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decade, Asian countries have signed over 70 trade  
agreements among themselves. Japan, which is not  
a member of AFTA, has signed a number of bilateral  
agreements with other countries in Asia, including  
an FTA with the members of ASEAN. It became a  
member of the Trans Pacific Partnership in 2013  
and is in the process of implementing new agree-  
ments with Australia, the Gulf Cooperation Council,  
India, and Korea. However, the key to the growth of  
most countries in Southeast Asia may be China and  
its rapidly growing influence in Asia and the rest of  
the world. ■



## CASE Walmart Goes South

Comercial Mexicana S.A. (Comerci), one of Mexico's largest retail chains, is faced with a serious dilemma.<sup>51</sup> Since Walmart's aggressive entry into the Mexican retail market, Comerci has found it increasingly difficult to remain competitive. Walmart's strong operating presence and low prices since NAFTA's lifting of tariffs have put pressure on Comerci, and now management must determine what the chain needs to do to compete against Walmart.

What has caused this intense competitive pressure on Comerci, and what is likely to be its future? Mexico's retail sector has benefited greatly from the increasing trade liberalization the government has been pushing. After decades of protectionism, Mexico joined GATT in 1986 to help open its economy to new markets. In 1990, with Mexico's economy on the upswing and additional free trade negotiations with the United States and Canada taking place, the founder of Walmart, Sam Walton, met with the president of Cifra, Mexico's leading retail store. Their meeting resulted in a 50/50 joint venture in the opening in 1991 of Mexico's first Sam's Club, a subsidiary of Walmart, in Mexico City.

It took only a couple of months after the opening to prove the store's success—it was breaking all the U.S. records for Sam's Club. The JV evolved to incorporate all new stores, and by 1997, Walmart could purchase enough shares to have a controlling interest in Cifra. In 2000, the name changed to Walmart de México, S.A. de C.V., and the ticker symbol to WALMEX.

Prior to 1990, Walmart had never made moves to enter Mexico or any country other than the United States. Once it started growing in Mexico, management created the Walmart International Division in 1993. By the first quarter of 2011, Walmart had expanded internationally to 15 countries outside the continental United States through new-store construction and acquisitions. It now operates in Argentina, Brazil, Canada, Chile, China, Costa Rica, El Salvador, Guatemala,

Walmart has successfully expanded into Mexico, and its stores reflect the scale and quality of Walmart's best in the world. The familiar Walmart logo and color scheme are typical of the Walmart stores.

Source: Courtesy of Walmart de Mexico y Centroamerica files



Honduras, India, Japan, Mexico, Nicaragua, Puerto Rico, and the United Kingdom. Walmart serves customers and members more than 200 million times weekly through its international operations.

With growth stalling in the United States, Walmart is looking to international expansion. It currently has more than 10,800 retail units worldwide, of which more than 6,100 are outside the continental United States, and it employs more than 800,000 people outside the U.S. In 2012, the international division increased sales over the previous year to almost \$125.873 billion. The international division accounts for approximately 15.2 percent of sales.

Nevertheless, Walmart's success internationally has varied by country. It has struggled to match consumer preferences and work successfully with suppliers in Japan, encountered trouble in the United Kingdom, and failed to turn profits in Germany and South Korea, forcing it to withdraw completely from the latter markets. However, it has flourished in Canada and, most notably, in Mexico. Walmart's operations in Canada began in 1994 with the acquisition of 122 Woolco stores. It now has more than 380 Walmart stores and enjoys strong partnerships with Canadian suppliers. In Mexico, Walmart operates 2,354 units, including Sam's Clubs, Bodegas (discount stores), Walmart Supercenters, Superamas (grocery stores), Suburbias (apparel stores), and VIPS restaurants, and it has become the largest retailer in the country.

Given its hit-and-miss success rate on the international scene, it is natural to wonder how much of Walmart's triumph in Canada and Mexico has stemmed from its internal processes, international strategies, and geographic proximity and how much can be attributed to the close economic ties shared by the United States with the two countries through NAFTA.

### Walmart's Competitive Advantage

Much of Walmart's international success comes from the tested practices on which the U.S. division bases its success. Walmart is known for the slogan "Every Day Low Prices," which is the core of their value proposition. It has expanded that internally to "Every Day Low Costs" to inspire employees to spend company money wisely and work hard to lower costs. Because of its sheer size and volume of purchases, Walmart can negotiate with suppliers to drop prices to agreeable levels.

The company also works closely with suppliers on inventory levels using an advanced information system that informs suppliers when purchases have been made and when Walmart will be ordering more merchandise. Suppliers can then plan production runs more accurately, thus reducing production costs, which results in cost savings for Walmart and passes on the savings to the consumer as lower prices.

Walmart also has a unique distribution system that reduces expenses. It builds super warehouses known as Distribution Centers (DCs) in central locations that receive the majority of merchandise sold in Walmart stores. It sorts and moves the merchandise via a complex system of bar codes, then its inventory information system transports it to the various stores, using its company-owned fleet or a partner. The central distribution center helps Walmart negotiate lower prices with its suppliers because of the large purchasing volumes. These strategies have resulted in great success for the company. And it even uses the second most powerful computer in the world—behind the Pentagon's—to run its logistics.

### Walmart in Mexico

Prior to the passage of NAFTA, Walmart faced some challenges as it expanded into Mexico. One of the biggest was import charges on many of the goods sold in its stores, which prevented it from being able to offer its "Every Day Low Prices."

Unsure of local demand, Walmart stocked its shelves with items like ice skates, fishing tackle, and riding lawnmowers—all unpopular items in Mexico. Rather than informing headquarters that they wouldn't need those items, local managers heavily discounted the items, only to have the automatic inventory system reorder them when the first batch sold. Walmart also encountered logistics problems due to poor roads and the scarcity of delivery trucks. Yet another problem was the culture clashes between the Arkansas executives and the local Mexican managers.

Some of these problems were solved by trial and error, but the emergence of NAFTA in 1994 helped solve most of them. Among other things, NAFTA reduced tariffs on American goods sold to Mexico from 10 to 3 percent. Prior to NAFTA, Walmart was not much of a threat to companies like *Comerci*, *Gigante*, and *Soriana*, Mexico's top retailers. But once the agreement was signed, the barriers fell and Walmart was on a level playing field with its competitors—which was all it needed to become number one. However, the retail sector in Mexico is the second most competitive sector of the economy behind auto parts, so Walmart has had its work cut out for it to remain competitive against local Mexican retail chains and other foreign retailers, such as U.S.-based *Costco* and French-based *Carrefour*.

Since NAFTA has gone into force, Mexico has invested significantly in public and private infrastructure which has helped Walmart to improve the efficiencies in its distribution network. The signing of NAFTA also opened the gates wider to foreign investment in the country. Walmart was paying huge import fees on goods shipped to Mexico from areas like Europe and Asia. Foreign companies knew that if they built manufacturing plants in Mexico, they could keep costs low with Mexican labor and also ship to NAFTA's free trade zone—Mexico, the United States, or Canada.

As companies began to build manufacturing plants in Mexico, Walmart could buy these products without paying the high import tariffs. An example of this tactic in the early years of NAFTA was Sony's flat-screen television line, *Wega*. *Sam's Clubs* in Mexico imported *Wega* TVs from Japan with a 23 percent import tariff plus huge shipping costs, resulting in a \$1,600 retail price. In 1999, Sony built a manufacturing plant in Mexico, thus allowing *Sam's Club* to purchase the *Wegas* without import tariffs; this tactic also yields much lower shipping fees. The *Sam's Clubs* passed on the savings to customers—with a retail price of only \$600. Although Sony still manufactures LCD TVs for the Americas region in its facility in Tijuana, it has entered into a strategic alliance with Taiwan's *Hon Hai Precision Industry Co.*, wherein it sold 90 percent of its ownership of *Sony Baja California* to *Hon Hai Group*, which will assume responsibility for employees in the Tijuana plant. This will now give the *Hon Hai Group* access to NAFTA.

NAFTA resulted in better suppliers due to an increase in competition, competitiveness, and efficiency among companies in order to gain the trust of their clients. Suppliers have invested in being more productive in order to be more competitive, while at the same time gaining greater

access to better materials and technologies in the region. Better suppliers also increased the variety of products available to consumers with wider price ranges, which allowed Walmart to offer customers better savings and thus increase their purchasing power. NAFTA also helped Mexico achieve greater economic growth and lower rates of inflation, again adding to the purchasing power of consumers.

Comerci and others have combated Walmart's tactics by lowering their own prices, but on many items, they can't get the prices as low. Walmart's negotiating power with its suppliers is large enough that it can get the better deal. Also, most of Mexico's retailers have priced goods differently. They were used to putting certain items on sale or at deep discount, a strategy known as "high and low," rather than lowering all prices. Though they have been trying to adjust their pricing structure to match Walmart's, they are still frustrated with the giant's continued cost cutting.

Walmart's continued expansion forced yet more drastic actions. Comerci had a bad year in 2010 when it had to restructure debt from losses resulting from foreign currency derivatives bets. In 2011, it announced that it was ready to expand by opening new stores. Comerci also entered into several strategic alliances, including one with U.S.-based Costco, a major competitor of Walmart: now Comerci owns 50 percent of Costco Mexico. One way to compete with Walmart is through diversification. In addition to its 199 stores, Comerci has moved into the restaurant business and owns 72 restaurants in Mexico.

### Walmart's Expansion into Central America

Walmart also made two significant changes in its operations in Mexico. First, Walmart de Mexico purchased Walmart Centroamerica in 2009. One thing that facilitated that acquisition was the fact that Mexico, in addition to being a NAFTA member, signed free trade agreements with 49 countries around the world, including several in Central America. This meant that they could gain access to even more products and suppliers. In 2010, Walmart worked with more than 26,200 suppliers throughout Mexico and Central America, with more than 60 percent of their supplier base in Mexico composed of SMEs (small and medium-sized entities). They were also able to better coordinate the network of 14 distribution centers in Mexico and 11 in Central America, locating them strategically throughout the region.



Superama is a supermarket chain owned by Walmart in Mexico that caters to the tastes of more upscale Mexican consumers.

Source: Courtesy of Walmart de Mexico y Centroamerica files

Second, Walmart established a multi-format operations approach in the region to address different consumer segments. This occurred not only in Mexico but also in Central America through Bodegas and discount stores, hypermarkets, clubs, and supermarkets. Two different store concepts it established are Bodega Aurrera and Superama, both supermarket stores aimed at different demographics. In addition, Walmart opened apparel stores and restaurants. It also learned things in Mexico to help target the Hispanic community in the United States by opening a Latin-themed warehouse store in Houston, Texas, called Más, a spinoff of Sam's Club. In addition, Walmart imported products from Mexico for its stores in the U.S. for the Hispanic community.

### How Much Did Bribes Help?

Just as things were looking bright, allegations were brought against Walmart in 2012 that systematic bribery was an important part of its expansion efforts. Apparently the CEO of Walmart de Mexico was using bribes to expedite their ability to obtain permits to build stores in a rush to expand. Nearly 20 percent of Walmart's stores are in Mexico, and Walmart is the largest private employer in Mexico, employing 209,000 people. Were these bribes "business as usual," or did they illegally give Walmart an advantage in its rush to expand there and gain greater dominance over its competition? This is an interesting question and one being investigated by the U.S. Department of Justice.

### QUESTIONS

- ★7-3. Walmart tried to be successful in Germany and failed. However, it has been very successful in Mexico. How has the implementation of NAFTA affected Walmart's success in Mexico?
- ★7-4. How much of Walmart's success is due to NAFTA, and how much is due to Walmart's inherent competitive strategy? In other words, could any other U.S. retailer have the same success in Mexico post-NAFTA, or is Walmart a special case?
- 7-5. What has Comerci done to remain competitive? What else do you think they need to do to remain competitive in the future?
- 7-6. What do you think of Walmart's strategy in Mexico and Central America, and how have bilateral agreements and geographic proximity played a role in its success? What impact do you think the allegations of bribery in Mexico will have on the company's future expansion?

ARY

General Agreement on Tariffs and Trade (GATT), begun in 1947, created a continuing means for countries to negotiate the reduction and elimination of trade barriers and to agree on similar mechanisms for the conduct of international trade.

The World Trade Organization (WTO) replaced GATT in 1995 and provides a continuing means of trade negotiations that aspires to foster the principle of trade without discrimination and to provide various means of mediating trade disputes and of enforcing trade agreements.

Regional economic integration began to emerge after World War II as countries saw benefits of cooperation and larger markets. The major types of economic integration are free trade areas and the customs union.

nonmembers. There are static effects of the reduction of trade barriers. The static effects of economic integration improve the efficiency of resource allocation and affect both production and consumption. The dynamic effects are internal and external efficiencies that arise because of changes in market size.

- Once protection is eliminated among member countries, trade creation allows MNEs to specialize and trade based on comparative advantage.
- Trade diversion occurs when the supply of products shifts from countries that are not members of an economic integration that are.