Capital Discipline and Financial Market Relations in Retail Globalization: Insights from the Case of Tesco plc

Abstract

This paper provides an in-depth study of leading transnational food retailer Tesco plc to explore how its financial management and relations with the investment community – notably its reputation for capital discipline – underpinned successful expansion. Informed by close dialogue with equity analysts, we investigate how this model deteriorated since the late 2000s with declining returns, leading to high-profile international divestitures. The analysis assesses the drivers of these difficulties, and conceptualises them. It examines how the retailer, pressured by the investment community, reviewed its international strategy and attempted to ‘reset’ its relations with capital markets to re-emphasise shareholder value and returns. The research teases out the manner in which legitimacy with capital markets underpins the extent, pace and form of global retail expansion, leading to significant implications for workers, consumers and wider stakeholders across spatially dispersed host markets.

Keywords: global retail, capital discipline, globalization, retailing, finance

JEL classifications: L81, F23, G30, G34

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Steve Wood¹, Neil Wrigley², Neil M Coe³

¹ The Surrey Business School, University of Surrey, Guildford, Surrey GU2 7XH, UK.
Email: sm.wood@surrey.ac.uk

² Geography & Environment, University of Southampton, Southampton, SO17 1BJ, UK.
Email: n.wrigley@soton.ac.uk

³ Department of Geography, National University of Singapore, 1 Arts Link, Kent Ridge, Singapore 117570
Email: geonmc@nus.edu.sg

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1. Introduction

The 2013 Annual General Meeting of international food retailer, Tesco plc, witnessed remarkable events. Without warning, former CEO and Chairman, Lord Ian MacLaurin, directed incendiary comments at the recently retired and highly regarded Sir Terry Leahy, who had stood down in 2011 after 14 years as CEO. Leahy had masterminded the strategic diversification of the firm – notably Tesco's transformation from primarily a domestic operation, with a limited presence outside the UK, into the third largest international retailer by revenue (Coe and Lee, 2013). Despite Leahy's record of consistently increasing Tesco's annual operating profit during that period from £774m to £3.8bn, MacLaurin's assessment was that:

‘when you judge the performance of a chief executive, you not only judge the performance of his day-to-day operation, but you also have to judge his legacy, and I think we are all very sad in this hall to see the legacy that Terry Leahy left’ (*Financial Times*, 2013, 1 & 10).

So what had produced such a damning critique? After all, Leahy had been a CEO widely admired for having skilfully negotiated the potentially hazardous transformation of the retailer into a champion of Britain's role in the global economy ‘under the radar’ of hostile public and financial market scrutiny (Lowe and Wrigley, 2010). The answer lay in the manner in which the retailer's aggregate performance – overall across its many divisions and specifically in its home market – had disappointed over the previous two years. Critics argued that recent international expansion had come at the expense of a focus on tight capital discipline and returns¹. This was illustrated most notably in April 2013 when the firm announced that it was intending to exit the United States – the last and most high risk of the

¹ We use the term ‘capital discipline’ to refer simply to the ability of a firm to balance its capital expenditure with its returns on investment. Notably, this is somewhat different to the way the term is often employed by some finance communities to justify systematic and wide ranging restructuring programmes involving cost cutting and subsequent job loss.

Leahy expansions – incurring a £1bn write-off and not far short of £1bn of trading losses (Shore Capital, 2013a) along with £150m in market exit costs. As pressures from the investment community began to mount, there were admissions by Tesco senior management that the rate of international expansion would be pared back involving reduced capital investment and a stricter focus on productivity and returns. Such admissions provided a marked contrast to the earlier period of Leahy's tenure as CEO (the late 1990s and early 2000s), when Tesco was widely regarded as a retailer that had been disciplined with its capital expenditure and lauded by the financial community on that basis.

In this context we note that issues of financial control and the relationships with capital markets have remained under-developed themes in the literature on the globalization of retailing. In consequence, this paper contributes to our understanding of these issues by analysing the experience of one of the world's leading transnational retailers, interrogating how its management of finance and relationships with the finance community affected the nature, scale and direction of its expansion to the start of 2014. More specifically, we use an in-depth case study to fulfil the following objectives:

- (1) To explore the link between successful international retail expansion strategy, capital discipline and support from the financial markets;
- (2) To assess the drivers behind deterioration in capital discipline in international retail expansion and to analyse the responses of the investment community to this;
- (3) To conceptualise retailer responses to weakening trust by the investment community and to appraise the implications this has for the geography of retail globalization more widely.

The paper is structured as follows: first, drawing on research across economic geography, we explore the importance of relations with the capital markets in retail TNC expansion and identify equity analysts² as key barometers of investment opinion. Second, we briefly explain our chosen methodological approach – an in-depth case study. Third, we examine how our case study retailer achieved high levels of international expansion while maintaining a tight grip on capital discipline which served to mollify the financial markets for a number of years. Fourth, these insights inform examination of the breakdown in capital discipline at the retailer which led to wide ranging capital market pressure on the firm. Fifth, we assess how, in 2013, the retailer has attempted to ‘reset’ its relationships with the investment community and the implications that this has for international expansion strategy. In doing so, we explore the relational challenge of maintaining support from the capital markets, engaging with practice at the firm level within a case study context. We conclude by considering the strategic implications of finance and firm relationships for conceptualising international business expansion in economic geography.

2. Finance Community Relations in Retail TNC Expansion

Transnational retail expansion became a focus of cross social-science scholarship in the early 2000s as the surge of retail FDI in the late 1990s and its impacts on emerging markets in East Asia, Central/Eastern Europe and Latin America became increasingly clear (see Dawson, 2007). Transnational *retail* expansion is distinctive compared to other international business in terms of the relative importance of organizational and scale economies, sensitivity to cultural and societal contexts, high labour costs and the capital demands of store networks and distribution facilities (Burt *et al.*, 2015). The financial drivers of such expansion over the past 20 years have included free cash flow from core markets, access to low cost debt or

² This paper uses the terms “equity”, “sell-side” and “securities” analyst interchangeably.

equity capital, super-normal returns accruing to first-movers in emerging markets, international merger and acquisition opportunities/multiples and negative working capital cycles (Wrigley, 2000a). Importantly, such financial drivers have been given the same prominence as the more conventional retail management and systems capabilities (innovative formats, sophisticated distribution/logistic and supply-chain management systems, human-capital resource methods and ‘best practice’ knowledge transfer techniques) in accounting for the flow of retail FDI into emerging markets which were increasingly pursuing policies of full or partial liberalization of FDI (Wood *et al.*, 2014). That is to say, from its outset economic geography scholarship on retail globalization was linked to the wider concerns of several disciplines with what has been termed ‘financialization’ – ‘shorthand for the growing influence of capital markets, their intermediaries, and processes in contemporary economic and political life’ (Pike and Pollard, 2010, 30). In particular, the link centred on the need ‘to understand firm finances as integral to our understandings of firm behaviour, governance and strategy’ (Pollard, 2003, 422) and to recognise how it ‘alters behaviour and values in the economy’ (Christopherson *et al.*, 2013, 352).

Financialization has impacted retail globalization in many ways. There has been an increasing focus on enhancing shareholder value leading to battles for corporate control, with attempts being made to restrict managerial freedom to engage in what is regarded by some stakeholder groups as essentially ‘unaccountable’ and ‘non value-adding’ expansionary investment into international markets (Palmer and Quinn, 2005). The emphasis on shareholder value has also led to changes in the ways that retail firms operate. For example, the global sourcing and supply networks of many of the leading apparel and fashion retailers have increasingly externalised low ROCE (Return on Capital Employed) production-related activities (such as manufacturing, assembly and distribution) to instead focus on the higher ROCE core competencies of design, marketing, etc. (Milberg, 2008). Correspondingly, many

retailers have rationalised their supplier base to stabilise relations with a few ‘preferred’ producers (Palpacuer, 2006).

More widely, Baud and Durand (2012) have explored the issue of how many retail TNCs were simultaneously able to increase returns on equity despite home market performance slowing. They argue that a blend of global expansion and the financialization of assets, alongside practices of ‘working capital management’, have leveraged concessions from less influential actors in the value network such as workers and vendors. In this context, unsurprisingly the pressures exerted by the focus on maintaining shareholder value are, at times, seen as conflicting with wider CSR values, sustainable operations and the maintenance of stakeholder partnerships (Hughes, 2012).

2.1 Relationships with the capital markets in retail TNC expansion

Consistent with Coe *et al.*’s (2014) concerns regarding an under-appreciation of finance within the wider global production networks literature, the role of relationships with the providers of finance and the financial community in the retail globalization process remains under-developed. Many retail TNCs employ a so-called ‘pecking order’ preference for raising finance – preferring to use internal funds, then low-risk debt, and finally, if the amount raised remains insufficient for their needs, equity (Myers, 2001). Consequently, they may seldom make use of their capability to raise capital in the equity markets. Nevertheless, share prices and in turn shareholder value remain extremely important objectives for active management given that most borrowing is based upon credit ratings derived from share price performance (Christopherson *et al.*, 2013). Consequently, pressures to improve the share price can significantly affect corporate behaviour and, as a result, retaining the faith of the capital markets is essential.

Investment houses and pension funds are responsible for shrewdly investing on behalf of their clients and consider guidance from equity analysts, the retailers themselves, and the wider financial media relating to company operations, strategy and performance forecasts. **Figure 1** (building on Wrigley and Lowe, 2002) positions equity analysts within the stakeholder system of corporate governance, locating them between the suppliers of finance and the corporate board of the firm. Equity analysts assess the performance of firms and issue research reports that include forecasts of the firm's stock price – in turn recommending whether the stock should be classified as 'Buy', 'Hold' or 'Sell' (Westphal and Clement, 2008). These judgements 'set the investment climate' for entire retail sectors and individual retailers. One influential study found that on average, the stock price adjusts up 5 percent (for added-to-buy changes) and down 11 percent (for added-to-sell changes) (Womack, 1996) with the effects of changes to analyst recommendations persisting for several months (Ryan and Taffler, 2006).

Take in Figure 1

By occupying a governance role that seeks to overcome the well-known tension between ownership and control, equity analysts are an important source of external institutional pressure on a firm (Benner and Ranganathan. 2012). Naturally, analyst knowledge is far from being a universal "truth" but is instead socially constructed through intra-, inter- and extra- firm relations and practices, which, in part, are the product of analysts' own work practices and background (Hall, 2007). Although they typically combine quantitative and qualitative insights to exhibit a 'rhetoric of scientific rigour' (Hall, 2006, 663), like any other financial actor, analysts are subject to the negative effects of heuristics and cognitive bias in their financial decision-making (*cf.* Strauss, 2009). In particular, partly due to the necessarily

specialised nature of analyst knowledge within their particular industry, they have been found to suffer greater degrees of ‘lock-in’ than might be expected by tending to respond more favourably to strategies that extend and preserve existing technologies rather than adapting to new ones (Benner, 2010).

2.2 Managing the relational analyst–retail TNC dynamic

Given the importance of investment opinion and forecasts from analysts, retail TNCs are keen to maintain legitimacy in capital markets and actively ‘manage the stock market perception of their company’ (Sparks, 1996, 166). In part, this could be viewed as an attempt to increase their proximity to, and influence over, key opinion makers in capital markets. While the power to achieve such influence may be seen as structural and embedded within particular job roles, we also understand that power can also be relational and emerge through social interaction (Faulconbridge and Hall, 2009). As both Glückler (2006) and Hall (2014) note, personal relationships often underpin successful internationalization as socio-cultural proximity with the providers of finance positively affects ongoing power relations. In turn, physical, cultural, virtual and organisational proximity within financial networks can partly govern one’s position and influence within such relationships (Jones and Search, 2009).

Retail TNCs regularly increase physical and virtual proximity to financial market opinion setters, both through media engagement and by granting analysts excellent access to senior management through investor conference calls and earnings announcements (Clark *et al.*, 2004). But perhaps more beneficial is the personal contact established through on-site visits, informal discussions following management presentations, and one-to-one phone calls which offer insight into ‘qualitative factors such as quality of management or strategic credibility’ (García-Meca, 2005, 428). A recent survey of US equity analysts suggested that

98.4% enjoyed direct contact at CEO or CFO level with the firms they covered at least once a year, with 53.2% reporting at least five times a year (Brown *et al.*, 2015).

Providing analysts access to senior management is clearly underpinned by the self-interest of the firm, but it is part of a complex reciprocal dependency. Analysts need the access to triangulate their quantitative investment analysis, but are well aware of the price of access to that relational network. That is to say, while investor relations departments of firms are managing expectations and correcting misconceptions, they are also acting as a vehicle of control and coercion. At its worst, that might involve ‘penaliz[ing] an analyst by threatening to withhold investment banking business to the firm that employs the analyst’ (Rao and Sivakumar, 1999, 33). In this context, issuing negative, sell recommendations is inherently risky, leading to ‘herding behaviour’ with analysts reluctant to stand out from the crowd when they convey negative information (Jegadeesh and Kim, 2010). Yet firms themselves are also known to obfuscate through misleading signalling to capital markets.

Because of, and despite, these imperfections in the governance of capital markets, analysts remain influential active agents affecting both the accessibility of funding for international retail expansion, but also the form that it takes. Palmer and Quinn’s interviews with retail equity analysts a decade ago (2003; 2005) revealed the generally sceptical views of analysts concerning cross border expansion, especially regarding the implications for short term profitability. They further underlined the importance of entering retail markets at an early stage of development and exhibited negative views concerning merger and acquisition as an entry method, not least due to the high degrees of upfront capital commitment. Instead, they noted a preference for tight capital discipline with organic (greenfield) expansion funded out of working capital on the back of vendors’ credit with minimal recourse to equity capital or debt financing.

2.3 Losing the faith of the capital markets in retail TNC expansion

In the context of the previous discussion, it is unsurprising that retailers have historically been severely penalised when the investment community perceives an over-leveraged acquisition, a loss of discipline in allocating capital expenditure, or neglect of operations in the home market. In some cases, the investment community loses faith completely in the internationalization strategies of retailers, with the case of Dutch food retailer, Royal Ahold particularly apposite, providing parallels with Tesco's experience in this paper (Wrigley and Currah, 2003). While Ahold had funded its largely acquisitive international expansion in the late 1990s and early 2000s by successive equity placements and high levels of debt, when views concerning the emerging markets of Latin America and East Asia which Ahold had entered turned negative, the retailer found its pipeline of equity funding effectively closed:

‘What had once been an important competitive advantage in a rapidly globalizing and consolidating industry – namely Ahold's high tolerance for financial leverage – suddenly became an important competitive disadvantage as it was forced to ‘tear up the script’ of its previous corporate strategy and adopt a new strategy of organic ‘capital-efficient’ growth’ (Wrigley and Currah, 2003, 236).

In particular, if performance in the retailer's home market deteriorates, analysts become increasingly sensitive to international market returns and the associated toll on senior management time, and begin to demand ‘core market focus’ (Wrigley, 2000b). Over the past decade, multinational retailers have become increasingly sensitive to the level of returns their international investments generate. In consequence, there is evidence of a decrease in ‘flag planting’ expansion involving the creation of under-developed businesses across numerous host markets with a shift toward strategies focused on growing market share in fewer, select countries where profitable trading scale can be established (Dawson and Mukoyama, 2014).

Having considered the importance financialized retail firms necessarily place on managing relations with the capital markets during internationalization, and the significant

role that equity analysts as a consequence play in that process, we now move on to explore and illustrate those themes using an in-depth case study.

3. Methodological Issues

Before presenting a case study of one of the world's leading international food retailers., it is essential to address two important methodological issues raised by our study – the potential and limitations of single-firm case studies, and similar issues in relation to the construction of knowledge from what Clark (1988) refers to as 'close dialogue'.

Case studies have long been favoured in economic geography and are known to offer opportunities to build theory in the social sciences. Yet not all economic geographers are convinced (Markusen, 2003) and we acknowledge those concerns regarding issues of rigour, generality and counterexamples. Single-firm case studies, as a sub-set of the category, have recently been suggested to present an extra dimension of concerns (Tokatli, 2014). Our response to these issues has two dimensions. First, not all case studies are equivalent in terms of their 'comparative potential' – that is to say gaining analytical traction and conceptual leverage by facilitating study of the same firm at different points in time; compared to *other* equivalent firms experiencing similar events (Lowe and Wrigley, 2010, 385-86). Second, it is not only economic geographers who have argued for the value of single-firm case studies, with the approach gaining traction across the social sciences, including disciplines more commonly characterised by positivist methodologies (Tokatli, 2014).

More specifically, in this study, Tesco is selected as a timely "critical case" which Barnes *et al.* (2007, 10) define as 'capable of generating new theoretical insights, rather than merely illustrating extant theory claims'. The retailer illustrates *both* adherence to tight capital discipline and robust relations with the financial markets in the 1990s and early 2000s,

and *also* a period of deterioration of that discipline and its reputation for financial prudence. Such a longitudinal perspective of relative success and then relative failure in this regard – tracking the change from what may be perceived as ‘tight’ towards more ‘loose’ capital discipline, offers the dimensions of comparison which, we suggest, are key elements in increasing the conceptual leverage of the single case study method.

While our focus is particularly on the retail firm–equity analyst dynamic as a surrogate for the means by which the retail firm seeks to manage its relationship with the investment community, we recognise the myriad of other nodal linkages within the relational networks between the firm and financial markets; to include for example, exchanges with institutional investors and credit rating agencies through AGMs and the business press. In undertaking our analysis we are also mindful that we have the benefit of hindsight, which can affect the way we subsequently frame our argument. As Clark *et al.* (2007, 20) remind us, ‘the language of finance is almost always the language of ex-post legitimisation’. We are conscious of not over-simplifying the challenges of managing international retail expansion from the perspective of senior management, nor the difficulty of analysing this strategy from a position external to the firm. A multitude of exogenous pressures challenge the processes of strategic management and restructuring within organisations and consequently there are limits to both managers’ and analysts’ knowledge and agency (Froud *et al.*, 2000).

In terms of the operationalization of our method, we have built ongoing links with a number of leading equity analyst teams which have provided access to their analysis on a longitudinal basis, allowing us to construct a comprehensive analyst report library concerning Tesco covering the period 2006-2014 (73 reports) and we have particularly used these narratives to inform our study. Analyst insights were selected for inclusion based on their profile within the financial market and their presence at invited analyst/investor meetings with the retailer. These insights were complemented by occasional conversations with some

of the analysts ($n1 = 7$) to clarify any issues as well as numerous follow up email exchanges. Of course ‘close dialogue’ raises concerns over possible ‘seduction and cooption’ (Clark, 1998, 80) — that is to say, becoming duped by ‘stories in the process of formation and competition for dominance’, and constructed to ‘deliver a particular set of accumulation outcomes’ (O’Neill, 2001, 194). We are conscious of the need to challenge widely held ‘universal truths’ within firm-level case studies (Tokatli, 2014) – something that requires extensive triangulation of the corporate narrative. Therefore, following Denzin (1970), we have used extensive ‘within-method’ triangulation to mitigate these potential problems in terms of contrasting numerous different analyst viewpoints over time, but also ‘between-method’ triangulation (contrasting research methods). We have achieved this by analysing recordings and transcripts of management results presentations, telephone conference calls and associated investor Q&A sessions (at preliminary and interim results meetings), assessing the slide presentations and analyst packs the retail firm produced for these occasions ($n2 = 43$), consulting the presentations/documents from specialist analyst briefing sessions and ‘road trips’ ($n3 = 85$), as well as the annual reports and strategy reports produced by the retailer ($n4 = 33$). We have also reviewed the insights from national media sources (e.g. *Financial Times*), the trade press (e.g. *Retail Week*), and benefitted from discussions with (and reading the analysis generated by) retail industry analysts and consultants who have knowledge of Tesco’s expansion. Therefore, our insights are both empirical and conceptual and derive from working ‘backwards and forwards between theory and the empirical world in a reflexive manner’ (Clark, 2007, 191).

4. Capital Discipline in Tesco’s Internationalization

4.1 Tesco’s emergence as a multinational operator

Tesco has built a retail presence across three continents, accounting for over £72bn in sales and £2bn in pre-tax profit in 2012/13, at which time it was the largest food retailer in four of the 11 markets within which it operated. **Table 1** highlights the increasing importance of international operations over the period 2000-2014, with the core UK market decreasing in relative importance to 69% in sales terms in 2014 from 90% in 2000. Similarly, the importance of the home market in contributing operating profit decreased from 95% in 2000 to 70% in 2014. The level of capital expenditure and acquisition activity supporting this growth has been considerable – between the fiscal years 2005 and 2012 the retailer expended an estimated £28.8bn (Shore Capital, 2013b).

Take in Table 1

Table 2 provides an overview of Tesco's continuing international operations in 2013. Particularly notable were the differences in presence and relative performance between countries and continents. The home UK market and Asian operations achieved healthy trading margins, while the European businesses trailed considerably. Recent under-performance was marked with poor like-for-like sales growth across much of Europe but also in South Korea, where protectionist regulations restricted opening times in large stores (Coe and Lee, 2013). There remained a number of under-developed businesses in the portfolio, notably within China where Tesco achieved only a 0.2% market share and Turkey where the retailer accounted for only 1.3% of the food market.

Take in Table 2

4.2 The foundations of capital discipline in Tesco's international expansion

In this section, we address our objective of exploring the link between successful international retail expansion strategy and capital discipline to retain the support of the

financial markets. However, prior to exploring how capital discipline was particularly exhibited by Tesco, it is essential to acknowledge the retailer's pro-active management of its financial reputation through the strengthening, and maintenance of, relational networks with equity analysts as explored in a more general sense earlier in the paper. Beyond presence at results meetings and taking advantage of the associated Q&A which is well known within the literature, analysts also enjoy access to senior management on a more informal basis to include regular senior management telephone contact if analysts require clarification on specific points. Particularly noteworthy and somewhat beyond the extent of the relational networks described in Section 2 are specialist analyst 'away days' and 'road trips' that have occurred over the past decade. At times these have been based in the UK and focused exclusively on UK strategy (for example in 2002; 2006; 2012; 2014), but also such trips have been explicitly international in orientation and location – for example, Europe (2011); Asia (2008; 2010) and the United States (2007). These visits are structured to include formal presentations with questions and store tours – sometimes to include competitor units – as well as visits to distribution centres. Importantly, they offer both formal and informal contact with senior management within the retail firm. They play a critical role in information exchange and facilitate the development of personal relationships between analysts and senior management, away from the 'hot house' atmosphere of formal results meetings.

Earlier in the paper we noted the imperfect nature of financial decision-making and the issue of power within such networks. Particularly with investor 'road trips' there is a risk of analyst judgement becoming clouded by senior management as they are exposed to what the firm wants them to see rather than a necessarily more representative picture of its operations and performance. Such a relational network is privileged, often relatively small, and while the retailer makes any formal slide presentations at these events available to wider

parties through its investor relations web site, there is clearly opportunity and benefit gleaned from more informal, unrecorded, contact and exchange.

In contrast to the tendency across international retailers to increase presence across multiple international markets without subsequently building profitable scale in those countries, Tesco had, until recently, been widely regarded as a firm that was judicious in its marshalling of capital and achieved profitable returns in its international expansion. First, market entry in Tesco's international expansion was typically achieved through limited up front capital commitment – small acquisitions or joint venture partnerships. If such investments proved successful, the retailer would normally increase investment to secure majority or outright control and then pursue organic growth. This contrasts with the alternative of large-scale acquisitive or organic entry that would require considerable up-front sunk costs and immediate extensive capital exposure. In doing so, the retailer focused primarily on under-developed retail markets characterised by weak retail competition, a retail structure offering few 'modern' retail formats and a growing middle class – conditions positively associated with performance more generally for international retailers (Coe and Wrigley, 2007). By entering markets early in their development, Tesco sought to become the 1st or 2nd largest operator in the country, often by leveraging its hypermarket format. **Table 3** underlines the limited commitment of these *initial* investments, with much of Tesco's capital expenditure occurring in the years *following* such transactions, once each respective in-country business model was proven to be viable. In many of the joint venture relationships, with South Korea being the best example, the initial ownership was relatively even between partners, yet as the business demonstrated its profitability, the UK retailer progressively increased its share until it achieved outright control. In other instances, such as in the Czech

and Slovak Republics, modestly sized acquisitions were made to gain footholds prior to subsequent organic growth and larger capital commitment.³

Take in Table 3

There are wider benefits that assist in realising territorial embeddedness which accrue from small acquisitions or joint venture relationships, including the knowledge gained of the host market, along with acquiring some degree of political influence (Wood and Reynolds, 2014). This approach also permits the retention of a ‘local’ customer fascia at least initially, leverages any market-specific retail skills in the management of operations acquired, and provides some degree of market scale prior to any organic expansion.

Second, having entered host countries, Tesco typically opted out of tempting acquisition opportunities if they failed to offer the necessary returns even if they promised a step-change in market coverage. Indeed, the analyst and wider investor community are naturally sceptical regarding high commitments of capital expenditure to new markets and international acquisitions (Palmer and Quinn, 2005) – something which is plainly evident in the forensic detail with which questions are asked in the Q&A sessions following the retailer’s results presentations. While international retail expansion is often associated with senior management ‘empire building’, until recently the retailer had benefitted from an experienced and stable senior leadership team that assessed expansion opportunities judiciously. As BOAML (2011, 6) reflected as late as 2011:

‘Thankfully, we don’t sense Tesco is in any rush to buy assets and is firmly focused on capital discipline and future-proofing the business.’

³ This model of development was the product of a painful learning process from Tesco’s early failed attempts at internationalization, such as its expansion into France (1992) and its first entry into Ireland (1979) (Palmer, 2005). By learning from such errors, a model for expansion emerged by the early-mid 1990s that involved a thorough appraisal of new markets, limited up-front capital exposure and a focus on countries with under-developed retail structures.

There were numerous instances when such prudence had been evident. For example, in 2010 when French food retailer, Carrefour announced that it was intending to auction its Thai, Malaysian and Singaporean operations, there was widespread speculation that Tesco would acquire the assets. Carrefour's 42 stores in Thailand could have transformed Tesco's market position given the complementary spatial fit between the two portfolios. Tesco CEO at the time, Terry Leahy, underscored the requirement of capital discipline: 'It makes sense in the sense that they're in-country acquisitions...but it depends on price always' (quoted in *Financial Times*, 2010). While Tesco bid conservatively for the Thai operations, it was unsuccessful and they were sold to another French retailer, Casino. The remaining Malaysian and Singaporean stores were retained by Carrefour. Instead of castigating Tesco management for missing out on a potentially transformative acquisition, key UK analysts commended the retailer for retaining its focus on returns and efficiency.

'[Capital] discipline has prevented acquisitions that in prior years may have been pursued, especially in Asia to good effect from a returns perspective in our view...[We] *believe organic growth and capital discipline are the order of the day, organic growth that is slower to yield rewards from a momentum perspective than acquisition, but tends to produce higher returns over time*' (Shore Capital, 2010a, 35, our emphasis).

This is not to say that Tesco shied away from acquisitions when assets were valued favourably and offered the potential for significant value creation and a complementary spatial fit. One such successful acquisition occurred in 2008 with the purchase by the South Korean Samsung-Tesco business of 36 Homever hypermarkets for £958m – a price that was a little over net asset value but below replacement cost (Shore Capital, 2010b). The acquired portfolio offered a good spatial match with the existing store base, being concentrated around Seoul where Tesco lacked a significant presence. Emphasising a focus on capital discipline, the deal was structured such that 50% of the price was paid on acquisition and the other half

when designated sales uplifts were achieved. There was considerable potential to realise such increased performance given the disparity between the returns on the acquired units (£283 per sq ft) versus Samsung-Tesco at the time (£437 per sq ft) (Nomura Capital, 2009).

Third, Tesco frequently funded international expansion without recourse to external capital. One source of funds came from a spatial switching of retail capital by exploiting its valuable freehold UK property portfolio through sale-and-leaseback initiatives. Between 2007 and 2012, the retailer sold £6bn-worth of property globally, giving it net divestments of £5.2bn on which it has made £1.3bn of profit (*Financial Times*, 2012). UK analysts asserted that by 2011, Tesco's international properties were worth £14-£15bn (Citigroup, 2011) with 75% of space freehold in Asia and 90-95% for all markets outside China (Nomura Capital, 2009).

While the UK historically acted as the 'cash cow' for international expansion, the international businesses themselves contained a mix of mature and developing operations that provided returns over different timescales. Given that hypermarkets are deemed to mature after four years of trading (Shore Capital, 2010b), South Korea and Thailand in particular had matured into reliable profit centres which provided capital to fund international businesses at earlier stages of development. Indeed, Shore Capital (2010a, 8) suggested that the performance of South Korea 'gives Tesco a certain degree of licence to explore other markets'. The first move to exploit the value specifically accrued in the international store estate occurred in August 2012, when the retailer announced that it had completed a sale-and-leaseback deal in South Korea for four Homeplus stores and accompanying mall space, with total gross proceeds in excess of £300m (Tesco plc, 2012) followed by an announcement of a further four Homeplus stores in January 2014, raising a further £355m (Tesco plc, 2014). Confidence in the Asian property portfolio to generate returns was such that in 2012 the

retailer launched an IPO of its Thailand Property Fund⁴ to finance further in-country retail property development – raising £152m and involving 17 Tesco Lotus hypermarkets located in several provinces across the country (*The Scotsman*, 2012).

Fourth, Tesco assessed its likelihood of success and divested out of markets that were not long term opportunities in an intelligent manner. By limiting its up-front capital exposure in markets where performance was unproven, and then by preparing for divestiture where this was necessary, the negative effects of departing a market were partially mitigated. In doing so, communication regarding strategy with the financial community was key. As one analyst noted five years prior to the announcement of Tesco's exit of Japan in 2012, the retailer was limiting its liabilities:

‘The fact that the company has not over-committed, taking time to understand the customer, the supply chain and the competition speaks volumes about its overall approach to all markets’ (Shore Capital, 2007, 54).

By writing down the final tranche of Japanese goodwill (£55m) in its 2010/11 interim results, Tesco was preparing for divestment which meant that its eventual announcement in 2012 had an immaterial effect on the share price.

Other approaches have seen strategic divestment that has bolstered market position elsewhere. For example, in 2005 when Tesco exited Taiwan, it successfully agreed to swap its hypermarket assets with 11 Carrefour hypermarkets in the Czech Republic – another of Tesco's international markets⁵. Such tactical moves cast divestment not necessarily as an outright failure but an international spatial switching of retail capital that can reinforce position in strong markets by sacrificing stores in peripheral or under-performing regions.

⁴ “Tesco Lotus Retail Growth Freehold and Leasehold Property Fund”

⁵ There were also plans for a further four hypermarkets in Slovakia but this purchase was vetoed by the government competition authorities and the stores were returned to Carrefour.

5. Exploring the Breakdown in Capital Discipline in Tesco's International Expansion Strategy

In this section, we address our objective of assessing the drivers behind a deterioration in capital discipline in international retail expansion and analyse the responses of the investment community to this. Given the vastly improved scale and profitability of Tesco over the past twenty years, what lay behind the weakening in its reputation for financial prudence? Tesco's performance slowed slightly in 2011/12, but it was in 2012/13 when trading profit declined by 10.3% in its Asian business and 37.8% in its European operations (*cf.* –8.3% in the UK). While such concerns were undoubtedly driven partly by the global economic downturn, they were also indicative of a sector-wide shift in many markets from large hypermarkets towards more frequent and smaller shopping trips and thus smaller format stores (Wood and McCarthy, 2014). Moreover, the poor performance was also likely the function of emerging deficiencies in Tesco's pricing, product ranging, marketing and store operations that have since become increasingly apparent through 2014/15. These disappointing results were compounded by the announcement in April 2013 of the intention to divest the US business, Fresh & Easy, which Tesco started in 2007 and consumed circa £1bn of capital investment, along with a similar level of trading losses. However, the level of returns in relation to capital investment was becoming a concern across the international operations. By early 2012, the comments of Citigroup analyst, Alastair Johnson on the longitudinal performance of Tesco were typical of the investment community:

‘In every one of these years Tesco's retail business yielded similar operational cash flow, a sequentially disappointing trajectory given the fast-paced expansion of the store estate and heavy capital expenditures’ (Citigroup, 2012a, 3).

A fundamental problem lay in the declining productivity and profitability of retail space at a time when capital expenditure dedicated to international operations continued at a high level.

In particular, under-developed operations in countries such as China consumed extremely high levels of capital expenditure yet remained stubbornly loss making, leading to analyst concerns that ‘internally generated funds [are] not covering ‘all in’ cap ex and dividends [so]... leverage is rising’ (Citigroup, 2011, 11). Two years prior to the severe deterioration in performance, analysts were actively questioning the level of investment in the international business in relation to returns:

‘Appropriate action requires a pause for breath and consideration of whether Tesco’s high space growth model is appropriate over the next five years’ (Citigroup, 2011, 14).

In the following section, we briefly examine Tesco’s most high profile expansion – the development of the US Fresh & Easy business – and how it came to exemplify the difficulties of capital expenditure in relation to returns.

5.1 The anatomy of failure in the United States

The embodiment of Tesco’s loss of capital discipline was its resource intensive entry into the US. Some brief reflection on this approach is instructive in the context of the disciplined expansion strategy that had earlier been pursued by the retailer. Tesco entered the US market from a standing start – organically developing a new, 10,000 sq ft small supermarket format, the ‘Fresh & Easy Neighborhood Market’, focused on the west coast, initially within California, Nevada and Arizona (Lowe and Wrigley, 2010). At the time, Chief Executive, Terry Leahy acknowledged the capital commitment and ‘reputational risks’ but argued the potential returns warranted such a bullish strategy:

‘[W]e’ve carefully balanced the risk. If it fails it’s embarrassing. It might show up in my career [and] it’ll cost an amount of money that’s easily affordable by Tesco—call it £1 billion if you like. If it succeeds then it’s transformational’. (Terry Leahy cited in *The Economist*, 2007)

The business model marked a significant departure from the staged management of risk and investment described in Section 4.2 involving joint venture partners or limiting initial investment through small acquisitions to gain initial footholds in host markets. In contrast, wholly owned large-scale organic entry to a developed retail market required considerable up-front investment with Tesco even bringing with it two food manufacturers from its home market – a ‘follower supplier relationship’ – and eventually bought them out (Lowe *et al.*, 2012). As Terry Leahy acknowledged in 2011:

‘There was an incredible amount of work to be done to build the new format, untried anywhere in a new country and based upon huge upfront investments in infrastructure. Normally you go into a country step by step, but this model wouldn’t allow that. You had to put the infrastructure in first – factories, computers and distribution centres’ (cited in Ryle, 2013, 305).

Understandably, given the scale of the venture, there were focused efforts by the retailer at courting the investment community beyond the regular contact described earlier in the paper. For example, in November 2007, Tesco led a two day study tour for 68 buy-side and 36 sell-side analysts across LA and Las Vegas, including visits to the initial Fresh & Easy units, competitor stores, its new distribution centre and a mock store/training centre. Such engagement with analysts was important to persuade them of the virtues of the considerable upfront investment that implied the initial market entry (encompassing a new store format, branding, pricing and product offer) had to be an immediate success. Given the financial outlay, there was minimal margin for error. The efforts by the retailer to win analyst support paid off, with glowing responses from many following the field visit, with ABN-AMRO (2007) titling their report on the return to the UK: ‘Don’t Miss the Bus’. Other assessments were also similarly supportive⁶:

⁶ While analyst opinion was generally positive regarding the US venture, it is important to note that enthusiasm was not universal with the title of a 2007 Credit Suisse’s research note being all too prophetic: ‘It May Be Fresh, But It Won’t Be Easy’.

‘...we believe that Fresh & Easy will be a major force in the U.S. food business for decades to come’ (CIBC World Markets, 2007, 2)

‘It’s absolutely no exaggeration to say that Fresh & Easy has the potential to be the ultimate expression of Tesco’s world-beating operating skills, combining these with a market that can reward at a speed and scale unmatched in any of its other markets’ (Deutsche Bank, 2007, 1).

‘...we believe that Tesco will make a success of its venture, and in all probability hit the breakeven point ahead of its February 2010 target’ (Societe Generale, 2007, 4).

Within 18 months, it became clear that success was not going to be immediate as many of retail fundamentals appeared to have been overlooked; effects that were compounded by the onset of the economic recession. Of course, it is tempting to simply attribute this failure in large part to a tendency to overlook the cultural distance between the UK and US customer base and retail environment. There would be some support from this from management studies which makes much of a paradox of psychic distance, whereby ‘operations in psychically close countries are not necessarily easy to manage, because assumptions of similarity can prevent executives from learning about critical differences’ (O’Grady and Lane, 1996, 309). Indeed, US big-box discount retailer, Target’s recent divestment from Canada provides evidence for such a theory. However, such a view is more difficult to apply to Tesco in this instance as it made much of (and the retailer received considerable credit from analysts for) the time it spent exploring the opportunity prior to committing to it. Tesco held off entering the US for upwards of three years as it conducted an extensive market analysis and a period of ethnographic marketing research, along with format and product development (Lowe and Wrigley, 2010). While the research initially considered an acquisitive entry into the US, the retailer implied that research with customers and its reading

of the wider competitive market suggested an unmet demand for a small, local quality food store. Unfortunately, its operationalization was disappointing. It appears that either the results of its research were not acted upon or the interpretation of the data led to ill-founded strategies. Analyst reports and subsequent discussions with our respondents uncovered basic problems with the stores in terms of their overly clinical feel, lack of assisted service, poor store locations and excessive packaging of fresh food for the US consumer. Consequently, store expansion slowed while the retail formula was tinkered with – all at a critical time for the fledgling business. The business model involved high upfront costs and therefore necessitated a quick timetable of building scale which required rapid, successful store expansion to a critical break-even mass of around 450 stores. Given the poorly refined retail proposition, this was not delivered and the decision to divest occurred when Tesco had opened barely 200.

Difficulties centred not only on the high investment–high commitment business model, with concerns also expressed that the retailer failed to receive ‘best value’ given its level of capital investment. Citigroup retrospectively contended that Tesco had overpaid for its Distribution Centre, that the incremental cost of store expansion appeared high compared to other US retailers, and that the price of the two food suppliers acquired in June 2010 (Wild Rocket and 2 Sisters) was excessive:

‘Tesco paid £116m for these two entities, a sum that represented 23% of F&E’s [Fresh & Easy’s] entire sales that year. A heavily loss-making chain of leasehold stores in the US would typically not command more than 10-15% of sales as a transaction price. Why two small suppliers to a heavily loss-making leasehold business in the US should command a transaction price well in excess of fair value for the chain itself is difficult to understand’ (Citigroup, 2012a, 6).

In April 2012, Citigroup argued that the capital expenditure outlay should have been in the region of \$500-600m versus the actual figure of \$1,888m – concerns mirrored across analyst houses:

‘The capital intensity of Fresh and Easy is a topic worthy of study. We can offer no explanation for it’ (Citigroup, 2012b, 18).

‘Arguably, Fresh & Easy is a luxury that cannot be afforded when the UK core is experiencing tougher times’ (Barclays Capital, 2012, 9).

Next, we assess Tesco’s response to the pressures from the investment community since 2013; measures which signal commitment to a more conservative approach to capital expenditure and increased sensitivity to shareholder returns. The re-setting of its relationship with the investment community marked a definitive change in strategy by Chief Executive, Philip Clarke, who replaced Terry Leahy in 2011.

5.2 Resetting the relationship with the capital markets – A new approach to disciplined international expansion

Our final objective is to conceptualise the retailer responses to the weakening trust of the investment community and to appraise the implications this has for the geography of retail globalization. Tesco’s recent experience provides wide ranging evidence of attempts to proactively manage such relationships which has led to marked changes in its emerging strategy for its international operations.

In 2013, given Tesco’s poor performance over the previous 18 months, particularly the admission that the US operation had failed, incurring a total of £2bn in write-off and trading losses, along with £150m of market exit costs (Shore Capital, 2013), it was essential that new Chief Executive, Philip Clarke effectively ‘reset’ the relationship of the firm with the capital

markets. Arguably this was easier to do given that the Fresh & Easy strategy was clearly wedded to his predecessor, yet in many respects it was acknowledged by our industry respondents that his hand was effectively forced in this matter. The April 2013 preliminary results presentation saw the unveiling of a strategic reprioritisation, putting an emphasis on generating positive free cash flow, ensuring a disciplined allocation of capital within a range of 3.5% to 4% of sales, and maintaining a strong investment grade credit rating. As Clarke commented:

‘I want to be very clear: if there is one lesson to be learned from the past it is the importance of capital discipline and this marks the start of a new era of capital discipline in Tesco’ (Tesco plc, 2013, 5).

A key element of this reorientation involved the departure of a number of senior board level directors from the Leahy era, including Tim Mason (former Fresh & Easy Chief Executive) and Richard Brasher (former UK Tesco Chief Executive) as well as many executives just below main board level. As Lowe and Wrigley (2010, 401) recognised at the time the international business was expanding, the reputational risk extended far beyond Terry Leahy and ‘was shared by the wider board of directors, diffused in complex ways across the various levels of the firm’s operational management’. These changes in key leadership positions underlined the significance of the transformation to the investment community, secured (for the short term) the new Chief Executive’s authority over the governance and direction of the organisation, and saw the retailer parting company with long-term corporate brokers, JPMorgan Cazenove and Nomura.

Table 4 summarises the revised strategic prioritisation for international development. First, countries where the retailer had established market leadership in growing economies and generated high returns, such as Thailand, South Korea and Malaysia, would continue to receive investment to further secure position and profitability. Second, many countries in

Europe would see a more conservative allocation of resources, particularly focused on convenience and online retailing instead of the widespread construction of hypermarkets. Finally, China, India and Turkey were singled out as long term growth opportunities albeit characterised by a more cautious approach to capital allocation – one predicated on achieving profitable avenues to expansion rather than a ‘jam tomorrow’ strategy that had latterly been pursued during the Leahy era.

Take in Table 4

The Chinese business was particularly affected by the more conservative approach. As recently as 2010, the retailer had unveiled a bullish six year China strategy of 80 1m sq ft ‘Lifespace’ shopping malls, trading across three major regions along the eastern seaboard, each anchored by a 100,000 sq ft Tesco hypermarket. The investment demands would have been a considerable £6.25bn, of which Tesco would have contributed £2.5bn, the balance being provided by Asian property investors (Shore Capital 2013a). However, by 2013, the retailer’s Chinese business was estimated to be losing in the region of £50m per annum (Shore Capital 2013a) and analysts widely doubted its continued viability:

‘Tesco’s determination to go ahead with shopping mall development in China despite its operation being sub-scale, thinly spread geographically and challenged from both a profit and sales momentum perspective surprises us’ (Citigroup, 2013, 5).

In August 2013, the retailer unsurprisingly signalled a new ‘capital light’ strategy for China, consisting of a joint venture with China Resources Enterprise (CRE), a state controlled retailer, ranked 2nd largest in China with coverage in 24 of its 34 provinces. Tesco argued this offered a route to growth that prevented it from over-extending its capital commitments, with a 20/80 ownership split in favour of CRE. In addition, the joint venture would create a

market leading grocery retailer with sales in excess of current market leader, RT Mart/Auchan (IGD, 2013b).

The reduced resource commitment across the international business was generally well received by the investment community at that time. Most positively, in mid-2013 Shore Capital improved their recommendation from 'Hold' to 'Buy' in the light of the revised approach to capital management:

'Tesco has largely completed a reasonably sustained period of refocus. ... Calmer waters and clearer focus permit a refined approach that has free cash flow at its core, predicated upon sweating its existing substantial asset base harder with lower capital expenditure' (Shore Capital, 2013b, 1).

5.3 Interpreting the loss of capital discipline amid capital market scrutiny

There are a number of implications specific to this particular case study, but also broader findings relevant for integrating finance into studies of international business within economic geography more widely. Specifically in relation to our case study, it is important to consider why Tesco departed from its disciplined model of international expansion to one that demanded such a high degree of up front capital investment. But equally, given oversight from the capital markets, one should question why the retailer was able to do so and effectively avoid the scrutiny of the investment community for so long.

Tesco's expansion into the US was the epitome of poor capital discipline in a misguided entry into a developed host market that had, without exception, seen previous failed UK food retailer expansion. The manner in which the capital markets remained broadly positive when the strategy was announced in 2006 and then stores first opened in 2007 must be seen in the context of the significant reputational capital that Chief Executive, Terry Leahy had accumulated with the financial markets and the retailer's efforts to engage analysts with the emergent business model. Leahy's (and ultimately Tesco's) relative position and power

within the relational network with analysts was extremely strong at the time of the entry to the US. The retailer was increasingly seen as dominating its domestic market and had established an effective and profitable portfolio of international operations.

In 2006/07, given Tesco's hitherto strong track record of success in international expansion, it is understandable how financial actors could easily lead themselves into a 'more of the same' argument, downplaying the step change in resource commitment that was gradually revealed when set against the potential of the US food market. We know that analysts tend to 'herd' in their investment outlook and are more reluctant to issue downgrades due, in part, to a range of 'microsocial factors in manager-analyst relationships' (Westphal and Clement, 2008, 890). Hence it was challenging to look 'beyond current events to underlying patterns and processes' (Clark, 2011, 9). Even when expansion of Fresh & Easy was stuttering, analysts commonly gave the benefit of the doubt to the experienced international retailer – for example, towards the end of 2009, one analysis house headlined their commentary on the business thus: 'Behind schedule but sunk infrastructure capex [capital expenditure] and early LFL [like-for-like sales] strength encouraging' (Nomura Capital, 2009, 89).

In addressing how such a change in strategy was able to be tacitly approved within the firm, there were elements of Chief Executive, Terry Leahy's own overwhelming influence within and beyond the immediate governance of the retailer that prevented adequate counterweight in decision-making. Our discussions with analysts emphasised the view that there was inadequate internal critique within the retail firm toward the end of the Leahy era. As one analyst suggested, at that time it was clear that the Chief Executive was in his final years in the lead role and therefore many of the senior management likely considered the implications that any strong objections might have had on their future career aspirations within the retail firm. More generally, such situations are associated with periods of success

and lead organisations to develop patterns of justification that support the CEO's pre-existing beliefs (Hayward and Hambrick, 1997) – conditions which likely lead to a degree of 'groupthink' as management's desire for unanimity 'overrides their motivation to realistically appraise alternative courses of actions' (Janis, 1982, 9). Importantly, the careers of many of the senior leadership team were inextricably tied to, and embedded within, an internationalizing firm where their talents had been accommodated. Having bought into this wider project, there was awareness that success or failure was likely to define personal livelihoods alongside firm performance:

'A U.S. expansion that ultimately "moved the dials" of Tesco's global presence, or that conversely ended in failure, would by default have profound effects on the nature of that ongoing organizational morphing. Most visibly, it was likely to play a role in Tesco's leadership succession and, as a consequence, in shaping the vision of the firm's future corporate strategy and its prevailing culture of innovation.' (Lowe and Wrigley, 2010, 401).

A change of Chief Executive to Phillip Clarke in 2011, who was largely free of responsibility for the strategy, provided adequate cover to announce the intention to divest.

6. Conclusions

Through the use of a case study of a leading retail TNC, this paper has addressed the role of relationships with the providers of finance and the financial community more broadly in underpinning the nature, extent and scale of retail globalisation, specifically exploring first how the retailer developed a broadly successful "model" of international expansion predicated upon a disciplined allocation of capital that appeased investor and analyst concerns; and second, how this framework deteriorated and with it the support of leading analysts. In doing so, the article exposes how the retailer was divested of reputational capital and needed to reposition itself vis-à-vis the investment community to reinvent its strategy for

capital allocation and therefore international expansion. Tesco is thus identified as a ‘critical case’ given its profile, international scale, market reach and its subsequent impacts both domestically and internationally. The paper reveals how pressure from the capital markets acts as a key relational moderator of international business expansion.

While the study is distinctive in its retail-specific focus, the research has implications beyond the specific internationalization of food retailing to also be relevant to other service organisations (e.g. hotels, restaurants) that share similar demands of capital outlay while experiencing robust market oversight (*cf.* Niewiadomski, 2014). The paper helps to enrich understanding of the critical role played by relations between the firm and finance markets in international business expansion. However, we have been conscious to resist proposing simplistic ‘one dimensional accounts that reflect simple *a priori* about the secret of success and which flatter management agency by presuming that management can both understand and change the world, in a way which reflects intention and capability’ (Froud *et al.*, 2000, 102). We have recognised the relational nature of interactions of firms with the capital markets and the causal ambiguity that often persists between strategic inputs and outcomes. In doing so the research has explored the globally integrated link between investment communities, analysts, the leaders of firms and their emerging strategies. While these interactions are often localised, embedded within personal relationships and situated within meetings at established financial centres, they effect – and are affected by – operations across the distant geographies of the firm at multiple spatial scales. Clearly then, the work builds on prior research within economic geography which has interrogated relational financial networks (Hall, 2015) whether this is through venture capital (Wray, 2012), private equity (Jones and Search, 2009) or more widely through institutional investment such as pension funds (Torrance, 2009).

The case study provides evidence of how the sentiments of the capital markets clearly affect the scale, speed and extent of international growth, but also that the nature of capital market pressure is (to a point) resistible and contingent – or, as Froud *et al.* (2014, 48) recently put it, ‘What “the market wants” is as much a moveable discursive construct as a set of fixed financial targets, as stock market expectations meet counter-narratives from corporate management and other relevant actors’. It also provides a cautionary warning that even the most tightly run international firms can suffer without a sustained focus on disciplined financial management. In doing so, retaining the faith of equity analysts and the wider investment community is critical to credibility. Losing focus on the balance between capital investment and returns inevitably causes wider ripple effects through the capital markets that likely necessitate scaling back of expansion plans.

In the case of Tesco, these pressures have become significantly more acute since the start of 2014 when the timeline for this case study concludes. This period has seen the resignation of the retailer’s CEO, Philip Clarke and the subsequent appointment of Dave Lewis from Fast-moving Consumer Goods (FMCG) firm, Unilever. More damaging was the unexpected identification of a £263m overstatement of Tesco’s profits in October 2014 arising from the way it recognised income from vendors, which struck at the heart of the retailer’s reputation for economic competence as did an exceptional pre-tax loss of £6.4bn for 2014/15. Such extreme stresses on the retailer’s balance sheet led to further retrenchment from international markets beyond those explored in this paper, with the retailer’s South Korean Homeplus business sold to private investors for £4.2bn in September 2015. The implications of changing market reactions to international expansion and the divestment of international subsidiaries should not be under-estimated, particularly for workers, consumers and wider local stakeholders within under-developed host markets. In this sense, there are

certain parallels with the implications of globalisation more widely within publicly listed international businesses across both service and manufacturing sectors.

The case study has also emphasised *the limits* to agency of both senior management and analysts. The paper has uncovered the role of equity analysts as imperfect assessors and validators of a firm's strategic plans for the wider investment community. Although important agents within the wider stakeholder governance of the retail firm, they may overlook shortfalls in strategic planning. The previous track record of international expansion and its leadership is likely to frame the narratives constructed for consumption by the investment community. Meanwhile, the process of actively managing legitimacy with capital markets places emphasis on the setting and signalling role of the firm with regard to its strategy and intended use of capital. Over the period under review, Tesco made considerable efforts to 'manage' the senior management–analyst dialectic in order to present their strategies in the most positive light possible. Just as marketing brands are notoriously unstable and constructed for a consumption audience (Pike, 2013), so the 'finance/capital management brand' of the firm has to be constructed and maintained for consumption by the wider capital market community (*cf.* Clark *et al.*, 2004). If this form of representation is well managed it is more likely that the barometer of positive analyst opinion can be maintained even during periods of turbulence and risk. But there are limits. A decline in performance of the 'cash cow' home market which, to a large extent, underpins investor confidence, leads to an increasingly diligent focus on capital expenditure and returns at home and abroad. In our analysis, it is clear the focus on capital discipline broke down and re-framing all strategic announcements to a consistent 'capital-light' narrative became necessary. When re-setting the relationship with the investment community, this signalling process not only concerns changes in strategy, but equally likely leads to changes in key leadership and personnel.

Removal of key actors so associated with the past stresses a clean break and ensures that future governance of the firm is coordinated by individuals unsullied by previous failures.

There remain significant opportunities for further exploring the interactions between international business strategy and the providers of finance. While our case study is firmly embedded within a particular mode of market capitalism with finance flowing through competitive capital markets, it would be informative to explore the variegated governance effects of relationships with finance providers for international firms originating from within different varieties of capitalism and across organisations with different ownership structures. Such insights would likely expose a different set of pressures and imperatives that would require further agile adaptation and sensitivity in the management of financial relationships – themes this paper has provided some important perspectives into.

Tables and Figures

Figure 1: Placing finance in the governance of the firm

Source: adapted from Wrigley and Lowe, 2002

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Table 1: The increased importance of Tesco's international operations, 2000-2014

Percentage contributions	2000	2002	2004	2006	2008	2010	2012	2014 ^{1 2}
Sales								
UK	90	85	80	76	74	69	67	69
Rest of Europe	7	9	11	13	14	15	15	15
Asia	3	6	9	11	12	15	17	16
USA	0	0	0	0	0	1	1	-
Operating Profit								
UK	95	91	83	78	75	73	69	70
Rest of Europe	5	7	10	12	14	14	15	8
Asia	0	2	7	10	11	13	20	22
USA	0	0	0	0	0	-	-4	-
Total sales area								
UK	70	58	51	47	39	35	35	38
Rest of Europe	20	25	28	30	30	30	29	31
Asia	10	17	21	23	31	34	34	30
USA	0	0	0	0	0	1	2	-

¹ US operations excluded as they cease to be considered "continuing operations"

² China is excluded due to joint venture with CRE

Source: Annual Reports

Note: Tesco's financial year finishes at the end of February.

Table 2: Tesco plc international operations, sales and estimated margin, 2013

Country (Year of Entry)	Sales £m	Market Share %	Sales Growth Y-o-Y %	L-f-L Sales Growth ³ Y-o-Y %	EBIT margin ¹ %	Store Numbers	Total Space '000 sq ft
UK	43,579	30.1	3.2	(0.3)	5.2²	3,146	40,495
Europe	9,312		(5.6)	(2.3)	3.5²	1,507	34,077
Hungary (1994)	1,606	14.9	(9.5)	(0.7)	1.2	216	7,329
Poland (1995)	2,176	7.0	(4.9)	(3.0)	5.1	446	9,426
Slovak Rep. (1996)	1,114	22.8	(1.2)	0.6	4.2	136	3,822
Czech Rep. (1996)	1,356	10.9	(11.8)	(7.0)	3.0	376	6,092
Rep of Ireland (1997 – re-entry)	2,315	20.0	(5.3)	(0.3)	5.9	142	3,455
Turkey (2003)	745	1.3	7.5	(5.4)	(3.4)	191	3,953
Asia	11,422		6.0	(1.8)	5.4²	2,131	41,664
Thailand (1998)	3,742	13.0	15.7	3.1	7.9	1,433	14,320
South Korea (1999)	5,311	8.6	(0.5)	(5.3)	6.9	520	13,230
Malaysia (2001)	937	4.8	5.2	0.5	4.9	47	3,918
China (2004)	1,432	0.2	9.2	(1.1)	(5.6)	131	10,196

Continuing operations only

¹ EBIT Margin is the ratio of Earnings before Interest and Taxes to net revenue - earned. It is a measure of a company's profitability on sales over a specific time period.

² Trading Profit Margin is listed to allow a clear comparison between the main Tesco businesses (i.e. UK, Europe, Asia)

³ Like-for-Like sales provide a comparable measure from stores open the previous year to provide an underlying measure of performance that strips out the effects of new stores, extensions and closures.

Source: Tesco Analyst Packs; IGD, 2013a; Shore Capital, 2013b

Table 3: Tesco plc international acquisitions and joint ventures (continuing operations only)

Continent/ Country	Date	Company acquired	Price paid (£m)	No. stores	Notes
Rest of Europe					
<i>Ireland</i>	May-97	ABF's Irish food business	643	109	
<i>Czech Republic</i>	Apr-96	Kmart CR	79	6	Price includes Kmart SR.
	Sep-05	Carrefour Czech republic	70	11	Slovak and Czech business exchanged for 6 stores, 2 sites in Taiwan
<i>Hungary</i>	Jun-94	74% of Global TH	15	44	
	1996	Further 23% of Global TH	3		
<i>Poland</i>	Sep-02	HIT	400	15	13 HM + 2 under-construction
	Nov-06	Leader Price	10	146	
<i>Slovakia</i>	Apr-96	Kmart SR	79	7	Price includes Kmart CR
	Sep-05	Carrefour Slovakia	asset swap	4	Slovak and Czech business exchanged for 6 stores, 2 sites in Taiwan
<i>Turkey</i>	Nov-03	Kipa	96	5	
SUB-TOTAL			1,316		
Asia					
<i>China</i>	Jul-04	50% of Hymall	148	25	
	Dec-06	Further 40%	181	-	
<i>Malaysia</i>	Nov-01	70:30 JV with Sime Darby	0	-	
	Dec-06	Makro from SHV	73	8	
<i>South Korea</i>	May-99	51% of Samsung Tesco	85		
	Jun-99	+ 30% of Samsung Tesco	57	-	
	Feb-02	+ 8% of Samsung Tesco	n.d	-	
	Jul-07	+ 5% of Samsung Tesco	40-60	-	
	Jul-11	+ 5% of Samsung Tesco	n.d	-	
	Mar-05	Store acquisition from Aram Mart	49	12	3 HMs, 9 SMs
	Apr-08	Homever stores from E-Land	958	36 HMs	50% on acquisition and 50% after sales uplifts achieved
<i>Thailand</i>	May-98	Lotus	206	13 HM	
SUB-TOTAL			1,807		
TOTAL CURRENT MARKETS			5,059		

HM - Hypermarket

SM - Supermarket

CS – Convenience Store

Source: Barclays Capital and JP Morgan (personal communication) with modifications

Table 4: Tesco revised strategies and priorities in international development, 2013

Priority	Countries	Strategy
Priority 1: Significant future potential	Thailand, South Korea, Malaysia	Highest international priority. Continue to build on, and invest in, leading positions in fast growing economies.
Priority 2: Improve returns, hold position	Ireland, Czech Rep, Hungary, Poland, Slovakia	Hold position. Make targeted investment in specific opportunities, such as online and convenience retailing.
Priority 3: Refocus on more profitable approach to growth	China, India, Turkey	Long term growth opportunities. Adopt a more cautious approach to growth and capital allocation.

Source: developed from company data and analyst reports

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