Clothing and Home
This year, we offered customers a much better choice of stylish and fashionable products at outstanding value and our sales improved as a result.
We gave our customers better product, better styling and outstanding prices, while maintaining our high quality standards. We also provided a clearer offer through fewer sub-brands and put new product more frequently into stores.

The year 2005/06 was a story of two halves. The first six months saw a weaker performance as the changes we made took shape. In the second half, customers began to respond to the improvements we had made by buying more, more often.

While we are pleased with the progress we have made this year, there remains much to do to further improve our core offer, as well as new opportunities to go for in the year ahead.

Performance
M&S continues to be the UK’s leading retailer of Clothing and Footwear by both value and volume.

Throughout last year, we improved our market share performance and ended the year ahead in volume terms with 9.9% share (last year 9.7%), as customers bought more in response to better product and pricing; but marginally behind in value terms at 10.2% (last year 10.5%), primarily reflecting price deflation.

In value terms, Womenswear ended the year with 10.5% market share (last year 10.7%); Menswear, 9.5% (last year 9.8%); Lingerie 24.1% (last year 25.5%) and Childrenswear 4.1% (last year 4.3%).

The increase in full price clothing market share was marked, up 2.0% to 14.2%, reflecting the real improvements we made in offering better values, with the first price being the right price.

This resulted in a significant reduction in the level of marked down products, which contributed some 50% of our margin improvement in 2005/06. In the last quarter, we achieved positive market share growth in all departments at a total level for the first time in three years, with gains most marked in Womenswear.

The difficult first half affected the performance of all departments, as we took action to adjust ranges and prices. But performance improved from the autumn, grew stronger over Christmas and momentum was sustained in the last quarter. Total Clothing sales stood level against last year at £3.3bn (last year £3.3bn), while Home turnover was 0.8% up on the year at £353.8m (last year £351.1m).

Womenswear experienced strong second half growth, reflecting our work to keep ranges fresh so every woman can find something new, every time she visits. We responded confidently to key trends including military jackets, re-establishing our reputation for grown-up fashion.

‘Per una’ performed strongly under the leadership of George Davies. George will take a new role as ‘per una’ Chairman from July 2006 but will remain very committed to the day-to-day running of the business.

Menswear and Lingerie followed a similar pattern of tough trading in the first half and strong growth in the second, although growth was more muted than that seen in Womenswear.

Menswear reduced its brands to three – ‘Autograph’, ‘Blue Harbour’ and ‘Collezione’ – by autumn 2005. ‘Autograph’ was re-launched in August 2005, providing a wider offer of designer-led pieces, and was a strong performer. Suiting also performed well and hit a three-year high in its market share. ‘Blue Harbour’, the biggest casualwear brand for men in the UK, also had a strong year.

In Lingerie, the move to fewer brands in 2005 made the offer clearer and easier to shop, whilst the ‘per una’ lingerie range, launched in November 2005, brought new excitement. A continued focus on really good basics at our ‘Opening Price Points’ and great value across the entire offer was complemented by beautiful detailing, colours and fashionable shapes. ‘Body’, with its simple, clean-cut lines, was particularly strong and now represents 30% of our ‘Collections’.

Our Home business continued with its clear strategy of great value and simpler but stylish ranges with mainstream appeal, supported by a much better catalogue and

We now use focus groups to ensure the changes we make hit the mark with customers. In 2005/06, our ‘Classic Collection’ team canvassed the views of over 800 members of the Women’s Institute, who gave a thumbs-up to the improved quality of fit and materials used within the range, but confirmed that we need to continue developing collections with more fashionability. The feedback had a direct impact on our buying. In January, for example, we doubled our order of a favoured printed skirt, so that we could stock it in all stores.
Our ‘Portofino’ rattan-style furniture has been developed for all-weather use, combining style with convenience and durability, making them perfect for the patio.

Our DD-G range, which is already one of the widest on the high street, will be extended further this year to include new styles and colours.

Outstanding value across our ranges
Offering customers outstanding value – great quality at great prices – at all points across our price hierarchy continued to be a key priority. We adjusted our pricing structure, raising the proportion of products we offer at opening prices from an average of 17% in 2004/05 to 31% at the year end.

We continued to re-establish our value credentials. We introduced new offers such as the £5 women’s t-shirt and £6 bra, the £50 career girl suit, £9 men’s jeans and fleeces.

In Home, we introduced a whole new value range, including a three-steamer set for £9.50 and a £15 bale of six towels. This was well received by customers and resulted in a significant increase in the volume of sales.

We used the autumn ‘Your M&S For Less’ advertising campaign to emphasise our competitive pricing from basic items to more desirable clothes and fabrics, like linen.

We also increased the number of products offered at the top end of the price spectrum. In Womenswear, we now use the ‘Autograph’ label across our ranges to distinguish extra special clothes made from the highest quality silks, lace, linen and cashmere. We expect ‘Autograph’ to become one of the biggest UK luxury women’s brands by the end of 2006/07.

Better buying, better product
Our Buying Academy, set up in 2005, trained our 900 buyers, designers and merchandisers during the year to ensure that we maintain tight control on all aspects of buying.

We set challenging weekly targets to control stock levels at every part of the supply chain, to improve availability and reduce levels of marked down product.

We also reduced the number of products we had to return to the manufacturer because of faults to the lowest level since our records began in 1988.

We are getting new product to stores more quickly and effectively from around the world – in just six weeks for some fast fashion lines.

We are also buying with more confidence, making sure that products we think customers will love are available in sufficient quantity when they want them.

Womenswear chased new trends and fast sellers by using an uncommitted ‘Open To Buy’ budget. Last autumn, we caught the...
trend for culottes and city shorts, transferring fabric originally set aside for skirts and trousers. Menswear is looking to use ‘Open To Buy’ in the same way during 2006/07.

Our 55 technologists introduced industry-leading innovations, including the first tumble-dryable suit and seamless moulded bra. We were also the first major UK retailer to sell Fairtrade cotton products, ‘Real Cool Cotton’ t-shirts, and ‘Heels with a Secret’ in women’s footwear. Lingerie greatly expanded its range of ‘Shapewear’, after the success of the ‘Magic Knicker’, and is planning the first co-ordinated range of mastectomy lingerie. In Home, we introduced all-weather rattan-style furniture and will be offering a wipe-clean fabric across our sofa ranges from autumn 2006.

Our sourcing offices in Hong Kong, India, Bangladesh, Sri Lanka and Turkey were up and running early in 2005/06, allowing us to source more efficiently and keep a close check that our strict ethical standards are being met. They also enable us to buy more product direct from the manufacturer.

Looking ahead

While we have seen improvements this year, we still see considerable potential over the coming 12 months and beyond.

Casual clothing remains the fastest growing market, in line with increased spending on holidays and weekends away, and will be a focus this year.

We introduced new Womenswear denim shops to all stores in April 2006 with a broader, more fashionable offer. In Menswear, we are re-vamping the casual ‘Blue Harbour Vintage’ range to create a distinct, slightly younger offer to ‘Blue Harbour’.

We will also expand the ‘Maternity’ offer that we introduced in January 2006 to a full range from t-shirts to suits.

Our ‘Classic Collection’ will be further developed using feedback from the special customer focus group we have established for the range.

We are repositioning ‘Collezione’ as our up-market men’s smartwear brand and rolling out a new men’s shoe shop format to 25 stores, providing better service and doubling the choice of shoes in the same space.

In Lingerie, we will broaden further our DD-G offer, introducing more styles, as well as more colours. We will also continue to add fashionable, trend-led lingerie to our ‘Collections’.

Improving Childrenswear is a key priority, as some 70% of women aged between 30 and 45, have children. Our restructure, splitting responsibility for our offer between our Womenswear and Menswear teams, is complete and we are working hard to deliver better product and to provide the different age groups with an appropriate offer.

Finally, we will continue to provide our customers with stylish, great value Home products through our website and improved catalogue, to build further on the progress made during 2005/06.
Our food business enjoyed a very successful year. Strong product development, new advertising, improved Food Halls and the performance of ‘Simply Food’ all helped drive sales.
M&S food stands, above all, for outstanding quality and innovation. Our customers expect us to offer them new, delicious food, sourced responsibly, and to create and interpret new trends in eating.

We are most successful when we do this with confidence, combining the skills of our buying teams, our food technologists and our suppliers.

In recent years, we have chased too wide a range of initiatives, often done on too small a scale to have real impact. We have since refined our product strategy, concentrating on four main areas – fresh, natural, healthy food; special celebration products; authentic ready meal ranges and exceptional everyday food like our ‘Oakham’ chicken and Aberdeen Angus steaks.

During the year we backed this strategy with powerful advertising and bold product development – including launching 1,600 entirely new lines and upgrading a further 1,100. We are also exploring different ways to make our food available to our customers through new locations and formats.

**Performance**

Total Food sales grew by 7% to £3.6bn and also enjoyed a 3.6% increase in like-for-like sales. Throughout the year, key areas such as fresh produce, particularly fresh fruit salads and juices, as well as meat, delicatessen and ‘Food to Go’ products experienced strong growth. Christmas was particularly successful with like-for-like sales growing 5%. Sales in the last quarter continued to improve, helped especially by a healthy eating campaign which included 200 newly developed products.

Improved marketing also contributed to our performance. Customers particularly welcomed our Food Festivals where those spending more than £35 could sample for free some of the products we are most proud of including salmon, wine and chocolate puddings.

**Healthy eating**

People want to know more about their food and are becoming increasingly health conscious.

We made healthy eating a particular priority during the year, increasing the number of products carrying our ‘Eat Well’ sunflower logo by 300 to over 1,000 – around 20% of our food offer.

Our ‘Eat Well’ logo is placed on foods which do not contain artificial colours, flavourings or sweeteners and are either naturally healthy foods or nutritionally balanced, based on current Government guidelines. This approach has been assessed by independent nutrition experts at the British Nutrition Foundation.

We have provided Guideline Daily Amounts (GDAs) on all our food since August 1999 and now plan to introduce colour-coded GDAs to help customers make healthier food choices.

Concern about additives in foods is also growing and we have moved faster than anyone to remove them. During the year, we were first to commit ourselves to removing hydrogenated fats from virtually all our foods by the end of 2006 – a challenging commitment, already achieved in over 90% of affected products.

Our ‘Marks & Spencer Cook!’ range – providing customers with prepared raw ingredients to make delicious meals – is already additive-free. The 19 products in our ‘Eat Well for Kids’ range contain no artificial colours, flavours or sweeteners and no added preservatives.

We remain the only major retailer to have met the British Retail Consortium’s salt reduction targets and are on track to meet the Food Standard Agency’s targets for 2010.

In another innovation, we introduced a unique Omega-3 rich milk, through a specially-developed feed for our dairy cows which allows them to produce milk rich in the optimum sort of Omega-3, properly balanced with Omega-6.

While healthy eating is a key trend, we never lose sight of the importance of great taste and eating quality. We employ trained chefs to develop new dishes and improve existing lines.
We are also continuing to work hard to improve everyday food. Our ‘Oakham’ chicken and ‘Muirden’ pork – both unique, naturally reared products – remain popular with customers. We were the first major food retailer in Europe to sell tenderstem broccoli, high in essential vitamins, and we now have a 40% UK market share. We also won 360 awards last year for our cheeses.

Responsible food sourcing
Our ‘Look behind the label’ campaign, launched in January 2006, allowed us to tell customers how carefully we source food. It highlighted our work to remove additives, reduce salt, ban GM-foods and encourage responsible fish sourcing. There is more detail on the campaign in our Corporate Social Responsibility Report online (www.marksandspencer.com/csrreport2006).

Our ‘Oakham’ chicken was recognised with an award from Compassion in World Farming and during the year, we introduced more naturally grown breeds of turkey and pork.

In March, we announced that we would switch all the coffee and tea we sell in our Food Halls to Fairtrade.

Last year, we introduced cardboard sandwich packs made from well-managed timber supplies with a biodegradable cornstarch film window.

Speciality foods
We go to great lengths to source speciality foods from home and abroad, assisted by our own team of agronomists, farmers, chefs, winemakers, animal welfare and marine specialists.

In spring 2006, we introduced a new range of 300 speciality products which illustrate the care we take in sourcing our food. The range includes Cuxwold pork from Norfolk and Lincolnshire and Apple and Cider Jelly from Biddenden, Kent.

During the year, we also set about giving all our food a distinctive look and will have re-packaged almost all our lines by the end of 2006. This work is already noticeable in our stores, particularly on ‘Food to Go’ items, like sandwiches and drinks, and on grocery, bakery and delicatessen products which have attractive, eye-catching designs.

Celebrate
We remain a first choice for customers looking for high quality, trusted food at celebration times like Easter and Valentine’s Day.

We saw strong demand at Christmas for products like ham and turkey joints and specially-prepared vegetables, including glazed parsnips. At Valentine’s, sales of single long-stem roses increased by 160%, helped by advertising.

In May 2006, we extended our in-store food ordering service, increasing our range of party food and personalised cakes by around a quarter.

Reaching new customers
Our ‘Simply Food’ stores continue to reach new customers who like the convenience offered by locations such as railway stations and motorway service areas.
We are currently reviewing the trial of ‘Simply Food’ in eight BP forecourts, which we launched in autumn 2005, and one which we opened after the year end.

The market for M&S food is potentially much wider. In seven stores we tested new formats including ‘Hot Food to Go’, like hot wraps and soups, and in four stores we introduced new bakeries, selling fresh crusty bread and first class patisseries and delicatessens where customers can sit and eat breakfast, brunch, a light lunch or supper. These ideas help bring theatre and excitement to our stores.

Looking ahead
We will continue to provide innovative food of exceptional quality in 2006/07. Healthy eating will remain a priority for us.

We plan to increase our ‘Eat Well’ products, extend our additive-free ‘Marks & Spencer Cook!’ range and continue to reduce salt and remove hydrogenated fats from our food. We will also continue to highlight the special quality of our food and its provenance.

Building on our popularity at Christmas and other key times of the year, we will seek to become the preferred destination for personal celebrations like birthdays, weddings and anniversaries.

We will open more ‘Simply Food’ stores and extend the trial of new formats, like our ‘Eat Over Deli’ bars, bringing our food to a wider audience. Later this year we will open our first stand-alone restaurant at our Newcastle store, where customers will be able to dine out on a range of our food.

International
Our International business contributed 9.1% to the Group’s pre-tax profits.

Comprising wholly-owned stores as well as franchise stores around the world, our International division continues to flourish. In 2005/06, it generated a turnover of £522.7m (last year £455.8m) and an operating profit of £65.6m (last year £60.4m). As part of our plan to refocus the business we agreed the sale of our US supermarket chain, Kings Super Markets, for £35.4m ($61.5m) in March 2006.

Franchise
We operate 198 franchise stores in 30 territories around the world. During the year, 22 stores opened including two in Moscow, an additional four in the Czech Republic and three more in India. We have also closed a number of stores in the period, either to move to better sites or to concentrate on larger, more profitable stores. Total space grew from 1.30 million sq ft to 1.43 million sq ft.

We see considerable scope to increase the number of franchise stores in our current territories and to enter new ones. We opened in Switzerland in April 2006, and have plans to open in Ukraine and Latvia, as well as to expand our Russian presence to St Petersburg, in 2006/07. Franchise stores give us the opportunity to expand internationally without significant capital cost. By continuing to work with trusted partners, we benefit from both their local knowledge and increased economies of scale.

Wholly-owned
We have eight wholly-owned stores in Hong Kong and this continues to be an attractive and profitable market for us. Competition for good sites remains tough and rents are high, but we are keen to expand our presence there.

Our stores in the Republic of Ireland are thriving. In 2005/06, we opened two stores in Blackrock and Galway and in April 2006 we opened another in Newbridge Retail Park, west of Dublin. We will open in Drogheda in summer 2006, bringing the number of stores there to 13.
We are pleased with the customer response to the stores we refurbished in our trial and now plan to roll the new design out across the chain, with more than 60 additional stores in the plan for this year.

By the end of 2006, every customer in the UK will be within easy driving distance of a newly refurbished M&S store.

Our Stores

We are carrying out our biggest store refurbishment programme ever and continuing to open new stores in key locations.

Our biggest tangible asset is our store portfolio. It is also the way that our customers experience our brand. Our stores are in great locations, but they have been subject to underinvestment in past years. We have embarked on a major refurbishment programme to rectify this and bring our stores up to the standards our customers expect. At the same time, we will open in new locations where opportunities exist to further grow our business.

Improving our stores
Following a four store trial in 2004/05, we refurbished 17 more stores by Christmas 2005. By this December, we will have converted around 35% of our store portfolio, equating to five million sq ft.

The format has a lighter, brighter feel, new equipment and an improved layout. We continue to make improvements, including to Womenswear, where we trialled a more feminine, clearer layout in March 2006, which is now being rolled out as part of the refurbishment programme.

We are also improving the consistency of standards across all stores, so that they look, feel and are maintained in the same way. In early 2006, we issued detailed visual packs called ‘The Look’, showing how each department should be laid out, to ensure a consistent spring product launch. Store standards remain a focus for us in 2006/07.

Meeting needs in new locations
We continue to look at locations where we are under-represented and opened eight main chain stores in 2005/06. We also took decisive action where stores were under-performing and closed seven. Following a net increase in store numbers of 29, we now have a total of 451 across the UK, including 43 ‘Simply Food’ franchise stores.

‘Simply Food’ stores are an important way to meet customer demand in convenient locations. During the year, we acquired 28 stores in select locations from Iceland for £38m. These will open this summer, taking the number of ‘Simply Food’ outlets to 172. Currently, we are opening around one store a week, either alone or in partnership with SSP at railway stations or Moto at motorway services.

Our Outlet stores allow us to sell excess product year-round, without taking space away from new ranges in our main stores. During 2005/06, we opened four new Outlets, taking the total number to 24, and expect to open more in the year ahead.

Simply Food to the Fore

We joined forces with BP Connect in 2005 to trial our Simply Food offer in BP forecourts. The trial provided a new, convenient option for existing customers and also introduced new customers to our Food offer.
Improving our employees’ ability to fulfil their roles is key to our success. To achieve this, we needed to simplify the way we pay, train and motivate people.

A clear structure with real opportunities
In May 2005, we introduced a new four-point pay and career structure for customer assistants, creating some of the highest rewards in retail and replacing a myriad of rates with clear career progression through the new roles – Trainee, Qualified, Coach and Section Co-ordinator. These changes mean we can now better recruit and retain talented people.

In 2006/07, we will continue to develop the ‘Your M&S Career Path’ and will also create a similar structure for Section and Store Managers. This builds on our new retail management structure which ensures that some of our most talented people manage our flagships, helping these key stores perform ahead of the chain.

Training to deliver
Last year, we worked hard to achieve consistently good service in every store. Although there is more to do, our customer research and monthly mystery shopper programme found significant improvements, following our biggest ever service training programme, with 56,000 completing ‘Our Service Style’ customer service training during the year.

One in six of our customer assistants has been trained as a Coach, responsible for training new staff and upskilling colleagues. Our 8,000 Coaches are critical in ensuring product knowledge, work methods and customer service are at the highest levels.

In head office, the Buying Academy has trained 900 staff in buying and merchandising practices, achieving far shorter lead times and increasing availability whilst managing tight markdown targets.

Listening to employees
Some 1,500 people across M&S are elected representatives on our Business Involvement Groups (BIGs), our vehicle for employee communication, consultation and involvement. We have broadened the BIG constitution, increased training to make it a more effective forum and now fund three full-time representatives.

We introduced a new employee survey in February 2006, ‘Your M&S, your say’, which allows us to compare satisfaction scores against other leading UK companies for the first time.
Responsible retailing

For many years we have applied strict ethical standards so our customers can make responsible choices.

In a year of significant achievement, a number of initiatives stood out.

We became the only major UK retailer to sell only Fairtrade coffee, both in our 200 ‘Café Revive’ coffee shops and our Food Halls. The Fairtrade Foundation estimates that this commitment will lift UK Fairtrade coffee sales by 18%.

We also announced that by the end of 2006 all our tea will be Fairtrade-only. In March, we also became the first major UK retailer to offer a range of Fairtrade cotton t-shirts and socks.

Healthy eating is increasingly important to our customers. Our healthy foods, identified by the ‘Eat Well’ sunflower, now make up 20% of our entire food catalogue. During the year, we were the first major UK retailer to commit to removing hydrogenated fats from virtually all our food and we are reducing salt ahead of industry and Government targets.

We take animal welfare seriously in the manufacture of all our products. The RSPCA recognised this when they gave us their 2005 Alternative Award for Fashion Retail for our policies on animal welfare.

On fish sourcing, Greenpeace, the Marine Conservation Society and the Seafood Choices Alliance named us the leading retailer in the protection of endangered fish species. This applies across our offer from fresh fillets to fish in sandwiches and pies.

Our customers have asked us to develop packaging that is more environmentally friendly. This year, we used around 1,500 tonnes of recycled plastic in our packaging and tested in-store recycling schemes. These efforts won us the Best Retail Recycling Initiative in the 2005 National Recycling Awards and the 2005 Institute of Grocery Distributors/Tetra Pak Environmental Award.

During the year, we invested heavily in our staff. You can read more about ‘Our People’ on page 17 and also in our Corporate Social Responsibility Report which is available to download from our website www.marksandspencer.com/csrreport2006.

We also continued to support the communities in which we operate and invested a total of £9.3m, in cash and in kind, in community initiatives.

Through ‘Marks & Start’, the biggest of these initiatives, we provided 2,635 people with work experience placements. 40% of adult participants, drawn from groups such as the disabled and homeless, went on to find work.

Finally, we worked closely with Care International and communities in Sri Lanka to re-build 80 homes destroyed by the 2004 tsunami. In addition, we helped the affected villagers set up their own businesses and provided them with training.

We recognise that climate change is a serious issue and have stepped up efforts to address it. Improved efficiencies together with our use of greener electricity meant that last year we produced 9% less carbon dioxide pollution than in 2002/03.

LOOK BEHIND THE LABEL

In January 2006, we launched ‘Look behind the label’, a campaign about the way our products are sourced and made. We want our customers to know about the lengths we go to to give them responsible and ethical choices – we want them to know what sets us apart from our peers.

The campaign covered areas such as animal welfare, Fairtrade, responsible fish sourcing, responsible use of chemicals, free-range eggs, non-GM foods, removing hydrogenated fats from virtually all our foods and leading the industry on salt reduction.

We’re reducing salt in our food faster than you can say ‘sodium chloride!’