
Supplemental Benefits Documentation

Board of Directors Retreat FY06

Wal-Mart Stores, Inc.

Reviewing and Revising Wal-Mart's Benefits Strategy

*Memorandum to the Board of Directors
from Susan Chambers*

The purpose of this memorandum is to update you on our efforts to review and revise Wal-Mart's benefits strategy. In response to concerns about cost trends and growing public scrutiny, I, with the support of McKinsey & Company, recently led a 15-person team, drawn from across the company, in 1) evaluating Wal-Mart's approach to benefits, and 2) developing a strategy to address any shortcomings.

We evaluated Wal-Mart's current benefits offering through three lenses – cost trends, Associate satisfaction, and public reputation – and are now recommending revisions to our benefits strategy built around nine “limited-risk” initiatives and five “bold steps.” While we continue to refine our thinking, I wanted to take this opportunity to share with you the breadth of our considerations, to highlight the direction we are headed, and to solicit feedback that will guide our final recommendations.

This memorandum summarizes our work and is divided into three sections:

- ¶ *Section 1* provides a detailed analysis of the three most significant benefits-related challenges we face:
 - Growth in benefits costs is unacceptable (15 percent per year) and driven by fundamental and persistent root causes (e.g., aging workforce, increasing average tenure). Unabated, benefits costs could consume an incremental 12 percent of our total profits in 2011, equal to \$30 billion to \$35 billion in market capitalization.
 - While Associates are satisfied overall with their benefits, they are opposed to most traditional cost-control levers (e.g., higher deductibles for health insurance). Satisfaction also varies significantly by benefit and by segment of Associates. Most troubling, the least healthy, least productive Associates are more satisfied with their benefits than other segments and are interested in longer careers with Wal-Mart.

-
- Wal-Mart's healthcare benefit is one of the most pressing reputation issues we face because well-funded, well-organized critics, as well as state government officials, are carefully scrutinizing Wal-Mart's offering. Moreover, our offering is vulnerable to at least some of their criticisms, especially with regard to the affordability of coverage and Associates' reliance on Medicaid.

¶ *Section 2* discusses in detail the nine limited-risk initiatives and five bold steps we are recommending. Given conflicts inherent in the challenges we face, any set of solutions will require carefully balancing, and sometimes making trade-offs between, cost, Associate satisfaction, and public reputation.

- **Limited-risk initiatives:** We are recommending that Wal-Mart realign eligibility requirements for health insurance; decrease cross-subsidization of spouses; give Associates more information about how to use healthcare and health insurance; lower company-paid life insurance coverage levels; capture savings from current initiatives to improve labor productivity; add a combination of best practice care management programs; further develop high-performance provider networks; offer Associates bundles of other benefits (e.g., paid time off) from which to choose; and continue to explore adding health clinics in stores. These initiatives will reduce costs and will slightly improve Associate satisfaction.
- **Bold steps:** The nine limited-risk initiatives will not fully address all the benefits-related challenges we face. To fully address these challenges, we recommend that Wal-Mart take five bold steps that will require more explicit trade-offs between cost, Associate satisfaction, and public reputation. The first two recommended steps primarily address cost trends, the third addresses attracting a healthier workforce, and the last two steps address improving our public reputation.
 - Move all Associates to “progressively designed” consumer-driven health plans to help control cost trends while allowing Associates to build up savings in Health Savings Accounts.
 - Restructure the retirement program (i.e., profit sharing and 401(k) program) to reduce costs and help Associates better save for retirement.

-
- Redesign benefits and other aspects of the Associate experience, such as job design, to attract a healthier, more productive workforce.
 - Make some select strategic investments in our healthcare offering (e.g., lower maximum out-of-pocket expenses) so it can better withstand external scrutiny.
 - Improve communication of Wal-Mart's benefits offering so we get more credit for what we provide, and, over the long-term, work to shape state and national outcomes on healthcare.
- ¶ *Section 3* summarizes the combined impact of the limited-risk initiatives and the bold steps. The team believes this new strategy will bring powerful advantages to Wal-Mart, including:
- Maintaining benefits spend at or below today's level as a percentage of sales;
 - Offering a more attractive benefits package for healthy Associates;
 - Better positioning us to fight Wal-Mart's critics.

We presented this material to the Executive Benefits Steering Committee (Tom Hyde, Lawrence Jackson, and Tom Schoewe) in late July. They received the recommendations enthusiastically and asked that we share them widely within Wal-Mart, something we have begun to do. They also asked that the team continue to test and refine the strategy, especially with Associates and external stakeholders. Our aspiration is to complete this work by late September, receive Executive Committee approval on the overall strategy by early October, and hold a special session with you in November for further discussion.

1 Major Benefits-Related Challenges

We analyzed the benefits-related challenges facing Wal-Mart through three lenses – cost trends, Associate satisfaction, and public reputation.

COST TRENDS

From 2002 to 2005, our benefits costs grew significantly faster than sales, rising from 1.5 percent of sales to 1.9 percent. Benefits spend grew from \$2.8 billion to \$4.2 billion during this period, at a rate of 15 percent per year. Striving to hold benefits costs as a percent of sales constant is critical for Wal-Mart's long-term economic success.

A few benefits made up the bulk of this increase: healthcare (\$1.5 billion) grew by 19 percent, paid time off (\$1.4 billion) grew by 14 percent, and the profit sharing and 401(k) program (\$740 million) grew by 13 percent. (Over the period, the domestic Associate base grew at 5 percent and domestic sales grew at 11 percent.)

Increased utilization of medical services, which grew by 10 percent per year, was the primary driver of the rapid growth in our healthcare costs (Exhibit 1). Almost half of this utilization growth was due to three Wal-Mart-specific workforce factors (distinct from national trends):

- ¶ Our workforce is aging faster (0.50 years per calendar year) than the national average (0.12 years per calendar year).
- ¶ Our workers are getting sicker than the national population, particularly with obesity-related diseases. For example, the prevalence of coronary artery disease in Wal-Mart's population grew by 6 percent compared to a national average of 1 percent, and the prevalence of diabetes in our population grew by 10 percent compared to a national average of 3 percent. (That said, our workforce is no sicker at present in absolute terms than the national population.)
- ¶ A segment of our workforce consumes healthcare inefficiently, in a pattern similar to a Medicaid population. Our population tends to over

utilize emergency room and hospital services and underutilize prescriptions and doctor visits. This pattern is most evident among our low-income Associates, and one hypothesis is that this behavior may result from prior experience with Medicaid programs.

Compounding these problems are several national trends, such as the increased use of technological innovations, which are driving increased utilization of medical services across the U.S. healthcare system.

The cost of Wal-Mart's profit-sharing and 401(k) program and paid time off grew faster than overall Associate growth, due largely to increasing Associate tenure. Over the past 4 years, the average Associate tenure has increased by 0.2 months per calendar year. As a result, more Associates qualify for participation in benefits programs like the profit sharing and 401(k) plan and for more paid time off. An even more important factor is wages, which increase in lock-step with tenure and directly drive the cost of many benefits (e.g., 401(k) is a percentage of wages). Given the impact of tenure on wages and benefits, the cost of an Associate with 7 years of tenure is almost 55 percent more than the cost of an Associate with 1 year of tenure, yet there is no difference in his or her productivity (Exhibit 2). Moreover, because we pay an Associate more in salary and benefits as his or her tenure increases, we are pricing that Associate out of the labor market, increasing the likelihood that he or she will stay with Wal-Mart.

We have also not effectively leveraged our benefits spend per Associate, which should be thought of as a fixed cost for employing that Associate. We have allowed our full-time Associates to average only 34 hours of work per week; increasing the hours worked per Associate would enable Wal-Mart to lower our labor cost per hour by spreading benefits costs over more hours. We also have one of the highest percentages of full-time Associates in the retail industry, even though full-time Associates are more expensive per labor hour (in terms of both benefits and wages).

ASSOCIATE SATISFACTION

Associates are satisfied with their overall benefits package, but they have expressed significant opposition to most traditional cost-control levers. For instance, Associates strongly oppose higher deductibles or limits to their choice of providers. Satisfaction varies significantly, however, by benefit and by segment of Associate, creating an opportunity to rebalance the benefits portfolio to improve satisfaction while reducing costs. In particular, the least healthy, least

productive Associates are more satisfied with their benefits than other segments and are interested in longer careers with Wal-Mart.

Overall, Associates are satisfied with their benefits relative to peers at other retailers. In a survey of retail workers, Associates ranked Wal-Mart's benefits above the industry average in availability, ability to qualify, quality, and execution (e.g., claims processing). The cost of healthcare coverage was the only factor on which we scored poorly.

Associate satisfaction and view of importance vary significantly by specific benefit (Exhibit 3). For example, Associates rank health insurance as the most important benefit Wal-Mart offers, but they also say it is the one with which they are least satisfied. The stock purchase plan, the profit sharing and 401(k) program, and life insurance are all ranked high-satisfaction, low-importance, suggesting an opportunity to rebalance Wal-Mart's investment in these benefits into other more important benefits. Paid time off and the discount card are the only high- satisfaction, high-importance benefits.

Associate satisfaction with benefits also varies significantly by segment of Associates. The team analyzed the Associate population on a wide variety of factors (e.g., attitude, health behavior, tenure), the most fruitful of which was annual healthcare spend. The so-called "low utilizers" are the most attractive Associate segment because they cost Wal-Mart less in terms of healthcare expenses and are more productive in their jobs. (Productivity findings were based on analysis of individual cashier items per hour data.) Moreover, this segment also showed healthier behaviors, specifically less prevalence of obesity. Unfortunately, the "low utilizers" were also least satisfied with our benefits and were planning shorter careers with Wal-Mart. This segment favors a different type of benefits package than do the "high utilizers," and different than what we offer today: health insurance more closely modeled on consumer-driven health plans – lower premiums, higher deductibles, and health savings accounts. They also prefer certain non-medical benefits, such as help in saving to purchase a home and help in paying for more education, neither of which do we offer in a robust way today.

It is worth noting, however, that overall benefits only play a small role in attracting Associates to Wal-Mart and in keeping Associates satisfied while at Wal-Mart. Our benefits offering played a key role in attracting just 3 percent of our Associates. Moreover, satisfaction with benefits does not correlate with satisfaction with Wal-Mart. A variety of factors – especially Associates' interactions with management – are more important.

PUBLIC REPUTATION

Healthcare is one of the most pressing reputation issues facing Wal-Mart. Survey work done last summer shows that people's perception of our wages and benefits is a key driver of Wal-Mart's overall reputation. Several groups are now mounting attacks against Wal-Mart focused on our healthcare offering. These increasingly well-organized and well-funded critics – especially the labor unions and related groups, such as Wal-Mart Watch – have selected healthcare as their main avenue of attack. Moreover, federal and state governments are increasingly concerned about healthcare costs, and many view Wal-Mart as part of the problem (a view due, in part, to the work of Wal-Mart's critics). Medicaid costs are a major priority on most governors' agendas; already a quarter of states are spending more than 25 percent of their budgets on Medicaid, and observers across the political spectrum assert that the current system – with spiraling costs, a large population of uninsured, and an increasing number of medical bankruptcies – is unsustainable (although there is little consensus on what should take its place). In this environment, we can expect efforts like those in Maryland (which is trying to mandate that companies spend a certain percentage of revenue on healthcare) and New Hampshire (which requires health services to track where Medicaid enrollees are employed) to accelerate. Proposals such as these, if successful, will bring added costs to Wal-Mart. Moreover, these battles with critics and governments are contributing to the decline of Wal-Mart's overall reputation.

Our healthcare offering is also vulnerable to attack. We have not effectively communicated the generosity of our healthcare benefits to the general public; instead, we have thus far allowed our critics to frame the debate. For instance, only 22 percent of Americans find it very believable that Wal-Mart provides health insurance to 900,000 people. Wal-Mart's critics can also easily exploit some aspects of our benefits offering to make their case; in other words, our critics are correct in some of their observations. Specifically, our coverage is expensive for low-income families, and Wal-Mart has a significant percentage of Associates and their children on public assistance. Consider the following:

- ¶ On average, Associates spend 8 percent of their income on healthcare (premiums plus deductibles plus out-of-pocket expenses) for themselves and their families, nearly twice the national average. The number varies significantly by plan type, rising to 13 percent for those on the Associate and Spouse plan. In 2004, 38 percent of enrolled Associates spent more than 16 percent of the average Wal-Mart income on healthcare.

-
- ¶ Critics contend that the costliness of Wal-Mart's healthcare coverage causes it to enroll fewer Associates in its health insurance plan than do most national employers (48 percent versus 68 percent) (Exhibit 4).
 - ¶ We also have a significant number of Associates and their children who receive health insurance through public-assistance programs. Five percent of our Associates are on Medicaid compared to an average for national employers of 4 percent. Twenty-seven percent of Associates' children are on such programs, compared to a national average of 22 percent (Exhibit 5). In total, 46 percent of Associates' children are either on Medicaid or are uninsured.

On both of these issues – affordability and public assistance – it is important to note that our offering and performance are on par with other retailers; Wal-Mart's critics, however, hold it to a “large company” standard, not a retailer standard. Despite the difference in industry economics, critics believe we should behave more like a GM or a Microsoft than a Target or a Sears. While critics have not yet harnessed all of these facts, they are successfully exploiting those they do have, suggesting that, when discovered, the others will also become effective ammunition.

2 Proposed Revisions to Benefits Strategy

Against the backdrop of these challenges, the team is recommending that Wal-Mart implement the nine limited-risk initiatives and five bold steps discussed in detail in this section.

LIMITED-RISK INITIATIVES

These nine initiatives require little or no trade-off between cost, Associate satisfaction, and public reputation. Exhibit 6 provides an overview of these initiatives:

- 1. Realign eligibility requirements for health insurance** so that Associates (full-time and part-time) and their children could qualify after, for example, a defined number of hours. This move would simplify external communications, make Wal-Mart even more competitive in the part-time labor market, and help align costs with the economics of the business (in that the benefit is based on hours worked). On average, for example, a 1000 hour requirement would translate into 6 months for full-time Associates (same as today) and 1 year for part-time Associates (versus 2 years today).
- 2. Decrease cross-subsidization of spouses** through higher premiums or other charges. Spouses are by far the most expensive plan members to cover, and Wal-Mart pays more per spouse than per Associate. This change would allow us to put more dollars towards Associates and their children.
- 3. Give Associates more information about how to use healthcare and health insurance.** Many Associates are making inefficient decisions about what healthcare services to use, e.g., relying too much on emergency rooms. We need to give Associates more information on the cost and quality of specific health services, better educate them on how best to utilize healthcare, and develop education efforts specifically for those Associates who have previously been uninsured or on public assistance.

-
- 4. Lower company-paid life insurance coverage levels** to a maximum payout of \$12,000. Life insurance, although a small cost, is the fastest-growing benefits cost. It is also a high-satisfaction, low-importance benefit, which suggests an opportunity to trim the offering without substantial impact on Associate satisfaction. The company-paid policy currently covers one times an Associate's annual salary, which is slightly more generous than most retailers.
 - 5. Capture savings from current initiatives to improve labor productivity.** These initiatives include reducing the number of labor hours per store, increasing the percentage of part-time Associates in stores, and increasing the number of hours per Associate. These changes represent a major cost-savings opportunity with relatively little impact on existing Associates. The most significant challenge here is that the shift to more part-time Associates will lower Wal-Mart's healthcare enrollment (even with the more generous part-time offering outlined above), which could have an impact on public reputation.
 - 6. Add a combination of best practice care-management programs,** including utilization management, case management, disease management, and errors and omissions programs. These programs primarily improve quality of care, but we believe they may also produce modest cost savings by improving care coordination and compliance for extremely sick Associates, who drive a disproportionate share of the cost.
 - 7. Further develop high-performance provider (e.g., doctors, hospitals) networks,** so as to direct Associates to the most efficient and effective healthcare providers. The quality of care and cost of care vary significantly among doctors. We should be on the cutting edge of efforts to identify the best doctors by, for instance, working with payors to find new ways to identify them. We should then create provider networks made up only of those doctors and provide Associates with incentives for using them.
 - 8. Offer Associates bundles of other benefits (e.g., paid time off, education, discount card) from which to choose.** Our benefits package today is "one size fits all," even though different segments of Associates value specific benefits differently. For instance, one segment would happily give up some paid time off in exchange for a more generous discount card. While we believe every Associate on a Wal-Mart plan should have a core healthcare and retirement offering, we

could more effectively spend our remaining benefits dollars by allowing Associates to choose from among several packages of benefits.

9. Continue to explore adding health clinics in stores. Wal-Mart is starting an effort to put clinics in stores, a strategy currently framed as a real-estate opportunity. Over the long term, and with several important modifications (e.g., innovations to create lower-cost visits), these clinics could become an important part of our healthcare strategy, especially as a substitute for emergency room visits.

Taken together these nine initiatives should reduce Wal-Mart's projected healthcare costs from a projected 2.3 percent of sales in 2011 to a projected 2.0 percent of sales, largely due to the impact of Initiative 5 on productivity. The initiatives should also slightly improve Associate satisfaction. They will not likely have any significant impact – positive or negative – on public reputation.

BOLD STEPS

The following five bold steps will be more difficult to execute than the limited-risk initiatives, but their impact will be much greater. Exhibit 7 provides an overview of these steps.

Move all Associates to “progressively designed” consumer-driven health plans to help control cost trends, while allowing Associates to build up Health Savings Accounts

While relatively new in the United States, consumer-driven health plans have been proven to control medical cost trends more effectively than traditional plans in both domestic (e.g., Logan Aluminum) and international (e.g., Singapore) settings. In the place of traditional plans with deductibles, Associates get a Health Savings Account (HSA) or a pretax bank account for health expenses that is similar to a 401(k). An HSA can be funded from three sources: annual seed money from Wal-Mart, an annual contribution from the Associate, and a matching contribution from Wal-Mart. The Associate uses the HSA to cover his or her first-dollar medical expenses every year. When an Associate has used up his or her HSA, there may be a “bridge” the Associate must cover, which would be the difference between the amount in the HSA and the point at which coinsurance takes over (typically a level equivalent to a traditional high deductible plan).

Consumer-driven health plans are more effective at controlling costs than traditional plans because enrollees have greater responsibility for their healthcare spending. HSA funds *belong* to the Associate, so he or she has a stake in using the money wisely. If the Associate leaves Wal-Mart, the HSA funds go with him or her. If HSA contains money at the end of the year, those funds roll over for use in the following year. The bridge which an Associate with high healthcare expenses may face would also serve as a further brake on spending. Consumer-driven health plans are particularly attractive to the healthy, productive Associate segment, because this segment now “gets something” for enrolling in health insurance and staying healthy – they can save money in their HSA.

The key to achieving these advantages is to have the vast majority of Associates participate in HSA plans or other plans that incent behavior modification and cost control. Otherwise only the healthiest enroll and there is very little cost reduction because healthy people spend so little on healthcare. During this year’s enrollment cycle, we are offering a few consumer-driven health plans, alongside many other options. These existing offerings can serve as an effective starting point for the transition.

Such plans would have several advantages for Associates. More than 80 percent of Associates would be better off financially under the proposed consumer-driven health plans than under traditional plans. Associates can also accumulate wealth in their HSAs. A typical Associate who is generally healthy would have \$600 to \$2,100 in savings after 3 years. Associates can use this wealth both for significant health events and retirement. Associates can also use their HSAs to cover a wide variety of health expenses, including vision, dental, preventive care, and other spending not covered by the plan.

To make this change palatable externally, the plan design must be “progressive,” meaning it cannot involve any cost shifting. In transitioning to consumer-driven health plans, many companies have chosen to push more costs onto employees, a move that has given these plans a bad reputation among progressives. The plans proposed by the team do not involve any cost shifting. Moreover, a growing number of companies are implementing such plans, providing Wal-Mart with more political cover. Many retailers (e.g., Staples, Toys R Us) are offering consumer-driven health plans as one option among many, and the ever-progressive Whole Foods recently moved all of its employees to such a plan, to much media fanfare.

The primary reason for making this transition would be to reduce future benefits costs, and those savings would be significant: \$400 million to \$700 million in FY2011, all from reduced trend. This change does, however, come with several

challenges. Overall consumer-driven health plans are less popular with Associates than traditional plans, albeit not dramatically so, and are more difficult to communicate. Strong opposition is isolated to approximately 10 percent of Associates. Wal-Mart will also face reputation challenges in implementing this change given that progressives view such plans as a “Republican answer.” Wal-Mart will have to be sophisticated and forceful in communicating this change internally and externally.

Restructure the retirement program (i.e., the profit sharing and 401(k) program) to reduce costs and help Associates better save for retirement

We should reduce our overall investment in the profit sharing and 401(k) program from approximately 4 percent of wages to approximately 3 percent of wages. Doing so would bring the program more in line with retail offerings and would save Wal-Mart a substantial sum of money. Hewitt ranks our retirement program as the best in its non-union hourly retail benchmark set. Given the scrutiny that Wal-Mart receives on healthcare and that retirement is a low-importance benefit for Associates, the retirement program seems to be the wrong place for overinvestment.

We should also redesign the specifics of our retirement program. In particular, we should convert the 401(k) program from a “no-strings-attached” flat contribution to a matching program in which Associates receive funds from Wal-Mart based on the contribution they make to their 401(k). Such a program would help Associates better prepare for retirement. A fully participating career Associate would be able to replace 30 to 40 percent of his or her income at retirement, compared to 15 percent today, resulting in some 80 to 90 percent of income replaced at retirement (when Social Security is included).

Overall this proposal would save Wal-Mart a significant amount of money: \$350 million to \$400 million in FY2011. With respect to Associate satisfaction, Associates reacted positively to a matching retirement program, although they slightly preferred the current program. Although critics will contend that the new program is less generous than the current one, retirement has not been a major issue in the external environment.

Redesign benefits and other aspects of the Associate experience, such as job design, to attract a healthier, more productive workforce

Given the significant savings from even a small improvement in the health of our Associate base, Wal-Mart should seek to attract a healthier workforce. The first recommendation in this section, moving all Associates to consumer-driven health plans, will help achieve this goal because these plans are more attractive to healthier Associates. The team is also considering additional initiatives to support this objective, including:

- ¶ Design all jobs to include some physical activity (e.g., all cashiers do some cart gathering);
- ¶ Offer savings via the Discount Card on healthy foods (e.g., fruits and vegetables);
- ¶ Offer benefits that appeal to healthy Associates (e.g., an education offering targeted at students).

A healthier workforce will lead to lower health insurance costs, lower absenteeism through fewer sick days, and higher productivity. It will be far easier to attract and retain a healthier workforce than it will be to change behavior in an existing one. These moves would also dissuade unhealthy people from coming to work at Wal-Mart. Even a modest shift in Wal-Mart's ability to attract and retain a healthier workforce could result in significant savings: \$220 million to \$670 million in FY2011. The key tasks in implementing this fourth bold step, once the team has developed a more complete list of actions, are to create a clear set of metrics to measure success, to run pilots in several stores to understand each idea's effectiveness, and then roll out the most successful ones.

Make a series of strategic investments in our healthcare offering so it can better withstand external scrutiny

The team is investigating several ideas to identify if there are targeted investments or plan modifications we could make that would yield significant reputational benefit. The following are a couple of ideas being explored:

- ¶ To address concerns about affordability, maintain commitment to offer an insurance plan that covers Associates for \$1/day (or \$14 per pay period) and allows them to cover their children for another \$1/day.
- ¶ To further address concerns about affordability, lower an Associate's maximum exposure to medical financial risk (premiums plus deductibles)

plus co-payments) to a more manageable level, potentially 15 percent of the average income for a full-time Associate.

- ¶ To address concerns about access, help Associates gain access to the private insurance market after 30 days of employment and potentially provide them with limited funding for doing so while they wait to become eligible for Wal-Mart's plan.

These changes would give us a powerful set of messages to use in combating critics. (For instance, "Wal-Mart offers Associates access to health insurance after they've worked with us for just 30 days.") These kinds of changes would also make Wal-Mart's coverage more affordable and accessible, directly addressing critics' and Associates' most persistent arguments.

While this fourth bold step should create goodwill both internally and externally, it will be expensive. In FY2011, the cost of these three proposals would be between \$300 million and \$350 million. Considering the steep cost, as well as the potential unintended implications on underlying plan design, the team is rigorously testing these ideas with the public and policymakers to determine whether these investments would effectively "move the needle" on Wal-Mart's public reputation.

Improve communication of our benefits offering so we get more credit for what we provide and, over the long term, work to shape the outcomes of state and national healthcare reform efforts

We need to be more proactive in the public arena. Three efforts are needed here:

- ¶ Address the Medicaid issue head-on by reframing the debate (e.g., this is everyone's problem, not just Wal-Mart's) and by offering some type of counterproposal or compromise. This first effort is critical because Wal-Mart is under serious attack from state governments with regard to the number of Associates on publicly funded health insurance. These attacks show no signs of abating – in fact, they seem to be accelerating – and elected officials are proposing increasingly costly solutions.
- ¶ Clarify and improve messages about our healthcare offering (building on the proposed changes outlined above) and engage in a sustained communication campaign. This kind of communication will help us reframe public perception of our healthcare offering, the only way for us

to start winning the debate with our critics. It will also help us build the credibility needed to weigh in more broadly on U.S. healthcare issues.

- ¶ Become more engaged in the national healthcare debate, to position Wal-Mart as a leader in healthcare in general and on access (e.g., individual mandates) and affordability (e.g., bringing IT to healthcare) in particular. Establishing Wal-Mart as a leader on this critical issue will help deflate our critics. It will also put us in a position to help shape the outcome of the public debate about the healthcare crisis in a way that is at least somewhat advantageous to our interests.

3 Impact of the Proposed Changes

Taken together the limited-risk initiatives and the bold steps create a powerful set of advantages for Wal-Mart.

SIGNIFICANT ADVANTAGES

The new strategy will enable us to deal with all three of the benefits-related challenges we face.

- ¶ **Cost control.** Benefits costs are modeled to be at or below 1.9 percent of sales (i.e., level as of FY 2005) in 2011. (The limited-risk initiatives result in a reduction in projected 2011 benefits costs of about 16 percent, and the bold steps yield another reduction of about 9 percent.)
- ¶ **Associate satisfaction.** Associates will have a more generous healthcare benefit with an HSA to cover first-dollar expenses, greater protection against medical risk, and the ability to accumulate wealth in their HSAs; a retirement benefit that helps them prepare more effectively for retirement, and more choice, especially with regard to selecting other benefits (e.g., paid time off). Moreover, we will be more effective at attracting and retaining the healthy, productive workforce Wal-Mart wants.
- ¶ **Public reputation.** By providing Associates more affordable health coverage and responding to concerns about Wal-Mart's Medicaid/S-CHIP enrollment, we will have addressed our critics' most potent arguments. We will also have stepped-up our efforts to communicate the strengths of Wal-Mart's benefits offering and counter critics' claims. Finally, we will have positioned Wal-Mart to have a "seat at the table" in the public debate about healthcare reform.

RISKS

The risks associated with these changes are worth carefully noting. Addressing them will require, among other things, attention to implementation planning, communication, and execution.

- ¶ **Cost risk.** If costs saving initiatives are not properly sequenced with those that require investments, costs could increase before they decrease.
- ¶ **Associate satisfaction risk.** Some of the proposed revisions to the benefits strategy (e.g., the move to consumer-driven health plans, the changes in the retirement program) have the potential to upset Associates, especially more tenured Associates.
- ¶ **Public reputation risk.** Healthcare enrollment will fall several percentage points due primarily to a shift to more part-time Associates, which could draw additional attacks from Wal-Mart's critics. Also, despite the proposed efforts, the Medicaid problem will not be "solved." A significant number of Associates and their children will still qualify for Medicaid. Because many of these programs will offer more generous health insurance than Wal-Mart provides, many Associates will still choose to enroll in Medicaid, leaving the door open for continued attacks.

The team believes that the advantages of the proposed strategy outweigh these risks.

* * *

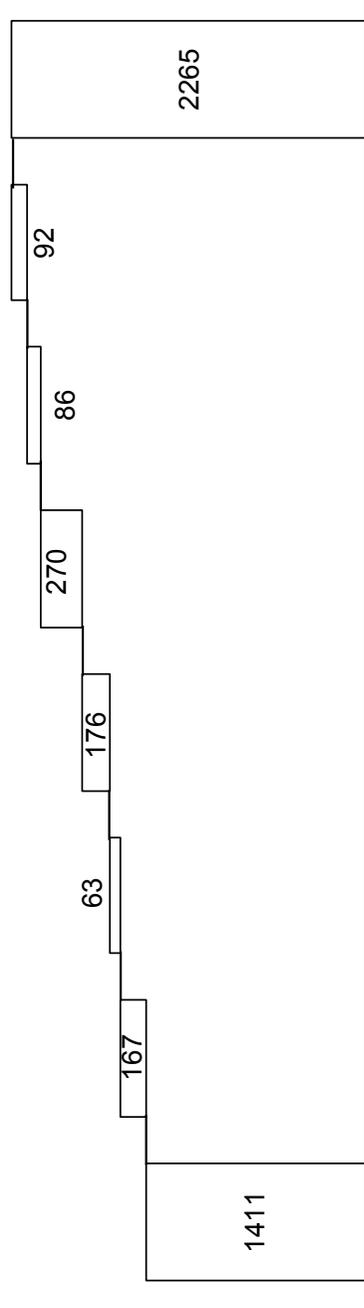
I appreciate your taking the time to engage so fully on this topic and look forward to discussions with you at the special Board meeting in November. In the meantime, I would welcome hearing your reactions to our work to date.

Supporting Exhibits: 7

EXHIBIT 1

Rising Healthcare Costs Driven Primarily by Utilization

\$ Millions



Category	Value (\$ Millions)	Notes
FY 2002*	1411	
More Associates	167	
More Dependents	63	
Unit cost increases	176	
National trends	270	Increased utilization
Aging faster	86	
Other factors*	92	
FY 2005*	2265	getting sicker faster and other factors

Historical growth rate (%)

Wal-Mart contribution \$ Millions

Wal-Mart contribution as a percent of sales

6.4 3.4 2.0 6.0 2.0 2.0

1,511

0.66

* Total plan costs – associate premiums plus Wal-Mart contribution
 Source: Wal-Mart Benefits Finance; Medstat; Milliman; U.S. Census

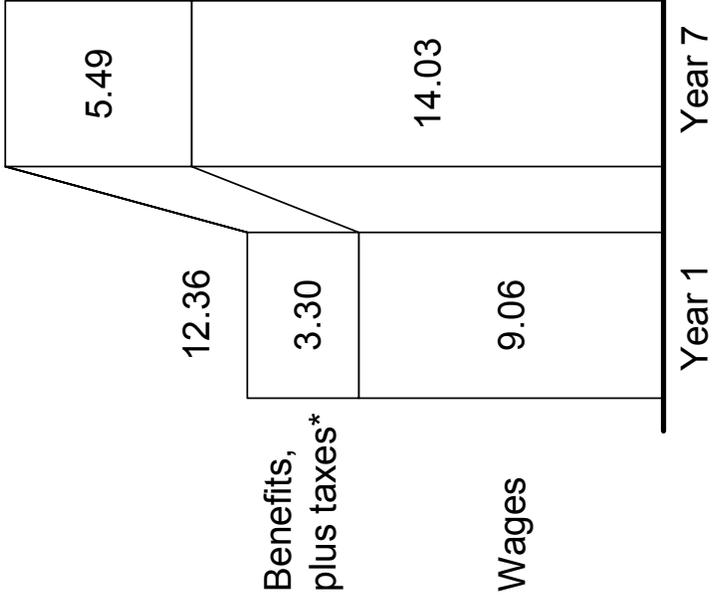
EXHIBIT 2

Costs Rise with Tenure but Productivity Does Not

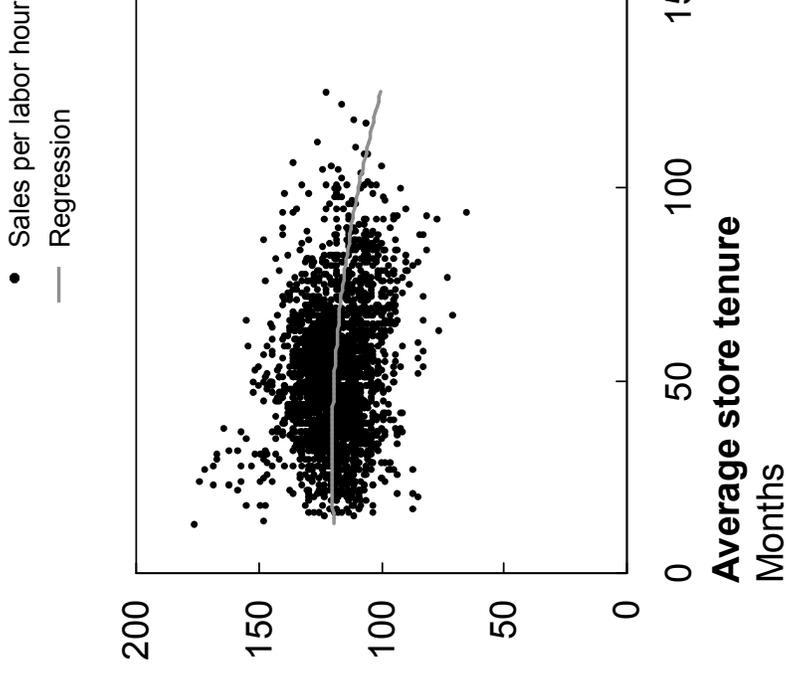
Associate cost per hour
Dollars

CAGR**
Percent

19.52
7.9



Sales per labor hour by store
Dollars



* Includes Medicare, FICA, Unemployment, Stock Purchase, Discount Card, Profit Sharing/401(k), Healthcare, and PTO; healthcare cost based on average age of 1-year and 7-year Associates

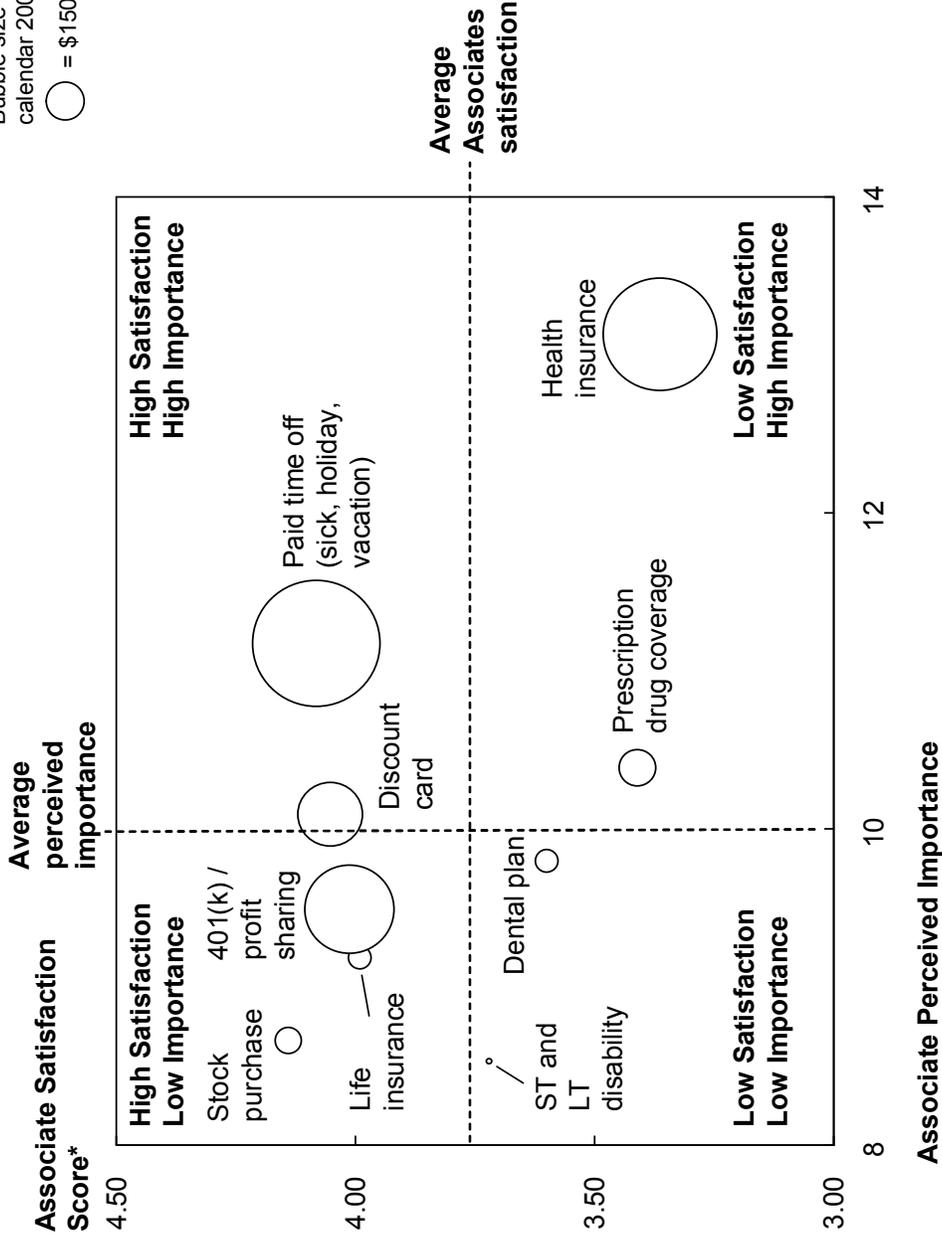
** Compounded annual growth rate

Source: FT / PT Economic Model; Store Database

EXHIBIT 3

Associate-Ranked Satisfaction and Importance Varies by Benefit

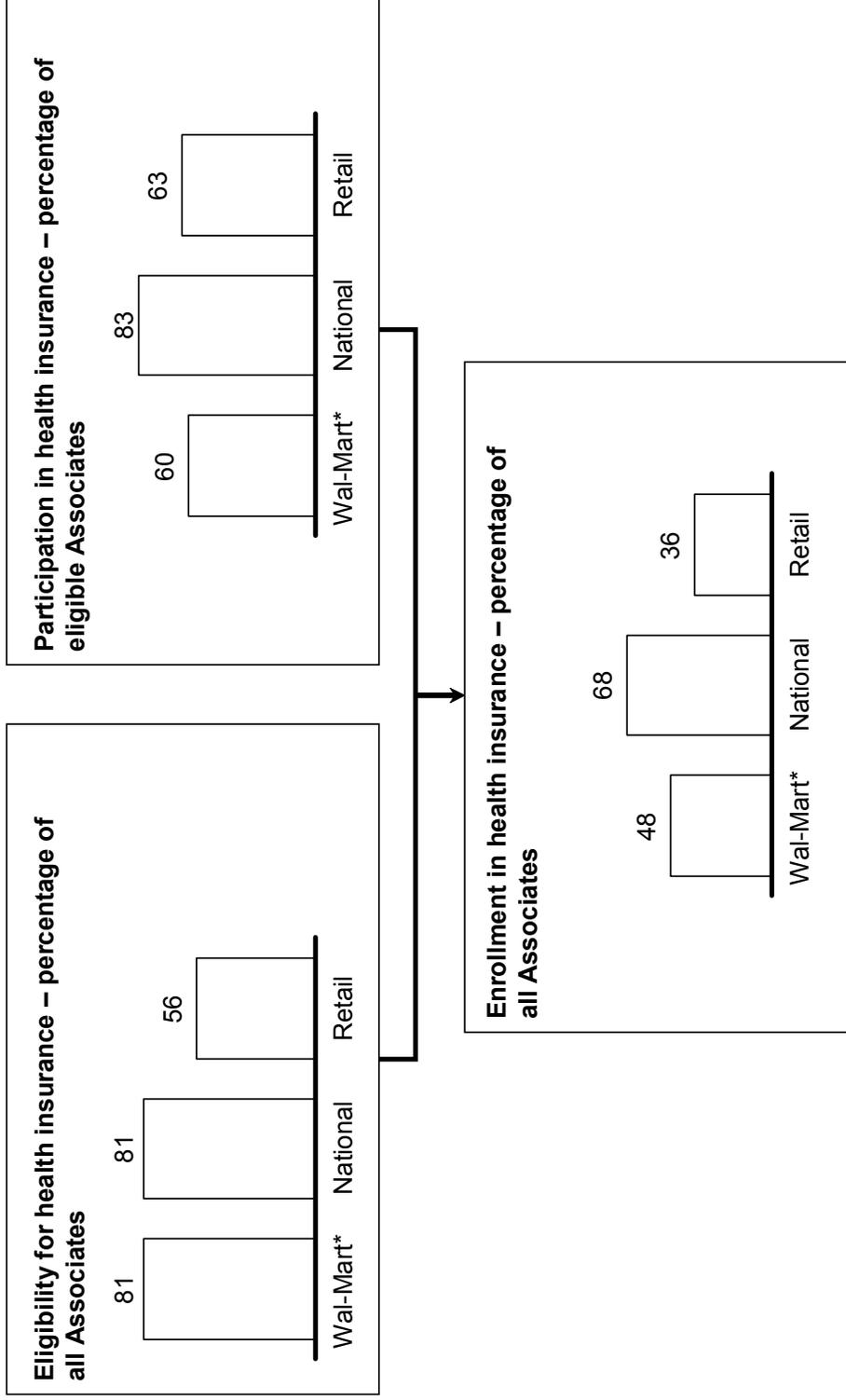
Bubble size represents calendar 2004 spend
 ○ = \$150 MM



* 5-point scale

Source: Associate Benefits Satisfaction and Preferences Survey, June 2005, n = 3,585; Benefits Finance; FACT

EXHIBIT 4
Wal-Mart Covers a Greater Percentage of Associates than Retailers but Less than National Employers



* Self-reported survey results
 Source: Yankelovich survey (2004); Kaiser/HRET Survey of Employer-Sponsored Health Benefits: 2003

EXHIBIT 5

Significant Portion of Associates and Their Children Are Uninsured or on Government Insurance

Associates/employees	Medicaid	Uninsured
Wal-Mart	5%	19%
National workers*	4%	18%
Retail	6%	18%

Children of Associates/employees	Medicaid/ S-CHIP	Uninsured
Wal-Mart	27%	19%
National workers*	22%	10%
Retail	36%	N/A

* Data is limited to those individuals (and their children) who are in the workforce
 Source: Associate Benefits Satisfaction and Preferences Survey (2005); Yankelovich survey (2004); 2003 Current Population Survey; Bureau of Labor Statistics; Consumer Population Report "Children With Health Insurance"; Employee Benefit Research Institute "Sources of Health Insurance and Characteristics of the Uninsured" (2004); Every Child by Two "Facts about Children's Health Insurance"

EXHIBIT 6

Limited-Risk Initiatives



Initiatives	Evaluation		
	Timing	Negative	Positive
1. Realign eligibility requirements for health insurance <ul style="list-style-type: none"> • All Associates* and children at 1,000 hours worked • Spouses* at 2,000 hours worked 	Short-term	(C)	(S) (R)
2. Decrease cross-subsidization of spouses	Short-term	(R) (C) (S)	
3. Give Associates more information about how to use healthcare and health insurance	Short-term	(C) (R) (S)	
4. Lower company-paid life insurance coverage levels	Short-term	(S) (R) (C)	
5. Capture savings from current initiatives to improve labor productivity	Medium-term	(R) (S)	(C)
6. Add a combination of best-practice care management programs	Medium-term	(C)	(S) (R)
7. Further develop high-performance provider networks	Medium-term	(S) (R) (C)	
8. Offer Associates bundles of other benefits (e.g., paid time off) from which to choose	Medium-term	(C) (R) (S)	
9. Continue to explore adding health clinics in stores	Long-term	(S) (C)	(R)

* Full-time and part-time

Note: Cost for Recommendation 1 takes into account workforce changes implied in initiative five

EXHIBIT 7

Bold Steps



Satisfaction evaluation

Step	Timing	Negative	Positive
1. Move all Associates to “progressively-designed” consumer-driven health plans to help control cost trends while allowing Associates to build up savings in Health Savings Accounts	Medium-term		
2. Restructure the profit sharing and 401(k) program to reduce costs and help Associates better save for retirement	Medium-term		
3. Redesign benefits and other aspects of the associate experience, such as job design, to attract a healthier, more productive workforce	Long-term		
4. Make some select strategic investments in Wal-Mart’s healthcare offering (e.g., lower maximum out-of-pocket expenses) so it can better withstand external scrutiny	Short to medium-term		
5. Improve communication of Wal-Mart’s benefits offering so the company gets more credit for what it provides and, over the long-term, work to shape state and national outcomes on healthcare	Medium-term		