THE HIGH PRICE OF LOW COST

The View From the Other Side of Walmart’s ‘Productivity Loop’

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EXECUTIVE SUMMARY

A Company In Crisis

This report seeks to provide an analysis of Walmart, the world’s largest retailer, from a perspective not usually available to most investors—frontline retail workers themselves. We believe this perspective is critical today, as the company faces a crisis in its core US business, where same-store sales have been shrinking for nine consecutive quarters, trailing behind competitors like Target and Costco, and underperforming other retail stocks over the past three years. Last year the company lost market share in the US for the first time in over a decade, a trend that appears to be continuing this year.1 Walmart executives have responded to this crisis by implementing deep cuts in labor hours at the company’s US stores, setting in motion a “vicious circle” of understaffing, operational miscues, and lost sales that is diminishing the company’s long-term value. This understaffing, combined with the computerized management initiatives imposed by the home office in Bentonville, is creating long lines at the register, backrooms clogged with inventory and bare shelves as restocking lags.

As these operational problems became apparent, Walmart’s US CEO attempted to shift the blame to local store managers, despite evidence the staffing cuts were a top-down directive. Meanwhile, many current and former associates say that the company surveys Walmart executives claim show high levels of employee satisfaction are tainted by management manipulation. And despite recent company claims that accident rates are declining, many associates believe accidents are increasing due to increased workloads but that the company is pressuring workers to not report them.

The ‘Walmart Economy’ In Crisis

As the largest employer in the country, Walmart’s effect on the US economy is hard to overstate. The company sets the standard in the retail industry and in the larger service economy as well, and as service sector jobs are projected to provide most of the growth in US employment for the next several years, the downward pressure Walmart exerts on the wages and incomes of American workers will create a significant drag on household purchasing power, sapping economic growth and hurting retailers—even Walmart itself.

Even before the recent staffing cuts, Walmart associates were struggling economically, and the widespread reduction in scheduled hours has pushed many associates into serious financial

1 Exstein, Michael “Where Does Wal-Mart Go From Here?” Credit Suisse, September 28, 2011.
stress, with as many as one-third of respondents to a recent poll reporting they recently relied on public assistance for themselves or their families. A study done in 2007 showed that Walmart associates make as much as 17% less than employees at comparable retail establishments, and a 2005 study found Walmart brings down the wages of other workers in retail and non-retail jobs throughout the economy.

Walmart’s emphasis on using more and more part time employees is also contributing to the dramatic rise in Americans who are classified as “involuntary part time” workers, creating a financial crisis for many American families who are struggling to make ends meet.

A Better Way

The only way to break the vicious circle and improve performance is for Walmart executives to decide to invest more in workers and to listen to what they are saying about how to improve store operations. A change of this kind could not only improve the company’s long-term revenue growth but could also boost the US economy by increasing the buying power of millions of American workers at Walmart and other service sector jobs.

There is a proven path to sustainable growth and profitability in retail, as the comparison between Costco and Walmart’s Sam’s Club demonstrates. The partly unionized, higher paid employees at Costco have significantly lower turnover than Walmart, and Costco stores are significantly more productive than Sam’s Club, with sales per square foot nearly 60% higher, and operating profit per square foot 27% higher. Meanwhile, Costco shares have consistently outperformed Walmart’s over the last decade.

Large institutional investors with investments throughout the economy cannot escape the portfolio effects of Walmart’s “low road” business model simply by selling Walmart stock. These so-called “universal investors” have a significant interest in changing the behavior of companies such as Walmart, and we hope this report is an important step in that process.

A note on sources: This report is based on information collected from a range of sources, including press accounts, academic studies, equity research reports, a nationwide poll of 501 associates conducted by Lake Research Partners in May and June of 2011, in depth interviews with dozens of current and former Walmart associates and managers, and social media sources including discussions on the Organization United for Respect at Walmart (OUR Walmart) Facebook page wall and an online survey of over 1,000 associates conducted in September and October of 2011. Unless otherwise indicated, quotations from associates are taken from interviews by the author. A full version of this report is available at: www.MakingChangeatWalmart.org/analyst

2 Based on data from most recently available 10-Ks, covering the periods ending August 29, 2010 and January 31, 2011 for Costco and Sam’s Club, respectively.
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Introduction

In one sense, Walmart has never been stronger. Last year the largest retailer in the world boasted $430 billion in revenues, with over $100 billion coming from outside the United States; the company’s balance sheet is stronger than ever, and with its AA credit rating from S&P, the company is free to issue billions of dollars in new debt at extremely low rates of interest. Meanwhile the company’s access to the White House and to senior political leaders from both parties has never been greater.

Yet today it is also fair to say Walmart is a company in crisis. Its US growth has slowed dramatically, and its stock price has been flat for the last decade. Two major attempts to reinvent itself—by remodeling the stores and altering the merchandise—failed, and leave the company today without a clear identity. Despite a multiyear, multibillion dollar public relations overhaul, Walmart’s brand still struggles, especially among the higher income consumers it needs to win over to fulfill its urban expansion goals. A network of labor, small business, religious and community leaders, neighborhood groups and Walmart’s own associates continues to shape perceptions of the company. In the minds of many, Walmart continues to represent the stereotypical corporate villain. While there is no publicly available update to the 2004 McKinsey study that found that as much as 8% of Walmart customers had stopped shopping there due to negative press coverage, the company’s continuing investment in image-softening PR suggests the negative perceptions continue to be a material factor.

But unlike much of the criticism that sought to reveal the “high cost” to workers, the environment, and small businesses, generated by Walmart’s “low price” strategy, this report seeks to explore the negative consequences of the company’s “low-cost” business model, and particularly its approach to labor relations and human resources management, on Walmart’s business itself.
A COMPANY IN CRISIS

As Walmart’s double-digit sales growth began to decline in the early 2000s, questions began to emerge about what kind of company it was becoming. Was it a mature retailer, one that would soon scale back capital expenditures and focus on improving margins in existing stores? Or was it still a growth company, about to enter then dominate new markets like e-commerce, health-care and financial services?

But as Walmart’s US growth continues to slow it is facing competition from all sides—above from traditional retailers like Kroger, below from the dollar stores, sideways from Amazon—and its price advantage has begun to erode.

Over the last several months a number of studies have shown that Walmart’s price advantage over the competition, and more importantly the perception of Walmart’s price advantage, has diminished. According to a survey conducted in May, 61% of Walmart shoppers believed the retailers’ prices are “no longer the lowest,” and only 25% believe Walmart’s prices are “significantly lower” than grocery stores.3 Other more recent surveys have confirmed the narrowing of the company’s price differential versus competitors.4

For a retailer like Walmart that sells almost exclusively on the basis of price, the lack of a clear price advantage represents an existential crisis. Without a higher level of service or a better shopping experience, Walmart has little more to offer.

“Wal-Mart has not done the lifting needed to retain aspirational shoppers gained in the throes of the recession. As a result, this has left Wal-Mart exposed to a core lower income customer base that spends cautiously on paycheck week, and not necessarily at Wal-Mart (dollar stores instead),” wrote one analyst in 2010.5

4 See Grom, Charles “WMT vs. TGT Pricing: Bentonville Leads Minneapolis... Barely,” Deutsche Bank, September 28, 2011; and Exstein, Michael, “Where Does Wal-Mart Go from Here?” Credit Suisse, September 28, 2011, “Our most recent pricing survey shows Wal-Mart has allowed its price differential with competitors to narrow.”
Another consultant added, “When all you mean to your customers is ‘cheap’, it’s hard to hold to them if they can find the same stuff at the same price or less elsewhere.”

The result has been nine consecutive quarters of same-store sales declines in Walmart’s core US stores, lagging behind competitors such as Target and Costco, whose same-store sales turned positive over a year and a half ago.

In response to this crisis, Walmart executives have pursued three primary strategies: first, the company significantly increased share repurchases last year, retiring approximately 7% of outstanding shares and providing important (if unsustainable) support for earnings per share.

Second, the company has sought to grow the top line by making international acquisitions, essentially buying revenue. While international growth was an important contributor to sales growth last year, the margins and returns of the company’s international operations are significantly lower than the US business, and analysts have expressed serious concerns about this strategy.

Additionally, despite the continuing decline in same-store sales, and the apparent saturation of the non-urban US market, the company has continued to expand domestic square footage, and to the dismay of some analysts the company recently announced its intention to ramp up US square footage growth, despite the fact that the new store openings are depressing same-store

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6  Marge Laney, quoted in ibid

7  Strasser, David “Wal-Mart: Remains Impacted By Difficult Trends At The Low End,” Janney Montgomery Scott, August 16, 2011: “We continue to question the wisdom of aggressive growth internationally, and remain perplexed by increased investment in both mature and emerging countries as timing and magnitude of returns remains unclear.”
sales in the company’s existing stores. A number of Walmart associates share this concern.

Angie, an overnight stocker at a supercenter in Baldwin Park, CA, who, like all other Walmart associates, is subject to Walmart’s quarterly bonus system that is based in part on same-store sales, expressed frustration in a late September 2011 interview:

Last year, the Covina store, a few miles from us, became a 24-hour store like us. So did the City of Industry store, also near us. So last night they said our sales were down 7% from the same time last year. We never have positive sales at night because the other stores are taking our business. Now they are opening another store in El Monte, also about 3 to 5 miles away.

In fact, a review of Walmart’s federal securities filings demonstrates that Angie’s analysis is correct: over the last three years, as the company continued to expand square footage in the US, that new retail space began to ‘cannibalize’ more and more sales from its existing stores. In the fiscal year ending January 2011, over 45% of the sales in new stores was diverted, or cannibalized, from other Walmart stores in the United States, as the chart below shows.

The third, and perhaps most significant strategy adopted by Walmart executives, has been significant cost cutting targeting the workforce.

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8 Wal-Mart Stores, Inc. Form 10-K 2011, Exhibit 13, p. 5.
9 Author’s calculation, which likely understates the level of cannibalization, based on data from Wal-Mart Stores, Inc. Form 10-K 2011, Exhibit 13, p. 5. Assumes new store square footage generates (or will generate) approximately the same sales as existing store square footage.
Impact of Cost Cutting on Operations, Revenue Growth

As revenue growth slowed and competition grew, Walmart management pursued several initiatives designed to improve sales and returns, but these have failed to achieve the kind of success the company had hoped. “Project Impact,” a costly store remodel program intended to help the company woo higher income customers, never met that goal. “Win, Play, Show,” an inventory rationalization (discussed below) was abandoned after less than two years.

On the expense side, the company already notorious for running a lean operation, initiated a new round of cost cutting. In 2010, Walmart management announced it was ending the practice of paying Sunday premium, Christmas premium, and reduced bonuses to store associates. Perhaps more significantly, the company also announced an end to its profit sharing plan, an incentive system some observers had considered to be a central element of the firm’s HR philosophy.

In addition to these cuts over the last two to three years Walmart management has sought to increase labor productivity by systematically reducing staffing levels in its stores, and has implemented a draconian timing system, called the “Task Manager,” which rigidly allocates a certain number of associates and a certain time period to discreet tasks.

As a result of these various initiatives, together with what many associates suspect is the targeting of more experienced workers for termination, numerous operational problems including inventory problems, inadequately staffed registers during peak hours, and lost revenue due to lack of sales floor associates, have been felt throughout the company’s US stores, and noted by industry observers.

For example, according to Retailing Today, in December 2010 the consulting firm Customer

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11 Nelson Lichtenstein, *The Retail Revolution: How Wal-Mart Created a Brave New World of Business*, (New York, NY: Metropolitan, 2009), p. 126: “the most important impact of the profit-sharing scheme was ideological, linking the employees to the fate of the company, but also justifying the self-exploitation that was integral to the Wal-Mart culture.”

Growth Partners reported “unmanned checkout register episodes at multiple Walmarts, and, in another case, customers entering a Walmart superstore could find no available shopping carts—since no employees were available to retrieve empty carts from the parking lot.”

In early 2011 the trade journal published a photo of a Walmart supercenter with largely empty shelves (see cover photo) and asked, “How could a retailer who so often talks about leveraging its supply chain to deliver upon all sorts of strategic initiatives allow an out of stock situation of such extreme proportion to happen?”

After numerous press reports documenting these problems the issue was placed squarely on the table in front of senior management at the June 2011 annual shareholders’ meeting, when US CEO Bill Simon fielded several questions about staffing levels. Simon’s initial response was to shift the blame to Walmart’s store managers.

**ANALYST**\(^{14}\): [A]s you’re looking at SG&A and you’re continuing to take out costs... are you still comfortable that you’re not taking out too many hours around the register and causing more lines and ultimately losing sales?

**BILL SIMON:** It’s a good question. And I’m not comfortable. I’m never comfortable.... With pressure on the top line, sometimes the behavior in the stores is great, and sometimes it’s not exactly what you’d like it to be. [CEO] Mike [Duke] was asked a question earlier today, how do you run so many stores? And we run them one at a time. So each store manager has a sales and a profit number that they’re trying to deliver. Some of them try to make their profit number the wrong way. And that’s in some of the cases driving some of the action that some people have seen.

But numerous associates complain that the staffing policies are emanating from Bentonville’s computerized scheduling system, and former store managers say they were explicitly instructed to reduce payroll costs.

One former store manager described the situation as it unfolded in early 2010.

“Sales were down more than the company had expected, so they instructed us to cut payroll and inventory. As a manager you had to choose: cut hours or cut associates.”

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14  David Strasser (Janney Montgomery Scott).
“The cuts were significant, from about $110,000 per week in wages to $90,000. The result was a number of associates left due to the increased workload, leaving those who remained to shoulder even more of the burden. They were irate. In addition now they are timed in their tasks. This had a very negative impact on customer service, and it also had an impact on in-stocks.”

Another former co-manager recalls a “mass firing” around the end of 2009 or early 2010: “The company needed to make its quarterly profit numbers and so everyone who had a ‘D-day’ coming up was fired. This was about 75 to 150 associates in my market area, and it was probably more widespread than that. That goes against company policy, because you have to have an infraction to receive your ‘D-day,’ but they did it anyway.”

The staff cuts and benefit reductions have significant implications for Walmart’s human resources culture, but also for the company’s business model. Through these expense controls Walmart has been able, during the last two years, to grow operating income faster than sales, albeit at a declining rate. In fact, Walmart US has grown operating profits at a rate that is 4.8, 23.7 and 30 times faster than the growth in sales during fiscal years 2010, 2011 and the 12-month period ending July 31st 2011, respectively. But the long term impacts are less promising.

“There is an old rule in retailing that you can only grow earnings through expense reduction for so long... [Walmart] must figure out a way to drive revenue if they want increased earnings,” wrote retail consultant Bill Emerson.16

**The Great Speed-Up**

While customers and analysts have noticed the operational problems in the stores, Walmart associates have felt the impact most acutely.

In the first national independent poll of Walmart associates, conducted by Lake Research Partners in May and June of 2011, concerns about staffing levels were broadly cited by associates among top three things they would change with the company, after higher pay and more respect on the job17.

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15 “D-day,” or decision day, is the highest level of a three-step discipline process, following a verbal warning and written warning.


17 See http://forrespect.org/public/national-poll-results/
Among the other findings:

- Nearly ¾ say understaffing has created problems such as stock-outs, messy stores and poor customer service;
- In contrast to company statements regarding high levels of employee satisfaction, 84% say they would take a better job if they could find one;
- ½ say they are living paycheck to paycheck; only 14% describe their household as living comfortably.

Across the country the reductions in staffing have translated into significantly increased workloads. A few examples convey the scale of the changes:

- An associate in the electronics department in Southern California: “There used to be four or five people in consumer electronics at any given time, now it’s one or two;”
- An associate in overnight stocking in Southern California: “I used to do five pallets a night, now they say I have to do 12;”
- A former assistant manager in Seattle: “Our store used to have about 600 employees, now it’s about 350.”

At the center of the speed-up in Walmart workers’ jobs is a new labor allocation system called the “Task Manager” which assigns strict timeframes for the completion of various tasks and functions in the stores. For many associates their shifts begin only once they slide their badges into the Task Manager, commonly referred to as the “hub” or the “scorecard” by associates. The computer then gives them a list of tasks that have to be completed in the allotted time period. This system is the object of scorn among thousands of Walmart associates who complain, as one associate said, “there is never enough time to complete all the tasks.”

Maggie, an overnight stocker who has worked for Walmart in Southern California for four years provides an example: “The Task Manager says you can stock the shoe department in 15 minutes. That’s six boxes with 12 pairs of shoes in each box.” [Equals 12.5 seconds per pair of shoes.] “I’m good at what I do, I know my department very well, but I simply cannot get the work done in the time the system says,” said Maggie.

Her colleague Toby, an unloader, chimes in that the system dictates that he unload one case per minute: “this is physically impossible.”
Kenny, a former department manager from Seattle points out that the system doesn’t account for breakdowns elsewhere in the store: “The ‘hub’ [Task Manager] will tell you you’re supposed to finish unloading and stocking the pallets in a certain amount of time, but if due to problems upstream workers aren’t begin fed with pallets when they’re ready for them the system doesn’t account for that—the clock doesn’t stop.”

Vikki, a former store manager with 23 years of experience working for Walmart in the Midwest, South and Northwest, points out that associates are typically required to multi-task—assist customers while stocking shelves, cover for another associate who’s on break—but the Task Manager time allocations are based on maximum efficiency for each task. “The times in the scorecards assume best possible conditions, but those conditions can’t really exist when the store is open,” she says.

John, a former assistant manager and co-manager who helped implement the Task Manager in a number of stores throughout the Midwest and Southeast, says the system is okay for some things but “there are things in the Task Manager that are not realistic. The times are too rigid, and any manager should walk the floor to make sure the type of freight matches the time allocated, but

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**BY THE NUMBERS**

- 45% make less than $10 per hour; 75% make less than $12 per hour
- Nearly 2/3 are women
- More than ½ have children under 18 at home; ¼ are single parents
- Nearly 1/3 recently relied on public assistance for self or family

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1 Demographic information collected by Lake Research Partners in national poll conducted May 24 to June 8, 2011.
there’s not always time to do that.” He gives an example from housewares: “There’s a big difference between a pallet of plastics and a pallet of heavy goods, yet the task manager gives the same time for both.”

Misty, a former assistant manager noted that “the scorecard resulted in a big increase in coachings [an initial disciplinary step], and in more terminations.” In the context of an often highly tense workplace environment in Walmart stores the increased disciplinary activity led some associates to suspect the Task Manager system was being used to target more experienced workers for discipline in order to force people to quit or to set them up for terminations, all part of a strategy to reduce average hourly wages.

John agrees: “The task manager times work better in some areas of the store. Some managers have used it unfairly by putting associates they don’t like in an area with unrealistic times, then the associate can be coached for failing to meet the standard.”

MULTI-TASKING: Walmart’s Task Manager system schedules associates in often unrealistic ways, both managers and associates say. Sometimes associates will be tasked with being in two departments at once and then penalized for not meeting sometimes impossible standards.
COMPUTERIZED SCHEDULING

The company introduced the new scheduling system in late 2008 and 2009 as part of a “productivity boosting” initiative similar to ones adopted throughout the industry. Workers complain these systems leave them with fewer hours, makes it difficult for them to schedule their lives and at times forces employees to compete for desirable shifts.18

Another explanation is that the computerized scheduling system provides the means, and the rationale, for Walmart to reduce the hours of more experienced, higher paid full-timers, in favor of a higher turnover model more reliant on part-timers. The situation of Floyd Kelly is a case in point.

A year and a half ago Floyd transferred from a Walmart store where he was working full-time to a Sam’s Club in Washington where he was promised a full-time schedule as well. But after the transfer was complete the manager told him there was only part-time hours available to him.

“Over the last year and a half I’ve averaged about 22 hours a week,” he said recently.

Despite the fact that Floyd has worked at Walmart/Sam’s Club for over 7 years, his part-time status means he only qualifies for 22 hours of vacation a year, and no paid personal time. Yet despite the apparent lack of available hours, Floyd reports that his managers continue to hire new employees.

“They are hiring left and right,” he said. “As people leave full-time positions they refuse to hire anybody full-time. They make that job into two or three part-timers.”

Angie, from Southern California, agrees. “We want more hours – many people want to work full-time, but they won’t give us the hours. Still they are hiring new people at part time.”

Greg, the electronics associate from Southern California, works 36 to 40 hours a week, but his status is still considered “part-time” by Walmart, because he was originally hired as a part-timer.

Retail analysts have noted that the apparent “productivity gains” achieved through these “flexible scheduling” initiatives create “havoc” in the lives of employees, and leads to “increased absenteeism and turnover.”

Ironically, this leads to even greater dependence on part-time, flexible labor, as employers “end up carrying a lot more people on their team than they really have adequate hours for.”

To compensate for the lack of hours employees may work two or three jobs.

but, notes one analyst, “when work or life schedules conflict, they call in sick or don’t show up, And that creates a vicious cycle: employees get stuck, they don’t show up; managers hedge by keeping more employees on the schedule and offering everybody fewer hours.”

An extreme but revealing example of schedule reductions occurred in July 2011 at a Walmart supercenter in Maryland, when the store manager announced he would have to cut hours across the board because the store had already “used up” too many of its allotted labor hours earlier in the month when the store was forced to hire a temporary staffing agency to bring extra workers to clean the store. Ironically, the need for the additional staff was due to an expected store visit by Walmart CEO Mike Duke. (According to a store associate, Duke ended up visiting a store in nearby Severn instead.)

“They had the managers in the store all day, even the ones from the district and regional offices,” says Cyndi, an associate at the store, “They were running around the whole store like chickens with their heads cut off, cleaning the aisles, removing freight that was stacked in the middle of the floor and hiding it in the backroom.”

“If our store doesn’t look good enough for Mike Duke, and if they don’t give us enough hours to make it look good enough for Mike Duke, what about our customers who shop here the other 364 days a year?,” she asked.
“**You Can’t Sell It in the Back Room**: Inventory Problems

As mentioned above, one major initiative to cut costs and boost returns was called “Win, Play, Show,” an inventory rationalization. The goal was straightforward: to reduce costs and increase productivity by limiting the assortment and focusing on faster selling items, while allowing lower volume items, those in the “show” category, to drop from the assortment. Management proudly described a “productivity loop” in which cost savings derived from limiting the assortment would be invested in lower prices which would in turn increase the speed of sales.

Walmart associates, on the other hand, describe the job cuts that coincided with this “streamlining” of inventory, and of the havoc that resulted. “One day they made an announcement, ‘The computer says there’s too many people staffing the supply room.’ Normally there were twelve people in the back, now they were going to cut it to four. The result was that department managers had to do the stocking for their own areas along with their regular duties, and that meant a lot of things just didn’t get done.”

A former Walmart store manager describes how her back supply room was dropped to only two associates, who had “thousands” of items to pull every morning, and “the only way to get it done was for the assistant managers and co-managers to step in and do it.”

During 2010, in an about face, Walmart management publicly stated they were reinstating over 8,500 items that had been pulled off of the shelves under Win, Play, Show. It was officially ended with the departure of John Fleming, the architect of the initiative, in July 2010. Even Mike Duke acknowledges this, speaking about the decline in US sales, “I think some of this was self-inflicted. . . about assortment, about the changes that we made—in some cases we caused ourselves the problem.”

This rare (if understated) mea culpa hints at how profound Walmart’s strategic identity crisis is. Some analysts predicted a period of soul searching at the company.

“WMT is admitting through its actions that it doesn’t have it all figured out and any such increase in inward-looking should be beneficial to WMT over the long term,” wrote one analyst.

“An organization the size of WMT will have to unlearn a number of behaviors at the store and central level.”

But when Walmart’s top executives looked inward for solutions it seems they simply doubled down on their favorite strategy: cost cutting. But the starting point for this round of cost cutting was arguably the leanest staffing model in retail, and to many outside observers the company has reached the point where further cuts are simply counter-productive.

Take the example of the short-lived SKU reduction. The initial reduction was combined with (and premised on) a reduction in staff—fewer SKUs would require fewer labor hours. But after the SKUs were added back did Walmart increase the staffing in the supply room? “Has Walmart ever increased staff?” replied one former store manager, with a laugh. (It did not.) She also said that in her store many long-time customers became frustrated with the lack of assortment and stopped coming to the stores.

To understand the way the company’s assortment changes and staffing levels are affecting inventory levels it is necessary to understand how Walmart’s inventory management system is supposed to work. The heart of the system is the point of sale barcode data collected at the checkout scanner. These data are famously updated to Bentonville’s database via satellite every three seconds. According to industry lore this information system is rivaled only by the Pentagon’s, and allows the company to monitor sales trends in real time and even to predict demand for certain products before store managers realize they need to order them.

Walmart’s information technology is the central nervous system that allowed the company to wring greater efficiency out of its supply chain (and better prices from its suppliers). Yet this system is only as good as the data that is entered at the checkout scanners. And in the context of a high stress, low staff labor model, this system is more fragile than it might appear.

“That point of sale data is not reliable,” said Sandy, a former department manager from a supercenter in Maryland. Due to the significant pressure exerted by store managers on cashiers to ring up each customer as quickly as possible, particularly when there are long

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21 David Schick, “Change Afoot and Change is Good, but Not in the Short Term; Downgrade to Hold,” WMT, Stifel Nicolaus, 27 July 2010.

22 Interview with Dan Binder, “Jefferies Downgrades Wal-Mart,” CNBC, Aug 2, 2011 CNBC: “we are starting to see some cracks in recent store checks... longer front end check out lines as fewer [cashiers] man the registers.”
lines, cashiers typically use the quantity keys to ring up multiple same-price items, even if the items are slightly different.

“Take noodle soups for example,” says Sandy. “Often people will have 10 or 20 soups in their cart, and they are all the same price but different flavors. You can either scan the first one and then hit the quantity keys for 20, or you can scan each one separately. You’re supposed to scan them separately, but you’re also supposed to go as fast as possible. Guess what happens?”

Ernestine, a cashier, says she always makes sure she scans each item, but she understands why other cashiers may not. “Cashiers are under a lot of pressure to keep their IPH [items per hour] scores up. Managers can come up to you at any time and ask you to do an ‘action code 10’ and the cash register will compute your IPH, and those go into points for your evaluation. When someone has that kind of pressure they may take short cuts such as using the quantity keys for multiple items.”

Vikki, the former store manager with 23 years of experience says the point of sale problem related to multiple item scans was so widespread the company actually disabled the quantity keys on the registers in many stores. (Of course this implies a tradeoff where more accurate point of sale data is achieved at the expense of slower checkouts and longer lines.)

As a department manager, a significant part of Sandy’s job involved correcting the inventory errors generated by the point of sale system. But as the staffing reductions and pressure to do more with less became more acute, Sandy reports, there was less time to correct these errors.

According to Kenny, a former department manager from Seattle the Task Manager system shares much of the blame for the problems he sees in the inventory system. “All of the tasks for stockers and unloaders are focused on newly arrived shipments, not previously delivered pallets and cases, so if a pallet or case of goods didn’t make it onto the shelf perfectly the first time there’s no follow up on it.”

Toby, the inventory control specialist in Southern California, agrees: “Task manager times are for new freight, and the old freight is not captured in the daily flow.” According to Toby the older freight, or “overstock,” is supposed to be placed in bins organized by department and product in the backroom, so that floor associates can easily restock shelves with these items, but, he says, “this is not happening regularly because there is not enough time to do it.”

And the pressure to keep up with the
A relentless pace is real. According to Toby, earlier this year four associates were fired from overnight crew at his store due to the task manager times not being met.

Across the country Walmart associates report problems with inventory, unrelated to any planned buildup associated with the return of SKUs. Instead, according to numerous associates, pallets are accumulating in the backroom, even when shelves are not fully stocked.

“There was a mountain of pallets for a while. They were even blocking the fire exits,” said Toby.

Toby reported this problem to his manager who “promised to take care of the problem, but never did.” Later OSHA was called and the problem was fixed.

“The situation became so bad that a number of pallets were actually ‘hidden’ in containers in the back parking lot during annual inventory,” he said.

Vikki, the former store manager, with experience in the Midwest, South and Pacific Northwest concurs: “The backroom gets clogged with previous shipments, and it becomes hard to access,” she said, “so sometimes the best thing to do is to order new merchandise.” The inventory system should function smoothly, according to Vikki, but not with the staffing levels the company typically tries to operate at. “Walmart has the technology but not enough people to make it work,” she said.

It is difficult to say whether the problems these associates cite are visible in the company’s financial reporting. Inventory has grown significantly, but that could be attributed to the reintroduction of many of the SKUs taken out under the Win Play Show initiative.

Additionally we would expect to see more shrink. Walmart reported lower shrinkage in FY 2010, but changed its inventory accounting method in FY 2011, resulting in a significant reduction in reported inventory levels, making year on year comparisons difficult. According to one associate, the FY 2010 annual inventory check at a Southern California store resulted in the store having approximately $600,000 worth of inventory more than it was supposed to; this year’s inventory check resulted in the inventory being approximately $1.4 million under its goal—both variances are large and problematic. According to another associate, one store in the Northwest had $900,000 in shrink last year.
**CUSTOMER SERVICE**

In its May-June 2011 survey of 501 randomly selected Walmart associates Lake Research Partners asked respondents to name the best thing about their jobs, and the number one answer, with a 23% plurality, was “helping/interacting with customers.” In-depth interviews with Walmart associates confirm this sentiment and offer further insight into its source. Time and again Walmart associates express empathy for and identification with the discounter’s cash strapped customers. (Half of the associates surveyed by Lake described themselves as “living paycheck to paycheck”; nearly one-third have recently been enrolled in a public assistance program for themselves and/or their families.) Often these conversations are tinged with a sense of regret that they don’t have more time to give customers the help they need.

The retail empire Sam Walton founded was once widely known for attentive customer service policies including the “ten foot rule,” which dictated that associates greet any customer that came within ten feet.

Clearly, the customers have noticed the problems with customer service. This past June Consumer Reports published the results of a study of customer service at various retail stores by its National Research Center based on surveys of its subscribers and found that Walmart and Sam’s Club stores “were ranked among the worst in areas such as buying small appliances, electronics, cell phones and groceries.”23

Vikki, the former store manager, says it’s about the math: “With fewer associates responsible for more areas of the store there is simply less time for customer service.”

An associate responsible for one department obviously has more time to assist customers in that department, and more knowledge about the products found there, than one responsible for four departments, but this problem is compounded in certain departments which require staff assistance to make sales because items have to be removed from locked cases (electronics, jewelry, lawn & garden, hardware, pharmacy, health & beauty, pets) or require a greater degree of staff assistance (courtesy desk, shoes).

Interviews with Walmart associates about their jobs inevitably evoke numerous stories of being stretched too thin to attend to customers adequately. Greg, the electronics department associate from Southern California, tries to quantify the problem: “I would estimate I lose about 12 customers in every 8-hour shift because I don’t have the staff help to serve them.”

According to Greg, the lack of staff means that stocking and “zoning” (straightening up disorganized shelves) is neglected, which results in a situation where “the stores aren’t just messy, they are often chaotic organizationally which makes it harder for customers find what they’re looking for, and difficult even for associates who aren’t familiar with that department, but may be ‘floating’ to cover it.”

Angie from the supercenter in Baldwin Park, CA says, “We have to hurry to get all the freight up and stocked, but don’t have time for customers when they want help finding something. You don’t have the option anymore of telling customers to let me go back to the store room and look for something- there’s just not time. A lot of the shelves are

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empty too, so customers are always looking for things.”

Greg adds that “customers are increasingly frustrated when products aren’t available,” and this is especially true when the customers have come to the store specifically for an item walmart.com indicated was at that store. “I have had customers become irate,” he says, “and it even gets to the point where it creates an unsafe work environment.”

Another frequent complaint about Walmart is the inconvenience created by long lines at the checkout, because not enough cash registers are open.

Ernestine, the day shift cashier from Maryland, agrees:

“I would estimate I lose about 12 customers in every 8-hour shift because I don’t have the staff help to serve them.

-Greg, Southern CA

Ernestine, the day shift cashier from Maryland, agrees:

“At our supercenter there are 32 lane cash registers but often we will only have two express lanes open and two regular lanes open. The lines get long. I would say that three or four times a week we have customers abandoning their carts in the aisle in frustration... I can only imagine how many customers just turn around and leave once they enter store and see the lines. And the problem is worse on second shift when customer traffic is heavier.”

Maggie, the overnight stocker in Southern California, reports that only two registers are open on day shift even during first 8 days of month, when the store tends to be busier due to heavier traffic from customers who receive paychecks on the first of the month.”
TRAINING

Part of the self-image Walmart seeks to project, particularly in new markets where the retailer is seeking to expand, is that of a company where entry level employees can build a career. Yet despite this public emphasis, Walmart associates report there is very little investment in the training that could facilitate such a career path. In the Lake survey, a 54% majority of employees said Walmart did a “poor or just fair” job of providing the training and mentoring that allows employees to earn promotions. To the extent that training does exist at Walmart it primarily takes the form of “computer based learning” tutorials, or “CBLs,” which usually consist of reading a one-page document about a specific product or how to sell certain kinds of merchandise, followed by several multiple choice questions designed to test comprehension of the text.

Whatever the efficacy of the CBL model in general, it seems to be falling short at Walmart. As one indication, the Consumer Reports survey found that Walmart had “the least-knowledgeable staff when it comes to buying computers.”

Greg, the electronics department associate in Southern California, isn’t surprised at the low score and agrees that there is generally very little product knowledge on the part of associates. “When a new employee starts he or she is given very little sense of the parameters of the job, what the duties are.” Instead, he says “routines are established by habit,” with very little explicit training.

“The CBLs are supposed to be completed about three times a week but we’re just too busy to do that,” he says.

Maggie, the overnight stocker in Southern California, says that, in her store, managers (who are required to ensure that their subordinates complete the CBLs) stand behind associates and tell them what answers to give on the multiple choice questions, “because there’s no time to read the text.”

“If Walmart would just invest in its employees it could run a better business and make more money,” adds Greg.

John, the former co-manager agrees: “Training is a huge problem in Walmart, there is really no training for associates. In Maryland, a store manager wanted me to fire associates for making mistakes, but we really hadn’t trained them how to do their jobs correctly, because there was no time. I quit because I didn’t think that was right.”

According to John, managers aren’t given enough training either.

The management training course he took in 2004 was 16 weeks; by 2010 it had been reduced to six.

“If you’re lucky you have a good store manager who can help bring you along, but you’re not always lucky.”

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LOW MORALE, INCREASING TENSION & DISCIPLINE

When the Lake Research poll was conducted earlier this year associates were asked to name the “one thing” they would change about their job it is not surprising that the most popular answer, among a workforce where nearly 45% make less than $10 an hour25, was “higher pay.” But what may be more notable is the second place answer: respect.

During the summer and early fall of 2011, interviewed Walmart workers described a “toxic environment” of ill-will in which managers verbally berate associates to work faster. The increased demands dictated by the Task Manager create a situation in which the three-step company discipline process (1: verbal warning, 2: written warning, 3: ‘D-day’ or decision day) occurs at what current and former associates and managers say is a significantly higher rate than in the past.

The frustration with the Task Manager system—and the belief that its time requirements are unrealistic—is so widespread among Walmart associates26 that one might suspect its power to credibly discipline workers would be inherently limited. But associates are quick to point out that while managers have the authority to override the system when tasks are not completed, and do so frequently, it is entirely at the managers’ discretion. Thus, the Task Manager system creates a workplace environment in which associates are often in a state of technical violation of the rules, potentially allowing managers to selectively apply discipline.

While such a system might hold some appeal for a certain philosophical approach to labor discipline, the increased possibility of managers engaging in disparate discipline of employees increases the potential legal liability of Walmart.

EMPLOYEE SURVEYS

In recent years Walmart has publicized the results of an “Associate Opinion Survey” the company conducts among employees throughout the United States. Based on these surveys, Walmart claims a strong majority of associates have a positive “engagement” with their jobs, and that that engagement is becoming more positive over time.

But a number of associates across the country question the reliability and in some cases the veracity of the company’s poll results.

Sandy, a former department manager from Maryland, suggested the surveys are not truly anonymous, pointing out that “there is potentially identifying information in the survey—what department you work in, which shift, your ethnicity, etc.”

Others report being instructed how to answer the survey questions. Maggie in Southern California says flatly that in last year’s survey the “personnel manager told us how to answer the questions.” Misty, the former assistant manager from Washington says she was told to stand behind associates while they were completing the surveys, making sure they gave the “right” answers.

Still others say they haven’t been asked to participate in a survey. Greg from Southern California says “I’ve been here 4 years, and I’ve never seen a survey.”

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25 Based on Lake Research Partners poll, June 2011.
26 In addition to the workers interviewed in this report see for example chat rooms such as http://trueinsider.com/frame/BoardRoom/566527487?company_id=1130190&page=1
INJURIES

Many Walmart associates across the country believe there is a higher rate of injury occurring as a result of the increased workloads and decreased staffing. Common injuries include pallets falling on associates, feet run over by forklifts, backs injured by the repetitive strain of unloading hundreds of boxes over extended periods of time.

Angie, the overnight stocker from Baldwin Park, says, “Our equipment is old. Pallet Jacks have wheels that don’t roll, so I end up using my body, not the machine to push and pull heavy loads. Our backs and arms get hurt in the process.”

In an apparent effort to reduce shrink, Greg, the sales associate from electronics was assigned to work in the receiving area and pull the electronics items from the conveyor belt delivering items from the trucks.

Greg describes this as very difficult work, with many items, some of them heavy (such as TVs), coming down the line at a rapid pace. As a result of this work Greg tore the connective tissue in his right scapula. Greg’s doctor prescribed “light duty,” but his manager told him to simply “do some stretches” and to continue to do the unloading work in the back of the store, in addition to his other duties.

Instead, Greg got a lawyer, and stood up to his manager, refusing the assignment. This standoff continued, with Greg refusing the assignment every day for about six weeks, until finally Greg’s manager relented. In an important sense, Greg’s is a story of an associate successfully standing up for himself and winning. But it would be a mistake to take from this the lesson that Walmart’s corporate culture is flexible, and accommodating to associates’ work needs. “It was the most stressful period in my life,” says Greg. “It’s a foreign concept to them that people have a value beyond their muscle.”

A number of associates report an apparently subtle (and not so subtle) pressure on associates to not report injuries. One widespread practice reported by associates is linking quarterly store bonuses to reported injuries in the store. Bonuses are apparently reduced if there are too many injuries at the store. In this way there is a great deal of peer pressure on associates who might otherwise report injuries.

“...and told everyone that they are aware of the rate of injuries and that it may not be a bonus this quarter.”

Vikki, the former store manager agrees: “When people get back injuries they are told what the cost to the company is, and the accident rates are posted in the breakroom or near the time clock so everyone could see it.”

One California associate told interviewers from the UCLA Occupational Health Internship Program “I did not get medical attention for my injury because I was afraid that I might lose my job.”

I did not get medical attention for my injury because I was afraid that I might lose my job.

-A California associate

“The managers will bring it up in the daily meetings,” said Greg. “They don’t say an individual associate’s name but they will say ‘As you know, because of the volume of customer and worker accidents there may not be a bonus this quarter.’”

Another possible reason some associates may be disinclined to report injuries is that, as Misty, a former assistant manager reports, the company has a policy to drug test any associate who is injured, and these “investigations” are led by the company’s loss prevention department which a number of associates have described as being notoriously heavy handed.

Misty cites an example of a woman run over by a water pallet who was drug tested and interrogated by loss prevention prior to receiving any medical attention. “Injuries are considered a cost center and they are actively managed by the company,” she says.

Walmart’s motivation to minimize the reporting of injuries, and the related workers’ compensation is clear, given that lower injury rates result in lower insurance costs to the company. Because Walmart self-insures through a subsidiary it is able, as several workers allege, to engage in bureaucratic tactics that may make it more difficult for workers to collect workers’ compensation when they have a legitimate claim. These allegations against Walmart have a long history.

In 2001, the state of Washington threatened to take over the company’s injured worker program, and prohibited Walmart from self-administering its workers compensation claims in that state for eight years. According to the order issued by the Washington Department of Labor and Industries, “Over the last seven years, Wal-Mart has “repeatedly and unreasonably” delayed giving injured workers the benefits they were owed under workers’ compensation laws, and, in some cases, Wal-Mart employees were not allowed to file workers’ comp claims at all.”

Current Walmart associates believe the pressure to not report injuries remains just as serious today, and they believe the company is also unfairly targeting injured workers for termination. Contrary to the widespread concern about injury rates expressed by associates across the country, in August 2011 the company reported cost savings resulting from lower accident rates in the stores during the 2nd quarter of FY 2012. Whether this cost savings is sustainable, or if it merely reflects a lower rate of reporting, is unclear.

A Better Path to Profitability

Walmart has long been known as a difficult place to work, with irregular hours and a corporate culture that many interviewed associates described as permitting favoritism and discrimination, and as a company that refuses to tolerate unions. Still, the company described today by thousands of current employees across the country is a far cry from even the Walmart of 10 years ago, when the company built by Sam Walton still retained a sense of corporate paternalism, and shared mission. As discussed above, recent changes including the elimination of profit sharing and the Sunday premium, the introduction of computerized scheduling and the generalized increase in workload, have seriously undermined that cohesiveness. This shift in the company’s HR culture parallels the recent strategic confusion in Bentonville regarding merchandising, marketing and store format, and is equally fundamental to the success of the company’s business model.

Employee Satisfaction

Many Walmart associates feel the company today regards them as commodities, easily replaced by the next job applicant who walks through the door. Yet research shows that employee satisfaction is an important component of business success.

A 2010 study, conducted by Alex Edmans at Wharton, examined the list of the “100 Best Companies to Work For in America” published in Fortune magazine over the 25-year period from 1984 to 2009 and found that employee satisfaction is positively correlated with shareholder returns. In fact these companies outperformed industry benchmarks by 2.1% annually. Edmans noted that the “Best Companies” also exhibited significantly more positive earnings surprises than other companies.

Important recent research by Françoise Carré and Chris Tilly, focusing on the US retail industry specifically, has found that many employers can achieve competitive advantage by investing in their workforces and “offering superior service and product knowledge—most likely in combination with higher quality fresh products and a broader range of offerings.” By contrast, the researchers found that companies pursuing low-cost labor strategies face costs associated with higher turnover, lower levels of product knowledge and a diminished internal pipeline of management candidates.

In summary, the researchers found that cost-cutting weakens retailers’ ability to implement service-intensive strategies, concluding that “For virtually all companies, the goals of cost-cutting and improving service quality are in tension, and at times in conflict.”

One example of this tension is the way Walmart’s low-wage, high-turnover model limits its ability to effectively sell higher ticket, less commoditized items. In a 2010 conference call with retail investors one consultant specializing in consumer electronics noted that Walmart’s push


31 Ibid.

to expand its market share in that area was most likely to succeed in those electronics categories where the customer “has confidence to be self-directed in the purchase,” but would struggle in areas including “value added solutions such as labor and extended warranties” or “positioning themselves as a place to go to answer questions or make recommendations,” or “creating solutions through the interoperability of different devices working together.”

**Sam’s Club vs. Costco**

The classic example of the high road/low road contrast in labor policy is that of Costco and Wal-Mart. Costco explicitly uses fewer part-timers and “offers superior compensation to keep turnover low and motivate a high productivity workforce—which in turn helps them attract higher income shoppers.” At times Costco’s labor-friendly policies have run afoul of Wall Street equity analysts who feel the “generous” employment practices have been implemented “to the detriment of shareholders.” Yet despite the occasional grumbling from analysts, Costco shares have substantially outperformed Walmart’s over the last decade, and Costco’s operations are also significantly more productive than those of Walmart’s Sam’s Club division.

Costco’s workforce is about 10% union, and wages and benefits are higher across the board compared to Walmart. But this investment in human capital is well worth it, and Costco’s stores generate nearly 60% more sales per square foot, and 27% more operating profit per square foot, than Sam’s Club.

As Tilly and Carré conclude, “Costco has adopted a labor strategy intended to further the goal of enhancing worker productivity; higher than average compensation is designed to limit undesirable turnover and to promote worker effort.”

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34 Carré and Tilly, 2010, p. 29.
37 Carré and Tilly, 2010, p. 17.
The Costco Advantage:
Total Shareholder Return, annualized
(through September 2011)

COSTCO ADVANTAGE
• Low-turnover workforce: Approx. 17%
• Relatively high pay; 10% union
• Significantly higher productivity:
  - Sales per sq. ft.: 59% higher
  - Operating profit per sq. ft.: 27% higher

Walmart’s Effect on the Economy
As Walmart lowered wages so did other retailers until Walmart’s wage advantage was less significant. Other retailers also invested in information technology systems that allowed them to gain leverage over suppliers and to wring efficiencies out of the supply chain. Walmart doesn’t have a patent on the barcode scanner, or the cross-dock distribution center, and many competitors implemented these systems under the direction of former Walmart managers. Indeed, one view of the Walmart phenomenon is that the company’s low cost model, aggressive antiunion behavior and leveraging of information technology to gain bargaining power over suppliers, reset competitive equilibrium, but at a lower level for wages and supplier costs. While the era of a clear advantage for Walmart is over, the challenges brought about by low wages have affected companies throughout the economy, but ironically perhaps none more directly than Walmart itself.
Walmart more than most other firms caters to lower-income consumers, and in the fall of 2010, the company reported a decline in traffic and sales among its core customers (households with incomes below $50,000.)³⁸ To the extent that the US recovery continues to be a bifurcated story of growing inequality and languishing incomes for most Americans, Walmart’s strategy will be challenged. In this sense, Walmart—the firm notorious for driving down wages in both the service and manufacturing sectors, and for lowering the incomes of a large section of American consumers—is now, to paraphrase historian Nelson Lichtenstein, struggling to adjust to the world it has created.³⁹

Walmart’s CFO, Charles Holley, Jr. acknowledged the disproportionate impact of the bad economy on Walmart’s core customers, who tend to be lower income.

“Our core customer continues to be strained, and we still see what we call the paycheck cycle as pronounced as ever ... We haven’t seen any relief...we’re starting to see jobs as the number one concern among our customers at Walmart.”⁴⁰

S&P projected continuing pressure on Walmart’s core consumer, “we expect demand from lower- and middle-income consumers to remain weak as economic pressures hurt demand for discretionary goods.”⁴¹

The challenges Walmart faces as its core customers attempt to make due with less are the result of a decades long process of hollowing out of the US middle class, a process that has been driven by a number of complex factors. But more than any other single company, Walmart is itself responsible to no small degree for the trends, largely due to the notoriously low wages paid to the company’s 1.4 million US associates.

**Walmart Associates Earn Poverty Wages and Substantially Less Than Workers at Other Retail Firms**

Although the company will often cite higher figures, in the range of $12 to $13 an hour, depending on the state, IBISWorld, an independent market research group recently reported that Walmart sales associates receive just $8.81/hour, on average. This translates to annual pay of $15,576, based upon Walmart’s full-time status of 34 hours per week or less than 70% of the poverty line for a family of four.⁴² Similarly, a 2011 national poll of Walmart employees by Lake Partners Research found that 45% of workers earn less than $10/hour and 74% earn less than $12/hour.

Walmart workers earn substantially less than retail workers in similar establishments. Although public data on a company by company basis is difficult to obtain, multiple studies have shown substantial wage gaps between Walmart associates and employees of comparable retailers.

A 2005 study found that Walmart workers earn an estimated 12.4% less than retail workers as a

³⁸ David Strasser, “Keeping the Growth Bug,” WMT, Janney Montgomery Scott, 14 October 2010.
³⁹ Lichtenstein, 2009.
⁴² http://aspe.hhs.gov/poverty/11poverty.shtml
whole, and 14.5% less than workers in large retail in general. A 2007 study which compared Wal-mart to other general merchandising employers found a wage gap of 17.4%.

**Walmart Also Brings Down Wages and Employment for non-Walmart Workers**

Walmart’s impact on wages is not limited to Walmart employees. Several studies have also shown that the presence of a Walmart store tends to reduce earnings for retail workers and for wage earners generally. A 2005 study by Neumark, Zhang and Ciccarella found evidence that “total payrolls per worker and per person decline, by about 2.5 and 4.8 percent, respectively, implying that residents of a local labor market do indeed earn less following the opening of Wal-Mart stores.” This study is particularly striking because these numbers are for workers in general, not just retail workers.

Other studies have focused more on workers in the retail sector but found a similar downward effect on wages. A 2005 study by Dube and Wertheim found that, in urban areas, where much of the company’s projected growth is expected to occur, Wal-Mart displaces general merchandising jobs that pay around 18% more. This same study, looking at combined impacts on wages and employment, estimated that “in 2000, total earnings of retail workers nationwide were reduced by $4.7 billion due to Wal-Mart’s presence.”

**The Economy Has Shifted Increasingly to the Service Sector Over the Recent Decades and this Shift Is Projected to Continue.**

From 1998 to 2008 the service producing sector grew at a rate of 1.3% a year, faster than any other segment of the economy.

Over the longer-term, from 1950-2010, while the US population doubled the number of jobs in the service-producing economy more than tripled. Meanwhile, despite the population growth, the number of goods-producing jobs increased by just 2.4%.

From 2008 to 2018, the US government projects service-providing industries will add 14.6 million jobs, or 96 percent of the increase in total employment.

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45 Dube, Arindrajit, and Steve Wertheim, 2005. Wal-Mart and Job Quality – What Do we Know, and Should We Care?

46 [http://www.bls.gov/emp/ep_table_201.htm](http://www.bls.gov/emp/ep_table_201.htm)

47 [http://www.bls.gov/news.release/ecopro.nr0.htm](http://www.bls.gov/news.release/ecopro.nr0.htm)
Walmart’s Cost Cutting: Profiting All the Way Down

In the face of these structural headwinds, and the resulting declines in personal consumption expenditures, Walmart has found ways to report growing profits despite flagging sales, primarily by cutting hours and wages of its 1.4 million US associates, leaving the remaining staff to do more with less (as discussed above). These trends are mirrored nationally, where the broad retail trade sector has seen strong growth in operating profits despite slowing growth or declining sales over the past few years.

The growing gap between workers’ output and compensation is at the heart of the decades-old trend of growing corporate profits, declining wages and greater inequality in the United States, and it has continued in the context of the current economic crisis.

But the question before analysts and investors today is how sustainable is this situation? For years US households relied increasingly on credit, often borrowing against the value of their homes, to fund current consumption. As Bloomberg Markets cautioned, “Profit growth during this weak recovery is coming from cost cutting, layoffs and higher productivity—and may be tough to maintain” in the absence of strong sales growth.48

POVERTY IS INCREASING

Census Data released in September of this year, showed that another 2.6 million people had fallen below the poverty line.\textsuperscript{49} The 15.1% poverty rate was the highest since 1993, which meant that more than 46 million Americans were living in poverty, the highest number in the 52 years the figures have been published.

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{poverty_chart.png}
\caption{Percent of US Population Below Poverty Line}
\end{figure}

The proportion of people living below the poverty rate rose 33.6% between 2000 and 2010. Moreover, the proportion of people living below 50% and 75% of the poverty line increased at an even greater rate over the last decade (49% and 34% respectively) and, in 2010, more than 1/3 of people in the US had incomes of less than 200% of the poverty rate – just $44,628 for a family of four.

Commenting on the release of the new data, economists noted that the current recession is now the first time since the Great Depression that median household income, adjusted for inflation, has not risen over such a long period.\textsuperscript{50}

\begin{quote}
\textit{This is truly a lost decade. We think of America as a place where every generation is doing better, but we’re looking at a period when the median family is in worse shape than it was in the late 1990s.}\textsuperscript{51}
\end{quote}

- Lawrence Katz, Professor of Economics, Harvard University

\textsuperscript{50} Ibid
\textsuperscript{51} Ibid
### Wages and Incomes are Flat, or Falling

As of August of this year, adjusted for inflation, wages have fallen 1.3% since October, 2010.\(^{52}\) Census data released in September, 2011 showed median household income fell 2.3% in 2010 over the previous year. The previous year, for first time on record, the nominal (non-inflation adjusted) income of the median, or typical, household actually fell, from $50,303 in 2008 to $49,777 in 2009.\(^{53}\)

According to data recently released by the Internal Revenue Service, the income for the average tax payer fell $8,588 or 13.7 percent in real terms from 2007 to 2009. This means, on average, people had $716 less each month to spend.\(^{54}\)

### Unemployment and Underemployment Highest in Nearly 30 Years

At the same time, unemployment and underemployment remains over 16%.\(^{55}\) The Economic Policy Institute reported that when we combine outright job losses with the increase in the number of workers working part-time of part-year, “there was a 4.7 million drop in the number of earners working full-time, full-year.”\(^{56}\) The August unemployment rate of 9.1% was the highest since 1983.

Given extraordinarily high unemployment and underemployment, increasing disparity in income and income growth, and high poverty rates, it is difficult to envision short-term wage and income growth for Walmart’s core customers.

In their study of retail trends in the United States Carré & Tilly point to the sharp decline in union density and the concurrent decline in the real value of the minimum wage, which have reduced standards for low-wage workers generally, and these efforts were often led by retailers such as Walmart. Indeed, they note that “retail seems a laboratory for changes in labor market institutions; the sector often leads with experimentation in this regard. Everywhere it currently seems to stand out as a sector where the relaxation of regulation combined with a vulnerable workforce intensify the danger of bypassing features of national institutions that protect low-wage workers.”\(^{57}\)

For low wage workers, and the households their incomes contribute to supporting, these trends have profound implications. But for institutional investors there are additional implications. Large investors, such as public pension funds, are not simply invested in certain stocks; they are invested in broad cross-sections of the entire market. These so-called “universal owners” can be thought of as “long-term owner[s] of a diversified investment portfolio that is spread across the entire market or markets,” and whose long-term financial interest “depends on the ability of


\(^{54}\) Johnston, David Cay, “Forget taxes, it’s wages that plague Americans,” Reuters, August 6, 2011.

\(^{55}\) http://www.bls.gov/news.release/empsit.t15.htm

\(^{56}\) Gould, 2010.

\(^{57}\) Françoise Carré, Chris Tilly, Maarten vanKlaveren, Dorothea Voss-Dahm, “Retail Jobs in Comparative Perspective,” 2008.
global markets to produce economic growth on a sustainable basis.”\textsuperscript{58}

Therefore, universal owners inevitably absorb the portfolio-wide effects of individual firm actions, including the effects of firms they don’t own. The larger the firm and its effects on the economy, the more significant the portfolio effects, and the greater the rationale for active engagement by the owner.

The move by Walmart and other large employers toward greater flexibility in scheduling and unprecedented reliance on part-time workers is a case in point. The dramatic growth of part-time work is an important consequence of a generalized risk shift, a negative externality generated by the business practices of large companies like Walmart. These externalities are absorbed, one way or another, by the larger economy and society in the form of reduced household incomes and greater burdens on public safety net programs, as well as the long-term consequences of lowered investments in human capital and productivity. Universal owners cannot avoid the costs associated with these externalities by simply divesting from the stocks of Walmart and other firms that practice “low road” labor strategies.

In a sense, the largest retailer in the world, serving a mass market hammered by the economic forces it has unleashed, is a universal owner as well. Walmart cannot simply decide to sell to a higher income market—they tried that with Project Impact, and either that market was already better served by others, or something about Walmart’s brand, locations, or low road business model wasn’t a good match. Or maybe the slightly higher income market just isn’t big enough to replace the more than $300 billion in US sales Walmart currently enjoys.

\textsuperscript{58} Briand et al, “Integrating ESG into the Investment Process: From Aspiration to Effective Implementation,” MSCI ESG Research, August 2011, p. 3.
CONCLUSION

In this report we have tried to bring the concerns and perspectives of frontline retail workers to a larger group of analysts and investors. We believe this perspective is critical to understanding the nature of the challenges facing Walmart today, and also has important implications for the larger economy.

Walmart is a company that has built its reputation on low prices, but today, for a variety of reasons, it no longer enjoys the kind of pricing advantage it once did, and competitors have started to eat away at the company’s market share. Will Walmart go the way of Sears and KMart, the once-dominant retailers unable to change with the world around them? Time will tell. But we believe Walmart’s leadership has the chance to reverse the vicious circle of cost cutting, deteriorating performance and lost sales. The first step is to respect the frontline associates who serve millions of customers in the stores every day, and to listen to their ideas about how to improve the company.

At the same time, Walmart executives have the opportunity to reverse the downward spiral of low wages that is eroding the purchasing power of US workers and decimating the American middle class. When many Walmart workers themselves are forced to rely on food stamps and other government assistance to make ends meet, is it any wonder that Walmart’s core low-income customers are cutting back on discretionary purchases?

Walmart is nothing if not big, and the company has often enjoyed pointing to its scale effects on the rest of the economy. For example, as part of the company’s rebranding campaign, Walmart executives have touted the supposed ripple effects of their “sustainability” and “healthy foods” initiatives throughout the retail supply chain, yet these same executives are curiously silent about the effect of Walmart’s low-wages and ‘part-timing’ of work on the economic security of millions of American families.

“Long-term profits cannot ultimately grow unless they are partnered with near equal benefits for labor,” a large investor recently observed.59 If the implications of this insight are to be applied in corporate America, it will be because large investors insist on it. Given its size, the nature of its operational challenges, and its effect on the larger economy, we believe Walmart is the logical place to start.
