Carrefour, S.A.

Background:

Carrefour started in 1960 with a single supermarket discount store which provided a one stop self service shopping to the customers. It opened its first hypermarket, selling both food and non food products in 1963.As this store proved popular with consumers Carrefour expanded rapidly with 50 % sales and asset growth rate. Non food items contributed 40 % of the sales. By mid 1972 it had opened 16 stores and was now facing major decisions regarding its future growth.

Carrefour Strategy

For consumers Carrefour offered **lower price** by maintaining average gross margin of 15% in comparison to competition's 20 to 25 % margin.

It provided consumers with the **convenience** of one stop shop with both food and non food items. At many stores it also opened discount petrol pumps as well.

Carrefour constructed its stores inexpensively outside the city, near highways where the land cost is low and consumers can have easy access to the store. Thus the cost of the Carrefour store was 1/3rd of the traditional supermarkets.

Decentralized management was implemented in which the store manager had full operating freedom. It allowed each store to quickly respond to the issues as a well as opportunities.

Carrefour had opened 16 own stores, invested in 5 joint ventures and had 7 franchise stores by 1971.

The above five factors contributed to the huge success of the Carrefour. Its sales grew by 50 % per year from 1965 to 1971.

Financing Strategy and risks

Carrefour was financing this expansion mostly by using non interest bearing trade notes and it has a very short cash conversion cycle. Its financial strategy is risky as it is maintaining a negative working capital and has a higher debt-to-equity ratio in comparison to its competitors
Please see **Exhibit 1** to see Carrefour's cash conversion cycle for last seven years.

Projected statements for 1972

Please see **Exhibit 2** for the Pro-forma Balance Sheet and
Exhibit 3 for the Pro-forma Income Statement.

Challenges & solutions

Opposition from small retailers and their unions compelled the govt. to institute a tax on retail merchants. A higher percentage of this tax was to be paid by the hypermarkets to provide pension for small shopkeepers who were unable to continue their business. The process of getting construction permits by large stores was made very difficult by the government. This made its strategy of rapid expansion difficult to implement.

It leased space to small independent shopkeepers in its commercial centers to generate local merchant support for the issuance of permit. Carrefour invested in joint ventures and set up franchise stores to overcome the shortage of construction permits. These ventures allowed it to continue its expansion as it was able to operate 12 additional stores either as a joint venture or a franchise.

Carrefour's mix of stores

It had 16 fully owned stores on which it was having a ROE of 39% in 1971. It had 5 joint ventures with 10 to 15 % ownership share which took longer to reach the same profitability as wholly owned stores. It had 7 franchise stores where it was getting 0.2% fees of total store sales and 1 % of non food item sales.
Please see **Exhibit 4** for an evaluation of Carrefour's mix of stores.

Market competition in France and International Strategy

Secondly it was facing increasing competition in France and future growth was beginning to look limited. It was estimated that 50% market saturation had already taken place. And it was expected in the next few years, market for hypermarket stores will be completely saturated at current growth rates. Therefore, Carrefour was considering expansion into new markets outside of France. It envisioned a growth opportunity outside France, for example Belgium. These countries had large and financially stronger retailers. But Carrefour believed that its strategy of low price one stop hypermarket will be successful with the consumers in these countries. It will need to go in for joint ventures and partnerships, where competition is strong and initial entry is difficult for a foreign company. For example it can invest in a minority stake in the Belgium firm GB enterprises. It can also go in for franchise contracts as it uses little capital and has good return on investment. After establishing itself for a few years in these new markets, Carrefour can expand by doing tactical acquisitions of smaller competitors and also grow organically. It can also divest itself of under - performing stores and invest in markets where it sees higher profit potential.

Alternative Scenario for year 1972

Carrefour should issue 50,000 shares at 1980 to raise approximately 100 Million Francs to improve its Debt-to-Equity ratio. With a better financial situation, Carrefour will be able to expand its operation outside of France.
Please see **Exhibit 5** for Pro-forma Balance Sheet for this alternative scenario
Please see **Exhibit 6** for Pro-forma Income Statement Sheet for this alternative scenario

Return on Equity and Sustainable Growth

The ROE of Carrefour is high which 39% for 1971 is because it has lower cost and higher profits.
Calculating sustainable growth rate as of 1971:

P* (1-d)*(1+L)/ T-P*(1-d)(1-L)
Where
P = net profit margin on sales of 2.3%
d = dividend pay out ratio of 45%
L = debt to equity ratio of 4.6
T = ratio of total assets to sales of 0.28

The above calculation gives a sustainable growth rate of 29.86%. The actual growth rate is 50 % for the last few years, which is higher than the sustainable growth rate. This high level of profitability over a long period of time is not sustainable as the company will have to keep borrowing to finance its rapid growth and the cost of borrowing after some time will become high. The company already has a high debt to equity ratio in comparison to its competitors and increasing competition will lead to decreasing sales growth and lower profit margins.