NEIGHBORHOOD MARKETS

Neighborhood Market is Wal-Mart's most recent entry into food, and possibly the one that will have the biggest impact on retailers all over the country.

"Some supermarket retailers have lost sleep over the spread of supercenters, but they've regained their normal sleeping patterns again," Giblen said. "But they should lose more sleep over Neighborhood Markets because those are conventional supermarkets that can go in anywhere."

Wal-Mart opened its first Neighborhood Market in its home city of Bentonville, Ark., in 1998. It operates 39 Neighborhood Markets today — in Arkansas, Texas, Oklahoma, Tennessee and Mississippi — with 11 more scheduled to open by the end of January and another 20 to 25 scheduled to open next year — the largest expansion in its modest four-year history — with stores reportedly slated for Alabama, Florida and Utah, plus Las Vegas.

All the Neighborhood Markets are located within the trading areas of existing supercenters as part of Wal-Mart's "saturation strategy," in which spillover business from supercenters can go to Neighborhood Markets instead of to other retailers.

White, the former supercenter executive, said Neighborhood Markets are "a logical extension of supercenters. It's a vehicle that makes sense, and it works."

Wal-Mart developed the format after it realized some consumers were interested in shopping for food and health and beauty aids in a smaller, more convenient location than a supercenter, he said. "As supercenters got larger and larger, Wal-Mart determined that Neighborhood Markets could fill in around them to provide a convenient food store for people to stop into on their way home from work."

The format is a 40,000- to 45,000-square-foot box featuring groceries and health and beauty care items — virtually the same assortment with

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in those categories found in supercenters — plus a drive-through pharmacy.

Wal-Mart is getting close to a codified format for the stores, Giblen said, "though they're still doing some fine-tuning and some tweaking."

Industry observers told SN the Neighborhood Market that opened last January in Rogers, Ark., seems to be the prototype that Wal-Mart will utilize as it expands. "They finally got it right," one industry executive told SN.

That store features fresh departments up front; slightly angled grocery aisles that all lead to the perishables area; and low shelving in the pharmacy area so customers can see the entire store.

According to Giblen, Wal-Mart developed the Neighborhood Market format by studying best practices among industry leaders "and then trying to work those into Wal-Mart's methods, so it's a synthesis of the best that's available in supermarkets."

Rogers said he believes Neighborhood Markets have benefited from cross-fertilization with Wal-Mart-owned Asda stores in the United Kingdom, "because a lot of those stores are 40,000 square feet, and that expertise is finding its way back to Neighborhood Markets. For example, Asda's gravity-fed dairy cases are being used at Neighborhood Markets, and Wal-Mart is introducing the George private-label clothing line, which was developed by Asda and expanded to Germany before coming into the U.S."

Industry analysts have been saying for years that Wal-Mart was on the verge of launching a major rollout of the Neighborhood Market format. "Wal-Mart has had a rough go in Germany and Latin America, and Sam's has been struggling, so the company has had to keep its focus elsewhere," Giblen said. "But at some point it will open the floodgates, and I don't think that point is far off.

"With so many of the major supermarket operators in very weak positions right now, there's a lot of blood in the water, and Wal-Mart wants to be the shark that gets to the blood first."

Once it decides to expand the format more aggressively, nearly every supermarket operator in the country could be going head-to-head with Neighborhood Markets, Giblen pointed out.

"The size required for supermarkets and even Wal-Mart discount stores has been a limitation on where the company could go, which means companies with a lot of stores in suburban areas have avoided heavy competition with Wal-Mart. But with Neighborhood Markets, there's no telling how much business Wal-Mart will do," Giblen said.

Rogers said Wal-Mart is closer than it was two or three years ago to finding the right formula for...
capital allocation issues are dominated by the success of supercenters, and that's probably going to continue to have a dampening effect on a true rollout of Neighborhood Markets.

According to Turock, the question Wal-Mart needs to ask itself is whether it will open Neighborhood Markets separate from supercenters — possibly as a vehicle to move into urban areas.

"Wal-Mart has always done well in formats that include large general merchandise assortments," Turock said. "But Neighborhood Markets have more food than general merchandise, so the big challenge is, can Wal-Mart do well in a store with less high-margin general merchandise? On that basis, Neighborhood Markets are still a bit experimental.

"Wal-Mart has not yet proven it can achieve the needed results in stores where general merchandise is not the largest component, so it may be constrained in its expansion because of potentially diminished margins."

Bishop said he sees Neighborhood Markets as "an incredible opportunity from a supply chain point of view because it will leverage Wal-Mart's distribution systems with efficiencies that are not at all typical for 45,000-square-foot stores."

However, he questioned whether Wal-Mart can scale down its food proposition and still deliver consumer value in markets that already have a supercenter.

"And the wild card is, what is the real profitability of these stores?" Bishop said. "Wal-Mart must be more discerning about where it puts capital to please Wall Street, and whether or not this is really a blocking, stoppable strategy that doesn't return as well as a supercenter will determine whether there is growth or a lack of growth in Neighborhood Markets.

"There's no question Neighborhood Markets return less, but how much less will determine how important that format is."

Another question the industry is asking is: Will Wal-Mart expand Neighborhood Markets through acquisitions?

White said he believes it's unlikely Wal-Mart will seek to acquire stores for Neighborhood Market expansion, "though anything is possible, and..."
I'm sure the management team has considered it. 

He said the possibility of single-store acquisitions makes more sense than acquiring a chain. Other observers said they expect Wal-Mart eventually will make large acquisitions for Neighborhood Markets.

"Wal-Mart might look for an acquisition when it feels it needs to achieve a better distribution of sales," Cerankosky told SN. "Though any acquisition could be more than five years off while Neighborhood Markets gain a more compelling return on capital."

According to Rogers, acquisition of a regional chain would enable Neighborhood Markets to grow. "Neighborhood Markets is an urban format, and because Wal-Mart wants to be careful not to attract attention from the Federal Trade Commission [which investigated its acquisition of Amigos in Puerto Rico before recently granting approval], it's not going to acquire a company with 100 or 200 stores. So it's more likely to look at smaller, more localized opportunities and acquire some regional chain over the next five years and convert those stores to Neighborhood Markets."

"And from a logistics standpoint, it's hard to enter certain parts of the U.S. with ground-up stores, so an acquisition in one of those areas — New York City, for instance — would make sense."

Gibbsen said Wal-Mart is likely to make acquisitions to expand Neighborhood Markets but is unlikely to venture into New York. "Wal-Mart recognizes the need to accelerate its expansion of Neighborhood Markets, and if it felt some group of stores could provide valuable expertise, it might very well consider an acquisition," he said.

"But I think Wal-Mart is still afraid of cities like New York. It's done less well overall in the Northeast because people there are more wary of greeters — they think it's hokey — and they don't like commercial boxes — they want something with more charm."