a home brewer in the first three months of the launch. Finally, a public relations campaign coupled with additional marketing activities by roasters such as placement in their retail stores, catalogs, and Web sites would provide additional avenues for sales to gourmet coffee drinkers.

Lazaris's Dilemmas

As Lazaris reflected on Keurig's strategy for the launch of its at-home brewer in preparation for the senior management meeting, he wondered:

1. How should we respond to GMCR's request to switch to the single K-Cup approach? What do we really need to know to make this decision? How will our other roasters and the KADs respond? Can our team really implement a new game plan at this late date and still launch in six months? Can we afford the write-off on the new Keurig-Cup and packaging line tooling?
2. What is the right price for the brewer? Is there a way to afford a $149 price point on the brewer that we have not thought of?
3. How should we price the at-home portion pack? If we have one cup in all markets, what pricing is optimal? If we have both the K-Cup and the Keurig-Cup, what pricing makes sense and optimizes our market opportunity?
4. Have we taken the necessary steps for our marketing plan to succeed? Is there another avenue that we are overlooking?

Source: Elizabeth L. Anderson, Keurig at Home: Managing a New Product Launch, Kellogg School of Management, January 27, 2006. One-time permission to reproduce granted by Kellogg School of Management.

Case 6-8

Tesco

Tesco is the UK's dominant retailer, taking around 30% of the national grocery market, and the company has overtaken Argos/Homebase to become the UK's biggest retailer of non-food items. It is the world's third largest retailer after Wal-Mart and Carrefour. Its annual group sales are pushing £53 billion, with profits of £2.75 billion in 2008. Tesco.com is one of the world's most successful Internet retailing models with 850,000 customers and sales growing at around 30% a year. The company's growth and business performance up to the mid-2000s has been outstanding.

After a decade of extraordinary growth, Tesco is nearly twice the size of its nearest competitors, Asda and Sainsbury, and takes £1 in every £8 spent in Britain's shops. However, for much of that time Tesco has faced only weak competition—Morrisons was embroiled in the problematic acquisition of Safeway, Sainsbury had a legacy of major operational problems and even Asda wobbled after it was bought by Wal-Mart. For this decade, Tesco appeared unbeatable and unstoppable. However, by mid-2008 there were growing signs that Tesco's performance could be faltering. A slowdown in sales growth over Christmas 2007 saw £1 billion wiped off Tesco's market value. Underlying sales growth in the UK was running at 3–4% compared to the 5–6% of earlier years, as rivals like Morrisons and Sainsbury have bounced back. Profit forecasts in the City have been trimmed, and Tesco had lost market share for three quarters in a row. Tesco shares fell 15% in the first quarter of 2008. Full year results were stronger, but investors were also unhappy to see a steady stream of senior executives leaving Tesco to join its rivals.

This case was written by Nigel F. Piercy, Warwick Business School, The University of Warwick.

Tescopoly in the UK

Tesco has become a profoundly unpopular company. In 2008, when Tesco collected awards at the Retail Week "industry Oscars"—leader of the year for CEO Sir Terry Leahy and "consumers" favourite retailer'—on the walk to the stage the Tesco executives were booed by their peers not cheered. Anti-Tesco protests are widespread among local communities resisting the arrival of new superstores in their towns and fighting the growing dominance of Tesco Express local stores in suburban areas. Some 2000 small independent food shops close every year because of supermarket competition. Competition Commission recommendations appear aimed directly at curbing Tesco's growth. Tesco's reputation is one of aggressive treatment of competitors, brutal almost feudal treatment of suppliers, and transgressions like collusion to fix prices in the dairy business. In

2008, when the *Guardian* newspaper published articles alleging that Tesco was avoiding paying UK taxes, the company moved rapidly to silence its critics through the courts, leading the *Guardian* to observe: "It is hard to think of another large public company that would resort to such bullying tactics." Tesco's 2008 AGM saw angry critics flying in from India, China and the USA to attack Tesco strategy, as well as a TV chef demanding better conditions for Tesco's battery-farmed chickens, amid much television and press publicity.

Internationalizing Tesco

In the 1990s Leahy started serious efforts to develop the Tesco business abroad. It has grown to a portfolio of around 12 different markets, employing 450,000 people, with the international business generating £7.6 billion in sales and £370 million profit. Tesco is increasingly looking to its international businesses to drive growth. About 80% of group capital is being spent on overseas expansion. While internationalization has been part of Tesco's strategy for some time, the way conditions are developing for the company in the UK now makes success in the international operations a much higher imperative. In 2008 the UK still accounted for 76% of Tesco sales and 78% of profits.

International growth at Tesco has a mixed history. A purchase of the French supermarket chain Catteau in 1993 was a disaster, and the company pulled out of its Taiwan operation because of poor results in the face of competition from Carrefour. However, the company has growing businesses in Eastern Europe—the Czech Republic, Poland, Slovakia and Hungary. In 2007 Tesco began rolling out Tesco-Express type stores in Japan, suggesting after four years of trying they had finally found an effective format. The company is looking for aggressive expansion in the world's second-biggest economy. It has around 150 stores in Japan—of which about 50 are its own-branded Tesco Express outlets. Tesco entered Japan in 2004, through acquisition of the Tsurakame chain of discount supermarkets. The venture was dogged by early setbacks, and returns were the lowest of all Tesco's international markets. Japan is not an easy market—Carrefour withdrew in 2005 and Wal-Mart is struggling.

Tesco operates around 50 hypermarkets in China, on the east coast between Beijing and Shenzhen. In 2008 Tesco took its Express convenience chain into China as well—the first Tesco Legou Express opening in February. China became the eighth overseas market to get the Tesco Express format, joining Thailand, Japan, South Korea, Ireland, Turkey, the Czech Republic and Hungary. The multi-format approach increasingly characterizes Tesco's international strategy. In 2008 the company acquired the South Korean discount chain Homeover for just under £1 billion, adding 36 stores to its existing Korean business.

The importance of international success underlines the significance of Tesco's entry into the USA with its Fresh & Easy retail concept. Leahy's international strategy has been based on only entering emerging markets with fragmented local competition, a large population and potential for rapid economic growth to boost consumer spending. Entry to the USA is a major departure from this successful strategy.

Tesco's American Adventure

The USA has been the graveyard for many British retailers' international strategies. It is a fiercely competitive marketplace and entries by firms like Marks & Spencer and Sainsbury have been disasters. Nonetheless, Tesco has committed £1.25 billion over five years to its new Fresh & Easy convenience store format in the USA. Leahy stands to make an £11.5 million bonus if the venture pays off. The goal is to have 200 stores open by the end of the 2008/9 financial year, though it could be a chain of 1,000 stores by 2012 if the retail format is favoured by US consumers. A rapid roll-out is important to making the low-margin business model work. Initial store openings were in California in 2007, with plans for more in Arizona and Nevada, and possibly Mexico. This rate of expansion is unprecedented for Tesco—its next biggest overseas market is Thailand, where it took 9 years to open 220 stores. Tesco has almost no brand recognition in the USA—when the F&E team first went to the USA they could not even lease cars easily—people would say "are Tesco good for the money?"

The Fresh & Easy Concept

Tesco's US market entry is based on a small-store format—loosely based on the Tesco Express, but emphasizing low price for high quality and healthy food—operating as Fresh & Easy (F&E) not as Tesco branded stores.

Developing Market Understanding...

The Tesco commitment to its US strategy is underlined by the intense efforts to build an understanding of the US market. Researchers probed the refrigerator contents of and lifestyles of US families, checking the time

they got up, what they ate for breakfast and when they shopped. The retailer even prepared meals for them. For two weeks 50 senior Tesco directors and managers lived the "American dream"—shopping and eating with US families on the West Coast, even sharing their leisure activities. Amid intense secrecy a prototype store was built in Los Angeles—the cover story was that they were making a movie, and executives used plastic bags of cash rather than corporate credit cards to buy things for the mock store, rather than risk tipping off rivals what they were doing. People were flown in from San Francisco, Las Vegas and Phoenix to test new ideas and products—more than 200 focus groups toured the store. Interestingly, part of the F&E strategy is to open its small stores in poor inner-city areas largely unpopulated by rival retailers—the US "grocery gap," where areas like South Central Los Angeles lack supermarkets and the city's poorest residents pay the highest prices for food at small local stores with limited access to fresh food.

Fresh & Easy's Market Positioning...

The F&E positioning is between the discount, cut-price supermarkets and the trendy, upscale "organic" food stores. The major competitors in the health-conscious market are Trader Joe's and Ralphs, featuring attractive stores with unpackaged fresh produce and expansive salad bars. The business model positions F&E as a hard discounter, with costs kept low by keeping product ranges and store formats identical across the chain. The goal is to undercut competitors like Trader Joe's by 10–25%. F&E CEO Tim Mason notes "The brand is designed to be as fresh as Whole Foods, with value like a Wal-Mart, the convenience of a Walgreens and product range of a Trader Joe's." Nonetheless, initial reactions were mixed—some consumers complained that the "Fresh & Easy" name sounded more like a chain of chicken ranches, or a tampon.

The Fresh & Easy Value Proposition...

The proposition is low-cost fresh food. Much of the fresh produce and premium ready meals are locally-sourced—F&E sells large sushi packs for under £2 and Australian wine for £1. Prices are low because stores are located in low-rent areas. Some locations are planned for "food deserts"—areas like Compton in Los Angeles, which other retailers have avoided. The F&E stores are small by comparison with normal supermarkets—at 10,000 square feet they are less than a third the size of the average supermarket. Many of the ideas like the free-sample and recipe kitchen and signs about being a good neighbour are very similar to Trader Joe's and Whole Foods, but the prices are substantially lower. For the USA, F&E is a radical innovation in the form of a neighbourhood convenience store with a distinctive offering. While related to the Tesco Express format, the goal was not to transfer the Tesco format from Britain to America, but to design an American store for American consumers.

As in all its operations, Tesco adapts to local market conditions. In the US chain there are no British products and no Tesco logos. The US operation in California is painfully "hip." The head office has life-sized surf boards pinned to the walls, middle-aged executives are squeezed into tight jeans, and CEO Tim Mason from the UK, normally "suited and booted," has taken to wearing friendship bracelets. The stores are predominantly painted green and include parking spaces reserved for hybrid cars and bicycle racks.

For the first time in its history, Tesco has become directly involved in food production. It operates a food preparation facility—dubbed the Fresh & Easy Kitchen—at its central distribution centre near Los Angeles. The company decided to set up its own kitchen because of concerns about using third-party suppliers who did not meet their standards. Forty percent of the ingredients for the kitchen, as well as prepacked fresh products for the stores, are provided by Wild Rocket Foods and 2 Sisters Food Group. These two UK suppliers have each invested $100 million in setting up food processing plants adjacent to the Tesco distribution "campus." None of Tesco's US competitors operates similar kitchen facilities.

The Underlying Relationship Network...

The F&E operation rests on a complex set of strategic relationships and networks, some of which provide the strengths of the F&E business model, and some of which underline weaknesses in Tesco's US operation.

The **consumer relationship** is potentially problematic. F&E is mainly own-brand, which is a risk with brand-obsessed US consumers. The stores are utilitarian and basic in a country where this is far from the usual food retail expectation. There are few staff on hand to assist, which is unusual for US stores and their service culture. The F&E stores use self-service check-outs to reduce costs, which is difficult for the elderly and non-English speaking consumers-Americans are used to being served. Neither are there any of the

money-off coupons and vouchers to which US consumers are accustomed. There may be good reasons why other retailers in the USA have decided not to try to change middle America's shopping and eating habits.

The **competitor relationships** are critical to F&E's survival. Initially, it seemed that the push-back from US competitors was muted, and Tesco believed that the local retailers assumed that F&E was so radical it would not be a threat to them. In fact, the F&E venture is being closely tracked by US competitors. Some analysts suggested that lining your tanks up on Wal-Mart's front lawn and expecting them to be ignored was a little optimistic. Wal-Mart is planning small-format grocery stores in the Phoenix area and Safeway is launching small stores in northern California. Indeed, Wal-Mart has hired a former Tesco executive to head its defence. The signs are that Wal-Mart's first-ever small stores under the banner "Marketside" will adopt a green logo with a stylized tomato, egg and grape design, suggesting a greater emphasis on healthy eating and fresh produce—and indicating an all-out war with Tesco's F&E operation. The first Wal-Mart Marketside locations are close to F&E sites. The Wal-Mart Marketside stores will be built around a "premium offering" rather than low cost—with less focus on price than F&E and more emphasis on "meal solutions," with food prepared in-store. The Safeway "Market by Vons" small-store format has been launched in California—described as "very pretty" but "very expensive" by Tesco's Tim Mason. The competitive responses by both Wal-Mart and Safeway are avoiding the F&E low price position.

Part of the F&E strategy relies on a new approach to **supplier relationships.** One critical part of the strategy developed by Tesco was to bring UK-based suppliers with them to the USA. This has the strength of securing expertise in the type of product preparation required for Fresh & Easy. However, it also has the attraction of avoiding dependence on local suppliers in the USA, who would likely be in the pocket of Wal-Mart or other US supermarkets—being a new, small customer for suppliers dealing with US retail giants would be a very weak and vulnerable position likely to lead to product shortages, short deliveries and poor service from suppliers. Tesco avoided this problem by bringing with them suppliers already trained to toe the Tesco line—unlikely to cause problems and risk their standing with Tesco in the UK. Relatedly, back-office functions have been outsourced to Bangalore in India to keep administration costs low.

There have been some problems regarding existing **partnership relationships.** One cost of Tesco's entry into the USA was the demise of collaborative relationships that had been established over time with US companies. A joint venture with Safeway in home shopping—Grocery Works—was ended by Safeway because of the F&E venture. Tesco owns 84% of Dunnhumby, the loyalty card research firm, and their largest client in the US—Krogers—was evaluating the viability of the relationship in the light of Tesco's entry into US food retailing.

Perhaps the most problematic part of the F&E relationship network relates to **relationships with employees and trades unions.** The main grocery workers' union—the United Food and Commercial Workers Union—represents almost 90,000 people in southern California. It is part of the Alliance for Healthy and Responsible Grocery Stores—a coalition of community groups, faith-based organizations and unions. The alliance was formed after a long strike by California grocery workers in 2003, and has since succeeded in blocking Wal-Mart superstore developments.

This alliance is a vocal critic of Tesco, accusing the company of arrogance, being out of touch with local communities, and failing to appreciate the close ties between consumers and grocery workers. The deal-breaker is Tesco's employment of non-unionized staff. Notwithstanding requests from the unions for meetings, backed by letters from Hillary Clinton and Barack Obama, Tesco has refused to meet union representatives. Obama urged Tesco to work with local communities to develop community-benefits agreements—written pledges of the rewards a store opening would bring to local areas. As he moved ever closer to the US Presidency, Obama renewed his pleas direct to Leahy on union membership, though with no discernible effect on the company's position. The union is also looking to British Labour MPs to support its campaign.

The union stepped up its campaign, dubbing the Tesco chain "Fresh & Queasy" and questioning the freshness of its products (using television programme evidence about shortcomings in hygiene and waste control in Tesco's UK food stores). The union's website accuses Fresh & Queasy of being the "Wal-Mart of the UK" with a "bad record" on selling organic foods. The union was behind the establishment of a new group called Health First, which was the group that brought a successful court case against Tesco on the basis that its main warehouse did not meet environmental planning law—similar tactics have been used to stop the expansion of Wal-Mart in California.

The Early F&E Results

Tesco declined to honour an earlier undertaking to break out the US results in its 2008 annual report, fuelling growing rumours that the early performance of F&E was falling short of expectations. Tesco strongly rebutted such claims. In March 2008, after a frenetic opening programme of 61 stores in five months, Tesco announced a three month "pause" in store openings on the west coast (although store openings resumed in July in Los Angeles). F&E losses up to February 2009 were predicted at £100 million compared to £62 million the previous year. Jeff Adams (former Tesco chief in Thailand) was parachuted into the US business as Chief Operating Officer—with plans he should be used in Chicago and the Midwest, once the California, Nevada and Arizona operation reaches critical mass. In April 2008 Tesco announced plans to cash in on part of its property portfolio by selling off some UK stores, to help fund its international expansion.

Suppliers were reporting disappointing sales at F&E, and that F&E stores were struggling to attract customers. While Tesco had targeted weekly sales at $12–$22 a square foot, one analyst reported sales densities in F&E were as low as $5 a square foot. One unsourced report suggested F&E was missing internal targets by as much as 70%. Analysts began to predict that F&E losses would escalate in 2009—possibly to more than double previous estimates. Consumer blogs described the F&E stores as "boring, sterile and depressing," and branded goods suppliers (frustrated by the fact that more than half F&E's 3,500 products are own-label) have not been slow to spread rumours that the chain is on its knees. Others suggest that the F&E retail concept is flawed and cannot succeed.

Tim Mason used the break in store openings to "tweak" the F&E model: **prices**—consumers did not get the low price image, so "extra-low price" promotions have been introduced—what Mason calls "turning up the volume on price;" **promotion**—introducing discount couponing around stores offering $5 off a $20 shop; **products**—new fresh food lines added; **shopping trolleys**—bigger trolleys outside the stores because small trolleys suggest small shopping trips; and **store design**—more colours to make the stores "warmer" and less sterile. He is also fighting very high wastage rates with fresh products.

Nonetheless, in April 2008 the company announced plans for a second distribution centre and kitchen in northern California. Leahy was positively gushing in presenting his 2008 report, claiming F&E was ahead of budget and that the F&E stores already had a "special place" with US consumers.

These judgements are grossly unfair, based on the first few months' trading of a new business. It will not be clear for a considerable period of time whether F&E will succeed. However, the issue becomes whether pressures will lead to premature exit from the business and the potentially disproportionate effect of the F&E venture's performance on Tesco's UK and other overseas businesses.

Dilemmas for Tesco's Fresh & Queasy

The F&E positioning is between the discount supermarkets (e.g., Wal-Mart) and upmarket, stylish "gourmet" retailers like Trader Joe's (and to a lesser extent the much larger Whole Foods Market and Bristol Farms). F&E offers more fresh and organic foods than the discounters, but is cheaper than the gourmet outlets. The classic dilemma is whether they have found a profitable and defensible new market space, or whether they have in effect created a "stuck in the middle" operation that is neither one thing nor the other, which will lose out on price to the discounters and on product quality to the gourmet stores. If F&E has uncovered a new market space, then the question remains whether it can be defended or whether it will simply be invaded by new formats developed by established US competitors or by new entrants. There appears little in the F&E format that could not be copied and bettered by competitors. These issues have not been resolved and will determine whether F&E survives competitive attacks. It is noteworthy that the new formats developed by Wal-Mart and Safeway to compete with F&E have avoided low price positioning.

Certainly, the factors that drove Tesco's initial success in the UK (radical price discounting) and then allowed the company to sustain and consolidate its position (market power used against suppliers, blocking competitors access to new sites, and political clout) simply do not exist in the USA. To local suppliers, Tesco is a small, new entrant with little buying power and they are unlikely to tolerate the aggressive attitudes to which Tesco exposes suppliers at home. Tesco has no record of working with trades unions and local communities, which is a requirement in the California marketplace. Tesco's clout in the UK is backed by muscle weight which it simply does not have in the USA. It

ıains to be seen if the company can adjust to these .lities and develop new ways of working.

In the short-term, Tesco faces the problem of vhether the retail format it has piloted in the south-vest USA, in the form of Fresh & Easy will be capable ıf successful expansion elsewhere in America. Will a ormat that matches the characteristics of California nd Arizona consumers really travel to Oklahoma, Visconsin and New York? Unlike the UK, there are elatively few genuinely national food retailers in ıe USA, reflecting this market diversity in America. Moreover, while the early operation in the south-west as several important protections built into the busi-ess model—most importantly the import of European uppliers to make the supply chain secure—there is major question mark over the extent to which these rotections can be maintained in a larger expansion in ıe USA. If Fresh & Easy has to change supply chain trategy to expand, dealing mainly with local suppli-rs, then the viability of the operation becomes more uestionable.

However, perhaps the largest dilemma for Tesco to onfront with Fresh & Easy in the USA is not simply will it work?" but "how much will it hurt us if it fails?" he immediate costs of failure in the USA would not e devastating—stores could be disposed of, and so on. he real damage would be the impact of failure on the ɛst of the business. It would raise the question that if esco can be beaten in one market, then perhaps it can e beaten in another—perhaps even in the UK. At a me when the Tesco UK juggernaut is beginning to ow, and Leahy is coming towards the end of his ten-re as CEO with no obvious successor apparent, this potentially a major new vulnerability for the busi-ɛss. The F&E operation is minute in terms of the total ɛsco business, but with its very high profile underlin-ıg its strategic importance, failure would have a dis-roportionate effect on Tesco's strength. Certainly, if ɛsco cannot succeed in the USA, then its aspirations ıwards being a genuine global competitor to Wal-Mart e at an end.

In particular (much to Leahy's disgust) Tesco went ırough the late-1990s and started the 2000s with its ıares considerably undervalued by the stock market. his largely reflected the market's nervousness about ɛsco's aggressive expansion strategy. A public failure the USA would provoke an unprecedented crisis for e business, and would very likely depress its share ılue yet again. In these circumstances, Tesco would ɛcome an attractive target for a strategic investor. The opportunities for an aggressive investor to release value for shareholders would be very attractive, for example: spinning off as separate businesses the different retail formats, the international operation and the Internet operation; selling assets like the land and property bank (estimated value of £14 billion alone); selling key operating retail sites to competitors. Such moves would transform the Tesco business, release huge value for shareholders, and probably meet with the wholehearted approval of the British regulators and critics of Tesco's market dominance. However, the legacy business would be nothing like the current Tesco operation, and Leahy's strategy would be in tatters. The incoming CEO would find that the Tesco business model was broken.

This scenario would be attractive to many suppliers who have had their profit margins crushed by Tesco's aggressive and oppressive use of its market power. Some might even play a role in orchestrating and supporting the investor-led restructuring of Tesco, as a way of reducing their dependence on the company. If Sainsbury were finally to be purchased by private equity interests and to undergo a similar type of restructuring, the UK retail grocery market would be a very different prospect for suppliers.

The F&E platform is intended to form a launch pad for a broader push against Wal-Mart, both in the USA and in other global markets where the two retailers compete against each other. If F&E fails, then Tesco is left without this component of its global competition strategy. This is an urgent issue. Tesco has placed India top of its target list after the USA. Its talks with local partner Bharti collapsed, and Bharti went on to partner with Wal-Mart, leaving Tesco to identify another possible partnership and play "catch-up" to Wal-Mart again.

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