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.

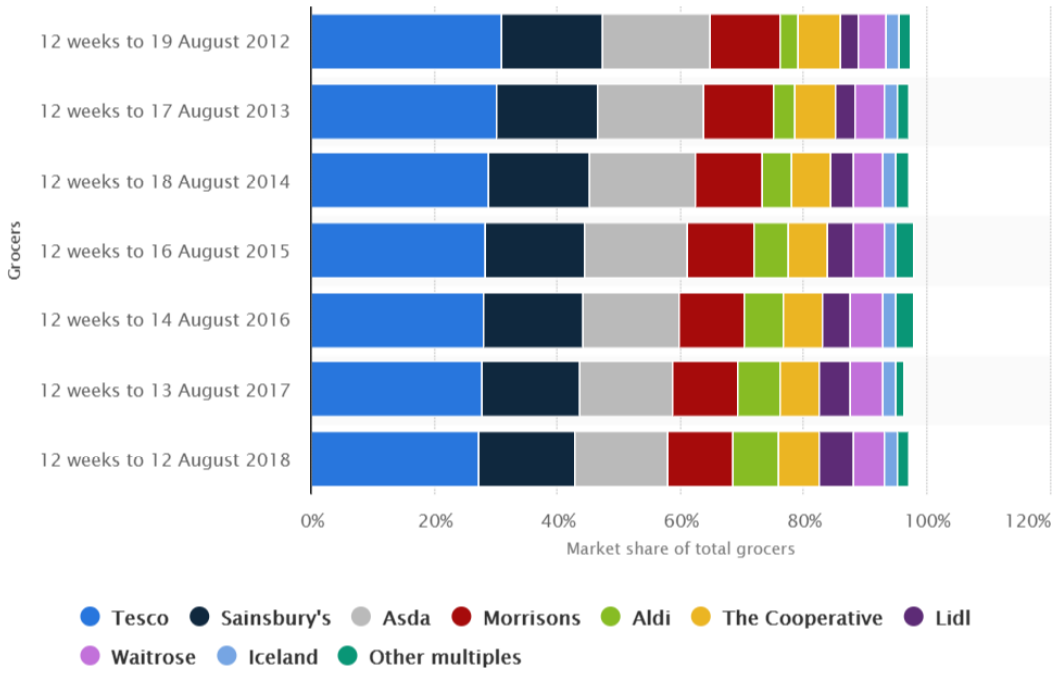


Figure 2: Market share of grocery stores in Great Britain from August 2012 to August 2018
Source: https://www.statista.com/statistics/300656/grocery-market-share-in-great-britain-year-on-year-comparison

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

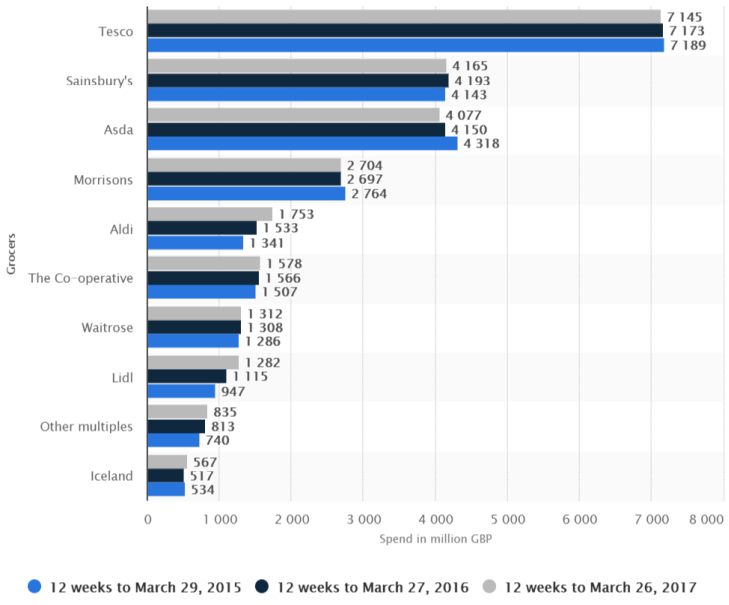


Figure 4: Total expenditure in grocery stores in Great Britain in 1st quarter 2015 to 1st quarter 2017, by grocer* (in million GBP)
Source: https://www.statista.com/statistics/300672/grocery-store-spending-in-great-britain/

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

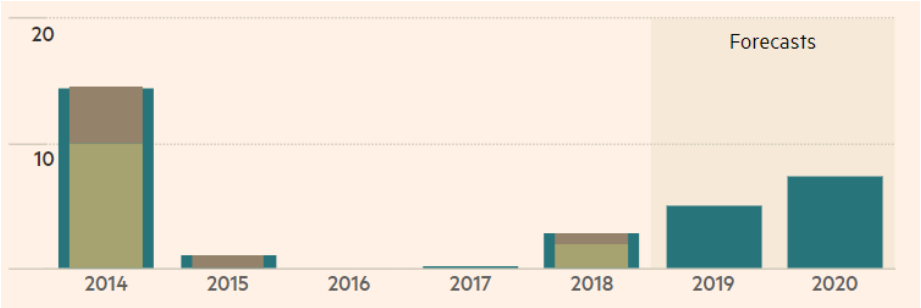


Figure 6: Dividends forecast (Financial Times, December 2018)
Source: https://markets.ft.com/data/equities/tearsheet/forecasts?s=TSCO:LSE

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% (semi annual 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.

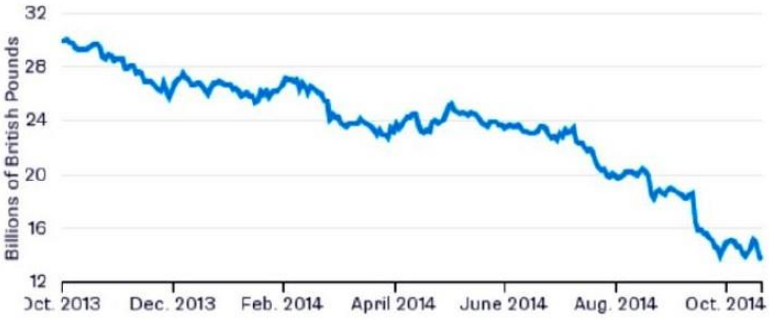


Figure 7: Tesco's market capitalization **Source**:https://www.researchgate.net/publication/319979994_Tesco_scandal_-_Financial_Reporting

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	-3.236	-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	3832	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	4059	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	4059	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.

TESCO PLC. Technical Note[2]

1. Prepare a qualitative analysis of Tesco PLC including the main strengths and weaknesses.

	STRENGTHS	WEAKNESSES
WHO	-Brand's reputation (ranked 102 Forbes most valued brands 2018) -Board and executive committee (high training level and experience of its members) - Employee's package of benefits and internship programmes - Promotion of good working climate - Seek for long term objectives	- High employee turnover rate in the retail sector - Dependence on suppliers (not vertically integrated), although measures are being taken (negotiating pact with Carrefour)
WHAT	- Food retail industry less affected by recessions - Dominant position in the UK grocery store market (28% market share) - By 2021, the total value of the UK Grocery Market is projected to grow 9.9 percent to £196.9 billion. - Diversified portfolio of products and services (food and beverages, mobile, clothing, home appliances, financial services) - Wide range of grocery products (Tesco's Value and Finest) - Barriers to entry the industry - Competitive advantage: economies of scale - Popular advertising "Every little helps" - Customer loyalty (Tesco Club cards)	- Dependence on the UK market despite doing business in several countries - Brexit, fluctuation of the pound and barriers to business expansion in the EU - Fierce competitiveness of the market (discounters are predicted to grow 57 percent to £41.8 billion by 2022, specially Aldi and Lidl) - Change in consumer patterns and necessity to adapt ("healthy", convenient, and ethnic foods) - Difficulty to offer competitive prices - Due to low competition the market is highly regulated (political, regulatory and compliance) - Difficulty to manage data privacy
HOW	- Innovation: good and pioneer online sales service - Geographic and product diversification - Satisfactory financial results and good investors relation webpage - Increasing profits over the five last years - Corporate social responsibility - Considerable decrease of dividends since 2014, although the forecast is a large increase by 2020 - Annual earnings with average growth rate of +4.10% - Generic brand with different qualities - dunnhumby: helps Tesco and its suppliers to make strategic decisions based on customer behaviour	- Bad reputation because of 2014 accounting scandal and other recent food scandals - Decline of the stock price since 2014 (from 330.5 GBp Jan 2014 to 208.5 GBp Jan 2018) - Stock price below the mean of the food & drugs retailers industry - Higher prices than discounters - Tesco bank exposed to a number of risks: operational, regulatory, credit, capital, funding and liquidity, market and business. - Booker synergy realisation and integration: its successful integration is at risk - Reduction in cost saving and cash generation (failure to achieve the group objectives)

[2] Technical Note written by Maria Sallent, Nerea Pérez and Paula Valenzuela. Universitat Pompeu Fabra, 2019.

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. Analyse also the main ratios.

	STRENGTHS	WEAKNESSES
BALANCE SHEET	Total **assets:** decreasing trend → a more efficient use of assets. ● current assets increase ● non-current assets decrease (due to the sale of many stores) → increase in cash Total **liabilities** decrease by 10th million due to the sale of assets: much of the debt is being paid up. **Creditors** are low (11%) compared to the industry (21%). The **working capital** is negative (-5512 million pounds), which is normal among the supermarket sector. Compared to the industry (-18.1 thousand million euros), real working capital of Tesco is higher. Therefore, WC deficit of the industry is also higher. **Cost of debt** is low (0.03) compared to the industry (0.08) and top 10 (0.06), because financial expenses have recently been decreasing. Related to this, **financial expenses/sales** is also low and similar to the industry, 0.011 and 0.010, respectively. Regarding **terms**, all three ratios, **inventory days** (15.26), **days receivable** (2.96) and **days payable** (36.5) are lower than the industry, 46.5, 28.8 and 98.2, respectively. Even, they are lower than the average top 10, 24.5, 51.8 and 61.2, respectively. When it comes to **liquidity** ratios, the **acid test** (cash/CL) is higher than both industry and top 10, since Tesco has a higher percentage of cash, despite the fact that their current liabilities are a bit higher. This fact affects the **current ratio** (0,71) and the **treasury ratio** (0,235), which are lower than the industry and top 10, 0,82 and 0,84, and 0,4 and 0,52, respectively. Again, it is because Tesco's current liabilities,	**Equity**: low (23.3%) compared to the industry (39%). **Capital** is low (0.9%). Debtors are low (1%) compared to the industry (15%). Other current assets (customers) are high (24.5%) compared to the industry (9.6%), which may be a problem of terms, that is, clients do not pay at the moment. Short term loans are too high (20.1%) compared to the industry (4%). **Z score** is, in general, negative: probability of insolvency. **Debt** represents a 76% of all liabilities + equity side, which is quite high, even compared to the industry (62%). **Debt quality ratio** (CL/total liabilities) is high, that is, CL represent a big % of total liabilities, which gives them little margin for management. About **financial leverage**, ROI should be > than cost of debt, but in this case ROI < cost of debt. Therefore, more debt is not advisable for Tesco.

	mainly loans, are higher. When it comes to **asset management**, **non-current assets turnover** (1,8) is a bit below the average industry (2.18), but above the top 10 (1.6). Whereas **current assets turnover** (4,19) is above the average industry (3.7) and top 10 (3.2). This is due to the fact that non-current assets represent a high percentage of the balance sheet (slightly above the % of the average industry) and current assets represent a lower percentage than in the average industry. Overall, we can say that their asset management is efficient, since they are capable to "produce" high sales with the assets. About **sales growth**, we see that it is negative (-1.3%). However, having seen the scandal of the accounts manipulation in 2015, when sales growth declined sharply (-18,97%), we see that they are recovering and each year this ratio is becoming less and less negative, which is good.	
INCOME STATEMENT	Higher **net profit** % than industry (2.1% vs. 1.5%). Low **other operating expenses** (2.7%) with a decreasing trend, compared to the industry (10.4%). EBT is higher (2.3%) than industry (1.3%) Great recovery capacity, from -7.914.917 in net income in 2015 to 1.362.932 in 2017. In relation to **profitability**, we see that **ROI** is lower than the industry and top 10 (0.029 vs. 0,039 and 0,036, respectively). This can be explained because of asset inefficiencies and high COGS. However, if we look at **ROE**, we see that is much higher than industry and top 10 (0,11 vs. 0.036 and 0.046, respectively). Positive **EVA** and **growth** prospects (Higgins model).	**COGS** is much higher than the industry (94.1% vs. 61.7%) → gross profit lower than industry (5.9% vs. 12%). **Financial result** is negative (it has always been), which means that they pay more interest than they receive (due to the low % of debtors). Decreasing operating revenues and constant COGS: the company is diminishing its business operations. Irregular net profits, which creates uncertainty for shareholders.

CASH FLOW	Cash flow from **operating** activities is high and positive (their main activity is efficient, capacity to generate cash), but at a decreasing rhythm. Cash flow from **investing** activities is negative at a decreasing rhythm: good because of Booker acquisition, expansion and investment. Cash flow from **financing** activities is negative: repaying borrowings (less debt), making dividend payments and stock repurchases (good for investors). Increasing cash and equivalents. **Overall cash flow** result is positive and increasing since the accounting scandal (diminishing risk of liquidity problems). Regarding the **dividends** policy, they carry out a prudent dividends policy.	Losses arising on sale property and equipment and intangible assets, and on subsidiaries and financial assets at fair value through other comprehensive income. Increasing **income tax** payments since 2016. Decreasing net cash flows from derivative financial instruments. Regarding the ratios **cash flow/sales** and **cash flow/assets**, they are very low (0.004 and 0.005, respectively), also compared to the industry (0.03 and 0.04) and top 10 (0.02 and 0.03). This is because both sales and assets are high and cash flow is not as high as it should be. This could mean that there is a problem of efficiency and of creating cash from their operations. However, if we look at the cash flow statement we see that c.f. from investing activities is negative (which should be wrong) but we see that this is because of the merger of "Booker", which is, then, not a problem.

3. Calculate the working capital of Tesco PLC and the working capital needed in order to analyse their financing necessities.

Tesco's Working Capital (real) has always been negative during the years we have studied. However, we have to consider that the industry's main activity is retail sales in non-specialized stores (food, beverages and tobacco, mainly code 4711). It can be also observed that for the industry the working capital real is negative and that they have a deficit.

On the other hand, we can also observe that the working capital needed has been negative during the studied period. However, Tesco has only experienced a deficit in 2012, 2014 and 2018. The general tendency is to decrease the deficit until reaching a surplus with some fluctuations. The deficit from the year 2014 can be explained by the accounting scandal.

To be sure if this deficit is a real liquidity problem, we should check the working capital cycle. If Tesco is able to sell their stock and collect debtors before paying its suppliers, it could be that there is no room for liquidity problems.

Working capital cycle: Stock days + debtors days - creditors days

2018 WCC: 15.26+2.29-36.51= -18.96 Average industry WCC: 46.52+28.82-98.94= -23.6

2017 WCC: 15.84+3.2-33.83= -14.79 Top 10 WCC: 24.57+51.86-61.20= 15.23

2016 WCC: 17.2+3.33-32.16= -11.63

2015 WCC: 16.76+0-28.77= -12.01

2014 WCC: 21.92+0-35.73= -13.81

2013 WCC: 22.5+0-36.27= -13.77

2012 WCC: 22.15+0-36.77= -14.62

We can see that Tesco has always been able to sell their stock and collect debtors before paying its suppliers. Moreover, we can say that their margin to pay creditors has an increasing trend. However, this margin is not as high as the average industry.

With respect the top 10 firms we can see that the working capital cycle is positive.

4. Does TESCO PLC have capacity to grow?

	2018	**2017**	**2016**	**2015**	**2014**	**2013**	**2012**
Net profit	1.362.932	-63.391	164.141	-7.914.917	1.171.893	138.856	3.337.321
Sales	64.899.488	65.770.993	69.278.899	85.496.475	77.121.443	75.012.303	76.987.275
Dividends	100.307	-	-	1.118.050	1.454.449	1.448.333	1.443.440
Debt	38.816.467	46.298.074	44.900.799	50.985.736	42.818.802	38.726.927	39.113.307
Equity	11.799.291	7.529.497	10.963.083	9.706.274	17.786.197	19.278.993	21.111.461
Assets	50.615.779	53.827.571	55.863.882	60.692.010	60.604.999	58.005.919	60.224.768

Table 6. Data needed to compute the self-sustained growth (in th €)

The formula to compute the self-sustained growth is the following:

$$\frac{M\,(1-D)\times(1+L)}{A-M\,(1-D)\times(1+L)}$$

· Asset sales (A=Assets/Sales)

· Leverage (L=Debt/Equity)

· Distributed dividends (D=Dividends/Net profit)

· Net profit on sales generated by the company (M=Net profit/Sales)

It is based on the Higgins model and concretely calculates the capacity of a firm to grow without increasing the capital contributed by shareholders (annual percentage of growth in sales).

To exchange the dividends, which are in pounds, to euros, we have used the yearly average nominal exchange rate (from 2014 to 2018), which is equal to 1.223254.

	2018	2017	2016	2015	2014	2013	2012
% growth	11.98	-0.84	1.54	-48.33	-1.56	-6.527	9.86

Table 7. % company growth

The evolution of the theoretical capacity to grow of the company is irregular over the studied period. From 2013 to 2015, the prospect was negative, as the capacity of Tesco to grow without increasing capital was negative, especially in 2015, which was almost -50% due to the accounts manipulation scandal. Nevertheless, if we focus on the current prospects for the company, they have very much recovered from setback in 2015. As the capacity to grow in 2018 according to the Higgins model is 11.98%, the company has a high margin to expand its business without neither engaging in too much debt nor increasing shareholder capital.

A good pattern of growth has the following characteristics: an increase in sales (S) greater than inflation and the increase achieved by competition; a lower increase in assets (A), thanks to an efficient asset management, which will avoid that necessary investments don't succeed; an even lower increase in debt (D), thanks to a steady increase in self financing and equity; and an important increase in profits (P).

SADP (theoretical) → **SADP** (Tesco PLC)

Thus, in the case of Tesco PLC, sales have decreased over the years, but assets have done so as well. Loans have increased steadily over the period. As for profits, they have been quite irregular, but for 2018 they were high and positive.

Increase in sales: -15.7% Increase in debt: 74.69%

Increase in assets: -18.98% Increase in profits: -59.16%

Profitability

In order to assess the profitability of Tesco PLC, we have used the following breakdown of profitability:

$$\text{Profitability} = \frac{\text{Net result}}{\text{Equity}} = \frac{\text{Result}}{\text{Total Sales}} \times \frac{\text{Total sales}}{\text{Total assets}} \times \frac{\text{Total assets}}{\text{Equity}}$$

→ Profitability = Margin x Turnover x Leverage

Computing the ratios, the results are the following:

	2018	2017	2016	2015	2014	2013	2012
Profitability	0.1155	-0.00842	0.015	-0.815	0.066	0.0072	0.1581

Table 8. Profitability

As it is observable from the table, profitability for 2018 is 11.55%, similar to the one in 2012, 15.81%. It was negative in 2015 because of the accounting scandal, and it has recovered well. In order to increase profitability, it is advisable to increase margin by reducing costs, as well as turnover, by increasing income and reducing assets. As for financial leverage, the weight of assets relative to equity has to be increased.

The average profitability for 2017 in the sector was 3.64%, and the average for the sector with profits was 4.62%. Therefore, Tesco in 2017 was below average, but note that in 2018 this number has positively changed and it is positioned far above average.

From the breakdown of profitability table located in the annex, it is observable that margin is decreasing over the period studied, but is approximately the same that the average of the sector. The turnover is also approximately equal than the average of the sector and the average of the sector with profits. The ratio "Net profit/EBT", excluding 2017 and 2013, is also not different from both the sector averages. Finally, as for financial leverage, all over the period, debt is profitable for the company as the numbers are above 1 (except for year 2016), even surpassing the industry. An increase in debt means an increase in profitability of equity.

EVA (Economic Value Added)

This formula is useful to define what is left after we have deducted the total amount of expenses from total income. It considers just ordinary results and also the cost of the whole financing used.

The formula is the following:

Net operating profit after taxes (NOPAT) - Assets*Weighted average cost of capital

	2018	**2017**	**2016**	**2015**	**2014**	**2013**	**2012**
EVA	1.161.521	9.666,438	-65.656	-9.043.063	2.208.929	1.545.706	3.702.270

Table 9. Economic value added (in th €)

This is, for 2018, 1.161.521 is the amount left once we have deducted the opportunity cost of capital and taxes inclusive from total income. EVA aligns the objectives directors and employees have with shareholders' objectives. We want the value to be as high as possible and in 2017 it was high indeed, although it has decreased a bit again this year. For the years after the accounting scandal, the value is negative, although the company has successfully recovered. A good strategy to increase EVA would be to increase ROA without investing more, as well as reducing the weighted average cost of capital, reducing assets with return lower than the cost of liabilities, and increasing investments in assets with a return greater than the financing cost.

5. Calculate the Z score from 2012 to 2018. Are the prospects for the company good?

Instead of using the UPF Z score, as it is not very reliable for businesses such as supermarkets or restaurants, we have used a different formula:

Z = -2.2 + 6.1*a + 6.5*b + 4.8*c → a=equity/assets → b=net income/assets → c=net income/equity

Note that in this formula we do not use the liquidity ratio, and it is a discriminant function. A negative result indicates high probability of default, while a positive one means high probability of good solvency.

	2018	2017	2016	2015	2014	2013	2012
E/A	0.233115	0.139882	0.196246	0.159927	0.293477	0.332362	0.350544
NI/A	0.026927	-0.00178	0.002938	-0.130411	0.019336	0.002394	0.055414
NI/E	0.1155	0.00842	0.015	-0.815	0.066	0.0072	0.1581

Z SCORE	**-0.048573**	**-1.317874**	**-0.911802**	**-5.98411**	**0.032694**	**-0.12175**	**1.05883**

Table 10. Z score components and results

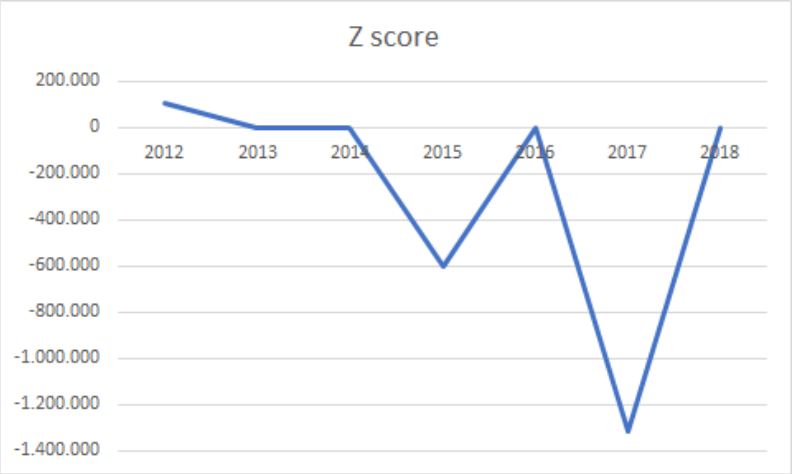


Figure 8. Z score evolution

The Z score for Tesco PLC tends to be negative, but not too much. Note that in 2014, which was when a case of accounting fraud was discovered, the Z score was positive. Nevertheless, in 2015, the value was very negative (-5.98), reflecting the fact that net profits were negative (a net loss of almost 8 billion €), and there was as well a decrease in equity (from 17.7 billion to 9.7 billion). Total assets have decreased over time (from 60.2 billion € in 2012 to 50.6 billion in 2018), and of course this fact has affected the result of these Z scores. As for net equity, it has gone from 21.1 billion € in 2012 to 11.7 billion € in 2018, which leads to concluding that an increase in equity would be of service to mitigate the risk of default of the company.

Furthermore, a decrease in assets would help increase the result of this Z score. Current assets have remained stable over the years (around 15 billion €), and non-current assets, on the contrary, have decreased substantially during the period studied (from 44.9 billion € in 2012 to 35.1 billion € in 2018). This, in fact, seems to be a sign of asset management improvement and, if the group remains improving this issue in the future, the Z score will improve. As for the impact of net income in the Z score, it is important to mention that both in 2017 and 2015 the company had losses, which were specially relevant in 2015, so this has affected very negatively the Z score for those years. Despite this fact, net income has increased a lot in the income statement for 2018, approximately in the same level as in 2014 (1.7 billion €), but it is not as high as it was in 2012 (3.3 billion €).

It has to be taken into account that supermarkets operate under a low margin, and trying to improve this aspect by increasing the margin by, for example, reducing the cost of sales, would be very relevant to increase net profits. Nevertheless, it is important to mention here that Tesco PLC has a higher percentage of cash and cash equivalents than the industry, which is, in principle, a signal of good financial health.

To conclude, the probability of default according to this Z score is present since previous years, despite fluctuating in intensity and seeming to improve in the last year. Obviously, other factors have to be analysed in order to assess the profitability and risk of default of the group, which we continue doing in the study.

6. Analyse the case of accounts manipulation in 2014

After the accounting scandal, Tesco has shown a decrease in production efficiency as it did not have the ability to generate earnings to overcome expenses. This low revenue is a result of too many operating costs and inadequate

revenue due to the quick recognition of commercial income and deferred accrual of costs, whose impact was reflected in the financial statements of year 2015. ROE went from 0.066 in 2014 to -0.815 in 2015, which destroyed value for shareholders. With the same token, ROI went from 0.045 in 2014 to -0.144 in 2015.

Talking about liquidity, there was not a noticeable change, as the liquidity ratio was 0.6 in 2014 and 0.75 in 2015. As for other important ratios, repayment capacity was also affected (from 1.75 to 0.0335), as well as inventory days (from 21 to 16).

Looking at the income statement, the biggest loss came from the cost of sales, which went from 71 billion € to 88 billion €. The cause of this event is the bad recognition of supplier discount during 2014. Operating revenues also decreased a lot, around 8 billion, affecting mainly gross profit. Notably, other operating expenses also increased considerably, around 3 billion euros.

In the balance sheet, it is important to notice an important decrease in inventories, which affected the efficiency ratio. Most importantly, a huge decrease in equity took place, from almost 18 billion euros to barely 10 billion. Nevertheless, total liabilities, specially non-current, increased by around 8 billion euros in just one year.

There is indeed a Z score used to detect companies that manipulate the accounts. The formula is the following:

Z = -4.5 + (0.03*r1) + (0.15*r2) + (0.17*r3) + (4.23*r4)

The result is interpreted as follows: the average for manipulators is 0.2, while the average for non manipulators is -0.24. We will calculate it for 2014 and for 2018, to see whether the accounts manipulation issue could have been anticipated and to assess whether there is risk of it happening again.

Ratio	Formula	Average for manipulators	Average for non manipulators
Receivables Index (R1):	$\frac{\left(\frac{Account\ receivables_t}{Sales_t}\right)}{\left(\frac{Account\ receivables_{t-1}}{Sales_{t-1}}\right)}$	1,39	1,34
Inventories Index (R2):	$\frac{\left(\frac{Inventories_t}{Cost\ of\ good\ sold_t}\right)}{\left(\frac{Inventories_{t-1}}{Cost\ of\ good\ sold_{t-1}}\right)}$	1,23	1,15
Depreciation Index (R3):	$\frac{(Depreciation_t/PPE_t)}{(Depreciation_{t-1}/PPE_{t-1})}$	1,03	1,08
Leverage Index (R4)	$\frac{(\text{Total liabilities}_t/\text{Assets}_t)}{(\text{Total liabilities}_{t-1}/\text{Assets}_{t-1})}$	1,10	1

2014
R1= 1.124
R2= 0.9742
R3= 0 (no depreciation data)
R4= 1.058
Z (2014)= 0.45867

2018
R1= 0.9263
R2= 0.963
R3= 0.97
R4= 0.8916
Z (2018)= -0.39

Table 11. Z score for manipulation, components and results

As it is observable from the results above, in 2014 this Z score is positive with a value of 0.46, close to the average value for manipulating companies, which is 0.2. On the other hand, in 2018, the result is negative, -0.39, close to the average number for non manipulators, which is -0.24. Therefore, if this analysis had been used, Tesco's accounting manipulation issue could have been anticipated. It also looks like the company learned its lesson, as it does not look like a case of accounts manipulation is going to occur any time soon.

Nevertheless, as for each of the four indexes individually, we can not draw any reliable conclusion, as they differ a bit from both the average for manipulators and for non manipulators. Thus, we have only focused on the final result.

Looking at the issue from a 2018 perspective and, as for the financial statements, a simple conclusion is that non-current assets have decreased, but current assets have remained stable. Equity has also recovered, and dividends are being paid again. Liabilities, on the other hand, have remained stable. Profits are positive again, and it seems that it is recovering well from the downfall.

7. Prepare the Cause & Effect diagram.

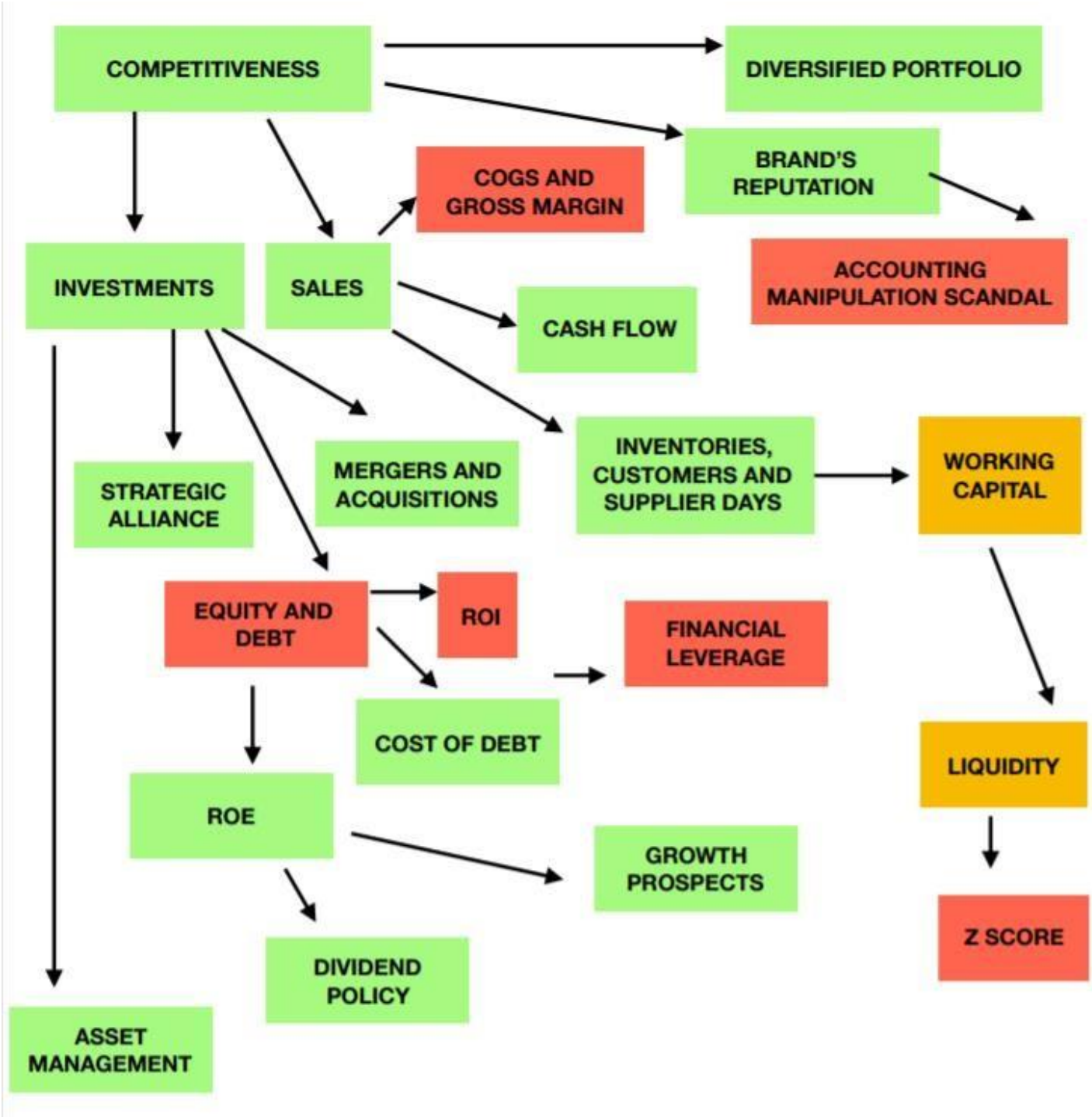


Figure 9. Cause and efect diagram

8. What measures would you recommend the company to apply so as to improve their performance? Demonstrate their effectiveness.

In order to improve the structure of the financial statements, it is advisable to increase total equity until it reaches 20.000.000 th euros and therefore gets close to the average value of the indsutry. As short term loans are too high compared to the industry value, so it is useful to negotiate terms of some of them, until the account amounts for a 5% of the total balance sheet. Debt quality ratio will improve, increasing management margin.

In order to increase profitability, it is advisable to increase margin by reducing costs, as well as turnover, by increasing income and reducing assets. As for financial leverage, the weight of assets relative to equity has to be increased. More specifically, it is needed to increase EBIT by reducing cost of goods sold.

A good strategy to increase EVA would be to increase ROA without investing more, as well as reducing the weighted average cost of capital, reducing assets with return lower than the cost of liabilities, and increasing investments in assets with a return greater than the financing cost.

To increase profits, cost of goods sold has to be lowered, and sales have to be increased.

All the measures are demonstrated in the following pages, and all of them will lead to higher and more stable profits to mitigate demage to owners and uncertainty.

CONSOLIDATED BALANCE SHEET	Average secto (%)	Average sector with profits (%)	Year 1	%	Year 2	%
Non-current assets	**63,4**	**66,3**	35.129.350	**69.4**	**30.129.350**	**66.18**
Current Assets	**36,6**	**33,7**	15.486.429	**30.6**	**15.486.429**	**33.94**
Total Assets	**100**	**100**	50.615.779	**100**	**45.615.779**	**100**
Net Equity	**37,9**	**39,1**	11.799.291	**23.3**	**20.000.000**	**43.84**
Capital	5,3	3,5	462.585	0.9	3.500.000	7.67
Other shareholders funds	25,9	21,9	11.336.707	22.4	15.000.000	32.88
Non-current Liabilities	**17,9**	**20,9**	17.111.116	**33.8**	**12.111.116**	**26.55**
Current Liabilities	**44,2**	**40**	21.705.371	**42.9**	**13.504.663**	**29.6**
Total Equity and Liabilities	**100**	**100**	50.615.779	**100**	**45.615.779**	**100**

Table 12. Demonstration of the effects of our proposal on consolidated balance sheet

PROFIT & LOSS ACCOUNT	Average sector	Average sector with profits	Year 1	%	Year 2	%
Operating revenues	**100**	**100**	64.899.488	**100**	**70.000.000**	**100**
Sales	68,9	54	n.a		n.a	
Cost of goods sold	41,9	61,7	61.084.857	94.1	55.000.000	78.57
Gross profit	9,6	12	3.814.630	5.9	15.000.000	21.42
Other operating expenses	9,4	10,4	1.742.026	2.7	5.000.000	7.14
EBIT	1,9	1,8	2.072.605	3.2	10.000.000	14.28
Financial revenue	0,2	0,1	103.799	0.2	103.799	0.0.35 15
Financial expenses	0,7	0,6	711.929	1	711.929	1.02
FINANCIAL RESULT	-0,5	-0,5	-608.129	-0.9	-608.129	-0.86
EARNINGS BEFORE TAX	1,4	1,3	1.464.475	2.3	9.391.871	13.41
Taxation	0,3	0,2	345.246	0.5	1.500.000	2.1
Income after tax	1,1	1,2	1.119.229	1.7	7.891.871	11.27

Extr. And other revenue	0,6	0,9	n.a		n.a	
Extr. And other expenses	0,5	0,6	n.a		n.a	
Extr. And other P/L	0,1	0,3	243.703	0.4	243.703	0.35
NET INCOME	**1,3**	**1,5**	1.362.932	2.1	8.135.574	11.62

Table 13. Demonstration of the effects of our proposal on consolidated income statement

(Ratios)	**Previous**	**Changed**
Debt	76.7%	56.15%
ROI	2.9%	21.92%
Liquidity	0.71	1.15
Debt quality	42.9%	29.6%
ROE	11.55%	40.67%
Asset turnover	1.28	1.53

Table 14. Demonstration of the effects of our proposal on the main ratios

After our recommendations, liabilities only represent a 56.15% of total assets, while in 2018 the proportion was of 76.7%. Comparing the new value with the industry, Tesco would be in a better position, better even than the top 10 firms.

Here, we see that ROI has suffered an excessive increase, from 2.9% to 21.92%. This is due to our recommendation of lowering COGS. We have also increased operating expenses (in the income statement) so that everything is more or less proportionate, however the decrease in COGS has been large and the new value for ROI is not real. Although this would not happen in reality, we get the idea that by lowering COGS, ROI would increase.

We can see that with our recommendations we can show an improvement in the liquidity ratio since now the ratio is greater than 1 and therefore, the working capital becomes positive. Moreover, we have achieved a greater debt quality since short term debt has decreased relative to total liabilities plus equity.

Return on Equity goes from 11.55% to 40.67%, meaning that with our recommendations, equity will be used more efficiently, increasing sales in a greater proportion than the previous year. Furthermore, asset turnover is also supposed to improve, starting from 1.28 to 1.53. This ratio indicates that sales will increase relative to assets, showing an improvement in asset management.

To conclude, with the recommendations indicated above, Tesco group should be in an improved position to face especially long-term challenges, empowering their position in the market by increasing sales and therefore net profits, creating value for shareholders and customers. By decreasing non-current assets, this is, by renting stores instead of owning or selling real estate, the company has more cash available for invesments.

As for the market strategy, in order to prevent against the threats of the industry, it is advisable to invest in the online grocery market before Amazon and other powerful retailers intervene. In order to provide low prices to customers, as we have already done, cost of goods sold needs to be a focus for management, preparing strategic alliances with suppliers and other supermarkets, increasing competitivity. Innovation is also key, so part of the cash obtained from selling non-current assets should be invested in that area. We more specifically recommend a focus on ecologic and healthy products, as more people are increasingly concerned about their health and the environment. Investment should also be made in market research before investing in other industries aside from supermarkets in order to avoid failure and a decrease in profits of the group.

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