EMCC case studies

Industrial change in the textiles and leather sector: Hennes & Mauritz

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Hennes & Mauritz (H&M) is well known throughout Europe as a highly successful company selling low-priced fashion clothing and accessories. Erling Persson established the company in Sweden in 1947, and today the Persson family is still on the company board. In recent years, Hennes & Mauritz has been very successful, expanding its outlets at a rapid pace. Today it is one of the most important players on the retail fashion textile market.

After opening its first store (as Hennes) in Sweden in 1947, the company expanded to the Danish and Norwegian markets in the 1960s and to the British market in 1976. In 1965, following the take-over of Mauritz, the company became Hennes & Mauritz. In 1974 the company was quoted on the Swedish stock exchange. Since then, Hennes & Mauritz has been entering several other European countries at a steady pace, being present in the USA since the year 2000. Today Hennes & Mauritz is present in 13 countries and is planning to expand into eastern Europe. Germany has been and still is by far the biggest single market, representing 30% of the group turnover. 89% of turnover takes place outside the home market.

As the table below indicates, in terms of turnover, international expansion, and profitability, Hennes & Mauritz is a very successful company.

Table 1: Financial data, number of stores and employees

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<tbody>
<tr>
<td>Turnover*</td>
<td>26,649</td>
<td>32,976</td>
<td>35,876</td>
<td>46,528</td>
<td>53,331</td>
</tr>
<tr>
<td>Net profit*</td>
<td>2,286</td>
<td>3,075</td>
<td>2,552</td>
<td>3,816</td>
<td>5,686</td>
</tr>
<tr>
<td>No. stores in Sweden</td>
<td>120</td>
<td>124</td>
<td>115</td>
<td>118</td>
<td>120</td>
</tr>
<tr>
<td>No. stores outside Sweden</td>
<td>430</td>
<td>489</td>
<td>567</td>
<td>653</td>
<td>724</td>
</tr>
<tr>
<td>No. of employees</td>
<td>14,101</td>
<td>17,652</td>
<td>20,680</td>
<td>22,944</td>
<td>25,674</td>
</tr>
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* in million/SEK

Hennes & Mauritz is a financially strong company and the strategy of the company focuses on continuous expansion: a 10-15% increase in profitability and in the number of new stores per year.

The head office is located in Stockholm, Sweden and this is also where company management and other staff departments (finance, logistics, procurement, HR, etc) are located. In addition, Hennes & Mauritz has 14 country offices as well as 21 production offices that are responsible for checking that orders are placed with the right suppliers, for identifying new suppliers, and for ensuring that suppliers live up to the Hennes & Mauritz code of conduct. The latter is relevant for the strong company focus on corporate social responsibility, as is discussed below.

Market dynamics and company changes

Hennes & Mauritz launches two main collections a year - autumn and spring. Within these ranges are a number of sub-collections that ensure that the customer always finds new goods in the stores. The stores are the main distribution channel, but in the Scandinavian market Hennes & Mauritz also distributes goods via mail order since 1980 and via e-commerce since 1998. Although the e-commerce activities in particular are subjected to continuous improvement, it is foreseen that the stores will continue to be the main distribution channel for Hennes & Mauritz.
The most significant challenges for Hennes & Mauritz are:

- continuous expansion;
- cost-efficient production and logistics;
- reduction of lead times.

**Expansion**

From the beginning, Hennes & Mauritz has focused on expansion, and this is seen as one of the main drivers of competitiveness. There is no franchising: Hennes & Mauritz owns its stores. This allows the company to maintain central control over the expansion strategy and business locations. When deciding on a new location, the department responsible for expansion analyses the best locations in the new market and waits until the location becomes available rather than opening a new store in a less preferred location. Another reason the company avoids franchising is that it can maintain central control over store design and communication.

**Cost-efficient production**

Another driver of competitiveness and profitability is the emphasis on cost-effective production of goods. Hennes & Mauritz has, like many other textile companies, gone through a major relocation in terms of production locations. At the very beginning, almost all production took place in Sweden, but during the 1960s it moved to the other Scandinavian countries and the United Kingdom. In the late 1960s, production moved to southern Europe - mainly Italy and Portugal. However, Hennes & Mauritz also had production operations in Hungary, Poland and former Yugoslavia. In the mid 1970s production moved to the Far East, where the first production office opened in Hong Kong in 1978. Today, Hennes & Mauritz has 21 production offices, which reflect the location of suppliers: 10 are located in Europe, 10 in the Far East, and one in Africa.

This is the classic story of production moving to locations with a good supply of labour, low wages, and good quality. It is simply cheaper to produce goods in the Far East due to low wages, while the quality of the goods produced there is of a good standard. This explains why the company has local production offices with local staff. These offices have a dual internal-external function. First and foremost, the production offices mediate contact between the internal buying department and the independent suppliers. This ensures that the right order is placed with the right supplier. Second, the production offices are responsible for identifying new suppliers and negotiating contracts with them. This also includes making sure that the suppliers conform to the Hennes & Mauritz code of conduct.

When deciding where to place an order, it is not only a question of where goods can be manufactured most cost-effectively, but also a question of distance to the market. It is evident that the transportation times from the Far East to Europe are greater than within Europe. This can have some influence on where specific goods are manufactured. A final aspect that plays a role when deciding on a manufacturer is the quota system. In common with all textile companies, Hennes & Mauritz are subject to the import regulations defined by the quota system. However, the company is unsure whether or not the abolishment of the quota system would have any impact on where the company has goods manufactured. It may be that the eventual abolishment of the quota legislation will mean that more goods are manufactured in the Far East, but this is uncertain simply because the company does not know what national or international regulations will be put in place afterwards. In this context, more timely information on the policy decision-making process would be helpful for Hennes & Mauritz. In any case, on account of the transportation time factor, Hennes & Mauritz thinks it unlikely that in the near future all production will take place in Asia.
Reduction of lead times

A final aspect, which has added positively to company competitiveness, is the focus on reducing lead times and improving logistics. Lead times from manufacture to store have been reduced by 15% to 20% over the last two to three years. In the competition with other fashion companies and department stores, it is crucial that there always be new goods in the stores and that Hennes & Mauritz can move fast when new trends are identified. All stores need to have the most crucial goods on stock at all times. Furthermore, the central logistics department needs to follow the sales progress of individual goods in order to avoid over-production of goods which cannot be sold.

In order to do this, the procurement staff works closely with the production offices, and information and communication technologies (ICT) are a crucial tool used to follow sales and make intelligent choices. A benefit of owning the stores is that they share a common ICT platform where all sales are reported. Thus, the procurement and logistics employees can keep track of sales and stock status (at individual store as well as at the central warehouse).

Purchasing flexibility is central to the Hennes & Mauritz strategy. The pattern of seasonal flexibility that applies to many retail fashion stores was broken as early as 1968. Instead, buyers started to purchase twelve times a year, making rapid switches of fashion possible.

In their own cultural perception, the strategic management perceives the company as being very informal in terms of decision-making processes. According to Kent Gustafson, Director of Development, ‘We know from previous experience that decision-making is based 90% on feeling and 10% on history’.

Nevertheless, company tactics are extremely visible to employees. The first CEO introduced ‘takten’ (the pace), an instrument that still remains in place and now supported by ICT. This is a visible list that arrives weekly, showing each buyer how much has been sold in the stores of each particular product. Everyone understands the risks involved in falling short, and, according to several sources, the saying ‘shape up or ship out’ is always present in the background.

In summary, Hennes & Mauritz operates in a highly competitive fashion market where it needs to offer goods of high quality at a competitive price. In order to achieve this, it has focused on expansion (market access as well as economies of scale in terms of production) as well as improved logistics (reduced lead times from manufacturer to warehouse to store). Company management is built on a central governing model (part of the organisation from the start as a result of the personality of the founder and his emphasis on control) combined with an environment where ideas can originate from the different parts of the company and can circulate freely. What sets Hennes & Mauritz apart from most of its competition is its lightning-fast turnaround: a garment can move from design to hanger in just 20 days. Only Zara can react more rapidly (14 days) but its prices are 30% to 50% higher than H&M’s. By comparison, Gap’s minimum turnaround is three months. As a result, H&M can add looks that were not part of its collections or increase quantities if an item sells well. For example, last autumn, when miniskirts began to sell well, H&M tripled the original order on a black wool miniskirt and distributed it to all markets instead of just to a handful of key stores.

Organisation and the market

Hennes & Mauritz is a global company in terms of production and market penetration. In 2002, Hennes & Mauritz had more than 25,000 employees worldwide. Most of these are employed in one of the 840+ stores, while others are employed in staff functions in either Stockholm or in one of the 21 production or 14 national offices. This highlights the fact that Hennes & Mauritz has no production facilities – all production is outsourced. The main argument for the company not having its own internal manufacturing facilities is that capital is not tied up in machinery and equipment, thus permitting a wide degree of flexibility.
Hennes & Mauritz has roughly 90 designers located in Stockholm. These employees are responsible for identifying new fashion trends and designing new models. Hennes & Mauritz sees itself as a fashion company which is able both to follow general trends and come up with totally new concepts when needed. The designers work closely with procurement, which in turn communicates with the production offices. The aim is to identify the best supplier worldwide for new goods in terms of price, quality, pace, and location (transportation). The production officers report back to procurement, which then places the order (50-50 within/outside Europe - outside usually being Asia).

Once the goods have been manufactured, they are shipped using H&M external contract companies. This is generally to the central warehouse in Hamburg, but it can also be to the national offices (if the goods are country specific) or directly to the store if the quantities are large enough. However, the most frequent scenario is that goods are sent to Hamburg where they are sorted and sent on to the individual stores. This transaction model is depicted in the diagram below.

Another factor contributing to Hennes & Mauritz success is the ICT-enabled feedback loop between the individual stores, the central warehouse, and the procurement department/production offices. It is possible centrally to follow sales of individual items in the stores and restock if necessary. This feedback loop achieves transparency between sales, stock, and production capacity, as well as intelligent procurement planning. As in other retail trade sectors, this means that employee skills relating to managerial planning processes are being taken over by ICT whereas the requirements for customer service orientation remain unchanged.

Another reason for setting up the production offices to oversee the manufacturing process is the translation of the designers’ models into actual goods. Discrepancies have previously been noted between the initial sketch and the final product. Today this can be seen as more or less an historical phenomenon: due to the long-term relationships with suppliers, it is no longer necessary to offer any ‘translation’ help to turn sketches into goods. Instead, the main functions of the production offices are to negotiate prices, to communicate between central functions and suppliers, and to follow
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up on the code of conduct. This code has been set up as part of the Hennes & Mauritz focus on corporate social responsibility (CSR). The code includes the following conditions:

- legal requirements;
- ban on child labour;
- safety and factory conditions;
- workers’ rights and freedom to organise;
- housing conditions and environmental aspects.

All suppliers have to live up to these requirements, and fulfilment of the code is frequently checked and enforced by the production office employees. Approval of a supplier by Hennes & Mauritz thus implies the existence of a very long-term relationship. Hennes & Mauritz is thereby often able to exploit economies of scale, and the supplier companies have a very loyal customer.

From autumn 2002, it is company policy to mark all goods with the country of origin. However, Hennes & Mauritz believes that the customer is not interested in where the goods have been produced, but more interested in quality and price and to some degree on whether or not the goods have been manufactured under sustainable conditions. Thus, the future of the European textile industry should be debated in the light of the trend towards production moving to the East. There is also the possibility of having not just production but also design carried out in the East. H&M management believes that one should stop viewing China as the ‘sweatshop of the world’ – the Chinese can also do work which requires higher levels of competences.

Employees

As mentioned above, Hennes & Mauritz has approximately 25,000 employees (81% female). Most of these work in the stores as shop assistants. Only about 3,000 are in staff functions (including production and national offices).

Hennes & Mauritz puts much emphasis on maintaining a corporate spirit, and therefore most recruitment and training is done internally. All new store employees undergo a three-week introduction course and get assigned a mentor. Employees for central functions are mostly recruited internally from the stores in order to maintain the corporate spirit, and central staff are regularly rotated to store functions in order to keep contact with customers.

H&M’s outsourcing model is different from that of most of its competitors in that H&M’s code of conduct is an ethical one which also applies to its global suppliers.

The basis of Hennes & Mauritz’s code of conduct is to maintain good labour relations. The code of conduct states that employees are free to organise. Furthermore, the code of conduct covers not only the 25,000 workers directly employed by Hennes & Mauritz but also those who are employed by sub-contractors producing the goods for the stores. These are independent companies, but often have very long-term relations with Hennes & Mauritz. If a company wants to become a supplier to Hennes & Mauritz, they must agree to adhere to the code of conduct: compliance with this code is continuously monitored by the local Hennes & Mauritz representatives. The code of conduct not only focuses on freedom to organise but also on establishing good working environments. Even more important, the code forbids the use of child labour. Thus, Hennes & Mauritz is convinced that employees working on the production line for subcontractors in foreign countries often have far better conditions than other employees in that country.

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H&M’s business model strength lies to a great extent in the central control of all phases from store location to inventory for campaigns and shop windows. At the same time, however, the H&M system is based on interaction between different localities and levels of management. Therefore internal recruitment plays a central role in promotion.

**Virtualisation of the workplace**

A central part of the Hennes & Mauritz success is the ICT system that connects the individual stores with the logistics and procurement department. As explained above, this system keeps track of sales and stock management centrally. Whenever an item is sold in a given store it is registered in the central system, which keeps track of the need for restocking and procurement.

There is also ICT-integration between the central office in Stockholm and the 21 production offices. All communication between the departments takes place by ICT, including the distribution of design sketches. It is foreseen that this integration will eventually include those suppliers with whom the most long-term relationships exist.

ICT plays an important role in Hennes & Mauritz’ effort to reduce lead times. It is of the utmost competitive importance that there is always new goods on the shelves, that stores do not run out of items, and that stores do not keep unsellable stock (i.e. having capital tied up in stock). This requires good market intelligence as well as tools for market prediction and inventory status, and for this ICT is essential.

The common ICT system facilitates this integration throughout the enterprise through both front-end and back-end data sharing and integration. Hennes & Mauritz can keep track of sales and integrate this directly with procurement. Very little human interaction is needed as data is sent to a central database as soon as one given item is sold in a shop. This facilitates the tracking of local and central stock and integration with the production facilities, and it provides Hennes & Mauritz with market intelligence – e.g. which products seems to be a ‘hit’ and those which are more difficult to sell.

Market intelligence can also come from other sources. In order to gain insight into new trends in the fashion market, Hennes & Mauritz representatives spend much time at trade shows and exhibitions, and in Europe designers attend the main design exhibitions. Another source of information on market development is found in the countries (mainly Asia) where production takes place. As mentioned previously, Hennes & Mauritz has local production offices whose main responsibility is negotiation with subcontractors and supervision of the code of conduct. However, an additional aspect of their work is to monitor local market development and send information back to the central administration in Stockholm.

A final aspect of virtualisation is the new eCommerce initiative, which is currently only being offered to customers in Scandinavian countries. This is considered as an additional distribution channel, but is not expected to replace or abolish the need for the more traditional channels – the stores are still and will continue to be regarded as the main distribution channel.

**Research and development**

Hennes & Mauritz aims to be always in step with current fashion trends as well as in some instances being at the forefront. This is done via the designers, who attend many exhibitions worldwide. Furthermore, managers in the national shops are responsible for following new market trends and competitors and reporting these to the central office in Stockholm. In these processes, H&M makes very little use of external consultants. Each store manager is encouraged to carry out market and competitor surveillance at a local level, but very little is done at central level in terms of competitor analysis. The same goes for customer analysis.
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Trial and error plays a central role in market strategy as practiced by H&M. It is viewed acceptable to make an error, as long as the same mistake is not repeated. This is particularly important for the buyers because it enables them to be more innovative in their purchasing. An example of a failed strategy was an attempt by H&M to introduce shoes as part of their accessories in 1974. This was abandoned due to strict trade regulations and requirements for larger stocks than H&M was accustomed to.

Hennes & Mauritz is not involved in experiments with new textile materials - there must be proof that textiles with new materials have valid market relevance before goods using them are introduced into the collections.

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Source list

Interview with Björn Palmqvist, Manager of production offices, November 2003.


Hennes & Mauritz homepage [http://www.hm.com](http://www.hm.com) and balance sheet.


