

Sainsburys supermarket consumer analysis



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A super market is the ' One-Stop-provider' of almost all the day to day basic necessities of any regular consumer in the given market industry. These necessities include the food items, drinks, toiletries, household stuff etc. Hence all you need to run your houses daily. These supermarkets have now further developed themselves by providing clothing's, shoes etc.

One of the leading names in the UK supermarket industry is Sainsbury's. J. Sainsbury plc is the parent company of Sainsbury's Supermarkets Ltd, commonly known as Sainsbury's (also Sainsbury and JS); this is the third largest chain of super stores in the United Kingdom with a market share of 16. 3%. The groups Head Office is located at Holborn in Central London.

1. 2. Operations:

Founded in 1869 by John James Sainsbury along with his wife Mary Ann in London and then gradually grew to become the largest grocery retailer by 1922.

The company has a chain of stores with 537 supermarkets and 335 convenience stores, hence a total of 872 stores in England, Scotland, Wales and Ireland, including Hypermarkets (super large stores- Sainsbury's stores-main plus), Sainsbury's Central and Sainsbury's local (supermarket and local convenient stores format – main mission). The company has been eyeing the opportunity of expanding its business outside the UK. Especially the hyper potential in Asia (especially South East Asia and China). By analyzing Tesco's huge success in the market outside UK, Sainsbury's venture might not be far away.

The Sainsburys family has 15% shares of J Sainsbury plc (as of May 2008)

The major family shareholder is Lord Sainsbury of Turville holding 5.83% and Lord Sainsbury of Preston Candover who holds almost 3% of the company's shares.

It is listed on the London Stock Exchange and is a constituent of the FTSE 100 Index

(July 12, 2010 <http://en.wikipedia.org/wiki/Sainsburys>)

In this report we have analyzed Sainsbury's on the basis of its financial performance through

Studying its last 2 years financials

Making necessary observations

Comparing its financial performance with the market leader Tesco

Commenting on the strengths and weaknesses as interpreted through their figures / ratios etc.

Calculating the WACC for Sainsbury's

Keeping in view the over saturated industry of supermarkets, it was needed that Sainsbury's should venture into 'something new' to increase its profit margins and give the company's portfolio some diversity.

A new project suggesting that Sainsbury's should open its "Sainsbury's Travels and Tours" has been discussed and a formal report which analyzes

the idea and calculates the projects NPV has been approved by the board and given a go ahead.

A format for quarterly report has been suggested for business updates of the new project every quarter.

Market Position.

The Sainsbury's is the UK's oldest major food retailer with their first store opened in 1869. It strives to keep up with its trusted heritage of quality with best services. The management has a continuous approach towards work with responsibility. They attempt to provide fresh food and innovate with respect to customers' needs. It serves over 18.5 million customers every week. The large stores offer over 30000 products along with complementary Non-Food products e. g. the TU clothing range which has over 1 million transactions every week. Along with other services, an Internet based shopping service has also been made available, keeping in trend with the changing requirements of the customers, to almost 90% of UK households.

In 1995, Tesco overtook Sainsbury's to become the market leader, and Asda became the second largest in 2003, demoting Sainsbury's into third place.

(July 12, 2010 <http://en.wikipedia.org/wiki/Sainsburys>)

(<http://www.j-sainsbury.co.uk/index.asp?pageid=12>)

2. Sainsbury – Financial Structure and Performance:

Sainsbury's is the 3rd largest UK super market with Tesco and Asda as its closest competitor's holding positions as No. 1 and No. 2 respectively.

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Presently Sainsbury's is operating in 872 stores across UK with 150, 000 employees

Sainsbury's closes its financial year in the third week of March every year.

The tools used are the Income Statement, Balance Sheet, Cash flow statement with the Notes to the Financial Statements.

The financial analysis of any company helps determine the financial standing of the company and helps in making decisions and plan future strategy and projects on its basis

The financial figures show a reasonable increase in sales. The gross profit showed a decline from 2007 to 2008 but is again on increasing trend in 2009.

Balance sheet shows growth in goodwill and shares and decrease in the borrowings. This might have been due to increase in the interest rates.

Cash flows show a significant increase in cash in hand which shows the company is stably liquid to handle its operations smoothly. Also the increase is due to sale of its stores.

2. 1. Comparison with Market Leader – Tesco:

2. 1. 1. Ratio Analysis:

Ratio analysis of any company provides very important information regarding the company's financial standing, financial strengths /weaknesses. They are calculated to compare a company's progress against other rivals of the industry as well as its previous performance. The ratios measure

The profitability of the business

The Performance

The quality of company's performance

A company's ability to meet the short term obligations

A company's debt burden

Value of business / Investment

2. 1. 2. Management:

Tesco is the market leader in UK supermarket industry holding almost 31% of the market. The 1st Tesco store was opened in 1929, in Edgware, Middlesex, UK. Since then it has gradually grown in to being the largest supermarket chain in the UK with almost 2200 stores in UK with over 285,000 employees. Since the mid 90's S, Tesco has been investing in new markets overseas, finding new opportunities for growth and means of generating long term returns for shareholders. The group operates in 13 markets outside the UK, in Europe, Asia and North America, and also announced their entry into the Indian market last year, where they are planning to establish cash & carry business.

2. 1. 3. Financial strength:

Both Sainsbury and Tesco have strong balance sheets, equipped with tangible real estate assets. This collateral allows them to borrow at lower rates and generate cash through sale-and-leaseback schemes if required.

Both the company's are operating in a saturated market.

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Sainsbury's almost 90% of revenue is consumed in COGS leaving from 5% to 6. 5% in lieu of gross profit margin and even the other expenses are insignificant comparatively still the company is left with 1. 5% to 1. 9% of net profit.

For Tesco, the situation is not very different from Sainsbury's. Here the gross profit margin is 7% which is a little better from Sainsbury's.

The current ratios and Quick ratios of both the company's are below 1 which is not a healthy trend. In order to obtain any finance the company should have a stable solvency indicator.

The debt ratio indicates that how much of the firm's assets are being financed by the debt. Both the company's show a stable debt ratio of 20% to 30%.

The debt to equity ratio measures the risk involved in investing in the particular company. Sainsbury's shows an acceptable debt to equity ratio of almost 50% but Tesco comparably has a huge debt to equity ratio of 91 which might be because of its full throttle expansion in international markets.

Most financiers analyze the company balance sheet before making an investment decision. The prime motive to check if the company's Capital Gearing is right. Capital Gearing is the relationship between Equity and Debt. It is always considered good for a company to have a reasonable Equity base to a business, as insurance against unexpected losses. This is to minimize the risk as much as possible. If a company has a Gearing of no more than

50% – 67% of their Gross Assets from Debt, depending on the risk associated with the business, it is considered acceptable. The higher the gearing, the more vulnerable the company is to the impact of increased interest rates.

Tesco and Sainsbury both show a sound gearing and though Sainsbury is more healthier to be invested upon, Tesco as well is well within the “ Good Gearing Grounds”

The interest coverage of both company’s show a very healthy standing to meet their interest payments deadlines.

[http://www. financesoutheast. com/](http://www.financesoutheast.com/)

From above comparison it is clear that retail industry is highly saturated and it is nearly impossible for the companies to earn super profits. Effective cost control techniques need to be applied and monitored on regular basis to improve profitability. Sainsbury’s have improved turnover at a rate of 5. 5% a year. Profits have grown even faster; increasing by 6. 7%. Tesco has a little edge based on earning slightly higher profits and showing rapid growth. Both the companies need to improve upon their debt structuring, especially Tesco and hence gradually improve their liquidity ratios.

2. 1. 4. Growth potential:

So far, Sainsbury’s has only concentrated on its business in the UK while Tesco has increased it’s operations in 14 countries. But we should not conclude that Sainsbury is lacking in growth opportunities. Sainsbury’s has two procurement offices in China but again no one is sure as to when

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Sainsbury's will be able to achieve increased growth and improved profit margin without international expansion.

Sainsbury has performed well by adding innovative non-food products and banking services, but competition is tough and increasing in these areas, too

Tesco, on the other hand, may have more growth opportunities in progressing Asian market and elsewhere, but it's also a much bigger entity than Sainsbury. For example, during last one year Tesco had £56.9 billion in turnover as compared to £19.9 billion for Sainsbury.

Sainsbury's has been concentrating on UK store expansion rather than overseas growth. It has increased the total number of stores from 583 in 2004 to 872 today. Today, Sainsbury's need to emphasize on its domestic growth and increase its store efficiencies, which is not an easy task, but it is more achievable than managing and controlling a group of international locations with diverse tastes and demands.

http://www.tescopl.com/plc/about_us/strategy/international/

<http://www.fool.co.uk/news/investing/company-comment/2010/07/16/a-foolish-fracas-sainsbury-vs-tesco.aspx>

3. Weighted Average Cost of Capital:

Debt

Equity

2,357 (Long term debt)

18.64m (shares) * 345 (share price) = 6,431

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3. 1. Equity:

No. of shares outstanding: 1, 864 (m)

Current market price per share: 345

Market Value of equity: $1, 864 * 345 = 6431$

<http://www.google.com/finance?q=LON:SBRY>

[http://www.digitallook.com/companyresearch/10079/Sainsbury_\(J\)/share_prices.html](http://www.digitallook.com/companyresearch/10079/Sainsbury_(J)/share_prices.html)

[http://www.digitallook.com/companyresearch/10079/Sainsbury_\(J\)/share_prices.html](http://www.digitallook.com/companyresearch/10079/Sainsbury_(J)/share_prices.html)

<http://www.bloomberg.com/markets/rates-bonds/government-bonds/uk/>

<http://www.j-sainsbury.co.uk/index.asp?pageid=23>

We calculate the cost of equity through Dividend Growth Model

Which is $Ke = [Do (1 + g) / (MV - Ex Div)] g$

Where

Ke = cost of equity

Do = Dividend given = 14. 20 (pence)

MV = Market value = 345 (pence)

Ex. Div = Ex Dividend = 10. 20 (pence)

g = growth rate = 7. 6%

Cost of equity: $[14. 20(1+0. 076) / (345 - 10. 2)] 0. 076$

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$$K_e = 12.11\%$$

3.2. Debt:

Book value of Debt: 2,135

1,074 @ 4.98%

861 @ 2.36%

171 @ 4.25%

251 @ 4.3%

$$K_d = 3.90\%$$

[http://www.j-sainsbury.co.](http://www.j-sainsbury.co.uk/ar10/downloads/pdf/Sainsburys_AR10_note_20_borrowings.pdf)

[uk/ar10/downloads/pdf/Sainsburys_AR10_note_20_borrowings.pdf](http://www.j-sainsbury.co.uk/ar10/downloads/pdf/Sainsburys_AR10_note_20_borrowings.pdf)

3.3. WACC:

V

K

V * K

Debt

2357

3.90%

9192

Equity

6431

12. 11%

77879

Total

8788

87071

$$\text{Sum VK} / \text{Sum V} = 87071 / 8788 = 9.91\%$$

4. Project:

4. 1. Opening up of Sainsbury's Travel and Tours:

Sainsbury has always aimed to be the consumer's first choice for food, delivering quality products with great service at a competitive cost. The company is striving to achieve the objective of leading margins with diverse market and delivering strong profits every year.

The values of Sainsbury's are defined in their website as

“ The values of the Sainsbury's brand – passion for healthy, safe, fresh and tasty food, our focus on delivering great products at fair prices, a history of innovation and leadership and a strong regard for the social, ethical and environmental effects of our operation – have continued to stand the test of time.

Five principles are at the core of Sainsbury's business:

The best for food and health

Sourcing with integrity

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Respect for our environment

Making a positive difference to our community

A great place to work.

These principles provide differentiation from our major competitors and define and direct all our activities.”

<http://www.j-sainsbury.co.uk/index.asp?pageid=14>

Keeping the tradition of the best services, the management has decided to venture into the ever growing market of Travel and Tourism industry with opening up of Sainsbury's Travels and Tours.

The idea of opening up a Travel Services business branch of Sainsbury's is based on the news of Sainsbury's opening up its “ Travel Clinics” in mid 2008. The clinics were established in outlets initially offering free consultation with nurses offering different injections and health products with advise for people travelling to countries requiring vaccinations and immunization from infections like flu, malaria etc. These products were offered at significantly cheaper prices than in any specialist clinics.

<http://www.holidaylettings.co.uk/resources/industry-news/general-travel/sainsbury-s-launches-travel-clinics-in-21-of-its-supermarkets/a-3-143-1264/>

The Sainsbury's Travels and Tours will provide the company to excel and achieve its strategic goals on the basis

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The supermarket industry has become fairly saturated in the UK and at present Sainsbury's is eyeing to expand itself in the International market but it will be a while before it actually does.

The Travel industry is a growing market and has a huge potential of growth.

The new product will benefit the company earn huge profitability margins which are becoming hard to achieve in the supermarket industry.

The Sainsbury's has a huge loyal customer base which will be utilized for promotions and marketing purpose.

The project has a high probability of success given a chance of a fresh new 'product' offered by a supermarket chain.

The company will use its existing huge customer base for the travel services marketing and promotion.

The existing 'nectar loyalty card' database will help the management to design the product, offerings, travel and tour packages as per the preferences.

4. 1. 1. Project Description and Key Elements:

The project will have a Head Office (With the existing HQ of Sainsbury's at Holborn Circus, London) have initially total 3-4 rooms allocated.

The HQ office will have 7 employees.

Initially only limited stores and selected cities will be setup with the "Sainsbury's Travels and Tour Desk" with one person behind the counter.

The Six major cities (with respect to area / population) i. e. London, Birmingham, Manchester, Glasgow, Belfast and Cardiff covering the whole of UK will be set up initially for kick off of the Travel and Tour Services.

10 stores in London and 5 stores in the remaining cities will be setup for providing the services.

Each of these cities will have a team of 2 people, 1 within the store premises (as mentioned above) and the other for monitoring and reporting purpose.

The number of employees will gradually be increased as per requirements with the project evolvment.

<http://www.ukcities.co.uk/populations/>

4. 1. 2. Initial Investment Cost:

Initial Investment

Cost

Cost of IATA Membership (<http://www.iata.org/membership/Pages/fees.aspx>)

33, 500 GBP

Total Staff 27 – Computers

http://www1.euro.dell.com/content/products/features.aspx/iip_notebooks?c=uk&cs=ukbsdt1&l=en&s=bsd&CID=41142&LID=1069631&DGC=ST

$650 * 27 = 17, 550 \text{ GBP}$

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(including VAT and Delivery)

Server

<http://configure.euro.dell.com/dellstore/config.aspx?b=&c=uk&cs=ukbsdt1&l=en&oc=PE2T610R&s=bsd>

2, 800 GBP

(including VAT and Delivery)

Software

http://www.britishsoft.co.uk/?gclid=CMmGudvPgaMCFSU_IAodWH6Zdg

940 GBP

(including VAT and Delivery)

Total Initial Cost

54, 790 GBP

4. 1. 3. Other Costs:

Type of cost

Cost Amount

Remarks

Salary for 1st year

450, 000

Inc. of 7. 5% each year

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Brochures / Stationary / Equipment

20, 000

Inc. of 10% each year

Marketing Budget

250, 000

Inc. of 15% every year

4. 1. 4. Assumptions:

We assume that Sainsbury will initially target the “ high spenders” from its customer database and target them for the promotions and marketing materials (leaflets etc.)

Initially the holiday packages and tours will be offered for 5 big holiday destinations including Egypt, Turkey, Tunisia, Barbados and Spain.

The packages the calculations are based include a general deal for 4 people for 7 days.

The holiday packages for these destinations cost as follows (based on holiday packages offered by Expedia.

Destination

Price for Customer (average) – <http://packageholidays.expedia.co.uk/tt.aspx>

Actual Cost (with Sainsbury’s profit margin @ 24 (Price – 24%) <http://www.thomascookgroup.com/annual-reports>

Egypt

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1150 (GBP) [286. 5 GBP per person]

874 GBP

Turkey

728 (GBP) [182 GBP Per Person]

553 GBP

Tunisia

1200 GBP [300 GBP per person]

912 GBP

Barbados

3120 GBP [780 GBP per person]

2371 GBP

Spain

1000 GBP [250 GBP per person]

760 GBP

We assume that Sainsbury will succeed on selling on 110 of these above mention packages for each country. Annual Revenues will be 718900 GBP

We assume that annual revenues will increase by 12% (2% more than the average growth in Sainsbury's revenues which is 9.4% given the growth potential in the industry)

Operating cost will include the salaries of the employees, day to day business running expenses etc. since we are sharing the premises of existing Sainsbury's stores and HQ so there will be no extra operating cost except the salaries.

As per the National Statistics Online, the Consumer Price Index (CPI) is at 3.2% and the Retail Price Index (RPI) is at 5.0%. <http://www.statistics.gov.uk/cci/nugget.asp?id=19>. The growing inflation rates have a direct negative effect on the customer's ability to spend on leisure and holidays. Although consumers have gradually developed this sense of planning ahead and saving for their Holidays.

Effective Tax rate of 28% is applied. <http://www.hmrc.gov.uk/rates/corp.htm>

4. 2. Identification of Risk and Uncertainty:

In any new project, one is never sure about 100% results. If the project is based on Risk then we might expect somewhat certain results based on previous data. The cash flows based on Risk might be forecasted and the associated possibilities are also known but in case of uncertainty the outcome is unknown and hence the related probabilities are also unknown. A study conducted with a few managers showed that they think risk is manageable if you have right information, sufficient knowledge about the project, and if the person is experienced in the particular field. Most of them

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stressed on the importance of alternatives, collecting more information and checking different aspects of the problem, along with being actively involved to reduce the risk.. (IAENG International Journal of Computer Science, 32: 4, IJCS_32_4_12)

It is the attempt to manage both the known-unknowns and unknown-unknowns. Preparation for and managing the risk is the result of what is unsure and unknown-decision risk.

4. 2. 1. Affects of Risk and Uncertainty on proposed project:

Let's consider the following aspects while making decision based on risk for the Sainsbury's Travels and Tours

What can go Wrong?

The Sainsbury's already has an established huge no. of loyal customers who would be happy to have an option o a different kind of service offered from their trust worthy service provider. The expectation for a stable turnover is based on the fact that it is an established name offering a new product on the basis of its goodwill.

How likely it is to happen?

The expected growth can be effected by increasing inflation rates.

The Travel Industry faced a huge blow after 9-11 incident.

What are the consequences?

Any unforeseen incident like this (God forbid) will have long lasting effects on the company's growth, profitability and future expansions and plans.

<http://www.robustdecisions.com/decision-making-tools/risk-vs-uncertainty.php>

5. Calculation of NPV:

NPV is a technique where cash inflows which are expected in coming years are discounted back to their present value. This is calculated by through a discount rate equal to the interest that was to be received on the sums, in case the inflows had been saved, or the interest that has to be borne by the firm on the borrowings. In case of more than one project appraisal, the firm should choose the one that produces the highest NPV.

5. 1. Sainsbury's Travels and Tours Expected Cash Flows (for 3 years):

The project has a positive NPV which is a healthy sign for the project. It can be proceeded with. The project is going to be beneficial for the company and add to the shareholders value. A positive NPV means that the project is worthwhile because the cost of tying up the firm's capital is compensated for by the cash inflows that result.

http://www.bized.co.uk/timeweb/reference/using_experiments.htm

6. Quarterly Report Format:

As per the requirement of the board every quarter a report has to be sent for updated performance and progress information. The report has to serve the purpose of giving a complete up to date data to be analyzed by the board. A company analysis gives a complete performance and financial picture of the company. The report should include all the data necessary to quickly compare it with the major competitors.

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6. 1. Reporting Layouts:

The report will be in Excel sheet format.

The Information provided will be in different excel sheets in the same document each covering a preceding quarter to give convenient comparisons

Title of the report: Sainsbury's Travels and Tours

Addressed to:

Date: from -/-/ to -/-/:

Date of submission:

Submitted by:

6. 1. 1. Holiday Packages Bookings:

6. 1. 4. Comparison of Actual and Forecasted performance:

The calculation of the “ Sainsbury's Travels and Tours' project NPV has been made by going through the three years forecasted figures of the company which show that it is progressing towards a high performing entity with reasonable growth in profit. Although with the growth of the company eventually it will require to use more resources in term of offices, employees, equipment, marketing budget etc. but the current performance clearly suggests that it will very strongly bear all the changes and keep on showing a steady growth.

7. Conclusion:

Sainsbury's is one of the key players of the existing supermarket industry in UK. This report gives an overview of its performance during the last couple of years, dealing with the financial figures we have tried to analyze the financial standing and strength and the comparison with the main market leader Tesco gives a fair idea of both the company's approach towards business.

Although Sainsbury's has not yet ventured into the International market but the step might not be that far away keeping in mind the huge success TESCO has had in the international market.

Sainsbury's has a huge loyal customer base. The suggested new service product through

' Sainsbury's Travel and Tours' will provide these customers to utilize yet another trustworthy service by their trusted name.

The growing Travel and Tours market will definitely have a positive effect on the Sainsbury's portfolio by increasing its profits and hence strengthening its business.