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Tesco: Price is the Key to Profit, Customer Value is the Key to Price

In the early 1990's, Tesco had the reputation as one of Britain's worst supermarkets. Today Tesco is a world leader in profitable grocery retailing

April 2005 and Tesco, once of Britain's least popular supermarket chains, announces itself as the first UK retailer to pass UKL 2 billions in profits – a 20% increase on the previous year - on worldwide sales of UKL 37 billions. What has happened to cause this turnaround and what can others learn from the Tesco experience?

MANAGEMENT STYLE AND LEADERSHIP OF CUSTOMER ORIENTATION

Success in companies is often linked to the leader and leadership style of a company. So, perhaps it is no coincidence that the transformation of Tesco's fortunes has occurred under the leadership of Chief Executive, Sir Terry Leahy, who has led the company since 1997 from a pre-tax profit of UKL 750 millions to the 2005 result of UKL 2.03 billions. Sir Terry ascribes some of Tesco's success – perhaps a little modestly – to several years of extremely buoyant consumer confidence in Britain (interestingly coinciding with the regime of Tony Blair's New Labour!). But there has to be more to it than this! Tesco has quite simply out-played and out-marketed its competition. As a recent FT article put it: "Tesco appears at times to do everything right. Whereas J Sainsbury or Wm Morrison (which bought Safeway in March 2004) are struggling, Tesco, with a nearly 30 per cent share of the domestic supermarket grocery sector, just goes from strength to strength." (By Sarah Ross, Financial Times, April 16 2005). Sir Terry Leahy was also named European Businessman of the Year by Fortune in February 2004. One of the key factors in Sir Terry's success is that he keeps in touch with customers and he keeps in touch with his staff. In fact, every year he spends one week working on the shop floor. One year he worked checkout, delivered Tesco.com orders to customers, worked in the clothing department and in the warehouse. "I learn an enormous amount from these stints with customers and staff." This unpretentious and down-to-earth style certainly contributes to Tesco's success.

Tesco actually dominates UK grocery sales with a massive 30% share. So customers MUST actually PREFER to shop at Tesco and MUST actually PERCEIVE and EXPERIENCE a better brand experience shopping at Tesco, because one thing is for sure, consumers DO have a CHOICE of retail outlet in most of the well-populated areas of the United Kingdom. Listening to a UK TV report on the Tesco result the other week, during which Tesco shoppers were interviewed, the customer satisfaction and delight was plain to hear. "The best choice of products", "...a wider range of choice and prices..", "... more convenient shopping..", "... good marketing...."

CUSTOMER CHOICE AND VARIETY

Tesco does lead with a low-priced range of staple grocery products, but part of their smartness is the fact that they offer consumers a choice of price bands in most categories of good and they present the higher priced one in an attractive way to entice the consumer away from the lower priced brands.

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Tesco has not only transformed the UK shopper's grocery shopping experience in their stores. Their higher profitability is linked also to their success in diversifying away from groceries. They have succeeded where others have tried and failed. Tesco has been the only retailer to really make a parallel success in online shopping, where they now boast 150,000 regular customers, generating UKL 36 millions of profit on sales of UKL 700 millions (note the handsome margin!). Tesco has also expanded its offerings to customers successfully in several other directions: non-food (now at more than UKL 9 billion or 25% of total revenues), services – such as mortgages and mobile phones, online grocery sales and international, which together now generate more profits than the entire company had earned in 1997. In fact more than half of Tesco's customers buy clothing in the store as well as food. Tesco also sold more than 15 million books in 2004/5. Tesco personal finance has more than 5 million customers and signs up 60000 new customers each month.

All of these diversifications of Tesco – into to markets with other established and successful incumbent suppliers – indicate that it is Tesco's business model and attention to customer needs and value drivers that are the basis of the company's success. As well as being the uncontested leader in UK grocery retail, Tesco is now competing successfully with UK non-food and specialist retailers such as Boots and Dixon's, as well as with the major suppliers of financial services.

VALUE POSITIONING, CUSTOMER PERCEPTION, CUSTOMER ATTRACTION

Tesco started life in the 1920's as a "pile it high, sell it cheap" retailer. It evolved in the 1970's and 1980's as a follower of then market leader, Sainsbury. When Leahy was head of Marketing in the 1990's he concluded that Tesco shoppers disliked the follower position Tesco had taken. He responded to customer demand for a retailer targeting the value-conscious shopper, upgrading the image from cheap to value. This is a VERY important realisation that value does NOT always mean lowest price. Tesco revamped its image not just in the in-store offering, but in the stores themselves, closing many of the older urban sites and replacing them with high quality buildings on out-of-town and close-to-town sites, with convenience and attractiveness to customers being paramount. The larger stores also enabled Tesco to offer customers a wider CHOICE, which the customer values. "The thing about Tesco is that there is something in the store for everybody." Tesco has also extended its store formats and styles to meet the various needs of different customer segments: from convenience stores at petrol stations, to traditional urban outlets (Tesco Metros) to suburban hypermarkets.

SELLING POWER DRIVES BUYING POWER AND FEEDS CUSTOMER UNDERSTANDING

Clearly the selling power of Tesco feeds back into the company's purchasing leverage with major suppliers and this enables them to buy at better prices. But that is not the only basis for Tesco's better competitiveness. The first to offer Customer Loyalty Cards – in itself a major coup, Tesco mines the customer contact and the customer data it collects through regular feedback from customer research and through the data it collects via its customer loyalty card programme and this unique set of knowledge is used to create and develop new ways to serve and delight the customers.

CUSTOMER FOCUS LED FROM THE TOP

The REAL key to Tesco's success is the customer focus throughout the organisation, ingrained into the culture and led from the top.

Tesco has moved from number 3 to number 1 in the UK and is now the third largest retailer in the World. Our advice: look out Wal-Mart and look out Carrefour.

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LESSONS WE CAN ALL LEARN

So any retailers, reading this article can clearly learn a lot from the Tesco case. But what about many of you who do not work in retail.

Well, the lessons are there for us all to learn

- Profit is driven by price is driven by value and value perceptions of customers

- Customers demand value, they often like to have a CHOICE, they are not only driven by lowest price

- Other value drivers of customers might be convenience, responsiveness, service

- Customers are loyal to suppliers who listen to, understand and respond to their needs

All of this should be ingrained in the company culture of the supplier and be led from the top, reinforced by the management and implemented by the staff every day without fail.

About the Author

Phil Allen runs the Marketing Excellence Practice, MarketAbility, serving a broad base of clients in chemicals, plastics, energy and other industrial and B2B sectors covering all aspects of improving business profitability through applied practical marketing excellence, customer value management and key account management. He counts more than 30 years of practical experience in marketing and sales.

MarketAbility operates both at global and local levels around the world.

In a recent profile of MarketAbility on EuroNews, Juan Senor, International Business Writer, praised MarketAbility for its unique and practical approach to business value creation.

Phil is the founder of the Customer Value Management Circle of Excellence (www.customer-value.org), a learning and sharing organisation for all involved and/or interested in managing customer value and building customer loyalty.

He is co-author, with J. Nicholas de Bonis and Eric Balinski, of the book "Value-Based Marketing for Bottom-Line Success", to be published by McGraw Hill in December 2002. Visit <http://www.pentadigm.com>

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Find out more about MarketAbility at: www.marketability.org

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