Barriers to ‘US style’ lean retailing: the case of Wal-Mart’s failure in Germany

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Abstract

Wal-Mart’s exit from the German market in 2006 after 10 years of attempting to achieve sustainable competitive advantage contributes an interesting case to the small but expanding literature on ‘failure’ in international investment. The work on the disinvest decision in all its forms has been critical to a re-conceptualization of the international investment process as dynamic rather than static, linear and inexorable. An important segment of the work on investment and disinvestment as dynamic processes focuses on the environment in which investment and disinvestment decisions evolve. While the environment of the host country market has begun to be examined, the market environment of the country in which the retail transnational corporation (TNC) originates also affects the international disinvestment process. To explore this ‘home country effect’, I examine the resources Wal-Mart brought into the German market and their ability to use those resources in the German context. Wal-Mart’s resources were shaped by the market governance regime in which the firm evolved, and not insignificantly, over which it had and has influence. Within this theoretical frame, Wal-Mart’s reliance on the resources of network dominance and autonomous action that made for its success in the USA contributed to unsuccessful strategies in the German retailing market.

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In July 2006, Wal-Mart Corporation announced that it would sell its holdings in Germany and end its 8-year effort to become a dominant player in Germany’s retail market. Wal-Mart’s failure in Germany had been predicted but still came as a shock to market analysts because of the losses that Wal-Mart had incurred in attempting to establish itself in Germany. Wal-Mart had been losing approximately $200 million every year of its operation in Germany and the transaction to divest itself of its German chain cost the company approximately $1 billion (US).

The Wal-Mart pullout from the German market also caused shockwaves because it raised questions about the globalization ‘project’, as it takes shape in the retail sector. The premise of trade liberalization is that the entry of foreign competitors into inefficient markets will drive out poorly performing firms and more efficient markets will produce not only super-profits but also gains for consumers. If Wal-Mart, an exemplar of best-practice because of its technological prowess and market dominance, could bring efficiency and low prices to German retailing, that success would legitimate the agenda of trade liberalization.

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Wal-Mart was an excellent candidate to demonstrate the gains to be achieved by trade liberalization. It is among the world’s largest firms and represents best practice in supply chain management. It also has been effective in moving into markets outside that of its home country. Canada and Mexico now compose the lion’s share of the approximately 22% of Wal-Mart’s total profits obtained from non-US operations (Durand, 2007). Wal-Mart’s success in the US, Mexican and Canadian markets has been attributed to its early adoption and application of ‘lean retailing’. Although the central focus in the literature on best practice lean retailing is on the application of logistics technology, used to track sales and manage inventory, effective lean retailing has a critical organizational dimension. Successful lean retailing is dependent on cost-effective relationships with suppliers and the ability to minimize labor costs on the distribution and retailing sides of the firm. The concept is sometimes expanded to refer to a firm’s agility in using the strategic resources at its disposal, including regionalized pools of skilled labor and public capital (Christopherson and Clark, 2007).

Wal-Mart’s exit from the German market is of interest not only because of the company’s size and the global reach of its supply chain, but because it contributes an interesting case to the small but expanding literature on ‘failure’ in international investment. The work on the divestment decision in all its forms has been critical to a re-conceptualization of the international investment process as dynamic rather than as static, linear and unrelenting (Clark and Wrigley, 1997; Alexander and Quinn, 2002; Burt et al., 2002, 2003).

In trying to understand the firm disinvestment process, some researchers have focused attention on the host country environment. These analyses reflect an organizationally attuned perspective on the context within which disinvestment occurs and on ‘the spatial and cultural contexts within which firms operate…and the influence of institutional actors and environments’ (Jackson et al., 2004, 257).

In this paper I look at another side of the contextual question—one that has heretofore been neglected. How does the market environment in the country in which the retail TNC originates affect the international disinvestment process? In particular, I examine the resources Wal-Mart brought into the German market and their ability to effectively use those resources in the German context. Wal-Mart’s resources were shaped by the market governance regime in which the firm evolved, and not insignificantly, over which it had and has influence. Within this theoretical frame, Wal-Mart’s reliance on the resources of network dominance and autonomous action that made for its success in the USA contributed to unsuccessful strategies in the German retailing market. In addition, the constant pressure for rapidly increasing return on investment from activist stockholders pressured Wal-Mart management to re-concentrate its internationalization efforts in countries where the governance rules align with Wal-Mart’s strategic resources.

1. Wal-Mart’s strategic advantage

Research on the internationalization of retailing and the adoption of lean retailing practices provides considerable insight into the resources that Wal-Mart brings to operations outside the USA, its home market, and its strategies with respect to international investment (Hallsworth, 1999; Alexander and Myers, 2000;...
Arnold and Fernie, 2000; Vida, 2000; Ernsberger, 2002; Fernie and Arnold, 2002; Brunn, 2006). In this literature, strategy typically refers to firm responses to external factors, such as market conditions and the degree and nature of competition, while resources refer to the internal managerial capabilities and organizational and technical assets that the firm brings to the market. Although resources and strategies are typically dealt with separately in the literature, we can assume that strategies emerge out of and depend on firm resources.

As manifested in the US market, Wal-Mart’s organizational resources are twofold: (i) hard control over factor inputs, including labor and supplier firms, which allows Wal-Mart to reduce product cost, time-to-market and inventory storage costs—a network domination resource and (ii) the ability to move rapidly and autonomously in response to changes in market conditions—an autonomous action resource. These resources underlie Wal-Mart’s strategies in response to market conditions and competition, including in the non-US markets they enter. Wal-Mart’s strategy for entering new international markets has been to assume a cost leadership position and to capture a significant portion of market share thus positioning itself to exercise network domination. The corporation has also zealously guarded and exercised its ability to act autonomously in order to preserve the prerogative to invest and disinvest rapidly, both locally and in under-performing international markets. In Canada, Mexico and the UK, Wal-Mart has been able to use these two key resources to full advantage and position itself in each country as a dominant national retailer.

If we look at what underlies Wal-Mart’s international investment strategies, the ability to realize the advantages provided by its resources appears significant to the success of its foreign investments. For example, Wal-Mart’s ability to assume a cost leadership position depends on control of supplier firms in national markets as well as in international supply chains. It also depends on autonomy of action vis-à-vis the government of the host country (regulatory control), the labor force and its competitor retailers. In the case of Germany it appears that Wal-Mart has been unable to take full advantage of these resources to pursue its particular version of cost leadership market strategies, that is ‘every day low prices’ across a wide range of consumer products.

Wal-Mart’s successes and failures internationally raise theoretical questions of interest beyond the arena of retail analysis, however. They have broader implications for our understanding of the globalization project and the interpretation of the consequences of trade liberalization. At the heart of these broader questions is whether Wal-Mart’s resources stem from its evolution in a particular market governance environment, that of the USA. Specifically, how is Wal-Mart’s ability to dominate its input networks and assume a cost leadership position across product categories dependent on a regulatory environment that enables market concentration? How does market domination lead to the path dependent development of certain types of technical abilities (in this case related to logistics) and to network power over suppliers and by extension, over labor?

Market concentration is a feature of many economies, however, so it has to be considered in conjunction with Wal-Mart’s other key resource, firm autonomy. The ability of a corporation to act independently, as an individual, makes for easier investment and disinvestment decisions but also for disassociation from the social costs of those decisions.

In the case of Wal-Mart’s operations in the USA, the firm has been able to shed the costs of continual experimentation (in geographic location and labor allocation) to
increase profits, and, in the long-term, the scale of its operations. These costs do not disappear but are redistributed, including to the public sector. In the USA, the regulatory environment supports and even tacitly encourages this cost shifting. In Germany, by contrast, the regulatory environment makes the redistribution of social costs associated with experimentation to increase profits (and expansion) difficult and expensive (Vitols et al., 1999). Additionally, social norms in Germany emphasize consultation and collaboration in decisions with implications for all firm stakeholders, including employees and for the society. In the German case Wal-Mart’s resource of autonomy clashed with these social norms and consultative practices to the firm’s disadvantage in carrying out its strategies. Wal-Mart retained its capacity for autonomous action, as manifested by its final rapid exit from the German market, but that autonomy also contributed to the firm’s difficulties in penetrating the market.

A conception of firm resources that recognizes how the firm is embedded in politically determined regulatory institutions runs contrary to much conventional wisdom about globalization. For example, in assessing Wal-Mart’s difficulties in Germany, the first reaction, and one in line with the business press depiction, might be to focus on the characteristics of the host market. The failure of Wal-Mart in Germany is attributed to ‘the usual suspects’—labor unions and dour and unresponsive customers who are unwilling to change their old-fashioned shopping habits. In this narrative, Wal-Mart’s ‘best practice’ is resisted by a backward and over-regulated market, which, with learning and deregulation, would allow Wal-Mart to achieve success (Christopher, 1998; The Detroit News, 2000). A second approach is to focus on the failures of individual Wal-Mart managers to respond effectively to international market conditions (Palmer, 2005).

A more probing examination of Wal-Mart’s difficulties in the German market, however, suggests the need for a more political and contextualized approach to analyzing foreign direct investment. In the case of distribution-based TNCs, this approach needs to address national differences in how markets are regulated and the consequences of distribution-based TNCs existing ‘in nested relationship with consumers and regulators’ (Marsden et al., 1998, 486).

To make this argument, I first critically review the literature on firm strategies as they emerge out of firm resources, particularly emphasizing the importance of looking at trade-offs implied in different resource ‘packages’. This review provides the basis for a more probing look at the case of Wal-Mart in Germany, one which moves beyond questions of culture traits to look at more fundamental issues of institutional mismatch and different approaches to retail competition. Finally, I suggest what a different conception of firm capacities and strategies might imply for our interpretation of the globalization project.

2. A resource-based conception of firm strategies in global markets

The original formulators of the firm resources paradigm, Penrose (1995) and Wernerfelt (1984), recognized that particular resource positions constrain firm choices as well as providing firms with capacities relative to markets. For example, the maintenance of a skilled workforce in the firm gives it capacities for process innovation and high productivity through, for example, multi-tasking, but also entails costs. These costs may include continual investment in the workforce and efforts to retain skilled workers.
Despite their insights into resources, the idea that resources represent a set of trade-offs with consequences for firm strategies, received scant attention. This meant that the possibility for a more contextualized understanding of firm strategies was lost, at least for a time.

What has been recognized in the management literature is path dependency—the concept that firm resources and competencies evolve over time. The understanding of learning and adaptation over time is incorporated in theories concerning the path dependent character of firm growth (Nelson and Winter, 1982; Penrose, 1995). Path dependency describes ‘the cultural and administrative heritage of accepted practices built up over the course of the firm’s history’ (Heenan and Perlmutter, 1979). Berger (2005, 36) describes this path dependency in terms of a ‘dynamic legacies model, the reservoir, or legacy, of resources that have been shaped by the past’. By resources, she refers to the ‘stock of experiences, skills, human talents, organizational capabilities and institutional memory’—not only material resources. A firm’s legacy or heritage of practices, built on successes, failures and learning underlies what Heenan and Perlmutter (1979) refer to as its ‘strategic disposition’.

Of course, the strategic disposition of a firm is determined by the industry in which it operates. This is particularly important to note because of the dominance of manufacturing firms in analyses of industry strategies. Industries whose profits derive from distribution, such as retail or entertainment, have distinctly different strategic dispositions than product manufacturers for consumer markets or intermediate inputs (Wrigley et al., 2005).

Industry characteristics are so important that they have been portrayed as trumping other sources of differentiation. What this misses, however, is the way in which industry specific requirements (as well as the learning associated with path dependency) are intermediated by territorially based incentive structures. So, for example, USA—originating Wal-Mart has different strategies in international markets than German-based Metro or French Carrefour, though all are food retailers that operate internationally (Aoyama and Schwarz, 2006).

The concept of strategies is valuable because it is commonly understood in the management literature as a product of resources internal to the firm and responses to external change in market conditions—technological change, the opening of new markets, policy changes or increasing competition. In formulating strategies, firms bring particular resources to bear, such as management skill, and in the more sophisticated analyses, path dependent learning (Berger, 2005).

Firm strategies are almost universally conceived of as firm specific. Even if strategy patterns, such as cost competition, are recognized across firms, they are represented as an aggregate of the decisions of individual firms rather than explicable in terms of a set of incentives creating a decision-making environment. The firm strategies literature also treats the firm operating apart from the market governance system, which construct the incentives within which it operates. So, for example, it would be as though Wal-Mart had no interest in the US National Labor Relations Board regulations regarding the rights of employees to unionize, or in the legal contracts that define Wal-Mart’s obligations to suppliers. On a local scale, the meaningful regulatory framework may be land use regulations that govern the location of ‘big box’ retail.

Under the conception of separate spheres of public sector regulation and private sector action, Wal-Mart must respond to exogenously developed regulatory standards. Its strategies are limited to attempts to deal with the problems created by regulation.
In reality, Wal-Mart is an active player in insuring that regulatory frameworks favor the interests of the corporation.\textsuperscript{1} While markets are unpredictable and full of risk, firm strategies will include attempts to shape markets and their governance structures so that they align with firm interests (Edelman, 2004). In carrying out strategies, firms also reshape governance. Thus, the concept of path dependence and the need for a dynamic rather than static perspective applies as much to the governance regime as it does the firm.

Ironically, the rules that provide the firm with distinct advantages in the home market, where it has the most political ‘clout’, may work to its disadvantage in territorial markets operating under other rules. This is one of the lessons that Wal-Mart learned in its unsuccessful entry into the German market.

While not rejecting the idea that individual firm managers develop strategies in response to changes in external conditions, it is useful to return to Penrose’s initial inclination to understand resources as also posing constraints on firm action and thus potentially contextualized by incentive structures outside the firm. This presents a need to examine the governance context or environment within which firms strategize and attempt to use in their strategic interest.

To make this conception of firm strategies and resources more concrete, I first look at the development of a lean retailing model in the USA and then look at the difficulties Wal-Mart faced in entering the German market from a resource perspective. In particular I focus on the two resources that have contributed to Wal-Mart’s unusual success in certain markets—network dominance and autonomy of action and the international strategies that emerged from those resources.

3. The US lean retailing model

The US lean retailing model, as exemplified by Wal-Mart, but also by other US-originating big-box retailers such as Staples and Best Buy, is based in two key resources and their realization in the market. The first resource is network power. Wal-Mart’s ability to ‘get to scale’, that is to dominate the national retail market allows the firm to reap economies of scale and, most importantly, to dominate supplier networks. Because Wal-Mart is such a big customer, small suppliers as well as major health, household product and food manufacturers cannot avoid dealing with the retail firm if they hope to reach the consumer market. Wal-Mart’s domination of the market and access to the largest number of customers in the USA allows the firm to continuously drive down consumer prices. Wal-Mart has used this resource to dominate the market for a full range of ordinary consumer products through economies of scale and of scope. The resulting strategy is an ‘every day low prices’ concept in which customers shop at one retailer, Wal-Mart, for a full range of household products and groceries.

Like lean production, lean retailing is not only about what happens inside a firm but also about the nature and content of relationships among firms—suppliers and manufacturers, retailers and distributors. These relationships are influenced by the incentives faced by the firms as individual entities and by the network. In some

\textsuperscript{1} From the corporation perspective, this is portrayed as representing their interests in a pluralistic democratic political system.
important respect, lean retailing competition is among supply networks rather than among firms. So, the type and quality of governance of firm networks makes a difference to the form lean retailing will take.

The 'everyday low price model', in which customers shop at one retailer for a wide range of consumer goods requires a regulatory environment that encourages concentration and returns to scale. The regulatory environment in the USA exemplifies such an environment, encouraging increasing firm size and market dominance in the retail sector (large firms with many establishments). Concentration among the retailers increases competition among suppliers to fewer retailer/distributors and allows the retailers to drive down prices achieving continuous increases in profits despite an every day low price strategy.

At the local scale, US tax policy and economic development incentives in combination with limited land use controls have favored large scale, space extensive so-called ‘gorilla’ retailing, encouraging large-scale retailers who offer many goods at low prices. These big box retailers include Wal-Mart and other discount retailers, including bookstores, such as Barnes and Noble, and Borders, and home improvement centers such as Home Depot or Lowes.

Despite its paeans to flat hierarchies, lean retailing in the USA is best described in terms of a virtually integrated firm (Christopher, 1998). It is organized vertically to enable the retailer to assess the market for subcontractors and to contract with those offering the lowest price. In the US model, decision making authority in firm networks is centralized so that lead firm executives can move very swiftly to respond to changes in customer demand and to enter and exit new markets rapidly (Christopherson, 1999). Case studies from the food and apparel industries in the USA demonstrate that one of the key uses of IT applications is to concentrate information at the executive level of the lead retail firm (Christopher, 1998).

Technology is applied instrumentally to serve centralized decision-making. Logistics applications, for example, facilitate subcontracting as many aspects of the production, distribution and retailing process as possible, in order to redistribute risk downward and allow for rapid market response to unpredictable consumer markets.

The resource of network domination extends to the labor force. The US model of lean retailing rests on the ability to deploy a large contingent workforce, particularly in part-time jobs. Wal-Mart pays its sales staff slightly above minimum wages but, because such a high proportion of the workforce is part-time, only 40% of Wal-Mart’s employees are covered by the chain’s health insurance package.

As in lean production in manufacturing, lean retailers have been able to restructure work in retailing, for example, eliminating skilled craft jobs, such as butchers and bakers, replacing them with less skilled and non-unionized service workers. Again technology is a means toward restructuring rather than an exogenous cause of change in the organization of the work in lean retailing.

One strategy the US United Food and Commercial Workers (UFCW) used to encourage unionization was to organize meat cutters who, because of their skills, were more susceptible to organization. Wal-Mart then eliminated meat cutter jobs in many of its stores, turning to prepackaged meat products. The company has also issued a 56 page ‘Manager’s Toolbox to Remaining Union Free’. The rationale for Wal-Mart’s policies is the flexibility and low operating costs required to compete on the basis of product cost.
With the organizational changes associated with lean retailing, we also see significant shifts in power associated with who controls information about end markets and with associated skills and job content. Whereas mid-level managers and buyers were once an important source of information on customer demand, that information is now provided by point of sale data. The availability of point of sale data and customer order information transforms the role of the mid-level product manager from that of an information holder to one that is more interpretive, problem solving and entrepreneurial. The food store product manager is, for example, evaluated on his or her ability to successfully introduce new high value-added products in cooperation with manufacturing suppliers rather than as a basic information keeper. The manager may also have more prerogatives and incentives to determine working conditions at the establishment level.

Workforce organization and deployment are another expression of Wal-Mart’s network power and inclination to centralize decision-making in order to quickly make changes that can improve the companies ‘bottom line’. This tendency was manifested once again in the fall of 2006 with Wal-Mart’s announcement that it would immediately cap salaries across the firm in order to impress stockholders with management’s resolve to maintain the company’s continuous double digit increases in stock value. A decision this dramatic could not have been taken in a German firm without a significant period of review and consultation with the firm stakeholders.

This example suggests how institutional context has shaped lean retailing in the USA and provided firms such as Wal-Mart with the ability to innovate to reduce costs, and to move in and out of markets depending on their short term profitability. Lean retailing, however, like lean production, can take different forms. In Germany a changing but still distinctive institutional context has influenced the adoption of lean retailing and how it is put into practice. Efficiency and the ability to compete, it turns out, are not necessarily dependent on ‘the big box’.

4. The case: Wal-Mart confronts Germany

To maintain and increase its high stock value, (which in 2002 was 42 times earnings but in 2006 dropped to 16.6 times earnings), Wal-Mart has undertaken an aggressive plan to go global with the Wal-Mart concept. Although the company’s international operations account for 22% of its total sales, international growth is considered insufficient, given that sales growth is slowing at its US stores (Hudson and McWilliams, 2006). In 2006, Wal-Mart operated 2700 stores in 14 countries outside the USA but its international operations (in terms of number of countries) are smaller than those of many of its international rivals, including Metro AG, the German firm, which recently purchased Wal-Mart’s failed German chain.

Wal-Mart, which is the largest employer in the USA, with a workforce of over 1.2 million people has expanded primarily by building new stores in rural and suburban areas. In the early 2000s, 93.6% of the US population lived within 15 miles of a Wal-Mart store (Hudson and McWilliams, 2006, A1). Since the 1990s, the firm has been entering urban markets with a smaller store format but still using its logistics system and control over suppliers to maintain a cost leadership strategy. This strategy has had only limited success, however, because preferred urban locations are opposing the location of new stores (Hudson and McWilliams, 2006, A1). As a result, Wal-Mart’s
ability to enter and succeed outside the USA has become ever more important to the company’s profits.

In the late 1990s, Wal-Mart entered the German market as a part of its international expansion strategy. Germany is the third largest retail market in the world (after the USA and Japan) and accounts for fully 15% of Europe’s approximately $2 trillion-a-year retail market. Germany was a critical market to enter and one that Wal-Mart intended to dominate, not only because of its own importance, but also because Germany provides a gateway to Eastern European markets.

In its international expansions, the discount retailer has used the same strategies that have allowed it to dominate the US market. The corporation has undertaken strategies to move to scale in order to dominate supply chains and negotiate low prices in order to drive up profits even with low margins. As described by Palmer (2005, 721): ‘A high controlling acquisition and de novo method of entry…allowed Wal-Mart’s management to closely replicate the operational dimensions of the successful supercenter format in the US market.’

Wal-Mart recognized that it faced some serious obstacles in entering the German market. German land use regulations are unfavorable to ‘Big Box’ store development, which is central to Wal-Mart’s ‘pile it high, sell it cheap’ approach. German retailing is carried out typically in neighborhood locations in small stores. More significantly, German companies tend to be privately held, relying on self-investment rather than public capital markets for investment capital. Because the leading food chains in Germany are privately held, there were no opportunities for hostile takeovers as there would be in the Anglo-American markets.

In order to enter the market Wal-Mart was forced to purchase two relatively weak chains, Interspar and Wertkauf, which included stores of various sizes. With these acquisitions, Wal-Mart was placed approximately 11th in overall German retail sales. The German food retailing market is, however, highly concentrated so the top five chains account for nearly 80% of overall sales. Thus, Wal-Mart began from a relatively weak position.

Wal-Mart’s inability to ‘get to scale’ and exercise its network power made it difficult to transfer the Anglo-American Wal-Mart model of lean retailing to Germany. According to articles in Wirtschaftswoche, Germany’s economics weekly, expediters delivering products to the distribution center had to wait for hours to unload their cargo and, by comparison with the smooth efficiency that characterizes its US operations, Wal-Mart Germany had difficulty keeping its networks of stores adequately supplied, especially with fresh produce (http://unionnetwork.org, 2000).

Wal-Mart’s difficulties with supplier networks emerged because it was unable to dominate the retail distribution system and its suppliers. Wal-Mart cuts costs by dealing directly with factories and getting factory direct delivery to its stores bypassing wholesaler intermediaries. Even in the concentrated German retail environment, wholesalers have continued to act as intermediaries between food producers and food distributors. Wal-Mart did not have the market power to alter the existing distribution system and so took on the extra costs associated with wholesaling and inventory that they are able to avoid in the USA.

Wal-Mart’s major strategy to conquer the German market was its major competitive device—price-based competition via everyday low prices across categories. Wal-Mart hoped to use this strategy to make up for its lack of an embedded network of
neighborhood retail establishments and to weaken competitors so they could be acquired.

To some extent, the belief that this strategy would be effective was influenced by a stereotype of the German economy as characterized by high wages and high prices. German consumers should have been attracted by Wal-Mart’s concept of ‘Every Day Low Prices’ as a way to undercut the high prices that characterize much of the economy. The German retailing sectors, especially food retailing, are, however, a different world from that of the coordinated high-price, high-wage manufacturing sectors that have defined the modern German economy. Food retailing in Germany is very price competitive and profit margins are as low as they are in the USA that is typically under 3%. This compares with profits of 6% or more in the UK, which historically has had a less price competitive market (Lewis, 2001).

Germans are accustomed to shopping at so-called ‘hard discounters’, such as Aldi and Netto, which operate out of small-scale establishments, providing a narrow range of goods with special offers each week and no customer service. For example, the week that Wal-Mart opened in Berlin, the Aldi across the street from the new super store was offering the same loaf of bread that Wal-Mart was selling for $1.13 US at $.34 US. Thus, Wal-Mart confronted a hard-nosed customer for whom ‘every day low prices’ meant little when they could be undercut at the neighborhood-based discounter.

In fact, Wal-Mart’s competition was a bifurcated sector composed of relatively high price food retailers located (and competing with one another via loss leaders) in urban neighborhoods and a set of hard discounters also located (and competing with one another) in urban neighborhoods. German shoppers on their way home from work or on their Saturday morning shopping tour can combine very low price special offers at the discounter with higher price goods at their neighborhood grocer. Like shrewd stock buyers, they engage in price averaging. The Wal-Mart alternative—traveling miles to a big box store to buy everything, doesn’t allow for comparison shopping, is less satisfying and doesn’t produce appreciably lower overall prices for necessities. ‘Every day low prices’ works for Wal-Mart, which can extract lower prices out of some suppliers while offering their goods at higher prices. It was unappealing, however, to the German consumer, who has come to rely on intense local competition and price averaging to save money.

Wal-Mart also underestimated the impact of social norms on their autonomy of action as well as consumer choices of where to shop. The retail sector is not as cohesive as other sectors in the German economy, with lots of conflict among the firms. In addition, the German food industry, including food retailing, has lower levels of unionization than the core export manufacturing sectors, and the unions are not as powerful. Because of these characteristics, a strong market entrant, such as Wal-Mart, might assume that autonomy of action would be possible within what is generally viewed as a highly regulated economy.

Despite weakening cohesiveness, however, German retailing has governance features that are unfamiliar to firms accustomed to relative autonomy of action within the context of arms-length state regulation (in arenas such as health and safety, for example). Germany’s is essentially a private regulatory system governed by trade associations and unions with state support. Individual firms have less autonomy of action and have more collective responsibilities than US firms even in a relatively weakly cohesive system.
This Wal-Mart assumption of firm autonomy in a collectively governed system was manifested in Wal-Mart approach to collective bargaining. Although Wal-Mart paid its German workforce 3% above the collectively bargained scale, the company refused to adopt German collective agreements (Gewerkschaft, 2000). They also refused to recognize and deal with basic consultative organizations that are present in all German firms. The chains that Wal-Mart acquired were unionized by the major German commercial workers unions, HBV and DAG, and each establishment had a Works Council with elected personnel representatives. Wal-Mart’s US managers, unfamiliar with the central role played by the Works Councils, consulted them only sporadically. So, while Wal-Mart paid (minimally) higher wages, the company rejected the cooperative and consultative nature of German labor and management policies and in doing so, violated basic social norms. Demonstrating the importance of consultation in the German system.

The German Wal-Mart workers picketed the stores in July 2000 to force the company to join the employers’ association and abide by collective agreements (Gewerkschaft, 2000). Even though the retail unions are weak, and the retail trade association fraught with conflict, the societal norms they draw on, for consultation and cooperation, are strong. These norms may be residual and weakening but they still have influence over individual behavior, including the choice of where to shop, and media portrayal of the company’s practices.

The willingness of German union members to picket on behalf of management power (in the form of trade association bargaining and influence) was a surprise to Wal-Mart management, which is famously anti-union. US union relations with management are adversarial by comparison with the German coordinated system practices, which bring union and management interests together. In the US, by contrast, an important dimension of Wal-Mart’s ability to keep profits high and prices low is its personnel policies. They utilize a marketing approach to personnel satisfaction (the Wal-Mart ‘cheer’) but are oriented around maintaining a high level of flexibility and low costs. For example, Wal-Mart keeps the number of employees receiving health benefits to a minimum and emphasizes the use of a demand driven part-time workforce. In 2006, the company announced a policy to cap wages and salaries in order to maintain increasing profit levels. The unfavorable image of Wal-Mart as unwilling to play by the rules of the collective decision-making game eroded the potential German middle class customer base.

By 2001, Wal-Mart Germany was the focus of concerted attacks in the press by unions, the employer or trade association membership, and farmers who attacked the company’s ‘every day low prices’ strategy. This, in an economy in which price competition among retailers is hot and taken for granted albeit not in the form that Wal-Mart needed in order to survive in the German market. Wal-Mart’s across the board price competition organized their higher priced competitors against them and was ineffective against the hard discounters.

Germans began to refer to ‘the Wal-Mart Myth’, critiquing the assumptions that Wal-Mart style logistics applications could transform German retailing. They pointed, for example, to the fact that the logistics chain is longer in the USA than in Germany with products in transit from producer to retailer for only half as many days in Germany as in the USA. What this means, practically, is that the type of logistics applications that are so famously associated with Wal-Mart’s success would not produce the same savings in Germany (Katsaras and Schamel, 1999).
The most significant problem Wal-Mart faced, however, came from within its own governance structure, that of publicly traded companies owned by shareholders, such as pension funds, with short-term goals. Wal-Mart’s shareholders began to lose patience that the firm’s investment in Germany would produce a profit (Palmer, 2005). Wal-Mart’s significant and continuous losses, and the continued aggressive stance of the competition, which used all of its institutional resources to halt Wal-Mart’s expansion, discouraged its investors (Greimel, 2001). The result was Wal-Mart’s withdrawal from the German market in mid-year 2006 to look for other investment opportunities that would produce profits more quickly for Wal-Mart’s voracious investors. Wal-Mart determined that it had to invest in markets and acquisitions, such as Asda in the UK, that were ‘Wal-Mart-ready’, that is positioned to provide an immediate positive impact on sustaining sales growth’ (Palmer, 2005, 724).

This brief account suggests that Wal-Mart’s failure in Germany was linked to the resources that Wal-Mart’s brought to its entry into the German market and its inability to realize the benefits of those resources in an institutional context very different from that of the USA. The story, thus far, has emphasized how the institutional environment makes market entry difficult. These might be termed defensive resources.

This still begs the question, however, whether the German economy provides another and different set of resources to retailers that might be applied in international retailing. That is, is there a German approach to ‘lean retailing’?

5. Lean retailing in the German context

Just as US firms bring the resources of network power and autonomy of action to the globalization process, German firms bring resources of highly skilled labor, including in technical logistics applications, and complex network coordination.

By contrast with the USA, Germany is an exporting economy with a strong, sophisticated manufacturing base. The development of an advanced logistics infrastructure in Germany (ahead of other European economies) was driven by the need of its manufacturers to move their goods into an international market. Political influence in Germany is disproportionately held by manufacturers and manufacturing unions. Together, they influence trade policy to favor manufacturers rather than retailers. What this means in practice is more emphasis on building a national and European infrastructure, both physical and regulatory, that will encourage the easy and fast flow of exports. Thus the emphasis in logistics applications has been on increasing the speed of product transfer from the manufacturer to the retailer but with the pressure coming from the manufacturing side rather than the retailing side.

Manufacturing-oriented German firms are using logistics applications to expand the market for their products and, in conjunction with their European partners, to develop a high quality transportation and communications infrastructure that can withstand economic assaults from firms (in Anglo-American economies) who shy away from responsibility for physical assets (Plehwe, 2000).

In general, coordinated economies, such as Germany, have been slower to utilize the logistics applications focused on cutting costs through subcontracting. In these economies, there is greater relative emphasis on using logistics applications to: (i) assure flow relative to demand and (ii) assure input quality. Both of these are related to the importance of customer service whether the customer is the retailer or manufacturer.
Although third party logistics provision is increasing in Germany, logistics activities (and its associated knowledge) are more likely to be carried out within the firm of the commodity producer. In part, this is a reflection of the service dimension embedded in German manufacturing whose history is one of technical innovation and a reputation for consistent high quality produced by close relations with both customers and suppliers. While third party logistics providers exist in Germany, they primarily meet limited strategic needs. Informal exchange of technical knowledge is perceived as the most important mode of cooperation between firms and their customers. This was particularly evident in the major German exporting industries fabricated metals processing, machinery, motor vehicles and technical services industries. While manufacturing practices regarding logistics are not followed in the same way in German lean retailing, there is a greater tendency to see logistics suppliers as strategic partners rather than as subcontractor-service providers.

German education and training systems continue to adhere to the principle that individuals should operate in the workforce with standardized and certified occupational qualifications. With increasing employment in commercial and other services (and with increasing feminization of the workforce) the traditional concept of Beruf or occupation is changing in Germany. In some industries and employment categories it is being replaced by the concept of ‘competence’ closer to that of the generally skilled worker who can fill a number of medium level skilled positions.

Coordination problems among workers, such as those that develop with the introduction of lean retailing, have typically been dealt with by the development of new training programs. When tasks arise, such as those involved with the introduction of new technology, they give rise to the creation of new skilled occupations defined so that their areas of competence overlap with those of workers performing adjacent tasks (Streeck, 1996) In a coordinated/manufacturing economy, such as Germany, the role of mid-level managers in retail is changing, but more slowly. They continue to hold information about customers and suppliers and a continued emphasis on firm specific knowledge.

In addition to the occupational skills system, the industrial relations system also provides for methods of adaptation to new technology that are absent in the Anglo-American merchant economies, particularly the USA. Unions independent of any particular workplace have the research capacity and political influence to shape the development of new occupations through political pressure for training programs and career paths as well as to protect traditional skilled craft occupations, which might be displaced by lean retailing.

While a German approach to lean retailing is not as well documented as the best practice model represented by Wal-Mart, there does seem to be evidence of different types of resources such as infrastructure and skilled labor, and of different strategies to successfully enter international markets. This evidence, then leads to a question of what Wal-Mart’s failure means for how we study and understand the processes leading to market integration.

6. What does Wal-Mart’s failure in Germany imply for the ‘globalization’ project?

How do we interpret Wal-Mart’s failure in Germany especially in light of its successes in Mexico, the UK and Canada? The best practice literature is not very helpful in
explaining the difficulties that Wal-Mart confronted in Germany. This literature essentially assumes that Wal-Mart is a highly successful corporation that is destined to succeed because of its market power and technological superiority. When Wal-Mart market entry fails, in Korea and Indonesia, as well as in Germany, the explanations almost always reside in the characteristics of the market not those of the context in which the corporation developed its strategies.

The Wal-Mart in Germany story, in fact, raises questions about the concept of globalization itself and the potential limits to the development and implementation of national models of business practice in an international context. The case bears on two questions of particular import: (i) whether lean production and lean retailing models can be abstracted as best practice from the regulatory regimes in which they emerge and with which they reflexively interact and (ii) whether adaptation problems are learning problems or whether they are the consequence of political decisions about societal governance, particularly about how to distribute risks.

6.1. Lean production and distribution as ‘ideologies of best practice’

Wal-Mart is recognized as a retail phenomenon, as ‘best practice in retailing’ because of a set of capacities and resources that, together, construct its retail ‘concept’. The most important of these is ‘every day low prices’, which are achieved by economies of scale, power over suppliers, and a highly efficient sales forecasting and replenishment system, incorporating state-of-the-art information processing and supply chain logistics systems (Fernie and Arnold, 2002). Its success, as has been noted repeatedly in the business press, comes from squeezing every last penny out of the supply chain and redistributing the (continually increasing) profits to its investors.

Analysts of international retailing have examined the expansion experience of US retailers, including Wal-Mart (Sternquist, 1997; Fernie, 1998; Alexander and Myers, 2000; Vida, 2000; Fernie and Arnold, 2002), and the logistics supply model that has come to be associated with best practice ‘Wal-martization’ (Christopher, 1998). These analyses shed light on how Wal-Mart’s strategy compares with those of other international retailers and on the potential contradictions between the Wal-Mart model and the requirements for success across global markets.

Within this literature, Wal-Mart’s distinctive national character and origins have not been completely neglected. Alexander and Myers (2000), for example, have described Wal-Mart as an ‘ethnocentric’ retailer. Among the key features of Wal-Mart’s global expansion strategy is its desire ‘to be the McDonald’s of retailing and to stamp its brand on every store’ (Fernie and Arnold, 2002). Alexander and Myers (2000) and Vida (2000) note that Wal-Mart favors repeating its successful US strategy (branding, regional distribution centers, highly centralized operational control) in markets that are similar to the US (i.e. Canada and Mexico) rather than adapting its strategy to allow wider adaptability to a multiplicity of international market conditions. Significantly, Vida (2000) notes that Wal-Mart’s desire to enter international markets under a full control strategy is more generally characteristic of US retail expansion. Wal-Mart’s success in the USA has been enabled by a high degree of corporate control over all dimensions of the distribution and retailing process and vertical organization of supply chains (Christopher, 1999). This command and control orientation is echoed in the work on Wal-Mart style logistics.
Christopher (1998), for example, in arguing for what are, in practice, Wal-Mart style logistics and information processing as best practice suggests that the types of applications considered and adopted will differ depending on the significance of: (i) reduction of input cost through competitive bidding; (ii) assurance of input quality; (iii) continuous flow relative to demand; (iv) ability to respond rapidly to unexpected market shifts and (v) the need for complex coordination of inputs in conjunction with projects or virtual firms.

Even within its own terms, this description of best practice evinces contradictions, for example, emphasizing information sharing and cooperation with subcontractors as a mark of success in some instances, while pointing to centralization of control in the lead firm as critical to success in others. In the case of Wal-Mart, however, the origins of its success in a vertically oriented command and control process are quite clear. This rigidity of the Wal-Mart (and generally, of the US corporate model) is one of the factors that make adaptation to a multiplicity of international market situations problematic.

In general, the arguments for the vertically organized version of lean retailing and lean retailing are based on a technological model of firm and industry strategies. They advocate the application of technical methods to solve practical problems. Examined at face value, the lean retailing model builds on the supply chain management strategies that have transformed high end manufacturing industries. They are problematic when applied to the retail sector, where strategies are oriented to the final consumer markets.

Looked at from a different perspective, lean retailing is also an ideological model, that is, it incorporates particular ideas about what exists and what is good. For example, in Christopher (1998) a key text in lean retailing, the only differences worth noting are cultural differences in commodity preferences. Some people prefer top-loading washing machines, while others prefer front loading. Some people eat more meat while others eat less. The assumption is that these differences can be solved by technical strategies, such as postponing production until it is based on actually existing demand. This appears to be an interpretation that Wal-Mart has adopted in looking for international investments that are ‘Wal-Mart ready’.

Given that lean retailing methods depend on labor markets with a high degree of labor flexibility, there is surprisingly little discussion of politics or institutions as a context for lean retailing. When institutions do enter in, they are perceived as barriers to best practice. So, retail is expected (à la staged economic development models) to move through a series of stages from ‘traditional retailing’ with low market concentration and segmentation of retail formats, to the ‘highest’ and ‘best’ form, advanced retailing, characterized by a high degree of market concentration, segmentation, capitalization, supply chain integration and use of information technology.

What is interesting (and ideological) about the lean retailing model is that it conveys that bigger is better. The possibility of alternative mixes, such as smaller scale establishments with sophisticated supply chain management, is not considered although that combination exists in one of the ‘advanced’ retailing countries, Germany. One could suggest, therefore, that the lean retailing model and its stages derive from a particular vision of the economic and political context necessary for efficient and competitive retailing.

The comparison of the retail sectors of the USA and Germany tells us that the globalization of technology and via multinational firms is neither easy nor straightforward. The very basis for success in one market may be inappropriate to competitive conditions in another.
Particular choices of what to do and how to do it are influenced, if not determined, by the rules that define what constitutes success (e.g., rapidly increasing shareholder value or return on investment versus capturing market share over time). They are also influenced by regulation in areas such as labor market policy, competition and intellectual property, and by the capacity of the state or states to set standards which enable effective integration of production, transport and distribution. The ways in which the market is governed have important implications for the resources and strategies of individual firms and for the interactions of firms in networks—at the center of the lean retailing revolution.

In addition, home country constraints arising from corporate governance regimes may clash with management objectives to internationalize. The impatience of Wal-Mart’s stockholders essentially foreclosed operating in the largest European retail market. In dealing with the threat to management authority presented by the long term failure of Wal-Mart’s operations in Germany, Wal-Mart management ‘re-established legitimacy by demonstrating goal-oriented action which adhered to the US governance system.’ (Palmer, 2005, 725). This entailed replacement of those managers who had been associated with the German investment strategy.

At a more theoretical level, a complex comparison (analogous to rich description) can also better inform questions of power and politics in industry and economic change. In the case of Wal-Mart’s attempted entry into the German market, we gain some interesting, though still perplexing, insights into the kinds of connections and coalitions that can be built in the face of exogenous threats to the status quo. Weak unions and fragmented trade associations can find common ground when it comes to working against a new and potentially disruptive player.

In the USA, where the battle of control over the supply chain was lost long ago, the new closely integrated and interdependent supply chains offer a different sort of political opportunity, one perhaps more amenable to an arms-length and conflictual bargaining system—that is a battle over the distribution center and its workforce. The UPS strike in the USA demonstrated the potential of striking at the heart of the new economy—its critical distribution function. So, we can expect to see concerted efforts both to organize and to use this key link in the commodity chain.

Despite their association with the mundane, with time and transport, logistics and lean retailing profoundly change key economic interrelationships, such as those among retailers and suppliers. Because of this pivotal role, they may be the sites for exciting political as well as economic developments.

6.2. What is the question—learning and regulatory reform, or political power?

The turn toward a more dynamic understanding of international economic activity, which recognizes processes of disinvestment as well as investment, is a valuable step toward a more concrete and specific description of globalization. In this paper I have argued that a political–economic analysis is also central to that project. Finally, the success of Wal-Mart in the USA and in Mexico, Canada and the UK, alongside its difficulties in Germany, suggests that politics matter in understanding foreign direct investment, particularly in retail firms.

Wal-Mart emerged in (and subsequently shaped by virtue of its market power) macro regulatory environments that construct labor costs, degree of competition, investment return pressures, and ease of local investment and disinvestment. Its capacities and
strategies were formed in a regulatory environment that, on the one hand, offered the firm an array of possibilities to experiment to keep profits rising and costs falling, and on the other hand, created constraint pressure on the firm to move rapidly to achieve continuous profit gains.

Wal-Mart’s capacities and strategies also took shape in a regulatory environment in which firms are presumed to stand in first place in representing consumer interests. In this regulatory environment, firms are the key actors in determining regulatory standards and how they will be enforced. As Marsden et al. (1998) suggest, this political power with respect to regulation allows firms to create strategic market opportunities using the regulatory environment as a tool, for example, creating new markets around higher versus lower quality standards. Regulatory variation around cost and quality stands in strong contrast to those regimes where firms are important but not the dominant regulatory players, especially as individual firms, and where standards of quality are more likely to be absolute rather than relative (the cases of BSE in meat distribution and the chocolate controversy in Europe are prime examples).

At the micro, local level, too, the political leverage of the firm in redistributing risks makes a considerable difference in its concept and strategies. By contrast with the USA, the institutions and practices that make up German market governance discourage experimentation and the redistribution of risks from firm to labor or communities. Despite its risk and experimentation-averse positions, Germany has sustained a highly competitive retail market and low prices. So the story of Wal-Mart in Germany ultimately raises questions of market governance alternatives.

Finally, Wal-Mart’s success should be attributed as much to politics as to strategic genius. Wal-Mart’s enormous success can be traced to effective firm strategies in particular economies but also to the evolution of its ‘concept’ and resources under the rules that govern firm investment in the USA. While there are many individual features of this governance regime, they can be encompassed in one concept:—the ability to continually experiment to find the optimal ways to reduce costs and increase profits. A major portion of the cost of this experimentation is borne outside the firm, by the workforce, and by the communities in which Wal-Mart locates.

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