

BMMB7006 – Global Business Challenges

Printed Name: **Megha Vaghasiya (2515214)**

Signature: Megha

Please state your chosen organisation & contemporary issue in the box below:

Selected Organisation: Tesco



AI GOVERNANCE AND RISK: A STRATEGIC ANALYSIS OF TESCO PLC

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Name: Megha Vaghasiya
Student ID: 2515214



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UNIVERSITY OF WALES TRINITY SAINT DAVID

Executive Summary

This report provides a strategic advisory analysis for Tesco plc on the risks and opportunities associated with the adoption and scaling of Artificial Intelligence (AI) across its operations. As a leading multinational retailer with a strong presence in both the United Kingdom and the European Union, Tesco faces increasing regulatory, ethical, and reputational challenges linked to AI-driven decision-making, data governance, and customer trust.

The analysis identifies that while AI offers Tesco significant competitive advantages in areas such as supply chain optimisation, demand forecasting, and personalised marketing, it simultaneously exposes the organisation to complex regulatory risks. A key finding is the divergence between the UK's principles-based AI regulatory approach and the European Union's legally binding AI Act, which imposes stricter compliance obligations. This regulatory gap creates operational complexity and highlights the need for a harmonised governance strategy.

From a data governance perspective, Tesco's extensive use of customer data through Clubcard and digital platforms raises concerns around consent management, transparency, and cross-border data transfers. Weak governance in these areas may increase exposure to legal penalties under UK GDPR and EU regulations. In addition, ethical risks such as algorithmic bias, lack of explainability, and accountability issues are identified as significant threats to Tesco's long-term reputation and operational integrity.

Customer trust is highlighted as a critical strategic issue. Drawing on Stakeholder Theory and insights from the Edelman Trust Barometer, the report demonstrates how failures in responsible AI practices can directly impact consumer confidence, brand loyalty, and overall financial performance.

To address these challenges, the report recommends the development of a robust AI governance framework positioned as a strategic organisational capability. A structured implementation plan is proposed, focusing on governance foundations, system development, and leadership in responsible AI practices. Key recommendations include the establishment of an AI governance committee, investment in explainable AI systems, alignment with EU regulatory standards, and the introduction of a consumer trust strategy.

In conclusion, the report argues that Tesco's ability to proactively manage AI-related risks will be essential not only for ensuring regulatory compliance but also for sustaining long-term competitive advantage in an increasingly data-driven and trust-sensitive global retail environment.

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Introduction

This report critically examines the strategic challenges associated with the adoption and governance of Artificial Intelligence (AI) within multinational organisations, focusing on Tesco plc. The increasing integration of AI across business functions is not only transforming operational efficiency but also intensifying exposure to regulatory uncertainty, ethical concerns, and declining consumer trust (McKinsey, 2023; WEF, 2024). In a global environment characterised by geopolitical tensions, evolving legal frameworks, and rapid technological change, businesses must adopt a more structured and accountable approach to AI governance.

Tesco plc, a leading UK-based multinational retailer with significant operations across the European Union, has embedded AI into core activities including supply chain optimisation, demand forecasting, dynamic pricing, and personalised marketing through its Clubcard ecosystem. While these capabilities enhance competitive advantage, they also create strategic risks linked to data dependency, algorithmic decision-making, and cross-border regulatory compliance (Tesco, 2024). From a Resource-Based View (Barney, 1991), such AI capabilities can be seen as valuable organisational assets; however, without effective governance, they may also become sources of reputational and regulatory vulnerability.

The central problem addressed in this report is how Tesco can balance the benefits of AI-driven innovation with the risks associated with regulation, data governance, and stakeholder expectations. This challenge is amplified by the divergence between the United Kingdom's principles-based AI regulatory approach and the European Union's legally binding AI Act, which introduces stricter compliance requirements and enforcement mechanisms (European Commission, 2024). According to Institutional Theory (DiMaggio and Powell, 1983), such regulatory pressures create coercive forces that shape organisational behaviour, requiring firms like Tesco to align with multiple and evolving standards.

The scope of this report is to provide a comparative analysis of AI-related risks and governance strategies across the UK and EU contexts. The analysis is structured around five key dimensions: regulatory frameworks, data governance, ethical AI, customer trust, and the macro-environment. In particular, the macro analysis draws on the PESTLE framework to highlight how political instability, economic pressures, technological disruption, and legal fragmentation are shaping AI adoption and risk exposure (Aguilar, 1967; Brown, 1971).

Methodologically, the report adopts a qualitative and theory-driven approach, integrating academic frameworks with industry evidence to support critical evaluation rather than descriptive discussion. Stakeholder Theory (Freeman, 1984) is used to assess the

competing expectations of consumers, regulators, and investors, while Information Ethics (Floridi, 2019) provides a foundation for evaluating fairness and transparency in AI systems. Additionally, insights from regulatory bodies and global reports, including the UK AI White Paper, EU AI Act, and Edelman Trust Barometer, are applied to ensure the analysis remains grounded in current practice.

Overall, this report aims to deliver a practical and evidence-based strategic advisory for Tesco's leadership, demonstrating how effective AI governance can mitigate risk, ensure compliance, and strengthen long-term competitive positioning in a complex global business environment.

Main Findings

1. Regulatory Analysis (UK vs EU)

The regulatory landscape surrounding Artificial Intelligence (AI) presents a significant strategic challenge for Tesco plc, particularly due to the divergence between the United Kingdom's flexible, principles-based framework and the European Union's legally binding, risk-based approach. For a multinational retailer operating across both jurisdictions, this fragmentation increases compliance complexity and introduces both operational and reputational risks.

In the United Kingdom, AI regulation is currently guided by a non-binding, principles-based approach outlined in the UK Government's AI White Paper (DSIT, 2023). This framework is structured around five key principles: safety, transparency, fairness, accountability, and contestability. Rather than introducing a single overarching AI law, regulatory responsibility is distributed across sector-specific bodies such as the Information Commissioner's Office (ICO), the Competition and Markets Authority (CMA), and the Financial Conduct Authority (FCA). While this approach provides flexibility and encourages innovation, it also creates uncertainty for organisations such as Tesco, as enforcement mechanisms remain fragmented and evolving (ICO, 2020).

In contrast, the European Union has adopted a far more prescriptive and legally enforceable framework through the EU AI Act (European Commission, 2024). The Act introduces a risk-based classification system, categorising AI applications into prohibited, high-risk, limited-risk, and minimal-risk categories. High-risk systems—particularly those impacting consumer rights, data processing, and automated decision-making—are subject to strict requirements, including conformity assessments, transparency obligations, and human oversight. Non-compliance can result in significant financial penalties of up to 7% of global annual turnover, making regulatory adherence a critical strategic priority.

For Tesco, this regulatory divergence has direct implications. AI systems used in personalised pricing, recommendation engines, and customer analytics may fall under higher scrutiny within the EU, particularly where automated decision-making significantly influences consumer behaviour. Under Article 22 of the EU GDPR, individuals have the right not to be subject to solely automated decisions, which places additional constraints on Tesco's AI-driven marketing strategies (European Union, 2018). In comparison, the UK's approach provides greater operational flexibility but lacks the same level of legal clarity, potentially leading to inconsistent governance practices across regions.

From an Institutional Theory perspective (DiMaggio and Powell, 1983), Tesco is subject to coercive pressures from formal regulation, particularly within the EU, as well as normative pressures from industry standards and ethical expectations. Additionally, mimetic

pressures may arise as competitors adopt stricter AI governance practices to align with EU requirements, further influencing Tesco's strategic decisions. This suggests that regulatory compliance is not only a legal necessity but also a competitive imperative.

The concept of the “Brussels Effect” (Bradford, 2020) further reinforces the strategic importance of EU regulation. Due to the EU's market size and regulatory influence, its standards often become de facto global benchmarks. For Tesco, aligning AI governance practices with the EU AI Act—even in UK operations—can reduce compliance fragmentation, streamline processes, and enhance reputational credibility across international markets.

Critically, while the UK's flexible model may support innovation, it also risks creating governance gaps that could undermine consumer trust if not proactively addressed. Conversely, the EU's stringent framework, although resource-intensive, provides clearer guidelines and accountability mechanisms. Therefore, Tesco must adopt a harmonised, forward-looking regulatory strategy that prioritises compliance with the most stringent standards while maintaining operational agility.

In summary, the regulatory divergence between the UK and EU creates both risks and strategic opportunities for Tesco. By proactively aligning with EU regulatory standards and embedding consistent governance practices across its operations, Tesco can mitigate legal exposure, strengthen stakeholder confidence, and position itself as a leader in responsible AI adoption.

Therefore, Tesco should adopt a **“EU-first compliance strategy”**, aligning all AI systems with the stricter requirements of the EU AI Act to minimise regulatory fragmentation and future-proof operations across both jurisdictions (Bradford, 2020; European Commission, 2024). This approach will reduce legal uncertainty and enhance Tesco's credibility with regulators and stakeholders.

2. Data Governance

Data governance represents a critical area of strategic risk for Tesco plc, given its extensive reliance on customer data to support AI-driven operations. Through its Clubcard loyalty programme, online platforms, and in-store technologies, Tesco collects and processes large volumes of personal and behavioural data to enable personalised marketing, demand forecasting, and pricing strategies. While these capabilities enhance customer experience and operational efficiency, they also create significant challenges related to data protection, transparency, and regulatory compliance (Tesco, 2024; McKinsey, 2023).

A key issue in Tesco's data governance framework is the management of consent and purpose limitation under UK GDPR and EU GDPR requirements. Personal data must be collected for specific, explicit purposes and cannot be reused without appropriate legal justification (European Union, 2018). However, AI systems often rely on continuous data processing and repurposing, which can blur the boundaries of original consent. For Tesco, this creates a risk that customer data collected for loyalty rewards may be extended into predictive analytics or behavioural targeting without sufficient transparency, potentially undermining compliance and consumer trust.

In addition, Tesco's multinational operations require the transfer of data across borders, particularly between the UK and EU. Following Brexit, the UK operates under a separate data protection regime, although it currently benefits from an EU adequacy decision. However, this status is subject to periodic review and potential withdrawal, creating uncertainty for long-term data strategies (ICO, 2023). Any disruption to cross-border data flows could significantly impact Tesco's AI capabilities, particularly in real-time analytics and integrated supply chain systems.

Another critical challenge is data lineage and traceability within AI systems. Effective governance requires organisations to understand where data originates, how it is processed, and how it influences decision-making outcomes. In complex AI environments, particularly those involving machine learning models, this transparency is often limited, increasing the risk of non-compliance and making it difficult to respond to regulatory inquiries or consumer requests, such as the "right to erasure" (ICO, 2020).

From an Information Ethics perspective (Floridi, 2019), data governance extends beyond legal compliance to issues of fairness and informational justice. Tesco must ensure that customer data is not only protected but also used in a way that respects individual autonomy and avoids exploitation. For example, excessive personalisation or behavioural targeting may create perceived manipulation, leading to ethical concerns even if legal requirements are met.

Furthermore, weak data governance can have direct commercial consequences. Data breaches, misuse of personal information, or lack of transparency can result in financial penalties, reputational damage, and loss of customer trust. High-profile cases involving companies such as Facebook have demonstrated how failures in data governance can lead to long-term brand erosion and regulatory scrutiny (Isaak and Hanna, 2018).

From a Resource-Based View (Barney, 1991), Tesco's data assets represent a valuable and potentially inimitable resource. However, without robust governance structures, this resource can become a liability rather than a source of competitive advantage. This highlights the need for Tesco to invest in strong data governance infrastructure, including data audits, consent management systems, and clear accountability mechanisms.

Critically, Tesco must move from a reactive compliance approach to a proactive governance strategy. This includes embedding "privacy by design" principles into AI systems, ensuring transparency in data usage, and establishing clear internal accountability for data-related decisions. Such measures not only reduce regulatory risk but also contribute to building long-term customer trust and organisational resilience.

In summary, data governance is a central pillar of Tesco's AI strategy, with significant implications for regulatory compliance, ethical responsibility, and competitive positioning. Strengthening governance practices will be essential for mitigating risk and enabling sustainable, responsible use of AI across the organisation.

A further critical issue in Tesco's data governance is the concept of **data minimisation and proportionality**, which requires organisations to limit data collection to what is strictly necessary for a specific purpose (European Union, 2018). In AI-driven environments, there is often a tendency to collect and retain excessive data to improve model accuracy; however, this increases exposure to regulatory risk and potential misuse. For Tesco, the extensive use of Clubcard data and behavioral analytics must be carefully balanced against these principles to avoid overreach. Failure to do so may not only result in non-compliance but also contribute to declining customer trust, particularly as consumers become more aware of how their data is utilized (Edelman, 2023). Therefore, Tesco should adopt stricter data minimisation practices supported by regular audits and clear data retention policies.

Accordingly, Tesco must implement a **centralized consent management system** and strengthen data transparency mechanisms, ensuring customers clearly understand how their data is used across AI applications (European Union, 2018; ICO, 2020). This will reduce compliance risk while reinforcing customer trust.

3. Ethical AI

The ethical implications of Artificial Intelligence (AI) represent a significant strategic risk for Tesco plc, particularly as AI systems increasingly influence customer interactions, pricing decisions, and operational processes. While AI enables efficiency and personalisation, it also introduces concerns related to algorithmic bias, lack of transparency, and accountability, which can undermine both regulatory compliance and public trust (Floridi, 2019; NIST, 2023).

One of the most critical ethical challenges is algorithmic bias. AI systems are trained on historical data, which may contain embedded biases that can lead to discriminatory or unfair outcomes. In Tesco's context, AI-driven pricing strategies or personalised promotions could unintentionally favour certain customer groups over others, leading to perceptions of unfair treatment. Evidence from previous cases, such as Amazon's AI recruitment tool, which demonstrated gender bias, highlights how even advanced organisations can fail to identify and mitigate bias within their systems (Dastin, 2018). For Tesco, similar risks in customer-facing AI could result in reputational damage and regulatory scrutiny.

Another key issue is explainability, often referred to as Explainable AI (XAI). Many AI models, particularly those based on machine learning, operate as “black boxes,” making it difficult to understand how decisions are made. This lack of transparency poses a challenge for Tesco in meeting regulatory expectations, particularly under GDPR requirements for meaningful information about automated decision-making (European Union, 2018). If customers are unable to understand why they receive certain prices or recommendations, it can lead to distrust and perceptions of manipulation.

Accountability is also a major concern in AI governance. Determining responsibility for AI-driven decisions—whether it lies with developers, managers, or the organisation as a whole—remains complex. The NIST AI Risk Management Framework (2023) emphasises the importance of establishing clear accountability structures to ensure that AI systems are monitored, evaluated, and corrected where necessary. For Tesco, this implies the need for defined governance roles and oversight mechanisms to manage ethical risks effectively.

From an Information Ethics perspective (Floridi, 2019), organisations have a responsibility to ensure that AI systems promote fairness, transparency, and respect for individuals. This extends beyond legal compliance to broader societal expectations. For example, overly aggressive personalisation strategies may be perceived as intrusive, even if they are technically compliant with data protection laws. Such practices risk creating what is often described as a “creepiness factor,” negatively affecting customer perception.

Stakeholder Theory (Freeman, 1984) further highlights the need to balance competing interests. While shareholders may prioritise efficiency and profitability through AI adoption, customers and regulators expect fairness, transparency, and ethical behaviour. Failure to manage these competing expectations can result in stakeholder conflict, reputational damage, and loss of long-term value.

Critically, ethical failures in AI are not merely theoretical risks but have tangible business consequences. Public backlash, regulatory intervention, and loss of consumer trust can significantly impact financial performance. In an era where consumers are increasingly aware of how their data is used, ethical AI practices are becoming a key differentiator in the market (Edelman, 2023).

To address these challenges, Tesco must adopt a proactive approach to ethical AI governance. This includes implementing bias detection and mitigation processes, investing in explainable AI technologies, and establishing an ethics review board to oversee AI-related decisions. Embedding ethical considerations into the design and deployment of AI systems will be essential for ensuring responsible innovation and maintaining stakeholder trust.

In summary, ethical AI represents a critical dimension of Tesco's overall AI strategy. By addressing issues of bias, transparency, and accountability, Tesco can reduce risk, enhance compliance, and strengthen its reputation as a responsible and trustworthy organisation.

Therefore, Tesco should introduce **mandatory bias testing and explainability standards** for all high-impact AI systems, supported by an internal ethics review process (NIST, 2023; Floridi, 2019). This will ensure fairness in decision-making and reduce reputational risk associated with unethical AI outcomes.

4. Customer Trust

Customer trust represents a critical strategic asset for Tesco plc, particularly in the context of increasing reliance on Artificial Intelligence (AI) and data-driven decision-making. As AI systems shape personalised marketing, pricing, and customer interactions, trust becomes a key determinant of customer loyalty, brand reputation, and long-term financial performance (Edelman, 2023; PwC, 2022).

The Edelman Trust Barometer (2023) highlights that consumers are increasingly concerned about how organisations use their data, with a growing expectation for transparency, accountability, and ethical behaviour. In Tesco's case, the extensive use of customer data through its Clubcard programme and digital platforms creates both an opportunity to enhance customer experience and a risk of eroding trust if data usage is perceived as intrusive or unfair. For example, highly personalised promotions or dynamic pricing strategies may improve efficiency but can also lead to perceptions of manipulation if customers do not understand how decisions are made.

A key issue is the transparency of AI-driven decisions. Customers are more likely to trust organisations that clearly communicate how their data is collected and used. However, as discussed in previous sections, many AI systems lack explainability, which can create a “trust gap” between the organisation and its customers (European Union, 2018). For Tesco, failure to provide clear and accessible explanations for AI-driven outcomes—such as personalised offers or pricing differences—may reduce customer confidence and increase scepticism.

From a Stakeholder Theory perspective (Freeman, 1984), trust must be managed across multiple groups, including customers, regulators, investors, and employees. While AI adoption may deliver short-term efficiency gains for shareholders, any perceived misuse of data can lead to negative reactions from customers and regulatory bodies. This creates a tension between commercial objectives and ethical responsibilities, requiring Tesco to adopt a balanced and transparent approach to AI governance.

Importantly, trust is directly linked to business performance. Research indicates that organisations with higher levels of consumer trust benefit from increased customer retention, stronger brand loyalty, and improved financial outcomes (Edelman, 2023). Conversely, trust failures can result in customer attrition, reduced engagement, and reputational damage. High-profile cases such as Facebook's data privacy controversies demonstrate how quickly trust can deteriorate and the long-term impact this can have on market value and public perception (Isaak and Hanna, 2018).

For Tesco, maintaining trust is particularly important in a highly competitive retail environment where switching costs for customers are relatively low. If customers perceive

that their data is being misused or that AI-driven practices are unfair, they can easily shift to competitors. This makes trust not only an ethical issue but also a key source of competitive advantage.

Furthermore, trust is increasingly influenced by broader macro factors, including rising public awareness of data privacy, regulatory scrutiny, and media coverage of AI-related risks (WEF, 2024). These external pressures amplify the consequences of any governance failures and increase the importance of proactive trust-building strategies.

Critically, Tesco must move beyond compliance-focused communication to actively building trust through transparency and engagement. This includes clearly communicating data usage policies, providing customers with greater control over their data, and demonstrating accountability in AI decision-making processes. Initiatives such as publishing transparency reports or responsible AI statements can further enhance credibility and stakeholder confidence.

In summary, customer trust is a central pillar of Tesco's AI strategy, with direct implications for both reputation and financial performance. By embedding transparency, accountability, and ethical practices into its AI systems, Tesco can strengthen customer relationships, mitigate risk, and achieve sustainable competitive advantage in a data-driven marketplace.

Another important dimension of customer trust is the concept of **perceived fairness**, particularly in relation to AI-driven pricing and personalisation strategies. While such systems are designed to enhance customer experience, they may also lead to concerns around price discrimination if different customers receive different offers without clear justification. Research suggests that consumers are more likely to distrust organisations when outcomes appear unfair, even if they are technically compliant with regulations (PwC, 2022). For Tesco, this creates a significant reputational risk, as customers may interpret personalised pricing as exploitative rather than beneficial. Therefore, Tesco should ensure that AI-driven decisions are not only legally compliant but also perceived as fair and transparent, supported by clear communication and consistent pricing principles.

Accordingly, Tesco must develop a **transparent customer communication strategy**, clearly explaining how AI influences pricing, recommendations, and data usage (Edelman, 2023). This proactive approach will strengthen trust and improve long-term customer retention.

5. Macroeconomic Context (PESTLE)

The adoption and governance of Artificial Intelligence (AI) within Tesco plc must be understood within a broader macroeconomic context shaped by political, economic, social, technological, legal, and environmental (PESTLE) factors. These external forces not only influence the pace and scale of AI adoption but also intensify the risks associated with regulation, data governance, and customer trust (Aguilar, 1967; Brown, 1971).

From a political perspective, increasing geopolitical tensions and the fragmentation of global trade systems are creating a more complex operating environment for multinational organisations. The World Economic Forum (2024) identifies geoeconomic confrontation and shifting alliances as key global risks, which can directly affect cross-border data flows and regulatory alignment. For Tesco, operating across the UK and EU means navigating evolving political relationships post-Brexit, particularly in relation to data adequacy agreements and regulatory cooperation. Any deterioration in these relationships could disrupt AI-enabled operations that rely on integrated data systems.

Economically, inflationary pressures and rising operational costs are influencing investment decisions in AI technologies. While AI offers cost efficiencies and productivity gains, it also requires significant upfront investment in infrastructure, talent, and compliance systems (McKinsey, 2023). For Tesco, balancing cost pressures with the need for responsible AI investment is a key strategic challenge. In periods of economic uncertainty, there is a risk that organisations prioritise short-term cost savings over long-term governance, increasing exposure to regulatory and reputational risks.

Social factors are also playing an increasingly important role. Public awareness of data privacy, algorithmic fairness, and corporate responsibility has grown significantly, leading to higher expectations for ethical AI practices (Edelman, 2023). Consumers are no longer passive participants but active stakeholders who demand transparency and accountability. For Tesco, failure to meet these expectations could result in negative public perception, reduced customer loyalty, and increased scrutiny from advocacy groups and the media.

Technological factors are central to this analysis, as rapid advancements in AI capabilities are both enabling innovation and increasing complexity. The growing use of machine learning, automation, and real-time analytics enhances Tesco's operational efficiency but also introduces challenges related to system transparency, integration, and cybersecurity (WEF, 2024). As AI systems become more sophisticated, the risks associated with bias, errors, and unintended consequences also increase, requiring more robust governance frameworks.

Legally, the regulatory landscape for AI and data protection is evolving rapidly, with significant variation across jurisdictions. As discussed earlier, the contrast between the

UK's flexible approach and the EU's binding AI Act creates compliance challenges for Tesco. In addition, the increasing use of sanctions, trade barriers, and data localisation requirements adds further complexity to global operations (WEF, 2024). These legal dynamics reinforce the need for a proactive and harmonised governance strategy.

Environmental factors, while less directly linked to AI governance, are becoming increasingly relevant in the context of sustainability and ESG (Environmental, Social, and Governance) expectations. AI technologies can support more efficient resource management and supply chain optimisation; however, they also require significant energy consumption, particularly in data processing and storage. Investors and regulators are placing greater emphasis on sustainable practices, meaning that Tesco must consider the environmental impact of its digital infrastructure alongside its AI strategy.

From a strategic perspective, the interaction of these PESTLE factors highlights that AI governance is not an isolated issue but is deeply embedded within the broader global business environment. According to Institutional Theory (DiMaggio and Powell, 1983), organisations are shaped by external pressures, including regulatory requirements, societal expectations, and competitive dynamics. For Tesco, this means that effective AI governance must align not only with internal objectives but also with external environmental forces.

Critically, the macroeconomic environment amplifies both the risks and opportunities associated with AI. Organisations that proactively adapt to these external pressures are more likely to achieve sustainable competitive advantage, while those that fail to respond effectively may face increased regulatory scrutiny, reputational damage, and loss of market position.

In summary, the PESTLE analysis demonstrates that Tesco's AI strategy is significantly influenced by external political, economic, social, technological, legal, and environmental factors. A comprehensive understanding of these dynamics is essential for developing a resilient and future-proof AI governance framework.

Therefore, Tesco should adopt a **proactive and adaptive AI governance strategy** that continuously monitors geopolitical, regulatory, and economic changes (WEF, 2024). This will enable the organisation to remain resilient in a rapidly evolving global environment.

Implementation Plan (Tesco plc)

To effectively address the risks associated with Artificial Intelligence (AI), Tesco plc must adopt a structured and measurable implementation plan that embeds governance, ethical standards, and regulatory compliance into its core operations. This plan is designed across three phases, ensuring a progressive transition from foundational governance to industry leadership in responsible AI practices.

Phase 1: Foundation (Months 1–6)

The initial phase focuses on establishing the core governance structures and identifying existing risks within Tesco's AI ecosystem. A dedicated **AI Governance Committee** should be formed, comprising senior representatives from data, legal, IT, and compliance functions. This committee will be responsible for overseeing AI-related decision-making and ensuring alignment with both UK and EU regulatory expectations.

A comprehensive **AI inventory and risk classification** exercise should be conducted to identify all AI systems currently in use across Tesco's operations, including customer-facing applications such as Clubcard analytics and pricing algorithms. Each system should be categorised based on risk level, in line with EU AI Act classifications (European Commission, 2024).

In addition, Tesco should undertake a **data audit** to assess data sources, consent mechanisms, and cross-border data flows. This will help identify gaps in compliance with GDPR requirements, particularly in relation to purpose limitation and data transparency (European Union, 2018).

- **Estimated Cost:** £300,000–£500,000
- **Key KPI:** 100% of AI systems identified and risk-classified
- **Responsible Role:** Chief Data Officer (CDO)

Phase 2: Build (Months 7–18)

The second phase focuses on strengthening systems, processes, and organisational capabilities. Tesco should implement **conformity assessments** for high-risk AI systems to ensure compliance with EU regulatory standards. This includes documentation, validation processes, and human oversight mechanisms.

Investment in **Explainable AI (XAI)** technologies is critical to improve transparency and support regulatory requirements for automated decision-making (NIST, 2023). This will enable Tesco to provide clear explanations for AI-driven outcomes, enhancing both compliance and customer trust.

An independent **AI Ethics Review Board** should also be established to evaluate potential ethical risks, including algorithmic bias and fairness. This board will provide oversight and ensure that AI systems align with organisational values and stakeholder expectations (Floridi, 2019).

Furthermore, Tesco should roll out **staff training programmes** targeting over 500 employees across data, marketing, and operations functions. These programmes should focus on responsible AI use, data protection, and ethical decision-making.

- **Estimated Cost:** £1 million–£1.5 million
- **Key KPI:** 90% compliance rate for high-risk AI systems
- **Responsible Role:** Head of AI Governance

Phase 3: Lead (Months 19–24)

The final phase positions Tesco as a leader in responsible AI practices. Tesco should publish an annual **Responsible AI Report**, outlining its governance framework, risk management practices, and compliance status. This enhances transparency and strengthens stakeholder confidence.

Active **regulatory engagement** with bodies such as the ICO and EU authorities should be prioritised to stay ahead of evolving requirements and demonstrate proactive compliance. In addition, Tesco should launch a **customer trust campaign**, clearly communicating how AI is used and how customer data is protected.

An independent **external audit or evaluation** should also be conducted to validate Tesco's AI governance framework and identify areas for continuous improvement. This aligns with best practices in accountability and enhances credibility with investors and regulators.

- **Estimated Cost:** £500,000–£800,000
- **Key KPI:** Increase in customer trust metrics (e.g., +15% trust score)
- **Responsible Role:** Chief Risk Officer (CRO)

Strategic Justification

From a Resource-Based View (Barney, 1991), investing in robust AI governance infrastructure enables Tesco to develop a valuable and difficult-to-imitate organisational capability, creating long-term competitive advantage. Additionally, aligning with EU regulatory standards reflects the “Brussels Effect” (Bradford, 2020), allowing Tesco to adopt a globally consistent approach that reduces compliance fragmentation.

This structured approach reflects the Resource-Based View, where robust AI governance capabilities become a source of sustained competitive advantage (Barney, 1991), while alignment with EU standards leverages the Brussels Effect to strengthen global positioning (Bradford, 2020).

Summary

This phased implementation plan ensures that Tesco moves from reactive compliance to proactive leadership in AI governance. By clearly defining responsibilities, timelines, costs, and performance metrics, the plan provides a practical and actionable roadmap for managing AI risks while strengthening regulatory compliance, ethical standards, and customer trust.

Strategic Risk Evaluation

In addition to the identified regulatory, ethical, and data governance challenges, it is important to evaluate the broader strategic risks associated with AI adoption within Tesco plc. AI-related risks are interconnected and can create compounding effects across operational, financial, and reputational dimensions. For instance, a failure in data governance can lead to regulatory penalties, which may trigger reputational damage and loss of customer trust, ultimately affecting revenue and market share (WEF, 2024; McKinsey, 2023).

From a strategic perspective, Tesco's increasing reliance on AI creates technological dependency, potentially reducing organisational flexibility over time. As AI systems become embedded within core operations such as supply chain management and customer analytics, any system failure, bias, or regulatory restriction could disrupt business performance. This highlights the importance of building resilient and adaptable AI systems supported by strong governance frameworks.

Furthermore, competitive pressures within the retail sector mean that Tesco cannot afford to delay AI adoption; however, rapid implementation without adequate safeguards increases exposure to risk. This creates a strategic tension between innovation and control. According to Porter and Heppelmann (2014), digital transformation enhances competitive positioning only when supported by strong governance structures.

To address these risks, Tesco must adopt a risk-based approach to AI implementation, prioritising high-impact areas while ensuring appropriate controls are in place. This includes continuous monitoring of AI performance, regular risk assessments, and integration of governance mechanisms across all levels of the organisation, enabling Tesco to balance innovation with risk management.

Conclusion

This report has critically examined the strategic challenges associated with the adoption and governance of Artificial Intelligence (AI) within Tesco plc, highlighting that while AI enables significant improvements in operational efficiency, customer personalisation, and decision-making, it also introduces substantial regulatory, ethical, and reputational risks. The analysis has demonstrated that these risks are particularly intensified by the divergence between the United Kingdom's principles-based regulatory approach and the European Union's legally binding AI framework, creating complexity in achieving consistent compliance across jurisdictions.

A central argument developed throughout this report is that AI governance should not be approached as a purely technical or compliance-driven function, but rather as a strategic organisational capability. Weaknesses in data governance, including issues related to consent, transparency, and cross-border data flows, increase Tesco's exposure to legal penalties and operational disruption. At the same time, ethical challenges such as algorithmic bias and lack of explainability pose significant threats to fairness, accountability, and stakeholder confidence. These risks are not isolated but interconnected, with failures in one area having the potential to amplify impacts across others.

Furthermore, the report has emphasised that customer trust is a critical determinant of Tesco's long-term success. In a highly competitive retail environment with low switching costs, any perceived misuse of data or lack of transparency in AI-driven decisions can lead to immediate reputational damage and loss of customer loyalty. Trust, therefore, emerges not only as an ethical consideration but also as a key driver of financial performance and competitive positioning.

The analysis also situates Tesco's AI strategy within a broader macroeconomic context shaped by geopolitical tensions, economic pressures, technological advancements, and evolving legal frameworks. These external forces increase uncertainty while simultaneously accelerating the need for responsible and well-governed AI adoption. As such, Tesco must respond not only to internal operational challenges but also to dynamic external pressures that influence regulatory expectations and stakeholder perceptions.

Importantly, the implementation plan presented in this report provides a clear and actionable pathway for Tesco to address these challenges. By establishing formal governance structures, investing in explainable and ethical AI systems, and aligning with EU regulatory standards as a global benchmark, Tesco can transition from a reactive compliance approach to a proactive and leadership-oriented strategy. This shift is essential for building organisational resilience and ensuring long-term sustainability.

In conclusion, the report argues that Tesco's ability to effectively manage AI-related risks will be a defining factor in its future success. Organisations that integrate strong governance, ethical responsibility, and stakeholder-centric practices into their AI strategies are more likely to achieve sustainable competitive advantage. Therefore, by embedding responsible AI at the core of its operations, Tesco can not only mitigate risks but also strengthen trust, enhance its reputation, and secure a leading position in an increasingly data-driven and trust-sensitive global marketplace.

Therefore, Tesco should position responsible AI governance not merely as a compliance function but as a strategic differentiator that enhances trust, reduces risk, and supports sustainable competitive advantage in the global retail market (Edelman, 2023; WEF, 2024).

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