Several Characteristics of Supermarket Industry from Financial Statement -- Simple Analysis Based on Walmart, etc.

Ruyi Wan *

Business School, Xi'an International Studies University, Xi'an, China

*Corresponding author: 107242020001518@stu.xisu.edu.cn

Abstract. In modern society, "supermarket" is not an alien concept. Supermarkets appear everywhere and bring convenience to people. When searching and calculating the financial data of supermarket industry and learning it as a kind of business models, some characteristics of their financial data can be seen, which are very different from the normal figures of other industries. However, seldom specialized studies can be found directly. In this article, the author is trying to discuss several categories of financial data briefly, for the analysis on evaluating a company's performance. Taking Walmart as a major example, the article mainly focuses on the profitability and liquidity of the Company, and choose some typical ratios to explain the differences. For the supermarkets, according to the special strategies and operating methods, the ROS and ROE data are not as high as other industries. Besides, for those large retailers, the current ratio and quick ratio data are far lower than average. Whereas, the inventory holding periods and working capital cycles are much shorter. When these characteristics are shown, it may indicate that the supermarket has well cost control, good profitability, strong power of bargain and high operating efficiency. However, they are not the only-needed elements. It is still necessary for people to take other measurement as evaluating a company.

Keywords: Supermarkets; General merchandise retailers; Chain groceries; Financial analysis; Case study.

1. Introduction

Retailers buy products from a manufacturer or wholesaler, and sell them to customers [1]. In transactions, the retailer plays the role as an intermediary between manufacturers and customers. In daily life, general merchandise retailers are the most common one.

In the financial statements of those companies, some special characteristics can be seen, which are very different from those of other industries. Questions have been raised up: What are these differences exactly about? What are the reasons? What can people learn from those special elements? How can managers and investors use the financial information to analysis the performance of a supermarket and how to improve?

Taking Walmart and other successful cases as examples, this article is going to put forward simple discussions on the special financial data and differences between, and try to give suggestions on evaluating and improving a supermarket's performance based on its financial statements.

2. Typical Items used to Analyse a Supermarket Financial

To evaluate a company's performance, it can start from their profitability, liquidity and efficiency. Different industries have different standards to follow. How can people analysis these aspects in supermarkets? The article will list several common ratios - return on sales (ROS), return on equity (ROE), current ratio, and quick ratio - focusing on profitability and liquidity analysis, and use Walmart (data from the annual report for the fiscal year ended January 31, 2022 of Walmart Inc.) and other famous business cases as examples.

3. Relevant Information about Walmart

3.1 Brief Introduction on Walmart Inc.

Starting its business empire from Bentonville, Arkansas, the United States by Sam Walton in 1962, Walmart Inc. (formerly Wal-Mart Stores, Inc.) is an American multinational retail corporation that operates a chain of hypermarkets (also called supercenters), discount department stores, and grocery stores. It also owns and operates Sam's Club retail warehouses.

3.2 Why Choose Walmart?

To analyze an industry, case study is one of the most direct methods. By starting with typical cases, people would have a quick understanding easily. Walmart was listed on the New York Stock Exchange in 1972. By 1988, it was the most profitable retailer in the U.S. [2], and by October,1989 it had become the largest by revenue [3]. Besides, Walmart was the largest grocery retailer of the United States in 2019, while there was 65% of its $510.329 sales came from the United States operations [4][5]. Nowadays, with an annual revenue for about $570 billion, Walmart has become the world's largest company by revenue, which is listed at the first place by Fortune Global 500 in May 2022 [6]. The employment of 2.2 million people has also made it the largest private employer around the globe [7]. As such a famous business, it is suitable to study it as an example.

3.3 Segments and Key Strategies of Walmart

A large business needs proper strategies, along with being well organized. Here the author is going to discuss the segments and key strategies which contribute greatly to Walmart's success.

3.3.1 Walmart U.S., Walmart international and Sam's club

Located throughout the U.S., Canada, China, Africa and many countries and regions, Walmart is committed to helping people around the world through its retail, wholesale and other units, as well as eCommerce. There are three segments in its financial statements: Walmart U.S., Walmart International and Sam's Club (Fig. 1). Each segment contributes to the company differently [8].

Fig. 1 Different Segments and Their Gross Profit as Percentages of Net Sales of Walmart Inc [9]

(1) Walmart U.S.

Walmart U.S. is the largest segment of Walmart Inc., and it operates in the United States. It is a mass merchandiser of consumer products. According to the annual report of Walmart (fiscal year ended January 31, 2022), Walmart U.S. has had the largest gross profit historically among the three segments, and also contributed most to the Company's net sales and operating income.

(2) Walmart International

Walmart International is the second largest segment of Walmart Inc., and it operates in 23 countries outside the United States. Retail and wholesale are the two categories of Walmart International's businesses. The gross profit rate is lower than that of Walmart U.S. primarily because of its format mix.

(3) Sam's Club

Sam's Club is a membership-only warehouse club owned by Walmart. It intends to offer customers goods with high quality and lower price. As a membership-only store, membership income is an essential component of the operating income of Sam's Club. In addition, compared with the other two departments, the gross profit and operating expenses of Sam's Club account for a lower proportion of net sales.

3.3.2 Several typical strategies of Walmart

As a world-famous business, Walmart has put forward many well-known strategies, which are significant in its development history. In this article, the author is going to introduce the three typical ones, which are studied and imitated by supermarkets around the globe.

(1) Every Day Low Price (EDLP)

Every Day Low Price (EDLP) is a core strategy of Walmart. It is like a "cornerstone" in the development history of the Company. The strategy acquires Walmart to provide its customers goods with high quality at lowest possible prices. The price advantage can attract and keep more customers for Walmart. This will be discussed in more detail later in Measuring the Profitability Section.

(2) Cost control

In order to keep the profit at a proper level, Walmart need a good Cost Control method to support its EDLP Strategy. Walmart has created a special system for itself to manage expenses and optimizing the efficiency of working, so the environment for sustainable lowest cost is able to realize. Walmart put effort in improving its technology and modifying the operating process, and as a result increasing productivity, managing inventory and reducing costs as much as possible. This will also be discussed in more detail later in Profitability Analysis Section.

(3) Systematize

Not only for Cost Control, Walmart's special operating system brings it super high efficiency. They are tightly related (explained in the previous paragraph).

3.4 Different Operations in Walmart

To make it easier to understand, let's take Walmart's business in the United States as an example. There are three kind of retail stores operating under Walmart U.S.: Walmart Supercenter, Walmart Discount Store and Walmart Neighborhood Market. Also, Sam's Club is a very important sector of Walmart in the United States. Here is an illustration to show (Fig. 2).

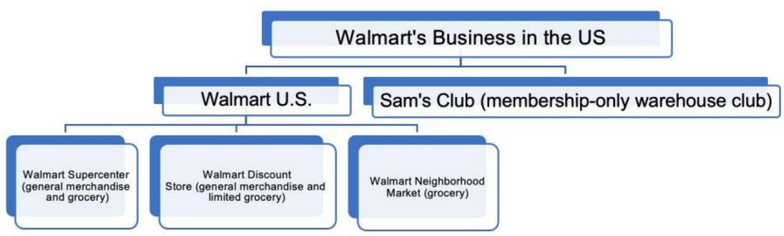

Fig. 2 Walmart business in the United States

3.5 Income Structure of Walmart

For Walmart, net sales are the company's biggest revenue every year, accounting for more than 90% in recent years. In addition to net sales, Walmart also makes money from its membership fees. Membership fees generated \$1.5 billion in revenue in 2020, compared with \$1.4 billion in 2019 [10]. Besides, Walmart benefit from the gift cards it released, as well as financial and other services. However, these are not taking a big section of the Company's sales.

4. Measuring the Profitability

For most of the industries, return on sales (ROS) and return on equity (ROE) are the two common means to measure a company's profitability. However, for the supermarket industry, figures of ROA and ROE have their special characters.

4.1 Normal Data of Other Industry

It is wide-acknowledged that the normal figures of ROS vary from industry to industry while the ROE data is often at a certain level. Comparing to those of science and technology companies, the ROS chain groceries are comparatively low. Also, for companies in the United States, the average level of ROE is around 12%; if the figure raises to 15%, it become the ideal value; if the figure increases to over 20%, it infers that the company performed excellent in making profit [11].

4.2 Data from Supermarket Industry

However, in general merchandise retailers, especially in those with large scale, the ROS would be at a lower level, but the ROE would stay at the same or a slightly higher level. Taking Walmart as an example, the ROS of recent three fiscal years are at about 2.5%, and the ROE of the Company are higher than 15% each year. Another example is one of Walmart's competitors, Target Corporation. ROS data from Target is between 4% and 7%, a little bit higher than Walmart, but still far lower than other industries. Whereas, the ROE of the both companies are showing a positive sign of profitability. Here are two charts to show the comparison and trend (Fig. 3 and 4).

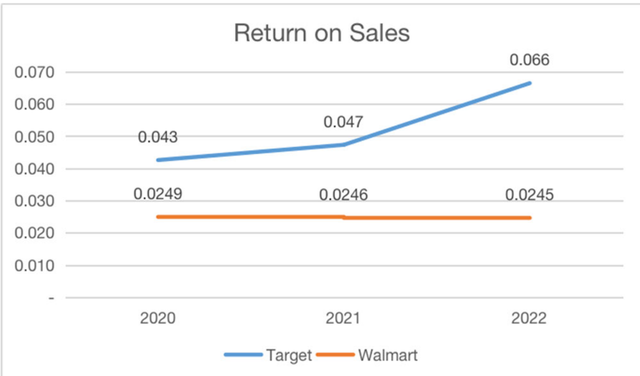

Fig. 3 ROS of Walmart and Target in recent three fiscal years [9,12]

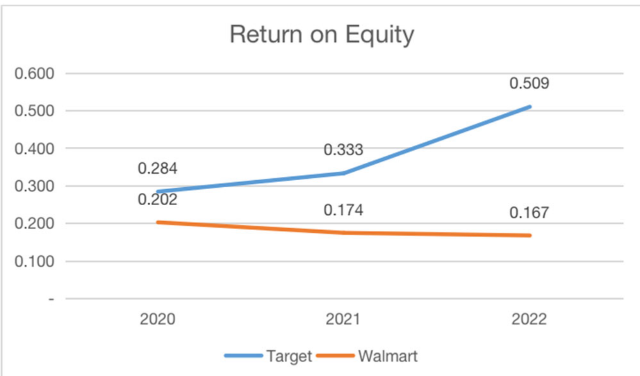

Fig. 4 ROE of Walmart and Target in recent three fiscal years [9,12]

4.3 Differences and Reasons Analysis

How do the differences come? It is tightly related to the special strategy of those general merchandise retailers - small profit but quick turnover strategy. For example, Walmart's "cornerstone strategy" EDLP (mentioned in Section 2.3.2 Several typical strategies of Walmart above). It attracts large numbers of customers, so that the Walmart can reach high volumes of sales, which means it gain profit from selling its product at low prices in a large amount. Besides, in order to keep the price lower, companies have to manage its costs and expenses properly, so that sustainable profits are able to realize. As mentioned in Section 2.3.2 Several Typical Strategies of Walmart, the Company has a good cost control in its daily operation, which contributes to its EDLP strategy and makes it a virtuous cycle. Also, investment contributes to the hypermarket. For example, Walmart had $1.0 billion investments in debt securities classified as the interest income [8]. To get evaluate the profitability, other measurement should be made. For example, in the annual report of fiscal year 2022, Walmart suggests investors pay attention to the return on investment (ROI) data, to access how effectively Walmart is deploying its assets [8].

Thus, to some degree, a lower ROS but high ROE indicates that the supermarket has a large scale as well as a strong power of controlling costs and making profit. In addition, other measurement should be taken to assist.

5. Measuring the Liquidity

Current ratio and quick ratio are widely used to describe a company's liquidity performance. They refer to the ability of paying debt in short terms. Whereas, for supermarkets, traditional evaluation criteria for current ratio and quick ratio do not applied.

5.1 Normal Data of Other Industry

For common enterprises, the ordinary figure of current ratio is 2 or higher, and the quick ratio is 1 or higher, and there are links between the two ratios according to their computing formulas. Since the data indicates if a company has sufficient current assets, and it is a sign of the profitability as well as the risk of paying debt within a short period of time, the management and investors often expect it a higher level.

5.2 Data from Supermarket Industry

Although higher current ratio and quick ratio is linked to higher liquidity, as an industry requiring higher liquidity, higher is not always better. On the contrary, sometimes smaller amount infers a healthier operating. Take Walmart and Target as example, current ratios of the two companies in recent two fiscal years are at around 1.0 while quick ratios are lower than 0.6, far lower than the ordinary of other industry. Here are two charts with data (Fig. 5 and 6).

Fig. 5 Current ratio of Walmart and Target in recent two fiscal years [9,12]

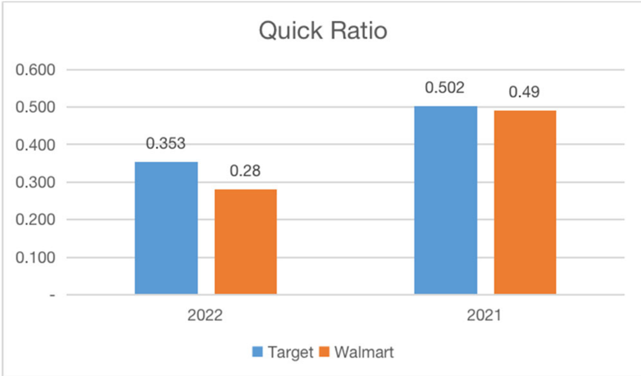

Fig. 6 Quick ratio of Walmart and Target in recent two fiscal years [9,12]

5.3 Differences and Reasons Analysis

The result is surprising, but it is also reasonable. A important factor is the methods of transaction recording in the financial statements. General merchandise retailers, for their part, tend to record items that they currently hold for sale as current liabilities rather than current assets in financial statements. To be more specific, supermarkets get their goods from the suppliers and record these items as liabilities, and when they sell the goods to customers and receive money from customers, they won't pay back to suppliers immediately, but will pay the liabilities in next accounting period. In that case, the companies can maximize the cash holdings and create a stronger cash follow, although some of the holdings are written as "liabilities" in the financial statements. Take Walmart as an example. Its total current assets of fiscal year 2022 are of $81.070 billion, while the total current liabilities are of $87.379 billion, higher than the total current assets [8]. Yet, it acts positively in the statement of cash flow as the net cash provided by operating activities is $24.181 billion [8].

Thus, to some degree, for supermarket industry, a high current liability holding with low level of current ratio and quick ratio infers that the company have a strong power of bargain, which means the ability to bargain for keeping the goods and paying back to the suppliers later. This reflects its business condition and goodwill from one aspect.

6. Challenges and Chances When Meeting the E-commerce

Nowadays, the booming of e-commerce. Many general merchandise retailers have built up websites and platforms for online shopping. There are differences in operating system between traditional shopping and the ones for e-commerce. For example, traditional shopping can choose to pay in cash, but in most cases of online shopping, online payments only. However, materials are not abundant enough for studying this influence at present. Combine with the COVID-19 Pandemic and low economy, the consumption habits and level of people have changed. The author can only speculate that it will have some impact on the recording of current assets and current liabilities in financial statements, then maybe some relevant ratios would be affected.

7. Conclusion

In general, the financial data of supermarket industry has its unique feature. When using the traditional format for calculation, it may acquire proper adjustment. Also, for a company's part, one single ratio computed from the financial statements is not comprehensive and lack of persuasion. Several calculations are necessary especially there are tight links between each financial data. Besides, when evaluating a supermarket's performance, one cannot only focus on figures in financial statements, but also need to pay attention to the competitors, and most importantly, should deeply take studies on the whole industry and learn about how those companies of the industry operating. Practically, a business's organization, structure, segment, system, strategy, etc. have significant influences on its operation performance. Without putting emphasis on these elements, the analysis or report will be no exhaustive and objective.

The article takes a view of several typical financial data of supermarket industry, and point out that the measuring standards based on the financial data should be adjust because of the different characteristics of different industries. Possibly, a figure is a positive sign in one particular industry, but infers bad management and future risks in another. The author except this study can answer some questions on why several ratios of supermarkets are widely divergent from the normal standards of other industries, and how to set about when evaluating a supermarket' performance. Nevertheless, only several ratios are chosen in this article, and the examples are not cover extensively, especially it lacks instants of smaller scale. In addition, further researches should be made for more comprehensive studies. Moreover, due to the author's limited ability level and poor knowledge, it still needs efforts for improvement.

References

[1] My Accounting Course. Accounting Dictionary. What is a retailer? Retrieved on October 15, 2022. Retrieved from: https://www.myaccountingcourse.com/accounting-dictionary/retailer.

[2] Hayes, Thomas C. (February 28, 1990). "Company News; Wal-Mart Net Jumps By 31.8%". The New York Times. Retrieved on October 15, 2022.

[3] 1990 Sales Lift Wal-mart Into Top Spot - Sun Sentinel Archived September 4, 2013, at the Wayback Machine. articles.sun-sentinel.com (February 15, 1991). Retrieved on October 15, 2022.

[4] "Earnings Release - 1.31.2020" (PDF). Walmart. Retrieved on October 15, 2022.

[5] "Walmart 2016 Annual Report" (PDF). stock.walmart.com (PDF). Walmart. p. 20. Retrieved on October 15, 2022.

[6] Fortune. Walmart | 2022 Fortune 500. Retrieved on October 15, 2022. Retrieved from: https://fortune.com/company/walmart/fortune500/.

[7] Wikipedia. Walmart. Retrieved on October 15, 2022. Retrieved from: https://en.m.wikipedia.org/wiki/Walmart.

[8] "Walmart Form 10-K (for the fiscal year ended January 31, 2022)". Retrieved on October 15, 2022. Retrieved from: https://www.sec.gov/ix?doc=/Archives/edgar/data/0000104169/000010416922000012/wmt-20220131.htm.

[9] Data from "Walmart Form 10-K (for the fiscal year ended January 31, 2022)". Retrieved on October 15, 2022. https://www.sec.gov/ix?doc=/Archives/edgar/data/0000104169/000010416922000012/wmt-20220131.htm.

[10] Business Strategy Insights. Walmart Business Model and How It Makes Money. Retrieved on October 15, 2022. Retrieved from: https://www.bstrategyinsights.com/walmart-business-model/.

[11] Baidu Baike. Return on equity. Retrieved on October 15, 2022. Retrieved from: https://baike.baidu.com/item/%E8%82%A1%E4%B8%9C%E6%9D%83%E7%9B%8A%E5%9B%9E%E6%8A%A5%E7%8E%87/10675269?fromModule=search_lemma.

[12] Data from "Target Form 10-K (for the fiscal year ended January 29, 2022)". Retrieved on October 15, 2022. https://www.sec.gov/ix?doc=/Archives/edgar/data/0000027419/000002741922000007/tgt-20220129.htm#ic3e4bf1571654b54a75e01746d337891_85.