**MEMORANDUM**

**To:** IKEW Review Board
**From:** 2353558
**Re:** Marks & Spencer Case Analysis
**Date:** 10/31/2021

After more than a century of uninterrupted growth culminating in record income of £829 million in 1998, publicly traded, UK-based retail giant Marks & Spencer (M&S) faced severe financial difficulties in the following years. Focused on food and apparel verticals (and to a much lesser extent financial services), operating expenses rose significantly across the board from roughly £7.1 billion in early 1998 to £7.7 billion in early 1999, decreasing net income by over £400 million to then £372 million total. At this time, cheaper supply chains became broadly available to competing retailers, and the Asian financial markets experienced significant contraction after years of expansion-fueled growth.

The decline in net income in 1999 was severe enough to prompt appointment of a new leadership board in the following year. Additionally, the company's financing was heavily equity based (about 2:1 in 1998) with a high focus on supply chain visibility and slow but steady international expansion. Supply chain visibility drove M&S's success in capturing significant market shares in mid- to high-end apparel segments through cost-leadership, and brand recognition. Store-integrated food operations sought to serve a similar clientele with high-quality, easy-to-prepare food products. Both verticals, food, and merchandise, drove revenue, generating significant income and value for shareholders due to conservative expenditures.

As a publicly traded entity, the new boards main priority must be reversing the downward trend addressed in net income. A year into their appointment, three main goals were summarized under a strategy dubbed "The Cube": Focus on the UK market exclusively, stop of losses through non-core activities, and redistribution of the company's financing to drive shareholder value. Any subsequent evaluation in this memo will discuss those goals as key drivers to address declining net income. Furthermore, subsidiary problems involving high costs of goods sold (and subsequent low margins and vulnerability to competitors) and overall financial market insecurities will be considered. All discussions are limited to a period from 1998 to 2002 with special attention to all events after Q4 1999.

Focus on the UK market led to the launch of additional brands and joint ventures to recapture lost market share in specific verticals such as women's lingerie. However, flat revenues across the entire analyzed period indicate shrinking operations to not be a main issue for M&S's income. Additionally, while operations in the Asian market did generate a net loss in 1998 - assuming a net margin of roughly 14.4% before the local financial crisis and other macroeconomic factors came into play - overall revenues at roughly £650 million (and therefore costs of £665 million in 1998; opposed to estimated costs of £550 million at £670 million revenue (all numbers rough estimates)) are not substantial enough to explain the overall close to £900 million decline in net income from 1998 to 2001. Effectively, efforts deployed in this regard improved brand loyalty short-term without addressing underlying cost structure issues.

Evaluating the stop of losses through non-core activities, the provided income statement in 2002 does not indicate any successful actions towards achieving the goal. Continued high employee costs (essentially flat from 1999 to 2002) at more than 30% layoffs during the same time, very slowly declining costs of goods sold (4.5% during the period), and extremely high tax rates (102.7% in 2001, likely through stock market investments), arguably fail to improve the companies standing in light of the challenges it faced three years before. Only “misc. income and expense” turns back positive from 2001 to 2002 while “other costs” decline, with these two expense accounts almost exclusively explaining the recovery of net income during that time.

Redistribution of the companies’ financing was more successful moving from a strong focus on equity in 1998 to a 56-44 distribution towards liabilities in 2002. However, decreasing equity-based financing does weaken shareholders’ positioning in the long-term by effectively redistributing decision-making power towards the company and its creditors. In the short-term payment of dividends is ensured, partly fulfilling the mission laid out in “The Cube”.

Overall, while brand loyalty improved, and net income turned back positive in 2002 after a consistent decline from 1998 to 2001, none of the growing expense accounts leading to the initial decline in net income from 1998 to 1999 and subsequent replacement of the leadership board were effectively resolved. It is strongly recommended to address rising employee costs and accelerate reduction in costs of goods sold (effectively decreasing risks from competitors filling the space) while decreasing volatility from cash investments.

Main criterion for choosing which of these three alternatives are most employable short-term base upon the individual impact each of them has on net income (reduce expenses at lowest possible introduction cost). Overworking investment strategies requires marginal analysis; subsequent move of short-term assets into less risky positions such as government bonds can be done without further expenses, ultimately introducing needed stability to miscellaneous income at very low costs.

Such stability can be used to address high employee expenses. Average employee costs of 13,800 GBP per employee in 1998 rose to 23,800 GBP in 2002, a relative increase of over 70%. Analyzing causes for this increase can be costly, subsequent introduction of changes however will substantially reduce employee costs long-term at low additional expenses. Opportunities include overworking the company culture, improving employee benefits, and deployment of modern management techniques (for example agile).

Lastly, costs of goods sold during the same period barely declined regardless of outsourcing efforts addressed in the case. Competitors with high quality products and (much) lower costs were analyzed as a major issue by the new board. Strategies to close the gap to leaner competitors include temporary reduction of supply chain visibility through vertical disintegration and outsourcing. Solutions incorporate deeper understanding of competitors suppliers and their main advantages, process and logistics optimizations, and reliance on flexible distributors to accommodate fluctuating demand. There are significant risks, as product quality and brand loyalty may be adversely affected, especially in the short-term. Thorough analysis and gradual deployment can help mitigate those risks, and high initial costs will be justified by significant expense reductions for costs of goods sold.

Ideally, these changes should be employed in Q1 of 2000, their effect however can significantly decrease the high expense accounts after FY2002 just as well and should therefore be introduced as soon as possible.