Entry of tesco

THE ENTRY OF TESCO

I. INTRODUCTION

In the world of the 21st century, the ongoing growth of phenomena of outsourcing, mergers, foreign direct investment, multinational enterprises and offshoring, among others has created a ‘ Global Economy’ of sorts. In such economic conditions, it would only be natural for a company to look to expand its market share by entering new international markets. The appropriate techniques used for international market entries have been a popular topic of discussion. Most companies have decided on their strategy depending on unique features of the country in question, namely government policies, profitability, market demand etc.

This report is essentially an analysis of the recent market entry of the leading British retailer Tesco plc into the United States of America in November 2007. Briefly discussing the history of the retail company, it outlines the key operational features of Tesco as a whole. An analysis of the main motives for Tesco to enter the US market is made, along with a brief study on the unique layout used by Tesco in the form of a newly labelled store, called ‘ Fresh & Easy’. The main functional strategies, including locational decisions, production decisions, and employment policies used by the company to tailor its features to the American culture and market are discussed. The chief factors of success and failure are evaluated; bringing out the cultural, social, political and psychological differences between the two developed countries, i. e. the United States of America and the United Kingdom. Based on these points of failure, basic learning outcomes and reasons for this failure are briefly considered; leading to final recommendations on how Tesco could have avoided the disappointments it faced on its market entry.

Through this report, an attempt is made to understand the underlying reasons for and outcomes of Tesco plc’s decision to enter the United States of America.

II. TESCO PLC – HISTORY AND BACKGROUND

The first Tesco retail store was opened in Burntwood, Edgware, North London by Jack Cohen in the year 1929. What followed was a phase of tremendous growth, with Tesco setting up the first modern food warehouse in the United Kingdom, acquiring a number of stores across the United Kingdom and through the 1950’s and 1960s, achieving annual sales of a whopping £1 billion in the 1970’s.

TABLE 1: Tesco’s Store Formats in the United Kingdom year ending 2009

FORMAT	NUMBER (Approx.)	AREA (SQUARE FEET)
Tesco Express	960	< 3000
Tesco Metro	170	

7000 – 15, 000

Tesco Superstore

450

20, 000 – 50, 000

Tesco Extra

175

> 60, 000

Tesco Homeplus

10

35, 000 – 50, 000

TOTAL

1765

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[Adapted from the Tesco plc corporate website]

Table 1 above displays the various retail formats utilized by Tesco in the United Kingdom, each one tailored to suit the needs of local customers. For instance, Tesco Express stores are neighbourhood convenience stores, set up with a view to offer customers quality and value in general food categories closer to their homes and places of work. On the other hand, Tesco Extra brings the widest line of food and non-food products to customers in the form of a large facility generally out of city limits. In keeping with current technological trends, it now operates a website to make online sales, called ‘ Tesco Direct’.

This success led Tesco to actively diversify and consequently pursue an internationalization strategy in order to capture larger markets.

STRENGTHS AND WEAKNESSES

STRENGTHS –

The primary strength of Tesco is its ability to customize its products and services according to varying local needs. Through careful analysis of its sales and loyalty card data, Tesco is able to tailor and offer products in keeping with the local tastes and preferences in various countries. Apart from this, the retail giant focuses on providing value for money. As per the SWOT Analysis report published in July 2009 by Datamonitor, Tesco has launched around 500 new products under its ‘ Discount Brands at Tesco’ initiative keeping in mind the recent global economic recession.

WEAKNESSES –

However, its excessive dependence on the UK market as a share of its total sales is seen as a weakness. This is seen from the Annual Report 2009, which states “ The UK grocery retail market remains our largest source of revenue, representing some 50% of last year’s £59. 4 billion of sales.”

OPPORTUNITIES –

THREATS –

DIVERSIFICATION STRATEGY

Tesco started off selling only food based product lines. From 1985, specialized food categories were introduced such as the ‘ Healthy Living’ line, which focuses on low fat products; the ‘ Free From’ line, which caters to consumers with sensitive allergies; and more recently, the ‘ Fairtrade’ line, which works to guarantee developing world farmers a reasonable income that covers the cost of production and a premium to be spent on community projects. Over time, other non food product lines have been introduced, such as electronics, sports, jewellery etc.

Tesco has also diversified to include services in its offerings. These include DVD rental services, broadband internet, mobile phone network services etc. In 2008, as a result of a complete buy-out of the Royal Bank of Scotland 50% stake in Tesco Personal Finance joint venture, Tesco set up ‘ Tesco Bank’, offering a comprehensive package of financial services including insurance, credit card facilities, children trust funds to name a few.

INTERNATIONALIZATION STRATEGY

As the retail company grew, Tesco made its first move into international boundaries by entering Hungary in 1995. This set the ball rolling, with entries into Poland, the Czech Republic and Slovakia in 1996 and into the Republic of Ireland in 1997. The year 1998 saw Tesco enter Asian markets with stores set up in Taiwan and Thailand, and later, South Korea. This trend carried forward into the new century, with entries into Malaysia, Japan, and China (Table2).

Today, Tesco conducts its operations across 14 countries with group sales totalling £59. 4 billion and 4332 stores worldwide. It is important to note that the retailer exited the Taiwanese market in 2005 through an asset exchange deal with Carrefour for outlets in the Czech Republic and Slovakia. The constant strategy we see used by Tesco is its focus on entering developing countries to capture relatively untapped markets rather than enter saturated retail markets in developed countries.

TABLE 2: Timeline of Tesco's International Expansion

YEAR	COUNTRY	STORE NUMBERS	STAFF NUMBERS
1995	Hungary	149	21356
1996	Poland	319	23569

Czech Republic

113

12677

Slovakia

70

8286

1997

Republic of Ireland

116

13764

1998

Taiwan

—

—

Thailand

571

38166

1999

South Korea

242

20626

2002

Malaysia

29

9872

2003

Turkey

96

7025

Japan

135

4007

2004

China

70

19452

2007

United States of America

115

2583

[Adapted from Tesco’s Annual Report 2009)

Tesco made its move to North America in 2007, entering the United States of America.

III. TESCO’S ENTRY INTO THE US MARKET

In 2006, Tesco announced its plans to enter the American retail market. After meticulous market research and detailed analyses, Tesco opened its first US store in Hemet, California in November 2007 as a store named ‘ Fresh & Easy’.

MOTIVATIONS TO ENTER

Departing from its strategy of expanding in developing countries, Tesco decided to enter the extremely developed North American continent. The main motive behind the US market entry is clearly the enormous size of the market and potential for increasing sales. In 2006, Tesco maintained that “ the US grocery market is worth $600bn a year and is expected to expand by 40% over the next five years”.

ENTRY STRATEGY

Unlike the previous approach of entering an international market through a partnership with a local player, Tesco decided to enter the US market without any guidance from a local counterpart.

After careful examination of its performance in other international markets, it was decided to drop the red, white and blue logo along with the Tesco name in favour of a new trading name ‘ Fresh & Easy’ with a green and white logo, essentially projected as a neighbourhood market. Tim Mason, chief executive of Fresh & Easy in the US said the new stores were designed to “ draw customers back to their local neighbourhoods by offering high-quality, fresh and nutritious food at affordable prices”.

First stores were planned to be concentrated along the west coast of the USA, considering the relative weakness of retail giant Walmart in this area. Moreover, Fresh & Easy was to be set up in the Express format, which varied from the out-of-town supercentre format used by Walmart. These stores cover smaller spaces of approximately 15, 000 square feet each owing to their neighbourhood orientation. This smaller format will also require lesser capital investment and consequently generate faster returns in relation to the initial investment made.

ADAPTATION AND CUSTOMIZATION

A number of features were introduced and changed in order to adapt Tesco to its American customer base. For starters, emphasis was made right from the beginning to focus its entry into the US market on environmental or issues. This was done with a view to gain leverage through the increasing environmental awareness among US consumers. Tesco pursued this strategy by positioning its stores as eco-friendly, with special importance given to transfat free foods. A clear, more obvious step taken is the introduction of the Fresh & Easy Brand with a specially designed green logo, displaying a green leaf and of course, emphasising the ‘ fresh’ nature of its products.

Fresh & Easy engaged in extensive product innovation to lure in the American customer. Over fifty per cent of the products stocked are own label, and the range extends from staples such as butter, sugar and tomato ketchup to ‘ wild blueberry muffin mix’ and ‘ udon noodle salad’ (Financial Times, 5 November 2007). Further, each Fresh & Easy store incorporates a kitchen table “ with a crew member offering food samples and menu suggestions”.

KEY OPERATIONAL/FUNCTIONAL ISSUES

The major functional decisions made by Tesco for its entry into the US market as Fresh & Easy include the following:

3. 1 Human Resource Issues – A vast majority of Fresh & Easy employees work on a part-time basis. These employees work for about 20 – 25 hours per week [Tesco’s employment practices in the USA, UNI Global Union Country Report, June 2009]. Each Fresh & Easy store hires about 25 store level employees. All these store level employees, except for the store managers and assistant managers, work part-time [Fresh & Easy Buzz, 2 October 2008].

3. 2 Early US Market Experience – It will not be wrong to say that Tesco entered the US market back in 2001. This was done through an acquisition of a 35% stake in the online retail market of American supermarket group

Safeway Inc. According to a Tesco spokesman, “ This is not just a dot. com deal; it gives us a foothold in the US”. [Tesco enters US market via internet, Guardian. com, 26 June 2001] Through this deal, Tesco acquired valuable experience of the US retail market with respect to prices, product ranges etc.

3. 3 Extensive Market Research – Tesco conducted widespread research of the US market to get specialized knowledge of consumer shopping habits and preferences. It conducted what is termed as an Acid Innovation Test, which stresses on the different cultural factors which drive forms to innovate and differentiate their products. For this purpose, an executive team was handpicked by Terry Leahy, CEO, Tesco. This team lived and worked on the West coast of USA for six months and interacted with US consumers of diverse backgrounds to find out their health preferences, food choices, dining lifestyles etc. This enabled them to design the appropriate store model tailored to suit American needs. [Joe Tidd, John Bessant, 2009]

3. 4 Integrated Production Facility – Tesco, set up its first food production facility in order to win over US consumers. Titled the Fresh & Easy Kitchen, Tesco built an 80, 000 square foot food production facility at its main distribution centre at Riverside county, Los Angeles. This was done with a view to provide US consumers with high quality food products. As Tim Mason said, “ The reason for doing it (self production) ourselves was that there was no one here that could do it to the same standards”. In addition to this benefit, Tesco enjoyed the advantage of a short supply chain, leading to reduced costs.

3. 5 Experimental Formats – Tesco tested various store layouts and operational formats discretely to reach the most suitable shopping format for its US customers. In addition to fake websites and amended names, Tesco organized ‘ dummy stores’ with its own specialized products to test the market and accordingly adapt its operations [Joe Tidd, John Bessant, 2009]

3. 6 Online Marketing – As a part of its marketing strategy, Tesco decided to take advantage of the exceedingly popular concept of online marketing in the USA by introducing a wide variety of online advertisements and ‘ virals’. In addition to this approach, Simon Uwins, Chief Marketing Officer, Fresh & Easy introduced an official blog in the run-up to its entry into America, starting May 2007. This has been a relatively successful strategy, drawing a number of comments and opinions from fellow bloggers, leading to increasing brand awareness and market knowledge.

3. 7 Locational Strategy – The key location strategy used by Tesco in the US was to open stores in the so called in relatively low income areas with lesser access to varied product ranges. This meant setting up stores in cities like Oakland, Hemet and other under-utilized areas. [Joe Tidd, John Bessant, 2009]

a. KEY SUCCESS AND FAILURE FACTORS

After meticulous research and only two years down the line, Fresh & Easy has received mixed reviews. The functional areas in which Tesco has been successful with its entry into the United States through Fresh & Easy are as follows:

i. Immediately following its entry into the US market, TNS, leading market research specialists projected Fresh & Easy to rank among the top 10 retailers in the United States of America by the year 2015. The retailer's key strength is its small size format, helping it to increase its sales per square foot, as compared to the super-size format norm in the country. Apart from this, TNS attributed its competitive power to its new line of prepared meals, tapping into the US customer preference for convenience.

ii. After its first six months of operation, Fresh & Easy scored the highest in the recommendation index in a brand evaluation conducted by Execution Research. After interviewing around 700 customers in nine different Fresh & Easy stores across California, Nevada and Arizona, 90% of the customers said they will ' highly recommend' the store to friends and family. According to Execution Research, " Fresh & Easy is the new cult retailer",…it " is already an incredible success story".

iii. In April 2008, Tesco claimed Fresh & Easy sales to be ahead of budget, exceeding $20 per square foot per week. At this point, fresh foods and its self produced products were particularly popular.

iv. A year down the line, Fresh & Easy has been able to learn from its mistakes and other feedback. With a few changes in its operational strategies, Simon Uwins, Chief Marketing Officer has helped Fresh & Easy sales go up by 30%. Modifications were made to the store interiors, along with new special promotions and other value offers. This flexibility can be attributed to the fact that Fresh & Easy is still very new in the US market.

v. Faced by considerable losses in the fiscal year of 2008, Fresh & Easy remains unfazed and plans to open twelve more stores in Central California as in November 2009. This decision has been made based on the positive response to its new product line of prepared meals introduced in March 2009.

In spite of these achievements, the feedback on its market entry has been more or less negative in nature. The fact remains that Tesco has, unfortunately, got more things wrong than right. In the first half of the year 2009, Fresh & Easy reported a loss of approximately £85 million [The First Post, 7 October 2009].

vi. Tesco was faced with the most common but important risk, that of a high degree of psychic distance. Psychic distance is defined as the sum of factors preventing the flow of information from and to the market [Jan Johanson, Jan-Erik Vahlne, 1977]. Factors such as cultural, political, legal and psychological differences between the customers in the United States and the United Kingdom has been the cause for many store features of Fresh & easy to not work in the USA. For instance, Americans found the portions offered by Fresh & Easy to be smaller than what they preferred [The First Post, 27 April 2009]. Also, Europeans are known to do their grocery shopping more frequently and in lesser quantities. On the other hand, Americans prefer buying in bulk. Another point is the American attitude towards self check-out points, which leans towards high levels of customer service rather than self service [Datamoniter, 2008]. These factors were ignored by Tesco, entering the US market.

vii. Another approach used by Fresh & Easy which wasn't very well received was the small size concept of convenience driven shopping. Fresh & Easy stores were introduced as shops covering smaller areas of approximately 10, 000 – 15, 000 square feet, as compared to the American norm of super sized stores. As a result, Fresh & Easy was unable to offer the kind of variety offered by other American supermarket competitiors.

viii. Fresh & Easy appeared to engage in contradicting product positioning. Tesco has been known for its policy of serving " all types of neighbourhoods" [Simon Uwins, Chief Marketing Officer, Fresh & Easy Quote Sheet]. However, Fresh & Easy has made it a point to keep prices on the lower scale to reach out to lower income areas of the country [Shepherd, 2007].

ix. The retailer has also been on the receiving end of a lot of criticism on its remuneration and anti-union attitudes from its employees. Primarily due to their part-time status, most employees are unable to clock sufficient number of hours at work. This, in addition to low wage levels, leaves them incapable of earning a decent livelihood. Fresh & Easy pays its employees starting $10 per hour in California and Nevada, and $9 per hour in Arizona. This rate, combined with low work shifts of approximately 20 hours a day, forces employees to take up second jobs to sustain themselves and their families. It has also expressed its refusal to be involved with the United Food and Commercial Workers' Union (UFCW), America's largest private-sector trades union [UNI Global Union Country Report, June 2009].

x. Unlike the Tesco Clubcard scheme used in the United Kingdom, no such loyalty points based scheme was introduced in the US arm of the retailer.

Moreover, Fresh & Easy did not have any tie-up with organizations to accept third party coupons, neither did it offer its own coupons [Datamonitor, May 2008]; thus discouraging lower income consumers from making regular purchases.

LEARNING OUTCOMES AND RECOMMENDATIONS

Looking at the big picture, it may appear that Tesco has drastically failed to successfully enter the United States. General statistics point out to the heavy losses incurred by Fresh & Easy. In my opinion, various factors need to be considered when evaluating Tesco's performance in the US market. There are several reasons why Tesco has found it difficult to make its mark in the American market.

* One must keep in mind the nature and structure of the American retail market when considering what some call Tesco's ' invasion that went wrong' [The First Post, 27 April 2009]. It is a well documented fact that the American retail market is a considerably saturated one [Brenda Sternquist, 1997]. This situation would without doubt make it hard for any foreign retailer to enter the US market. Entering its first mature market, Tesco would have had to work hard to earn its place in the market.

* With the USA marred by the sub-prime crisis in 2007 and the following economic recession, there couldn't have been a worse time for Tesco to dive into the US retail market. With a sharp increase in the loss of jobs and a consequent decrease in the consumer purchasing power, having a hard time maintaining its sales in the US would be only natural for the British retailer.

However, several strategic decisions regarding the entry could have been made differently to reduce the difficulty to enter the market, if not completely avoid it.

* First and foremost, being a popular and successful British retailer enjoying a good coprporate image, Tesco should have considered the possibility of retaining its own name in the USA and making changes in other features like the logo, colour scheme etc. This would have saved them the costs involved in increasing brand awareness.

* Looking at the decisions made by Tesco in the run-up to its market entry into the United States, it seems to me that market research clearly was not given sufficient importance. Introducing bigger stores covering larger areas similar to other top supermarket retailers in the country, rather than positioning itself as a small sized neighbourhood market would have helped Fresh & Easy increase its sales. Similarly, careful research would have alerted the company of the reluctant attitude of the American shopper towards self check-out counters.

* In my opinion, Fresh & Easy had a flawed marketing and promotional strategy. In a country where coupon shopping is a weekly affair, taking a stand of refusing third party coupons was a very careless move on Tesco’s part. Apart from making this change, introducing a point based loyalty scheme will encourage American customers to be brand loyal, thus guaranteeing a sizeable market share.

* Fresh & Easy has to come to terms with the fact that an organization’s man power is the key to its excellence. Tesco should take cue from its own

operations in the United Kingdom, and engage in healthy dialogue with labour unions and other organizations. In addition to this, full time work options must be given to employees to lift their morale.

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