportunity to do so. For example, when a supplier reduced its production cost, Wal-Mart would seize the opportunity to negotiate a lower price and pass on the savings to its customers.

Wal-Mart also flagged certain items with their “Special Buy” logo to attract customers. It could be an everyday item that was bundled with either additional amounts of the same product or simply another product for a limited time. It could also be an item at a very special price while supplies lasted.

⁵ Slater, R. (2003) *The Walmart Decade*, Penguin Books: London

⁶ Walmart Stores [www document] <http://www.walmartstores.com> (accessed November 16th 2004).

⁷ Stone, K., “How Do You Deal with the Entry of a New Walmart Supercentre into Your Town?”, PM Magazine, March 2005

⁸ Schafer, S., “A Welcome to Walmart”, Newsweek International, December 20th 2004.

EDLP, mixed with other pricing philosophies, brought customers from all income levels to Wal-Mart and proved to be the most important value that Wal-Mart offered in differentiating itself from its competition⁹ [see **EXHIBIT 5** for an ACNielsen study of the primary reason why shoppers shop at a grocery store].

Customer is Number One

If EDLP was the crux of Wal-Mart's value offered to customers, then its hallmark was the services they received there. As a shrewd merchandiser, Sam Walton knew all too well that competing only on price would not take him far. The three cardinal beliefs Wal-Mart's founder relied on for attracting and keeping customers were: providing great customer service, showing respect for the individual and striving for excellence. These beliefs were translated into ten specific business rules that he tried to implant into the heart of every executive, manager and associate. Among these rules was "exceed your customers' expectations" [see **EXHIBIT 6** for Sam Walton's Ten Rules]. A former executive recalled that at Wal-Mart, unless the situation was completely unreasonable, a customer could never be allowed to leave the store unsatisfied.¹⁰

During many of his store visits, Sam Walton encouraged associates to take a pledge with him: "I want you to promise that whenever you come within 10 feet of a customer, you will look him in the eye, greet him, and ask him if you can help him."¹¹ This was called the "Ten Feet Rule". There was also the "Sundown Rule". The Sundown Rule required that employees answer requests from customers or colleagues by the end of business hours on the day the requests were received.

These beliefs and rules had been glued into Wal-Mart's culture by Sam Walton, were carried through the company's history and were followed by managers and associates alike no matter what country they were located in. It could be as simple as a warm smile, remembering a customer's name or carrying a customer's purchase out for them. At other times, it could be cardiopulmonary resuscitation (CPR) administered on a store floor, an associate jumping in front of a car in the store's parking lot to protect a little boy, or a pharmacist rushing back to the store to fill a diabetic customer's insulin prescription on a Sunday morning.

Customers did feel the difference and came back again and again. Every year over 80% of US households shopped at Wal-Mart, which served 138 million customers a week worldwide.¹²

Providing quality goods at a low price in a friendly environment seemed to be an open secret, or even common sense to anybody who contemplated on the success factors in running a retail establishment. But while Wal-Mart kept its success story alive, many others failed. Behind this success was a model that the leadership of the company transported from one store to another, one state to another and one country to another.

⁹ Hale, T., "Understand the Walmart Shopper", ACNielsen, [www document] www2.acnielsen.com/pubs/2004_q1_ci_walmart.shtml (accessed December 2005).

¹⁰ "Corporate Culture Provides Walmart Competitive Advantages", Refrigerated Transporter, July 1st 2002.

¹¹ Walmart Stores [www document] www.walmart.com (accessed April 20th 2005).

¹² Walmart Stores, 2005 Annual Report.

The Success Model

Small-Town Locations

A key strategy in Wal-Mart's early days was opening discount stores with a sizable spread of assorted merchandise in small, one-horse towns. Once it had established the first store, Wal-Mart then saturated the region by spreading out its stores and filling un-served gaps. Wal-Mart benefited from this strategy in several ways. First, it avoided direct competition from stronger players since larger companies such as Kmart believed that populations under 50,000 would not be able to support a large store in the long run. So, Wal-Mart was able to grow below its competitors' radar. Secondly, due to the small populations it served, once Wal-Mart opened a store, the town could not support another store of similar size. Thus, Wal-Mart saturated its market and effectively barred new competition from entry. Meanwhile, many small mom-and-pop stores were also driven away because they could not compete with Wal-Mart's cost structure. Thirdly, locating stores in rural backwaters also reduced costs due to lower land and real estate prices.

Relentless Cost Control

From the very beginning, Wal-Mart operated on the principle that saving was as important as pricing. Every penny saved in operating costs was as important as a penny generated from sales. Relentless cost control was one of the company's core capabilities and the principle of frugality had stayed at the heart of the company's culture since its early days.

Although Wal-Mart was the world's number one company in terms of sales, its headquarters had remained in Bentonville, Arkansas. It was located across the street from a modest clapboard house. The main building was little more than a dreary, three-storey warehouse with a brick façade. Suppliers conducted business with company "associates" in the lobby. Wal-Mart executives flew economy class, shared budget hotel rooms and emptied their own trash. Although chief executive officer (CEO) Scott Lee and chief financial officer (CFO) Tom Schoewe earned a combined US\$14 million in stock and cash in 2003, on business trips the two would share a US\$49 hotel room.¹³ A common ground had been established among all employees, managers and hourly workers alike that the only worthwhile cost was one that got their customers to buy a product and everybody played a part in keeping the cost down, not just the buyers who negotiated prices with suppliers. The goal was to drive down the price of their products to the lowest they could possibly be.

Partnerships with Suppliers

Wal-Mart, despite its folksy and small-town image, was regarded as one of the toughest and shrewdest negotiators in the world. It could leverage its huge purchasing power in its negotiations with 68,000 suppliers, which it was not shy to use. Some described a supplier's relationship to Wal-Mart as a love-hate relationship. While a contract from Wal-Mart presented unlimited growth potential for a supplier due to its mere size, the terms of the transaction were also dictated by the giant vendor who never stopped pressing for a lower price; and that was not all—Wal-Mart also demanded, amongst other things, high quality, efficient bookkeeping and punctual delivery.

Wal-Mart denied any coercive tactics. The company claimed that it had always treated its suppliers as partners and helped suppliers improve inventory management and efficiency. When the suppliers' manufacturing processes were analysed and extra costs weeded out, they usually found that they could offer a lower price. With that lower price, Wal-Mart could sell

¹³ Faber, D., CNBC TV Report, November 10th 2004.

more, and consequently increase the size of business with the supplier. Wal-Mart saw this as a win-win partnership. One example was of a fan manufacturer in Chicago. In the early 1990s, a 20-inch box fan cost US\$20. Wal-Mart pushed the manufacturer to lower the price, and the supplier responded by automating the production process. The supplier also badgered its own suppliers to knock down prices of parts. Then, in 2000, it opened a factory in China. By 2003, the price on a fan in Wal-Mart had dropped to about US\$10.¹⁴

Indeed, Wal-Mart had forced its suppliers to search hard for ways to eliminate the inefficiency in their own processes in order to drive costs to a minimum and to improve the quality of their products.

Unrivalled Distribution and Logistics Management

During Sam Walton's era, when technology did not play a major role in business management, Walton strove to create a distribution system that could ensure a short time to market and low inventory levels. The target was to have inventories grow at half the rate of sales,¹⁵ and to have any required delivery arriving on the shelves within one day. At the beginning, Sam Walton acted as his own distribution system, driving miles in his pick-up truck to manufacturers and returning with it fully loaded. Later, when business grew, Wal-Mart had its own fleet of trucks with more than 3,000 tractors and 12,000 trailers. Operating its own fleet gave Wal-Mart full control over the movement of merchandise that would never be possible with a third party contractor. By 2005, the fleet had an on-time delivery record well in excess of 99.5%.

Moreover, to achieve shorter lead times, Wal-Mart created distribution centres. Purchasing was centralised, and suppliers shipped merchandise to the distribution centres. By 2002, Wal-Mart had 62 centres that handled more than 85% of all merchandise it sold. They used highly automated handling systems and carefully co-ordinated cross-docking to move goods through the system with minimum inventory while operating 24 hours a day. The distribution network was based on the hub-and-spoke concept, with warehouses at the centre of a trade area where no store was more than a day's drive from its distribution centre.¹⁶

If there were major differences in the way of doing business between Sam Walton and his successor David Glass, investment in technology would top the list. Walton doubted the wisdom of investing in high-tech logistics systems since he was unwilling to part with a single penny that did not directly affect customers, but was eventually convinced by Glass that the use of technology would give Wal-Mart great efficiency in the supply chain arrangement and a distinct competitive advantage. David Glass had the foresight to understand that the company's growth required warehouse-sized distribution centres and high-tech, merchandise-tracking wizardry.¹⁷

Wal-Mart very early demonstrated commitment to technology in its industry. As early as in the 1980s, Wal-Mart started using computers to track and analyse sales data and transmit orders to suppliers by electronic data interchange¹⁸ (EDI). It also pioneered the use of bar codes through which it collected valuable market intelligence. By 1990, Wal-Mart was collaborating electronically with its suppliers, using EDI at first and later its own applications.

¹⁴ Schafer, S., "A Welcome to Walmart", Newsweek International, December 20th 2004.

¹⁵ Schafer, S., "A Welcome to Walmart", Newsweek International, December 20th 2004.

¹⁶ "Corporate Culture Provides Walmart Competitive Advantages", Refrigerated Transporter, July 1st 2002.

¹⁷ Slater, R. (2003) *The Walmart Decade*, Penguin Books: London.

¹⁸ EDI refers to the transfer of data between different companies using networks such as WAN or the internet. As more and more companies get connected to the internet, EDI is becoming increasingly important as an easy mechanism for companies to buy, sell and trade information.

Being the earliest in the industry to adopt satellite technology, Wal-Mart was able to connect all stores to the home office at the same time and tie everything together—stores and suppliers—within one big network.¹⁹ The suppliers could, by this time, track sales second-by-second and deliver new stock as fast as old stock disappeared from the shelves. By 2000, suppliers were also electronically exchanging invoices, purchasing orders and other documents with the company.

By 2005 the biggest building at the Wal-Mart complex in Bentonville housed the firm's mainframe computers that ran sophisticated programs allowing instant tracking of products, shipments, inventory and sales. The company's data warehouse storage capacities exceeded 570 terabytes. That was more than all of the fixed pages on the internet.

Wise use of technology provided Wal-Mart with real-time insight into merchandise forecasting, planning, producing and shipping, and substantially improving efficiency and productivity. It boasted the most efficient distribution and logistics network in the industry, which allowed it to keep merchandise moving to its 1,353 discount stores, 1,713 supercentres, and 551 Sam's Clubs in the US, [see **EXHIBIT 4** for a description of each store format], and enabled it to offer its customers the right product mix at the right time while keeping the inventory and associated costs as low as they could possibly be.

A Culture That Reduced Agency Costs

Wal-Mart had grasped the art of motivating its employees from all levels to perform their best. To Sam Walton, salaries were never the only way of keeping a workforce happy; when happy, they would have a smile, a natural enthusiasm in what they were doing and a willingness to help their customers. Besides a cheerful atmosphere displayed on the store floor, eg, the famous Wal-Mart cheers that aimed to break barriers and establish links between managers and associates, Walton and his successors made it a crusade to unswervingly adhere to the three cardinal beliefs, which were translated into ten specific business guidelines [see **EXHIBIT 6**].

Wal-Mart was the first retailer to start profit-sharing plans for rank-and-file workers, and not limit these merely to executives. By 2003, roughly two-thirds of the company's American workforce owned stock in Wal-Mart.²⁰ The management also tried to foster an environment for personnel empowerment beyond handing out stocks. This was illustrated by the fact that 76% of the store's management started in hourly positions and had moved up the ranks to reach their current position.²¹ Moreover, many important initiatives were first suggested by ordinary associates in regular morning meetings. People had to systematically switch jobs (labelled "cross-training") to enable them to understand different parts of the company's operation; this also gave them more variation in their jobs. Also, crucial corporate information, such as financial numbers, was shared with every employee. This not only conveyed trust, but also helped staff to understand and care for the business.

Another aspect of Wal-Mart's culture was its aggressive position against unions. Not a single one of its more than 1 million employees in the US was unionised. Known for driving costs down in the supply chain by surpassing the middleman and buying directly from manufacturers, Sam Walton also regarded unions as a costly middle layer between the owners and employees. He would rather close a store than allow it to be unionised. The company promoted an open door policy so that employees could channel their complaints and feel like they were being treated fairly.

¹⁹ Gilman, H., "The Most Underrated CEO Ever", *Fortune*, April 5th 2004.

²⁰ Slater, R. (2003) *The Walmart Decade*, Penguin Books: London.

²¹ Walmart stores, 2005 Annual Report.

When employees were motivated, happy and passionate about their job, the cost of monitoring and bonding was reduced even when many claimed that cash compensation to associates at Wal-Mart stores was kept at a minimum.

When all the above elements worked together seamlessly, they became a distinct Wal-Mart model, successfully allowing the giant retailer to buy cheap, to sell cheap, to motivate its employees and to keep its customers happy and satisfied. In the US, Wal-Mart's sales per employee were easily the highest in the industry. So were the sales per square foot, which stood at US\$413 per square foot of space compared to US\$222 at its nearest competitor, Kmart.²²

Going International

We'll lower the cost of living for everyone, not just in America, but we'll give the world an opportunity to see what it's like to save and do better.

- Sam Walton, upon receiving the Medal of Freedom in 1992²³

In the early 1990s, Wal-Mart Stores started eyeing areas beyond its home country and looking at unchartered waters in the overseas markets. By this time, it had rapidly expanded into many states in the US and saturated many regional markets where competition was growing fiercely. Wal-Mart's mature discount concept and business model were ready to be exported. With 95% of the world's population living outside the US, many of them under-served, going international seemed to be the next natural step in driving further growth. The management firmly believed that consumers were alike everywhere around the world in searching for quality products at great prices and desiring to be treated well.

In 1991, the first Wal-Mart outside the US was opened in Mexico. By early 2005, the company had established a presence in nine countries, with 1,587 stores and more than 500,000 employees. The international stores were responsible for a combined turnover of US\$56.3 billion, which constituted 19.7% of total sales at Wal-Mart [see **EXHIBIT 7** for statistics of Wal-Mart's international operation].

In exporting its business model, Wal-Mart had met with a mixed reception. It had done well in Mexico, Canada and Britain, becoming the largest retailer in Mexico and Canada and third largest in Britain, but it was struggling in Japan and Korea. Entry into Germany was seriously hindered by strict union rule, high labour costs, zoning laws and existing competition. In the end, it had to withdraw from the market by selling all the stores to its German rival Metro. China, the only market with a population and geographical size that would allow Wal-Mart to repeat the scale of its domestic success, presented enormous challenges—at least as enormous as the appeal it presented to the world's leading retailer.

The Middle Kingdom Challenge

China created a level of ambivalence in investors that few other markets resembled. From the population of 1.3 billion had grown an increasingly serviceable and sizable market, demonstrating continued consumer confidence. Wal-Mart's Asian chief, Joe Hatfield described it as this: "It boggles the mind to think if everybody washed their hair every day,

²² "Corporate Culture Provides Walmart Competitive Advantages", Refrigerated Transporter, July 1st 2002.

²³ Walmart stores [www document] www.walmart.com (accessed May 27th 2006).

how much shampoo you would sell.”²⁴ China’s retail sales were expected to reach US\$860 billion in 2006, making it the world’s seventh largest retail market. Annual compound growth rates of 8 to 10% would push this to an enormous US\$2.4 trillion by 2020.²⁵ Added to the optimism on the part of foreign players was an improvement in the general business environment and relaxation on the regulatory front that allowed them freer access to a fairer, competitive landscape.

This optimism was, on the other hand, accompanied by disappointing and frustrating experiences by many multinationals operating in China. Wal-Mart also faced unique and serious hurdles that directly challenged its successful US-bred model centred on EDLP. According to figures from China General Chamber of Commerce (CGCC), Wal-Mart had been losing money since it arrived in the country in August 1996, when it opened a Supercentre and a Sam’s Club in Shenzhen—a booming southern city bordering Hong Kong.

China’s Retail Industry

A Brief History

Prior to China’s economic reform, started in 1978, the retail sector in China was predominantly under direct state control and was characterised by low-quality products and poor service, typical in a market dominated by the seller. Until the late 1980s, state-owned stores and co-operatives were the only retailers.²⁶ Production and distribution were governed by central planning, and allocation was governed by a hierarchical vertical structure; market forces played a minimal role. As a legacy of this structure, there was never a well-developed national market in China.

Two decades of reform initiated in early 1980 completely transformed the retail market. By the end of 1996, the role of non-state enterprises—including those financed by individuals, shareholders and foreign investors—had grown to account for 72.6% of consumer goods sales. Since the 1990s, retailing had become increasingly competitive, resulting in economies of scale for both state and private enterprises.²⁷ Across the country, traditional, state-owned department and general stores disappeared and were replaced by new shopping centres, superstores and hypermarkets. Better store environments, higher product quality, and greater variety all worked together to lure Chinese consumers, who now had higher incomes. The total retail market in China grew by 51.86% between 1996 and 2002 in current terms, at an annual average growth rate of 8.68%²⁸ [see **EXHIBIT 8** for retail growth in China].

One should note that much of the development and brisk growth had taken place in urban centres, and could not be seen as a truly nationwide phenomenon. In rural areas, growth had been much slower [see **EXHIBIT 9** for urban and rural differences in retail sales]. The quick spread of retailing into the hinterland had been hindered by huge differences in income between rural and urban dwellers and between coastal and inland regions, by problems such as backward infrastructure, diverse regional consumption patterns and other issues, which will be discussed in later sections.

The existing types of retailing in China included licensed individual stores, general stores, secondary food stores, supermarkets, hypermarkets, convenience stores, department stores, hardware stores, free markets, fabric shops, pharmacies and book shops. In recent years,

²⁴ Keith B. Richburg. The Washington Post. Washington, D.C.: Feb 12, 1997. pg. C.13.

²⁵ “Ready for Warfare in the Aisles”, The Economist, August 5th 2006.

²⁶ Sternquist, B. and Qiao (1995) “China: The Planned to Free Market Paradigm”, *International Journal of Retail and Distribution*, 23(12): 21-29.

²⁷ Taylor, R., “China’s Consumer Revolution”, *Asian Business and Management*, 2003 2.

²⁸ “Retailing in China: A Market Analysis”, Access Asia Limited, 2003.

organised retail in the form of chain stores, Wal-Mart's chosen format, had been prioritised by the government and had seen tremendous growth. Chain stores first emerged in the early 1990s.²⁹ In 1996, there were 700 chain store companies engaged in organised retail in China; the figure grew to 1,150 in 1998, and 16,986 by 2002.³⁰ Chain stores were considered an important and effective way to expand modern retailing from major urban centres into the rest of China.

On the regulation front concerning foreign capital participation, China opened the retail sector phase by phase. The publication of the *Official Reply to Utilizing Foreign Investment in Commercial Retail*, issued by the State Council in 1992, was the first act of opening the door to foreign investment. It allowed foreign investors to establish retail joint ventures in Beijing, Shanghai, Tianjin, Guangzhou, Dalian and Qingdao, and in the five special economic zones (Shenzhen, Zhuhai, Shantou, Xiamen and Hainan) [see **EXHIBIT 10** for a map of China and its major municipalities]. Applications to establish Chinese-foreign retail joint ventures had to be approved by the State Council, and the Chinese partner had to have a majority share of at least 51%. In 1999, the State Economic Trade Commission and the Ministry of Foreign Trade and Economic Cooperation jointly issued the *Measures for the Trial Establishment of Foreign-Invested Commercial Enterprises*. This extended potential foreign presence to the capitals of all provinces and autonomous regions, but approval was still controlled at the central level.

China's entry into the World Trade Organization (WTO) in December 2001 expedited China's opening up. All restrictions concerning geographical expansion, product range and ownership structure were to be lifted based on a timeline. It also forced the opening up of the distribution and logistics sector, giving foreign companies more control over wholesaling and distribution [see **EXHIBIT 11**]. One caveat worth mentioning was that Beijing's promises could be circumvented at the local level as the local governments were given much greater freedom in and control over what was to happen in their respective jurisdiction.

Intensifying Competition

In the early 1990s, Wal-Mart's request for permission to open stores in Shanghai was allegedly turned down by an official replying: "There is too much competition. It would be too unruly." By spring 2005, the retail market had fully embraced this unruliness and had seen ever intensifying competition. The industry was crowded with both internationally renowned retailers supported by deep pockets and management expertise, and domestic players boasting better knowledge of local consumer preference, both opening new shops at a brisk pace to snap up prime locations and expand their territories. The growth in the number of stores far outpaced the growth in overall sales, resulting in high store density in larger cities. Store productivity was declining, sales per square foot were falling and profit margins were shrinking.³¹ Consequently, the retail market was also undergoing continuous consolidation to eliminate weaker operators. The top 100 retailers accounted for 4.3% of the total retail sales, and the percentage grew to 9.3% in 2004.³²

Apart from Wal-Mart, other world retail giants had also established a significant presence in China. These included France's Carrefour, Thailand's Lotus, UK's Tesco and Germany's Metro to name a few. More would enter the market, and the lifting of restrictions would lead to existing retail giants expediting the pace of expansion [see **EXHIBIT 12** for a list of major foreign chain stores in China, their revenues, number of stores and expansion plans

²⁹ Taylor, R., "China's Consumer Revolution", *Asian Business and Management*, 2003 2. [REFER TO COMMENT FOR REFERENCE 27.]

³⁰ "Retailing in China: A Market Analysis", Access Asia Limited, 2003.

³¹ "Ready for Warfare in the Aisles", *The Economist*, August 5th 2006.

³² China Chain Store and Franchise Association.

announced in early 2005]. These foreign operators usually had a dominant market position in their home markets, had strong liquidity and came armed with long-term plans for China. They mostly operated in the form of hypermarkets, a format that was becoming increasingly popular in China. In 2004, 23% of the total revenues generated by the top 100 chain stores in China came from the 15 foreign brands, compared with 16% in 2003. In 2005, over 1,000 new retailers received government approval, of which more than half had foreign investors.³³

Despite foreign retailers growing rapidly in China, they commanded a market share estimated at only 3% in 2004. In some big cities, their market share was higher, but they were far from dominating the market.³⁴ Local rivals were competing head-on with the foreign operators. While foreign retailers usually focused on hypermarkets and convenience stores, the supermarket segment was primarily dominated by domestic players. After more than a decade of development, domestic retailers had established an extensive network, and many of their stores were located in prime areas. They were also picking up new revenue models and management techniques from their foreign rivals and rapidly improving efficiency in their supply chains. For example, the largest chain store in China, Bailian Group, was investing heavily to build a state-of-the-art distribution centre where everything was automated and sorted on conveyor belts using barcode scanners. On the other hand, a localised demand, localised supply base and localised distribution in China also provided domestic players with an edge in establishing a strong regional dominance when foreign retailers found it hard to leverage national presence in a regional market.

One China, Many Markets

The central planning and allocation that were carried out through a vertical structure had greatly hindered the development of a national market in China where goods and materials flowed freely. In the two decades since economic reform began, China saw substantial growth in the inter-regional flow of goods and services, but many factors, either a legacy of history or new phenomena born of reform, still impeded the fast development of a national market.

Income Disparity

Two decades of brisk economic growth in China had not only created significantly higher income and more rapid wealth accumulation in the nation on average, but had also vastly broadened the gap in wealth between rich and poor and between urban and rural populations. Critics refer to this phenomenon as a transformation from shared poverty to uneven wealth. In coastal regions, the gross domestic product (GDP) per capita reached US\$2,117 in 2002, compared to US\$765 and US\$773 in interior and western regions [see **EXHIBIT 14** for detailed statistics on regional income disparity]. China's Gini coefficient—an internationally accepted measure of income equality—was over the “alarm level” of 0.4. A survey which polled 54,000 urban and rural households found that China's richest 10% had disposable incomes 11.8 times greater than that of the poorest 10% at the end of the first quarter of 2005.³⁵

The growing differences in income were reflected not only in the extent but also the diversity of consumption patterns. While poor consumers spent less, they also shopped for different merchandise. While urban markets for certain goods may have become saturated, their consumption may have just started in more remote, rural markets. People with an annual income below US\$500 would limit their purchases to daily necessities such as food and clothing. A higher income level, between US\$500 and US\$1,000, meant that essentials were met and further goods and services could be consumed. People with an income in the

³³ “Ready for Warfare in the Aisles”, *The Economist*, August 5th 2006.

³⁴ “China Food Retail Sector”, Merrill Lynch, October 21st 2005.

³⁵ “Income Gap in China Widens in First Quarter”, *China Daily*, June 19th 2005.

US\$1,000–US\$2,000 range were considered reasonably well off, or *xiaokang* in Chinese. At this level, people started purchasing consumer durables and commercial housing. When income exceeded US\$2,000 to reach the prosperous, or *fuyu*, stage, people started looking for sophisticated products and advanced information services.

The widely dispersed consumption pattern in terms of both scale and variety meant to a retailer that it was almost impossible to develop a uniformed national merchandising or marketing strategy. Thus, satisfying the consumers' demand in different regions became a costly practice. The likes of Wal-Mart, who were used to operating at a national level, were faced with many distinct markets in China. And although China was the most populous country in the world (1.3 billion people), many Chinese could not even afford a bottle of shampoo. The low income in rural areas also cast doubts on Wal-Mart's US-bred strategy of locating stores in smaller communities. Wal-Mart seriously questioned whether such areas could support a large supercentre, and were forced to re-focus on more expensive, urban locations.

Local Protectionism

Local protectionism was a serious problem faced by many multinational firms trying to expand operations throughout China. One example cited by the 2003 white paper of the American Chamber of Commerce in China was that "in many localities, out-of-province trucks are arbitrarily stopped at city borders and subjected to tolls that local trucks are not required to pay."³⁶

The major cause of all forms of ad hoc barriers imposed by local governments against inter-regional trades was the lack of promulgation, and later an ineffective implementation of, a fiscal policy that prohibited such behaviours. Fiscal decentralisation in 1978 allowed local governments to retain a percentage of the tax revenue. This provided local governments with a strong incentive to protect their tax base by shielding local firms and industries from inter-regional competition. Local governments also had incentives to protect state-owned enterprises under their jurisdiction as they were the base of their political power, and a source of private benefits as well as fiscal revenue.³⁷

In 2001, the State Council issued a circular that prohibited local protectionism in all forms in a bid to build and improve a unitary, fair and orderly market system in China. The State Council stated that no unit or individual was allowed to violate these laws and regulations, and could not stop or interfere in the sale and purchase of products and services from other parts of the country.³⁸ The enforcement of such regulations, however, seemed to be ineffective. If in the late 1980s local protectionism took the form of various internal trade barriers, then in recent years it was more often manifested in a range of problems relating to market integration, policy implementation, judicial integrity and enforcement, and corporate development.

Wal-Mart's expansion in China came up unavoidably against such local protectionism. The most indicative example might be its effort to enter into China's wealthiest and most commercially developed city, Shanghai. For eight years it negotiated with city and district governments over a store opening. The city demanded that Wal-Mart set up a national distribution centre there, but the company refused because its existing centres in Tianjin and Shenzhen sufficed its mainland operations. Since Wal-Mart's Chinese operation was headquartered in Shenzhen, and the accounts of all its stores were settled there, it paid taxes

³⁶ EIU (2004) *Coming of Age: Multinational Companies in China*, Economist Intelligence Unit Limited, p. 44.

³⁷ Bai, Chong-En, Du, Yingjuan, Tao, Zhigang and Tong, Sarah Y. "Local Protectionism and Regional Specialization: Evidence from China's Industries", April 2003.

³⁸ People's Daily, April 30th 2001.

in Shenzhen rather than where the stores were located. In 2003, Shanghai published a new commercial plan to restrict the opening of new supercentres in the inner city. The delay in obtaining municipal approval put Wal-Mart in a much disadvantaged position against its major competition in Shanghai's retail market. In contrast, Carrefour, which delegated the accounts and financial control to each of its stores, was warmly welcomed by most Chinese city governments.³⁹

Infrastructural Deficiency

Before 1997, China had virtually no expressways. By the end of 2004, the total length of expressways had grown to 34,288 km, while that of highways grew to 1.8 million km.⁴⁰ Although this was a substantial expansion of a once non-existent infrastructure, it continued to struggle in keeping up with demand as a result of explosive economic growth. By comparison, the US, which has a similar geographic range, had an expressway network that stretched for 120,000 km.⁴¹ The density of land transport system in China amounted to just 157 km per 1,000 square km. This compared with equivalent figures of 720 km in the US and 3,138 km in Japan. The highways were also notoriously costly to use: toll fees could reach as much as 10% or more of the total freight costs, much higher than in developed countries. In many cases, toll collection at the local level was arbitrary and illegal.⁴²

In addition to China's under-developed highway network, on which Wal-Mart's distribution system depended, different forms of transportation were not well connected and were seriously fragmented. From port to railway, and from railway to highway, goods often had to be warehoused while in transit, leading to substantially higher costs and more waste, especially with regard to perishable goods.

The backward transportation network greatly added to the cost of inter-regional distribution. Logistics costs were estimated at 20% of GDP according to the World Bank, compared with just 10 to 12% in more developed markets.⁴³ Physical obstacles and high costs significantly stalled retail companies' plans to expand into the hinterland outside the more economically developed areas, and to establish a seamless and efficient national market.

Distribution King Impaired

Besides the highly fragmented market, some other factors also impaired the distribution king in transplanting its distribution model directly into China.

Regulatory Restrictions

A core part of Wal-Mart's success in the US was to launch a cluster of stores within one day's driving distance from a distribution centre. When a distribution centre served a large enough number of stores, economies of scale would be achieved, thus pushing costs down. The magic number of stores was estimated at 120.⁴⁴ In China, however, the constraints on a foreign retailer's operation directly limited the regional expansion of Wal-Mart stores and the efficient use of distribution centres.

For a long time after Wal-Mart's Chinese debut, its stores were confined to southern China. Regulations stated that only three stores were allowed to be launched in one city, and only a handful of cities were open to foreign retailers. Every store opening had to be approved by the

³⁹ "Comparison of the Strategy of Carrefour and Walmart", China Commercial Daily, August 4th 2003.

⁴⁰ National Bureau of Statistics, 2005 Year Book.

⁴¹ EIU (2004) *Coming of Age: Multinational Companies in China*, Economist Intelligence Unit, p. 14.

⁴² EIU (2004) *Coming of Age: Multinational Companies in China*, Economist Intelligence Unit Limited, p. 85.

⁴³ EIU (2004) *Coming of Age: Multinational Companies in China*, Economist Intelligence Unit Limited.

⁴⁴ "Comparison of the Strategy of Carrefour and Walmart", China Commercial Daily, August 4th 2003.

central government, which also delayed the process because of multiple layers of bureaucracy. Because it stuck to the rules strictly, Wal-Mart's expansion in China was slow. By early 2005, when China largely opened its retail market to comply with WTO's timetable, Wal-Mart had just 43 stores in China [see **EXHIBIT 15** for Wal-Mart Stores in China]. These stores were supported by two distribution centres: one in Shenzhen and one in Tianjin, a northern city neighbouring Beijing. The small number of stores meant that the two distribution centres were significantly underused. At the same time though, it was inadequate to have only two distribution centres serving the entire country, given the slow speed of transportation. As a result, using the distribution centres did not enable Wal-Mart to reduce costs.

Wal-Mart's rival Carrefour expanded quickly to occupy important markets and established a national network by openly bending Chinese regulations. It bypassed the central government to open stores on local approval, retained much higher de facto ownership than the regulatory limit, and courted strong local support by offering jobs, taxes and rents. Since all it did was to anticipate the changes that were to occur in any case, the central government's punishment was only transient and it still led everybody by a good margin when the market was opened in the end.

Lack of IT Network

Wal-Mart's chief of international operations, John Menzer, said the biggest obstacle Wal-Mart faced in mainland China was the lack of an information-technology network with suppliers, making purchasing and distribution difficult.⁴⁵ Such a network was critical to Wal-Mart's success in the US, where the web-based system allowed suppliers hourly tracking of sales, inventory and pricing of their goods, and satellites connected the headquarter to every store and supplier for real-time communication. In China, the lack of an information-technology network and regulatory ban of satellite usage impaired the retailer's efficiency in communicating with its 15,000 local suppliers, who supplied more than 95% of the goods sold in its local stores. Although Wal-Mart was launching a large-scale project to link suppliers electronically to its system, less than 30% had been connected and the rest still received orders through fax.⁴⁶

Chinese Consumers in the Shop

The Chinese consumers' tireless pursuit of value, the growing size of an eager-to-spend middle class, and higher demand for quality and service all seemed to support Wal-Mart's superstore format and its EDLP strategy. However, Chinese consumers also displayed behaviours that were very different to that of consumers in Wal-Mart's home market, which added pressure to Wal-Mart's operational costs and directly threatened its ability to set the price of its goods as low as possible while still enjoying comfortable profit margins.

Many Trips, Little Purchase

On the first Saturday that Wal-Mart's first supercentre opened in Shenzhen in 1996, there were 80,000 Chinese who walked through the door.⁴⁷ The number could be misleading if it were interpreted as 80,000 people who made purchases there.

Due to the living environment in China, which was usually small and noisy when compared to that in developed countries, many Chinese spent their leisure time in commercial centres instead of staying at home. Strolling from store to store, comparing the quality and price of

⁴⁵ O'Neill, M., "Battle Looms in Mainland Retail Sector: Walmart Seeks to Overtake Carrefour as the Market Is Thrown Open to Foreigners", South China Morning Post, September 2nd 2004.

⁴⁶ Ready for Warfare in the Aisles", The Economist, August 5th 2006.

⁴⁷ Slater, R. (2003) *The Walmart Decade*, Penguin Books: London.

merchandise in different shops, and inspecting new stores out of curiosity could be part of weekend leisure activities.

Purchase was more often impulsive rather than according to a plan, and consumers were easily swayed by promotional campaigns. Consumers were brand conscious, but loyalty was very hard to cultivate when consumers always shopped around for the best bargain.

In addition, Chinese consumers' obsession with the freshness of food and limited space at home meant that people would rather pick up a small amount of goods at any one time and visit a shop frequently than purchase in bulk. The fact that most shoppers came by bicycle or on foot instead of by car also limited any possibility of bulk buying. The hypermarket format, usually based on the principle of "infrequent shopping and bulk purchase", did not fit well with the traditional shopping pattern in China. It might take a Chinese customer at least five trips to buy as much as an American shopper got in one. Whilst Americans visited a grocery shop once or twice a week, the Chinese could stop by such a store every day. Even in the city of Shanghai, the capital of consumerism in China, the average spend per visit in a hypermarket was estimated at just US\$6 to 10.⁴⁸ As a result, the average cost of serving a customer greatly increased.

Fresh Means Alive

Chinese consumers had been raising their expenditure on food as their living standard improved, and expenditure on food accounted for the largest share of a mainlander's consumer expenditure. Wal-Mart stores in China had a high percentage of sales from its food section. To most Chinese, freshness of food was the most important factor in its quality, and in many cases, fresh meant alive. Therefore, to many Westerners' amazement, a Wal-Mart store in China sold many animals that were still alive, like fish, eels, frogs and even snakes. Customers' demand for absolute freshness combined with the poor transportation network required that a large variety of foods had to be procured locally instead of through Wal-Mart's centralised procurement system. Diminished economies of scale and interrupted supply chain meant higher costs in satisfying Chinese consumers.

Shoplifting

Shoplifting had always been a problem with chain stores and department stores in China. According to estimates, the retail sales sector lost US\$3 billion in 1997 to theft, and chain stores suffered the most.⁴⁹ Senior executives in retail complained that laws against shoplifting were ineffective in China, and that police officials paid little attention when complaints were lodged. The problem was aggravated by the presence of a considerable mass of transient population or "immigrants" from the poorer provinces. Shoplifting by employees could further complicate investigation.⁵⁰ The magnitude of the problem could take away as much as 5% of sales, compared to an international standard of 0.3%.⁵¹

The highly fragmented market, impaired distribution network and unique consumer behaviour in China pushed Wal-Mart's operating costs higher and worked against a straight duplication of its home model. There were also other challenges that worked against the model: associates' morale was not easy to maintain when they were paid low wages and did not have the upside of stock options; management turnover was high and Wal-Mart China was nicknamed the "training centre for Chinese retail management"; it was impossible to cut the

⁴⁸ "Ready for Warfare in the Aisles", *The Economist*, August 5th 2006.

⁴⁹ "Retailing in China: A Market Analysis", Access Asia Limited, 2003, p. 65.

⁵⁰ Lo, W.C. and Lau, G.S. (2001) "Problems and Prospects of Supermarket Development in China", *International Journal of Retail and Distribution Management*, 29(2).

⁵¹ "Retailing in China: A Market Analysis", Access Asia Limited, 2003, p. 65.

middlemen altogether when purchases were made from tens of thousands of very small suppliers; the law required a labour union to be formed in any organisation and China's labour officials openly condemned Wal-Mart for squeezing suppliers and making workers suffer; local competition was rising fiercely, supported by government policy and financial support and was sourcing from the same cheap sources while copying Wal-Mart's EDLP strategy.

Beyond the First Decade: "We've Just Begun"⁵²

The hard work has already been done. It doesn't mean the job is going to get easier.

- Joe Hatfield, president and CEO, Wal-Mart Asia⁵³

Wal-Mart's China headquarters, a low building tiled in white, was a testimonial of its frugality. Here, the linoleum conference table was blemished with gaps where the plywood showed through and tea was served in plastic cups. In Joe Hatfield's office, where he presided over Wal-Mart's Asian operations, the rusty window frame was open, the sound of car horns washing in from the street.⁵⁴ Despite the slow pace of expansion and prolonged losses, the president and CEO of Wal-Mart Asia, who had been on the driving seat of the retailer's Chinese business, seemed to be confident of the ultimate win of Wal-Mart's home model over China. "We have the core beliefs and operating strategy of American stores, but it is critically important to let Chinese customers understand those. We should crawl, walk and eventually run."⁵⁵

The fate of duplicating its domestic business model successfully in other parts of the world was further shadowed by its loss-making operations in Japan, its complete retreat in 2006 from Germany due to a failure to generate profits after bitterly struggling for nearly a decade, and a retreat from South Korea where it had ranked at the bottom among five major discount store operators.

Now that the door to the consumer market in China was open to all, could the retail giant eventually win over its competition with its successful American model? How should it implement such a model effectively in China's unique environment? The answer to these questions would come out of the small, tiled building which will open a new phase of Wal-Mart's corporate strategy in China and probably leave the world with another model case in international business expansion.

⁵² Sam Walton, quoted in Walmart Stores' 2005 Annual Report.

⁵³ Wonacott, P., "Walmart to Extend Reach in China: U.S. Retailer Gets Creative as it Builds on Local Groundwork", Asian Wall Street Journal, July 17th 2000.

⁵⁴ Goodman, P.S. and Pan, P.P., "Chinese Workers Pay for Walmart's Low Prices; Retailer Squeezes its Asian Suppliers to Cut Costs", Washington Post, February 8th 2004.

⁵⁵ "Walmart Asia President: I Hope to Retire in China", People's Daily, December 7th 2003.

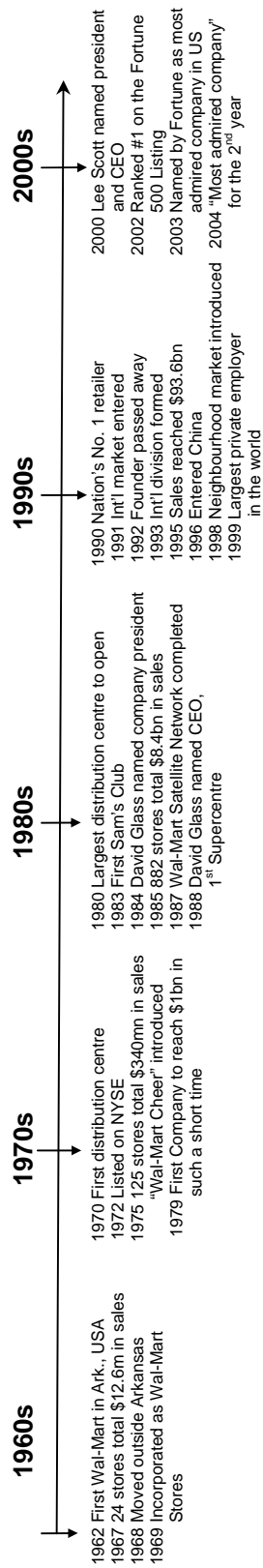
EXHIBIT 1: TOP 25 CHAIN STORES IN CHINA AT END OF 2004

	Company	Ownership Form	Sales (mn USD)	Growth from 2003 %	Number of Stores	Growth from 2003 %
1	Bailian (Group) Co. Ltd.	State-Owned	8,453	22	5,493	25
2	Gome Electronics Co. Ltd.	Private	2,985	34	227	63
3	Dalian Dashang Group Co. Ltd.	State-Owned	2,886	27	120	25
4	Suning Electronics Chain Stores	Private	2,764	80	193	30
5	Carrefour (China)	Joint Venture	2,030	21	62	51
6	Beijing Hualian	State-Owned	2,000	18	70	13
7	Shanghai Yongle	Joint Venture	1,981	62	108	71
8	Suguo Supermarket Co. Ltd.	Joint Venture	1,735	45	1,345	16
9	NongGongShang Supermarkets	State-Owned	1,713	11	1,232	2
10	Beijing Wu Mart Group	Private	1,660	56	606	17
11	Sanlian Shangshe	Private	1,657	24	254	26
12	Chongqing Shangshe	State-Owned	1,639	18	153	16
13	Trust-Mart	Joint Venture	1,500	155	88	226
14	Parkson	Joint Venture	1,484	26	1,400	27
15	China Resources Vanguard Co. Ltd.	Joint Venture	1,377	7	476	2
16	Jiangsu Wuxing Electronics	Private	1,172	84	120	25
17	Shenyhen Xinyijia	Private	1,063	44	58	26
18	Wushang Group	State-Owned	982	12	39	26
19	Jiangsu Wenfeng Big World Chain	State-Owned	955	34	506	55
20	Wal-Mart (China)	Joint Venture	954	30	43	30
21	Lotus (China) Chain	Joint Venture	924	40	41	86
22	Hefei Baihuo Dalou	State-Owned	913	26	49	32
23	Jia Shi Jie	Private	903	37	69	41
24	Jinjiang Metro	Joint Venture	807	15	23	28
25	Renrenle Chain	Private	775	93	32	113

Note: Numbers in RMB have been converted to US\$ at RMB8 = 1US\$.

Source: China Chain Store Association, March 17th 2005.

EXHIBIT 2: WAL-MART TIMELINE



Source: Adapted from the Wal-Mart stores' website: <http://www.Wal-Martstores.com>.

**EXHIBIT 3: OPERATING INFORMATION OF WAL-MART STORES
1970 TO 2005 (IN MILLION US\$)**

	Net Sales	Cost of sales	Operating, SG&A	Net Income	Number of Stores
2005	285,222	219,793	51,105	10,267	5,289
2004	256,329	198,747	44,909	9,054	4,906
2003	229,616	178,299	39,983	7,955	4,672
2002	204,001	159,097	35,147	6,592	4,398
2001	180,787	140,720	30,822	6,235	4,172
2000	156,249	121,825	26,025	5,324	3,983
1999	130,522	102,490	21,778	4,397	3,591
1998	112,005	88,163	18,831	3,504	3,394
1997	99,627	78,897	16,437	3,042	3,054
1996	89,051	70,485	14,547	2,737	2,943
1995	78,338	61,929	12,434	2,681	2,784
1990	25,810	20,070	4,070	1,076	1,525
1985	6,401	4,722	1,181	271	756
1980	1,248	919	252	41	276
1975	236	177	48	6	104
1970	31	23	6	1	18

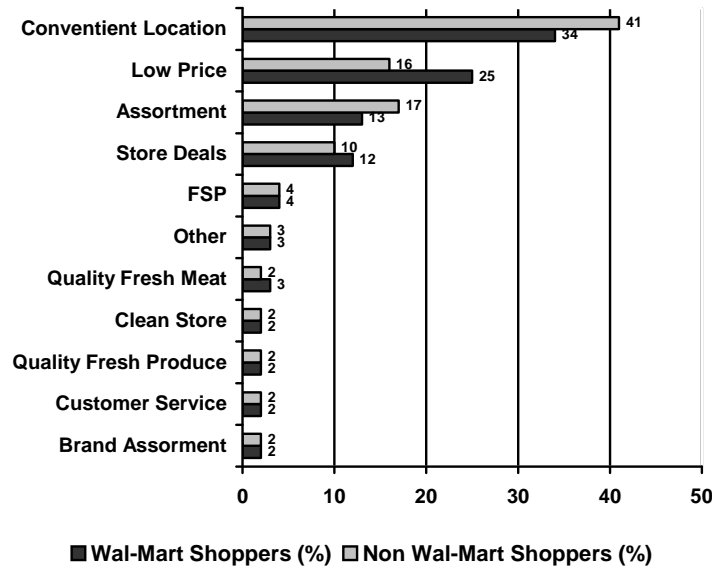
Source: Compiled from annual reports of Wal-Mart stores.

EXHIBIT 4: STORE FORMATS AT WAL-MART STORES

Format	Year of Start	Description
Wal-Mart Discount Stores	1962	The flagship retail division of Wal-Mart Stores. A national discount retailer offering a wide variety of general merchandise. Wal-Mart stores offer a Pharmacy Department, Tire & Lube Express, garden centre, snack bar or restaurant, Vision Center and One-Hour Photo Processing.
Sam's Club	1983	Sam's Club is the largest membership warehouse club in the US, focusing on serving small business owners. Each Club is consistently stocked with 1,500 core business items. It offers "members only" prices.
Supercentres	1988	This store format combines a full line of groceries and general merchandise department. Supercentres also often include Wal-Mart Specialty Shops such as the Vision Center, Tire & Lube Express and One-Hour Photo Processing.
Neighbourhood Markets	1998	Neighbourhood Markets serve customers who need groceries, medicines and general merchandise. Generally, they are located in markets with Wal-Mart Supercentres, supplementing a strong food distribution network and providing added convenience while maintaining the EDLP philosophy.

Source: Adapted from Wal-Mart stores' website: <http://www.Wal-Martstores.com>.

EXHIBIT 5: PRIMARY REASON FOR SHOPPING AT A GROCERY STORE



Source: ACNielsen HomeScan.

EXHIBIT 6: SAM'S TEN RULES

1.	Commit to your business
2.	Share your profits with all your associates, and treat them as partners
3.	Motivate your partners
4.	Communicate everything you possibly can to your partners
5.	Appreciate everything your associates do for the business
6.	Celebrate your success
7.	Listen to everyone in your company
8.	Exceed your customers' expectations
9.	Control your expenses better than your competition
10.	Swim upstream

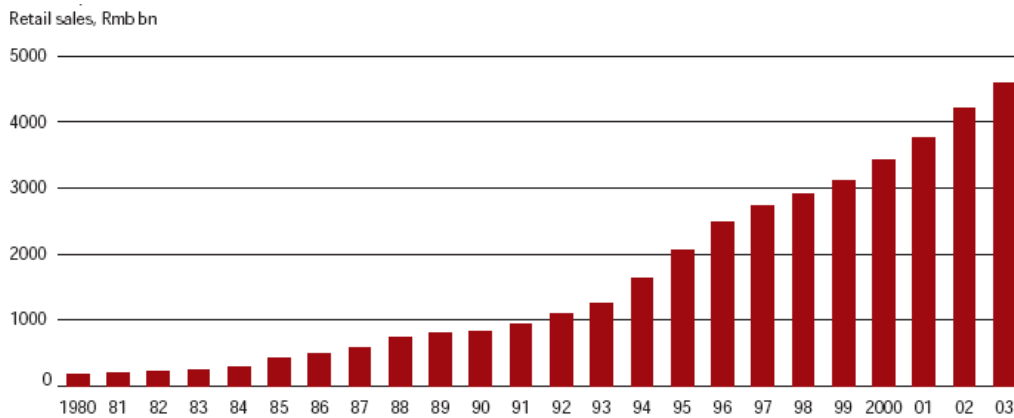
Source: Slater R. (2003) *The Wal-Mart Decade*, Penguin Books: London.

EXHIBIT 7: WAL-MART'S INTERNATIONAL OPERATION

	Year of Entry	Number of Stores in Jan. 2005			
		Supercenters	Sam's Club	Discount Stores	Neighborhood Market
Argentina	1995	11	0	0	0
Brazil	1995	17	12	118	2
Canada	1994	0	6	256	0
China	1996	38	3	0	2
Germany	1998	91	0	0	0
Korea	1998	16	0	0	0
Mexico	1991	89	61	529	0
Puerto Rico	1992	4	61	9	32
United Kindom	1999	19	0	263	0

Source: Wal-Mart stores' annual reports.

EXHIBIT 8: RETAIL MARKET GROWTH IN CHINA FROM 1980 TO 2003



Source: Economist Intelligence Unit.

EXHIBIT 9: RETAIL SALES AND SALES PERCENTAGE BREAKDOWN BY HABITATION

Retail Sales by Habitation:

USD bn	1996	1997	1998	1999	2000	2001	2002
Urban sales	162.8	186.2	203.2	219.2	243.5	269.6	289.7
% growth	20.3	14.4	9.1	7.9	11.1	10.8	7.5
Rural sales	152.8	157.2	158.9	164.3	175.9	182.4	189.5
% growth	14.5	2.9	1.0	3.4	7.1	3.7	3.9
Total retail sales	315.6	343.5	362.1	383.5	419.3	452.0	479.3
% growth	17.4	8.8	5.4	5.9	9.4	7.8	6.0

Retail Sales Percentage Breakdown by Habitation:

%	1996	1997	1998	1999	2000	2001	2002
Urban	51.6	54.2	56.1	57.2	58.1	59.7	60.5
Rural	48.4	45.8	43.9	42.8	42.0	30.4	39.6
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Adapted from “Retailing in China: A Market Analysis”, Access Asia Limited, 2003.

EXHIBIT 10: MAP OF CHINA



EXHIBIT 11: WTO: CONSUMER MARKET TIMELINES

Retailing	
Before WTO	Foreign firms can set up minority-controlled Joint Ventures (JVs) in Special Economic Zones (Hainan, Shantou, Shenzhen, Xiamen, Zhuhai), major cities (Beijing, Dalian, Guangzhou, Qingdao, Shanghai, Tianjin, Wuhan, Zhengzhou). JVs may retail most products except books, magazines and newspapers.
2003	Foreign firms may take majority stakes in JVs. JV retailers allowed to operate in all provincial capitals plus Chongqing and Ningbo.
2004	All geographic restrictions lifted. Full foreign ownership of JVs permitted (except those retailing chemical fertilizers or operating certain chain stores with more than 30 outlets). All restrictions on foreign ownership in franchising lifted.
2006	Foreign retailers allowed to trade chemical fertilizers.
2007	All restrictions lifted on foreign ownership of chain store operations.

Distribution and Logistics	
Before WTO	Foreign companies can establish JVs to undertake commission agency business and wholesaling of imported and domestically manufactured products except printed materials, pharmaceuticals and agricultural chemicals. Foreign ownership of warehouses allowed up to 49%, rising to 100% in 2003.
2003	Foreign companies can assume majority ownership of distribution JV businesses, foreign freight forwarders can establish second JVs.
2004	Foreign firms have full distribution rights for rental, leasing, air courier, freight forwarding, storage, wholesale, transport, maintenance and servicing. Foreign firms can start to distribute printed materials, pharmaceuticals and agricultural chemicals as well as crude oil.
2005	All restrictions on foreign involvement in warehousing, advertising and packaging services removed. Wholly foreign owned freight forwarding subsidiaries can be established.

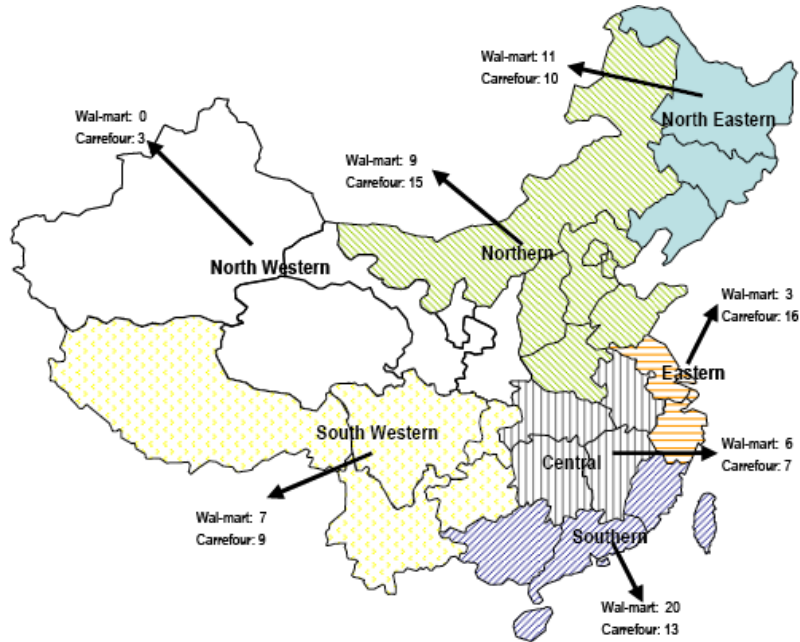
Source: Adapted from China's Consumer Market 2004, Access Asia Limited

EXHIBIT 12: MAJOR FOREIGN CHAIN STORES IN 2004

	Country	Sales (RMBmn)	No. of Stores	Some Expansion Plans Announced in Early 2005
Carrefour	France	16,241	62	- Set up 4 regional HQs (Eastern, Western, Northern, and Southern China); - To open 1000 stores in the next 3 to 5 years.
Suguo	HK	13,880	70	
Trust Mart	Taiwan	12,000	88	- Number of stores to reach 106 and sales to reach US\$1.8 to 1.9 bn in 2005; - Capital increase of US\$30m for expansion; - Operating on 4 regional HQs and to have 4 logistics centres.
CRC Vanguard	HK	11,014	476	
RT Mart	Taiwan	9,500	40	
Wal-Mart	US	7,635	43	- Number of stores to reach 52 in 2005 and 13 more in 2006; - Put more stores in city centre instead of the suburbs and focus on 2nd, 3rd tier cities.
Lotus	Thailand	7,394	41	- Number of stores to reach 67 in 2005, and 100 by end of 2006.
Hymall (Tesco)	UK	7,000	31	- Number of stores to reach 38 in 2005 and 150 by 2008.
Metro	Germany	6,459	23	- Number of stores to reach 27 in 2005 and 40 more in the next 3 to 5 years.
Auchan	France	3,512	11	- Number of stores to reach 13 by mid-2005 and to open 3 to 4 per year. - Beijing, Shanghai and Chengdu as regional expansion centres.
ParknShop	HK	2,750	31	- Number of stores to reach 100 by 2008.
Ito Yokado	Japan	2,900	5	- 10 hypermarkets and 54 franchised supermarkets in Beijing by 2008.

Source: "Supermarkets: Filling up the Shopping Bags", BOC International, January 16th 2006.

EXHIBIT 13: CARREFOUR AND WAL-MART —CHINA STORE MAP IN 2005



Source: “Intensifying Overseas Competition”, Merrill Lynch, June 7th 2006.

EXHIBIT 14: THREE CHINAS—REGIONAL INCOME DISPARITY

	Population (millions)	GDP per capita (US\$)	Share of national GDP %
Coastal region	482	2,117	58
Shanghai	16	4,909	
Beijing	14	3,436	
Tianjin	10	2,703	
Zhejiang	47	2,034	
Guangdong	79	1,815	
Jiangsu	74	1,738	
Fujian	35	1,630	
Shandong	91	1,406	
Hebei	67	1,101	
Liaoning	42	1,007	
Hainan	8	942	
Interior region	710	765	38
Heilongjiang	38	1,230	
Jilin	27	1,007	
Hubei	67	1,005	
Hunan	66	793	
Henan	96	777	
Chongqing	31	767	
Shanxi	33	742	
Jiangxi	42	704	
Anhui	63	703	
Sichuan	87	696	
Shaanxi	37	667	
Guangxi	48	616	
Guizhou	38	381	
Western region	83	773	4
Xinjiang	19	1,012	
Nei Mongol	24	875	
Qinghai	5	776	
Xizang	3	736	
Ningxia	6	701	
Yunnan	43	625	
Gansu	26	543	

Source: Woetzel, Jonathan R. (2004) "A Guide to Doing Business in China", McKinsey Quarterly.

EXHIBIT 15: WAL-MART STORES IN CHINA, 2005

Store Format	Location (City)
Supercentres	Shenzhen, Shanghai, Beijing, Tianjin, Nanjing, Kunming, Chongqing, Fuzhou, Xiamen, Shantou, Dongguan, Harbin, Dalian, Changchun, Shenyang, Changsha, Nanchang, Wuhan, Ji'nan, Qingdao, Taiyuan, Guiyang, Nanning
Hypermarkets	Shenzhen, Beijing
Sam's Club	Shenzhen, Beijing, Fuzhou
Neighbourhood Store	Shenzhen, Beijing

Source: Wal-Mart stores' website: <http://www.Wal-Martstores.com>.