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RE: Expanding H&M to Brazil: A Strategic Approach

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I. Abstract

H&M aims to expand its number of stores by 10-15% each year, yet has not entered any markets below the equator. Though seasonal differences are an issue when looking at markets located below the equator, H&M must make the jump to these new markets in order to stay competitive in the retail industry.

This paper looks into why H&M has been so successful in the past, and how the company can take its business model into the Brazilian market. Then, various options are presented that H&M could take when expanding its chain into Brazil. After analyzing the benefits and drawbacks of each option, four strategic recommendations are offered to ensure H&M's continued success upon entering the Brazilian market. These strategic recommendations are as follows: First, H&M should look to franchise its business in Brazil. Brazilian laws and business culture are very particular to the country, and business relationships are based strongly on personal relationships. Therefore, H&M should franchise to locals who understand Brazilian market intricacies. Second, H&M should change some of its production in Latin America to produce clothing appropriate for Brazilian seasons. Because H&M already has a production agreement with a plant in Latin America, this should be a relatively easy transition. Third, H&M should start in Sao Paulo, a city of 20 million fashion-conscious, potential customers. Specifically, H&M should bid for a spot in the up-and-coming JK Iguatemi mall. Finally, H&M should look to partner with a high-end Brazilian designer in order to produce affordable clothing that Brazilians will appreciate. H&M has a long and profitable history of partnering with high-end designers from all over the world to create limited time clothing lines, so

partnering with a Brazilian designer would continue this trend while making H&M more accessible and relatable to the Brazilian market.

II. Introduction

As the world's society becomes more affluent, so expands the market for technology, automobiles, fashion apparel, and other luxury goods. The fashion apparel industry, in particular, has seen an increase in consumers internationally in developing markets. The BRIC countries account for a significant amount of this recent growth, as large parts of their population rise out of poverty and realize their buying power potential. Manuela Artigas and Nicola Calicchio write in *McKinsey Quarterly* that, "Multinational retailers seeking new sources of growth are watching the mass markets of Brazil, China, and India, whose large populations and strong economic growth have made them nearly irresistible. As consumers have greater disposable income, they increasingly spend their money on items beyond the basic necessities. One of the first categories to feel this change is apparel".¹

These countries are continuing their path toward higher GDP per capita and affluence. Brazil, in particular, is an attractive market for the fashion apparel industry. Its size, population, and relative wealth as a country mean vast opportunities for brands looking to expand their market internationally. However, multinational fashion brands must take into consideration the different retail landscape of Brazil: Artigas and Calicchio go on in their report, reminding us that multinational corporations must remember that "product demands differ from those in their home markets, [and there is] a strong

¹ Artigas, Manuel and Nicole Calicchio. "How Half the World Shops: Apparel in Brazil, China, and India." 21 November 2007. *The McKinsey Quarterly: The Online Journal of McKinsey and Co.* 20 March 2011. Accessed via PDF document.

preference for local fashions, and [also a] unique combination of widespread consumer credit use and an undeveloped consumer credit market”.¹

H&M – the world’s most valuable clothing brand as of 2010, with an estimated worth of over 16 billion USD, according to Interbrand² – has hinted at its interest in entering the Brazilian fashion market³. In fact, in a 2010 *Bloomberg Businessweek* publication, Karl-Johan Persson, acting CEO, was quoted, saying ““Brazil and Argentina are very interesting.””³

As of today, however, H&M has yet to form any serious plans for its entry into Brazil. Though the aforementioned issues of local brand loyalty, underdeveloped credit use, and different consumer preferences are certainly important, the fact remains that Brazil is the fifth-largest apparel market worldwide, and it is continuing to grow at a rate of 7 percent yearly.¹ With careful research of the Brazilian market, as well as attention to Brazilian consumer trends and preferences, H&M could become a national success.

III. Company Profile

Hennes & Mauritz (H&M) was established in 1947 in Västerås, Sweden, by Erling Persson. Stefan Persson, Erling’s son, took over H&M in 1982. As of October 2010, Persson was estimated to have a net worth of 22.4 billion dollars. He is ranked as the 13th richest man in the world. Today, Erling Persson’s grandson and Stefan Persson’s son, Karl-Johan Persson, is the CEO of the enterprise. He

² “Best Global Brands: 2010 Rankings.” 2010. Interbrand. 20 April 2011. <<http://www.interbrand.com/en/best-global-brands/best-global-brands-2008/best-global-brands-2010.aspx>>

³ Kenna, Armored and McLaughlin, Kim. “H&M Examining Latin America, Australia for Openings (Update2).” 14 May 2010. *Bloomberg Businessweek*. 20 April 2011. <<http://www.businessweek.com/news/2010-05-14/h-m-examining-latin-america-australia-for-openings-update2-.html>>

took over this position from his father in 2009.⁴ With this succession of family ownership, the business continues to thrive.

Originally, H&M was named simply Hennes, Swedish for Hers. However, in 1968, Erling Persson expanded his store and purchased Mauritz Widforss, a hunting equipments store that also sold men's apparel. He changed the name from then on to Hennes & Mauritz, and shortened it to H&M. Until 1976, when its first store opened in the UK, H&M was only found in Scandinavia. In 2004, H&M entered the North American market, with its store opening in Toronto, and has experienced rapid and successful growth since then⁵.

H&M's main target market is men and women from 18-45 years of age. This encompasses a large portion of the retail market as a whole, meaning H&M must provide a wide variety of clothing suited for a wide variety of style preferences.⁶ In addition to clothing, H&M provides its customers with an original cosmetics line, as well as a variety of shoes and accessories.

H&M was one of the first brands to revolutionize the fashion industry with increasingly quick fashion turnover and cheap prices. H&M has remained true to its business concept: "fashion and quality at the best price". Because H&M clothing is so relatively low priced, the company experienced significant growth, even from 2008 to 2009 when the world was experiencing one of its

⁴ "#13: Stefan Persson". Forbes: The World's Billionaires. < http://www.forbes.com/lists/2010/10/billionaires-2010-Stefan-Persson_XM99.html>

⁵ "H&M Company Profile". <<http://company.monster.ca/hmhenc/>>

⁶ H&M Hennes & Mauritz AB. Hoovers Academic Database. Retrieved from: <http://subscriber.hoovers.com.proxyau.wrlc.org/H/company360/overview.html?companyId=100801000000000>

most massive economic downturns in history.⁷ In fact, H&M expanded by 250 stores in 2009, entering into new markets and gaining customer loyalty in previously untapped markets.⁴

H&M has been able to achieve this rapid and sustained growth by maintaining effective distribution channels, buying large volumes of clothing at a time, reducing middlemen by interacting directly with its suppliers, and remaining cost conscious at every developmental stage⁸. The company is able to remain cost conscious at every stage, and thus, keep its clothing prices low through a variety of innovative methods. First, H&M does not own any of its factories; instead, it buys clothing from approximately 700 international suppliers.⁹ Approximately 30% of H&M's clothing is manufactured in China, and approximately 60% of total production is outsourced to other countries in Asia.^{4,10} Other manufacturing plants are located in parts of Europe and Latin America.⁶

All H&M designs are created by in-house designers, whose designs are then sent out to H&M's international suppliers. This helps to maintain a standard H&M "look", which can be lost when 700+ manufacturing plants are producing the company's clothing. In fact, there are 140 in-house designers, led by head-designer Ann-Sofie Johansson.¹¹ Today, the most difficult task is making sure the customer gets what the customer wants. Since H&M has expanded so rapidly in recent years and entered into so many new markets, it has become increasingly difficult to manage the design process.

⁷ "H&M Description – Hoover's". Hoover's Database. Retrieved from:
<<http://subscriber.hoovers.com.proxyau.wrlc.org/H/company360/fulldescription.html?companyId=10080100000000>>

⁸ "Our Business Concept". H&M.

<http://www.hm.com/us/about/hm/factsabout/hm/ourbusinessconcept__ourphilosophy.html>

⁹ "Business Concept, Goals, and Strategy". H&M Jobs: Monster. < <http://company.monster.com/profiles/h--m.aspx>>

¹⁰ Kingsbury, Kathleen. (2007, May 3). "H&M Sets up Shop in China". Time Magazine Online.

<<http://www.time.com/time/magazine/article/0,9171,1617522,00.html>>

¹¹ Bourne, Leah. (2011, April 14). "H&M's Head of Design Ann-Sofie Johansson On Sustainable Fashion and Managing a Team of 140". NBC New York Online. <<http://www.nbcnewyork.com/blogs/threadny/THREAD-HMs-Head-of-Design-119865484.html>>

In order to ensure quality control and compliance with international labor standards, H&M operates 22 production offices in Asia, Central America, and Europe. These offices work closely with H&M's regional manufacturers, also located in these regions.⁶

Another way in which H&M is able to cut costs and maintain low prices in its stores is by renting – instead of buying – its retail outlets. In fact, H&M does not own any of its retail outlets worldwide. Instead, H&M rents retail space, which prevents the company from being roped into long mortgages and potentially high depreciation rates. Renting instead of buying also allows H&M to quickly set up and take down retail areas according to customer saturation and buying power in a given area. Being able to move quickly to where the customers are, and also leave locations in which customers are not shopping, is one of the key reasons H&M has been so successful.

H&M drastically cuts its costs through its renting-over-buying method, but also keeps costs low through its relatively low number of warehouses. The majority of H&M clothing is shipped to its main warehouse in Germany, where it is promptly packaged and shipped off to retail stores around the world. Though H&M has other warehouses all over the world, the majority of its clothing inventory passes through its main warehouse in Hamburg, Germany. Because H&M operates with such a quick turnover rate, inventory costs are kept extremely low.

H&M's distribution methods are quite unique. Edwin Cheng and Tsan-Ming Choi offer a succinct description of H&M's innovative distribution and supply-chain methods in their book *Innovative Quick Response Programs in Logistics and Supply Chain Management*:

In production, H&M operates within two distinct supply-chains located in Asia and Europe. The Asian supply chain focuses on manufacturing methods to increase profits and decrease costs, while the European supply chain uses “rapid reaction” for the unpredictable fashion items. Distribution is centralized through the company’s single major warehouse in Hamburg, Germany. A separate distribution center was established in all countries that have H&M operations, and merchandise is shipped daily to stores from these local DCs.¹²

H&M keeps local distribution centers relatively small by shipping all of its merchandise to Hamburg first. This lowers costs and also makes sure inventory holding costs are also reduced.

Currently, H&M stores are located in Western Europe, North America, and parts of the Middle East, North Africa, and Asia. Though there are general trends that one can find in each and every retail outlet, H&M prides itself on responding quickly and efficiently to local trends. It is able to do this through a complicated IT and logistics program, but also through simple marketing research methods such as street polls and in-store surveys. These simple research methods together with the complex IT and logistics programs H&M has created which remain a secret to the public allow H&M to record information on each retail store and transmit this information back to Germany and Sweden, where decision-making hubs are located. Here, decisions are made as to what fashions should be sold in what locations through collaborations between the design, marketing, sales, and management teams.

¹² Cheng, Edwin, and Tsan-Ming Choi. *Innovative Quick Response Programs in Logistics and Supply Chain Management*. Springer Heidelberg Dordrecht: London and New York, 2010. Page 14.

Finally, H&M is especially renowned for its collaborations with high-end designers. In 2004, H&M tested out this collaboration method with its flagship high-end design collaboration. H&M paired with Karl Lagerfeld to bring his designs into H&M stores worldwide. The collaboration was an instant success, and Lagerfeld's designs sold out within minutes in some H&M chains.¹³ After witnessing such rampant success, Jörgen Andersson, head of Brand and New Business was quoted as saying, "We've been operating this business for some 60 years and we've never seen anything like it."¹⁰ Subsequent designer collaborations have included Madonna, Roberto Cavalli, Stella McCartney, and Jimmy Choo. Through these collaborations, H&M makes these top designers more accessible, bringing their designs to the masses at comparatively affordable prices. In turn, H&M sees a boost in profit from these designers' higher-priced items.

IV. Growth Strategy

Today, H&M employs over 87,000 workers and has expanded to over 2,200 retail outlets in 40 countries worldwide.¹⁴ H&M's goal is to increase its total number of stores worldwide by 10-15% each year. H&M also aims to increase the profitability of each store each year.¹⁵ H&M has been able to accomplish this goal in the past few years, with a 12% gross increase in stores worldwide in 2005. However, H&M's current apprehension at entering markets below the equator means that soon, its markets will be completely saturated. H&M will have to look to new areas and new expansion methods to maintain and increase its current rate of growth.

¹³ Bohan, Olga. "Why Wearing H&M is Prestigious". Fashion Collector. <<http://fashioncollector.net/why-wearing-hm-is-prestigious/>>

¹⁴ "Our Employees". H&M. <http://www.hm.com/us/abouthm/factsaboutm/ouremployees__ouremployees.nhtml>

¹⁵ "H&M: Business Concept, Goals, and Strategy". Monster. <<http://company.monster.com/profiles/h--m.aspx>>

Currently, H&M's number one market is Germany, which makes up approximately 33% of H&M's total worldwide sales.¹⁶ In addition, the brand has been steadily growing in popularity in all of its markets. In its 2009-2010 annual report, H&M reported a 15% increase in sales worldwide. Karl-Johan Persson, CEO of H&M, reported that H&M plans to open approximately 250 new retail outlets worldwide in 2011, as well as establish a new presence in Romania, Croatia, Singapore, Morocco, and Jordan. In the past, H&M's growth has been entirely self-financed. From 2005-2010, H&M saw sales increase by 72% and earnings per share by 183%, so financing its own growth has not been an issue as of yet¹⁷.

As previously stated, Germany is H&M's principal market. Though H&M has continued to grow steadily over the past seven years, it has yet to enter into business in any countries located below the equator. There are many logistical reasons for this, including differences in seasons that translate into differences in clothing seasons, as well as geographic distance and transportation issues. This means, however, that large potential markets including Australia, New Zealand, South Africa, Brazil, Chile, and Argentina, just to name a few, have yet to be entered. Though the number of H&M outlets are quickly increasing in countries north of the equator, they are nonexistent in the other half of the world. H&M's growth strategy must take into consideration the fact that a time will come when southern growth is no longer an option, but a necessity.

¹⁶ "Germany: The World of H&M". H&M.

<http://www.hm.com/nl/abouthm/theworldofhm/europe/germany__worldofhm_countrycode_de.nhtml>

¹⁷ "Profile: H&M". Innovation Leaders. <http://www.innovationleaders.net/hm_company_profile.html>

V. Latin American Expansion: Brazil

Brazil as an emerging economy

Currently, H&M does not have any retail outlets in Latin America, even in countries like Mexico that are located north of the equator. As such, Brazil is the perfect country for H&M to establish a preliminary Latin American presence, and test its potential to open up new markets south of the equator.

The South American market – and the Brazilian market, in particular – is expanding at a booming rate. H&M's top competitor, Spain's Inditex, has had a presence in Brazil since 1999, when it opened two Zara stores in Sao Paolo and one in Rio de Janeiro. Given Zara's twelve-year head start in the Brazilian market, H&M must move quickly and efficiently to catch up. As it stands, H&M cannot afford to simply pass on the opportunity to expand into Brazil; the Brazilian market is too lucrative, its population too fashion-conscious, and its potential for growth undeniable.

Benefits

Not only is Brazil one of the BRIC countries, but it is also the fifth largest country in the world in terms of population (~200 million people), and the tenth largest economy (in terms of GDP)¹⁸.

Moreover, Brazil did not suffer as severely as European or North American countries in the Great Recession, meaning its population has maintained its relative level of expendable income to a greater degree than its European or North American counterparts. By the end of 2009, Brazil's markets were relatively stable, and its economy was back on track, growing an estimated 7-7.5% in 2010¹⁹. Brazil

¹⁸ "Brazil". CIA World Factbook. <<https://www.cia.gov/library/publications/the-world-factbook/geos/br.html>>

¹⁹ "Analysts and government forecast Brazilian economy set to expand 7.3% in 2010". MercoPress. <<http://en.mercopress.com/2010/09/07/analysts-and-government-forecast-brazilian-economy-set-to-expand-7.3-in-2010>>

is also relatively politically stable compared to other South American countries, meaning it is a good country to test out the Latin American market.

As previously stated, H&M's top competitor, Spain's Inditex, has had a presence in Brazil since 1999²⁰. Zara now has 34 stores throughout Brazil, meaning they have a well-established presence in the country. Many other retail companies have seen the growth potential Brazil offers, and have already moved their chains down to metropolitan centers such as Sao Paulo, Rio de Janeiro, Salvador, Recife, and Belo Horizonte, to name a few.

Drawbacks

Brazilians show a "strong preference" for local brands²¹. This means H&M would face tough local competition. Brazilians have a very unique sense of style, and many times, local Brazilian designers are the only ones who know how to really access and cater to this style. In particular, strong preference for local brands makes it difficult for large, multinational retail lines like H&M to be successful, because they are catering to a much larger, general, international customer. In Brazil, many corporations fail because they lack the foresight to do adequate market research on their local Brazilian customers. Though local brands and unique style preferences has been the downfall of foreign retail lines in the past, this does not mean H&M will to fail in the Brazilian market. Again, Zara has seen success in the Brazilian market. If H&M's top international competitor can be successful in the Brazilian market, odds are H&M can find a way to accomplish this as well.

²⁰ "Zara opens its first stores in Brazil". Zara Press Releases.
<http://www.inditex.es/en/press/press_releases/extend/00000085>

²¹ "How Half the World Shops: Apparel in Brazil, China, and India". The McKinsey Quarterly.
<http://www.mckinseyquarterly.com/article_print.aspx?L2=20&L3=73&ar=2075>

Another drawback is the custom of personal interactions and relationships required to find success in the Brazilian business sector. In general, Brazilian business is largely based on personal relationships, making it difficult for foreign companies to successfully enter into the Brazilian market without local support. Many times, it is advisable to seek out local assistance through franchising or other types of joint ventures in order to ensure success in the Brazilian market.

Upon entering the Brazilian market, H&M will face tough competition from local brands such as Riachuelo, a clothing store virtually unheard of outside Brazil, but with a large market share nationally. The US Commercial Service recommends that foreign companies attempting to set up a business in Brazil meet “one-on-one” with Brazilian partners. USCS goes on to write that, “It is essential that a U.S. business entering the market work through a qualified agent or distributor. Some firms establish an office or joint venture in Brazil”. Though H&M is a Swedish company, it would be advisable for them to follow an approach similar to the one outlined by the USCS.

Brazil also has confusing and, at times, virtually unintelligible laws related to conducting business. Furthermore, Brazil was ranked 127 out of 183 countries in terms of ease of conducting business within the country, meaning it is easier to conduct business almost anywhere else in the world. One example of this lack of ease when conducting business is the amount of time it takes to establish a business. In Brazil, it takes approximately 120 days to form a business. This means at least three months of preparations are needed to obtain a valid Brazilian business license. This is, of course, in addition to searching for real estate, hiring employees, marketing, setting up the store(s), and making all the other arrangements associated with opening and creating a business. Compare that to

an average of 6 days to obtain a valid business license in the United States, and one begins to realize the reasons behind foreign entities' apprehension when looking to establish markets in Brazil.²²

Finally, apart from local brands and difficulties upon entering the Brazilian market as an international corporation, H&M will face competition from other international brands, such as its main competitor worldwide: Zara. Since Zara entered the Brazilian market in 1999, it already has an established market and brand following that will be difficult to compete with. Other companies such as Ralph Lauren, Billabong, and Lacoste have already entered into the Brazilian market. Though it is a difficult step to take, H&M must take it in order to remain competitive internationally.

VI. Starting in Brazil: Sao Paulo and Iguatemi Shopping

Though there are many large cities in Brazil with vast potential consumer markets, Sao Paulo is H&M's best choice for starting up operations. Not only is Sao Paulo Brazil's largest city (pop. 20 million as of 2009²³), but it is also home to Brazil's fashion week, where well-known designers from all over the world come to showcase their newest fashion trends. Because of this, Sao Paulo is known for its attention to current fashion trends, as well as its fashion-conscious population. H&M's low-cost fashion model would be a viable addition to the already fashion-minded Sao Paulo public.

In addition to hosting fashion week each year, Sao Paulo is home to many up-and-coming "bairros", or neighborhoods. As far as fashion is concerned, the best bairros are Vila Madalena Jardim Paulista, and Itaim. The exclusive Rua Freire, which is similar to the United States' Rodeo Drive, is another luxury shopping locale. For H&M's flagship Brazilian store, Itaim is an ideal locale.

²² "Doing Business in Brazil". World Bank. <<http://www.doingbusiness.org/data/exploreconomies/brazil>>

²³ Cia World Factbook.

Not only is Itaim home to exclusive shopping centers, but its residents are also some of the most affluent Brazilians. On average, the Itaim surrounding area boasts an annual per capita income of \$8,320 annually, more than double that of most Brazilians (2007 est.). Sao Paulo in general is home to a concentrated population of affluent Brazilians. In 2007, it was estimated that Sao Paulo residents alone accounted for 35-40% of Brazil's total GDP²⁴.

Itaim and the surrounding shopping centers, then, are located in the center of concentrated Brazilian affluence. Iguatemi Shopping, the oldest and most renowned mall in Sao Paulo, is located just around the corner in the Jardim Paulista bairro. As Sao Paulo Cushman and Wakefield representative Paul Weeks writes, "Iguatemi is not only well located but was also the first shopping mall built in Brazil [est. 1966]...It's where wealthy Brazilians have traditionally shopped"¹¹. Because of Iguatemi's continued success as a luxury shopping mall, Iguatemi Group has opened up various malls throughout Brazil under the Iguatemi name.

Unfortunately for H&M, Iguatemi Shopping and other Iguatemi Group malls only have a set amount of retail space, and that could mean years of waiting for space to open up. Luckily for H&M, Iguatemi Group is planning the opening of a new Iguatemi shopping mall, JK Iguatemi, in 2011. JK Iguatemi is currently under construction in the Itaim district, located less than three miles away from the flagship Iguatemi Shopping mall, and in the heart of Sao Paulo affluence²⁵. This means H&M has the opportunity to bid on retail area in a mall that has not yet opened, but still carries the lucrative Iguatemi name. Because the Iguatemi name is already associated with high quality and

²⁴ "Iguatemi Polishes its Status as Brazil's Bastion of Luxury". Shopping Centers Today.
<http://www.icsc.org/srch/sct/sct0505/atg_8.php>

²⁵ "JK Iguatemi". <<http://www.jkiguatemi.com.br/en/?>>

service, H&M can expect to pay top of the line prices for floor space, even in JK Iguatemi. The payoff for H&M, however, is the positive and upscale name association Sao Paulo residents already have with Iguatemi. This tradition of shopping at Iguatemi means that if H&M were to choose Iguatemi as its starting point in Brazil, it would be guaranteed a large amount of shoppers passing by its store on a daily basis.

VII. JK Iguatemi: High-End Retail

Priced at over \$350/sq foot, retail space in Iguatemi Shopping is competitive, yet reserved for the world's most exclusive brands²⁶. Since there are already 290 established stores in Iguatemi Shopping, going for a larger floor space would raise customer awareness and ensure that H&M's opening in Iguatemi would not go unnoticed. Understandably, Iguatemi Shopping is a mall, and therefore has limited space. Luckily, JK Iguatemi provides H&M with a new chance to bid for mall floorspace.

H&M can expect to pay similar prices for floor space in JK Iguatemi, since it is located in the same area and is targeted toward the same shoppers. H&M's top international competitor Zara already has a retail outlet in Iguatemi Shopping, measuring approximately 16,000 square feet¹¹. Given H&M's propensity for large stores and massive floor spaces, H&M can expect to bid for a similar-sized store in JK Iguatemi. At \$350/sq foot, a store of this size would cost approximately \$5.7 million annually.

²⁶ "Toronto Retail Report 4Q09". Cushman and Wakefield.
<www.cushwake.com/cwmbs4q09/PDF/retail_toronto_4q09.pdf>

VIII. H&M in Brazil: Enter Market Directly or Franchise?

Franchising in Brazil: Overview

Setting up a franchise

Brazil is one of the largest franchising markets in the world. As of 2008, there were over 1,000 franchise networks with more than 62,500 outlets nationally. In 2009 alone, around 14,400 new franchise outlets were opened in Brazil, bringing the national total to 149,000, with a total turnover of 128 billion USD²⁷. Because of this, there are many franchise laws set up to protect both the franchisor and franchisee. Unfortunately, this also means that setting up a franchise in Brazil is particularly complex. Article 2 of the Brazilian Franchise Law defines a franchise as follows:

A system whereby a franchisor licenses to the franchisee the right to use a trademark or patent, along with the right to distribute products on an exclusive or semi-exclusive basis and, possibly, also the right to use technology related to the establishment and management of a business or operating system developed or used by the franchisor, in exchange for direct or indirect compensation without, however, being characterized as an employment relationship.

Given the large number of franchises in Brazil, it only makes sense that franchising laws are extremely well defined and strict. However, by partnering with a local franchisee, H&M can use its partner's local knowledge to avoid misinterpreting these laws – something that could end up with costly penalties and fees.

When it comes to any business relationship in Brazil, “due diligence” is particularly important. This means financial and legal verifications of potential Brazilian partner companies. Investigating tax

²⁷ “Brazil is Number 3 in Franchises With Revenues of US\$135 Bi in 2010”. BrazzilMag. <
<http://www.brazzilmag.com/component/content/article/82-february-2010/11811-brazil-is-worlds-number-3-in-franchises-with-revenues-of-us-135-bi-in-2010.html>>

liabilities and labor law liabilities is particularly important in Brazil. As Brazilian business expert Robert Eugene DiPaolo writes, “These areas in particular can be traps for those with limited experience doing business in Brazil, where the sheer number taxes can be mind boggling and the labor laws can seem, at least to someone more accustomed to the ‘at will’ employment regime in the U.S., onerous and counterproductive”²⁸.

Benefits

As one of the largest franchise markets worldwide, Brazil has many local franchisees and well-established franchising laws. Also, franchising means H&M would not have to deal with day-to-day business practices in Brazil, particularly since H&M. Franchising is also an attractive option for H&M is not familiar with Brazilian business practices. After finding a dependable franchisee, H&M could rely on them to finalize an agreement for JK Iguatemi retail space.

Franchising H&M in Brazil also relieves much of the risk of entering a new market. Once a price is agreed upon, the franchisee takes care of the brunt of the business. Also, H&M would profit based on the franchisee’s gross sales, and not their net profit.

Drawbacks

Franchising is never certain. Because so much power is given to the franchisee to make decisions, manage the enterprise, and conduct day-to-day business activities, it is primarily up to them to ensure the success of the business. This means that H&M would not only have to find a reliable franchisee, but also be sure to conduct its due diligence before entering into a franchise agreement.

²⁸ “Acquisitions, Investments, and Joint Ventures”. Brazil Max.
<<http://www.brazilmax.com/columnist.cfm/idcolumn/105>>

Also, H&M would have to surrender much of its power over its brand and company upon entering into a franchise relationship.

In Brazil in particular, the franchise business is booming, which has led to strict regulations and franchise laws. While this may seem like a “pro” to franchising in Brazil, it also means H&M would have to deal with lengthy, confusing laws pertaining to starting up and maintaining a franchise.

Direct Entrance into Brazil: Overview

Directly entering into the Brazilian market is also a possibility for H&M. In fact, Zara decided to directly enter into Brazil in 1999 without the aid of local partnerships²⁹. This shows that, while difficult, directly entering the Brazilian market is not only possible, but can also be profitable.

Benefits

When compared to franchising, entering into a joint venture would provide H&M with more decision-making power in Brazil. A joint venture would also increase H&M’s ability to deal with Brazilian culture and business practices, as their partner company would be well versed in both. H&M would also be able to share the risk associated with entering a new market with its business partner.

H&M would also be able to retain 100 percent of its profits. This is one of the biggest benefits of entering the Brazilian market directly. Similarly, H&M would not have to deal with lengthy franchise contracts, laws, and regulations. H&M would also be able to avoid the long due diligence

²⁹ “Internationalization of Spanish Fashion Brand Zara”. Brunel Business School. <
www.nihul.biu.ac.il/_Uploads/dbsAttachedFiles/Zara.pdf

process, including hiring an independent firm to conduct checks on a company and verifying tax and labor compliance.

Drawbacks

It is generally not advisable to enter directly into the Brazilian market. Though Zara has seen success with this model, it can be difficult for foreign firms, since Brazilian bureaucracy and business practices are oftentimes confusing and unclear. Similarly, Brazilian business is based largely around social interaction, meaning a foreign company with no previous history in Brazil would have a hard time establishing itself without local support.

Another drawback to direct market entrance is the potential culture clash. Though H&M could hire people locally, the Swedish business model and culture may not be translatable to standard Brazilian business culture. This could be disastrous, even if H&M were ultimately successful at marketing their product. If nobody wants to work for H&M, their reputation will suffer in Brazil.

IX. Strategic Recommendations

Upon entering the Brazilian apparel market, H&M will have to make a few decisions, including whether it wants to enter the market directly, or through franchising. As previously stated, it is nearly impossible to enter the Brazilian market without some sort of national support. However, setting up H&M stores as franchises would mean local owners – who have a better knowledge of the Brazilian market and what consumers are looking for – would have more power when making important decisions.

Enter the Brazilian Market through Franchise

Though franchising means giving up some decision-making power, profits, and control, franchising is still H&M's best option when entering the Brazilian market. Because H&M has no experience operating in Latin America, franchising is a way to decrease H&M's risk and reduce cultural clashes. Also, because of the geographic distance, franchising H&M means managers and franchisees can deal with most problems on a local level.

Because of problems that could arise in the future, H&M should make sure to write a clear and exhaustive franchise agreement. H&M should also check and re-check their Brazilian franchisee to make sure there are no hidden legal liabilities involved in entering into business with said franchisee.

Produce Seasonally Appropriate Clothing in Central American Plant

In the past, H&M has been discouraged from entering into any markets below the equator due to seasonal differences and supply-chain logistics. However, as previously mentioned, H&M has suppliers and production offices in Central America. Though seasonal differences are still an issue in terms of timing production, this problem could be resolved by switching production to meet Brazilian seasonal needs at one or two Central American plants. This may be costly to begin with, but if H&M is looking to expand to other countries in the southern hemisphere such as Australia, New Zealand, South Africa, Argentina, or Chile, for example, they need to start seasonal production for these countries at some point.

In the future, H&M should look into subcontracting with more plants in South America, as Brazil becomes a bigger market. As a test run, however, switching over production in an already-existing

Central American subcontractor plant is the best option. This way, H&M does not have to invest many resources into R&D, searching out new subcontractors, and refining logistics in terms of production for Brazil before it determines whether or not the endeavor will be successful.

Bid for Retail Space in JK Iguatemi

H&M's franchisee should move quickly to secure a spot in the up-and-coming JK Iguatemi mall. Though prices per square foot have not been published for the new Iguatemi shopping mall, H&M's franchisee can expect to pay similar prices in JK Iguatemi as those previously published for Iguatemi Shopping. This could mean lengthy negotiations between H&M and franchisee, but ultimately, H&M should work to establish itself in Brazil alongside the Iguatemi name. H&M can guarantee compliance on this issue by writing it into the original franchise agreement.

By securing a spot in JK Iguatemi, H&M is, in effect, securing its success in Brazil. As a newcomer to the Brazilian fashion scene, opening a flagship store in JK Iguatemi mall means high shopper saturation as well as association with an established, high-quality Brazilian name.

Partner with a Brazilian designer

Since Brazilians are so keen on Brazilian fashion and current Brazilian trends, partnering with a local designer only makes sense for H&M. Given H&M's history of partnering with top-name designers from all over the world (Jimmy Choo, Roberto Cavalli, Karl Lagerfeld, for example), it already has the tradition and know-how to succeed in these partnerships. Not only will partnering with a Brazil designer introduce Brazilian-inspired clothing into H&M's flagship Iguatemi store, but these designs can be sold all over the world in all of H&M's retail outlets and international markets.

This would also help temper financial risk by launching an economically viable product line into all of H&M's stores.

X. Conclusions

Upon entering the Brazilian market, H&M must remain aware of various cultural and business differences. Because of the confusing legislation and amount of time it takes to start up a business in Brazil, it only makes sense to partner with a local franchisee who has a general knowledge of Brazilian business practices. In this way, the H&M and its future franchisee can work together to establish H&M in Brazil smoothly and efficiently. Though there are drawbacks to franchising, Brazilian business laws are so complicated that having local support is one of the keys to success. Also, since business relationships are largely based on personal relationships, having a local Brazilian partner will make it easier for H&M to gain credibility. Furthermore, a local franchisee can represent H&M in local business negotiations. These personal business relationships are especially important when looking to bid for retail space in JK Iguatemi.

In order to ensure H&M's continued profitability in the Brazilian market, H&M should partner with local high-end designers, and also use Brazilian fashion models in its print advertisements. H&M should use its production facilities already located in Latin America to produce a test run of seasonally appropriate clothing for Brazil. Of course, if business takes off in Brazil H&M will have to look into investing into a new partnership with a Brazilian plant.

H&M has the potential to turn significant profits in Brazil. By partnering with a local Brazilian franchising company and using in Latin American production plants already in partnerships with

H&M, H&M can limit its risks up front. Though H&M is not guaranteed to be an instant sensation in the Brazilian market, implementing these four strategic recommendations will greatly increase its likelihood of success.

XI. APPENDICES**Appendix 1: H&M Five-year summary**

	2009/10	2008/09	2007/08	2006/07	2005/06
Sales including VAT, SEK m	126,966	118,697	104,041	92 123	80 081
Sales excluding VAT, SEK m	108,483	101,393	88,532	78 346	68 400
Change from previous year, %	7	15	13	15	12
Operating profit, SEK m	24,659	21,644	20,138	18 382	15 298
Operating margin, %	22.7	21.3	22.7	23.5	22.4
Depreciation for the year, SEK m	3,061	2,830	2,202	1 814	1 624
Profit after financial items, SEK m	25,008	22,103	21,190	19 170	15 808
Profit after tax, SEK m	18,681	16,384	15,294	13 588	10 797
Number of shares, thousands *	1,655,072	1,655,072	1,655,072	1,655,072	1,655,072
Earnings per share, SEK *	11.29	9.90	9.24	8.21	6.52
Liquid funds and short-term investments, SEK m	24,858	22,025	22,726	20 964	18 625
Stock-in-trade, SEK m	11,487	10,240	8,500	7 969	7 220
Equity, SEK m	44,172	40,613	36,950	32 093	27 779
Shareholders' equity per share, SEK *	26.69	24.54	22.33	19.39	16.8
Return on shareholders' equity, %	44.1	42.2	44.3	45.4	40.2
Return on capital employed, %	58.7	56.7	61.1	63.7	58.7
Share of risk-bearing capital, %	76.2	78.5	75.7	78.5	80.0
Equity/assets ratio*, %	74.6	74.7	72.1	76.9	78.1
Number of stores	2,206	1,988	1,738	1 522	1 345
Average number of employees	59,440	53,476	53,430	47 029	40 368

Appendix 2: H&M SWOT Analysis

Strengths	Weaknesses
<ul style="list-style-type: none"> • Fast fashion retailing will increase the appeal for H&M products, increasing inventory turnovers and enabling low markdowns • Presence in complementary business processes increases control and flexibility • Wide geographical presence increases addressable market 	<ul style="list-style-type: none"> • Target customer base is negatively impacted by macroeconomic conditions • Weak competitive position as the prominence of value retailers and premium luxury brands increases
Opportunities	Threats
<ul style="list-style-type: none"> • Significant opportunities in online arena • Potential to expand business to new locales: Brazil, Jordan, Morocco, etc. • Emerging economies will support H&M's expansion plans • H&M well positioned to tap into the organic apparel niche market 	<ul style="list-style-type: none"> • Unemployment continues to pressurize discretionary spending • High input costs will pressurize margins • Decelerating homewares market in Europe will impact sales adversely from the newest business line • Competition from similar brands such as Zara.

Adapted from *Datamonitor* report on H&M: 18 June 2010.

Appendix 3: JK Iguatemi “Technical Sheet”

Location	Av. Juscelino Kubitschek, 2041 and 2235 x Av. Nações Unidas, 10631 Av Chedid Jafet
Gross Leasable Area	36,000 m ²
Gross Building Area	116,048.22 m ² (source: city permit of March 4, 2009)
Total Area	61,055.85 m ² (source: city permit of March 4, 2009)
Number of Floors	4 floors of stores and 3 floors of parking for the mall
Number of Parking Spaces	2,000 spaces for the mall
Spaces for people with special needs	58 spaces
Spaces for Motorcycles	105 spaces
Anchor stores	4 stores
Semi-Anchor	5 stores
Megastores	11 stores
Satellite Store	170 stores
Food Court	12 operations
Restaurants	9 restaurants
Movie Theaters	Nine premium movie rooms
Theaters	1 room
Children’s Park	1
Events	1
Escalators	6
Social Elevators	6
Service Elevators	4
Emergency Stairway	23
Social Female WC	5
Social Male WC	5
Family WC	2
Male WC for Employees	2
Female WC for Employees	2

Baby Care Center	1
Ambulatory	1
Forecasted Daily Average Flow	20.000 thousand people
Forecasted Annual Flow	7,2 million people
Entrepreneurs	Iguatemi Empresa de Shopping Centers S.A. WTorre Properties S.A
Commercialization	Leasing Mall
Architecture Project	Arquitectonica
Execution	WTorre Engenharia e Construção S.A.

Source: <http://www.jkiguatemi.com.br/en/>

Map of São Paulo, Brazil, showing the location of Parque Municipal Mário Pimenta C. A red pin marks the park's location near the Coliseu and Itaim Bibi neighborhoods. The map includes major roads like SP-270 and Av. São Gabriel, and other landmarks like Parque Alfredo Volpi and Moema.

Appendix 6: Doing Business in Brazil: 2011

Metric	Rank
Ease of Doing Business	127
Starting a Business	128
Dealing with Construction Permits	112
Registering Property	122
Getting Credit	89
Protecting Investors	74
Paying Taxes	152
Trading Across Borders	114
Enforcing Contracts	98
Closing a Business	132

Ranking: out of 183 Countries

Source: World Bank: <http://www.doingbusiness.org/data/exploreeconomies/brazil>

Appendix 7: Sao Paulo Fashion Trends (on the Street)



<http://street-fashion.net/sao-paulo-brazil/>; <http://obviousmag.com/wp-content/uploads/2010/07/Sao-Paulo.jpg>;
<http://www.patriarchrecordings.com/imagesblog/august/sao1.jpg>; http://www.elle.com/var/ezflow_site/storage/images/sandbox/rio-de-janeiro/3/3022888-1-eng-US/3.jpg; http://farm5.static.flickr.com/4006/4682421547_c6a7ee9ac9.jpg

Appendix 8: Current H&M Fashion Trends



http://1.bp.blogspot.com/_VnxRi9tzzEE/TDc8XS7etEI/AAAAAAAAAP8/ZezAF5I3q1M/s1600/hm-lookbook-spring20091.jpg
<http://shop.hm.com/de/start>