

Convenience Store Decisions

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Tesco Prepares for its U.S. Invasion

With the development of a new convenience store format to be unveiled in California early next year, UK retailers and analysts say marketers should prepare for Wal-Mart, Part II.

By Andrew Don

Not since The Beatles has a British invasion been so eagerly anticipated. But UK market observers warn that Tesco's reputation as a bigger, meaner Wal-Mart is only a slight exaggeration. The London-based marketer has no intention of failing to dominate the West Coast convenience market when it begins opening stores early next year.

Little is known in the U.S. about Tesco, the UK grocery giant that earlier this year announced plans to launch convenience stores on America's West Coast. Tesco has allocated up to \$436 million a year for the development of the new convenience format in the U.S. market, beginning in 2007. Break-even is anticipated by the end of the second full year of operation.

But it would be shortsighted to think this aggressively expansionist, 87-year-old player will stop there. "I would expect Tesco to expand all over the U.S. because it is easy to expand there," said Bill Currie, a UK foodservice analyst.

So what can potential U.S. competitors expect?

In just 11 years, Tesco has grown from underdog to the market leader everyone loves to hate in the UK's \$207.5 billion grocery market. It's now the world's fifth-largest grocery retailer by sales, behind Wal-Mart, Carrefour, Ahold and Metro, and from 2001 to 2004 it opened more space in new stores than its three nearest rivals combined, according to Citigroup.

As recently as the 1980s, few would have thought Tesco could leapfrog Sainsbury's, for years the dominant player. But in 1995, it did just that and has consolidated its lead ever since.

Tesco accounts for 12.5% of spending in all shops across the UK and accounts for 30.4% of the grocery market, about twice that of its nearest competitors, Wal-Mart's Asda (16.6%) and Sainsbury's (16.2%), according to market-research group TNS. Tesco reported annual profits of \$3.5 billion last year on worldwide sales of \$59.2 billion, and this year Deutsche Bank forecasts profits of \$3.8 billion on sales of more than \$67 billion when results are announced in May.

Getting Bigger

The chain has earned a reputation for making a big splash when it sees an opportunity to enter a new market. For example, prior to 2003, farmer cooperatives, single-store operators and small chains dominated the UK's \$349 million neighborhood stores sector.

In early 2003, Tesco shocked the sector with its acquisition of T&S Stores' 862-store portfolio of convenience stores, candy and smoke shops and newsstand outlets for just under \$1 billion (\$924 million) including debt, of which it now operates 512 under the One Stop brand, which it is continuing to expand.

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It followed this up a year later with the acquisition of Adminstore, operator of Europa Foods and Cullens and Harts, for \$92.4 million. The deal netted Tesco 45 convenience stores in central London.

Sainsbury's also has moved aggressively into this sector of the market snapping up well-respected regional operators such as Bell's Stores and William Jackson. Wal-Mart's Asda has steered clear of this market, instead opening superstores and a planned chain of smaller, deep discount stores.

"When the [hypermarts] decided to target the smaller convenience store market they were, with their huge buying power, able to offer prices and promotions which simply could not be matched by independent convenience stores," said Rod Alexander, a spokesman for convenience store operator Musgrave Budgens Londis.

Independents say the consequences of Sainsbury's and Tesco cashing in on the small stores sector have been devastating. But it also has forced them to raise their game.

Some have launched postal services, provided home news delivery services, bill payment facilities, grocery deliveries, collection points for packages, take-out food and in-store coffee bars.

"What Tesco has brought to the sector is a different league of professionalism and competition," said Richard Hyman, a prominent London-based market analyst and chairman of Verdict Research. "They've made the sector more dynamic."

Deutsche Bank estimates Tesco Express' convenience store sales at about \$2.96 billion. The business expects to add about 100 Express stores each year, of which 15 to 20 will feature gasoline sales under the Esso brand. The rest will be neighborhood stores.

Tesco now operates roughly 900 convenience stores in the UK and the competition authorities are worried enough about the impact of the major multiples' incursion into this subsector to have referred the grocery market to the Competition Commission.

Cost of entry in the UK is far cheaper than in the U.S., but Tesco is accustomed to profit margins of about 5.5% in the UK. This means economies of scale in the U.S. will be critical, Hyman said.

Colin Graves, managing director of the Costcutter franchise, with nearly 1,400 outlets operated by independent storeowners in the UK, claims Tesco has driven many independents out of business although its own retailers were "keeping their heads above water."

Shane Brennan, spokesman for the Association of Convenience Stores, believes it is not coincidence that two years after buying T&S, there was a dramatic spike in closures with 2,000 convenience outlets shuttering in 2004 and 2005. "We put it down to Tesco's and Sainsbury's incursion into the convenience market," he said.

Brennan concedes that some have closed, in part, because they were not good enough, "but we've also seen good retailers struggle to compete because of the way Tesco and Sainsbury's have driven up the cost of expansion and investment and the way they price in those stores."

One concern of the UK's Office of Fair Trading since the powerhouses entered the market is the cost of entry into the sector. Brennan said large companies are "cherry picking" the best sites and paying real estate prices independent operators cannot afford.

What Tesco does have in its favor is that customers believe its convenience stores feature value offerings, even though the units charge marginally more than its other outlets, which include 104 Extra hypermarkets (from 60,000 sq. ft.), 447 superstores (20,000-50,000 sq. ft.) and 160 Metro stores (7,000-15,000 sq. ft.), which are considered neighborhood supermarkets—a total estate of nearly 2,000 UK outlets. It is also experimenting with a Tesco Homeplus non-food-only format and in 2001, it took a 35% share in GroceryWorks, the online business of Safeway Inc, in the U.S.

Value Top Priority

UK convenience stores traditionally have charged premium prices, and Tesco and Sainsbury's have forced them to address this where they compete.

Tesco's strengths are adapting its offer to local markets. The company is noted for its buying muscle, a commitment to driving a hard bargain, a meticulous attention to detail, brilliant marketing, scrupulous research when exploring new markets—it has been researching the U.S. for 20 years—and an ability to turn that research into a strong proposition, and an in-depth understanding of its customers.

"Any idiot can amass intelligence. It is being able to leverage that knowledge. They are good at that," said Hyman, of Verdict Research.

The company's chief executive is Sir Terry Leahy, the son of a greyhound trainer who grew up in a Liverpool council house, and worked his way up from the bottom. He has taken the company into entertainment products, home furnishings, fashion, mobile phones and financial products and has built *Tesco.com*, the biggest online grocery business in the world.

Leahy also has taken Tesco into 11 new countries, including the Czech Republic, Hungary, Poland, Ireland, Slovakia, Turkey, China, Japan, Malaysia, South Korea, and Thailand. In March, Tesco announced it was in negotiations to establish a joint venture with Bharti Enterprises in India. Indeed, more than half of Tesco's selling space is now outside the UK.

Tim Mason, Tesco's marketing and property director, leads the U.S. project.

Tesco is coy about answering questions regarding its U.S. ambitions because, company officials say, its plans are "commercially sensitive." Leahy, however, said: "It is a market we have researched extensively for many years and over the last year we have committed serious resources to developing a format that we believe will be really popular with American consumers."

"Tesco is not only by some distance the best retailer in the UK, but I don't think there is an operator in the world that is better at retailing," Hyman said. "I won't say it is better than Wal-Mart but it is probably the best competitor Wal-Mart has."

Hyman pointed out that Tesco also has a history of great success overseas. "It demonstrates a worldliness that I think is a prerequisite to success. What it has not tried to do is take the Tesco way of doing it in the UK and exporting it," he said. "Is Tesco whiter than white? I don't suppose it is? Does it sometimes put undue pressure on people? I'm sure it does. Does it screw its suppliers? I think the answer is unequivocally no.

"Do they drive a hard bargain? Yes. Do they negotiate hard? Yes. Are they single-mindedly driven? Yes. Do they break most of the rules? I don't think they do. Is it a really tough competitor that is pinching your market share all the time? Yes."

All the U.S. convenience trade can do is wait and see what happens...and hope.

Harrods Aims for its Slice of the Convenience Pie

Harrods, the lavish West End of London department store, is giving itself about a year to decide whether to roll out a breakthrough chain of convenience stores.

It launched its first convenience store on March 1, Harrods 102 in Brompton Road, opposite its existing site. The company says it is the first store of its kind in the UK, mixing health, nutrition and convenience.

A company spokesman told *Convenience Store Decisions* that the 8,900 sq. ft. store could be rolled out if worldwide if it's successful. Market rumors suggest it will launch 100 outlets in key metropolitan cities, such as Paris, New York and Rome. But the spokesman said it was still too early to speculate. "We have no idea of numbers," he said.

Harrods, which is chaired by Mohamed al-Fayed, whose son Dodi, was killed with Princess Diana in August 1997, offers a selection of goods from the Harrods Food

Halls as well as Blossom and Browne dry cleaners offering hand-finished dry cleaning and shoe repair off-site. A concierge service will deliver to local addresses.

The 102 convenience store features include freshly made bread and bagels, a Yo! Sushi eating area Krispy Kreme, a florist and an oxygen spa bar.

Yo! Sushi has more than 100 freshly made dishes on a conveyor belt and the in-house bakery has been branded Fournil de Pierre. A delicatessen sells gourmet sandwiches, snacks and salads. Its Energy Kitchen brand comprises a fresh juice bar, soup and pretzel stand.

Harrods 102 also has a Chinese herbalist bring the science of Traditional Chinese Medicine to the West. Other services include walk-in foot massages and a nail salon in the privacy of screened rooms.

Comments

Posted: May 8th, 4:41:49 PM

From: Pravahan

Do not know if Tesco delayed its entry into the American market. Remains to be seen how it fares on over-crowded American shores of retailing. Or, as they say, "there is space for everyone, everywhere!". It'll be interesting to watch Tesco's performance in the US market. The smart thing, though, is the decision to open shop in the West Coast--that could eventually turn to be the decisive one, in favour of Tesco!

Posted: May 8th, 4:40:20 PM

From: David Egan

USA is the home of "Retail" Customer Service. It is very different to Europe and in particular to Tesco(Europe). It could also be a steep learning curve for Tesco but as history has shown in Europe, one that Tesco is ready to learn. e.g. Ireland, France, Poland.

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