IB Business and Management Standard Level

Written Commentary

What caused Woolworths Group Plc to enter administration?

Word Count: 1495

Centre Name:

Centre Number:

Candidate Name:

Candidate Number:

Contents

Procedure

The commentary will be based upon the following supporting documents:

Secondary:

1. Fundamentals for Woolworth Group Plc
2. Article by Robert Stevens "Britain: Woolworths and MFI go bust"
3. Woolworths Group Plc Annual Report 2008

Primary:

4. Woolworths Survey

Introduction

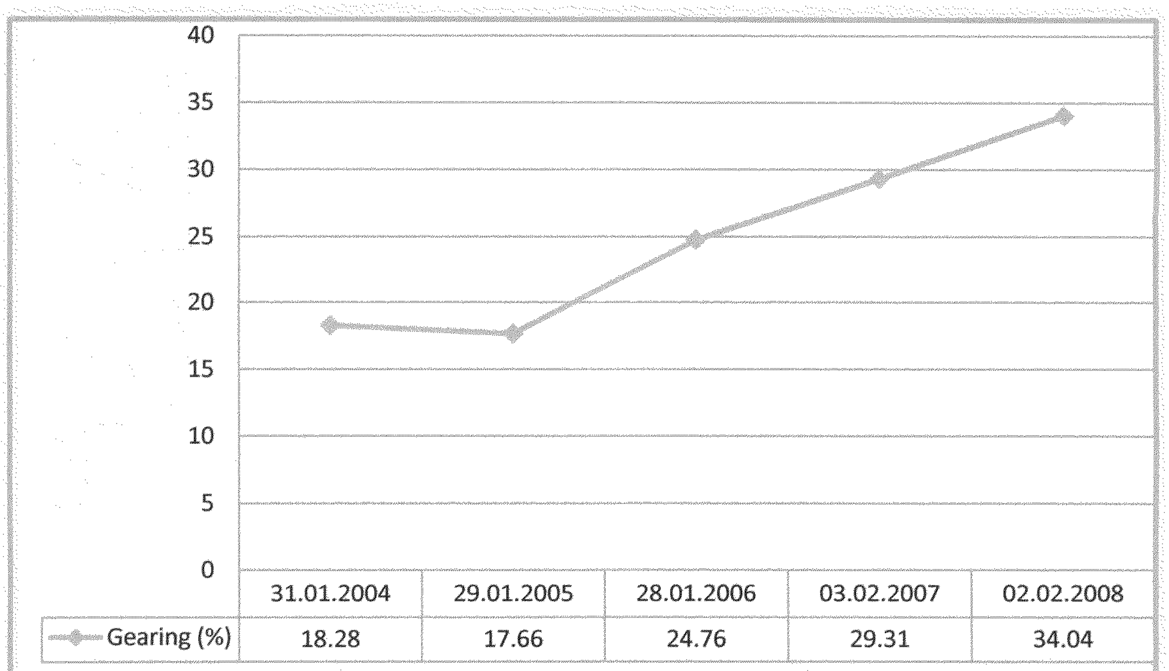
Woolworths Group Plc has entered administration. The firm consists of:

- 58% Retail
  - Woolworths Chain Stores
- 42% Entertainment Wholesale and Publishing
  - 2 |Entertain: joint venture with BBC Worldwide Limited
  - Entertainment UK Limited ('EUK') : distributor of entertainment products
  - Bertram Group Limited : Books wholesale, distribution and publishing

When a firm enters into administration, because funds aren't sufficient to continue trading, it is put into the charge of an administrator who will either; attempt to rescue the company, use its assets to repay its debts or sell the company on. When trying to sell the business is unsuccessful the firm usually enters liquidation.

This commentary will analyse the causes behind Woolworth's administration; using a SWOT analysis, focusing on their gearing and return on capital employed ratios and a Boston matrix.

Analysis



Gearing Ratios for Woolworths from 31.01.04 to 02.02.08
(MoneyAM Corporate Solutions , 2008)

Gearing shows the proportion of capital employed that is funded by long term liabilities. From the graph it is clear that Woolworth's gearing has been increasing since 2005. Growth continues and then peaks when in January 2008 Burdale and GMAC lent Woolworths £385m in an attempt to "[help] development and ... support the growth in the Entertainment Wholesale businesses," (GMAC Financial Services, 2008).

However, a firm that is highly geared is considered more risky. Suppliers know that the company will prioritise debt repayments, so if the firm experiences problems the money owed to suppliers may not be paid. Woolworths has felt this impact as they have recently had to pay cash in order to gain stock.

The question is what caused Woolworths to take on this huge amount of debt and why did it not help them develop their Entertainment Wholesale businesses. To address the underlying causes to Woolworth's administration a SWOT analysis has been made:

	Strengths	Weaknesses
Internal	• Varied product portfolio-potential to target many customers (Peston, 2008) • Large target audience • Well known high street name: loyal customers • Diversified: potential to attract many different types of customer	• Varied product portfolio: can't concentrate on targeting a specific market • Large debt: gearing and repayments. Constraints on cash flow (Stevens, 2008) • Concerned employees: become de-motivated • Demerger from Kingfisher in 2001 (Stevens, 2008) • Do not own premises: rent repayments will have an impact on cash flow. Less assets (Stevens, 2008) • Poor return on capital employed (MoneyAM Corporate Solutions , 2008)
	Opportunities	**Threats**
External	• Christmas shoppers: increase in potential customers • Entertainment wholesale business • 'Star' products in the Boston matrix	• UK's current economic conditions: lack of consumer spending • Competition: ○ Supermarkets ○ Online retailers • Negative publicity: Woolworth's large debt and financial problems have been very publicised: causing suppliers to demand payments in cash (Stevens, 2008)

There are many factors that weakened Woolworth's financial position and caused them to employ more capital:

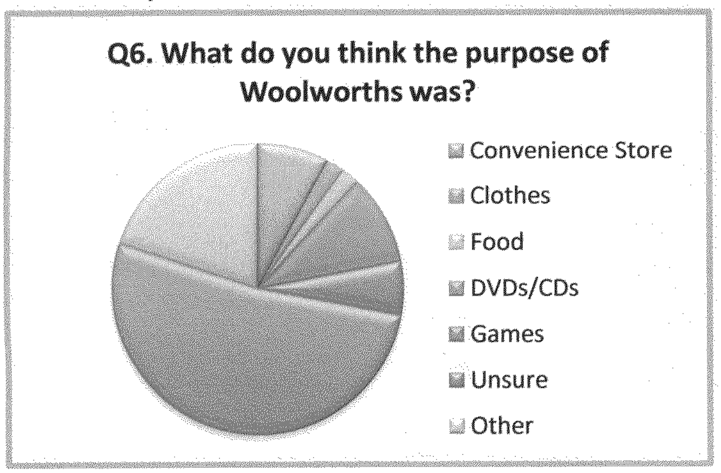


Figure 1: Results from supporting document number 3 "Woolworths Survey"

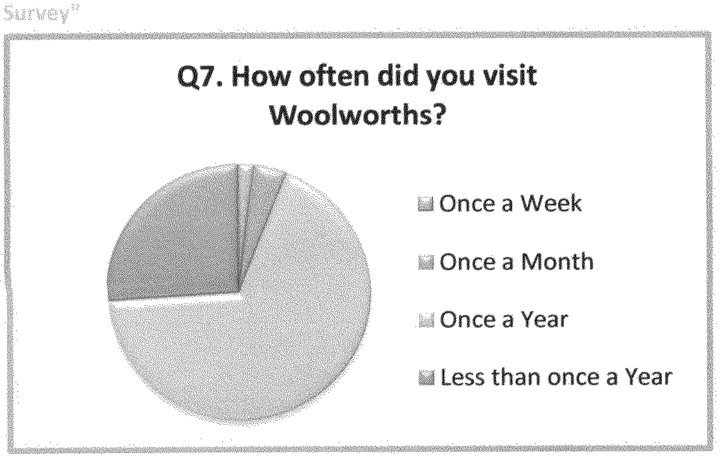


Figure 2: Results from supporting document number 3 "Woolworths Survey"

Woolworths has a diverse product portfolio, meaning the store is targeting a large variety of potential customers. However, it appears that Woolworths has over diversified. Woolworths has no clear purpose to consumers. No USPs means there is nothing unique about what Woolworth's sells therefore, there is no reason why customers will not go somewhere else to purchase what they want. This lack of targeting markets provides customers with no incentives to shop there, hence why it has experienced consistent falls in sales each year. Looking at Woolworth's product portfolio we can see it contains many 'dogs'. The 'stars' that it does held are from 2 |Entertain joint venture with BBC Worldwide Limited:

Market Growth	Question Marks	Star
	• Lady Bird Children Clothes Brand "total unit sales surpassed the prior year and market share continued to grow"	• Music and DVD venture 2Entertain ("2 entertain Video, is the UK's largest independent video publisher/distributor, a dynamic player in the UK market.) This venture supplies many businesses e.g. Asda and Zavvi • Computer Games- The demand for computer games is high and is growing because of the improvement in technology. They continued to "outstrip supply"
	Dogs	**Cash Cows**
	• Confectionary: "experienced price deflationary pressure." • Gifts: "products tend to be used by the supermarkets to drive value price perception" • Toys: "sales were held back as spend was diverted to computer games"	• Worthit! Range: "enhanced our value positioning, driving incremental volumes"... "Worthit! products accounted for 7.9 percent of total sales and 11.6 percent of total transactions" *Information from Annual Report*
	Market Share	

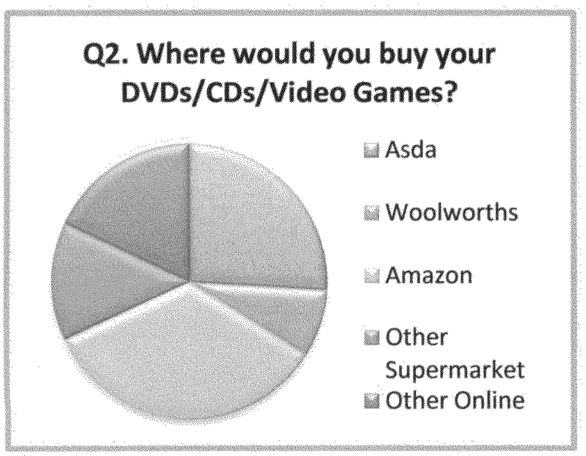


Figure 3: Results from supporting document number 3 "Woolworths Survey"

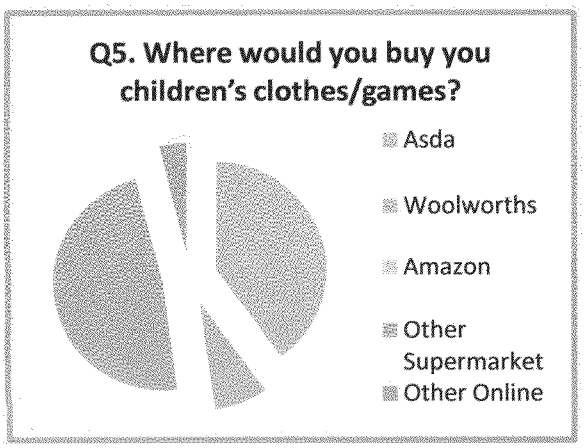


Figure 4: Results from supporting document number 3 "Woolworths Survey"

The portfolio has potential, if it was to be refined. There are too many dogs; probably because there are so many other shops that specialise in these items. It is also obvious that Woolworths was succeeding in the entertainment market so if they concentrated on this as a USP they could increase sales and remove wasted effort on unsuccessful products. The product portfolio that Woolworths does offer is much like those offered in supermarkets. However, supermarkets are able to provide these goods for much cheaper prices as they benefit more from economies of scale and have guaranteed sales revenue from food products. General food products within a supermarket effectively act as cash cows for the diversification into products such as those sold within Woolworths. Therefore, due to intense competition, Woolworths is losing a large amount of the market share and its sales revenue is decreasing.

Supermarkets are not the only competition. With the increase in E-commerce, many people purchase online. Woolworths offers an online purchasing service, however, it cannot be as cheap as they will have larger fixed costs from overheads, such as their premises and increased numbers of staff. Therefore, due to Woolworth's extreme diversification, many products can be bought from a wide range of competitors online.

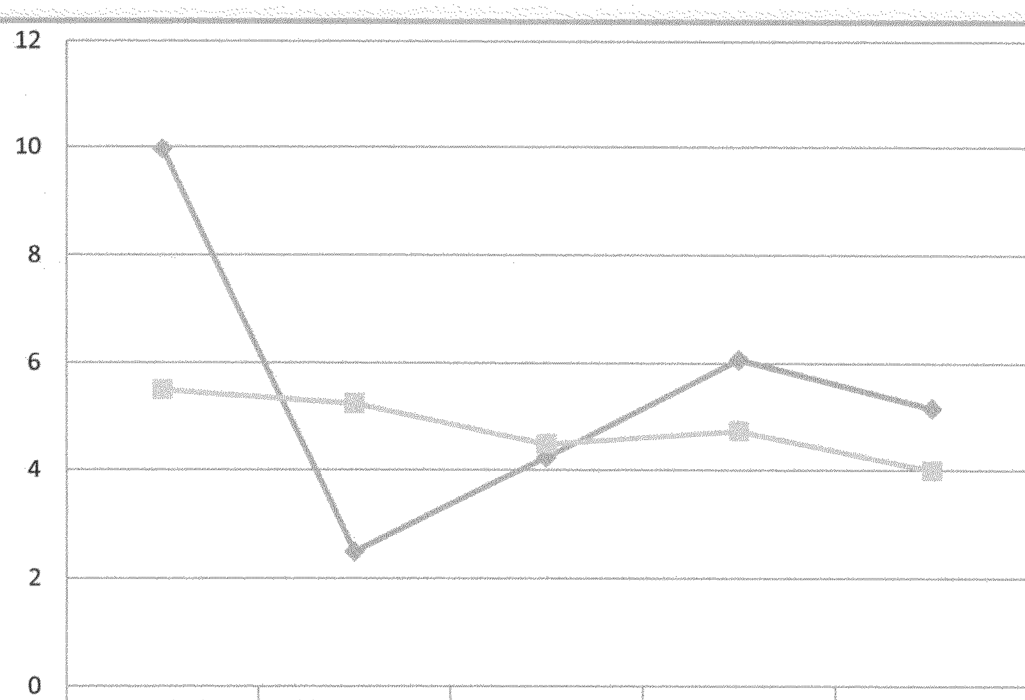
In 2001 Woolworths demerged from the retailer 'Kingfisher'. For the exchange of £614 million, 182 Woolworth stores were sold to Kingfisher and leased back to Woolworths. This means that over the past ten years their rent liabilities have increased from £70 million to £160 million, putting huge pressures on their cash flow and further impairing their financial position. (Stevens, 2008)

Woolworth's may have solved some of these problems with the new capital and prevent them entering administration. Unfortunately, there were additional factors that prevented this:

Their low sales (partially caused by lack of USP and competition from supermarkets and online retailers) combined with a decrease in consumer spending in the UK has exacerbated the problem, meaning their income from sales will be minimal. This decrease in sales, hence sales revenue, increases pressure on cash flow as inflows are reduced. Meaning, if they were not already struggling to meet debt repayments before they employed £385 million, they certainly would be after. Further increased pressure on cash flow was caused by paying concerned employees wages, meaning debt repayments and supplier payments will be harder to meet. This did not cause Woolworth's problems, but is a result of it, and has in turn amplified it.

Woolworths has a very well known high street name. This has worked to their advantage: attracting customers and maintaining them. However, due to the recent publicity and the knowledge of them struggling with large debts, credit insurers have become increasingly wary and are no longer prepared to insure supplies (Peston, 2008). They are concerned that if they sell supplies to Woolworths in the form of credit they will not receive the funds owed by them, or if they do Woolworths will ensure they are paid as late as possible, this would have a very negative impact on their own cash flow. Therefore, Woolworths has been forced to pay cash for goods from suppliers, this exacerbates cash flow problems, making it harder to meet debt repayments.

The large amount of debt means that no buyers are willing to purchase Woolworths to rescue them from administration. Even if they were bought, being valued at only £17.8m once share prices dropped (Stevens, 2008), it would have little reduction on debts.



	31.01.2004	29.01.2005	28.01.2006	03.02.2007	02.02.2008
ROCE	9.97	2.49	4.24	6.07	5.17
Interest Rate	5.5	5.25	4.5	4.75	4

ROCE Ratios for Woolworths from 31.01.04 to 02.02.08

(MoneyAM Corporate Solutions , 2008)(Bank of England 2008)

It can be seen from Woolworth's history that their employment of capital began well but, in 2005 and 2006 their return on capital employed fell below the interest rate. A decline is then seen again from 2007 to 2008. The interest rate is a good indication of the quality of investment as it should never fall below it as the money would create more return in a savings account. This may provide some indication of how well their newly obtained capital (£386m) has been employed.

Conclusion

In conclusion, as a consequence of their poor product portfolio, intense competition and decreases in consumer spending, Woolworths was forced to employ too many long term liabilities. Even after the employment of new capital, problems continued. Therefore, Woolworth's cash flow became a major problem as they had to meet huge debt repayments with no increased inflows. Woolworths had to prioritise debt repayments; however with added pressures on cash flow such as rental repayments, concerned employees' wages and new stock purchases, this was hard to do. Combining these factors meant debts could not be re-paid and Woolworths had no other option but to enter administration.

Evaluation

The administration of Woolworths may have been unavoidable. Even if they had made more successful use of the large amount of capital they employed (for example, improving their product portfolio and establishing and strong purpose and target market) it may have been futile in resisting the effects of UK's current economic conditions.

Looking at the nature of the other supporting documents data may have been biased. Articles will have influenced the SWOT analysis. Because of Woolworth's situation they are highlighting weaknesses and threats, not opportunities and strengths.

Also financial ratios may be misleading. Within the Woolworths Group Plc there are two profitable companies. These would have had an impact on the ratios; if gearing was looked at solely for the retail store it would have been higher. The financial ratios show the situation of the firm based on the end of that year, in Woolworth's case 02.02.08 it cannot be used as a representation of their circumstances throughout the year and we cannot see their situation past February for the remainder of 2008.

Finally, Woolworths had potential. It was one year from its centenary: if a company can survive that long they must accumulate much goodwill. However, it seems that Woolworths hadn't adapted sufficiently over time to the current retail climate. Also, if Woolworths had done things differently in the past, such as keeping their own premises, they may have been in a better financial position. Although it may have fixed a temporary cash flow problem, they should have foreseen what cash flow problems it could cause in the future. If Woolworths had been aware of and responded to social trends, the economy and consumer demands, and thought about the future implications of their actions, they may have survived.

Word Count: 1495

Bibliography

Bank of England. (2008, December 4). *Statistical Interactive Database - official Bank Rate history*. Retrieved January 4, 2009, from Bank of England: http://www.bankofengland.co.uk/mfsd/iadb/Repo.asp?Travel=NIxIRx

Dave Hall, R. J. (2004). *Business Studies.* Lancs: Causeway Press Limited.

GMAC Financial Services. (2008, February 8). *GMAC Commercial Finance and Burdale Financial Limited Provide Innovative Financing for Woolworths*. Retrieved January 2, 2009, from GMAC Financial Services: http://media.gmacfs.com/index.php?s=43&item=31

McLaney, E. (2006). *Business Finance.* Essex: Pearson Education Limited.

MoneyAM Corporate Solutions . (2008, February 2). *Fundamentals for Woolworths Group Plc*. Retrieved January 11, 2009, from Telegraph.co.uk: http://shares.telegraph.co.uk/fundamentals/?epic=WLW

Peston, R. (2008, November 26). *BBC*. Retrieved January 12, 2009, from Woolworths into Administration: http://www.bbc.co.uk/blogs/thereporters/robertpeston/2008/11/woolworth_into_administration.html

Stevens, R. (2008, December 1). *Britain: Woolworths and MFI go bust*. Retrieved January 13, 2009, from World Socialist Website: http://www.wsws.org/articles/2008/dec2008/ukre-d01.shtml

Woolworths Group Plc. (2008, February 2). Annual Report. *2008 Annual Reports and Accounts* . London, United Kingdom: MAGEE.