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VERTICAL INTEGRATION IN FOOD INDUSTRY

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VERTICAL INTEGRATION IN FOOD INDUSTRY

Analysing the feasibility of Vertical Integration within food industry by taking an example of Compass Group Plc.

ABSTRACT

Vertical integration has become an important business strategy to respond to the needs of a consumer-driven marketing system. Although one of the perceived benefits of vertical ownership integration is improved profitability of the integrated firm, empirical literature mostly ignores this issue. Using a sample of a leading food and support services players – Compass Group Plc. this study examines the feasibility of vertical mergers on behalf of the firm.

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Purpose

The purpose of the report is to analyse the feasibility of vertical integration of one of the leading players in the food and support services business – Compass Group. Using economic theories, the aim is to evaluate the current sourcing strategy of the company and see if theoretical frameworks agree with their strategy.

Design

The paper is designed around the theories of Vertical Integration and the application of these theories into practice. However while applying these theories to an organization (Compass Group Plc.) I realized that economic theories alone are insufficient alone to derive a conclusion on the feasibility of vertical integration. Therefore the paper is designed in a way that covers economic theories (discussed in the literature review) and Strategic frameworks that have been integrated to provide a recommendation on the feasibility of vertical integration to Compass Group Plc.

Methodology

This report contains primary and secondary data obtained from publications, research groups, business journals, scientific papers, company literature, and investment reports. Interviews with industry insiders from within Compass Group Plc. and external consultants were conducted, particularly to speak about the company's future strategic plans.

Research limitations

Although this research was carefully prepared, I am still aware of its limitations and shortcomings. First of all, the research was conducted in a short period of 12 weeks. It would be better if it was done in a longer time. Secondly, most of the data has been collected making use of secondary sources. This approach is ok as far as writing the literature review is concerned, but is not always the best approach while doing a company analysis. Due to lack of access to company executives from Compass Group Plc., the data was only collected through other sources and thus a true ambition of a company and its decision making criteria has not been factored in thus having a limitation towards practical implication.

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INTRODUCTION

"Vertical integration occurs whenever a business firm does something for it that it might otherwise have obtained on the market. The very concept is artificial because production and distribution processes can be divided up arbitrarily." (Martin Rickets, 2002)

The nature of a firm

As per the neo classical view the firm is a 'planning unit' that accepts the factors of production and utilizes the factors of production (land, labor and capital) to create a 'marketable output' (goods & services) in exchange for financial gain. It is seen as a 'black box' that absorbs the factors of production and magically turns them into a valuable output.

Figure 1: Nature of a firm

"Outside the firm, price movements direct production, which is coordinated through a series of exchange transactions on the market. Within a firm, these market transactions are eliminated and in place of the complicated market structure with exchange transactions is substituted the entrepreneur-coordinator, who directs production. It is clear that these are alternative methods of coordinating production. Yet, having regard to the fact that if production is regulated by price movements, production could be carried out without any organization at all, well might we ask, why is there any organization?" (Ronald Coase, 1910)

The Concept of Transaction Costs

Transaction costs simply are the costs incurred to use a market. To use the market it requires two parties – buyer and seller. For example buying a mug of beer from a bar involves the buyer (individual) and the seller (firm). On the other hand the cost involved to use a firm is called 'Management costs'. For example if a firm is buying the beer from another firm it is a 'firm-to-firm'' transaction' or the cost incurred by the management. A 'transaction' involves:

- Identifying trading partners
- Negotiating contracts

- Monitoring compliance
- Enforcing fulfillment

The traditional theory assumes that the 'economic agents' have full and perfect information therefore mistakes are never made and thus transactions costs are brought down. The modern literature assumes that an individual's ability to absorb complex information is limited. Hence no individual or a firm can have perfect information, hence the. This is termed as *'bounded rationality'.* Since there is 'bounded rationality' as per the modern approach, the transaction costs are higher leading to the question – 'In-house or outsource?'

LITERATURE REVIEW

The new concept of Vertical Integration

The terminology developed in this section explicitly recognizes that firms may:

1. Control vertical relationships without fully owning adjacent business units.
2. May enjoy benefits of vertical integration without transferring all of their output internally,
3. May or may not perform a variety of integrated activities at a particular stage of processing, or
4. May engage in many (or few) stages of processing in the chain of production from ultra-raw materials to the final consumer.

Source: The academy of Management Journal, (Kathryn Rudie Harrigan, 1985)

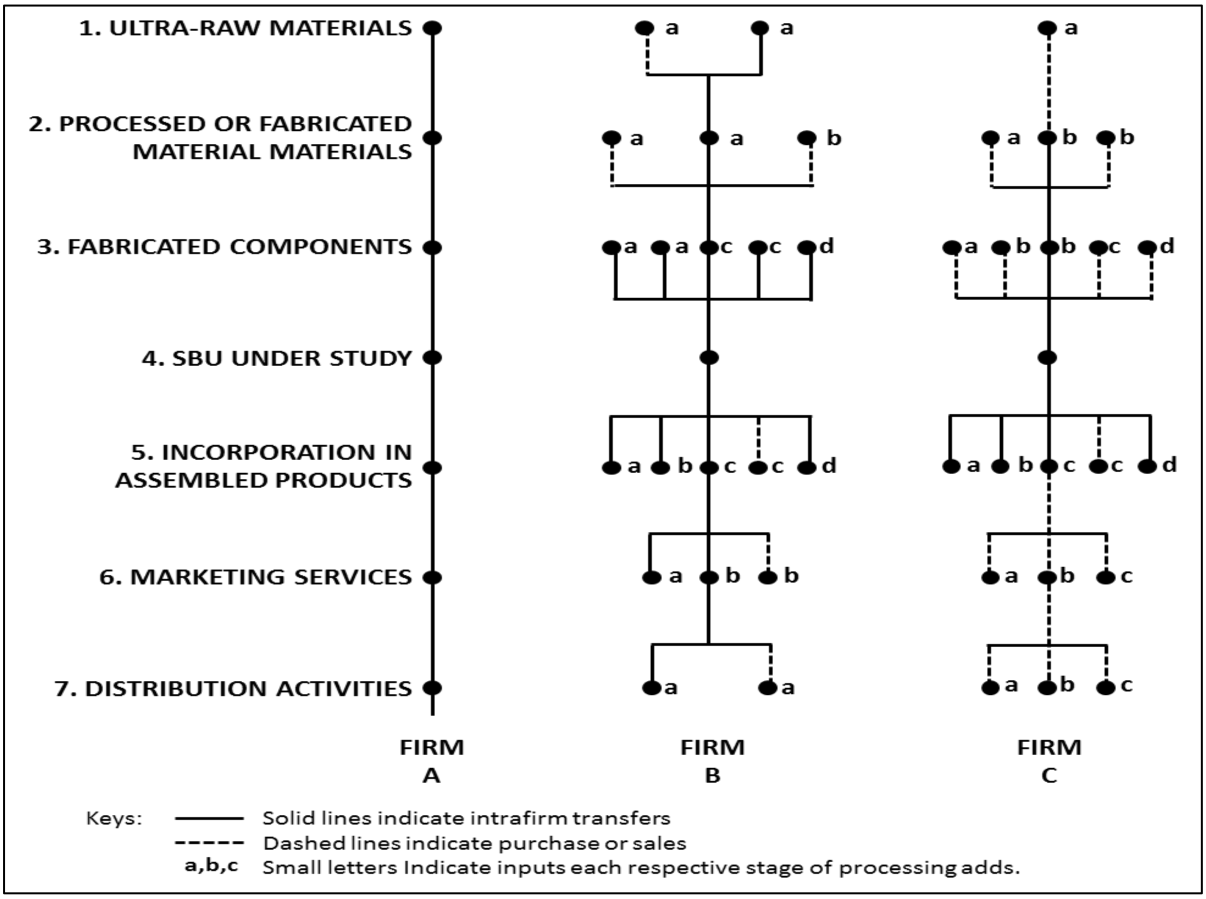
Theory suggests that firms may adjust the dimensions of their vertical integration strategies to suit competitive or corporate needs of vertical integration need not be the same under all circumstances in order to be effective. Managers can fine-tune their uses of vertical integration in accordance with changes in the forces that this study outlines. (Kathryn Rudie Harrigan, 1985)

Dimensions of Integration

Stages

The number of stages in the chain of processing that a firm engages in – from ultra raw material to the final consumer determines the number of stages of integration.

Figure 2: Dimensions Characterizing Vertical Integration Strategies



Source: The academy of Management Journal, (Kathryn Rudie Harrigan, 1985)

Firm A: The firm is engaged in many stages of integrated activity but adds only one input per stage of processing (it is narrowly integrated). Firm A transfers all of its outputs from stage 1 to stage 2 and so on in-house and does not purchase or sell any inputs from or to the market. This firm is fully integrated from stage 1 to 7.

Firm B: The firm makes four inputs (a, b. c, and d) at stages 3 and 5, respectively. Firm B purchases some 3c from (and sells some 5c to) outsiders. Firm B is more broadly integrated at stages 3 and 5 than at stages 2 and 6 since it performs more activity there. Firm B is engaged in many stages of integrated activity, but because it produces some of its inputs from the market, its degree of integration for some activities is lower than Firm A's and therefore Firm B is ‘taper integrated’.

Firm C: The firm makes only ‘b’ at stages 2 & 3 and ‘c’ at stage 5. Firm C is narrowly integrated and engaged in few stages of integrated activity. It purchases some 2b and 3b from (and sells some 5c to) outsiders, making it taper integrated.

Breadth of Integration

The way a firm defines the boundaries of its SBUs vary. Figure 2 suggests that broadly integrated SBUs (like B3, B5, C3 & C5) perform more activities in-house than outsource. “Broadly integrated SBUs increase a firm's value-added margin substantially at their stage of processing because they make more goods and services in-house, and vertically integrated firms could be broadly integrated at several stages of processing.” (Kathryn Rudie Harrigan, 1985)

Breadth of integration matters because plants that try to produce too many diverse components for a product line may lose opportunities to enjoy scale economies (Kathryn Rudie Harrigan, 1985). A broad manufacturing policy could mean that the SBUs could lose cost advantages of purchasing components or services from more efficient outsiders.

Degree of integration

Degree of integration determines the proportion of total output (of a particular component or service) an SBU purchases from (or sells to) its sister SBUs. Fully integrated SBUs transfer 95 percent or more of their requirements for a particular resource in-house. Taper integrated firms purchase more than 5 percent of their requirements for that resource from outsiders (Crandall, 1968a. 1968b). The degree of internal transfers matter because studies suggest that upstream plant's minimum efficient scale is larger than the downstream plant's (Kathryn Rudie Harrigan, 1985). Excess capacity is costly yet firms are happy to allow some proportion of one SBU plant to be idle justified by the advantages they perceive from fully integrated strategies.

Form of integration

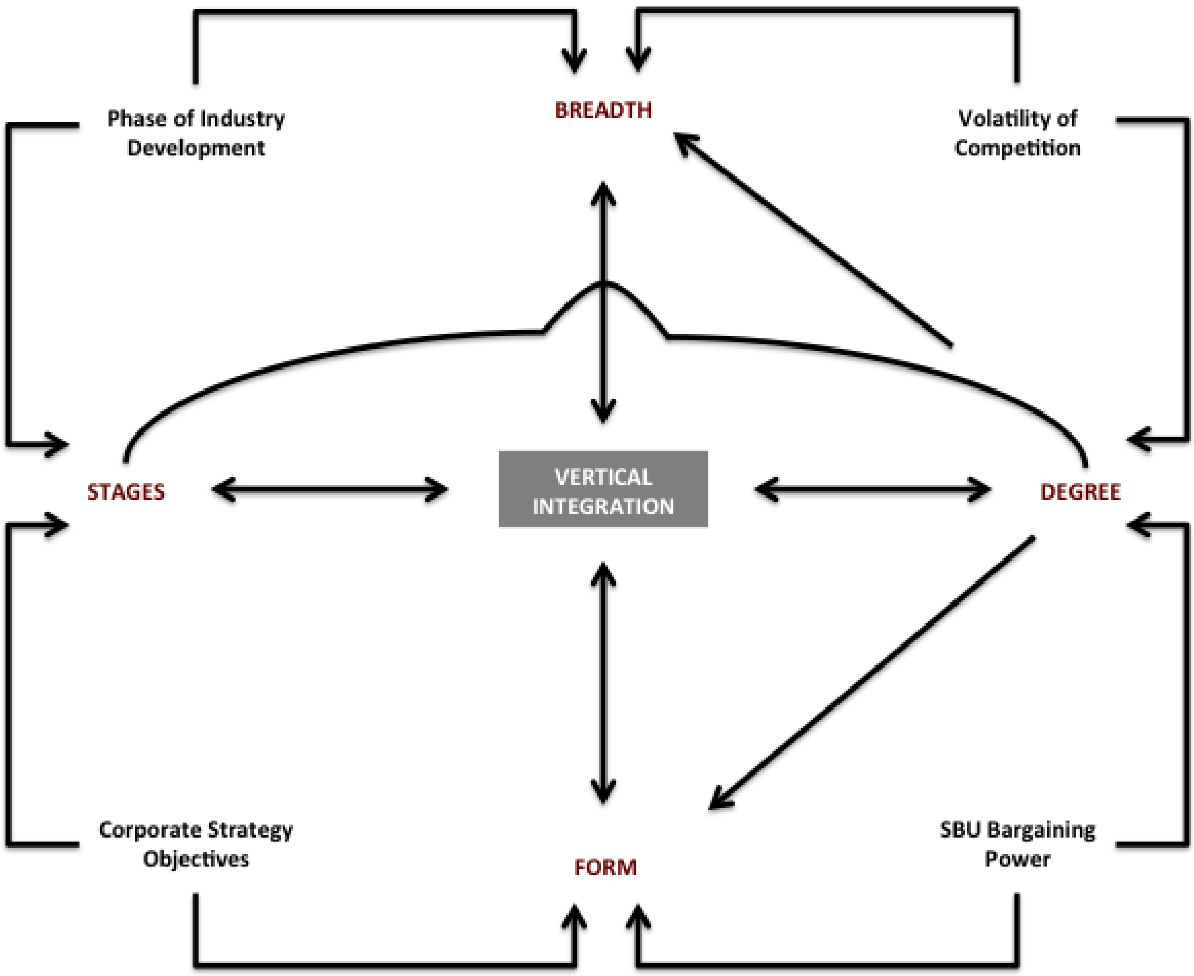
Although many firms prefer to own vertically integrated units entirely, they need not own a business unit to control it and enjoy the benefits of vertical relationships, for a variety of other control arrangements are possible (Kathryn Rudie Harrigan, 1985). Quasi-integrated firms, for example, share ownership with others, underwrite part of the vertically related firm's capital structure, or possess other stakes in the business unit short of full ownership (Blois. 1972). “In many environments, firms can obtain leverage over other's assets without owning them fully”. (Kathryn Rudie Harrigan, 1985) Often firms can secure knowledge, services, and materials in this manner with only a small ownership stake. For example, fledgling or undercapitalized firms can hurdle entry barriers by forming joint ventures with established firms (Kathryn Rudie Harrigan, 1985).

Forces affecting the Choice of Vertical Integration Strategies

“A firm will adapt the dimensions of vertical integration according to –

1. The phase of industry development (sales growth, changes in growth rates),
2. Industry volatility (concentration and heights of exit barriers),
3. Asymmetries in bargaining position (vis-à-vis suppliers, distributors, and customers' or competitors' integration strategies), and
4. Firms' strategy objectives.”(Kathryn Rudie Harrigan, 1985)

Figure 3: Forces Tempering the Vertical Integration Strategy



Source: The academy of Management Journal, (Kathryn Rudie Harrigan, 1985)

The following set of structural equations describes the hypothesized relationships as described in figure above:

- STAGES = *f* (corporate strategy, phase of industry development)
- DEGREE = *f* (number of stages, volatility of competition. SBU's bargaining power vis-a-vis outsiders)
- FORM = *f* (degree of internal transfers, SBU's bargaining power vis-a-vis outsiders, corporate strategy)
- BREADTH = *f* (degree of internal transfers, phase of industry development, volatility of competition)

Phase of Industry Development

The degree of Vertical Integration depends upon the nature of the industry, whether it was an embryonic or an established industry—by studying sales growth and the degree of uncertainty surrounding sales. “Uncertainty may be due to sales growth patterns or technological change at some stage in the vertical chain of processing. Demand uncertainty would be particularly great when an industry is young and customers are highly reluctant to try a new product. Demand would also be uncertain if a product's sales were declining for systemic reasons”. (Harrigan, 1980)

If the demand for the output of the Strategic Business Units (SBUs) is uncertain, chances of insufficient sales volumes, resulting in costly excess capacity is increased. In this case the variability of demand creates a risk for integration. Thus, the number of integrated stages will be low when growth in industry sales is uncertain and vice versa. More integrated activities and stages will appear when demand is increasing steadily and less integrated activities will appear if the demand is stagnant or decreasing.

Volatility of Competition

In case of the industry’s volatility is high, it increases the risk of vertical integration because the competitors are more likely to go adapt a price cutting strategy to fill in the capacity. “An industry's volatility, which stems from the presence of certain structural traits and competitive practices, make the costly overhead associated with vertical integration more difficult to bear” (Harrigan, 1983a; Porter. 1980). When the competition is volatile, SBUs will choose to produce lesser in-house and purchase more from the market, thereby shifting some risks. If competition is volatile, firms will be reluctant to let their SBUs rely heavily upon each other for purchases or sales and when returns are stable, SBUs can safely gear up to produce more in-house or purchase products from sister units.

Bargaining Power

“SBUs with bargaining power can often exert it to persuade outsiders to perform low value-added tasks for them” (Porter, 1974, 1976). The bargaining power is important for a firm to reduce the risk of firms ‘asset inflexibilities’ as it shifts the risk on to the outsiders. There are ways to approximate the bargaining power of SBUs such as: the height of cost barriers to customers' switching suppliers, the availability of alternate suppliers (or customers), the competitors' degrees of backward and forward integration, the degree of ‘asset specificity’, the dependence of a supplier, and the ability to self-manufacture (Kathryn Rudie Harrigan, 1985). When these cost barriers are not high, the degree of vertical integration will be lesser as compared to when these cost barriers are high (Kathryn Rudie Harrigan, 1985).

Corporate Strategy Objectives

“Considering the importance of vertical relationships in the context of firms' corporate strategies, however, alters the framework's apparent rationale. Corporate strategy needs may increase the number of stages of integration undertaken or the proportion of ownership held beyond the levels of vertical integration other variables suggested. Thus, firms seeking to penetrate mature markets with new products will integrate forward to prove their product's superiority to risk-averse customers, maintaining full ownership of activities they deem of strategic importance.” (Kathryn Rudie Harrigan, 1985).

The economic advantages of Vertical Integration will be transitory because the volatility and the competition within the industry and the relationship among firms are not static. Since most of the industries go through volatile competition at some point in their evolution, business leaders must understand that the long-term benefits of vertical integration are often primarily those of intelligence gathering or quality control (Kathryn Rudie Harrigan, 1985).

Make or buy decision?

The decision of producing in-house or outsourcing arises due to the complexity and limited information of the economic agents. Does being vertically integrated always result in growth? The answer is no because it is important for business to know when to integrate vertically to gain maximum benefit. For example if a food company was to vertically integrate into having their own network of farms, would it result in increased profitability? Theory suggest that a firm's decision to produce in house or outsource could be made based on a few broad economic theories – Economies of scale, Number of firms, Asset specificity, Firm specific knowledge, Uncertainty, Scope of opportunism, monitoring costs and complexity of production.

Economies of Scale

Economies of scale occur when a 'proportionate increase in all inputs leads to a more proportionate increase in output' thereby reducing the cost of production and thereby reducing transaction costs. Economies of scale are often seen in larger firms that have been in the business for a long time. If a supplier enjoys economies of scale, it would be cheaper to source from him instead of backward integrating and vice versa.

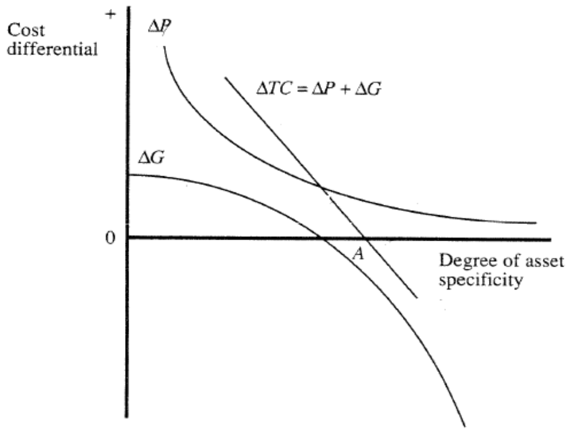
Number of Firms

Theory suggests that the price that the firm pays for its inputs or will receive for its outputs will depend on the number of firms in the market. For instance if a firm has an option to choose from a large number of buyers, the price will be kept lower and in the same way if a firm has a lot of competitors in the market it will have to keep its prices low

Asset Specificity

An increasing number of business relationships, characterized by high degrees of asset specificity, choose contracts instead of integration to protect against potential hold-up problems. As noted by Holmstrom and Roberts (1998, p. 80), "there seems to be something of a trend today toward disintegration, outsourcing, contracting out and dealing through the market rather than bringing everything under the umbrella of the organization". The firm vs. market in terms of asset specificity can be explained with the help of the figure below:

Figure 4: Firm vs. Markets (Asset Specificity)



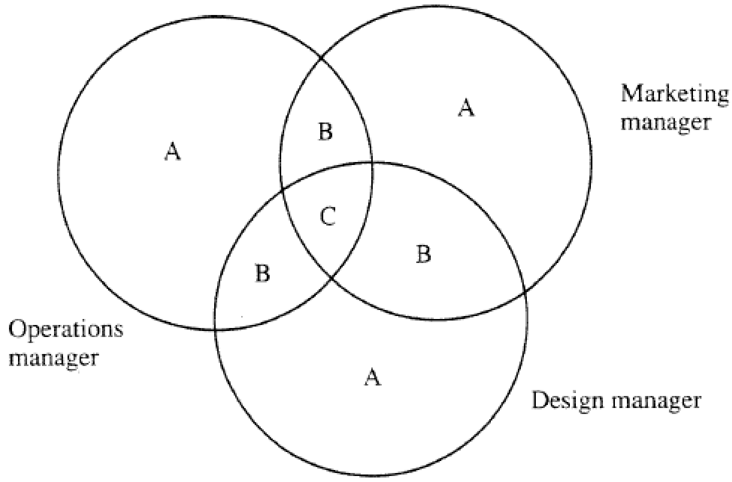
Source: The Economic Institution of capitalism, (Oliver E Williamson, 1985)

ΔG represents governance cost. It is positive with lower asset specificity but becomes negative with increase in asset specificity, showing that the firm's governance costs are lesser than that of the market. This is because the market finds it hard to restrict opportunism. This opportunism increases with the increase asset specificity due to which the number of suppliers decreases. ΔP curve shows that the transaction costs reduce as a company starts to generate economies of scale. The ΔTC curve is derived by the addition of ΔG and ΔP. This shows that up to point A the use of the market is more efficient than producing in house.

Firm specific knowledge

A firm's competitive advantage is the result of the collective knowledge about the market, the production or production technology. For example if a firm has an advantage linked to R&D, the use of the market may be risky because it threatens the security of that knowledge. The knowledge links within the firm can be explained in the following figure:

Figure 5: Firm specific Knowledge



Source: The Economic Institution of capitalism, (Oliver E Williamson, 1985)

Uncertainty

Economic theory assumes perfect knowledge on the part of economic agents and therefor it there would be no difficulty in making long term contracts between firms. However, since perfect knowledge does not exist on the part of the economic agents and due to the future being unpredictable it is better to outsource a part of the production in order to maintain flexibility and thereby reduce risks.

Scope for Opportunism

Markets often fail because of opportunism and bounded rationality. Williamson defines opportunism as 'a lack of candor or honesty in transactions, to include self-interest seeking with guile (1975, p.9) 'Cowboy builders are by definition, opportunists'. Theory suggests that customers sometimes are poorly informed about the quality of work of these builders and the transaction costs are likely to go up if the customers are to acquire such knowledge. This presents an opportunity for the cowboy builder to misrepresent his abilities and competence in order to win contract. Since this is a one-off transaction, there is no prospect of future loss of business, which might serve to constraint the cowboy's activities. However the scope of opportunism reduces with the increase in the number of firms because there are a series of awards and opportunities for everyone.

Governance costs

These are the costs involved in governing a business: 'how individuals interact and the extent to which they can be harnessed to pursue common goals'. Thus deciding whether to use the market to source the product or produce in house is influenced by the availability and effectiveness of the control and governance structure that each institution possesses. If a business is undertaking a complex process, the cost of supervision governance goes up. This suggests that the higher the cost of monitoring it must be left to the market for gaining the benefits of low transaction costs.

Complexity of Production

The complexity of production also increases the transaction costs, as specialized labor and machinery needs to be employed. For example in case of custom made cars (Rolls-Royce) complexity of production increases making the market higher in transaction costs. Therefore in theory it is assumed that the higher the complexity of production, the firm must undertake production in order to lower transaction costs.

APPLICATION – COMPASS GROUP PLC

Company Overview

Compass Group PLC provides catering and support services to offices, factories, hospitals, care homes, schools and universities, sports venues, military facilities, offshore platforms and other remote locations. Some of its key facts are:

- They employ more than 470,000 people in around 50 countries
- They serve around 4 billion meals a year
- They work in around 40,000 client locations
- 90 of Fortune 100 companies are their clients

Source: Company Website (www.compass-group.co.uk)

Table 1: Key Figures – Compass Group

Op. Revenue (Turnover)	15.8 (Bn. £)
P/L for Period (Net Income)	774 (Mn.£)
Total Assets	9.4 (Bn. £)
No of Employees	471,108
Market cap. (15/08/2012)	13.3 (Bn. £)
No of recorded subsidiaries	697

Source: Fame - company report of Compass Group PLC

Sourcing Strategy

The group has an extensive range of products sourced because of their clear regional provenance, quality and integrity. Within their business, they conduct the following activities:

- They claim to buy more British meat than any other UK caterer
- They source bread from a network of local craft bakeries from around the country no loaf of bread travels more than 30 miles to reach their clients
- They source 39 million eggs from Oakland Farm Eggs Ltd. where they are produced to the highest standards of food safety and animal welfare

- They buy 20 million liters of British milk a year from a total of 82 British farms (Diary farmers of Britain Co-operative)
- They purchase fish from sustainable well managed marine sources
- 95% of their entire vegetable purchase from British growers
- All of their fruits sourced are 'Fairtrade'[1]
- The group employs a total of 5000 trained chefs

Source: Company Website (www.compass-group.co.uk)

Make (M) Vs. Buy (B)?

Based on the theoretical discussions on in house vs. outsource we can analyze the feasibility for Compass group to undertake backward integration as a cost reduction strategy. This is shown in the table below:

Table 2: Make (M) Vs. Buy (B)

ECONOMIC PARAMETERS	**RAW MATERIALS**														**LOBOUR**	
	Meat		**Bread**		**Eggs**		**Milk**		**Fish**		**Veg.**		**Fruits**		**Chefs**	
	M	**B**	**M**	**B**	**M**	**B**	**M**	**B**	**M**	**B**	**M**	**B**	**M**	**B**	**M**	**B**
Economies of Scale	+	-	+	-	+	-	+	-	+	-	+	-	+	-	+	-
Number of Firms	-	+	-	+	-	+	-	+	-	+	-	+	-	+	+	-
Asset Specificity	-	+	-	+	-	+	-	+	-	+	-	+	-	+	+	-
Firm-specific Knowledge	-	+	-	+	-	+	-	+	-	+	-	+	-	+	+	-
Uncertainty	-	+	-	+	-	+	-	+	-	+	-	+	-	+	-	+
Scope for Opportunism	-	+	-	+	-	+	-	+	-	+	-	+	-	+	+	-
Monitoring Costs	+	-	+	-	+	-	+	-	+	-	+	-	+	-	-	+
Complexity of Production	+	-	+	-	+	-	+	-	+	-	+	-	+	-	+	-
TOTAL	**3**	**5**	**3**	**5**	**3**	**5**	**3**	**5**	**3**	**5**	**3**	**5**	**3**	**5**	**6**	**2**

1 Fairtrade is a tool for development that ensures disadvantaged farmers and workers in developing countries get a better deal through the use of the international FAIRTRADE Mark

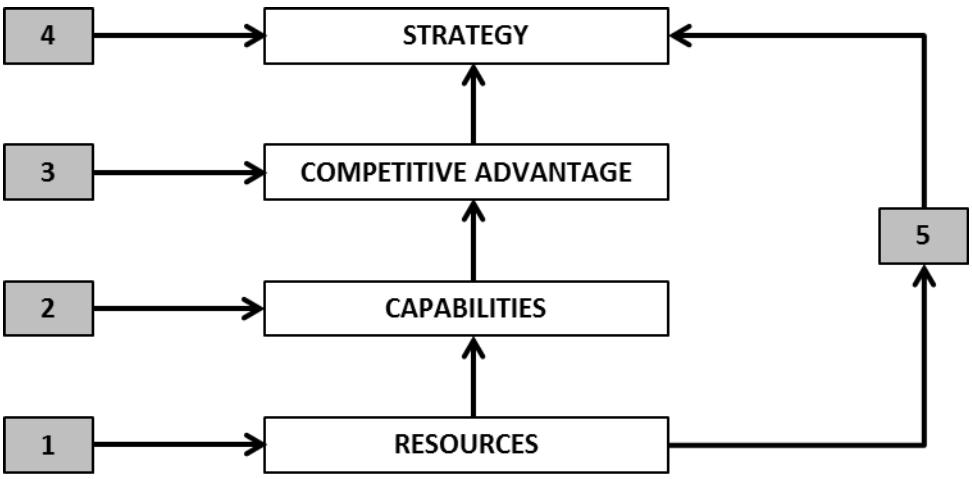
The above analysis shows that Compass Group Plc. has adopted an optimum strategy by outsourcing the raw materials such as meat, bread, eggs, milk, fish, vegetables and fruits. On the other hand its decision to employ 5000 chefs is also the right decision instead of depending on the market as that would increase transaction costs and impact the profit margins of the company.

Strategic Analysis

Analysis 1: Resource Based View

There are two fundamental reasons for making the resources and capabilities of the firm the foundation of its strategy. First, the internal resources and capabilities provide the basic direction for the firm's strategy and, second, resources and capabilities are the primary source of the firm's profit.

Figure 6: A resource-based view of strategic analysis



Source: R.M Grant, 1991

Compass Group's resources can be divided into four broad categories – Financial Capital, Physical Capital, Human Capital and Organizational Capital.

Table 3: Compass group resources

CATEGORY	DESCRIPTION
Financial Capital	Market capitalization = 13.3 Bn. £ ; Revenue = 15.8 Bn. £ ; Net Income = 774 Mn. £ ; Cash and near cash items = 1.1 Bn. £ ; Total Assets = 9.6 Bn. £
Physical Capital (Technology, plant, equipment, location, access to raw material)	675 Mn. £ Fixed assets ; 95% of the RM being sourced from UK,
Human Capital (Training, expertise, judgment, intelligence, relationships and insights of managers and workers)	471,108 employees (5000 chefs) – rigorous evaluation and selection procedure; high training levels through e-learning, higher skills than competitors; Application of Management & Performance (MAP) framework.
Organizational Capital (Brand Value, Organizational structure, planning, controlling and coordinating systems, informal relations among groups within the firm and with outside groups)	Brand value = 13.3 Bn. £; Number of subsidiaries = 697, Global presence, good corporate image within the local communities.

Source: Fame - company report of Compass Group PLC; Bloomberg, 2012

Applying Barney's (1991) VRIN framework can determine if a resource is a source of sustainable competitive advantage.

Table 4: VIRN Framework

Resources	Valuable	Rarity	Imitability	Non Substitutable	Competitiv e Implication	Perform -ance
Physical Capital	Yes (+)	No (-)	Yes (-)	No (-)	Yes (+)	Good (+)
Financial	Yes (+)	No (-)	No (+)	Yes (+)	Yes (+)	Yes (+)

Capital						
Human Capital	Yes (+)	Yes (+)	No (+)	Yes (+)	Yes (+)	Good (+)
Organizational Capital	Yes (+)	Yes (+)	No (+)	Yes (+)	Yes (+)	Good (+)

Table 5: Sources of sustainable competitive advantage and strategy formulation

Resources	**Capabilities**	**Core competence**	**Strategy**	**Justification**
Physical Capital	Lower logistics costs	Cost effectiveness	Cost leadership	Compass Group sources 95% of its raw materials from UK allowing it to lower logistics cost. The location of its
Financial Capital	Differentiation and diversification (facilities management), exploration of emerging market	Economies of scale and economies of scope	Differentiation, Diversification and Internationalization	Financial capital allows it to diversify and invest in new service lines, or to invest in a new market (emerging markets) thereby enabling it to achieve economies of scale and economies of scope.
Human Capital	Product and Service differentiation, quality and efficiency	Human resource efficiency	Keeping employees under direct payroll rather than outsourcing	High training levels of chefs and management, allowing maintenance of quality and efficiency. MAP framework to improve performance.
Organizational Capital	Secure major contracts	Brand value	Differentiation, Diversification and Internationalization	The brand value of the organization allows the company to mobilize major contracts in different parts of the world. It also allows the company to think on lines of diversification

Analysis 2: Porter's Five Forces

Applying the porter's five on Compass Group the following results are obtained:

Figure 7: Porter's five forces

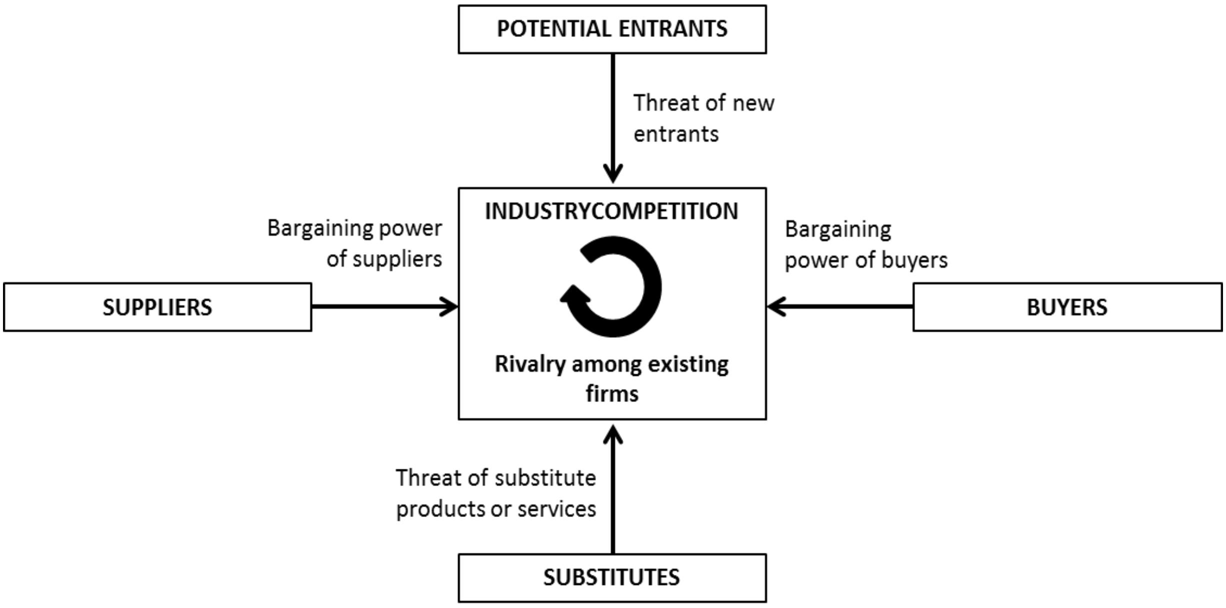


Table 6: Porter's five summary

Category	Risk	Result	Justification
Potential Entrants	Threat of new entrants	High (-)	Small business within the catering industry can emerge.
Substitutes	Threat of substitute products or services	High (-)	Catering services for B2B have competition form cafe's, fast food joints, restaurants, hotels etc.
Buyers	Bargaining power of buyers	High (-)	Demand is driven by corporate profits and consumer incomes
Suppliers	Bargaining power of suppliers	Low (+)	Many suppliers in the UK for fish, milk, meat, vegetables, fruits, etc.
Industry Competition	Rivalry among existing firms	High (-)	Catering services market is relatively fragmented

The threat of potential entrants is high as the market for catering services is still fragmented. The catering industry does not require huge amount of capital injection. Even through there are bigger players like Compass yet the differentiation and the low cost competition adapted by the smaller players can lead to potential threats to new entrants, This makes the threat of entrant within this industry high and the success depends upon differentiation in services offered as well as keeping the prices at competitive levels.

The threat of substitute products or services is high as there are many options available to the customers – from restaurants to fast food cafes, hotels, in-house canteens and cafes homemade food. Therefor Compass group will always face a threat from its substitutes. Again the in order to sustain the competition the company must come up with a differentiation strategy that will increase customer value.

The bargaining power of buyers is high as the demand is driven by corporate profits and customer incomes. Therefore there is a price war and only the companies that enjoy economies of scale like Compass have a greater chance to sustain competition. The bargaining power of the buyers depends on the type of Industry the buyer operates in. For example if the catering services are being offered to 'business and industry' the power of the buyers is high as there are many options available. Similarly if the buyer is a large hospital, the options available to the hospital in terms of 'healthy' food sourcing are comparatively limited thus making the bargaining power relatively lower. For compass since most of the business is generated from 'business and industry, the threat of higher bargaining power of the buyers exists for the business.

The bargaining power of the suppliers is low. The size and the scale of Compass' operations allow the suppliers to maximize their revenue and thus have a sustainable growth. Besides Compass group has a wide options to source materials (meat, eggs, milk, vegetables, fruits, fish, bread etc.) within the UK and also from the overseas suppliers. The following table shows the bargaining power of each supplier according to the product.

Table 7: Product wise analysis of bargaining power

Product	Number of suppliers	Bargaining Power
Meat	Several[2]	Low
Bread	60	Low
Egg	1	High
Milk	82	Low

[2] The Exact number of suppliers in this category is not mentioned.

Fish	Several	Low
Vegetables	Several	Low
Fruits	Several	Low

Source: Company Website (www.compass-group.co.uk)

As per the available data, conclusion can be drawn by saying that the bargaining power of the egg supplier (Oakland Farms – supplies 39 million annually) will be higher than the suppliers for other products since he enjoys the advantage of scale over the other suppliers. Compass groups sourcing strategy focuses on sourcing only from UK farms and thus promoting the welfare of its suppliers and enjoying a higher bargaining power over them.

The degree of competition for compass group is subject to the industry it competes in. There are several industries that Compass Group Competes in. Their competition within the industries can be explained with the help of the table below:

Table 8: Industry wise competition analysis

Industry	Degree of Competition	Justification
Catering Services	High (-)	Fragmented market – Pricing and differentiation strategies are of high importance
Security Services	Low (-)	Few players in the market
Bars and Night clubs	High (-)	Many players and competition on price and quality
Security System services	Low (+)	Hi-tech industry, capital requirements, few players in the market
Restaurant bars and Food services	High (-)	Many players and competition on price and quality
Facilities management	High (-)	Fragmented market and competition on price and quality of services

Source: IMAP report, 2010

The above analysis suggests that the industry Compass Group operates in is a highly competitive industry mainly because of existence of a number of small firms providing similar services. In an industry like this the pricing and the differentiation strategy and the quality of services provided plays a crucial role. This makes the overall industry extremely competitive. However for a company like Compass can easily sustain the competition due to its economies of scale and its brand image.

Analysis 3: SWOT

Table 9: SWOT

STRENGTHS	WEAKNESSES
▪ Large scale operations provide competitive edge to Compass ▪ Robust revenue growth from North America-Compass' largest market ▪ High revenues as compared to competitors ▪ Management and Performance (MAP) framework has reduced costs	▪ Unfunded employee post-retirement benefits
OPPORTUNITIES	**THREATS**
▪ Strategic acquisitions likely to drive growth Strong growth opportunity in health care sector ▪ An expanding food service industry to provide market penetration opportunities ▪ Vegetarianization strategy within the food industry ▪ Manufacturers of meat-free	▪ Group exposed to currency risk fluctuations ▪ High labour costs could increase the operational costs

products are largely based in Western Europe and North America, not in emerging markets. Hence an opportunity to enter emerging markets ▪ Vertical Integration	

Source: Date Monitor, 2012

DISCUSSIONS & FINDINGS

By applying the 'Make vs. Buy' framework the following conclusions can be drawn:

Table 10: Make vs. Buy Summary

Category	In-house (score)	Outsource (score)	Justification
Raw Material	21	35	Firm specific knowledge and number of firms available in the market.
Labor (Chefs)	6	2	Asset Specificity and Economies of scale

By applying the strategic frameworks, the following conclusions can be drawn:

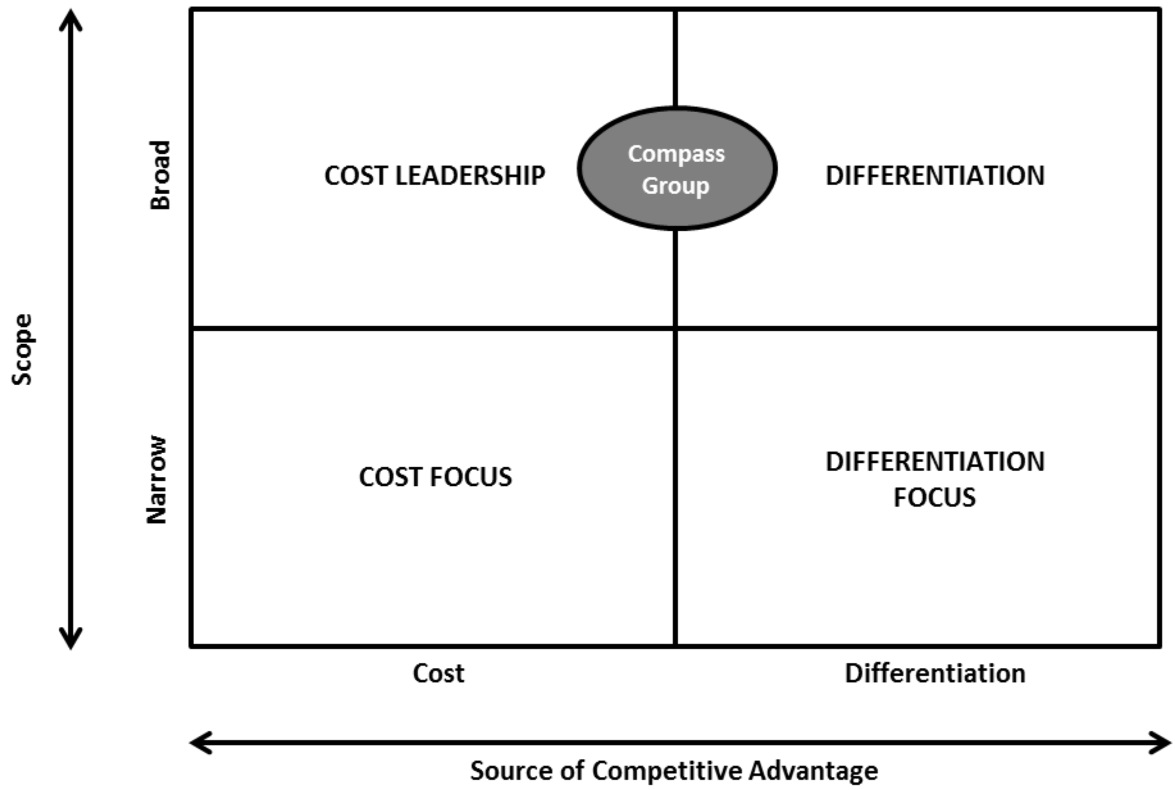
Table 11: Summary of strategic analysis

Framework	Raw Materials	Labor (Chefs)	Justification
Resource Based View	Outsource	In-house	Core capabilities arise from its resources, training levels of chefs and management, allowing maintenance of quality and efficiency. It must focus on its providing quality services keeping its human capital in-house while outsourcing the raw materials
Porter's Five Forces	Outsource	In-house	The bargaining power of the suppliers being lower therefore raw materials can be outsourced. Since the industry rivalry is high, the direct labor needs to be in-house to allow differentiation in its services.
SWOT	Outsource	In-house	Large-scale operation allows Compass to source materials at a lower cost from the market. The 'Management and Performance

			(MAP)' framework allows compass to improve performance of its employees and thereby reduce transaction costs allowing the company to keep the labor in-house.

By applying Porter's Generic strategy we can conclude that Compass is a neither a complete cost leader nor a complete differentiator. It is adapting to a mix of both these strategies to gain a sustainable competitive advantage. It is also using this combination to diversify and internationalize into emerging markets to spread out it geographic mix to gain economies of scale and scope.

Figure 8: Porter's Generic Strategy

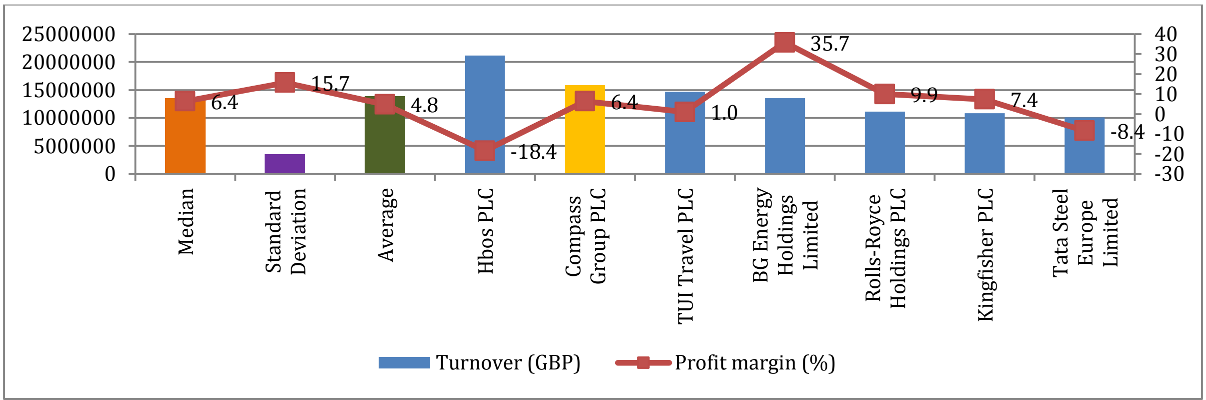


CONCLUSION

The recognition of Compass group's core competence can be basis of its decision to provide a product or a service itself or outsource it. Its focus on its competencies that is **providing low cost and differentiated 'catering and support services'** has allowed it to earn higher profits within the industry even though the rivalry is intense. Further **its brand value allows** it to secure major contracts and allow the company to think on lines of internationalization and diversification. As a result, the company enjoys a higher net margin of 6.4% as compared to the industry average of 5.3% (Fame - company report of Compass Group PLC). The aim of the company is to focus on its core competencies as the basis of achieving a sustainable competitive advantage, and as a result it has outsourced all the other activities such as having its own farms for bringing raw material because it does not fall under its core competencies. The decision is made intrinsically with the understanding of the activities contained within the firm's value chain and as a result, it enjoys a higher profit margin as compared to even some of the other companies similar in size from different industries.

Figure 9: Financial Analysis

Peer group - Closest 10 companies according to the Turnover for the last available year amongst the standard peer group.



Source: Fame - company report of Compass Group PLC

"Whereas historically firms have vertically integrated in order to control access to scarce physical resources, modern firms are internally and externally disaggregated, participating in a variety of alliances and joint ventures and outsourcing even those activities normally regarded as core." (McKinsey & Company, 1990)

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APPENDICES

Appendix A: Vertical Integration in the Food Industry – A modern paradigm

The organization structure within the agricultural sector has undergone massive change in the last few decades. For instance, poultry production has been completely industrialized while vertical integration and production marketing contracts have become prominent in other agricultural sectors. Barkema, Drabenstott and Welsh have observed an increase in the vertical coordination trends for various products between 1960 and 1990. For instance, fed cattle under this arrangement, produced in 1960 was only 16.7% as compared to 22.5% in 1990. Similarly, hogs produced under such an arrangement in 1960s were only 0.8% and by 1990 it was 14.5%. Drabenstott reports similar vertical coordination trends over this period for fresh vegetables, from 45% in 1960 to 65% in 1990 and processed vegetables from 75% to 95% respectively.

Barkema argues that there are two main reasons for this phenomenon – The modern consumer is demanding more and more processed food due to increase in stress and limited time to eat food. Therefor the demand to move food out of the kitchen to a more centralized location is increasing. Similarly the demand for more specialized food such low-caloric and ethnic foods is increasing (Kinsey, Mercier and Hyberg, p.38). However, technological advancements have allowed the food industry to deliver processed food to the consumer in the modern times requiring a qualitatively homogeneous supply of raw materials (Barkema, Drabenstott and Welsh)

Streeter, Sonka and Hudson also address the interaction between increasingly fragmented demands and information flow. They argue that the traditional approach of Marketing has the retailer expending resources to manipulate customers taste and preferences (Packard). They contrast this with a perspective more in sync with the information driven modern markets (Rapp and Coullins). In the modern paradigm, information structures are used to discover product characteristics and consumer demands. To illustrate the relevance of the more modern paradigm, Streeter, Sonka and Hudson cite the examples of companies like Pioneer Hybrid and Frito-Lay based on the contractual agreement they require from their suppliers emphasizing the importance of information sharing along the marketing channel thereby increasing the scope of vertical integration.

Appendix B: Compass Group - Business Strategy

Their objective is to deliver value to their shareholders and customers by leveraging the benefits of being a Group to deliver structured and sustainable organic growth and achieve our vision to be a world-class provider of food and support services. To achieve these goals the strategy focuses on:

- Developing existing expertise and strengths in contract foodservice and a range of support services in those sectors and countries that have real prospects for growth, as well as providing the global capability necessary to support our growing international client base.
- Delivering the highest quality and service performance, whilst at the same time relentlessly driving to be the lowest cost, most efficient provider.
- Establishing a strong performance culture, based on a global performance framework, MAP (short for Management and Performance), which concentrates on the five key drivers of our performance:
    - Client Sales & Marketing
    - Consumer Sales & Marketing
    - Cost of Food
    - Unit Costs
    - Above Unit Costs
- Setting the highest standards for corporate governance and responsible business practice, including all aspects of business conduct, health, safety and environmental practices.

Management and Performance (MAP)

MAP is the Group-wide framework they use for managing their business. MAP is fundamental to driving consistent performance across the Group and the discipline it brings to the way they run the business. MAP continues to be embedded deeper in the organization, not only providing them with the intensity of focus that is driving their performance, but also a common language and agenda, enabling everyone to think, act and behave as ‘one Compass’.

MAP focuses on the key drivers of their performance:

- **Client Sales & Marketing**. Growing their markets and their new and existing client relationships.
- **Consumer Sales & Marketing**. Earning ongoing consumer loyalty to grow volume, participation and spend.
- **Cost of Food**. The optimal quality and range for their customers delivered at the lowest cost with the most efficient in-unit production.
- **Unit Costs**. Delivering the right service in the most efficient and cost-effective way.
- **Above Unit Costs**. Creating the simplest organizational model with the fewest layers and reduced bureaucracy.

Chairman’s Statement (Future priorities)

“We have a clear, focused strategy that is delivering value for our shareholders and has created a well-balanced and sustainable business model with significant opportunities to deliver continued growth.

- Focus on our contract foodservice business
- Grow our support services business
- Committed to giving our customers superior levels of service
- Focus on driving cost efficiencies

Focus on food

Their strategy remains unchanged. Food is their core business. The structural growth opportunity is significant with an estimated market size of around £200 billion of which less than 50% is already outsourced. Although Business & Industry is the most penetrated sector, there remains excellent growth potential, as there is a strong propensity to outsource within the sector. Less penetrated sectors, such as Healthcare and Education also offer great opportunities for growth. These markets are significant and, as economic conditions continue to put increasing pressure on both the public and private sectors, Compass believes that benefits of Outsourcing will become ever more apparent.

Fast growing support services

Support and multi-services are becoming an increasingly important part of the Group and now represent 22%, or £3.5 billion, of Group revenues. Within the 22%, 7% relates to the food element of multi-service contracts and 15% to support services. Country by country, Compass is continuing to build a strong support services offer. Although organic growth is the priority, they have acquired over 20 support services businesses during the past 10 years to help accelerate growth and bring new capabilities to the Group. They have had another excellent year of new business wins including a significant contract with Ascension Health, one of the largest non-profit healthcare systems in the US. They will be providing food and support services to 86 sites across the US.

Geographic spread

Increasingly, they see their business in three segments: North America, the more developed markets of Europe and Japan and our fast growing and emerging markets. These segments comprise countries, which are at similar stages of development and demonstrate similar characteristics. North America accounts for nearly £7 billion of revenue and remains our biggest growth engine. The US culture is open to outsourcing and the current economic climate is resulting in some increased activity. They have an excellent pipeline of new business, high retention rates and ongoing opportunities to drive efficiencies. Europe and Japan, which, at just over £6 billion of revenue, account for around 40% of the Group, offer good growth potential, although the weak economic backdrop is affecting current performance. As well as core Business & Industry, there are good opportunities in Healthcare and Education and increasingly in multi-services. With operating margins currently below the Group average we see lots of potential to drive greater efficiency. The fast growing and emerging countries, which together generate revenues of £2.8 billion, are becoming much more important to the Group. Having exited over 40 difficult and sub-scale countries in the middle of the last decade and with the confidence derived from rapid margin Expansion, They have been increasingly focusing on and investing in Australia and the emerging countries. They enjoy high rates of organic growth in these countries and they would hope to see double-digit growth for many years to come. One day this segment will be a much larger proportion of the Group.

Management changes

With the differing opportunities and challenges in each geographic region, they are evolving their management structure to bring a more incisive focus to each area. They are therefore pleased to have announced the appointment of Andrew Martin, Group Finance Director, as a Group Chief Operating Officer. Andrew will assume responsibility for the Group's operations in Europe and Japan from 2 April 2012. From the same date Gary Green, currently Group Managing Director for North America will also assume the title of a Group Chief Operating Officer with responsibility for North America. Both Messrs Martin and Green will remain Directors of the Company. On 27 February 2012, Dominic Blakemore will be appointed as Group Finance Director Designate. Mr. Blakemore, 42, will succeed Mr. Martin as Group Finance Director on 2 April 2012. Mr. Blakemore is currently chief Financial Officer of Igloo Foods Group Limited, which he joined from Cadbury Plc., where he was European Finance and Strategy Director, having previously held senior finance roles as Corporate Finance Director and Group Financial Controller. Prior to joining Cadbury Plc., Mr. Blakemore was a Director at PricewaterhouseCoopers.

Acquisitions

In tandem with their concentration on organic growth, over the last couple of years they have placed more focus on making selective infill acquisitions. Over the past two years, they have invested over £600 million in small to medium-sized infill acquisitions, with a good mix between food and support services and an increasing amount in the fast growing and emerging markets, for example, more than doubling their presence in Turkey and Establishing a strong national footprint in India. They continue to have a strong Preference for small to medium-sized infill acquisitions, building scale in food and support services in their existing geographies. As appropriate acquisition opportunities arise, they will invest in food and support services, in both developed and emerging markets.

Shareholder returns

In addition to pursuing our strategy of infill acquisitions, the strength of their cash flow has enabled them to invest in organic growth and to reward their shareholders. Their commitment to a progressive dividend policy remains strong, and to drive greater efficiency in the balance sheet, they will now commence a £500 million share buy back with the intention to complete this over the next twelve months. The increasing predictability of the business and cash flows gives them confidence that they should retain their existing credit ratings (A- with Standard & Poor's and Baa1 with Moody's) and an appropriate level of financial flexibility.

Appendix C: Compass Group - Organization Structure

Compass Group's business is organized into four main sectors:

- **Eurest Services**: workplace dining and support services
- **Restaurant Associates**: workplace dining, hospitality, business services and hotels
- **Sports, leisure and hospitality**: retail and hospitality at sporting and leisure venues.
- **Specialist markets:**
  - Education: Chartwells
  - Healthcare: Medirest
  - Government and Defence: ESS Support Services
  - Offshore: ESS Support Services

Appendix D: Organization Culture

Governance and Ethics

The highest levels of corporate governance underpin their structure. This empowers their local management teams to manage their businesses to be competitive in their marketplace, whilst operating within a strict corporate framework with clearly defined parameters. Their Codes of Business Conduct and Ethics set out their social, ethical and environmental commitments towards each of their stakeholders and the communities in which they operate. They have a global whistle-blowing programme, 'Speak Up', which is managed by an independent company, so that their employees can raise, in confidence, any concerns they may have about how they conduct their business. This year, they have refreshed the 'Speak Up' programme to ensure that it remains relevant and that they optimize employee awareness.

Corporate Responsibility Committee

The Corporate Responsibility Committee of the Board oversees their overall commitment to good corporate governance. Established in 2007, the Corporate Responsibility Committee continues to provide direction and guidance on all aspects of business practice and responsibility, ensuring consistent application wherever they operate. The Committee's primary responsibilities include: endorsement of CR policies; overseeing occupational health and food safety performance; environmental practices; business conduct and the positive promotion of employee engagement, diversity and community investment. A key focus of the Committee has been to improve the scope of the CR commitments and develop their longer-term CR vision and performance measurement.

Appendix E: Compass Group - Board of Directors

Table 12: Board of Directors

Sir Roy Gardner (Chairman)	Appointed Chairman in July 2006 having joined as a Non-Executive Director in October 2005. Sir Roy is a senior advisor to Credit Suisse, a Non-Executive Director of Willis Group Holdings Plc, Chairman of Mainstream Renewable Power Limited, Chairman of the Advisory Board of the Energy Futures Lab of Imperial College London, President of Careers UK, Chairman of the Apprenticeship Ambassadors Network, Chairman of EnServe Group Limited and a Director of Cilantro Jersey Limited. He was formerly Chief Executive of Centrica plc and Chairman of Plymouth Argyle Football Club, Manchester United Plc, Connaught Plc and a Director of British Gas Plc, GEC-Marconi Ltd, GEC Plc and Laporte plc. He was also Chairman of the British Olympics Appeal Committee for the Beijing Games 2008
Richard Cousins	Appointed Group Chief Executive in 2006. Richard had previously spent six years as CEO of BPB Plc, having held a number of positions with that

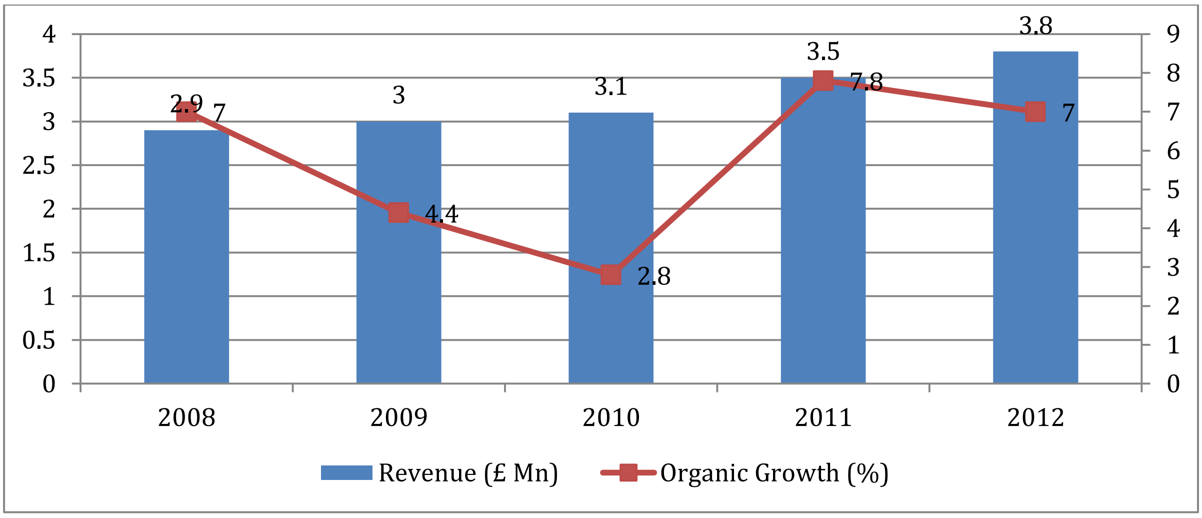
(Group CEO)	company. His earlier career was with Cadbury Schweppes Plc and BTR plc. He is a Non-Executive Director of Reckitt Benckiser Group Plc, a member of the Advisory Board of Lancaster University Business School and a former Non-Executive Director of P & O Plc and HBOS plc.
Gary Green (Group MD US & Canada)	Appointed to the Board in January 2007. Gary joined the Group in 1986 in a senior finance role in the UK and became a UK director in 1992. He relocated to the USA in 1994 as Chief Finance Officer of the Group's North American business and in 1999 became Chief Executive Officer. He is a chartered accountant and in 2001 received an honorary doctorate from Johnson & Wales University in the USA.
Andrew Martin (Group Finance Director)	Appointed to the Board in March 2004. Andrew is a Non-Executive Director of EasyJet Plc and was previously a partner with Arthur Andersen and held senior financial positions with Forte Plc and Granada Group PLC. Following the disposal of the Hotels Division in 2001, he joined First Choice Holidays PLC as Finance Director. Andrew is an Associate of the Institute of Chartered Accountants in England and Wales and an Associate of the Chared Institute of Taxation.
Sir James Crosby (Senior Independent Non-Executive Director)	Appointed to the Board in February 2007. Sir James is Chairman of Misys Plc, Chairman of Duncton plc and Treasurer and Trustee of Cancer Research (UK). He was formerly Chief Executive of HBOS Plc, Deputy Chairman of the Financial Services Authority and a Non-Executive Director of ITV plc. He is a Fellow of the Faculty of Actuaries.
John Bason (Non-Executive Director)	Appointed to the Board in June 2011. John is Finance Director of Associated British Foods plc. He was previously Finance Director of Bunzl Plc and is a member of the Institute of Chartered Accountants in England and Wales. He is a Trustee of Voluntary Service Overseas and is Deputy Chairman of the charity Fareshare.
Susan Murray (Non-	Appointed to the Board in October 2007. Susan is Non-Executive Chairman of Farrow & Ball and a Non-Executive Director of Pernod Ricard, Enterprise Inns

Executive Director)	Plc and Imperial Tobacco PLC. She is a former Non-Executive Director of Aberdeen Asset Management PLC, SSL International PLC and Wm Morrison Supermarkets PLC, former Chief Executive of Littlewoods Stores Limited and former Worldwide President and Chief Executive of The Pierre Smirnoff Company, part of Diageo plc, and a former Council Member of the Advertising Standards Authority. Susan is a Fellow of the Royal Society of Arts.
Don Robert (Non-Executive Director)	Appointed to the Board in May 2009. Don is Chief Executive Officer of Experian Plc, having joined the Board of Experian in July 2006 as part of the demerger of GUS plc. He is a Trustee of the Education and Employers Taskforce. Don was formerly Chairman of the Consumer Data Industry Association and previously held positions with First American Corporation, Credco, Inc. and US Bancorp.
Sir Ian Robinson (Non-Executive Director)	Appointed to the Board in December 2006. Sir Ian is a former Chairman of Ladbrokes Plc, Hilton Group Plc and Amey Plc, and a former Chief Executive of Scottish Power plc and Non-Executive Director of ASDA Plc, RMC Plc, Scottish & Newcastle Plc and Siemens Holdings Plc where he remains a member of the Advisory Board. He is a Fellow of the Royal Academy of Engineers and a Member of the Takeover Panel.
Mark White (General Counsel & Company Secretary)	A solicitor who joined Compass Group on 1 June 2007. Mark is Secretary to the Audit, General Business, Nomination and Remuneration Committees and is a member of the Corporate Responsibility Committee. Mark was previously Group Company Secretary and Counsel of Wolseley Plc and Company Secretary of Enterprise Oil Plc and Rotork plc.

Appendix F: Compass Group - Business Performance

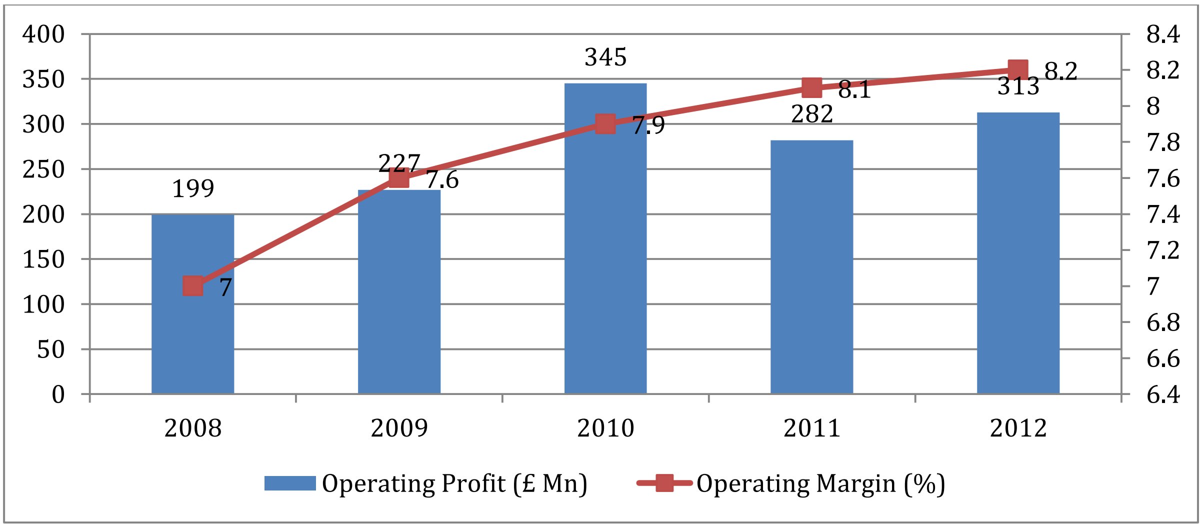
Review of North America

Figure 10: North America - Revenue (£Mn) & Organic Growth (%)



Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website

Figure 11: North America - Operating Profit (£Mn) & Operating Margin (%)



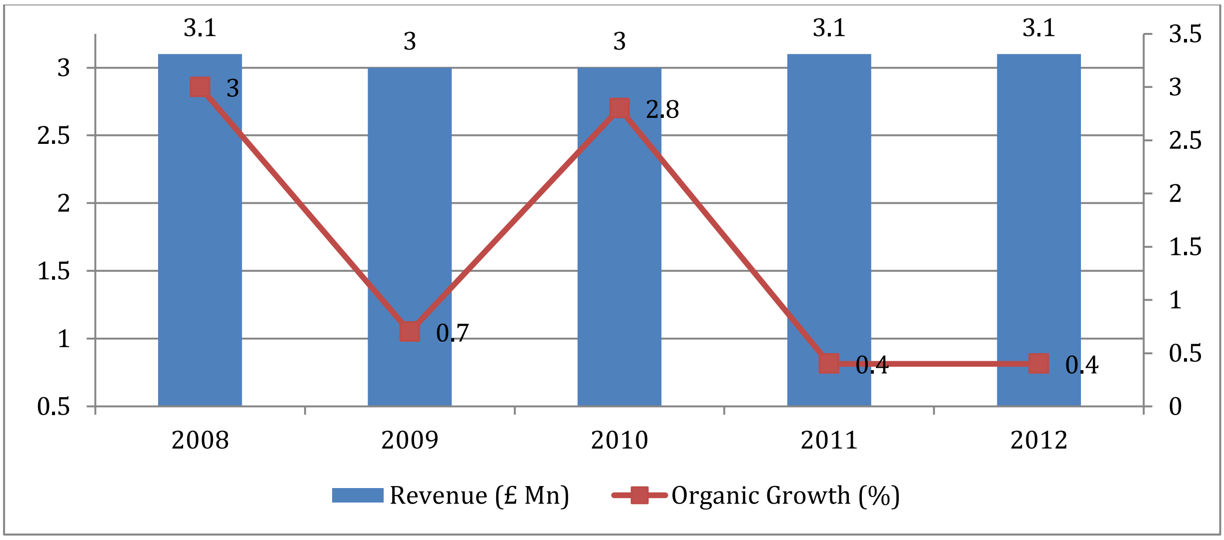
Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website

Derivations:

- Positive Trading Momentum
- Strong organic growth across all sectors
- Underlying Margin improvement
- Start-up of Ascension Health Contract
- Fall in organic growth rate in H1 2012

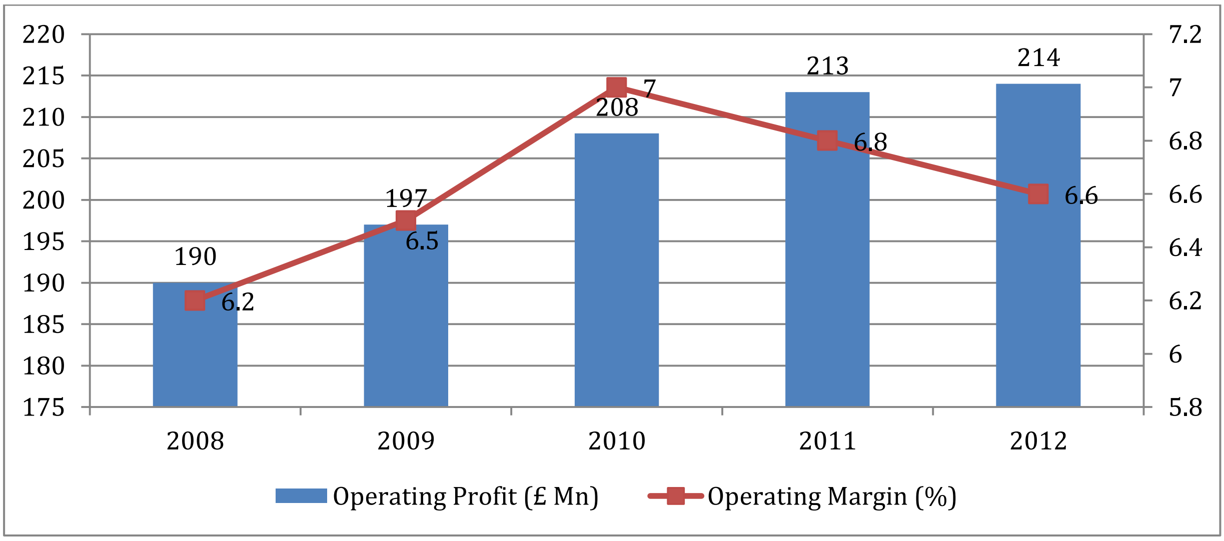
Review of Europe and Japan

Figure 12: Europe & Japan - Revenue (£Mn) & Organic Growth (%)



Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website

Figure 13: Europe & Japan - Operating Profit (£Mn) & Operating Margin (%)



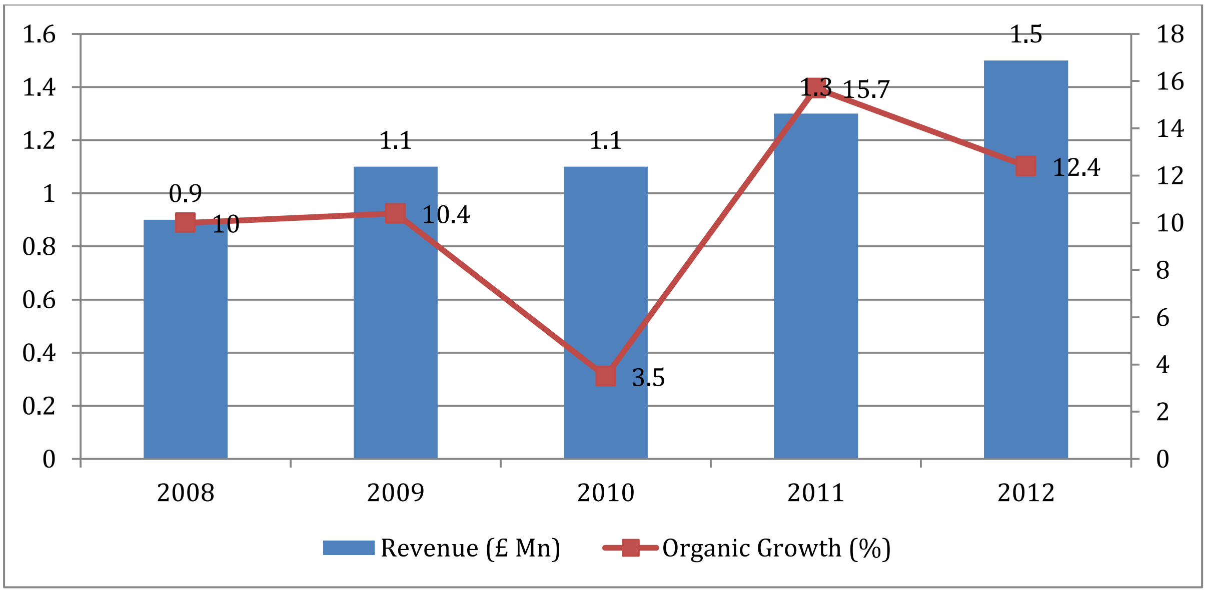
Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website

Derivations:

- Mixed Performance Across Europe
- Good new business win in some countries
- Difficult economic conditions, negative like for like revenue
- Japan Continues to improve Gradually
- Stagnant Organic Growth Rate and fall in operating Margins in H1 2012

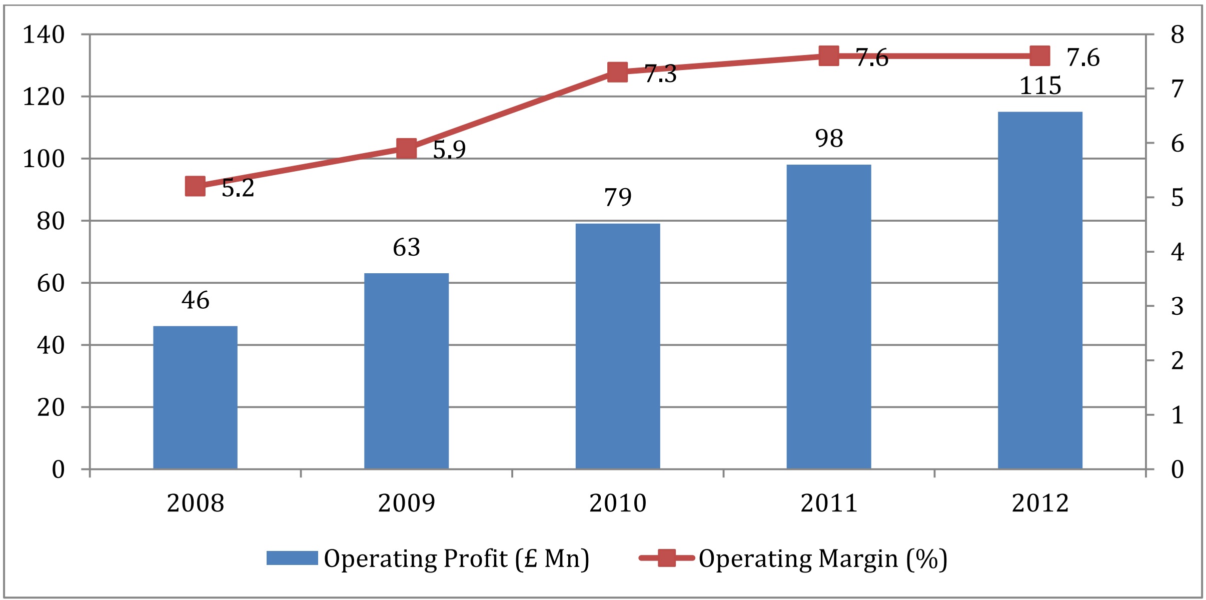
Review of Fast Growing and Emerging Markets

Figure 14: FG&E - Revenue (£Mn) & Organic Growth (%)



Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website

Figure 15: FG&E - Operating Profit (£Mn) & Operating Margin (%)



Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website

Derivations:

- Strong Organic Revenue Growth
- Good levels of new business & like for like revenue
- Strong growth in Energy and Extraction
- Continued investments in growth opportunities

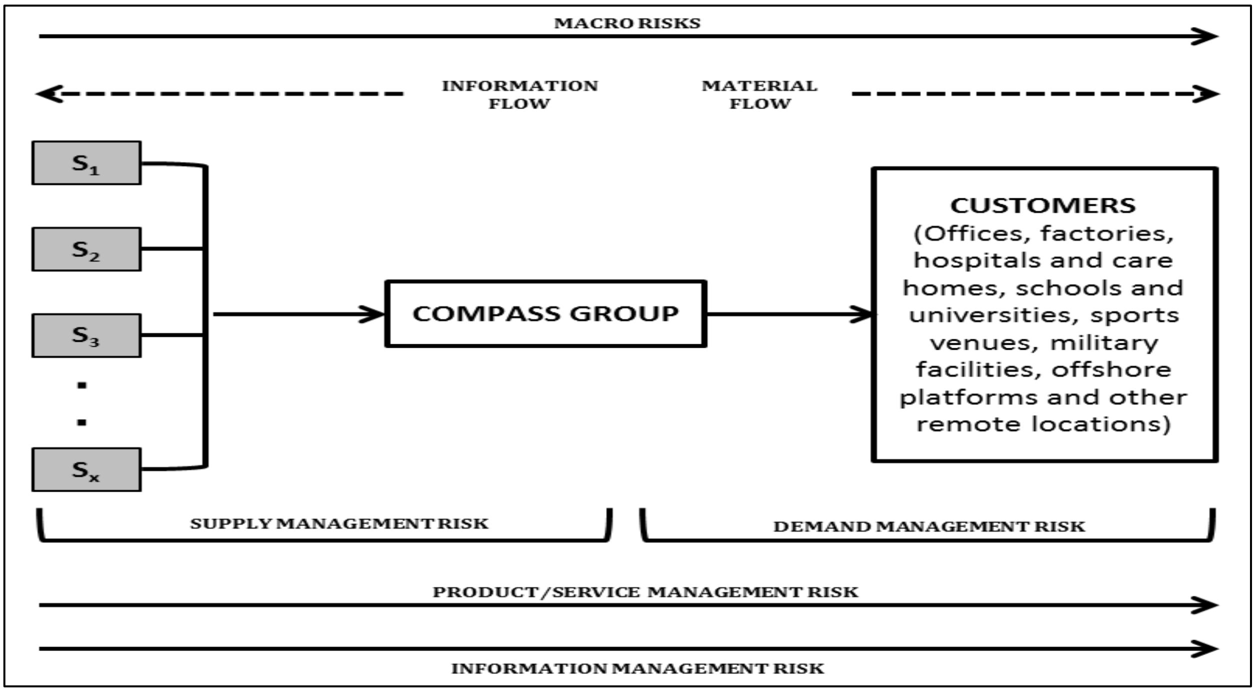
Appendix G: Supply Chain Risks and Mitigation Strategy for Compass group

A number of authors have studied supply chain risks or supply chain risk management. Norrman and Lindroth (2002) define supply chain risk management as 'collaborating with partners to deal with risks and uncertainties caused by, or impacting on, logistics-related activities or resources'. Supply chain risk management (SCRM) can be defined as 'the management of supply chain risks through coordination or collaboration among the supply chain partners so as to ensure profitability and continuity' (Tang 2006).

"Supply chain risk may result from unexpected variations in capacity constraints, or from breakdowns, quality problems, fires or even natural disasters at the supplier end" (Blackhurst et al. 2005, Yang and Yang 2010). "A failure of any one element in a supply chain, potentially causes disruptions for all partnering companies, upstream and downstream" (Yang and Yang 2010). The vulnerability of a supply chain increases with increasing uncertainty (Svensson 2000), and it increases even further if companies, by outsourcing, have become dependent on other organizations

We can apply a framework taken from International Journal of Production Research as shown below to analyze the supply chain risks for Compass Group Plc. The firm obtains the required raw materials from many suppliers within UK and provides food and support services directly to its clients that comprise of Offices, factories, hospitals and care homes, schools and universities, sports venues, military facilities, offshore platforms and other remote locations.

Figure 16: Compass Group supply chain analysis



Source: International Journal of Production Research, 2012

Table 13: Supply Chain Risks and Mitigation Strategies (Compass Group)

RISK CATEGORY	RISK TYPE	MITIGATION STRATEGY
MACRO LEVEL RISKS	1. Natural Disasters 2. Political Unrest 3. Government Regulations	1. Identifying vulnerability points and making contingency plans 2. Lobbying 3. Participative management style
DEMAND MANAGEMENT RISKS	1. Loss in demand due to economic downturn 2. Volatility 3. Changes in Customer tastes 4. Failure to communicate with customers	1. Cost reduction in operations 2. (1), Demand management through promotions and incentives and help of marketing agencies 3. (2) 4. Better planning and coordination of demand and supply
SUPPLY MANAGEMENT RISKS	1. Supplier Bankruptcy 2. Communication failure 3. Failed partnership 4. Poor quality of supply goods	1. Multiple sourcing strategy, supplier evaluation and selection, integration, flexible capacity, supplier development programme
PRODUCT/SERVICES MANAGEMENT RISKS	1. Excessive Inventory 2. Underutilised Capacity	1. Better planning and coordination of demand and supply 2. Better planning of capacity requirements
INFORMATION MANAGEMENT RISKS	1. Error in forecasting 2. Distortion in information sharing 3. Failure in IT Systems	1. Better planning and coordination of demand and supply ; investment in communication infrastructure 2. Identifying vulnerability points and making contingency plans 3. TCS !

Source: International Journal of Production Research, 2012

Fawcett and Magnan (2001) aptly sum it up by stating: 'information is the ''life blood'' of effective supply chain management'. Large (2005) equally comes to the conclusion that 'open, friendly and extensive communication' with the supplier encourages successful supplier relationship management.

Appendix H: Business Case: Indian Facilities Management Market - Growth Opportunities and Challenges Ahead (Source: Frost & Sullivan, 2011)

Introduction

Facility Management (FM) services imply the use of a third-party service provider to maintain part of the building facility or outsourcing the management of entire facilities to an organization that executes this service professionally. It includes hard services or building operation and maintenance and soft services or support services, and energy management services. Hard services include electrical, electro-mechanical, mechanical; water management and energy management. Soft services include housekeeping, security, cleaning, catering, transportation, horticulture, landscaping, and front office management, etc. In developed markets, FM services are closely integrated with other services such as rent collection and lease management. However in India, the concept of FM has not matured enough to provide complete property management solutions. Increase in investments in IT/ITeS/BPO, finance/banking, telecom, retail/malls, and industrial sectors will continue to witness strong growth in the next 2-3 years and due to the expected influx of major global Multinational Companies (MNC) in India across various end-user verticals.

Source: Frost & Sullivan, 2011

The Indian Market vis-à-vis the Global Scenario

The Indian FM services market is in its early growth stage and is evolving rapidly, fuelled mainly by the high pace of growth in the construction sector. Increased awareness levels among different vertical markets are expected to take this market to a mature growth phase in its life cycle.

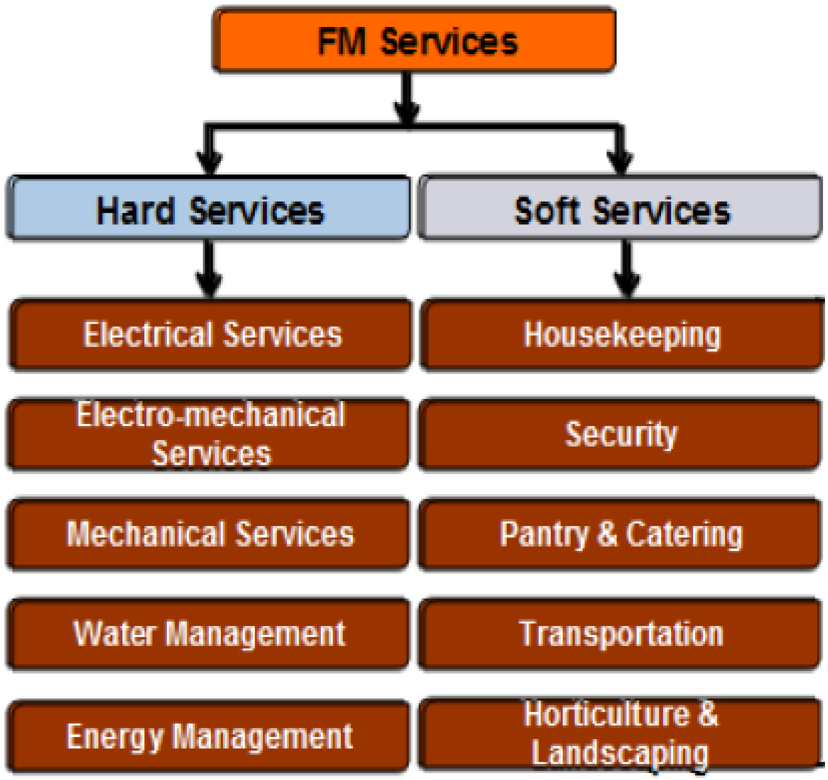
Figure 17: Market Life Cycle

Source: Frost & Sullivan, 2011

Increase in outsourced services coupled with the investment boom in real estate and construction sectors, growth of this market is driven by the need for safety, comfort, and healthy environment of the employees as well as the increase in awareness about outsourced services among customers. The market sustained the situation and improved its penetration largely through existing contracts although the economy witnessed slowdown in the last 2-3 years. Therefore, it is observed that the current economic situation prevailing in the US and Euro zone will not have much impact on the growth of this market. India's growth is expected to be intact with a GDP growth rate of 7.5-7.9 % in the coming years due to the current economic scenario and its long term implication on the emerging countries.

The market for outsourced FM services in India was estimated to be USD 650 million in 2010. Due to the size of the construction market and geographic space, the FM market revenues in India are higher than other nations such as Singapore that are smaller in geography. But, in terms of market maturity and understanding and accepting of such services by end users, India has a long way to go.

Figure 18: Facilities Management – Services Types



Source: Frost & Sullivan, 2011

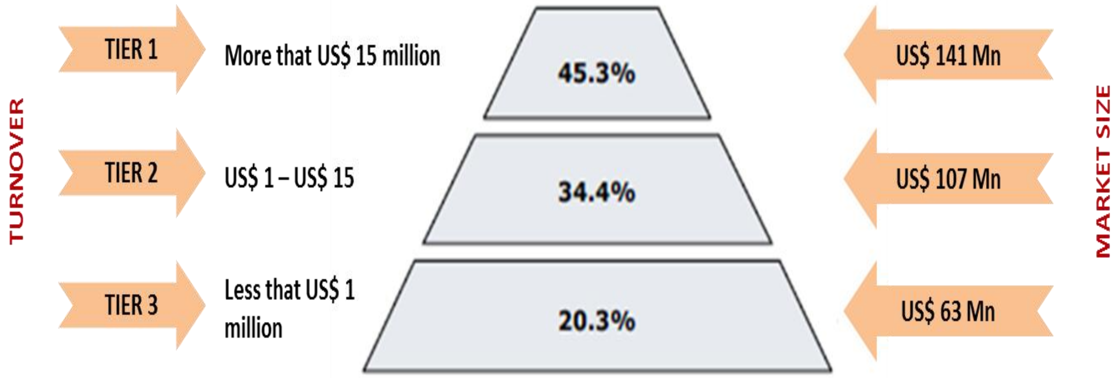
About 54.9 % of the overall market was for soft services and 45.1 percent for hard services in 2010. The market for soft services comprises a large cluster of companies that provide single services and specialize in services such as catering and pantry, cleaning and housekeeping, security and others. The market for hard services has high prominence in the IT sector as it outsources the work to professionalized and well-equipped service providers.

Cleaning and Housekeeping services contribute a higher percentage of the market followed by maintenance and engineering services and finally security services and others.

The commercial sector witnessed the highest percentage share of the overall FM services market. The commercial sector is maturing, providing huge potential among other sectors such as telecom, retail and industrial as Global MNCs such as Accenture, Nokia, Cisco, Microsoft, and others demand outsourced FM services in India. Presence of global and

Indian MNCs is the major driver for the growth of this market across various end-user sectors as they are the potential customers due to their increased awareness levels and willingness to invest in such services.

Figure 19: Facilities Management Services Market – Competitive Structure India (2010)



Source: Frost & Sullivan, 2011

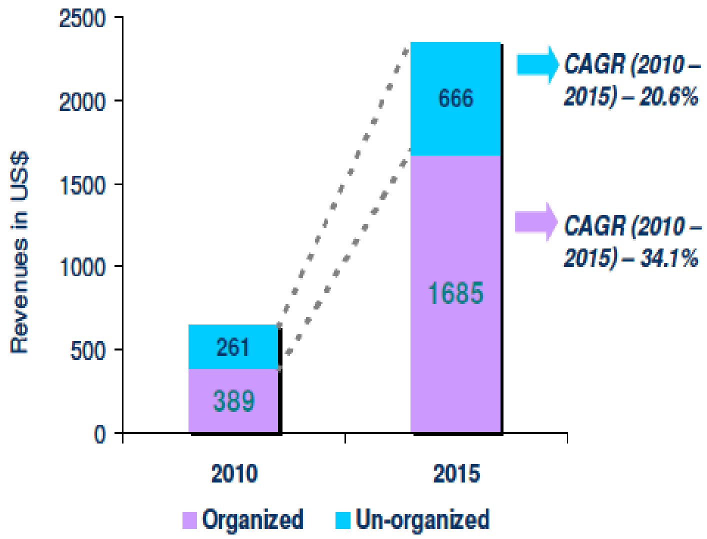
Tier I Competition: Jones Lang LaSalle, CB Richard Ellis, Updater Services, Johnson Controls, Knight Frank, ILFS Project Management & Services Limited

Tier II Competition: Vipul, Cushman & Wakefield, Colliers, Sodexo, Haden, Tyco, CNCS, Sinar Jernih, Tenon, ISS, MacLelan, Indeco, Hofincons,

Tier III Competition: Vatika, MM Enterprises, Peninsula, Tops group, Reylan Facilities, George Maintenance, Perks, Neat Space, Unicorn and others.

Increase in outsourced services coupled with the investment boom in real estate and construction sectors; growth of this market is driven by the need for safety, comfort, and healthy environment of the employees as well as the increase in awareness about outsourced services among customers. The market sustained the situation and improved its penetration largely through existing contracts although the economy witnessed slowdown in the last 2-3 years. Therefore, it is observed that the current economic situation prevailing in the US and Euro zone will not have much impact on the growth of this market. India's growth is expected to be intact with a GDP growth rate of 7.5-7.9 % in the coming years due to the current economic scenario and its long term implication on the emerging countries.

Figure 20: Facilities Management Market in India – Organized vs. Unorganized



Source: Frost & Sullivan, 2011

Industry Challenges

Lack of availability of technical and non-technical manpower is one of the biggest challenges the industry is facing currently. The lack of qualified staff has increased the lead times in mobilizing resources/staff after a project has been successfully contracted. Increase in inflation and labour cost have forced many customers to replace long-term contracts with medium-term ones. Many customers find it easier to maintain medium- and short-term contracts rather than long-term ones as the latter will lead to price rise.

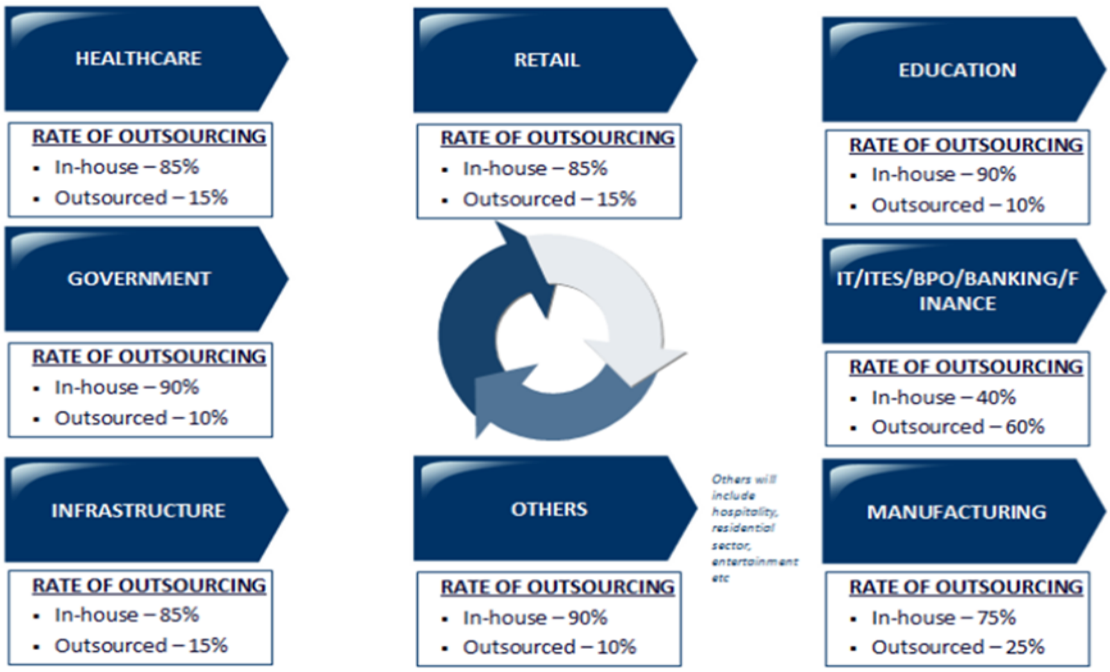
The next big factor posing as a deterrent is competition. Since the market is riddled with low cost unorganized service providers, pricing and margins come under pressure as these unorganized players provide services at low rates, essentially scuttling the competition from large organized players. However, many international property management companies have entered into this market and achieved phenomenal growth rates over the last five years. As the construction sector is witnessing an increase in investments across vertical markets, this sector is expected to witness more competition from new entrants, majorly from the US and UK, in the future.

Joint ventures (JV) are being viewed as a disincentive factor, due to high entry barriers. JVs would make it easier for the market players to provide easy access to the customer network, increase manpower strength, widen their service portfolio, and expand their geographic footprints to increase brand visibility. Very few new or existing FM companies are looking at entering or expanding into this market by partnering or acquiring a local company.

Source: Frost & Sullivan, 2011

Growth Opportunities

The outlook of FM services in India is shaping up to be highly optimistic mainly due to the growing maturity of end users and the need for improved safety, comfort and professional maintenance of assets.



Source: Frost & Sullivan, 2011

Presence of Global and Indian MNCs across various end-user sectors is mainly driving the market for FM services in India as they are the potential customers due to their increased awareness levels, exposure to facilities and willingness to invest.

The IT sectors are more concerned about personalized and specialized services utilizing both hard and soft services due to the recent boom and increase in investments in the Indian

IT/ITeS/BPO and finance/banking sectors. Increase in investments from emerging sectors such as healthcare, retail and infrastructure sector are expected to further push this market to a higher growth curve in the life cycle.

The public sector, namely government offices, industrial and educational segments offer very minimal opportunity as the market is currently in the early stages of development with limited penetration of the outsourcing concept. They majorly outsource only the soft services to the local FM companies.

Expansion of business activities in tier 2 and tier 3 cities by the end-user segments are considered to be an increasing regional growth trends for FM services market in India.

FM companies should be able to overcome competition factors and capitalize on the vast opportunities in store. Simultaneously, the FM market in India is moving towards involving an organized approach in order to achieve higher market penetration and maturity. Many companies have adopted inorganic growth models to penetrate the market by acquiring well-established firms to capture a considerable market share. Companies are constantly looking for growth options and modifying their business models to suit market trends.

Some of recent / major acquisition are India based A2Z Group acquired IPMSL and CNCS Facility Solutions. Secondly, UK based compass group acquired India’s Vipul Facilities Management and Ultimate Hospitality Services and Thirdly, Tenon Property Services who have expanded its portfolio by acquiring companies Peregrine Guardine, Roto Power and Mortice Group.

Source: Frost & Sullivan, 2011

Recommendations & Conclusion

1. Outsourcing of these services was initiated by IT/ITeS sector. Therefore, increase in focus on commercial sectors such as IT/ITeS/BPOs/Finance/Banking is recommended as these would drive demand for outsourced services in future. Targeting industries such as oil and gas, power, petroleum, steel, cement, pulp and paper, pharmaceutical and auto is also recommended as they are aware of the concept and understand the benefits of outsourcing.

2. Brand visibility and competitive pricing are the two most important key success factors for an FM service provider in deciding the success rate of the company; key industry alliances can also be leveraged by participating in /organizing major events and conferences.

3. The real estate developer plays a major role in influencing the FM service provider. Therefore, it is recommended to maintain consistent relationship or to have a tie-up with a civil contractor / real estate developer to execute a FM project. This will well create value by facilitating marketing and ensuring better selling price of the property.

4. Due to high entry barriers and the fragmented nature of the market and to sustain local competition since high preference is given to local companies joint ventures with a local FM company are recommended in order to understand the local laws and variations in customer preferences.

The FM industry is all set to enter the next phase of the market life cycle, the development stage. Industry participants are looking for unconventional areas to expand their growth prospects. The market is poised to grow at a stupendous rate and offers huge area of growth for FM companies. Demand for both hard and single services is expected to remain strong as end users value the experience and professional service that these providers can offer.

Source: Frost & Sullivan, 2011

Appendix I: Presentation to Tata Consultancy Services

BUSINESS OVERVIEW

COMPASS GROUP

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COMPASS GROUP

COMPANY OVERVIEW…

MAIN ACTIVITY & SIZE

Compass Group PLC provides catering and support services to offices, factories, hospitals and care homes, schools and universities, sports venues, military facilities, offshore platforms and other remote locations

Op. Revenue (Turnover)	15.8 (Bn. £)
P/L for Period (Net Income)	774 (Mn. £)
Total Assets	9.4 (Bn. £)
No of Employees	471,108
Market cap. (15/08/2012)	13.3 (Bn. £)
No of recorded shareholders	120
No of recorded subsidiaries	697

Source: Fame - company report of Compass Group PLC

KEY PEOPLE

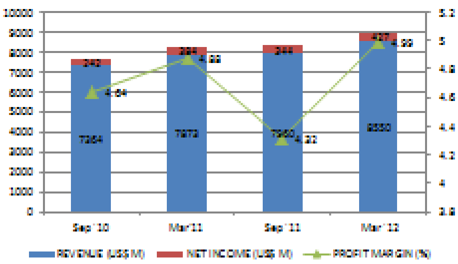
Roy Alan Gardner	Chairman
Andrew D Martin "Andy"	Chief Operating Officer
Richard J Cousins	CEO
Gary R Green	COO – North America

Source: Bloomberg

KEY FACTS

- They employ more than 470,000 people in around 50 countries
- They serve around 4 billion meals a year
- They work in around 40,000 client locations
- 90 of Fortune 100 companies are their clients

KEY FINANCIALS



Source: Bloomberg

REGISTERED OFFICE

Compass House, Guildford Street, Chertsey, Surrey KT16 9BQ, United Kingdom.
Tel +44 1932 573 000 ; Fax +44 1932 569 956

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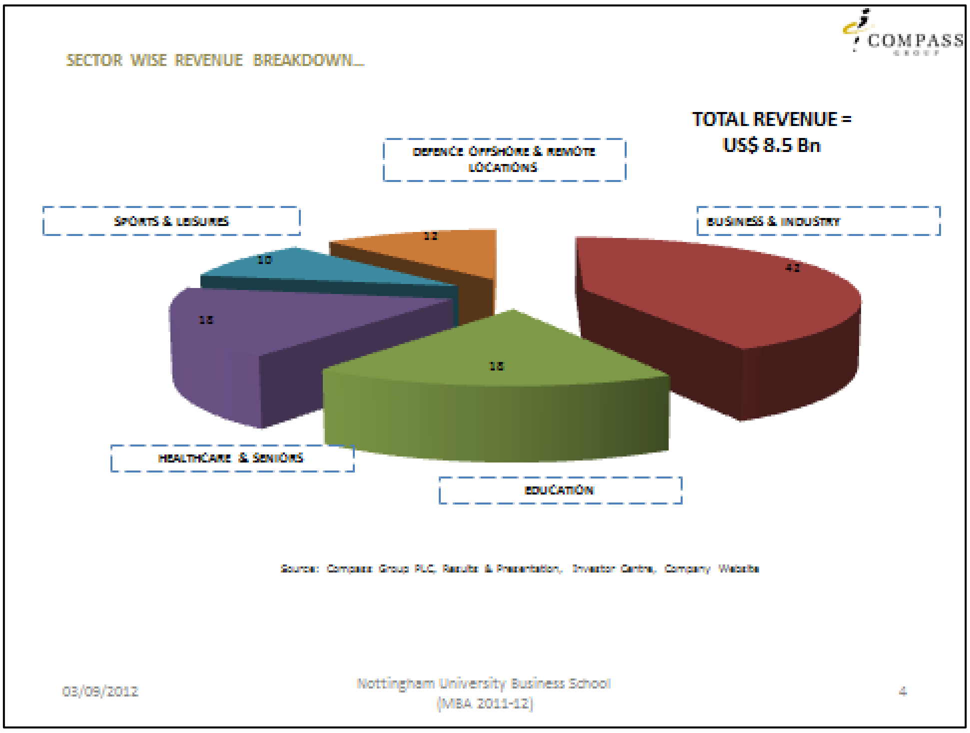
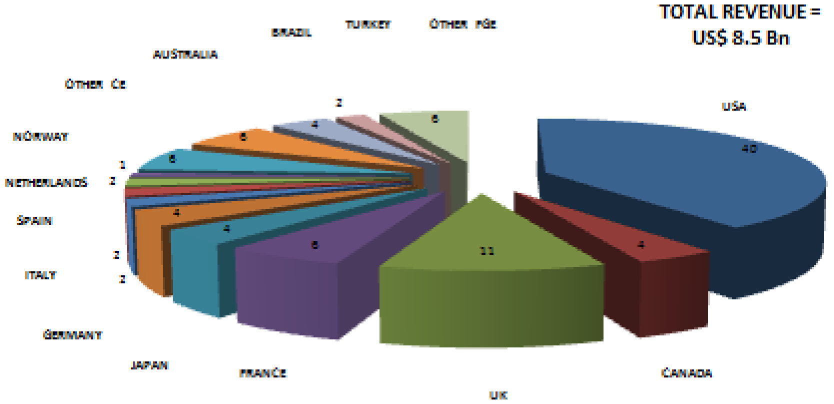
BOARD OF DIRECTORS…
COMPASS GROUP
Sir Roy Gardiner (Chairman)
Richard Cousins (Group CEO)
Gary Green (Group MD – US & Canada)
Andrew Martin (Group Finance Director)
Sir James Crosby (Senior Non-Executive Director)
John Bason (Non-Executive Director)
Susan Murray (Non-Executive Director)
Don Robert (Non-Executive Director)
Sir Ian Robinson (Non-Executive Director)
Mark White (Non-Executive Director)
Source: Compass Group PLC Annual Report, 2011, Company Website
03/09/2012
Nottingham University Business School (MBA 2011-12)
3


SECTOR WISE REVENUE BREAKDOWN…
COMPASS GROUP
TOTAL REVENUE = US$ 8.5 Bn
DEFENCE OFFSHORE & REMOTE LOCATIONS
SPORTS & LEISURES
BUSINESS & INDUSTRY
HEALTHCARE & SENIORS
EDUCATION
12
10
18
18
42
Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website
03/09/2012
Nottingham University Business School (MBA 2011-12)
4

REGION WISE REVENUE BREAKDOWN…



Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website

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PERFORMANCE HIGHLIGHTS

COMPASS GROUP

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COMPASS GROUP

ORGANIC REVENUE GROWTH & LIKE FOR LIKE REVENUE GROWTH...

ORGANIC REVENUE GROWTH	2010 (%)		2011 (%)		2012 (%)
	H1	H2	H1	H2	H1
New Business	9	10	9	8.5	8.5
Lost Business	7	6.5	6	5.5	5.5
Net New Business	2	3.5	3	3	0
Like for Like Revenue	-1.6	2	2.7	2	2
Organic Growth	0.4	5.5	5.7	5	5

Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website

Region	Trend
North America	Positive
Europe & Japan	Small Negative
FG&E	Good growth

LIKE FOR LIKE REVENUE	2010 (%)		2011 (%)		2012 (%)
	H1	H2	H1	H2	H1
Price	1.5	1.5	1.7	2	2
Volume	-3.1	0.5	1	0	0
TOTAL	-1.6	2	2.7	2	2

Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website

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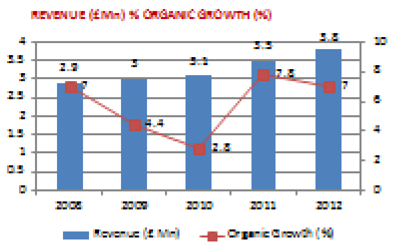
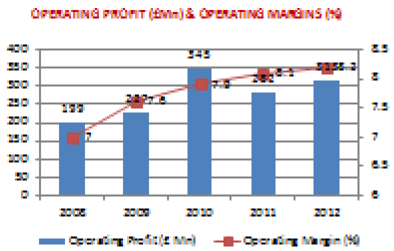
COMPASS GROUP

REVIEW OF NORTH AMERICA...





- Positive Trading Momentum
- Strong organic growth across all sectors
- Underlying Margin improvement
- Start-up of Ascension Health Contract
- Fall in organic growth rate in H1 2012

Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website

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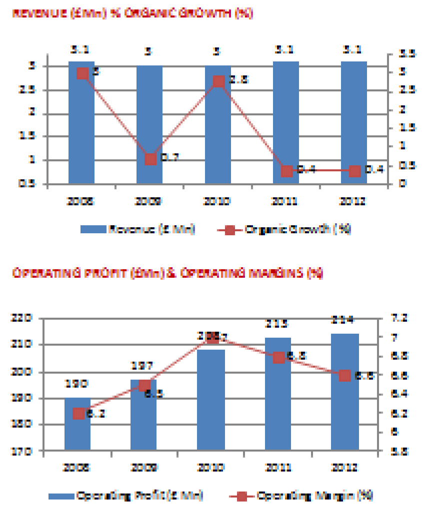
REVIEW OF EUROPE & JAPAN…

COMPASS GROUP



- Mixed Performance Across Europe
- Good new business win in some countries
- Difficult economic conditions, negative like for like revenue
- Japan Continues to improve Gradually
- Stagnant Organic Growth Rate and fall in operating Margins in H1 2012

Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website

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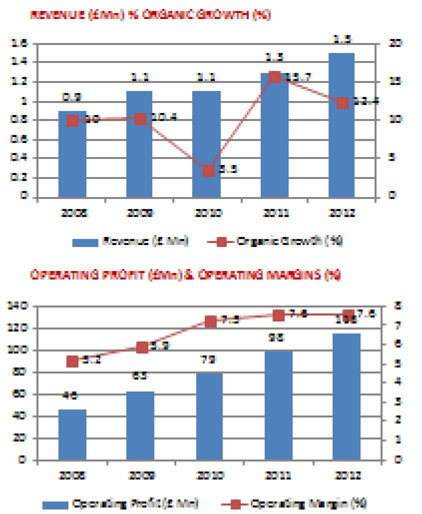
REVIEW OF FAST GROWING & EMERGING MARKETS…

COMPASS GROUP



- Strong Organic Revenue Growth
- Good levels of new business & like for like revenue
- Strong growth in Energy and Extraction
- Continued investments in growth opportunities

Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website

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BUSINESS STRATEGY
COMPASS
GROUP
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Nottingham University Business School
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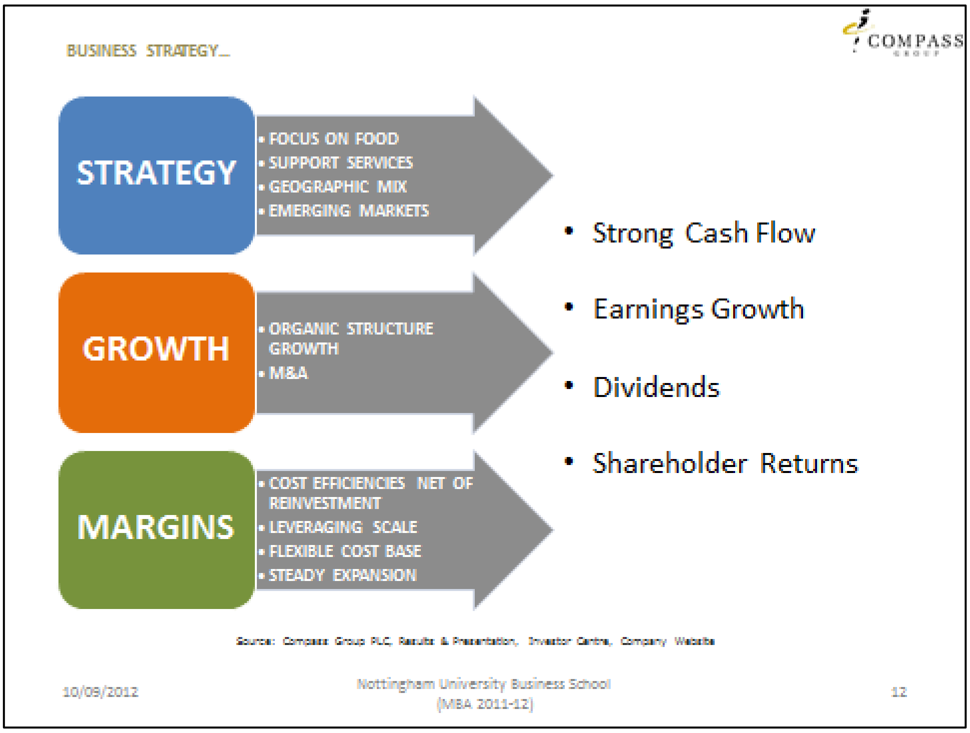
11


BUSINESS STRATEGY…
COMPASS
STRATEGY
• FOCUS ON FOOD
• SUPPORT SERVICES
• GEOGRAPHIC MIX
• EMERGING MARKETS
GROWTH
• ORGANIC STRUCTURE GROWTH
• M&A
MARGINS
• COST EFFICIENCIES NET OF REINVESTMENT
• LEVERAGING SCALE
• FLEXIBLE COST BASE
• STEADY EXPANSION
• Strong Cash Flow
• Earnings Growth
• Dividends
• Shareholder Returns
Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website
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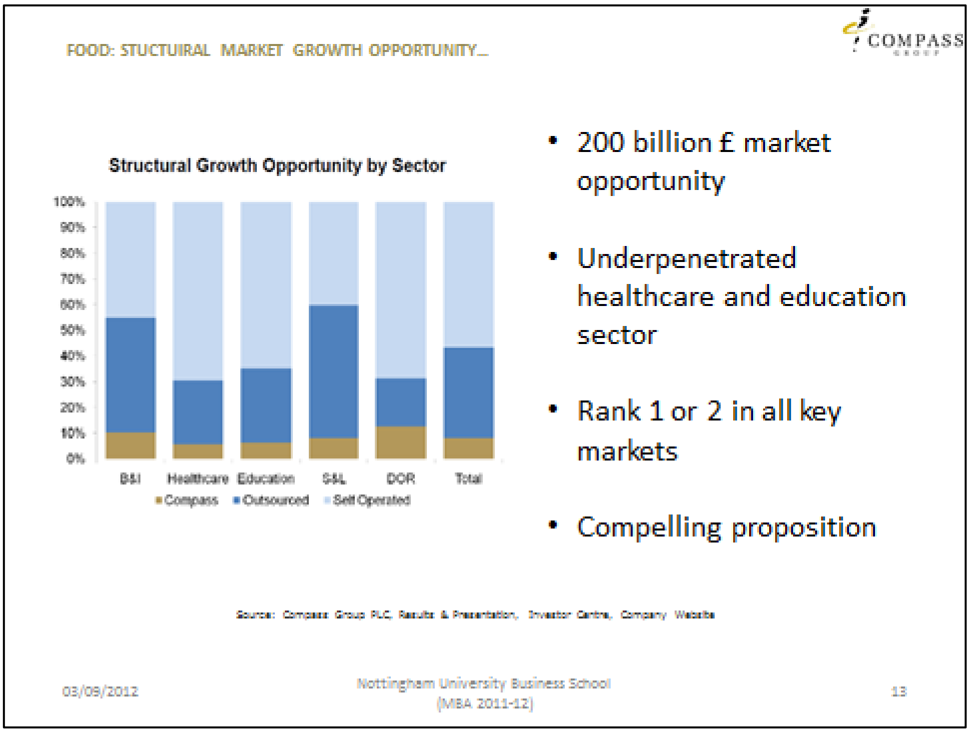
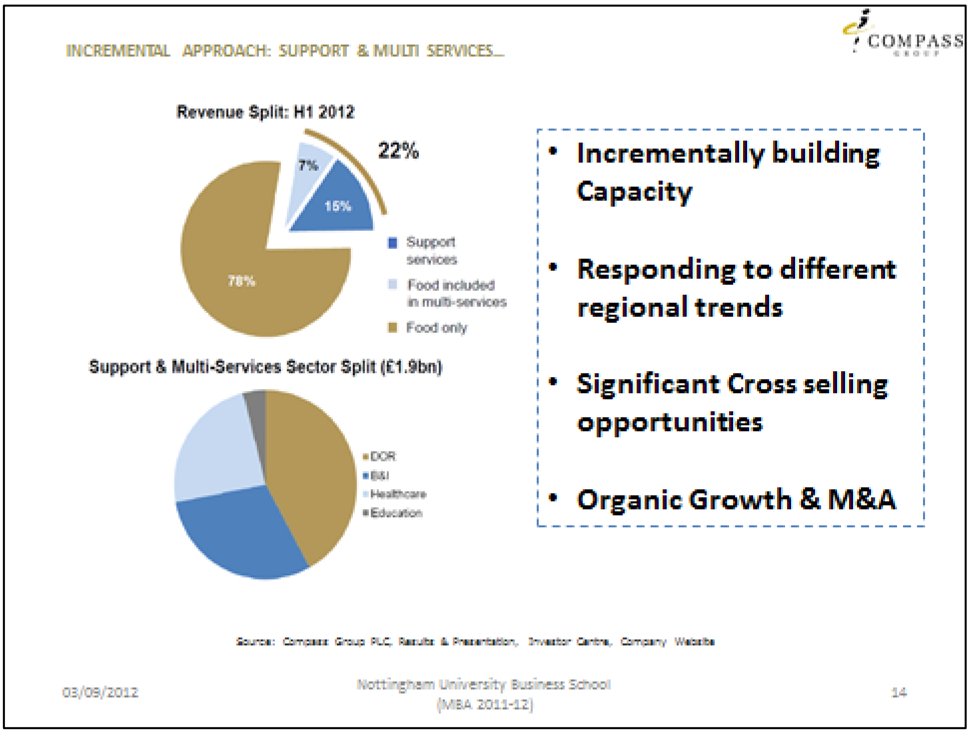
(MBA 2011-12)
12


FOOD: STUCTUIRAL MARKET GROWTH OPPORTUNITY…
COMPASS
Structural Growth Opportunity by Sector
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
B&I
Healthcare
Education
S&L
DOR
Total
Compass
Outsourced
Self Operated
• 200 billion £ market opportunity
• Underpenetrated healthcare and education sector
• Rank 1 or 2 in all key markets
• Compelling proposition
Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website
03/09/2012
Nottingham University Business School (MBA 2011-12)
13


INCREMENTAL APPROACH: SUPPORT & MULTI SERVICES…
COMPASS
Revenue Split: H1 2012
22%
7%
15%
78%
Support services
Food included in multi-services
Food only
Support & Multi-Services Sector Split (£1.9bn)
DOR
B&I
Healthcare
Education
• Incrementally building Capacity
• Responding to different regional trends
• Significant Cross selling opportunities
• Organic Growth & M&A
Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website
03/09/2012
Nottingham University Business School (MBA 2011-12)
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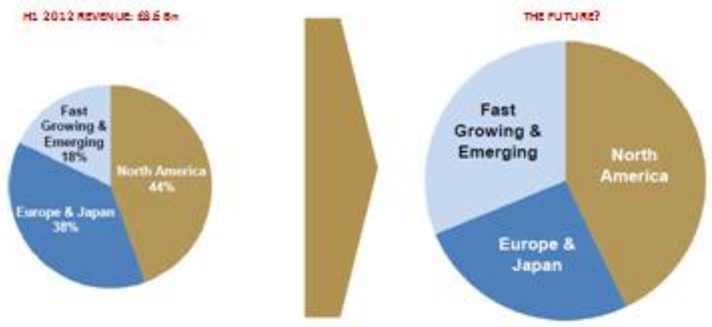
INCREMENTAL APPROACH: GEOGRAPHIC PRIORITIES…



Region	2012 H1 organic growth rate	Revenue opportunity	Margin opportunity
North America	7.0%	Ongoing; core growth engine	Ongoing
Europe & Japan	(0.4)%	Modest	Further efficiencies
Fast Growing & Emerging	12.4%	High growth rates	Steady expansion

Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website

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BUSINESS CASE

COMPASS GROUP

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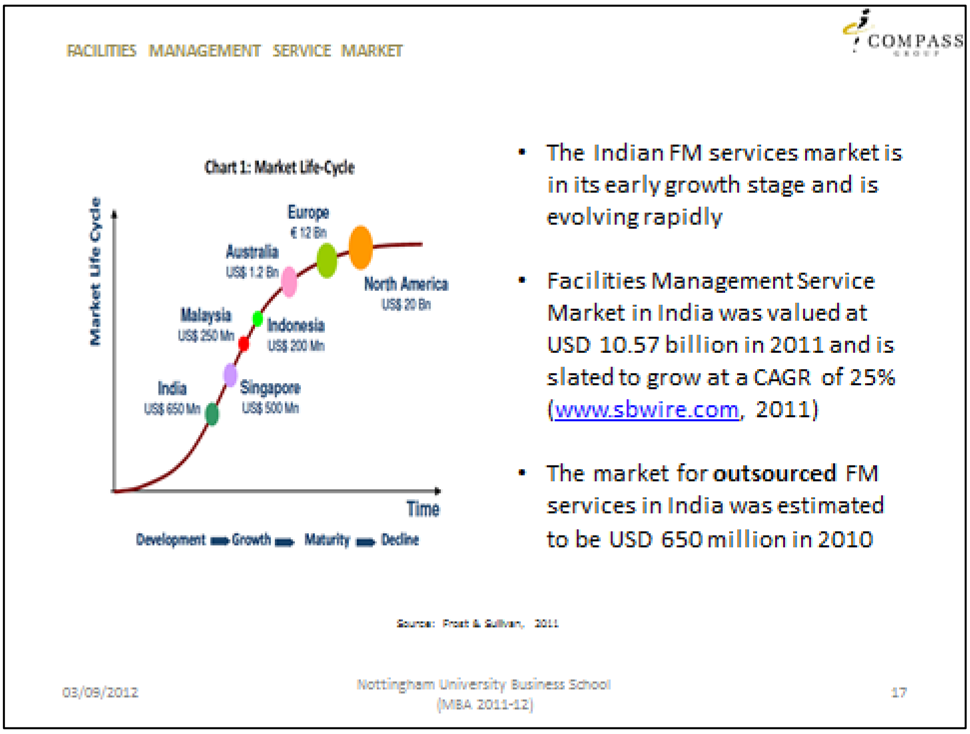
FACILITIES MANAGEMENT SERVICE MARKET
COMPASS
Chart 1: Market Life-Cycle
Market Life Cycle
Europe
€ 12 Bn
Australia
US$ 1.2 Bn
North America
US$ 20 Bn
Malaysia
US$ 250 Mn
Indonesia
US$ 200 Mn
India
US$ 650 Mn
Singapore
US$ 500 Mn
Time
Development Growth Maturity Decline
• The Indian FM services market is in its early growth stage and is evolving rapidly
• Facilities Management Service Market in India was valued at USD 10.57 billion in 2011 and is slated to grow at a CAGR of 25% (www.sbwire.com, 2011)
• The market for outsourced FM services in India was estimated to be USD 650 million in 2010
Source: Frost & Sullivan, 2011
03/09/2012
Nottingham University Business School
(MBA 2011-12)
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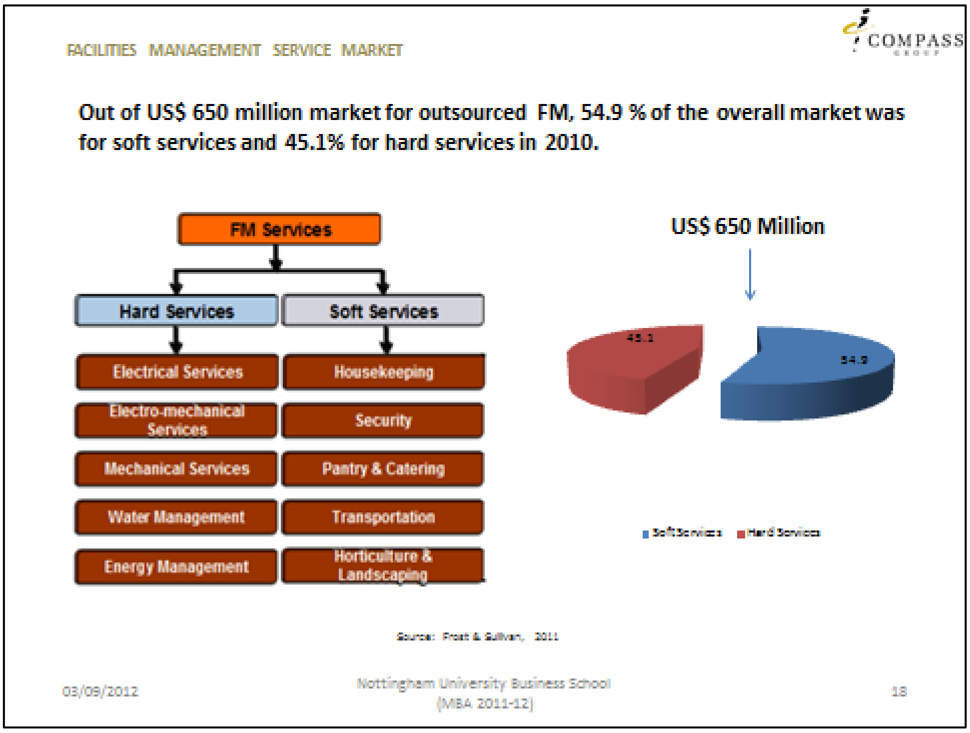
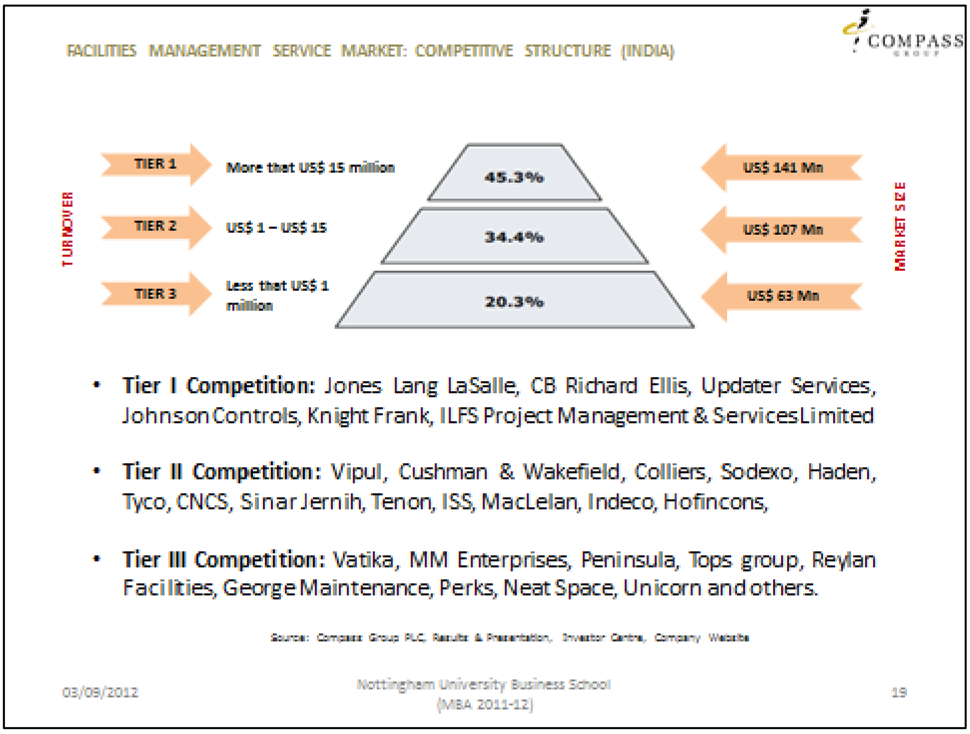

FACILITIES MANAGEMENT SERVICE MARKET
COMPASS
Out of US$ 650 million market for outsourced FM, 54.9 % of the overall market was for soft services and 45.1% for hard services in 2010.
FM Services
Hard Services
Soft Services
Electrical Services
Housekeeping
Electro-mechanical Services
Security
Mechanical Services
Pantry & Catering
Water Management
Transportation
Energy Management
Horticulture & Landscaping
US$ 650 Million
45.1
54.9
Soft Services
Hard Services
Source: Frost & Sullivan, 2011
03/09/2012
Nottingham University Business School
(MBA 2011-12)
18


COMPASS GROUP
FACILITIES MANAGEMENT SERVICE MARKET: COMPETITIVE STRUCTURE (INDIA)
TURNOVER
TIER 1
More that US$ 15 million
TIER 2
US$ 1 – US$ 15
TIER 3
Less that US$ 1 million
45.3%
34.4%
20.3%
US$ 141 Mn
US$ 107 Mn
US$ 63 Mn
MARKET SIZE
• Tier I Competition: Jones Lang LaSalle, CB Richard Ellis, Updater Services, Johnson Controls, Knight Frank, ILFS Project Management & Services Limited
• Tier II Competition: Vipul, Cushman & Wakefield, Colliers, Sodexo, Haden, Tyco, CNCS, Sinar Jernih, Tenon, ISS, MacLelan, Indeco, Hofincons,
• Tier III Competition: Vatika, MM Enterprises, Peninsula, Tops group, Reylan Facilities, George Maintenance, Perks, Neat Space, Unicorn and others.
Source: Compass Group PLC, Results & Presentation, Investor Centre, Company Website
03/09/2012
Nottingham University Business School (MBA 2011-12)
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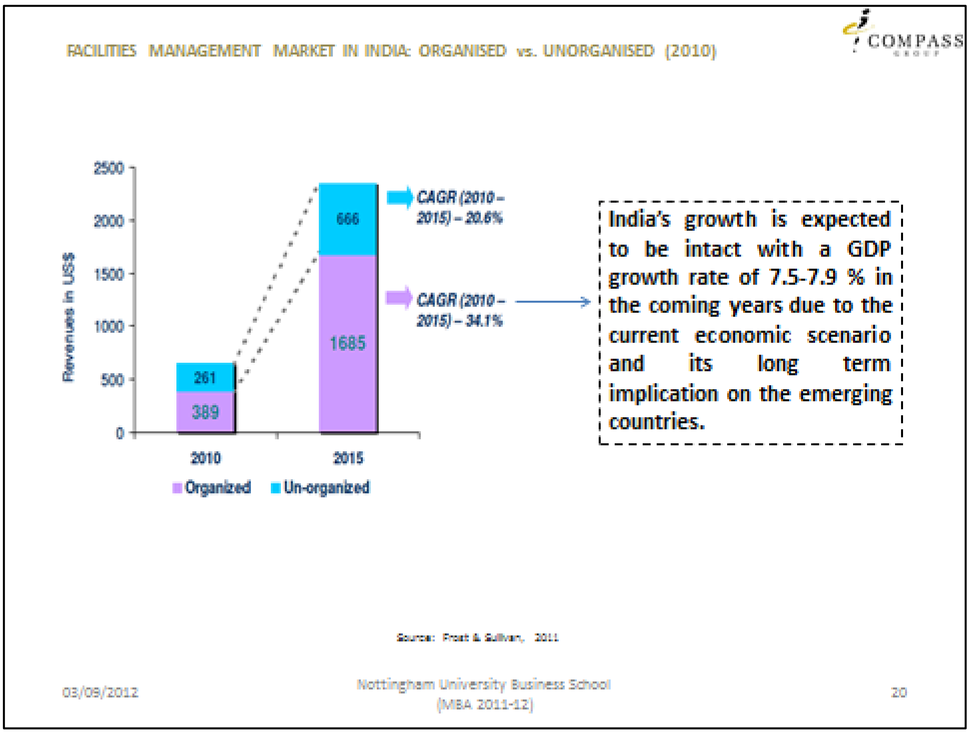
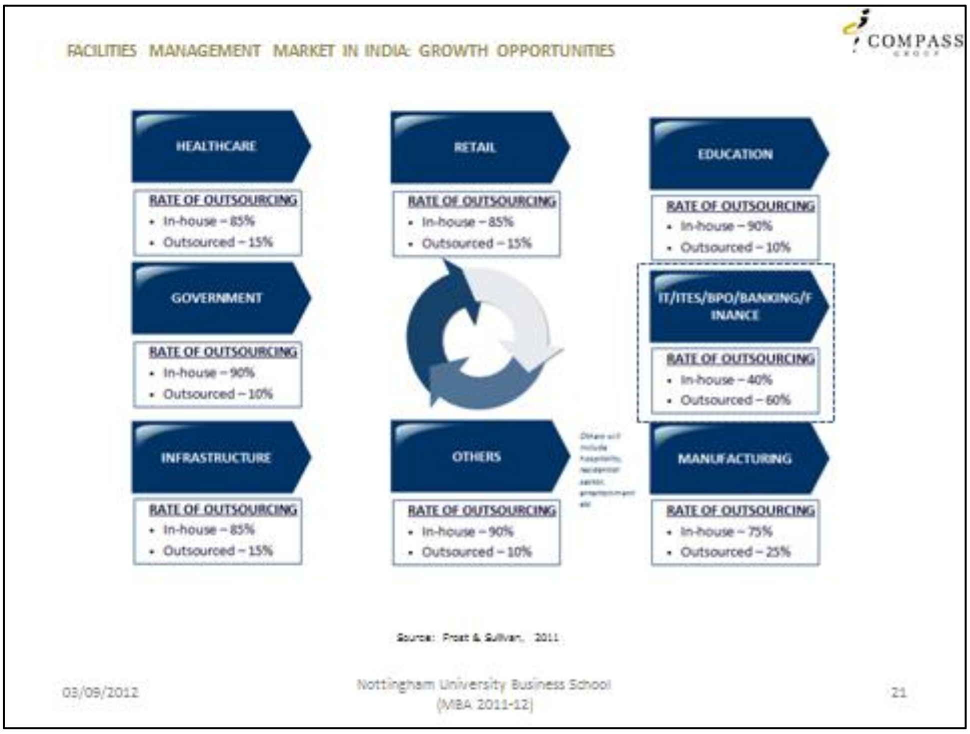

COMPASS GROUP
FACILITIES MANAGEMENT MARKET IN INDIA: ORGANISED vs. UNORGANISED (2010)
Revenues in US$
2500
2000
1500
1000
500
0
261
389
666
1685
2010
2015
Organized
Un-organized
CAGR (2010 – 2015) – 20.6%
CAGR (2010 – 2015) – 34.1%
India's growth is expected to be intact with a GDP growth rate of 7.5-7.9 % in the coming years due to the current economic scenario and its long term implication on the emerging countries.
Source: Frost & Sullivan, 2011
03/09/2012
Nottingham University Business School (MBA 2011-12)
20


FACILITIES MANAGEMENT MARKET IN INDIA: GROWTH OPPORTUNITIES
COMPASS GROUP
HEALTHCARE
RATE OF OUTSOURCING
• In-house – 85%
• Outsourced – 15%
RETAIL
RATE OF OUTSOURCING
• In-house – 85%
• Outsourced – 15%
EDUCATION
RATE OF OUTSOURCING
• In-house – 90%
• Outsourced – 10%
GOVERNMENT
RATE OF OUTSOURCING
• In-house – 90%
• Outsourced – 10%
IT/ITES/BPO/BANKING/FINANCE
RATE OF OUTSOURCING
• In-house – 40%
• Outsourced – 60%
INFRASTRUCTURE
RATE OF OUTSOURCING
• In-house – 85%
• Outsourced – 15%
OTHERS
RATE OF OUTSOURCING
• In-house – 90%
• Outsourced – 10%
MANUFACTURING
RATE OF OUTSOURCING
• In-house – 75%
• Outsourced – 25%
Source: Frost & Sullivan, 2011
03/09/2012
Nottingham University Business School
(MBA 2011-12)
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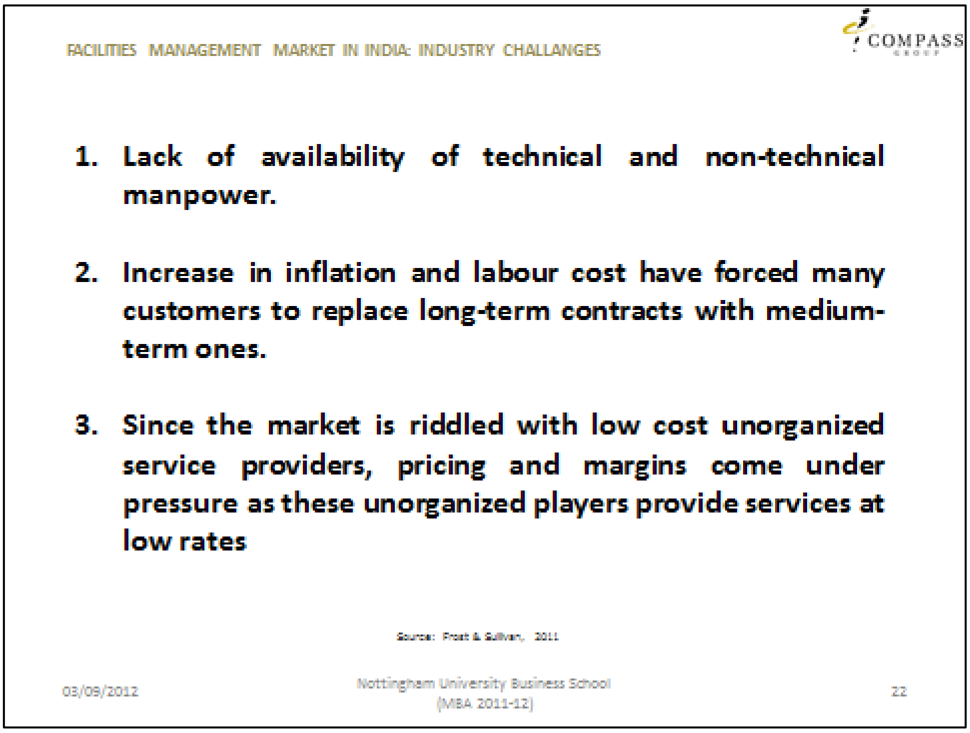
FACILITIES MANAGEMENT MARKET IN INDIA: INDUSTRY CHALLANGES
COMPASS GROUP
1. Lack of availability of technical and non-technical manpower.
2. Increase in inflation and labour cost have forced many customers to replace long-term contracts with medium-term ones.
3. Since the market is riddled with low cost unorganized service providers, pricing and margins come under pressure as these unorganized players provide services at low rates
Source: Frost & Sullivan, 2011
03/09/2012
Nottingham University Business School
(MBA 2011-12)
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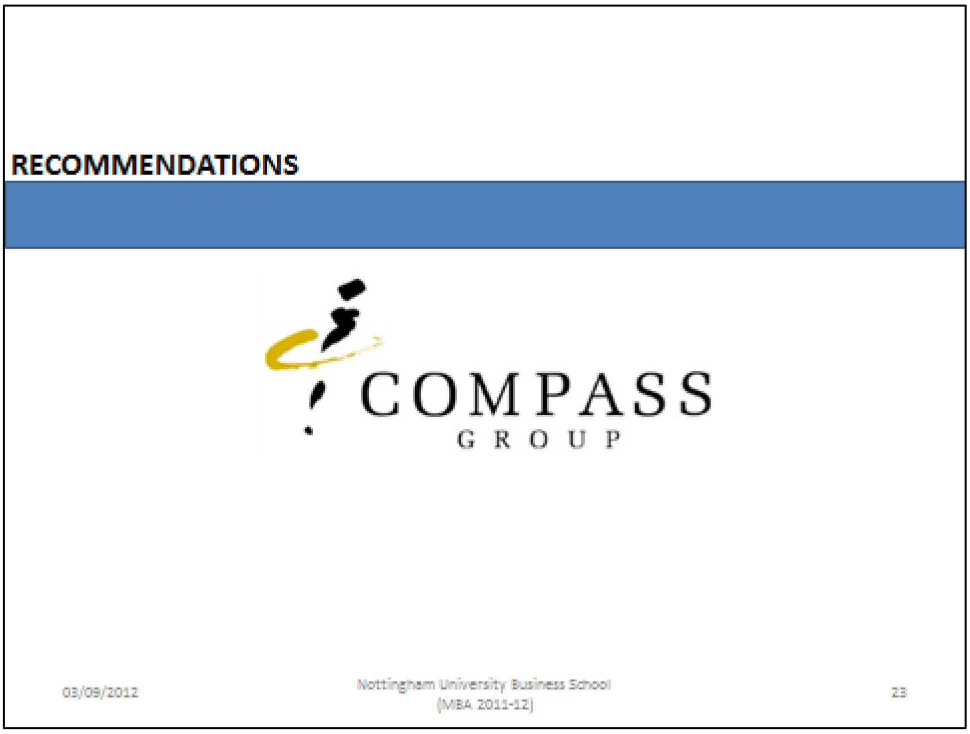

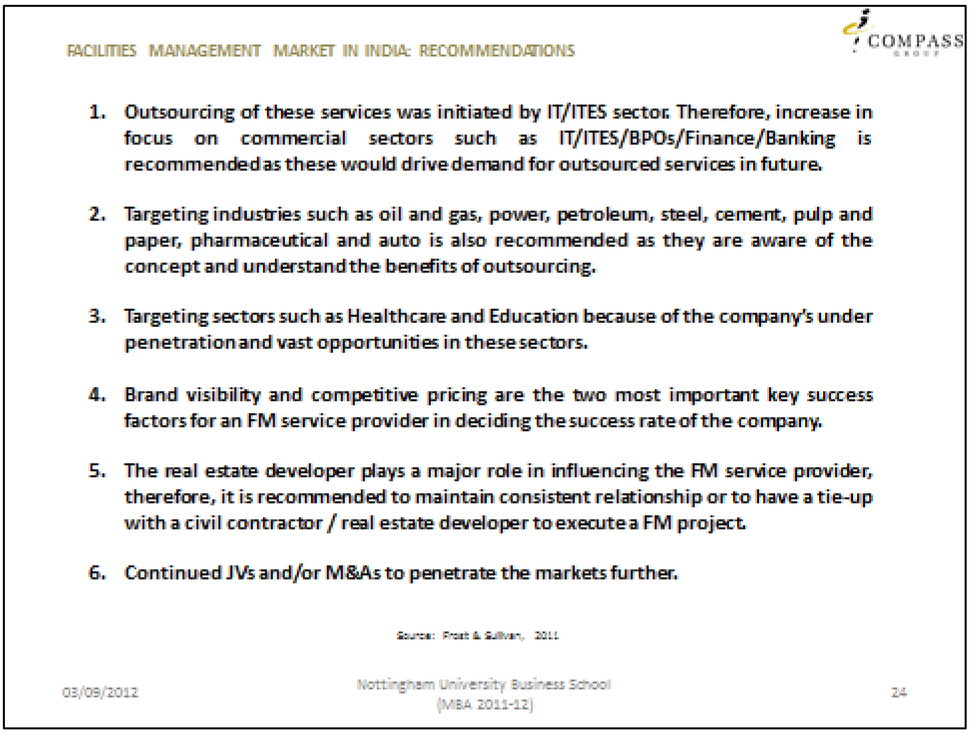

FACILITIES MANAGEMENT MARKET IN INDIA: RECOMMENDATIONS

COMPASS GROUP

1. Outsourcing of these services was initiated by IT/ITES sector. Therefore, increase in focus on commercial sectors such as IT/ITES/BPOs/Finance/Banking is recommended as these would drive demand for outsourced services in future.

2. Targeting industries such as oil and gas, power, petroleum, steel, cement, pulp and paper, pharmaceutical and auto is also recommended as they are aware of the concept and understand the benefits of outsourcing.

3. Targeting sectors such as Healthcare and Education because of the company's under penetration and vast opportunities in these sectors.

4. Brand visibility and competitive pricing are the two most important key success factors for an FM service provider in deciding the success rate of the company.

5. The real estate developer plays a major role in influencing the FM service provider, therefore, it is recommended to maintain consistent relationship or to have a tie-up with a civil contractor / real estate developer to execute a FM project.

6. Continued JVs and/or M&As to penetrate the markets further.

Source: Frost & Sullivan, 2011

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