AMAZON KNOW WH

After years of futility, Wal-Mart has an expensive new plan to win at e-commerce

Wal-Mart CEO Doug McMillon and Jet.com founder Marc Lore

N WON'T AT HIT 'EM!

By Brad Stone and Matthew Boyle

Photograph by Meredith Jenks

Last summer, Marc Lore, founder and chief executive officer of e-commerce startup Jet.com Inc., sat down to record a private video for the top officials of the world's largest retailer: Wal-Mart. In the video, meant for Wal-Mart executives and board members who weren't yet part of weeks of secret negotiations between the companies, Lore stares earnestly into the camera and shows off his Bentonville bona fides. After humblebragging about reading every annual report since 1972, he says he's been "struck by Wal-Mart's maniacal focus" over its storied 54-year history.

But Lore's 40-minute presentation doesn't hold back about the threat posed by its most fearsome and increasingly powerful archrival. "AMAZON IS DOMINATING" reads a slide on a large screen behind him. In the video, Lore presents a plan to bet Wal-Mart's future not on e-commerce standbys such as books, electronics, and toys, but on product areas only now becoming popular online, including apparel, fresh food, and "everyday essentials" like drugstore items. "We'll need to take the offensive, swim upstream," Lore says. "As Sam Walton said, 'Opportunity lies in the opposite direction.' "

The video worked exceedingly well. In August, Wal-Mart Stores Inc. announced it would acquire Jet.com for $3.3 billion in cash and stock. It was an extraordinary sum for a 15-month-old, purple-hued website that was struggling to retain customers and is still far from making a profit. Even more astonishing, Lore and his management team in Hoboken, N.J., were put in charge of Wal-Mart's entire domestic e-commerce operation, overseeing more than 15,000 employees in Silicon Valley, Boston, Omaha, and its home office in Arkansas. They were assigned perhaps the most urgent rescue mission in business today: Repurpose Wal-Mart's historically underachieving internet operation to compete in the age of Amazon. "Amazon has run away with it, and Wal-Mart has not executed well," says Scot Wingo, chief executive officer of Channel Advisor Corp., which advises brands and merchants on how to sell online. "That's what Marc Lore has inherited."

Lore's ascendancy at Wal-Mart adds bitter personal drama that wouldn't seem out of place on *Real Housewives of New Jersey* to a battle between two of the most disruptive forces in the history of retail. In 2010, Wal-Mart tried to buy Lore's first online retail company, Quidsi Inc., which operated websites such as Diapers.com for parents and Wag.com for pet owners. But it moved too slowly and lost out to a higher bid from Amazon.com Inc. Lore then toiled at Amazon for a year and a half before quitting, in part out of disappointment with its refusal to invest more in Quidsi and to integrate his team into the company, according to two people close to him.

Jet, which he started a year after leaving Amazon, sells almost everything—books, electronics, clothes—so it was difficult to miss an element of revenge among his motivations. Jeff Bezos, Amazon's CEO, certainly noticed. In case anyone underestimated the enmity coursing through the Lore-Bezos feud, Amazon announced in March that it was closing Quidsi, saying it didn't see a path to profitability. Coming from the historically money-losing internet giant from Seattle, the pointed wording of the announcement was widely interpreted as an effort to undermine Lore's credibility at Wal-Mart.

Lore cuts an unusual figure at the Bentonville headquarters, which he now visits once a month on a private company plane, and in the geeky hallways of San Bruno and Sunnyvale, Calif., where most of Walmart.com's engineers work. He's a former bank risk manager and longtime New Jersey resident who's a fan of Bruce Springsteen and of figuring out ways to simplify the routines of daily life. He recently ditched his Tesla and uses only Uber, for example, and he visits the same sushi restaurant near his office four times a week, always ordering the salmon sashimi. He also spends time on customer-pleasing contrivances that, in the parlance of Silicon Valley, do not scale. He recently devoted a 12-hour day to recording a thousand variations of a video greeting for new Jet customers. Now when customers sign up, Lore welcomes them by their first name.

He'd like to extend Jet's sensibility and business model to Walmart.com, the second-biggest e-commerce destination in the U.S., according to ComScore Inc. A site redesign is due this summer. (He's thinking of recording another set of personalized introductions.) Lore also recently announced free delivery on Walmart.com for orders of more than $35, a Jet-like (and Amazon-like) tactic to give customers discounts for buying more stuff at once, so it can be shipped more efficiently in a single box. He also announced that shoppers will be able to save money on 1 million products if they order online and pick them up at one of the chain's 4,700 U.S. stores, where it's cheaper for the company to deliver.

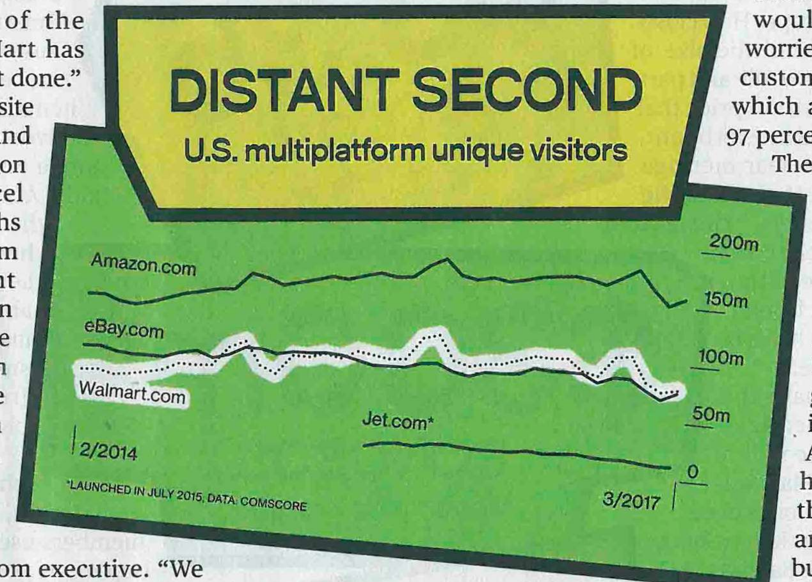
Crowning the entire strategy is an acquisition spree: buying middling e-commerce startups such as Shoebuy.com ($70 million), fashion retailer ModCloth ($75 million), and outdoor apparel seller Moosejaw ($51 million); installing their founders as his deputies; and selling their products on Walmart.com, where the selection still lags far behind Amazon's. Later this spring, Lore is also likely to announce Wal-Mart's reported $300 million acquisition of Bonobos Inc., a decade-old menswear website that offers well-fitting pants and a team of enthusiastic customer service people—Bonobos calls them "ninjas"—that wouldn't normally be associated with a giant like Wal-Mart.

"The Jet.com deal is a big inflection point," says a former Wal-Mart executive. "This is Wal-Mart's last shot here"

Wal-Mart has a lot riding on Lore. Last year he received $244 million in pay, 10 times that of his boss, Doug McMillon, Wal-Mart's CEO. His project could determine the future of Sam Walton's legacy and the eventual success of McMillon. It will also settle the score on whether Lore is good at building profitable e-commerce sites or just selling unprofitable ones to his competitors for piles of money.

"Marc's been given quite a bit of freedom to go get it done," McMillon says.

Since the beginning of the e-commerce era, Wal-Mart has repeatedly failed to "get it done." In 2000 it spun out its website as a separate company and raised capital from the Silicon Valley venture firm Accel Partners. Eighteen months later, after the dot-com crash, Wal-Mart bought the operation back for an undisclosed sum. The move didn't accomplish much of anything: Sales were disappointing–$25 million in 2000, with $100 million in clothes and other inventory left over after the holidays, according to a former senior Walmart.com executive. "We had built fulfillment for apparel, but all the demand came from electronics," he says.



The company considered buying Gap Inc. and even Netflix Inc., the former executive says. But the decision-makers in Bentonville, intoxicated by the narcotic of constructing profitable superstores, underestimated the sublime convenience of shopping from the home or office. Many Walmart.com managers reported to Wal-Mart's chief financial officer or vice chairman instead of the CEO, and they were pressured to show profitability. Over in Seattle, Bezos was building Amazon to gobble up market share, not generate earnings for investors.

Wal-Mart showed flashes of commitment to the internet later in the decade, engaging in a holiday price war on media products with Amazon in 2009 and making its unsuccessful run at Quidsi in 2010. But the next year, then-CEO Mike Duke spent $300 million to acquire a search engine, Kosmix, run by two former Amazon executives, who then created a Silicon Valley skunkworks called @WalmartLabs. They left after a year, partly in frustration over Wal-Mart's bureaucracy.

In 2012, with Amazon's stock booming–up 45 percent that year–Duke hired Neil Ashe, the former chief executive of the online news network CNet, to run Wal-Mart's global internet operation. Ashe, who had no previous retailing experience, reported directly to Duke and was given a mandate to deepen Wal-Mart's digital investments. He and his team made some progress. They rebuilt the badly outdated technology infrastructure underlying Walmart.com, introduced smartphone apps, and constructed six fulfillment complexes outfitted with state-of-the-art automation. The company's U.S. e-commerce revenue went from an estimated $4.54 billion in 2012 to $8.03 billion in 2016, according to an analysis by Wells Fargo & Co.

It was a start. But though Amazon loomed large, Wal-Mart's most significant fights were internal. One perennial source of tension involved prices. Amazon typically sets them using algorithms that scour the web to monitor and match the lowest number they find, which means prices can change constantly on the site. Wal-Mart sets a consistent "everyday low price" inside its stores. It's one of the most sacrosanct brand promises in retail, practically inscribed onto holy tablets by Walton himself as a way to assure customers they won't have to comparison-shop. The philosophy created problems on the web, though. Whenever the online price dropped below the in-store price, the merchants in Bentonville would balk. They were worried about siphoning away customers from their stores, which account for more than 97 percent of Wal-Mart's sales.

The company was also hesitant to let outside sellers list their wares on Walmart.com. This "marketplace" idea generates half of Amazon's unit sales. It also creates a prodigious amount of unseen internal conflict, since Amazon employees have to compete with third-party sellers who are pursuing the same buyers. But the company tolerates and even encourages the tension because choice and price competition are good for customers. Wal-Mart, accustomed to dominating its relationship with brands and showing its entire assortment in its massive stores, was reluctant to foster such competition, and it didn't have the technological chops to support an expansive marketplace. Instead of focusing on increasing online selection, Wal-Mart kept building supercenters–more than 700 from 2010 to 2016 in the U.S. alone. Walmart.com only started adding third-party sellers in 2015, and though it now has more than 40 million products in its marketplace–Toms canvas shoes, Rebecca Minkoff satchels, and other stuff it doesn't sell in stores–the number is small compared with the 350 million or so items available on Amazon.

When McMillon, now 50, took over as CEO in late 2014, things began to change. He's a sandy-haired former high school point guard who famously started at Wal-Mart as a teenager, working summers in an Arkansas stockroom. He's also the company's first CEO since the founder young enough to have high school-age children. McMillon has gradually come to shed the customary Wal-Mart suit and tie in favor of casual sport coats and open-collar shirts, and plays up the notion that he's a "bit of a gadget guy." He once bought a Kindle for his mother, and regularly invites tech luminaries such as Facebook Inc.'s Sheryl Sandberg to senior staff meetings. "I want us to sell VR before the customer is ready for it," he says. "I keep telling our folks, 'Buy a little and put it online, put it in 50 stores.' Don't tell me it won't sell unless you try it. You gotta catch the wave. And to catch the wave, you gotta be early."

Over the past few years, Wal-Mart has notched decent numbers, including 10 consecutive quarters of same-store sales growth in the U.S. and 1 percent to 2 percent increases in revenue each year. Over the holidays, its online unit recorded 29 percent sales growth over the previous year. But Amazon has been enjoying 20 percent-plus annual sales growth, and many experts say the e-commerce market could double in the next decade. The company already dominates the cities and coasts, and its next stop is the heartland, home to Wal-Mart's customer base.

McMillon has attempted to adjust to the shifting retail landscape. He's closed about 175 stores, reduced the size of others, and boosted pay to full- and part-time workers. He also paid a price that most analysts thought was exorbitant, if necessary, to send a clear message to everyone inside Wal-Mart about the urgency of the online effort. "The Jet.com deal is a big inflection point," says Venky Harinarayan, one of the Kosmix founders and a former @WalmartLabs director. "This is Wal-Mart's last shot here."

Several analysts share the sentiment. "Doug realized there needed to be some radical changes made, as Wal-Mart was rapidly going in the direction of close-to-defunct retailers," says Karen Short, who studies the stock for Barclays PLC. "There was a realization that you have one shot to get that customer back in the door, so you better make sure you get it right." Sanford C. Bernstein & Co. analyst Brandon Fletcher is reading from the same script: "This is their last window to get it right," he says.

Perhaps the same could be said of Lore. In the fall of 2015 he was seeking Jet's fifth round of funding. The startup had already spent almost $200 million in venture capital setting up its website and blanketing cities with mailings and outdoor ads. A year after the site's launch, critical media reports suggested Jet wasn't gaining traction with customers, framing the company as an example of Silicon Valley profligacy. The accounts weren't altogether off-base; according to Second Measure, a company that analyzes credit card data, among a sample of 8,000 customers who joined Jet.com that October, fewer than 400 were still buying from the site six months later.

Publicly, Lore played it cool. Privately, he was a wreck. He says he pulled two straight all-nighters while he was closing the round. He was so exhausted on one red-eye flight, he vomited all over his coach-class airplane seat. He eventually succeeded, though, raising $500 million, at a $1 billion valuation, from Fidelity International, Bain Capital, Google Ventures, and Alibaba Group Holding.

Recent Acquisitions

$3.3b
JET.COM
Discount e-tailer

$300m*
BONOBOS
Men's fashion retailer

$75m
MODCLOTH
Women's fashion retailer

$70m
SHOEBUY.COM
Footwear e-tailer

$51m
MOOSEJAW
Outdoor apparel seller

"That round was definitely stressful," he says. "We had less than four weeks of cash left in the bank when we finally closed it."

Lore was making the same risky bet that Bezos had years before. E-commerce businesses that start out looking frail can generate healthy amounts of cash if they make it past infancy. And though it wasn't working yet, Lore argued that Jet's "smart cart" system—which gives customers opportunities to save money when they buy multiple items at once or agree to a longer delivery time—would eventually entice a price-conscious swath of Middle America. "We weren't seeing the benefits of it because we had not yet reached scale," Lore says. "But the model was absolutely viable. I think the market is massive, and even a small share of a trillion-dollar [retail industry] is a pretty big business."

In early 2016, with Jet churning through its new cash, one of the startup's board members used that pitch on Wal-Mart, hoping to get Lore an introduction to McMillon. It worked, and Lore flew out for a meeting in Bentonville. What started out as a preliminary discussion about an investment in Jet flowered quickly into a corporate bromance. In June, McMillon visited Jet's offices in Hoboken, wearing a brand-appropriate purple shirt. Lore says they spent considerable time at a whiteboard, sketching out a shared future: "We just sort of immediately saw eye to eye on what needed to be done." It's unclear if harps played in the background.

They both needed the partnership: McMillon to send up a flare for employees and investors about the importance of Wal-Mart's online efforts, and Lore to pay off his backers and escape the fund-raising circuit, where he'd spent about half his time over the previous two years. McMillon also came away with a handy pitch for Wal-Mart shareholders who might have blanched over the purchase price—that the company's founder himself would have loved Jet.com. "The Jet concept of sharing savings

*NOT COMPLETED

with customers is a very Sam Walton-like idea," says Richard Cook, co-manager of the Cook & Bynum Fund, which owns Wal-Mart stock. "You will help us lower costs, and we will share that savings with you."

McMillon and Lore structured the Jet deal differently from Amazon's purchase of Quidsi. Lore took over Wal-Mart's entire e-commerce business in the U.S. and combined the Jet and Walmart.com teams, though he continues to run them as separate websites.

In January, hoping to streamline the two companies' digital strategies, Lore eliminated 200 jobs in Silicon Valley and created a new class of so-called category specialists, each of whom oversees a narrow product area, such as food-storage bags or cribs, on both sites. He also changed these employees' incentive structure. Instead of evaluating them entirely on quarterly profit and loss, as Wal-Mart managers have been judged in the past, Lore introduced five bellwethers related to the customer experience, such as whether products are in stock, how easily they can be found on the site, and how quickly they're delivered.

Lore says he enjoys a kind of autonomy at Wal-Mart that he never had inside Amazon—about as close to a criticism of his former employer as he'll make. "When you give people all the information and you trust them and keep everything fair," he says, "people have room to run and to be empowered."

The Wal-Mart fulfillment center in Bethlehem, Pa., is a marvel of 21st century retail. It's an absurdly vast 1.2 million square feet, with products stacked 40 feet high on metal shelves that extend in both directions nearly as far as the eye can see. Quotes from Sam Walton—"To succeed, stay in front of change"—pepper the walls. The prevailing sensation in the warehouse is one of sound: The drone of conveyor belts and computer-controlled chutes threaded through the facility blends with a symphony of beeps from forklifts, producing an orchestral hum that drowns out the actual music playing on distant overhead loudspeakers. Flying along those belts at 8 mph is the bounty of modern capitalism: dog treats, underwear, Nintendo Switch controllers, Campbell's cream of chicken soup. "If Wal-Mart sells it, we fulfill it here," says David Tarnosky, the center's general manager.

Although the fulfillment complex and its five cohorts were built by Lore's predecessor, they're key to Wal-Mart's renewed bid for relevance. They allow the company to ship its most popular products anywhere in the country within two days on the ground or one by air, down from a week five years ago. These are table stakes in the pricey poker game that is contemporary e-commerce.

At one end of the facility, among rows of yellow-safety-vest-wearing packers earning about $14 an hour, another aspect of the strategy reveals itself. In February, in one of his first acts in his new role, Lore scrapped Wal-Mart's two-year-old Amazon Prime copycat, called ShippingPass, and instead offered free two-day shipping on any order of more than $35. (In a rare act of following a competitor, Amazon dropped its free-shipping minimum purchase from $49 to $35 for non-Prime members.) The free-shipping gambit has translated into boxes packed to the brim with jumbles of baby wipes, paper towels, and other everyday items. The sight should come as a relief to the company's accounting department. "Shipping one unit is *ex-pen-sive*," McMillon says, drawing out the word. "It costs five bucks to ship one item, seven bucks to ship seven. So when you aggregate volume on the supply side, the economics change in your favor."

He contends that you can't ship items individually and make money, but that may not be entirely true. Amazon, with its vaster scale and hyperefficient fulfillment centers, has trained consumers to order a single product whenever they need it. Wal-Mart may never get there, but it has other advantages, which Lore plans to exploit. The main one is the cost efficiency produced by its 4,700 stores, hundreds of distribution centers, and 6,200 trucks, which prowl the country bearing the company slogan, "Save Money. Live Better." Wal-Mart has spent decades ensuring it can ship products to its stores more cheaply than any other retailer, which also means it can do so more cheaply than sending them directly to customer's homes. Lore wants to entice shoppers to stores with discounts and then lure them inside to pick up jumbo packs of bottled water, bags of charcoal, and other products, where Wal-Mart's prices can't be beat. To do so he's experimenting with a 16-foot-tall octagonal orange "pickup tower" code-named Rapunzel—a vending machine that sits inside a store, holds as many as 300 orders, and spits the right one out when a customer feeds info into a touchscreen.

He's also prioritizing groceries. Wal-Mart, the country's leader in this category, allows grocery pickup from 600 locations and plans to add an additional 525 this year. "If Wal-Mart can translate that food trip to the digital realm, they're in a good spot," says Robin Sherk, an analyst at Kantar. "For them, winning online grocery is mission-critical."

Finally, Lore hopes to rip out the barriers between the store and the e-commerce business that have stymied Walmart.com in the past. For example, he's expanding a service called Easy Reorder: Everything you buy with a credit card at a Wal-Mart store will show up in your online account, ready to be replenished with one click. It'll almost certainly hurt store traffic in favor of online sales, but Lore says that shouldn't matter: "If you don't want to let another business cannibalize your customer, you have to let them shop whatever way they want to."

Of course, Wal-Mart's biggest challenge is that its primary rival isn't standing still. An estimated half of all U.S. households subscribe to Amazon Prime, according to a report from Consumer Intelligence Research Partners. And Amazon currently takes more than $5 out of every $10 spent buying stuff online, says Macquarie Research. Its market value, buoyed by its cloud-computing business, is now around twice Wal-Mart's. In Seattle, Amazon is also trying out concepts, such as the Amazon Go store, where customers are automatically charged for items they pick from shelves without going through a checkout line, and a hybrid supermarket-and-pickup center for people who order groceries online. All of this stands to eat into Wal-Mart's advantages.

There are other challenges. Can Wal-Mart translate its domestic progress overseas, particularly in the fast-moving markets of China and India, currently outside Lore's domain? And can Lore, a veteran of grow-at-all-cost startups, find long-term profits in Walmart.com to satisfy the company's vocal investors?

Lore doesn't seem overly anxious about that last issue. Over lunch, he shares a story about his teenage daughter, who's started an online sticker-selling business whose proceeds go to philanthropies fighting celiac disease, an autoimmune disorder. When his daughter recently told him she was making money, Lore says, he was shocked. "How are you profitable?" he asked her.

"Well, Dad, it's easy," she replied. "You just make sure your revenues are higher than your expenses."

"Oh," Lore recalls saying. "I never really thought about it that way."

One wonders what Sam Walton would make of that. Ⓑ
—*With Molly Smith*