A Higher Wage is Possible at Walmart

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Walmart's focus on short-term results at the expense of front-line service is hurting the company

Impressive returns in the 1990s and billions of dollars in annual profit have positioned Walmart investors to expect a commitment to growth and financial performance from the company. Recently though, Walmart's focus on returning value to shareholders through raising short-term earnings has diverted resources away from the kind of human capital investment that would lead to sustainable value creation in the long run. This brief explains how investors committed to long-term firm performance would benefit from reallocating resources to human capital management, raising productivity by reducing turnover and improving employee engagement, enhancing customer service, and building long-term value.

Last year, Walmart spent more than $6.6 billion repurchasing shares of its stock, bumping up earnings per share and consolidating ownership among the Walton family heirs. But the company's performance slumped anyway as weak consumer demand, operational problems as a result of understaffing, and federal cuts to the food stamp program (a critical source of revenue for Walmart) undermined sales. Media and market analysts identified Walmart's own human capital management practices as a central factor in execution failures at US stores.[1]

KEY FINDINGS

Walmart investors committed to long-term firm performance would benefit from reallocating resources. If Walmart redirected the **$6.6 billion** spent on share repurchases in 2013 toward investment in human capital, it could give its 825,000 low-wage employees a raise of **$5.13 per hour**, boosting productivity and sales.

In an uncertain economy where households curtail even the most basic expenditures, Walmart has a unique opportunity to turn things around. As the world's largest retailer and biggest employer, effective human capital management at Walmart would not only have benefits for the company, but create spillover effects supporting greater economic stability and growth.

Reallocating resources can solve the under-investment problem at Walmart

Walmart spends a sizable portion of its profits—$6.6 billion in 2013—on share repurchases that benefit an increasingly narrow group of owners and executives. Repurchases help the company meet earnings targets even when sales are down by reducing the number of shares on the market and lifting earnings for those that remain. But when buybacks are poorly timed or crowd out other investment, they can actually undermine longer term goals.[2] In a 2012 study, analysts at Credit Suisse showed that just 36 percent of S&P 500 companies performing share buybacks returned value to shareholders above the basic cost of equity.[3] In Walmart's case, even these massive financial maneuvers are increasingly insufficient to make up for listless company performance.[4] Unproductive spending on share repurchases is displacing sustainable human capital management that would better align the interests of workers, managers, and shareholders in the company and materialize as greater revenue over time.

Walmart employs 825,000 workers who earn less than $25,000 per year, wages that leave many of the company's workers and their families below the poverty line.[5] Redirecting current investment in share repurchases toward human capital could mean a raise of $5.13 per hour for this low wage workforce. The results would be a significant raise in living standards for hundreds of thousands of households and an increase in US sales growth for the company.

According to a growing body of research on human capital management in retail, experienced employees with broad knowledge of the company are better equipped to serve customers, leading to higher sales numbers and better performance overall.[6] Research from management experts at the Wharton School of Business shows that stores see an average of $10 in new revenue for every additional dollar spent on payroll.[7] Better staffing practices lead to higher sales, since customers can count on stocked shelves and knowledgeable employees. Investing in front-line services would increase consumer spending at Walmart's own stores and improve company performance.

Food stamps and poor sales—the downward trend that Walmart can address

Walmart's current pay practices have a negative impact on fundamental performance measures. In the retail market, customers' brand perception is primarily formed by their experience with human capital outcomes. Last year, media reports of Walmart customers abandoning the store for competitors cited underinvestment in front-line services as the central cause, as workers were stretched too thin to accommodate the needs of patrons and keep inventory on the shelves.[8]

Walmart investors have also experienced first-hand how the low-wage economy thwarts performance. In 2013 sales at comparable US stores declined 0.5 percent and revenue growth fell drastically to 1.6 percent, down from 5 percent the year before.[9] The company pointed to benefit cuts in the Supplemental Nutrition Assistance Plan (SNAP, or food stamps) in November and January as a catalyst to their falling profits and identified changes to the program as a notable risk for shareholders in their latest annual report.[10] The company's reliance on the food stamp program creates vulnerability in two ways. Millions of dollars in subsidies support the firm's labor costs and enable Walmart to pay wages below the level necessary for workers and their families to survive. Dependence on public subsidies to finance the wage bill transfers the cost of maintaining a labor force onto taxpayers and externalizes the consequences of human capital management at the firm. Additionally, Walmart depends on a consumer base that spends more than $13 billion in SNAP benefits at the store each year.[11] When customers—a population that includes Walmart's own workforce—have to cut back on the basics, those cuts appear in the financial performance of the firm.

In a recent report, the consulting group Institutional Shareholders Services Inc (ISS) criticized Walmart for inadequate oversight concerning human capital management among the company's Board of Directors.[12] According to ISS, the Walton family heirs' ownership control and the lack of an independent board has led to troubling executive pay practices and inadequate transparency surrounding shareholders' legal risks. The ISS recommendation that shareholders vote no on the reappointment of two board members and the executive compensation package suggests that human capital management practices at Walmart are not aligned with shareholder interests.

The Waltons:

Despite growing vulnerability, disappointing sales results, and an economy that is still struggling to regain its course, founder Sam Walton's heirs earned even more from their company ownership stake in 2013 than they did the year before. The Waltons are now majority owners in the firm, holding more than 50 percent of the company's public shares and collecting dividend payments of more than $3 billion in total—a raise over their 2012 dividend earnings by more than $400 million. Yet while the Waltons already control more wealth than 40 percent of Americans combined, the workers who contribute to generating this wealth every day must often choose between buying food or keeping the electricity on.[14] The divergent fortunes of these two sides of the Walmart family are a prime example of the way business decisions at the company fuel inequality and undermine broad economic stability and growth.

The $3 billion spent in dividend payments to the Walmart heirs would amount to a raise of **$2.38** per hour for Walmart's 825,000 low-wage workers.

Walmart's unique opportunity to stabilize an uncertain economy

When firms like Walmart pay so little that workers cannot make ends meet, the negative effects of the company's human capital management resound throughout the economy. With paychecks that fall short, families go without, businesses see lower sales numbers, hiring slows or sputters, and the economy gets stuck in a low-performing, vicious cycle. Walmart plays a significant role in perpetuating the low-wage economy because the pay practices at Walmart put downward pressure on wages at other businesses. According to research from the UC Berkeley Labor Center, retail wages fall 10 percent and health coverage declines when Walmart enters a market.[13] That means that improving human capital investment at Walmart can have dual effects on the bottom line: improvements in productivity and customer service that lift sales, and positive effects on consumer spending among the company's low-income customer base.

The short-term focus of Walmart's current business model undermines the company's performance with negative implications for long-term sustainable value creation. The retailer's outsized impact on broader markets means that those decisions are problematic for the US economy as a whole, but also demonstrate that Walmart has a unique opportunity to lead the way to a high-wage, high-performing economy with broadly shared gains from growth. This year, Walmart can break the vicious cycle of the low-wage economy by providing a productive boost to workers and its own bottom line through human capital investments that generate real returns. ■

Endnotes

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