

Risk Management in Tesco plc

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Context: The nature and size of the business

Ranked 4th in the world in Deloitte's "Global Powers of Retailing" list 2009/10

Operates across a range of formats:

- Convenience/Forecourt Stores; Department Store; Discount Department Store; Hypermarket; Supercenter; Superstore; Supermarket

2000 Tesco.com launched

2010 Tesco Personal Finance rebranded as Tesco Bank

UK based but total overseas floor space now 80% greater than that within the UK

Geographic Spread of operations

Country/Region	Number of Stores		Retail Space (millions of square metres)	
	2004	2009	2004	2009
Year ending (February)				
United Kingdom	1878	2282*	2.39	2.91
Rest of Europe: Republic of Ireland, Czech Republic, Hungary, Poland, Slovakia, Turkey	261	863	1.09	5.11
Asia: Malaysia, South Korea, Taiwan, Thailand, Japan, South Korea, India	179	1047	0.95	
USA	0	115	0	0.2**
Total Non-UK	440	2,025	2.22	5.31
TOTAL	2,318	4,307*		8.22

*Excludes 28 Dobbies stores

** Calculated from global total less known regional statistics

Key Statistics

Year ending (February)	<u>1995</u>	<u>1999</u>	<u>2004*</u>	<u>2009</u>
<u>Turnover excluding VAT (£ Million)</u>	9655	15835	24760	38,191
Rest of	4616	1167	3385	8,862
Asia (excluding)	Nil	156**	2669	7,068***
	Nil	Nil		702
TOTAL	<u>10,101</u>	<u>17,158</u>	<u>30,184</u>	<u>47,298</u>
Group Operating Margin	6.1%	5.6%	5.9%	5.9%
Profit before taxation (£m)	551	842	1600	2954
Earnings per share	6.9 p	9.59p	16.45p	28.92p
Full time equivalent employees	68,552	108,284	152,408	468,508
Total Sales Area (thousands of square feet	12,641	15,975	45,402	88,451

*53 weeks

** Thailand only

*** Includes China in 2009

Managing growth and managing risk

Statistics suggest sustained growth

Pattern of growth indicates strategies are continually evolving

Operating margins are relatively constant

HOW??

A Simple Approach

“having a risk management function probably gets in the way of actually managing the risks because people are thinking about the risks as opposed to thinking about the customer, so all we are worried about is serving the customer and what can go wrong with that.”

Head of Internal Audit

Core risks

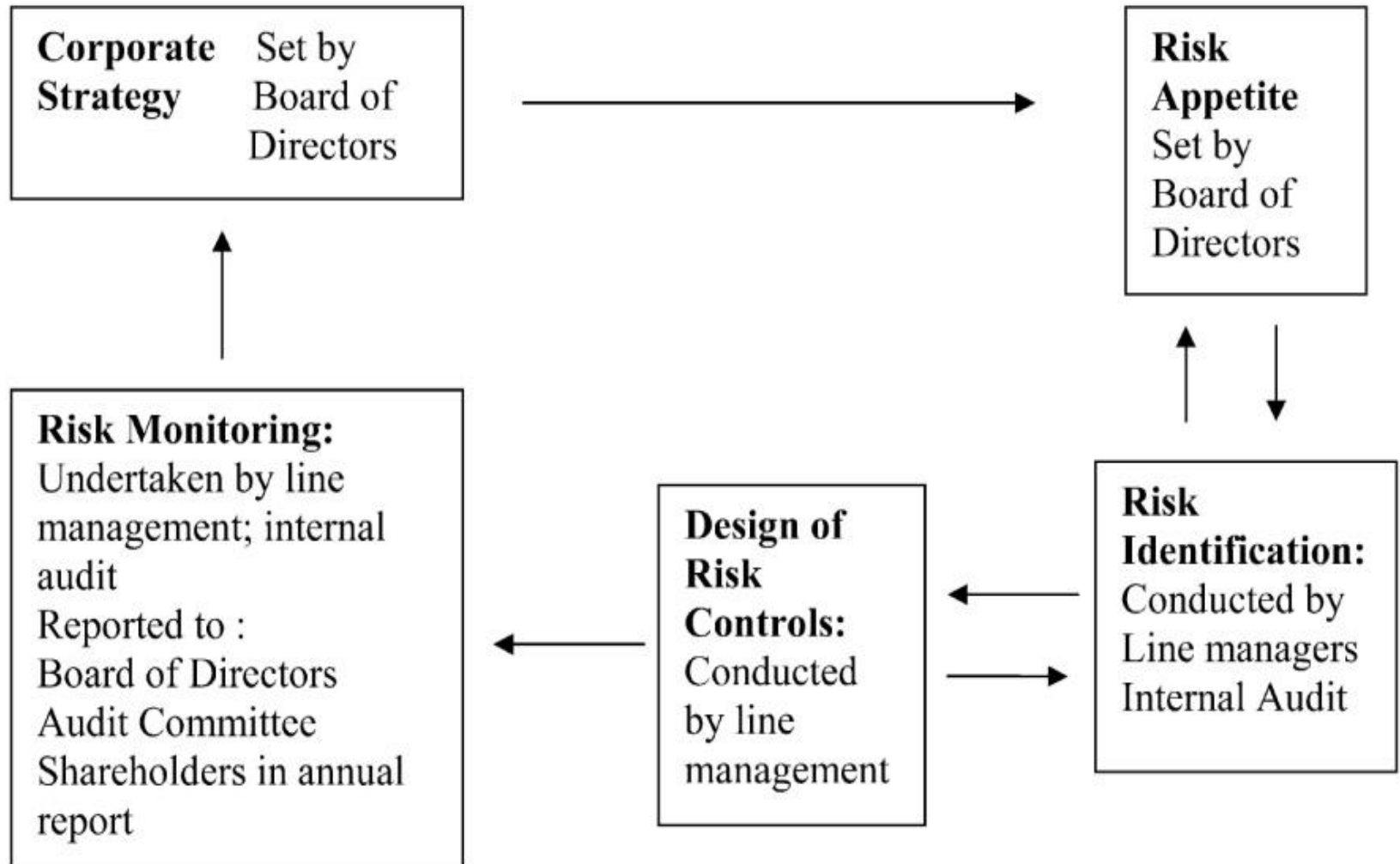
Fundamentally simple retail distribution

business comprised of six core processes:

- buying products from suppliers
- sending them to a distribution centre
- transferring goods from the distribution centre to the stores
- taking cash
- banking the receipts

Primary risks are threats to these processes

Risk management model



Key elements of risk management in practice

Group level

Key risk register maintained by Internal Audit – updated regularly; register identifies “owners” and responses

Annual Board meeting dedicated to reviewing strategic risks

Audit Committee annually reviews the internal control system; also proactive eg call in line managers ; trips to Korea!

Compliance Committee – meets 6x per year

Finance Committee – sets Treasury limits

Internal Audit monitor (using risk based planning) & facilitate risk management

Key elements of risk management in practice

Sub Group Level

International CEOs & local boards hold own risk registers

CEOs must issue annual assurance statements that Board governance systems are in place

Same process at functional level

National level key boards manage core operational risks eg IT; trading

Every store has RAG graded performance targets – **risk defined as missing targets**

Powerful Internal Culture (1)

Two key elements: customers and staff

Caring for customers

“Tesco is about creating value for customers to earn their lifetime loyalty.”

Magic Monday:

‘this is the person to whom you bow down, and he is the customer’

Powerful Internal Culture (2)

Caring for Staff

Flat structure- only 5 levels of management

Very wide base. 470,000 staff; just 200 in top 2 levels

Scope for success; Leahy started as graduate in 1979

Staff retention rate in excess of 80% is KPI

Average longevity of the management team is 14 years

Knowledge of group priorities permeate the business at all levels

Implications for Risk Management

Customer is focus of attention



Performance measured in terms of customer loyalty



Risk management structures need to reflect this philosophy

How?

Aim is to dovetail risk management into everything that is done

Risk management and performance management are integrated

Examples

- “every little helps”
- “one in front” promise
- shelf filler

The formality of linking risk and performance management

Governance structures

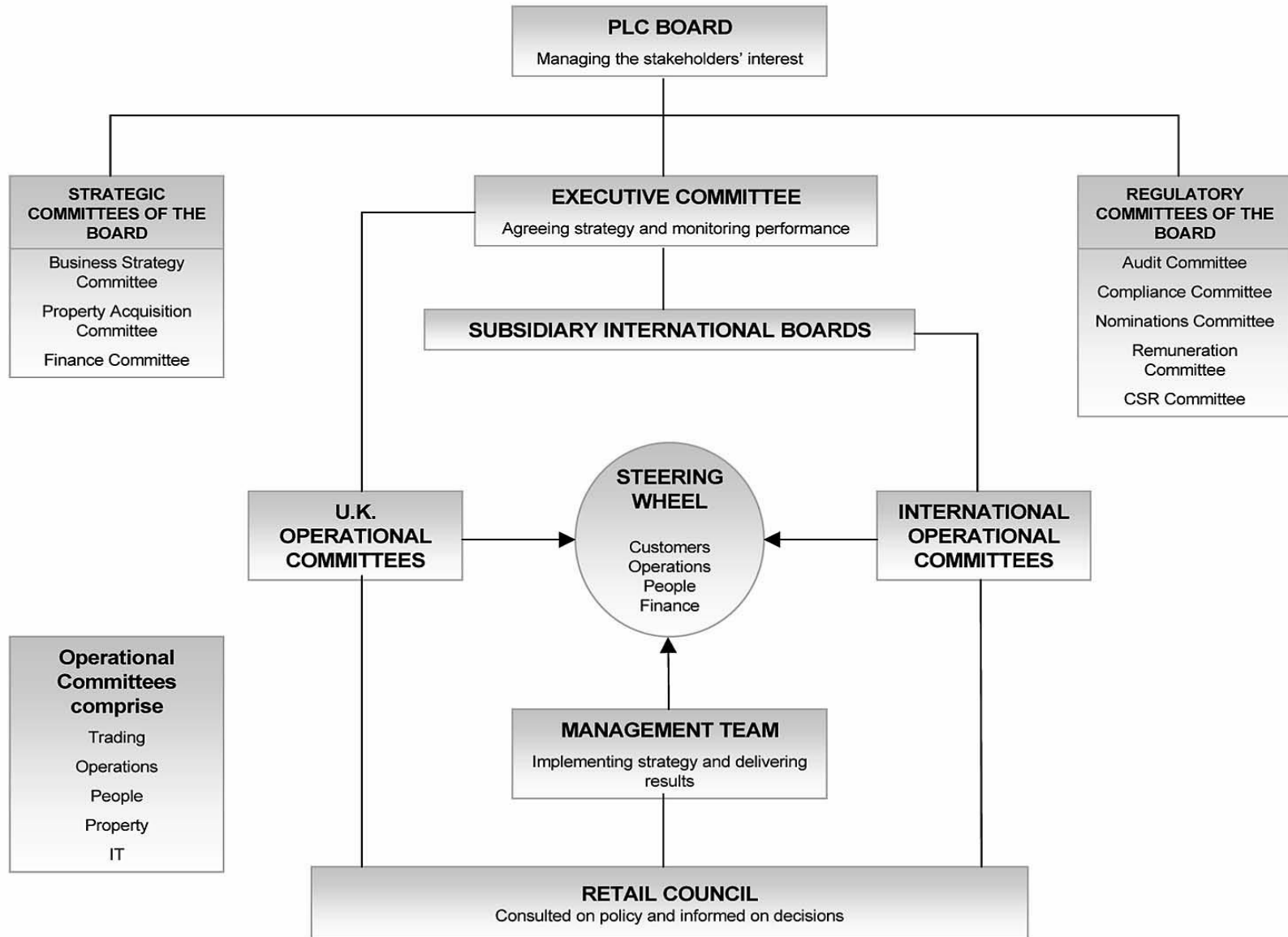
Financial risk is separated out – managed by Treasury

Risk management structures – **but no separate function**

Tesco version of a Balanced Scorecard

Performance based remuneration linked to risk ownership

TESCO GOVERNANCE MODEL



Tesco Steering Wheel (2005ff)



Cascading performance targets down the organisation

5 year strategic plan set by BoD – targets set for each geographic & business segment

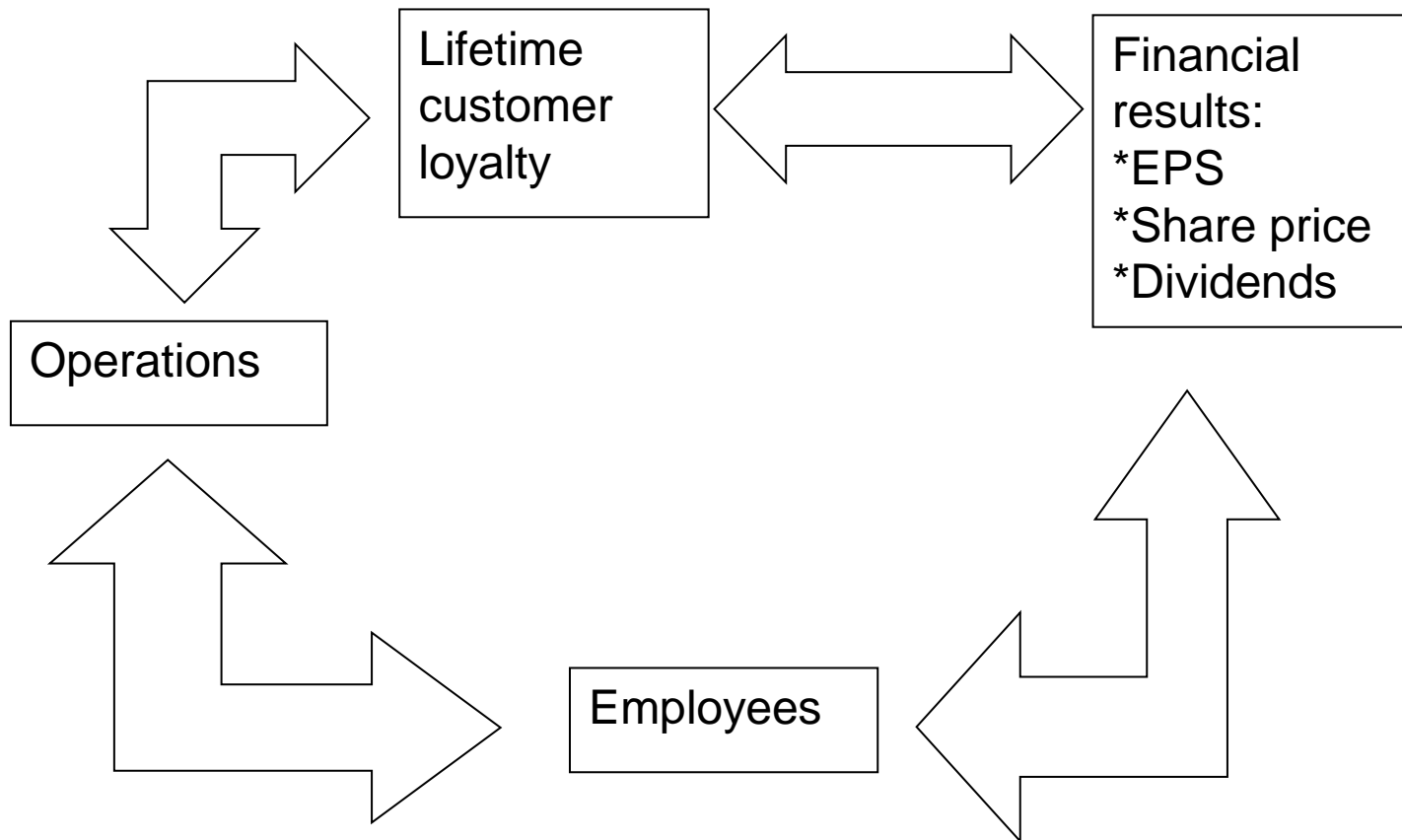
Pushed down to store level

At all levels targets are expressed in terms of the five perspectives of the steering wheel

At store level the steering wheel is linked to individual staff plans

Quarterly performance reports go to BoD & summary sent to top 2000 managers for dissemination

Cause and Effect in the Steering Wheel



Tesco “Values”: Re-inforcing the messages of the steering wheel

Used globally to ensure every member of staff understands the group’s culture and goals

No-one tries harder for customers

- **Understand customers**
- **Be first to meet their needs**
- **Act responsibly for our communities**

We treat people how we like to be treated

- **Work as a team**
- **Trust and respect each other**
- **Listen, support and say thank you**
- **Share knowledge and experience**

Performance related pay

Executive directors – long + short term targets; paid in cash + options

All employees

Profit share via a partnership share plan

if > 1 year's service; % salary up to max. £3,000

Savings related share option scheme

Integrating risk and performance

“One of the reasons we are a successful company is because of risk management – people do it without actually knowing they are doing it, its part of their accountabilities. They are held to account. We monitor things on such a micro level.”

Summary

Risk management is not about *compliance* but *performance*

A risk management bureaucracy is not essential

Emphasise simple messages and staff commitment

Additional information

Detailed case study plus three other cases on RBS, DCMS and Birmingham City Council in:

Risk Management in Organizations: An Integrated Case Study Approach, published by Routledge in May 2011. Available for pre-order from Amazon.

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