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WAL-MART EASES ITS GRIP; The retailer isn't squeezing suppliers as hard -- or slashing its own prices as much

Wendy Zellner in Dallas and Robert Berner in Chicago. **Business Week**. New York: Feb 16, 2004. , Iss. 3870; pg. 40

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Full Text (742 words)

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The chief executive of a U.S. plastic-goods maker recently got the shock of his life. He had asked Wal-Mart Stores Inc., his biggest customer, to absorb a 5% to 7% price increase. The exec had good reason for the hike: The cost of resin, a key raw material in plastics, was going through the roof. Still, he didn't expect Wal-Mart, with its fearsome reputation for squeezing suppliers, to go along with the increase. Yet Wal-Mart allowed the supplier to lift its price for the first time in a decade. "If your argument is strong enough, you can actually win," says the executive. "It's a huge change."

Say what? Wal-Mart, which has come to dominate American retailing largely through its ferocious drive to push down prices, is easing up? Apparently so. Not only is it lessening the pressure on its suppliers, it also appears to be less fixated on slashing its own retail prices for everything from blue jeans to DVDs.

'A BATTLE WITH ITSELF'. So should rivals and suppliers breathe a sigh of relief? A small one, perhaps, but only that. While Wal-Mart will be a bit more flexible in giving its suppliers a break, it will continue squeezing costs on many products, especially those it orders directly from manufacturers. Says Jay Fitzsimmons, Wal-Mart's senior vice-president for finance: "Prices will continue to go down, but not as fast." Indeed, the overall price on a typical basket of Wal-Mart goods is still likely to fall this year. It just won't drop the 2.5% to 3% it did last year.

Some see Wal-Mart's shift on pricing as a way to answer critics who argue that its endless squeeze on suppliers is forcing production offshore. But the company denies that's the reason, saying it realized the relentless price-cutting is hurting it almost as much as rivals. The self-imposed deflation, which holds down revenues, was making it harder for Wal-Mart to show healthy same-store sales gains. Moreover, the chain's lower prices didn't always create enough new volume to cover rising costs and stoke earnings; indeed, weaker-than-expected sales and profits have left the stock lagging the market recently. "Wal-Mart over the last few years has been in a battle with itself," says analyst Gary Balter of UBS Investment Research in a recent report.

But if its goal is to improve its profitability, why ease up on suppliers? Vendors say Wal-Mart realizes that, after years of absorbing rising costs, they too need some relief. With suppliers in any given industry often facing the same pressures on raw materials costs, many are also more willing to push for a price increase without fearing Wal-Mart will pass them over for a cheaper rival. And with the economy picking up, the retailer will likely find it easier to pass along those hikes to consumers.

NOT DOING ANY FAVORS. It's not clear how much Wal-Mart will allow suppliers to raise prices. Some analysts believe the gains aren't likely to be big. Instead, Wal-Mart will still push them to cut costs but may be willing to let suppliers keep more of the savings from any efficiencies they eke out. When branded goods producers do win price increases, Wal-Mart typically passes them along to consumers and holds its own margin steady. Fitzsimmons says that approach won't change. But where Wal-Mart oversees the sourcing of its own products -- now less than 10% of sales but growing -- it's expected to keep more of whatever savings it earns by driving out middlemen and consolidating production. That should lead to better gross margins while still reducing prices for consumers, figures UBS' Balter.

Will a less aggressive Wal-Mart provide relief for rivals such as Target Corp., which have struggled to keep up with the giant's rock-bottom prices? Lehman Brothers Inc. analyst Robert S. Drbul believes it will. "If Wal-Mart is not as aggressive on pricing, it bodes well for most of retailing," he says. But Fitzsimmons points to Wal-Mart's hefty price advantage over rivals. "I don't think [Wal-Mart's new pricing stance] gives any room for competitors," he says. Now that sounds more like the old Wal-Mart.

(available online)

Penny-Wise

The cost of a typical basket of Wal-Mart goods fell roughly 3% in 2003, but that didn't spark strong enough sales gains. So this year, the retailer will ease the pressure on prices.

[Illustration]

Photo: Photograph: BEAT THIS: Cutthroat pricing has taken a toll PHOTOGRAPH BY SHAUN HEASLEY/GETTY IMAGES

Credit: Wendy Zellner in Dallas and Robert Berner in Chicago

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