

BUSINESS HORIZONS

Wal-Mart fights the battle of Conway - Arkansas, predatory pricing suit

by David L. Kurtz, Scott B. Keller, Mike J. Landry, Daniel F. Lynch
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Dwayne Goode's mother-in-law went to her grave saying, "You'll never beat Wal-Mart, son." But Mom was wrong, at least in the first battle of the war. Dwayne Goode's predatory pricing lawsuit against the nation's largest retailer may yet become one of Wal-Mart's worst nightmares. The ultimate outcome of this lawsuit, based on the 1937 Arkansas Unfair Trade Practices Act, may also affect both consumers and retailers for years.

It's tough being Wal-Mart lately. No sooner had Sam Walton died when the legend began to tarnish for the discount chain that "Mr. Sam" had cultivated into the nation's largest retailer. Some television types claimed that Wal-Mart's made-in-America buying policy wasn't all it was cracked up to be. Vermonters were no more welcoming to Wal-Mart than their ancestors had been to British troops.

In 1993, Wal-Mart found itself on the wrong side of a judge's ruling on Dwayne Goode's lawsuit. Aimed at the heart of Wal-Mart's low price strategy, this lawsuit reflects a long simmering animosity between the big discounter and rival rural shopkeepers. Left to follow its logical course, the lawsuit that hooked Wal-Mart could reshape how American retailers market and sell their goods and services.

THE BATTLEFIELD

Conway, Arkansas is where the suit against Wal-Mart originated. That in itself is ironic because Wal-Mart is headquartered in Bentonville, Arkansas. With the press having characterized the Arkansas community as close-knit, it was highly unlikely that a few Arkansas pharmacists would challenge the retailing giant. Yet that is exactly what Dwayne Goode, Jim Hendrickson, and Tim Benton did.

Goode, owner of American Drugs, Inc. in Conway, is the picture of the small-town Southern gentleman entrepreneur. He exhibits a rural folksiness along with a quiet sophistication that prompts him to take in the theater when he's in New York City on buying trips. His store in Conway, American Drugs Inc., is

spacious and well stocked. Then there's Jim Hendrickson, owner of Baker Drugs, also in Conway, who worked for Goode during his high school years. And there's also Tim Benton, owner of Family Drug Center of Mayflower, about 10 miles south of Conway on Arkansas Highway 365. Benton is a soft-spoken man who enjoys sponsoring the local baseball team. His store is small and friendly, with a kind of down-home atmosphere.

It may be the Donald Trumps and Lee Iacoccas of the world that get all the publicity. But in talking with these three pharmacists one gets the feeling that the rock solid Dwayne Goodes of this country are equally crucial to the economic welfare of America.

THE BATTLE

According to Goode, Hendrickson, and Benton, Wal-Mart was competing unfairly when it came to selling pharmaceuticals and health and beauty aids. The retailing giant has the ability to buy products in volume with the accompanying discounts, whereas small businessmen like Goode, Hendrickson, and Benton cannot. To make matters worse, Wal-Mart then sold some products below the wholesale cost it had paid, making it impossible for the local pharmacies to compete. Its prices were so low that Goode began stocking his store with items he bought at retail from Wal-Mart. He could actually get better prices there than he could from his wholesale suppliers. Goode even took out additional credit cards to finance these purchases.

In an interview with the authors, Tim Benton discussed whether anyone should be able to sell any item at just any price. His reply sheds some interesting light on the topic of below-cost pricing and intent: "If it is the intention of [Merchant A] to run [Merchant B] out of business to raise the prices, then the law says that [Merchant A] is in violation of the law and shouldn't do it." According to Benton, predatory intent on Wal-Mart's part was proven by shopping different Wal-Marts in the area. "When the competition was gone," he said, "the price went up." He went on to add that "the higher prices were in little towns that no longer have anything [in terms of competition]."

Of course, Wal-Mart didn't sell everything below cost; it couldn't stay in business and do so. Rather, it priced certain products in the time-honored tradition of the loss-leader: Lose money on some items to pull customers into the store, then make money on other items they buy. It's a regular retail practice. But

harbored in Arkansas's law, like some time-delayed computer virus, was an old statute that seemed to say Wal-Mart's loss-leading was illegal. The law said products could not be sold below cost to injure competition. That is what Goode, Hendrickson, and Benton claimed in their lawsuit, and that is what Faulkner County' Chancery Judge David L. Reynolds ruled in November 1993.

The ruling, which made national news, shocked Wal-Mart. The retail giant's aggressive marketing strategies now placed it in the position of having to keep one eye on the market and another on the law books. Because some 20 other states have similar "unfair trade practices" acts on the books, Wal-Mart may have to become more familiar with additional state statutes.

The Arkansas Unfair Trade Practices Act had become law in 1937. It was passed by a Depression-weary legislature desiring to jump-start local economies, avoid bankruptcies, and protect small businesses from chain stores. The law explicitly states that a business may not sell a good or service "at less than the cost thereof to the vendor . . . for the purpose of injuring competitors and destroying competition." The law does allow merchants to sell items below cost when the goods are seasonal, damaged, or in danger of spoiling, and are clearly advertised as such. Also, products may be sold below cost to meet the price of a local competitor, provided that competitor's prices are "legal," as defined by the Unfair Trade Practices Act.

In addition, the law says a business may not engage in geographic price discrimination--it may not sell items at one price in one place, then sell the same item somewhere else for a different price. The only instances in which the law allows price discrimination are when price adjustments must be made to cover the cost of transporting products to different places, or to meet competition that may crop up in one specific location.

The Conway litigation began one day when Dwayne Goode's curiosity was aroused by a newspaper story on below-price milk sales that caught his attention. At about the same time, Goode saw Wal-Mart offering three pharmaceutical drugs for below-cost prices. So Goode began a thorough study of Wal-Mart's selling practices. Over the course of four or five years, he shopped every WalMart store in the area, buying products, keeping receipts for proof, and eventually filling an entire stockroom with a collection of Wal-Mart merchandise. By making trips to outlying towns, Goode made another discovery: Wal-Mart might be selling a product below cost in a place where there was substantial competition, such as Conway or Little

Rock. But in rural Arkansas towns like Flippen, for example, competition was minimal. There, Goode found Wal-Mart selling the same product at a much higher price.

Though it was easy to determine Wal-Mart's selling price for an item, more effort was required to determine what Wal-Mart was paying for it. So Goode called a national supplier that, although it would not reveal the price at which it had sold the product to Wal-Mart, did quote the absolute lowest selling price of the product. Because Wal-Mart is among the biggest volume buyers and has a reputation for using its massive purchasing power in negotiations with vendors, Goode could reasonably assume that the lowest prices suppliers were quoting were Wal-Mart's purchase prices. Comparing the suppliers' prices with what Wal-Mart was pricing at retail suggested that the discounter was selling items below cost--a tactic it never denied in court.

Although Goode had painstakingly built a case against Wal-Mart, it took some convincing to get his attorney interested in pursuing a lawsuit. As Goode put it, "He absolutely laughed at me." Later, though, when the attorney got back to him, he was no longer laughing. He told Goode that there was indeed a law, as well as a penalty for violating it. Tim Benton of Mayflower Family Drug recalled, "In the back of our minds I think we all knew what was happening to us; we could see our businesses shifting. Dwayne called me one day and said, 'Do you want to sue Walmart?' I don't even think I asked him what about. I think I said 'Yeah, why not!'"

Even though the attorney had come around, many people had not. Hendrickson said that the three pharmacists were ridiculed in Conway when the local paper first carried the story of their lawsuit. "Everyone thought it was impossible," Goode said, "but now I think they have a lot of respect for us." Hendrickson added, "It hasn't been any fun. I mean it's been hard!"

Goode replied, "Oh, it's been fun, Jimbo?"

Hendrickson conceded, "Win, lose, or draw, we stood up!"