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Case Study: Why Walmart Failed in Germany?

Wal-Mart, the mega-retailer, was founded by Sam Walton in 1962 in Bentonville, Arkansas. It started with $700,000 in its first year and scaled up to $5.4 million by 1974. The retailer continues to grow while others struggled with inflation and recessions. In 1980, Wal-Mart became the youngest US retailer to exceed $1 billion in net sales. During the 1980s, Wal-Mart began to further expand and thus pushing some retailers to closing some of their regional stores. The company engaged in diversification by creating membership-stores such as Sam's Club, smaller, more conventional pharmacy/grocery stores called Neighborhood Markets, and finally Supercenters with a wide selection of consumer goods. And, in 1991, Wal-Mart became the world's largest retailer.

Wal-Mart had been able to implement its Every Day Low Price strategy by focusing on 1) developing a sophisticated logistics system with heavy information technology investments, 2) efficient distribution system by placing retail stores close to distributi centers and using RFID technology, and 3) being a non-union employer.

Wal-Mart was a relative latecomer to international retailing. It started in 1991 by opening two stores through a joint venture in Mexico. Then, by 1997, it had 41 stores in Mexico and had also expanded to Argentina, Brazil, China, Germany, Korea, Japan and the UK.

With the largest economy in Europe, Germany comprised around 15% of Europe's annual retail market in 2001. In 1997, Wal-Mart moved into the German market through acquiring the Wertkauf chain (24 stores) and unprofitable Interspar chain (74 stores). The two chains made up only less than 3% of the market. The Interspar stores were in poor repair and in poor locations. The leading German retailer was Metro Group followed by Rewe Group. Germany's top ten retailers captured 30% of the total retail sales in 2001.

Retail market growth rates had averaged at 0.3% per year in the 1990s. Profit margins in Germany were also low for retailers compared to retailers' margins in other European countries. Bankruptcy filings were numerous. In 2002, 10,000 retail stores filed for bankruptcy. This points towards a competitive landscape that might prove to be challenge for Wal-Mart to succeed in.

Wal-Mart's initial strategy was to refurbish the stores to improve appearance and maintain price leadership through cost leadership as they had done in the US market. They would overhaul the supply chain systems, and incorporate new scanning systems, centralized distribution, and high quality customer service. By doing so, Wal-Mart had created a fierce price war in Germany.

According to a Goldman Sachs report, Wal-Mart could be trusted to implement its US strategy and gain efficiency, low prices, and inventory control and thus propel the underdeveloped German market into the future. However, to the contrary, an analyst in a DG Bank report warned of many foreign retailers failing in Germany because of land-use restrictions.

Germany had limited store hours, price regulations (prohibiting retailers from selling below costs), and stringent zoning requirements. Also, Unions were more influential than their US counterparts.

In 1977, Germany had enacted strict planning and zoning regulations designed to protect traditional retailers and thus prohibited construction of stores with more than 800m^2 sales area in locations not designated for retailing. This resulted in large-store development being restricted to town/city centers. Yet, even within cities, where retail restrictions were less onerous, the approval process for a new store still could require from 1 to 4 years.

Opening a large retail store outside urban area was possible however require multiple steps. The retailer would be required to create a building use plan that would cover a comprehensive development concept that accounted for environmental, conservation, and private legal concerns. An example would be the new site could not sell products that would compete directly with stores in nearby towns. The plan would need to be first approved by the town or city council and then regional planning boards at the state and national level. This resulted in little to no success rate especially since the German government did not want retail businesses to pull away customers to outside of a to leaving old buildings and monuments in the city center vacant. This would be extremely problematic for Wal-Mart because all of its stores in Germany were Supercenters.

Germany service sector union Ver.di, the largest union in the world, filed a lawsuit against Wal-Mart for not releasing year-end figures that could be used to negotiate wages. This ultimately led brought Wal-Mart to the negotiating table with Ver.di. As a result, the retailer conceded a salary increase that was 0.5% over negotiated retail-sector levels.

As of 2003, the Store Closing Law limits store hours to a 6:30 pm closing on weeknights and 8 pm on Saturdays. Stores could not open at all on Sundays with exceptions granted by state government or if they provided 'essential' functions: pharmaceutical drugs and tobacco. It was instituted to protect domestic retailers from larger competitors who could afford to keep their stores open longer with lower expenses. This was also reinforced by religious factions who supported the importance of family time while the left side of the political spectrum believed that retailers working longer than other workers was inherently unfair. The shortened working hours have resulted in higher wages per worker for retailers. For instance, full-time floor staff workers in Germany demanded a 19% premium compared to UK workers on average.

Unlike many of its German competitors, Wal-Mart offered credit card payment and free bags for goods purchased, improved store interiors, and friendly customer service. Since German customers were not accustomed to friendly greetings, they focused more on how much more is Wal-Mart charging customers for these additional services. Not having to hire greeters helped mitigate costs from having to pay higher wages per worker compared to the UK. Customers were also loyal to the domestic large players in the retailing industry including Metro, Aldi, and Rewe.

Wal-Mart experienced great difficulties in dealing with suppliers. The retailer did not have the bargaining power to buy goods from suppliers at low cost and also did not have a reputation of low prices with German consumers. And, upon implemented its centralized distribution system, they experienced high backorder rates (20% vs. indus average of 7%) and thus successfully implemented new scanning systems to better manage inventory.

In 2001, a consumer study showed that Wal-Mart's prices were 11-25% higher than its German rivals. This can be explained by many of its competitors' simple business model to minimize costs even if it is to reduce customer service levels. Many of its competitors focused on providing minimal customer service and using minimal labor in order to minimize costs. Before Wal-Mart's entry, the retailers burdened with high labor costs and the need to keep prices low had decided not to invest in store design, IT systems, or merchandising. However, after Wal-Mart entered, an increasing number of German retailers began utilizing advanced scanner systems and increased their pressure in dealing with suppliers to lower shelf prices.

Higher costs, lower margins, smaller stores, undeveloped supply chain relationships, and price sensitive customers loyal to German chains forced Wal-Mart's stores to only have a margin of less than 1% while Wal-Mart's ASDA had 6-8% in the UK. Yet, this problem also affected other foreign companies such as GAP and Marks & Spencer, who both decided to leave the German market.

Unfortunately, Wal-Mart had decided that its successful track record in US, Mexico, and the UK would serve as a sufficient prerequisite in entering Germany through acquisition. Also, it assumed that its country-dependent advantages would be able to transfer over such as supplier relationships and consumer market knowledge. As a result, the company's German stores are facing shrinking margins and thus low profitability.

In 2006, Wal-Mart decided to exit the German market by selling its retail stores to German retailer Metro. The exact terms of the agreement were not publicly disclosed; however, the result was that Wal-Mart's decision to leave incurred a $1 billion loss.

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