

Assessment 1

INTERNATIONAL FINANCIAL MANAGEMENT

LCBB6002

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Introduction

Tesco is a multinational grocery and general merchandise retailer based in the United Kingdom. The company was founded in 1919 by Jack Cohen as a group of market stalls in the East End of London and has since grown to become one of the largest retailers in the world.

Tesco operates in over 12 countries and has a workforce of over 450,000 employees. In addition to its core business of grocery retail, Tesco also operates a range of other businesses, including financial services, telecommunications, and clothing.

The company's core strategy is to focus on providing customers with good value and high-quality products. Tesco achieves this through its "Every Little Helps" philosophy, which emphasizes the importance of attention to detail and constant improvement in all aspects of the business.

Tesco is also committed to corporate social responsibility and has implemented several initiatives aimed at reducing its environmental impact, promoting sustainable sourcing, and supporting local communities.

In recent years, Tesco has faced significant challenges, including increased competition from discount retailers, and changing consumer shopping habits. The company has responded by streamlining its operations, divesting non-core businesses, and investing in new technology and digital initiatives to improve the customer experience.

Tesco's financial structure is relatively conservative, with a low debt-to-equity ratio, strong cash position, and strong credit rating. The company's dividend policy also aims to provide a stable and growing income stream for shareholders.

Dividend distribution policy

A dividend distribution policy is an important tool for companies to communicate their commitment to creating value for shareholders and can play a significant role in attracting and retaining investors, it is a company's policy that outlines how it plans to distribute profits or dividends to its shareholders. The policy typically includes guidelines on the frequency of dividend payments, the number of dividends to be paid, and any conditions or requirements that must be met before dividends are distributed.

Dividend distribution policies can vary widely between companies and industries. Some companies may choose to pay out a high percentage of their profits as dividends, while others may retain more earnings for reinvestment in the business. Factors that can influence a company's dividend distribution policy include its financial performance, growth prospects, and investor expectations.

The purpose of a dividend distribution policy is to provide transparency and predictability to shareholders about how the company intends to distribute profits. It also helps to establish trust and confidence in the company's financial management by ensuring that dividend payments are made in a consistent and sustainable manner.

Tesco's dividend policy is to target a pay-out ratio of approximately 50% of adjusted earnings per share, subject to the company's cash flow, financial performance, and investment requirements. The company aims to pay a dividend twice a year, with an interim dividend in December and a final dividend in June.

There are several strengths of Tesco's dividend distribution policy. Firstly, the company has a history of consistently paying dividends to its shareholders, which provides investors with a reliable source of income. Secondly, Tesco's policy of targeting a pay-out ratio of around 50% of adjusted earnings per share provides a degree of stability and predictability for investors, as it ensures that the company is not over-distributing profits to its shareholders and maintains an appropriate level of retained earnings to invest in future growth opportunities.

However, there are also some potential weaknesses of Tesco's dividend distribution policy. One criticism is that the policy of targeting a fixed pay-out ratio may not always be the best use of the company's cash flow. For example, in years where the company generates significant free cash flow but does not have suitable investment opportunities, it may be more beneficial to return excess cash to shareholders through special dividends or share buybacks rather than adhering strictly to a 50% pay-out ratio.

Also, Tesco's dividend distribution policy is subject to change based on the company's financial performance, market conditions, and investment priorities. While this flexibility can be beneficial in certain situations, it also means that investors may not be able to rely on a consistent dividend payment from year to year.

The efficient market hypostasis ("EMH")

The efficient market hypothesis is a theory that suggests that the financial markets are efficient, and all publicly available information is already reflected in the prices of financial assets, such as stocks. Therefore, it is impossible to consistently achieve superior returns by trying to outperform the market.

From an EMH perspective, the stock price of Tesco should fully reflect all publicly available information about the company. However, in reality, it is unlikely that the stock price fully and immediately reflects all available information about the company. This is because the market is not perfect, and it takes time for new information to be fully incorporated into the stock price. In the case of Tesco, the company operates in a highly competitive industry that is subject to rapid changes in consumer preferences, new technology, and economic conditions. Therefore, it is possible that new information or events that affect the company's performance may not be fully reflected in the stock price immediately.

The EMH assumes that all investors have access to the same information and use it rationally to make investment decisions. However, in practice, some investors may have access to more information or may use that information more effectively, giving them an advantage over others. This can lead to information asymmetry and potentially distort the efficiency of the market.

In addition, the EMH assumes that investors are rational and make decisions solely based on information and not on emotions or other behavioural biases. However, research has shown

that investors are prone to behavioural biases such as overconfidence, herding behaviour, and loss aversion, which can result in inefficient market outcomes.

Overall, while the EMH provides a useful framework for understanding the behaviour of financial markets, it is not a perfect model and does not fully capture the complexity and imperfections of real-world markets. In the case of Tesco, the EMH may not be entirely applicable due to the unpredictable and competitive nature of the retail industry, potential information asymmetry, and the influence of behavioural biases on investor decision-making.

Methods of appraising projects

There are various techniques used to evaluate the potential profitability and feasibility of a specific project. The purpose of project appraisal is to assess the costs and benefits of undertaking a project to determine if it is a viable investment opportunity.

Some commonly used methods of appraising projects include:

Net Present Value (NPV): NPV is a method that involves estimating the future cash flows generated by a project and discounting them back to their current value using a specific rate of return. If the NPV of a project is positive, the project is considered profitable and vice versa.

Internal Rate of Return (IRR): IRR is the rate at which the net present value of a project's cash flows equals zero. The IRR is used to compare the profitability of different projects, with a higher IRR indicating a more profitable project.

Payback Period: The payback period is the amount of time it takes for a project to recoup its initial investment. Projects with shorter payback periods are generally considered more attractive as they generate returns more quickly.

Sensitivity Analysis: Sensitivity analysis involves assessing how changes in key variables, such as costs or revenues, affect the profitability of a project. This can help identify the most critical factors that may impact a project's success.

Tesco uses a variety of methods to appraise projects and assess their potential for generating returns for the company. Some of the most used methods include net present value (NPV), internal rate of return (IRR), and payback period.

Net Present Value (NPV) is a commonly used method to appraise projects, and Tesco uses it extensively. NPV calculates the present value of future cash flows generated by a project by discounting them back to their current value using a specific rate of return. If the resulting value is positive, the project is considered profitable and vice versa.

Internal Rate of Return (IRR) is another method used by Tesco to appraise projects. The IRR is the rate at which the project's net present value equals zero. In other words, it is the project's break-even point. A higher IRR indicates a more profitable project, and Tesco typically uses a benchmark rate of return to compare the IRR of different projects.

Payback Period is another appraisal method used by Tesco to evaluate projects. The payback period is the amount of time it takes for the project to recoup its initial investment. The shorter

the payback period, the more attractive the project is considered. Tesco typically has a specific payback period target that projects must meet to be approved.

Tesco's methods of appraising projects are generally effective in evaluating the potential profitability of different projects. However, there are some limitations to these methods. For example, the use of NPV and IRR assumes that cash flows are reinvested at the same rate of return, which may not always be the case in practice. Additionally, these methods do not account for non-financial factors, such as the impact of the project on the environment or the company's reputation.

Despite these limitations, Tesco's methods of appraising projects provide a useful framework for evaluating potential investment opportunities. By carefully evaluating all available information and using a combination of quantitative and qualitative factors, Tesco can make informed decisions about which projects to pursue and which to reject.

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