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Bill Nichol Negotiates with Walmart: Hard Bargains over Soft Goods (B)

As the results of Bill Nichol's "open door" efforts made Walmart's decision to drop the LOP-branded line of infant sox seem increasingly irreversible, he decided to involve Little Ones Products¹ in his next major meeting with the buyer. He decided to wait to inform JP Morgan, KDH's bank, until and unless the outcome of this episode became material to his loan covenants. Nichol stated that

The first thing we did, at the first sign that the Little Ones brand may not be accepted in the near future, was to advise Little Ones that we thought that Walmart was likely to make a major change that could involve dropping the LOP-branded infant sock line from the store. We said, "We need your help. We need to collaborate together, go back to Walmart to make sure we have our best foot forward." We worked to bring them into the process, so they could help.

Nichol set up a three-way meeting among KDH, LOP, and Walmart's buyer.

That was done. Together, we argued that Little Ones product was a good one for Walmart's "end-consumer" and should remain in the store. As before, KDH and LOP supported this position with strong financial and market data. Again, however, Walmart proved completely unresponsive to this argument. The buyer made it clear that they simply no longer wanted to carry the brand.

But because we did this, Little Ones knew this was happening through no fault of Kentucky Derby Hosiery's. They could see it was not negligence. We were performing quite well, meeting all of the numbers. The fact was there was a decision at Walmart that we could not control.

He knew that he would soon have to deal with LOP over KDH's minimum sales volumes and forward financial obligations. For now, Nichol focused on salvaging what he could from Walmart.

¹ "Little Ones Products" is a fictitious name used to disguise the actual company involved in the situation described in the case.

Professor James Sebenius and independent researcher Ellen Knebel prepared this case. This case draws on an earlier case series, "William Nichol, Jr. and Kentucky Derby Hosiery: Negotiating with Wal-Mart" (A) and (B), HBS Nos. 907-001 and 907-002. Certain details have been disguised. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

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Negotiating within Walmart

In his successive “open-door” negotiations up through the Walmart management hierarchy and with other Walmart contacts—while keeping the buyer informed—Nichol relentlessly probed for Walmart’s interests and plans, asking “Why? Why not? What if? etc.” In these meetings, Nichol underscored that KDH had invested very heavily to support Walmart’s volume growth expectations over the years. In fact, he disclosed the precise nature of KDH’s multi-year minimum volume requirements and financial obligations to LOP, as well as the bank debt assumed to make the equipment needed to produce the LOP-branded infant sox. With this disclosure, senior management was increasingly receptive to his arguments, stating that “we want good, profitable suppliers.”

While Walmart’s decision to drop the LOP-branded line was unchanging, it took Nichol intensive negotiations over the next four to six months to clarify the rationale for this move. With globalization, the retailer was trying to reduce what it believed was brand fragmentation and increasingly to shift to a smaller number of house brands under its sole control. While Walmart was convinced of the power of the LOP brand in hard goods, it was not so sure about the brand’s value for soft goods like infant sox. Moreover, it gradually became apparent that a KDH competitor had made the case to a key Walmart Merchandising VP that infant sox by themselves, rather than as part of a matched set of branded infant clothes, would be a superior consumer offering and reduce further the number of suppliers. In any event, Walmart planned a much more strategic approach to branding and would later reveal a new organization for managing house brands.

By listening hard and probing, Nichol was increasingly able to articulate the interests underlying the two parties’ incompatible positions. To KDH, profit and volume were both important, but maintaining volume was indispensable. To Walmart, shrinking brand proliferation by moving to a house brand was key. Moreover, although not focused on infant sox, Walmart had launched a major “sustainability” initiative at the corporate level. Therefore, Nichol concluded

While we were disappointed, we were equally concerned about the pending volume loss relative to the high volume production capacity we had built up. Once we understood that the loss of the brand would occur, our next focus was to discuss the total volume of business, which was of great concern to our company.

As a long-term dependable supplier, it was clear that Walmart’s intention to change branding strategy should not necessarily mean the volume of our business would be materially disrupted . . . As such it was imperative to shift the KDH-Walmart negotiations from “total branded volume” to “total volume.”

Working with the buyer, who had become aware of senior management’s preference not to harm a long-term supplier, Nichol finally negotiated the right to assign several KDH personnel to work intensively “with the new (house) brand manager to develop and produce a new Walmart house brand of infant sox going forward.” Other manufacturers actively competed with the KDH team to win this business and the eventual “victor” was not clear. However, Nichol thought hard about the potential opportunity presented by the major new Walmart sustainability initiative. His team developed and proposed a house brand that made use of organically grown cotton. If their proposal were chosen, Walmart could announce this “organic cotton” house brand of infant sox as part of its first rollout of sustainable soft goods.

Nichol commented on the problem-solving, creative approach necessary to succeed in such negotiations

In Bentonville, you're trying to understand what their process is and collaboratively reach goals, talk about different product mixes, how they're going to merchandise the shelf space piece of it. The more that you can move to something that is highly collaborative—though extremely demanding as you experience it—the more on track that is, the more effective it will be given that you're performing both in substance and in fitting into their process. Once you're in there dealing with the buyer, whether it's face to face or by e-mail, that is more the culmination of a lengthy prior process. If you're thinking about it just in terms of price, you're thinking about it in the wrong way. And if you have a one-sided view, say you're a manufacturer with the attitude, "Here's what I want to do. I go there to figure out the terms on which I'm going to do it" (price, delivery, and what have you), that's a recipe for a high-risk encounter.

Ultimately, the new Walmart house brand manager chose KDH over the other contenders. The results of this intensive process, while disappointing relative to simply continuing with the LOP-branded infant sox, were at least tolerable for KDH. Nichol summarized the outcome:

We were surprised and disappointed by these developments, and so, through the "levels process," dealing with Walmart's managers, we were finally comforted or somewhat relieved that we wouldn't lose the volume of business—we would only lose the branding part. ... Alternative branding strategies were openly discussed that ultimately led to KDH's retaining an acceptable volume by producing a new line that made use of organically grown cotton. This ensured that our production capacity would still be utilized by Walmart, but now through a Walmart house brand of their choice that supported their sustainability initiative.

Negotiating with Little Ones Products

As the Walmart-focused negotiations proceeded, Nichol had to deal with LOP, the brand owner, regarding Kentucky Derby Hosiery's contractual and royalty obligations to Little Ones Products. Having brought LOP into the process early on, it was clear to them that this unfortunate turn of events was not KDH's fault. Nevertheless, "we have a signed contract that we intend to enforce," said Nichol's LOP counterpart.

"True," replied Nichol, "but for you to simply receive a stream of revenue over the next three years wouldn't serve your more important brand-related interests. It would seem to me that you have even stronger interest in widening sales of your LOP-branded softline products, especially after loss of huge Walmart volume. Although your core interest is in hard goods, without a soft goods presence in the marketplace, you have a potentially valuable asset that will dissipate." And Nichol knew that KDH still had exclusive rights to this brand in infant sox—a vital asset in these negotiations. Terms of the exclusive prevented LOP from creating another licensee in the mass-market segment. Nichol continued

We negotiated hard with LOP to increase sales of infant sox (and related items such as bibs and t-shirts in matched, LOP-branded "layette" sets) to other chains such as Kmart, Target, Dollar General, and Family Dollar where we had good relationships. Ironically, LOP-branded infant sox became MORE desirable in other channels when Walmart stopped carrying them. And KDH had to show real flexibility; it agreed with LOP to broaden its product line to include the other items in LOP-branded "layette" sets, in order to meet the interests of these other retailers and close the deal with LOP.

Based on our joint desire to make the brand an ongoing success, KDH was willing to enter new product categories and partner with LOP across a broader base of products. KDH had

new resources based on our new China importing business. LOP understood the strength of our retail relationships and had confidence in our ability to rebuild the sales we had lost at Walmart. The result of this change in product offering resulted in major placement of the LOP brand in infant socks and the other basic apparel products we began importing from China. In addition, LOP created their first direct to retail contract in additional product areas resulting in sales dollars to replace the lost Walmart business. This positive result for LOP was enabled by the KDH's solid retailer relationships that they "coat-tailed" in building a new business.

As part of a very protracted negotiation between LOP and key retailers, especially Dollar General, KDH also "gave up" its exclusivity right to sell LOP-branded infant socks to high-end department store channels like Federated and Kohl's.

Nichol concluded

So on that basis, Little Ones finally agreed to modify our contractual obligations. For example, they eliminated previously agreed-to minimum guaranteed payments and required sales volumes associated with our Walmart channel.

We still do a lot of business with Little Ones Products. We just signed a multi-year contract to move forward in other product areas with Little Ones Products. The sales of Little Ones Products have shifted to retail customers in the mass market other than Walmart. We would much preferred to have maintained the brand, but that's not what happened.

In the meantime, we moved forward with the Little Ones brand, placed it elsewhere, and we were selling a lot of volume under that brand to other retail customers in the mass-market channel. As it relates to Walmart, our business did suffer from that event, but it wasn't catastrophic. So we were able to take what could have been a catastrophic event and remold it into an acceptable, or tolerable, defeat.

Epilog

Nichol reflected on this challenging series of events:

So this is an example of making the most of a challenging situation. Everyone is still in the hunt, everybody's still in business, and you live to fight another day.

Ironically, Walmart awarded its Vendor of the Year (2006-7) to KDH for its actions to bring environmentally sustainable products to its line of soft goods.

Not long after the dust from these events had mostly settled, Gildan Activewear called Nichol to again inquire about his interest in selling the firm. Nichol was aware that Gildan had a major new Honduran production facility under construction that would require significant volume of socks to be economically successful. Nichol took stock of the situation:

The US hosiery industry was going through radical shifts to offshore production at a very fast pace. KDH had achieved a large percentage of offshore production but still has had approximately 50% US-based production. Pricing pressure was increasing. Average selling prices were decreasing at approximately 5% annually and gross margins had decreased to under 10%. We felt we could not maintain any capacity in the US and survive this intense decline in pricing. The cost of shut down in the US and at the same time to open new offshore facilities was not only financially possible without a major infusion of new capital.

I called Gildan back and advised I would sell the company. Since KDH was family owned--three stockholders and I held the majority of the stock--I recommended to the other family stockholders that we sell the company and they agreed. There were no family business succession plans other than selling the company. The opportunity to "cash out" became very appealing and outweighed the emotional attachment that had contributed to an impasse with Gildan in its first attempt to buy KDH. This appeal of selling KDH became even greater after we had encountered a series of major negative events including the LOP-Walmart challenges and experienced how fast many things were adversely changing in our industry and in the US retail marketplace.

In July 2006, KDH sold 100% of its equity for US \$45 million to Montreal-based Gildan Activewear, which also bought another U.S.-based sock company.

It turned out that Gildan had relatively modest interest in KDH's fixed assets and production capabilities. Rather, Gildan particularly valued Nichol and his team's proven ability to negotiate effectively and productively with major retailers. Nichol reflected: "I guess it is a good thing that we successfully persisted in that difficult three-way earlier negotiation among ourselves, LOP, and Walmart." Prior to the KDH acquisition, Gildan had primarily been a producer that sold to the wholesale market. Following the sale, Gildan made its first major move into retail. Nichol was named President of Gildan's new Retail Division with major responsibilities to negotiate and improve relationships with all retail accounts. Within a year, however, Nichol moved to a consulting status at Gildan and soon left the firm to focus on unrelated business projects.

All 2000 U.S.-based plant employees of the two acquired companies lost their jobs as Gildan moved the remaining production to a new, state-of-the-art facility in Honduras.

Bill Nichol: Broader Reflections on Dealing with Walmart

Nichol observed that the nuances of negotiating with Walmart involved a shift in the thinking of the supplier before entering into the negotiations from a "directive, I make, you buy" mentality to a collaborative, discussion-based orientation.

Yesteryear you used to mix up your products and figure it out that this is what we want to produce as a manufacturing company, and we're going to take this group of products out to Walmart and we're going to sell this to them. And, that's yesterday's way of thinking. Today's way of thinking is in a more collaborative merchandising environment where there's an intense focus on the customer first—to understand the Walmart end-customer. They often say, "Who's Number One? The customer." A lot of us in the manufacturing business are quite guilty of thinking we're going to make a given product and sell this to them. We [some manufacturers] do it backwards, looking at it as if we want to sell this jar of pickles and that's what we're going to do. [They say] "here's what we're going to do—we're going to make this stuff and sell it to Walmart." It doesn't work that way anymore. The collaboration about the price points that they want to achieve, the quality/value relationship, the many different consumer advocates have to be understood and ever-present so that the proper thinking goes into the product mix. In other words, the retailer is much, much more into the product they want on the shelf. And that does not go over well with a lot of people that have never been in that position from a manufacturing point of view.

We started as a sales company and we still think that way. We understand that that is what drives the train, not what our manufacturing engineers would come up with. And there's nothing negative toward manufacturing at all, on the contrary, when you understand some of

these fundamental shifts and changes in principle, then if that can be communicated to your manufacturing base, the environment will change to a collaborative environment where manufacturing is also thinking about the end-consumer. It used to be that 90 percent of their thoughts were, "How can we reduce costs by 2 cents on the dollar on this widget." And they still have to do that, but they have to also think in a more consumer friendly manner, literally all the way down the pieces and parts of the supply chain.

With respect to negotiation, Nichol summarized his key principles:

Offer genuine value. "Be sure you have a product they (retailer and consumer) need before you offer it for sale."

Relentlessly improve your offerings. "Maintain a high level of innovation in your products. Practice ongoing improvement with all products on the shelf space you occupy (this means adding a feature, improving the quality, or overall adding value)."

Listen. "[O]ne enormous skill that has to be on the team dealing with Walmart is the ability to listen. A lot of companies don't recognize the importance of listening to what their customers are telling them. I would say that is something that is oftentimes overlooked."

Collaborate. "Today's way of thinking is in a more collaborative merchandising environment where there's an intense focus on the customer first—to understand the Walmart end-customer." "I was talking to a competitor this morning—actually, someone who was not in the hosiery business but wants to get into it—and they're telling me, "Well, here's how we're going to approach Walmart; we're going to sell them this and we're going to sell them that," and I said, "You're not going to sell them anything with that attitude." So you'd better learn how to listen, and you'd better learn how to work with and for them, because if they don't think what you want to sell them is best for their customer, you won't sell them anything. You'd better not go in there with the attitude that you know the answer without doing this collaborative process, because it does change your approach and the way that you think about doing business. It's real, Walmart has mastered it, and very few other companies have reached that level of collaborative communication."

Produce. "Do whatever it takes to ensure that sales velocity meets the requirements defined by your customer. If your performance passes the retailer numeric tests (rate of sale, inventory turn, gross profit margin, profit productivity per linear foot of store space occupied) negotiations will generally go well. Always know your numbers and track your business with the customer each week. If the velocity decreases, be prepared to take immediate corrective action and replace non-performing products."

Communicate both good and bad news:

Tell them (Walmart) how well you are performing—they may not know if you do not advise them.

If your performance is not up to the test, always be prepared to take corrective action before the retailer drops your products from the store."

No end-runs. "In your negotiations with management, do not "skip any rungs going up the [corporate management] ladder." In other words, negotiate at each layer of management as you move through the negotiation process, without skipping over levels in the management hierarchy. This enables each layer of management to be informed as negotiation issues or concerns are escalated. Do not go right to the top; instead, hold successive negotiations along the way."

Don't rely on the past. "A long history (between your company and Walmart) is important but not mandatory. It's important to have a history, they do recognize that, but that in itself will not get you in one order or in a position; its just nice to have it and that you have credibility and some long term standing."

Manage risks of individual negotiations. "We sell to different departments of Walmart, sell different brands to Walmart, and sell a variety of products to Walmart. So if one segment gets in trouble, the others will carry the volume. We watch our long-term debt—our long-term commitments—very closely to be sure that if something happens in one area or another, that we're not stuck with idle capacity and long-term associated debt. We may have idle capacity, which is okay as long as we don't have the long-term debt to go with it. So basically there are ways to manage the risk, but it is not easy."