H&M Brazil Company Readiness Report

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Executive Summary

We have developed this document to showcase our understanding of the profit potential in Fortaleza and suggest a single store expansion into the RioMar shopping mall. This document will present our recommendations for expansion and a comprehensive overview of the research that led our team to this conclusion. Our Global Expansion team completed an extensive look into the company's preparedness to enter the market. This preparedness consists of two main parts: 1) motivational preparedness and 2) organizational preparedness. Motivational preparedness highlights attractive market, competitive threat, and stakeholder push; while organizational preparedness focuses on the operational, managerial, and financial preparedness of our company. Upon the completion of this document, the H&M C-suite should have the necessary information to understand the decision made by our team.

By 2020, the Brazilian fashion segment is expected to grow by 48%. Within the Brazilian fashion industry, “apparel” is the largest and fastest-growing segment with a market volume of $4,721 million. This is more than double the market volume of footwear, accessories, or any other market segmentation. With Fortaleza’s large population and fast-growing middle class, our company sees an attractive market within Fortaleza. Our low-pricing, relationship-based commerce style, and company values set us up to be successful in this market.

Zara and Forever 21 are among the top fashion companies in Brazil and our two top competitors. Zara is the most relevant competitive threat to our Fortaleza location due to its presence in the RioMar mall. Zara's prices range from R$19.00 to R$1223.60, and the average price point is R$182.4. While H&M prices typically range from R$3.80 to R$1105.80 with an average price point of R$81.32 (Smith, 2016). Furthermore, Forever 21 price points are higher than both brands. Our high product quality coupled with our low prices will give us a competitive advantage in this market.

The most influential stakeholders for the expansion into the Fortaleza market are communities, investors, and policymakers. In order to reach communities, H&M will recreate the art of shopping through e-commerce and the integration of smart devices such as iPads and smart mirrors inside the store. In terms of investors, our initial investment will be recovered in the 13th month of operations. The evidential success of e-commerce in India, as well the continuous increase in e-commerce growth, will mitigate any concerns our investors may have with expansion into Fortaleza. Finally, for policymakers, it is important to understand how the upcoming election in October poses a potential threat to shift Brazil towards protectionism. This is important to consider when proposing market entry.

Significant operational concerns when entering Fortaleza include shifts within the Brazilian fashion industry and the fragility of our sustainable reputation. As an expansive and global company, H&M’s ability to integrate into different cultures serves as a vital asset for worldwide success in the industry. With over 4,550 stores worldwide, this reassures our flexibility with the derived demand and required inventory for the desired country of entry (Supplier List, 2018).

In terms of managerial preparedness, maintaining the structure of our company values is extremely crucial in our store's expansion to Fortaleza. With 25 employees getting paid R$1,500 per month, and with an 80% employee tax going to the government, total employee payroll will be R$810,000 per year (H&M Group, 2018). Our employees will also receive discounts on our merchandise and receive sales commission bonuses at the end of each month. Moving forward, another key point of emphasis for managerial team is to look at other global H&M expansions over the world to ensure that management is liaising with the goals of our head office.

The initial investment to get an H&M store up and running in the RioMar mall in Fortaleza will be R$1,504,000. This initial investment includes: inventory costs, employee payroll for the first month, and all costs of technology that our store will require. A breakdown of our projected financials in the first year is as follows: Sales R$19,500,000, COGS R$9,392,000, selling and administrative expenses R$8,392,000, Operating Profit R$1,716,000, Other tax Expense R$10,000, and Profit R$1,706,000. Our profit margin is projected to be around 8%. In thoroughly analyzing the financial evidence, it is clear our company exhibits financial preparedness.

A further analysis of our motivational and organizational preparedness for market entry in to the Fortaleza market is featured below.

Motivational Preparedness

Our team has assessed motivational preparedness in terms of three main criteria: attractive market, competitive threat, and stakeholder push. Within attractive market, we analyze the current market volume of the fashion industry and demographics of Fortaleza that make entry ideal. In competitive threat, we examine our two main competitors (Zara and Forever 21) and what factors contribute to our competitive advantage. Finally, within stakeholder push, we address our primary stakeholders, the effect our entry into the market will have on them, and our strategy for ensuring their support of our expansion.

Attractive Market

As our company has seen through our vast global reach, the fashion industry is one of continuous growth and opportunity for profit. This is especially true in Brazil. By 2020, the Brazilian fashion segment is expected to grow by 48% as Brazil increases in value by 0.8% within the next five years (Fashion, 2018). Within the Brazilian fashion industry, "apparel" is the largest and fastest-growing segment with a market volume of $4,721 million. This is more than double the market volume of footwear, accessories, or any other market segmentation. Additionally, the market volume of the e-commerce segment within the fashion industry is expected to triple by 2022 (Fashion, 2018). These ideal conditions indicate a profitable market entry in Brazil.

More specifically, we plan to open our flagship store in the RioMar mall in Fortaleza, Brazil. We are confident that Fortaleza is the perfect city for initial market entry. With a population of 2.5 million, Fortaleza is the fifth largest city in Brazil and offers a plethora of potential customers (Lima, 2014). Although 47.2% of the population falls into the lower class, Fortaleza boasts a more fast-paced growing middle class than most other cities of its size (Ness, 2016). This ever-increasing middle class increases the discretionary income available within the city and offers more availability for profit than many other Brazilian cities.

The target demographic of our Fortaleza location reflects that of the average target demographic for our stores worldwide. Therefore, our demographic is men and women in the middle-class from ages 15 to 35 with a slightly greater emphasis on females due to higher predicted demand. Because 62% of Brazilians are under the age of 29 and the Fortaleza population is 54% female and 46% male, we believe this an attainable target market (Lima et al., 2014).

According to an article from Boston Consulting Group, "Almost three out of every four respondents in Brazil agreed that they're increasingly looking for ways to save money" (Donatelli et al., 2016). While Brazilian shoppers tend to remain loyal to their favorite brands, they will alter their shopping behaviors if they discover a less expensive brand that satisfies their needs. Considering that H&M offers high-quality products at lower price points than their competitors, there is an opportunity for attraction and brand loyalty to our company.

The Brazilian culture revolves around interpersonal relationships, and we plan to nurture these relationships by creating a one-of-a-kind in-store experience for our shoppers. Our Fortaleza store will be the most high-tech of our stores with smart mirrors that allow you to try on clothes as holograms and iPads that serve as personal stylists for each shopper. These innovations cater to the Brazilian relationship-based culture as every trip to our store will be a personalized experience for every shopper.

Brazilian identity is based on economic standing and not racial standing, which directly aligns with our company values. H&M strives in fairness, diversity, equality and the same ambition to lead the change towards a sustainable fashion and design industry (H&M Group, 2018). Therefore, merging our vision for sustainability and inclusiveness in the local market will be our competitive edge towards our competitors.

Competitive Threat

Zara and Forever 21 are among the top fast fashion companies in Brazil. These stores have been successful in Fortaleza because of the high demand for American brands. From a survey conducted at the RioMar mall, locals stated that Forever 21 and Zara are very popular among teens. The locals mentioned that although both stores are priced pretty high, they are still willing to buy from them due to popularity and high quality from the United States. The U.S. is known to be very influential to the teenage population worldwide. For this reason, H&M will be able to compete against its competitors in Brazil because teens will be able to shop at an American store with affordable prices.

Zara is the most relevant competitive threat to our Fortaleza location due to its presence in the RioMar mall. Zara and H&M are the world's two largest retailers. H&M has a strong and diversified presence geographically across the globe which enables the company to minimize business risks. Due to the country's economic downturn, a large number of Brazilians are abandoning higher-end brands in search of more affordable options. Even with the economic downturn, some Brazilians are still attached to foreign products due to it being a sign of wealth.

In comparison to H&M, Zara is consistently priced higher. Zara's prices range from R$19.00 to R$1223.60, and the average price point is R$182.4 (Smith, 2016). Many of their products are endorsed by fashion insiders which makes them attractive to consumers looking for an individual style. However, they generally have low replenishment rates and only 3.2% of their store is discounted online (Smith, 2016). Although Zara is known for high-quality products, their prices may steer away consumers in the Fortaleza market.

We see this same issue with Forever 21. While Forever 21 is generally cheaper than H&M and Zara, it is priced more expensively in Brazil than in the United States. Because of this, we see average prices that rival those of Zara. While the Forever 21 prices rival those of Zara, the quality does not. This makes them a more expensive, lower quality option and gives us the competitive advantage.

H&M is known for having good quality and affordable clothing. Prices typically range from R$3.80 to R$1105.80 with an average price point of R$81.32 (Smith, 2016). H&M has high replenishment rates, 24.2% of the store discounted online, and collaborations with designers and celebrities to create products (Smith, 2016). These qualities make H&M stand out in the retail industry. Therefore, being priced lower than our competitors puts us at an advantage and allows us to gain more customers.

Stakeholder Push

We have identified the most influential stakeholders for the expansion into the Fortaleza market: communities, investors, and policymakers. Because of our adaptation to retail's technological shift, Brazil's specific culture, and the consistent global success of our brand, we are confident the majority of our stakeholders will push us to move to Brazil. However, we are prepared to combat the resistance of the few who may be hesitant, and have developed unique strategies to address the concerns of each our primary stakeholders.

Communities

H&M thoroughly works toward long-lasting positive change in our communities by following three main principles: innovation, involvement, and impact. As the world continues to become more technologically advanced, reaching our consumers through innovative methods is vital to company success. H&M will recreate the art of shopping through e-commerce and the integration of smart devices such as iPads and smart mirrors inside the store. This integration of technology will keep our consumers engaged by enhancing the brand experience.

As one of the world's leading retailers, it is essential for H&M to have a positive impact on our communities, especially in Fortaleza. Brazilians are passionate about sustainability and protecting the Earth's environment. Fortunately, H&M remains sustainable by sourcing materials that are naturally grown, cultivated and created using renewable processes. We have strict requirements to purchase 100% sustainable cotton, and our goal is to have 100% of our wool products certified by the Responsible Wool Standard (RWS) by 2022 (H&M Group, 2018). Our continued emphasis on community involvement is imperative for expansion into Brazil and increases support for our company.

Investors

In 2013, H&M was scheduled to expand into Brazil and open its first store by 2014. However, in August 2014, H&M cancelled the plan due to high expansion costs, an unsteady economy, bureaucracy, and infrastructure corruption (Picasso, 2015). Realizing this, we are implementing e-commerce with expansion into Fortaleza. H&M’s online store in India, launched in mid-March of this year, increased revenue by 21% in quarter two using e-commerce (Martins, 2018). Our Fortaleza store will follow a similar approach when entering the Fortaleza market.

The country's e-commerce market is booming. Brazil is one of the most promising online retail industries in the world and the largest economy in Latin America, generating more than R$50 billion in annual e-commerce sales (Pofahl, 2018). This is a captivating market opportunity for merchants that understand global expansion is the answer to long-term healthy growth. With profit margins projected to be about 8%, our initial investment will be recovered in the 13th month of operations. Beginning in the 14th month of operations, our profits will be distributed back to our shareholders in the form of dividends. The evidential success of e-commerce in India, as well the continuous increase in e-commerce growth, will mitigate any concerns our investors may have with expansion into Fortaleza.

Policymakers

With an upcoming election in October posing a potential threat to shift Brazil towards protectionism, there is uncertainty within the government, economic, and political climate in Fortaleza. Being a foreign company to Brazil, it is essential that we have the support of Brazilian policymakers for market entry. Shifts in protectionism policies put our company at risk for higher tariffs and more regulations. Furthermore, the corrupt tendencies of the Brazilian government pose a potential threat to our company brand. We cannot be seen as a company which aligns themselves with corrupt government officials; this could negatively impact our sales on a global scale.

Eduardo Guardi, Brazil's current finance chief, stated that Brazil is currently not in favor of the idea of protectionism because of the limited long-term benefits (Amaro, 2018). Although this idea is in H&Ms favor now, it could be altered due to the election. The current election projections indicate a likelihood of Brazil's continued movement away from protectionism. However, we will need to be prepared if this is not the case. Our company intends to market our inclusivity of Brazilian culture, a creation of jobs, expansion of Fortaleza economy, and respect for sustainability to each of the presidential candidates. Being transparent about our goals within Brazil and our desire to create a relationship with their country will lessen potential concern from Brazilian policymakers.

Organizational Preparedness

When assessing organization preparedness, our team looked at three main divisions: operational, managerial, and financial. The operational preparedness of our company addresses adaptation, sustainability, and sourcing. Managerial preparedness discusses the structure of our management both in our new Fortaleza location as well as the payroll and benefits of our new employees. Finally, the financial preparedness of our company addresses our company's financial ability to extend abroad, the specifics of the costs of expanding abroad, and the potential gain in profit available from this expansion.

Operational

Significant concerns when entering Fortaleza include shifts within the Brazilian fashion industry and the fragility of our sustainable reputation. Due to unforeseen changes in consumer demand or infractures within our method of processing, we know our recognized brand and devotion for global change will ensure that our supply chain will work within Fortaleza.

Adaptation

As an expansive and global company, H&M's ability to integrate into different cultures serves as a vital asset for worldwide success in the industry. With over 4,550 stores worldwide, this reassures our flexibility with the derived demand and required inventory for the desired country of entry (Supplier List, 2018). Determination and resilience for a new market push H&M to adapt quickly to consumer behavior and instantaneous trends in fashion; an obstacle that has previously been overcome. Our essence to enhance fashion's ambiguity on an international level sets us apart from the competition.

Sustainability

We are accredited for our support of the ideology of sustainability. Using new recycling technology in factories, our company's supply chain is circular and renewable, rather than linear. For instance, our company emphasizes the importance of finding new solutions for substitutes for fibers. These solutions reduce the harmful chemical process of raw materials and conservatively allocates resources for production (Sustainable Fashion, 2017). The fore-mentioned solution, in addition to H&M's many others, collaborates H&M's image of sustainability with the World Wide Fund for Nature, the world's leading conservation organization (Vision and Strategy, 2017). Considering Brazil's importance of preserving the Amazon Rainforest, our strategic focus centers around climate and water by evading fossil fuel emissions and water pollution from textile production.

Sourcing

To enter Fortaleza, our operation plan will consider all supply logistics and risk levels to thrive in the Brazilian environment. Looking at our disbursement of sourcing, we have four options of deriving our inventory: China, E.U, Morocco, and the United States (Value Chain, 2017). China is optimal, given that it is the least expensive option. Multiple factories are found in many European countries, such as Spain, France, England, and Sweden (Supplier List, 2018). These countries have already established a strong relationship with Brazil and the level of trade interventions would be reduced when importing our products. Geographically, Morocco is also the closest in distance to Brazil; the U.S can ultimately do the same with inter-sourced products to Latin American locations such as Chile, Peru and Columbia.

However, expense, fluidity, and distance will depend on the required processes for production. All factories will not be needed, since our merchandise require different and specific needs depending on the materials used: linen, cotton, polyester, wool, or silk. Tailoring more to products that we will offer into Fortaleza, we can maneuver around these loopholes to allocate the resources needed, to have the least amount of intermediaries and expenses.

Managerial

H&M focuses heavily on creating a workplace that is outgoing and positive while also being diverse and inclusive. Maintaining the structure of these values is extremely crucial in our store's expansion to Fortaleza, as Brazilian consumers are looking to buy from people that understand their own relationship-based values and culture. Our company plans to achieve this by targeting local Brazilian people to become our in-store managers and employees, so that our customers feel open to exploring their personal style.

We plan on recruiting workers who have past retail experience in their job careers and follow the same values and missions that H&M represents. In order to attract and target these specific employees, we plan on increasing our wages compared to our competitors in Fortaleza, while also offering other benefits. With 25 employees getting paid R$1,500 per month, and with an 80% employee tax going to the government, total employee payroll will be R$810,000 per year (H&M Group, 2018). Our employees will also receive discounts on our merchandise and receive sales commission bonuses at the end of each month. This will help to ensure employee retention and reduce costs associated with employee turnover. That being said, our newly recruited management team will play a crucial role in dictating our success and have a lot of responsibility within our expanding store.

Managerial goals include maximizing profitability, maintaining financial records, preparing the store for display, and overall being the day-to-day supervision of the store. Dealing with customer concerns and complaints is another role of the managerial position, and having employees who understand the culture here in Brazil will help grow our store's reputation. Moving forward, another key point of emphasis for managerial team is to look at other global H&M expansions over the world to ensure that management is liaising with the goals of our head office. H&M arrived in Chile in 2013 with an existing international reputation, which is why it has become the highest revenue-producing store H&M currently operates. Continuing this reputation in Brazil will make H&M successful in Fortaleza and future locations of expansion.

Financial

Our capital management goal at H&M is to enable growth and exploit business opportunities. The board of director's intent is to continue providing shareholders solid returns while allowing expansion and investing activities to proceed freely.

The initial investment to get an H&M store up and running in the RioMar mall in Fortaleza will be R$1,504,000. This initial investment includes: inventory costs, employee payroll for the first month, and all costs of technology that our store will require. To keep our store operational after the initial investment, our recurring costs will include employee payroll, insurance, rent, electricity, and costs related to maintaining inventory in our store. Insurance costs for our H&M store will be R$26,250 per year, and rent will be R$50,000 annually. This figure considers H&M bringing in consumers to the mall and in return, the mall giving our store a break on rent. Our electricity fee will be R$30,000 per year.

Our cost structure will primarily consist of fixed costs, which allow our profits to increase substantially when the Brazilian economy is thriving. However, when the economy begins to suffer, and fewer consumers are willing to spend their discretionary income on our product, our store will be impacted in our bottom line. This is a risk that we are willing to take because we are mitigating risk in other areas of our operation. For instance, we have a smaller store with less inventory compared to the average H&M store. In addition, we are not setting up a manufacturing plant locally as we do not want to take on that financial risk.

A breakdown of our projected financials in the first year is as follows: Sales R$19,500,000, COGS R$9,392,000, selling and administrative expenses R$8,392,000, Operating Profit R$1,716,000, Other tax Expense R$10,000, and Profit R$1,706,000. Our profit margin is projected to be around 8% (See figure 1A). As mentioned above in the stakeholder’s push, our initial investment will be recovered in the 13th month of operations (H&M Group, 2018). Our projected sales growth is 4% annually and by the year 2022, sales will be approaching R$27,000,000 (See figure 1B).

All of the projected figures from above were created using averages across all H&M stores globally. Since a large sample size exists, we assume this method to be reasonably accurate. When pricing our product for the Fortaleza market, H&M will need to come in at a price that is just under our direct competitors for our store to remain profitable. Our store is not meant to be an inexpensive brand or the “cheap” clothing store; rather our prices will still be relatively high for the consumer. Realizing that our target demographic is the middle class, we will implement a 2-month payment plan to allow our customers to pay off their purchases over weekly installments to make our products accessible to more people.

Conclusion

H&M aims to enter the Fortaleza market through an extensive application of motivation and organizational preparedness. Our store will be located in the RioMar shopping mall to easily reach our target demographic: middle-class men and women aged 15 to 35. By pricing products lower than our top competitors, Zara and Forever 21, consumers will have the opportunity to purchase high-quality fashion at an affordable price. This provides us a clear competitive advantage.

As today's generation continues to be drawn towards technological advancement, we will foster an enhanced shopping experience through e-commerce, iPads, and smart mirrors within our store. With an additional emphasis on sustainability in the Brazilian environment, H&M will strive towards sustainable sourcing of products to maintain support from our communities. Furthermore, the promising dividend returns for investors will secure their support. Understanding the impact of our policymakers, the risks associated with possible changes in protectionism, and are prepared to protect our company brand.

To ensure that our store succeeds in the Fortaleza market, we will follow the methods H&M has previously used to enter international markets. This can be achieved by fully adapting to the Brazilian culture, implementing recycling technology, and importing products from nearby countries with a strong relationship with Brazil (i.e. China and Morocco). Our company goal is to create a positive workplace that centers around relationship-based values for our employees through incomparable working benefits. Our H&M store in the RioMar shopping mall has a projected profit of R$1,706,000 and sales of R$27,000,000 by 2022.

For the reasons mentioned above, we propose that H&M pursue a one store expansion into Fortaleza and are confident in its success. After reviewing this report, the C-suite should have a comprehensive understanding of our reasoning and plan for introducing the H&M brand to the Fortaleza market.

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Appendix

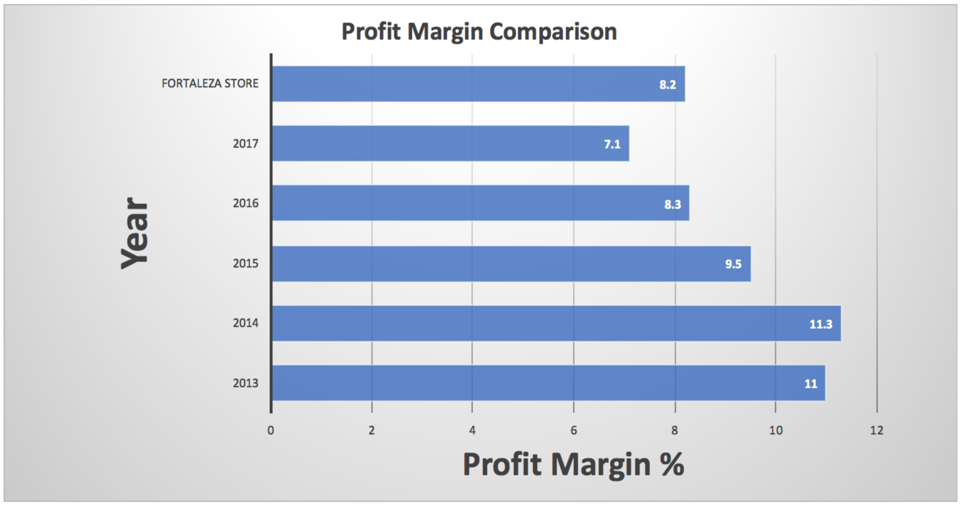

Figure 1A: The graph above depicts the profit margin comparison of our H&M store in Fortaleza to the average profit margin of H&M stores globally.

Figure 1B: The graph above forecasts the five-year projected sales of our H&M store upon entering the Fortaleza market.