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Report

SMALL AND MEDIUM COMPETITIVENESS.
INTERNATIONALIZATION STRATEGY

"H3 INTERNATIONALIZATION TO BRAZIL"

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Executive Summary

h3 is a Portuguese firm competing in the fast food market with a hamburger gourmet concept. The firm is now a strong player in Portugal (39 stores); Poland, Warsaw (1 store); Spain, Madrid (1 store) and Brazil, São Paulo (2 stores). As a result of their successes in the domestic market, internationalization was a natural step. One of the major challenges the firm faces is the model to use in expanding into the Brazilian market. The aim of this project is to suggest to the firm the best approach for h3 in their expansion into Brazil. In order to assess the best mode of entry into new markets within Brazil, an in depth analysis of the h3 success performance in Portugal is necessary. By analyzing the Brazilian fast food market, we can see to what extent these markets achieve and do not achieve parity. As we shall see from the analysis, expansion is completely viable within the Brazilian market, to the states of Rio de Janeiro, Bahia and Estado Federal. Furthermore, the existing model h3 uses in its current Brazilian stores, that is, a joint venture model with h3 and its Brazilian partners as the master franchiser, will be the most successful route to rapid expansion in the region and in ensuring that competitors do not steal the concept h3 has pioneered.

Key Words

h3; Brazil; hamburger; Franchising

Description of the firm (Exhibit1.)

h3 is a Portuguese firm established in 2007 by three old friends[1]. Before running h3, the partners had managed a restaurant called "Café 3"[2] with a gourmet concept from 2004-2009. This experience has been fundamental in the acquisition of know-how in

[1] Albano Homem de Melo, António Cunha Araújo and Miguel van Uden
[2] Located in Av. da Liberdade with an average price of 30€ per meal

successfully implementing h3. Although Café 3 was conceptually a success, particularly with their hamburgers, it wasn´t as profitable as the partners expected. Aware of a potential opportunity, the three partners decided to create an innovative business, "Hamburger Gourmet"[3] using the title h3 and the slogan “Not so fast food". This was an entirely new concept in the Portuguese fast food market. The product consists of a hamburger made of fresh beef (200 gr) served on a plate garnished with "thai rice" and fresh fried potatoes[4], in contrast to the usual bread roll. The fact of there being just one core product leads to two big advantages: the process is simple (assembly-line) for employees and the final product is delivered faster to consumers. In addition to the new hamburger concept the firm also developed two original natural drinks, lemonade and ice tea. These two drinks have been very successful and have the advantage of being much more profitable than conventional soft drinks[5]. The company has achieved rapid growth and it now sells around 10.000 hamburgers per day in part due to the fact that h3 is using this growth as a tool to protect the concept from imitators, build brand awareness. Revenue increased from 341.000€ in 2007 to 22.000.000€ in 2010 (Exhibit2.). The cost of setting up an h3 restaurant is from 200.000€ to 250.000€. At present there are 39 stores (37 in shopping malls) operating in Portugal. The main reason for opening two street stores that are outside shopping malls is to use them as pilot stores to test the potential of the model for future entry into countries without a shopping mall culture. The partners consider Portuguese shopping mall culture a crucial factor in the success of the model in Portugal.

The firm has an unconventional management style, for example, not investing in promotion and advertising. The partners believe that if they have a superior product, fast

[3] h3 concept

[4] In all the menus the client can choose salad or spinach as an extra

[5] eg. Coca- Cola, Fanta

service and an affordable price, the experience of the customers and consequently "word-of-mouth" will work perfectly as promotion. Consequently, most of the investment is in training. The firm developed a unique training tool, the "grill school" to achieve high quality and best practice. Due to fast expansion in the domestic market the firm established a franchising contract in the north of Portugal (north of Coimbra). The franchisees are chosen in a very informal way. For example the franchisee in the north of Portugal (João Ventura), after being turned down many times, was allowed a meeting with the partners. The three partners liked Ventura´s profile and attitude, and believed his experience in the sector, (he was the franchisee responsible for the entry of "Vitaminas & Companhia"), added value, know-how and synergy to the business model. h3 also established a franchising contract to expand into Madeira and Açores. Domestic expansion and local success encouraged the firm to go farther and internationalize the business. As a result in January 2011 a new h3 restaurant was opened in Poland (Warsaw) as a joint venture with a Polish partner. After Poland the three partners decided to enter in Spain (Madrid) as a franchisee in partnership with Group VIPS[6].

Vision and Mission

h3's vision is to aim to be the best hamburger chain in the world. Therefore, the firm is planning to a have a global presence within 5 years.

Its mission is to aim to serve an excellent tasty meal at a low cost in a short period of time.

[6] Franchisee group agglomerating 17 different brands in the restaurant industry operating in Spain and Portugal

Table I- Strategic Objectives for 2012

Domestic Market	Foreign Market	Globally
• Opening 4 to 5 stores in the Lisbon area • Opening 4 to 5 stores in the Oporto area • Opening a restaurant outside of a shopping centre in Oporto	• Opening 10 stores in Spain • Opening 3 to 4 stores in Poland • Opening 3 to 4 stores in São Paulo	• Achieving a global sales volume of 40 million Euros • Decreasing operational losses by 10% to 15% • Increasing brand recognition mainly in foreign markets

Source: h3, 2011

Methodology

The first phase of the research began with an analysis of the firm and the industry/ market using secondary data such as web sites, the goal being to gain a broad general knowledge of the firm and the industry. The main sources were newspaper articles related to the firm or to the industry, some available on the firm´s official web site. As a general background to the industry, a short operational search of the main players was undertaken. In the second phase, after consultation with my advisors, I was able to structure the project in clearer terms and to complete my research. The first phase of the project was in group with four colleagues, also focusing on h3, but in different target countries[7]. The goal of this phase was to gain a complete understanding of the organization at an operational, financial and management level. To understand all these issues the meetings we had with h3 staff were crucial. We had several meetings with staff in different areas of the business. We met with Albano Homem de Melo and Miguel van Uden, both partners and founders of h3 who contributed with most of the information used in developing the Description of the Firm, Industry Mapping and also

[7] UK; U.S.A, France and Germany

contributed to the TOWS, Competitive Advantages and Porter´s Five Forces analysis. In another meeting we were able to interview Nuno van Uden, from the Marketing and Communication Department and who more recently has taken over as manager of the firm's Spanish operations. This meeting was very important in order to understand the Spanish franchising model, helping to define the terms of expansion in the Brazilian market. The last meeting was with Sofia Ribeiro Teles, from the Financial Department, who provided information that helped to design the h3 Value Chain. Besides the meetings to elaborate the internationalization part of the project, it was essential to read some researches from Euromonitor International, Datamonitor and some literature related to the theme. During our project we experienced some difficulty in defining the competitors and possible substitutes. To be sure of these two important themes we developed a survey (Exhibit5.), with some limitations, which helped us in answering these questions.

Industry Mapping (Exhibit7.)

Suppliers and Distribution Company

h3 established a formal contract with a distribution company where this firm has the responsibility of acquiring all the different raw materials and delivering them to the stores[8], each to the store´s requirements, although h3 Headquarters is notified of the deliveries, to be able to control the requirements. In practice this distribution company is a sole supplier to h3. The distribution company has some freedom in choosing the suppliers. This freedom was established by h3 and varies in order of the importance of the raw material to the final product. h3 defines the "raw materials" in three areas. The areas are: "exclusive", "important" and "others". "exclusive" are so important raw

[8] Either franchisee or own stores

materials (eg. hamburgers, lemons) that h3 chooses the supplier and the distribution company is obliged to acquire from the suppliers designated by h3. This condition is defined in the agreement[9] established between h3 and the distribution company. In terms of "important", h3 only requires certain specific characteristics in the product. According to the requirements of h3 (eg. rice has to be "thai" type), the distribution company has freedom in choosing the supplier taking in account the specifications h3 has stipulated. In relation to "others" raw materials, the distribution company has totally freedom in choosing the suppliers (eg. salt, pepper), which means h3 doesn´t interfere in the choice of the suppliers. According to the agreement the distribution company is responsible for the quality management of the raw materials, stock management, and storage/warehouse.

Competitors/Substitutes

In a remarkably short space of time h3 has become a player competing almost globally in the international restaurant business. Due to the vast dimension and complexity of the industry it is productive to divide competitors as being either direct and indirect. Direct competitors of h3 are those restaurants which have the same location (food courts[10]), quick service and an affordable price. The main direct competitors are: McDonalds, Vitaminas & Companhia, Go Natural and Noori Sushi and indirect competitors are all other restaurants. Substitutes are classified as all the other forms of having a meal without being in a restaurant, such as having lunch at home or bringing food from home.

Shopping Malls

[9] Formal written contract
[10] A common area within a facility that is contiguous to all restaurants in the shopping mall

The main h3 locations in Portugal are in the food courts of shopping malls (37 of 39 stores). For this reason shopping malls play a central role in h3 operation. Shopping malls are growing in Portugal, due to the importance they have this represents a significant opportunity. h3 establishes formal contracts with shopping malls, these contracts stipulate the duties of both parties. h3 has to pay a rent in these shopping malls, some of which are fixed but in others there is a variable component depending on the total revenue. The fixed part of the rent depends on the location of the shopping mall, the location of the store within the shopping mall and, finally, the area of the store. h3 is obliged to follow some general shopping mall rules applicable to all stores (eg. open/close the store according to set hours). Besides this the shopping mall has further obligations in the arrangements relating to the physical space (eg: the cleaning service for the shared food court area, security and cleaning of the bathrooms).

Market Regulators

In the fast food market the entity responsible for the granting of licenses to run a restaurant is different from that which holds the responsibility of supervision. In relation to the granting of licenses the entity responsible is the local Municipality. Depending on where the store is located, h3 needs the licenses of the related local Municipality. The entity responsible for supervision of the catering industry is the "Autoridade de Segurança Alimentar e Economica" (ASAE) which is responsible for all issues related to this sector (hygiene, licenses, schedules,...). This regulator can act on its own initiative or on behalf of a customer.

External Auditors

h3 has different companies providing external accounting related to specific areas within the business. "Controlvet" (or a subsidiary of "Controlvet") audits all issues relating to hygiene and quality. In terms of customer feedback, quality management and perception, h3 outsources its audit to "Cliente Mistério". h3 has a specific company which provides the audit service for all its equipment.

Key Partners

The Chef[11] plays a central role in the operation of the firm and so is considered to be a key partner. Due to his importance, he is a minority shareholder. The Chef is responsible for the mass production and quality guarantee of the exact specifications of the original recipes designed by one of the partners. The Chef is also responsible for the training standards of the "grill school", a program to establish best practice of employees who work with the grill station. The suppliers of exclusive products are also considered to be key partners. Due to the importance of the core raw materials, some of these suppliers have grown together with h3 (eg. their meat supplier). The franchisees in the north of Portugal and Spain are key partners. Due to their experience in the fast food market, their contribution has been very useful to h3 which is a new business and the partners have no previous experience in the fast food sector. João Ventura, the franchisee in the north of Portugal has for a long time worked as a consultant to h3 headquarters, the partners have asked João Ventura to make important decisions in the firm. The partners consult him on all key decisions and he has contributed with critical expertise to the organization.

Final Customer

h3 has two types of stores: own stores and franchisee stores. The key difference between the two types is the business model. Own stores are B2C (business to customer). In this model the firm has direct contact with customers and h3 headquarters

[11] Vitor Lourenço

are totally responsible for the management of the stores. In the franchisee stores, the model is B2B (business to business). In this case h3 headquarters doesn´t have direct contact with the final customer - the firm interacts with another firm (franchisee). In this model the management of the stores is the whole responsibility of the franchisee, h3 headquarters only receives royalties. Although in both types of stores there are different firms managing, there is no difference in the perception of the product and service by the customer. There is no difference in the products, the service or the branding. When h3 wants to test a new product, it first tests it in its own pilot stores. If feedback is good in the pilot stores, the final product is rolled out to customers in all the stores.

Value Chain[12](Exhibit4.)

In terms of the value chain there is very limited information on the franchised stores. As a result we had to consider only the revenues of the own stores. We computed a final margin of 4%, we are certain this margin is below the actual margin, due to not being able to take into consideration the royalties franchisees pay to the brand.

Primary activities are divided in two main sectors, "Assembly Line" and "Marketing & Sales". "Assembly Line" is the group of activities related to meal production in the stores: employee wages, hygiene and cleaning services, store utilities, product waste, repair and maintenance of equipment, and acquisition of cooking ware. This section represents 31% of the total revenue costs. The firm is making an effort to reduce this amount without reducing employees. The measures are: minimization of wastage of goods, reduction of employee wages and reducing the number of employees per store by relocating existing employees to new stores. The other main sector, "Marketing & Sales" represents 5% and manly includes the royalties paid for the use of the h3 brand.

[12] Information provided from the annual report, 2010

Also included in this sector are the costs of advertising and promotion which are almost non-existent, being word of mouth the main form of promotion.

Secondary activities are mainly divided in three sectors, "Firm Infrastructure", "Human Resource Management and Technology Development Costs" and "Procurement". "Firm Infrastructure" represents 25% of the total cost, which includes management costs, consulting and auditing costs, legal issues and quality control management of the service. Of the three main sectors of the secondary activities "Procurement" has the most impact with 34% of activities included in this sector being led by the distribution company. These activities are: purchase of all raw materials, quality management of raw materials and suppliers, storage of raw materials and certain goods, stock management, and the distribution of raw materials and certain goods into the stores. From the beginning the firm has been growing substantially every year. A consequence of this growth has been an increase in the scale of the business which has allowed h3 to renegotiate the prices with its distribution company. By increasing the scale of business, the firm has increased the number of stores, resulting in reduced administration costs[13] per store. The remaining sector "Human Resources Management and Technology Development", represents 3%, including mostly office employee wages and bonuses. The development of new products[14] is also included in this sector but since there is not a specific department for this, the impact is not relevant.

Competitive Advantages

For a player to "survive" in the fast food market, cost and time management is absolutely critical, the level of standardization of the process must be very high. Without precise training protocols set down in clear instruction manuals it is impossible

[13] Fix cost

[14] Most of the development of new products is done informally by one of the partners

to lead in this market. To enter the best shopping malls high brand recognition is also very important. Most of the shopping malls are full and when a vacancy is available one of the main criteria of the shopping malls for filling this vacancy is brand recognition. These factors are also important in finding the best partnerships for the firm. h3 fulfills all these conditions and that explains a large part of their success. In addition to the essential factors, to "survive" in the market, h3 has three particular competitive advantages. The first is that customers can design their own menu. For example, it´s possible to personalize the hamburger (eg: egg, cheese,..) and garnishes can also be chosen by the customers (rice, salad, potatoes). Secondly, this idea of menu design is reinforced by the perception that h3 product as not just another mass produced hamburger but a gourmet product and this is central to the h3 success performance. Customers feel they are eating homemade food in a market associated with mass production. The other main advantage is the perception customers have of be eating homemade food served fast, when it is usually slow. h3 is a mix of fast food and homemade food taking the best of each one, from fast food the quick service and affordable, from homemade food the perception of quality.

Market Definition

By definition fast food marketing is the sale of food and drinks for quick and easy consumption. The market can be divided into four segments: Quick Service Restaurants (QSR) , Takeaways, Mobile & Street Vendors and Leisure Locations. h3 belongs to the QSR segment, where the restaurant focuses on serving complete meals and table service is usually shared with other restaurants in a food court.

The growth of the global fast food market has slowed down in recent years as a consequence of the global economic crisis. In 2009 QSR was the segment leader, valued at 70,9% of the overall market value. South and North America represented 47,4% of the value of this market (Datamonitor, 2010a).

Portuguese Fast Food Market and h3 Positioning

Consequence of the economic crisis, since 2008, allied to unemployment, Portuguese restaurants market and fast food market faced a sales decline and some structural changes. In a global level the consumers started being more price sensitive and more receptive to discount, either price or quantity discounts. A significant number of consumers stopped lunching out and some consumers changed from conventional restaurants to fast food restaurants. These changes represent at the same time a threat and an opportunity to fast food players in the Portuguese market. Besides the discounts another technique that some players are using to beat the sales decline is the expansion through franchising. This way a fast and low costly expansion is guaranteed.

Between 2010 and 2015 the value of sales is forecasted to growth by a CAGR (Compound Annual Growth Rate) of 2,2%.

Although, since the opening of the first h3 store[15], the market started going down and h3 expansion is being very successfully. In 2010, h3 reached a market share of 3% in the Portuguese fast food market. Considering only the hamburger segment, in 2010, h3 had a market share of 7%. This grown during the dark period Portuguese economy is facing just was possible with a new concept and an affordable price (Euromonitor International. 2011a).

Competitive Assessment

Barriers to Entry

[15] Dolce Vitta Monumental shopping mall

The entrance of new players in the fast food market has no barriers, it is easy to obtain the legal licenses. However, it is very difficult to create new brand recognition in the market, which makes it difficult to access distribution channels, the shopping malls giving priority to brands already recognized in the market. Among the companies that are already players in the market, the most important have a presence in shopping malls with the best locations and highest customer turnover, run by the Sonae Sierra and Dolce Vitta groups. This presence brings benefits through economies of scale. The market is already in a saturated phase, with a very wide range for clients to choose from (sushi, hamburgers, all types of ethnic foods, ...). The investment required to open an h3 store is from 200.000€ to 250.000€. It is not a great deal of money to build a new business compared to most other industries, but when taking into consideration the economic and financial situation of Portugal, the investment, in terms of bank approval and high interest rates, make it very difficult. **Conclusion: High**

Threats of Substitutes

Substitutes are considered to be any type of meals that can replace a meal in a restaurant. The main substitutes for fast food are: lunch at home, a home packed lunch and buying a ready-meal in a supermarket to eat in the office or other location, in general all less attractive than eat out. In the past substitutes have had a low impact on this market for both practical reasons and those of taste. However, with the economic crisis, many people are switching from a conventional restaurant to fast food or to a substitute. In general all types of substitutes are cheaper than lunch in a restaurant[16], so with the crisis there is an incentive for people to save money. The substitutes are

[16] Either conventional or fast food

gaining popularity and at least in the short term will continue to do so due to predictions of the crisis continuing. **Conclusion: Medium**

Buyers Bargaining Power

In the fast food market clients don´t always go to the same restaurant, preferring to switch between different brands and buy in low volume (usually one meal per person), insignificant when one takes into account the total of meals bought. Due to these three facts the buyers have low power to negotiate the price with the fast food restaurants. Although in the fast food market buyers are considered high price sensitive, specifically in the "casual fast food"[17] sector buyers are low price sensitive. Inside the "casual fast food" market prices are identical, if a brand sets a price a little bit above the medium price it is because that brand has greater brand power. Although the customer has low negotiating power in terms of costs there are no switching costs from fast food to conventional restaurants, nor to the substitutes. **Conclusion: Low**

Supplier Bargaining Power

In practice h3 has a single supplier (the distribution company), creating a high dependence. However, h3 is the supplier´s best client and the fact of its being a key partner slightly diminishes the risk of using a single supplier/distribution company. While h3 in practice has just one supplier there is a relationship of interdependence between them which makes sense to analyze. The meat supplier is independent of h3 and, due to the special characteristic h3 requires in the hamburgers this makes h3 highly dependent on them. Conversely, the meat supplier also is a key partner and has grown together with h3, which represents a very significant part (more than 50%) of this firms

[17] Sub sector of the fast food sector which h3 belongs

revenue. If h3 changes its meat supplier this company would have difficult in continuing to operate. **Conclusion: High**

Competitive Rivalry

The fast food market has a significant number of players and most of them have high brand recognition worldwide (eg. McDonalds, Burger King and KFC). In addition to the wide range of strong competition, customers don't have switching costs, which increases the competition even more. Although the competition is high, there is a strong differentiation and the industry is still growing. Concerning fast food providers a customer has a wide range of options, most of them being very different. Like h3 most of the players in the fast food market are mono product, all the menus are concentrated on a core product (eg. hamburgers, sushi, ethnic foods). **Conclusion: High**

TOWS(Exhibit6.)

Through the TOWS analysis I will do some suggestions on how some combinations of the four topics of the SWOT analysis (Strengths, Weaknesses, Opportunities and Threats) can be useful to the firm in the future.

Transforming Strengths into Opportunities

The process has already achieved a high level of standardization so it is easier to franchise the business model. h3 only uses fresh and high quality raw materials, following recent trends towards healthier food. The brand has strong recognition in the domestic market facilitating its entrance into the new shopping malls that are expected to appear in the Portuguese marketplace. h3 has a good price/quality ratio, a relationship that is very much in demand in times of economic crisis. h3 has created a trademark and a powerful identity encapsulated in the slogan, "New Hamburgology" and "not so fast food" which highlights their position in the trend towards healthier and more discerning choices of eating in the fast food market.

Using Strengths to prevent Threats

Due to the high level of standardization h3 is cost and time efficient allowing the firm to "fight" against strong competitors. Having only a core product h3 faces a strong threat due to the dependence on a single raw material. Most of the main competitors of h3 are companies with a globally recognized brand. In trying to combat this competition, the firm should invest much more in brand recognition, such as advertising, sales promotions and sponsorship.

Preventing Threats, improving Weaknesses

h3 must create menu items such as soya or vegetarian burgers to avoid perceived threats like "mad cow disease" and to heighten its profile as a healthier alternative. h3 invests poorly in market research, and is largely unaware of many market opportunities such as popular trends or key locations. Increased investment in market research is critical.

Combating Weaknesses, using Opportunities

Although the shopping mall environment is not the most pleasant, the location guarantees a high flow of people through the area. In addition, due to the increased number of specialized coffee brands operating in this location, the firm is not obliged to provide coffee, representing a significant saving in time efficiency. The corporate team members have a strong and close relationship so there is no risk of losing focus in terms of the companies vision and strategy in relation to its core business and franchising.

Brazilian Market

The Brazilian fast food market reached peak revenue in 2007. The annual growth rates after 2007 started slowing down. This tendency (of annual growth rates slowing down) is forecasted to continue at least until 2014. In 2009 the total revenue of this market in Brazil was 6,9 billion.

Between 2005 and 2009 the CAGR was greater in Brazil (6,8%) than in U.S.A. (3,7%) and Canada (3,8%), although the U.S.A. market value is much higher. The segment with the most market share in this market is the QSR: in 2009 the market (value) share was 70,3%. The segment of mobile & street vendors in the Brazilian market has more significance than in most of the other countries: in Brazil this segment represents 25,8% of the market (value) share. In 2014 the expected value of the market in Brazil is 9,2 billion (Datamonitor. 2010b).

Competitive Assessment

Buyers Bargaining Power

As a result of the worldwide economic crisis, Brazilian consumers are more price sensitive. Consequently companies in this market are undertaking a number of competitive price strategies. Examples of this are discounts and new forms of menu creation. Although this is a recent tendency, the main source of consumer power is that there are no switching costs between the different choices available.

In relation to a specific range of prices, the main factor in consumer choice is the taste, where on one day a brand is chosen, and on a different day, another. An additional source of consumer power is that fast food is not an essential item. However these points are rendered irrelevant when one takes into consideration the high number of transactions. Brazilian fast food companies invest a lot in branding to create loyalty and are thus viewed by the consumer not simply as providers of food (Datamonitor. 2010b).

Conclusion: Moderate

Supplier Bargaining Power

Naturally food suppliers are of critical importance to fast food providers. In a market where the margins are low, volume of sales is the point at which high profits are achieved. A good relationship with a food supplier is essential in maintaining relatively low food costs. Due to the vast area of Brazil it is much more difficult to have the same supplier in all the stores. In addition, some products h3 uses in Portugal are not easy to source in Brazil (eg. lemons). Usually the suppliers provide generic raw materials and consequently their dependence on the fast food companies isn´t high. Most of the food suppliers are large companies, with a broad client base, so they don´t feel pressure to lower their prices (Datamonitor. 2010b). **Conclusion: Moderate**

Barriers to Entry

From a financial perspective entering the Brazilian fast food market is not difficult. The capital required to open a store is relatively low and furthermore the cost of entrance can be reduced through the possible expansion into Brazilian territory. However, there are several barriers to entrance into this market. There is a strong threat of retaliation in such a concentrated segment as the hamburger market by established fast food providers in the form of price wars. The brand strength of some of the main players (eg: McDonalds), may neutralize the effect of the lack of switching costs by consumers. Also, decelerating growth rates in the recent years have made the market less attractive. However, in short term these rates are expected to increase (Datamonitor. 2010b). **Conclusion: Moderate**

Threats of Substitutes

In terms of substitutes, the most frequent is to prepare a meal at home, which makes the switching cost equal to the time spent cooking, sourcing and buying the materials. This "cost" can be significant. The main strengths of fast food compared to the substitutes are convenience and availability. Fast food has the disadvantage of being considered unhealthy. Substitutes are associated with a quality product, and some of them coordinate quality with a low price. In addition, in many regions in Brazil, going to a restaurant is still considered a luxury (Datamonitor. 2010b) . **Conclusion: Moderate**

Competitive Rivalry

Brazilian fast food has a high number of players, but despite this there are strong differences between them. The players can be divided in two main groups, independents (eg. Koni) and large chains (eg. McDonalds). Besides the question of size, the players also can be divided by concept (eg. hamburger, sushi and pizza). The market has low exit costs, which motivates the companies to continue playing in the market, thus increasing the rivalry. All the players have ways of increasing capacity. The large chains can easily increase the number of stores, taking advantage of the range of Brazilian territory. On the other hand independents can increase the number of employees or the opening hours of each store to take advantage of demand. Besides location and number of stores, the players also compete at the price level (meal/menu value). This price war takes place within the fast food market and also against the other food provider markets. The economic crisis is intensifying this fight particularly between the different food provider markets. In relation only to the fast food market, the main source of rivalry is in brand power. Large chains invest the most in this area. **Conclusion: High**

Mode of Entry

h3 has already entered the Brazilian market, namely in São Paulo. In the short period that it has been operating, since November 2011, the sales have been higher than expected and this has encouraged the partners to think about expansion even more. The mode chosen to enter the São Paulo market was joint venture. There are several reasons which justify this choice. Brazil is a country with massive demographic and economic potential. In order to take advantage of this potential, joint venture was considered the best mode for the firm to rapidly build brand awareness, working as a master franchiser to expand over the whole territory. Another important reason for the decision to use joint venture was the appearance of a perfect partner, an old friend of António Cunha Araújo (partner and founder), who has previous experience in the Brazilian fast food market, specifically in the headquarters of McDonalds in Brazil. The experience of this partner was essential to overcome barriers in the Brazilian market. The main barrier h3 faced when entering this market was in sourcing suppliers. Top quality raw materials (particularly the exclusive specification of the raw material) is essential to the h3 operation. Without the experience of the partner it would be even more difficult to find the appropriate suppliers. Another barrier which the partner helped overcome was the legal constraints. Brazil is a country with high levels of corruption and a lack of transparency. Without a partner with a comprehensive knowledge of the market it would be very difficult to overcome this problem.

Expansion

By starting in São Paulo the biggest city in the country, h3 realized that joint venture is the best mode of entering and expanding in Brazil as master franchiser. Due to rapid expansion and to make use of the opportunities of this market the firm should franchise. This mode is most frequently chosen by fast food chains because it has the two crucial advantages of enabling faster expansion and requiring low capital investment by the owners of the brand. Fast expansion is important to prevent other firms from copying the concept. In the case of the Brazilian market there are additional opportunities such as sports events that will occur in the short and medium term. In 2014 the Football World Cup will be in Brazil (nine cities), and in 2016 the Olympic Games will be in Rio de Janeiro. I suggest h3 open up the franchise by zones (states). In the short term, over the next two years, it should expand into three specific states, Rio de Janeiro, Bahia and Estado Federal. With this expansion plan h3 would be present in the four most important cities in Brazil, together with São Paulo (State of São Paulo).

It is recommended that h3 design a contract for each franchisee similar to the contract (Exhibit7.) that company signed in Spain with group VIPS. This contract is very comprehensive and favorable to h3. In all the franchisee stores an effort must be made to use the some suppliers as São Paulo. In this way the quality of the products can be guaranteed, the products/service would be identical in all stores and there are excellent possibilities for economies of scale.

The firm has two ways to choose the franchisee. It can call on "Associação Brasileira de Franchising", a company specialized in franchising. This company has around 900 firms on its database. Although this option has a cost it can be a good way to access an appropriate partner. This company can also help in the choice of the suppliers, a possible threat to h3 expansion. The other route h3 can take is to use the knowledge of its Brazilian partner to approach firms recommended by him.

It is suggested that h3 continues to offer the same menus in Brazil in all its restaurants, as it does in São Paulo as this has been shown to be a winning formula (it is important to note that most of the menu items have changed from the ones offered in Europe), and to include a healthier menu option. Brazilian people are very concerned with their appearance (especially in coastal cites like Rio de Janeiro) and this menu could exploit the quality/health perception the brand has in attracting many Brazilian consumers. The firm should also create specific menu items for the 2016 Olympic Games and the 2014 Football World Cup. It is important to understand that this kind of brand differentiation is not really possible in a fast food provider like MacDonald's. The individual identities created by the gourmet concept enables the h3 brand to build strong and separate identities within its product range.

Implementation

In this section the goal is to define priorities and timelines among the different tasks in implementing a strategy for h3 in the State of Rio de Janeiro. I have chosen Rio de Janeiro to design the implementation plan because after São Paulo it is the city with the greatest potential in Brazil. The implementation plan should take place over two years (starting in June 2012) using the 4 M (Men, Money, Minute and Memo) approach.

Men

Before opening its first stores in Sao Paulo h3 had a country manager responsible for liaison between h3 and the joint venture in Brazil. The joint venture responsible for the operation in São Paulo´s stores will be the Master Franchiser over all Brazilian territory. The Brazil country manager has to recruit a partner to be the franchisee in the State of Rio de Janeiro.

Money

Due to h3 already employing a country manager, that salary is a sunk cost, as are the costs of accommodation and travelling (due to the long distance from the h3 headquarters in Lisbon, the Brazil country manager operates permanently in Brazil territory).

In order to find a good partner to be the Rio de Janeiro franchisee h3 should contact "Associação Brasileira de Franchising". This organisation is a non-profit entity and periodically publishes reports on and about potential franchisees. Selecting a good partner to establish a franchisee contract is fundamental for h3 to have sustainable growth and the successful implementation of its strategy in Rio de Janeiro.

From the franchisee partner h3 will receive royalties, entry fees and a payment for the use of the brand.

Table II- Minute

	Activity	Duration	Dependency
1	Contact "Associação Brasileira de Franchsing"	2-3 months	X
2	Choose Rio franchisee	3-8 months	Act 1
3	Celebrate the Contract	2- 3 months	Act 2
4	Stores Construction	8-10 months	Act3
5	Employees Training	1-2 months	Act3
6	Marketing Plan	3 months	Act3

Source: Primary Data

Table III- Memo

	Objectives	Measurement	Target	Initiative
Financial	• Increase the number of stores • Increase the revenue	• Sales´ revenues • Royalties • Entry fees	1- Positive revenues in the first semester	• Choose a key partner to be the franchisee
Customer	• Be the main Brazilian reference in hamburger gourmet market	• Customer feedback ("Cliente Mistério")	1- 50% awareness of the final customer in year 1 (only in the state of Rio de Janeiro)	• Promotion campaigns related to the Olympic Games and Football World Cup
Internal	• Recruit workers • Time and cost effectiveness • Minimize waste	• Number of meals served per minute • Internal evaluation tools of performance	1- The grillers start the training three months before in São Paulo stores	• Training programs

Learning	• Use the customers feedback from São Paulo stores to forecast the clients need	• Customer feedback ("Cliente Mistério")	1- Increase customer preference and satisfaction level	• Adapt the menu from São Paulo stores´, make it healthier • Special menus to Olympic Games and Football World Cup

Source: Primary Data

Conclusions and Recommendations

As previously mentioned, h3's priority should be to begin its expansion into Brazil by starting in the state of Rio de Janeiro. Although this expansion will take place within a scenario of economic crisis and the vast range offered by Brazilian fast food competitors, the market is expected to grow more than in most other countries. In addition to this growth Rio de Janeiro has a large population and a high profile in the ranking of the most important Brazilian and South America cities.

Furthermore, Brazilian and Portuguese culture are in many ways identical which immediately opens up the market for the h3 concept, a fact that has already been proven in São Paulo, a first-rate indicator of the acceptance in Rio de Janeiro.

Rio de Janeiro has a very high flow of tourists all year round, coming from all over the world, an opportunity to make the brand visible to the global market and to make further expansion possible. In the short and medium term Rio de Janeiro will be one of the locations of the 2014 Football World Cup and the sole location of the 2016 Olympic Games. These are the two major sports events in the world and will bring even more tourists and credit to the state.

h3 follows the trend towards healthier food in the fast food sector using only fresh high quality ingredients. This represents a big advantage to the body conscious population of Rio de Janeiro and of course to h3. To capitalize on this consciousness h3 should focus on the creation of a low calorie menu in Rio de Janeiro. A high quality meal served quickly with low calories and low price would be a perfect option for these customers and further differentiate h3 from its competitors. For a successful implementation in Rio de Janeiro I also recommend that the firm invest in reliable market research before and after entering the market in order to be prepared for the challenge the vast and powerful competitors will make against it and to be able to follow the trends of the Brazilian casual fast food market. h3 must take advantage of its presence in Brazil by using the suppliers and key partners it has already established in the São Paulo region. By building on this first strong step it has enormous potential and could in the coming years be one of the major players in the Brazilian fast food market.

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Appendix

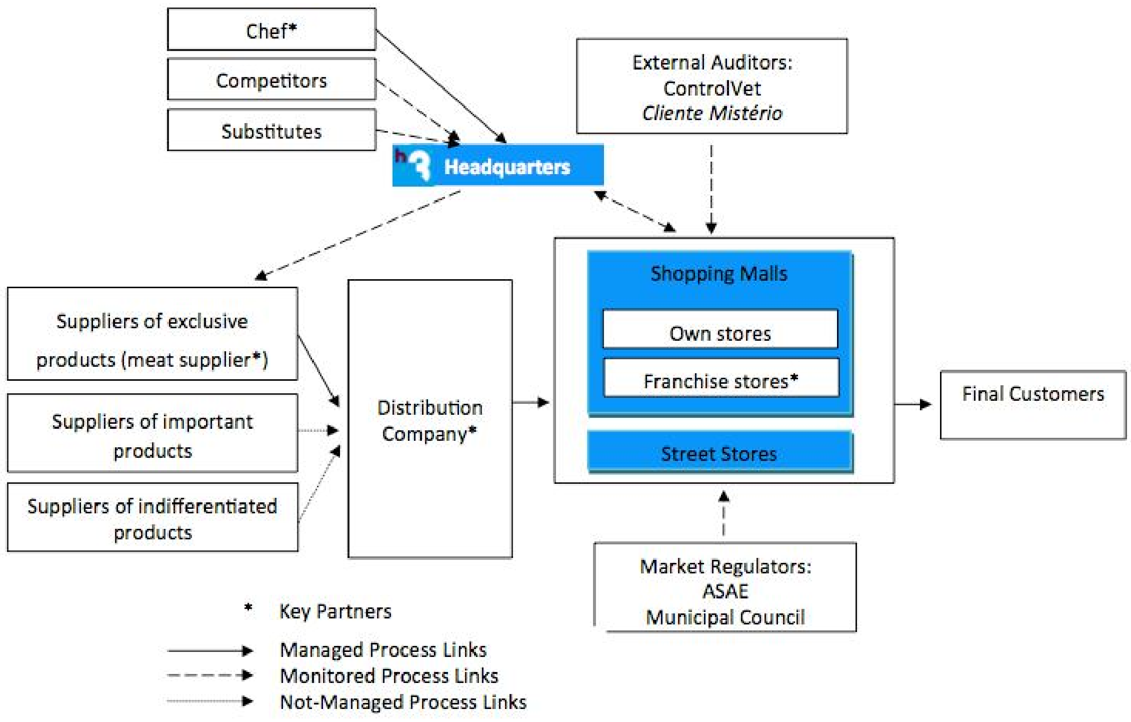
Exhibit 1. h3 Logo

Exhibit 2 Evolution of h3 Sales

	Total Revenue (thousand of €)
2007	341
2008	3, 027
2009	10, 987
2010	22, 000
2011	n.a.

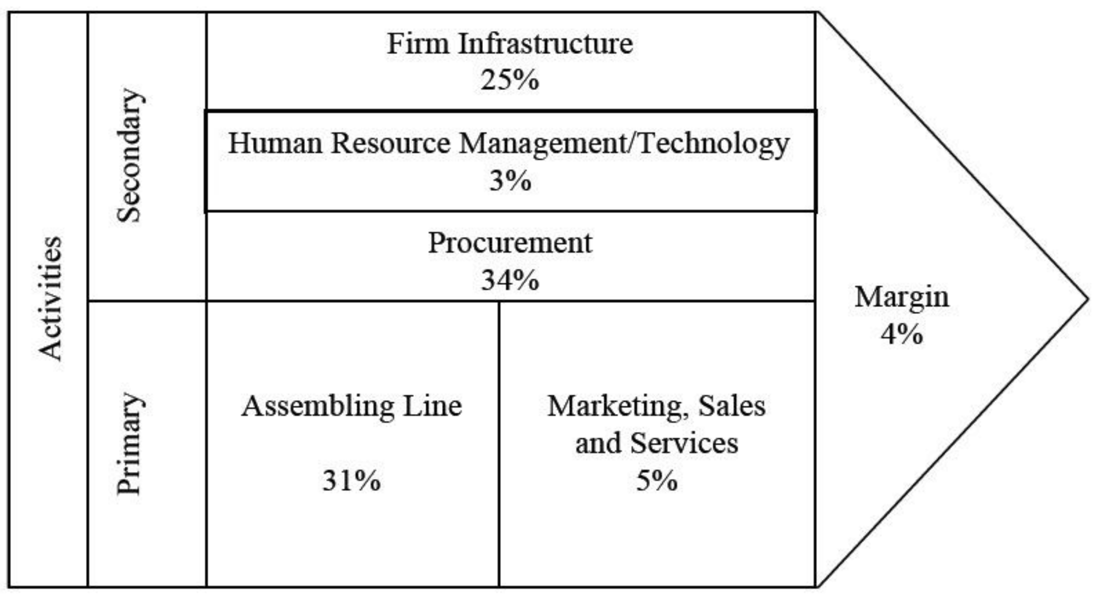
Source. h3, 2011

Exhibit 3. Industry Mapping



Source: Primary data

Exhibit 4. Value Chain

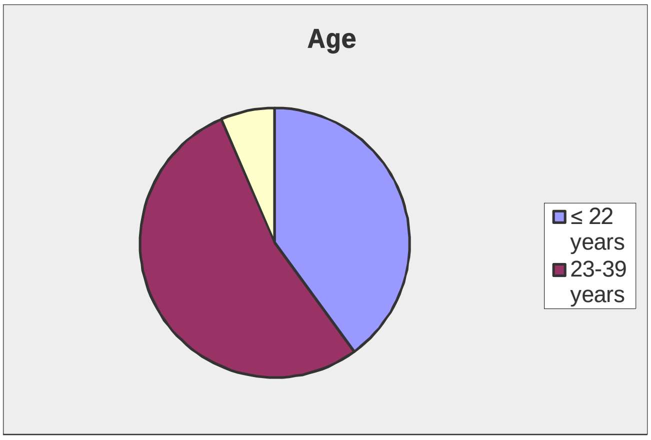


Source: Primary data

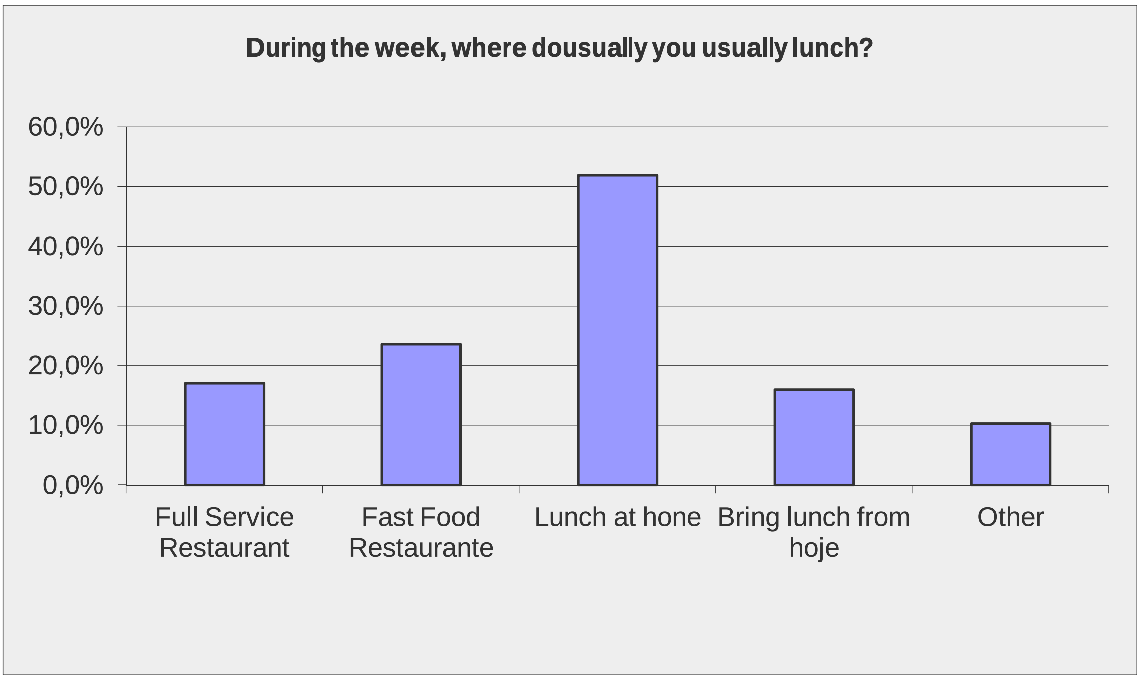
Exhibit 5. Survey

Our group of study developed a survey with the goal of define appropriately the competitors and substitute of h3. The survey was made mostly only, just a few answers were obtained in a queue of an h3 store in a shopping mall. In the total the survey was answered by 368 persons. The questionnaires has some limitations such as the greater part of the persons live in Lisbon and are friends no less than one of the members of our group. The options available in the question number 5 also limited the range of possibilities to answer that question.

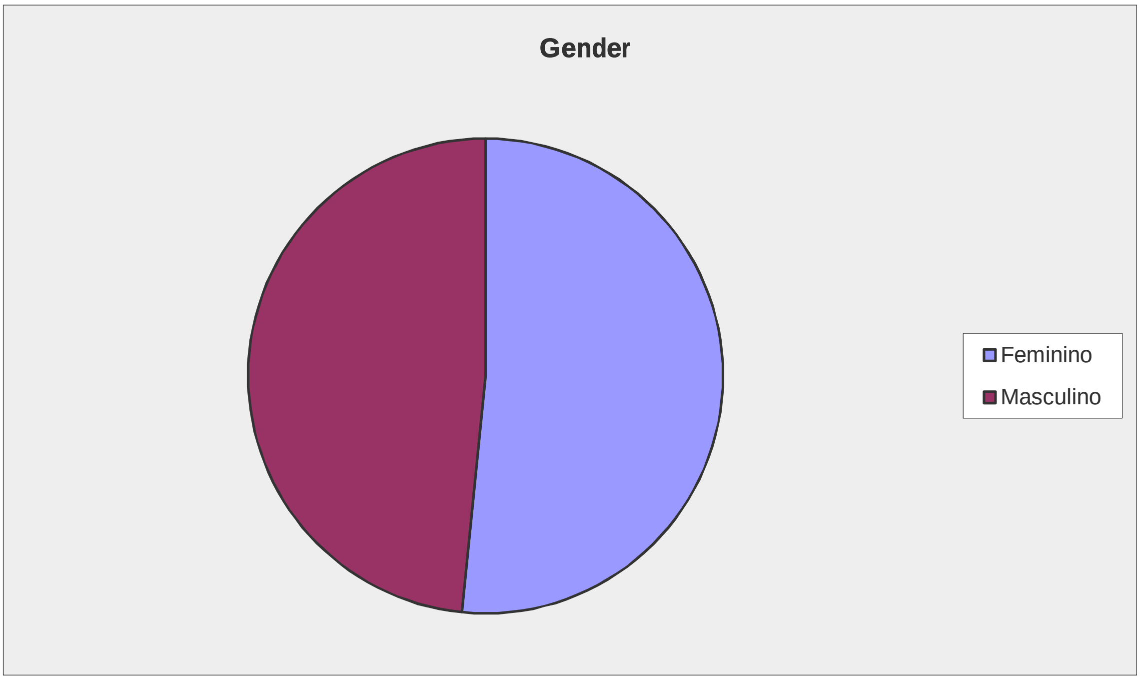
The main answers were:



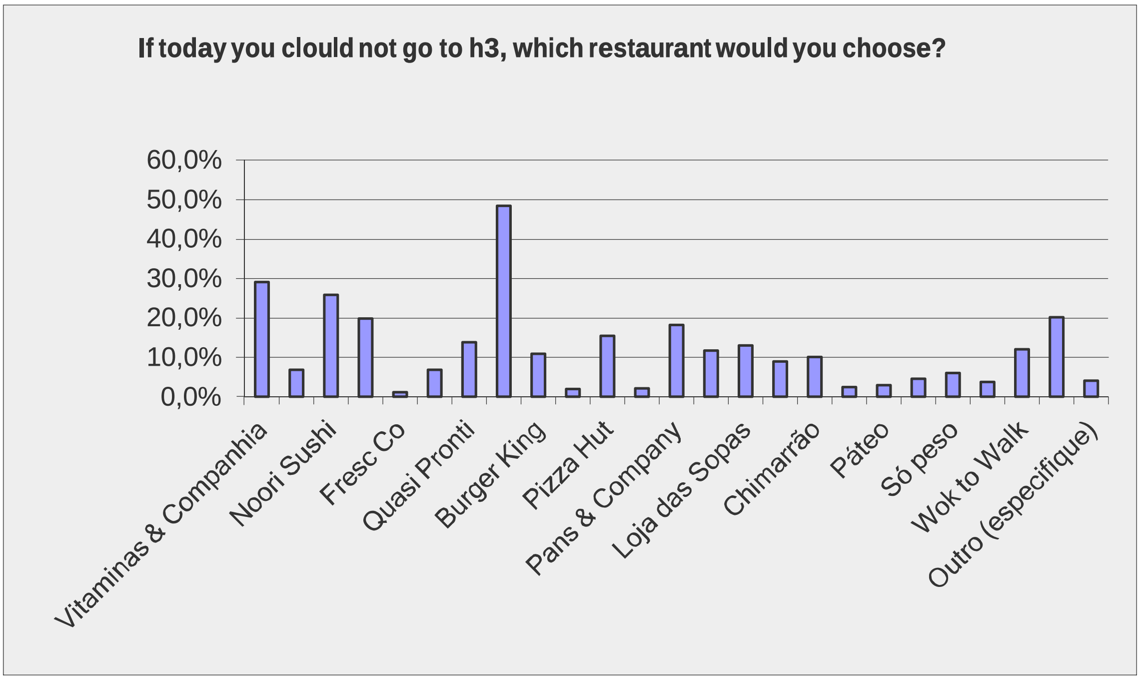
Source: Survey research, 2011



Source: Survey research, 2011



Source: Survey research, 2011



Source: Survey research, 2011

Exhibit 6. SWOT

1. **Strengths**

1.1. Standardization, easy to monitor the production process and its collaborators. Production process: Cost effective (mono-product) and time effective

1.2. Fresh and high quality ingredients

1.3. Flat corporate team structure and high communication flow

1.4. Branding and creativity

1.5. Strong training program for employees

1.6. Key partners: north of Portugal franchisee, Group VIPS, meat supplier, chef, distribution company

1.7. Good price/quality ratio

1.8. Trade mark of "New Hamburgology" and "not so fast food"

2. **Weakness**

2.1. High similarity of menus, all around the same

2.2. Environment where the stores are located is not pleasant, no table service

2.3. Because the corporate team members are really close to each other, they do not define all strategies and sometimes they are not available and decisions need to be taken

2.4. Very low marketing research

2.5. Specialization in a single product (hamburger)

3. **Opportunities**

3.1. Expected increasing of shopping malls in Portugal

3.2. Increasing in the Fast Food consumption

3.3. Trend towards selecting healthy food

3.4. Economic crisis, consumers search for affordable prices

3.5. The franchising model is being showing success in the fast food sector

4. **Threats**

4.1. The fast food market is in the matures stage with a significant variety of restaurants (not concentrated)

4.2. Trend towards food to go or take away in other countries in Europe

4.3. Potential epidemics (eg. cow disease)

4.4. Main competitors are well expanded and recognized international brands (eg. MacDonald's)

4.5. Main competitors offer more options of menus and additional products/services

4.6. 10% increase in VAT since January 2012

Exhibit 7. Group VIPS Franchising Contract

- Group VIPS obligations:
  - Has to pay: a entry cost (includes h3 image), operational costs, promotion costs, royalties depending on the revenue
  - Specific grow objectives (ex: open 10 restaurants in 2012)
  - Use the suppliers chosen by h3 to the exclusive products

- h3 obligations:
  - "Supply" the concept, image, restaurants design

- Provide ongoing support with a “country manager” responsible of the Group VIPS franchisee
- Has to provide and share the know how through workshops, manuals,...