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Wal-Mart Thinking Smaller to Get Bigger

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Wal-Mart sees opportunities for new formats that take up less space and offer more groceries

Even as [Wal-Mart Stores](#) continues to grow its U.S. store base, it is getting smaller.

Actually, it is the boxes that are getting smaller as Wal-Mart finds more efficient ways of doing the same things in ever-shrinking spaces; as it seeks sites in more urbanized locations; and as it looks for ways to skirt “big box” laws that keep stores of 100,000 square feet out of many communities.

Wal-Mart is no stranger to operating small stores, given that most of its international stores operate in smaller boxes than the U.S.-based supercenters and discount stores.

“I think it's not a coincidence that Wal-Mart keeps moving many senior and middle management people in and out of its international operations,” David Marcotte, director of retail insights for Kantar Retail, Cambridge, Mass., told *SN*, “because the more small stores take hold in the U.S., the more Wal-Mart wants to make sure its people understand the concept.”

While Walmart U.S. is continuing to test smaller formats, it is unlikely to roll any of them out until after it resolves issues related to declining traffic at its supercenters, Leon Nicholas, director of retail insights for Kantar, pointed out.

“Right now, Wal-Mart is concerned with boosting traffic in supercenters, and until those concerns are resolved, format expansion in the U.S. is on hold,” he said. “Meanwhile, it will play around with the size of its boxes — and how much general merchandise it can include — to find the sweet spot where it can get the optimal return on its investment in the smallest footprint possible.”

One of the new formats Wal-Mart is developing is a store of 75,000 to 80,000 square feet called Neighborhood Marketplace — a concept double the size of a Neighborhood Market that combines the food-and-drug components of those stores, including the drive-through pharmacy, with an assortment of higher-margin general merchandise items.

Wal-Mart has one Neighborhood Marketplace in operation — an 80,000-square-foot unit in Alexandria, Va. — with plans to open a 75,000-square-foot version in Torrance, Calif., later this year. Wal-Mart reportedly developed the prototype in Canada, where its supercenters run around 85,000 square feet.

Although stores under 100,000 square feet may allow Wal-Mart to enter communities that it could not enter with larger stores, opposition groups may still have their say.

For example, Rick Icaza, president of United Food and Commercial Workers Union Local 770 in Los Angeles, said he expects some activists in the Torrance area to fight Wal-Mart. “They kept Wal-Mart out once, and there is likely to be a groundswell of people that don't want the traffic issues a Wal-Mart could bring nor the environmental concerns, and they're also concerned about local businesses closing down.”

For its part, Icaza said the UFCW is concerned that Wal-Mart “does not provide quality jobs and that it offers 401(k)s and other benefits to just a handful of people. That's just not fair to companies like Ralphs and Vons, who have trouble competing from the moment Wal-Mart turns the key.”

Besides the Neighborhood Marketplace, another new format Wal-Mart contemplates does not yet have a name or a location, Nicholas said — an urban market of 20,000 to 25,000 square feet “that would be easy for Wal-Mart to drop into inner-city areas,” he noted.

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The urban format would qualify as one of “the stores of the community” that Wal-Mart is committed to operating — tailored to fit the needs of different demographic populations — with growth potentially coming from a series of drug store acquisitions, Marcotte suggested.

Wal-Mart could achieve a massive presence instantly for this format through an acquisition, he said, “and it’s possible Wal-Mart will vigorously pursue drug store sites operated by Rite-Aid if they become available.”

Hispanic Formats



Some observers believe the Supermercado de Walmart banner — a 40,000-square-foot concept geared toward Hispanic shoppers — has expansion potential.

Wal-Mart’s move into more urban locations could also come from recasting one of its Hispanic formats, observers told *SN*.

For example, Wal-Mart could expand its existing two-store Hispanic format, Supermercado de Walmart, beyond Houston and Phoenix to additional locations, they said; or it could expand its Mas Club to more locations beyond the single one in Houston.

Eduardo Castro-Wright, corporate vice chairman and president of Walmart U.S., said Supermercado and Mas are part of Wal-Mart’s effort to become a more dominant fresh-food operator. He said the company plans to preserve its core assortments at both formats to serve the bulk of customers while editing presentations to better satisfy Hispanic customers shopping at those locations.

Speaking about the Supermercado test, one Wal-Mart executive said, “We had an opportunity with an existing Neighborhood Market [in Houston] to convert it to the Supermercado [banner] because it was in a Hispanic neighborhood, and it gave us a chance to really pilot a new program that would better connect with the consumer. We did some pretty dramatic things there where we increased the presentation of fresh and downsized some of the packaged goods and some of the frozen areas.”

Bill Bishop, managing partner at Willard Bishop, Barrington, Ill., said the Hispanic tests make sense. “When you take a look at the growth in the U.S. grocery business today, it tilts very heavily in terms of minority and even more so in terms of Hispanic. That’s where the growth is, even though it’s niche.”



Wal-Mart debuted its first Más Club — a version of its Sam’s Club format targeted to Hispanic shoppers — last year.

If Wal-Mart can perfect the Hispanic model, it has the potential to open hundreds of Hispanic stores, Bishop said. “The big question is, how does Wal-Mart create a more efficient supply chain for products that are frankly not going to have the same volume as mainline Anglo products?” he noted.

For Bishop, the basic Wal-Mart supercenter may be the ideal format for Hispanic stores. “It puts the best spin I've seen on a Hispanic format because, from a merchandising point of view, those stores are doing all they need to do to appeal to that demographic.”

According to Marcotte, “Wal-Mart is extraordinarily concerned with the Hispanic population because so many of its stores are in Hispanic areas, and if it doesn't move forward with Supermercado, then it will go in some other direction to accommodate that demographic.”

Matt Casey, president of Matthew P. Casey & Associates, Clark, N.J.-based real estate consultants, told *SN* he's been in the Houston Supermercado but was not impressed. “It's certainly not catering to Hispanics the way [H-E-B](#) or Rancho Liborio or Avanza are,” he said. “To me it's simply a store with bilingual signage and some additional Hispanic products in the mix, but it doesn't have that Hispanic feel to it.”

Marcotte said he believes Wal-Mart is satisfied with Supermercado. “No one talks about it as anything less than a great experiment,” he said.

“It's the right size, it's easy to shop and people seem to like shopping it. It's particularly attractive to second-generation Hispanic shoppers — the ones who spend the money.”

Nicholas, his Kantar colleague, told *SN* he believes Wal-Mart has big plans for Supermercado. “Wal-Mart is very, very excited about it,” he said, “and when the company decides to resume expansion, Wal-Mart sees the Supermercado as a bodega killer and as a key to unlocking inner-city locations.”

According to Marcotte, Mas — which means “more” in Spanish and is also “Sam” spelled backward — grew out of an internal analysis by Sam's Club of how certain demographic groups behave, “which showed a large number of Hispanics going to Sam's.”

“Although the Mas store certainly has more of a Hispanic flavor, I'm not convinced it will do better in terms of promoting sales to Hispanics than the original Sam's does because, despite the bilingual signage, a lot of Hispanic merchandise is displayed in kind of a sotto voce manner only in the ethnic aisle,” Marcotte pointed out.

The 143,000-square-foot Mas club, which opened last July, includes a service meat and seafood counter, fresh-made tortillas and a selection of Hispanic foods and international brands from South America, Central America and the Caribbean for individual use and small-business resale.

Casey told *SN* he believes Mas is “a weak effort.”

“Putting in bilingual signs, offering 12 feet of service meat and adding a certain number of products from Goya and other Latin manufacturers doesn't make a store Hispanic,” he said.

“To be more authentically Hispanic, a store needs a certain ambience, whether that's generated by pi atas hanging from the ceiling, Hispanic music, a large service meat counter or a cocina [hot kitchen].

“I suspect Wal-Mart will continue to tweak the Hispanic formats till it is comfortable with the sales levels, then decide when and where to expand them,” Casey said.

Marcotte said he believes a store aimed at Hispanics could be a big winner for Wal-Mart, based on its experience with Bodega Aurrera in Mexico — a chain of stores that range from 20,000 down to 3,000 square feet. “Those stores have been incredibly successful,” he said.

Adding to their effectiveness are ads that use a cartoon character, Mama Lucha, who fights with other operators to keep prices down, Marcotte pointed out. “No one ever thought of Wal-Mart as being funny or clever — just big. But if it ever decided to get funny in its advertising in the U.S., it would be terrifying [to competitors].”

More Groceries

Wal-Mart has continued to remodel its Division 1 discount stores every five years, adding more groceries and refrigerated doors with each remodel, observers said, but there is an expectation Wal-Mart intends to convert most of its 800 discount stores to supercenters over the next few years.

Supercenters have been Wal-Mart's primary growth vehicle over the last decade or so. In their larger incarnations — 130,000 to 195,000 square feet — they each generate annual sales estimated at \$100 million, with groceries, HBC,

pet foods and paper goods accounting for 50% to 60% of the total; in the smaller range — 100,000 square feet or so — sales average an estimated \$40 million a year, with groceries accounting for roughly 50% of volume.

Wal-Mart has been able to reduce the size of supercenters while maintaining profitability through various efficiencies, Bob Gorland, vice president of the Harrisburg, Pa., offices of Matthew P. Casey & Associates, said.

“To make space more profitable, Wal-Mart has been eliminating some of the leased departments across the front of the stores due to the liabilities they incur and because the chain is finding it tougher to find tenants,” he noted.

“It is also eliminating tire and lube centers at some stores, probably because they are less profitable and because there’s a lot of over-storing in that category.

“And Wal-Mart is also eliminating service seafood in many prototypes and replacing it with frozen cases or limited assortments of wrapped seafood for the labor savings, plus the shrink savings.”

Wal-Mart is said to be anxious to convert most of its existing Division 1 discount stores to supercenters by boosting the assortment of groceries — a prospect that should put conventional retailers on alert, Craig Rosenblum, a partner in Willard Bishop, warned.

“The ability for Wal-Mart to convert the traditional boxes in Division 1 to a stronger grocery mix should be frightening to the grocery industry,” he said.

Wal-Mart is interested in adding more food to the mix wherever possible, Rosenblum said, “because the company is enamored, to put it mildly, of the cash-flow opportunities groceries provide.”

Wal-Mart’s goal is to boost grocery offerings to 50% of the space, he explained. “If food is of such strategic importance to Wal-Mart, as it obviously is, and it wants to continue to grow its share, then the Division 1 format provides a quick opportunity in stores with a smaller footprint than most supercenters,” Rosenblum said.

New Prototypes

As it sets about converting more discount stores to supercenters, Wal-Mart has developed a smaller supercenter prototype — a store ranging from 90,000 to 105,000 square feet — that it calls its “high-efficiency prototype,” or HEP.

HEP stores devote half the floor space to groceries and half to an assortment of edited general merchandise offerings, Nicholas said. Wal-Mart operates HEP stores in Bloomington, Minn.; Mount Prospect, Ill.; and Delray Beach, Fla.

“The HEP format takes the footprint of a traditional discount store and converts it to a supercenter,” Bishop explained. “At 100,000 square feet or so, the store is on a scale that’s less intimidating to shoppers than a larger supercenter. And what makes it so efficient is Wal-Mart doesn’t have to expand the box — it can upgrade a discount store to a supercenter on the same piece of property without knocking down any walls.”

In retrofitting the discount store in Bloomington to an HEP supercenter, Rosenblum said, Wal-Mart put a traditional grocery store in the right half of the building — with produce up front; bakery, deli and dairy cases along one wall; paper goods, pet supplies and baby products at the back, along with DSD goods; dry groceries, meat and frozen foods between the front and back; and a pharmacy — with an edited nonfood assortment (apparel, electronics, paint, automotive, sporting goods and home products) on the other side.

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If there’s any retailer that knows how uncomfortable the murky middle can be, it’s Wal-Mart, which over the past 30 years has plowed scores of its

The converted stores also have better signage and clearer sight lines and do a better job of communicating the price message, he said.

smaller...

"It all adds up to a clean, inviting shopping experience that enables consumers to fill their complete shopping needs in one trip in what looks and feels like a very traditional grocery store," Rosenblum said.

The produce sections at the HEP supercenters have "a very traditional offering, with good variety and good prices and a quality that's on a par with most traditional supermarkets," he pointed out.

Bishop said Wal-Mart has "really punched up" produce at the HEP store in Bloomington, which opened in February. "It's the first thing you see in the store, and they've done a very nice job," he told *SN*.

"In the same way that produce was well thought out, so was the meat section — a 12-foot wall display with multi-deck cases, plus three island displays that present product for meal preparation in a very attractive manner — though the signage isn't great.

"And off to the right of the meat section is a wall of luncheon meats, which is done very well."

A 12-foot wall with multi-deck produce cases separates the produce section from the pharmacy, "and it's pretty progressive to pull the pharmacy so far toward the front as Wal-Mart has done," Bishop added.

In what Rosenblum called "a very un-Wal-Mart-like design," the pharmacy is "very warm, clean and inviting," with wooden floors and with the cosmetics gondolas set at an angle "to act like a funnel to direct people into the HBC area."

According to Bishop, "When you're in the pharmacy area, it feels like you're in a different store."

All items along the side and back walls on the grocery side — soft drinks, water, pet food, paper and dairy — are gravity-fed for easy replenishment; and all direct-store-delivery items are located at the back "to make it easier and more expeditious for vendors to get in and out," Rosenblum noted.

"The Bloomington store also had something I've never seen at a Wal-Mart — a very good-looking Subway counter, with over-stuffed leather chairs," Bishop added.

Gorland said Wal-Mart is testing different layouts at HEP supercenters. For example, a 100,000-square-foot location in Flemington, N.J., has food along the entire back half of the store instead of on one side, he pointed out.

With an eye toward opening more supercenters in urban areas, Wal-Mart is looking for vacant department stores of up to 100,000 square feet to convert, Gorland noted.

He said he does not believe Wal-Mart intends to convert all discount stores to supercenters. "Many of the discount stores are in excellent locations, but some have leases that limit how much food they can carry or else they may already be surrounded by supercenters, which could cannibalize their sales," he explained.

"In many large markets Wal-Mart operates stores as close as four miles apart, and a supercenter can take 20% to 25% of sales away from a Division 1 store. As a result, a big issue within Wal-Mart is how to avoid over-cannibalizing sales at existing stores, which makes the discount stores less profitable."

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Neighborhood Markets



Growth has slowed in recent years for the Neighborhood Market format, a traditional supermarket operation that was once thought to be a prime expansion vehicle for the company.

Wal-Mart is still opening Neighborhood Markets here and there, Gorland said — conventional grocery stores with expanded drugs and a drive-by pharmacy in the 40,000-square-foot range. The stores have a warehouse feel, with concrete floors and high ceilings and a lot of bulk items, Rosenblum noted.

According to one corporate executive, “We are taking that same approach with the general Neighborhood Markets [as with Supermercado], where we will apply some of those same principles in terms of adjacencies and space allocation, sight lines and product presentations to figure out how we can better engage customers on different shopping occasions.”

Casey said, “The Neighborhood Market is still a bare-bones store — like a Food Lion on one side and a CVS drug store on the other. And it lacks any of the service aspects and perishables quality of other supermarkets.”

Though expansion of Neighborhood Markets has been slow — as Wal-Mart discovered it could open supercenters closer together than it had originally thought — the company is continuing to tweak and refine the concept.

According to Nicholas, Wal-Mart has developed a new prototype for Neighborhood Markets at a location in Rogers, Ark., in which it's added a service seafood offering, adjusted the level of private-label items, adjusted the labor, and lowered the sight lines — “though the cafe at the store may not last,” he added.



Wal-Mart said expansion of the small-format Marketside banner is on hold — but it has adopted the brand for prepared foods in supercenters like this one.

Although Neighborhood Markets were once viewed by the industry as a potential scourge, Wal-Mart's discovery that it could open supercenters closer together meant it didn't need to rely on Neighborhood Markets as much for expansion.

“I think what Wal-Mart also found was the Neighborhood Markets did not meet the returns it had anticipated,” Casey said. “Wal-Mart expected its low-price reputation to draw customers with the kind of eye-popping sales numbers it was seeing at the supercenters, and although it does have some strong locations, the ROI just isn't there for most locations.”

Rosenblum said he agreed. "Wal-Mart can't get the same kind of margins out of a basket that it gets at stores with more general merchandise," he noted.



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While Neighborhood Markets may have a future, Marketside probably does not, Bishop pointed out. Wal-Mart opened four Marketside stores of 20,000 square feet each in Phoenix in 2008, "but it's found it can't get the right mix to make the stores profitable," Bishop said.

"However, the in-store experience is excellent, the labor and inventory are very efficient and the assortment is astute.

"And Wal-Mart did learn some things from those stores," Bishop added. "For example, in produce it learned how to dramatically reduce inventory while using basket displays to give the impression of variety, and I give the company credit for finding an efficient way to present produce in a low-volume store.

"What Marketside also did was it taught Wal-Mart how to integrate bakery and deli into a foodservice area, with good soups and an excellent sandwich program with just an 8-foot service case and a lot of personality from employees.

"And the stores also do an outstanding job merchandising wine."

As for Sam's Club, Rosenblum said he sees few significant changes. "Wal-Mart continues to clean them up and refresh them, as it has done all along,"