Major Flaws Uncovered in Study Claiming Wal-Mart Has Not Harmed Small Business

Stacy Mitchell

"We can firmly conclude that there is no evidence that Wal-Mart has had a significant impact on the overall size, growth, or profitability of the U.S. small business sector," asserts a new study published in the October issue of the academic journal *Economic Inquiry*. The authors of "Has Wal-Mart Buried Mom and Pop?" are Dr. Russell Sobel, chair of Entrepreneurial Studies at West Virginia University, and Andrea Dean, a Kendrick Fellow in WVU's Economics Department.

The study's sensational findings have attracted significant local and national media attention, including featured interviews with Dr. Sobel in *U.S. News & World Report* and on Fox television, and blog articles on the web sites of *Business Week* and the *Wall Street Journal*. A shorter version of the study ran as the cover story in *Regulation*, the quarterly magazine of the Cato Institute.

Wal-Mart has also leaped on the study, producing a fact sheet that highlights key findings and quotes from the study. The fact sheet is being distributed in communities where the company is proposing new supercenters.

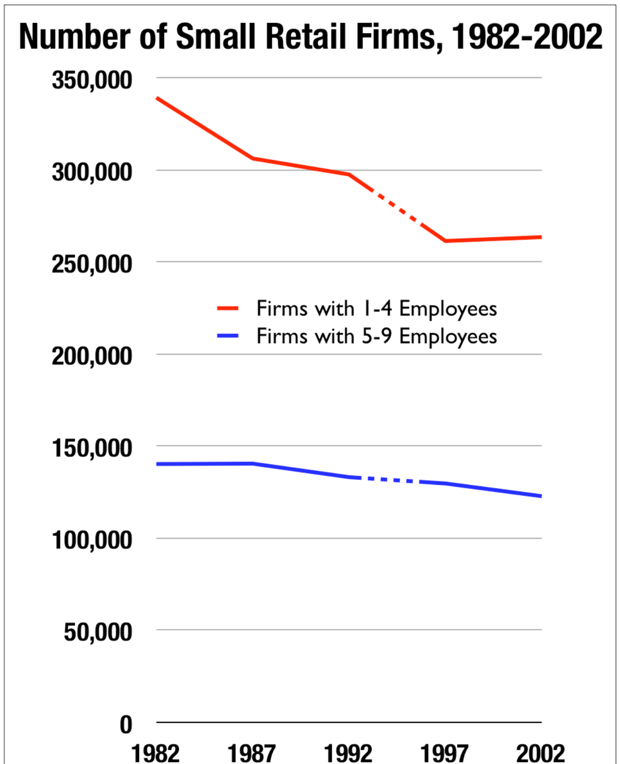
A close inspection of the study by the Institute for Local Self-Reliance, however, found fatal flaws. Most remarkable, the study's authors fail to recognize an important distinction in the definitions used by the U.S. Census Bureau and are in fact using the wrong dataset. Using the correct data produces very different results.

Creative Destruction or Just Destruction?

The authors' thesis is that the growth of Wal-Mart has been a process of "creative destruction." Some small businesses have failed, but their failure has spurred competitive pressures and freed up resources that have given rise to new small businesses. When Wal-Mart comes to town, a hardware store may close, but in its place a new coffee shop or art gallery opens. The authors then present what they describe as a rigorous analysis, backed by data and charts, that seems to confirm that the small business sector has remained robust despite the growth of Wal-Mart.

The study's keynote chart, "Wal-Mart Stores and Small Retailers," (which appears on page 2 of the *Regulation* article), shows that the number of small retail establishments, those with 1-4 and 5-9 employees, remained virtually unchanged from 1985 to 2002, even as the number of Wal-Mart stores grew from about 700 to over 2,800.

The problem here is that an *establishment* is not the same as a *firm*. The U.S. Census Bureau defines a firm as a single business entity. An establishment is a single business location. Starbucks, for example, is one firm with thousands of establishments. The authors, therefore, are counting not only genuine small businesses, but every corporate-owned chain store with fewer than 10 employees at that particular location. Since the goal is to measure impact on small "mom and pop" businesses, this is a crucial distinction. Using the correct data — number of small retail firms — one finds that, between 1982 and 2002, the number of retail businesses with 1-9 employees actually fell by one-fifth (Figure 1).[1]



Source: U.S. Census Bureau.
Note: Automotive dealers, eating and drinking places, and nonstore retailers are excluded. In 1997, the Census Bureau reclassified certain businesses, rendering the data from 1992 and 1997 not precisely comparable, hence the dotted line. For a fuller explanation, see footnote 1.

Figure 1

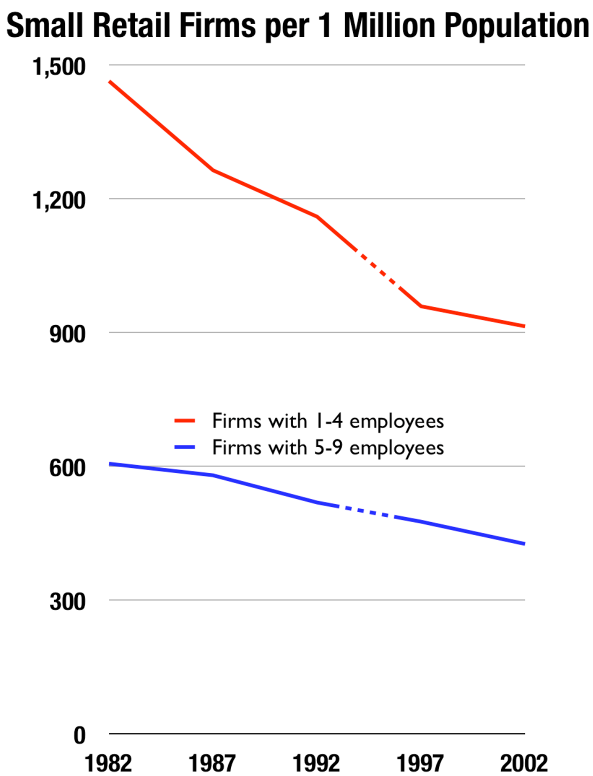


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Figure 2

What's more, this decline in absolute numbers tells only part of the story. A far more instructive measure of the presence of small businesses is to chart their numbers relative to population. The U.S. population grew by 24% between 1982 and 2002. Had the level of small business activity held steady over those years, one would expect the number of small retail firms per 1 million people to remain about the same. Instead, the number of small retail firms with 1-4 employees per 1 million people fell by 38%, while those with 5-9 employees declined 30% (Figure 2).

(Incidentally, the number of small retail *establishments* also fell relative to population during this period, reflecting the fact that, as Wal-Mart and other "big box" retailers multiplied, the trend has been a shift not only in favor of chains, but also to bigger stores.)

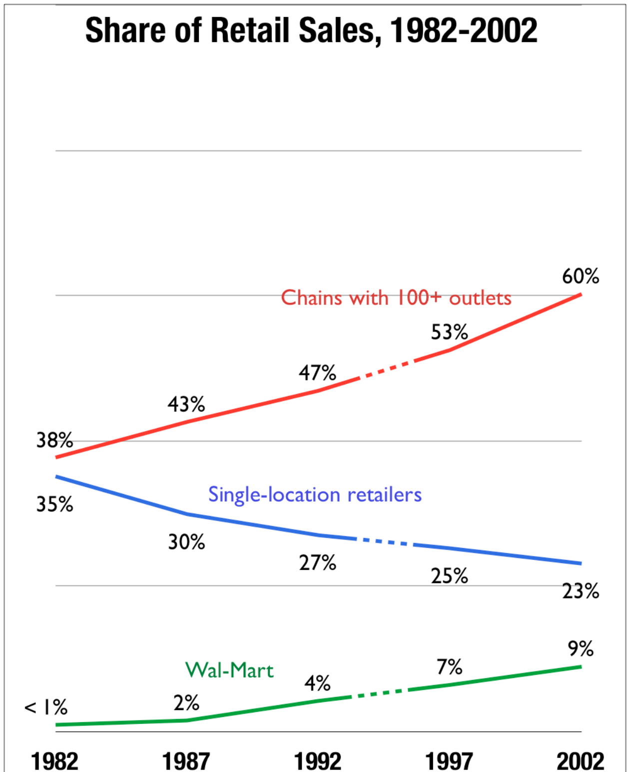
Market Share of Independent Businesses

Many independent businesses have more than 9 employees. This is especially true for the grocery stores, hardware stores, and other more substantial enterprises that can form the backbone of a community's Main Street.

One way to measure the changing strength of independent retailers overall, rather than just small firms, is to look at the market share of single- and multi-location businesses. Between 1982 and 2002, the share of the nation's retail spending going to single-location businesses dropped from 35 to 23%, while the share captured by chains with 100 or more outlets climbed from 38 to 60% (Figure 3). Retail firms with more than 1 but less than 5 locations also lost ground, falling from 9% to less than 5% market share.

Comparing States

The authors then go on to offer a cross-sectional analysis that compares the number of small retail establishments in the five states that have the most Wal-Mart stores per capita with the five that have the fewest. Again, the authors use *establishment* rather than *firm* data, rendering the figures that they present irrelevant.



Sources: Wal-Mart, U.S. Census Bureau.
Note: Wal-Mart's sales are included in the figures for chains with 100 or more outlets. Automotive sales, sales at eating and drinking places, and sales at nonstore retailers are excluded. In 1997, the Census Bureau reclassified certain businesses, rendering the data from 1992 and 1997 not precisely comparable, hence the dotted line. See footnote 1 for a fuller explanation.

Figure 3

But a more fundamental problem is that the approach that the authors take is far too simplified to provide a well-founded answer to the question. For one, Wal-Mart may be the leading example of a "big-box" retailer and the company most responsible for the dominance of this business model, but it is hardly the only one. Some of the states that have relatively low numbers of Wal-Mart stores, such as a California, have high numbers of Target stores and other large-format retailers.

The state that has most limited this type of retail is Vermont, which has a variety of statewide policies, notably Act 250, that favor downtowns and restrict large-scale development on the outskirts. Vermont has only four Wal-Mart stores, three of which are much smaller than the chain's average. This gives Vermont the lowest amount of Wal-Mart square footage per capita in the country and it has only a modest presence of other large retailers. Vermont also has the highest ratio of small (1-9 employee) retail firms of any state — almost 300 per 100,000 people.

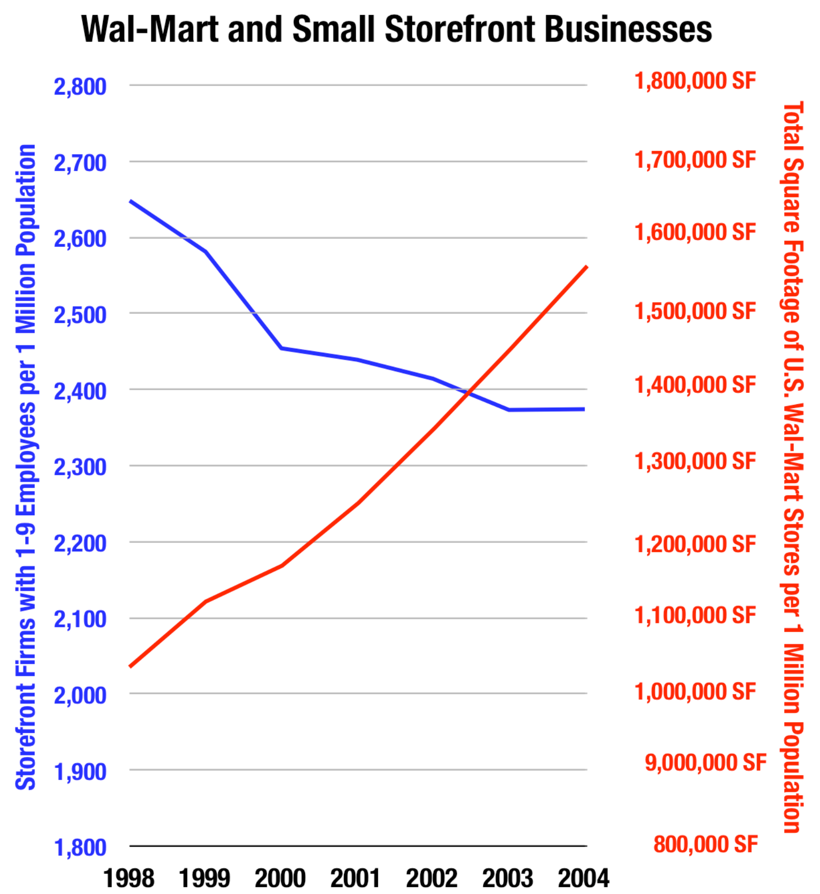
Are these facts connected? Perhaps. But to truly test this, one would have to look at the overall square footage of all big-box retailers in each state, track the growth of these stores over time, compare with changes in the number of small retail firms, and account for other factors that influence small business activity, such as the degree of urbanization.

Beyond Retail Businesses

Although the authors rely on data from the retail sector for their analysis (albeit the wrong dataset), their discussion references a broader range of businesses. A local department store or hardware store may close after the arrival of a new Wal-Mart store, they state, but "downtowns with empty storefronts … soon see new small businesses opening in these vacant locations." As examples, they mention "a coffee shop", "dinner theater," or "ice cream parlor."

To further evaluate the authors' thesis that the rise of Wal-Mart has caused some small businesses in direct competition to close, but has led to the creation of others, we expanded the types of small businesses in our sample to include all that could be categorized as "storefront" businesses — those that require a high degree of street visibility. These are the types of businesses that fill the street-level spaces in a downtown and populate malls and neighborhood shopping centers. In addition to retail stores, we include certain services, such as dry cleaners and hair salons; eating and drinking places, such as restaurants and bars; and places that rent consumer goods, such as video stores and costume shops.

Between 1998 and 2004 — a six-year period in which Wal-Mart expanded its U.S. store square footage per capita by more than 50% — the number of small storefront firms (those with 1 to 9 employees) fell by more than 18,000. Relative to population, the decline was 11% (Figure 4). Storefront firms with 10-19 employees also declined, by 6%.



Sources: Wal-Mart, U.S. Census Bureau.
Note: "Storefront" firms include retail stores (except for automotive and nonstore retailers); eating and drinking places; consumer goods rental, such as video stores; and selected services, such as drycleaners and hair salons.

Figure 4

Allocating Storefront Space

The creative destruction thesis posits that the failure of some businesses frees up resources that then give rise to other businesses. One of the primary resources the authors discuss in the context of Wal-Mart's expansion is storefront space. "Only when these valuable store locations were freed up by the entry of Wal-Mart did they become economically viable locations for many other types of small businesses," they write. In addition to ice cream parlors and coffee shops, they also offer the example of "a new law firm" occupying a vacant storefront space. Although brief, this reference suggests that the authors have not consulted the work of retail market analysts or considered the basic economics of retail space in formulating their argument.

When a law firm or other office opens in a storefront space downtown, it is a sign, not of the "productive 'recycling' of resources," but rather of a misallocation of resources. Ground-floor retail spaces, with their expansive window displays, command significantly more visibility for products and services than upper floors do. In a properly functioning commercial district, the ground floor will cost more to rent than the upper floors.

If the price of prime storefront space has fallen to the point that it's comparable to the cost of an upper floor — so much so that a law firm or other office business that does not require a highly visible storefront to display its wares would opt to rent it – that's an indication of a ailing commercial district. The culprit is usually an excess of retail space in the market (often caused by large-scale development on the outskirts of town) and the consequence is a downtown riddled with vacant and poorly utilized ground-floor space.

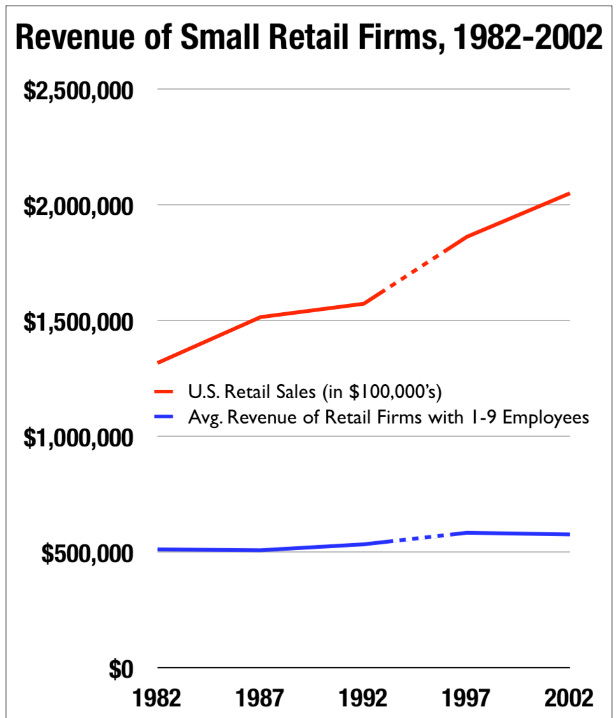
It might be one thing if property owners were the only ones who were negatively affected by this scenario. But they are not. Other stores and restaurants suffer when they are surrounded by low-traffic uses. Too many vacancies and poorly utilized storefronts can render a neighborhood or downtown business district unappealing to shoppers and destroy its ability to incubate new entrepreneurs — something Main Streets have traditionally been much better at than malls.

The community pays a price as well, not only in the loss of a lively community center, but a real financial cost. Downtown commercial districts represent tremendous investment, both private and public, made over many years. When these districts becomes underutilized, the result is an inefficient allocation of economic resources and a waste of tax dollars.

Small Business Revenue

The authors end by attempting to refute a potential argument against their study, namely that the new antique stores and diners that they theorize spring up in the wake of Wal-Mart's "creative destruction" are inferior to the businesses that closed. To demonstrate that the "quality" of small business has not declined, they present data showing that the average revenue of sole proprietors rose more than 250% (in constant dollars) between 1980 and 2000.

But data on sole proprietors is not very useful in answering this question. For one, sole proprietors include large numbers of people who have small amounts of business income but who would not be considered small business owners in any common sense of the term. Someone who has a full-time job, for example, but reports a few hundred dollars in income from freelance writing or selling crafts on eBay is counted as a sole proprietor. That people who have a small amount of business



Source: U.S. Census Bureau.
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Figure 5

income on the side make up a large share of the authors' data is clear from the fact that the average annual revenue reported for a sole proprietor in 2000 was only about $5,000 a year. The vast majority of these are not full-fledged businesses.

Second, most retail businesses with employees, large and small, are not sole proprietorships. They are incorporated.

A better measure would be to look at changes in the average revenue of small retail firms. Between 1982 and 2002, overall retail sales, adjusted for inflation, grew 56%, while average revenue for retail firms with fewer than 10 employee rose 13% (Figure 5).

That small, independent retail firms managed to keep revenue moving in a positive direction (on average) is a sign of their resilience and skill. That they so underperformed the market, even as the weakest among them fell by the wayside, is a pretty good indication of just how challenging the environment for independent businesses has been in recent decades.

Conclusion

None of the data presented here is causal: the fact that independent retail businesses declined in numbers and market share at the same time that Wal-Mart and other large-format retailers grew does not prove that one caused the other.

But it does make clear that the small business sector is not as robust as it was 20 years ago. Sobel and Dean's sweeping conclusion that "there is no evidence that Wal-Mart has had a significant impact on the overall size, growth, or profitability of the U.S. small business sector" is unfounded.

In the last few years, more communities have been carefully weighing both the benefits and costs of a new Wal-Mart store or other large-scale retail development before approving these projects. Their discussions are informed by a growing body of empirical research showing that these stores have significant economic impacts and the impacts are not necessarily positive.

Poorly constructed and misleading studies like this one may make for eye-catching headlines, but they only frustrate and impede the ability of citizens to make informed decisions about development in their communities.

Notes

[1] In 1997, the U.S. Census Bureau introduced a new business classification scheme. The most significant change to the Retail Census was that "eating and drinking places" (restaurants, coffee shops, bars, etc.) were no longer included as retail businesses. In the data presented in figures 1, 2, 3, and 5, eating and drinking places have been excluded in order to render the data broadly, though not precisely, comparable across this classification change.

Nonstore retailers, such as heating oil dealers, and automotive dealers have been excluded as well. The automotive sector, which accounts for almost one-quarter of all retail sales, is distinct in many respects from other types of retail, notably in that most sales occur in branded franchise dealerships with defined territories. In order to present a more accurate picture of the rest of the retail segment, automotive sales have been excluded. (Although it should be noted that the trend lines shown in all figures are similar with automotive sales included.)

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