With Profits Elusive, Wal-Mart to Exit Germany

Local Hard Discounters
Undercut Retailer’s Prices;
'Basket-Splitting' Problems

By ANN ZIMMERMANN and EMILY NELSON
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Wal-Mart Stores Inc. boasts that its discount pricing attracts more than 127 million visits to its American stores each week. In Germany, however, its prices apparently weren’t low enough.

Admitting defeat, the world’s largest retailer said yesterday it will sell its German operations to rival German retailer Metro AG, giving up its foothold in continental Europe at a time when it is trying to rejuvenate growth through international expansion. After eight years of trying, Wal-Mart said it couldn’t turn around its 85 German stores, which have lost money. Terms of the sale were not disclosed, but Wal-Mart said it expects to incur a pretax loss of $1 billion on the deal.

Germany’s discount retail market is turning out to be a tough one to crack for some of the world’s biggest companies. Homegrown discount retailers offer very low prices. German shoppers are frugal and demanding. And regulations restrict store hours and other retailing basics. Wal-Mart’s biggest global competitor, Carrefour SA of France, operates in 29 countries, but has steered clear of Germany.

Nestle SA and Unilever are among the large companies that also have had to rethink how they do business in Germany. Nestle, the world’s biggest food maker, began making a low-priced bottled water to sell in Germany’s discount stores.

In April, Wal-Mart Chief Executive Lee Scott warned that the stores it purchased in Germany “are difficult stores.... It is clearly a very challenging market for us that we have not figured out.”

Wal-Mart’s retreat from the market represents the second time in recent months that it has bailed out of a foreign country. In May, the company said it would sell its 16 stores in South Korea. Yesterday’s announcement represents Wal-Mart’s most significant foreign retrenchment since it began expanding internationally in the early 1990s.

Wal-Mart’s core American customers have been pinched lately by soaring gas prices and stagnant wage growth. In June, Wal-Mart posted sales gains of just 1.2% at stores open at least one year, compared with 4.7% during the year-ago period. Sluggish sales have weighed on its shares, which have declined 5% this year.

Wal-Mart’s international operations accounted for 20% of the Bentonville, Ark., retailer’s total sales of $312.4 billion in the year ended Jan. 31, and represent its fastest-growing business segment. Michael Exstein, a Credit Suisse Group analyst, estimates that Wal-Mart’s international revenue will increase to $78 billion in fiscal 2007, from $63 billion in fiscal 2006.
Wal-Mart’s global ambitions are now focused on Asia and Latin America. It sees India and China as the most promising markets to try to replicate the rapid growth it witnessed in the U.S. It has been opening stores in China, and recently received approval to open a liaison office in Bangalore, India, where it will have a team conducting market research with an eye to eventually opening stores there, says Wal-Mart spokeswoman Amy Wyatt. Late last year, it bought a stake in Central America’s largest retailer, Central American Retail Holding Co., and in March it gained a majority stake. Recently, it bought a Brazilian grocer.

**Behind Rivals**

Still, Wal-Mart has fallen behind some of its rivals in expanding globally. After it completes the sales of its German and South Korean operations later this year, it will operate in just 11 countries outside the U.S., compared with 29 for Carrefour and 30 for Metro, the world’s third-largest retailer by sales.

In addition, Wal-Mart is beginning to face aggressive German-style discounting on its home turf. Aldi Einkauf GmbH, a German retailer, has opened more than 700 stores in the U.S., and Eden Prairie, Minnesota-based SuperValu Inc., now has more than 1,200 small, no-frills Save-A-Lot stores in the U.S.

After Wal-Mart acquired two small, struggling German retail chains eight years ago, it ran up against several problems. It found itself being underpriced by local retailers called hard discounters, such as Aldi. German shoppers flock to these stores, which sell a limited selection -- often 850 to 1,000 items, compared with 100,000 at Wal-Mart -- and stock mainly their own store brands.

Some 80% of German consumers are about 20 minutes from an Aldi, according to Nestle’s research. The hard discounters account for about 40% of the German retail market, compared with Wal-Mart’s share of less than 2%, analysts say.

German shoppers are accustomed to buying merchandise strictly based on price, German retail consultants say. They are willing to buy laundry detergent at one store and then go to another to get a better price on paper towels. That behavior is called “basket splitting.” It is the antithesis of what American shoppers like: one-stop shopping. A big plank of Wal-Mart’s strategy in the U.S. and elsewhere is getting shoppers to turn to it for an increasingly wide array of goods.

German shoppers, used to bagging their own purchases, were turned off by such American practices as clerks who bagged groceries. And some German employees objected to American-style workplace rules such as Wal-Mart’s prohibition of romantic relationships between supervisors and employees. A lawsuit by workers forced Wal-Mart to lift its ban.

Wal-Mart has said it made other mistakes as well. The two retailers it purchased were headquartered in different cities. It chose one city for the merged headquarters, prompting many executives from the other retailer to quit rather than relocate. Its German unit has had four presidents in eight years. It ran up against strong unions, as well as laws against selling goods at below cost, which made it difficult to lure shoppers with so-called loss leaders. Initially, Germany’s stringent operating laws required it to shutter stores by 6 p.m. on weekdays and 4 p.m. on Saturdays, although those restrictions eased a bit in recent years.

‘What German Consumers Want’

Hans Joachim Körber, chief executive of Metro, said yesterday he is confident Metro can avoid the pitfalls that hurt Wal-Mart in Germany. “We are Germans,” he said. “We know what the German consumers want. You can make money in Germany.”

**Sam’s Formula**

Wal-Mart’s global sales by division:

[Table showing Wal-Mart’s international sales by country with percentages and estimated sales in billions for U.K., Mexico, Canada, Germany, Brazil, China, and Japan.]

Metro said it paid less for Wal-Mart’s operations than the combined value of its stores and merchandise. Mr. Körber said he expects to

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return the stores to profitability within two years by relying on its buying muscle and logistics network to improve operations. Metro, based in Dusseldorf, operates about 385 supercenter stores across Germany under its Real brand. It says it can do a better job than Wal-Mart matching merchandise to local tastes. Metro has also struggled in Germany, where its sales slipped last year.

Some other companies have begun adjusting their formulas in an effort to make headway in the German retail market. Consumer-goods companies such as Unilever, which has headquarters in Rotterdam and London and makes such brands as Dove soap and Ben & Jerry's ice cream, have traditionally been wary of working closely with German discounters. They worried that the no-frills stores cast a negative light on their brands.

But over the last several years, Unilever and Nestle have begun making a concerted effort to work with the discounters. They have tried to exploit the fact that discounters are searching for new ways to get shoppers to spend more, a perpetual problem in Germany, where the economy has struggled because people aren't spending.

Nestle has repackaged its candy brands and cappuccino flavors into mixed assortments to meet demand from the retailers for bigger packs. Consumer-goods companies are also coming up with less expensive varieties of some of their main brands to compete with store-brand items.

Wal-Mart's operations in both Germany and South Korea exposed similar vulnerabilities. It had too small a presence in both countries to amass effective economies of scale. In the U.S., its stores are nearly ubiquitous, and its logistics network allows it to swiftly move merchandise into stores based on what's selling where.

"We had a difficult time in Germany from the get-go," says Ms. Wyatt, Wal-Mart's spokeswoman. "Looking at the international business around the world and where we would have the greatest impact on growth and investor return, it became increasingly clear that given the German business environment, we could never obtain the scale and results we desired."

Mike Duke, who runs Wal-Mart's international division, said in a recent interview that the company has made strides in improving its international strategy. "I do think we have become more strategic over time in assessing the growth and market development opportunities in foreign countries," he said.

**Challenges in India, China**

But Wal-Mart's other expansion targets also present unique challenges. India doesn't permit foreign companies to set up stores there unless they sell only one brand. China's state-run union is trying to force Wal-Mart to set up unions at its 60 stores there. In addition, China is drafting rules to regulate large-scale shopping outlets, which could impede the expansion plans of foreign retailers.

Wal-Mart's decision to get out of Germany leaves its plans for Europe unclear. It owns the 315-store Asda chain in the United Kingdom. If Wal-Mart had amassed scale in Germany, it would have gained muscle to negotiate with European suppliers. Germany could have also have served as a gateway for Wal-Mart to expand into Eastern Europe.

Adrienne Shapira, a retail analyst at Goldman Sachs, says the move will allow Wal-Mart to focus on more promising expansion markets such as China and Latin America. "In the end," she says, "I think, Wal-Mart saw Germany as a rounding error and a distraction."

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