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Economic Scene | Virginia Postrel

Lessons in keeping
business humming,
courtesy of Wal-Mart U.

WAL-MART STORES has just passed Exxon Mobil to become the world's largest company by sales and will thus top the Fortune 500. Wal-Mart's achievement is particularly striking as its once-mighty competitor, Kmart, struggles under bankruptcy protection.

Wal-Mart is not just big. It's popular. In an annual survey by WSL Strategic Retail, a consulting firm, a plurality of Americans, around 25 percent, say Wal-Mart is their favorite store. And in a recent survey of children 8 to 18, Teenage Research Unlimited found that 58 percent declared Wal-Mart their favorite place to shop for clothes. (It ranked fifth when price was no object.)

Critics carp about consumerism and wax nostalgic about the old corner store. Some even mount performance-art protests, called Whirl-Mart, in which groups push empty carts through Wal-Mart's aisles.

But most people aren't complaining. By making goods cheap and available, Wal-Mart has raised the standard of living of average Americans.

Now the McKinsey Global Institute, the research arm of the McKinsey consulting firm, reports that Wal-Mart's impact on the economy goes further than most ever imagined. Wal-Mart's managerial innovations contributed mightily to the big increase in American productivity in the late 1990's, an increase most observers assumed came from high-technology companies.

The McKinsey study looks at why labor productivity shot up in the late 1990's and



Richard L. Harbus for The New York Times

While the public knows Wal-Mart for prices like those posted at its store in Monroe, N.Y., analysts admire its ability to move and stock goods and build a hub system.

how important information technology was in that acceleration.

"Surprisingly, the primary source of the productivity gains of 1995 to 1999 was not increased demand resulting from the stock market bubble, as some economists have claimed. Nor was information technology the source, though companies accelerated the pace of their I.T. investments during those years," reports a summary of the findings published in *The McKinsey Quarterly*. "Rather, managerial and technological innovations in only six highly competitive industries — wholesale trade, retail trade, securities, semiconductors, computer manufacturing and telecommunications — were the most important causes." (The journal is online at www.mckinseyquarterly.com, and the entire study is at www.mckinsey.com/knowledge/mgi/feature/index.asp.)

Competition and better management, not

simply the spread of computers and the Internet, made the difference. Nowhere was that clearer than in retailing.

From 1987 to 1995, labor productivity grew an average of 1 percent a year. From 1995 to 1999, it grew 2.3 percent a year. This big jump, combined with increased employment, meant that real output per capita grew nearly 4 percent a year — an extraordinarily fast rate, comparable with those of some Asian economies during their period of economic takeoff.

A quarter of that increased productivity came from retailing. And about a sixth of the improvement in retail productivity came from general merchandise, most of it directly or indirectly from Wal-Mart.

"More than half of the productivity acceleration in the retailing of general merchandise can be explained by only two syllables: Wal-Mart," writes Bradford C.

Johnson in a McKinsey Quarterly article "The Wal-Mart Effect." As Wal-Mart became more and more efficient, its share of the market expanded, thereby applying its efficiency to a larger portion of total purchases. And Wal-Mart's rivals began to emulate its highly productive practices.

Most of those practices aren't glamorous. Take the big-box format. Larger stores increase sales per square foot by encouraging customers to buy additional goods, often on impulse. Big-box stores also let retailers spread fixed labor costs like store management and cleaning crews across more sales.

While the public knows Wal-Mart or low prices, business analysts admire its logistics management. It has always been efficient at moving and stocking goods, building its stores as spokes around distribution center hubs. In the late 1990's, it was better.

Instead of simply maximizing efficiency at the warehouse, for example, Wal-Mart began to analyze costs over the entire shipping process, including how quickly goods can be moved onto shelves once they arrive at the store. In some cases, not completely filling a pallet with goods can save so much time in stocking the store that what

seems "inefficient" at the warehouse is more productive over all.

That attention to detail makes for big savings when it is applied to an operation the size of Wal-Mart and then spreads to competitors. Other advances include tracking how busy cashiers are, so they can be used elsewhere during slack times, and using forecasting tools to figure out how many checkout employees to have in the first place.

Throughout its operations, Wal-Mart applies information technology. But the operations come first.

After the fact, the study's results seem obvious. Retailing employs a huge number of people and accounts for a lot of the economy. But the importance of retailing to the late-1990's boom wasn't clear before the study began.

"It's certainly surprising to people outside the United States," says Lenny Mendonca, a McKinsey director and chairman of the McKinsey Global Institute. Europeans tend to assume that American growth is driven by Silicon Valley and that they can emulate that growth by developing their own high-technology industries.

When retail and wholesale operations

turn out to be as important as semiconductors and communication, that can change how foreigners think about economic policy.

"It's as much about competition policy that discourages retail innovation" as about technology policy, Mr. Mendonca said. In Europe, anticompetitive retail policies are common, restricting real estate use, store hours and what can be sold by whom. Wal-Mart developed in a largely unregulated retail environment, so its big-box model can't be copied in much of Europe.

"If anything, the restrictions on retail in other parts of the world may hurt standard of living more than they hurt productivity," he says, "because you can still have a very productive store if it's only open five days a week." This summer, McKinsey Global will have a similar report on productivity growth in Europe. "When you complete the whole story about what's going on around the world, it's quite an informative picture," Mr. Mendonca says. "It reinforces the view of how important the basics of competition and capitalism are to improving productivity. It gives you a sense of don't hope for silver bullets — let the market work."