Supermarket finance

A mortgage from Tesco?
Oct 2nd 2008
From The Economist print edition

A retailer branches out

MORTGAGE banks may be falling like ninepins, but that does not matter to Tesco, Britain’s leading supermarket chain. “Mortgages are looking quite attractive as a line of business,” said an official this week, as the firm reported buoyant half-year profits to August 23rd. Later this month Tesco expects to take full ownership of Tesco Personal Finance (TPF), its 11-year-old joint venture with RBS, a retail bank, and has big plans for it. TPF now has around 5.6m customer accounts with deposits, savings, loans and credit cards. It made a relatively modest £71m profit over the past six months, but wants to increase that, along with profits from other services including telecommunications, to £1 billion a year.

Tesco has the freedom to expand into banking, touting its well-known brand, because its main business is thriving, even in tough markets. Global retail sales grew by 14% and profits by 11% compared with the same period last year. It has seen particularly strong growth in Malaysia and Poland, and rapid expansion (but a small loss) in China. Even in its embattled British home market (which accounts for over 70% of its business), turnover in its seasoned stores rose by 3.7%. Its upmarket rival Marks & Spencer, by contrast, has seen a 6.1% drop in sales over the past quarter.

Analysts reckon that Tesco too has lost some customers to stores that discount their goods heavily, but it still accounts for more than 30% of all supermarket sales. Its smaller “Express” shops—designed to compete with little convenience stores—have invaded the high street, with profitable results. As prices rise and disposable incomes are squeezed, shoppers are foregoing car journeys to out-of-town supermarkets and expensive nights out, staying at home with a couple of DVDs and food and wine from their local grocer.

That is partly the fault of higher petrol prices but may also—perversely—reflect the efforts of local planning bodies to protect independent stores in town centres by blocking new supermarket developments outside them. Raffaella Sadun, of the London School of Economics, has found that supermarket chains, denied an out-of-town site, are more likely to set up in town centres themselves, bringing the battle straight to the high street. Some corner stores benefit from having a mini supermarket next door because it attracts more shoppers to the area; others decide to specialise; and the less fortunate are sometimes driven to bankruptcy. The message of Ms Sadun’s study seems to be that denying planning permission to supermarket “boxes” does not preserve high streets from change—rather the reverse.

One might expect the Competition Commission to have something to say about this, and it does. The watchdogs are working on ways to reduce the retail dominance of supermarkets, to which customers normally flock however much they lament the threat to independents. More concerned with securing the benefits of competition for consumers than with ruling on who should operate where, they proposed in April applying a “competition test” to guide decisions made by local planning authorities. Most supermarkets have protested, and Tesco will contest the whole idea of “adding another layer of bureaucracy” before a tribunal in November. The commission’s other proposal—that supermarkets appoint and pay for an ombudsman to handle competition complaints, has met with similar resistance.

As if the attentions of one competition watchdog were not enough, the Office of Fair Trading, too, has two big investigations pending into supermarkets’ pricing practices—one on milk and other dairy products, the other on tobacco. And there is interest from higher up too. More than 400 members of the European Parliament have asked the European Union’s competition enforcers to investigate concentration in Europe’s supermarket sector, arguing that a handful of retailers may be acting as “gatekeepers” between food producers and consumers, to the detriment of both.
In the meantime, Tesco will be exploring prospects in financial services. And who is to say it’s wrong? For the moment, at any rate, Britain’s biggest retailer looks a safer bet than most of its banks.