Finance and Marks and Spencer

Phil Waterhouse analyses Marks and Spencer's accounts to help you sharpen your exam skills

For many students the topic of finance is the one they worry about the most. However, give a profit-and-loss account or a balance sheet to successful business owners and they tend to get excited, as the numbers help to reveal the true position of the business and the relative strengths and weaknesses of the company.

Publicly listed companies publish their full financial accounts each year, and these reports are available from the London Stock Exchange. Major plc accounts can appear daunting to A-level students, as technical language is often used, but fundamentally the account ratios and margins that you calculate in class are there to be analysed and used effectively.

No longer number one?

The high street continues to be a highly competitive marketplace, though the emergence of e-commerce and online-only stores has cut into the sales figures achieved by the major players on the market. Once the undisputed king of the UK high street, Marks and Spencer (M&S) has faced increasingly difficult times. While the fortunes of the business saw a revival under former CEO Stuart Rose, the last few years have brought further challenges for the company in terms of falling market share and fluctuating profits despite an increase in turnover for the group as a whole.

The challenge for the current CEO Marc Bolland is to improve the operating profit margins. This is good news for investors in the business. In the last set of half-year accounts the company was able to report that underlying profits rose by 6.1% to £284 million, but after taking into account one-off items pre-tax profits fell 22.7% to £216 million. This is where it becomes important to fully understand what the accounts are revealing, as the company has reported increased profitability despite overall sales falling by 0.4% in the last 6 months. The one-off costs included almost £50 million on revamping stores across the UK and Europe, which will mean the current set of accounts takes the brunt of this, but hopefully it will pay off in the longer term.

Paying dividends

The share of profits that the company allocated to its shareholders increased by 6.3% to 6.8p a share. At the time of writing each share in M&S was trading at 462p, which gave the company an overall valuation of £7.8 billion. The fact that M&S's share price has risen by over 20% in the past year suggests that the financial institutions believe that Marc Bolland is the right man for the job to turn the business around.

The focus for the company has been on trying to discount fewer of its prices, which could impact on cash flow as consumers opt for cheaper alternatives, but it will mean that the company can enjoy higher gross margins on the products it sells. This has been a feature of its UK strategy, and by looking to bring more production of products in house the company aims to reduce operating costs, which will further increase profit margins.

It could be argued that instead the firm should look to pass on these cost savings to customers in the form of lower prices, but this is where the functional area of marketing comes in. The company is keen to position itself at the higher end of the market in terms of price and quality, and so rather than get into a price war with other retailers, it is happy to endure lower sales figures as long as the margins are maintained or improved. This is the key message that Marc Bolland is keen to get across and one that for now the shareholders and investors are buying into.

Good food, bad clothes?

The issue for the firm is the performance of its clothing range. By analysing the full breakdown of the accounts, it can be seen that 40% of sales for the business comes from the clothing range, and it is this aspect of the business that is underperforming, with like-for-like sales down on the previous year. The food section is growing and has been the business' redeeming feature for a while. Overall like-for-like sales for M&S fell by 0.4% in the UK, but food sales rose by 0.2%.

Being an international operation, the company is also susceptible to both increased competition from overseas and currency fluctuations. This is a further area that the business needs to work on, as international sales fell 0.9% (5.1% in real terms). Again the company chose to absorb higher costs rather than raise prices.

All of this information is vital to shareholders and stakeholders alike and will provide useful insight into the performance of the business in both the short and long term. It is always important to compare financial data over the life of the business itself with other competitors in the market. Making comparisons and spotting trends in both the firms' performance and within the context of the industry as a whole is vital. The ratios that you have been taught in class will be examined in two ways:

- You will be expected to recall the key formulae to make calculations.
- To access the higher marks you need to be able to interpret the data to gain analysis marks.

The accounts in Tables 1, 2 and 3 show how M&S has performed over the last 5 years, but what they don't reveal is how the firm has performed against other companies.

Analysing the accounts

When summarising, you should be able to identify trends over the last 5 years, revealing growing sales turnover and fairly consistent levels of profits and therefore good levels of profit quality for the firm, despite the pressures it has faced from external factors. Issues such as the general downturn in consumer spending due to the recession, along with increased competition from rivals in the food supermarket sector such as Aldi and Lidl, have made the whole marketplace more competitive.

M&S has adopted a Porter differentiation strategy to maintain its position at the higher end of the market. Profits after tax of over £450 million for the last 5 years suggests a strong company. However, by now you should understand the importance of calculating percentage margins. By calculating these you should be able to see that there is much greater variation in performance.

Table 1 M&S gearing and ROCE (2015)

Gross gearing	60.97%
ROCE	9.86%

Source: http://shares.telegraph.co.uk/fundamentals/?epic=MKS

Table 2 M&S profit-and-loss data

Year	Sales turnover (£m)	Profit (£m)	Earnings per share (p)
2011	9,740	599	38.80
2012	9,934	490	34.90
2013	10,027	458	29.20
2014	10,310	506	32.50
2015	10,311	482	29.70

Source: http://shares.telegraph.co.uk/fundamentals/?epic=MKS

Table 3 M&S balance sheet

	2011	2012	2013	2014	2015
Assets (£m)					
Tangible assets	4,662	4,790	5,034	5,140	5,031
Intangible assets and goodwill	528	584	695	808	858
Investments and other non-current assets	513	439	571	586	852
Total non-current assets	5,702	5,813	6,300	6,535	6,741
Inventory	685	682	767	846	798
Trade and other receivables	250	253	245	310	322
Cash and equivalents	470	196	193	182	206
Other current assets and assets held for resale	236	329	63	31	130
Total	7,344	7,273	7,568	7,903	8,196
Liabilities (£m)					
Short-term liabilities	2,210	2,005	2,238	2,349	2,112
Long-term liabilities	2,457	2,489	2,843	2,847	2,886
Total	4,667	4,495	5,081	5,196	4,997
Net assets (£m)					
Net assets	2,677	2,779	2,486	2,707	3,199
Equity (£m)					
Share capital	392	412	423	409	413
Retained earnings	5,873	5,991	6,117	6,325	6,671
Share premium account	255	294	315	356	392
Other equity	(3,851)	(3,897)	(4,330)	(4,381)	(4,275)
Total	2,677	2,779	2,486	2,707	3,199

Source: http://shares.telegraph.co.uk/fundamentals/?epic=MKS

The food section has long been M&S's redeeming feature

It is always best to work with percentage margins rather than absolute values.

M&S is rather highly geared and this needs to be factored in. With UK interest rates at a record low, it is not that significant right now, but with the UK economy starting to recover and move into growth, there is likely to be significant pressure in the coming months to increase interest rates, which will add to the interest payments on long-term loans. This could impact on M&S's overall profitability, despite the company having a relatively strong cash flow position.

The return on capital employed (ROCE) is relatively healthy and reflects a business that is still a relatively safe bet for investors, despite the various challenges. As long as it is able to improve what it offers in regards to its clothing provision, the future shows considerable promise.

The problem is that its clothes have fallen into the middle of the market — not cheap enough to compete on price, and not differentiated enough to justify a higher price. In the future it is essential that M&S attracts younger customers to its clothing line, or moves its focus to the food retail sector, or both. While you might be able to draw these conclusions without having the financial data to hand, your analysis becomes a lot more effective when you have the data to back it up. So try and learn to love the numbers — they reveal a lot.

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disasters

M&S e-commerce

In 2015, with e-commerce sales still in a sharp growth phase in the UK, Marks and Spencer reported that its online sales were 2% down on 2014. While John Lewis had pushed online to 33.3% of its business by 2015, M&S had to make do with 15%. That figure matches the John Lewis position in 2010, so M&S is 5 years behind. For a business with as many strategic problems as M&S, getting online wrong is a disaster.

Twenty years ago M&S was king of the UK high street. Every shopping centre property developer's number one priority was to secure agreement that M&S would be there. M&S could push for bargain rents because the developers were desperate for a signed contract. Once you could tell other retailers 'M&S is signed up', renting out the rest of the shop space was no problem.

What followed was a series of mistakes by chief executives trying to find a quick fix for the long-standing M&S problem that its clothes were too old and too dull. Fixing that problem would probably take 10 years of consistent focus — and a willingness to ditch older customers.

But what went wrong with the online offer? If John Lewis could succeed so effortlessly, why not M&S?

The first M&S e-commerce offer came in 2007, with a site developed jointly with Amazon under a contract that would run until the end of 2013. In 2010 new chief executive Marc Bolland wanted something bigger and bolder. He wanted to 'develop M&S into an international, multi-channel retailer, making the M&S brand more accessible to more customers around the world'. So this was the development focus for the in-house M&S IT team — and would succeed the Amazon deal.

By 2012 IT websites were reporting that M&S was spending £150 million on its complex, all-embracing new software platform. The company announced the start of a 2-year testing programme to make sure that customers loved the new site. It also built a dedicated e-commerce distribution centre at Castle Donington, near the M1 motorway.

When the new M&S website started in 2014, online sales fell by 8%. Customers found the site too complex to navigate. Today M&S should probably have around a third of its sales online, which would be more than £1 billion. In fact the figure is £600 million and its international sales position is weak. Bolland's online strategy has failed, but he is still M&S chief executive.