

Pros & Cons of Wal-Mart introducing Supercenters stores to Canada

When facing the potential of Wal-Mart introducing their *Supercentres* retail offering in Canada the opportunity and costs of such a venture must be measured. By leveraging Michael Porter's *five competitive forces* one can analyze the attractiveness of the grocery Canadian industry. Following this analysis, one will have a broad understanding of the Canadian grocery industry, where Wal-Mart's *Supercentre* offering fits within that context and how well Wal-Mart's goals align to the opportunities within the Canadian marketplace.

Wal-Mart's offering: *Supercentres*

Larger format stores consisting of full line of general merchandise, groceries and specialty services. Sales are split at 35% food and 75% merchandise retail, respectively.

Threat of New Entrants

The average number of Canadian grocers has declined at a rate of -1.8% (**see Figure 1**) over the last five years. There is a low threat of new markets opening up through the opening of net-new stores. Canada is considered one the world's most mature grocery industries and so, significant

Year	# of Supermarkets	Growth YoY
2001	1538	-2.72%
2000	1581	-1.86%
1999	1611	-4.51%
1998	1687	1.87%
1997	1656	
AVG YoY Growth		-1.80%

Figure 1 – AVG Growth of Canadian Grocery Stores¹

market share gains are only possible through merger and acquisition (M&As). Wal-Mart has targeted a third of profit growth to come from its international operations by 2005². With ambitious growth targets, *Supercenter's* would be best suited to leverage an existing Canadian discount value grocer brand via an acquisition. M&A activity will be the best tactic for expanding in a market where existing supermarkets are consistently closing year-over-year.

Bargaining Power of Buyers

A high degree of choice permeates the Canadian grocery market. With 24,132 grocery stores in Canada—consumers have a wide array of choices available. Often though, the nature of the geography and habit dictates where individuals shop. Wal-Mart has an opportunity to own relationships where communities have relationships with a grocery store. These relationships can be either dictated by geography and/or a personalized experience. The more personal a shopping experience—the higher degree of loyalty.

¹ (Canadian Grocer, 2000-2001)

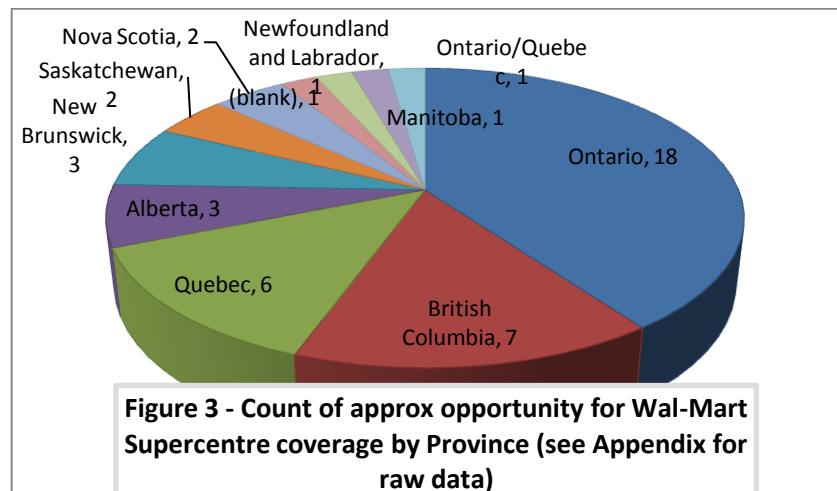
² (Dawson, 2002)

Threat of Substitute Products or Services

Canada's grocery market maturity translates into customers offerings tackled in a grid like structure; with some grocers offering a wide range of low cost items, up through high value shopping experiences. Virtually every customer segment, from small-businesses to metropolitan shoppers, have local and specialized grocery offerings positioned directly at their needs. This level of saturation translates to low industry attractiveness.

Bargaining Power of Suppliers

Market share dictates retailer-supplier relationships in the Canadian grocery industry. Grocer's who command a greater market share wield power over suppliers and vice versa Suppliers looking to win greater market share offer retailers allowances to have their products placed in high-traffic areas.³ Adversely, category-leading item vendors force grocers to purchase their goods—sometimes even at a loss. As a recognized low-value goods provider, Wal-Mart will have the opportunity to drive costs of category-leading products down. In addition, buy utilizing there 30,000 worldwide suppliers⁴ there in a position to wield significant power over vendors. The challenge for Wal-Mart will be securing perishables (representing a critical 67% of total grocery sales⁵) from local suppliers. Any type of cooperation from Canadian groceries will put Wal-Mart in a marginalized buying position (relative to co-ops banding together) and may result in Wal-Mart paying a premium for product.



³ (Kingston, 1992)

⁴ (businessweek.com)

⁵ (Tutunjian, 2002)

Rivalry amongst Competitors

The biggest challenge facing Wal-Mart will be distribution. Canadian mega-grocers are largely competing as value-added facilities; the emergence of shopper loyalty cards, full services like gas and photo processing and franchised restaurants validates this claim.

Supercentres operate off economies of scale garnered through significant buying power and extremely diverse product offerings. The challenge is there are only 45 Canadian cities (see **Figure 3**) that can support the required base population of 76,000 people. With limited cities to leverage, gaining economies of scale may be difficult.

Figure 4 – Wal-Mart Inc. Sales / Sq. Feet (approx)

CDN Stores ¹	213
Avg. Sq. Ft. / Store	116,795
Approx CDN Sq. Feet	24,877,335
CDN Sales ¹	\$5,643,000,000 CAD
Sales / Sq. Ft	\$227 CAD

In addition, Canadian Wal-Mart stores are currently only operating at an annual average of \$227 sales / square foot (see **Figure 4**). Loblaw's leads Canada with a \$575 sales / square foot annual

Supermarket Info	Margin %s
CDN Avg Grocer Profit Before Tax as % of Sales ²	3.00%
Wal-Mart Margin Contributions from <i>Supercentre</i> Food Sales ¹	1.05%
Wal-Mart Gross Margin on Merchandise	21.20%
Wal-Mart Margin Contributions from Merchandise Sales	13.78%
SUM of Potential Margin Contributions for Supercentres	14.83%

Figure 5 – Contribution Margin from Grocery Sales via Supercentres

average and this figure was achieved while the chains average store size increased by as much as 11,000 square feet. Loblaw's is beating Wal-Mart's current sales percentages by a factor one and sustains only a 3.0% margin⁶. Sustaining Wal-Mart's 21% gross margin in the Canadian marketplace will be difficult. For Wal-Mart to compete, a reduction in contribution margin as large as 5% from Canadian *Supercentres* may be necessary. Slashing average food sales margins down from 6.6% *Supercentre* average to the Canadian average of 3.0% will reduce *Supercentre's* profit line to 14.83% (see **Figure 4**)—

down from the 21.2% Wal-Mart average.⁷ This reduction does not align to Wal-Mart's goal of doubling international contribution margins in two years.

⁶ (Canadian Grocer, 2000-2001)

⁷ (Canadian Grocer, 2000-2001)

Recommendation

The risks of moving ahead and introducing Wal-Mart *Supercentres* into Canada outweigh the potential opportunities. Canadian grocery supermarkets are in decline. Existing personal, geographical and habitual relationships with incumbents often dictate consumer choice. A mature and large-breadth of retailer offerings have virtually all customer needs' answered. Even with Wal-Mart leveraging their deep supplier pool there remains a high degree of uncertainty for securing crucial goods at competitive pricing. Distribution will be challenging as the scale of successful stores is limited and current market conditions do not offer adequate margin contributions. Wal-Mart's bottom-line will suffer with the expansion of *Supercentres* in Canada.

Countering Threats from Wal-Mart: How Can Loblaw's Respond & Take Action

In order for Loblaw's to compete and win against the threat of *Supercentres* they must maintain their influence over suppliers and maintain market-leader status. Within the complexities of the Canadian grocer industry Loblaw's has emerged as the market leader due to its proven strategy.

The threat from Wal-Mart is simple: *Supercentres* will land as another multi-faceted retailer with broad offerings and personalized services. The differentiation will happen outside of food sales where Wal-Mart will leverage its 30,000 worldwide suppliers⁸ and offer lowest-cost general merchandise. Even at the risk of sustaining reduced contribution margins Wal-Mart will push hard to own the general merchandise category.

Action Plan

Positioned as the market leader while offering wholesale and supplier programs, Loblaw's has a unique advantage to stave off Wal-Mart. With Canadian grocers increasingly focusing on demand-side competition there is reduced risk in cooperating with major grocers to create greater buying power and drive down the costs of food. Loblaw's can spearhead the consolidation of its closest five competitors' (capturing 67% market share⁹) buying power and ensure Wal-Mart is unable to compete in the foods market.

Current Strategy and Proposed Adaptations

Along with the proposed action plan—Loblaw's will be best suited to refresh its strategy and make some limited adaptation. Current strategy and proposed adaptations are as follows:

- High prevalence of corporate store ownership; better shopping experience through frequent store facelifts and redesigns.
 - *ADAPTION*: Begin investing on in-house technology solutions¹⁰ that are custom designed around the organization sustainable competitive advantages.
- Control label products help keep margins high and supplier power reduced; market share wins (more revenue) and higher margins (greater income)—helps garner customer loyalty
 - *ADAPTION*: Invest in organic food offerings through control labeling to be included in the 20% / anum growth in this \$1.8 billion market¹¹

⁸ (businessweek.com)

⁹ (Canadian Grocer, 2000-2001)

¹⁰ (The IT Inside the World's Biggest Company, 2002)

¹¹ (Rostoks, 2002)

- Localized (grocery & service) offerings helps secure broad customer satisfaction across all segments.
- Convenience factors: non-food items, general merchandise under the control label program and gas stations; helps drive deeper customer relationships by meeting all their needs.
- Performance (market share) measured on an individual basis.
 - *ADAPTION*: Shift HR strategy from regional segmentation to banner segmented structure. With regional segmentation local appeal of each store increases but banner managers are separated from their regional *partners*. Managing banner and formats under product groups, one may see the emergence of customer data sharing and new insight—across regions—as well as greater ownership of profit-centre responsibility across the business.

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Appendix: 2001 Census Canada (Statistics Canada, 2001)

Rank	Place	Province	Population	Approx. Opportunity for Supercentre Coverage (# of Stores)
1	Toronto (Mississauga)	Ontario	4,682,897	62
2	Montreal (Laval)	Quebec	3,451,027	45
3	Vancouver (Surrey, Burnaby)	British Columbia	1,986,965	26
4	Ottawa (Gatineau)	Ontario/Quebec	1,063,664	14
5	Calgary	Alberta	951,494	13
6	Edmonton	Alberta	937,845	12
7	Quebec City (Lévis)	Quebec	686,569	9
8	Winnipeg	Manitoba	676,594	9
9	Hamilton (Burlington)	Ontario	662,401	9
10	London	Ontario	435,600	6
11	Kitchener (Cambridge, Waterloo)	Ontario	414,284	5
12	St. Catharines-Niagara (Niagara Falls, Welland)	Ontario	377,009	5
13	Halifax	Nova Scotia	359,183	5
14	Victoria (Saanich)	British Columbia	311,902	4
15	Windsor (Tecumseh, LaSalle, Lakeshore)	Ontario	307,877	4
16	Oshawa (Whitby, Clarington)	Ontario	296,298	4
17	Saskatoon	Saskatchewan	225,927	3
18	Regina	Saskatchewan	192,800	3
19	Sherbrooke (Magog)	Quebec	175,950	2
20	St. John's (Mount Pearl, Conception Bay South)	Newfoundland and Labrador	172,918	2
21	Greater Sudbury	Ontario	155,601	2
22	Saguenay	Quebec	154,938	2
23	Barrie (Innisfil)	Ontario	148,480	2
24	Kelowna (West Kelowna)	British Columbia	147,739	2
25	Abbotsford (Mission)	British Columbia	147,370	2
26	Kingston (South Frontenac)	Ontario	146,838	2
27	Trois-Rivières	Quebec	137,507	2
28	Saint John (Quispamsis)	New Brunswick	122,678	2
29	Thunder Bay	Ontario	121,986	2
30	Moncton (Dieppe, Riverview)	New Brunswick	118,678	2
31	Brantford (Brant)	Ontario	118,086	2
32	Guelph	Ontario	117,344	2
33	Peterborough (Smith-Ennismore-Lakefield)	Ontario	110,876	1
34	Cape Breton	Nova Scotia	109,330	1
35	Chatham-Kent	Ontario	107,709	1
36	Kamloops	British Columbia	88,951	1
37	Sarnia (St. Clair)	Ontario	88,331	1
38	Belleville (Quinte West)	Ontario	87,395	1
39	Lethbridge (County of Lethbridge)	Alberta	87,388	1
40	Nanaimo	British Columbia	85,664	1
41	Prince George	British Columbia	85,035	1
42	Fredericton	New Brunswick	81,346	1
43	Saint-Jean-sur-Richelieu	Quebec	79,600	1
44	Sault Ste. Marie	Ontario	78,908	1
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