roadblocks to production, major producers like BP, ExxonMobil, and Shell are investing heavily in areas like the Caspian Basin, the Gulf of Mexico, and Angola and are trying to enter areas like the Russian Federation. Production in these areas is expected to grow significantly.

Another problem is that higher oil prices could depress growth worldwide and thus lower demand for oil. Also, because of OPEC's power, for the most part its countries have been able to avoid competitive pressures to improve their industries—and some are, therefore, decades out of date.[55]

Political and social forces are also affecting oil prices. High oil prices have permitted President Hugo Chávez of Venezuela to spend millions on domestic poverty programs and foreign aid while underinvesting in Venezuela's oil infrastructure. As long as prices are high, he has no incentive to balance his priorities between spending and investment. When prices fell, however, he began to face the twin problems of deteriorating production and social unrest.

Walmart Goes South

Comercial Mexicana S.A. (Comerci), one of Mexico's largest retail chains, is faced with a serious dilemma.[56] Since Walmart's aggressive entry into the Mexican retail market, Comerci has found it increasingly difficult to remain competitive. Walmart's strong operating presence and low prices since NAFTA's lifting of tariffs have put pressure on Comerci, and now management must determine if Comerci's recent participation with the purchasing consortium Sinergia will be sufficient to compete against Walmart.

What's caused this intense competitive pressure on Comerci, and what is likely to be its future? Mexico's retail sector has benefited greatly from the increasing trade liberalization the government has been pushing. After decades of protectionism, Mexico joined GATT in 1986 to help open its economy to new markets. In 1990, with Mexico's economy on the upswing and additional free trade negotiations with the United States and Canada taking place, the founder of Walmart, Sam Walton, met with the president of Cifra, Mexico's leading retail store. Their meeting resulted in a 50/50 joint venture in the opening of Mexico's first Sam's Club, a subsidiary of Walmart, in 1991 in Mexico City.

It only took a couple of months after the opening to prove the store's success—it was breaking all the U.S. records for Sam's Club. The joint venture evolved to incorporate all new stores, and by 1997, Walmart purchased enough shares to have a controlling interest in Cifra. In 2000, the name changed to Walmart de México, S.A. de C.V., and the ticker symbol to WALMEX.

Prior to 1990, Walmart had never made moves to enter Mexico or any country other than the United States. Once Walmart started growing in Mexico, management created the Walmart International Division in 1993. By 2009, Walmart had expanded internationally to 15 countries outside the continental United States through new-store construction and acquisitions. It now operates in Argentina, Brazil, Canada, Chile, China, Costa Rica, El Salvador, Guatemala, Honduras, India, Japan, Mexico, Nicaragua, Puerto Rico, and the United Kingdom. Walmart serves customers and members more than 200 million times weekly through its international operations.

With growth stalling in the United States, Walmart is looking to international expansion for growth. It currently has over 8,000 retail units worldwide, of which 3,659 are outside the continental United States, and it employs 680,000 people outside the U.S. In December 2005 alone, it acquired 545 new stores and increased its personnel by 50,000 in Japan and South America. In fiscal year 2009, the international division increased sales over the previous

year by 9.1 percent—to $98.6 billion. The international division accounts for approximately 24.6 percent of sales.

Nevertheless, Walmart's success internationally has varied by country. It has struggled to match consumer preferences and work successfully with suppliers in Japan, encountered trouble in the United Kingdom, and failed to turn profits in Germany and South Korea, forcing it to withdraw completely from both markets. However, it has flourished in Canada and, most notably, in Mexico. Walmart's operations in Canada began in 1994 with the acquisition of 122 Woolco stores. It now has more than 254 Walmart stores and 58 Supercenters and enjoys strong partnerships with Canadian suppliers. In Mexico, Walmart operates 1,242 units, including Sam's Clubs, Bodegas (discount stores), Walmart Supercenters, Superamas (grocery stores), Suburbias (apparel stores), and VIPS restaurants, and it has become the largest retailer in the country.

Given its hit-and-miss success rate on the international scene, it is natural to wonder how much of Walmart's triumph in Canada and Mexico has stemmed from its internal processes, international strategies, and geographic proximity and how much can be attributed to the close economic ties shared by the United States with the two countries through NAFTA.

Walmart's Competitive Advantage

Much of Walmart's international success comes from the tested practices on which the U.S. division bases its success. Walmart is known for the slogan "Every Day Low Prices." It has expanded that internally to "Every Day Low Costs" to inspire employees to spend company money wisely and work hard to lower costs. Because of its sheer size and volume of purchases, Walmart can negotiate with suppliers to drop prices to agreeable levels.

It also works closely with suppliers on inventory levels using an advanced information system that informs suppliers when purchases have been made and when Walmart will be ordering more merchandise. Suppliers can then plan production runs more accurately, thus reducing production costs, resulting in cost savings for Walmart, which then can pass on the savings to the consumer as lower prices.

Walmart also has a unique distribution system that reduces expenses. It builds super warehouses known as Distribution Centers (DCs) in central locations that receive the majority of merchandise sold in Walmart stores. It sorts and moves the merchandise via a complex system of bar codes, and its inventory information system then transports it to the various stores, using its company-owned fleet or a partner. The central distribution center helps Walmart negotiate lower prices with its suppliers because of the large purchasing volumes.

These strategies have resulted in great success for Walmart. And it even uses the second most powerful computer in the world—behind the Pentagon's—to run its logistics.

Walmart in Mexico

Despite its current success in the region, Walmart encountered some difficulties with its opening in Mexico prior to the passage of NAFTA. One of the biggest challenges it faced was import charges on many of the goods sold in its stores, thus preventing Walmart from being able to offer its "Every Day Low Prices."

Unsure of local demand, Walmart stocked its shelves with things like ice skates, fishing tackle, and riding lawnmowers—all unpopular items in Mexico. Rather than informing headquarters that they wouldn't need those items, local managers heavily discounted the items, only to have the automatic inventory system reorder the products when the first batch sold. Walmart also encountered logistics problems due to poor roads and the scarcity of delivery trucks. Yet another problem was the culture clashes between the Arkansas executives and the local Mexican managers.

Some of these problems were solved by trial and error, but the emergence of NAFTA in 1994 helped solve most of the problems. Among other things, NAFTA reduced tariffs on American goods sold to Mexico from 10 to 3 percent. Prior to NAFTA, Walmart was not much of a threat to companies like Comerci, Gigante, and Soriana, Mexico's top retailers. But once the agreement was signed, the barriers fell and Walmart was on a level playing field with its competitors—all it needed to become number one.

NAFTA encouraged Mexico to improve its transportation infrastructure, thus helping to solve Walmart's logistical problems. The signing of NAFTA also opened the gates wider to foreign investment in Mexico. Walmart was paying huge import fees on goods shipped to Mexico from areas like Europe and Asia. Foreign companies knew that if they built manufacturing plants in Mexico, they could keep costs low with Mexican labor and also ship to NAFTA's free trade zone—Mexico, the United States, or Canada.

As companies began to build manufacturing plants in Mexico, Walmart could buy these products without paying the high import tariffs. An example of this tactic is Sony's flat screen television line, Wega. Sam's Clubs in Mexico imported Wega TVs from Japan with a 23 percent import tariff plus huge shipping costs, resulting in a $1,600 retail price at Sam's Club. In 1999, Sony built a manufacturing plant in Mexico, thus allowing Sam's Club to purchase the Wegas without import tariffs; this tactic also yields much lower shipping fees. Sam's Clubs passed on the savings to customers—with a retail price of only $600. As noted earlier in the chapter, Sony has expanded its manufacturing facility in Tijuana to produce flat-screen TVs that can be used to supply the local market or export to the United States.

The benefits of NAFTA, such as lower tariffs and improved infrastructure, helped not only Walmart but also its competitors, like Comerci. But Walmart used the advantages of NAFTA better than anyone else. Rather than pocketing the differences the lower tariffs made, Wal-Mart reduced its prices. In 1999, it closed one of its Supercenters for a day to discount up to 6,000 items by 14 percent.

Comerci and others have combated Walmart's tactics by lowering their own prices, but on many items, they can't get the prices as low. Walmart's negotiating power with its suppliers is large enough that it can get the better deal. Also, most of Mexico's retailers priced goods differently. They were used to putting certain items on sale or at deep discount, a strategy known as "high and low," rather than lowering all prices. They have been trying to adjust their pricing structure to match Walmart's, but they are still frustrated with Walmart's continued cost cutting. Competitors and certain suppliers are so angry that they have gone to Mexico's Federal Competition Commission (known in Mexico as *CoFeCo*) with complaints of unfair pricing practices.

Formation of Sinergia

Unable to compete with Walmart under the new conditions, Comerci has been faced with extinction. Walmart is the largest retailer in Mexico and owns more than half of all retail sales, has captured 55 percent of the Mexican retail market, and has become the largest private employer in Mexico with 140,000 employees.

Fear over the giant retailer's predominance and over its unexplained withdrawal from the Mexican National Association of Department Stores (ANTAD) in 2004 prompted Comerci to band with two other struggling homegrown supermarket chains, Soriana and Gigante, to form a purchasing consortium that would allow them to negotiate better bulk prices from suppliers.

The collaboration, known as *Sinergia,* was initially rejected by CoFeCo and met resistance from the Consumer Product Council of Mexico, a 46-member organization representing major consumer goods companies, which feared that Sinergia would use its purchasing power to force unreasonably low prices on suppliers. However, after its second presentation to CoFeCo, the consortium was at last approved, provided that it issue regular reports to CoFeCo outlining the nature of its purchasing agreements and that it sign confidentiality agreements with the participating chains to prevent price-fixing and monopolistic behavior.

As a representative body with no assets, Sinergia's purchases are currently limited to only local suppliers, and its future is still uncertain.

Should Sinergia fail to improve the situation, Comerci could try to duplicate the efforts of its Sinergia partner Soriana, which is attempting, with some notable success, to differentiate itself from Walmart by offering products and a store atmosphere that appeal more to Mexicans' middle-class aspirations.

The government may give Comerci a break if it rules against Walmart's aggressive pricing, but as one analyst put it, "We do not believe the CFC will end up penalizing Walmart for exercising its purchasing power in an attempt to get the best deals available in the marketplace, which is the goal of every retailer in the world, especially when [these savings] are ultimately passed on to consumers." One thing is certain, however: Comerci cannot afford to sit still. ■

QUESTIONS

1. How has the implementation of NAFTA affected Walmart's success in Mexico?
2. How much of Walmart's success is due to NAFTA, and how much is due to Walmart's inherent competitive strategy? In other words, could any other U.S. retailer have the same success in Mexico post-NAFTA, or is Walmart a special case?
3. What has Comerci done in its attempt to remain competitive? What are the advantages and challenges of such a strategy, and how effective do you think it will be?
4. What else do you think Comercial Mexicana S.A. should do, given the competitive position of Walmart?

SUMMARY

- The General Agreement on Tariffs and Trade (GATT), begun in 1947, created a continuing means for countries to negotiate the reduction and elimination of trade barriers and to agree on simplified mechanisms for the conduct of international trade.
- The World Trade Organization (WTO) replaced GATT in 1995 as a continuing means of trade negotiations that aspires to foster the principle of trade without discrimination and to provide a better means of mediating trade disputes and of enforcing agreements.
- Efforts at regional economic integration began to emerge after World War II as countries saw benefits of cooperation and larger market sizes. The major types of economic integration are the free trade area and the customs union, followed by broader economic and political integration in the common market.
- Free trade agreements result in trade creation and trade diversion as barriers drop for member countries but remain higher for nonmember countries. There are static effects of the reduction of trade barriers. The static effects of economic integration improve the efficiency of resource allocation and affect both production and consumption. The dynamic effects are internal and external efficiencies that arise because of changes in market size.
- Once protection is eliminated among member countries, trade creation allows MNEs to specialize and trade based on comparative advantage.
- Trade diversion occurs when the supply of products shifts from countries that are not members of an economic bloc to those that are.
- Regional, as opposed to global, economic integration occurs because of the greater ease of promoting cooperation on a smaller scale.
- The European Union (EU) is an effective common market that has abolished most restrictions on factor mobility and is harmonizing national political, economic, and social policies. It is composed of 27 countries, including 12 countries from mostly Central and Eastern Europe that joined since 2004. The EU has abolished trade barriers on intrazonal trade, instituted a common external tariff, and created a common currency, the euro.
- The North American Free Trade Agreement (NAFTA) is designed to eliminate tariff barriers and liberalize investment opportunities and trade in services. Key provisions in NAFTA are labor and environmental agreements.
- There are key trade groups in other parts of the world, including Latin America, Asia, and Africa.
- The United Nations is composed of representatives of most of the countries in the world and influences international trade and development in a number of significant ways.
- Many developing countries rely on commodity exports to supply the hard currency they need for economic development. Instability in commodity prices has resulted in fluctuations in export earnings. OPEC is an effective commodity agreement in terms of attempting to stabilize supply and price.