

Innovation in the Service Sector: Tesco Case study

For: Dinner / discussion organised by the Foundation for Science and Technology

Date: 25th April 2006, 5.30 pm

Location: The Royal Society, Carlton House Terrace, London

Chair: The Baroness Wilcox

Overall Topic: *"How should the Government support innovation in the economy?"*

Speakers Sir Keith O'Nions FRS, Director General Science and Innovation, OSI, DTI, Stephen Heal, Tesco and Norman Pickavance, Corporate Services Director, Northern Food

Stephen Heal speech topic:

"Innovation in the service sector: A Tesco case study"

Allotted time : 15 – 20 mins

Introduction

I had a visit recently from the newly appointed Finnish Ambassador. Not unusual these days at Tesco Business Development. I had expected him to want to talk about Hypermarkets in Helsinki, or about Tesco Expresses in Turku.

But no, he wanted to talk about innovation. How *did* Tesco innovate in its services? What *could* he and his friends from Nokia learn about the process and structures that lead to innovative service companies?

Dougal Goodman subsequently kindly invited me to share some thoughts with you on *innovation in Tesco as a Case Study*. Thank you. So I reflected on the Ambassador's visit.

Two things intrigued me:

1. That he came at all. – Do British Ambassadors do such things ? – do they visit SAP in Germany or Ito Yakado in Tokyo?
2. Just how *does* Tesco 'do' innovation?

Tesco does not have a *Department for Innovation*, a *Tsazar* or a Director General of new product or service development. Not that I could find.

So I asked some members of the board for examples and for what they thought was important ... *This case study* is of innovation in the *service sector*. By most measures an important and growing part of the UK economy [].

To state the obvious, innovation here is *different* from the rarefied fields of medical research in the pharmaceutical industry where innovations are protected through long-lasting patents.

We are looking at innovation in the delivery of goods and services from manufacturer to the customer. 24 hours per day, 365 days per year. Tesco does this for millions of customers in 12 countries. We delivered over 1 billion products and services last year.

Innovation has led to growth – real growth

By *adapting to the changing needs of its customers*, Tesco has come a long way from being the #3 supermarket chain in the UK. Just 10 years ago Tesco had no operations overseas. We sold food. And that was it. Today we are an international business in 13 countries.

- 1 Half our space is outside the UK. We have moved into selling clothes, electrical goods, books, music and financial services.
- 2 We have developed Tesco.com into Britain's biggest on-line retailer.
- 3 We have come up with formats like Express stores
- 4 We have moved into 24 hour shopping and along the way become a mobile telephone provider.

What the board unanimously told me was that *All of this growth* from each of these innovations is based on listening carefully to the *customers* – they are our both our research base *and* our judge.

Clubcard's role

I'd like to select one for its particular contribution to the innovation process itself - the launch and ongoing development of ***Clubcard***. *Clubcard* is a loyalty programme that provides a 'thank you' to over 12 million of our regular UK customers. Loyalty programmes are per-se not innovative these days, and ours was neither the first nor is it the largest (I believe that Boots have more members in their programme).

Its more than loyalty. Tesco has however invested continuously in the incredibly rich seam of data that it provides – it is a *powerful R&D tool that helps us innovate by better understanding the changing behaviours of our customers.*

With the necessary safeguards in place of course, it can be used to analyse the shopping and eating habits of a very broad cross-section of the UK population. It is full of fascinating insights.

Teacher's pet. We noticed for example that just before the *summer holidays* each year, sales of flowers, chocolates and wine were suddenly going up. The question was why? We looked at the clubcard data and saw that it was families with children who were doing the buying. They were buying end of year presents for their teachers. Obviously an Apple for teacher isn't enough any more.

When we have this sort of information we can act on it. It doesn't just sit in the dusty in-tray of some head of strategy. It is plugged directly into the business and influences all of our decisions.

Clubcard can help us test innovations in product, promotions or store format or service. It has helped us with the development of new services such as Tesco dot-com and Tesco mobile. By analogy with the R&D of the pharmaceutical industry, we can do Phase II and III trails to monitor results and responses of consumers before a full launch.

We can also now target specific service offers to customers with specific profiles. Put this tool in the hands of well-trained and empowered category directors and they can collaborate with suppliers to develop more of the products and services that customers want.

And what do customers want? – simpler and cheaper

One thing customers tell us is that they want more for less. They have limited budgets or limited time or both. So services need to be delivered as simply and cheaply as possible. Tesco does this in-part through a *very large number of small changes* - individual innovations and improvements to existing services that make things *simpler and cheaper* for customers and staff.

How do we get these ideas?

They don't *flood out of the 'ideas department'*. They come from the people who do the work.

Everyone who works in our stores is encouraged to suggest ways to make their work easier. If

their idea is picked up and implemented, that person is given a company award, recognition of the contribution that they have made. 6000 ideas have been generated since last autumn by this distributed network of 'intra-preneurs' and innovators.

We do have teams responsible to collect, develop, test and deliver a rolling programme of these changes to stores and distribution centres. They measure and monitor the improvements in service and productivity very closely.

Continual change is a way of life. It has to be.

What about Motivation? To support this way of life, our values must encourage innovation and risk-taking in our people. Going into new areas makes us more entrepreneurial. There are many start-ups within Tesco. New countries. New concepts. Each with their own team. By example, we have a team dedicated to finding a way into the US market. They conduct the research and development work and will be responsible to build a new business. They are taking personal risk in order to be part of a new venture, and they will really have to innovate in order to succeed.

What of the science and the technologies we need?

I found one innovative example of a **combination of technologies** behind-the-scenes in our distribution centres.

It is a device. Strapped to the arms of our 'pickers' in the distribution centres. These 'pickers' are people who physically move the goods that arrive on lorries from our suppliers (such as Northern Foods) at one side of the distribution centre to our lorries on the other side, who are waiting to take the goods to specific stores where our customer Mrs Jones is waiting for fresh strawberries.

The arm-mounted device is linked to the central replenishment system and tells the picker where to go to collect exactly how many of a specific product. There is a bar-code scanner built into the

glove of the device to ensure that the right products are picked, it counts them off as he picks. [one, two, three cases of strawberries]. It then tells him which lane to take it to for a specific store and checks that they are placed in the right location.

The system can now optimise the movement of the pickers around the centre and can monitor productivity, improve accuracy and remove paperwork. Of course implementation of such technologies requires working closely with your staff to ensure that they are implemented in the right way.

The arm-mounted device combines communications, scanning, location and information technologies probably developed in many countries and combined here to meet a specific need. I don't think the device is unique to Tesco, but for me it illustrated how innovative combinations of technologies can meet the needs of customers (getting fresh strawberries cheaply and reliably to Mrs Smith in Risborough).

It also, in its small way, improves the productivity of the UK economy.

Where else will we need science and technologies for innovation?

I am pleased to say that today we can announce a new **£100m fund** that Tesco has set aside to be used for ***innovation in sustainable environmental technology***.

Why? Well, for one we are faced with the challenges of rising energy prices. We are also committed to playing our part in tackling climate change by reducing our energy use and emissions.

We built our first energy efficient store in 2005. It uses 20% less energy than a typical store. Our second model energy store has now opened in Swansea and we are drawing up plans for the first ever supermarket built entirely of recyclable materials.

We will be installing wind turbines at some of our new stores alongside solar energy technology, and combined heat and power units. We will also be trialing gasification a technology to turn waste into clean sustainable power.

For that's some of how Tesco thinks about innovation in the service sector.

Implications for the policy debate

So what might this case examples imply for the debate?

Firstly, service companies are an important and growing part of our economy. We might not measure R&D in the same way that research intensive industries do. But we do spend considerable resources understanding the customer as best we can. Then we use technologies to adapt to keep pace with them. Perhaps the first take-out from our case study is to follow your customer. Will the Government follow the customer into supporting the service sectors, and how will it do so given we are structured differently from the research intensive industries?

Secondly, service companies will require access to communications and information technologies, and the new and old technologies that will help companies reduce their environmental footprint. How will the Government be supporting investment in such technologies?

Thirdly, Service companies will need people skilled in the implementation of these technologies. A supply of well-trained people, capable of adaptation and change. Entrepreneurs. How will the Government foster the development of entrepreneurial culture through education that supports and rewards risk taking?

Fourth. Competition. It is perhaps the *mother of innovation*. Competition enables the customer to switch between one service provider and another. This pushes each to innovate in order to survive. In our industry, the impact of the judgements being made by shoppers is very stark.

Retailer A who gains 1% more customers a year can double his market value compared with retailer B who loses 1% of customers a year. It is customers who make the difference between success and failure - they force providers to *adapt and innovate to survive*.

In today's environment, Global Competition is important too. Internationalisation has greatly benefited Tesco's customers back home. As Tesco developed its offer in different countries, it has learnt from different customers and different challenges. Some services may not be able to travel across borders, but ideas and innovations can. Will the Government be fostering competition and international collaboration?

*Lastly, a dynamic, innovative and competitive **public** service sector.* It strikes me that after all, we serve the *same customers* and many of the logistics and technology challenges are common.

Continually improving operations in of the public service sector might help raise the bar in customer expectations. It would provide a larger market for the development of technologies such as our arm mounted device. It also develops *talent* that innovative service companies need to make us more competitive in the global market.

Easy to say. I'll leave it to Government to do.

What might the Finnish Ambassador say ?

As he left our meeting, the Ambassador showed me his new Nokia mobile phone. With some pride I might add.

It has a built in innovation – Nokia's response to competition from Motorola's flip phone – it slides open. Simple.