FDI Tesco: Business Analysis

Introduction

Tesco is the United Kingdom's (UK) largest Supermarket holding the greatest market share. Tesco was originally founded by Jack Cohen back in 1919 selling groceries on market stalls. The name Tesco came to fruition in 1924. Tesco opened its first retail store in 1929 continuing to expand. Tesco became a private firm and floated on the stock market in 1947. Tesco diversified into other areas such as petrol, financial services, electronics and clothing. During the 1990's Tesco expanded into other countries.

Tesco recognised the UK was a saturated market and a way of continuing growth shareholders look for were expansion into international markets. Tesco had successfully entered many foreign markets.

America is the world's largest national economy and an article in the Guardian in 2006 put the worth of the USA grocery market at over $600bn (£345bn) with the forecast of growth at 40% in the next five years. Even though a saturated market with plenty of competitors including the world's number one retailer Walmart the size and potential would be attractive to Tesco

After extensive research Tesco announced in 2006 its intention to invest in the American market.

This report will reflect on textbooks, journals, sources researched analysing Tesco's Foreign Direct Investment (FDI) into the United States in 2006. The analysis will relate frameworks associated with each pillar of Dunning's paradigm along with data that has been gathered. It will critically consider the ethical dimensions of Tesco's FDI in relation to the United States of America before drawing conclusions.

Analysis

In 2006 Tesco announced its intention to enter the American market. The UK was a saturated market and did not offer the scale of growth that expanding into foreign markets did. Although a mature market the size and potential of the American market was attractive.

Dunning (2000) explains how the eclectic paradigm remains the dominant analytical framework to explain why a MNE such as Tesco would undertake foreign investment. It is primarily the interaction of three sets of interdependent variables also referred to as OLI, Ownership advantage, location advantage and internalisation.

Tesco need to have an ownership or Firm Specific Advantage (FSA). By investing in America Tesco are at an inherent disadvantage they are non-native so will have to deal with things such as different legislation, culture and limited knowledge of the habits of the local customers this can increase cost giving them a competitive disadvantage compared to companies from the host country. Ownership or competitive advantage comes from a firms resources being valuable, rare, costly to imitate and the firm organised to capture the value of the resources?

This is known as the VRIO framework (Barney, J. B. (1995)). The VRIO framework analyses internal resources and capabilities to identify if they are a sustained source of competitive advantage. This builds on the Resource based view (RBV) of Wernefelt Barney (1991). Appendix 1 shows a model explaining RBV.

Tesco have a large economy of scale in their size and market share. In 2006 the Guardian reported that Tesco had increased its market share to 31.1%, this was an all time high. As the UK's largest supermarket they have a monopolistic advantage. This large market share and economy of scale gives a strategic advantage such as strong bargaining power (through large sales volumes) and an ability to spread its overheads. It is valuable as it allows Tesco to exploit and have capacity to defend against threats and they are organised to capture that value which gives them a temporary competitive advantage. Tesco also had good financial performance and profitability. Their annual report and financial statements for 2005 showed all parameters on an upward trend (see financial tables in Appendix 2). This is also valuable as financially Tesco was in a strong position with capital (tangible asset) to make an investment and absorb any impacts from that investment. Tesco's previous experience and successes in both its domestic market and international market also gives it an intangible resource which can lead to competitive advantage.

Tesco have a strong culture and brand reputation, since 1995 they have used a loyalty scheme. So successful was the Clubcard scheme it is attributed as helping Tesco overtake its closest rival Sainsbury and becoming the UK's largest retailer. A report in the Guardian attributed the Clubcard as one of the most important retail innovations of the 20th century. Behind it was a powerful database the Dunnhumby database which provided Tesco with a level of detail on shoppers and their shopping habits that was unprecedented allowing them to predict and react to consumer trends. By 2006 Tesco owned an 84% share in Dunnhumby. The Clubcard and database behind it ticks all the attributes of the VRIO model Valuable as it enabled Tesco to have unprecedented levels of data and the ability to predict trends and target products, rare as although a loyalty card would be easy to imitate the database behind it would not be making it costly to imitate and Tesco had organised themselves by acquiring an 84% stake by 2006 in the database company behind the Clubcard thus giving Tesco a sustained competitive advantage in the UK. The use of the Clubcard has been a successful strategy for customer retention.

Another ownership advantage Tesco has is its technological systems (tangible resource). Tesco have invested in technology such as RFID (radio frequency identification) this along with techniques and systems e.g. point of sales data, primary distribution and continuous replenishment have allowed Tesco to achieve a more effective and efficient supply chain i.e. minimisation of waste with timely delivery of products. Tesco uses technology to offer products direct to customers, eliminating any third party this also keeps prices low. By investing and using technology to highly develop its supply chain this also acts as a barrier to new companies wanting to enter the sector. Technology is core to Tesco and its systems controlling stock, deliveries and analysing business transactions are invaluable. Looking at the VRIO attributes of this then it is valuable and although not rare significant capital would be required to imitate the IT systems of Tesco making it costly to imitate. Tesco are capturing the value from their investment in IT giving them temporary competitive advantage.

Porter's Diamond Model of National Advantage, Porter, M.E. (1990) gives a good summary of location advantages that Dunning refers to. The Diamond Model can be used to analyse potential entry into foreign markets or for making Foreign Direct Investment. Appendix 3

contains diagrams showing the model and the elements of it are discussed below.

Firm Strategy, Structure and Rivalry – Tesco are subject to intense domestic rivalry mainly from Sainsbury, ASDA and Morrison's but has also faced competition from ALDI and Lidl. Tesco has continued to innovate and improve to maintain their competitive edge. Some of these were discussed in more detail above (Clubcard, IT and improved Supply Chain efficiency). Tesco have a wide range of products to compete with their rivals. Tesco had a four part strategy (Tesco Financial report 2005), grow its core UK business, be as strong in non-food as in food and develop retailing services and become a successful international retailer. This strategy had been laid down in 1997 and was seen as the foundation of its success over recent years. Structure wise Tesco's different store formats have been designed to suit the varied shopping partners of its customers. This intense domestic rivalry has forced Tesco to find ways of keeping its competitive edge which means it is an advantage when entering the international market as it can apply these.

Factor Conditions - as discussed earlier Tesco have capital resources and have made technological advances. They have an established brand and product range. Tesco also have a diverse, skilled, modern workforce and have invested in training and customer service. Tesco have a sophisticated infrastructure which has yielded efficiency. The US Bureau of labour statistics showed in 2006, 15.4 million people employed in retail sector so there is a readily available workforce. America is a developed country so has infrastructure and transport and logistics networks. Although there are cultural differences there is no language barrier.

Demand Conditions – The size of the domestic market has been covered earlier. In Tesco satisfying its domestic market it has achieved number one status, its innovative Clubcard (also discussed earlier) allowed Tesco to respond to emerging trends and customer demands. In America the demand is currently met by Walmart and others. The size and forecasted growth of the American retail market are attractive.

Related and Supporting Industries – Tesco has a large number domestic suppliers that are also global suppliers (e.g. unilever). It also has globally competitive diversified businesses. As the retail market in America is large there is already a well established supply chain, entering the American market could also provide opportunity for Tesco's current suppliers who themselves may wish to expand.

Government policies can influence the components of the diamond model, for example in the UK, Tesco's store model addressed demands of planning policies giving them flexibility. America is seen as a stable political environment. Porter originally didn't write anything about chance or luck in his papers, but it is often included, an example that illustrates this which affected previous Investors W.H. Smith was the 2001 twin tower terror attack.

Tesco had carried out extensive market research. Prior to entry Tesco had sent 50 of its executives to live with families in the state of California. The extensive research identified a gap in the market for fresh food that was convenient and at a modest price and that the west coast of America was the state's most likely to take up the healthy eating route. Tesco had internal advantage with this as their freshly prepared convenience foods was successful in the UK and they have the infrastructure in place however, due to the distance involved and the concept was fresh food ready meals, Tesco could not simply expand their UK business they would have to replicate it. The current retailers in America were not offering a similar concept which is a FSA

Tesco could exploit.

Tesco had developed in the UK a structure of different store formats and their smaller store format had increased. The success of this format was underpinned in their 2005 financial summary “Over four million of our customers walk to their local Tesco as a result of the growth of Express. We converted 202 T&S stores during the year, bringing the total number of Express stores to 546”. Choosing a similar format of neighbourhood convenience stores was an area Tesco had good understanding and experience of success with. In addition it did not directly compete with Americas leading retailer Walmart.

Another ownership advantage Tesco has is its capital. Tesco planned to fund from its existing resources investment of initially £250 million a year into its expansion into America. The prediction was Tesco would break even in its second year. Tesco’s total commitment was £1.25 billion over 5 years.

Reviewing the data captured so far Tesco’s internalisation advantages gave good justification for them to undertake FDI. The advantages discussed above do not lead to a model for exporting, licensing or franchising. There are 3 main ways that investment could take which are a Greenfield Strategy, Acquisition Strategy or Joint Venture all have advantages and disadvantages. Most of Tesco’s international growth had come from investing in emerging markets by joint ventures or acquisitions. This method often provides immediate access not only to the market but to local knowledge on such things as culture; what are the shopping habits, what store formats work best, where best should stores be located. It also allows capitalisation of existing established relationships with suppliers and logistics as well as existing employees. Having access to this local knowledge had proves successful for Tesco they had experienced success with this format entering many markets one example being South Korea.

To enter America Tesco chose the Greenfield strategy and established Fresh and Easy which was an urban style supermarket. Advantages of this strategy are it gave Tesco full control and ownership over its operations. An article in the Financial Times (Nov 2006) detailed that Tesco were also taking two of its preferred suppliers to America, Natures Way Foods, which produces prepared salads and lettuce for Tesco, and 2 Sisters Food Group, one of Britain’s leading poultry processors. Both suppliers planned to open sites next to the distribution centre Tesco planned to open. Not only were Tesco planning to open stores but also looking to establish a distribution system as well and rely on their established relationships rather than form new ones. It would appear Tesco felt the quality of the meals it was to provide was going to be a key to its success. It is reasonable to say that Tesco were looking to duplicate its UK operations rather than look to localise them also as the concept of fresh ready meals was not one embraced by the American market then it was likely there was not ready established production centre that Tesco could have utilised.

Tesco opened its first Fresh and Easy store in 2007 in Southern California. The store focussed on fresh and chilled ready meals supplied by its integrated food preparation and distribution centre. The store was self checkout a concept embraced in the UK but not so familiar in the USA where good service is highly valued. A further 60 stores were opened in the first five months and by the end of the first year 150. It would not be unreasonable to say that in order to justify the investment in its distribution centre Tesco needed to open a lot of stores and needed to open stores in reasonable distance of its distribution centre.

A Harvard Business School Case by Sean Silverthorne 2010 including insight from John Quelch identified some mistakes. Many stores were on the wrong side of the road so were not as accessible by the target market i.e. those going home thinking about what to buy for dinner. The decoration and feel of the stores was not appealing. Fresh produce was pre-packed rather than loose. 50% of the products were private label so there were a reduced number of familiar American brands. California is a car culture so a large weekly shop was more the norm with convenience stores used for stock ups. It didn't embrace the coupon culture so loved by Americans. Despite all the research done by Tesco prior to its investment you can see that that value of local knowledge was missing it feels like they almost picked up their UK model and applied it in America without allowing for or recognising any cultural differences. What is surprising is that one of Tesco's most valuable tools that had given it a competitive edge in the UK its Clubcard was not introduced although a version was introduced eventually loyalty was going to be key to the success of Fresh and Easy. Further research showed that the US subsidiary of Dunnhuby who were behind the Clubcard was already working for an American competitor so when they did eventually launch one it was with another company.

It is well known that Tesco's venture into the American market failed one of the reasons given for it failing was the global financial crisis that hit in 2007 – 2008 you could consider this an example of the chance element often weaved into Porters diamond.

Further considerations of the ethical dimensions were improvement of a healthy lifestyle and being environmentally responsible. The concept was aimed at making healthy eating easier. It has to be said America is not known for its healthy eating ways it is more known for its love of fast food and fizzy drinks. The branding was green to emphasise its environmental credentials. Tesco's large distribution centre used solar power and the delivery vehicles were hybrid electric-diesel. Tesco had also invested in some stores with parking places reserved for shoppers with hybrid cars. It is hard to fault Tesco with this vision and if successful then real health benefits could be felt by the customers. Tesco was also doing its bit to reduce its carbon footprint.

The FDI opened up employment opportunities both in its stores and supply chain and benefit to the local labour market. In 2008 the Guardian ran an article that Fresh and Easy had run into trouble with the American Unions as it was treating its American workers worse than its UK workers. It claimed a refusal to recognise shopworker unions. Other claims included American workers not entitled to contracts, meaning they could be dismissed without warning, sick leave counted as holidays and poor pension and health benefits. It also referenced a job advertisement where one of the responsibilities was to maintain a non-union status. The UK unions supported the American Unions and it is hard to argue with their take that in the UK Tesco recognises unions as valuable partners so why should that stop at the borders. Tesco countered the claims made stating staff were happy with the terms and conditions. It is hard not to feel that there was short-sightedness over their engagement with the Unions. As well as being bad publicity they were missing good insight into local knowledge, something already highlighted in this report as lacking.

Conclusion

In 2006 Market conditions at home were favourable with Tesco having increased their share to the highest they had ever had. Couple this with the potential and growth of the American market and the gap in the market identified by their extensive research there was good justification for

Tesco to enter the American market.

Analysis showed that Tesco had both ownership and location advantages along with a sustained competitive advantage in the UK, these advantages were transferable on some level into the American market making Foreign Direct Investment a viable option for Tesco.

Tesco chose a Greenfield Strategy to make its foreign investment into America this was not the strategy usually deployed by Tesco when it made FDI. This strategy gave Tesco full control but it missed that vital ingredient of local knowledge. It would appear Tesco underestimated the value of local knowledge and applied its successful UK model into the USA without allowing for cultural differences. Tesco didn't capitalise quickly enough on a version of its Clubcard which had been instrumental in promoting loyalty and helping Tesco reach its UK number 1 position. A Joint Venture or acquisition would have potentially been a better strategy.

The timing of Tesco's investment was unfortunate it is hard to rule out the impact of the Global financial crisis but with a different FDI strategy they may have been able to better weather it.

Tesco's concept brought ethical advantages of a healthy lifestyle and its brand had an environmental positive to it. Its increasing of the labour market should have been a positive but its lack of engagement and recognition of the American Unions undermined this.