

## “Creating New Opportunities in Bakery”

**Tony Reed**



Good Morning. A couple of points on your fascinating speech Professor Henry. One is after doing all the work with Tesco why the hell did you mention Warburtons and Sainsburys bread, but nevertheless we should thank Jonathon Warburton for letting us have a photo of his belly button.

I'd like to take you through the outline of my speech today but first a little bit about me. I've been running the bakery category for the last four and a half years following twenty two years working in our stores. As some of you may know in this room, in addition to being an opportunity to share my views it forms a bit of a farewell to me in the commercial bakery business within Tesco. After today, actually it was last week, I go back out into our shops to look after 240 of our Superstores in the north of the country which in typical Tesco terms sort of starts in Norfolk, up through Cambridgeshire, then it is north and across to Northern Ireland and I'll be the Operations Director for Superstores North. I am certain that the bakery will be the first arm I will go to in my store visits. I would like to use this platform to thank everybody in this room that has helped me and all the businesses that have also helped me and there are a number of you in this room that I have great relationships with, so thank you.

On to today. I am going to take you through a brief introduction to the Tesco business and then I'm going to talk to you about Tesco bakeries, specifically our suppliers, some customer drivers and then finally some opportunities for us all.

Let's start with some brief history. We had humble origins in the Spring of 1919 having served in the First World War a young man called Jack Cohen invested his

demob pay, £30, and set up a barrow in the east end of London selling products. The business grew quickly in the years that followed and in 1924 the Tesco name was used for the first time and in 1929 the first Tesco store opened in Edgware. By 1939 there were over 100 Tesco stores.

Following the Second World War Tesco's growth accelerated again and we led the way in new innovations such as self-service stores, supermarkets, centralised distribution and all the while Jack and his team never lost sight of the customer. However difficulties arose in the late 70's because Tesco's approach was based largely on the 'pile it high, sell it cheap' model. Competitors were faster responding to a more sophisticated customer by offering quality and range before price. Tesco became more concerned with what its competitors were doing rather than what the customer wanted. By the early 90's our market share was significantly behind Sainsburys. Terry Leahy and Tim Mason joined the board followed latterly by David Potts and Philip Clarke. It was only then that we started to get the basics right. We started to work on improving our stores, listening to customers, improving quality and range, getting cheaper and it was at this point that we developed our four part strategy.

In 1997 we launched this strategy – to be as strong in non-food as we are in food, move into retail services, e.g. our bank, have a strong UK core business and to develop an international business of scale. And this strategy is as relevant today as it was in 1997.

I've already mentioned that one of the most important steps in our recovery was that we became great at listening to customers. In order to put the customer first we had to first understand what they wanted and we had a number of methods to explore that, which are on the screen. Then we actually overlaid that with what they do do. Personally I sat on dozens of customer question times throughout the years listening to their views, and it was at these sessions in particular that we developed things like Clubcard. Clubcard gets better and better for us and is now the most advanced customer database in the world with over 11 million people regularly using it.

Because we listened so much and because we do so much research, we have the confidence to be first, and we have the confidence to be innovative, we have the confidence to stay ahead – whether it be in new products, new markets, supporting local communities or improving the shopping trip for customers in their local stores.

Listening to customers has led to numerous innovations in Tesco to improve our customers shopping experience. You can see a selection of these in a list. We had

to develop a new store format called “Extra” and the first one opened in 1999. Not long ago we would have struggled to fill a shop of 80,000 sq ft with the right range and today we will open one at 140,000 sq ft and we now have 160 of them. This determination to listen to customers and develop a better shopping trip for them had led us into new businesses such as ‘Tesco Personal Finance’, non-food and telecoms.

The slogan “Every Little Helps” was borne out of our obsession to listen to customers. We use the slogan so much and we use it to refer to everything we do in our business, whether its about what we try to achieve for our customers which is clear aisles, better availability, good prices, no queuing, great staff, the way we behave with our suppliers or the way we work in the office and our stores, where we really try to deliver consistently every day and to get it right first time. We make jobs simple to do, and we always save time and money.

What else is happening in Tesco. The UK portfolio is changing, no longer are we a superstore business. This is a change that we in Tesco have had to come to terms with ourselves. All our new store growth has been generated by what five years ago were unknown formats. Since 2002 we’ve also become a convenience store operator and we now have 700 ‘Express’ stores. We’ve also learned to do non-food well and become a hypermarket player and we now, as I mentioned earlier, have 160 of those. We all need to change to reflect requirements of these markets.

Now on to Tesco Bakery. It is with a great deal of pride that I present this slide. The bakery in Tesco is a business in excess of £1billion a year to us. Year on year growth is in excess of 14% and when I first joined the category four and a half years ago it was a £600M business. That’s not to blow my own trumpet, but just to celebrate the efforts of many of the people here today and my own team back at the office. From this slide you can see that over the last two years without the growth in Tesco, the bakery market in the UK would at best be flat and it probably would have been in decline. You lot have to follow the money.

But don’t think of us just as retailers though. Like you we are bakers, which raises a question, could I join the Federation of Bakers. We have over 1,000 bakeries in the UK with 7,000 staff working in them and Tesco are just as proud to be involved in this industry as you are. We are proud to share the challenges that it represents. The bakery department in Tesco is complex though and we all need to make the job in our stores simpler to do. Our costs our increasing like yours. Our energy bill in my bakeries is 10% of Tesco’s energy bill. Recruitment and retention of staff become harder for us just like they do for you. The customers are getting more demanding. We need to work together to overcome some of these challenges.

Let's talk about my suppliers a little. I have over 100 suppliers and I'm very proud of the relationships we have built with them. There are suppliers in this room who have invested millions of £'s in equipment on behalf of Tesco, they have followed the money. Tesco tried hard to have a thriving own label supplier base in my time. We successfully established the Tesco 'Own Label' brand as a significant brand in the bakery markets. Within cake, Tesco Own Label is now the biggest brand in the market.

We aren't just about huge suppliers though, our smallest is £5,000 a year, our largest is £210Million. I'm delighted that in a comparatively flat market the average supplier growth with Tesco is 13% in 2005. And we're not just about national suppliers either. In the bakery category we have 37 regional suppliers. They supply us with 360 plus dedicated regional lines. To fully satisfy our bakery customers we must continue to offer a range of products that are specific to regions or even stores. As customers become more sophisticated and challenging in what they want, our mutual ability to respond to demands even at store specific level is crucial in maintaining our commercial advantage.

I look forward now to taking you through some of the challenges that are facing our industry by having a look at the bakery customer. The customers of the future will be – our customers are changing too – we already know from current trends that customers of the future will be older on average than they are now. They will be more adventurous and active than their counterparts in previous generations and we know that the makeup of the population will contain more people from varied ethnic backgrounds. We also know that households are getting smaller, people are having less children and they are having them later. Most importantly we know the future is here now.

I've tried to breakdown what I see as the key drivers of growth over the next few years and how customers may interpret them. Firstly **Convenient** - making everything easier for us. **Health** – helping me live more healthily. **Responsibility** - being honest with me. **Value** - save me some money. Indulgence – allow me to treat myself and my family. Let's take each one in turn.

Once upon a time bakery, and sliced bread in particular was symbolic for everything that was convenient and labour saving for our customers. I don't know if we can honestly say as an industry we are still at the forefront of making customers lives easier. Together we need to find ways of addressing this. Together we need to ensure that the convenience for customers and in particular convenience formats are at the forefront of our minds as an industry. We must make products fresher, they

must last longer, they've got to keep better in their homes and they've got to be in stock at all times.

On to Health - At the risk of stating the completely obvious, healthy eating is big news. It's not just about upmarket customers, it's about everyone. Parents are now the most aware about healthy eating for them and their families. It's no longer about diets. We are looking at long term sustainable changes in the products people buy and the food they eat. It's great news for us because when you ask customers they intuitively feel that bread is healthy and the industry is well placed to make the most of this trend. But we are still for the most part responding to customers rather than helping them and leading them.

Let's continue with health for a moment. You can see from the graph here the scale of change in buying behaviour that has happened in the Tesco plant bread business. The declining white bread sales is accelerating and it's now at -8%. Customers are switching into wholemeal breads with growth at +16%. In three years time at this rate wholemeal will overtake white bread. How quickly we respond to this will dictate how well we and you perform in the months to come. A question for you - do you believe cake, muffins, croissants and the product development that goes with it is reflecting this massive change in customer eating habits?

Let's move on to the responsibility for our customers. Responsibility is perhaps the most diverse of customer drivers. It covers how reliable they believe we are, we all are, whether it be store factors, the quality of products, availability, integrity of ingredients and so on. It reflects our honesty and trustworthiness in our pricing and our promotions. It is also dependent on the ingredients we put in our products and how we declare them on our packs. By the end of this year all Tesco Own Label bakery products will have the new GDA label on. They are more concerned than ever about the environment and how we treat each other and they care about our role within the communities more than ever before.

Let's move on to Value. Our customers are more price sensitive than they have ever been. More importantly they are more value sensitive. Nobody whether price sensitive or affluent likes to think they have been ripped off. They enjoy and like to share bargains with friends and families, but we need to remember value is more than a brand. It doesn't necessarily mean cheap. Rather it requires a mind set change where we charge as little as we can for our standard products rather than as much as we can. Premiumisation is a good way to try and improve margins; however it only works if you sell enough of these products to make a difference.

There is a little 'watch out' though. The impulse areas of bakery are highly promotionally driven and respond well to promotions. We cannot rely only on promotions to provide our only source of growth. Long term customer focus, product development and being the right price week in, week out, is the only way to ensure the long term sustainability of this and any category. This isn't to underestimate the value of effectiveness of deals, but the frozen food market is full of examples of companies who sold their soul for promotions and ultimately paid the price.

Finally let's have a look at the need for indulgence. Perhaps the most fun part – people love bakery – it's an emotive part of their shopping trip. It's a Hero department for them. They love sweet products like doughnuts and pastries, they love cakes loaded with chocolate and they loved speciality breads topped with cheese and peppers. And they love the smell of fresh bread and croissants. Bakery and us have unique attributes that customers adore. We need to ensure that we feed our customers love of baked-off goods, their desire for indulgence, give them options that don't provoke the same feelings of guilt, and ensure that we have a wide range to suit every pocket and every stomach.

So finally, we are in this together. I have 240 of my own bakeries which will be the first thing that I look at in any store. We need to ride the health wave and develop products across the category that reflect customers changing requirements. We as an industry need to find ways of communicating to customers the health benefits of our products in a way that is as simple and memorable as the five a day of fruit and veg. We need to make our shelves the destination for customers in search of guilt free indulgence. We need to be brave with the shelf space we give growing markets and we need to deliver outstanding value for money. We need to be aware of the growth opportunities represented by convenience both in format and for customers. The product needs to be on sale at all times and it needs to stay fresher for longer. We need to make mine and your operations as simple and cost effective as possible. When distribution represents such a large proportion of product cost it can't surely be right that my superstores have five separate bread deliveries on a daily basis. Tesco want to make bakery a 'Hero' department, do you?

Good luck in the future and thanks for making my four and a half years so exciting.

Thanks for listening.



## New Opportunities In Bakery

Tony Reed , Bakery Category Director

---

### A brief history



- Tesco founded in 1919. Sustained growth based on low prices and innovation.
- Growth falters in 1970s. Competitors more attuned to customer demand.
- Early 1990s - Number 3.
- Customer focused turnaround.



---

## Listening to customers



---

### What they say

Stores feedback panels  
Customer surveys  
Customer focus groups  
Customer Question Times  
Product testing panels  
External research and surveys  
Customer comments and complaints  
Staff feedback  
Call Centre trends

### What they do

Clubcard data on shopping patterns  
Sales data on products  
Government data on spending patterns  
Local shopping patterns and demographics  
Tesco.com home shopping picking results

---

## 'Every little helps'



---

### Shopping trip for customers

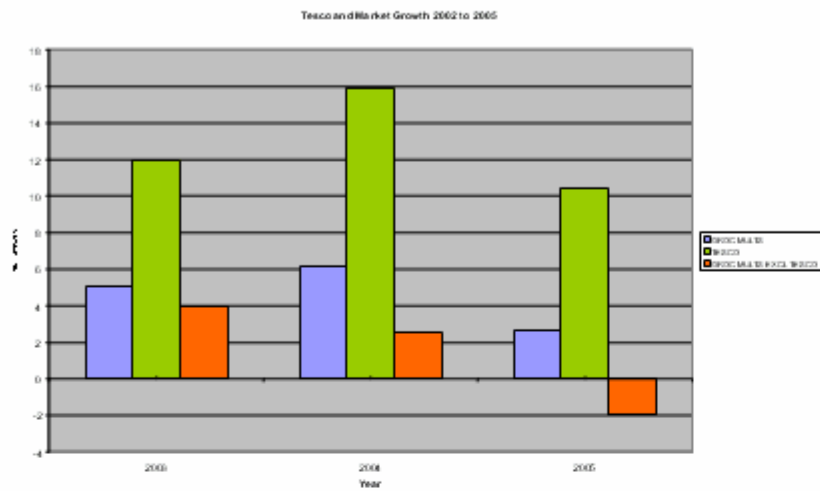
- The Aisles are clear
- I can get what I want
- The prices are good
- I don't queue
- The staff are great

### The way we work

- We deliver consistently every day
- We make jobs easy to do
- We know how vital our jobs are
- We always save time and money



## Tesco Bakery growth v the market



## Bakery - Suppliers



100+ suppliers

£600m+ per year sourced from the UK (95% of all our expenditure).

Smallest supplier has a turnover of £5k last year, the largest £210m

Average supplier growth 13%

---

## Bakery - customers

---



The customers of the future will be

Older

More ethnically diverse

Smaller family units / More likely to be single

---

## Bakery - customers

---



Convenience

The best thing since.....

Convenience formats are where the growth is

People feel they have less and less time both to shop and to prepare food.

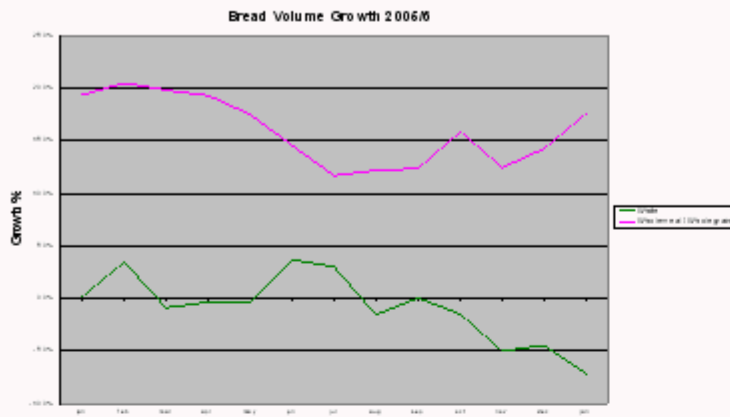
Their tolerance of poor availability is reducing all the time.

This drives both further preparation and increased life.

**However:**

Health and 'honesty' can seem to conflict with current views on convenience

## Bakery - customers



White bread in significant and growing decline, Wholemeal in strong growth

## Bakery - customers



### Value

75% of customers 'Pay more attention to price than they used to'

Customers are more likely to tell people about something they bought and liked if it was 'a bargain'.

Customers freely admit that they economise on some things to be able to afford others.

Value doesn't just mean cheap.

Promotions are becoming increasingly important to customers.

---

## Bakery - customers

---



### Indulgence

Customers love to treat or indulge themselves.

'Bakery' comes very highly up their list of desirable treats.

Bakery products have a number of key USP's vs other treat products

It is viewed as equally suitable for sharing or 'solo enjoyment'

60% of customers state they would treat themselves more frequently - 'if it weren't for the guilt'.

There is a difference between indulgent and expensive!

Sessional Chairman: Thank you Tony, I am sure you're not going to get away that easily and that quickly at the moment. Tony has agreed to answer some questions, any from the floor or can I pose the first one please.

Question: Paul Heygate, Bugbrooke

On the slide, and I believe that you are still imperial, or the figures that you quoted were, you've got 982,000 sq ft allocated to bakery. In your new job you said you were going to go and look at the bakeries straight away, once the novelty of having left that and moving into the new job, how important is that and will you be able to influence the same amount of space being allocated in new stores to bakery and particularly to the scratch side of it?

Answer: We have a format plan that each store should adhere to when we open each store. We know how much space each store gets to it so I can certainly make sure that's what laid down in the format plan actually happens because in some cases because there might be the odd wall in the way it doesn't, and in existing stores where I see there are opportunities then I can influence that quite easily. So I do think having spent four years in commercial and now going back out it will be

advantageous from a space point of view in superstores north. As it happens Tesco has recognised that the space they are allocating to Instore Bakeries is less than we need because we've grown so much over the last four years and format plans have been updated to reflect that, not just in superstores North, in all formats. I think by growing the business we achieve that anyway. Things can only get better from here on in.

Question: Paul Matthews, Shipton Under Wychwood

What is your view on on-line shopping? Do you see this as a big growth area or will it always maintain a small percentage?

Answer: I can only say from a Tesco point of view, its huge growth for us and I was in Barnsley store about two weeks ago, I had never been to the store and the grocery home shopping part of that store's business was over 10% of its sales. Actually this manager was using it as a vehicle to achieve his sales budgets and smash them by really getting behind it. My view is that it's just going to get bigger, and bigger, and bigger. For our industry its quite a challenge because we're sort of stuck in a morning industry, I think we call them morning goods don't we, that's because they are only on sale in the morning but we need to keep them on sale and call them all day goods I think. The grocery pickers in our stores, because as most of you know, apart from London we run a picking operation in our stores. It starts at five o'clock in the morning so if you haven't got every product in stock whether it be Instore bakery or bread or morning goods, the pickers miss the bread area or substitute and its quite a frustration for customers. I was getting more and more stores contact me saying can I have my delivery the night before because that way their breads in, morning goods are in and they can put them out before the dot com pick starts. So I think that we'll be gradually, without sending you all into a worry about we want our deliveries overnight, but I think over time there will be a gradual request to move to that.

Question: Sir Mike Darrington, Northumberland

Looking at the international side of the business to what extent have you got involved with your bakery hat on, going and seeing what's going on around the world and passing round ideas and gaining ideas?

Answer: Probably not as much as they would like because like everyone I have a day job to do and I'm accountable for the UK performance, but in my last year I've begun to help them more so. I spent a week in Shanghai which was a great experience for me because I hadn't been there and it was really helpful for them. So Instore bakery in our Chinese business of 60 hypers is now a customer planned

project for our Chinese business. Andy Brocklehurst who works for me spent a week in Korea and again Instore bakeries is a Hero department for Koreans, it is now a customer plan for Korea. Then people will come here and spend time with you. Last year was the most we did and if I was not moving on it would be an area where I think that demands it. And also the fact that Richard Brazier the Commercial Marketing Director has the aid for international commercial teams as well so he was very keen this year that we all worked together to share knowledge. A little bit but more to follow.

Question: Keith Shaw, London

How long do you think it will be before Instores pick up the trend that is already racing away which is flat breads, i.e. Naan, Fresh Naan, Fresh Pitta and all these kind of things which are predominantly in London growing and growing?

Answer: Do you mean Instore Bakeries? I don't think we ever will. We face labour challenges anywhere and we've done extensive research and really tried to understand what is it customers want from an Instore bakery and then overlay that with their behaviour. It goes back to this obsession with listening to customers and then overlaying. And the research for us came out – we want you to do crusty bread and French brilliantly and we like your Danish and sweet patisserie and there was a whole load of stuff in the middle, Pitta, Naan, soft roll even, and we actually don't care where it comes from as long as its great. And as labour challenges and space challenges and energy challenges continue to impact us, I'd argue that soft roll (we'll pick that one) may well be an area that in three or four years time, that we no longer manufacture in our Instore bakeries and we let the Joe Streets of the world do it better for us. So to answer your question Keith, I don't think we will ever do Naan bread, Pitta bread, it's too hard. The Pride Valleys and the Arnucis of the world, they do a great job for us with it anyway, let them have it.

Question: Sylvia Macdonald, Croydon

You've grown the category hugely, what has been your strategy on new product development and can you also allude to your policy of salt in bread?

Answer: Strategy on product development, we try to follow the money. This year in particular we'll get after the wholemeals, bread with bits etc. We've got a bit of a space change in July and we'll change the space we allocate for it. We launched a whole ranch of healthy eating lines in January. The strategy is based a lot on, you know there will be some gaps against competitors that we'll always want to man mark, and there'll be some growing markets that we should be getting after because some of my team have been out in the States or wherever and thought "here's an

opportunity". And things like croissants and that you know it was us that started it with Northern Foods and Grain D'Or. We do believe in Tesco that we can turn on some markets and make them big markets and we could sit here and reel off what they are.

Salt - We are reducing salt, I'm not going to put a number on it but we are actively trying to. But it's tough because it's a big part of the product and I think Heinz suffered a problem where they took a load of salt out of their tomato soup and it tastes crap and it doesn't sell any more. So we are being very careful, we want to do it but we've got to do it sensibly so that the product tastes right. We are taking other stuff out, where we can take hydrogenated fats out of products, we will but as those in the room will know it's a huge amount of work and we are all busy people at the moment.

Question: Andrew Williams, London

On the salt issue I was wondering what you thought about the FSA's traffic light labelling which would give salt typically an amber warning on nutritional labelling?

Answer: I don't know what – its public knowledge that we've not gone down the traffic light route and we are going to go down our own labelling way which is to earmark the percentage of your daily intake for the product that you are eating. And we've done that because we talked to customers about it. They don't really understand red, amber, green in any way. I've got a muffin that if you put it in a traffic light it would kill people according to these traffic lights. However we've got to be sensible about these things so we are working very hard to take all this stuff out, salt, hydrogenated fats, etc etc unnecessary colourings. We've got a whole load of colourings which we just don't need, but if you read the list at the back of the pack it's as long as my speech. We are going down that route and most own label Tesco products will be labelled this year and I know we will have as much salt out of them as we can take. But it's a huge workload for my technical teams so if any of you are struggling get in touch with my technical teams, or any Tesco technical team.

Question: Ann Bruce, London

I'm just wondering if you would go into more detail about the growth of wholemeal bread compared with the decline of white bread in the bakery department, what are the best sellers?

Answer: I couldn't say. We've got a couple of lines 800gm which are done by Fine Lady Bakeries and 400gm by New Rathbones and they have a huge growth. But if you ask the branded people, Best of Both what a phenomena that's been quickly followed by Kingsmill Whole and White and Warburtons All in One, so they are all in big growth as well. Principally anything brown, or anything brown with bits, you know the Bergen relaunch from Allied just after Christmas has gone very well, it certainly did for us. Anything like that. I don't think we're doing the same in morning goods though so where's the best of both pitta, or the pitta with bits so I think they're the opportunities. Food Doctor Bagel has gone very very strong, it must be the Doctor on it appeals, it appeals to me anyway and tastes all right as well.

Question: Martin Churchill, Christchurch

In the interests of developing the baking industry what training modules do you have in place to enhance the skills of your bakers?

Answer: In Tesco we have what we call Bronze, Silver and Gold. Richard who came along with me today wrote the packages. Bronze is a very basic level, switch on the ovens, for how long etc right up to Gold which is how you manufacture bread from scratch and Silver is somewhere in the middle around bake off. So quite extensive training material. It's quite a challenge for Tesco because not everybody learns by reading module or ticking boxes. We are developing a DVD at the moment that might be someone else's preferred learning style. We get quite a lot of support from millers, and the ingredients suppliers, some of them here today as well, on one to one training which is very useful, and we are working with a company in Chipping Campden to help us open our new stores. If you get it right a couple of weeks before a new store opens you generally see that through in great product quality. A number of methods to be honest.

Question: Paul Heygate, Bugbrooke

As you are, or have now basically officially left, you are going away with some memories. I hope that you go away with memories that the industry has been responsive and has been innovative but would you have said enough, or not enough? It's a leading question giving you the obvious answer.

Answer: I think four and a half years ago, probably with the exception of your company Paul, because he's got loads, and Warburtons, the industry was probably struggling a little and I think to some extent it has innovated itself out of it. You know Hovis and the initial relaunch changing the packaging which was really brave for RHM I think to go to those baked beans and cucumbers and tomatoes and that was just as I started. We all thought they were mad at the time and had the cheek them



to try and put up the prices so that was even madder, but it was the start and I think since then, yes. There are things that frustrate me like the tray. You use five different types of tray and the delivery consolidation thing may go round and round the houses for a while, but yes, I do think it's in much better condition than it was four and a half years ago. Some great people working in it. I've been very privileged and lucky to work in it and there's a real lack of understanding in the stores about how complex it is, how hard working it is etc. You will have to rely on me to sprinkle that stardust around.

Question: A quick view in organics in bakery please?

Answer: Big growth. People see organic as healthy as well so its not just people who want clean ingredients etc people link the two. It's quite difficult for us and it gets quite difficult for you because generally its small production runs etc but you have got to follow the money. It's a big priority for us this year so you're going to see some changes with what we're doing in Tesco. We've got to get the prices down because the premiumisation in some respects, the products are three times the price of the standard price and I accept it's a bit more premium flour etc but surely it cant be three times the price. It goes back to my point in the talk, you've got to be selling enough of it to make some money out of it otherwise we may as well pack up and go home. I'd probably say that nobody really leads us, it's generally our talking and our priorities, people do things for us and it would be good if it created some experts who really understood the organic bakery business and helped our thinking, because we don't profess to know everything. So follow the money, get on the wagon, it's a big opportunity.

Sessional Chairman: I think we've about finished at the right time. I told you that besides Tesco's he has bakery emblazoned across his body. Tony you have given us a very interesting and fascinating insight and your views on Tesco's and the success is there for everybody to see, particularly in the bakery and I'm sure that your closing comments, except for the last bit about getting prices down, you leave us on a very good note. Thank you very much and we wish you well in the future in your new role.