

THE WAL-MART YOU DON'T KNOW: WHY LOW PRICES HAVE A HIGH COST¹

Charles Fishman

A gallon-sized jar of whole pickles is something to behold. The jar is the size of a small aquarium. The fat green pickles, floating in swampy juice, look reptilian, their shapes exaggerated by the glass. It weighs 12 pounds, too big to carry with one hand. The gallon jar of pickles is a display of abundance and excess; it is entrancing, and also vaguely unsettling. This is the product that Wal-Mart fell in love with: Vlasic's gallon jar of pickles.

Wal-Mart priced it at \$2.97—a year's supply of pickles for less than \$3! "They were using it as a 'statement' item," says Pat Hunn, who calls himself the "mad scientist" of Vlasic's gallon jar. "Wal-Mart was putting it before consumers, saying, This represents what Wal-Mart's about. You can buy a stinkin' gallon of pickles for \$2.97. And it's the nation's number-one brand."

Therein lies the basic conundrum of doing business with the world's largest retailer. By selling a gallon of kosher dills for less than most grocers sell a quart, Wal-Mart may have provided a service for its customers. But what did it do for Vlasic? The pickle maker had spent decades convincing customers that they should pay a premium for its brand. Now Wal-Mart was practically giving them away. And the fevered buying spree that resulted distorted every aspect of Vlasic's operations, from farm field to factory to financial statement.

Indeed, as Vlasic discovered, the real story of Wal-Mart, the story that never gets told, is the story of the pressure the biggest retailer relentlessly applies to its suppliers in the name of bringing us "everyday low prices." It's the story of what that pressure does to the companies Wal-Mart does business with, to U.S. manufacturing, and to the economy as a whole. That story can be found floating in a gallon jar of pickles at Wal-Mart.

Wal-Mart is not just the world's largest retailer. It's the world's largest company, bigger than Exxon Mobil, General Motors, and General Electric. The scale can be hard to absorb. Wal-Mart sold \$244.5 billion worth of goods last year. It sells in three months what number-two retailer Home Depot sells in a year. And in its own category of general merchandise and groceries, Wal-Mart no longer has any real rivals. It does more business than Target, Sears, Kmart, J.C. Penney, Safeway, and Kroger combined. "Clearly," says Edward Fox, head of Southern Methodist University's J.C. Penney Center for Retailing Excellence, "Wal-Mart is more powerful than any retailer has ever been." It is, in fact, so big and so furtively powerful as to have become an entirely different order of corporate being.

Wal-Mart wields its power for just one purpose: to bring the lowest possible prices to its customers. At Wal-Mart, that goal is never reached. The retailer has a clear policy for suppliers: On basic products that don't change, the price Wal-Mart will pay, and will charge shoppers, must drop year after year. But what almost no one outside the world of Wal-Mart and its 21,000 suppliers knows is the high cost of those low prices. Wal-Mart has the power to squeeze profit-killing concessions from vendors. To

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survive in the face of its pricing demands, makers of everything from bras to bicycles to blue jeans have had to lay off employees and close U.S. plants in favor of outsourcing products from overseas.

Of course, U.S. companies have been moving jobs offshore for decades, long before Wal-Mart was a retailing power. But there is no question that the chain is helping accelerate the loss of American jobs to low-wage countries such as China. Wal-Mart, which in the late 1980s and early 1990s trumpeted its claim to “Buy American,” has doubled its imports from China in the past five years alone, buying some \$12 billion in merchandise in 2002. That’s nearly 10% of all Chinese exports to the United States.

One way to think of Wal-Mart is as a vast pipeline that gives non-U.S. companies direct access to the American market. “One of the things that limits or slows the growth of imports is the cost of establishing connections and networks,” says Paul Krugman, the Princeton University economist. “Wal-Mart is so big and so centralized that it can all at once hook Chinese and other suppliers into its digital system. So—wham!—you have a large switch to overseas sourcing in a period quicker than under the old rules of retailing.”

Steve Dobbins has been bearing the brunt of that switch. He’s president and CEO of Carolina Mills, a 75-year-old North Carolina company that supplies thread, yarn, and textile finishing to apparel makers—half of which supply Wal-Mart. Carolina Mills grew steadily until 2000. But in the past three years, as its customers have gone either overseas or out of business, it has shrunk from 17 factories to 7, and from 2,600 employees to 1,200. Dobbins’s customers have begun to face imported clothing sold so cheaply to Wal-Mart that they could not compete even if they paid their workers nothing.

“People ask, ‘How can it be bad for things to come into the U.S. cheaply? How can it be bad to have a bargain at Wal-Mart?’ Sure, it’s held inflation down, and it’s great to have bargains,” says Dobbins. “But you can’t buy anything if you’re not employed. We are shopping ourselves out of jobs.”

There is no question that Wal-Mart’s relentless drive to squeeze out costs has benefited consumers. The giant retailer is at least partly responsible for the low rate of U.S. inflation, and a McKinsey & Co. study concluded that about 12% of the economy’s productivity gains in the second half of the 1990s could be traced to Wal-Mart alone.

There is also no question that doing business with Wal-Mart can give a supplier a fast, heady jolt of sales and market share. But that fix can come with long-term consequences for the health of a brand and a business. Vlastic, for example, wasn’t looking to build its brand on a gallon of whole pickles. Pickle companies make money on “the cut,” slicing cucumbers into spears and hamburger chips. “Cucumbers in the jar, you don’t make a whole lot of money there,” says Steve Young, a former vice president of grocery marketing for pickles at Vlastic, who has since left the company.

At some point in the late 1990s, a Wal-Mart buyer saw Vlastic’s gallon jar and started talking to Pat Hunn about it. Hunn, who has also since left Vlastic, was then head of Vlastic’s Wal-Mart sales team, based in Dallas. The gallon intrigued the buyer. In sales tests, priced somewhere over \$3, “the gallon sold like crazy,” says Hunn, “surprising us all.” The Wal-Mart buyer had a brainstorm: What would happen to the gallon if they offered it nationwide and got it below \$3? Hunn was skeptical, but his job was to look for ways to sell pickles at Wal-Mart. Why not?

And so Vlastic's gallon jar of pickles went into every Wal-Mart, some 3,000 stores, at \$2.97, a price so low that Vlastic and Wal-Mart were making only a penny or two on a jar, if that. It was showcased on big pallets near the front of stores. It was an abundance of abundance. "It was selling 80 jars a week, on average, in every store," says Young. Doesn't sound like much, until you do the math: That's 240,000 gallons of pickles, just in gallon jars, just at Wal-Mart, every week. Whole fields of cucumbers were heading out the door.

For Vlastic, the gallon jar of pickles became what might be called a devastating success. "Quickly, it started cannibalizing our non-Wal-Mart business," says Young. "We saw consumers who used to buy the spears and the chips in supermarkets buying the Wal-Mart gallons. They'd eat a quarter of a jar and throw the thing away when they got moldy. A family can't eat them fast enough."

The gallon jar reshaped Vlastic's pickle business: It chewed up the profit margin of the business with Wal-Mart, and of pickles generally. Procurement had to scramble to find enough pickles to fill the gallons, but the volume gave Vlastic strong sales numbers, strong growth numbers, and a powerful place in the world of pickles at Wal-Mart. Which accounted for 30% of Vlastic's business. But the company's profits from pickles had shriveled 25% or more, Young says—millions of dollars. The gallon was hoisting Vlastic and hurting it at the same time.

Young remembers begging Wal-Mart for relief: "They said, 'No way,'" says Young. "We said we'll increase the price"—even \$3.49 would have helped tremendously—"and they said, 'If you do that, all the other products of yours we buy, we'll stop buying.' It was a clear threat." Hunn recalls things a little differently, if just as ominously: "They said, 'We want the \$2.97 gallon of pickles. If you don't do it, we'll see if someone else might.' I knew our competitors were saying to Wal-Mart, 'We'll do the \$2.97 gallons if you give us your other business.' Wal-Mart's business was so indispensable to Vlastic, and the gallon so central to the Wal-Mart relationship, that decisions about the future of the gallon were made at the CEO level."

Finally, Wal-Mart let Vlastic up for air. "The Wal-Mart guy's response was classic," Young recalls. "He said, 'Well, we've done to pickles what we did to orange juice. We've killed it. We can back off.'" Vlastic got to take it down to just over half a gallon of pickles, for \$2.79. Not long after that, in January 2001, Vlastic filed for bankruptcy although the gallon jar of pickles, everyone agrees, wasn't a critical factor.

By now, it is accepted wisdom that Wal-Mart makes the companies it does business with more efficient and focused, leaner and faster. Wal-Mart itself is known for continuous improvement in its ability to handle, move, and track merchandise. It expects the same of its suppliers. But the ability to operate at peak efficiency only gets you in the door at Wal-Mart. Then the real demands start. The public image Wal-Mart projects may be as cheery as its yellow smiley-face mascot, but there is nothing genial about the process by which Wal-Mart gets its suppliers to provide tires and contact lenses, guns and underarm deodorant at everyday low prices. Wal-Mart is legendary for forcing its suppliers to redesign everything from their packaging to their computer systems. It is also legendary for quite straightforwardly telling them what it will pay for their goods.

John Fitzgerald, a former vice president of Nabisco, remembers Wal-Mart's reaction to his company's plan to offer a 25-cent newspaper coupon for a large bag of Lifesavers in advance of Halloween. Wal-Mart told Nabisco to add up what it would