Why do companies go global – building or acquiring facilities outside their home country? Discuss this question with particular reference to Tesco's international strategy.

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Introduction

The essay will discuss the motives and ways of business internationalisation and relate the discussed theories to the internationalisation of retailers in general and Tesco in particular. The essay will focus mainly on retailers because the service component of retailing means that the internationalisation of its 'product' is a special case and this has implications for the options that are available to retailers and the behaviour adopted. The essay draws on literature from International business, economics, economic geography, and international marketing.

Globalisation progressed significantly in the past decade, facilitated by modern communication, transportation and improved legal infrastructure as well as the political choice to consciously open markets to international trade and finance (WTO, GATT, GATS, as well as regional trade blocs: EU, NAFTA, ASEAN, etc.). Included in this wave were the efforts of companies to broaden the geographic reach of their products. Today multinational "*enterprises*[1] *which own or control production or service facilities outside the country in which they are based*",[2] exhibit a degree of transnationality that would not be possible without the facilitating character of globalisation. Although a company can achieve MNE status through the level of control that for example Nike exercises over its manufacturers without actually owning them, most companies become multinationals because of some form of foreign direct investment (FDI) that spreads their geographic activities.

The literature (Wrigley, 2000; Coe, 2003; Sanghavi, 2000) agrees that international retail expansion started late compared to manufacturing/non-services companies but really took off in the past fifteen years: "*One clear indication of the rapid growth of […] retail TNCs is that, while in 1993 there were no retailers in the top 100 TNCs, in 1999 there were four […] [and] [b]y 2003, there were no less tan 14 retailers (all but two were food and general merchandise retailers) each deriving over US$10bn of annual sales from international markets.*" (Wrigley *et al.*, 2005, p.438). At the same time a 'neglect' or 'paucity' of internationalisation of retailing in the literature has been noted (Wrigley, 2000; Sternquist, 1997; Dohorty, 1997)

The internationalisation of a retailer such as Tesco is a special case: It does not have a single, physical product that could be exported, but retailers typically sell many products by many manufacturers and provide the shopper with an experience, hence retailing contains a major, intangible service component. While consumer tastes in areas such as electronic goods and clothing converge, different cultures still maintain their distinct

[1] MNE, or transnational companies, TNC, here used interchangeably
[2] UN definition

ethnic preferences in certain product categories; food for example remains a largely local product.
Tesco's self-proclaimed international strategy has be reproduced (Tesco.com) below to be kept in mind for the remainder of the essay.

Box 1

Tesco's own 'Key criteria for entry' are given as follows:

- Under-developed retail sector
- Customers with spending power
- Opportunity for market growth
- Potential for market leadership

Tesco has evolved an international strategy based on six elements:

- Be **flexible** - each market is unique and requires a different approach
- Act **local** - local customers, local cultures, local supply chains and local regulations require a tailored offer delivered by local staff - less than 100 of Tesco's International team are ex-pats
- Keep **focus** - to be the leading local brand is a long term effort and takes decades, not just a few years
- Be **multi-format** - no single format can reach the whole of the market. A whole spectrum from convenience to hypermarkets is essential and you need to take a discounter approach throughout
- Develop **capability** - developing skill in people, processes and systems and being able to share this skill between markets will improve the chances of success in challenging markets
- Build **brands** - brands enable the building of important lasting relationships with customers.

Source: Tesco.com, *cf Appendix [Box 6] for reasons given by Tesco managers in interviews*

Why do firms internationalise?

At the most basic level, firms' motivations to carry out FDI can be summarised by descriptive lists where the firms' reasons are certain to fall under at least one of the following categories (e.g. Johnson & Turner, 2003):

- *Resource seeking,*
- *Market seeking,*
- *Efficiency seeking,*
- *Strategic asset seeking*

These can also be split up in greater detail, and divided into 'push' (also 'proaction') and 'pull' (also 'reaction') factors as Wrigley and Lowe (2002) have done for the retail industry in Table 2.

Table 2 Factors traditionally cited as influencing retail internationalisation

'Push' factors	Facilitating factors	'Pull' factors
• Perceived/imminent saturation in domestic markets • Spreading of risk • Consolidation of buying power • Public policy constraints • Economic conditions • Maturity of format • PPG Note 6 • Increased taxes	• Use of surplus capital/access to cheaper sources of capital • Entrepreneurial vision • Inducement from supplier to enter new markets • Removal of barriers to entry • Lower tariffs	• Unexploited markets • Pre-emption of rivals • Higher profit margins • Consumer market segments not yet exploited • Access to new management • Reaction to manufacturer internalization • Following existing customers abroad

Source: adapted from Wrigley and Lowe, 2002, Table 8.7, supplemented with Author's own additions

A variation, but in the same category are studies that identify a range of factors to evaluate a market's attractiveness (Appendix [Box 5][3] cf Box 1 and [Box 6]).

While these lists and typologies are useful, Wrigley and Lowe (2002) point out that there is a tendency to dwell on the implementation of international investment rather than its sustenance and expansion.

Finding more conceptual alternatives proved difficult since *'[…] the highly developed research on the economics of international production, which focuses on why the multinational enterprise (MNE) arises and when foreign direct investment (FDI) takes place […], has been virtually ignored in the international retailing field. This has occurred in spite of the many insights which this specialist area of economics may have to offer. From this literature, only Dunning's Eclectic Paradigm […] has been introduced and adapted to international retailing […]'* (Doherty, 1999, p.380).

Based, *inter alia*, on Stephen Hymer (1960, published 1976) and internalization[4] theory, derived from the work of Ronald Coase and Oliver Wiliamson, John Dunning (1981) developed the dominant explanation for the growth of multinational activity. Dunning's elective paradigm (1981) integrates several theoretical frameworks into three sets of factors or 'conditions' to explain the 'why', 'where' and 'how' of the internationalisation of production: Ownership factors, Location factors and Internalization factors (OLI). It must be noted that this theory was designed with manufacturing companies in mind but that retailing has a significant service component. Hence some care is due when applying this model to retailers. Pelligrini (1991) and Sternquist (1997, SIRE, [Figure 13]) have used this approach to analyse the internationalisation of retailers and this essay follows roughly Sternquist's (*ibid*) interpretation in using the framework to explain internationalisation in the retail context.

[3] References to figures in square brackets […] are listed in the Appendix.
[4] To avoid confusion betwen internalization and internationalisation the former has been written in US spelling in this essay

Ownership advantages are company assets used to obtain market power linking to Hymer's firm specific advantages (FSA) and the core competences or resource-based school of corporate strategy (Johnson & Turner, 2003). These advantages can be *asset*-based or *transaction*-based. Unique products such as Asda's fashion label 'George', or Waitrose's reputation for quality are asset-based examples. Transaction-based advantages come about because of the way things are done. Clearly, these are difficult to identify but could be Tesco.com's in-store picking method, Tesco's lean supply chain management, and its use of loyalty card data, which for example Tesco plans to introduce in South Korea soon.
Simply put, ownership advantages are the firm's belief to be fit, in terms of skill or assets or both, to survive and compete in the foreign market.

Location advantages describe how attractive a foreign country is to a retailer, and these factors are usually grouped as push or pull factors (see above). While push factors make the home market less rewarding (see Table 2), pull factors make a foreign market attractive. The factors to measure the investment incentive have been added to the framework by Pellegrini (1991):

> *Cultural proximity* and *Geographic proximity* facilitate entering a new market, because it reduces uncertainty. For example most companies seem to first expand into similar markets. After moving into Mexico, Wal-Mart's second expansion was into Canada in 1994, and Tesco's first expansion was into central Europe, then Ireland (after a failed attempt in 1979) and then into East Asia.
>
> *Market Size*: Saturation of the home market is a major motive for expansion into other markets, and it is not by chance that European companies (e.g. Carrefour, Ahold, M&S, Tesco, Sainsbury's) internationalised earlier than American companies (so far only Wal-Mart has built up a significant overseas store network, see [Table 9]), which have much more scope for expansion in the US market and where it remains easier for longer to grow by building another store in an unexploited region in the home market (Coe, 2003).
> In the UK the revised *Planning Policy Guidance (PPG) Note 6* limited planning permissions for large out-of-town stores, to which Tesco responded with the Metro and Express format, but still PPG6 limited or slowed growth of sales from newly opened retail space. Alexander (1997) also notes that it is critical to expand well *before* the home market is saturated.
>
> *Competitors' moves*: According to Wrigley (2000), Carrefour, one of the first internationalisation movers, was able to achieve exceptionally high returns "on

invested capital in the 25 to 30 per cent range" (*ibid*, p. 305) in emerging markets (Brazil, Poland) where it didn't face competition from western-style large-store retailers. The opportunities in the emerging markets in the form of prime locations, especially larger ones, are limited, or a retailer could have built up scale and trust which would be more difficult to overcome by late-movers. Hence, Carrefour enjoyed a first mover advantage and catching the growing middle class effect (Lasserre, 2003, p.164). So once competitors are acting, only a quick response could prevent them from establishing themselves rapidly.
Walmart's acquisition of ASDA in 1999 could have accelerated Tesco's international expansion because Tesco was expecting competition to intensify.

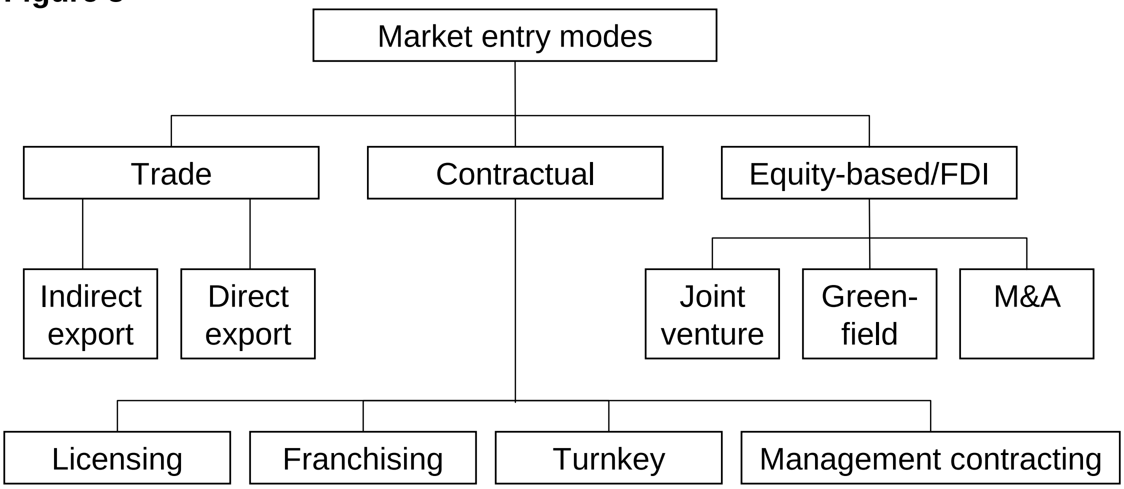
Low cost land and labour: The decision of selecting a market may depend on the availability of suitable acquisition targets and the condition of potential sellers as it does on the attractiveness of the market (Dawson, 2001). For the retail sector the availability of skilled, culturally aware management might also be a factor. The Asian crisis of 1997 seemed to rather facilitated the expansion, and offer more opportunities to acquire assets cheaply (Coe, 2003)

If <u>*Internalization advantages*</u> outweigh the benefits of using the market the firm will use some FDI method over contracting. The greater the company's ownership assets, the more important it is to protect these assets by maintaining control over company secrets. [Figure 8] orders the entry modes according to the level of cost and control (internalization) which will be discussed in more detail below.

Dunning acknowledges that, "*it is not possible to formulate a single operationally testable theory that can explain all forms of foreign-owned production.*" (Dunning, 1992, p.86, quoted in Johnson and Turner, 2003)
Because Dunning's eclectic paradigm merely establishes conditions which, if met, indicate that an expansion abroad through FDI is appropriate, there are aspects of strategy that are not necessarily captured by the eclectic framework, or require more attention such as entry mode and style.

How to go international?
Picking up the thread at the internalization point of the paradigm, the business which passed all conditions of the eclectic paradigm will already have rejected the options of expansion via trade and contracts because they require more control over their competitive advantage. Their choice is limited to the right branch of Figure 3.

Figure 3



Source: adapted from Johnson & Turner, 2003

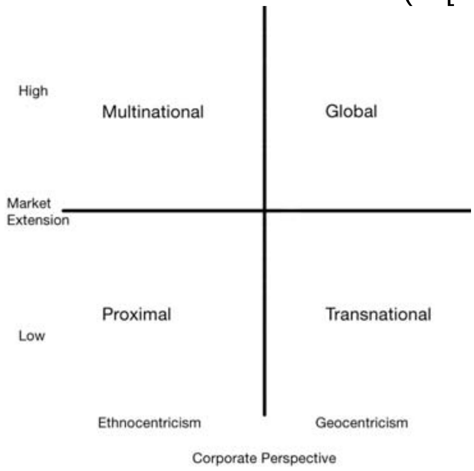
"*The major factor which will impact on international retailers' entry mode choice is how the information in their intangible assets is embedded. Given intangibility, the problem of information asymmetry is accentuated. Consequently, internalization theory postulates that when the transaction costs of using the market […] are high due to the risk of opportunism and moral hazard, retail firms should internationalise by internalizing the market through organic growth or merger and acquisition rather then by contracting out […]*" (Doherty, 1999, p.389). In some emerging markets this option might not always be available since some government restrict licences or foreign ownership (e.g. China).
The (sometimes vital) benefit of entering a foreign market through a joint venture with a local partner will be the learning that will take place. The greater the cultural differences the more likely the multinational retailer will enter a joint with a company from the host country (Sternquist, 1997, p.263).

Local Responsiveness: Global vs. Multinational

Based on Perlmutter's (1969) classification of MNEs, Sternquist (1997, cf [Figure 13]) extends the eclectic paradigm to qualify the subsequent choice of how to enter a foreign market. "The two major strategic alternatives available for international retail expansion are *global* and *multinational* strategies. Global retailers replicate a standard format throughout the world. Multinational retailers adapt their retail offering" (ibid, p.266).

IKEA, Gap and Benetton for example penetrate all international markets with the same products. Tesco has lived up to its self-declared strategy and so far has acted truly 'flexible', 'local' and 'multi-format' as shown below.

Figure 4 Market and operational internationalisation (cf [table 12])



Source: Alexander and Myers, 2000, p. 348

Tesco's Internationalisation
Tesco has varied its entry method in each region [Table 12]. In newly created markets in central Europe Tesco acquired stores from competitors (Kmart) and the state at low cost. In East Asia it follows a partnership approach whereby it enters new markets through joint ventures with local retailers. This gives it initial scale and access to knowledge of local political and institutional conditions, as well as a 'local face'. Such partnerships are often followed by the acquisition of larger stakes (Wrigley, 2005). Initial investments were rather small to minimize the risk (Palmer, 2005).

Tesco has entered its first and culturally most proximate markets with a fairly unchanged retail model ('global') but adopted a local strategy when it entered the east Asian markets ('multinational'). In Thailand, where transportation is expensive but labour is relatively cheap, Tesco adapted its logistics to this situation. It has developed small format skill, which also circumvent trading hours regulations. It has developed a low cost 'value' format for up-country expansion – a hypermarket format surrounded by leased space for local fresh fruit and vegetable vendors – which provides a vehicle for entry into neighbouring economics (Wrigley, 2005). Tesco's first ever hypermarket was built in Asia, not in the UK. Tesco's expansion into the US is considered to take place under a different brand name.

And while Palmer (2005, p.35) describes the 1990s as "*one of the most intense periods of retail merger and acquisition driven internationalisation*" Tesco took its time and entered markets sequentially rather than simultaneously. Several competitors had to withdraw from markets (Carrefour: Slovakia/Czechoslovakia, Wal-Mart: Germany, Kmart: Czecheslovakia/Singapore), and even though not all of Tesco's market entries were successful (Tesco had to divest its Catteau acquisition in France, 1990, Taiwan store swap with Carrefour, 2005), today it can show a handful of market-share leaderships in significant markets [Table 12, Chart 14 & 15]. Using a multinational strategy means that expansion will be slower than that of global retailers, but the advantage of this method is a greater learning effect (Palmer, 2005; Sternquist, 1997) each country mastered gives the retailer a broader knowledge base.

On each occasion Tesco's strategy matched the conditions of the environment. Tesco stands for an 'intelligently federal' method of international expansion (and this includes several other European retailers, such as Carrefour and Aldi) while (the only) US retailer Wal-Mart adopted an 'aggressively industrial' model (see [Table 10])

Conclusion

The text so far has shown in which situations and how retailers will go international. But the broad frameworks did not capture qualitative details such as internal firm specific factors and external or home market specific issues, or only vaguely.

For example, Coe (2003) refers to Wrigley (2000) as the "*most convincing account*" of retailer internationalisation. Wrigley describes how overseas expansion was not simply a defensive reaction to overdependence on the home market, but was also fuelled by a need to sustain earnings growth (and therefore equity valuations) by using their free cash flow to secure revenue growth. Diversification into non-food was a second pillar of this attempt. Pressure from financial institutions and shareholders was a significant factor (cf Palmer, 2005). The emerging markets offered several opportunities in this respect: potentially rapid economic development and rising levels of affluence, consumer spending and sales, in combination with low competition from Western stores and associated distribution systems. Often inefficient local retailers could not prevent the rapid organic growth once a western retailer had entered the market.

What are the drawbacks?

Just like Tesco's expansion into non-food, international expansion diverts management attention away from the still competitive UK retail market. There are more balls to juggle. And international expansion carries significant risk, due to Tesco's relatively weak position against its much larger and more experienced international peers (Palmer, 2005, p.35):

- Acquisition outside the UK may prove highly dilutive
- The size of possible acquisitions are effectively reduced
- A merger with a large European retailer would leave Tesco as the junior partner and
- Tesco is more vulnerable to an aggressive bid

In addition to these risks, Tesco has to keeps its secrets internal (loyalty card, online) to maintain its ownership advantages. At the same time Tesco must make sure to maintain their customer focused culture despite international acquisitions and to find the right mix between global operations that allow standardisation and multinational (local) adaptation that are required in each market - globalise where possible, localise where necessary.

The literature does not give a single view on internationalisation, and it is clear that the reasons for international expansion, in their weighting at the very least, will differ for each company, as will necessarily their optimal entry modes. To give a systematic account of the motives of internationalisation that can be applied to every firm, broad and universal categories as used by the eclectic paradigm are necessary. As pointed out, this might lead to exogenous factors such as the capital markets, or internal causes (firm structure, organisational culture or politics) not being captured by the model. Hence careful qualitative research (e.g. interviews) is required to in find those reasons.

Appendix:

Box 5

Chain Store Age (1997) identifies the following checklist of factors to consider when evaluating a potential entry market:

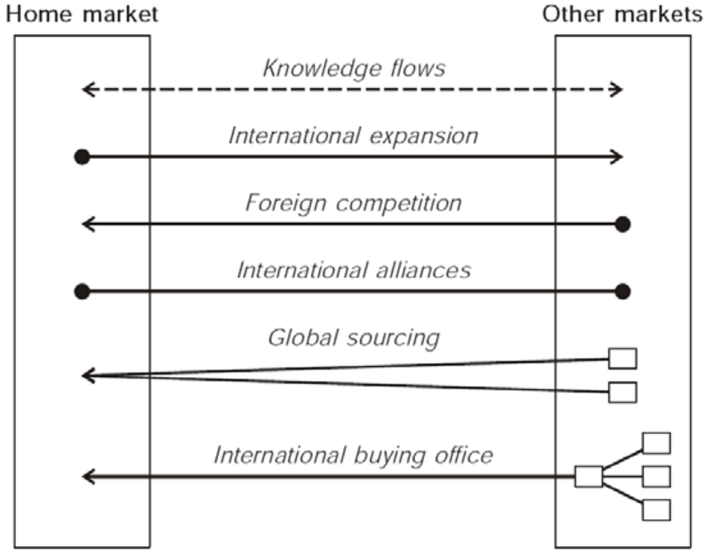
- Macro-economics
- Country background (e.g. political stability)
- Distribution structures
- Competitive nature of market
- Sophistication of customer base
- Technical feasibility
- Supplier base
- Retail market size and growth
- Additional growth drivers such as lifestyle and pricing trends
- Real estate issues
- Market forecasts
- Relevant regulation
- taxation

Box 6

Tesco's market selection decisions as found by interviews with 68 company employees, 1999-2000 (Palmer, 2005)

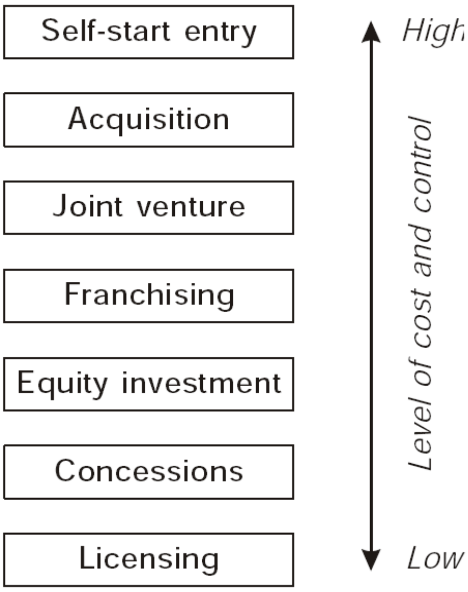
- Retaining spatial focus is more important than capitalising on small-scale opportunities in diverse markets
- Competition from local retailers in their chosen markets is virtually non-existent
- Dynamics for the international retailers are relatively level (which is not the case in Latin America where Carrefour has operated for almost 20 years)
- Capitalised on opportunistic events unfolding within the existing portfolio of international retail markets

Figure 7 Facets of retail internationalisation



Source: quoted in Coe, 2003

Figure 8 Mechanisms of market entry



Source: quoted in Coe, 2003

Table 9 Leading transnational retailers, by international sales, 2003*

Rank	Name of company	Country of origin	Key format(s)	International sales (US$m)	International sales as % of total	No. of countries of operation
1	Wal-Mart	US	Superstore, discount, warehouse	53,573	20.9	11
2	Ahold	Netherlands	Supermarket, convenience, hypermarket	53,320	84.2	27
3	Carrefour	France	Hypermarket, discount/ convenience, supermarket	39,247	49.3	32
4	Metro	Germany	Cash & Carry, department, DIY, hypermarket, specialty, superstore	28,511	47.1	26
5	Delhaize	Belgium	Supermarkets	18,319	79.9	10
6	Pinault	France	Department, mail order, specialty	16,376	54.7	16
7	Aldi	Germany	Discount	15,174	37.0	12
8	Tengelmann	Germany	Supermarkets	14,110	50.9	14
9	Auchan	France	Hypermarkets	13,779	42.5	15
10	Rewe	Germany	Supermarkets	12,656	28.6	12
11	Lidl & Schwarz	Germany	Supermarkets	11,274	33.8	16
12	IKEA	Sweden	Specialty	11,224	92.0	43
13	Intermarche	France	Supermarkets	10,487	27.8	7
14	Tesco	UK	Superstore, hypermarket, supermarket, convenience	10,015	19.9	12
15	Ito Yokado	Japan	Superstores with food	8,002	26.2	18

*There are difficulties when comparing annual revenues for retailers due to their different financial years. While Ahold and Carrefour complete their accounts at the end of December, Wal-Mart reports at the end of January, and Tesco at the end of February, for example. The figures quoted above, therefore, may not correspond exactly with the calendar year 2003. Such issues are important given the extremely rapid growth of these retailers over the last few years.

Source: www.planetretail.net

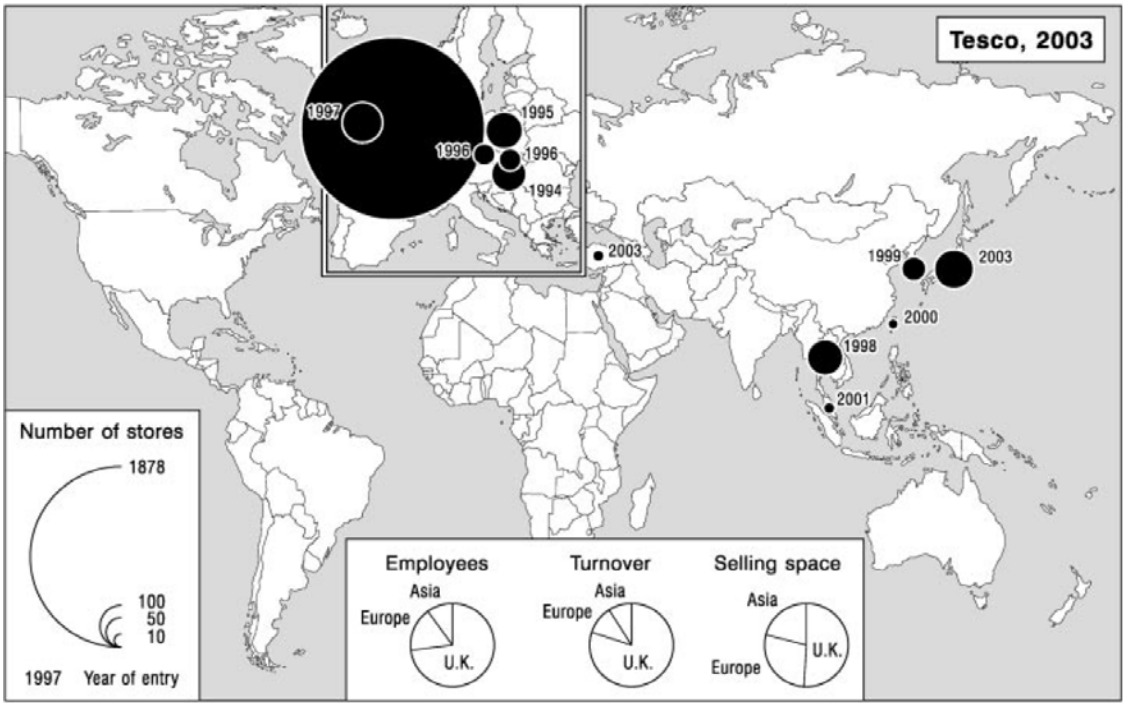
Quoted in Coe & Hess, 2005

Table 10 A characterization of alternative corporate models for retail globalisation

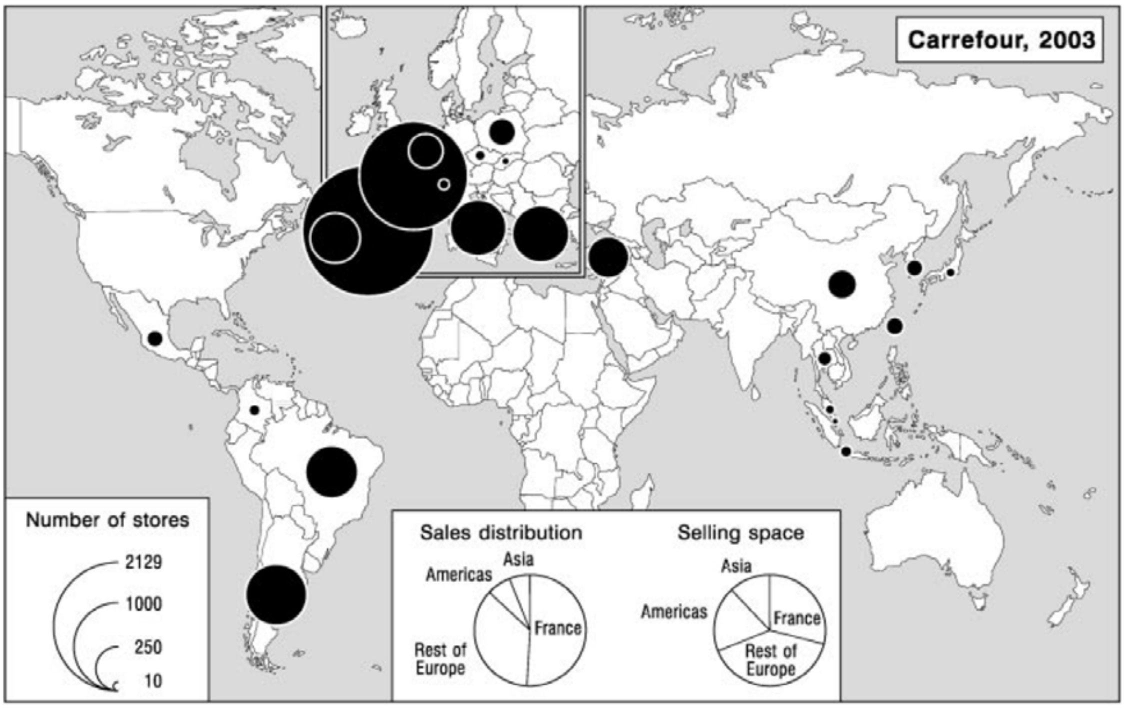
'Aggressively industrial'	**versus**	**'Intelligently federal'**
• Low-format adaptation	versus	• Multiple/flexible formats
• Lack of partnership in emerging markets	versus	• Partnerships/alliances in emerging markets
• Focus on economics of scale in purchasing, marketing and logistics	versus	• Focus on back-end integration, accessing economies of skills as much as scale, best practice knowledge transfer
• Centralised bureaucracy, export of key management and corporate culture from core	versus	• Absorb, utilize/transfer best local management acquired
• The global 'category killer' model	versus	• The umbrella organisation/corporate parent model

Source: adapted from Wrigley and Lowe 2002, Table 8.6

Figure 11



(a) The global distribution of Carrefour stores, 2003



(b) The global distribution of Tesco stores, 2003

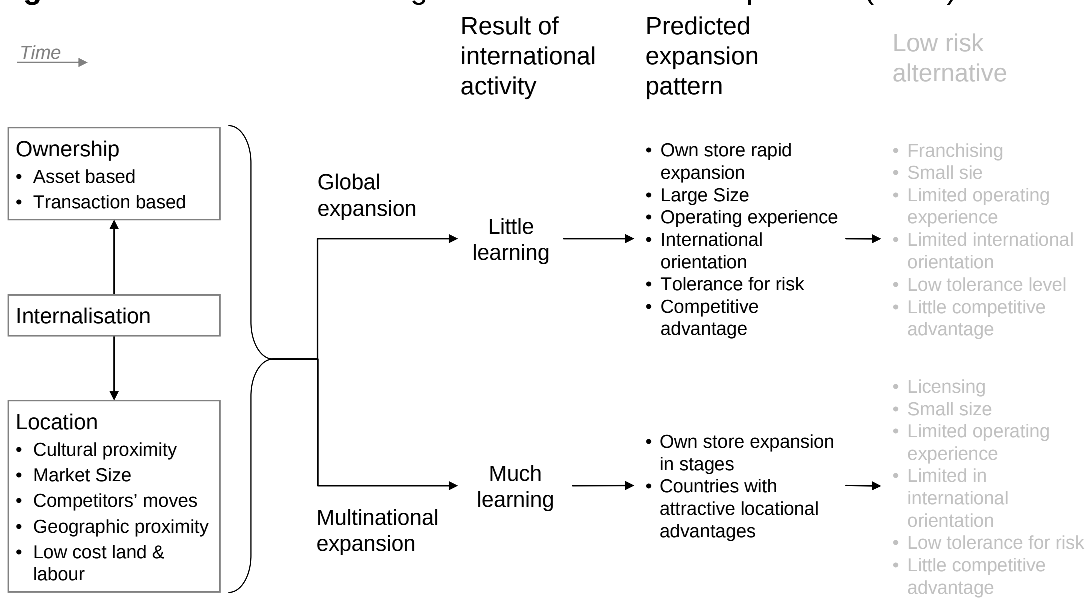
Source: company reports, quoted in Coe and Hess, 2005

Table 12 Tesco's foreign operations

Country	Year	Sales area (million sq ft)	No. of stores	Planned store openings 2005/06	Method of Entry	Price of Acquisitions (£million)	Market-share leader
China	2004	2.6	31	15		n/a	
Japan	2003	0.4	104	15	Acquisition	n/a	
Malaysia	2001	0.6	6	5	JV (Teso share 70%)	n/a	
South Korea	1999	3.2	38	31	Partnership with Samsung (81%)	80.0	
Taiwan	2000	0.5	5	1	Acquisition	n/a	
Thailand	1998	5.9	107	83	Acquisition of 75% of Lotus	200.0	x
Asia		**13.2**	**291**	**150**			
Czech Republic	1996	2.1	25	8	Acquisition	77.0	x
Hungary	1994	3.5	69	14	Acquisition (51%)	13.4	x
Poland	1995	4.2	78	20	Acquisition	392.0	
Rep. or Ireland	1997	2.0	87	6	Acquisition	n/a	x
Slovakia	1996	2.1	30	6	Acquisition	see Czech	x
Turkey	2003	0.4	5	3	Acquisition	n/a	
Central Europe		**14.3**	**294**	**57**			
Total Non-UK		**27.5**	**585**	**207**			
UK		**24.2**	**1,780**	**111**			

Soucre: compiled from Tesco.com, Palmer (2005), Child (2002)

Figure 13 The model of strategic international retail expansion (SIRE)



According to Sternquist (1997), grey shaded part not considered in essay.

Chart 14

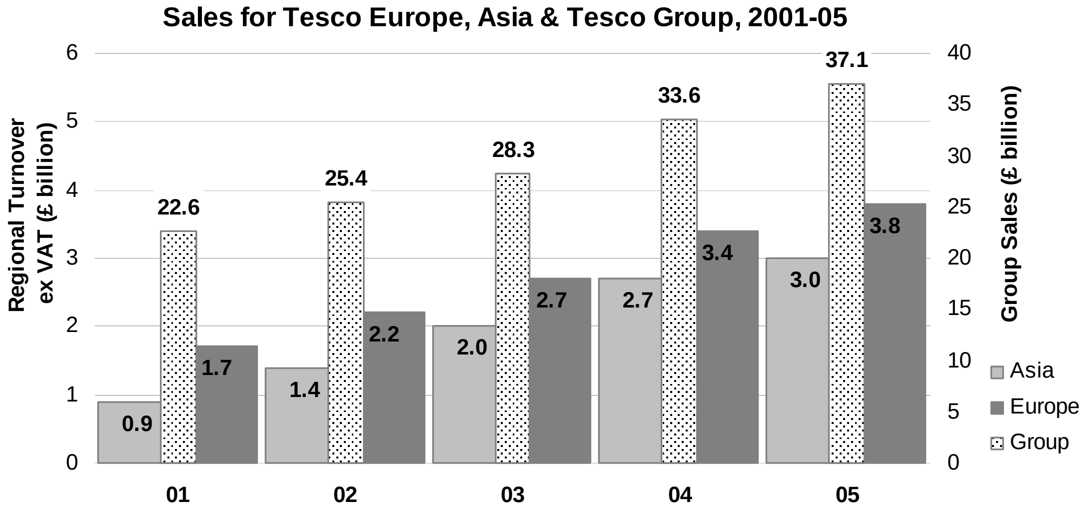
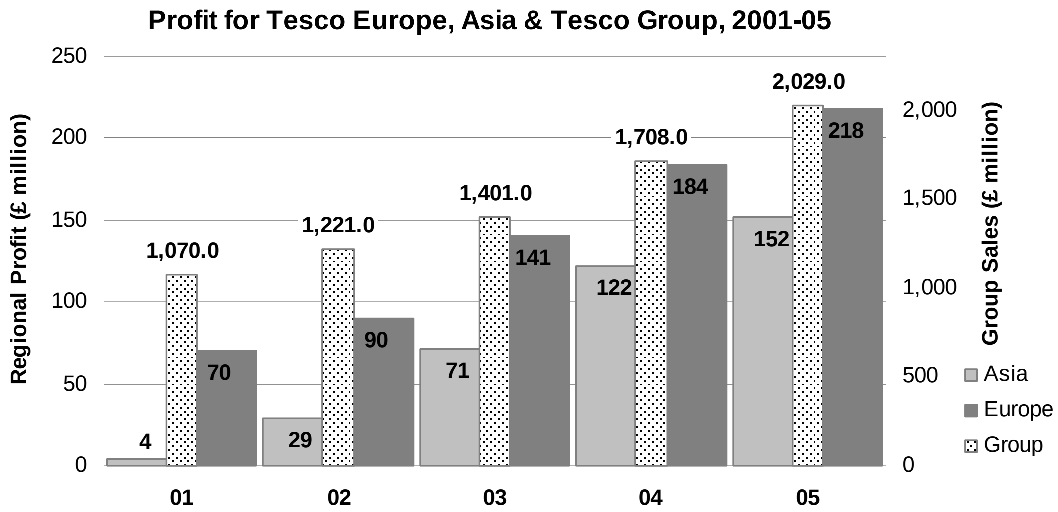


Chart 15



Source: Tesco.com, annual reports

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