TESCO PLC[1]

1. INTRODUCTION

"Every little helps", the slogan Tesco PLC has used for so long, really seems to have helped the group in creating a successful business. With more than 440.000 employees nowadays, the UK grocery store market leader Tesco has created a renowned business model over the world. Starting in London with a little store in 1919, Jack Cohen, its founder, has jumped from the local grocery market to a multinational diversified business with several subsidiaries: supermarkets, a bank, petrol stations, telecommunications, etc. The group focuses on meeting its customers' needs by offering a wide range of products including the own brand products and a focus on customer satisfaction and corporate responsibility.

2. HISTORY OF TESCO PLC

Jack Cohen realized in 1919 that he could make profits from selling war surplus groceries and, in fact, Cohen started from a stall in East End of London. Tesco as a brand did not appear until 1924, when Cohen bought from T.E Stockwell a shipment of tea, which was its first own-brand product. The first Tesco store was opened in 1929 and during the 30's about one hundred stores were opened in London under the business core of buying small grocery stores and selling the products cheaper than ever. During the 60's Tesco continued its expansion and started diversifying its products for the first time. Since the 90's, Tesco has launched a great variety of products such as books, financial services, telecoms, petrol, etc. Moreover, the company decided to attract also people who cared about quality and not just low-cost and grew by having 2.000 more shops fifteen years later. It was not until 2013 that Tesco reported its first drop in profits in 20 years. Moreover, one year later the brand was accused of manipulating the way commercial income was registered causing a deep impact into its reputation. Aldi and Lidl were taking Tesco's position and eating it away.

Nowadays is one of the world's largest retailers and serves millions of customers per week either in physical stores or online. The following figure shows the main facts of Tesco's history.

1919	Cohen starts selling surplus groceries from a stall in Est End London
1929	First Tesco store is opened in Burnt Oak
1932	Tesco is founded officially as a private limited company
1947	Tesco goes public
1948	First self-service stores in North America
1958	First supermarket is opened in Maldon, Essex

[1] Case written by Maria Sallent, Nerea Pérez, Paula Valenzuela; with the supervision of Professor Oriol Amat. Universitat Pompeu Fabra, 2018.

1960	First product diversification: household goods and clothing
1968	First “superstore” in Crawley, West Sussex
1973	First petrol station across UK
1993	Tesco Value is launched offering products at a great price
1993	The campaign “Every little helps” attracts 1,3 million new costumers between 1993-1995
1995	Tesco Clubcard is launched and it overtakes Sainsbury’s in market share
1997	Tesco Personal Finance is launched
1998	Tesco Finest is launched
2000	Tesco.com is launched
2004	A new “Every little helps” campaign is launched
2007	Tesco enters in the US with Fresh & Easy
2009	Tesco Personal Finance becomes Tesco Bank
2012	Everyday Value is launched to replace Tesco Value
2012	Tesco is awarded Green Retailer of the Year at the Annual Grocer Gold Awards
2013	Major charity partnership with Diabetes UK
2014	“Healthy living” is launched
2014	Dave Lewis becomes Group Chief Executive joining from Unilever
2016	Tesco makes a commitment that by the end of 2017 no food that is safe for human consumption will go to waste.
2017	Tesco becomes the first retailer to offer same day grocery delivery nationwide
2018	Tesco completes merger with wholesaler Booker Group

3. BUSINESS MODEL

3.1. MISSION, VISION AND VALUES

Tesco’s core purpose is “Serving shoppers a little better every day”. They have a simple mission: being the champion for customers by making easier their way of living and improving their quality of life. Serving customers is the core of everything they do.

Tesco puts this into practice with the following values:

- No one tries harder for customers:
  - Understand customers
  - Be the first to meet their needs
  - Act responsibly for their communities
- Treat people how they want to be treated:
  - Teamwork
  - Trust and respect
  - Listen, support and say “thank you”
  - Share knowledge and experience
- Every little help makes a big difference:

- Helping to decrease food waste and ensuring that surplus food goes to those in need
- Making easier living healthier
- Sourcing great quality, affordable and sustainable products
- Making positive contributions to the communities where they operate

Their Code of Business Conduct is a key concept on how they run the business, it is designed to help and protect themselves. For Tesco it is very important that everyone understands the rules and the conduct the company expects to show. The goal is to make the best for customers and to protect their reputation.

3.2. CORPORATE GOVERNANCE

- **Board role and effectiveness:** The goal of the Board is to achieve long term success for the firm and long term returns for shareholders. In order to reach it, the Board is required to set the firm's strategic goals and ensure that all the human and financial resources are placed where they are needed. Moreover, they have to be aware of the management's performance when delivering and also of the necessities of their shareholders in order to be able to respond them. Moreover, the Board makes an effectiveness evaluation per year.
- **Governance:** They want to keep high standards of corporate governance. They ensure a transparent decision making process and they are open to discussions and constructive challenges.
- **Succession planning:** The Board invest an important part of their time to discuss the succession planning and talent.
- **Remuneration:** Their goal is to have a fair and balanced remuneration plan based on the achievement of their key strategic objectives while shareholders receives long term and sustainable returns.
- **Culture:** For Tesco, culture is a key concept in their business. Their goal is to construct a culture where their stakeholders are recognized while their needs are understood in order to be able to innovate and meet them.
- **Diversity and inclusion:** Tesco has become member of the 30% Club which fights to achieve a 30% female representation in the Boards and in the senior leadership teams. They have established an External Advisory Panel that helps to guide their inclusion agenda and they have as well implemented an Inclusion strategy.

4. INDUSTRY ANALYSIS AND COMPETITORS

4.1. SALES EVOLUTION IN THE INDUSTRY

In 1977, in the middle of some economic problems, the chief executive of Tesco's UK Ian McLaurin implemented a price cut plan to increase sales. This started a price war with Sainsbury's, one of the main competitors. Also, the retailer closed 500 unprofitable stores and invested the money saved from this in other stores, putting better lighting and wider aisles. Two years later, thanks to that, sales went up to 1 billion pounds. In 1982, McLaurin cut prices again by 3%-26% in at least 1.500 different products, starting another price battle with Sainsbury's. The results of this price cut were that sales had reached 2 billion pounds. Three years later, Tesco also implemented more technology and expanded their stores and warehouse.

Some years later, with the UK in recession, Tesco launched a campaign to fight other competitors (Aldi, KwikSave and Netto) by reducing prices. then, it acquired a French 92-store chain. A year later, it bought Hungary S-Market, expanding their influence overseas to China, Korea and Turkey, among other European countries. In 1995, with all this, Tesco won the top position of food retailers in the UK knocking its main competitor Sainsbury's.

In 1997, Terry Leahy becomes the new chief executive and Tesco opens its first extra hypermarket in Essex. In 2000, tesco.com opened, which allowed more people to buy from it without the need to have a physical store near you.

In 2005, benefits reached 2 billion pounds. And two years later they entered the US market. Meanwhile the market share in the UK was of about 31.2%. In 2011, Phil Clarke became the chief executive and announced that profits of 3.8 billion pounds. The same year, a price cutting plan is launched, but it fails the objective and sales go down. one year after, it became clear that Tesco was going down and had lost the first position in UK food retailers as well as the disaster of trying to enter the US market, which ended up being a loss of 1.8 billion pounds. In 2013, Tesco made public its first loss in 20 years and stated that it would not open any more store. In 2014, thanks to Christmas sales, even though they were poor, the company had some profits. The same year they started a price cutting campaign to fight close competitors to try to gain market share, which at the moment was of 28.7%, the lowest of the decade. By August, Tesco announced the third profit warning of that year and cut its dividends by 75%.

However, by September this year, their shares went down since they admitted exaggerating the profit by 250 million pounds. From this moment on, because of many more managerial, executive and administrative problems and scandals and also accounting errors, the company is at risk, their shares keep on going down. The last downfall and biggest scandal resulted in a 6,4 billion pounds loss that dragged the company into the red as a result of a massive depreciation of its stock and portfolio value.

Furthermore, we need to take a look at what the industry will look like in the near future in order to make recommendations. The sources we have used to obtain the information displayed below are the Financial Times market database and a 2017 report by the USDA Foreign Agricultural Service about UK retail foods. According to these sources, the grocery sector in the UK records the strongest growth in retailing, being the discounters, convenience stores and online shopping the ones expanding the most. The predictions are that by 2021, the value of the UK grocery market will grow 9,9% to 196.9 billion pounds, and online shopping will increase by 68% in the next 5 years. Regarding convenience stores, they are the third fastest growing sector (from £37,5 billion in 2016 to £41,9 in 2021), and could represent a quarter of the grocery store market by 2021.

	% share, 12 weeks to 20 May 2017	% share, 12 weeks to 21 May 2016	% sales change vs. same 12 weeks year ago
TESCO	27.2%	27.6%	2.2%
SAINSBURY	15.1%	15.5%	1.2%
ASDA	14.0%	14.5%	-0.1%
MORRISONS	10.0%	10.3%	1.4%
ALDI	8.1%	7.1%	18.1%
LIDL	5.4%	4.7%	19.7%
CO-OPERATIVE	5.0%	5.1%	2.7%
WAITROSE	4.3%	4.4%	2.2%
MARKS AND SPENCER	3.3%	3.3%	4.4%
ICELAND	2.3%	2.1%	9.8%

Figure 1: *12-weekly % share of grocery market spend by retailer and value sales % change*
Source: https://www.campaignlive.co.uk/article/tesco-best-performing-big-supermarket-latest-sales-figures/1435036

The previous figure displays Tesco in the healthiest position of the big four supermarkets with a balanced increase in sales and a high market share. This means that Tesco's retail strategy is carried on effectively.

4.2. SWOT OF THE INDUSTRY

To better understand the situation of the industry it can be useful to check the SWOT analysis:

STRENGTHS	**WEAKNESSES**
Tesco is a powerful food retailer, between the global top 100. It has around 7.000 stores. It has won many prizes due to its quality of services, products, client services. Strong financial situation, because it has significant cash reserves and many properties. People trust Tesco and believe it will last long, especially in the UK. Good use of technologies in its operations.	Some subsidiaries do not work as well and are more sensitive to external damages. The retailer operates well in the UK and Europe but not so well in other markets, since it has not spent as many resources to make it work. They have a high cost of inventory because they do not renovate the products they sell and customers, with less income, are not buying them. Competitive price wars have lowered Tesco's profits, when they should have focused on other competitive strategies. Tesco has entered in other markets to sell different products but without the due investigation to enter and succeed, which has led to failure (smartphones and tablets, for example).
OPPORTUNITIES	**THREATS**
Strategic alliances with other brands of the sector. Private label market. Online shopping and home delivering. Joint ventures in markets where Tesco is not doing well, which may provide them with more knowledge on how to correctly perform. Continue investing in Research and Development so as to keep evolving and improving.	Economic recessions threaten their market share and their volume of sales. Prices around the globe are rising and people cannot afford to buy as many things as in the past. Government regulations and the political situation are making Tesco impose new regulations that need to change their operational structure. Other retailers offer lower prices, which puts pressure on Tesco to lower theirs.

4.3. MAIN COMPETITORS

Tesco targets the middle class market, as it provides both economy and up-scale products. Tesco's main competitors in the grocery industry are ASDA, Sainsbury's and Morrison's, which are called the Big Four. However, Aldi and Lidl are starting to gain territory. In addition, Tesco has to compete with convenience stores, which are gaining popularity.

- **ASDA**: it is a subsidiary of Walmart and it has 604 stores in total, 196 of which are supermarket. ASDA also sells clothes and furniture. Of the Big Four, ASDA is the one that keeps the lowest prices. It is trying to improve the online channels to buy through the internet, the appearance of the stores and the nutritional value of its products.
- **SAINSBURY'S**: this is the third largest retailer and is said to have the highest quality of all Big Four members, which allows them to charge an extra price in all its food products. They are trying to expand by widening its offer and boosting their banking services, and they have announced the will to do a takeover of ASDA (pending regulatory' approval).
- **MORRISON'S**: this is also involved in food production and it is, in fact, the second largest UK producer. So, we know that this company is vertically integrated and is trying to make this structure more efficient while reducing prices too. They have implemented a rigid CapEx plan and all new stores that are opened are small convenience stores.
- **ALDI**: their strategy to success is based on the low price of their products in relation to their quality. They have a special focus on private brands. They also have different weekly merchandise products and do not accept discount coupons.
- **LIDL**: similar to Aldi, Lidl does not focus on a good presentation but on offering low price products from the country where it is located. Like Aldi, they also have weekly merchandise products changing every week.
- **WAITROSE**: they focus on the quality of staff and production processes. They have attempted to rise prices a bit to give the image of a higher quality grocery store, matching the prices of Tesco in the most select products.

Apparently, the most dangerous of competitors are discounters such as Aldi and Lidl, which are expected to grow 57% to 42.8 billion pounds in 2022.
As for the non-grocery sector, such as gas stations, the largest players in the UK market are Shell (569 stores in 2017), Esso (198 stores) and BP (313 stores). As for Tesco, it owned 504 gas stations in 2017. In total there are around 8438 functioning gas stations in the UK.

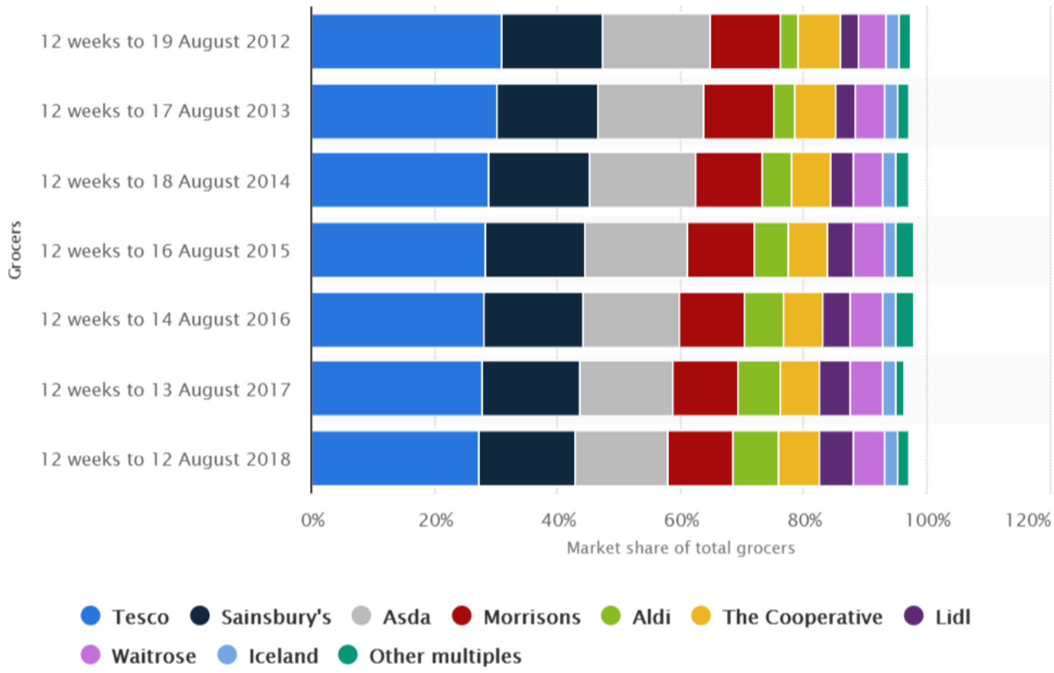

Figure 2: *Market share of grocery stores in Great Britain from August 2012 to August 2018*
Source: https://www.statista.com/statistics/300656/grocery-market-share-in-great-britain-year-on-year-comparison

3.3. SALES RANKING

On the one hand, Figure 3 displays a table with the best British supermarkets according to a survey carried on to 6800 members of the general public in October 2017 about their experience of shopping for groceries in different types of supermarkets or even online. Customers rated the range of products, the quality of the products, the store appearance, the value for money and finally the queuing time. When it comes to satisfaction, customers seem to give priority to price over in-store experience. Tesco is ranked the 6th, while other discounters are in the best positions. This is due to the fact that Tesco's value for money qualification is not so good, while with discounters the value for money is five-star, and weighing more than the overall shopping experience.

On the other hand, with Figure 4 on the right, it is seen that spending in Tesco was measured at almost 7.2 billion pounds in the first quarter of 2015, the highest expenditure at all British grocery stores, even if the number has slightly decreased over time.

	Store appearance	Queuing time	Staff availability	Range of products	Quality of own-label products	Quality of fresh products	Value for money	CUSTOMER SCORE
1 Aldi (1,620)	★★★☆☆	★★★☆☆	★★☆☆☆	★★★☆☆	★★★★☆	★★★★☆	★★★★★	74%
2 M&S (857)	★★★★★	★★★★☆	★★★★☆	★★★★☆	★★★★★	★★★★★	★★★☆☆	73%
3 Lidl (1,346)	★★★☆☆	★★☆☆☆	★★☆☆☆	★★☆☆☆	★★★★☆	★★★★☆	★★★★★	69%
4 Waitrose (531)	★★★★★	★★★★☆	★★★★★	★★★★☆	★★★★★	★★★★★	★★☆☆☆	68%
5 Iceland (1,131)	★★★★☆	★★★☆☆	★★☆☆☆	★★★☆☆	★★★★☆	★★★☆☆	★★★★☆	65%
6 Tesco (2,502)	★★★★☆	★★★★☆	★★★★☆	★★★★★	★★★★☆	★★★★☆	★★★☆☆	64%
7= Asda (1,741)	★★★★☆	★★★☆☆	★★★☆☆	★★★★☆	★★★★☆	★★★★☆	★★★★☆	63%
7= Morrisons (1,432)	★★★★☆	★★★★☆	★★★☆☆	★★★★☆	★★★★☆	★★★★☆	★★★☆☆	63%
9 Sainsbury's (1,711)	★★★★☆	★★★★☆	★★★★☆	★★★★☆	★★★★☆	★★★★☆	★★★☆☆	62%

Figure 3: *The best and worst UK in-store supermarkets of 2018*
Source: https://www.which.co.uk/news/2018/02/the-best-and-worst-supermarkets-of-2018

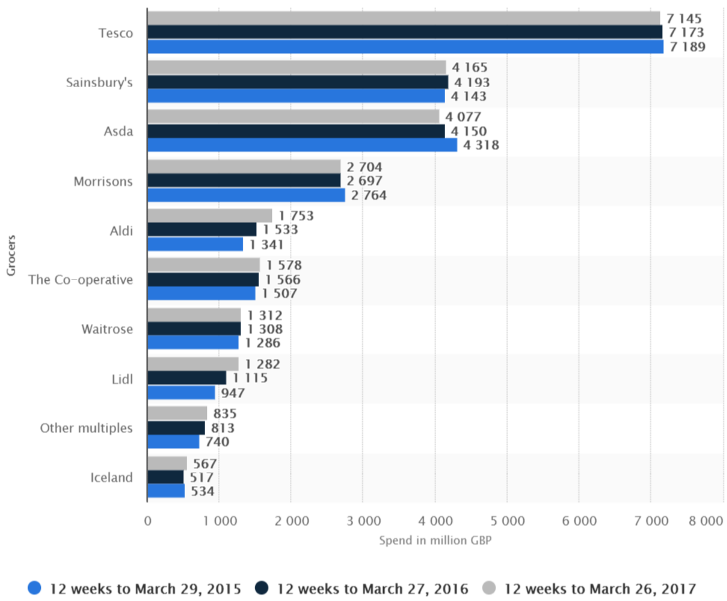

Figure 4: *Total expenditure in grocery stores in Great Britain in 1st quarter 2015 to 1st quarter 2017, by grocer* (in million GBP)*
Source: https://www.statista.com/statistics/300672/grocery-store-spending-in-great-britain/

5.PRESENT SITUATION OF THE COMPANY

5.1. PRODUCTS AND SERVICES OFFERED

They build close and mutually-beneficial relations with their suppliers in order to get the best products and to meet and anticipate customers' needs.

Tesco PLC provides a wide range of products to its customers thanks to their business model. From their groceries stores, they offer from fresh and frozen products, drinks, food cupboard, health and care to household items and even exclusive products for pets among others.

From Tesco Bank they want to make banking and insurance easily accessible by providing a simple range of products. They offer car, home, pet and travel insurances; credit cards and personal loans, personal saving products, mortgages and current accounts.

Thanks to the F&F brand, Tesco is able to offer to its customers clothing for kids, women and men.

Tesco also have their own loyalty card, the Tesco Clubcard. Customers who are holders receive points based on the amount spent. They can spend these points to enjoy discounts either in physical or online stores or even on day trips, hotel breaks, restaurants etc. Moreover, they are able to enjoy Clubcard clubs such as baby and toddler club.

They offer mobile telecommunications thanks to Tesco Mobile, a mobile virtual network operator. Moreover, with Tesco Photo they provide photo printing and processing services either in-store and online. To arrive easily to customers, ten times a year Tesco publishes a magazine which includes information about the company and its products according to the season and even includes several recipes that can be made with products purchased from Tesco.

5.2. CUSTOMERS, DISTRIBUTION CHANNELS AND LOGISTICS

Their main focus is customers. They want to do their best for them because that will improve sales. With the improve on sales they will be able to reinvest in improving the shopping experience.

Customers feedback keeps improving and reflect the effort of Tesco to serve a little better every day. Within the year 2017/2018 they gained 5 points in comparison with the previous year on the Group net promoter score that is equal to fans (those scoring 9-10 out of 10) minus critics (those scoring 0-6) on an 11 point scale question 0-10. 2017/2018: 12 pts whereas in 2016/2017: 7 pts. So customers not only are recommending Tesco but also are coming back time and again.

Moreover their colleagues recommend them not only as a good place to work but also a great place to shop. With over 6900 shops around the world, and with 440000 colleagues, they have around 80m shopping trips per week and serve millions of customers every week in-stores and online.

Tesco operates in a wide range of channels in order to bring the best products to their customers. They operate from small and big shops as well as online. With the merger of Booker, Tesco has been able to enjoy new channels that include Business Centers and delivered wholesale. This multichannel strategy has helped Tesco to adapt their operations within this new era of retailing.

5.3. KEY SUCCESS FACTORS

Regarding the retail stores, location is very important. Stores have easy access for cars and enough parking places. Also, both product range and product availability, meaning big stores that offer a wide range of different products, which are always available. That is, shelves are constantly replaced. Of course, this has a cost, which is between 12 and 20% of the value of the products and it can be reduced by investing in IT, which they do. Prices are an important feature too, since they have to be competitive.

Tesco offers a clubcard that rewards the clients in order to make them come back. For every purchase, customers collect some points and when enough points are collected, they can be exchanged for vouchers to be used in Tesco. This system ensures brand loyalty and gives the clients incentives to come back and only buy in their stores. Another advantage of this system is that all purchases are registered and customers can track them. However, this is also useful for Tesco because their team of analysts can examine this data so as to make improvements depending on the preferences and tastes of their clients. In addition, and thanks to the analysis of the club-card database, Tesco has launched some products of their own brand. Many of these products are labelled as *premium* and they really have succeeded when competing with other brands classified as premium too. And because Tesco is the owner of this brand, it can create an exclusivity environment, promoting brand loyalty.

Moreover, after the crisis Tesco suffered in 2014, in 2015, it launched the Brand Guarantee scheme. This consists in the following, they promised their clients that if a branded group of 10 or more products appeared to be more expensive than their rivals', they would made them a refund.

In relation to social media and publicity, Tesco is very active in social networks like Facebook and YouTube. In Facebook, they have more than 2 million likes, and if clients have any doubt or complaint about anything regarding the company, they can post it on Facebook and Tesco will answer them in a short period of time.

As for advertising, it is mainly aimed at satisfying stakeholders. It all moves around Tesco's slogan "Every little helps", and although publicity expenses have decreased from 110.6 million pounds in 2013 to 77.7 million pounds in 2015, it has gained efficiency. Its marketing strategy is based on an extensive use of print and media advertising as a way to communicate with current customers and potential ones. This has been done through marketing differentiations, for example, by using singular Christmas ads. For sales promotion, Tesco uses free gifts (such as promotions for specific products) and point of sale materials (conducted with the cooperation of manufacturers in a way that they may supply posters and other promotional materials). The head of marketing at Tesco, Robin Terrell, prefers to use humour as a way to attract customers.

5.4. STOCK MARKET AND DIVIDEND POLICY

Tesco is listed on the London Stock Exchange and is also a constituent of the FTSE 100 Index. In 2015 it had the 28th largest market capitalization on this stock exchange, with around 18 billion pounds. The figure below displays a share price forecast, offering 12 month price targets for Tesco with a median of 280.00, which represents a 41.74% increase from the last price of 197.55.

Figure 5: *Share price forecast (Financial Times, December 2018)*
Source: https://markets.ft.com/data/equities/tearsheet/forecasts?s=TSCO:LSE

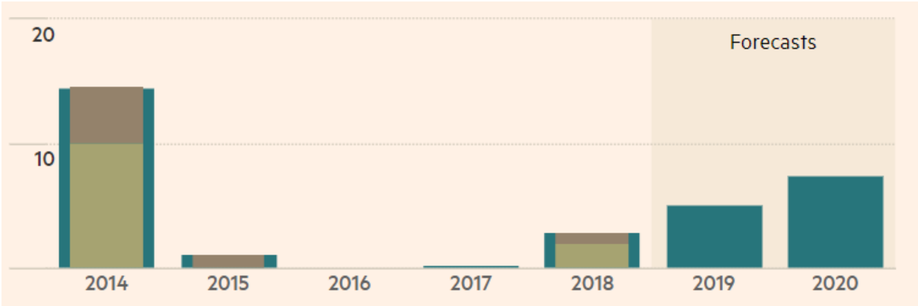

Figure 6: *Dividends forecast (Financial Times, December 2018)*
Source: https://markets.ft.com/data/equities/tearsheet/forecasts?s=TSCO:LSE

The figure above shows the evolution of Tesco's dividend policy. Notice that in 2014 it distributed relatively high dividends, while in 2016 and in 2017 it did not. Nevertheless, notice that the forecasts for the next two year are positive for the shareholders, as it is expected that profits will rise. Earnings per share are also expected to increase, with an average growth rate of 21.7% (semiannual 2019 earnings are of 0.0636 per share).

6. MAIN CHALLENGES THE COMPANY IS FACING

6.1. ACCOUNTS MANIPULATION

A member of staff approached Tesco's general counsel in September 2014 to warn that something was array in the accounts. This information was passed on to Dave Lewis, the CEO, who spent days analysing the problem. It was on the 22nd September that the issue was uncovered, and Tesco's shares in the London Stock Exchange declined 11,6%. Lewis then asked Deloitte to undertake an independent investigation on the issue, working also with Freshfields, the Group's external legal advisers (before the scandal, it was PwC the independent auditor).

This scandal was anticipated for several reasons: the company issued five profit warnings in one year and reported a decline of 3,7% in sales in the first quarter, and also cut dividends in August. Profits for the six month to the end of August were overstated by 250 million pounds due to the accelerated recognition of commercial income and delayed accrual of costs. This is a breach of the Groceries Supply Code of Practice and of the IFRS reporting requirements (recognizing premature and fictitious commercial income, overstating inventory, misrepresenting "trading profit" and "underlying profit" and delaying accrual of costs). In 2012

Tesco already began to misinterpret profits and losses and, more specifically, the IFRS reporting requirements violated were: IAS 18 (revenue), IAS 2 (inventories), IAS 37 (on contingent assets), IAS 34 (Interim Financial Reporting), IAS 8 (accounting policies, changes in accounting estimates and errors).
The manager was asked to estimate the provisional value of rebates by an individual judgement based on future transactions and, and this methodology can be very unclear and subjective. Besides, Tesco recorded millions of pounds in discounts which the suppliers were not willing to give, and recorded reductions to cost of goods before they were actually sold, all with the aim of increasing gross margin by premature or non existing commercial income or by overstating inventory. Also, contingent gains are not recorded, but Tesco did so, and did not disclose its increased commercial income balances. Finally, Tesco delayed the accrual of costs.
The scandal affected directly the board of directors of the company, as seven members were dismissed because of the issue. The SFO engaged in a criminal investigation, and three members of the board were charged with fraud (the managing director of Tesco UK, the finance director and the commercial director for food).
On the other hand, shareholders were also heavily affected by the accounting scandal because of a great loss in shareholders' equity. Stock prices went down as well as market capitalization, and some of them took legal action against Tesco. Dave Lewis took serious measures to raise capital, which involved mainly asset sales.

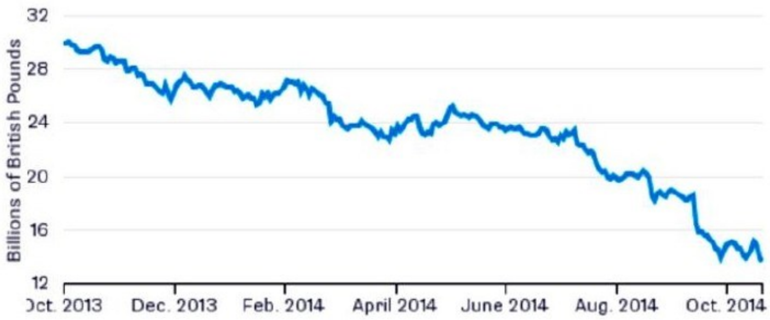

Figure 7: *Tesco's market capitalization*
Source:https://www.researchgate.net/publi cation/319979994_Tesco_scandal_-_Financial_Reporting

6.2. OTHER SCANDALS

In 2007, Tesco was accused of price-fixing and was put under investigation by the UK Office of Fair Trading for acting as a cartel together with four other supermarkets: Asda, Sainsburys, Safeway and Morrisons. Besides, a number of dairy companies were also involved in the scandal. The total fine amounted 116 million pounds. In the same year, it was revealed that Tesco had moved the head office of its online operations to Switzerland in order to avoid the Value Added Tax.

Now about food scandals, in January 2013 it was publicly reported that horse meat had been found in some meat products, specially burgers, sold at Tesco and some other retailers. Tesco has also been targeted by protesters complaining that it sells goods made in Israel, and there was also a scandal because it was selling anti-Semitic books through their website.

6.3. A STRATEGIC ALLIANCE WITH CARREFOUR IN 2018

Traditional grocery stores are more threatened every day by discounters, specially Aldi and Lidl, and also, more recently, by Amazon, as well as by the takeover of Asda by Sainsbury.

Sainsbury has already stated that if its proposed takeover of Asda is approved by the competition authorities, it will target its bigger suppliers for cost reductions by flexing its increased purchasing power. On the other hand, Amazon has become a real threat as it has moved to traditional grocery retail with the acquisition of Whole Foods and launched Fresh last year in the UK, an online delivery service. As for discounters, Tesco remains under their pressure, especially the German ones. According to Euromonitor International, the combination of Tesco and Carrefour would hold 8% of the European grocery market, as compared to Lidl's 6% or Aldi's 5%. A key focus if the strategic alliance is to reduce prices on own-brand products as a direct response to discounters, whose products are basically own-brand, in order to make their products more competitive. They want to imitate Sainsbury in its merger with Asda, reducing the number of branded products, and analysts at Jefferies believe the groups could save up to £400m from the alliance (in case of a hard Brexit it is necessary to be safe from possible supplier price rises).

The strategic alliance between Tesco and Carrefour will consist in increasing the pressure on supermarket suppliers by teaming up to buy own-brand products together, which they claim will lead to lower prices and more options for customers. They attempt to secure better deals from multinationals such as Nestlé as well. It is planned to last for 3 years, and analysts claim they will squeeze suppliers.

A consequence of this strategic alliance would be having more British products in Carrefour supermarkets, and more French products, such as cheese or wine, being sold in Tesco. Nevertheless, with increasing globalization, this would give a plus to both retailers, even if they are already selling foreigner products.

The recent merger with Booker has also been aimed at reducing supplier costs and increasing market power in this fierce competition environment.

7. APPENDIX: FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEET	Average sector (%)	Average sector with profits	24/02/2018 000 EUR	%	25/02/2017 000 EUR	%	27/02/2016 000 EUR	%	27/02/2015 000 EUR	%	22/02/2014 000 EUR	%	23/02/2013 000 EUR	%	25/02/2012 000 EUR	%
Non-current assets	**63,4**	**66,3**	35.129.350	**69.4**	35.729.308	**66.4**	36.996.589	**66.2**	44.277.412	**73**	44.796.522	**74**	42.852.106	**73.4**	44.969.629	**74.7**
Intangible assets	10,9	13,5	3.002.287	5.9	3.189.530	5.9	3.656.906	6.5	5.176.405	8.5	4.584.881	7.6	5.047.414	8.7	5.476.812	9
Tangible assets	40,2	43	20.896.412	41.3	21.257.271	39.5	22.776.136	40.8	28.057.735	46.2	29.587.282	48.9	28.777.897	49-6	30.491.301	50-6
Other fixed assets	11,9	9,8	11.230.651	22.2	11.282.507	21	10.563.547	19.6	11.043.272	18.2	10.624.359	17.5	9.026.794	15.6	9.001.516	14.9
Current Assets	**36,6**	**33,7**	15.486.429	**30.6**	18.098.263	**33.6**	18.867.293	**33.8**	16.414.598	**27**	15.808.476	**26**	15.153.814	**26.1**	15.255.138	**25.3**
Stock	10,7	8,4	2.553.241	5	2.701.181	5	3.091.956	5.5	4.059.037	6.7	4.320.299	7.1	4.332.306	7.5	4.267.122	7
Debtors	10.9	15,6	525.767	1	575.219	1	631.115	1.1	0	0	0	0	0	0	0	0
Other current assets	14,9	9,6	12.407.421	24.5	14.821.864	27.5	15.144.222	27.1	12.355.561	20.4	11.488.177	19	10.821.508	18.7	10.988.017	18.2
Cash & cash equivalents	6,8	5,5	4.579.587	9	4.485.533	8.3	3.921.567	7	2.971.869	4.9	3.027.592	5	2.906.718	5	2.733.662	4.5
Total Assets	**100**	**100**	50.615.779	**100**	53.827.571	**100**	55.863.882	**100**	60.692.010	**100**	60.604.999	**100**	58.005.919	**100**	60.224.768	**100**
Net Equity	**37,9**	**39,1**	11.799.291	**23.3**	7.529.497	**14**	10.963.083	**19.6**	9.706.274	**16**	17.786.197	**29.2**	19.278.993	**33.2**	21.111.461	**35**
Capital	5,3	3,5	462.585	0.9	480.132	0.9	517.871	0.9	557.311	0.9	489.296	0.8	466.325	0.8	476.760	0.8
Other shareholders funds	25,9	21,9	11.336.707	22.4	7.049.366	13	10.445.212	18.7	9.148.963	15	17.296.901	28.5	18.812.668	32.4	20.634.701	34.3
Non-current Liabilities	**17,9**	**20,9**	17.111.116	**33.8**	23.518.234	**43.7**	19.816.511	**35.5**	23.792.794	**39.2**	16.965.872	**28**	16.758.757	**28.9**	16.640.352	**27.6**
Long term debt	12,9	15,8	11.411.172	22.5	13.745.383	25.5	13.628.782	24.4	14.620.496	24	11.239.301	18.5	11.650.015	20	11.754.154	19.5
Other long term liabilities	4,9	5,1	5.699.945	11.2	9.772.851	18.2	6.187.729	11	9.172.299	15.1	5.726.571	9.4	5.108.742	8.8	4.886.198	8.1
Long term provisions	2,6	3,4	916.143	1.8	907.437	1.7	1.016.655	1.8	1.227.183	2.02	938.723	1.5	1.478.816	2.5	1.494.323	2.5
Current Liabilities	**44,2**	**40**	21.705.371	**42.9**	22.779.840	**42.3**	25.084.288	**44.9**	27.192.942	**44.8**	25.852.930	**42.6**	21.968.170	**37.9**	22.472.955	**37.3**
Short term loans	5,5	4	10.505.183	20.1	10.875.158	20.2	3.613.644	6.5	2.787.929	4.6	2.334.121	3.9	924.549	1.6	2.658.946	4.4
Creditors	22,8	21	6.110.629	12	5.768.623	10.7	5.783.103	10.4	6.967.762	11.5	7.044.648	11.6	6.984.455	12	7.081.430	11.8
Other current liabilities	11,4	5,8	5.089.559	10	6.136.059	11.4	15.687.541	28	17.437.251	28.7	16.474.160	27.1	14.059.166	24.2	12.732.579	21.1
Total Equity and Liabilities	**100**	**100**	50.615.779	**100**	53.827.571	**100**	55.863.882	**100**	60.692.010	**100**	60.604.999	**100**	58.005.919		60.224.768	**100**

Table 1. Consolidated balance sheet (2018-2012)

PROFIT & LOSS ACCOUNT	Average sector	Average sector with profits	24/02/2018 000 EUR	%	25/02/2017 000 EUR	%	27/02/2016 000 EUR	%	28/02/2015 000 EUR	%	22/02/2014 000 EUR	%	23/02/2013 000 EUR	%	25/02/2012 000 EUR	%
Operating revenues	**100**	**100**	64.899.488	**100**	65.770.993	**100**	69.278.899	**100**	85.496.475	**100**	77.121.443	100	75.012.303	**100**	76.987.275	**100**
Sales	68,9	54	n.a		n.a		n.a		n.a		n.a		n.a		n.a	
Cost of goods sold	41,9	61,7	61.084.857	94.1	62.235.158	94.6	65.629.628	94.7	88.395.592	103.4	71.940.951	93.3	70.280.786	93.7	70.301.959	91.3
Gross profit	9,6	12	3.814.630	5.9	3.535.835	5.4	3.649.271	5.3	-2.899.116	-3.4	5.180.493	6.7	4.731.517	6.3	6.685.316	8.7
Other operating expenses	9,4	10,4	1.742.026	2.7	2.341.962	3.6	2.318.331	3.3	5.051.490	5.9	2.001.883	2.6	2.199.710	2.9	1.959.223	2.5
EBIT	1,9	1,8	2.072.605	3.2	1.193.873	1.8	1.330.941	1.9	-7.950.607	-9.3	3.178.609	4.1	2.531.807	3.4	4.726.092	6.1
Financial revenue	0,2	0,1	103.799	0.2	2.348	0.003	10.179	0.01	105.697	0.1	231.962	0.3	409.625	0.5	482.690	0.6
Financial expenses	0,7	0,6	711.929	1	1.026.003	1.6	1.134.990	1.6	907.347	1	681.389	0.9	673.451	0.9	660.586	0.8
FINANCIAL RESULT	-0,5	-0,5	-608.129	-0.9	-1.023.655	-1.6	-1.124.810	-1.6	-801.650	-0.9	-449.427	-0.6	-263.826	-0.4	-177.896	-0.2
EARNINGS BEFORE TAX	1,4	1,3	1.464.475	2.3	170.218	0.6	206.130	0.29	-8.752.256	-10.2	2.729.182	3.5	2.267.981	3	4.548.197	5.9
Taxation	0,3	0,2	345.246	0.5	102.131	0.2	-68.710	-0.1	-901.856	-1	419.224	0.5	664.194	0.9	1.042.468	1.4
Income after tax	1,1	1,2	1.119.229	1.7	68.087	0.1	274.841	0.4	-7.850.400	-9.2	2.309.958	3	1.603.786	2.1	3.505.729	4.6
Extraordinary items	0,1	0,3	243.703	0.4	-131.479	-0.2	-110.700	-0.2	-64.516	-0.07	-1.138.065	-1.5	-1.464.930	-2	-168.408	-0.2
NET INCOME	**1,3**	**1,5**	1.362.932	2.1	-63.391	-0.1	164.141	0.2	-7.914.917	-9.3	1.171.893	1.5	138.856	0.2	3.337.321	4.3

Table 2. Consolidated income statement (2018-2012)

Cash flow statement (in £ million)	2018	2017	2016	2015	2014	2013	2012
1) Earnings before taxes	1.837	1017	1046	-5750	4316	3873	5688
2) Adjustments							
Operating (+) profit/ (-) loss of discontinued operations		-117	128	-52			
(+) Amortization and depreciation	1.295	1304	1334	1552			
(-) Profit/(+) loss arising on sale property and equipment and intangible assets	-66	-78	164	49			
(-) Profit/(+) loss arising on sale of subsidiaries and financial assets at fair value through other comprehensive income	-165	3		41			
(-) Profit / (+) loss arising on sale of joint ventures and associates	-23	-5	-1				
Impairment loss on goodwill		46	18	116			
Net impairment (+) loss / (-) reversal on other investments	-22	-12	-7				
Impairment of loans/investments in joint ventures and associates			1	712			
Net impairment (+) loss / (-) reversal on property, plan and equipment, intangible assets and investment property	-167	-5	182	4171			
Adjustment for non-cash element of pensions charge	4	7	-395	68			
Additional contribution into defined benefit pension schemes	-245	-248	-223	-13			
Share-based payments	113	15	283	105			
Tesco bank fair value movements included in operating (+) profit / (-) loss	156	98	72	58			
3) Change in current (working) capital	592	533	-168	410			
4) Other cash flows from operating activities							
(-) Interest Payment	-351	-522	-426	-613	-496	-457	-531
(-) Income tax payment / (+)Income tax revenue	-176	-47	118	-370	-635	-579	-749
5) Cash flows from operating activities (1+2+3+4)	**2.782**	**1989**	2126	484	3185	2837	4408
6) Payment for investments (-)	-1685	-1399	-4438	-2943	-6168	-3260	-4589
7) Divestments costs (+)	2351	1678	3823	505	814	2982	1406
8) Cash flows from investing activities (6+7)	**-666**	279	-615	-2015	-2854	-278	-3183
9) proceeds from issue of ordinary share capital	11	1	1	15	62	57	69
10) own shares purchased							-303
11)increase in borrwings	313	185	586	4889	3104	1820	2905
Repayment of borrowings	-3.721	-2036	-1328	-3185	-1912	-3022	-2720
Net cash flows from derivative financial instruments	253	475	154	-6			
Repayments of obligations under finance leases	-10	-12	-17	-3	-9	-32	-45
Purchase of non-controlling interests				18		-4	-89
Dividends paid to equity owners	-82			-914	-1189	-1184	-1180
Dividends paid to non-controlling interests							-3

12) Cash flows from financing activities	- 3.2 36	-1387	-604	814	56	-2365	-1366
E) INCREASE / DECREASE IN CASH AND CASH EQUIVALENTS (5+8+12)	212	881	907	-717	387	194	-141
Cash and cash equivalents at the beginning of the year	383 2	3082	2174	2813	2531	2311	2428
Effect on foreign exchange rate changes	15	-131	1	78	-105	26	24
Cash and equivalents at the end of the period including cash held in disposal groups at the end of the period	405 9	3832	3082	2174	2813	2531	2311
Cash held in disposal groups		11		-9	-307	-19	-6
Cash and cash equivalents at the end of the year	405 9	3821	3082	2165	2506	2512	2305

Table 3. Consolidated cash flow statement (2018-2012)

Ratios	Average sector	Average sector with profits	2018	2017	2016	2015	2014	2013	2012
DEBT AND CAPITALIZATION									
Debt = Liability / Assets	0,62	0,60	0,76	0,86	0,80	0,84	0,70	0,66	0,65
Debt Quality = Current Liabilities / Total Liabilities (and equity)	0,44	0,39	0,42	0,42	0,45	0,44	0,42	0,38	0,37
Repayment Capacity = Cash flow /Loans	0,84	0,79	0.32	0.17	0.58	0.03	1.75	3.77	1.94
Cost of debt = Financial Expenses / Loans	0,08	0.06	0.03	0.04	0.065	0.05	0.05	0.053	0.045
Financial Expenses = Financial Expenses / Sales	0,01	0,01	0,01	0,01	0,01	0,01	0,01	0,01	0,01
LIQUIDITY									
Liquidity = Current Assets / Current Liabilities	0,82	0,84	0,71	0,79	0,63	0,75	0,6	0,61	0,69
Treasury = Debtors + Cash / Current Liabilities	0,40	0,52	0,23	0,22	0,18	0,10	0,11	0,13	0,12
Acid Test = Cash / Current Liabilities	0,15	0,13	0,21	0,19	0,15	0,10	0,11	0,13	0,12
Working Capital (real) (million pounds)= Current assets – Current liabilities(*)	-14797	-5641	-5512	-3817	-4250	-1426	-6850	-4230	-5944
Operating Working Capital (million pounds)= Operating current assets – Operating current liabilities (*)	13079	9728	-5022	-5300	-4586	-4127	-4925	-4721	-4488
Operating CA (million pounds) = Inventory + Clients + Other operating CA + Minimum cash required (*)	79215	33926	4308	4187	4704	4536	6593	6687	7111
Operating CL (million pounds) = Suppliers + Other operating CL + Accruals (*)	66053	24116	9331	9488	9291	8664	11518	11409	11600
Working Capital Deficit (million pounds) (*)	- 25424	- 15369	-489	1483	336	2701	-1925	491	-963
ASSETS MANAGEMENT									
Non-current assets turnover = Sales / Non-current assets	2,18	1,65	1,84	1,84	1,87	1,93	1,72	1,75	1,71
Current assets turnover = Sales / Current assets	3,78	3,26	4,19	3,63	3,67	5,20	4,87	4,95	5,04
DEADLINES									
Inventories days = Stocks / Daily cost of sales	46,52	24,56	15.26	15.84	17.2	16.76	21.92	22.5	22.15
Days receivable (days) = Clients / Daily Sales	28,81	51,86	2.96	3.2	3.33	0	0	0	0
Days payables (days) = Suppliers / Daily cost of sales	98,92	61,20	36.51	33.83	32.16	28.77	35.74	36.27	36.77
SALES									
Sales growth = [This year's sales-Previous year sales / Previous year sales]*100	-	-	- 1,3%	- 5,0%	- 18,9 %	10,9%	2,8%	- 2,5 %	6,9%
PROFITABILITY, SELF-FINANCING AND GROWTH									
Return on assets = EBIT / Assets	0,03	0,03	0,02	0,003	0,003	-0,14	0,04	0,03	0,07
Return on equity = Net Income / Equity	0,03	0,0	0,11	0,01	0,01	-0,81	0,06	0,00	0,15
Cash flow / Sales	0,03	0,02	0.004	0.01	0.01	-0.01	0.006	0.00	- 0.002
Cash flow / Assets	0,04644	0,03253	0.005	0.02	0.02	-0.014	0.008	0.00	- 0.003
Dividends / Net profit	-	-	0.074	-	-	-0.14	1.24	10.4	0.433
Dividends / Net equity	-	-	0.008	-	-	0.115	0.082	0.07	0.07

Table 4. Main ratios and comparison with the industry (2018-2012)

Breakdown of profitability	ROE (using net income %)	EBIT/Sales	Sales /Assets	(Assets/Equity) x (EBT/EBIT)	Net Profit/EBT
Average sector	3,64	0,02836	1,384319	1,0727	0,86318
Average sector with profits	4,62	0,0331	1,1	1,15505	1,09954
2018	11,55	0,0226	1,2822	3,031	0,9307
2017	-0,84	0,002588	1,2219	1,0193	-0,3724
2016	1,5	0,003755	1,2401	0,7892	0,7963
2015	-81,54	-0,1024	1,4087	6,883	0,9043
2014	6,59	0,0354	1,2725	2,926	0,4294
2013	0,72	0,0302	1,2932	2,6953	0,0612
2012	15,81	0,0591	1,2783	2,7454	0,7338

Table 5. Breakdown of profitability (2018-2012)

- In order to compute the average sector data we have taken into account within 250 companies the ones which have financial data of 2017 (168)
- In average sector with profits we have chosen the top 10 companies which have financial data of 2017:

KONINKLIJKE AHOLD DELHAIZE N.V.
J SAINSBURY PLC
CSF
MERCADONA SA
WM MORRISON SUPERMARKETS P L C
АКЦИОНЕРНОЕ ОБЩЕСТВО ТАНДЕР
CARREFOUR HYPERMARCHES
АКЦИОНЕРНОЕ ОБЩЕСТВО ТОРГОВЫ..
ALDI STORES LIMITED
SAFEWAY LIMITED

- We have not included Tesco PLC neither in the average sector nor average sector with profits

8. QUESTIONS

You are asked to prepare the following:

1. Prepare a qualitative analysis of Tesco PLC including the main strengths and weaknesses.
2. Analyze the balance sheet, income statement and cash flow statement from 2018 to 2012 in order to identify the main financial strengths and weaknesses of Tesco PLC.
3. Calculate the working capital of Tesco PLC and the working capital needed in order to analyse their financing necessities.
4. Does TESCO PLC have capacity to grow?
5. Calculate the Z score from 2012 to 2018. Are the prospects for the company good?
6. Analyse the case of accounts manipulation in 2014.
7. Prepare the Cause and Effect diagram.
8. What measures would you recommend the company to apply so as to improve their performance? Demonstrate their effectiveness.