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Domination: The Consequence of a Modern Day Monopoly

Matthew Haimson

University at Albany, State University of New York

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Domination: The Consequence of a Modern Day Monopoly

An honors thesis presented to the
Department of Business
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Matthew Haimson
Research Advisor: Raymond K. Van Ness

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Abstract

The objective of this study is to find out what constitutes a company as a monopoly. There are various indicators which establish a monopoly from other dominating businesses; however, it is difficult to pin-point how one company controls the market over its competitors. With financial and quantitative data, there are ways to determine how a company may be heading towards that direction. In this study, there were two organizations selected and compared; one which has displayed monopolistic features, while the other is slowly being dominated by its competitor. After carefully analyzing and comparing the two well-known corporations, various inferences were made in the developing monarch. It is evident that Walmart has been evolving into a modern day monopoly, yet due to certain governing regulations the company cannot be labeled as exclusively controlling the market. As a dominating force in the retail industry, it can be concluded that Walmart's efforts will continue to progress and could potentially lead them into something worth worrying about in the future.

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Introduction

For over a century, various corporations have been competing to dominate their sector of the market. In the United States, the populace values when organizations compete against one another; however, there are regulating forces these companies must consider when attempting to do so. According to our justice system, the government has mitigated these cases as a result of the loss in contending businesses. Furthermore, rendering around this declaration, a competitive market can be paralleled to a monopoly because of several commonalities. Some of these may include: economies of scale, technological superiority, minimizing costs and maximizing profit. On the contrary, they differ in ways such as: product differentiation, number of competitors, barriers to entry, profit maximization and the supply curve.¹ When looking at all of these factors, it is imperative for the government to step in and take a close look at these individually. As a result, if these are deemed unlawful, they have the right to proclaim that a business is violating our country's antitrust laws.

In order to assure that not one company has the upper hand over the market, the government has passed laws in order to maintain control. The three major Federal antitrust laws are: The Sherman Antitrust Act, The Clayton Act, and The Federal Trade Commission Act. These three laws prohibit business practices that unfairly rob consumers of the benefits of competition, thus, causing greater prices for their products and services.² Even with these laws intact, certain businesses have been able to find loopholes and work around these acts so they cannot be tried against. As a result in the absence of intervention, businesses will set any price

¹ Boundless, "Defining Monopoly" (Boundless, 2014).

² USDOJ, "Antitrust Laws and You" (Antitrust Division).

they choose and will usually mark the price which will yield the greatest possible profit.

Although economists find organizations which can be considered a monopoly in the works, there are certain boundaries which must be crossed for them to be categorized as one.³

My concern for the economy and the rest of society has led me to question whether the government should keep a closer look at big businesses. Yes, even with these huge corporations around, people still seem to gravitate towards corporations that what will maximize their spending habits. Consequently, my research questions become:

- a) How does a company evolve to become a monopoly?
- b) What key quantitative indicators help determine a monopoly?
- c) What characteristics constitute a business as a monopoly?

There are thousands of varying brands and companies who comprise the same sector of the market. In the retail industry, it is often hard to pinpoint companies who are developing into a monopolistic stature, yet there are certain corporations in the market who are able to attract specific audiences greater than others. This is exemplified by the world's leading retailer, Walmart Stores Inc.

³ George Stigler, "Monopoly" (Liberty Fund Inc., 2008).

Literature Review

Walmart Stores Inc. designed a business that appeals to its customers' needs so they would ultimately come back again. The founder of Walmart, Sam Walton, believed in "everyday low prices" in order to appeal to any consumer within the market. A solid strategic positioning is crucial to a corporation's competitive advantage. Currently, Walmart Stores Inc. operates more than 11,000 retail units under seventy-one banners in twenty-seven countries, not to mention e-commerce websites in eleven countries.⁴ Unlike most retailers in the market today, Walmart offers its customers exceptional deals by supplying a vast number of products, which include: groceries, clothing, sporting goods, entertainment and other household goods. With such a large array of products, Walmart is able to uphold its competitive advantage in the market. Providing customers with a one-stop shopping experience puts Walmart at an advantage for convenience, not just price. As a result of the company's dominating cost leadership tactics and competitive advantage, Walmart Stores Inc. can be compared to a modern day monopoly.

Overpowering your competition is not enough to consider oneself as a monopoly, yet there are other factors surrounding the market that prevent competition. This can include an entry barrier. Relative to past monopolies such as Standard Oil or Microsoft, they were all able to control the market share and their industry. As the use of railroads became prominent to farmers, railroad owners started charging whatever prices they wanted because farmers were so dependent upon them for transporting their goods. Similarly, in the late 1970s when smaller companies ran out of money, bought out, or simply failed to develop operating systems,

⁴ Walmart Corporate, "Our Business."

Microsoft swooped in and ensured dominance in the field.⁵ After realizing the importance of these industries in their line of business, major companies such as these took advantage by fixing their own prices, thus creating a barrier to competitors. Consequently, they were able to set prices to their advantage, hence attracting consumers using underlying features which could not be contested.

In order for a company to sustain competitive advantage against rivals, the organization must match its core competencies to their opportunities. This is seen when a business provides the same value as its competitors but at a lower price, or by charging higher prices while providing greater value through differentiation. The ability to acquire these attributes over its competitors can help a company outperform its opponents. With Walmart's exceptional competitive advantage over similar organizations, it is clear as to why the company is driving out other participating businesses in the industry.

A major advantage that Walmart holds over its competitors is price. Monopolies are price makers and Walmart is able to dictate prices to its suppliers.⁶ Walmart looks to hire suppliers who will efficiently work with them, as well as help expand their business. They want their suppliers to deliver high quality products at a competitive price in order to sustain an upper hand. This can be seen through the firm's Supplier Diversity Program. One of Walmart's extraordinary efforts in order to maintain a positive vendor relationship can be seen through their trend-forecasting software called Retail Link. In 1985, Sam Walton and his chief lieutenant David Glass, developed this software to deliver sophisticated information on consumer behavior,

⁵ Stanford, "Rise of Monopolies."

⁶ Investopedia, "Price Maker."

which is drawn from the data imbedded in the barcodes that passed through checkout counters. Walmart then shared this revolutionary program to its suppliers at no cost, in order to help them meet the retailer's needs more efficiently.

As an ambitious leader, Walton felt, "You must play by our new rules and we will be your gateway to sales beyond your wildest dreams. Or refuse and be shut out of America's dominant chain."⁷ Walmart took control of its sources when technology started to boom and used its innovativeness to keep a firm grasp over the nation's most significant suppliers. This depicted the idea that "Walmart was plugged into the supplier and the supplier was plugged into Walmart." Having access to its suppliers' books, the company was in a position to virtually dictate the relations of its contracts on price, volume, delivery schedule, packaging, and quality. This permitted the largest retailer to set the profit margin each supplier would get. It turned the "supplier-retailer relationship" upside-down.⁸

The ability to differentiate from other competing industries contributes to Walmart's supremacy. Another characterization of monopolies includes differentiating ones products in the market.⁹ By adding Walmart to the supermarket chain, as well as owning Sam's Club, Walmart only continues to enhance its differentiating achievements. As a result of possessing another store which produces and offers the same products, it becomes very difficult for other businesses to do well. Trying to keep up with these dominating corporations leaves competing industries lagging. Because Sam's Club sells its products in bulk, it is allowed to conduct business

⁷ Christopher Matthews, "10 Ways Walmart Changed The World" (TIME, 2012).

⁸ Homblower, "Always Low Prices" (PBS, 2004).

⁹ Boundless, "Defining Monopoly" (Boundless, 2014).

alongside of Walmart. Walmart is considered a dominating force because it operates in diversified fields; this sanctions Walmart from merging with a company in the same industry, hence not violating any antitrust laws.

It is evident Walmart utilizes its economies of scale. In other words, this process explains how an increase in quantity will result with a decrease in the average cost of production. Monopolies are acknowledged when there are large economies of scale because “the biggest producer can undercut the prices of the others and drive them out business and/or because the costs of entering the industry are so great that newcomers are effectively prohibited.”¹⁰ The largest retail provider uses its size in the market to set the prices of their choosing, not just in purchasing, yet through its distribution efforts as well. In 2012, Walmart was so large even their second biggest competitor in the United States, Costco, was behind five times in sales.¹¹ Currently in today’s economy, Walmart’s counterpart Target Corp. sits as the second largest retailer in the country and can be perceived as Walmart’s rival.

¹⁰ The Linux Information Project, “Economies of Scale” (LINFO, 2006).

¹¹ Economy In Crisis, “Walmart’s Impact on America” (2012).

Hypotheses

H-1: It is hypothesized that an organization's profit maximization efforts can be positively correlated to the demand curve of a monopoly.

H-2: It is perceived that a company's dominance can be correlated with a company's financial performance. (Walmart = Target Company, Target Inc. = Benchmark Company)

H-3: It is not impossible to presume that there is a negative correlation between market dominating corporations and employee welfare.

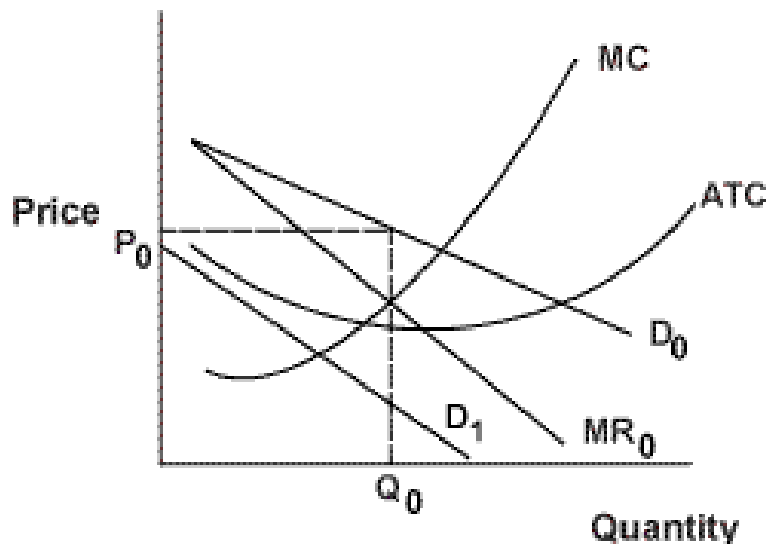
Results

Hypothesis 1 was supported.

A monopoly is evident when a business has control over the quantity produced and price charged; as a result, it will face a downward-sloping demand curve for the goods manufactured.

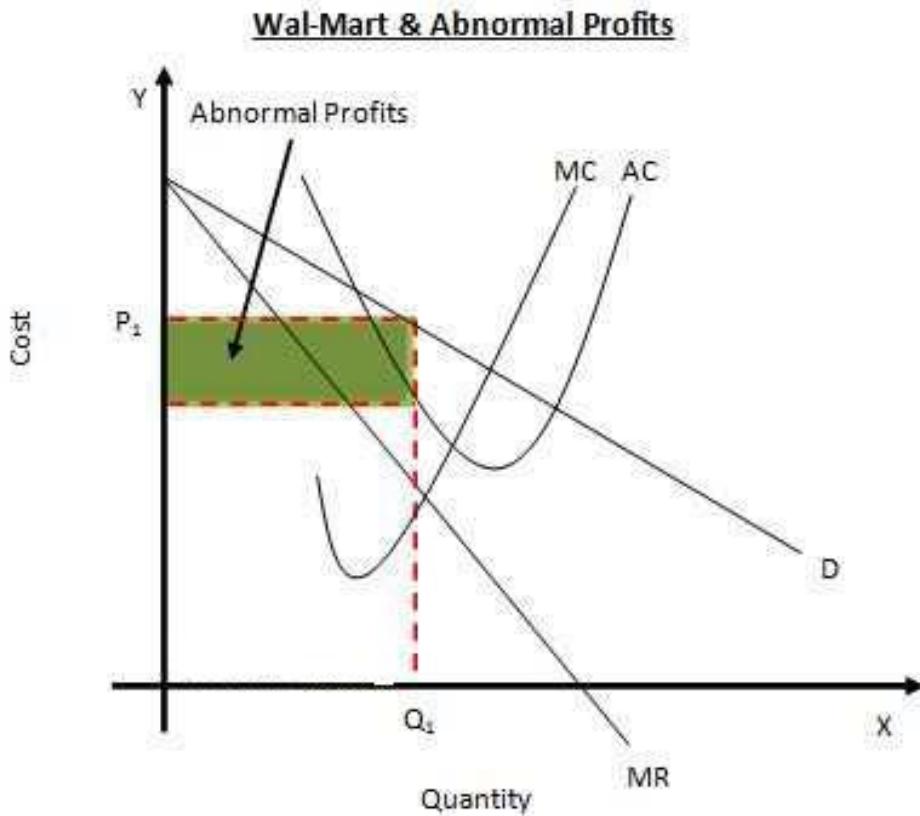
A common rule of thumb for profit maximization involves the equation $MR=MC$. Walmart examines the optimum price it looks to create and is successful because other retailers cannot keep up, therefore constructing an entry-barrier [Table 1].

Table 1 – Demand Curve of a Monopoly



In both the short term and the long term, Walmart is able to gain abnormal profits by generating the highest income according to their set output. The company is able to dictate the market as a result of its power, thus leaving its competing retailers fearful due to setting prices, controlling suppliers and mitigating costs [Table 2].

Table 2 - Demand Curve and Profit Maximization



Hypothesis 2 was supported.

When looking at the profit margins of Walmart and its competitor Target between 2012 and 2014, it is clear that Walmart's net margin has stayed relatively consistent; however, Target recently plummeted in its earnings productivity. It is evident that Walmart has a dominating earning power relative to its major rival, Target [Tables 2 & 3].

Table 3 - Net Income to Gross Revenue (2012-2013)

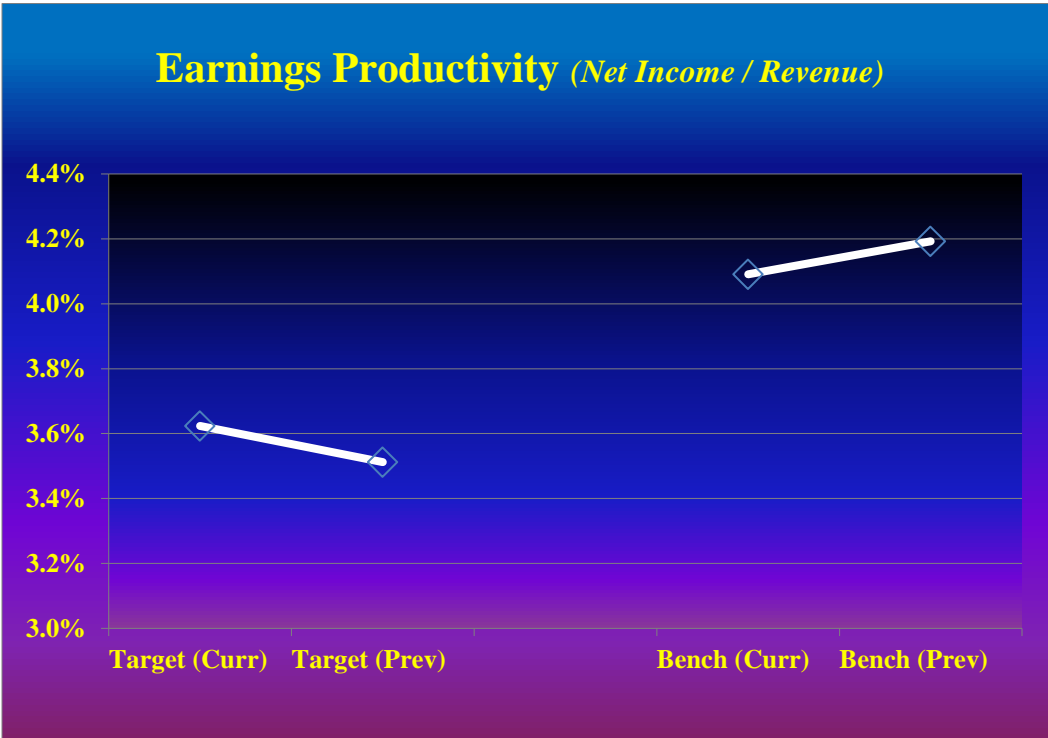


Table 4 - Net Income to Gross Revenue (2013-2014)



Looking at the Return on Equity (ROE) between 2012 and 2014, Walmart's relationship in its net income and stockholders equity is much more desirable than Target's. Target witnessed a decrease, whereas Walmart has remained moderately equivalent over the past few years [Tables 5 & 6].

Table 5 - Return on Equity (2012-2013)

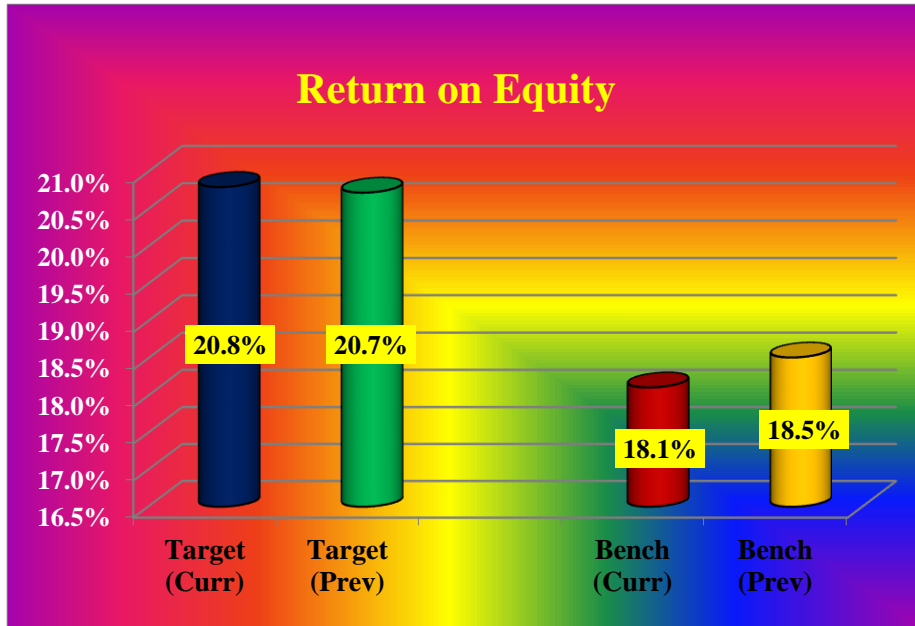
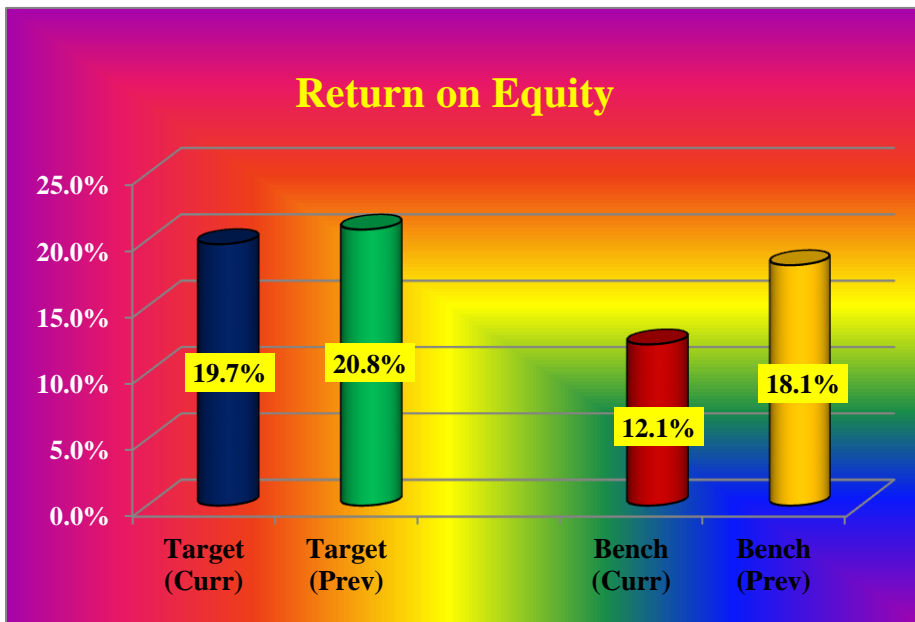


Table 6 - Return on Equity (2013-2014)



The Earned Capital to Total Capital is imperative to consider when comparing the two companies. During the period of 2012 through 2014, Walmart’s financial worth is positively correlated to its performance in earnings versus paid in capital. It was able to increase this by 2% over these years; meanwhile, Target’s percentage has dropped [Tables 7 & 8].

Table 7 - Capital: Earned / Total (2012-2013)

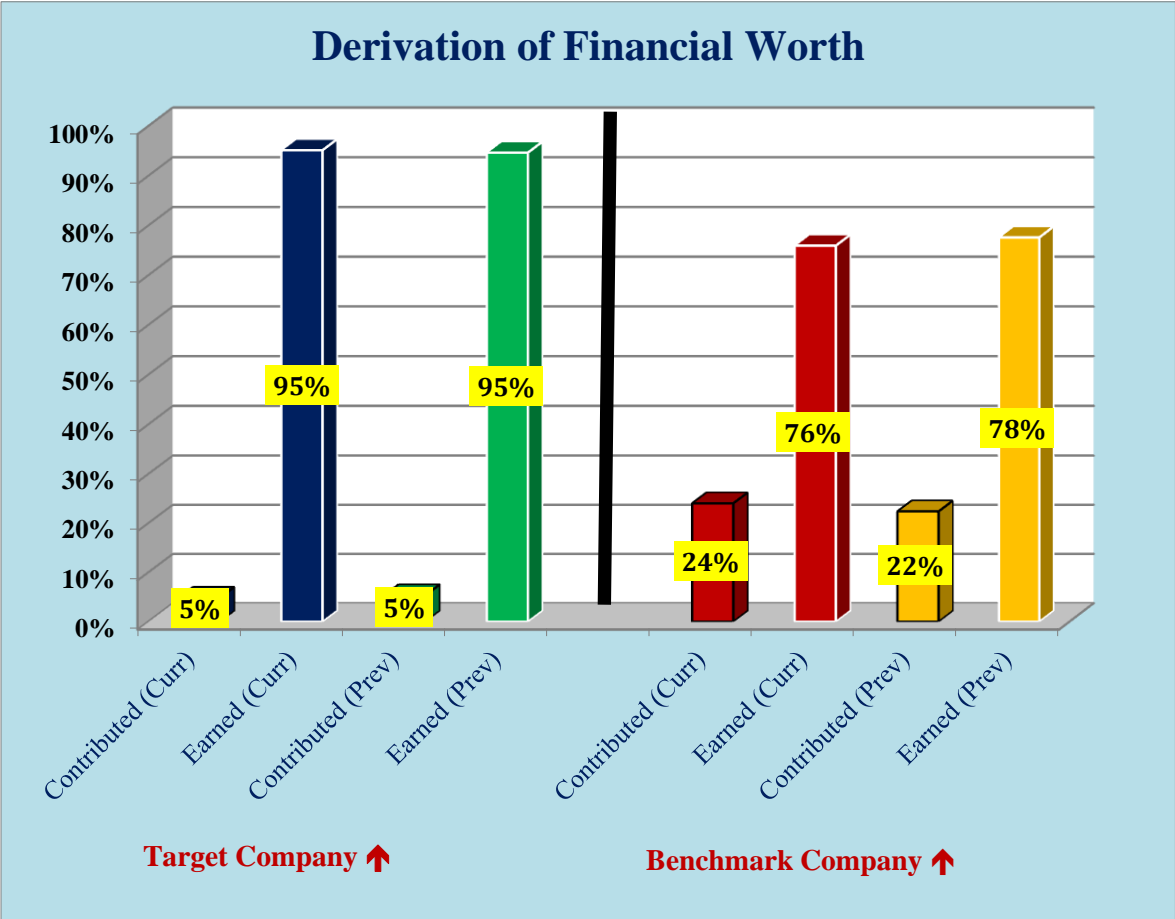
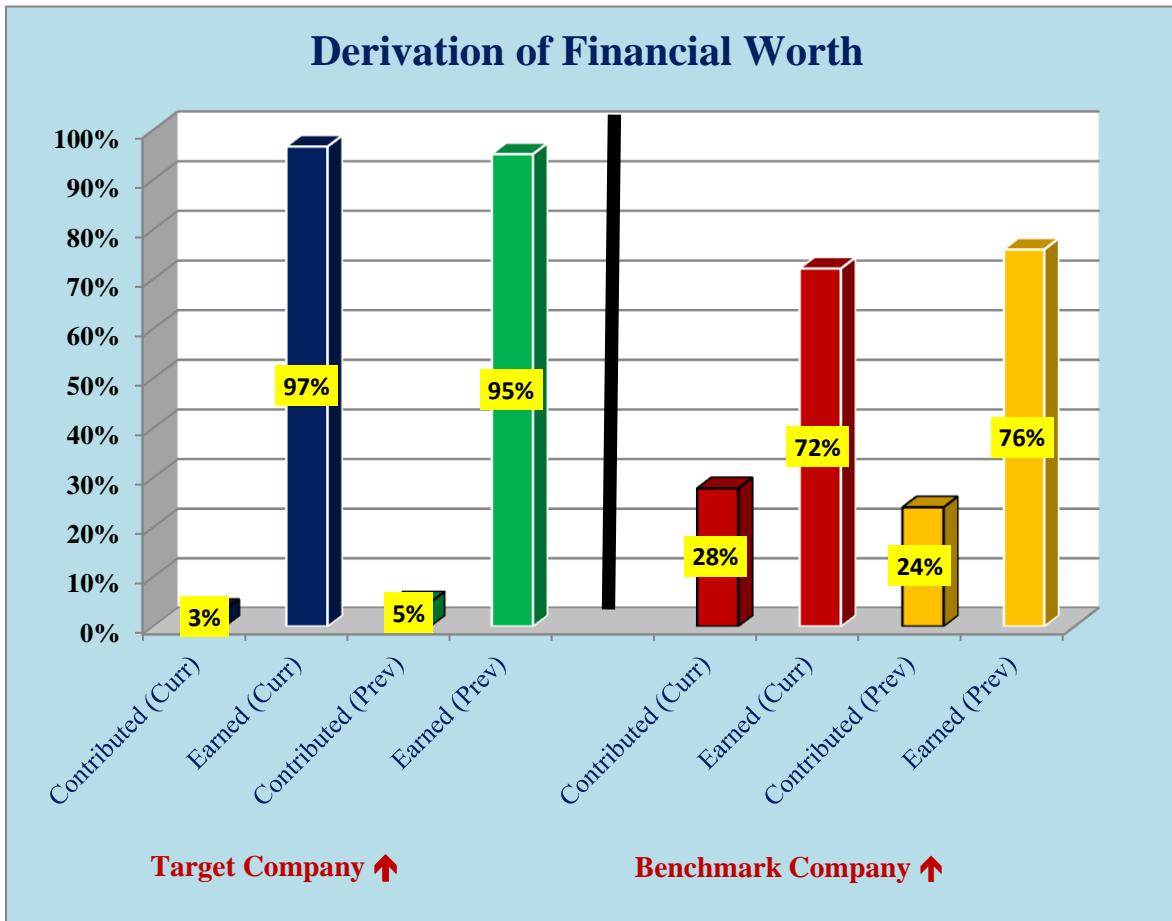


Table 8 - Capital: Earned / Total (2013-2014)



Hypothesis 3 was supported.

Employee satisfaction is an essential component to the success of a business. Maintaining worker satisfaction should be the employer’s main focus when running a business because with happy employee’s comes happy customers. While this is a well-known fact in management practices, some companies still fail to acknowledge the importance of keeping their employees pleased.

Society is left dubious as to why this dominating global retail provider experiences so many faults in terms of its employee relations. When running a successful company like

Walmart, workers should feel content and loyal towards their job. A happy worker reflects how the organization is operated and how employees are treated. Employee satisfaction is an essential ingredient in any successful business; however, Walmart does not seem to always make its employees a priority. As a result of Walmart's fair share of class action lawsuits, employee benefits, insurance, minimum wage and no opportunities for growth, it has ruined the firm's reputation in the eyes of several consumers.

Walmart has been portrayed as a corporate behemoth that puts profits above its workers. Labor unions and anti-Walmart associations have argued that Walmart, the largest U.S. private employer with 2.2 million workers, does not pay fair wages or provide adequate health care. Ad campaigns were held as these groups toured around the country holding protests in attempt to aid these victimized workers. There were attempts to shield Walmart from opening new facilities in places like New York City, meanwhile, its competitor Target, was greeted with fanfare. In 2008, Walmart was even referenced by President Barack Obama as an example of "what's wrong with big business."¹²

With these complications, Walmart's employee relations have been heard universally. One big issue that arose along with Walmart's lawsuits was health care. *New York Times* noted that Walmart workers were "sicker than the national population" and tended to overuse emergency rooms instead of going to the doctor.¹³ This resulted from the retailers' internal memo recommending numerous ways to reduce health care spending. Walmart's employee

¹²Syracuse, "Walmart's Reputation Takes Another Beating amid Bribery Allegations" (The Associated Press, 2012).

¹³ Steven Greenhouse & Michael Barbaro, "Wal-Mart Memo Suggests Ways to Cut Employee Benefit Costs" (The New York Times, 2005).

neglect and mistreatment has become a never-ending issue with the company. Walmart has become too preoccupied in its Cost Leadership rather than employee health care. Workers complained that they were being neglected in this area which ultimately affected their overall wellbeing.

Employee abuse is not just occurring domestically, but overseas, as well. Every year there are nearly 5,000 lawsuits filed against Walmart pertaining to employee abuse. One case deals with a Bangladesh employee who worked seven days a week from 7:45 AM to 10:00 PM without a day off for six months.¹⁴ This is just one of the many alleged instances involving Walmart abusing its workers. It also was not supplying regulated safety tools in relation to their dangerous machinery, such as fabric cutters. As a result, the International Labor Rights Fund filed a class-action lawsuit against Walmart for violating workers' rights in foreign countries. It seems impossible for such a dominating corporation like Walmart to deny minimum wage to employees, make overtime a requirement, and even punish workers who participate in union activity. In terms of pay, employees at Walmart are earning 5% below market compared to similar employers such as CVS/Pharmacy or Walgreens.¹⁵ If this continues at Walmart, the company's employee turnover will steadily increase, leaving many to question whether or not to work there in the future.

¹⁴ Family Court, "Superior Court Of The State Of California For The County Of San Diego" (1979).

¹⁵ Payscale, "Average Hourly Rate for Wal-Mart Stores, Inc. Employees" (2014).

Discussion

After carefully examining Walmart's economic stance, the company has nothing to worry about. It is the world's leading discount company and has displayed no signs of economic despair or that it could be impending. As a corporation, Walmart is able to inversely control its profits. This may seem abnormal from a monopolistic sense; however, Walmart is able to control their sector of the market because they position themselves better than any other retailer. Society would much rather adhere to an organization which will maximize their spending habits. If this means lowering prices in order to turn profits in the long run, then the firm is doing a great job. This will eventually run other competitors out of business, as well as prevent new businesses from emerging. Although the demand curve of a monopoly is negatively sloped, like Walmart's, they cannot raise prices high enough because they would ultimately lose all of their customers. Even though their low cost motto goes against the characteristics of a monopoly, their business tactics are parallel to how a monopoly looks to operate. In addition, the indication behind Walmart's Net Profit Margin, ROE, and Earned/Total Capital can be tied to their dominating performance in the market. After carefully collecting a large amount of data from both company's annual reports, the accuracy of my study revealed factual evidence which can prove Walmart's supremacy in their industry. Despite only comparing Walmart's financial stance related to their main competitor Target, the results of my hypotheses support the conclusion of this investigation.

When looking ahead, there are no signs of Walmart slowing down as the leader in their market. Walmart plans to remain an uncontrollable force now and in the future. The company

believes it can maintain a strong grasp over competition and continue to come up with ways in order to control their market. For the first time in history this year, Walmart will open smaller grocery and convenience stores rather than supercenters. Walmart feels that a lot of its larger products, such as televisions and bikes, are being purchased online. As a result, Walmart's current supercenters' inventories are larger than necessary. Furthermore, Walmart seeks to double its alcohol sales by 2016. The company is currently weighing their options as to whether to construct free-standing liquor stores in states like Florida, which prohibit vendors from selling alcohol inside grocery stores. Additionally, Walmart is constantly looking for ways to improve their e-commerce. While Amazon's retail frenzy can be seen through their exceptional deals online, Walmart is eager to create a similar experience by using a "dynamic pricing" system which frequently changes prices based on fluctuating data and competitive offerings. According to last year's web sales, Walmart's web sales rose 30% compared to Amazon's 20%.¹⁶ It is evident that Walmart is taking the right path towards their progress and competitors will have a difficult time trying to come up with ways to surpass this dominating corporation.

In the last decade, Walmart doubled its store count, tripled its revenue, and almost quadrupled its net income; however, the company must be conscientious of free trade agreements as they are shaping the markets. Walmart has "destroyed tens of thousands of small businesses and countless manufacturing jobs" and has been able to "sell five times more stuff than any other retailer in the United States."¹⁷ In the public eye, Walmart appears to be micromanaging the market and breaking antitrust laws, yet they are still able to behave in whatever way they choose.

¹⁶ Shelly Banjo & Wall Street Journal, "Wal-Mart Looks to Grow by Embracing Smaller Stores" (Dow Jones & Company Inc., 2014).

¹⁷ Economy In Crisis, "Walmart's Impact on America" (2012).

This will continue along as there are still other companies that try to compete. Until Walmart wipes out all the other businesses in their industry, they cannot be ruled as a monopoly. Despite the fact they are portrayed as a monopolistic corporation, Walmart needs to be aware of their corporate strategy, as a company's image is vital to their reputation. Walmart has already damaged their socio-cultural reputation by discriminating against women, in addition to political cases involving low salaries and health care. This needs to be constantly monitored because lawsuits do in turn tie back to company's reputation and can alter their dominating image.

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