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economy using our strengths to deliver unbeatable value

Economy



Tesco makes a significant contribution to economic activity wherever we operate. Every week our 366,000 staff serve around 30 million customers in 13 countries. We have a track record of providing value for customers, creating jobs and training, providing opportunities for suppliers, and regenerating deprived areas.

Mojzner Istvánné Százhalombatta Compact, Hungary

Last year we paid our workforce £3,534 million, re-invested £779 million back into the business and returned £587 million to our shareholders. Our success delivered a Tesco group turnover of £33,974 million with profits of £2,029 million.

Customers

Delivering value At the heart of all we do is delivering cheaper, better products and providing more choice. During the year, we continued to make long-term price reductions throughout our businesses. This year we invested £56 million in price cuts in Central Europe. In the UK, our price cuts of £230 million this year plus the £67 million more announced in April mean that the average weekly shop at Tesco costs less than it did a year ago.

Supporting this price reduction process are a set of exacting standards, policies and guidelines which ensure that our drive for value doesn't mean reducing quality, environmental or labour standards in our supply chain.

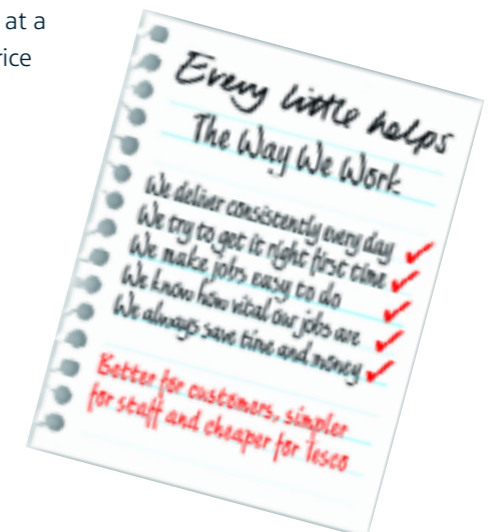
Informed choices More than ever, our customers are conscious about their health and what they eat. Many people still think that eating well costs more. We believe that income should not be a barrier to healthy eating. So, on top of our extensive Healthy Living range, we have extended our Value range to include fruit, vegetables, salads and many other healthy foods. We have calculated that a healthy daily diet bought from our Value range can cost just £1.40, compared to £1.87 for a less healthy option.

More information on how we are addressing a range of health issues, including nutritional labelling and salt reduction, can be found in the Society section on page 40.

Staff

Tesco is the UK's biggest private sector employer with over 250,000 people, and we employ a further 116,000 internationally. With a total wages bill of £3,534 million, our business has a direct positive impact on local economies. As well as paying salaries and local taxes, we foster skills in areas often overlooked by other investors.

Share schemes While many UK companies grant share options to their directors and senior managers, we are committed to providing share ownership for our employees after one year. We encourage staff to become part owners of the company and share in our success. This year, £63 million worth of shares were given to 160,000 staff as part of our Shares in Success scheme. All staff with more than one year's service received shares worth 3.6% of their salary. In addition, we offer a save as you earn scheme to enable staff to buy shares at a discounted price as a medium or long-term investment.



Economy

Communities

As well as bringing lower prices, more choice and better food, a Tesco store in a local community also brings wider economic benefits – directly, by creating jobs and generating taxes, and indirectly, by helping to attract further inward investment.

We are sensitive to both the opportunities created and concerns raised when we invest. We try to work with the grain of planning law and social change – embracing town-centre stores and bringing life back to declining urban areas where possible rather than building edge-of-town stores accessible only by car. We strive to balance the interests of all our various stakeholders and take a sustainable approach.

Regeneration partnerships In the past few years, we have focused on opening stores in some of Britain's most deprived urban areas. Working with local community groups and

agencies, we have been delivering what we call regeneration partnerships. These focus on training and employing staff who have been out of work for years: single parents, older people who have been made redundant, and younger people who may never have worked.

We try to address the issues which are often seen as barriers to getting a job – low levels of literacy and numeracy, responsibilities as carers, and disabilities. We aim to assess people on aptitude rather than existing qualifications. Crucially, we promise that provided a recruit finishes the 8-12 week training programme, we will guarantee them a job. This guarantee is one that no other UK employer matches.

This year we completed two large-scale regeneration partnerships at Dumfries and Stockport and a smaller scheme in Stafford.

case study Dublin

This year we opened our first regeneration store outside the UK at Clare Hall, Dublin, Ireland. The Clare Hall Centre won the Irish Property Award for Commercial Development of the Year.

We worked with the Northside Partnership to allocate 100 of the 400 new jobs created to the long-term unemployed.

'I hope that other employers planning to recruit on the north side of Dublin and elsewhere in the future will mirror the Tesco model and play their part in reducing the number of unemployed.'

Micheál Martin, Ireland's Minister for Enterprise, Trade and Employment.



case study Coventry

Over the past year, more than 9 in 10 new Tesco stores were built on brownfield sites, exceeding our published target (see page 56).

This year we opened an Extra on a former gasworks site in Coventry, England. The Tesco store was the main catalyst for a major mixed use development including a sports facility that will provide a new stadium for Coventry City FC and create over 1,000 jobs.



Over the past six years we have created a total of 12 regeneration partnerships, creating 3,000 jobs and helping back into work over 2,000 long-term unemployed and disadvantaged people through the job guarantee scheme. Over the next year, we hope to open another three partnership stores, bringing the total completed to 15.

'Tesco continue to invest in local employment opportunities and contribute to the vitality and viability of towns across the country'

Jon Ladd, Chief Executive, British Urban Regeneration Association.

Market towns Supermarkets are sometimes accused of having an adverse effect on the high street, especially in market towns. We are sensitive to such concerns and try to address any specific issues which are raised by local communities when we invest in a new store.

Among large retailers, we have pioneered small neighbourhood stores. By linking local convenience stores to world-class distribution and supply chain management, Tesco is bringing to otherwise neglected neighbourhoods all the benefits of big supermarkets – economies of scale, prices and product ranges that are close to superstore levels.

Our experience of operating in more than 100 UK market towns suggests that we play a positive role in rural regeneration by keeping shopping local and improving the viability of surrounding businesses. Independent research in the market town of Beverley, with corresponding studies in Ludlow, Brackley and Haslemere, supports our view that Tesco stores have improved the availability of food shopping, reduced the leakage of trade away from the town centres, and improved the reputation of market towns as shopping destinations.

case study Ludlow

In August 2000, Tesco opened a store in Ludlow town centre, on the site of the former cattle market. At the time of planning application by Tesco in 1998, Ludlow was losing as much as 60 per cent of its convenience shopping trade to other towns in the area. Research on the vitality

and viability of Ludlow town centre has concluded that our new store had no significant impact on convenience stores in the town centre. Indeed, the study indicates that our store benefits the town centre by retaining shopping which may have been lost to other towns.

Urban renewal and affordable housing

Working with local authorities, housing associations and other community groups we have successfully delivered a number of mixed-use schemes with housing, leisure or community facilities as well as retailing. Over the next 12 months we hope to deliver over 1,000 new residential units in South East England – including 500 flats in Dartford and 200 in Streatham.



Affordable housing and play area above our Kensington store.

Post offices In 2003 Tesco purchased the T&S chain of around 900 small convenience stores. Around half of these are being upgraded to the Tesco Express format, which offers an improved convenience store service with wider choice, including more fresh fruit and vegetables.

Roughly one in three of the T&S stores contain post office counters and the majority are retained if the store is converted. In some cases, however, this is not possible for reasons of space: our Express stores need a little more room to provide the wider range of products that our customers like to have. In these cases we work to relocate the post office counter locally by advertising for suitable candidates and providing financial and practical support for those who want to transfer the post office to their business.

We have successfully relocated post office counters to a variety of locations including other retailers and community centres. For example, in Bury St Edmunds we worked with the local MP and Council to relocate the post office to a nearby community centre.

Suppliers

Tesco does business with nearly 2,000 own-brand primary suppliers in 98 countries. The supply chain is made up of a complex range of relationships – from individual farmers and growers through to processors, manufacturers and distributors.

We have built strong long-term partnerships with suppliers at all levels. This partnership approach ensures that our customers have a reliable supply of goods, and new and better products through investment and innovation. We do not encourage practices which are unsustainable such as below-cost selling. These are bad for suppliers, and are therefore bad for customers and for Tesco.

A partnership approach benefits our suppliers by giving them a certain and growing market for their products, regular payments and payments on time, and our commitment to sharing our understanding of customers and changing consumer behaviour. Partnership also means working with suppliers to apply the ETI base code (see page 22) and to improve environmental standards through Nature's Choice accreditation (see page 51). For example our largest South African supplier runs programmes to develop and train women workers and encourages farm worker ownership and empowerment through the Thandi initiative.

'Nine years ago we were just normal farm workers. Today we are owners. The Thandi initiative is developing leaders for sustainable agriculture in South Africa.'



Susan Kraukamp of the Lebanon Trust, the first Thandi farm to be accredited to Tesco Nature's Choice.

We also work with suppliers to help prepare them for legislative and subsidy changes, such as the removal of European Union production-related subsidies. An example of how we are trying to help is the Tesco-Grampian cattle initiative in Scotland. This has produced a guide for producers on cattle production methods that maximise non-subsidy returns. It advises on weight-for-age ratios, food conversion ratios, conformation grades and processing yields. We think this is a responsible way to help manage significant change in the industry at the same time as reducing costs and maintaining quality for our customers.

Supplier Code of Practice We are one of only four signatories to the UK Government's statutory Supplier Code of Practice. Since the introduction of the Code, we have run a tailored training programme for all Tesco buyers to promote understanding and compliance. In March 2005 The Office of Fair Trading (OFT) audit found no breaches of the Supplier Code at Tesco. The audit showed that suppliers do take up issues with us regularly, and to support this process we will be appointing a Code Compliance Officer to hear formal complaints, confidentially if requested.

Managing our supply chain ethically We aim to act reasonably and responsibly in all our commercial and trading activities. We cannot claim to have all the answers to complex ethical or social issues. However, we will do what we can to ensure that the standards of our suppliers meet relevant international requirements.

As a founder member of the Ethical Trading Initiative (ETI), Tesco uses the ETI Base Code as its standard for all primary suppliers across our businesses.

ETI Base Code

- ★ employment is freely chosen;
- ★ freedom of association and the right to collective bargaining are respected;
- ★ working conditions are safe and hygienic;
- ★ child labour shall not be used;
- ★ living wages are paid;
- ★ working hours are not excessive;
- ★ no discrimination is practised;
- ★ regular employment is provided;
- ★ no harsh or inhumane treatment is allowed.

In 2004 we started a three-year initiative to extend our ethical trading policy and programme beyond the UK to cover primary suppliers to all our businesses. We were also influential in developing Sedex (Supplier Ethical Data Exchange), a web-based system that encourages businesses to share data on labour standards at production sites. This means that retailers can now get important information without duplicating assessments. It allows inspection resources to be better targeted and removes unnecessary costs for suppliers across the world. For further information visit:

www.sedex.org.uk

Buyer training All Tesco commercial staff involved with buying for the UK are expected to understand and reflect ethical considerations in their purchasing practices – their job description makes this clear. All buying staff must attend a 'Buying With Your Eyes Open' course which teaches them how to recognise potential problems and employ purchasing practices that minimise ethical risks. Over the past year, we have restructured the training into two half-day courses – one specifically for food buyers and one for non-food buyers. Our 89 UK technical managers must complete a two-day social accountability audit training course, run in conjunction with Bureau Veritas Quality International (BVQI).



treating our partners as we like to be treated

Supplier training We organise 'Supplying With Your Eyes Open' courses and ethical trading workshops for our suppliers. These courses explain our ethical trading policy and programme, raise awareness of ethical issues and build supplier confidence in managing ethical issues in their own countries and industry. This year ten full-day courses have been held in the UK, Hong Kong, Shanghai, Bangalore, Dhaka, Cape Town, Sao Paulo, Lyon and Malaga. Based on the positive feedback we received from participants we will continue to run supplier training as a tool for ensuring the delivery of our ethical trading programme. To date, 100% of high-risk suppliers have attended this training, enabling us to achieve our target for the year.

In the UK this year there has been increasing public concern over the poor employment practices of gangmasters – principally in picking and packing fresh produce. We are committed to making the Gangmaster (Licensing) Act a success, and are participating actively in the ETI Temporary Labour Working Group. This year, we wrote to all our produce suppliers to explain the work done by the Working Group, and are holding workshops for our suppliers to raise awareness of the legislation and the Code of Practice for Labour Providers.

case study supporting Sri Lanka's fishing industry



A small but very tangible example of our positive relationship with suppliers can be seen in our response to the Asian tsunami. In addition to our support for the Tsunami Appeal and funding a number of new fishing vessels to replace those lost (see page 31), our fish buyers plan to increase the amount of tuna we buy from Sri Lanka from £5 million to £6-7 million this year. We hope this will help the Sri Lankan fishing fleet by sending a clear message of our commitment to their future.

Risk assessment and auditing We take a risk-based approach to managing labour standards in our supply chain, in addition to the due diligence work we do on legal compliance, product safety, quality and capability for product development.

We assess ethical risk using three criteria:

- ★ the risk inherent in the country where the supplier is located, using a country risk matrix provided by an independent ethical consultancy;
- ★ the risk inherent in the industry and employment types, e.g. use of seasonal workers, homeworkers and subcontractors;
- ★ our own knowledge of the risks posed by the site and supplier, e.g. the types of raw materials, the role of secondary sites, and any previous record.

Using these criteria, we place suppliers into high, medium and low ethical risk categories:

- ★ we carry out annual reviews of the Sedex self assessment forms of our **high-risk** suppliers, and require them to have a 2-3 day ethical assessment by a third party every year. This year we reached our target of assessing 100% of our high-risk suppliers;
- ★ we carry out annual reviews of the Sedex self assessment forms of our **medium-risk** suppliers, and require them to have a 1-2 day ethical assessment by a third party assessor at least every two years;
- ★ we carry out annual reviews of the Sedex self assessment forms of our **low-risk** suppliers.

We write to suppliers to inform them of their risk rating. Third party assessors conduct the ethical assessments, highlight non-compliance and manage the verification of corrective actions to ensure implementation. If a non-compliance has not been verified as resolved by the third-party company six months after the assessment date, a Tesco technical manager will assess the suitability of the site to continue supply. When problems with compliance emerge, our aim where possible is to work with the supplier to resolve the issue. We believe this approach helps achieve long-term improvements in ethical performance. However, if there is no commitment from the supplier to improve, we would cease to trade with them.

To date, almost all our primary suppliers have registered on Sedex and we aim to have independent audits from all high and medium-risk suppliers uploaded on to Sedex by the end of the year. We also aim to have all self assessment for all primary suppliers complete by September 2005.

We received five external complaints during 2004, concerning the labour standards at two salad suppliers, a flower supplier, a fruit supplier and a hosiery supplier. All complaints were followed up by unannounced visits from Tesco technical managers and Product Integrity Unit auditors. Third-party ethical assessments were carried out, which were then verified by a second set of unannounced visits by Tesco. We are also working with ethical consultants to strengthen the confidential complaint mechanisms for workers throughout our supply chain.

case study Fairtrade

Tesco strongly supports Fairtrade, which guarantees that developing world farmers are paid a price that covers the cost of production, plus a premium to be spent on community projects such as better healthcare, sanitation, education or housing. This is vital in bringing stability to many small suppliers in developing countries.

We stock over 90 Fairtrade lines, of which 14 lines are own-brand, including roses, mangoes, avocados, citrus fruits and cookies. This year we have achieved a 60% increase in Fairtrade sales. Our customers now buy 1 in 3 Fairtrade products sold in UK supermarkets. We supported the Fairtrade Fortnight in March 2005 by raising customer awareness through in-store promotions and by inviting local Fairtrade groups to hold food tastings and talk to customers about Fairtrade in our stores.

'Fairtrade has been the saviour of farmers in Dominica - of agriculture and the whole economy. Since we started selling Fairtrade to Tesco, we have moved on by leaps and bounds.'

Amos Wiltshire, National Fairtrade Co-ordinator for Dominica.

Tesco has worked with the Fairtrade Foundation over the last three years to secure the supply of Fairtrade bananas from the Commonwealth of Dominica. As a result, the smallest producers in three communities are able to supply the UK market. Fairtrade has helped fund the following projects:

- ★ constructing, furnishing and equipping a pre-school building so children no longer have to walk four miles to school;
- ★ construction of a community centre and a bus shelter, and installation of streetlights;
- ★ renovation of 12 farm access roads with labour supplied by the farmers;
- ★ renovation of a former banana distribution centre to accommodate the Dominica Fairtrade Group meetings;
- ★ purchase of weed trimmers to replace the use of chemical herbicides, and mist blowers to control leaf spot disease of banana plants;
- ★ upgrading of packing sheds, building charcoal pits for the safe disposal of fungicides and the provision of hand washing facilities in the field.

Photograph provided by WINFA



Marius Ismael, Fairtrade banana farmer, Dominica.

Buying locally

Although we are increasingly an international company, to our customers we are their local store and as such we recognise the importance of buying locally in all our businesses. However, not everything can be sourced locally – and customers now expect to be able to buy what they want regardless of season or country of origin.

We have dedicated buying teams in Scotland, Wales and Northern Ireland, whose task it is to seek out and develop relationships with suppliers. In the UK, Tesco stocks over 7,000 local products. All products are labelled with the country of origin and, where appropriate, with national flags.

Tesco remains British agriculture's biggest customer. During the year we sold more British apples and strawberries than any other supermarket. Our fresh chicken is 97% British, fresh beef is 95% British, fresh pork is 92% British and fresh lamb is 88% British. All our fresh shell eggs and fresh, UHT and organic milk come from British farms.



Scottish white potatoes labelled with the national flag.



Penang hypermarket, Malaysia.

Buying locally – internationally

We promote local produce in all our stores, not just in the UK. A team of buyers in each country work with local suppliers to tailor our range to local customers. There is a huge range of in-store promotions of local produce throughout our international businesses. For example, our businesses in Poland and Malaysia source the vast majority of their own-brand range nationally. At the same time, our international growth has created new opportunities for many local producers.

In Thailand we help more than 1,700 One Tambon One Product (OTOP) producers to sell their products. Village residents work together to produce one quality product. We now sell 89 such products in our stores across Thailand and encourage OTOP producers to hold exhibitions in our malls and car parks.

case study working with our suppliers in Northern Ireland

'Tesco have provided local farmers and food processors with a very valuable route to market not just in Northern Ireland but more importantly throughout the whole of the UK and Ireland. Many local businesses who have been able to meet the challenging requirements of the Tesco consumer have seen their sales grow and their business flourish.'

David Dobbin, Chairman of CBI Northern Ireland and Group Chief Executive of Dale Farm, Northern Ireland's leading dairy company.

Many Northern Ireland suppliers have grown in partnership with Tesco. This is crucial to keeping what we offer customers fresh, attractive and local. As a result:

- ★ Tesco is the biggest customer of Northern Ireland's agriculture;
- ★ we spend more than £300 million per year with Northern Ireland food and drink suppliers;
- ★ we have a team of eight based in a dedicated regional office who focus on buying local products, to try to reflect customer preferences;
- ★ our stores in Northern Ireland stock over 1,500 local and regional products.

All fresh beef and lamb sold in our Northern Ireland stores is sourced from over 1,500 local farmers through Foyle Meats.

