Turnaround priorities

Regaining competitiveness

Over the course of this year, we have worked hard to regain our competitiveness – particularly in the UK. To do this, we first listened to our customers and understood what it was that they needed from their shopping trip.

They highlighted three main themes:

• they wanted their shopping trip to be easier;
• they wanted better availability on the products that matter most, every day; and
• they wanted lower, more stable prices they can trust all of the time.

Over the past year, we have responded. We simplified our store structures, investing in 9,000 more customer-facing roles in store. We have reviewed the range of products we sell in every one of our 33 food categories, reducing the total number of product lines by 18%. As well as making the range easier for customers to shop, this has helped us to increase on-shelf availability to record levels by providing more space for the products which are purchased most frequently.

These changes have been delivered by working closely with our supplier partners. Together, we have moved to a more efficient and sustainable way of working, helping us to further reduce prices for customers. In total, in the year we have brought down the cost of an average weekly shop by over 3%. In addition, by removing inefficiencies in the supply chain, we have been able to provide up to two days’ more freshness in our fruit and vegetables.

As well as lower, more stable prices, customers want complete peace of mind that they won’t lose out at Tesco – even if the products they wish to buy are available on promotion elsewhere. They also prefer simple, immediate value rather than vouchers. In October, we launched our unique Brand Guarantee, reassuring customers that if their branded shop could be found more cheaply elsewhere, we would take the money immediately off their bill.

The progress we have made is being recognised. We measure customer satisfaction through our Customer Viewpoint Survey – a weekly measure that captures direct customer feedback in every store. In total, we have seen an improvement of 5% in the proportion of customers rating overall service and colleague helpfulness as excellent, and every individual measure below this has also improved.

The clearest sign that we are more competitive again is that more customers are buying more things at Tesco. We have seen sales volumes and weekly transactions improve throughout the year, generating annual positive volume growth for the first time in five years. Volumes were up 3.3% and transactions were up 2.8% in the fourth quarter.

We are encouraged by our progress but we know that there is a lot more we can do and that we can continue to become even more competitive by putting the customer at the heart of every decision we make.

For more information visit www.tesco.com/brandguarantee

Brand Guarantee

If a customer’s branded grocery shop is cheaper at Asda, Morrisons or Sainsbury’s, when they buy 10 or more different products, we instantly take the money off the bill at the till. We even compare branded promotions, so customers can check out with confidence there and then. No vouchers, no waiting, no wondering if there’s a better deal elsewhere. We’ve introduced this because it’s the right thing for customers – and we’re very proud of it.
Protecting the balance sheet

We have made significant progress towards our aim of protecting and strengthening the balance sheet this year, reducing our total indebtedness by £6.2bn. A strong balance sheet gives us more flexibility to invest in improving the shopping trip for customers.

We have taken a number of actions to strengthen our position:

• repositioned the finances of the Group through the sale of our Homeplus business in Korea, which itself reduced total indebtedness by £4.1bn;

• provided sustainable benefits for colleagues and a greater certainty on future cash requirements by replacing the UK defined benefit pension scheme with a defined contribution scheme;

• improved the potential for medium-term returns by consolidating the Central European businesses;

• taken a much more disciplined approach to capital investment and delivered, as planned, a significant reduction in total expenditure;

• adopted a new approach to cash payments to suppliers as part of our efforts to build trusted and transparent relationships; and

• increased our ownership of freehold property, reducing exposure to index-linked and fixed-uplift leases.

We have begun to make a big cultural shift in the way colleagues think about the finances of the business, with a much improved understanding of the importance of cash. All colleagues are asked to think about the impact they can have on improving the cash flow in the business, whether that be through reducing slow-moving stock in our warehouses or making our shop floor operations more efficient.

Our firm focus on generating cash from our trading activities and maintaining discipline in our capital expenditure will be key to making further progress in protecting and strengthening the balance sheet going forward.

Property ownership
Our long-term aim is to increase the ownership of our property and reduce our exposure to index-linked and fixed-uplift inflation.

In March 2015, we completed an asset swap with British Land, regaining sole ownership of 21 superstores and in February 2016, we regained sole ownership of 49 large stores and two distribution centres from Phoenix Life Assurance and the British Airways Pension Fund.

These transactions increased our freehold ownership ratio in the UK & ROI by 6% to 47% and generated a saving in fixed-uplift and index-linked rent of £115m per annum at current rental levels.

We continue to evaluate opportunities to further reduce our exposure to indexed rent inflation.
We also became the first UK retailer to publish payment terms with suppliers.

The Supplier Network which we launched at the start of 2015 has now grown to more than 5,000 members, and we set up a special helpline for suppliers to solve any issues that may arise within 48 hours.

Our latest Supplier Viewpoint measure of how suppliers view their relationships with Tesco recognises the positive impact of all these changes. The results show a significant improvement year-on-year, increasing from 51% to 68% in the UK and from 58% to 70% for the Group as a whole.

We have also made a number of changes which aim to help shareholders and other stakeholders understand our performance. These include much greater alignment between the way we run the business internally and the way we report our results externally and a move to operating profit as our headline performance measure, adjusted only for any large and distorting impacts.

Tesco today is a very different business. We are proud of how our colleagues and suppliers have responded to the changes we have made. Our customers are noticing the differences too – they’re enjoying better service and buying more of what they need at Tesco. And our journey will continue, guided by our commitment to serve shoppers a little better every day.

Dairy farmers

The groundbreaking Tesco Sustainable Dairy Group, set up in 2007, continues to give farmers fair prices and deals for their milk.

In our commitment to dairy farmers, all Tesco own-label standard-tier yoghurt is now made with milk sourced from Britain with the exception of those with protected origins – including authentic Greek yoghurt and French fromage frais. This has seen us increase the amount of British milk in our standard-range yoghurts from two-thirds to 100% and has increased the demand for milk from farms across the whole country.

We have also extended our financial support for First Milk farmers who supply milk for our own-label cheese to help cover production costs throughout the winter and into the spring.

Visit www.tescoplc.com/ar2016 to see more about our supplier relationships

Sadly, trust in our brand has been eroded in recent years. Trust should never be taken for granted and it will take time and perseverance to restore it fully.

We are working hard to rebuild that trust with our colleagues, customers, suppliers and other key stakeholders and want to build more open and transparent relationships.

We are giving customers lower, simpler and more stable prices to ensure they can trust Tesco to deliver the best shopping trip at the best price. And having listened to customer feedback, we are redirecting promotional spend into shelf-edge prices.

In addition, we have completely reorganised our relationships with suppliers. In October 2014, we drew a line under our past and started to reset the way we work. We refocused on new performance measures and retrained our teams.

We have fundamentally changed the way we operate and have implemented significant initiatives that improve the way we work with suppliers and our commercial culture, and simplify how we buy and sell.

We have completely changed our Product team structure, focusing on getting the offer right for customers and prioritising sales and total profit over margin rate.

Rebuilding trust and transparency

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Turnaround priorities continued