# Walmart sears case essay sample

Business, Accounting

Case Questions: Sears, Roebuck and Co. vs. Wal-Mart Stores, Inc. Answers must be posted to Compass. You may work in groups of no more than four people. Be sure to remember to submit ALL names and UINs on the assignment.

1. How do the retailing strategies of Sears and Wal-Mart differ? How does each firm operate their business/attempt to create value?
The major difference in these two companies' retailing strategies, according to their filings in 2014, lies in the ways they expand their sales. Wal-Mart realizes its sales by opening new retail units both in the U. S. and abroad, broadening the scope of merchandise offered for sale, and committing to price leadership. According to its annual report, it prices items at a low price every day so its customers trust that its prices will not change under frequent promotional activity. Sears, on the other hand, does not open as many stores as Wal-Mart does, but it has another two segments that mainly deal with appliances, electronics and equipment. It also opens a special kind of store named Land's End, which is a direct merchant of clothing, accessories and footwear. Moreover, it sells merchandise, parts and services to commercial customers through business-to-business Sears Commercial Sales and Appliance Builder/Distributor businesses.

2. Wal-Mart's average ROE for the 1997 fiscal year was 19. 7% [$3, 525/($18, 503+$17, 143)/2] while Sears' average ROE over roughly the same period was 22. 0% [$1, 188/($5, 862+$4, 945)/2]. Don Edwards was puzzled by these numbers because of WalMart's reputation as a premier retailer and Sears' financial difficulties not long ago. Use the 3step DuPont method to break down the ROE calculation and determine what is driving the

individual performance of each of these two companies during fiscal 1997. How do they differ?

ROE

Net profit margin Asset turnover Financial leverage

Wal-Mart

19. 7%

3. 0%

2. 78

2. 38

Sears

22. 0%

2. 9%

1. 10

6. 93

Apparently Sears' higher average ROE was due to its higher financial leverage, which made Sears riskier than Wal-Mart. Wal-Mart's higher asset turnover means it was using assets to generate revenue in a more efficient manner. The two companies' net profit margins were approximately equal.

3. Wal-Mart is known for managing inventory and costs very well. Yet, both firms have roughly the same sales per square foot. Calculate ratios for the three main items of the cash conversion cycle: receivables, inventory and payables. Where and why can you see evidence of differences in the two firms' operating strategies? Based on the numbers, which firm is executing better? How can you tell?

According to these two companies' latest annual reports, the ratios are as follows: Days sales

Days inventory

Days payable

Cash conversion

outstanding

outstanding

outstanding

cycle

Wal-Mart

5. 2

45. 2

38. 5

11. 9

Sears

6. 0

97. 1

35. 0

68. 1

The difference between their days inventory outstanding mostly underlies the difference in cash conversion cycle. This difference cannot be fully explained by the difference in their inventory valuation methods because the inflation for last year was between 1% and 2%, which could not cause such a big difference between inventory levels and costs under FIFO and LIFO. A more likely reason lies in their operating strategies concerning inventory management. Wal-Mart manages to maintain a high inventory turnover thanks to its low price. It also has some of its merchandise shipped directly from suppliers. As a result, Wal-Mart does not store much inventory. As for Sears, two of its segments that account for a large portion of its revenue, Sears Domestic and Sears Canada, primarily sell appliances, electronics and equipment. This requires a larger storage of inventory than grocery and entertainment goods, which Wal-Mart sells mostly. Besides, in preparation for the fourth quarter holiday season, Sears significantly increases its merchandise inventory levels, which may have some effect on its reported inventory levels. Apparently Wal-Mart is executing better because its cash conversion cycle is far smaller than Sears.

4. How useful are financial ratios in evaluating the current performance of each of the two companies? Are there any distortions in the comparisons? Most financial ratios are useful in evaluating their performance, including days inventory outstanding and days payable outstanding. However, since these two companies basically receive cash upon transaction, their days sales outstanding are significantly low compared to companies in other industries. Thus their receivable turnover ratios are less useful than other turnover ratios. Besides, because their accounts receivable levels are low, some of their liquidity ratios are low. Wal-Mart’s and Sears’ current ratios are 0. 88 and 1. 09. It appears that both companies have trouble satisfying short-term obligations, which is not the case. Similarly, working capital creates distortions in the evaluation of their performance as well. 5. How useful are financial ratios in comparing the relative performance of these two companies? Are there any distortions in the comparisons?

Because these two companies fall in the same industry category, most financial ratios are useful in comparing the companies' relative performance such as days sales outstanding and days payable outstanding. But there can be some distortion when comparing their days inventory outstanding due to their segmentation difference. Sears have two segments that account for a large portion of its sales and turn over inventory relatively slowly. This makes the two companies' inventory turnover ratios less comparable. In the meantime, because the two

companies are adopting different inventory valuation methods for different segments, ratios that involve inventory level, such as current ratio, and those that involve inventory cost, such as various profit margins, must be adjusted. ROA and ROE should also be adjusted. 6. Convert both companies to the FIFO method of inventory accounting. Does using LIFO have any impact on Sears or Wal-Mart? If so, how?

According to Wal-Mart's filing, at January 31, 2014 and January 31, 2013, the company's inventories valued at LIFO approximate those inventories as if they were valued at FIFO. So there would have been no change in inventory level and cost of goods sold under FIFO, and using LIFO has had little impact on Wal-Mart. For Sears, however, if the FIFO method of inventory valuation had been used instead of the LIFO method, merchandise inventories would have been $70 million higher at February 1, 2014 and $72 million higher at February 2, 2013. This suggests that the cost of goods sold would have been 2 million higher for the year ended at February 1, 2014. In a word, using LIFO has caused Sears to underestimate its inventory level compared to using FIFO, but has had little impact on its cost of goods sold.