HARVARD | BUSINESS | SCHOOL

9-514-022
JANUARY 16, 2014

JOSE B. ALVAREZ
DAMIEN P. MCLOUGHLIN
MARY SHELMAN

Tesco Group Food

The transactional model of supplier relationships is too wasteful and we can no longer afford to do this in today's multi-channel world.

— Matt Simister, Group Food Commercial Director

With 2012 sales of £72.4 billion, Tesco was the largest retailer in the United Kingdom and third largest in the world behind Walmart and Carrefour. It operated 6,700 stores in 12 countries and sold a wide variety of products, including food, clothing, and electronics, through several formats ranging from 2,000 square foot convenience stores located in city centers to 100,000+ square foot hypermarkets on the outskirts of towns. Internet sales were also growing quickly.

The fresh food and store-brand[a] grocery products sold by Tesco were produced by thousands of suppliers in more than 70 countries. Traditionally, commercial directors in each of Tesco's 12 markets were responsible for sourcing and also for in-store decisions such as shelf space, pricing, and promotion. For years, this arrangement had worked well to meet local preferences and keep retail prices low. But changing conditions, as well as the need to improve sales and margins to meet tougher competition, had led Tesco to create a new centralized sourcing department for food in 2010. Matt Simister, head of the new Group Food division, explained:

> There are fundamental changes underway in food retailing. Our customers are shopping at multiple channels, our competitors have gotten sharper, and information flows very quickly. Customers are still under economic pressure to buy cheaper food, yet they are also increasingly concerned about its safety, where it came from, and how it was produced. At the same time, rising global demand and climatic changes has led to higher and more volatile commodity prices and the need to find new sources of supply. Group Food's job is to develop a global approach to sourcing and an end-to-end supply chain system, including integrated forecasting and logistics, which will allow Tesco to be faster, nimbler, and more efficient. We are a key enabler in an increasingly dynamic, multi-channel world.

After three years, Simister was proud of Group Food's many successes but he knew much more remained to be done. As he considered the next steps in December 2013, a number of questions were

[a] Store brands were lines of products sold by a retailer under a single marketing identity, which often included the retailer's name. Store brands were also referred to as private labels, own labels, or house brands.

Senior Lecturer Jose B. Alvarez, Professor Damien P. McLoughlin of UCD Michael Smurfit Graduate Business School, and Agribusiness Program Director Mary Shelman prepared this case. It was reviewed and approved before publication by a company designate. Funding for the development of this case was provided by Harvard Business School, and not by the company. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

on his mind: What else could Group Food do to help Tesco meet the challenges presented by the new consumer and competitive environment? Were the internal systems in place to ensure that the changes that were starting to materialize were sustainable into the future? Would Tesco's suppliers provide the level of long-term support required to deliver on Group Food's objectives? Were there other ways that Tesco could use its scale to support new producers and build sustainable supply chains in emerging countries?

Tesco Background

Tesco began in 1919 when Jack Cohen started selling surplus groceries out of a London market stall. Cohen introduced the first "Tesco"-brand product, tea, in 1924 and opened the first Tesco shop in 1929. His business model of "stack 'em high, sell 'em low" earned him the nickname "slasher Jack."[1] Over the years, expansion came through opening new and larger stores (supermarkets and hypermarkets[b]) as well as convenience stores, adding more categories of products, and through acquisitions. Tesco passed historic market leader Sainsbury's in 1995 and continued to gain share, supporting its "value-for-money" position with heavy investments in information systems and logistics infrastructure and a strong multi-tiered store brand program. Tesco also introduced a number of innovations such as the Tesco Clubcard—a customer loyalty scheme that was pivotal in helping it understand consumers—and the selling of financial services, such as deposits, credit cards, insurance, and mortgages, through Tesco Bank. It launched internet grocery sales in 1997.

As its U.K. market share grew, Tesco faced increasing regulatory pressure because of its size and turned to international development to secure long-term growth. It looked to expand into countries with strong growth prospects and minimal competition from other global chains. It entered the emerging post-Soviet consumer markets of Central Europe in the mid-1990s, followed by Asia. Initial entry into each new market was usually done by acquiring a local chain and then building more stores, especially hypermarkets. By 2005, Tesco had more retail space outside the U.K. than it did at home. In 2007, it entered the U.S. with big plans for a new banner, Fresh & Easy, a 10,000-square-foot store that carried a limited assortment of mostly store-brand products.

In 2013, Tesco operated multiple store formats in 12 countries, employed 520,000 people (310,000 in the U.K.), and was the world's largest online supermarket retailer and one of the few operating in the space that was profitable. It also owned Dunnhumby, the leading customer science and loyalty marketing firm in the world.[c] Group sales for the fiscal year ended February 23, 2013, were £72.4 billion[d] and included 38% from store-brand products and 4.1% from internet sales. (See **Exhibit 1** for Tesco financial results, **Exhibit 2** for a description of Tesco store formats, and **Exhibit 3** for a list of Tesco store-brand products.)

Tesco U.K.

Two-thirds of Tesco's 2012 sales and three-quarters of profits were generated in the U.K.[e] Sixteen million customers—representing half of all British households—had active Clubcards. In November

[b] A hypermarket was a combination department store and supermarket that was usually larger than 100,000 square feet and typically located outside of a city center.

[c] In 2013, Dunnhumby employed 1,900 people in 30 offices and worked with retailers and brands on a worldwide scale, analyzing data from over 350 million people in 28 countries.

[d] Sales included VAT and excluded petrol. On December 2, 2013, £1 equaled €1.21 or US$1.64.

[e] Tesco had a stronger reliance on domestic sales than its French rivals Carrefour (46% of 2012 sales in France) and Auchan (43% of 2012 revenues in France), but was more international than its British rival Sainsbury's, which did not operate outside of the country.

2013, Tesco held 29.8% market share[2] (down from 30.5% the previous year) through its 3,146 stores.[f] It also held about 50% of the U.K. online grocery market. Online orders were filled from regular store locations and six dedicated "dark stores" (not open to the public). In addition to home delivery, customers could pick up their Tesco.com orders at 200 "click-and-collect" drive-thru collection points located at Tesco stores. Collection at smaller Tesco stores as well as non-Tesco locations, such as school parking lots, was being tested. (See **Exhibit 4** for information on Tesco U.K.)

Tesco's U.K. sales growth, which had been robust between 2007 and 2010 due to new store openings, slowed in 2011 and 2012 as its rivals became more aggressive on price. Tesco was caught in the mid-price segment between premium-positioned retailers such as Waitrose and fast-growing discounters such as Aldi and Lidl. (See **Appendix** for background on the U.K. grocery industry.) Industry analysts attributed some of Tesco's results to market saturation, but also noted that Tesco "failed to innovate with the same intensity as its competitors."[3] To counter this decline, in April 2012 CEO Philip Clarke launched Build a Better Tesco—a £1 billion plan to "improve every aspect of our customers' shopping trips." (See **Exhibit 5** for information on the plan.) Clarke also announced the "end of the space race," conceding that shoppers had fallen out of love with large out-of-town stores. Tesco wrote down £804 million on real estate it had purchased for store development and began to redesign its hypermarkets, devoting additional floor space to food. Future expansion would come from additional smaller stores and e-commerce offerings. In September 2013, Tesco introduced its own low-priced tablet computer, the Hudl (retail price of £119), as part of its multi-channel strategy.

Even with its troubles, Tesco's U.K. business was highly profitable due to its operational efficiency, and although its U.K. operating margin fell from 6.1% in 2011 to 5.3% in 2012 Tesco was still considered best in class.

Tesco International

About 17% of Tesco's 2012 sales were in Asia (China, Malaysia, South Korea, and Thailand) and 15% in Ireland and continental Europe (Czech Republic, Hungary, Poland, Slovakia, and Turkey). South Korea and Thailand were the two largest international markets. Most foreign sales were through hypermarkets, although Tesco was expanding the number of small supermarkets and convenience stores in selected markets to better compete with discounters and to serve urban shoppers. Tesco also offered online grocery shopping in more than 50 cities across nine markets outside the U.K.; in 2011, it opened the world's first "virtual" grocery store[g] in a Seoul, South Korea, subway stop; by mid-2013, there were 22 virtual stores in subways and bus stops in the country. (See **Exhibit 6** for information on Tesco's international operations and **Exhibit 7** for a photo of Tesco's virtual store.)

As it did in the U.K., Tesco collected extensive customer buying information from its 27 million international Clubcard holders that was used to develop products and store assortments tailored to local preferences. International retail margins in general were lower than the U.K. due to more intense competition.

While Tesco was acknowledged as one of the few supermarket retailers in the world that had successfully built a global business, it had run into difficulties in some areas. The company sold its Japan operations in 2012 after a decade and in September 2013 divested its five-year-old U.S. division after taking a £1.17 billion write-off. Also in September, Tesco announced it would combine its nine-

---

[f] In addition to Tesco-brand formats, Tesco also owned One Stop, a chain of 639 very small convenience stores, which was operated as a separate unit and 32 Dobbies Garden Centers.

[g] In Tesco's virtual store, interactive walls around the subway station displayed photos of fruit, vegetables, milk, and other grocery staples. Commuters could buy these products by photographing QR codes printed on the images and paying through their Smartphone. Tesco delivered the purchases to the customers' homes the same day.

year-old China operations (131 outlets) with state-owned China Resources Enterprise (CRE), the largest food retailer in China. Tesco would take a 20% stake in the joint venture, which would have sales of more than US$15 billion through 3,000-plus stores. This was the first step in a new international strategy to work with partners in high-potential markets. Lang Chen, the chairman of CRE, described the partnership as a "compelling combination of global expertise and local knowledge."[4]

Group Food

Tesco's Group Food division was established in 2010. Matt Simister, returning to London after a three-year stint as a commercial director in Central Europe, was given the challenge to build a central sourcing team for a diverse set of products ranging from fresh produce, meat, and seafood to store-brand soups, biscuits (cookies), and toilet paper. Tesco had previously moved to group buying for store-brand non-food products such as clothing and electronics with good results. "The person I reported to was the founding father of Tesco's non-food sourcing model," Simister noted. "He gave me the opportunity to set up a new business that could be potentially transformational to the organization."

Tesco's non-food sourcing operation was run principally from the manufacturing and textile centers of production in Asia. In contrast, food sourcing was run by 12 separate country commercial buying teams that both sourced and merchandised products[h]—and thus were responsible for margins. "In this system, buying was a transactional model based on tough price negotiations and frequent switches between suppliers to keep costs down," Simister remarked. "It worked well when Tesco was growing by adding more stores. However, it created adversarial relationships with suppliers and resulted in a very fragmented supply chain." Group Food Category Technical Manager Richard Bellamy described how the system led to lack of alignment in pork buying:

> Tesco operates in four countries in Central Europe and so had four buying teams and four technical teams buying pork from the same supplier in Spain. That supplier might have had four different prices depending on how good a negotiator he was. We operated like a football team with no defense but 10 strikers.

Another problem was that Tesco's intense focus on operational efficiency encouraged supply chain teams to delay finalizing orders until the very last minute, when there was the greatest insight into customer demand.[i] (Perishable food sales were particularly sensitive to the weather.) Siobhan Harrison, head of supply chain for Group Food, explained how this compromised performance:

> For 30 years, Tesco has massively invested in perfecting the final part of the supply chain, from depot to store. We have great information systems and know instantly when something is sold, can replenish that product on the retail shelf in hours, and have virtually no waste in our system. But we made our order lead times so short that everyone else held extra inventory to meet our tight schedules. For example, our salads and fresh vegetables are grown in Spain, Italy, and Greece during the winter months. We bought from importers, who held stock in the

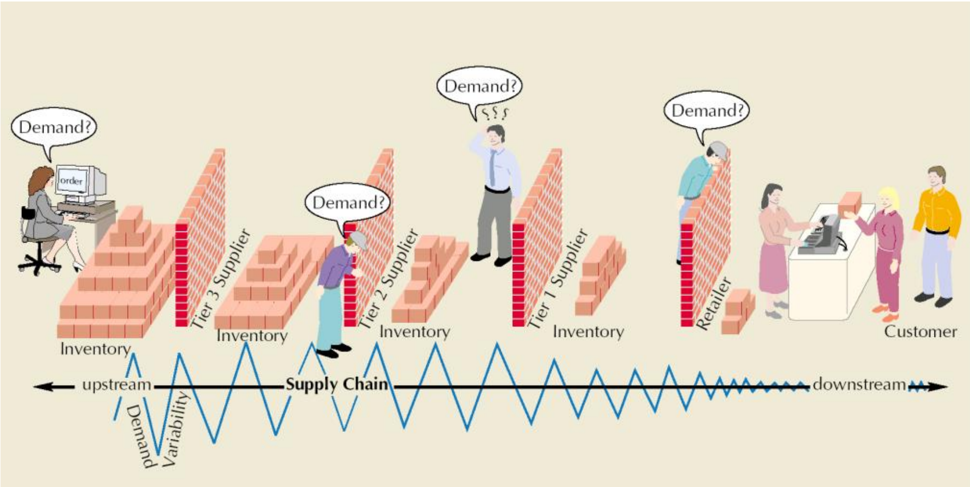
[h] Sourcing activities included identifying suppliers, negotiating prices and terms, and signing contracts for a specific quantity over a set time period. Contracts often included a volume commitment and incentives or rebate targets for volume or costs. Multiple suppliers were used to mitigate risk (such as a fire, food safety incident, or regional catastrophe). Merchandising activities included setting the retail price, determining shelf space and arrangement, and planning promotions. Commercial directors were supported by technical directors who visited suppliers and ensured products met quality specifications.

[i] Purchase orders were created by replenishment buyers who were members of the supply chain team. This team looked at forecasts for product movements and also looked at the trucking and other transport that needed to happen into the warehouse. The replenishment buyers attempted to minimize transport cost while minimizing inventory and maximizing in stock at the warehouse and store. They made the final determination of what went on the purchase order.

U.K. for our last minute orders, and they purchased from growers, who also held stock so they didn't get caught short.

Harrison used the graphic shown in **Figure A** to illustrate the amplification effect Tesco's approach had on inventories, which led to extra costs and waste. The problem was further compounded outside of the U.K. where systems to share information with suppliers were not in place. "We didn't provide forecasts and changed our orders at very short notice," she remarked. "As a result, there was no ability for our suppliers or us to drive efficiency in the supply chain. We did not have visibility or understand the impact we were having on end-to-end costs by making sure the store shelf was always full."

Figure A Supply Chain Problems Caused by Lack of Communication



Source: Company document.

Simister believed that Tesco would benefit from a new approach to food procurement that would include centralizing supply chain operations, getting closer to producers, and better information sharing. This would require significant changes in Tesco operating practices. To figure out how to implement this, Simister spent much of his six months as head of Group Food talking with Tesco's non-food and clothing teams, as well as visiting firms with world-class brands:

> One of the most significant benefits I had was a blank sheet of paper since I was setting up a new function. I had some time to think, to explore other benchmarks, and to understand and scope out the opportunity for change. In particular, I spent a lot of time with Unilever trying to understand their journey from local buying to central and regional supply. I not only looked at their organization, but also the cultural and organizational change that was required. However, unlike Unilever, we don't own the factories where our own-brand products are manufactured, so we must work through our suppliers and create a virtually integrated supply chain. And as a retailer, our offer must be more local in store assortment as well as in the formulations of some products, so we have to build in that flexibility.

Group Food thinking had also been informed by a wider review of supply chain practices. Alex Brown, Group Food sourcing director for meat and poultry, explained:

> We have studied multiple industries, from foodservice to automotive and aircraft to fashion. Our goal is to identify the best models. For example, like McDonald's, we want to be

long-term strategic partners with our suppliers and operate on an open-book basis. Like automotive, we want to optimize system inventories. And like airplane designers, we want to collaborate on new product development from the earliest stages of the innovation process, rather than being presented with a final concept that could have been tailored much better for Tesco customers with our input.

Tesco's Approach

The key concept behind Group Food was to split buying from selling while still making sure that consumer needs were met. Under the new Group Food structure, Tesco's country-based buying teams would relinquish their responsibility for purchasing most store-brand food and grocery products to the Group Food team. This would allow the country teams to devote more time to product development and innovation while the Group Food teams developed deeper sourcing expertise in each category. Simister explained that new complexity on both the selling side and the buying side drove the change:

> Our commercial teams' worlds are much more complicated than ever before. They need to understand the vastly more complex selling environment in detail. The digital channel is a very significant stream for customers and it is evolving at a pace we have not seen before. Who knows how today's 15-year-old will shop in the future? Customers also need a more personalized offer regardless of channel. On the buying side, commodity prices have become more volatile since 2007, which requires a very special set of skills to manage. And because the selling channels have become more complex, we need supply chains that are more responsive. To get to that point, we have to understand them properly and create partners, rather than adversaries.

Group Food's role was to identify suppliers, develop relationships, negotiate contracts and prices, remove middlemen that added no value, and work as deep in the supply chain as possible. (See **Exhibit 8** for Group Food priorities.) The initial team included Simister, two sourcing directors (one for produce and Brown doing everything else), a head of supply chain and logistics (Harrison), and a technical director (Lisa Hoyle). They started with products where they believed they could add immediate value, such as produce, meats, and central grocery lines that were common across countries (e.g., canned meats).

For fresh produce, which had previously been purchased from importers, sourcing hubs were added in key growing areas, such as South Africa and Chile. "Historically, the importers would have had people on the ground in these countries," Brown remarked. "We would fly in a couple of times a year and they would connect us to the growers they wanted us to meet." Group Food removed the middlemen but did not eliminate all importers because they performed an important coordination and consolidation function. But wherever possible, the number of firms was reduced and Tesco paid them for their services rather than buying products from them. (See **Exhibit 9** for an example.) For meats and processed products, Group Food changed from buying finished products through tenders to long-term contracts and an open book model and provided help sourcing key ingredients. "This is not simply about direct sourcing, which some of our competitors are adopting for fresh produce," noted Simister. "It is about building a center of expertise that reflects the value and volume of purchasing activity Tesco engages in globally."

The key elements of Group Food's approach included: introducing buying specialists, leveraging scale, partnering with suppliers, applying sourcing skill, and end-to-end supply/demand planning.

Buying Specialists

Supermarket buyers typically rotated between product categories every 18 months as they moved up in their career. The traditional thinking was that this kept negotiated prices down, as buyers did not have time to form personal relationships with suppliers. Group Food required exactly these relationships in order to be effective. "We want people to develop deep knowledge of their categories," Simister explained. "It takes a long time to really know suppliers and their capabilities, and to understand the total cost structure of a product. We now clearly communicate to our Group Food team that constantly moving around is no longer the path to career progress."

From the outset, Simister saw the recruitment and retention of the best sourcing talent as a pillar of the Group Food project. "We realized very early that we needed to bring in expertise that we didn't have," Simister noted. "We deliberately recruited individuals from industry with specific knowledge of commodities, supply chain, sourcing, and logistics. However, we found that we couldn't take just anyone. They also had to be able to work in the retail environment, which is very dynamic." Another objective was to develop a multinational team that reflected Tesco's diverse sourcing and selling locations; by late 2013, half were from outside the U.K.

Sourcing specialists had the time to investigate and follow-through on opportunities. "We hired a specialist in dried fruit and nuts who understands the micro-dynamics of the market," Brown remarked. "He has already saved us several million pounds through his in-depth knowledge of the supply chain and the multiple markets that make up the area. This would not have been possible under the old structure, because the volume sold in any one market would have been too small to justify a dedicated position."

Leveraging Group Scale

Simister believed that Group Food could unlock substantial cost savings and secure additional benefits, such as increased quality, lower risk, and reduced complexity, by consolidating buying across markets. For example, local teams tended to source chilled, frozen, and canned fish and seafood from local traders and processors, who sourced the raw material on Tesco's behalf. Combining volume across countries would allow Group Food to work directly with primary suppliers, such as Norway for salmon or Thailand for prawns, which would eliminate the importer markup. In addition, Tesco would be able to audit the production sites where the raw material was first handled, rather than depending on the importer to do it.

Under Group Food, country buying teams remained the starting point for purchasing to ensure that consumer needs were the driving force. They worked with customer insight and marketing teams to understand local preferences and competitor offerings, then wrote a product brief that Group Food used to develop a global supply base. Inevitably, brief development and implementation was a two-way process that saw local teams seeking to drive their business and Group Food "challenging where needed," according to Brown. Scale and efficiency had to be balanced against the need to keep customers satisfied and the realities of a highly competitive retail landscape, as he explained:

> Some products, like cooked meats, are national or even regional due to different taste preferences. We won't tell the local buying teams what to buy, but Group Food owns the supplier relationship. We will also get involved when a buyer wants 3 millimeters of chocolate on a biscuit when everyone else is using 2.5 millimeters and our supplier has optimized production to deliver that. We tell them how much extra it will cost and they make the decision about whether they really need it.

In addition to raw materials, Group Food also worked on packaging, using Tesco's scale over multiple products to negotiate better prices and then instructing its suppliers on what and where to buy. The same was true for logistics. Prior to Group Food, Tesco had no separate inbound logistics function, although it did have what one Tesco manager described as a "very slick" store replenishment system, with 35,000 trucks on the road each week making deliveries from Tesco distribution centers to its stores. Group Food, however, implied the need for marine and transcontinental logistical capabilities to handle orders directly from suppliers around the world. Group Food's new logistics department negotiated freight rates from the origin and consolidated loads from different suppliers instead of depending on suppliers to organize the shipping and include freight in their price. By mid-2013, non-perishable food and non-food were being shipped together in the same container.

Partnering with Suppliers

Group Food aimed to move from transactional buying (i.e., where each contract was negotiated with the short-term goal of minimizing costs on that particular deal) towards supplier partnerships that would ultimately deliver lower total costs and differentiated products. "There is a need for a big mindset change internally and externally," Brown remarked. "We want to foster an atmosphere of collaboration, where we share information and get more information in return. The automotive firms work with suppliers for years and work on innovations for years. Flip-flopping between suppliers does not allow this." Steph Davidson, Group Food sourcing director for chilled, frozen, and fish, explained why long-term relationships created value:

> Short term-ism is often a barrier to innovation and ultimately to cost savings. If a supplier is thinking about investing in equipment that will allow it to produce new products and enhance productivity but has to put down £10 million to get it, who will do that if they are unsure about the future? Brands have relative certainty of sales and so they invest. We want to provide private label producers with the security of business that they need to make these investments and ultimately allow Tesco to be first for customers.

Group Food lengthened contract periods to provide a stable investment horizon; in return, suppliers were required to operate on a fully open book basis and would be paid a pre-agreed margin over costs. Ultimately, the goal was to have fewer but larger suppliers. Group Food Beef Category Manager Brian Byrne noted that traceability would be easier to maintain under the Group Food model. "Too much focus on cost drives bad behavior," he remarked. "Under the Group Food model, we focus on building relationships with suppliers that are committed to us for the long term. We use fewer abattoirs and the ones that we use must be approved as a primary supplier. They work directly with farmers or farming groups, so know exactly where all their raw material comes from."

Not all suppliers were able and willing to work under the new model. While some were happy with an open book arrangement, others—particularly those that made branded products or supplied multiple customers—were uncomfortable with it or with Tesco sourcing raw material and packaging and arranging the shipping. The regulatory environment in the U.K. also required some flexibility in the Tesco approach.

Applying Skill in Sourcing

A cornerstone of Group Food's approach was the ability to understand and actively manage the entire supply chain, including packaging and logistics, to obtain cost and quality benefits as well as speed to market. "We can be a lot more strategic," noted Davidson,. "Our goal is to develop a robust long-term sourcing strategy for each product. This dedicated sourcing function represents a real step change in retail buying, as the fast-paced retail environment is often more conducive to tactical rather than strategic sourcing."

For example, Tesco historically negotiated its contract for packaged orange juice products once a year. "We typically fixed the price for 12 months, but when we spent time analyzing when we re-negotiated the price versus the movement of the orange juice market, it became clear that we were typically agreeing our contracts at the peak of the market," Davidson remarked. When Group Food took over, Davidson studied the market dynamics of orange juice and began by fixing the price with suppliers for three months: "The fundamental analysis of the market suggested that the price was at an all-time high and would fall. Our suppliers initially resisted. Being able to talk knowledgeably about supply and demand, commodity prices, and government policy put me in a strong position."

As part of their sourcing strategy, all options were reviewed, including the possibility of buying directly from Brazilian orange processors. Working with the right supplier, however, enabled the Group Food team to benefit from the supplier's scale and strength of relationship with the processors. Instead, Group Food offered its key supplier a 27-month contract with prices based on a mutually agreed market anchor point. Group Food and the supplier then went to meet the Brazilian processors together to make sure they were working with the best ones. "We told the processors we were changing the way we bought and asked the best ones to come with us," she explained. "Today our supplier is buying from the Brazilian processors on our behalf with a cost model that benefits both parties. It was difficult to get them to change, but not impossible."

When Davidson examined the non-concentrate orange juice contract and researched other key sources, she found that Spain was a cheaper source compared to Brazil. Switching five high-volume lines to a Spanish supplier provided a significant cost benefit. Reflecting on what happened in orange juice, Davidson said:

> We had worked with one supplier for a very long time and had a good relationship with them. The pressures of the traditional buyer's job, where buying and selling are equally important, had meant that we didn't have the time to critically appraise what we were doing and how we could make it better. Once we spent time understanding and analyzing the sourcing of the category, we started to think about what role we wanted suppliers to play and then we began to optimize the supply chain to provide the best quality products at the best possible prices. Making these changes takes time and on some categories we are at the beginning of this journey with lots more work to do around understanding the end-to-end value chain.

As the Group Food team became more actively involved in sourcing, opportunities to restructure some supply chains in a way to better support Tesco's business were identified. Instead of buying filleted salmon in display-ready flat packs, Group Food began buying whole gutted fish from Norway and paid a supplier to cut up and pack the fish. This approach proved to save money and was being rolled out to other fish species. In beef and pork where Tesco historically bought only the cuts of meat it would sell, Group Food went all the way back to the farmer and bought whole animals for a large portion of its needs. Brown explained the rationale:

> We need farmers to be successful so that we can have a secure supply of raw material. We know they work in a volatile world. We want to make sure they are raising the products that our customers want—specific origins, genetics, feeding regimes, health treatments, and animal welfare standards. Our goal is to have as many animals as possible under contract and to move away from using the market price. Instead, we want a model based on input costs plus the cost of transformation, include a margin, and that is the price the farmer receives. The market price is historically a source of conflict, but in our model it becomes less relevant.

In the U.K., Tesco had established a farming group for each animal species to identify and spread best practices and had hired an agricultural director to bridge communications between the retailer and farmers. As with other elements of Group Food, Brown wanted to improve the supply chain and remove historic barriers:

> Farmers are suspicious of our motives. They see Tesco as a tough bargainer, pushing hard on processors and packers who then push hard on the farmer. But we don't see why everyone shouldn't make money. Good farmers will make a profit under our system. We want to work with entrepreneurial farmers who want to grow their business.

A growing realization of the finite nature of natural resources and the increased volatility of commodity prices since 2007 had pushed Tesco to find new ways to reduce price risk while ensuring access to supply. Tesco purchased £16 billion of own brand food in 2011/12. A lot of its products had embedded commodity exposure—such as wheat for flour or animal feed used in meat and dairy production—estimated at around £5 billion. Group Food set up a special team under Commodities Sourcing Director Gordon Gafa, who was charged with building a center of excellence to support commodity purchasing. The group began with consumer-facing commodity lines, such as flour and vegetable oils, and would expand to ingredients (e.g., flour used for Tesco's bread), packaging, and animal feed. Gafa explained the approach to retail flour:

> In the past, we signed annual contracts with millers in October, when new crop wheat was available. Sometimes the price jumped by 20% but you don't have much room to negotiate when you are running out of stock. Now we sign longer contracts with a much lower number of millers, pay them on a cost-plus basis, and work with their procurement teams to decide the best times to buy wheat. In the first half of 2011/12, we saved 8% by negotiating wheat directly. Today we use the futures market as a guide for pricing but at some point we will start taking positions. It is easier to unwind a financial position than a physical stock position if we are wrong about the market direction.

End-to-End Supply/Demand Planning

Accurate and timely information was needed across the supply chain to drive efficiencies and reduce waste. "Getting supply forecasts and demand forecasts to line up is the big prize," Brown remarked. "It means we can get rid of a mountain of stock. For example, we found that our nappy (diaper) supplier was holding six times more stock for Tesco than for other retailers."

Group Food's first step was to build a new centralized forecasting system to support buying. Demand planners were placed in each country to work with the commercial teams to build forecasts based on sales and promotional plans. A tool was developed to plan buying week-by-week for each product. The results were uploaded each week into the central system, where they were combined with other information to build a complete picture of what stock Tesco had in stores, in warehouses and distribution centers, on trucks and ships, and how much consolidators were holding. "This gives us a complete view of our supply and likely demand, which we never had before," remarked Harrison. "In the U.K., systems are in place to enable suppliers to access this information online through Tesco Link, which also lets them see how each of their products is doing in every store."

Forecasts were further refined closer to the delivery date. Sales forecasts were reviewed 10 days out and at that time Tesco guaranteed the supplier 70% of the forecast and rounded all orders down to that quantity. Group Food worked out the price the supplier would receive for the 70% and also a (higher) price for the remaining 30% if it was needed. "We then figure out how much we need to hold in warehouses and have our logistics teams build loads across all suppliers for movement directly to our distribution centers," Davidson explained.

The absence of a common information system across countries was an initial obstacle to managing supply. "Information and visibility are keys to fresh food supply systems. We are building tools ourselves to achieve this," Harrison remarked. "We have been working to shorten lead times and also to drive costs out by providing better forecasts." She noted that forecasting improvements and the move to direct relationships with growers had yielded important trading and cost benefits:

> Our direct relationships in fresh produce mean we can actually tell growers when to pick. For example, we buy seasonal vegetables in Kenya and used to ship them to the U.K. to be cut and packed. We asked our stores to order one day earlier, which means we can cut and pack in Kenya. Product is air-freighted here and goes directly to a Tesco distribution center and then to the store. We get two extra days of code life by doing it this way. Some people were nervous that we would end up overstocked since we were ordering earlier, but the customer gets fresher product and we don't have waste because it can stay on the shelf longer.

Supplier's Perspective on Group Food: Hilton Food Group

Hilton Food Group was a long-standing supplier of packed beef, lamb, and pork to Tesco and several other large chains. Hilton's role was solely as a packer (it did not slaughter or bone carcass in its facilities) and it had an unusual business model in that it aligned with a single retailer in a market. Group Food had taken on the sourcing of beef products for Tesco U.K. in 2012. Frank McMyler, managing director of Hilton Meats Retail U.K. and Ireland, explained how the change to Group Food impacted Hilton:

> Prior to Group Food, Tesco drove margin hard, the business was running hot, and we were potentially in a race to the bottom. For example, a number of years ago additional packers were introduced into the U.K. supply base to put pressure on prices. This has now been reduced back to two core packers each with different expertise. We now work on an open-book system and work towards circa a 3% margin and we are happy with that. Previously, where the two businesses would have been fighting for a bigger share of the cake, today we can focus on the right things: continually looking at the supply chain and figuring out how to take out costs, understanding the consumer, and getting the right range on the shelf at the right time.

For Hilton, the ultimate commercial benefit of Group Food was increased scale. "At its simplest, Group Food means that Tesco's costs will come down," McMyler noted. "They will pass the lower costs to their customers, which will increase sales. The result is higher volumes and a larger business for all of us." (See **Exhibit 10** for a comparison of activities under the old and new model.)

McMyler was pleased to be investing in the Tesco relationship as it allowed access to opportunities that had not been open to Hilton before. Hilton and Group Food now worked collaboratively on concepts and innovation to grow the category. "Business development and innovation is a costly part of any business. Before, we would go through a lot of expense and not have any guarantee that it was what Tesco was looking for, and therefore if the product would go ahead,'' McMyler explained. "Since Group Food has been involved, our innovation is now formed as part of a more integrated process, which means ultimately they will be taken forward more targeted, be right for the consumer, and ultimately lead to increases in sales over time. We must grow Tesco's business to grow our own.''

Building interdependence with Tesco, or with any retailer, was often seen to have disadvantages for suppliers. "We are sometimes asked 'what if Tesco walked away from you in the morning?'" McMyler remarked. "The grass in faraway fields always looks greener, but once you go after it you can't go back. We have Tesco in our DNA. We think they need us as much as we need them."

On December 2, 2013, Hilton announced a new five-year contract with Tesco that was expected to raise volumes by 40% in 2015, the first full year of the deal.[5]

Developing a High Quality, Sustainable Global Supply Base

Tesco and other large food buyers faced an additional challenge in 2013. In the face of rising global demand for food and changing consumer expectations about how food was produced, how did they ensure an adequate, safe, and sustainable supply? "We have a big business in Central Europe and a potentially very big business in Asia to feed, but the product quality and supply chain infrastructure needs to improve," Simister remarked. "That's what Group Food must develop and accelerate. In addition, we must work beyond our own business boundaries if we are to meet our corporate sustainability targets and especially to cut down on waste." (See **Exhibit 11** for Tesco's sustainability commitments and **Exhibit 12** for a diagram of food waste.)

Ensuring that Tesco could access products with the quality, safety, sustainability, and ethical production its customers expected while keeping costs down was the responsibility of Group Food Technical Director Lisa Buckley-Hoyle; hers was the second job on the sheet along with Simister when Group Food was established. "Matt was given a blank sheet of paper," she explained. "I joined him because Tesco has a huge ability to change global food. We can literally influence the food supply base in 52 countries. We can get local people in developing countries better food and better skills. We can also enable Tesco to tell a grower-to-shelf story."

Buckley-Hoyle was responsible for 39 people in sourcing hubs in 20 countries as part of Tesco's strategy to get closer to the supply base. Having an on-the-ground presence allowed Tesco to identify and form relationships with the best producers, inspect merchandise before it was shipped, and assess how weather was affecting product quantity and quality, which helped Tesco to develop a firsthand view of the best place to take product at any particular time of the year. Buckley-Hoyle and her team also looked for ways to extend seasons (e.g., sourcing fresh tomatoes from farms in the Canary Islands that produced two weeks later than other locations), to diversify sourcing areas to manage crisis, and to improve quality and productivity by sharing information. Buckley-Hoyle explained that the development of new production areas was increasingly critical:

> We are starting to be challenged in our ability to find supply. Climate changes are a real issue for us; for example, Brazil used to reliably produce two grape crops a year, now the quality is variable. With the growth in Latin America and Asia, Europe is no longer a customer of choice for countries like Chile. South African growers are now preferring to supply Africa, Middle East, and Russia. And when will European suppliers start shipping to Africa rather than to the U.K. or Central Europe? It's easier to deal with non-European retailers than it is with Tesco because our specifications are so tight.

The team had to carefully manage the reality of new suppliers in developing countries against Tesco's tight product and manufacturing standards, as Buckley-Hoyle explained:

> Our suppliers must achieve a "green" rating on their compliance scorecards. But if we apply this to processed ingredients in the developing world, we wouldn't have any supply! Instead, we recognize that not meeting Tesco's standards, which are the highest in the industry, does not mean a supplier is bad, just that a gap exists that needs to be closed. Now we work with the supplier and put together a program, sometimes over two years, to take them from a red to a green rating. This allows us to develop good suppliers without compromising our ethical or sustainability non-negotiables.

Buckley-Hoyle credited the Group Food approach for improved relations with existing suppliers:

> Group Food allows us to be in the supply base. We can build proper relationships and have a deeper understanding of what is going on with supply. Three years ago, our fruit suppliers in South Africa felt disconnected from us. I met one at a conference and he said "you impose changes and never consult us, never recognize the years of service we have given to you." We

> set out to correct that and today we work together on things like agricultural standards. Ten years ago, agricultural standards were extremely variable. We brought in [Tesco's proprietary program] Nature's Choice--now known as Nurture. Today, everyone's moving to GlobalGap.[j] We are discussing how to integrate these standards to avoid duplication. It's very important for our suppliers, so we must convince our colleagues in Tesco to move in this direction.

As relationships and communications improved, problems could be identified and solved jointly. For example, South African produce suppliers had trouble with Tesco's annual packaging changes. Produce seasons were short and suppliers often over-ordered to avoid running out, then could not use it the next season. "They asked for our help and together we came up with a plan to move packaging around between suppliers," Buckley-Hoyle said. The next advance in problem solving was to connect growers around the world, as she explained:

> Every time we met with growers they told us things we were not thinking about. We realized that product quality and sustainability lay with them rather than with distributors and exporters. So we built a producer network—an online community that now has over 1,600 members and is growing across all agricultural categories—and introduced a number of working groups so we can learn from each other. I got excited recently by an outcome that we had hoped for but weren't sure we would achieve. One of our Asian growers had a defect that he hadn't seen before. He put the question up on the network and there was an incredible response. Within two hours, the problem was identified and he got a number of different suggestions on how to solve it.

Group Food 2013

By 2013, Group Food's activities had expanded to well over 2,000 products, split equally between fresh produce, meat/dairy, and grocery items that were sourced from 1,100 supplying sites in 52 countries. Group Food sourced 12% of Tesco's U.K. food sales in 2012, 30% of Central Europe, and 3% of Asia. Purchases had increased from £750 million in 2010 to over £5 billion and the number of Group Food employees from two to 300 in the same period. Simister estimated that Group Food would be fully integrated by 2016 or 2017 and that the final value of purchases would be in the region of £12 billion. "The full realization of change is far from complete, but three years on we have moved from being a business startup to delivering sizeable cost savings for the business and significant customer value," Simister remarked.

Over time, a different understanding of Group Food's value had emerged. "In the beginning, we thought scale was the big prize and we probably overemphasized it when speaking with our colleagues," Brown remarked. "We now realize the majority of the benefit is due to increased skill. For example, the quality of produce and meat in Central Europe is much better than before due to Group Food's work." Buckley-Hoyle agreed:

> All of our efforts to build a sustainable supply base are underpinned by skill. Our buyers are no long buyers and sellers. They are now just buyers and this has really allowed for skill development. Group-based specialists have more time than generalists. Their expertise allows us to source things that we couldn't source before. For example, our tropical fruit specialist works directly with banana and pineapple growers in Costa Rica to deliver better product quality, improve farm standards, and advance ethical practices.

Yet even with the successes, further expansion of Group Food was not clear cut. Simister had come to appreciate that centralized buying was a bigger undertaking for grocery retailers than brand

[j] GlobalGap was a non-governmental organization that set voluntary standards for the certification of agricultural production around the world.

owners like Unilever, restaurants like McDonald's, or even car manufacturers like Ford, because of the total number of products sold in a typical supermarket. An average Tesco supermarket offered more than 40,000 stock-keeping units (SKUs), and the products and assortment had to fit local tastes. Some products, such as spices, were just too small or localized for Group Food to handle effectively. In addition, innovation was potentially threatened when the supply base was removed from direct customer interaction. Group Food had dealt with this in Central Europe by having a brand team that acted as conduit between the countries and Group Food.

More significantly, centralized buying challenged a fundamental principle of the retail industry—that the buyer was responsible for the margin. "The rational of Group Food is never questioned," Simister remarked. "The implementation is often culturally more challenging. That requires massive cultural change because the commercial team owns the margin in the retail business." He noted that the journey had been a process of "one step back, then two steps forward" and that some buyers were still making their own deals, even when Group Food was actively sourcing a product.

Simister needed to win over country buying teams as they were important stakeholders in the success of Group Food. One U.K. category buying manger confirmed Simister's view:

> Intellectually, Group Food is a great idea. But the reality is that you are taking people who have been responsible for multi-billion pound turnover businesses—who believe they are already getting the best result they can—and trying to convince them that this a better way of doing things. Our KPIs [key performance indicators] include a margin target, so change is risky. Also, Group Food did not have the smoothest of starts from a process and systems standpoint and that led us to make some mistakes early on. It has also added complexity and points of contact to our business and I have been surprised by what we have had to work around in areas like supplier control and supplier briefing.

Resolving these issues involved a number of practical moves to clarify the intent and principles of Group Food, according to Davidson:

> First, Tesco is a very large company and we have a stakeholder management matrix. This is flexible and dynamic style of leadership is the reality of modern day multinationals, but can sometimes delay decision making. It's important that these delays don't impede our progress in making things better for our customers. Second, we have had to figure out what Group Food means for different categories. The principle of taking away 50% of a buyer's purchases and allowing them to focus on market-driven innovation works well in some categories—in fruit, for example. Conversely, where there is high innovation and significant product churn, being close to customers is key. Third, Group Food has to work hard at communicating our value internally. What we are doing is truly pioneering and we should be proud about our achievements to date, and energized around our plans going forward.

Simister remained convinced that Group Food was a transformational approach:

> On the supply side, Group Food means better prices, better products, less waste, and long-term supply security. On the demand side, it means Tesco can develop innovative and unique store brands and re-build customer loyalty. It's also a fundamental enabler of success in a multi-channel retail environment. In today's dynamic new world, customer needs are changing faster than ever before and we need a retail revolution if we are to keep up. How can we get Group Food embedded in Tesco's DNA and everyone in the company on the same team?

Exhibit 1a Tesco Financial Information, 2009–2013

	2009	2010	2011[b]	2012[a]	2013[a]
Financial Statistics (£m)					
Sales including VAT excluding IFRIC[m,p]	59,426	62,537	67,074	71,402	72,363
Revenue excluding IFRIC[m]					
United Kingdom	38,028	39,104	40,766	42,803	43,579
Rest of Europe	8,862	8,724	9,192	9,866	9,319
Asia	7,068	8,465	9,802	10,828	11,479
United States	206	349	495	–	–
Tesco Bank	163	860	919	1,044	1,021
Group revenue excluding IFRIC[m]	54,327	57,502	61,174	64,541	65,398
Trading profit					
United Kingdom	2,309	2,413	2,504	2,478	2,272
Rest of Europe	496	474	527	529	329
Asia	355	440	605	737	661
United States	(142)	(165)	(186)	–	–
Tesco Bank	68	250	264	225	191
Group trading profit	3,086	3,412	3,714	3,969	3,453
Operating profit[c]	3,169	3,457	3,917	4,182	2,188
Operating profit margin[c]	5.8%	6.0%	6.4%	6.5%	3.3%
Share of post-tax profits of joint ventures and associates	110	33	57	91	54
Net finance costs	(362)	(314)	(333)	(235)	(282)
Profit before tax	2,917	3,176	3,641	4,038	1,960
Taxation	(779)	(840)	(864)	(874)	(574)
Profit for the year from continuing operations	2,138	2,336	2,777	3,164	1,386
Discontinued operations	–	–	(106)	(350)	(1,266)
Profit for the period	2,138	2,336	2,671	2,814	120
Attributable to:					
Owners of the parent	2,133	2,327	2,655	2,806	124
Non-controlling interests	5	9	16	8	(4)
Underlying profit before tax—continuing operations[d]	3,124	3,395	3,853	4,149	3,549
Other financial statistics					
Diluted earnings per share—continuing operations (£)	26.96	29.19	34.25	39.23	17.30
Underlying diluted earnings per share—continuing operations (£)	28.87	31.66	36.26	40.31	35.97
Dividend per share[e]	11.96	13.05	14.46	14.76	14.76
Return on capital employed ('ROCE')[f]	12.8%[g]	12.1%	12.9%[h]	14.7%	12.7%
Total shareholder return[d]	8.0%	9.5%	6.7%	(3.0%)	2.1%
Net debt (£m)	9,600	7,929	6,790	6,838	6,597
Enterprise value (£m)[i]	35,907	41,442	39,462	32,324	36,578
Group retail statistics					
Number of stores	4,332[l]	4,836[l]	5,265[j]	6,049	6,784
Total sales area - 000 sq ft[k]	88,556[l]	95,231[m]	103,172[j]	110,563	116,236
Average employees	468,508	472,094	488,347	514,615	537,784
Average full-time equivalent employees	364,015	366,413	382,049	401,791	416,441

Exhibit 1a (continued)

	2009	2010	2011[b]	2012[a]	2013[a]
UK retail statistics					
Number of stores	2,306	2,507	2,715	2,979	3,146
Total sales area—000 sq ft [m]	32,389	34,237	36,722	39,082	40,495
Average full-time equivalent employees	194,420	196,604	200,966	205,852	213,304
Revenue per employee—£ [n]	195,597	198,897	202,850	207,931	204,305
Weekly sales per sq ft—£ [o]	25.34	25.22	24.95	24.86	24.15

Source: Company documents.

[a] During the financial year, the Group decided to sell its operations in the US. Accordingly, these operations have been treated as discontinued in 2013. The 2012 statistics have been re-presented to be consistent with 2013. Prior years have not been re-presented.

[b] Excludes Japan.

[c] Operating profit includes restructuring costs and profit arising on sale of fixed assets. Operating margin is based upon revenue excluding IFRIC 13.

[d] See glossary for definitions.

[e] Dividend per share relating to the interim and proposed final dividend.

[f] Return on capital employed is profit before interest and tax less tax at the effective rate of tax divided by the calculated average of opening and closing net assets plus net debt plus dividend creditor less net assets held for resale.

[g] Excluding acquisition of Tesco Bank and Homever, India start-up costs, and after adjusting for assets held for sale. Calculated on a 52-week basis, ROCE for 2009 is 12.8%.

[h] Includes Japan.

[i] Market capitalisation plus net debt.

[j] Includes franchise stores but excludes Japan.

[k] Store sizes exclude lobby and restaurant areas.

[l] Restated to include Dobbies stores.

[m] Restated to include Dobbies stores and account for a space restatement of 109,000 sq ft driven by a comprehensive remeasurement of One Stop stores.

[n] Based on average number of full-time equivalent employees in the UK and revenue excluding IFRIC 13.

[o] Based on weighted average sales area and average weekly sales, excluding Dobbies stores.

[p] IFRIC 13 was an accounting rule for entities that granted loyalty award credits, such as points or miles, to customers who bought other goods and services. It required that some proceeds of the initial sale had to be allocated to the awards credits as a liability.

Exhibit 1b Tesco Summary Financials, 2009–2013

Fiscal Year	2009	2010	2011	2012	2013
Sales[a] (£ mil)	53,898	56,910	60,455	63,916	64,826
Operating profit (£ mil)	2,926	3,137	3,467	4,182	2,188
Gross profit (% sales)	7.7%	8.3%	8.5%	8.4%	6.3%
SG&A (% sales)	2.3%	2.8%	2.7%	2.5%	2.4%
Operating profit (% sales)	5.4%	5.5%	5.7%	6.5%	3.4%
Net Income (£ mil)	2,138	2,336	2,671	2,814	120
Balance Sheet (£ mil)					
Cash, securities	4,742	4,133	3,450	3,548	3,034
Inventory	2,669	2,729	3,162	3,598	3,744
Current assets	13,479	11,765	12,039	12,863	13,096
Current liabilities	17,575	16,015	17,731	19,249	18,985
Total assets	45,564	46,023	47,206	50,781	50,129
Total liabilities	32,658	31,342	30,583	32,980	33,468
Long-term debt	12,195	11,521	9,541	9,777	10,068
Equity	12,906	14,681	16,623	17,801	16,661
Cash Flow (£ mil)					
Operating cash flow from cont. operations	3,960	4,745	4,239	4,408	2,837
Purchases of property and equipment	-4,487	-2,855	-3,178	-3,374	-2,619
Sale of property and equipment	995	1,820	1,906	1,141	1,351
Cash flow from investing activities	-5,974	-1,877	-1,873	-3,183	-278
Movements in short and long-term debt	4,636	-2,780	-1,978	140	-1,238
Foreign exchange effects	120	49	-46	24	26
Equity issues/stock repurchases	-135	143	67	-234	57
Dividends	-883	-968	-1,081	-1,180	-1,184
Net cash flow	1,721	-690	-674	-123	194

Source: Tesco Annual Reports and Capital IQ.

[a] Sales are Group Revenues excluding VAT and including IFRIC.

Exhibit 2 Tesco Formats

Tesco Express (10% of Tesco U.K. floor space): Launched in 1977, Tesco Express stores averaged 2,200 square feet, stocked about 3,500 items, and placed an emphasis on products such as fresh produce, wines and spirits, and baked items. They were typically sited in densely populated urban locations. In February 2013, Tesco operated 1,547 Tesco Express stores in the U.K. Express or similar small formats were also used in South Korea, Thailand, Czech Republic, and Turkey.

Tesco Metro (6%): The first Tesco Metro store opened in 1992 in London's Convent Garden. Tesco Metro stores were located in inner cities and were 10,000 to 15,000 square feet in size. Their flagship product offerings focused on ready-made meals and sandwiches. In February 2013, Tesco operated 192 Tesco Metro stores in the U.K.

Tesco Superstore (38%): Tesco opened its first superstore in 1968. Tesco operated 481 superstores in the U.K. in February 2013. These stores ranged in size from 35,000 to 50,000 square feet and offered a wide range of non-food as well as food items.

Tesco Extra (46%): Tesco opened its first Extra store in 1977. By February 2013, there were 238 Tesco Extra stores in the U.K. These stores often exceeded 60,000 square feet (and could be as large as 150,000 square feet), contained up to 60,000 product lines, and were usually located out of town. In addition to a full selection of groceries, these stores offered a variety of home goods ranging from electronics to household furnishings, clothing, health and beauty, and seasonal items such as garden furniture. Some Tesco Extra and Tesco Homeplus stores also included pharmacies and opticians. Tesco Extra stores were located in Ireland, Slovakia, and Malaysia as well as in the U.K.

Tesco Homeplus (1%): Tesco Homeplus stores sold no food products. Rather, these stores focused on selling Tesco's clothing line and general merchandise. These stores averaged 35,000 to 50,000 square feet. Tesco opened its first Homeplus store in 2005. By February 2010, 12 Homeplus stores were operating in the U.K.

Source: Company documents and John A. Quelch, "Tesco PLC: Fresh & Easy in the United States," HBS case No. 511-009 (Boston: Harvard Business School Publishing, 2010).

Exhibit 3 Examples of Tesco Store Brand Lines

Tesco Finest
(re-launched in October 2013)

Tesco Organic

Tesco Free From

Tesco Everyday Value
(re-launched in April 2012)

Tesco Goodness for Kids

Source: Company documents.

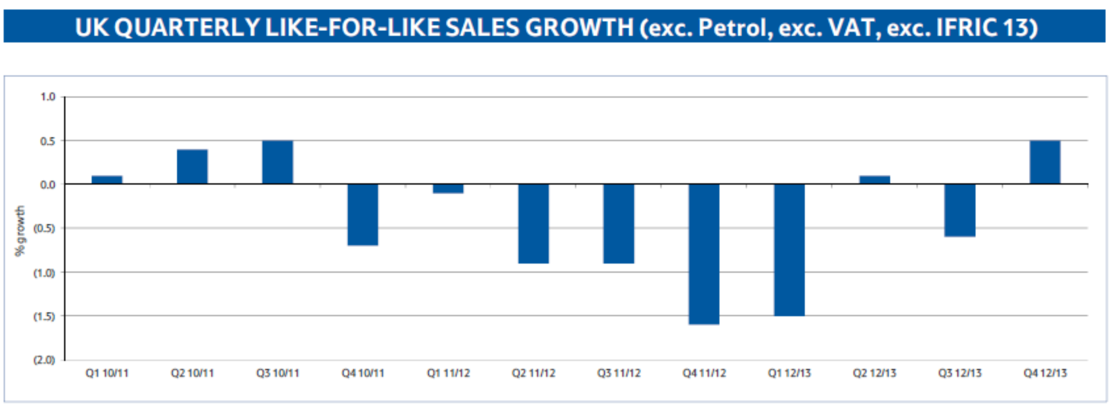
Exhibit 4 Tesco U.K. Operations

Space Summary by Format

	2009/10 Year End		2012/13 Year End	
	# Stores	Thousand Sq. Ft.	# Stores	Thousand Sq. Ft.
Extra	190	13,627	238	16,346
Homeplus	13	554	12	523
Superstore	455	13,515	481	14,142
Metro	181	2,076	192	2,139
Express	1,130	2,544	1,547	3,713
Dot-com	0	0	5	604
Total Tesco	**1,969**	**32,316**	**2,475**	**37,964**
One Stop	513	675	639	991
Dobbies	25	1,137	32	1,540
Total UK	**2,507**	**34,128**	**3,146**	**40,495**

Source: Company documents.

U.K. Sales Growth, 2010/11–2012/13



Source: Company documents.

Exhibit 5 Clarke's "Build a Better Tesco" Plan

The six parts of the plan are:

- **Colleagues & Service –** more colleagues in our existing stores, in the departments that matter most to customers
- **Stores & Formats –** faster store refresh programme, introducing a warmer look and feel
- **Range & Quality –** better ranges, starting with the relaunch of our Tesco brands
- **Price & Value –** better prices and promotions, more personalised offers
- **Brand & Marketing –** better, clearer, more relevant communication with customers
- **Clicks & Bricks –** Click & Collect roll out, transforming range and online presence

Source: Company documents.

Exhibit 6 Tesco International Operations

Space Summary by Country and Format

	2009/10 Year End		2012/13 Year End	
	# Stores	Thousand Sq. Ft.	# Stores	Thousand Sq. Ft.
ASIA				
Malaysia				
– hypermarket	31	2,774	47	3,918
– other	1	31	--	--
South Korea				
– hypermarket	114	10,273	133	12,108
– other	191	654	298	934
– franchise stores	--	--	89	188
Thailand				
– hypermarket	116	8,898	149	10,709
– other	547	1,601	1,284	3,611
China				
– hypermarket	80	7,053	117	10,165
– other	8	23	14	31
Total Asia	**1,230**	**31,784**	**2,131**	**41,664**
EUROPE				
Czech Republic				
– hypermarkets	65	3,935	86	4,627
– other	71	956	148	1,324
– franchise stores	0	0	142	141
Hungary				
– hypermarket	101	6,129	118	6,753
– other	75	487	98	576
Poland				
– hypermarket	62	4,825	82	5,737
– other	274	2,728	364	3,689
Slovakia				
– hypermarket	49	2,506	62	2,960
– other	32	642	74	862
Turkey				
– hypermarket	37	2,279	56	3,351
– other	68	220	135	602
Ireland				
– hypermarket	10	607	13	821
– other	109	2,424	129	2,634
France	1	16	0	0
Total Europe	**954**	**27,754**	**1,507**	**34,077**

Source: Company documents.

Exhibit 6 (continued) International Results

INTERNATIONAL SALES PERFORMANCE (inc. Petrol, exc. IFRIC 13)

		SALES GROWTH (inc. VAT)				REVENUE (exc. VAT)			
		CONSTANT RATES			ACTUAL RATES				
Continuing Operations		like-for-like %	net new stores %	total %	total %	in local currency m	£m	average exchange rate	closing exchange rate
China	TY	(1)	7	6	9	14,317	1,432	10.00	9.53
	LY	4	12	16	15	13,477	1,311	10.28	9.94
Malaysia	TY	-	6	6	5	4,591	937	4.900	4.733
	LY	(2)	14	12	12	4,345	891	4.876	4.757
South Korea	TY	(5)	5	-	(1)	9,421,714	5,311	1,774	1,656
	LY	-	6	6	7	9,428,674	5,339	1,766	1,777
Thailand	TY	3	13	16	16	183,470	3,742	49.03	45.57
	LY	5	10	15	14	157,739	3,235	48.76	47.92
India	TY	25	-	25	11	4,884	57	85.68	82.84
	LY	40	-	40	30	3,906	52	75.12	77.47
Czech Republic	TY	(7)	5	(2)	(10)	42,009	1,356	30.98	29.38
	LY	(1)	10	9	14	43,682	1,537	28.42	29.47
Hungary	TY	(1)	1	-	(9)	569,648	1,606	354.7	337.7
	LY	2	4	6	8	574,213	1,775	323.5	340.7
Poland	TY	(4)	5	1	(5)	11,150	2,176	5.124	4.797
	LY	2	7	9	7	10,994	2,288	4.805	4.913
Slovakia	TY	(1)	7	6	(1)	1,371	1,114	1.231	1.154
	LY	6	6	12	14	1,301	1,128	1.153	1.179
Turkey	TY	-	13	13	8	2,123	745	2.850	2.736
	LY	3	12	15	(1)	1,894	693	2.733	2.782
Republic of Ireland	TY	(1)	3	2	(5)	2,850	2,315	1.231	1.154
	LY	(3)	6	3	5	2,818	2,444	1.153	1.179
Franchising[1]	TY	n/a	n/a	n/a	n/a	9	7	1.231	1.154
	LY	n/a	n/a	n/a	n/a	1	1	1.153	1.179
Discontinued Operations									
Japan	TY	(3)	(19)	(22)	(24)	42,630	328	129.9	142.6
	LY	(7)	(6)	(13)	(8)	55,067	436	126.3	127.1
United States	TY	2	9	11	12	1,112	700	1.588	1.526
	LY	12	20	32	27	1,001	625	1.601	1.578

Note
[1] Wholesale sales to F&F franchisees located in the Middle East

Source: Company documents.

Exhibit 7 Tesco "Virtual" Store in Seoul Subway Station

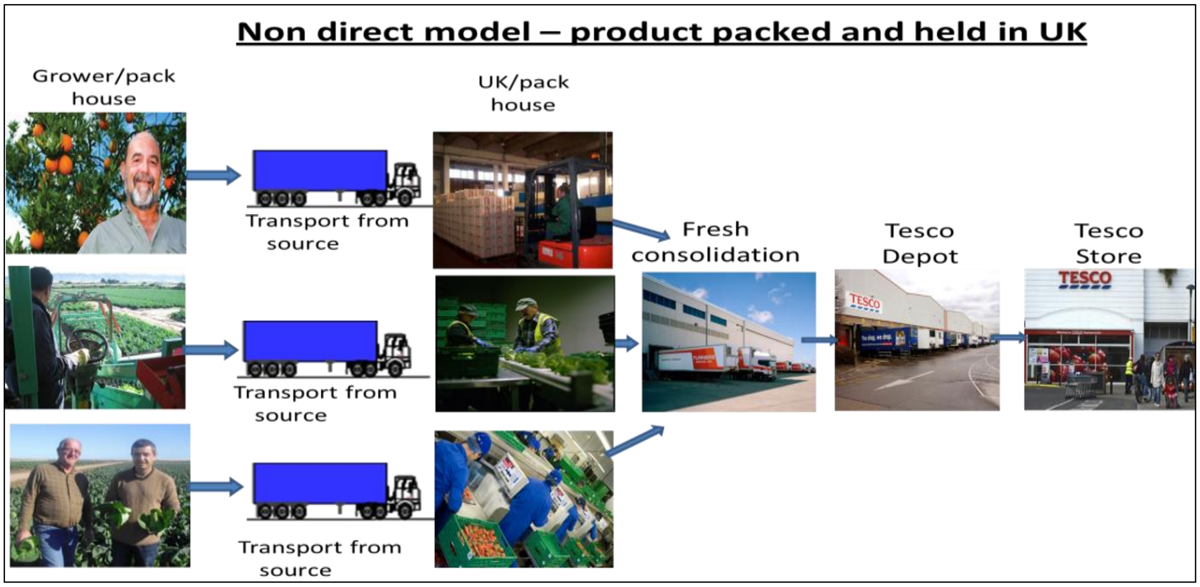
Source: Company documents.

Exhibit 8 Group Food Priorities

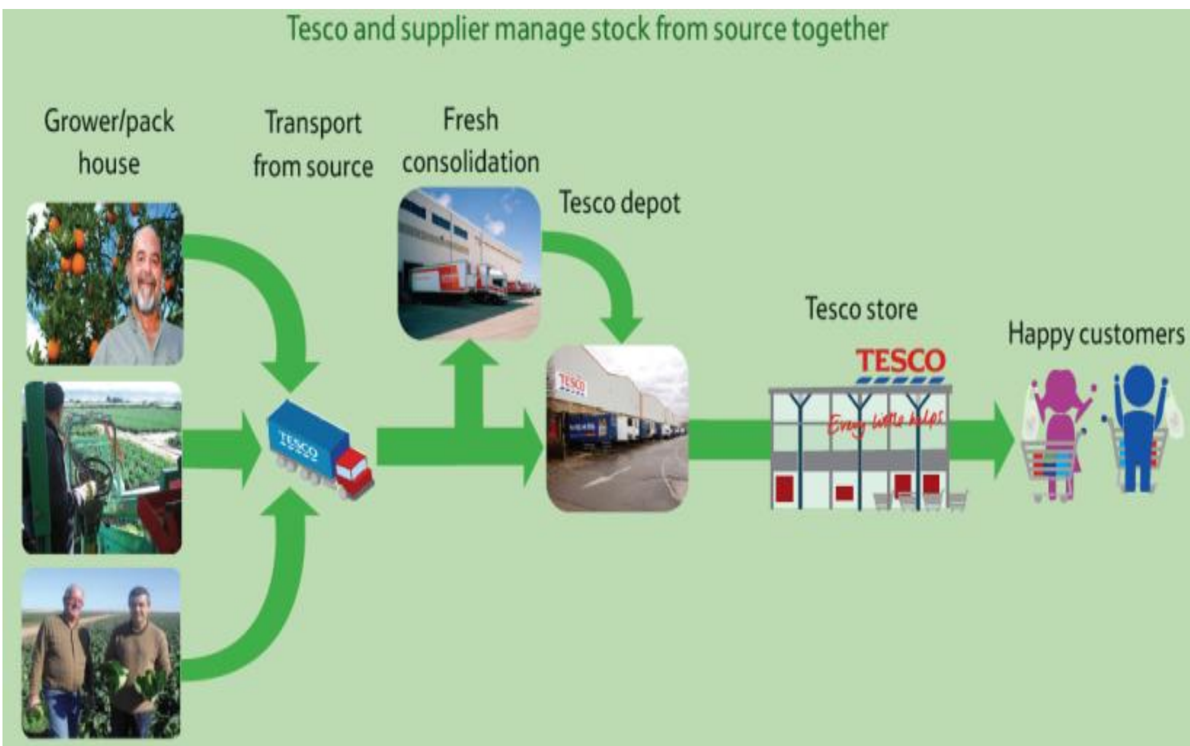
Source: Company documents.

Exhibit 9 Old and New Approach to Fresh Produce Sourcing

Traditional Approach



Group Food Approach



Source: Company documents.

Exhibit 10 Hilton-Tesco Relationship Before and After Group Food

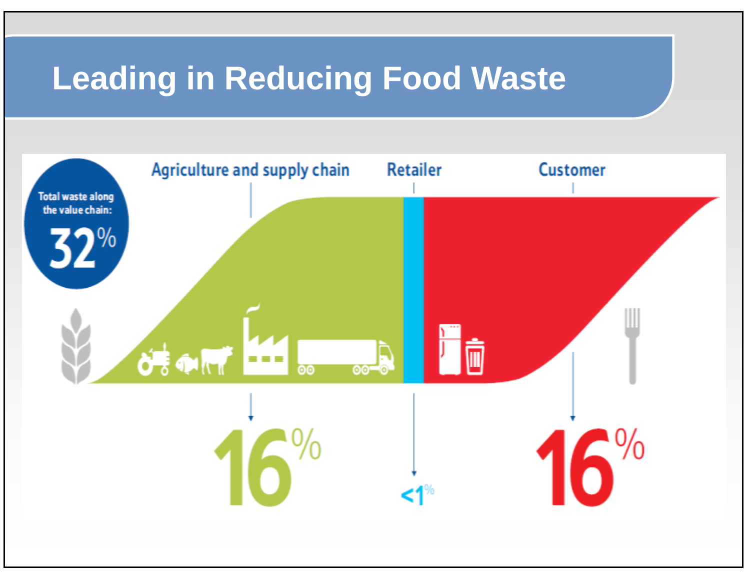
Previous Model—Hilton	Revised Model—Hilton/Group Food
• Hilton negotiations on raw material (80% of costs)	• Group Food negotiated raw material (80% of costs)
• Hilton supply chain management	• Hilton/Group Food supply chain managed fixed kill and traded primal
• Hilton negotiated packaging	• Group Food negotiated packaging
• Blend of pack prices, tender, and kill model	• Transport yield and process rate model
• Hilton managed logistics	• Hilton/Group Food managed logistics

Source: Hilton company documents.

Exhibit 11 Tesco Sustainability Commitments

Source: Company documents.

Exhibit 12 Food Waste in the Supply Chain



Source: Company documents.

Appendix

Food Retailing in the U.K.

Grocery retailing in the U.K. was a £160 billion business in 2013.[6] Meat, fish, and delicatessen products accounted for about a quarter of retail food revenues, while packaged non-perishables, like cereal and pasta, accounted for about one-third. See **Table A-1** for a breakdown.

Table A-1 Supermarket Sales by Segment, 2013–14

Products and Services Segmentation	
Meat, fish, and delicatessen items	23%
Beverages (includes alcohol)	22.5%
Other food	16%
General merchandise (e.g., cosmetics, detergents)	15%
Frozen food	10%
Fruit and vegetables	7%
Dairy products	6.5%

Source: Adapted from Christopher Edwards, "Industry Report G47.110: Supermarkets in the UK," IBISWorld, July 2013.

Consumers

Britons spent less than 10% of their income on food (including nonalcoholic beverages), which was the third lowest in the world behind the U.S. and Singapore.[7] (See **Exhibit A-1** for food spending in selected countries.) But even with the low spending rate, the ongoing recession had squeezed household incomes and affected British food buying behavior. (See **Exhibit A-2** for household incomes.) Although retail food sales did not fall as more people ate at home rather than dining out, consumers cut back on premium products such as organics, switched to cheaper cuts of meat, and in some cases switched to discount retailers such as Aldi and Lidl. Hypermarkets in particular had fallen out of favor, as customers reduced their driving, bought smaller amounts at one time, and shifted to online shopping for certain non-food categories, such as DVDs and electronics. Instead of weekly shopping trips, the trend was for consumers to shop more frequently and locally on foot in smaller "convenience" stores (c-stores). One analyst noted that consumers perceived they spent less in c-stores overall given that, for example, they did not spend on petrol and because there was less opportunity for impulse purchases due to the limited assortment.[8]

Public interest in food surged in the U.K. in January 2013 after equine DNA was discovered in frozen beef burgers and other fresh and frozen products, such as meat pies and lasagna, at several retailers including Tesco, Asda, and Aldi. A survey conducted two months later found that public trust in the food industry had dropped by 24% and more than half of consumers reported changing their shopping habits, with 30% of those polled buying less processed meat, almost a quarter buying fewer ready meals with meat or choosing vegetarian options, and 44% spending more time looking at ingredient labels. Confidence in food safety had also dropped, from nine in 10 (92%) feeling confident when buying products in the supermarket before the scandal broke to seven in 10 (72%) feeling confident at the time of the poll.[9] Six months after "Horsegate," research by Mintel found that just half (49%) of the British public trusted the food industry to provide safe food to eat, with another 37% undecided.[10]

Retailers

The U.K. market was mature and marked by high retail concentration, with the top four supermarket chains accounting for over 70% of industry revenue. Tesco was the market leader, followed by J. Sainsbury's, Walmart-owned Asda,[k] and Morrisons. (See **Exhibit A-3** for information on major U.K. grocery retailers.) Most British retailers had developed strong store-brand programs; in 2012, 51% of food by volume and 43% by value was sold under own brands,[11] the second-highest own brand share in Europe (Switzerland had the highest) and far ahead of the U.S. (23% volume share and 19% dollar share[12]).

The tough economy helped German "hard discounters" Aldi and Lidl, which had entered the U.K. market in the early 1990s, win share from the traditional market leaders. Aldi saw sales growth of 33% for the 12-weeks ended September 16, 2013, over the same period in 2012 to reach a 3.7% share of the U.K.'s grocery market. In October 2013, Aldi opened its 500th U.K. store and was on track to add 50 new stores in 2013. Lidl achieved growth of 14% during the same period and held a 3% share. In December 2013, Lidl's U.K. managing director said that Lidl hoped to ultimately expand from 600 to as many as 1,500 stores.[13,14] Along with very competitive prices, Aldi and Lidl both had smaller "no frills" shops with limited assortments of almost exclusively own-label products. A study by *The Grocer* found that on a shopping basket of 33 items Aldi was 16% cheaper than Asda, 20% cheaper than Tesco, and 40% cheaper than Waitrose.[15]

To serve their economically challenged consumers, the top British retailers had focused on price competition, offering price matching for national brands, pressuring suppliers to maintain or lower prices in the face of rising costs, and increasing their private label offerings, which were priced about 30% lower than manufacturer's brands. Some industry observers blamed the intense price competition for the horsemeat contamination problems.

To meet the customer need for local shopping locations and increased convenience, retailers shifted their focus from building hypermarkets to adding c-stores and increasing their online sales. Industry research body IDG forecasted that the c-store market would grow by 29% between 2012 and 2017, from sales of £33.9 billion to £43.6 billion,[16] and grocery internet retailing was expected to double in value by 2015.[17]

[k] Walmart acquired Asda in 1999.

Exhibit A-1 Spending on Food in Selected Countries

Percent of consumer expenditures spent on food, alcoholic beverages, and tobacco that were consumed at home, by selected countries, 2012[a]

Country/Territory	Population (millions)	Share of Consumer Expenditures: Food[b] (percent)	Share of Consumer Expenditures: Alcoholic Beverages and Tobacco (percent)	Consumer Expenditures[c] (U.S. dollars per person)	Expenditure on Food[b] (U.S. dollars per person)
United States	313.9	6.6	1.9	34,541	2,273
Singapore	5.3	7.3	2.1	19,398	1,422
United Kingdom	63.2	9.1	3.8	24,260	2,214
Canada	1.4	9.6	3.4	27,761	2,679
Austria	8.5	10.1	3.3	25,908	2,617
Ireland	4.6	10.1	5.4	20,093	2,037
Australia	22.7	10.2	3.6	37,492	3,814
Germany	81.9	10.9	3.0	22,762	2,481
Switzerland	8.0	11.0	3.5	44,899	4,943
Denmark	5.6	11.1	3.8	27,306	3,036
South Korea	50.0	12.2	2.2	12,002	1,468
Czech Republic	10.5	13.3	9.3	9,643	1,279
Hungary	9.9	16.2	7.5	6,972	1,127
Slovakia	5.4	16.8	4.9	9,556	1,603
Malaysia	29.2	19.5	2.5	5,557	1,084
Poland	38.5	19.6	6.5	7,773	1,521
Turkey	74.0	22.2	4.6	7,705	1,708
China	1,354.0	26.9	3.6	2,149	577
Thailand	66.8	32.0	4.7	3,177	1,016

Source: Compiled from Economic Research Service, United States Department of Agriculture, http://www.ers.usda.gov/data-products/food-expenditures.aspx#26636, accessed December 2013.

[a] The data were computed based on Euromonitor International data extracted July 2013.

[b] Includes non-alcoholic beverages.

[c] Consumer expenditures comprised personal expenditures on goods and services. Consumption expenditures in the domestic market were equal to consumer expenditures by resident households plus direct purchases in the domestic market by non-resident households and minus direct purchases abroad by resident households.

Exhibit A-2 U.K. Average Total Disposable Income by Quintile Groups of All Households, 2005/06–2011/12 (£)

	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12
Bottom 20%	3,695	4,329	4,071	4,434	4,717	5,065	5,436
2nd Quintile	10,109	10,932	11,535	10,743	11,034	11,718	11,813
3rd Quintile	21,014	22,856	23,200	23,304	23,001	22,552	22,946
4th Quintile	36,274	37,759	39,186	38,235	37,994	39,641	38,906
Top 20%	70,028	74,526	73,959	75,720	77,875	81,501	78,283
Average	28,228	30,080	30,930	30,485	30,924	32,096	31,477
Total Number Households	**24,799**	**24,836**	**25,289**	**25,874**	**26,053**	**26,265**	**26,436**

Source: U.K. Office for National Statistics licensed under the Open Government Licence v.1.0, www.ons.uk.gov, accessed December 2013.

Exhibit A-3 Top U.K. Grocery Retailers' Key Market Data, 2011–2012

	Grocery Store Sales 2012 (£M)	% Change in Grocery Sales (2011–2012)	Number of Grocery Stores	U.K. Sales Area (sq. ft., M)	Retailer Market Share (%)
Tesco	44,600	2.6%	3,141	39.9	30.1%
Sainsbury's	23,159	3.9%	1,112	21.3	16.7%
Asda	22,800	4.5%	532	18.5	17.2%
Morrisons	17,915	2.5%	498	13.4	11.2%
The Co-operative	7,511	2.2%	2,889	12.9	6.4%
Waitrose	5,416	6.8%	290	5.1	4.9%
M&S	5,785	2.9%	702	4.6	N/A
Aldi	3,600	30.1%	465	4.1	3.8%
Lidl UK	2,720	11.0%	635	6.1	3.0%
Iceland	2,478	-4.0%	750	3.7	2.0%

Source: "An Overview of the UK Grocery Retail Market 2013, Profile of 1st Tier Retailers," Bord Bia/Irish Food Board, November 2013, p. 9.

Endnotes

[1] Denise Winterman, "Tesco: how one supermarket came to dominate," *BBC News Magazine*, September 9, 2013, http://www.bbc.co.U.K./news/magazine-23988795, accessed November 2013.

[2] Sarah Butler and Simon Bowers, "Britain's big supermarkets lose ground to cut-price rivals and upmarket grocers," *The Guardian*, November 19, 2013, http://www.theguardian.com/business/2013/nov/19/britain-supermarkets-market-share-fall-tesco-sainsburys-lidl, accessed December 2013.

[3] "Passport: Grocery Retailers in the United Kingdom," Euromonitor International, May 2013.

[4] Graham Ruddick, "Is Tesco's dream of building an international empire unraveling?" *The Telegraph*, October 2, 2103, http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/10349392/Is-Tescos-dream-of-building-an-international-empire-unravelling.html, accessed December 2013.

[5] Katy Askew, "UK: Hilton picks up additional Tesco volume," just-food.com, December 2, 2013, http://www.just-food.com/news/hilton-picks-up-additional-tesco-volumes_id125267.aspx?lk=dm&utm_source=daily-html&utm_medium=email&utm_campaign=02-12-2013&utm_term=id84084, accessed December 2013.

[6] Christopher Edwards, "Industry Report F47.110: Supermarkets in the U.K.," IBISWorld, July 2013.

[7] Economic Research Service, "Food Expenditures," United States Department of Agriculture, http://www.ers.usda.gov/data-products/food-expenditures.aspx#26636, accessed November 2013.

[8] "Analysis: Retail space—Where are the big grocers investing?" *Retail Week*, July 12, 2013, available on Lexis-Nexis, accessed August 2013.

[9] "Horse Meat Scandal Dents Food Trust," *Express*, March 13, 2013, http://www.express.co.U.K./news/U.K./383895/Horse-meat-scandal-dents-food-trust, accessed November 2013.

[10] "Just half of Brits trust the food industry to provide safe food to eat," Mintel, July 3, 2013, http://www.mintel.com/press-centre/food-and-drink/food-safety-after-horse-meat-scandal, accessed November 2013.

[11] Christopher Edwards, "Industry Report F47.110: Supermarkets in the U.K."

[12] Share data as reported by The Nielsen Company in PLMA's *2013 Private Label Yearbook*, "Private Label Growth Outpaces National Brands," Store Brands Decisions, http://www.storebrandsdecisions.com/news/2013/07/02/private-label-growth-outpaces-national-brands-, accessed November 2013.

[13] Sarah Butler, "U.K.'s biggest supermarkets now face fresh challenge from competitors," *The Guardian*, September 24, 2013, http://www.theguardian.com/business/2013/sep/24/biggest-supermarkets-challenged-by-rivals, accessed November 2013.

[14] "Lidl discount supermarket plans to double UK stores," *BBC*, December 1, 2013, http://www.bbc.co.uk/news/business-25175188, accessed December 2013.

[15] Robyn Vinter, "Discounters Mark Their Mark in U.K. Food Retailing," *Farmers Weekly*, July 27, 2013, http://www.fwi.co.U.K./articles/27/07/2013/140187/discounters-make-their-mark-in-U.K.-food-retailing.htm, accessed November 2013.

[16] "Analysis: Retail space—Where are the big grocers investing?" *Retail Week*, July 12, 2013, Lexis-Nexis, accessed August 2013.

[17] "Passport: Grocery Retailers in the United Kingdom," Euromonitor International, May 2013.