

# Marks and spencer business and financial performance analysis



Marks and Spencer is a British retail giant specialised in apparel and food industry. The company had been in its business for more than hundred years and has the biggest market capitalisation in the retail industry. This research is conducted to measure and analyse the business and financial performance of the company. Business performance is measured in this study considering the opportunities and constraints in company macroeconomic and industry circumstances. Financial performance had been measured using ratios on profitability, liquidity, efficiency and leverage. There performance of M&S is then compared with the financial performance of Next Group, the next biggest player in British retail industry. The study found that, although M&S has many business successes over the years, it had been performing financially poorer than Next Group and needs emergency improvement in its liquidity. The study recommends Marks and Spencer to rethink its leverage strategy and exploit the benefit of debt as like Next Group.

## **Chapter 1**

### **Introduction**

#### **1. 1 Study Background**

Marks and Spencer is one of the largest retailers in UK specialised in clothes and foods with a market capitalization of more than £6400 million<sup>1</sup>. We have over 700 stores located throughout the UK and Republic of Ireland; this includes our largest store at Marble Arch, London. In addition, the company has over 300 stores worldwide, operating in more than 40 territories<sup>2</sup>. In 2010 the company's sales revenue from general merchandise was £4. 1 billion and £4. 3 billion from foods. Its nearest competitor Next, which has a market capitalisation of around £4100 million<sup>1</sup>, had a turnover of £3. 41

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million in 2010 with a market share of 8.3% in comparison to 11% by Marks and Spencer in general merchandise segment. This study is particularly concerned with the business and financial performances of Marks and Spencer which are compared with the performances of Next.

## **1. 2 Study Objectives**

The prime objective of this research is to analyse and evaluate the key business and financial performances of British retail giant Marks & Spencer from year 2007 to 2010. While achieving this objective the research will try to meet the following secondary objectives –

1. 2. 1 Analyse the major business performances of the company over last three years: The study will examine the company's performances in major business areas including its growth, market share, competitive position in the whole macro environment and major strengths over its competitors.

1. 2. 2 Identify and analyse the measures key financial performances: The second objective of the study is to identify the measures of company's financial performances especially in profitability, liquidity, investment and leverage performances. Besides this operational performances in other areas would be identified and analysed under this objective.

1. 2. 3 Compare the performances against Next: The third objective of the study is to compare the financial performances of M & S with the performances of Next, the nearest competitor in general retail section.

1. 2. 4 Identify the major problems of Marks & Spencer in business and financial performances and provide recommendations: Finally the study will

try to identify the major weaknesses of Marks & Spencer's based on the measures of business and financial performances. The research will also formulate

### **1. 3 Study Scopes and Usefulness of the Study**

Scope of this research work is three years' (2007-2010) business and financial performances of Marks and Spencer. The scope also includes financial performance of Next for the same period. The findings of the study can be useful information for investors. The method used by the study can be a guide for the business and financial analysts.

### **1. 4 Research Structure**

The research paper is structured in line with the sequence of objectives. The first chapter includes the rationale and objectives of the study. Then relevant literatures and theoretical issues are discussed in chapter two. The third chapter will present the methods of conducting this research work. Company's business performances and financial performances would be presented consecutively in chapter four and five. In chapter six Marks and Spencer's performance will be compared with Next's performance and areas of improvement for M & S would be identified. Finally in chapter six recommendations would be provided with final remarks.

## **Chapter 2**

### **Literature Review**

#### **2. 1 Introduction**

As discussed earlier, this research work is concerned with the business and financial performance of Marks and Spencer. This chapter will narrate an <https://assignbuster.com/marks-and-spencer-business-and-financial-performance-analysis/>

overview of the business operation of the company. This chapter will also review the techniques of measuring business and financial performance especially using qualitative and quantitative techniques along with brief interpretation of the performance measures.

## **2. 2 Marks and Spencer: An Overview**

Marks and Spencer is a FTSE 100 company with the largest revenue base of more than £8 billion as a retailer. It is headquartered in City of Westminster, London having operation in more than 40 countries. The following section provides a brief discussion on company's history, main line of business, geographical spread, summary of financial performances, its corporate social responsibility and the management.

### **2. 2. 1 Corporate History**

Marks and Spencer was established in 1884 by Michael Marks and Thomas Spencer<sup>3</sup>. The company had a policy of selling only British-made goods which made it popular in early 20th century. It started its apparel brand St Michael in 1928 and in 1950 St Margaret label was introduced for woman clothing. The company started its international expansion in 1970s by putting its step in central Europe and Ireland. During its hundred years of lifetime the company became the pioneer in quality management, customer relationships, health and safety and energy efficiency. The company's performance briefly slumped during the first decade of new millennium. However, the company is back to profit and growth in 2010 under the strong leadership of Marc Bolland who joined the company as CEO in May 2010.

## **2. 2. 2 Core UK Businesses**

M & S's core UK businesses include general merchandise and foods. It is largest clothing retailer including womenswear, lingerie and menswear and kidswear. Last year the company's turnover in general merchandise was £4. 1 billion which constituted a stunning 11% of the overall market share. Marks and Spencer is also the leading provider of high quality food, selling everything from fresh produce and groceries, to partly-prepared meals and ready meals and an award winning range of wines. Turnover from foods was £4. 3 billion in 2010 with a modest market share of 3%.

## **2. 2. 3 Sales Channel**

Customers shop with M&S in many ways – in stores, online or over the phone (M&S Annual Report, 2010). The company has 690 stores across the UK. Its shops are located in convenient locations – from high streets to retail parks, train stations to airports. Over the past four years the company has transformed these stores into bright and contemporary destinations with a range of hospitality options. The company also sells online which it calls M&S Direct. M&S Direct is a platform for improving customer convenience and service including via its website and newly launched ' Shop Your Way' facility. The company aims to achieve £500m in sales through M&S Direct by 2010/11.

## **2. 2. 4 International Business**

M&S has 320 owned and franchised stores in 41 countries. The company's mix of ownership models and countries enabled it to perform well over the

past year even when individual markets were weak. In 2010 its international turnover was £949 million which is more than 15% of its overall revenue.

## **2. 2. 5 Recent Business and Financial Performances**

In 2010 the company's sales were up by 3. 2% despite recessionary pressure. The overall gross margin was 41. 2% with sales revenue £9. 3 billion. The company significantly improved its cost by saving £145 million. The company reduced its capital expenditure cash outflow and generated a cash inflow of £412m after tax and dividend. However, the company's market share was slightly down from 4. 3% to 3. 9%. Average visit to M&S shops had been estimated around 21 million and average mystery shopper score was found to be stunning 89% in 2010.

## **2. 2. 6 About Next: The Nearest Competitor**

NEXT is the second largest UK based retailer offering clothing, footwear, accessories and home products. It distributes through three main channels: NEXT Retail, a chain of more than 500 stores in the UK and Eire, NEXT Directory, a home shopping catalogue and website with nearly 3 million active customers, and NEXT International, with more than 180 stores around the world. In 2010 the company had overall revenue of £3. 4 with a profit after tax of £400 million.

## **2. 3 Techniques of Measuring Business Performances**

A company's business can be analysed using various tools like PESTLE, SWOT analysis and Porter's five force models. Measures of business performance might be company's expansion rate, revenue growth, development of strength, management of weaknesses and exploitation of

opportunities etc. These measures can be achieved by subjective analysis and using business analysis tools. A brief discussion on these tools is presented as below.

### **2. 3. 1 PESTLE Analysis**

PESTLE, which is a popular macro-environmental analysis tool, stands for Political, Economic, Social, Technical, Legal, and Environmental analysis.

Political factors include government's tax policy, employment and environmental law, trades and tariffs regulation, and political stability.

Common Economic factors are GDP growth, nominal interest rates, exchange and the inflation rate. Key social factors are population growth, age

distribution, health consciousness, religious views and career attitudes etc.

Technological factors are spread and dependence on technology, innovation, research, and technological change etc. Legal factors are laws on

discrimination, consumer, health and safety law etc. Finally environmental factors include weather, climate, climate change etc.

### **2. 3. 2 Porter's Five Force Model**

The five forces model is an industry analysis tool and provides a good idea of how a business should perform inside an industry. The model analyses five industry variables.

These variables are – ease of getting entry into industry, availability and potentiality of substitute products, suppliers' and customers' bargaining power and degree of competition in the industry. These factors determine how attractive and profitable an industry might be.



### **2. 3. 3 SWOT Analysis**

PESTLE and Porter's models are used to analyse a company's macro and industry environment. SWOT Analysis is used for measuring a company's internal strengths and weaknesses. It also helps to identify specific opportunities and threats to company from the macro environment.

### **2. 4 Techniques of Measuring Financial Performances**

Generally, financial performances are measured using the financial information of a company. Practically, ratio analyses are conducted on financial statement figures. Financial statements include company's income statement, balance sheet, statement of cash flow and statement of equity. There are several types of ratios – profitability, liquidity, efficiency, gearing, and investor ratios. In following sections these groups of ratios are briefly discussed –

#### **2. 4. 1 Profitability Ratios**

These ratios are also called performance ratios where profit at different levels are compared with other figures and expressed in percentage. These ratios are –

(a) Gross Profit Margin: Gross profit margin is found by dividing gross profit by sales turnover and the formula looks like following –

The ratio can be a good indicator of company's direct cost or cost of sales. Profitability of a company in its core operation can be determined using this ratio. The higher the ratio the better it is.

(b) Operating Profit Margin: Operating profit margin is found by dividing net profit by sales turnover and the formula looks like following –

As operating profit is found by deducting indirect expenses from gross profit, the ratio shows how much a company spends on non-direct activities. Too much cost on indirect cost might result in lower or negative operating profit margin.

(c) Return on Capital: Shareholders and debt investors generally count profit on their investments. Return on capital can be calculated using the following formulas –

This ratio (ROCE) provides percentage return on the overall funds invested in the business. There is another ratio that provides return on stockholders' equity which is called Return on Equity (ROE). The formula is as following –

ROE measures the profitability of the fund provided by the company's owners or shareholders.

Profit margins and return on capital ratios together gives a good idea of overall profitability of the firm. A company having very good profit margin may have a poor ROCE or ROE ratio. Such cases happen when companies large investment operates in small scale or during the initial years.

## **2. 4. 2 Liquidity Ratios**

These are also known as solvency ratios, as they refer to the ability of the business to pay its payables in the short term. There are two main liquidity ratios.

(a) Current Ratio: This is also known as the working capital ratio, as it is based on working capital or net current assets. It is calculated as:

Current ratio is a measure of the liquidity of a business that compares its current assets with those payables due to be paid within 1 year of the statement of financial position date (otherwise known as current liabilities).

(b) Quick Ratio: This is also known as the acid test ratio and is calculated as following -

This is similar to the current ratio, but takes the more prudent view that inventories may take some time to convert into cash, and therefore the true liquidity position is measured by the relationship of receivables and cash only to current liabilities.

### **2. 4. 3 Efficiency Ratios**

These ratios are also referred to as use of assets ratios. They measure the efficiency of the management of assets, both non-current and current.

(a) Asset Turnover Ratio: These ratios compare the assets with the sales revenue (turnover) that they have earned. The end result is often expressed in money value to represent the value of sales revenue for each \$1 invested in those assets. The formula is:

(b) Inventory Days: Inventories may be analysed by calculating the ratio of inventories to cost of sales, and then multiplying by the number of days in a year to give inventories days. The formula is as following -

This figure gives the number of days that on average an item is in inventories before it is sold; this may alternatively be expressed as the number of days a firm could continue trading if the supply of goods ceased.

(c) Receivable Days: This is a measure of the average time taken by customers to settle their debts. It is calculated by:

As with inventories days, a slowing down in the speed of collecting debts will have a detrimental effect on cash flow. On the other hand, it may be that the business has deliberately offered extended credit in order to increase demand.

(d) Payable Days: This is a measure of the average time taken to pay suppliers. Although it is not strictly a measure of asset efficiency on its own, it is part of the overall management of net current assets. It is calculated by:

The result of this ratio can also be compared with the receivables days. A firm does not normally want to offer its customers more time to pay than it gets from its own suppliers, otherwise this could affect cash flow. Generally, the longer the payables payment period, the better, as the firm holds on to its cash for longer, but care must be taken not to upset suppliers by delaying payment, which could result in the loss of discounts and reliability.

It is important to recognise when using these ratios that it is the trend of ratios that is important, not the individual values. Payment periods are longer in some types of organisation than in others.

## 2. 4. 4 Capital Structure Ratios

Different firms have different methods of financing their activities. Some rely mainly on the issue of share capital and the retention of profits; others rely heavily on loan finance; most have a combination of the two.

(a) The Gearing Ratio/Leverage Ratio: Gearing is a measure of the relationship between the amounts of finance provided by external parties (e. g. debentures) to the total capital employed. It is calculated by:

The more highly geared a business, the more profits that have to be earned to pay the interest cost of the borrowing. Consequently, the higher the gearing, the more risky is the owner's investment. On the other hand, a highly geared company might be more attractive to shareholders when profits are rising, because there are fewer of them to share out those profits.

(b) Interest Cover: Connected to the gearing ratio is a measure of the number of times that the profit is able to 'cover' the fixed interest due on long-term loans. It provides lenders with an idea of the level of security for the payment. The formula is:

## 2. 5 Using Ratio Analysis

Calculating the ratios is only one step in the analysis process. Once that is done, the results must be compared with other results. Comparison is commonly made between:

Previous accounting periods;

Other companies (perhaps in the same type of business);

Budgets and expectations;

Government statistics;

Other ratios.

## **2. 6 Conclusion**

This chapter gave brief overview of Marks and Spencer and also the tools and ratios that will be used to analyse the business and financial performances the company. The same ratios will be used to compare the performance of M&S with Next. The next chapter will provide a brief overview on the research methodology and data that will be used for the research.

## **Chapter 3**

### **Research Methodology**

#### **3. 1 Introduction**

Methodology may be defined as procedures that are used to conduct a function or activity. This chapter will briefly discuss on the methodology that will be used to analyse the business and financial performance of Marks and Spencer and comparing its performance with that of Next Inc. This section will also provide an overview of the data used in this study and their sources.

#### **3. 3 Required Data, Sources and Collection Methods**

Data required for completion of this research work are of secondary nature.

Mark & Spencer's business related information were collected from company's website and annual reports of three years – 2007, 2008 and 2009. Annual reports were collected from company website. The data <https://assignbuster.com/marks-and-spencer-business-and-financial-performance-analysis/>

required for macro-environmental analysis were collected from various articles, national statistical websites and newspapers. Financial information required for analysing financial performances are extracted from the annual reports of the company. Financial information of Next was collected in the same way. Findings of financial performance analysis are then used to identify the areas of improvement for M&S.

### **3. 4 Research Methodology**

Various quantitative and qualitative methods had been used to achieve the objectives these research. The nature of the methodologies are briefly discussed as following –

#### **3. 4. 1 Method for Analysing Business Performances:**

Method used for this purpose is qualitative. PESTLE analysis had been used for analysing the business performance in macro-environment. Porter's model were used for analysing industry performance and position of M&S. Finally, SWOT analysis was used to find out company specific opportunities and threats and company's key strengths and weaknesses. (See Chapter One to have idea of these tools).

#### **3. 4. 2 Methods Used for Analysing and Comparing Financial Performances:**

Financial ratio analysis (discussed in chapter 1) is used to analyse the company's performance in profitability, liquidity, efficiency and leverage. The values of these ratios are compared against the ratios of Next to compare the performances of two companies. For presentation of findings different types of charts were used.

### **3. 4. 3 Methods of Identifying Improvement Areas:**

Areas of improvement would be identified using the findings of financial performance analysis using ratios. The areas where Next is performing better than M&S would be identified as areas of improvements. After identifying areas of improvement strategy would be formulated to eliminate problem areas in company's financial performances.

### **3. 4. 4 Research and Data Analysis Tools**

Microsoft Excel 2007, which is a popular spreadsheet application, is used for conducting the ratio analysis and presenting findings of analysis graphically.

### **3. 5 Conclusion**

This chapter provided a brief overview of the research data, methods and tools used in this research. In next, chapter the findings of the research would be presented followed analysis of findings.

## **Chapter 4**

### **Analysis and Findings**

#### **3. 1 Introduction**

This research is conducted based on the information available on the Annual Reports of Marks and Spencer and Next Group as well as on the findings of professional business analysts found on reliable internet sources. In this chapter, the most important section of this study, key findings of company's business performance in light of PESTLE, Five-Forces and SWOT analysis and also the financial performance over last three would be presented. A comparison of performance with Next Group would also appear in this section.

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## **3. 2 An Analysis of M&S's Business and Performance Summary**

Business performance of Marks and Spencer can be measured in reference to the factors available in macro-economic environment, factors in apparel and food industry and in terms of company's strengths and weaknesses. The findings of business analysis are presented as following.

### **3. 2. 1 Findings from PESTLE Analysis & M&S's Performance**

Key factors relevant to Marks and Spencer's business found from PESTEL analysis can be summarised as following (table 3. 1) –

Recent political development in United Kingdom is posing threat to many businesses in form of rise in tax rate, cut of social benefit and cap in immigration. There is also setback of recession that had injured the British economy significantly. Despite these negative elements in political and economic environment Marks & Spencer's revenue has grown at a steady rate over last three years (See Chart 4. 1) showing no sign of recessionary impact on its business. Social environment however demonstrate goods signs for clothe and food retailers. Marks and Spencer had introduced various successful brands that meet the changing social pattern and consumer demand. The company is also successful in adopting technologies. Its ecommerce sales have increased at a sizable chunk in last few years. M&S has also successfully used consumer research technologies for identifying market demands and customer needs. The retailer has proved it as one of the most energy conscious and environmentally friendly company

in British history. Marks and Spencer is a century old company and had well adopted itself in the macroeconomic context of United Kingdom.

British retail industry is run by a few very big players. In apparel retailing the popular names are Marks and Spencer, Next and Debenhams. However, food retailers like Tesco and Asda are trying to get into apparel market with lower prices. However, for completely new businesses it would be very tough to challenge companies like Marks and Spencer which have grown its market share by 4% from 7% to 11% in cloth and general merchandise. The company's market share has also improved by 2% in 2010. However, M&S could not maintain its image regarding its relationships with suppliers. Many international pressure groups had criticised its bargaining power on its suppliers.

### **3. 2. 2 SWOT Analysis and M&S's Performance**

Marks and Spencer is well capitalising on its strength by adding more clothing brands and stepping foot in international markets. Last year company's international revenue was more than £900 million with a growth of 5%. The company also have capitalised on ecommerce technology; in 2010 M&S Direct's revenue grew by 27%.

### **Financial Performance Analysis**

In this study, Marks and Spencer's financial performance have been analysed on four performance areas. These areas were – profitability, liquidity, efficiency and leverage. For measuring performance in these areas eleven different ratios had been used. The findings of ratio analysis are presented as following.

### 3.3.1 Profitability: M&S vs. Next

Average operating profit of M&S and Next is respectively 11% and 15%.

Though revenue of both the companies grew over the period, operating profit was steady. However, according to findings Next Group is more profitable than Marks and Spencer. Next's Return on Capital Employed and Return on Equity are also significantly higher than M&S (See Figure 4.3 and 4.4).

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Based on the above analysis, the research concludes that Next Group is a highly profitable business by providing extra ordinary return to its equity holders.

### Liquidity Performances

Both the companies' liquidity is poor scoring far below standard value of 2: 1. Marks and Spencer's liquidity is at an alarming level of around 50% capability of paying off its current liabilities. Also, over the year none of the retailers could improve liquidity performance.

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### 3.3.4 Efficiency

Although in profitability and liquidity M & S is lagging behind Next, in case of efficiency in receivables, payables and inventory management M&S had been showing excellent dexterity. ....

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The ratios (Figure 4. 6) indicate that, inventories are sold in 23 days by M&S and in 40 days by Next after purchase. On the other hand, M&S is capable of collecting its receivable assets within eleven days of sales which Next can do in 67 days. Payable days are matched with receivable days. However, though M&S's collection from customers is faster, its payment frequency to suppliers is a little slow. This might a sign of efficiency in working capital management. The reason behind M&S's extra ordinary efficiency is because of its long experience in British industry.

Average Asset Turnover Ratio of M&S over the last fours years is below 1. 5 which is above 2. 0 for Next. The ratio indicates that M&S can generate sales of around £1. 34 against £1 of its assets which, though is not poor, in comparison to Next is pretty ordinary.

### **3. 3. 5 Leverage Performances**

Leverage indicates the use of debt in boosting of equity return. Both Marks and Spencer and Next Group use debt which is reflected in their gearing ratios (See Table 4. 7).

. From Figure 4. 8 it can be easily understood that Next Group a highly geared company in comparison to Marks and Spencer. M&S's policy seems to be keeping long-term debt less than 50% in its balance sheet. The leverage ratio better explains why Next's Return on Equity is very high.

Now question is “ are the company's comfortable with these levels of leverage?”

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In managing its leverage M&S is again performing poorer than Next. While Next's average interest cover ratio is 13.45 times, M&S's one is only around 6 times. The figures indicate that, M&S generate only around £6 of operating profit for paying £1 of debt cost.

Therefore the leverage ratios indicate that M&S's competitor is better managing its leverage with higher interest coverage ratio against higher leverage rate.

### **3. 4 M&S Summary of Business and Financial Performance**

#### **Business Performance Summary**

#### **Financial Performance Summary**

Marks & Spencer's revenue has grown at a steady rate over last three years

Introduced various successful brands that meet the changing social pattern and consumer demand.

Ecommerce sales have increased at a sizable chunk in last few years.

Successfully used consumer research technologies for identifying market demands and customer needs.

Most energy conscious and environmentally friendly company in British history.

Grew its market share by 4% from 7% to 11% in cloth and general merchandise.

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Market share has also improved by 2% in 2010 in foods.

M&S could not maintain its image regarding its relationships with suppliers.

International revenue was more than £900 million with a growth of 5%. The company also have capitalised on ecommerce technology; in 2010 M&S Direct's revenue grew by 27%.

Average operating profit margin is 11% in comparison to 15% of Next;

Liquidity performance is very poor; Both current and quick ratios are less than 0.5;

Average asset turnover rate is more than 1 in comparison to 1.5 of Next;

Inventory, receivables and payables management is highly efficient and better than Next;

Moderately levered company while Next is a highly levered one;

Interest coverage ratio is healthy; but Next is doing better which shows the rationale behind using more debt by Next

Overall financial performance of M&S is not satisfactory against its competitor.

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Table 4. 9: Performance Summary

## **Chapter 5**

### **Conclusion & Recommendations**

#### **5. 1 Introduction**

In previous section, it has been observed that Marks and Spencer's financial performance is not satisfactory in comparison to Next Group. Except the efficiency areas, M&S needs to improve itself in profitability, liquidity and leverage.

#### **5. 2 Improving Profitability**

M&S's average operating profit margin was only around 11%. It is found that though company's revenue has grown in last three years its profit margin shrank because of increase costs. Marks and Spencer needs to cut its operating costs to match its profitability with the industry.

#### **5. 3 Improving Liquidity**

The company's liquidity is below the alert level which had been persistent over last four years. Although for very large and established company's it is not a big concern. However, in times