SuperMart Case Study

This case study exercise is based on the supermarket industry – SuperMart is a fictitious company that incorporates elements of events and developments occurring in the supermarket sector. It has been adapted and updated from an old CIMA case study for use at postgraduate level.

SuperMart - Case study information

Contents

Background to SuperMart

SuperMart Inc. was started in 1907 as a family grocery business and has now grown to be a leading grocery retailer. In fact, prior to the development of supermarkets, SuperMart was one of the world's largest grocery retailer. It is incorporated in the United States of America and has its head office in New York. In the early days it prided itself on high quality produce and service levels, but as markets grew and transport links became more efficient SuperMart found that it had a competitive advantage on costs, as it was able to buy in more volume than its smaller competitors. It retained the ethos of high quality and high levels of service, but also managed to base its strategy on cost-leadership as the ever increasing volumes provided significant buyer power in the industry.

The initial development of self-service groceries was ignored by SuperMart, which regarded personal customer service as more important to its customers, and viewed the potential labour savings as irrelevant. Its immense buying power led to very satisfactory profits. However, developments in the USA moved in ways that SuperMart did not anticipate. Labour became more expensive in conditions of full employment with increasing legislation protecting employee rights. The personal service on which SuperMart had prided itself was being priced out of the market. The leverage of its vast buying power over domestic supplies became less effective under successive legislation to prevent anti-competitive behaviour, which constrained buying powers to reflect real differences in costs incurred by the suppliers. Under this legislation, other customers could demand comparable prices, unless the suppliers could show differences in cost arising from variations in manufacture, packaging and distribution. Perhaps more important for the longer term, customers regarded the new self-service stores as modern and preferable, and the SuperMart stores as old-fashioned and dull.

GlobalStores, which is also incorporated and based in the USA, had originally been a smaller rival of SuperMart, but had been an early developer of self-service grocery stores. GlobalStores continued to innovate, developing larger stores. It found that labour savings increased, and that a wider range of groceries and general merchandise could be sold in these stores without excessive stockholding costs. The customers liked this, and were also attracted by the first out-of-town stores, which were even larger, and provided easy and free car parking for customers, avoiding town centre congestion. Customers were no longer limited to buying what they could carry away by public transport; they could, if they wished, fill their cars.

GlobalStores continued to innovate in retailing, introducing additional facilities and services into its stores, such as post office boxes, cash-point banking facilities, baby-changing facilities, mother and baby parking facilities, home-delivery service, special food counters, (such as fresh fish), in-store bakery, pharmacy, coffee shop, restaurant, and gasoline filling stations. Customer loyalty was fostered by offering loyalty discount schemes where points could be saved and used against future purchases in store.

The market in which GlobalStores and SuperMart operates changed into one in which, with the development of a "one-stop shop" pattern, customers could buy most or all of their weekly food and other regular requirements in a single visit. The market comprises a large number of local catchment areas within which customers can reach a supermarket in a relatively short time. In some cases, these catchment areas overlap. Supermarkets tended to open up close to each other to try and capture local trade, this increased competition and forced prices and margins down. The larger supermarkets were able to use volume to increase buyer power over suppliers, and frequently came under the scrutiny by the USA Federal Trade Commission's Bureau of Competition for abuse of power over smaller suppliers. Supermarkets also realised that they were collecting useful information about the demographics within the areas where they were located and began to sell this information (de-personalised, i.e., no individual was identified) to other companies, such as insurance companies. Later, as supermarkets developed their own range of non-food products to include legal services, insurance, and financial products they ceased to make the data available to other companies, preferring instead to retain the information to develop their own diversification strategies. However, supermarkets kept a keen eye on local government counties and municipalities where housing projects were being developed to attract certain types of people in to the area. Supermarkets were very interested in monitoring housing plans that were developed to attract their 'type of customer to an area' and would themselves seek planning permission to build a store in the area.

By the time that SuperMart started to assess developments by GlobalStores, and recognised that the market for groceries may have changed, investors had been attracted to GlobalStores because of its high growth rate and attractive margins. GlobalStores used its resulting high share price to acquire several smaller groups, and to raise new capital to continue to build out-of-town stores. Every time GlobalStores reviewed its building programme, it commissioned larger stores.

SuperMart had responded to the developments by GlobalStores, and followed it in converting stores to self-service, and in building out-of-town stores. But this was initially done on an experimental basis, to see if there were genuine savings to be achieved. Development did not occur on the same scale as, or with the speed of, GlobalStores. SuperMart also followed GlobalStores in selling a much wider range of products expanding beyond food items to include a range of non-food items. SuperMart was late in introducing technology into the stores such as electronic-point of sales checkouts and hence did not have access to the information that the use of electronic loyalty card schemes could provide about the customers. SuperMart has also been slow in implementing payment methods such as 'proximity contactless cards', which are growing in popularity with younger shoppers. However, some of the more senior, older, shoppers are worried about the cyber threat to their data security, so, in many of SuperMart's markets, still prefer to pay by more conventional methods. It also missed out on developing efficient just-in-time delivery relationships with its suppliers, which meant that its cost base began to rise compared to that of competitors, and particularly that of GlobalStores. Competitors such as GlobalStores had developed Planning and Replenishment Inventory Management Systems in which suppliers were linked to the planning systems of the stores so that the suppliers were aware of up-coming promotions and would therefore be able to plan their own production processes around the forthcoming requirement of its customers. This not only ensured an efficient inventory system but also locked in suppliers and increased their willingness to work closely with other members of the supply chain.

GlobalStores had, many years ago, overtaken SuperMart to become the largest and most profitable supermarket group in the USA.

SuperMart and GlobalStores - financial information for years ended during 2018

	SuperMart	**GlobalStores**
Sales	$ 43.9 billion	$ 211.4 billion
Profit after tax	$ 1.43 billion	$ 7.10 billion
Shares	900 million	4,700 million
Earnings per share	$ 1.59	$ 1.51
Information as at 31 March 2019		
Share price as at 31 March 2019	$ 34.96	$ 56.65
Price / Earnings ratio	22.0	37.5
Market capitalisation	$ 31.46 billion	$ 266.3 billion

One billion = 1,000 million

The last published quarterly "like for like" sales growth figures (that is, for comparable stores, excluding new openings) show that GlobalStores is growing at a rate of over 5% each year in these terms, whilst SuperMart is achieving under 2%. To this must be added the vast area of new sales space being built each year by GlobalStores. It is also expanding overseas very rapidly, and is rumoured to be likely to make further acquisitions. Supermarkets were also being criticised for holding 'land banks', which is land they own that could be developed into a supermarket. Supermarkets often purchased land simply to stop a competitor building a store in the area. GlobalStores had a significant holding of land with planning permission for development in areas where the target customer groups were being encouraged to locate.

Analysts working for consumer organisations broadly agree that GlobalStores, with its greater turnover leading to immense purchasing power, now buys more cheaply than SuperMart. It can match selling prices or can sell even more cheaply without damaging margins. Measurements of this are disputed, and confused by the number of special promotions that GlobalStores normally operates to stimulate customer interest. Measurement is also confused by quality issues; SuperMart targets more affluent customers than GlobalStores, and claims to place more emphasis on quality. However, the recent decision for SuperMart to do price comparisons with all of the major supermarkets has confused the customers (and city analysts) into wondering what strategy SuperMart is operating in terms of market positioning, i.e., is it adopting a strategy of low cost, or differentiation? The low cost strategy view is based on the fact that SuperMart now issues vouchers to customers that can be redeemed against future purchases, based on the savings that customers would have made if they had shopped at other supermarkets. SuperMart include the more recent low cost 'discount' providers within the comparison supermarkets. A differentiation strategy, however, could be applied, as SuperMart has many more 'over-the-counter' services, where customers are served by a member of staff, rather than self-service from pre-packaged goods. This obviously increases staffing costs of SuperMart.

A greater proportion of GlobalStores' sales comes from very large out-of-town GlobalStores, while a considerable proportion of SuperMart's sales are generated in smaller stores in central locations. GlobalStores is believed to have a significantly higher spend per customer visit. An interesting trend has been occurring over the last few years in that the 'in-town' stores are coming back into fashion with many supermarkets, including GlobalStores, opening an increasing number of what are known as 'convenience stores'. These are smaller stores located in-town and where SuperMart probably had an advantage in this area a few years ago, GlobalStores is now threatening to overtake them in this market as well.

SuperMart has also come under pressure from other fast-growing competitors, which have either prospered by being more "up market", in an era of growing affluence, or have built very strong regional market shares. Some of these now appear to be able to buy at least as effectively as SuperMart, and have a significant number of 'in-town' convenience stores. The supermarket industry is currently undergoing a change in terms of shopping habits. Growth in 'click and collect' and online shopping has continued in most of the markets in which SuperMart operates, but city analysts think that SuperMart has been slow to recognise this. An innovation by some supermarkets is the growth of the 'dark stores'. These are located in cities on major traffic routes in and out of the city, typically used by commuter traffic, and are stores designed to allow customers to collect their shopping on their way home from work. Although these stores are not open to the public for general shopping, they are set out like a normal supermarket, as this enables a similar range of products to be stocked, and the store layout facilitates the picking of goods by the staff who prepare the orders for collection by the customers, who are able to 'drive through' and collect their shopping from a collection point.

Another worrying trend is that foreign companies, those not previously operating in the USA, have captured a significant segment of the low cost market. These were quite small companies a few years ago but their growth rates have been very high such that they now pose a significant threat to the market share of the big players, such as GlobalStores and SuperMart. These overseas companies have announced large expansion plans to increase their share of the USA's market and they are using aggressive pricing and advertising tactics to gain market share, which appears to be working.

Sustainability

The supermarket industry has been under fire from the media and consumer groups in recent years, and the USA, like many countries has experienced a growing concern with obesity within its population. The types of food sold by supermarkets has been heavily criticised, as has the amount of packaging and food wastage. SuperMart has attempted to respond by actively seeking ways to reduce food wastage. However, problems with the supply chain and poor information systems creating stock-outs sometimes encourages over ordering, which then leads to high levels of food waste. Consumer bodies are quick to highlight this, which exposes internal problems to the outside world. However, sustainability is not just about food wastage and eating habits but involves close working relationships with suppliers to reduce transport costs, production and processing costs, packaging and food presentation. It is also about reducing the carbon footprint throughout the whole supply chain and trading responsibly. Recent government promises to legislate to ban the use of single use plastics in packaging has sent shock waves through the industry.

GlobalStores has been producing a Sustainability and Corporate Social Responsibility report for several years but SuperMart has not produced a separate report, preferring to pay lip service to its polices in the Annual Report and Accounts. However, SuperMart does have a sustainability policy which was put together by Susan Paine, the VP Human Resources. In the overall summary it talks about not just working to reduce food waste but to improve the health of the nation by working towards offering healthier food options with less additives and processed foods. The difficulty with this for SuperMart is that most members of the executive management team see it as increasing the costs, and with the price wars in the industry it is difficult to put this into practice and remain competitive unless the whole industry adopts the same policy. There is then the danger that consumers buy less if prices go up.

Working closely with suppliers is seen as a positive step in that it can reduce costs through improved communication and increased efficiencies but unless suppliers adopt similar policies and commitments to reduce carbon, change processing practices, find new sustainable methods and materials for packaging, etc., it is difficult to make it work in practice. SuperMart have found that it does not have the buyer power it used to have and is not able to insist that suppliers adopt sustainable policies if they wish to trade responsibly with SuperMart. There is a danger that if SuperMart is too insistent it will make suppliers unwilling to work closely with them if they feel they can make a higher margin by supplying

SuperMart's main competitors. Zhang Yixing, VP Operations, and Michael Chang, Chief Purchasing Officer, are both in favour of sustainability, but not at the expense of profitability, or making supplier relationships difficult.

Susan Paine (VP Human Resources) also included elements in the CSR report about being a responsible employer and ensuring jobs were sustainable, and that SuperMart would strive to make a positive social and economic contribution by working closely with the local communities in which it operates.

As the reporting of its sustainable activities is limited now, SuperMart does not have any specific performance measures or control systems in place to effectively monitor the degree to which it is achieving any degree of sustainability in its operations. However, Susan Paine is supported by the Chief Executive Officer, Christiana Tasousa, that SuperMart should strive to be seen as a sustainable company, i.e., one that takes its responsibility seriously.

Preparation for a strategy meeting

Jacob Standing, President of SuperMart, has asked the members of the Executive Management Team at SuperMart to attend a meeting to review the current strategy.

Heinrick Volkler is head of compliance and was formerly the partner within SuperMart's auditors with responsibility for SuperMart. He is concerned that, while SuperMart's accounts met all relevant standards, and presented no problems to his former firm, he would have preferred a more conservative view to be taken on certain issues. In particular, he is concerned that SuperMart appears to depreciate investments in store fittings and information technology more slowly than GlobalStores. The effect of this would be that the charge for depreciation to the accounts is lower than GlobalStores which means that the lower profits of SuperMart is even more worrying. Also, GlobalStores will potentially replace the equipment more regularly than SuperMart adding to the problem that SuperMart is seen as old-fashioned and out of touch with modern technology. He is also concerned by differences in accounting for pension liabilities, as SuperMart has proportionately many more long-service employees than GlobalStores. The treatment of supplier payments and the early recognition of revenue, (e.g., recognising revenue at full sales price, and delaying the impact of promotional discounts until payment is made to the supplier, which has the effect of distorting revenues across accounting periods) by some of the competitors has also been a cause for concern among city analysts and there is talk of a potential fraud case being made against one particular competitor. Heinrick is confident that SuperMart has accounted correctly for revenue and payments to suppliers, but he is concerned that it could damage supplier relationships if the publicity raises suspicion about the practices of supermarkets.

Christiana Tasousa is 60. She has been Chief Executive Officer (CEO) of SuperMart for four years, the culmination of a lifetime working for the company. Her career had started as a trainee in a SuperMart grocery shop. She had risen from a store manager to a regional manager, and eventually progressed, via Human Resources, to the post of USA Retail Operations Manager, prior to becoming CEO. She is well known locally as the President of a successful Major League Soccer Club. She is known nationally as a past President of the Retail Business Federation, and has often appeared on television to comment on possible regulation of the industry, and new developments as well as being a strong supporter of women in senior corporate positions and promoting opportunities for women in business. She is concerned that the growth of GlobalStores continues to outstrip that of SuperMart, but could not see any easy answer in terms of improving operations in the USA. She liked the present SuperMart supermarkets just the way they were. She was pleased she had been able to persuade the executive team last year to increase job security and pension benefits for long-service employees. However, she recognised that something had to be done to please the investors and raise the share price. She thought she might have to re-consider her ideas, if changes to the supermarkets could attract new customers into the stores.

Mohammad Hafeez had been appointed VP Finance two years ago, having previously been an audit partner with the auditors, but not directly concerned with the SuperMart audit. He found the accounting system to be rather old-fashioned. He hoped to develop a new integrated system as part of any (much overdue) information systems update. He understood the concerns expressed by Heinrick Volkler regarding depreciation and pension liabilities. He felt uneasy in discussions with the institutional investors and financial analysts, who were always seeking "guidance" on likely future statements on profits, although profits had been stable and predictable. When asked further questions about future plans, he did not respond. The accounts for 2018 were still not finalised, but he had circulated, before the meeting, a summary statement, showing very limited progress in a difficult market. (This financial statement is given as Exhibit 1).

Zhang Yixing had been appointed as VP Operations Director - USA, four years ago. He is responsible for controlling the stores through a structure of regional offices, and has responsibility for sales policy and sales promotions in USA. Previously he had been a Purchasing Manager for eight years. While he has been in the company all his working life, he does not share Christiana Tasousa's view of present operations. If he had the opportunity to succeed Christiana Tasousa as CEO, he would like to cut staff considerably and close many of the smaller stores. He would like to carry out such a policy now, but sees no prospect of gaining support.

Victor Adebowale was appointed VP Information Systems two years ago. He had previously held a similar position with a major European supermarket group, where he had installed new advanced systems. He had been appointed by SuperMart with the implied brief to modernise its systems, but he was uncertain whether he could persuade the executive team to authorise the very considerable investment required. Part of the problem related to the limited success to date of the on-line home shopping development in USA. SuperMart had been very late into the home shopping market and was trying to catch up with the other supermarkets who had much more experience of operating home shopping. In fact, GlobalStores used to 'sell' their Internet shopping system to other supermarkets, as it was deemed one of the best in the industry.

Michael Chang is Chief Purchasing Officer. He had moved into this role four years ago after a career in purchasing with other major groups. He found that SuperMart valued relationships with old established suppliers, and that other senior managers tended to intervene to protect their old friends whenever he wished to change suppliers. He felt that he was achieving little, and was tentatively looking for a move to another group, that would allow him more latitude to make an impact. He felt there was scope for reducing buying prices with a much stronger approach to managing the supply chain. Even 1% would be very big money.

Amelie Poulain had joined SuperMart two years ago as the first person to hold the appointment of VP International Operations. At 40 years, she was the youngest of those to attend the meeting. Her career had been in supermarket management and regional management, including three years in Canada. She found the present overseas operations to be a "dreadful muddle", with no clear strategy, and no clear rationale for why the various investments had been made. Some investments had been sound and traded profitably. Others were at best marginal. All were quite small. While overall, they added up to 12% of SuperMart's turnover, they contributed less than 2% of the profit. SuperMart's market share did not exceed 3% in any of the international markets in which it traded. Ideally, she would sell most of the present overseas stores, retaining only the most profitable operations, and then persuade SuperMart to make a major overseas investment. (Exhibit 2 includes information that Amelie has gathered about competitor stores in Europe).

Susan Paine had been recently been appointed VP Human Resources and had not been involved before in a meeting such as that planned. She was uncertain of quite what to expect, but was preparing papers on matters that concerned her, in case there was an opportunity to raise them. In particular, she wished to raise the case for a policy of allowing early retirement for some long-service employees to provide scope to recruit younger staff, especially from ethnic minorities, even though she did not think the CEO would be enthusiastic. She would also like to get involved with SuperMart's operations outside USA, to achieve a universal employment policy. It appeared that in many countries, staff enjoyed far greater job security and holiday entitlements than did SuperMart staff in USA. The Government had also pushed for companies to increase the minimum wage to what it referred to as a 'living wage'. A competitor had recently stated that it was going to increase its pay to employees to levels above the 'living wage' from next year. Based on information that Susan's staff had managed to find out through industry contacts, if SuperMart followed this step it would add approximately $5m to SuperMart's wage bill. Susan also wanted to push the sustainable policies more as, with the recent focus on these issues in the media, there was an opportunity for SuperMart to differentiate itself from the market by promoting a sustainable approach as its key strategy - her feeling was that if they emphasised the Planet and People elements, the Profit would follow.

The strategy meeting

The President outlined the problem of needing to raise earnings and show a positive trend. He considered that greater growth was needed to boost the share price and enable future rights issues.

The CEO, reporting on current trading, and short-term forecasts indicated that like-for-like sales in the current quarter were expected to rise by up to 2%. However, GlobalStores was showing a much stronger trend, and may be growing by 5% to 7% each year in terms of like-for-like sales. Including the new stores being built each year, GlobalStores is growing in total at well in excess of 15% each year. SuperMart profits would probably be no more than static at best, and may fall slightly. He regarded maintaining the dividend as a priority, even it if meant restraining investment.

Heinrick Volkler commented that this could only lead to a further fall in the share price.

The President then opened the meeting for wider discussion, seeking suggestions for the way ahead.

The VP Operations – USA, stressed the problem of keeping the major supermarkets within SuperMart up-to-date and constantly refurbished to compete with GlobalStores. With the large number of stores, it was difficult to achieve the target of modernising each store every seven years. If necessary to have sufficient funds for this refurbishment, he was prepared to see the closure of some of the smaller, older stores, though this would involve significant personnel redundancies.

Both the CEO and the VP Human Resources stressed the importance of having due regard for employees in difficult times, and protecting their interest as far as possible. SuperMart had a deserved reputation as a good employer; this could easily be lost.

Questioned by Heinrick Volkler, the VP Financial confirmed that some 20% of SuperMart's more than 2,000 stores in USA made no significant profit. The Chief Purchasing Officer commented that the additional volume from this 20% of the stores helped towards obtaining the best purchasing terms. The VP Operations – USA, suggested that, without this volume, the number of suppliers could be reduced and the supply chain simplified. He continued by saying, "If we have learned anything from our exercises in activity based costing, it is that overheads are driven by complexity. The more complex the operation, the more non-value adding coordination costs there are. The way ahead is to focus on core products, reducing the number of product lines and the number of listed suppliers. If we force suppliers to compete to remain SuperMart suppliers, we could capture more of the value chain from our chosen suppliers, recovering our marketing costs and our sales data costs." He also noted that a major competitor, but not GlobalStores, had recently announced that it was reducing the number of product lines stocked so that they can compete more effectively with the growing rise of the discount stores.

The VP Finance raised the question of whether pressure should be put on suppliers to provide extended trade credit to finance refurbishment. Anne Marie McTavish, an independent consultant who the President had invited to the meeting, wondered whether the anti-trust authorities would accept this, but thought that it could be possible, provided that the credit taken did not extend beyond that taken by close competitors. This information was not available, and needed to be investigated. The CEO and the Chief Purchasing Officer both commented on the long-term loyalty and support of many suppliers who had worked with SuperMart, in some cases for over fifty years.

The development of on-line home shopping was discussed. The VP Information Systems stated that, after initial difficulties, the system was fully operational and reliable, but major investment was required to achieve a 'state of the art' system. He commented that it appeared that all key dates had been met, and that sales targets had been achieved. The VP Operations - USA commented less favourably. There were still significant numbers of queries and complaints that had to be resolved with customers. The system costs and system support staff costs were high. There was also the problem that using store staff to pick orders from supermarket shelves placed irregular loads on store staffing; this was not practicable when the stores were busy. Home shopping orders were then delayed, which led to more queries and complaints. Questioned by the VP Information Systems, he confirmed that the frequent delivery delays were caused by operational and staffing problems in store, rather than information system problems. There was a separate problem that also affected this issue. The basic information on sales by product was still very slow, and Purchasing, waiting for this information, was unable to prevent a high level of stock-outs. This problem particularly affected special promotions and products sold at exceptionally low prices which are widely advertised. He agreed to circulate a note of problems after the meeting. (This is given as Exhibit 3.)

A related issue caused some inconclusive discussion. Both the VP Operations – USA, and the VP Information Systems commented that, on their reading of the original justification for on-line home-shopping, it should have been in profit by the time present sales levels were reached, but that the current reports showed significant losses. The VP Finance said that this was a matter of the allocation of overhead costs for the information system and the stores. He was asked to provide a clear report and a post audit report of the project for a subsequent meeting. It was considered undesirable to proceed too far with this venture without knowing whether it was profitable.

The VP International Operations suggested that sales growth rates in a number of countries were more attractive than those in USA, and that trading profits were potentially significantly higher. Amelie considered that it would be sensible to go for a major acquisition which was big enough to make a significant difference to SuperMart's earnings, rather than a series of small investments like the present scattered SuperMart international operations. Challenged by both the CEO and Anne Marie McTavish (independent consultant) on whether this was a high-risk strategy, she commented that 'doing nothing' in USA also appeared to be a high-risk strategy, with very limited possible outcomes. Amelie presented some brief statistics on the market and the competing stores in Europe which presented major opportunities to expand (Exhibit 2), and was asked to provide further data.

The question was raised as to who would manage the acquired company. The VP International Operations stressed the need for good local management, by local nationals, who understood local customers and tastes. She cited the saying, 'Think Global, Act Local'. The CEO stressed the desirability for top jobs to be held by USA nationals to ease communication with head office.

Heinrick Volkler suggested that a major acquisition within the USA should be considered. However, no one present had any clear ideas of potential acquisitions or synergies. This was left for further investigation.

Summing up, the President commented on the need for all ideas to be followed up for a further meeting as soon as more data was available. He stated that he would discuss with the CEO what information would be immediately available for prompt circulation, and a programme for collating further relevant information for another meeting in two or three months' time.

Exhibit 1

Summary financial statements circulated by Mohammad Hafeez, VP Financial

SuperMart draft summary data for 2018 – subject to audit

Year ended 31 December 2018	2018 Draft	2017 Actual	2016 Actual
	$ billion	$ billion	$ billion
Sales	43.9	41.5	38.4
Cost of goods sold	34.6	32.54	29.8
Gross profit	9.3	8.96	8.6
Store and administration costs	5.89	5.64	5.52
Depreciation	0.92	0.91	0.79
Interest	0.35	0.34	0.37
Profit before tax	2.14	2.07	1.92

Tax	0.71	0.68	0.63
Profit after tax	1.43	1.39	1.29
At 31 December	2018	2017	2016
	$ billion	$ billion	$ billion
Non Current assets	7.56	7.4	6.96
Current assets	9.08	8.28	8.17
Less current liabilities	4.61	4.11	3.69
Net current assets	4.47	4.17	4.48
Total assets less current liabilities	12.03	11.57	11.44
Non current liabilities	4.56	4.40	4.58
Shareholder’s equity	7.47	7.17	6.86
	12.03	11.57	11.44

Exhibit 2

Basic financial data for the top 5 European supermarket groups for years ended during 2018

Supermarket group	A	B	C	D	E
Sales	€ 34.1 billion	€ 28.26 billion	€ 16.86 billion	€ 13.36 billion	€ 7.56 billion
Profit/(loss) after tax	€ 1.26 billion	€ 0.44 billion	€ 0.49 billion	€ 0.37 billion	€(0.03) billion
Shares	7,140 million	1,950 million	2,560 million	1,020 million	490 million
Earnings per share	€ 0.179	€ 0.23	€ 0.19	€ 0.36	€ (0.06)
Information at 31 December 2018					
Share price at 31 December 2018	€ 3.40	€ 5.40	€ 3.65	€ 5.20	€ 1.67
Price / Earnings ratio	18.9	23.5	19.2	14.4	-
Market capitalisation	€ 24.28 billion	€ 10.53 billion	€ 9.34 billion	€ 5.30 billion	€ 0.82 billion

Exchange rate € = $ 0.86

Summary financial information at dates in 2018

Profit and loss accounts

Supermarket group	A	B	C	D	E
	€ billion	€ billion	€ billion	€ billion	€ billion
Sales	34.10	28.26	16.86	13.36	7.56
Profit before tax	1.75	0.71	0.73	0.52	(0.14)
Less Tax	0.47	0.27	0.24	0.15	(0.11)
Profit after tax	1.258	0.44	0.49	0.37	(0.03)

Summary balance sheet information at dates in 2018					
Supermarket group	A	B	C	D	E
	€ billion	€ billion	€ billion	€ billion	€ billion
Non Current assets	16.40	10.91	7.17	14.78	1.53
Current assets	2.76	6.04	1.66	3.74	0.94
Less current liabilities	7.21	7.09	3.84	4.38	1.07
Net current assets/(liabilities)	(4.45)	(1.05)	(2.18)	(0.64)	(0.13)
Total assets less current liabilities	11.95	9.86	4.99	14.14	1.40
Non current liabilities	3.25	1.81	0.92	7.88	0.24
Shareholder's equity	8.70	8.05	4.07	6.26	1.16
	11.95	9.86	4.99	14.14	1.40

Statistics – Europe stores (figures for years ended during 2018)

Supermarket group	A	B	C	D	E
Europe total stores	697	470	249	488	1,319
Supermarket Extra stores*	297	304	242	160	0
Europe sales**	€ 29.8 billion	€ 20.2 billion	€ 16.2 billion	€ 12.8 billion	€ 7.56 billion
Employees (thousands)	225	197	109	87	60

* Supermarket Extra stores are large out-of-town stores. The number is included in the total number of stores above.
** Europe sales exclude sales to courtiers outside of Europe by the groups

Percentage of own brand products sold (figures for years ended during 2018)

Supermarket group	A	B	C	D	E
Percentage of own brand products sold	53	62	31	45	48

Latest quarterly data like-for-like sales

Supermarket group	A	B	C	D	E

Percentage increase/(decrease) in like-for-like sales over 1 year	4.4	6.1	5.2	4.2	(5.1)

Total growth latest quarterly data

Supermarket group	A	B	C	D	E
Percentage increase/(decrease) over 1 year	9	8	12	7	(3)
Estimated market share %	25	18	15	10	6

Home shopping - Europe on-line sales (% of total sales)

2014	2015	2016	2017	2018	2019 forecast
0.9%	1.9%	3.5%	5.6%	7.3%	9%

Online sales as a percentage of total sales are at less than those in the USA, but are growing rapidly. Most are made by supermarket A, with a store-based distribution system. Other supermarkets are catching up quickly. In some cases, dedicated warehouses are being used for order picking and delivery. One supermarket group (not listed above) probably has some 15 to 20% of the on-line market and sells itself as the online retailer of choice. Its market share is growing as the appetite for online grocery shopping increases in Europe.

Exhibit 3

Memorandum – information systems and home shopping

To: Executive Management Team (EMT), SuperMart
From: Victor Adebowale, VP Information Systems
Date:
Subject: Information Systems and Home Shopping

The present apparent losses on home shopping reflect some operational problems, and some poor accounting.

The original proposals, assumed that picking (selecting from the shelves the items ordered by customers and packing them) would be done in slack time by 'free' store staff. The cost was ignored in the home shopping proposal. Picking is done on the basis of when staff have spare time, but is now charged to the home shopping cost centres, thus reducing the costs of normal store operations. If dedicated staff were engaged, it would cost the home shopping cost centre no more than is charged by various stores, and picking would be done when required. However, store managers would be under further pressure to control their overall staff costs and would likely reduce the number of staff in-store. I understand from the accounting staff that a technique of time driven activity-based costing may provide a better costing of the operation.

The original proposals considerably underestimated the stock-out problem. This has always existed, because the main stock control systems are over 10 years old. The problem is made worse by the heavy use of special promotions, advertising a limited range of products at low prices, which leads to erratic demands on suppliers. The main accounting and stock control system is so slow that the home shopping data is often used to 'forecast' the main system output, especially in providing early indications of the success of the various promotions.

Queries arising from stock-outs have added significantly to system costs. Customers complain if a product is out of stock and a substitute product is delivered.

On present volumes, the home shopping is unprofitable, but this ignores any customer gain achieved by internet shoppers also visiting stores. We know that on average internet customers have a higher average income and spend more per visit.

A more recent development utilised by several competitors is the use of 'dark-stores'. These are stores laid out like supermarkets and located in high-streets and local areas where internet shopping is 'picked' and made ready for either delivery or collection by the customer. These are popular with 'click and collect' customers. The layout makes the 'picking' of the goods easy but customer do not enter the store, only access the 'click and collect point' which operates like a drive-through, hence the name, ‘dark-stores’. These have proved to be popular with customers and efficient to operate by the supermarkets.

Information provided by the accounting department

	$ billion
Sales	43.90
Cost of Goods sold	(34.60)
Gross profit	9.30
Store running costs	(1.18)
Delivery costs – online sales	(0.50)
Staff costs	(2.55)
Marketing	(0.86)
Website maintenance costs	(0.50)
Administration costs	(0.30)
Depreciation	(0.92)
Operating profit	2.49
Interest	(0.35)
Profit before tax	2.14

Number of SuperMart stores 2,663
Average number of customers per store is 4,500
Percentage of customers that shop online 25%
Percentage of staff involved in the online sales operation is 50% - note this is because staff currently undertake activities in store as well as helping with the online sales. There are no dedicated staff associated with the online sales operation.

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Your role as a consultant

Various members of the executive management team (EMT) and senior managers have been asked to put their proposals in outline form to the EMT for the next strategy meeting. You have been engaged by the President, as a consultant, and have been given copies of the various proposals made by the EMT members and senior managers. These are documented as Exhibits 4 to 8 inclusive, and are shown on the following pages. You have also received notes of previous strategy meetings and related documents.

Exhibit 4

Memorandum - Developing USA Operations

To: EMT, SuperMart

From: Zhang Yixing, VP Operations - USA
Date:
Subject: Developing USA Operations

I propose that we should simplify operations. I have estimated the effect of the proposals on operating profits and my thoughts are as follows:

- Close down home shopping and focus on in-store high quality service. I estimate that this would save approximately $1.1 billion of operating costs each year, but we would also lose the gross margin (21%) on an estimated $5 billion of sales (This considers that some customers may buy in-store as well as online).
- Close all unprofitable stores or marginally profitable stores in USA. This will mean shutting at least 400 stores with a present turnover of $2.9 billion and total operating costs $0.8 billion per annum. One off closure cost relating to building and staff redundancy would amount to $0.5 billion during the first year of this proposed plan, as the stores are closed and disposed of.
- Having closed many smaller stores, review head office functions, and see what can be decentralised to the stores, and what else can be closed down in head office – a target would be saving $0.05 billion a year.

To move forward we should:

- Set tough targets for Central Purchasing, to save at least $1 billion in the first year, and $2 billion in each year from year 2, remaining at this level from then onwards. They should be given freedom to change from the old suppliers, and import more.
- Make small acquisitions in USA to grow the business.

My calculations on small acquisitions are that we could borrow and spend up to $1 billion in year one without upsetting the competition authorities. We could borrow the money at 6%, as we would be acquiring property that the bankers would regard as good security. (Note: this would be used as the marginal cost of capital for the investment appraisal).

Prices for small store groups may be quite high – we may find ourselves paying up to 30 times current after-tax profits. We should be able to produce rapid increases in profit from better buying and stronger management, especially if we free up management time by disposing of, or closing, our poorer stores.

I would set targets for earnings from acquired stores as follows:

- In the year of acquisition, having covered all reorganisation costs, to make profits at 50% of pre-acquisition profits;
- In the next year, to make 150% of pre-acquisition profits;
- In the third year, and onwards, to make 200% of pre-acquisition profits.

To put this in figures, our investment of $1 billion would probably generate profits of about $25 million before interest and tax. In the second year, we would make

$75 million before interest and tax, and in the third year $100 million. Once the benefit from the SuperMart brand and efficiency savings had filtered out this could then grow at the same annual rate as SuperMart in year four onwards.

If this proved to be successful, we could make further similar acquisitions, adding to profit. There are still plenty of good independent stores and small groups of stores out there to buy as the families that own them want to sell up.

Exhibit 5

Memorandum - Home Shopping Operations

To: EMT, SuperMart
From: Victor Adebowale, VP Information Systems
Date:
Subject: Home Shopping Operations

I have again reviewed the current home shopping operation.
There is no point in closing down the present operation. There would be no real saving, unless store staff could be reduced, which could be difficult, as many of the stores with significant home shopping volumes are failing to meet their in-store customer service standards. The software systems would have to be written off at a cost of $50 million. I am told that there would be little or no loss on the disposal of the delivery vehicles.

We have two development options:

1. Develop a better accounting and stock control system for the stores. This could take one year to develop and install and cost up to $5 million to implement in all SuperMart stores.
2. Develop a different approach to home shopping with dedicated warehouses (picking centres) in selected locations, some of which could operate as 'dark-stores'. This could provide a radically better service to customers, and build up greater volume than the present in-store system could handle. This would require an investment of at least $1 billion, would break-even in the first year, and then produce profits before interest and tax of 10% of sales per year. Estimated sales could be as much as $5 billion in the first year of operation and achieve a 5% growth rate each year.

Exhibit 6

Memorandum - Future International Operations

To: EMT, SuperMart
From: Amelie Poulain, VP International Operations

Date:
Subject: Future International Operations

I propose:

1. That most of the present international operations should be sold as soon as feasible. The Canadian operations, which are modestly profitable, should be retained. Others should be sold to anyone who will take on the staff contracts, supplier contracts, and building leases. If all can be sold, this would potentially release funds of approximately $1 billion as a one off cash receipt in the first year. There would be a loss on the disposals of around $500 million compared with the book values. There would be no significant ongoing effect on SuperMart's profit, although there will be exceptional costs in the year of sales approaching $100 million. If the sale of any operation is not feasible, it may be cheaper to continue trading than to close, but this requires further investigation.
2. The preferred route forward is to invest in Europe. This may be 'now or never'. The market is highly concentrated. If any of the existing major players are bought by GlobalStores, or possibly by some very large foreign group, late entry may be very difficult. Both possible acquisitions, B or D, are quite attractive in various ways. I would prefer to see the acquisition of B.

I attach the report from StrategicsPartners, Merchant Bankers as Appendix A to this document.

Appendix A

Report - Assessment of Europe supermarkets

To: Amelie Poulain, VP International Operations and Members of EMT SuperMart
From: StrategicsPartners, Merchant Bankers, Europe
Date:
Subject: Assessment of Europe supermarkets.

The possible acquisition of supermarkets groups A, C and E have been reviewed and rejected. A is too expensive; C is not feasible because of its ownership structure; and E has major problems.

Supermarket group B, the market leader until a few years ago and the present 'Number 2', is a very solid business with a good reputation for quality and customer service.

While it was always regarded as impregnable, with the large family holdings and their involvement in management, it is understood, in the strictest confidence, that this is about to change. A suitable cash (not shares) offer could enable the family to unravel various family trusts and complex holdings and move away from the business. They may require supplementary agreements that protect various employees for a period of years. The departure from the board of directors (European equivalent of the EMT) of the family representatives would provide easy scope for introducing new management, which would be essential. Although B's like-for-like sales have recovered in the last two years, it is obvious they are not achieving the sales intensity of A, or the same standard of stock and logistics management. B's home shopping venture is very limited.

There is considerable scope for effective investment in new systems, and B has considerable scope to extend existing stores, having a number of very large sites that are not fully utilised. However, the family has decided that it does not wish to invest any more in the business, and if more investment is needed, this is the time to sell completely.

The only alternative proposition is Supermarket D. It is smaller than B.

You will know the Chief Executive of D – Alfredo Garcia – he used to work for you. As we understand the matter, some four years ago you restructured, and combined the two posts of VP Marketing, and VP USA Retail Operations, into the new post of VP Operations - USA, which he did not succeed in obtaining. He then left your employment. Subsequently he became CEO for two years of a smallish supermarket group in Europe, and apparently increased profit there. In the two years he has been CEO of D, he has certainly made an impact on profits and the share price. He has followed a policy of special promotions successfully, but never had the finances to modernise the stores.

We have provided below schedules giving our views of future sales and profits of the two groups. We would recommend that an acquisition premium of 33% above the current market capitalisation be assumed in preliminary calculations, although it may not be as much in practice.

Figures for Europe

Forecast earnings per share

	Supermarket B	Supermarket D
	€	€
Actual 2018	0.23	0.36
Broker forecast 2019	0.35	0.40
Broker forecast 2020	0.45	0.45
Broker forecast 2021	0.60	0.50
Broker forecast 2022	0.80	0.55
Broker forecast 2023	1.00	0.60

Updated financial data for Europe Supermarkets B and D for the year ended during 2018

	Supermarket B	Supermarket D
Sales	€ 28.26 billion	€ 13.36 billion
Profit after taxation	€ 0.44billion	€ 0.37 billion
Shares	1,950 million	1,020 million
Earnings per share	€ 0.23	€ 0.36

Information at 31 March 2019

	Supermarket B	Supermarket D
Share price at 31 March 2019	€ 6.27	€ 4.92
Price/Earnings ratio	27.3	13.7
Market capitalisation	€ 12.23 billion	€ 5.02 billion

Exchange rate assume € 1= $ 0.86

Exhibit 7

Memorandum - Update on current performance

To: EMT, SuperMart
From: Christiana Tasousa, Chief Executive Officer
Date:
Subject: Update on current performance

SuperMart's current trading is not encouraging, and the outlook for the year is not as good as it appeared in January. The VP Finance current forecast is that earnings per share for 2019 will be materially below that for 2018 – possibly as low as $ 1.25 compared with $ 1.59. This will not leave any dividend cover.

Exhibit 8

Having seen the memorandum from Christiana Tasousa, Jacob Standing despatched a final note:

Memorandum - The new earnings forecast

To: EMT, SuperMart
From: Jacob Standing, President
Date:
Subject: The new earnings forecast

I am most concerned by the memorandum from Christiana Tasousa, especially the information on current trading. I do not like being surprised by bad news. Better financial systems should enable us to anticipate problems.

When the markets are informed, as they must be, of the new earnings forecast, there will be a sharp fall in the share price and a fall in the price/earnings ratio. To maintain investor confidence, a clear and convincing statement of a plan to improve earnings in the medium term will be essential. A P/E ratio of 20 is the best that can be expected, and this would result in a share price of $25. Maintaining even this share price probably depends, to some extent, on speculation regarding a possible bid for SuperMart from a large foreign group. It is known that some of these have looked at possible acquisitions in USA.

The city appears to view SuperMart as a defender – it's time we began to think more like a prospector.

End of case study