

Due Diligence

The Ebbs and Flows of Target and Wal-Mart

# A Tale of Two Boxes

by Thomas D. Saler

If you've ever questioned the impact of stock picking on a portfolio, consider the recent performances of Wal-Mart and Target. Over the past year — a period that included a severe credit crisis, rising unemployment and a decelerating economy — Target's shares (ticker: TGT) tumbled almost 20 percent, while Wal-Mart's stock (WMT) soared nearly 30 percent. Clearly, a falling tide doesn't strand all boats (no matter how similar they might appear).

Nor should it. According to a working paper by Emek Basker, an assistant professor of economics at the University of Missouri, Wal-Mart's revenues actually increase during bad economic times, whereas Target's revenues decline when the economy stalls. That's because Wal-Mart sells "inferior goods," according to Basker, although he makes it clear the term isn't meant literally but as a technical phrase referring to products "for which demand increases when income falls." (*Companies mentioned are for educational purposes only. No investment recommendation is intended.*)

The average income of a Wal-Mart shopper is between \$40,000 and \$45,000, or slightly less than the typical

U.S. household's, the study says. The average income of Target shoppers is \$60,000 — a figure that hardly qualifies them as rich but is still significantly higher than that of Wal-Mart customers. Basker is an expert on Wal-Mart, having previously penned a paper on the causes and consequences of the company's remarkable growth (you can download it for \$7.50).

For another view of the dissimilarities between WMT and TGT, check out management consultant Markham Lee's blog at Seek-

ing Alpha. The two retailers aren't necessarily direct competitors, Lee argues, because they sell different items to different people. As such, earnings fluctuations are the result of not only income elasticity but also profit margins embedded in each store's top-selling goods.

Wal-Mart "is basically a grocery store and pharmacy with a strong entertainment business," Lee says, "while Target is primarily a household goods and clothing retailer." He asserts that Wal-Mart is benefiting from customers going downmarket from pricier grocery stores, but Target is being hurt by cutbacks in discretionary spending on clothes and household items. Wal-Mart's financial services business (mostly check cashing and money transfers) also helps the company sustain earnings during difficult economic times.

Of course, the corporate organism either adapts or it perishes. An article by Sarah Gilbert at BloggingStocks notes that Target is changing its spots by attempting to attract more upper-middle-income customers who are still willing to spend a buck but are looking for ways to make it stretch a bit farther. Wal-Mart, meanwhile, is apparently positioning itself for an economic rebound with a focus on apparel, trying to shed its image as the brown shoes of the fashion world.

The battle between these big-box retailers will take more twists and turns in coming years, which is why you'll want to bookmark Target Versus Wal-Mart. The site provides links to newspaper articles about the two companies. At the left side of the homepage is an archive of stories back to October 2007, when the site was launched.

Journalists aren't the only people with strong opinions about the retail behemoths: A Yahoo! search for "Wal-Mart vs. Target" turned up more than 4 million hits. For all the recent efforts to improve its image, Wal-Mart remains a lightning rod for consumers upset about a laundry list of social and environmental issues. Judging from its stock price, however, Wal-Mart investors aren't complaining. **B**

**Websites of Interest**

**"Does Wal-Mart Sell Inferior Goods?"**

[http://economics.missouri.edu/working-papers/2008/WP0805\\_basker.pdf](http://economics.missouri.edu/working-papers/2008/WP0805_basker.pdf)

**"The Causes and Consequences of Wal-Mart's Growth"**

[www.atypon-link.com/doi/abs/10.1257/jep.21.3.177](http://www.atypon-link.com/doi/abs/10.1257/jep.21.3.177)

**Markham Lee's blog**

[www.seekingalpha.com/article/78586-wal-mart-vs-target](http://www.seekingalpha.com/article/78586-wal-mart-vs-target)

**"Battle of the Brands: Wal-Mart vs. Target"**

[www.bloggingstocks.com/2008/05/07/battle-of-the-brands-wal-mart-vs-target](http://www.bloggingstocks.com/2008/05/07/battle-of-the-brands-wal-mart-vs-target)

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