

A Work Project, presented as part of the requirements for the Award of a Masters Degree in Management from the NOVA – School of Business and Economics.

Sweetening abroad:  
Internationalization Strategy of  
*A Tarte*

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## Abstract

This project aims to plan the internationalization strategy of the Portuguese small firm *A Tarte*, producer of a gourmet pie, to a European country in order to enlarge its sales. Therefore, a thorough analysis of the company and of the bakery market is performed to understand the complete environment. It is followed by a quantitative analysis of fourteen countries to select the most attractive market, whose results indicated United Kingdom as the best option. After, the direct exporting entry mode was analysed and costs estimated. Lastly, the expansion to London is recommended to be pursued with a UK local agent/distributor support.

**Keywords:** International business, bakery industry, UK, direct exporting

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## **Introduction**

The purpose of this project is to develop an internationalization strategy for a small company *A Tarte*. This is a company that involves the production, distribution and selling of a gourmet almond pie. The firm has recently started its internationalization process to Spain and wants to pursue further markets. As the Portuguese market is small, the advantages of expanding abroad are related with the possibility of reaching new and larger markets; of growing economies of scale with increasing sales; and becoming less dependent on domestic sales.

First, a literature review is presented followed by the methodology used. After, an analysis of the company and its products is provided. Owing to the company's preferences, the European market is the one selected to be analysed. Therefore, in a second, an analysis of the Portuguese and the European bakery markets is performed. It is also displayed a global readiness examination of the company to expand abroad.

Next, a quantitative analysis of fourteen Western European Union countries is conducted to rank the markets regarding their attractiveness. To classify each country, indicators related with demographics, economics, the bakery market, bakery products consumption, distance to capital cities and shopping centres density and sales are employed.

According to the results, the United Kingdom is proposed as the most interesting market for developing *A Tarte*'s internationalization strategy in the short term. At this point, a detailed analysis of the UK's cakes industry is completed. The appointed entry mode is direct exporting and a financial analysis of the process is provided. Lastly, it is given a final recommendation about the adoption of an agent/distributor to support the expansion.

## **Literature Review**

International business refers to business transactions between parties across national boundaries (Griffin and Pustay, 2005). To expand sales, achieve scale economies and

reduce risk through sales diversity are among the main reasons for companies to expand abroad (Daniels and Radebaugh, 2007). These motives can be proactive which lead firms to enter foreign markets for existing chances; or reactive which involve declining prospects in the internal market (Griffin and Pustay, 2005).

Traditional internationalization theories and concepts were mostly focused on multinational firms. Only later, approaches concerning SMEs internationalization processes have been developed. According to the literature, regarding SMEs internationalization, there are three leading approaches: the stage approach; the network approach and the international entrepreneurship approach.

### **The Stage Approach**

According to the stage approach the internationalization of firms occurs through a gradual process where companies start operating in their home markets and then they progressively enter foreign markets. Two main stage approach models can be identified: the Uppsala model (Johanson and Vahlne, 1977, 1990, 2006; Johanson and Wiedersheim-Paul, 1975) and the Innovative-Related Internationalization Model (Bilkey and Tesar, 1977; Cavusgil 1980; Czinkota, 1982; Reid, 1981).

The U-model describes the internationalization process as a gradual learning procedure. Commonly, firms begin by entering closer markets and with traditional exports to evolve to more distant markets and more intensive modes. As Johanson and Vahlne (1990) defend, this gradual process is related with a growing experiential knowledge of foreign markets and increasing commitment. (Forsgren, 2002)

The I-model describes a sequence of steps with stagnation periods, where firms accumulate the resources needed to continue the process. The model is focused on a learning path associated with the use of innovation.

Researchers of this model define the internationalization decision as an innovation for the firm and a process that develops by steps.

### **The Network Approach**

This can be considered an extension of the stage approach. It was introduced by Johanson and Mattson (1988), then improved by Johanson and Vahlne (1990) and Laghzaoui (2009). This model highlights the significance of placing the firm in its network. To gain access to international markets, firms must build relationships. According to this theory, the success of international activities are mainly dependent on the firm's network and its position in it. The relations with the network can drive the internationalization process.

### **International Entrepreneurship Approach**

This theory was born from a new perspective on company's rapid international development. There is a growing number of firms that do not show a gradual path as indicated by the stage approach. In fact, this approach was challenged by the arising companies known as *international new ventures* and *born-global*. According to Oviatt and McDougall (2000), these are companies that from its outset seek to deliver value through international operations. The entrepreneur or the management team adopts a global vision since the creation of the firm and engages rapidly on internationalization.

The approach that best suits the internationalization process of *A Tarte* is the international entrepreneurship approach. The firm's CEO is a committed entrepreneur seeking foreign markets to implement the business. This is a recent company with a global vision already implemented and available to take risks within its financial restrictions.

### **Methodology**

A variety of resources was used upon the different stages of the project. Firstly, several unstructured interviews were conducted with the CEO of the company to understand the

functioning of the business. Information and data were gathered and an internal analysis of the firm using the McKinsey 7-S framework was completed.

Secondly, a research about the Portuguese and the foreign markets was performed using the Euromonitor International database and other organizations' reports and articles. The Porter's Five Forces model was used to evaluate the industry and the SWOT analysis was applied to weigh opportunities and threats of the business. Finally, the GMMSO program was used to classify the company's level of readiness to expand abroad.

Subsequently, it was created a score model, where macro and micro data were considered to evaluate the attractiveness of the countries. The Eurostat database was the main source, along with other organizations' data. Upon the findings, the indicators were classified and weighted in order to rank each country's attractiveness to internationalize *A Tarte*.

After selecting one country according to the model results, research was made about which approach would be the most accurate to expand the business. A financial analysis was then performed. Internet sources and financial information provided by the company were the main vehicles to conduct this stage of the project.

## **I. Business Description**

### **Business Idea**

Created in 2012, *A Tarte* is a small business involving the production, distribution and sale of a gourmet almond pie. The business was launched by two friends that started by introducing the pie to stores. *A Tarte* became well-known due to small cards inside the packages, friends' help and the Facebook page. One of the owners is the CEO of the company, whereas the other owner is non-executive. Today, *A Tarte* has more than 100 selling points and two corners – Amoreiras Shopping Centre and El Corte Ingles – and sells 3 000 pies per month. The corners represent 35 percent of turnover, whereas retailers represent 65 percent. The firm has already internationalized the product to Spain.

## **Strategy**

The firm offers a high quality product, well priced and with a modern packaging, at modern and trendy coffee shops and restaurants, besides its corners. At the corners, a pie is offered at €18<sup>1</sup> and one slice at €2.5, which translates a good price-quality since similar quality Portuguese cakes are sold at higher prices<sup>2</sup>. The stores order a certain variable number of units to the firm when they need. *A Tarte* delivers those orders to the stores, selling them by an average price of €14. In turn, the stores sell the product to the customer. This positioning has enabled the firm to generate awareness and product familiarity needed to build stores loyalty where, by a lower price, the financial margin is higher.

## **Structure**

*A Tarte* has the structure of a start-up, with limited resources and multi-role employees. It accounts for 12 employees, 3 business areas and some outsourced services. The business areas are the following: the manufacturing area, composed by 4 employees; the management department comprising the CEO and her assistant; and the direct sale, accounting for 3 vendors in each corner. The outsourced services include ingredients delivery, product distribution, accounting and Facebook management. The current production capacity is 8 000 units per month and the product is distributed frozen.

## **Systems**

The company's systems are very simple. There is a daily contact between employees and the contact with clients is informal. Once a week the customer portfolio is accessed and, on a monthly basis, a total overview of costs and revenues is performed.

## **Staff and Skills**

The staff and skills of the firm are sufficient and the business has been able to grow. The outsourced services have fulfilled the missing internal competences of the team.

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<sup>1</sup> All prices in this section include VAT

<sup>2</sup> Melhor Bolo de Chocolate do Mundo sells at €21. Landeau sells at €3.5 per slice.



## **Style**

The CEO is a strong believer of the product's value. She has been able to perform an effective leadership for her focus on getting results and assigning responsibilities.

## **Shared Values**

The mission of *A Tarte* is to make the best almond pie ever made – thin and crispy. The vision is to be considered the adequate gourmet pie to be consumed at any enjoyable moment. The pie is made with Portuguese ingredients. Therefore, values of quality, commitment, enjoyment, passion for “home” are some of the values of the organization.

## **Product & Services Offering**

The company is focused on maintaining a single product business but it has launched some limited edition pies, a pie flavour ice-cream and it has created some partnerships with Portuguese brands. The chocolate pie represents 5 percent of the revenues, whereas the ice cream represents 10 percent. The partnerships amount residual values. The pie generates 85 percent of total revenues with a financial margin of around 20 percent.

## **Overall Analysis**

The firm has achieved a solid volume of sales, establishing a good customer base and generating brand awareness. Overall, the elements of the company are aligned and the business is working properly. Nevertheless, the company is still evolving and its nature of start-up does not allow a complex structure. The capacity to invest is minor but the low fixed costs required to operate in the industry have allowed the business to grow.

The Portuguese market presents limits for its small size. The possibility of reaching new and larger markets is attractive in order to increase sales, to achieve scale economies and to be less dependent on the internal market sales. The prospects to expand abroad will be evaluated.

## **II. International Involvement**

## Industry Analysis

### Porter's Five Forces

The Five Forces framework of Michael Porter analyse the industry level of competition and its attractiveness. Applying to *A Tarte*, it was concluded that the overall intensity of competition is high and its attractiveness is low. Details of the analysis are shown below.

|   |   |
|---|---|
| <b>Supplier Power – Medium</b>            |   |
| Presence of substitute inputs             | There are no substitutes for the pie ingredients (e.g. almond)          |
| Impact of almond cost                     | The company is not an almond producer, prices variation impact          |
| Supplier concentration                    | Low concentration of suppliers  |
| Switching costs of suppliers              | As the market is fragmented it is easy to change suppliers              |
| Importance of volume to suppliers         | <i>A Tarte</i> represents a low share of total sales of suppliers       |
| <b>Buyer Power – Medium</b>               |   |
| Buyer volume                              | Each store that buys the pie represents a low share                     |
| Buyer concentration                       | There is a high number of buyers – low concentration                    |
| Substitute products                       | Many goods satisfy the same need – various cakes, traditional bakery    |
| Brand identity                            | <i>A Tarte</i> is a recognized brand                                    |
| Price sensitivity                         | There is low price sensitivity since it is a gourmet product            |
| <b>Threat of Entry – High</b>             |   |
| Government policy                         | There is no restrictions on number of companies operating               |
| Economies of scale                        | It is not a necessity – companies of many sizes operate in the industry |
| Capital requirements                      | Initial investment required is relatively low                           |
| Distribution channels                     | High number, very fragmented, easy to establish                         |
| <b>Threat of Substitutes – High</b>       |   |
| Relative price performance of substitutes | Many substitutes presenting a worthy price - quality relation           |
| Switching costs                           | High readiness to buy substitutes with low cost                         |
| Buyer propensity to substitute            | Consumers like to diversify what they eat                               |
| <b>Degree of Rivalry – High</b>           |   |
| Demand                                    | The demand for <i>A Tarte</i> is increasing                             |
| Concentration                             | Very low: there are a lot of companies operating in the business        |
| Price comparability                       | Easy to compare products' prices  |
| Diversity of competitors                  | There is a high diversity of companies and products                     |
| Exit barriers                             | Since investments are low it is relatively easy to exit                 |

## The Portuguese Industry

The cakes' industry sales in Portugal are measured at 15 000 tonnes and €88 million. In the last years, the cakes' industry has shown a decrease in sales, as depicted below:

Table 1 – Portuguese Cakes industry sales

|       | Volume<br>'000 Tonnes<br>2014 | Value<br>€ million<br>2014 | Percent value<br>growth<br>2009-2014 | Percent volume<br>growth<br>2009-2014 |
|-------|-------------------------------|----------------------------|--------------------------------------|---------------------------------------|
| Cakes | 15                            | 88.4                       | -2.2                                 | -7.1                                  |

Source: Euromonitor International, 2015

Moreover, the bakery industry is highly fragmented characterized by a large number of companies – more than 6 500 bakery enterprises (LEO, 2014). Its low concentration is also highlighted by an HHI of 132 on a scale range of 0 to 10 000 (INE, 2014).

The decreasing sales and the large number of firms operating in the domestic bakery market are additional motives for *A Tarte* to seek new markets.

## The European Industry

Due to company preferences and the readiness of internationalization, European countries are the target to be analysed. The readiness of the European market is justified by the short distance to the market and the relatively simple approach regarding laws and culture.

### Market Size, Value, Growth

The European bakery market is one of the largest bakery markets in the world. In 2011, the EU bakery consumption (bread, viennoiserie, pastry and savoury pastry snacks) was measured at 40.1 million tonnes and €126.4 billion. The pastry market (cakes, muffins, tarts, cream pastries) accounted for 8 percent in volume. From 2001 to 2011, bakery consumption shrank by 0.2 percent pa, which reveals a mature market. (Girafood, 2013)

### Demand

As customers show growing time pressure, seeking convenience and functionality, packaged food sales raise in favour of artisanal food. Still, fresh bakery dominates consumption with 68 percent of market volume (Girafood, 2013). Also, consumers

demand innovative and indulgence products to be eaten as delights and search for healthy products with less sugar and fat (Euromonitor International, 2015).

### **Supply**

The European bakery industry is very fragmented, with more than 150 000 firms where more than 99 percent are SMEs with less than 9 employees. France and Italy, with more than 40 100 and 35 600 firms respectively, occupy the first places in number of bakery firms. Nevertheless, Greece and Portugal are the two countries with the highest number of bakery enterprises per 10 000 people, 8.44 and 6.14 respectively. (LEO, 2014)

### **Distribution Channels**

In 2011, across the EU-27, the main distribution channel was modern retailing (supermarkets) with 42 percent of the market volume, followed by the artisan bakeries, such as *A Tarte*, with 22 percent and catering with 20 percent. (Girafood, 2013).

### **Legislation**

The general principles of food law targeted to the EU members are outlined in the General Food Law Regulation which covers all the stages of production, processing and distribution of food. Rules are harmonised at EU level to enable European consumers to make informed choices and to remove barriers to the free circulation of food products.<sup>3</sup>

### **Market Trends**

The European bakery industry shows increases in demand for high quality products (Euromonitor International, 2015). This adds to the healthy food tendency, as the Western Europe displays the largest gluten-free bakery market – sales' value raised from US\$400 million in 2006 to US\$600 million in 2011 (Euromonitor International, 2012). Also, convenience food (ready-made and frozen bakery) and industrial supply sales are raising (Girafood, 2013).

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<sup>3</sup> [http://ec.europa.eu/food/safety/general\\_food\\_law/principles/index\\_en.htm](http://ec.europa.eu/food/safety/general_food_law/principles/index_en.htm) (European Commission)

In the view of these trends, *A Tarte* may foresee a positive scenario as customers prefer ready-made pastry and high quality products. In contrast, healthy issues and industrial suppliers leading the market may pose some barriers on the business evolution.

### **Key Success Factors**

Taking into account the market characteristics and *A Tarte*, some key factors that may influence the success of the company in the international bakery industry were found:

- Proximity to key markets – transportation costs are high relative to the product value;
- Market size as it indicates a higher number of potential customers;
- Selling place, as a pie is an impulse product its selling place is decisive;
- Demand characteristics (consumption level, health concerns, purchasing power);
- Product differentiation – may drive increases in market share in a mature industry.

### **Target Market Profile**

Consumers buy the pie for personal consumption or as a gift, to consume as a desert or with tea /coffee. The target market are adults and, for the quality and price, it is aimed at middle-high and high classes.

### **The Spanish market**

In March, the firm initiated the internationalization process to Spain through a *corner* in El Corte Ingles Madrid with whom all the contacts and processes were established directly. In the first month, 600 units were sold. The product is currently being sold in ten El Corte Ingles' coffee shops in Madrid with a small area solely dedicated to *A Tarte* in order to communicate the brand. Currently, there are already retailers interested in selling the product but no agreement has yet been completed.

The operation is entirely dependent on the CEO who is permanently in Madrid. In Portugal her assistant is responsible for the ongoing activities. According to the CEO, the implementation process for a new country must be more independent of her.

## Global Readiness

The GMMSO<sup>4</sup> software was used to measure the firm's readiness to internationalize. This assessment is based on 22 questions answered using a scale from 1 – 5 (least favourable to most favourable, respectively). The criteria is provided in Appendix I.

*A Tarte* obtained a score of 70 out of 110 (64 percent) which indicates the suitable method of internationalization is *direct exporting*. The company may have foreign based agents and distributors, foreign sales representatives and retailers, and direct sales to end user.

In order to complete this result, it should be highlighted that investment on capacity is not required and, as the product is distributed frozen, production may be maintained in Portugal. Also, exit costs are almost inexistent as investment costs are low.

## SWOT Analysis

| Strengths  | Weaknesses  |
|--|---|
| <ul style="list-style-type: none"> <li>• <b>High quality and differentiated:</b> hard to find an equal product</li> <li>• <b>Difficult to imitate:</b> the receipt is secret</li> <li>• <b>Communication plan:</b> story around the pie is an attractive attribute</li> <li>• <b>Good price-quality relation:</b> similar high quality cakes are more expensive</li> <li>• <b>Excess production capacity:</b> no investment needed to increase production</li> </ul> | <ul style="list-style-type: none"> <li>• <b>Low market share:</b> large number of companies operating in the market (LEO, 2014)</li> <li>• <b>Little investment capacity:</b> the company has little capital to invest</li> <li>• <b>Lack of experience:</b> the company staff has little experience on the bakery market</li> <li>• <b>Reduced international knowledge:</b> the Spanish market is the only experience</li> </ul>   |
| Opportunities  | Threats   |
| <ul style="list-style-type: none"> <li>• <b>Clients are more demanding:</b> due to increasing number of products in the market (Euromonitor International, 2015)</li> <li>• <b>Higher demand for already made food:</b> people do not want to spend much time cooking (Girafood, 2013)</li> <li>• <b>Readiness of European markets:</b> EU markets have rules that facilitate the internationalization of products</li> </ul>  | <ul style="list-style-type: none"> <li>• <b>Highly fragmented market:</b> difficult to stand out from the competition</li> <li>• <b>Many substitutes:</b> costumers change consumption easily and frequently</li> <li>• <b>Low entry barriers:</b> low capital requirements to enter the market</li> <li>• <b>Healthy food concerning:</b> people are more health conscious and like to consume gluten-free or fat-free products (Euromonitor International, 2012)</li> </ul> |

<sup>4</sup> The GMMSO is a research and strategic planning management tool designed to help companies expand into foreign markets. It enables the analysis of a company situation in a global market and it can be used by business managers or consultants seeking potential markets, or instructors teaching international business. (<http://www.gmms3.com/>)

## **TOWS Analysis**

### **Strategies that use Strengths to maximize Opportunities**

The company should rely on its product quality as consumers are more demanding and prefer to buy already made food. Also it should take advantage of its price-quality relation entering the European markets in order to attract consumers. Enhance its communication plan based on *A Tarte*'s story to increase public awareness should be considered.

### **Strategies that use Strengths to minimize Threats**

Though the market is highly fragmented and it is difficult to attain a major market share, the firm should focus its strategy on the product quality to increase customer value. It should benefit from the low investment needs of the industry to enter external markets without significant investments and small risks.

### **Strategies that minimize Weaknesses by taking advantage of Opportunities**

The investment capacity restriction is minimized by entering a European market where low risk entry modes may be applied due to short distance. Additionally, the small market share that may be attained enables the firm to focus on demanding niche markets.

### **Strategies that minimize Weaknesses to avoid Threats**

As the industry's entry barriers are low, the short investment capacity should not preclude the firm from growing its activities gradually. Also, as customers change easily their expenditures among the many substitutes, the company may capture clients rapidly.

## **III. Global Market Research**

### **Country Analysis**

#### **Country Selection**

The fourteen EU Western countries included in the analysis are: Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Italy, Ireland, Netherlands,

Spain, Sweden and UK. Several reasons underlie this choice: firm's preferences; free markets rules facilitating product trade; the proximity and similar culture easing the process as the company has little experience on internationalization. Though in these countries the bakery industry is a mature market with many firms and countless products, the high-level of consumption patterns aligned with a high purchasing power generate the right conditions for a gourmet pie to succeed (Euromonitor International, 2015).

### **Criteria Selection**

A rank of markets' attractiveness is provided with the chosen criteria. The aim is to obtain a quantitative and objective rank. For each indicator, intervals of values were created and scores from 1 to 10 were distributed across them, being 1 the less favourable and 10 the most favourable. The criteria is composed of five main categories as following:

- **Demographics:** total population and population growth rate;
- **Geography:** driving distance in km from Lisbon to the capital of each country;
- **Economics:** GDP per capita and GDP growth rate, turnover and turnover growth rate, number of enterprises and value added of the *manufacture of bakery and farinaceous products* industry;
- **Local consumption:** consumption per capita of *Sugar and Confectionery* and total imports of *bread, biscuits, wafers, cakes and pastries*;
- **Infrastructure:** shopping centres density and shopping centres sales.

The demographics measure the number of potential customers. The geographic indicator measures the distance from Lisbon to the capital cities as these are the prospective cities to sell the product. Considering that the product is manufactured in Lisbon and it is distributed frozen by car, this was used as a distribution cost indication.

The economic indicators represent the purchasing power of the population. The industry specific indicators represent the size of the market, its value, evolution and its rivalry.



The levels of local consumption and imports express customer expenditures on bakery products which anticipate the success of an almond pie. Shopping centres indicators were included in the analysis since a shopping centre is a predictable place for the product to be sold, taking into consideration the Portuguese market where a big portion of sales stems from the two shopping centres. It is worth to mention that indicators related to the political environment were not included in the analysis since there are no political constraints in the evaluated countries. The legal environment is favourable and legislations do not vary considerably because all the countries belong to the EU.

The weights of the indicators are depicted in the following table:

Table 3 – Criteria Weight

| Criteria                     | Indicator                                | Weight |      |
|------------------------------|--|--------|------|
| Demographics                 | Total Population                         | 10%    | 15%  |
| Demographics                 | Population Growth                        | 5%     |      |
| Geography                    | Driving distance to capitals             | 10%    | 10%  |
| Economics                    | GDP Per Capita (PPS)                     | 10%    | 15%  |
| Economics                    | GDP Growth                               | 5%     |      |
| Economics – Market indicator | Turnover of bakery industry              | 5%     | 20%  |
| Economics – Market indicator | Turnover Growth of bakery industry       | 5%     |      |
| Economics – Market indicator | Value Added of bakery industry           | 5%     |      |
| Economics – Market indicator | Number of enterprises of bakery industry | 5%     |      |
| Product Consumption          | Imports                                  | 15%    | 30%  |
| Product Consumption          | Consumption Per Capita                   | 15%    |      |
| Infrastructure               | Shopping Centres Density                 | 5%     | 10%  |
| Infrastructure               | Shopping Centres Sales                   | 5%     |      |
| Total                        |  | 100%   | 100% |

The demographics indicators and the economic indicators were both given a 15 percent weight as for an impulsive and indulgence product the larger the market the higher the number of potential sales and, at the same time, the differences in the GDP among the evaluated countries are not considered decisive for the purchasing of a gourmet pie. The purchasing power of the Western European countries do not have large variations that justify large differences in terms of possibility of buying the product.

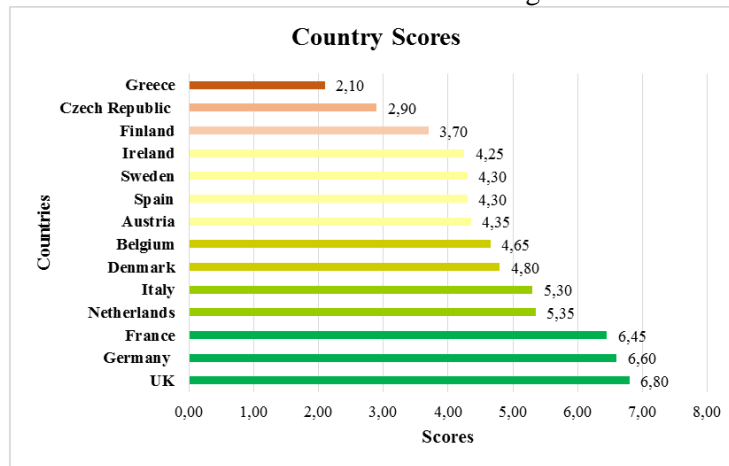
Furthermore, the market specific indicators represent the second most important category as they reveal the market potential and its entrance conditions. Finally, the consumption amount of these type of products is considered the most important category as it

represents the local habits in the country and expected sales. The details of the criteria and the variables' intervals are shown in Appendixes 2 and 3.

### Country Evaluation Results

The results obtained from the criteria adopted were the following:

Table 4 – Countries ranking



The country chosen to be analysed is the UK as it ranks first. France and Germany also show high scores but the number of competitors in the French market and the language and the distance of the German market pose additional barriers to the company.

### The UK Market Analysis

#### Market Size, value, growth

The cakes' industry sales are valued at 43 9000 tonnes and €2 700 million. Packaged products represent a higher share of sales but in the last years artisanal cakes lead growth.

Table 5 – Sales of Cakes by Category

|                            | Volume<br>'000 tonnes<br>2014 | Value<br>€ million<br>2014 | Percent Volume<br>Growth<br>2009-2014 | Percent Value<br>Growth<br>2009-2014 |
|----------------------------|-------------------------------|----------------------------|---------------------------------------|--------------------------------------|
| Cakes                      | 438.9 (100%)                  | 2700 (100%)                | 2.0                                   | 6.7                                  |
| Packaged/Industrial Cakes  | 262.5 (60%)                   | 1636 (61%)                 | 1.7                                   | 0.0                                  |
| Unpackaged/Artisanal Cakes | 176.4 (40%)                   | 1064 (39%)                 | 2.4                                   | 18.9                                 |

Source: Euromonitor International, 2014

### Supply

The bakery industry is composed by 2 400 firms, mainly well-established domestic manufacturers. The number of enterprises per 10 000 people is the lowest in the EU (0.37), for an average of 2.6. (LEO, 2014)

## **Demand**

The UK is the larger importer of bakery products in the EU. Currently, single portions are more prevalent due to increased concerns about waste and more people living in smaller households. Furthermore, cakes are expected to perform well as customers' disposable incomes increase and allow them to indulge in treats more frequently. (Euromonitor International, 2014)

## **Distribution Channels**

The main distribution channels are the grocery retailers, which account for 96 percent of the retail value. Modern grocery retailers account for 80 percent of the value, whereas traditional grocery retailers represent 16 percent. (Euromonitor International, 2014)

## **Market Trends**

Hypermarkets and supermarkets are refining in-store shopping experience via in-store bakeries with varied fresh products. Unit prices are rising as volume purchasing declines. (Euromonitor International, 2014)

## **Mode of Entry**

The place to enter is the capital city, London, for its great dimension. Taking into consideration the Global Readiness Index results and the company's few resources, the mode of entry considered the most adequate is direct exporting. Production is expected to be maintained in Portugal and distribution is made by an outsourced company with the product frozen. Taking into consideration the Portuguese business model, two options are considered: selling the product in restaurants and coffee shops and the adoption of *corners* in shopping areas. Since the company is currently using around 50 percent of its production capacity, initial investment on growing capacity is not expected.

The option of selling the product through restaurants and coffee shops involves lower initial expenditures as the *corners* involve renting costs, vendor's costs and managing

costs. Taking into account the firm's low capacity investment and the impact the expansion may have on the business, a progressive process could be applied by initially selling the product solely in coffee shops and restaurants. Nevertheless, from the analysis made, the publicity and representation a *corner* conveys to the company is very important. Thus, it is advisable that the company implements simultaneously a *corner* in a major shopping area as it sells the product through its retailers.

The firm should choose a representative shopping centre in London to raise awareness about the product. The five shopping centres that appear in the top of the list are the following: Westfield Stratford City, Westfield London, Brent Cross Shopping Centre, Covent Garden Market and High Street Wood Green (DTZ, 2013).

Additionally, the firm must find retailers to sell the product. Although the modern grocery stores account for a high share of baked goods sold, the traditional channels are associated with higher quality and prices. For a gourmet pie, the traditional retailers are more suitable to reach the target customers. Trendy places and gourmet shops in the city centre are appropriate selling places. As well, premium shops selling Portuguese products are adequate. It is important to have retailers diversification to ensure the company is not too depend on one retailer's sales or solely in one area of the city.

### **Cost and Revenue Analysis**

An analysis of the expansion costs is crucial to understand whether the activity is expected to be profitable. An analysis of the first year operating in the London market was performed. To enable a comparison, the P&L of the Portuguese market (without the expansion option) is provided in the Appendix 4.

Below, the P&L of the expansion to London is presented. It is followed by a clarification of the revenues and the costs projected.

Table 6 – P&amp;L London - 1 year (unit: €)

|                             | Corner         | Retailers     | Total          |              |
|-----------------------------|----------------|---------------|----------------|--------------|
| <b>Quantities</b>           | 18 000         | 3 600         | 21 600         | <b>%</b>     |
|                             | 83%            | 17%           | 100%           |              |
| <b>Total Revenues</b>       | <b>298 440</b> | <b>46 512</b> | <b>344 952</b> | <b>100%</b>  |
| Revenues/Unit               | 16.58          | 12.92         | 16.0           |              |
| <b>Cost of sales</b>        |                |               |                |              |
| Production                  | 54 900         | 10 980        | 65 880         | 19.1%        |
| Corner's costs              | 92 400         | 0             | 92 400         | 26.8%        |
| Distribution                | 16 200         | 3 240         | 19 440         | 5.6%         |
| <b>Total costs of sales</b> | <b>163 500</b> | <b>14 220</b> | <b>177 720</b> | <b>51.5%</b> |
| <b>Gross Profit</b>         | <b>134 940</b> | <b>32 292</b> | <b>167 232</b> |              |
| Gross Margin                | 45%            | 69%           | 49%            |              |
| <b>Overhead costs</b>       |                |               |                |              |
| Staff costs (Portugal)      | 21 875         | 4 375         | 26 250         | 7.6%         |
| Facilities (Portugal)       | 3 375          | 675           | 4 050          | 1.2%         |
| Marketing                   | 40 000         | 8 000         | 48 000         | 13.9%        |
| Others                      | 23 500         | 4 700         | 28 200         | 8.2%         |
| <b>Total Overheads</b>      | <b>88 750</b>  | <b>17 750</b> | <b>106 500</b> | <b>30.9%</b> |
| Total Overheads/Revenues    | 30%            | 38%           | 31%            |              |
| <b>Net Profit</b>           | <b>46 190</b>  | <b>14 542</b> | <b>60 732</b>  | <b>17.6%</b> |
| Net Profit per Unit         | 2.57           | 4.04          | 2.81           |              |
| Net Margin                  | 15%            | 31%           | 18%            |              |

## Revenues

The price of the product was considered using a comparative relation with the Portuguese market. According to the Eurostat's price level index of food, Portugal presents an index of 90 whereas the UK presents an index of 102. As in Portugal, without the VAT, the company receives €14.63 when sells directly through the corners and €11.40 through its retailers, the UK market values obtained are €16.58 and €12.92 respectively.

To estimate the initial sales in the London's *corner*, it was performed an extrapolation with the Spanish market. In the first month, 600 units were sold in Madrid. The estimation was made taking into consideration the total population of both cities as below:

Table 7 – Extrapolation Madrid-London

|                  | Madrid    | London    | Portugal   |
|------------------|-----------|-----------|------------|
| Population       | 3 232 463 | 8 278 251 | 10 000 000 |
| Sales            | 600       | 1 500     | 3 000      |
| Sales/Population | 0.019%    | 0.018%    | 0.030%     |

Taking into account the Portuguese market, a conservative approach was taken and the relation between sales and total population is lower in the London market.

To estimate coffee shops and restaurants sales, the Portuguese market was taken into account where the average sales of a retailer is 5 units per week. In Lisbon, the firm has

20 retailers. The initial number of retailers considered in London was 15 to maintain the conservative approach. Following this, per year, 3 600 units are expected to be sold through the retailers and 18 000 units through the *corner*. No growth was considered.

### **Costs**

As regards to costs, according to company data, the production cost of one unit of pie is €3.05, which includes the costs of ingredients, energy, water and packaging. The distribution costs were obtained by contacting a Portuguese distribution<sup>5</sup> company and account for an average cost of €0.90 per pie (cost per unit decreases as quantity raises).

Concerning the *corner*, the rent in a shopping area in London is estimated at €3 500<sup>6</sup> per month and the monthly wages of three employees working in the corner (following the Portuguese model) are €4 200<sup>7</sup> per month.

Additionally, as reported by the firm, the production area rent is €900 per month and the wages of the Portuguese workers are €5 833<sup>8</sup> per month. Since these are also costs incurred to produce the units sold in Portugal, these costs were weighted considering the sales in the UK market over total sales (corners: 31.65 percent; retailers: 6.25 percent).

Three other expenses were considered under the item *marketing*. Travelling and accommodation costs for London including one plan trip, flat rent and the living costs for the CEO are considered to be around €2 500 per month. Also, following the Spanish and Portuguese models, a public relation advisory is accounted for €1 000 per month. In terms of initial set-up material, expenditures to be considered are the decorative material, corner furniture and its transportation. According to the company, these set-up costs are estimated at €6 000 – €5 000 for the corner and €1 000 for retailers' material.

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<sup>5</sup> STEP Portugal – specialist in food distribution at controlled temperatures (distribution with the product frozen)

<sup>6</sup> Information according to a shopping centre in London: <http://www.boxpark.co.uk/enquiries/>

<sup>7</sup> This accounts for the minimum wage in the UK for the three employees

<sup>8</sup> Includes production area employees and assistant (excludes vendors in Portuguese corners)

Expansion capacity costs are not considered as the firm has an excess capacity of 4 000 units and it is not considering to invest. In order to increase further its production capacity the company incurs in extra shifts. With this procedure, the capacity may be increased to 18 000 units per month (or 216 000 per year), comparing to the previous 8 000 units.

The break even values of the first year are considered in the following table:

Table 8 – Break-even values of London

|                          | Corners | Retailers | Total    |
|--------------------------|---------|-----------|----------|
| Gross Profit per unit    | 7.50€   | 8.97€     | 7.74€    |
| Total overheads          | 88 750€ | 17 750€   | 106 500€ |
| Number of pies per year  | 11 833  | 1 979     | 13 760   |
| Number of pies per month | 986     | 165       | 1 147    |

The company is expected to sell more than the break-even values. As it occurred in Portugal, in the first operational year the corner is expected to represent a high share of total sales – 80 percent. As the number of retailers raises, the weight of the corner’s sales is expected to decrease. After these predictions, the forecasts of entering the market are optimistic as the expected profit is positive (€60 732) and the total margin is 18 percent.

### **Recommendations**

From the overall analysis and the firm’s experience, the company should not pursue this expansion alone, but with an agent/distributor support. This agent is important for two main reasons: the first is to provide network to the company, which it lacks in the UK; the second advantage is to make the operations management less dependent on the CEO (a problem faced in Spain). The company may contact the firm *Atlântico- Sharing a Passion for Food & Wine*, which has already demonstrated interest in the product. Alternatively, from web research, the company *Bake to Bake* distributes bakery products in the UK from European manufacturers and it is available to adapt its processes to small businesses. The contractual agreements are unknown but the prospect greater sales are expected to overcome the costs of contracting. The contract arrangement is limited upon the business financial margins that were projected and detailed in the P&L.

## Conclusions

The firm is advised to pursue its internationalization to London as positive results are projected. Surely, it will face risks expanding its operations to the UK, mainly because its investment capacity is small and the impact on the business is large. The adoption of a *corner* involves additional costs but they represent a low portion of the revenues.

Given the size and the characteristics of the market, the prospects of attaining a high level of sales are encouraging. Nevertheless, to take advantage of the market opportunities, the product must be well positioned and communicated. It is worth to mention that for a small company, even a trivial increase in sales represents a major impact on the business.

Taking into consideration the firm conditions, the direct exporting method was considered a safe entry mode in terms of investment requirements, which simplify the process. The strategy of implementing a *corner* and engaging on spread retailers increase brand coverage and diversify sales, decreasing firm's dependence on one selling place. Still, *corner* sales are expected to represent a great share of total sales in the first year.

Since the company will use its excess production capacity of the Portuguese facility to engage in this expansion, the entry costs are very small. Simultaneously, the exiting costs are minor as no initial investment is required. Thus, if the expansion do not yield the expected results, the company is not committed with a high level of resources.

It is expected that the agent/distributor eases and accelerates the entry approach to the market, making the procedure more assertive and efficient. Also, it makes the business less dependent on the CEO. However, this analysis lacks the contractual conditions of an agent. This option is expected to be advantageous but the firm is required to explore further the possibility and to measure the impact on the process.

The firm is facing a mature and saturated industry, but the product has been able to penetrate successfully the Portuguese market. Considering the characteristics and size of London, the market presents good conditions for the product to succeed.



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Eurostat: <http://ec.europa.eu/eurostat>

Knoema: <http://knoema.com>

Global Marketing Management System Online - GMMSO: <http://www.gmmso3.com/>

Box Park Shopping Centre: <http://www.boxpark.co.uk/enquiries/>

Bake to Bake: <http://www.baketobake.com/>

## Appendixes

### Appendix 1 – GMMSO Evaluation Criteria

| Criteria  | Score      |
|---|------------|
| 1. Is the foreign market similar to the domestic market?  | 4          |
| 2. Is the End User of the product in the foreign market the same as in the domestic market?             | 4          |
| 3. Is the product successful in the domestic market?  | 4          |
| 4. Is the product unique?   | 4          |
| 5. Does the product perform the same function in the foreign market as it does in the domestic market?  | 5          |
| 6. Are the product use conditions the same in the foreign market as they are in the domestic market?    | 4          |
| 7. Does the product need modifications to meet the needs of the customers in the foreign market?        | 4          |
| 8. What is the stage of the product's life cycle in the home market?                                    | 1          |
| 9. What is the stage of the product's life cycle in the international market?                           | 1          |
| 10. Does the product require after-sales service?   | 5          |
| 11. Is the company in a position to provide after sales-service to its customers in the foreign market? | 2          |
| 12. Would export orders hurt domestic sales?  | 2          |
| 13. Does the company have the financial resources necessary for export?                                 | 2          |
| 14. Does the company have in-house personnel with export related knowledge/experience?                  | 1          |
| 15. Is international/global participation part of the Mission Statement of your company?                | 4          |
| 16. Is international expansion a part of the strategic business plan of the company?                    | 4          |
| 17. Would the company be willing to investigate export market opportunities?                            | 4          |
| 18. Would the company be willing to attend and/or participate in Trade Shows abroad?                    | 5          |
| 19. Is the company willing to translate company literature into one or more foreign languages?          | 4          |
| 20. Are the company's top competitors involved internationally?   | 2          |
| 21. Is the industry highly regulated?   | 3          |
| 22. Is the company certified- ISO 9000 or other certification?  | 1          |
| <b>Total</b>  | <b>70</b>  |
| <b>Score</b>  | <b>64%</b> |

## Appendix 2 – Country Evaluation Criteria

| Variable                     | Source                                    | Year | Unit              | Max Score   |
|------------------------------|---|------|-------------------|-------------|
| Total Population             | Eurostat                                  | 2014 | million           | 1,0         |
| Population Growth            | Eurostat                                  | 2014 | %                 | 0,5         |
| GDP Per Capita (PPS)         | Eurostat                                  | 2013 | €                 | 1,0         |
| GDP Growth                   | Knoema.com                                | 2014 | %                 | 0,5         |
| Turnover                     | Eurostat                                  | 2013 | million €         | 0,5         |
| Turnover Growth              | Eurostat                                  | 2013 | %                 | 0,5         |
| Value Added                  | Eurostat                                  | 2012 | million €         | 0,5         |
| Number of Enterprises        | Eurostat                                  | 2013 | -                 | 0,5         |
| Driving distance to capitals | Google Maps                               | 2015 | km                | 1           |
| Imports                      | Trade Map – ITC                           | 2013 | thousand €        | 1,5         |
| Consumption Per Capita       | Euromonitor                               | 2014 | €                 | 1,5         |
| Shopping Centres Density     | Cushman & Wakefield Research              | 2013 | sq.m per 1000 pop | 0,5         |
| Shopping Centres Sales       | International Council of Shopping Centers | 2012 | million €         | 0,5         |
| <b>Total</b>                 |   |      |                   | <b>10,0</b> |

## Appendix 3 – Variables' intervals and respective punctuation

| Variable                     | 1       | 2      | 3      | 4      | 5      | 6      | 7      | 8      | 9      | 10      |
|------------------------------|---------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| Total Population             | <10     | 20     | 30     | 40     | 50     | 60     | 70     | 80     | 90     | >90     |
| Population Growth            | <0      | 0,25   | 0,5    | 0,75   | 1      | 1,25   | 1,5    | 1,75   | 2      | >2      |
| GDP Per Capita (PPS)         | 20      | 25     | 30     | 35     | 40     | 45     | 50     | 55     | 60     | >60     |
| GDP Growth                   | <0      | 0,5    | 1      | 1,5    | 2      | 2,5    | 3      | 3,5    | 4      | >4      |
| Turnover                     | <2500   | 5 000  | 7 500  | 10 000 | 12 500 | 15 000 | 17 500 | 20 000 | 22 500 | >22 500 |
| Turnover Growth              | <0      | 0,5    | 1      | 1,5    | 2      | 2,5    | 3      | 3,5    | 4      | >4      |
| Value Added                  | <1000   | 2000   | 3000   | 4000   | 5000   | 6000   | 7000   | 8000   | 9000   | >9000   |
| Number of Enterprises        | >18000  | 18000  | 16000  | 14000  | 12000  | 10000  | 8000   | 6000   | 4000   | <2000   |
| Driving distance to capitals | >4500   | 4500   | 4000   | 3500   | 3000   | 2500   | 2000   | 1500   | 1000   | <500    |
| Imports                      | <200    | 300    | 400    | 500    | 600    | 700    | 800    | 900    | 1000   | >1000   |
| Consumption Per Capita       | <70     | 900    | 110    | 130    | 150    | 170    | 190    | 210    | 230    | >230    |
| Shopping Centres Density     | <100    | 150    | 200    | 250    | 300    | 350    | 400    | 450    | 500    | >500    |
| Shopping Centres Sales       | <10 000 | 20 000 | 30 000 | 40 000 | 50 000 | 60 000 | 70 000 | 80 000 | 90 000 | >90 000 |

## Appendix 4 – Financial Analysis (unit: €)

| P&L Portugal 2015 – without internationalization process |                       |                       |                        |              |
|--|-----------------------|-----------------------|------------------------|--------------|
|  | Corner                | Retailers             | Total                  | %            |
| Quantities   | 12 600                | 23 400                | 36 000                 |              |
| <b>Total Revenues</b>                                    | 35%<br><b>184 338</b> | 65%<br><b>266 760</b> | 100%<br><b>451 098</b> | <b>100%</b>  |
| Revenues/Unit  | 14.63 €               | 11.40 €               | 12.53 €                |              |
| <b>Cost of sales</b>                                     |                       |                       |                        |              |
| Production   | 38 430                | 71 370                | 109 800                | 24.3%        |
| Corners' costs   | 110 227               | 0                     | 110 227                | 24.4%        |
| Distribution   | 3 276                 | 6 084                 | 9 360                  | 2.1%         |
| <b>Total costs of sales</b>                              | <b>151 933</b>        | <b>77 454</b>         | <b>229 387</b>         | <b>50.9%</b> |
| <b>Gross Profit</b>                                      | <b>32 405</b>         | <b>189 306</b>        | <b>221 711</b>         |              |
| Gross Margin   | 18%                   | 71%                   | 49%                    |              |
| <b>Overhead costs</b>                                    |                       |                       |                        |              |
| Staff costs  | 24 500                | 45 500                | 70 000                 | 15.5%        |
| Facilities   | 3 780                 | 7 020                 | 10 800                 | 2.4%         |
| Marketing  | 2 520                 | 4 680                 | 7 200                  | 1.6%         |
| Others   | 9 870                 | 18 330                | 28 200                 | 6.3%         |
| <b>Total Overheads</b>                                   | <b>40 670</b>         | <b>75 530</b>         | <b>116 200</b>         | <b>25.8%</b> |
| Total Overheads/Revenues                                 | 22%                   | 28%                   | 26%                    |              |
| <b>Net Profit</b>  | <b>-8 265</b>         | <b>113 776</b>        | <b>105 511</b>         | <b>23.4%</b> |
| Net Profit per Unit                                      | -0.66                 | 4.86                  | 2.93                   |              |
| Net Margin   | -4%                   | 43%                   | 23%                    |              |

Note: The item *Others* includes accountant, Facebook page management, advertising, participation in events, insurance, among others