



## One Europe or Several?

# The Emerging Industrial Architecture of the Wider Europe: the Co-evolution of Industrial and Political Structures



# **INTERNATIONAL EXPANSION AND BUYER-DRIVEN COMMODITY CHAIN: THE CASE OF TESCO\***

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## 1. Introduction

Following the collapse of Communism, central European countries have experienced an invasion of foreign investment in many sectors. The sectors that target consumers directly have found an opportunity to gain market share with considerable long-term profit potential. Thus, investments by western retailers are quite large when compared to other industries<sup>1</sup>. These multinationals have changed traditional shopping customs by introducing a western shopping culture through product variety and modern store formats. Of these, Tesco is the UK retailer with firm-specific advantages that it carries from the UK retail market to the central European markets. The saturation of the UK retail market led Britain's largest retailer in terms of market share and the world's biggest e-grocer to venture into foreign markets. It began with unsuccessful trials in Ireland (in the 1970s) and France, with rout these experiences led Tesco to look to the emerging markets for further growth while aiming to retain and consolidate its leading position in the UK. Particularly in Central Europe, the slow progress of privatisation has placed restrictions on the choice of location, since the city centres, potentially the most attractive places, are still owned by local governments who prefer to subsidise single-product stores through low rents (McKinsey Co. 2000). Tesco, therefore, took the approach of taking over local chains in Hungary and Poland, and a US chain of Kmart in the Czech Republic and Slovakia, as a mode of entry. After it gained experience in market of these economies through these acquisitions, it continued to expand through greenfield investments, i.e. the construction of new hypermarkets in suburbs, again as a result of local government policies followed in zoning in the cities (Beckmann 1999).

Tesco's operations in these countries demonstrate the market-seeking motives of the foreign investor's expansions. In driving for this goal, they have a strong influence on the production and distribution structures within these countries through their business strategies. Tesco is a good example of such a buyer-driven commodity chain. It is playing a significant role in the development of the Central European retail market. It expedites the introduction of IT systems used in the retail sector and helps to change attitudes through training programmes for staff in line with its customer service philosophy.

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<sup>1</sup> The number of European retailers in Poland is seventeen, dominated by Germany and France across a spectrum of superstores, supermarkets, hypermarkets and discounters. Eight are hypermarket operators, Carrefour, Metro, Aldi & Lidl, Auchan, Dohle, E.Leclerc, Casino & Promodes and Tesco (Ankers, G., E. Gerova, et al. 1999).

The 'own-brand' policy of Tesco also affects its relationships with its suppliers, who are expected to facilitate the involvement of local producers in the networks. The cultural habits of the people, for instance to drink a national beer or to buy locally produced items, forces Tesco and other retailers to set up supply chains with local suppliers. In addition, Tesco has sought to add its existing UK suppliers to its supply chains by encouraging them to open branches in these European countries.

This paper discusses how a multinational retailer can be successful in establishing itself in the emerging markets of central Europe by selectively exporting the strategies and first-mover advantages it holds/enjoys in its home market, and how host-country firms are influenced by its operations, particularly by the establishment of its (local) commodity chain. Also, the choice of entry mode and the choice of different strategies for different locations will also be examined. In essence, Tesco's move into Central Europe illustrates the role of network-based knowledge and communications technology in the buyer-driven commodity chain.

The paper is organised as follows. The next section examines the profile of Tesco UK; it looks at how it exploited first mover advantages in its home country, its performance, business philosophy and strategies, what makes it different and the role of information technologies in its business. The third section details the international expansion of Tesco, focusing on first its failures and then the evolution of expansion in Central Europe. The fourth section reviews the buyer-driven literature, regarding the relationships of Tesco with its suppliers and regarding its distribution system. The fifth part concludes the paper.

## **2. Profile of Tesco UK**

Eighty years ago, in 1919, Jack Cohen opened a market trader's stall in the impoverished East End of London, and became known for his cut-price approach to retailing. He managed to cope with adverse world economic conditions and subsequently with rapidly changing technology, increasingly sophisticated consumers and competition. In 1924, in partnership with, TE Stockwell, a tea company, Tesco was born and Cohen developed his Tesco shops (Tesco PLC 2000). Tesco has grown steadily since then. In recent times, major changes occurred under the

chairmanship of Lord (Ian) MacLaurin who was chairman of Tesco for 12 years from 1985 to 1997. His career spanned 38 years in Tesco, during which he played a critical role in the company's transition by introducing the Green Shield stamps in 1977, which became a widely popular loyalty scheme. From this time, Tesco was the retailer who continuously developed or introduced novelties in the retail market, picking up so-called 'first-mover advantages' (Lieberman and Montgomery 1988).

The penetration of European discount retailers into the UK market in the 1980s at first was problematic for Tesco, but it managed to circumvent this through the introduction of new policies such as its own-brand economy product range. Terry Leahy, who was the mastermind behind this new scheme, took over the chairmanship in 1997. 'If there is a difference between the two [CEOs] it must be that while MacLaurin was building an efficient and customer-focused retailer in the UK, the 41-year-old Leahy has ambitions to conquer the globe.' (Hollinger 1998). However, the company had two unsuccessful experiences in its first attempts at investments abroad, in Ireland and France. Today the growing business in Central Europe has made the company more confident about global expansion. As the IT director Ian O'Reilly said 'If we do not do it, then ultimately we will die' (Hollinger 1998).

## **2.1. First mover advantage**

Tesco is seen as the most innovative food retailer in the UK retail market, enjoying the advantages of a first mover but also striving to avoid the disadvantages that become advantages to followers (Lieberman and Montgomery 1988), such as retaining its trained staff. Its history is rich in innovative activities. It was one of the first food retailers to develop large supermarkets in the UK; it was the first to launch a cut-price policy which led to serious price wars; it was the first to introduce the card-based loyalty scheme, and was the first to add financial services to it; and finally it has become the first to launch electronic shopping in the mid-1990s. Through the effective use of information technologies, it was the first retailer to introduce a completely automated replenishment system, aimed at linking in suppliers, and use an advanced scanning programme (barcode reader) from Siemens Nixdorf, aimed at cutting cashier training by up to 60 percent while simultaneously detecting the available stock in the supermarkets. Tesco was

one of the first supermarkets to pursue a policy of organic food as opposed to GM food, for two reasons: response to consumer demand for organic food, and use of local sources, which are GM-free suppliers, wherever possible (Greenpeace 1999)<sup>2</sup>.

The three most important advances were the introduction of cut-price products under its own brand name in 1993, the introduction of a customer loyalty programme with the Tesco Clubcard which was followed by the rival UK chains like Sainsbury and Safeway, and lastly the introduction of internet shopping. Also noteworthy was the launch of its first credit card in 1997 through a joint venture with the Royal Bank of Scotland, which offers points towards its loyalty programme and so has supported the latter. Referring to all these innovations and efforts, IT director, Ian O'Reilly said that they wanted the advantages of being first mover, despite this helping the competition somewhat (Hollinger 1998). Until the follower retailers adapt these novelties to their markets, Tesco is able to exploit the advantages arising from their pre-emptive investments.

Terry Leahy, the current chief executive, but the then marketing director, was appointed to launch the own label range and the Tesco Clubcard loyalty scheme. His ambition to transform Tesco into a one-stop sort of shopping mall shapes the outlook of the company as a whole (Hollinger 1999). Though it would be inappropriate to assert that just one person was responsible for company enhancement, this case demonstrates the importance of an employment strategy (to be discussed below) and good management as determinants of corporate strategy.

## **2.2. Performance**

Tesco sees 'market share' as the key business driver and aims for life-time loyalty from its customers (ICL 2000). Tesco has improved its market share in the UK from 10.4% (1992) to

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<sup>2</sup> John Burry, the commercial director of Tesco in the Czech Republic, says his supermarket chain tries not to sell GM products, since they know from the UK studies that customers do not want GM products and such products must be suitably labelled (van Os, A. 1999). Tesco tested consumer demand by selling organic food at the same price as non-organic food (GM-food) in 1996 to analyse the choice of the consumer. Similar trials in Central European countries would prevent a reflection of UK customers' tendencies on the Central European customers and would give a clear idea about the attitudes of the Central European customers toward GM foods.

15.2% (1998) and has undergone considerable growth as a conspicuous result of being a pioneer in the UK consumer market. This is discernible in its turnover and profit (see Table 1).

Table 1. Group turnover and operating profit 1992-1998

Year	Turnover (£m) (exc.VAT)	Group operating profit (£m)	Market share
1992-1993	7,581	496	10.4%
1993-1994	8,600	521	10.7%
1994-1995	10,101	617	12.0%
1995-1996	12,094	724	13.7%
1996-1997	13,887	774	14.5%
1997-1998	16,452	817	15.2%
% change 1992-3 to 1997-8	+117%	+65%	+46%

Source: Tesco Annual Report 2000 and [www.bized.ac.uk/compfact/tesco/tescoindex.htm](http://www.bized.ac.uk/compfact/tesco/tescoindex.htm) 1996-2000.

The group as a whole had a turnover of £18.8bn in 2000, 9.5% higher than its 1999 turnover and its pre-tax profits were 8.4% higher at £955million in 2000 (see Tables 2 and 3). Tesco has a market capitalisation of £14.2bn. Some of the key financial ratios relating to the 1997-98 financial year show the burgeoning position of Tesco: return on capital employed of 18.4%; turnover per employee at £146,404; profit per employee at £8,660 and return on shareholder's fund at 21.4%. Its capital expenditure was £758m in 1997-98, and £841m in 1998-99, which went mainly on investments in the UK (£737m), and also Ireland (£63m) and Central Europe (£41m) ([www.bized.ac.uk](http://www.bized.ac.uk)). In 2000, the Group capital expenditure has risen to £1.488m, of which £313m was spent in Europe, £186m in Asia, and an extra £35m added to its home shopping policy, with plans to increase this figure to around £1.6bn in 2000 (Reuters 2000), (Tesco PLC 2000).

Table 2. Basic Financial Record (year ended February 28<sup>th</sup>)

	1996	1997	1998	1999	2000
Group Sales (inc.VAT)	13,028	14,984	17,477	18,546	20,358
Turnover (exc.VAT)	12,094	13,887	16,452	17,518	18,796
Pre-tax Profits (£m)	681	750	817	881	955
Capital expenditure	666	758	841	1,067	1,488
Operating cash flow	1,046	1,219	1,156	1,321	1,513
Earning per share (p)	7.30	7.83	8.70	9.37	10.18

Source: Tesco Annual Report 2000

Table 3: Sales growth and operating profit 1999-2000

	sales (inc.VAT) growth (%)	change in turnover (exc. VAT) (%)
UK	7.4	7.1
Rest of Europe	18.8	6.3
-Republic of Ireland	6.1 (in local currency)	n.a.
-Central Europe	76.8 (at constant exchange rate)	n.a.
Asia	192	50
Total	9.77	9.54

Source: Tesco Annual Report and financial statements 2000.

Every year Tesco opens new stores worldwide. In 1999, 39 stores added 2.5m sq.ft of new selling space of which 1.6m sq.ft. was international, and 3.8m sq.ft more are planned for 2000, of which 2.8m sq.ft (73.6%) will be overseas (Tesco PLC 31.03.2000). Already 30% of Tesco's selling space is outside the UK (see Table 4).



Table 4: Comparison between operations of Tesco in Republic of Ireland, Central Europe and in Asia, 1999; UK, 2000

country	number of stores	sales area (000sq ft)	new stores opened in 1999	planned openings in 2000
Hungary	39	980	4	6
Poland	34	690	3	6
Czech Rep.	10	980	2	2
Slovakia	8	620	2	3
CE Total	91	3,270	11 (1,3m sq ft)	17
Thailand	17	2,100	3	7 (34 by 2002)
South Korea	2	200	-	5 (50 hyper-markets in the next 5 years)
Taiwan	0	sites identified:3	first store to open in 2001	-
Rep.Ireland	75	1,600	-	2
UK	659	16,895	14	(38 opened in 2000)
Total	844	24,065	28	31

Source: Tesco Annual Report 1999, 2000.

As of January 24, 2000, Tesco had achieved strong sales growth, strong hypermarket growth internationally, and a tenfold increase in e-commerce (Tesco PLC 2000) (see Table 3, 5 and 6). The current company focus is on concentrating on non-food items by increasing its market share to 3% and doubling this over the next four years (Tesco PLC 2000). The main reason behind this policy in non-food business is the price-war in the UK retail market (Finch 1999), which squeezes performance margins, especially when compared to performance in foreign markets.

Table 5: Total number of hypermarkets of Tesco abroad

	Central Europe*	Asia**
1997	2	-
1998	-	14
1999	19	19
2000 forecast***	69	61

Source: Annual Report 1999, Tesco.

\* All the hypermarkets in CE were opened by Tesco.

\*\*The retailing chains in Asia have already had hypermarkets when Tesco acquired these chains. So, the new hypermarkets by Tesco are constructed in 2000.

\*\*\*The numbers means that 50 and 42 more hypermarkets will be opened in CE and in Asia respectively in 2000.

Table 6: Growth in grocery homeshopping customers

year	Number of customers
1998	12,000
1999	13,500
2000	370,000

Source: Tesco Annual Report, 2000.

### 2.3. Philosophy

Tesco's business philosophy is based on 'customer services', whose components can be depicted as a pyramid with a cumulative perspective from bottom to top (see Figure 1). The chief executive, Terry Leahy, who has been with Tesco since 1979, believes that "the biggest challenge for any business is to keep in touch with customers and be aware of how their needs are changing and be able to respond quickly to their changing needs." (Tesco, 2000).

Figure 1: Business Philosophy: Customer Services



Source: [www.bized.ac.uk/compact/tesco/tescoindex.htm](http://www.bized.ac.uk/compact/tesco/tescoindex.htm)

With this orientation to the customer, quality and value constitute the basis for customer services. The shopping environment and the staff are the elements for attracting customers. Customer assistants deal with the customer needs and demands at each store and the customer service centre is responsible for developing customer services policies. The staff constitutes an important part of Tesco's policies in terms of its training, motivation through rewards, welfare and safety. Basically, training to provide 'First Class Service' is given to everyone in the store from the store manager to the general assistants, through an intensive in-house training programme in order to provide outstanding customer services. This is primarily done by getting the staff to think, in a structured way, about the store from a customer's point of view and by encouraging positive attitudes towards customers all times. The long-term objective is to develop all their senior management from new people they take on, an objective at the heart of 'entrepreneurship' at Tesco. There are also "A" level and Degree level management entry programmes for staff. At any one time, there are 2000 trainees world-wide on Options Schemes for store staff, 500 on Select Schemes for Section Managers and 130 graduates on Excel Schemes to develop managers internationally (Tesco PLC 2000). Apart from certain positions, no specific requirements are demanded when recruited staff since the opportunities given to people who are enthusiastic enough to develop themselves are numerous. For these potential frontline managers, Tesco invests £15m a year (Tesco PLC 2000). For instance, the Hungarian Commercial Director of Tesco, Paul House, the CEO Terry Leahy and the former CEO, Lord MacLaurin are all examples of this progression. The trick is to prevent this advantage turning into a disadvantage as a result of follower retailers seeking to free ride on these valuable human resources and luring staff away. Tesco is successful at integrating people into its body, and sees management by the dynamism of young people as the key to becoming the most innovative company in the retail sector in the last decade.

In an interview Paul House declared that in 1999 the Hungarian management spent nearly 5% of their total wage bill on training, and a training centre will soon open in Budaors where Tesco's head office is located. Training is crucial for Central European stores, as they face the difficult task of finding senior managers as quickly as possible with the mushrooming of new stores and hypermarkets (Mohorovice 17.07.2000).

## **2.4. Business Strategies**

The key business strategy of Tesco is continually to increase value for customers and earn their lifelong loyalty, a strategy that is related to the staff, through appreciation of their contribution, and to the consumers by providing innovative services to meet their needs and wants.

Tesco's marketing strategy is based on price, quality and service competitiveness. Their ways of achieving these include policies concerning customer service, pricing, product promotions, product range, store design, store refurbishment and advertising on TV, and in the local and national press. These strategies along with the Tesco Clubcard, which has 10 million active members in the UK, help to preserve customer loyalty.

Tesco has expanded in Central Europe and Asia, with priority being given to the former. The current total number of employees of Tesco is 163,401 of which 104,930 are full-time. At the end of 1997, Tesco was employing 1900 staff in Hungary, 1400 in Poland, and 5000 in the Czech Republic and Slovakia, accounting for 5.07% of its total employees. Employee numbers are constantly increasing as a result of the opening of new hypermarkets, which are expected to create 12,000 new job opportunities outside the UK. For instance in 1999 Tesco had 5500 staff working in Hungary, an increase of 3600 in just two years.

## **2.5. What differentiates Tesco?**

Tesco is a company with two main distinguishing features; it is Britain's biggest retailer in terms of market share, (15.2% in 1998); and it is the world's biggest e-grocer with annual sales of £125million and estimated to be worth £4bn by analysts. It believes and rightly so that it has established supremacy in the UK with 659 stores, carrying all types of food and non-food consumer goods, and with 10 million customers with loyalty cards. Of its UK stores, only 100 accept online sales, and Tesco Direct service<sup>3</sup> has 300,000 registered customers and £2.5m of sales per week in 2000. Tesco plans to triple the number of stores that offer online shopping and to expand its non-food-related e-commerce business. This will allow Tesco to create 7000 new

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<sup>3</sup> Tesco Direct service is the service (including delivery) to the customers who use home internet shopping.

jobs (Broersma 2000). Tesco claims that its success in online shopping derives from its store-picking approach<sup>4</sup>; Asda fills its online orders from central warehouses. However, the chief executive, Terry Leahy, does not rule out investing in stand-alone warehouses to serve online customers in the future: “It’s going to be a building block when we get whole supply chain onto the Internet” (Reuters 2000).

The store formats, designed initially for the UK market, give Tesco the flexibility to respond to customers wherever they live or work. Tesco stores are classified into different groups: superstores, compact superstores, supermarkets, Tesco Metro, Tesco Express<sup>5</sup> (see Table 7). With the experience of seeing foreign retailers’ hypermarkets failing in the UK market, Tesco introduced its hypermarkets in the home market as ‘Tesco Extra’ stores. This was a considerably risky enterprise. O’Reilly, the IT director of Tesco, says ‘It is in all parts of Tesco to take measured risk. Pace, risk, progress. Those are all things that epitomise Tesco’. Nevertheless, there is a visible difference between the store formats in the UK and those abroad, which will be examined below.

Table 7: UK store profile

<i>Store format</i>	<i>number</i>
Extras	9
Superstores	277
Compact superstor	81
Metro stores	41
Express stores	27
Other supermarket	224
<b>Total</b>	<b>659</b>

Source: Tesco Annual Report, 2000.

<sup>4</sup> This means that Tesco does not have depots devoted to online shopping; rather the delivery system has been set up based on picking the goods from those stores that do offer online shopping.

<sup>5</sup> Superstores are where customers are able to purchase almost everything they need under one roof, whereas Compact (Neighbourhood) Superstores are scattered around the suburbs of larger cities and on the outskirts of small towns/villages with the range of 25,000 food items. Supermarkets are mainly located in the shopping centres of towns and cities, where Tesco Metro is a city centre supermarket format which has been trading since 1992 and involves modern, stylish and up-market stores. Tesco Express are petrol service stations including a small supermarket, with the aim of supplying customers in the local community with the convenience of purchasing top-quality Tesco food items at times convenient to themselves, while also providing inexpensive fuels (Ankers, G., E. Gerova, et al. 1999).

## 2.6. The Use of IT in Tesco Stores

Tesco boasts the largest Internet supermarket in the world. It has become the number one in the retail sector by being a proactive and innovative organisation with a very positive attitude towards leading-edge information technology (ICL 2000). It co-operates with other companies to improve its home shopping service and the technologies used in the stores, as well as to use the Internet for sales co-operation purposes. Tesco chooses technology providers that offer the most flexible systems in order to gear up to the rapidly changing IT world.

Recently (Corporation 09.05.2000) Tesco established a strategic partnership with Autonomy Corporation PLC by purchasing Autonomy's technology to power its online shopping service through 'personal shopping assistants' on the Web. This technology will make online retailing completely automatic, and do away with the need for a team in the back room<sup>6</sup>.

Tesco has co-operated with companies that help to circumvent the hard tasks of its business area and to operate much more efficiently in customer services thereby benefiting from the effective use of IT. Reference Point is one of such company, from whom Tesco adopted in spring 1998 a specially adapted version of Reference Point's 'Easi-Quest', which is software for creating, entering and analysing questionnaires. After conducting such in-house consumer research for ten years, it has been shown that these questionnaires allow broad trends among the customers to be identified and assessment of the potential of new products to be made (Reference Point 2000). Tesco also intends to put computer terminals in its stores, to allow shoppers who do not have access to the internet can shop online. This policy appears to be a way of introducing customers to internet shopping, i.e. it can be seen as an investment for the future by changing the habits of customers (Finch 1999). Also, point-of-sale software systems (barcode systems) have been in Tesco stores since 1995 with a multi-site purpose ([www.pos.co.il/customers.htm](http://www.pos.co.il/customers.htm)).

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<sup>6</sup> The CEO of Autonomy, Dr. Mike Lynch, said that using their technology Tesco can automate the entire online shopping experience, enhancing personalisation, and turning one-time visitors into regular users. Another partner of Tesco in internet shopping is Grattan, a mail order company, to selling household goods on the internet. The e-commerce operation with Amazon.com and WH Smith to offer one million book titles was realized at the end of 1999.

As new hypermarkets are launched, Tesco needs a settled financial system to conduct the high number of transactions involved and to support the growth of its business. So this end Tesco has developed a common 'European' Core Financial System<sup>7</sup> to replace the existing, different but less sophisticated, financial systems in Hungary, Poland, Czech Republic and Slovakia. This more integrated financial system that is being operated in the four countries with only slight modifications to comply with statutory requirements will allow Tesco to have more accurate and better quality reporting, more accurate asset management and more controlled and centralized purchasing (Andersen Consulting 2000).

This combination of supply chain and customer relationship management systems facilitates the emergence of new alliances. The search for more flexible systems of production and distribution creates a demand for information technologies. It was stressed in an FT survey on supply chain management (Ody 25 Oct 2000) that the pace and configuration of logistics are just about to change. The cross-docking<sup>8</sup> system, which was an innovation in supply chain management a few years ago has now almost become out of date with the penetration of 'last hour assembly of the product' at one point, whereby staff, packaging and components all converge for the product to be assembled, just before distribution. Such a process will be handled through fourth party logistics providers, a virtual service provision concerned with directing the necessary network traffic for last hour assembly who will thus become service facilitators. This means that the third party logistics providers, who cover sub-contracting warehouses and distribution services, will become functionless because of the extensive use of IT.

### **3. International expansion policy**

A Tesco retail sector analyst says that "The strategy is vintage Tesco; by showing a high degree of flexibility, the company can carve out a competitive edge in terms of size, location and the range of goods on offer." Also Terry Leahy admits that, despite their business in France being

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<sup>7</sup> 'European' indicates the operations of Tesco in these four central European countries, to have unanimity in their financial records.

<sup>8</sup> Cross-docking is a system where goods arrive on one set of lorries to be immediately resorted and reloaded on to another with no need for any warehousing in between (Ody, P. 25 Oct 2000).

less successful in terms of profit, the group has learned an enormous amount about trading in different markets and benchmarking different competitors (Hollinger 1998). The central challenge for Tesco is to carry on with its original Tesco formula, which has proved to be a winner in the UK and to balance it with enough regional touches to appeal to local communities. This latter point is important if Tesco is to avoid unsuccessful foreign ventures, such as have been experienced by UK retailers in the US market and by Tesco itself in France (Murphy 1999).

### **3.1. Learning by failing**

In June 1993, Tesco bought seven hypermarkets and 95 supermarkets for £150m from the French food retailer, Cateau and with the exception of Tesco Vin Plus Store sold them to Promodes SA in February 1998 for £250m. There were several significant reasons for Tesco's divestiture from its French stores. Tesco tried to apply the same strategies, i.e. the 'Tesco formula', that it pursued in the UK, to France, but it came up against the protectionist policies of the French government<sup>9</sup> against the intense competition that might be created by large foreign retailers (The Nation 2 August 2000). It was unable to increase its market share due to the restrictions on out-of-town store expansions, which prevented it from opening as many stores as it wanted and establishing discount stores to apply its price-cutting policies. Also inability to adapt its own-brand products to local tastes ended up with a loss of market share. Steve Woolf, a retail analyst, criticizes the attitude of British retailers to think that 'what works in the UK will work abroad', maintaining that retailing is a very localised concept that requires sensitivity to local tastes and habits (Murphy 1999). Reduced profits and smaller increase (1%) in sales compared to 1996 (Benady 1997), even after over £300m of further investment, were the reasons that Tesco put forward for its disposal of the French chain (Tesco News Centre August 2000; Tesco PLC 2000).

Through this bitter and costly experience and learning from the experiences of other failed UK retailers in overseas markets, Tesco has learned to keep its formula abroad but with some modifications appropriate to the new environment in terms of cultural differences. These requirements have been virtually satisfied by hiring for foreign stores, supplemented by staff

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<sup>9</sup> Namely the 1995 law 'Loi Raffarin', which effectively froze the opening of new large retail formats (McKinsey Co. 2000).



from the UK with experience of working for Tesco and the ability to transfer the knowledge about how Tesco functions (Murphy 1999). New positions were created in these overseas stores with the appointment of experienced personnel from the UK to bear the main responsibility than the local managers had. In 1997, two trading directors of Tesco chains, John Burry and Reg Curtis, were sent as commercial directors of Tesco, to the Czech Republic and Slovakia and to Hungary respectively, to be responsible for merchandising, buying and marketing. Another new position was created that of trading supply director (Benady 1997).

These newly-created positions are described by Tesco as “all-encompassing roles”, since they were created to pursue Tesco’s investments in its European operations and prepare for a major expansion in Central Europe. The holders of these executive positions are of crucial importance to Tesco, as their interpretations of these markets, and how welcoming these markets would be to Tesco will determine its investments in the region (Benady 1997). This strategy was devised to avoid a repetition of the experience in France.

### **3.2. Expansion to unsaturated retail markets**

In the mid-1990s, Tesco accelerated its European expansion through opening of commercial operations in Central Europe; in Hungary in 1994, Poland in 1995, Czech Republic and Slovakia in 1996. These will be examined in detail below. Apart from this Central European expansion, other phases of Tesco’s expansion included Ireland and several Asian countries (see Table 8). Tesco initially acquired the Quinnsworth and Crazy Prices chains, which accounted for 75 stores in Ireland and Northern Ireland in 1997, for £640m. Since their acquisition, the stores that have been rebranded have shown a cumulative sales growth of 20% with a market share of 23.3% (Tesco PLC 2000). Tesco next invested in Thailand and South Korea, and is presently researching the potential of Taiwan and Malaysia. Tesco, like other retailers, has not been slow to exploit the enormous potential for Western retail brands in the Asian retailing market, mirroring the situation as in the UK market 40 years earlier according to Steve Woolf, retail analyst. In May 1998, Tesco acquired a 75% stake in Thailand’s 13-strong Lotus hypermarket chain with pledges to double the number of stores by 2002, and in April 1999 it established a joint venture with Samsung to run two of its Homeplus hypermaket chain in Korea (Murphy

1999). Tesco entered the Thai market just after the collapse in asset values of the Asian crisis, by acquiring a majority stakes holding in the cash-strapped company, CP, the biggest retail chain in Thailand (Business in Thailand Magazine June 1998). Thus, it can be inferred that Tesco exploited a worsening or transitioning economic situations very successfully and have had no more failures in the overseas markets it has entered. It was too late to enter the highly profitable Chinese market after a search of the possibilities for investment in China, with its 1.4bn people. The licences were all seized by foreign retailers. Tesco was also considering investing in Latvia at the beginning of 1998 by opening a hypermarket, but this did not materialise (Benady 1997)<sup>10</sup>.

Table 8: Performance of Tesco in the UK, Rest of Europe (Republic of Ireland and Central Europe) and Asia, 1999-2000.

	2000					1999				
	Sales inc. VAT (£m)	Turnover exc. VAT (£m)	Profit (£m)	Assets (£m)	Operating margin (%)	Sales inc. VAT (£m)	Turnover exc. VAT (£m)	Profit (£m)	Assets (£m)	Operating margin (%)
UK	18,331	16,958	993	5,685	5.9	17,070	15,835	919	5,392	5.8
Rest of Europe	1,527	1,374	51	771	3.7	1,285	1,167	48	522	4.1
Asia	497	464	-1	374	-0.2	170	156	-2	151	-1.3
Total	20,358	18,796	1,043			18,546	17,158	965		

Source: Tesco Annual Report, 2000.

Initially, the penetration into Central European retail markets was considered to be experiment, since the territory was unknown and many adaptations to the region were necessary. Such problems were costly compared for instance to entry into the French market. The establishment of the new executive positions with their long experience and expertise has encouraged further investments in the region.

The Central European markets are still far from saturated when compared to the UK retail sector, and Tesco has benefited from this by having a strong presence in these countries during the transition. There are foreign retailers who preceded Tesco, but for the time being there is room for every company to reap profits as demand for better stores and wider choice increases.

<sup>10</sup> The latest attempt by Tesco is to acquire Real, Germany's biggest hypermarket chain, although this is denied by Tesco. It is said that this is a £3bn bid for Real, that has been interpreted as a very high sum by Goldman Sachs (Hume, N. 2000).

Tesco has continued to open new hypermarkets in these Central European countries (see Table 5). The reason for the opening of new hypermarkets in Central Europe but not in Asia is twofold. First hypermarkets already exist in Asia, and Tesco acquired hypermarket chains in Asia rather than relatively small food stores of Central Europe. Second the newly emerging middle class in Central Europe relishes the opportunity to shop at a hypermarket.

Tesco has the confidence to continue its ambitious overseas expansion based on the increases in its pre-tax profits (in 1999 by 7.8% to £881m) and the fact that food retailing in the UK offers few opportunities for growth (i.e. the market is saturated) (Murphy 1999). One of Tesco's advantages over other UK retailers lies in its choice of locations for expansion, i.e. non-saturated markets that allow market share to be gained relatively easily, Tesco learned a lot from its experience in the French market. For instance, its UK rival, Sainsbury chose to expand in the very competitive US market. Nevertheless, Tesco has to compete with other robust European retailers, if not with its UK counterparts. As a result of its expansion policy, in mid-2000 30% of Tesco's selling space is overseas and it is planned that this will increase to 36% by the end of 2000 as the number of hypermarkets increases almost geometrically, with the target of 200 hypermarkets by the end of 2004 (see Table 5). At present, it appears that Tesco is successfully going ahead (see Table 9).

Table 9: Central European sales performance, 1997-1998

	Existing stores sales growth (in local currency), %	Total stores sales growth (in local currency), %	Sales (£m)
Hungary	23.9	80.5	78
Poland	41.2	99.4	34
Czech Rep.	6.4	6.4	96
Slovakia	13.9	13.9	80
Total			288

Source: Tesco Annual Report, 1998.

The mode of entry Tesco chooses to enter to these unsaturated markets is summarised together with its actual presence in Table 10.

Table 10: Subsidiary undertakings in food retail business

Country	Name of the retail chain	share of equity capital (2000)	mode of entry*
Hungary	Global TH	99%	majority acquisition (at first 51.3%, then 57%)
Poland	Tesco Polska Sp.z.o.o.	98%	majority acquisition (at first 79%)
Czech Rep.	Tesco C c R a.s.	100%	complete acquisition
Slovakia	Tesco SR a.s.	100%	complete acquisition
Rep. Ireland	Tesco Ireland Limited	100%	complete acquisition
Thailand	Ek-Chai Distribution system Co.Ltd.	93%	majority acquisition (at first 75%)
S.Korea	Samsung Tesco Co.Ltd.	81%	majority acquisition

\*These are the first entry modes chosen by Tesco. They are followed by greenfield investments of hypermarkets. Only in Poland, after the first acquisition of Savia chain, two other local chains were acquired.

Source: Tesco Annual Report and financial statements, 2000.

### 3.3. Chosen First to Expand: Hungary

In 1994 Tesco bought a 57% stake for £15million in the supermarket chain Global, which owns 41 stores in Western Hungary (Gyor, Sopron and Szombathely), these subsequently become known as Tesco-Global Rt., with Tesco's share rising to 99% in 2000. Tesco had an annual turnover of £40.3m (HUF 8bn)<sup>11</sup> in 1995 with a 15-16% share of the Hungarian supermarket trade. In 1998, it raised its share to over 30-40% in western Hungary (Vegh 1998). According to the weekly magazine Figyelo, in June 1997, Tesco had 50 stores in Hungary with a gross turnover of £47.4m (HUF14.5bn). In 2000, Tesco-Global Rt. is expected to make a profit for the first time since 1994, after an investment of £340.6m (HUF100bn)<sup>12</sup>, as a result of the 58.5% increase in sales from £229.3m (HUF88bn) in 1999 to £363.5m (HUF150bn) in 2000<sup>13</sup>. In 1999 alone, Tesco invested £104.3m (HUF 40bn) in the expansion of its hypermarket chain. This may be related to its frustration, at its slowness in entering the Hungarian market where they did not establish hypermarkets until 1996 (Mohorovice 17.07.2000). However, the Commercial Director Paul House thinks the Hungarian market is not yet saturated. This gave windows of opportunity within the Hungarian retail market for Tesco to continue with its greenfield investments via a plan to open five new hypermarkets a year which will result in twenty-five hypermarkets by the

<sup>11</sup> The conversions between exchange rates are based on statistics in IMF International Financial Statistics. A conversion between the period averages of the local currency per US dollar and period average of US dollar per pound has been made in order to find the local currency per pound. The latter finding is used in the conversions unless otherwise stated.

<sup>12</sup> Average values for the 1994-2000(Jan) period has been used.

<sup>13</sup> January 2000 exchange rates have been used, unless otherwise stated.

end of the year of 2002. Based on this belief of there being room for growth, Tesco-Global Rt. opened the two largest Tesco's in Europe soon in East and West Budapest (Mohorovice 17.07.2000) - one of 8500sqmt and the other of over 11,000sqmt (Tesco News Centre August 2000). The hypermarkets which were opened in 1999 are located in the east and northeast of Hungary: the first opened in Nyiregyhaza in June 1999, followed by others in Miskolc (northeast Hungary) in July, in Debrecen (east Hungary) in September, and lately in Pecs. An additional 5-7 hypermarkets are due to open in 2000. In September 2000, one new hypermarket was opened in Veszprem, worth £9.7m (HUF 4bn). The company has announced that the planned investments in northeast Hungary in 1999 amounted to £36.5m (HUF14bn) (Hungarian American Lists 1999). These investments have helped to enhance the economy of the region, which suffers from significant unemployment problems, by creating 1600 jobs. Tesco now employs a total of 8000 people altogether in Hungary (Press 2000).

In May 2000, Tesco-Global Rt. declared that it had increased its registered capital by £16.5bn to £72.1bn to fund its ongoing investments (AM 19.06.2000). The company has doubled its revenues each year since it entered the market and aims to continue to do so. In order to strengthen its position and become Hungary's biggest hypermarket chain operator, Tesco changed its holding structure (Press 2000). The managing director for Hungary, Miklos Walatsyan, points out that Tesco plans to become one of the top three supermarket chains in Hungary within ten years (Bank&Tosзде 1996), with an escalating number of new hypermarkets each occupying a floor space of 10,500sqmt and employing 450 employees, and by extending its credit card application to Hungarian customers, as in the UK, in order to develop financial services to its customers.

### **3.4. Benefiting from underdeveloped retail market: Poland**

In 1999 Poland attracted more than \$2.2bn of foreign investment in retail and wholesale trade, with a further \$2.8bn of planned investment due to the country's huge potential. Professor Marian Struzycki, director of the Institute of Domestic Market and Consumption, predicts that the share of hypermarkets in food sales will continue to rise at least to 2005 and that, ultimately, large retail chains will account for 45-50% of Poland's total food sales. The mid-1990s

witnessed growth in retail sales: in 1996 the volume of sales was 4.5% more than in 1995. It was at about this time that Tesco invested in Savia, a Polish retail chain.

In 1996 the number of retail outlets decreased by about 20,000 due to the closure of small shops (50 sq m). At the same time 187 new large stores with a floor area of more than 400 square meters were opened. The number of customers per outlet in Poland in 1996 was 95, far fewer than the 330 in France and 500 in Hungary ([www.paiz.gov.pl](http://www.paiz.gov.pl)). The fragmented and fast-growing structure of the Polish retailing market is the main attraction to foreign investors eager to exploit profitable opportunities. In addition, the liberalisation policies, the political framework and government incentives play a role (Pearce 1999). The share of foreign firms participating foreign capital in the turnover of the 50 largest retailers accounted for 40%, and the share of firms that are fully or partly owned by foreign trading enterprises amounted to 28% in 1997 (Works 1997). FDI has a huge presence in the Polish retail sector. The new chains, of which one is Tesco, bring lower prices, diversity and better quality (Pearce 1999).

Tesco chose Poland in preference to the Czech Republic to invest in, following a feasibility study by the European Privatization and Investment Corporation, who pronounced in favour of Poland's strong and fast growing economy and its underdeveloped retail market (Merchandise 1996).

In November 1995, Tesco bought 79% of the Savia supermarket chain of Bielsko-Biala, which owns 36 stores in southern Poland, for £8million<sup>14</sup>. This acquisition gave Tesco shops in Bielsko-Biala and in the Walbrzych and Legnica provinces. Tesco immediately sold off 5 of the small, less profitable stores of Savia and committed itself to refurbishment of 31 stores (Smyk 1998). By 1997, Tesco had invested US\$33.4m and was planning to make new investments, such as establishing a hypermarket in Bielsko-Biala. At the end of the first year the turnover of Tesco-Savia<sup>15</sup> was £33.8m (PLN 91m) and it ranked 19<sup>th</sup> position in the 50 largest retail companies in

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<sup>14</sup> The acquisition of Savia was pursued in secrecy so that even the previous owner, Bank Slaski, which held 69% of stakes, had not known that Tesco was behind the bid, otherwise it would raise the price, which means that the Savia chain was such a lucrative one.

<sup>15</sup> Tesco keeps the name/brand of the local chains together with its own name/brand, like Tesco-Savia in Poland and Tesco-Kmart in Czech Republic and Slovakia. However, except Hungarian Global chain, Tesco does not use these names in the original corporate names in these countries.

Poland in 1996 (Works 1997). Its next acquisition was Madek and Minor, two local small chains, in 1997. In 2000 Tesco owns 98% of the Tesco-Savia Group, and opened its 5th hypermarket in Warsaw in April 2000.

Following these acquisitions, Tesco introduced its own systems and supply chains to improve on Savia's £200,000 pre-tax profits for 1994. Savia was consolidated into the Tesco Group, and as a means of making a quick recovery Tesco made cash injections into the Savia chain. Tesco-Savia attributes the increase in sales and profitability after acquisition, to the speedy refurbishment of existing stores along with increased product lines, lower prices and the greatly improved customer services (Smyk 1998).

The strong presence of large foreign retailers has helped to nurture some of the large Polish companies, who were losing customers daily and struggling to pay their suppliers. The Polish company, MarcPol, which was very successful at the beginning of the transition, is a good example of such companies (Smyk 1998). Some retailing groups responded to the foreign competition by bringing together networks of smaller stores into co-operative purchasing organizations. One example of this strategy is the Robert supermarket chain. Despite the fact that Polish rivals have better knowledge about their customers and often occupy the best sites in the shopping centres, foreign firms compensate for their disadvantages through easier adaptation to competition and their modern retail business environment, and hence are able to operate on a profitable basis (Pearce 1999). Domestic retailers lack the necessary capital and expertise to develop modern retailing networks.

In addition, these foreign retail multinationals have exploited local customers' priorities much better through their customer services and price-cutting policies, and facilities such as credit cards, etc. Research by GfK Polonia shows the order of these priorities as being low prices (58%), proximity (54%) and friendly service (47%) (Jelonkiewicz 2.2.1999).

### **3.5. Fragmented retail market structure: Czech Republic and Slovakia**

In March 1996, Tesco bought 13 department stores in the Czech Republic and Slovakia for £79m from the US retailer K-Mart, who had been running them since they were privatised. K-Mart had bought them for \$110m in 1992 and had invested approximately \$50m in rebuilding and renovating these former state-run stores. It had established its European flagship in Prague in 1993 by taking over the 11,000sqmt department store which was formerly called Maj. K-Mart later sold its stores to focus on its core operations in the US and North America. Tesco paid \$118m for these stores, which were large and well-managed, were in prime sites with a high customer count, and the purchase was consistent with Tesco's expansion strategy. Tesco's spokesman, Kevin Charles said that it recognised the potential to expand the grocery part which accounted for 30% of these stores at the time of purchase, and they hoped to make improvements by renegotiating supply contracts and centralising operations (Merchandise 1996).

Nevertheless, the stores that were purchased from K-Mart required a design, planning and layout strategy for all multi-floor sites, together with a visual merchandising and display policy. £1.1m was spent on refurbishment and executed in co-operation with a Czech team. A Marketing Director was appointed to establish a marketing team (Retail Projects 2000).

In 1997, Tesco had a majority interest in six large department stores and four hypermarkets in the Czech Republic and seven in Slovakia, and was the largest foreign retailer in the Czech and Slovak Republics, with some \$150m in sales. The stores in the Czech Republic and Slovakia also had synergies with and benefited from other operations in Poland and Hungary (Merchandise 1996).

In the Czech Republic, the development of retail networks has been accelerated. After the collapse of communism did it make a rapid comeback by being the first industry to be privatised. However, the retail sector is highly fragmented as in Poland. In 1997, the top 50 operators in the Czech Republic accounted for only about 20 percent of the market; the top five controlled only about 7.5 percent of the market. The 50 leading Western European retailers account for as much as 90% of the Czech retail market (Hruby 1997), foreign retailers having a lot more experience and much better purchasing conditions than their Czech counterparts. The Ministry of Trade and



Industry attempted to ‘intensify competition’ among retailers but this strategy was criticised as this limiting the growth of chains. The proposals of the Ministry, presented in June 1997 to the Cabinet, were in favour of small Czech companies, although they did not single out foreign chains for regulation. The objectives of these proposals covered expediting the development of a Czech wholesale distribution network, providing financing opportunities to small retailers, and removing the legal obstacles to the establishment of consumer co-operatives (Sturm 1997). However, as will be discussed below in the case of Tesco, foreign retailers like those in the US tend to use just-in-time distribution systems at home, rather than wholesale. The long-term objective is to achieve this delivery system by improvement to its local supply chain, since to date Tesco has stored the commodities it buys from the local suppliers.

In 1997 the Tesco-Kmart group, with a turnover of \$172m, was among the top five foreign retailers in the Czech Republic, the others being Euronova of Holland, Plus Discount of Germany, Delvita of Belgium and Julius Meinl of Austria. The investments of these foreign firms has increased in recent years and they have promoted new trends in retail development in the Czech Republic, especially in shopping centres (Sturm 1997). Tesco opened the Czech Republic’s largest hypermarket – 10,000 square meters – in Prague on 29 October 1998. A second hypermarket opened in Brno on Nov 19, 1998. Tesco’s advantages over the other hypermarkets, besides low prices were supposedly the customer services policy of the marketing manager of the Tesco hypermarket in Zlicin, Petr Varmuza (Orol 1998).

The first hypermarket in Slovakia opened in Nitra on 11 June 1999. The second was in Kosice, eastern Slovakia which opened in August 1999, in whose construction Tesco invested \$11.6m. The Chief Executive of Tesco Stores in the Czech and Slovak Republics, Mike Mellor said, “Tesco is the largest retail company (by sales and employees) in Slovakia.” Tesco started to offer its own-brand products in stores and hypermarkets in Slovakia, where some of them are produced locally, e.g. milk, soft drinks and flour (Embassy 1999).

Tesco Czech Republic posted sales in 1999 of £178.8m (Kc10bn), an increase of 89%. Tesco opened its fifth store, in Plzen in July 2000 (AM 14.07.2000), and plans to open six new hypermarkets in the Czech Republic and Slovakia in 2000 and a further seven in 2001 (AM

12.04.2000). In 1999, Tesco invested \$414.7million (£256m) in total in Slovakia, the Czech Republic, Hungary and Poland (Pravda 26/1/1999), far more than had been planned in 1997 for the subsequent three years (Voice 1997).

### **3.6. Gains of Central Europe**

The philosophy that Tesco UK applied to its management was applied Tesco stores in Central Europe, i.e. a strong focus on customer needs and wants. Tesco follows a strategically different policy on cumulative learning from their experience in every one of its stores, which results in applying customer feedback from its most recently opened store as the starting point for its newest stores, in order to get closer to what customers want (Mohorovice 17.07.2000).

Therefore, in addition to its own-label products, Tesco has introduced Tesco 'Value' to Central European markets, guaranteed low prices on basic products plus quality across a wide range of product lines (Tesco PLC 2000). This policy underwrites its promise of reasonable prices. The challenge for all foreign retailers, including Tesco, is to inculcate Western standards of shopping in Central Europe. In this, Tesco is offering Central Europe the benefit of its experience in running retail outlets in the UK.

Because its Central European stores require improvements to their IT infrastructure Tesco has introduced an advanced technological infrastructure compatible with point-of-sale, stock control, financial and office systems in central European stores in order to achieve identical performance with the UK. To this end, Tesco is collaborating with Lucent Technologies whose Czech subsidiary, Techniserv, installed the cabling system for all the Central European Tesco stores to enable Tesco to adopt new IT systems without concerns about communication bandwidth. Again the flexibility and capacity of the system enables the adaptation to changing needs in Tesco stores (Lucent Technologies 1999).

However, the infrastructure for the use of e-commerce in business-to-business applications has still not been well developed in central Europe<sup>16</sup>, which is a disadvantage when trying to

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<sup>16</sup> A pilot Electronic Data Interexchange (EDI) system initiated by Procter and Gamble and Julius Meinl (Austrian retail chain) was built up in 1996. Since then, with the efforts of the Hungarian service providers, EANCOM and MATAV, more than 100 companies operating in different sectors including retail sector have joined the EDI Forum initiated by the Hungarian Efficient

establish a primacy for Internet shopping in Central Europe. Tesco has expanded its online services to the Scotland in March 1998. It plans to start online sales in Asia as it expands in Asian markets, which offer greater growth potential than at home. In South Korea in particular, 50% of households own a PC and 78% own a mobile phone. Deputy chairman of Tesco, David Reid said that Tesco could start selling food and financial services on the Internet in European and Asian markets as early as 2001. Tesco still has to decide where it can choose to launch services without huge investment (AM 31.03.2000). Financially Tesco has a strong background thanks to its home market share, which supports its risk-taking, trial-and-error strategies in outward investments. Nevertheless, as the Central European markets are small and not ready for extensive use of e-commerce, it intends to minimise the probability of less successful online business in this region to avoid losses. Despite the dominance of foreign retailers in Central European countries, only a few local (Czech) entrepreneurs, such as Z-Market and Az do domu, have taken the risk of starting to use the Internet to prop up their business. These firms say that they are building their customer base through advertisements, escalating the number of customers in order to be profitable. Their only consolation is the possibility of exploiting the persisting deficiency of the relationship of Tesco with its local customers (Poston 1998).

### **3.7. Cultural Influences to Retailing in Central Europe**

Retail chains, anchored by hypermarkets, drive Central European consumers towards Western-style shopping centres. Nevertheless Central Europeans are keen to have national products on offer to reflect their national identity. In the Czech Republic, it is suicide for retailers not to offer Czech products. Thus this is imperative that foreign retailers establish good and long-term relationships with local producers, and also puts pressure on them to get better price deals similar to what they get from their own-brand producers. Local food processors transmit this pressure to farmers. In the Czech Republic, government officials proposed the adoption of legislation to regulate trade relations between chain retailers and suppliers. Marketing consultants, on the other hand, believe there is no unfair price pressure on domestic suppliers. On the contrary, it pushes the domestic supplier to exploit market techniques, such as making products to be sold under

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Consumer Response. Tesco-Global is one of the firms joining this forum (Uni Commerce 11.04.2000) with the introduction of online shopping to the Central Europe in mind.

supermarkets' own labels, or developing their brands and looking for opportunities to specialize, climbing the ladder through industrial upgrading (Business Central Europe Magazine May 2000). Local suppliers might also try to take the advantage of large customers.

Recently, some of the traditional Hungarian brands have started to gain market share, giving the impression that old Hungarian companies, have overcome their previous backward situations.<sup>17</sup> However, these are not a sign of improved position of home-grown companies. Rather it is that these Hungarian brands have been marketed by the Western companies for most of the last decade. The renewed vigour of the old brands is due both to Western marketing techniques and capital, and to the loyalty of the Hungarian consumers old brands. The low purchase price from local production facilities together with the purchase of the local brand compares favourably with imports and advertising exports the local nostalgia for traditional brands. The commercial director of Tesco in Hungary, Paul House, pointed out that the Hungarian companies that really seem to be on the way back are not food retailers (Economist Intelligence Unit 27.06.2000).

#### **4. Buyer-driven Commodity Chain**

Tesco's operations are a good example of a buyer-driven commodity chain with regard to governance structure, described in the literature of 'global commodity chain' by Gereffi (1994). Gereffi and Korzeniewicz (1994) define a global commodity chain as "sets of interorganizational networks clustered around one commodity or product, linking households, enterprises, and states to one another within the world economy"<sup>18</sup>. Porter (1998) emphasizes this point in his value chain approach, which shows similarities to Gereffi's global commodity chain, by defining the competitive advantage of a firm that is embedded in the commodity chain when the chain is managed in an integrated fashion.

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<sup>17</sup> The privatisation of retail outlets during the 'Pre-privatization programme' was achieved by auctions and they were bought mainly by former employees (and their families) who had worked there for several years (Vegh 1998). Thus, the domestic Hungarian retail sector is dominated by small, family-owned outlets and it is totally unrealistic to expect that these companies can successfully compete with large foreign retailers.

<sup>18</sup> Hopkins and Wallerstein (1986) define a commodity chain as "a network of labor and production processes whose end result is a finished commodity", with the emphasis on processes.

According to Gereffi (1994), the commodity chain approach has three dimensions: an input-output structure, related to the link of value-adding economic activities; a territoriality, related to the spatial dispersion or concentration of production and distribution networks between firms; and a governance structure, related to the authority and power relationships within a chain. With regard to this third dimension, he puts forward two distinct types: producer-driven<sup>19</sup> and buyer-driven commodity chains. The latter are essentially governed by retailers, brand-name merchandisers and trading companies through decentralized production networks in a variety of exporting countries (Gereffi 1994). Their strong influence on the organization of the chain arises from their oligopolistic power. Manufacturers comply with their product specifications but retailer are not involved in the production process at all. Thus they are known as ‘manufacturers without factories’ and separate the physical production of goods from the design and marketing stages of the production process (Gereffi Sept 1999). This process not only involves local firms in the commodity chain as suppliers but also upgrades their capabilities as a result of having to meet the requirements of buyer/retailer firms, like Tesco, with respect to the specifications of commodities. Upgrading or switching to higher value-added activities by a beginner local firm to a great extent hinges on its embeddedness in a larger chain of production (Kessler 1999). Thus, the relations within the supply chain favours the retailer, and allows the retailer to exercise its organizational power and innovation within the supply chain, particularly with regard to its own-brand products. This applies to Tesco in the Central European retail market.

Tesco has already started to export its own-label capability to its Central European stores and wants to increase the proportion of its own-label products. For instance, in Hungary, it launched 500 new products under its own brand name in April 2000, which helped extend its range of own brand products that are 20% cheaper than the branded products. Sales of these products in Hungary account for 12% of total sales. 200 more own brand products will be added to the range to increase both the number of products and the percentage of this representation initially to 15% and then to 20% by the end of the year, and ultimately to 40%, to match the current market share of own-label goods in the UK. However, the product range must be carefully chosen to achieve success. The appointment of new personnel plays a crucial role in the strategic decisions

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<sup>19</sup> The producer-driven commodity chain is primarily based on the subcontracting of components in capital- and technology-intensive industries and therefore is managed by the transnational corporations that exercise control from the headquarters (Gereffi, 1994).

concerning the products that will be attractive to local people along with well-established local supply network. These factors will determine the success and robustness of Tesco.

In 1997, when Tesco was making plans to strengthen its own-label product presence, it called on some of its existing own-label suppliers to set up in Central Europe to supply their new hypermarkets. The aim was to establish a local network of suppliers in order to reduce the costs of sourcing products from the UK. Thus Tesco behaves as a 'network organizer', acting as part of the buyer-driven commodity chain. However, a 'network relocation' also occurs. The role of Tesco as a buyer/retailer is so effective in the commodity chain that one of its major British suppliers, HL Food, has already opened premises in Poland and other suppliers have plans to do the same (Benady 1997). This is one way of creating a local network since Tesco has long-lasting and trust-based relations with its suppliers in the UK. Though Tesco buys local goods from the local suppliers and stocks them in Central European stores, the task is to link them to its own-label product policy to the large extent that Tesco plans to do.

In buyer-driven commodity chains, the host-country state<sup>20</sup> is expected to be facilitative in contrast to producer-driven commodity chains, where it becomes more interventionist (Smith *et al.* 2000). An example of this was the abolition of the import tax in Poland. Up to 1997, this tax was applicable and Tesco was obliged to exploit the privileges CEFTA (Central European Free Trade Area) Agreement offers, by locating its stores close to the borders with other central European countries within a radius of 200km and distributing commodities among the stores without incurring import tax. This was open to interpretation as import from the home country to one specific point from which to make distribution with the intention of paying less import tax. After the abolition of import tax, Tesco began to import its own brand products from the UK as it had done to France. However, as this policy was not successful it is now looking to establish its two-sided supplier chain, i.e. local suppliers and UK suppliers' representatives / branches in Central Europe, which will save costs.

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<sup>20</sup> Sometimes foreign investors may have problems with the legal requirements in the host countries. An example can be the failure of Tesco to recognise the national holiday in Hungary and to keep hypermarkets open during these special days. After the complaints from the Trade Union of Commercial Employees (KASZ), Tesco was fined HUF 20m for opening on national holidays (Hungary AM 14.03.2000).

On the one hand, local governments have regulated against the spread of retailers in city centres, so many retailers have established hypermarkets, in addition to the local supermarket chains they have acquired. On the other hand, Tesco made a considerable loss in 1999 due to the bureaucratic pressures among the local governors<sup>21</sup> (Beckmann, 1999).

#### **4.1. Relationships with Local Suppliers and Companies**

A memorandum submitted by Tesco to the Committee on Agriculture about the UK sea fishing industry and Tesco's policies towards fish purchase and sale draws attention to the approach of Tesco to retailer supply chains. Tesco believes that "A retailer's supply chain is the guarantor of the freshness of goods on sale and their smooth flow to the customer, whereas a disrupted and fragmented supply chain increases costs and interferes with price stability and product quality." Tesco gives importance to supplier selection as it wants to establish long-lasting relationships with suppliers based on its proven ability to meet detailed technical and quality specifications, and meet the varied demands of customers. Then 'obligation contractual relations' with the suppliers<sup>22</sup> rather than 'arm's length contractual relations' becomes essential (Dolan *et al.* Sept 1999). Though Tesco stresses the significance of supplier selection in particular to this segment of business, it applies to all its businesses as a rule (Tesco Stores Ltd. 1999). How important supply chain efficiency is for Tesco is borne out by the £100million savings in 1999, and the operating margin being maintained at 5.9%, despite the £380m investment in price-cut campaigns in that year (Reuters 2000).

Closer working with local and small suppliers, who do not necessarily have large marketing budgets and strong infrastructure, is needed for the production of Tesco's new own brand products, and the extension of the operations of UK suppliers to Central Europe. It is a natural result of retailing abroad, that dependence on local tastes brings about co-operation with local

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<sup>21</sup> "Tesco hoped to build another hypermarket along the Prague-Brno highway at the southern edge of the city. The billion crowns that the company spent on a prime spot of land was lost in one fell swoop when city councilors unexpectedly agreed to change zoning for the area. They bowed to protests from the mayor of Prague 11, who argued that the hypermarket would suck business from the small and medium-sized shops in his district and create snarls of traffic." (Beckmann, 1999).

<sup>22</sup> The obligation contractual relations are classified as relations with high transactional dependence, quite durable relations and intense communication by the authors. They draw the attention of suppliers towards two attitudes of retailers: considerable power

suppliers. In the UK many former small suppliers have grown together with Tesco, and by establishing long-term relationships from which both sides benefit. This phenomenon can take place in Hungary. Moreover, setting up close relationships with agricultural producers helps Tesco to become involved in the whole supply chain in Hungary, and prepares the Hungarian agricultural and horticultural community to be able to compete in the tough European market of the future (Mohorovics 17.07.2000). In Hungary, Tesco has already achieved this close relationship to a large extent. The procurement of more than 90% of the 115,000 products on sale in Tesco stores was from domestic producers and wholesalers. A total of £112.6m (HUF 40bn) worth of goods was ordered and bought from Hungarian companies in 1998 (Hungarian American Lists 1999). The remaining 10%, sourced from abroad, was mainly electrical and branded sports goods. In addition, Tesco exports Hungarian goods, mainly wine, onions and paprika, worth £4m annually.

Tesco closely monitors its suppliers to keep a check on a variety of aspects, including hygiene and safety. For instance local suppliers are required to meet the high standards of hygiene demanded for food safety reasons by Tesco's microbiology team. If conditions are found to be below standard Tesco will review its relationship with the supplier. Compliance with their safety and hygiene standards improves the efficiency of suppliers and also the quality of the products supplied.

A sub-sector has emerged, dominated by domestic companies, that provides services to multinationals operating in central Europe to facilitate their adaptation and to expedite the process of learning the market. Tibbett & Britten Hungaria Kft is one such company that has been in business since 1997 and provides a nationwide distribution service to multinationals in Hungary. Tesco entered into a logistics partnership with Tibbett & Britten Hungaria Kft the end of 1999 when establishing its local supplier network in Hungary (Kft. 2000). This is a general complaint area, as the retail chains do suffer from the performance of the logistics system. It should be improved by not only reducing costs but through raising service quality levels, i.e. stable supply, short and low-cost delivery times, high product and service levels and competitive

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in the hands of retailers and 'scouting' for new sources of supply, by promoting the entry of new suppliers into the chain (Dolan, *et.al.*, 1999).



prices, because complaints gather around inefficiency, excessive bureaucracy, improper stock control and a shortage of personnel trained in merchandising (Vegh 1998). These problems are overcome to a large extent when Tesco UK's systematised distribution system is introduced to Central Europe. The increasing number of hypermarkets requires a smooth distribution system. Tesco works with domestic firms in the construction of its hypermarkets in these countries. The Slovakian company Hupro is one with which Tesco co-operated on the engineering and detailed design of hypermarkets in Bratislava and Trnava in 1999-2000 (Hupro 2000). The construction of the Tesco hypermarket in Kosice was also realised by a Slovak company.

There is an anxiety in developing markets that the small fry will be swallowed by the bigger fish. However the Commercial Director of Tesco in Hungary maintains that the two formats – small retailers and supermarkets- can coexist because customers use them for different purposes. When the market is mature, such as is the case in the UK, both formats will operate profitably side by side (Mohorovice 17.07.2000). However this successful outcome requires the implementation of government of appropriate policies.

#### **4.2. Distribution Facilities of Tesco**

In the UK, Composite Distribution Centres control the distribution system of Tesco. There is one in Harlow responsible for sorting out goods from many producers and wholesalers and distributing them to 74 different Tesco stores, using huge trailers. The distribution system of Tesco can be called just-in-time since there is no storage of food products which have a short shelf life. Stores receive frequent deliveries from distribution depots, as store managers are able to say at any time which goods need replenishing due to the recording of sales by tills (Brown, October 1999).

In Central Europe, Tesco currently uses three distribution channels located in the Czech Republic, which handle only 15% of Tesco's goods, as opposed to the 90% of Tesco's goods handled by the distribution facilities in the UK. Apart from this, it has a central storage depot and in-house logistic network in Poland. To improve this, Tesco is currently working on establishing

its own central European distribution strategy to make it ready in the autumn 2000 (Zivnustkova 26.06.2000).

## **5. Conclusion**

Tesco undoubtedly has contributed to altering the retailing structure of Central Europe. Many traditional businesses have disappeared and new ones have emerged, along with the development of shopping malls and retail chain stores. Not only has the number of entrepreneurs increased but also the introduction of new marketing concepts and new forms of information technology have helped to accelerate this transformation of certain features. The retail system have had to change as a result of the development of West European marketing and advertising concepts as well as the application of West European business understanding. The former comprises mainly attractive design, packaging, and better customer services, and the latter includes the efficient and timely supply and distribution of (foreign and local manufacturer's) products in the domestic market. New information technologies, such as computerised inventories and bar-code systems, both in production and warehousing, and point-of-sale have been introduced via the foreign retail chains. All of these have changed shopping habits in Central Europe and introduced the use of television, catalogues and credit cards. The problems that exist are related to government, which lacks the ability to enforce strict regulation of retail activities to avoid the black market and to reduce the disadvantages of the business environment for foreign retailers (Vegh 1998).

Tesco is determined to apply and benefit from its UK strategies in its investments overseas. It has benefited greatly from its rapidity in developing new ownership-specific advantages and exploiting existing ones (Dunning 1993) in the UK retail markets, and has become a first mover that grasps its advantages. The fragmented market structure and further development opportunities of the retail sector in Central Europe have expedited the progress of Tesco. The relatively easier entry of Tesco to these countries led to its focusing on other activities to help boost investments, such as the introduction of IT to stores, training and management, and establishment of supplier networks.

Greater flexibility in production processes and distribution systems facilitate both the configuration of its network structures and technology and knowledge spill-overs within Tesco. When the training and management policies it pursues in Central European stores have coincided with the policy of long-lasting relationships with the suppliers, the backbone of its business has been shaped. These characteristics have also brought its lead position in the commodity chain, making Tesco an example of an emerging Central European buyer-driven commodity chain.

The adoption of and adaptation to advancements in IT in the retail sector have propelled Tesco's success not only in its store management and employee training but also in its network with suppliers. Tesco's philosophy of exporting customer services has determined their employee training policy. The creation of new positions for British managers in Central Europe has paved the way for transfer of knowledge. The supplier network of Tesco has developed in two ways: one with local suppliers, the other with the UK suppliers that have established offices in the CEE with the encouragement of Tesco. The smooth functioning of a supplier chain governs the extent of success of a retailer. Therefore, Tesco has acknowledged the advantage of a chain consisting of local producers, even for its own-brand products, that will maintain a robust position in the CEECs in terms of both price competitiveness and market share. Taking all these factors into consideration, it is apparent that the technology, knowledge and network structures of Tesco intersects well with the buyer-driven commodity chain. This interface is positive, and as long as it continues to be encouraged there is no reason for Tesco not to build upon its operations in the Central European countries.

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