

**TESCO: A CASE STUDY IN
SUPERMARKET EXCELLENCE**

July 2004

Coriolis Research Ltd. is a strategic market research firm founded in 1997 and based in Auckland, New Zealand. Coriolis primarily works with clients in the food and fast moving consumer goods supply chain, from primary producers to retailers. In addition to working with clients, Coriolis regularly produces reports on current industry topics. Recent reports have included an analysis of The Arrival of Costco in Australia and answering the question: “Will selling groceries over the internet ever work?”



The lead researcher on this report was Tim Morris, one of the founding partners of Coriolis Research. Tim graduated from Cornell University in New York with a degree in Agricultural Economics, with a specialisation in Food Industry Management. Tim has worked for a number of international retailers and manufacturers, including Nestlé, Dreyer’s Ice Cream, Kraft/General Foods, Safeway and Woolworths New Zealand. Before helping to found Coriolis Research, Tim was a consultant for Swander Pace and Company in San Francisco, where he worked on management consulting and acquisition projects for clients including Danone, Heinz, Bestfoods and ConAgra.



The coriolis force, named for French physicist Gaspard Coriolis (1792-1843), may be seen on a large scale in the movement of winds and ocean currents on the rotating earth. It dominates weather patterns, producing the counterclockwise flow observed around low-pressure zones in the Northern Hemisphere and the clockwise flow around such zones in the Southern Hemisphere. It is the result of a centripetal force on a mass moving with a velocity radially outward in a rotating plane. *In market research it means understanding the big picture before you get into the details.*



PO BOX 10 202, Mt. Eden, Auckland 1030, New Zealand
Tel: +64 9 623 1848; Fax: +64 9 353 1515; email: info@coriolisresearch.com
www.coriolisresearch.com

TESCO - MARKET CONDITIONS IN 1992

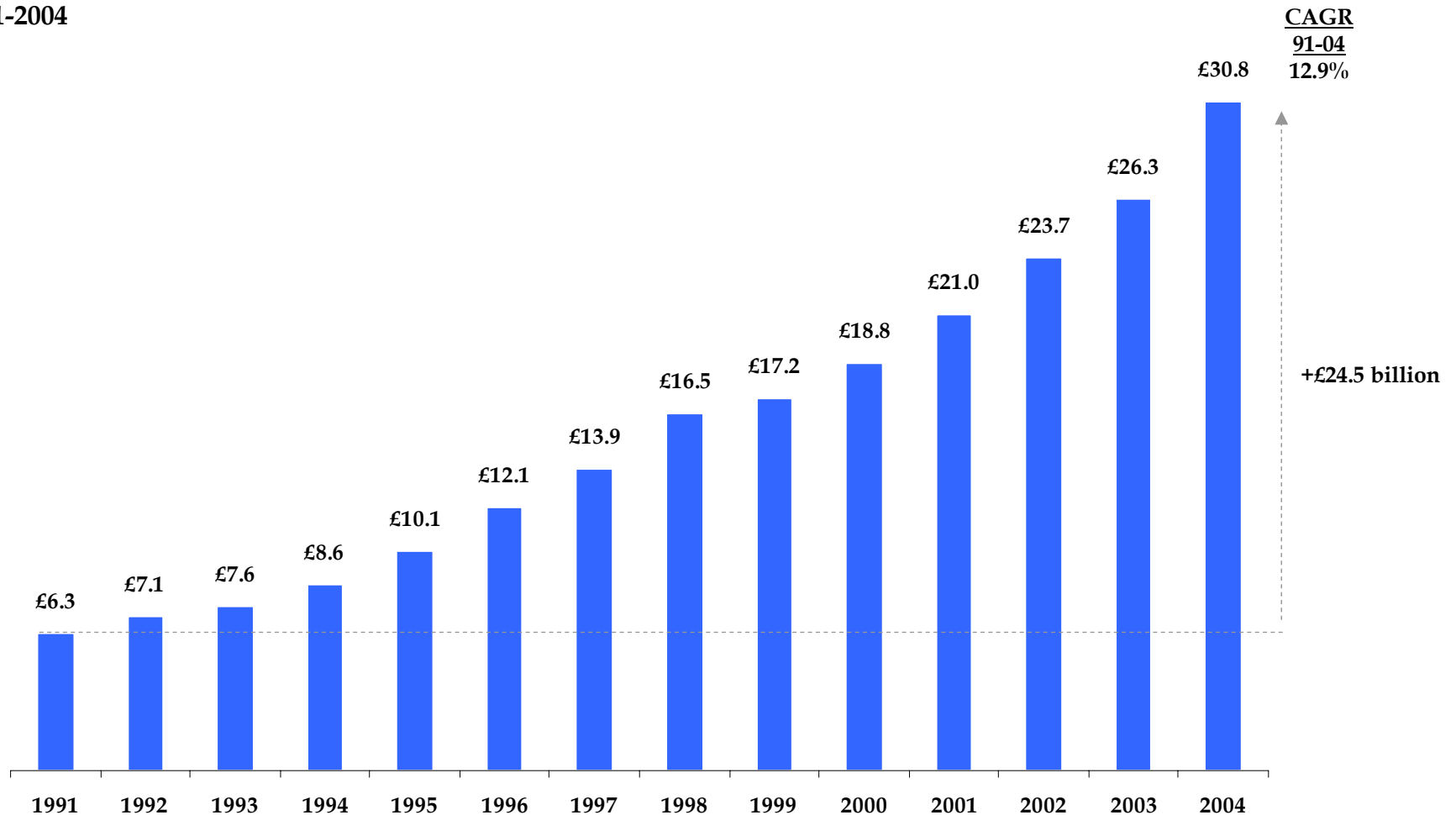
Tesco faced the following difficult market conditions in 1992

- 1. Low population growth**
- 2. Low food price inflation**
- 3. Well developed and relatively saturated supermarket market in the UK**
- 4. Increasing difficulty in getting planning permission for large greenfields sites**
- 5. Three strong competitors (Sainsbury, Asda & Safeway)**
- 6. Number two market position (16.7%) behind Sainsbury (19.0%)**
- 7. The arrival of two new store formats: warehouse clubs (Costco) and limited assortment stores (Aldi, Lidl, Netto)**

TESCO SALES GROWTH

Tesco then turned on a dramatic growth spurt – growing total group sales at a compound rate of 12.9% per year for the past fourteen years, adding £24.5 billion in sales over the period

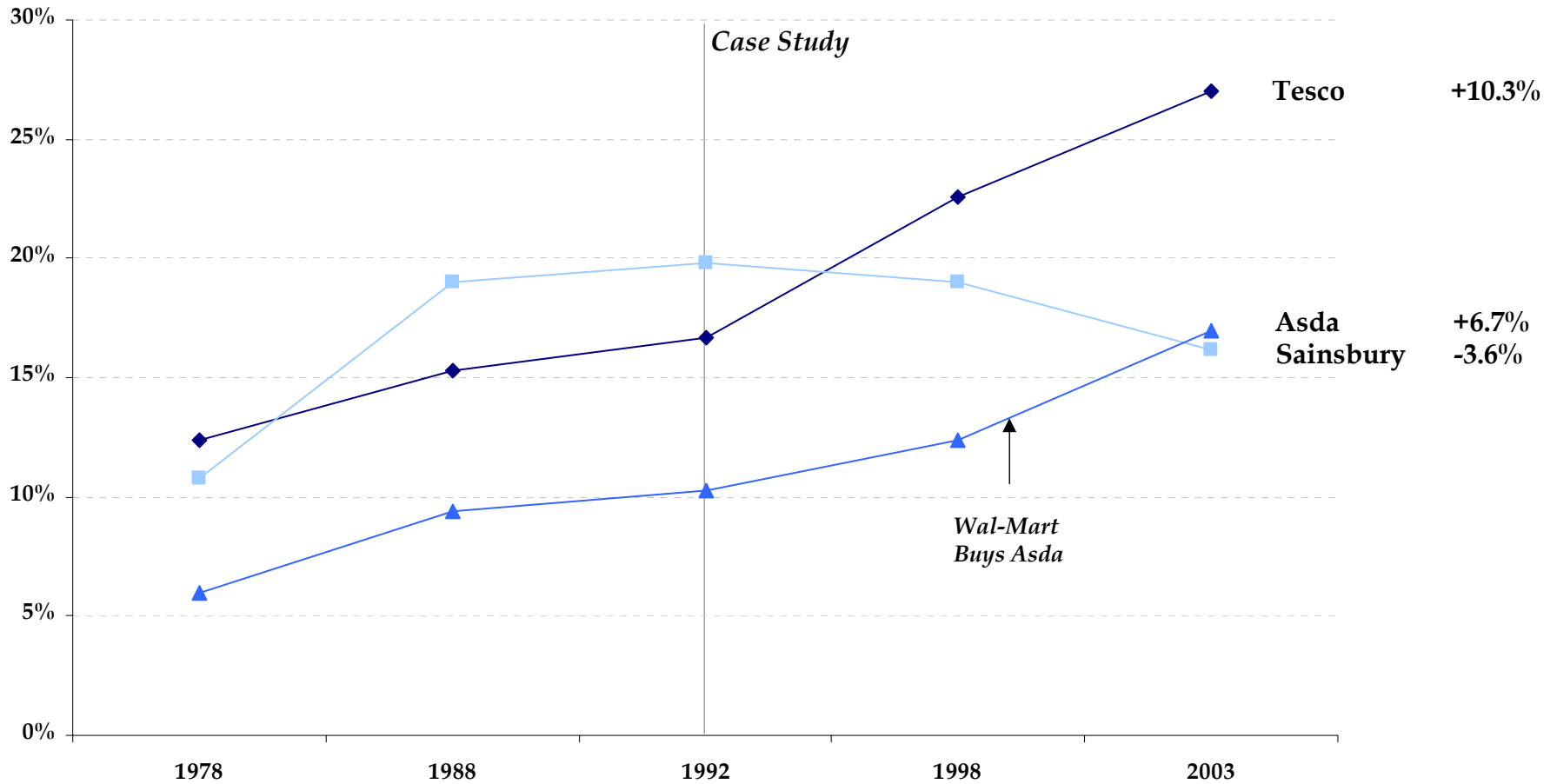
Tesco annual group sales
%, 1991-2004



MARKET SHARE OF TOP THREE

Tesco has added 10.3% percent market share in 11 years - and has been unfazed by the arrival of Wal-Mart in the UK

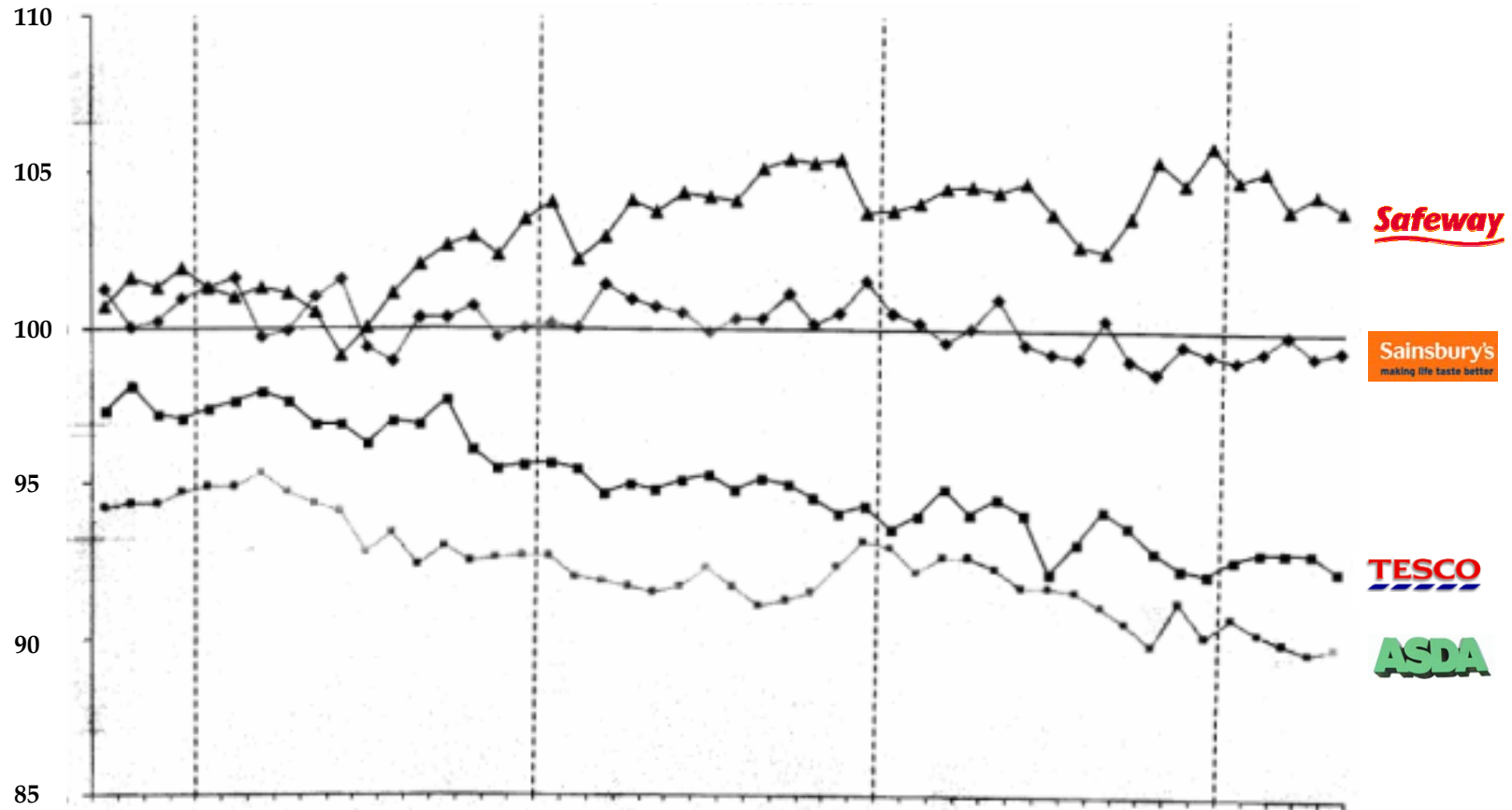
United Kingdom Market Share by group
%, 1978-2003



RELATIVE PRICE POSITION

Tesco tracked ASDA down in terms of price following the Wal-Mart acquisition

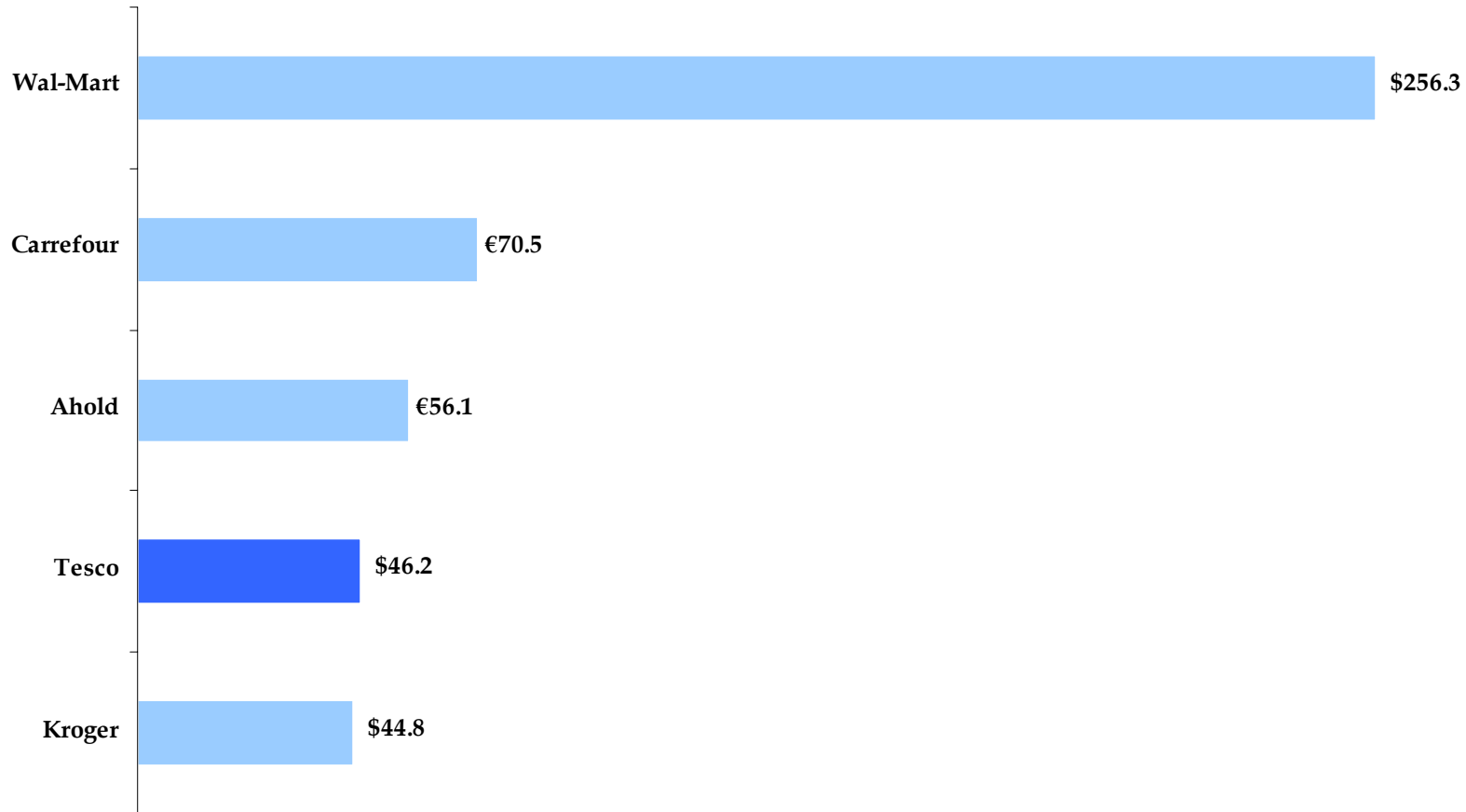
United Kingdom relative price position
Index, 1998 - 2002



TOP FIVE GLOBAL RETAILERS

Through strong growth, both in the UK and internationally, Tesco is now the fourth largest supermarket retailer in the world

Top Five global supermarket-type retailers by sales
US\$; Euro; 2004



RECOGNIZED LEADERSHIP

Tesco is the recognised role model for supermarkets globally

- **“Tesco is emerging as a virtually impregnable retail machine.”**

Steve Gotham, Analyst, Verdict Research, Oct 2003

- **“One of the retail success stories.”**

Simon Dunn, Analyst, UBS, April 2004

- **“Tesco is at the top of its game.”**

Business Week, October 2003

TESCO STRATEGY DIAGRAMS

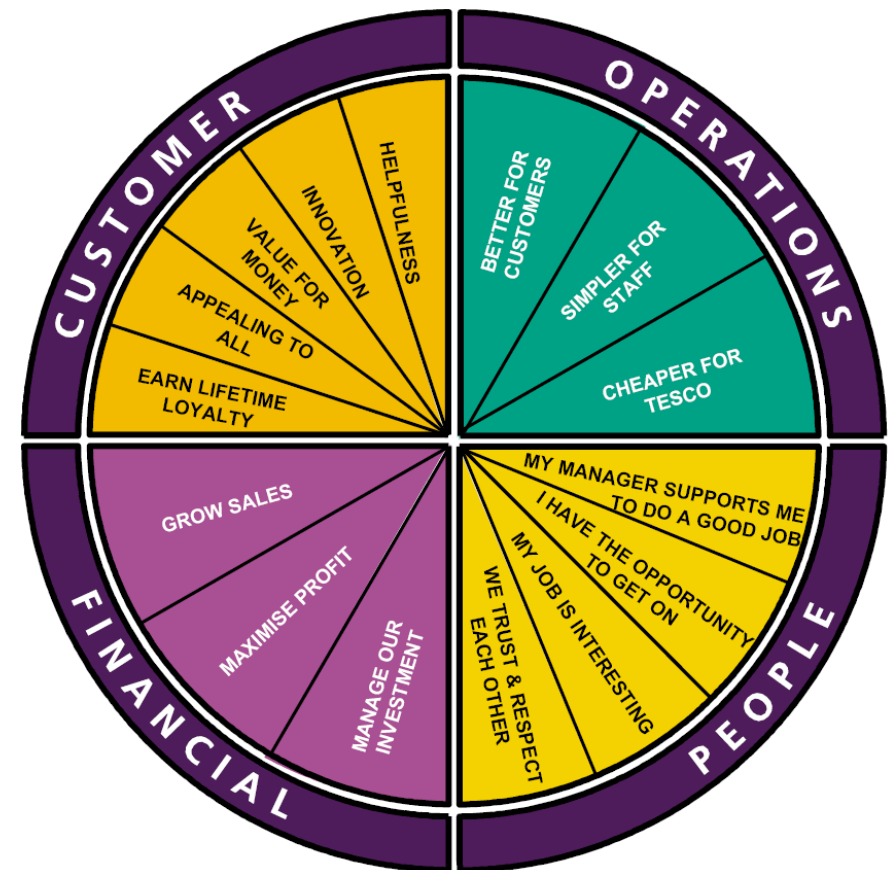
Tesco explains its growth strategy with two basic diagrams

Tesco strategic diagrams

Bringing Prices Down

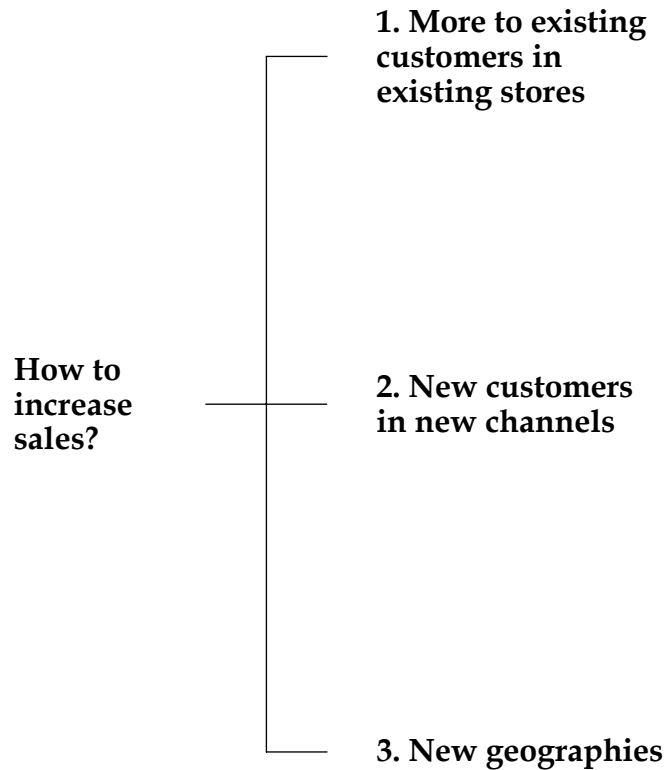


Steering Wheel



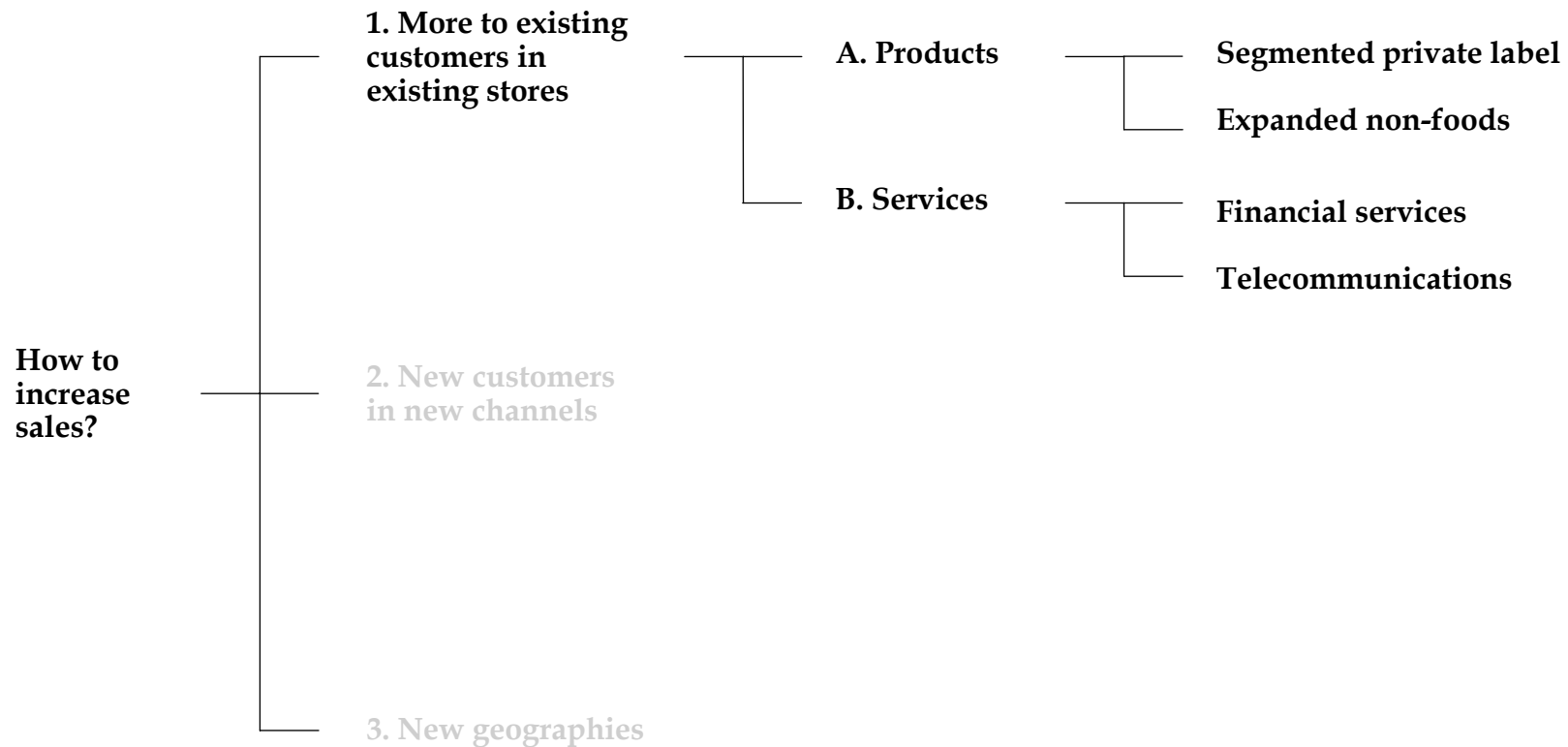
GROWTH STRATEGY OVERVIEW

This report explains Tesco's impressive growth as a result of three broad strategies



GROWTH STRATEGY OVERVIEW

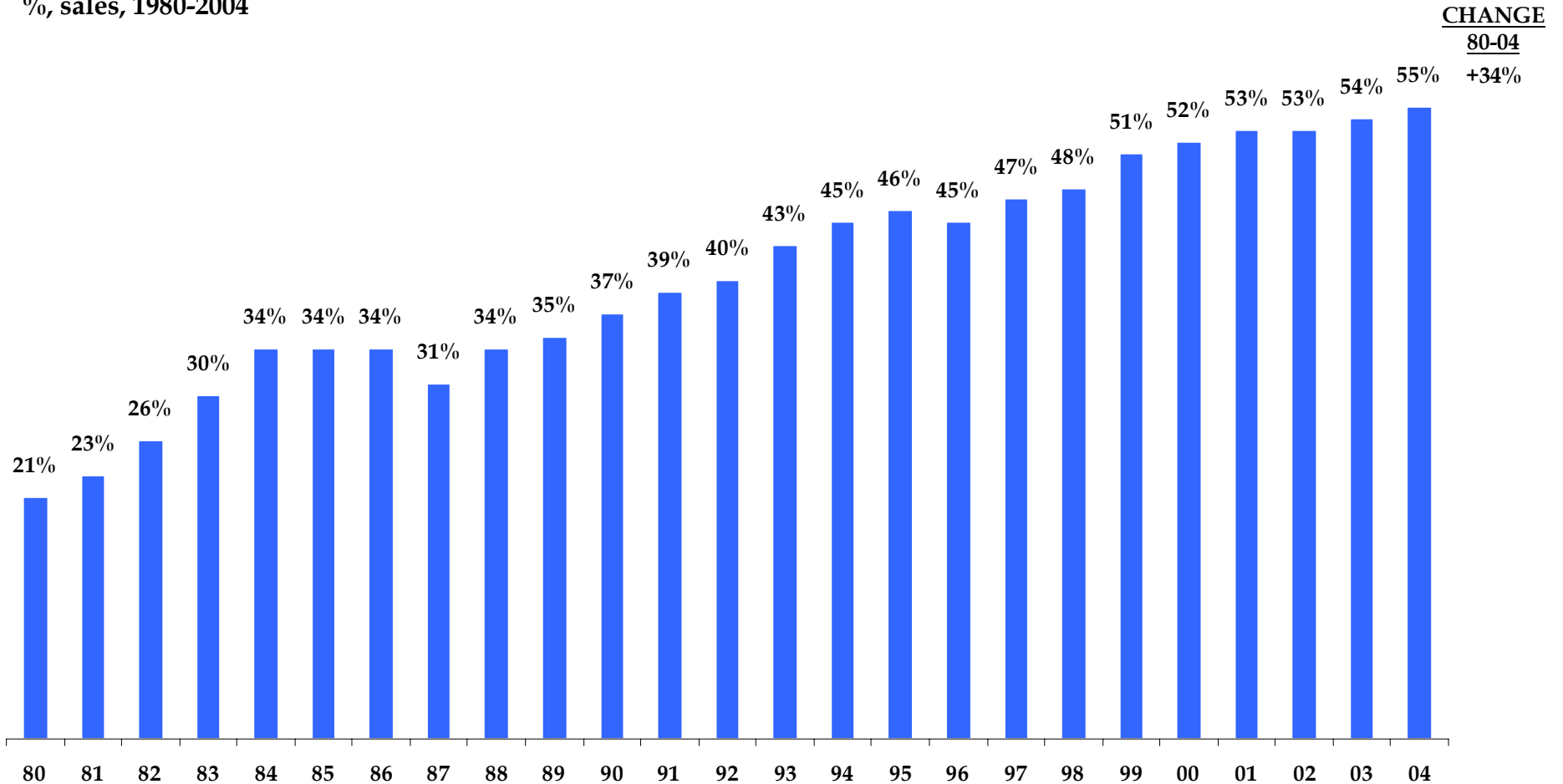
First, Tesco developed new products and services to sell to existing customers



1A. PRODUCTS - PRIVATE LABEL GROWTH

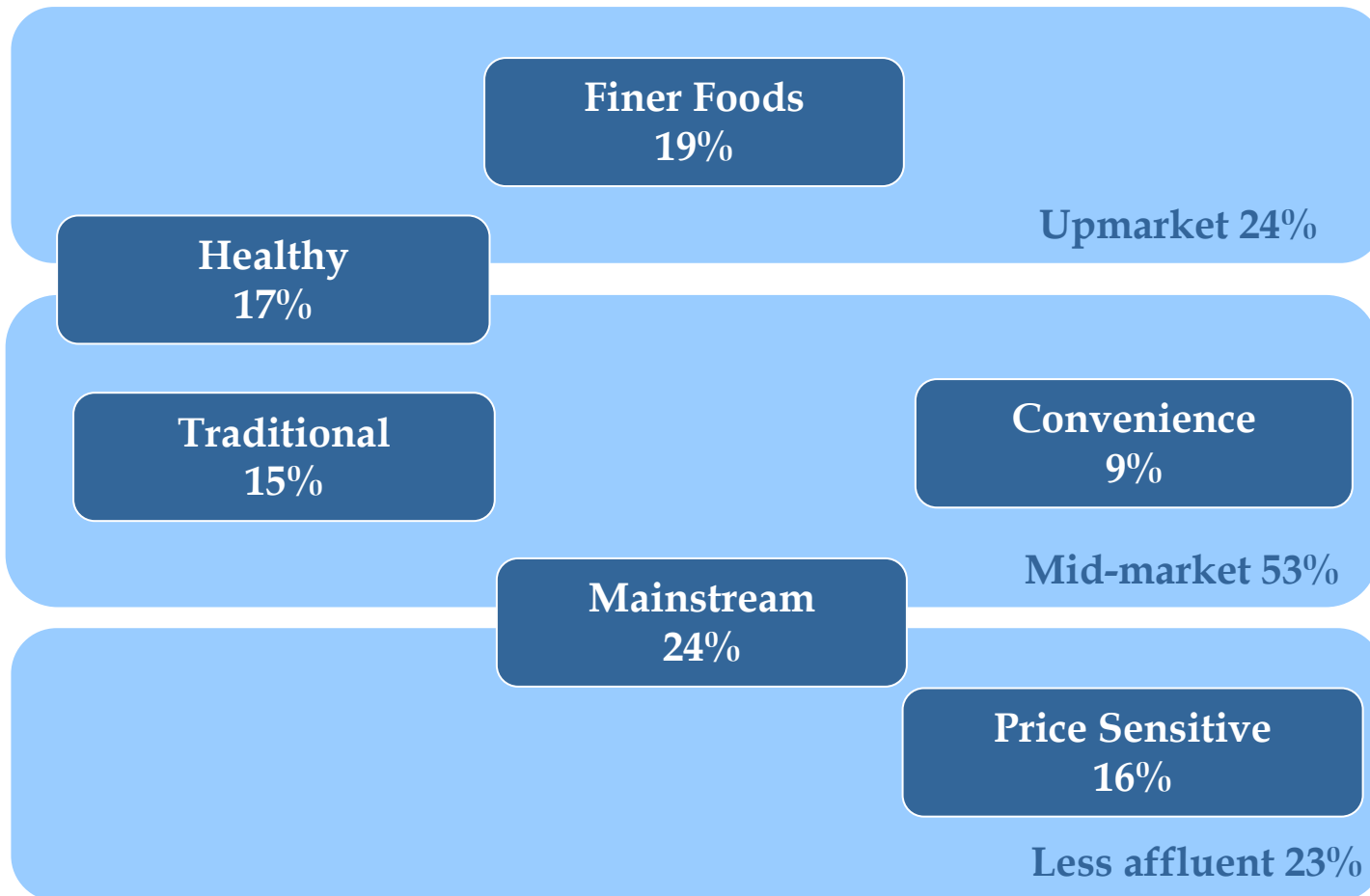
A strong and growing private label programme has been one of the key elements of Tesco's success

Tesco private label percent of sales¹
%, sales, 1980-2004

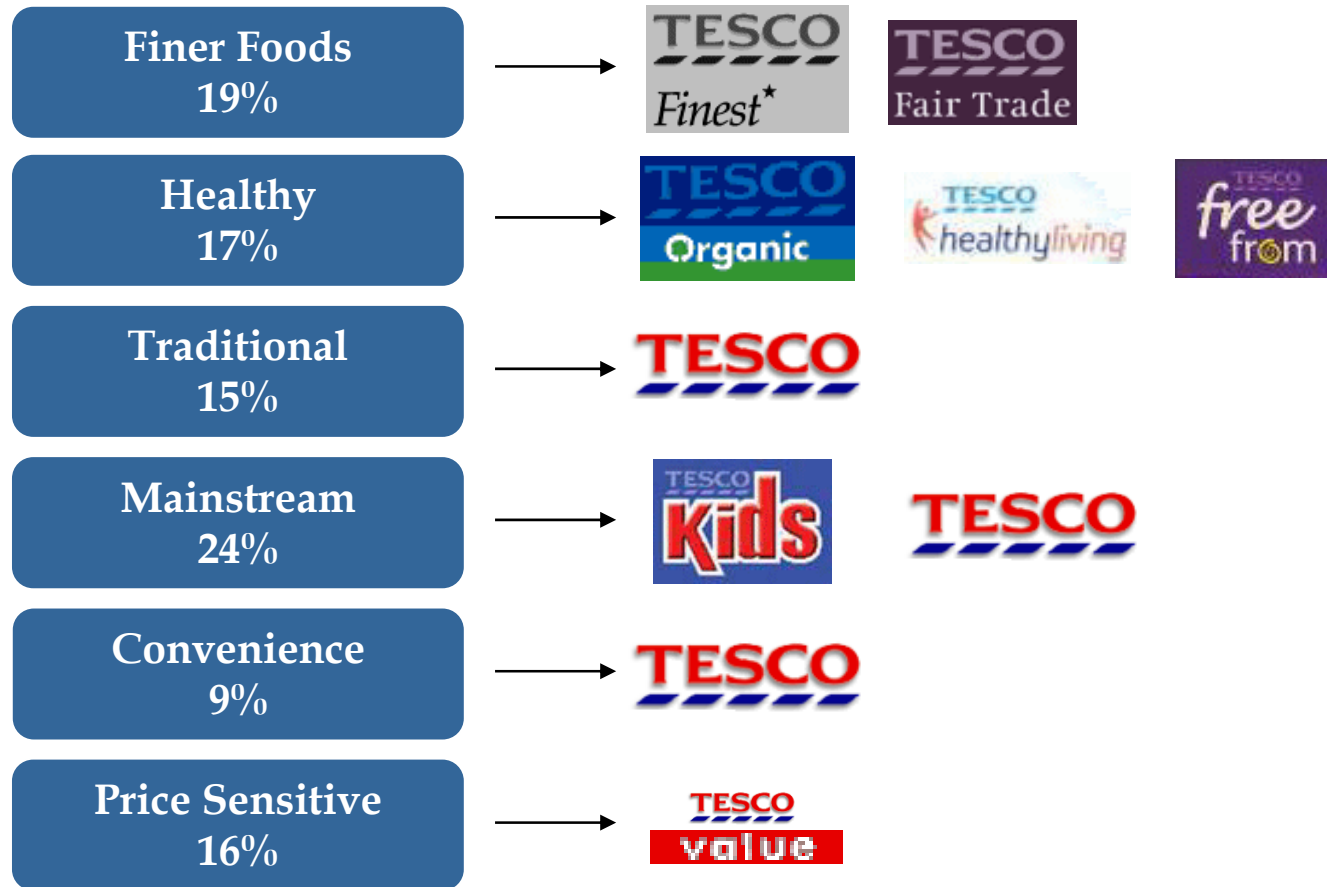


1A. PRODUCTS - CUSTOMER SEGMENTATION

Analysing data from its 10 million Tesco Clubcard holders, Tesco segmented its customers as follows:









1A. PRODUCTS - CUSTOMER SEGMENTATION DRIVES PRIVATE LABEL
 Tesco then launched brands targeting these identified segments



1A. PRODUCTS – PRIVATE LABEL ARCHITECTURE

While all private label products are labeled Tesco, the company uses sub-brands to segment the market

Tesco private label architecture

	# of lines	Strategy
	1,200	<ul style="list-style-type: none"> - Directly address Marks&Spencer - Super-premium product and price - Limited to high-value added items
	1,245	<ul style="list-style-type: none"> - Attract upmarket shoppers - Capture margin in new category - Aim to provide complete basket
	8,000	<ul style="list-style-type: none"> - Same quality as national brand - To be the brand to choice - Increase margins vs. branded
	1,200	<ul style="list-style-type: none"> - Directly address limited assortment (e.g. Aldi) - Cheap and basic - Limited to low-value added items
	600	<ul style="list-style-type: none"> - Targeting specialty niches with products - Recently renamed Healthy Eating to Healthy Living to stretch to non-foods
	50	<ul style="list-style-type: none"> - Aimed at children aged 5-11 years - Help parents improve diet - Minimum use of artificial ingredients

1A. PRODUCTS - EXAMPLE: FINEST PRIVATE LABEL ACROSS DEPARTMENTS

Tesco carries its private label brands across all departments

Examples of Tesco Finest by department

Bakery



Produce



Meat



Deli



Ready Meals



Dairy



HBC



Wine



Non-Foods



1A. PRODUCTS - IN-STORE SUPPORT

Tesco gives store brands strong in-store support



1A. PRODUCTS - PRIVATE LABEL EXAMPLE: EGGS

Examples of Tesco private label eggs
£, shelf price



£1.16



£1.55



£1.95

—————→
+68%

1A. PRODUCTS - PRIVATE LABEL EXAMPLE: BEANS

Examples of Tesco private label beans
£, shelf price



£0.11



£0.17



£0.21

—————→
+91%

1A. PRODUCTS – PRIVATE LABEL EXAMPLE: BAGGED SALAD

Examples of Tesco private label bagged salad
£, shelf price



£0.65



£0.99



£1.39



£1.79

—————→
+175%

1A. PRODUCTS - PRIVATE LABEL EXAMPLE: SOAP

Examples of Tesco private label soap
£, shelf price



£0.21



£0.88



£5.00

+2,280%

1A. PRODUCTS – PRIVATE LABEL SUCCESS

Tesco sees private label as a key element of its success

- **“Tesco selects, prepares and packages everyday products in dozens of different ways – from fresh to frozen, from value packs to gourmet treats, from raw ingredients to ready meals. We are continually innovating and investing in new lines to increase choice for our customers... The Tesco Finest range, introduced in February last year, has been a great success.”** *Tesco Annual Report 1999*
- **“This year saw the tenth anniversary of the launch of our Value brand and our prices today are cheaper than a decade ago. The price of 41 lines in a shopping basket in 1993 was £19.31. Today that cost is just £12.59, a saving of £6.72 or 35%. We have re-launched our Value packaging in a contemporary style and introduced new Cookshop, clothing, stationery and grocery lines. There are now 1,200 products in the Tesco Value range and 70% of Tesco customers buy from the Value brand.”** *Tesco Annual Report 2004*

1A. PRODUCTS – NON-FOODS: FOCUS ON FOUR AREAS

To achieve growth in non-foods, Tesco has focused on building its capability in four non-foods areas



Entertainment



Health & Beauty



Household



Clothing

1A. PRODUCTS - NON-FOOD: OBJECTIVES

Tesco sees non-foods a cornerstone of its future growth

- Tesco has set a goal of “being as strong in non-food as we are in food”
- “The strategy, which we set out some years ago, said we've got great locations, so why don't we sell them nonfoods and become as strong in nonfoods as in foods? What we've done is increase the size of our stores in two ways. One is to build bigger stores. Plus, we've extended a lot of our existing stores where we owned the land. That's been a pretty powerful thing... We have the same strategy on nonfoods as on grocery: If we can be 15% to 20% cheaper than the expensive British high street, customers will come to you. So if we sell them the right products at the right price at a convenient location, we're going to do well.” *David Reid, Chairman, Tesco, October 2003*

1A. PRODUCTS - NON-FOOD: CLOTHING

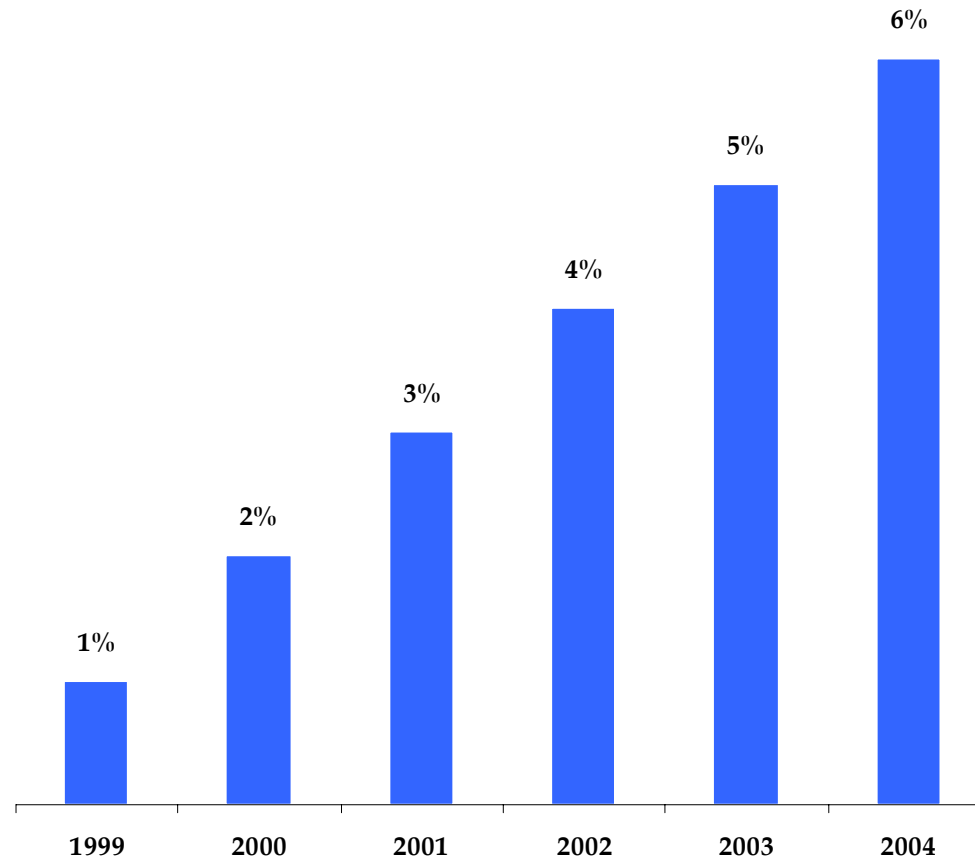
After struggling early-on, Tesco is achieving success in clothing



1A. PRODUCTS - NON-FOOD MARKET SHARE GROWTH

Tesco has grown its market share of total United Kingdom non-foods from 1% to 6%

Tesco non-food market share in the United Kingdom
%, 1999-2004



1B. SERVICES – EXPANSION INTO SERVICES

Tesco has expanded into five services

Tesco service offers

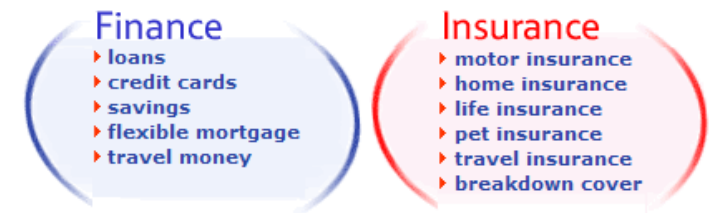
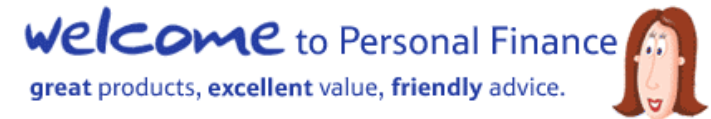
Product	Partner(s)	Year Launched	Details
Tesco Financial Services	Royal Bank of Scotland	July 1997	Created a 50/50 joint venture with a major bank Targeted Tesco Clubcard holders initially
Travel Services	Travelcare	Dec 2002	Focused on low-cost packages and travel deals Online travel sold through tesco.com Joint-venture with the UK's largest independent travel agent
iVillage.com	iVillage Inc. (US)	Dec 2000	The leading shopping and information website for women in the UK Tesco initially acquired a 50% stake; later 100% Expanding the brand into magazines and books
Tesco Telecom Fixed Line Telephone	Cable & Wireless Servista Vertex	Jan 2003	"Tesco Talk" home telephone service Offering lower prices than British Telecom
Mobile Phones	O2	May 2003	Created a 50/50 joint-venture with major UK mobile phone network Operated as a stand-alone business Initially pre-pay only; contracts later launched

1B. SERVICES – TESCO FINANCIAL SERVICES

Tesco Personal Finance (TPF) is a 50/50 joint-venture between Tesco and the Royal Bank of Scotland

Tesco financial services products

Product	Launched	Details
Clubcard Plus	1996	Grocery shopping budgetary account that allowed cheque deposits and cash withdrawals at checkouts (pre-TPF JV)
Tesco Visa	July 1997	
Savings account	Sept 1997	Instant access savings account
Home Insurance	April 1998	
Personal Loans	May 1998	Borrow from £2k to £25k for almost any purpose; over £700m in loans (2003)
Travel Insurance	June 1998	Including instant travel insurance pack purchased in-store
Tax-free savings	April 1999	ISA tax-free savings accounts
Pet Insurance	Oct 1999	Peace of mind for £7 to £10/month; over 330,000 pets covered
Motor Insurance	Nov 2001	Over 750,000 policies issues
Life Insurance	2001	Coverage from just £5/month Extended to include mortgage protection and critical illness options
Travel Money	2001	Travelers checks



1B. SERVICES - FINANCIAL SERVICE IN-STORE SUPPORT

Tesco gives its financial services offer strong in-store support and has TPF cash machines in every store



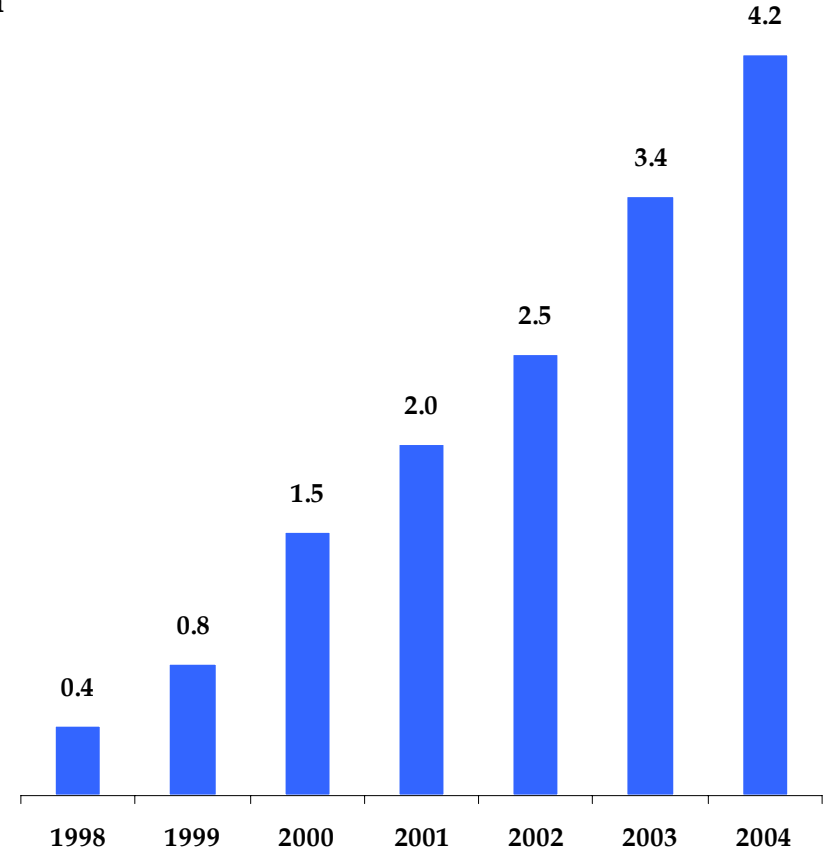
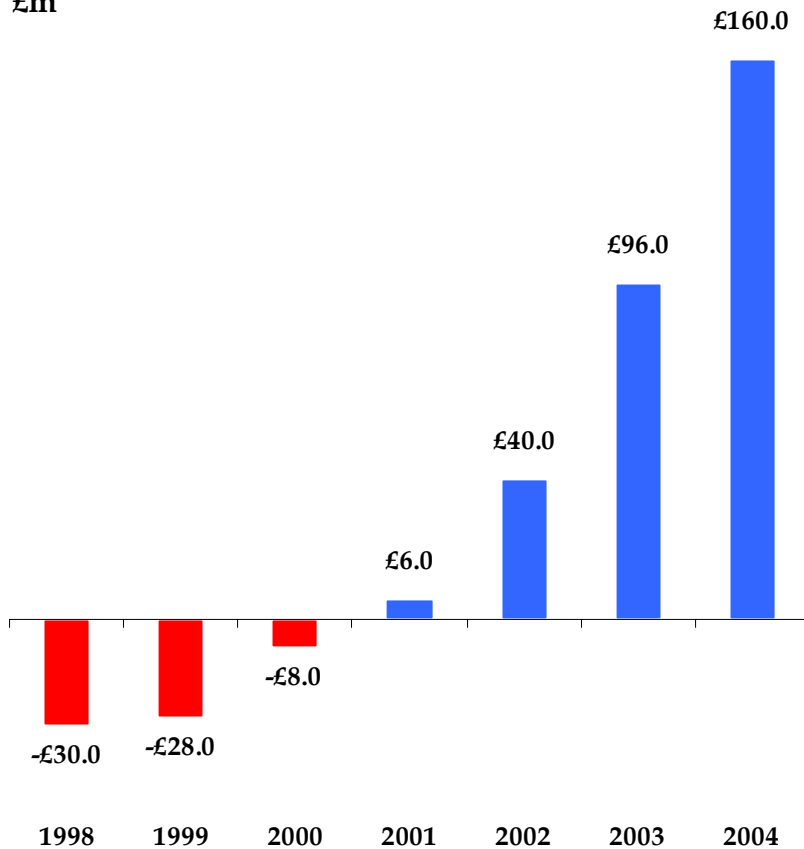
1B. SERVICES – TESCO PERSONAL FINANCE PERFORMANCE

Tesco Personal Finance made a profit of £160 million across 4.2 million customer accounts

Tesco Personal Finance performance
FY1998-FY2004

Pre-tax profit¹
£m

Number of customer accounts
m



1B. SERVICES – ONGOING DEVELOPMENT

Tesco continues to experiment with new ideas for services to sell its customers

new!

Legal Store

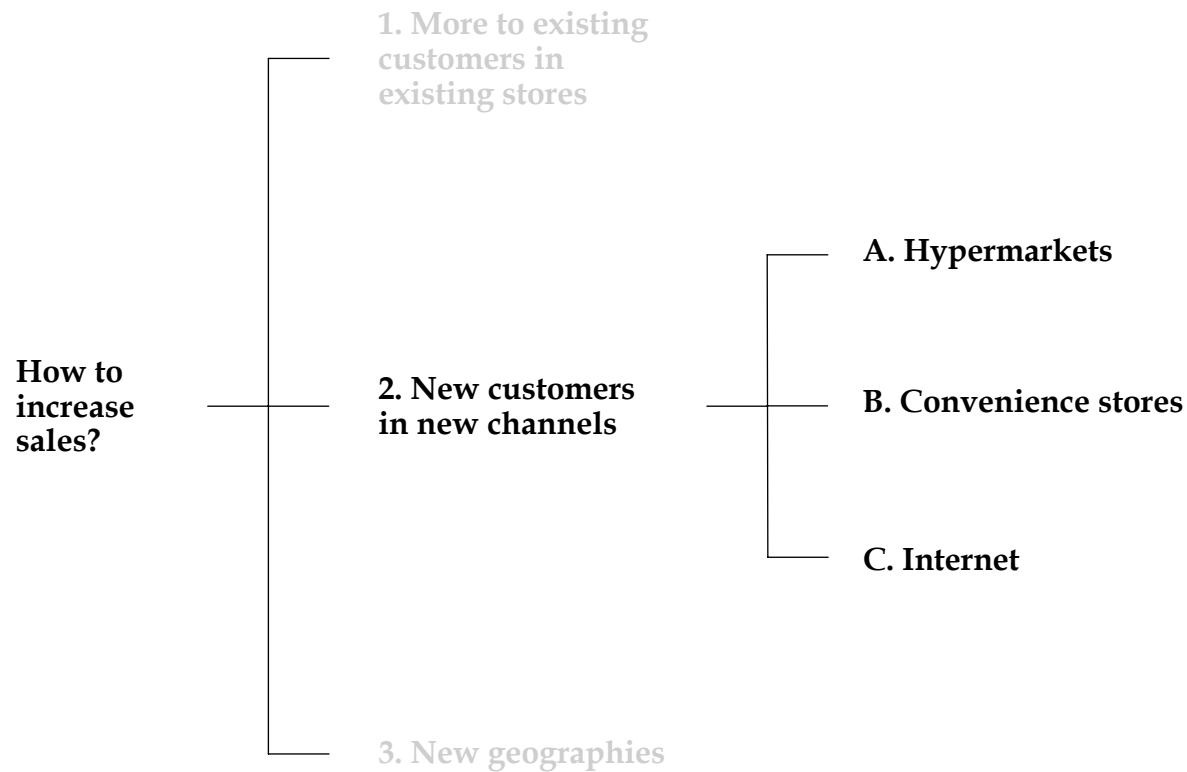
Legal help
from as little
as **£1.99**

DIY legal solutions at great value prices

The advertisement features a blue background with a white curved shape on the right. A red pound sign (£) is cut by a pair of scissors. Two legal forms are shown: 'Residential Lettings' and 'Last Will Statement'.

GROWTH STRATEGY OVERVIEW

Next, Tesco developed new store formats to capture more customers



2. FORMATS - FOUR TESCO STORE FORMATS

Tesco segments its store portfolio into four different store formats

Tesco UK store formats

Express



Metro



Extra



Superstore



2A. FORMATS - HYPERMARKET

The 70,000+ sqft Tesco Extra hypermarket format makes a strong one-stop-shop offer



2B. FORMATS – CONVENIENCE: METRO

The 10,000sqft Tesco Metro makes a limited supermarket offer in an urban location



2B. FORMATS – CONVENIENCE: EXPRESS






Tesco Express brings a limited supermarket offer to small spaces, either in conjunction with Esso or as a stand-alone fuel offer



2. FORMATS – TESCO STORE FORMAT CHARACTERISTICS

Tesco's store formats can be characterized as follows

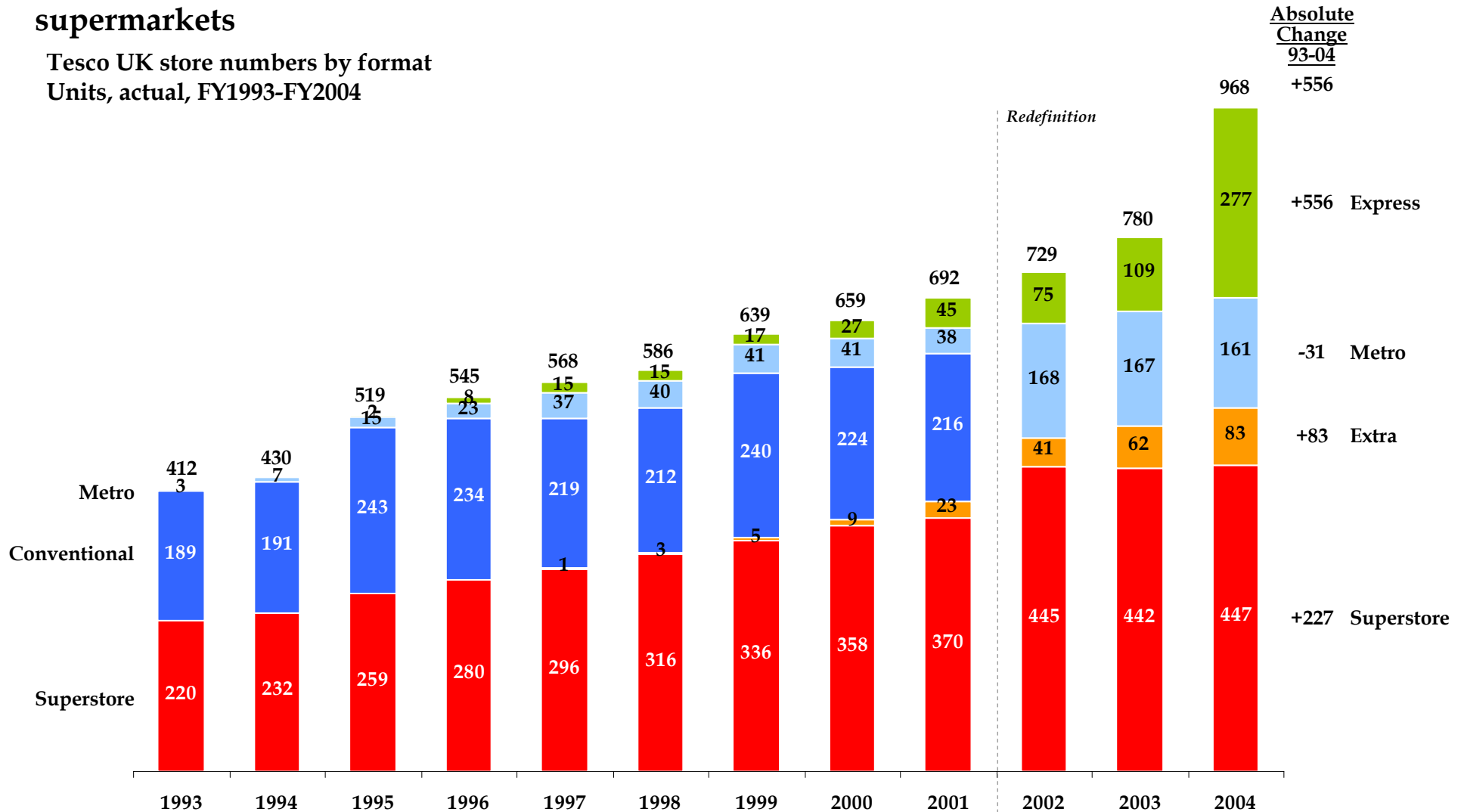
Tesco UK store format characteristics

Fascia	Format	# of units (FY2004)	Sales/store /week	Average sales area	# of sku	Purpose	Description
	Hypermarket	83		7,500m ²	50,000	Destination shopping	Very large stores offering the maximum food and non-food range
	Superstore	} 447		3,600m ²	30,000	One-stop weekly shop	Large stores offering a full range and many non-food products
	Compact Superstore			1,900m ²	25,000	One-stop weekly shop	Superstore range in a more compact environment
	Metro	161		1,000m ² +	10,000	Top-up	High street store/shops in large city centre shopping areas aimed at workers, shoppers and local residents
	Express	277	£53,000	200m ²	2,500	Impulse	Petrol station forecourt shops selling a range of everyday products

2. FORMATS - CHANGE IN STORE NUMBERS BY FORMAT

Tesco has focused on developing either large or small stores, moving away from conventional supermarkets

Tesco UK store numbers by format
Units, actual, FY1993-FY2004



2. FORMATS – STORE FORMATS

Tesco adapts its stores to meet the needs of its customers

- **“The different Tesco store formats are designed to suit the varied shopping patterns of our customers. The flexibility they provide also helps us meet the changing demands of planning policy. In designing new stores, we take account of the specific needs of the local community and are careful to ensure that architecture and landscaping are in sympathy with the surrounding area... Improvements in our ordering and distribution systems now allow us to supply smaller compact stores in areas which were previously difficult to serve. ” *Tesco Annual Report 1995***
- **“We tailor our stores to meet our individual customers. requirements and all our formats provide a different shopping experience. Our portfolio of stores: Extra, Superstore, Metro and Express are all different store types but all offer outstanding value.” *Tesco Annual Report 2004***

2C. FORMATS - INTERNET

Tesco is the world's leader e-grocer with operations on three continents



try shopping
from home
this year!
at www.tesco.com

shop
from home
today!

The graphic features a blue background with white and red text. At the bottom, there is an image of two Tesco shopping bags filled with fresh produce like apples, oranges, and a pineapple. A red circular badge with white text is overlaid on the bottom right of the graphic.



2C. INTERNET - TESCO.COM FACTS

Tesco.com is one of the few success stories in selling groceries on the internet

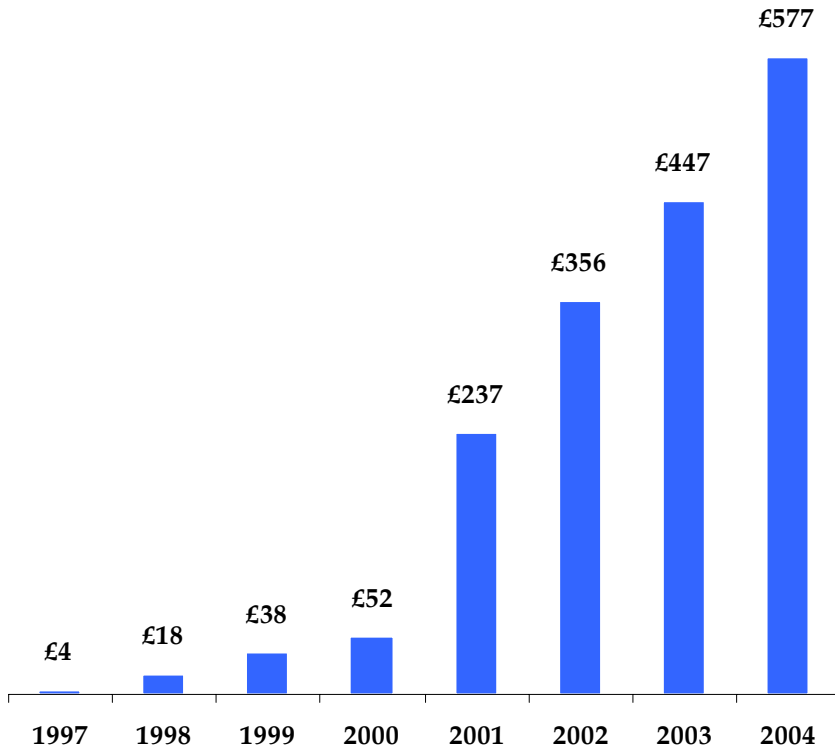
- **World's largest internet based grocery retailer**
- **Second largest e-tailer after Amazon**
- **International Expansion**
- **Expanded to international markets**
 - **Republic of Ireland**
 - **South Korea**
 - **United States (with Safeway USA; Purchased 35% of Grocery Works in Texas)**
- **93% of shoppers use their favorites list (basket of past purchases)**
- **Majority of customers are parents**
- **Busiest time for ordering is Thursday evening between 9-10pm**

2C. INTERNET - PERFORMANCE

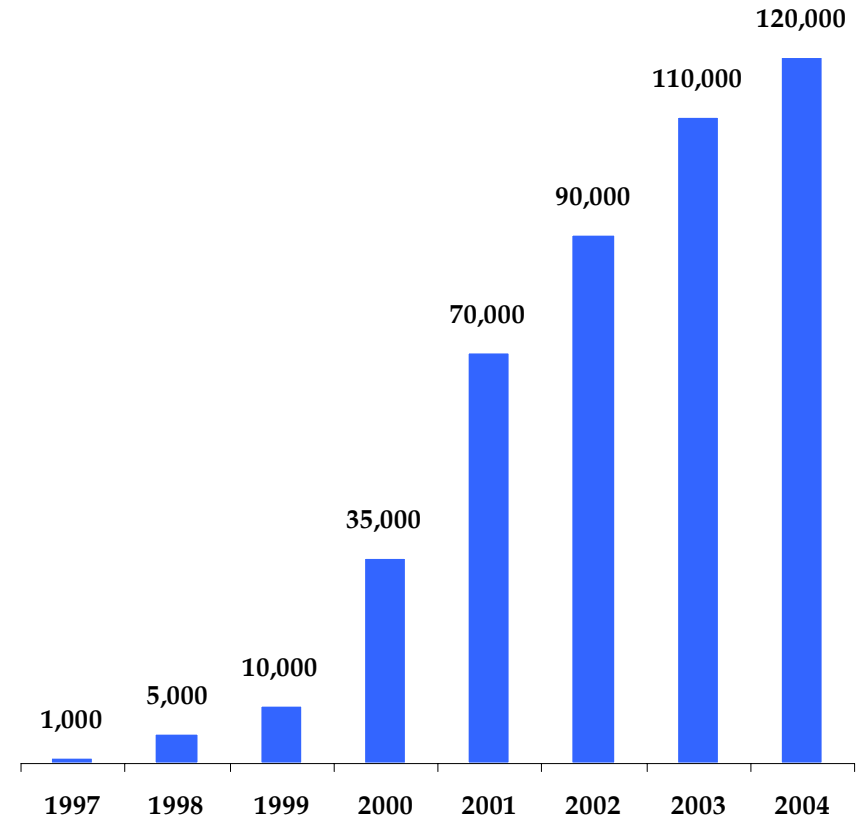
Tesco.com has shown strong sales growth driven by strong order growth

Tesco.com performance
FY1997-FY2004

Internet sales
£m

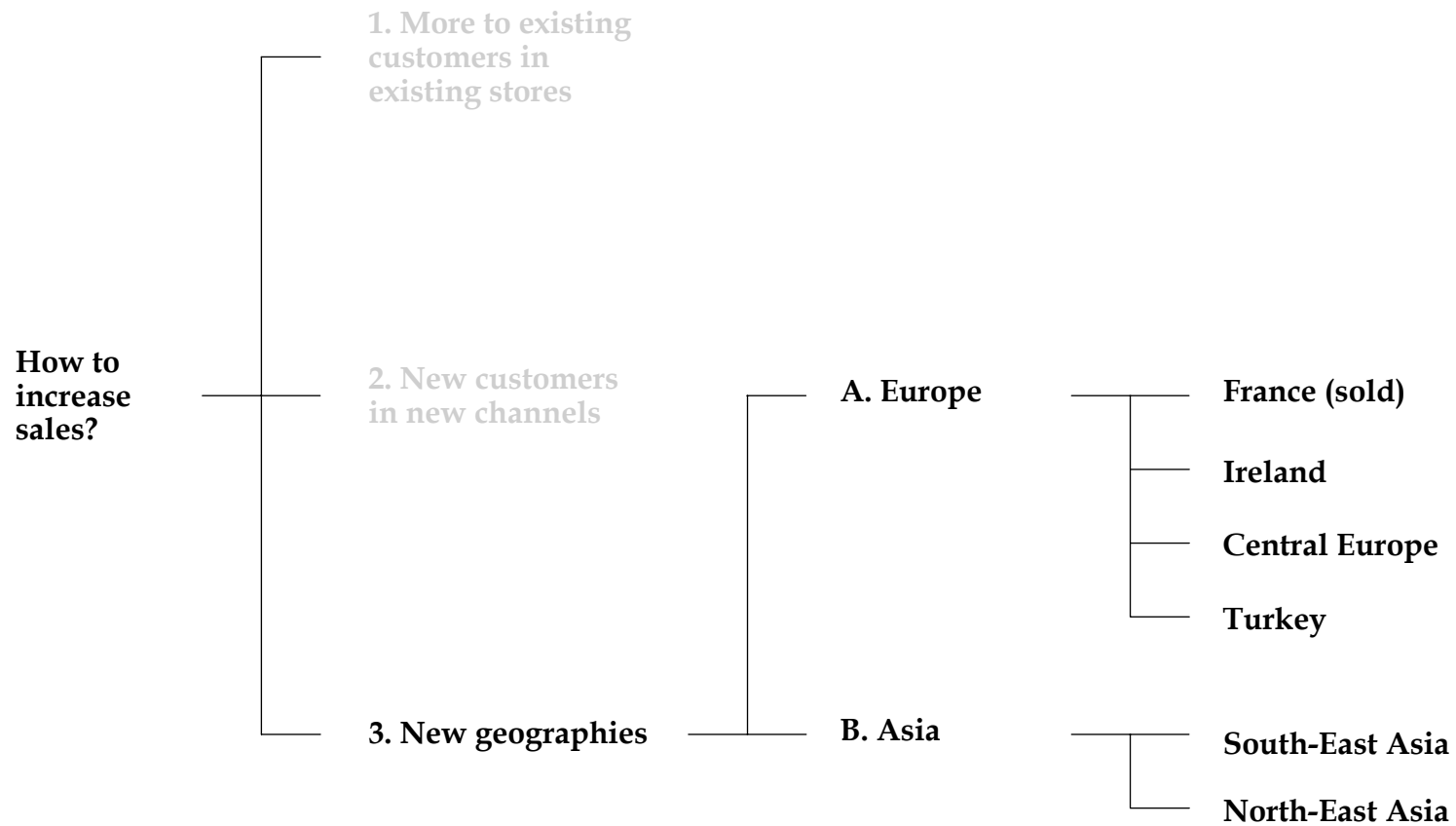


Average orders per week
Actual



GROWTH STRATEGY OVERVIEW

Third, Tesco expanded into Europe and Asia



3. NEW GEOGRAPHIES – TESCO'S FIVE PREREQUISITES

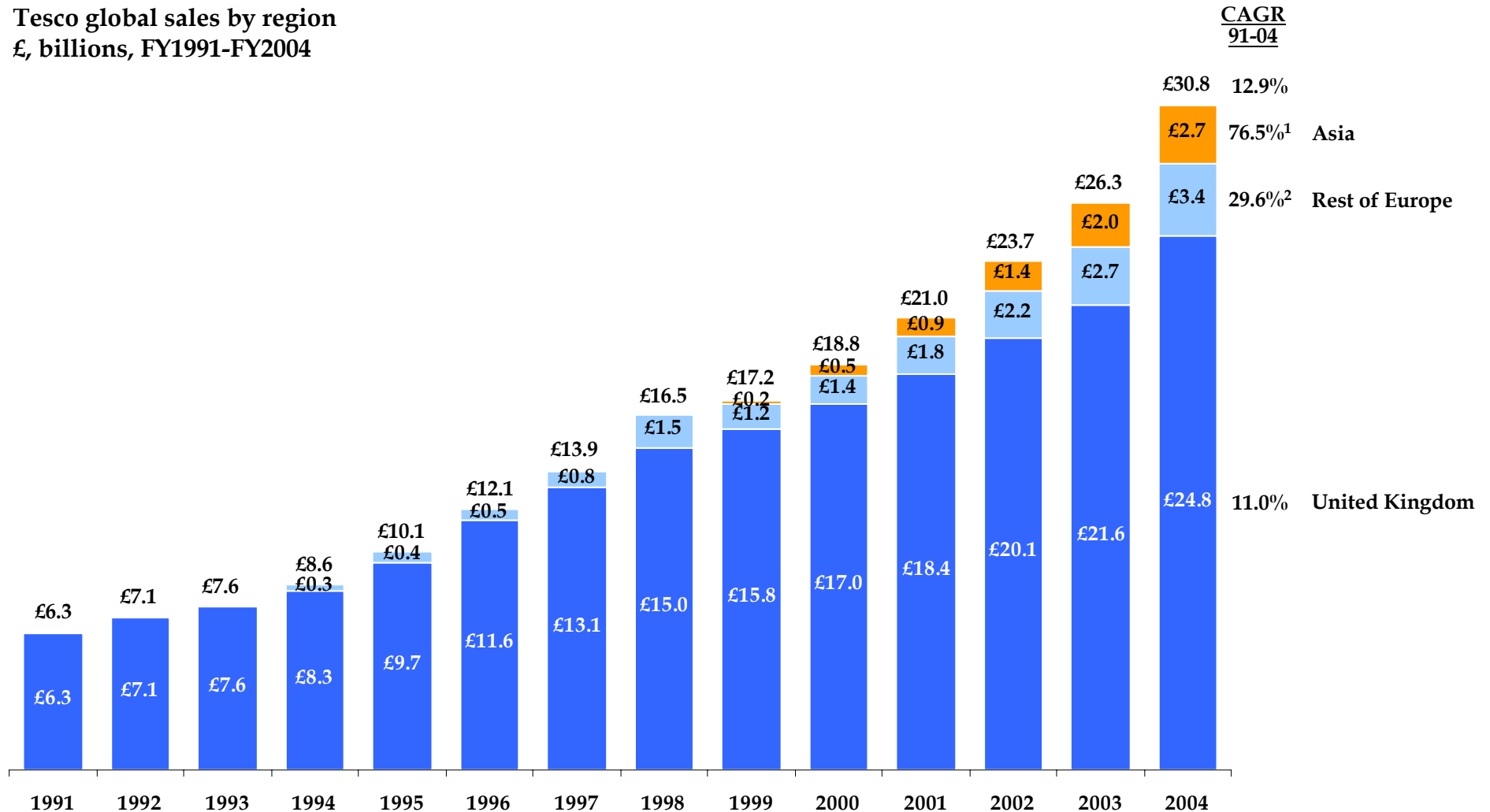
Tesco identified five prerequisites for new international markets targeted for expansion

Objective	Key points
Large market	Must add meaningful scale to existing United Kingdom business
Growth market	Participate in strong organic growth and strong like-for-like store growth
Underdeveloped retail market	Set up early, buy the best sites, introduce modern retailing Underdeveloped markets = underdeveloped competition
Opportunities for mass merchandise	Hypermarkets/supercenters as the vehicle for growth Skipping the supermarket phase in developing countries
Market-leading position	Scale creates both a defensive position and growth leadership Market leadership usually associated with higher returns

3. NEW GEOGRAPHIES - GLOBAL SALES GROWTH BY REGION

Tesco has financed its global growth with the profits of its UK operations

Tesco global sales by region
£, billions, FY1991-FY2004



3. NEW GEOGRAPHIES - COUNTRIES OF OPERATION

Tesco is rapidly expanding internationally and now has operations in twelve countries

Europe



United Kingdom
Republic of Ireland
Hungary
Poland
Slovakia
Czech Republic
Turkey

Asia



Thailand
South Korea
Taiwan
Malaysia
Japan

3. NEW GEOGRAPHIES – TESCO COUNTRIES OF OPERATION

Tesco has a range of operations and competitors around the world

Tesco by country

Country	Year of Entry	Entry Method	# of units (FY2004)	Sales (£m)	Average store area (sqft)	Key competitors
United Kingdom	1924	-	1,878	£24,760m	25,800	Sainsbury, Wal-Mart, Morrisons
Ireland	1978 (failed) 1997	Acquisition Acquisition	- 82	- £1,234m	- 22,117	- Dunnes, Superquinn, Musgrave
France	1993 (sold 1998)	Acquisition	-	-	-	Carrefour, Auchan
Hungary	1994	Acquisition	60	£818m	46,585	Interspar, Auchan
Poland	1995	Acquisition	69	£665m	50,773	Dohle, Metro, Auchan Casino, Carrefour
Czech	1996	Acquisition	22	£374m	94,588	Lidl & Schwartz, Ahold, Globus, Spar, Carrefour
Slovakia	1996	Acquisition	23	£277m	81,118	Metro, Rewe, Lidl & Schwartz, Carrefour, Ahold
Thailand	1998	Acquisition	64	£935m	92,692	Casino, Makro, Carrefour
South Korea	1999	Acquisition	28	£1,446m	101,190	Carrefour, E-Mart, Magnet, Wal-Mart
Taiwan	2000	Organic	4	£98m	109,667	Carrefour, Casino, Auchan, Makro
Malaysia	2002	Organic JV	5	£77m	105,333	Dairy Farm, Carrefour
Japan	2003	Acquisition	78	£113m	3,000	Ito-Yokado, Aeon, Daiei, Uni, Seiyu (Wal-Mart)
Turkey	2003	Acquisition	5	£18m	76,400	

3. NEW GEOGRAPHIES – ACQUISITIONS

Tesco typically enters new countries by buying a well run retail chain

Date	Company	Acquisition Form	Purchase Price	# of stores	Details
June 1994	Global TH	57%	£15m	44	Purchased share of 44 store publically listed Hungarian chain; average store size 3,000sqft
Sept 1994	Wm Low & Co.	100%	£257m	57	Regional supermarket chain with 45 stores in Scotland and 12 England
Dec 1994	Catteau	final 5%	£9m		Increased stake in Catteau to 100%
Nov 1995	Savia	100%	£8m	36	Small retail chain in southern Poland; average store size 5,280sqft
April 1996	Kmart Czech & Slovakia	100%	£77m	13	Retail food and general merchandise business of US retailer Kmart in former Czechoslovakia
May 1997	ABF Retail	100%	£643m		Acquired Food Retaining business of Associated British Foods in Northern Ireland and Republic of Ireland
1998	Lotus	49%	£200m	13	Tesco owns 49% of Tesco Stores Thailand which acquired 75% of Lotus (£270m sales); Charoen Pokhand owns remainder
Mar 1999	HomePlus	81%	£142m	2	Purchased share in two hypermarket operation from Samsung

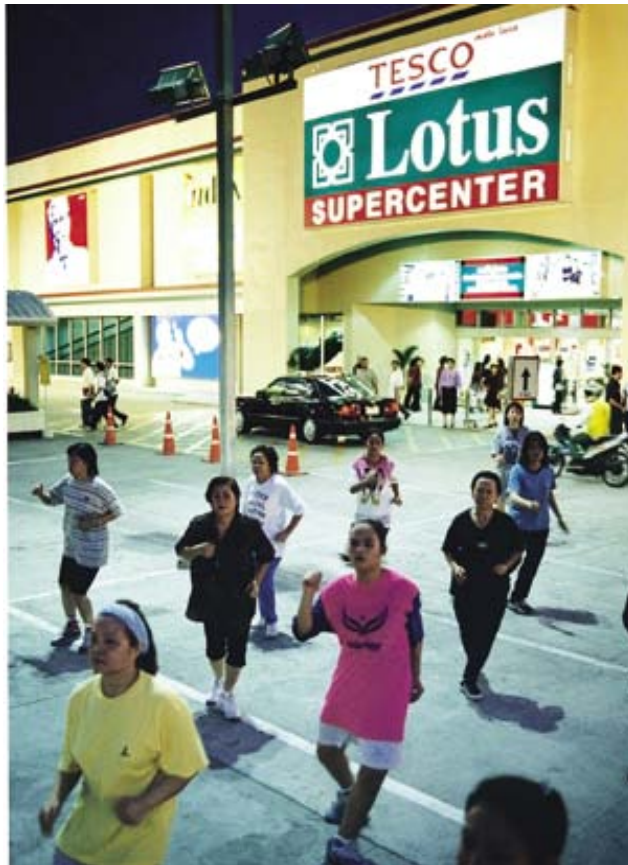
3. NEW GEOGRAPHIES - ACQUISITIONS

Tesco typically enters new countries by buying a well run retail chain (continued)

Date	Company	Acquisition Form	Purchase Price	# of stores	Details
2003	T&S	100%	£520m	870	UK chain of convenience stores trading under One-Stop name
2003	HIT	100%	£350m	13	Purchased chain of hypermarkets and two sites from Dohle Germany
June 2003	C Two Network	100%	£139m	78	Chain of smaller stores in Tokyo region
Nov 2003	Kipa	51%	£75m	5	Small chain of five modern hypermarkets in Izmir in western Turkey with sales of £124m; initial stake raised to 84.3%

3. NEW GEOGRAPHIES

Tesco now has operations on two continents



3. NEW GEOGRAPHIES – ACHIEVE LEADERSHIP OR EXIT

Tesco has learned that it must achieve leadership or exit a market

- ***“Our strategy is to expand rapidly and become the strongest player in the markets we operate in.” Paul Kennedy, CEO, Tesco Hungary, September 2003***
- ***“Tesco always acknowledged that owning (and even organically developing, prior to planning restrictions) Cateau in 1993-97 was never an end in itself. However, when the opportunity to take the next step forward emerged (to acquire some or all of Docks De France in 1996), Tesco could not justify the considerable outlay (c. £2 billion) to itself in returns terms (and in the short time allotted). And we can add that many shareholders were relieved that Tesco made this decision.” Morgan Stanley, Jan 1999***

3. NEW GEOGRAPHIES – WHERE NEXT?

Tesco has a number of options for future growth...

- **"We're not in South America, happily. We've been pretty careful. We haven't invested in Russia or Indonesia. You have to make choices about where you go. We don't always get it right, but we're pretty happy about our country selection. So far, so good."** *David Reid, Chairman, Tesco, October 2003*
- **"We never say never to the U.S. It's a big market, it's a good market in many ways. If we could find the right way, we'd obviously have a look at it. We're very cautious because Britain doesn't have a great track record over there. But equally, if Tesco is in Europe, in Asia, then maybe one day it will be in the U.S."** *David Reid, Chairman, Tesco, October 2003*
- **"We don't want to be sitting here in 10 or 15 years' time saying China has been a great success and what a shame Tesco wasn't there."** *David Reid, Chairman, Tesco, Sept 2003*
- **"Tesco is considering an audacious £10bn swoop on the assets of Ahold, the troubled Dutch supermarket giant whose shares tumbled 64 per cent last week after it revealed accounting problems at its US and Argentinian operations... The most attractive assets are the Dutch supermarket business and the two US operations not hit by the accounting scandals, Stop & Shop and Giant."** *The Independent, Mar 2000*

3. NEW GEOGRAPHIES – TESCO IN THE UNITED STATES

There are a number of potential scenario's for a Tesco entry into the US market – a market it needs to be in if it intends to continue to battle rival Wal-Mart



Build on internet
relationship; bring some
new ideas



Buy and fix a troubled
giant



Bring world-class food
skills; gain world-class
non-foods skills