Strategic Management for Growth in International Food Retail Market: Case of Carrefour SA

Renee B Kim†

ABSTRACT

This paper provides in-depth analysis of internal and external factors that are important to food retailers' international market expansion, presenting Carrefour as a case.Nine sources of risks inherent in international retail market operation are explored and examined which are critical for Carrefour's international expansion. Key financial ratios of Du Pont System are used to assess Carrefour's performance in local market and relative to competitors. Carrefour's competitive advantages are also explored and compared with Wal-Mart, its major competitor in the international expansion.

Key words : Carrefour, strategic management, competitive advantages, Du Pont System, International Business

1. Introduction

The global retail market place is characterized with reduced trade barrier, intensified competition and heightened market consolidation and capitalization. In this fast-paced business environment, international food retailers fiercely seek to secure their market positions both by organic growth and by merger and acquisition. The ability to expand beyond the local region and to create "added-value" to oversea customers is critical for international food retailers in order to sustain market leadership. The extension of value-adding activities across national boundaries is an inherently dynamic process, which requires the adaptation of firm strategy, resources, structure, and organization to new international environments[20][4]. This paper presents Carrefour SA, the second world's largest food retailer as a case to examine the dynamics and the factors of international food retail market and to illustrate what is required in successful international expansion of food retailers.

Carrefour aggressively expanded to international markets and managed to grow for the past three decades and maintained its position as the world's second largest retailer after Wal-Mart, operating in over 30 countries under five store formats - hypermarkets (Carrefour), supermarkets (Champion),

† Associate Professor, Hanyang University, School of Business
Received : 2009-01-23, Accepted : 2009-03-10

hard discounters (Dia, Ed), convenience stores (Shopi and March Plus), cash & carry (Promocash), electronic corner(Ooshop)[6]. While France accounted for more than 50% of its sales, Carrefour positioned itself as a market leader in the European market after merging with the food retailer-Promod in 2000, and also entered China in 1995 as the first foreign food retailer and gained a strong market position with the first mover advantage. Deflation and a weak demand prevailed in the background of the French food retail sector in the early 2000s. Carrefour had to strike a balance between upward pressure on the supplier's prices and consumers' demand for lower prices in France, which compressed its margin. Carrefour mitigated its decline in the profitability of the French operation by having a better performance outside France.

The European food retail sector has reached a maturity stage, and growth was somewhat limited. Carrefour needed to cut its structural costs in order to stabilize the margins against competitive and economic backdrop that required the retailer to reposition its pricing. Thus, prospects for sales growth of Carrefour in Europe posed weak for immediate future. Carrefour aimed to be in the top three in terms of market share, and to generate satisfactory return on capital (ROC) for each business unit. Carrefour reallocated its capital to China expansion, which was a high growth market, while disposing its poor performing operation in several markets, including Japan,Mexico and South Korea and that of Podirest in France (foodservice) in recent years. Carrefour's future growth was expected to be driven by international sales, which was projected to be up to 8% to €11.1 billion, while French sales were expected to be up 0.9% to €10.1bn (Carrefour 2006)[6].

Pricing was a sector-wide prevailing issue as the consumers remained cautious, and most of food retailers' offering was too commoditized to generate any significant sales growth in such a poor environment[19]. To sustain competitive advantage in this challenging environment, food retailers needed to reduce the production costs, to increase customer demand for their products, and to reduce the overall risk of their business portfolio[17]. This paper presents a comprehensive assessment of Carrefour's performance both in domestic and international markets as a case to analyze relevant risks in international food retail market and to assess its competitive advantages.

The paper is organized as follow. The paper starts with a discussion of nine sources of external risks Carrefour faces in international expansion, followed by section on analysis of Carrefour's internal strength with Du Pont financial ratios. This section reports Carrefour's performance relative to local French market and relative to other international competitors. The paper ends with discussions and conclusions about what are Carrefour's competitive advantages and what needs to be improved for further growth.

2. Principal Risks of Carrefour's International Food Retail Operations

The growth dilemma for the MNE is that it must 'reproduce' itself in an environment to which its competencies are, as yet, un-adapted and, potentially, ill-adapted. It is important for a firm to understand factors and risks important to its oversea expansion. In this section, nine sources of risks that are critical to Carrefour's international operation are assessed. Identification of these factors provides in-sight to important external determinants of international food retail operation that need to be considered.

First, Economic environment and Market Condition is a primary source of market risk that Carrefour needs to monitor on constant basis. Economic risk has significant impact on Carrefour's profit margin and earning as its sales is highly correlated with consumers'disposable income. The food retail business is sensitive to business cycle and economic conditions as these plays as constraints to consumer spending. For example, demand trends in 2006 appeared weak, with French consumers having to spend more on energy and services[19]. On the other hands, Chinese market was considered to be strategically important for Carrefour's long-term growth given remarkable growth rate and enormous market size of China. China's retail sales were set to expand by 13% to the equivalent of $860 billion in 2006, making the mainland the world's seventh-largest retail market; and annual compound growth rates of 8%-10% would push this to an enormous $2.4 trillion by 2020[16].

Second source of market risk Carrefour need to manage is the Change in Consumer Taste and Preference. Consumers/ customers around the world are savvier, more demanding, more diverse, segmented, hard to predict. Consumer shift satisfaction criteria from traditional to more experience based. They are harder to reach with multilayer of fragmented media, new emerging multi channel shopping options. French consumers increasingly preferred hard discounter store format, posing a threat to Carrefour's hypermarket segment which was Carrefour's main revenue source. To sustain market share for the hypermarket segment, Carrefour needed to have aggressive price cuts, compromising its margin. However, price cutting wasnot the only solution for Carrefour to stay competitive. Carrefour's recent failure in South Korean market exhibited the importance of localization and adaptation of merchandising and marketing strategies in food retailing.

Carrefour's "warehouse" style retail format was not accepted well among the Korean consumers who were used to extensive sales-service environment in which sales ladies assisted with free samples, packaging and wrapping services[12]. Carrefour's price cutting strategy may have been effective in attracting price conscious shoppers who were willing to compromise customer service and quality for low price in Europe. On the other hand, the Korean consumers preferred to have extra sales people and aggressive promotion in the value of service and products offered by the retailers. Carrefour's low price was perceived to be insufficient "value" in the minds of Korean consumers. This suggests that the compatibility of Carrefour's product offering with the Korean consumers' perceived value was a critical factor determining the retailers' successful market penetration and positioning in Korea.

Third, French Macroeconomics Fundamentals are important particularly for Carrefour's revenue; half of Carrefour's net sales including tax were generated from France, and 87.6% of net sales including tax were generated from Europe[9]. Carrefour's share is traded in Paris stock exchange and its share price is quoted in Euro. This implies that macroeconomics fundamentals in Europe, particularly in France have substantial impacts on Carrefour's share price.

Regulatory Change of the Loi Jacob in 2006 posed an opportunity for Carrefour relative to other retailers in its local market. The easing of the Loi Jacob (price regulation policy in France) on loss leaders from January 2006 in France allowed the retailers to pass onto customers' part of the rebate granted by suppliers [13]. This had a potential for an outbreak of a price war in France among major food retailers. Increased price competition put pressure on Carrefour's sales and margins. The French retailers werelikely to continue price cuts on major brands at a pace of 2%, hurting their margins[10]. Given that net profitability of the food retail sector was estimated to be 2%-2.5% of sales, the players with insufficient critical mass had disadvantage in the price war. This placed Carrefour (market leader with 25% market share) at more advantageous position, as it could command pricing competition with its scale and increased competitive pressure in the sector[10]. However, overall, the pressure on margins persisted since 2006 due to this new legislation and mid-sized players eventually got weakened and the sector started to consolidate. Increasing concentration and progressive saturation of the French market and intensive price competition, the mediocre growth of household consumption constrained the food retailer's turnover and had pressure on the margin in Europe[7].

Carrefour's fifth source of risk is Currency Risk related to International Expansion. Carrefour operates in 32 countries around the world and approximately 50% of its revenues are generated oversea[18]. Carrefour continues to increase its level of internationalization, which may increase risks related to fluctuation in currency values of local markets. However, the Group's activities throughout the world has been carried out by subsidiaries primarily operating in their own countries (purchases and sales are made in local currencies). Thus, the Group's exposure to foreign exchange risk on its commercial transactions was limited[5]. The main source of exchange risk was essentially related with imports. The risk on fixed import transactions was hedged by forward purchases of currencies.

Carrefour's aggressive international expansion likely to leads to high level of exposure to political risks in local markets which is closely associated with regulatory/legal risks, aforementioned as fourth source of risks. In particular, food retailing in Eastern European markets and China are heavily influenced by government policy. Sudden changes in the government regulation of these countries or trading relationship between these countries and France could have significant shock to Carrefour's operation.

Regulatory policies regarding food retailing plays a key factor in foreign operation. Chinese government relaxed its regulation on foreign food retailers' operation in China according to WTO agreements, which set to open further to foreign retailers and to accelerate consolidation among local retailers[21]. However, China imposed much tighter regulatory restrictions on foreign service-sector companies than on manufacturing firms[3].

Seventh source of risk for Carrefour can be identified as Wal-Mart's Aggressive Pricing Scheme. Wal-Mart's global sourcing advantage for non-food items posed a major threat to Carrefour, as buyer power was less localized for non-food segment. Wal-Mart's virtuous cycle led to market share gains and to improved buying power with suppliers, lower input prices and therefore lower prices for customers driving further sales. Carrefour had head to head competition with Wal-Mart in Asia, Europe and South America, and Wal-Mart's buying power and aggressive pricing placed pressure on Carrefour's margin. Intense price competition and commoditization of the global food retail sector diminished prospects for sales growth of Carrefour. Wal-Mart invested RMB 1.3bn in China since it opened its first store in Shenzhen in 1996, and chased after Carrefour to take over the market leadership among foreign operation[21]. Wal-Mart China wasthe 14th largest chain store carrier in China with sales of CNY 6.2 billion in 2006 with 60 stores, close to number of Carrefour's[15].

Food Price Fluctuations is commodity related risk Carrefour faces in its food merchandising operation. Carrefour's sourcing for food products in foreign markets was primarily done locally, thus Carrefour's foreign operation was subject to fluctuation of commodity prices and food prices such as dairy products, vegetables, fruits and processed food products in a particular local market. French operation was also subject to this risk. Carrefour also had service stations in France Motorway since 2001, thus this operation was subject to risk related to gas price fluctuation.

Finally Carrefour has Interest Rate and Inflation Rate Risk as it has several subsidiaries that are heavily affected by risk of interest rate changes. These operations included Carrefour Insurance service, "Carrefour Property" and Carrefour service stations[5]. Its food retail operation was also influenced by this risk as this involved investing, financing and operating activities. In other words, changes in interest rates affected the value of projects or investments directly, through discount rates and indirectly through the cash flows. Other factors that affected all investments included the term structure (the difference between short and long term rates), risk preference of investors, inflation, economic growth in a particular market.

In the following section, performance of Carrefour is analyzed using key financial ratios. Data for this analysis is obtained from Carrefour's annual financial statement. Return on equity (ROE), a key measure of earning of a firm is decomposed to understand factors affecting firm's performance according to the Du Pont system[3].

3. Carrefour's Financial And Strategic Management

Overall, key financial ratios using the Du Pont system for Carrefour <Table 1> show that Carrefour had a weak performance in its local French market, while its competitive performance relative to other players in the industry did not gain much recognition in recent years. Liquidity and solvency ratio analysis <Table 3> show that Carrefour was streamlining its globalization strategy by divesting unprofitable operations and selectively investing in certain region (i.e. China) and in acquisition. Carrefour's financial structure appeared to be in reasonable condition, as it continued to reformulate financial resource allocation among different market regions and optimized its strategic positioning without increasing its long-term debt substantially. Carrefour choseto expand with modest capital investment as indicated by declining debt ratio <Table 3>.

Industry analysts claim that Carrefour sought to maximize the margins by chasing after discounts from suppliers while neglecting customer expectation, resulting in losing market share and weak performance[9]. Carrefour needed to enhance customer focus by: price repositioning; enhancement of the fresh produce range; increase in proportion of local goods carried; more management by local staffs.

3.1 Carrefour's Performance relative to French Market

Using the Bloomberg application, Carrefour's share price for period (2002 to 2004) was compared with the CAC index (French S&P) <Figure 1>. The white line represents Carrefour's share price and red line indicates the CAC index. Figure 4 exhibits that Carrefour underperformed for the past three years compared to the French market. For example, total return for Carrefour was -39.18%, while the CAC index return was -34.17%.

Carrefour's share price has fallen significantly since 2000: the share price was around €80, and reduced to half €40 in recent years. Overall there was a sharp slowdown in consumption in several major European countries and consumer spending remained depressed in France[13]. This economic climate combined with increasing deflationary pressure (coming from intense price war and change in pricing regulation in France) led to Carrefour's poor performance[14]. More importantly, Carrefour's main store format-hypermarket segment had been performing particularly poor, due to a shift in European consumers'shopping preference from hypermarket to hard discounters such as Aldi and Lidl[9]. Also, Carrefour lost its market share to its aggressive competitors- Auehan and Leclerc who wereprice competitive.

Table 1. reports Carrfour's performance ratio. Return on earning (ROE) is one of the two basic factors in determining a firm's growth rate of earnings[2]. Carrefour's ROE declinedin 2004 compared to two previous years, and declining ROE is an evidence that the firm's new investment offered a lower ROE than its past investments[2]. Jensen's alpha is the average return on the portfolio of a firm over and above/below the predicted market performance statistics according to Capital Asset Pricing Model (CPAM)[2]. This measure showsthat Carrefour increasingly underperformed the market. In 2004, Carrefour underperformed the market by 26.89% according to the Jensen's alpha for 2004.

3.2 Relative Performance of Carrefour among Major Food Retailers

Key financial ratios were estimated for seven major food retailers for past three years (2002-2004) were compared in order to have a comprehensive overview of relative performance of Carrefour in the food retail sector <Table 2>. Carrefour clearly underperformed compared to its competitors as indicated by 3 year total return measure. Metro had 41.1% total returns on its stock, while Carrefour had 7.85% total returns on its stock. Although Carrefour had competitive asset turn over (ATO) and comparable EBIT margin, its total return on stock was the second lowest among its peer group. It is interesting to note that Wal-Mart had negative total return on its stock despite its superior ROCE and ATO. Earning generated in Europe and the US showed potential risk, as these markets experienced increasing price competition and low sales growth[19].

Earning per share (EPS) for Carrefour was 2.29, above a few players in the market, however, this did not translate into stock performance and the market didnot recognize its relatively high EPS, implying under-price of Carrefour equity. On the other hand, Tesco's last share price was quoted at 336.50 and its EPS was 0.18. This suggests that market favored Tesco stock.

3.3 Carrefour's Financial Strategy and Management

Carrefour had significantly large negative working capital which had been increasing for the period of 2001 to 2004 <Table 3>. The nature of food retailing business allowed retailers to have fast cash conversion cycle, as customers largely paid cash or credit/debit card that had short cash conversion cycle. Carrefour used negative working capital to improve its operating margin and used as a cushion against market jolts[5].

However, Cash ratio declined during this period, indicating decline in overall cash availability as short term liquidity. It might be that Carrefour did not increase equity financing during this period to raise liquidity, as indicated by decline in the total shares outstanding. Carrefour did not issue new shares during from 2002 to 2004, and repurchased its shares from the market. Cash flow statements showed that capital increase in cash declined significantly from 17.3 to (367.6) which was due to acquisition of Centros Comerciales Carrefour securities and implementation of stock buyback programme[5].

In recent years, Carrefour had refocused its international growth by divesting some unprofitable assets. In the period of 2001 to 2003, Carrefour disposed of a large proportion of its shopping galleries, Picard Surgeles, Chilean hypermarkets, and its stake in Petsmart, raising over €1.2bn, and in 2005 it disposedits hypermarkets in Mexico, Czech Republic Japan and South Korea, and its food service operations for €1.2 bn [5]. Carrefour continued its disposals of some divisions, while making additional acquisitions in future.

4. Conclusions: Strategic Management Perspective

Figure 2 illustrate 7 sources of competitive strategy a firm can possibly use to obtain competitive advantage, which need to be chosen in regard to industry conditions and firm's particular endowments. Seven sources of competitive advantage are drawn in the value net to exhibit relationship among these sources. The food retailingis commoditized business which has tight margin and accelerated turnover, thus it is difficult for retailers to create value through rapid sales growth or superior offering(low price) of product. In the food retail industry, superior advantages may needto come from downstream of the offer in the value chain. In other words, food retailers' inputs, technology and operations are often similar, while offering, access, segments and customers are factors that can vary for each retailer depending on their strategic directions.

Carrefour managed to grow for the past three decade by aggressively pursuing superior market access and segments in oversea operation. Domestic expansion in France presented a limited opportunity due to French legislature in 1973 to regulate expansion of hypermarkets in an effort to preserve the integrity of smaller traditional retailers. Therefore, Carrefour seeked growth opportunities oversea and through acquisition, obtaining early mover advantages to createsuperior access, segment and establishing superior customer relationships. Carrefour made almost half of its sales outside France, commanding market leadership particularly in Asia. Carrefour arrived in Asia in 1989 with a store in Taiwan and expanded its Asian operation to more than 100 stores with approximately $4 bn in sales in 2000[8]. One of the strength of Carrefour's globalization strategy is Carrefour's regional operation's autonomy to be flexible and adaptable to local conditions. This allowed international business units to have ability to respond to local conditions effectively.

Carrefour's major competitor, Wal-Mart, on the other hand, uses superior technology (extensive IT investment), superior offer (everyday low price) and superior operation (constant cost cut) to gain competitive advantages in global food retail market. Given the significant domestic market size of the U.S., Wal-Mart initiated its international expansion strategies later than Carrefour. Wal-Mart is reported to be catching up with Carrefour in strategically important markets such as China by injecting heavy capital investment and establishing good relationship with Chinese government.

Important question for Carrefour regarding long-term growth and global leadership is whether it has sustainable advantages over fierce competitors such as Wal-Mart. Carrefour may need to align its value chain activities tighter to match Wal-Mart's efficiency in operation and cost structure. This may include coordinating activities across its infrastructure, human resource management, technology and procurement, while compressing supply chain activities more closely from inbound logistics to sales. However, just by attempting to match Wal-Mart's cost compression efficiency, Carrefour may not be able to sustain its competitive advantage. Sustainable competitive advantage for any firm requires that its resources be unique[1].

Carrefour may need to focus on improving its downstream activities by striving to have superior offering, superior access, superior segment and superior customers.Superior offering may involve offering right mixture of merchandising that include most preferred national brands and good quality/value private labels; superior access involves building sufficient geographic saturation and critical mass in areas where Carrefour has high potentials of success to compress costs from economies of scale. Superior segment can be achieved by matching Carrefour's offering with customer profiles to maximize sales. From these carefully targeted activities, Carrefour can create "added value" in the minds of customers who eventually become loyal repeat customers and captive dependent, thus forming superior customer. It should be kept in mind that a winning strategy entails the ability to anticipate and act on major shifts in business environment before rivals and to create "added value" particularly at consumer end.

〈Table 1〉 Carrefour's Performance Ratio

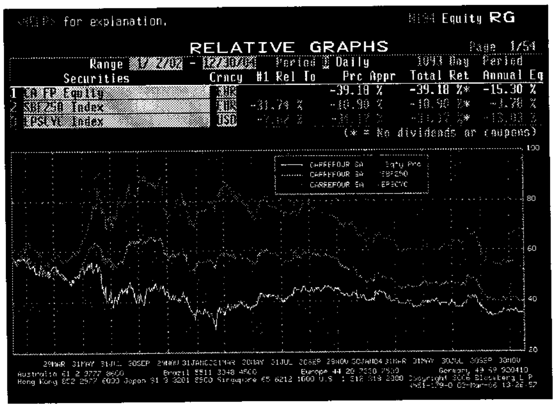
		2002	2003	2004
1. Accounting Measure	ROE	20.40%	21.77%	18.13%
	Required rate of return	-33.75%	16.20%	7.40%
	ROE - Cost of Equity	54.15%	5.57%	10.73%
2. Stock Performance Measure	Returns on stock	-27.35%	2.57%	-19.49%
	Required rate of return	-33.75%	16.20%	7.40%
	Jensen's alpha	6.40%	-13.63%	-26.89%

〈Table 2〉 Liquidity Analysis of Carrefour

	FY1 2004	FY1 2003	FY1 2002	FY1 2001
Cash Ratio	0.13	0.15	0.13	0.18
Current Ratio	0.61	0.63	0.64	0.72
Total Debts to Total Capital	56.17	60.51	63.10	62.39
Cash & Equiv to Current Assets	21.16	23.55	21.37	25.94
AR Days	15.71	16.40	11.78	6.85
Inventory Days	38.61	38.12	39.91	39.38
Inventory to Cash - Days	54.33	54.53	51.70	46.23
Op Inc to Current Liab	0.12	0.12	0.09	0.10
Op Inc to LT Debt	0.40	0.40	0.26	0.23
Op Inc to Total Debt	0.29	0.25	0.17	0.18
Working Capit	-8675.40	-8281.3	-7707.3	-6112.2

〈Table 3〉 Solvency Analysis of Carrefour

	FY1 2004	FY1 2003	FY1 2002	FY1 2001
Assets/Equity	5.13	5.29	5.52	5.28
LT Debt to Total Capital	41.17	38.68	43.62	47.72
Debt To Market Cap Ratio	0.39	0.36	0.39	0.33
Total Debts to Total Capital	56.17	60.51	63.10	62.39
Total Debt to Total Assets	24.94	28.95	30.95	31.38
Total Debt (ST & LT Debt)	9724.29	11312.3	12049.2	13471.3
Shares Outstanding	696.80	708.81	711.79	693.89



〈Figure 1〉 Three Year Analysis of Carrefour's Stock Performance vs. CAC Index

References

[1] Welch, L. and Luostarinen, R. (1988) 'Internationalization: evolution of a concept', *Journal of General Management* 14(2): 34-57.

[2] Calof, J. and Beamish, P. (1995) 'Adapting to foreign markets: explaining internationalization', *International Business Review* 4(2): 115-131.

[3] Carrefour (2006). Annual Report. www.carrefour.com

[4] UBS (2006). Food for Thoughts #9, 2 February 2006, pg 7.

[5] Tihanyi, Laszlo, David A. Griffith, and Craig J. Russell. (2005). The effect of cultural distance on entry mode choice, international diversification, and MNE performance: a meta-analysis. (Multinational Enterprises). *Journal of International Business Studies* 36.3: 270(14).

[6] The Economist (2006). Speacial Report: Ready for warfare in the aisles - Retailing in China. The Economist. London, Aug 5, 2006. Vol. 380, Iss. 8489, P. 60.

[7] Ramstad Evan. (2006). South Korea's E-Mart is no Wal-Mart, which is precisely why locals love it. *Wall Street Journal*. (Eastern Edition). New York, NY. Aug 10, 2006. p.1

[8] Morgan Stanley (2006b). Carrefour - Poor non food performance led to a decline in French EBIT in 2005. Jan, 11 2006.

[9] Oviatt, Benjamin M.,Phillips McDougall.(2005). Toward a theory of international new venture. *Journal of International Business Studies*. 36.1

[10] SG: Cross Asset Research (2005a). Food & Staples Retailing. SG: Cross Asset Research -Equity Research, 14 September 2005 pg29.

[11] Morgan Stanley (2006a). Retailing - Food. France 2006: Less risk than you would expect. Jan, 23 2006.

[12] Deutsche Bank (2006). Carrefour: Taking the fear out of France. DB: Company Research. Feb 22, 2006.

[13] UBS (2005). Investment Research, Carrefour 5 October, 2005.

[14] Carrefour (2005) Annual Report, 2005.

[15] Young, Edward (2002). Shoppers flock to western stores: Retail. Financial Times. London (UK): Mar 15, 2002. p 05.

[16] Business Asia (2001). How to win in China. Business Asia. New York: June 11, 2001. Vol. 33, Iss. 12, P 2-5.

[17] SinoCast ChinaBusiness Daily News. (2006). Wal-Mart China to catch up with Carrefour in store number. SinoCast China Business Daily News. London (UK). Aug 24, 2006. p.1

[18] Bodies, Zvi, A. Kane and A.J. Marcus (2004). Essentials of Investments. McGraw-Hill/Irwin, New York, NY.

[19] SG: Cross Asset Research (2005b). Carrefour. SG: Cross Asset Research -Equity Research, July 4, 2005.

[20] Barney, J. (1991) Firm resources and sustained competitive advantage, *Journal of Management* 17: 99-120.

[21] Flagg Michael (2001). In Asia, Going to the Grocery Increasingly Means Heading for a European Retail Chain. Wall Street Journal. (Eastern Edition). New York, N.Y. Apr 24, 2001, p 21.

Renee B Kim

Major : International Business
2000-2007 Associate Professor at University of Manitoba
2007- Present Associate Professor at Hanyang University
E-Mail : Kimrby@gmail.com