

## **The Influence of Transaction Costs on the Business Performances of Tesco Supermarket**

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### **Abstract**

*The main purpose of this research is to analyse the influence of transaction costs on the business performance of Tesco supermarket. This research is structured into four sections which are introduction, literature review, theoretical analysis and conclusion. Literature review on transaction cost theory and the business phenomenon which is the Tesco £4.6 billion loss in 2015 was critically reviewed. A theoretical analysis was carried out identifying Tesco supermarket having high transaction cost. The Chief Executive of Tesco reduced the price of some goods and close down some outlet of Tesco which was not making profit, the business performance improves and they gain sustainable competitive advantages. The research concluded that for any business organization to perform and to gain sustainable competitive advantages, top managers must be ready to review the strategic roadmap of the business organization to fit in any political, economic, social, cultural and technological environment challenges.*

### **Introduction**

The main aim of any business organization is to meet its above-average returns and to gain sustainable competitive advantages over competitors in the industry using any available means. In 2015, Tesco had a huge loss ever reported on the United Kingdom high street, the leading supermarket chain loss 6.4 billion GBP as a consequence of the massive property portfolio and stock write-downs value (Butler and Farrell 2015). Nevertheless, the chief executive of Tesco Dave Lewis was able to reduce transaction cost to retain the loss and achieve a sustainable competitive advantage in the United Kingdom supermarket. This business phenomenon is common for some business organization and its use to effect the business performance of an organization. Nevertheless, transaction costs uses to influence business performance, in spite of the fact that top managers need to review the business organization, strategic roadmap in other to meet above-average returns of the business organization in a time.

Williamson (1979) transaction cost economics is a discipline that involves two or more disciplines that connect organization theory and economic theory to extend over widely with the law of contract. Transaction costs theory could be define as the expenses involved in carrying out some goods and services through the market. In other words, Transaction cost can be the market running cost. Transaction costs theory has to deal with the running cost while selling or buying goods or services. Transaction costs can be as monitoring costs, negotiating costs and enforcing exchange among parties. Melvor (2009) Transaction cost economics states explicitly the pre-requisite in which a business organization should be able to handle economic exchange internally within the business organization jurisdiction. Brouters and Nakos (2004), Transaction costs theory have been extensively apply as a state of completion from the entry mode selection for the powerful business organization. Transaction costs are not establishing by the *asset specificity* of the investment needed during initiating a new international entry. Asset specificity means human resources physically. Similarly, transaction cost theory is over use in more than one or two management faculties and particularly in strategy works. Transaction costs theory emphasizes emphatic extent on asset specificity and the task to fix conclusively on how to improve coordinated exchanges (Martins, et al 2010). During 1960's Roland Coase originated Transaction costs theory. Williamson and Roland Coase further developed transaction costs theory. Oliver Williamson was one of the scholars who further developed and put in to practice Transaction cost economics (TCE), is among the recent leasing and influential new ideas of social and management sciences (Carter and Hodgson 2006).

Notwithstanding, transaction cost is important in social and management science specifically in strategic thinking and value management. Transaction costs economics do not focus concentration solely on revolving the extent of transaction costs on the other hand also study transaction costs determinants in order to look for how the organizational makeup (or set of contracts and institutions) which consolidate or preferably reduces manufacturing and transaction costs to the lowest level (Ostertag 1999). Transaction costs comprise of the costs compulsory in which without the expenses incurred transactions cannot be successful. In genuine markets, running cost, advertising, ownership and internet connection or electronic shop can make up transaction costs (Vasiliauskiene 2011).

Butler and Farrell (2015) Tesco customers were returning to Tesco because of the reduction of prices, which Tesco had to improve service in stores by investing about 200 million GBP just to make sure Tesco gain sustainable competitive advantages in the United Kingdom supermarket. This is another important reason why this research topic, which is the influence of transaction costs on the business performances of Tesco supermarket, is vital within the context of strategic thinking value management.

In general, transaction cost is important because it uses to influence business performance in a positive way, for example, the supermarket group recorded its worst report in the history of United Kingdom retail loss as a company. But when the chief executive officer of Tesco Dave Lewis reduce prices and close down some stores that are not generating sales, Tesco was able to make a profit. Williamson (1979) research on the transaction costs economics confirmed the importance of transaction cost: the governance of contractual relations.

Armstrong, (2016) Tesco recorded a sale growth in the United Kingdom Supermarket industry during the first quarter of 2016, which increase until the fourth quarter of 2016. This excellent improvement was a little bit above analyst expectation compare to the previous quarter of 2015.

Jiang, Chu, and Pan (2011) noted that fundamental logic of transaction cost economics is that business organization will assist non-horizontal integration during transaction costs, which include performance evaluation, adaptation, and safeguarding costs are more than within the scope that is administrative and manufacturing costs. A business organization that function excellently has arguably greater the options to invest in emissions-reducing activities, noting that these are occasionally both outrageous upfront cost investments as well as low direct investments (Broadstock, et al 2017). This research is to examine the influence of transaction costs on the business performances of the Tesco supermarket.

### ***Literature Review***

Researchers have been able to conduct research on transaction cost theory, but few or little have been conducted out on Tesco supermarket huge loss, which affects the supermarket chain. Transaction cost economics was originated by Roland Coase, this theory encloses four research areas, transaction costs is one of the research areas, which dominates (Vasiliauskiene, 2011). During the 1960's transaction costs argumentation began to take hold, transaction costs were usually implemented in a one-sided way as with the reasoning, that the presumed efficacy of priceless bargaining (Williamson 2007). For many years, transaction costs theory has been in existence. Transaction costs economics is among the foremost prospective study in strategic management and organization, besides argument lingers concerning its empirical support (David and Han 2004).

Petrović and Krstić (2011) noted that the biggest acknowledgment goes to Roland Coase and Williamson for the concept developing transaction cost. As for the term “transaction costs“, transaction costs are consequently the real resource cost, with the opportunity cost of time, in connection with agreement, conclusion, and execution of the act of exchange. Jiang, Chu and Pan (2011) argue that transaction cost economics do regard the measurement of a hybrid governance structure and not only considering the issues of the selection of government structure.

According to Brouthers, Brouthers, and Werner (2003) transaction cost theory, firms select the international mode of entry that provides the most efficient form of governance. Generally, transaction cost-based entry mode choices are efficiency-driven decisions focusing on the least (transaction) cost option.

Vasiliauskiene (2011) stated that scholars have researched on transaction costs in numerous economics studies. Various institutions can procreate different transaction cost. The use of information technology does reduce the transaction cost of information search. Transaction costs economics has indisputably played a vital role in strategic management, also the transaction costs theory tackle structure of hierarchical and nonhierarchical such as to work with others as alternatives (Madhok 2002).

Lajili and Mahoney (2006) emphasized that transaction costs economics, fundamental law are possess the needed power to exist and retain original capabilities, but that the intensive advancement in information technology also durable emphasis have been made on the logic of transaction costs theory. McIvor (2009) carried out a research on how transaction costs and resource-based theories of the firm inform outsourcing evaluation, McIvor findings show that transaction cost theory should be apply with caution due to contradictory prescriptions in some instances.

Vasiliauskiene and Snieska (2009) affix that transaction costs and transportation costs are unavoidable, and transaction costs carry important aspect in any part of all contract. Tesco supermarket huge loss was a serious issue which would have made Tesco supermarket bankrupt, but the chief executive officer was able to recognize transaction cost theory. Priyanto et al (2014) found out that transaction costs have an indirect influence towards organization performance, positive business performance influence in an organization. Transaction costs analysis can play a significant act of seeing into a situation on possible beginning stages of intervention policy (Ostertag 1999). However, Brouthers and Nakos (2004) affix that environmental uncertainty uses to influence transaction cost, target market environment use to develop environmental uncertainty.

Priyanath (2017) mentioned that market or hierarchy controls characteristics of transaction cost. Business firms attempt to control the transaction cost in reducing behavior employing these two alternative strategies. Vasiliauskiene and Snieska (2009) claim that the minimization of transaction costs influences greater demands and performances in place of the source of supply and production of an enterprise. Transaction costs are link with looking and maintaining a business associate, which are reliable, negotiation, the development and control of the contract.

Petrović and Krstić (2011) assumed that the market, as the coordination mechanism and business organization, is free of charge, and that transaction costs are equal to zero or negligible. Man et al (2017) studies proved that transaction costs are not easy to measure and there are no specific guidelines to assess the transaction but can and should predict because transaction costs are vital costs which constituent part in the process of decision making. However, Tecos supermarket loss of 6.4 billion pounds might be a result of not recognizing transaction costs when making a decision. Lijia and Xuexi (2014) claim that transaction costs include the information cost, negotiation cost enforcement cost, and the transaction cost. Similarly, Ostertag (1999) affirms that the cost of information, searching, monitoring, and negotiation are part of transaction costs. There might be some incidental costs or hidden charges, which might not be recognized during the transaction. Man et al (2017) found out that conventional machinery costs could be lower than transaction costs, which thereafter influence the contractual arrangement choice.

### ***Theoretical Analysis***

Tesco supermarket is one of the leading supermarkets in the United Kingdom supermarket industry. In the year 2015, Tesco Suffer a huge loss of about 6.4 billion GBP, this was among the worst result recorded in the history of the United Kingdom supermarket. Scholars have research on transaction cost and business performance, the transaction cost cannot be neglected in a business organization, Tesco did not give full attention to the transaction cost, that's why they had issues in the United Kingdom Supermarket industry. Vasiliauskiene and Snieska (2009) affirm that an entrepreneur who has the ability to maintain low transaction costs will have greater chances to give several charming products to the market since in international trade transaction costs play a greater role. Husmann (2015) noted that high transaction costs are the cause of market failure, in other words, poor business performance.

Priyanto et al (2014) argue that outrageous transaction costs will lead to increasing the selling price of the product, which will be a financial responsibility to the consumer. Similarly, Petrović and Krstić (2011) emphasized that the conspicuous of the imperfect functioning of the market is due to a high level of transaction costs, which has a straight consequence on business organization performance as well as efficient operations of the economic. In the same vein, Jiang, Chu, and Pan (2011) stated that the notable managerial consequence is that high level of asset specificity and behavior uncertainty led to non-horizontal integration. Asset specificity is the greatest vital aspect of transaction costs, and it's mostly verified to be having close harmonic connection positively to the selection of hierarchy in transaction costs economics. Brouthers and Nakos (2004) claim that the transaction costs theory, behavioral uncertainty might serve as a channel to take advantage of opportunities as they arise behavior involving avoiding responsibility, cheating, and alteration of information.

Brouthers, Brouthers, and Werner (2003) Affix that at an entry point choice several scholarships widely give little attention to the impact of the transaction costs variables on business performance and transaction costs have an outward aspect to be determining norms.

Jiang, Chu, and Pan (2011) noted that effective hostage serves as a high level of asset specificity which becomes progressively shared in common forbearance and develops to move toward one point or to approach each other objectives among associates as well as ties associates together.

Husmann (2015) found out that high transaction costs influence poor business performance and the value chain in the Ethiopian formal seed market and a new idea for giving hope to an investor in the private sector. Tesco notices that one of the reasons they had the huge loss of 6.4 billion GBP was due to the high price of some product which they worked on to regain their place in the United Kingdom supermarket industry. The chief executive Dave Lewis confirm the loss as a big significant number, due to the 6.4 billion GBP, numerous staff of Tesco lost their jobs with the closure of 43 Tesco stores (Butler and Farrell 2015).

Successful transactions help to advertise the business performance of an organization and create new technologies. The aim idea of transaction costs motive is to clarify which costs must be included in total costs of ownership, and it takes precautionary measures as a way which costs must be put into consideration in the selection of a provider (Vasiliauskiene and Snieska 2009). Tesco was able to recover from the huge loss, which was the biggest loss for the United Kingdom Corporation. The biggest supermarket chain posted 162 million GBP, net income before tax for the year ending 27 February 2015, which is the Tesco supermarket. The spectacular fall from 6.4 billion GBP financial detriment on the back of heavy property write-downs (Armstrong, 2016). Transaction costs economics discover the understanding link in between production efficiency and transaction costs. When the transaction is less stressful, the transaction costs factors use to make sure the transaction is easier. Except for the fact that the transaction is further difficult, then additional highly complicated contracts should be practiced (Vasiliauskiene and Snieska 2009).

Lijia and Xuexi (2014) stated that the appropriate means to minimize transaction costs and to facilitate access to small-scale producers experiencing outrageous transaction cost are cooperatives. The Tesco supermarket needs to consider reducing the transaction costs in other to meet above-average return. Petrović and Krstić (2011) argue that the costs of some transaction must be lower than the benefits it provides, that is an owner disposes of the property only if he or she thus achieves satisfaction greater than the benefit of using it. In general, there is an optimal level of transaction costs for each business entity in various stages of development. In one of the Tesco outlet, Customers affix that Tesco should reduce the price at an affordable rate, the shelves well stocked and the tills manned with much available staff (Tesco 2015). However, Ostertag (1999) noted that the concept of transaction costs could be ascertain by the organizational constitution and the routines for making and implementing decisions. Therefore, there can be other issues which can be control or uncontrollable by the organization, some issues might be from their competitor, that is an industrial rivalry. The suggestion was made that Tesco should shut down as many as possible stores, not less than 200 more stores because of the challenges Tesco is experiencing (Butler and Farrell 2015). The Chief Executive of Tesco, Dave Lewis admitted that Tesco is in a different place compared to 2015. There is a substantial improvement in services and easier range stable prices which made Tesco to regaining competitiveness in the United Kingdom Supermarket (Armstrong 2016). In the United Kingdom supermarket there was political and regulatory issues. Tesco had some other challenges, Tesco Shares fell almost 5%. Tesco urged to close down more stores after the recording loss of 6.38 billion GBP (Butler and Farrell 2015).

A customer in Ipswich noted that she thinks the store sincerely and honestly making the effort to enhance value or quality performance and there is an outward sign of progress (Tesco 2015). Vasiliauskiene (2011) noted that it is most advances vital to maintaining low transaction costs because any modern company will not be able to strive consciously in international markets. Hosseini et al (2012) affix that all the cost aside, interest rate cost incurred during the transaction could be refer as transaction costs. Transaction costs use to influence business performance either positively or negatively.

The value that s accepted in the transaction normally contain the total cost involved in the transaction, but not because of production of goods. The cost of goods and services do not depend exclusively on the production cost (Vasiliauskiene and Snieska 2009).

Figure 1. Tesco plc market per share from 2013-2017



Source: Aj bell media, (2017)

From the above diagram, Tesco was doing well in 2013. Tesco market share was over 380 GBP per share in 2014. The fourth quarter in 2014. Tesco start to experience fall in market share till, the last quarter in 2015 from over 380 Great Britain Pounds to almost 160 GBP per market share, which means Tesco loss more than 200 GBP per market share, but the first quarter in 2016 Tesco was able to bounce back to more than 200 GBP per market share. However, Tesco fall in market share also affects their financial year. The Tesco group statement of comprehensive income and loss in 2015, Tesco had a negative balance of 6,850,000, GBP but in, 2016 a positive balance of 1,270,000 GBP, (Tesco, 2016). The Tesco supermarket had some challenges like their transaction costs was on the high side which made them to loss 6.4 billion GBP. Vasiliauskiene and Snieska (2009) claim that transaction costs are the costs that arise from the process of substituting goods and services, except for the fact that these costs are not link together with the development of goods or services. Also, it is most vital to maintaining low transaction costs in the international trade environment. Despite returning to net income Tesco Shares, fall by 3.8%, The Chief Executive of Tesco, Dave Lewis cautioned that the supermarket repossession would not be straightforward because of market uncertainty (Armstrong 2016).

Tesco Chief Executive Officer was able to make sure Tesco reduce the transaction cost, Vasiliauskiene and Snieska (2009) noted that Institutions take part in the main role of transaction costs economics. Various institutions can develop various types of transaction costs. Formal and informal contracts are a basis in which transactions has been executed.

Figure 2: The Biggest Supermarket Chains in the UK, by market share



Source: BBC.CO.UK, (2017).

From the above chart, the Tesco supermarket has the highest market share of 29% out of 100% which means Tesco supermarket, business performance is good compared to Sainsbury's and Asda which have 16% each respectively of the total market share of the UK supermarket chain. Morrisons have 11% of the total UK supermarket market share that is not too bad. Aldi and Co-operative have 7% each respectively of the total market share of the UK supermarket chain. Lidl and Waitrose 5% each respectively of the total market share of the UK supermarket chain. The lowest supermarket chain market share are Iceland and Ocado have 2% each respectively of the total market share of the UK supermarket chain that is very poor that is Iceland and Ocado might be suffering from some issues that are affecting their business performance negatively and the low market share.

### **Conclusion**

It's true that transaction cost uses to influence business performance, the higher transaction cost the higher the chance to lose profit and once any business organization starts to lose profit they tend to lose sustainable competitive advantages. Top managers have a big role to play in business performance. A good management team needs to strategize and follow the strategic roadmap of the organization. Nevertheless, there are some challenges, which are inevitable in the supermarket industry, but the top management team can review the organization strategy in other to meet above-average return. According to Martins, et al (2010) the transaction costs theory, the transaction costs emerge because there are limits to human cognition, transaction costs theory have been often applied to studies on the boundaries of the firm discussing the rationale for deciding on such an essential matter as to make or to buy. Transaction costs have today become the symbol of the neo-institutional theory, and that is the reason why, among other things, neo-institutional economics is often called theory of transaction costs (Petrović and Krstić 2011). Transaction costs are all costs, which was originated by a vital making trade contracts or process of substituting goods or services in market contracts. Transaction costs could be connect to difficulties, which arise from selling goods, or services when the place of production or resource mining has been changed (Vasiliauskiene and Snieska 2009). The transaction costs based contingency model of mode choice can successfully indicate in advance better performing entry modes as suggested by scholars because transaction costs theory communicate directly the question of why business organization organizes within (Brouthers and Nakos 2004).

Transaction costs are inevitable. For Tesco to recover from its loss, it had to close down some outlets which were not making enough profits, reduce the price of goods and services and layoff some staffs that were not productive, which is a means of reducing transaction cost. One of the limitations of transaction cost is that high transaction costs might lead to a poor business performance influence, and low transaction costs use to influence business performance positively. Another limitation of transaction costs is that some business organization use to neglect transaction costs in decision making, just like the case of the Tesco supermarket.

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