Plenty in store

MICHELLE PERRY TALKS TO THE TREASURERS WHO HAVE PLANNED THE FINANCIAL STRATEGY BEHIND TESCO'S MOVE ABROAD.

A successful UK business model doesn't automatically translate into the same success story abroad, as any seasoned businessman will know. For this reason Tesco, the UK's most successful supermarket chain, avoided the trap of transferring wholesale its British model to other nations and expecting the same results. Perhaps rather ironically its forays outside Britain resulted in transforming the company's original business model.

What was critical to their international plans was a simple, clear strategy of what they wanted to achieve and how they were going to do it. Simplicity across all departments is what drives progress at Tesco and particularly in the treasury division, says Keith Richardson, Deputy Treasurer at Tesco.

The result is that in a decade the supermarket's reach has exploded. Tesco operates in 12 countries outside the UK; in five of those it is the market leader. Tesco employs 100,000 staff overseas, serves over 15 million customers and generates £7.6bn sales and £370m profit. Over half of the group's space is now outside the UK.

Tesco's strategy for growth, explains Nick Mourant, Group Treasurer of Tesco, is to enter a target country without great fanfare. "Typically we go in low key and then build organically so we keep value for shareholders."

Typically these start-up operations were funded using equity, ultimately from the parent company, which in turn would have used a variety of funding methods to generate the cash. As the cycle moved on, the stores became profitable and then the treasurers changed the mix of funding.

Before it went international Tesco didn't have a hypermarket – food and non-food store – offering. "We became a hypermarket retailer in the UK because of our international experience. We've grown organically by using a format that was alien to Tesco in the mid-1990s," explains Mourant.

A typical example of organic growth has been in the Czech Republic, where Tesco acquired two stores from Kmart in the mid-1990s. The operation was then developed into the country's number two retailer.

"In Poland we are the largest hyper-market operator, even though our market share is only c. 5%. This suggests we still have lots of room for growth."

Executive summary

- Simplicity in all areas of the business – including the treasury function – has been the watchword as Tesco has expanded overseas.
- The company runs a centralised treasury operation using an electronic cash management system to mitigate counterparty risk.
- The group hedges its balance sheet to avoid both currency volatility and avoid surprises from its international operations.

Opposite: Inside a Tesco store in Slovakia. **Above clockwise from top left**: Clare Hall Dublin, Rep. Ireland; Melnik, Czech Republic; and Lublin, Poland.

Tesco now operates in six countries in Europe as well as the UK. It first dipped its toes outside the UK around 10 years ago when it ventured into Hungary. After its success there the supermarket entered the Czech Republic, Poland, the Slovak Republic and the Republic of Ireland. The latest European acquisition was in Turkey where it purchased a profitable retailer known as Kipa. Management chose this region because it was considered a growth area, "where we can add value; where the current retailing provision isn't up to par."

"The likely growth in consumer wealth and infrastructure over the next 10 years will add enormous value to Tesco. In Turkey, for example, it's a market that we see growing fast over the next 15 to 20 years," says Mourant.

During 2004/05 Tesco added 35 new stores overseas, including the first Tesco Extra in Dublin. The first compact hypermarket (developed in Thailand) was opened in Hungary as well as new distribution centres in Poland and Hungary. A further distribution centre was opened in the Slovak Republic this summer.

A significant proportion of Tesco's overseas investment is in Europe with the lead countries being Hungary and the Republic of Ireland. Despite the simple strategy for growth, there have been myriad of obstacles to overcome, particularly from a treasury perspective.

"Over the course of a year, these include currencies that can easily move by 25%, to managing the interest cost in Europe, which can range from 18% in Turkey to 2% in the Republic of Ireland." says Richardson

To avoid surprises, Mourant says the group has a policy of hedging its balance sheet to reduce the volatility in the currencies. "We don't believe our shareholders are expecting any surprises from our international operations. We will hedge between 50% and 100% of investments in our overseas businesses," says Mourant.

Banking, taxation and law have all proved challenging areas for Tesco's treasurers. Despite central Europe's close proximity to the UK, compared to the other regions in which Tesco operates, the legal and tax frameworks are complex and very different to Britain.

As a big buyer of freehold sites the group has faced some difficult times in terms of tax strategy. "Purchase of freehold sites is difficult, as the legislative framework tends to be underdeveloped," says Mourant.

Banking also proved to be an area pitted with obstacles, given the region's political and economic history. When Tesco launched its expansion plans there was a limited number of recognised banks and an unknown quality of credit. "We had to lay down simplistic rules for treasury, how to manage cash plus provide the level of control and visibility we had become accustomed to in our UK operations," says Richardson.

This has been achieved through its centralised treasury operation using the electronic cash management systems provided by Citibank and HSBC. This enables treasury to mitigate counterparty risk and centralises cash with the minimum loss of value.

Tesco manages this by using a tri-bank account structure, which was developed when Tesco first went international. On a weekly basis each country is responsible for producing a cashflow statement, which is sent to centralised treasury.

On request from the local operation, money is then released into a locally controlled account. Depending on the amount of funding required, centralised treasury will either fund or deposit cash as required.

"It's a great discipline for any company to understand its cash requirement. It's simplistic but effective," says Richardson.

"We have two international treasurers; one covering Asia and one covering Europe. Douglas Stevenson is our European Treasurer and one of his main tasks is to act as the link between the local business and the centralised treasury operation. This is an extremely important role as it enables treasury to understand the business needs and keeps open the lines of communication across the Tesco operations," Richardson explains.

Credit quality of the local banks in the region has improved a great deal since Tesco began operating there, but the primary objective is still control and visibility, so all cash is still swept into a centrally controlled account held at Citibank for each of the countries in central Europe (HSBC in Asia).

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