Sustainability, Fast Fashion & Other Stories

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Sweden's H&M, the second biggest vertically integrated clothing retailer in the world by value, is throwing down the gauntlet to its rivals, firstly by announcing the planned launch of a new chain in 2013 and, secondly, by flexing revitalised sustainability muscles in a bid to steer (rather than be steered by) green and social responsibility issues.

H&M eyes brand segmentation to close the gap on Inditex

Cotton prices might have come down since last year as supply catches up with demand but the fast fashion industry, which is harnessed to a low-price model, is far from out of the woods as it battles to retain cash-strapped consumers in developed markets and win new business in emerging markets.

What is more, a recent ban on cotton exports in India has sparked fears of a renewed rally on prices. Wage inflation is also on the rise in the production hubs of emerging Asia, austerity measures are eroding consumer confidence in developed markets and economic growth is slowing in the BRICs.

The impact of the difficult global operating environment was visible in H&M's latest financial reporting as gross margin for the first quarter of 2012 dropped to 55.8% compared with 57.8% for the same period last year. On the plus side, sales were up 13% in local currencies, but the squeeze on (all important) margins could get tighter as the year unfolds.

To close the gap on Inditex, which appears to be going from strength to strength despite heavy exposure to debt-ridden Spain and Western Europe (net profit rose by 12% for the year to January 2012), H&M cannot rely on new emerging market positions to beef up market share.

Hence, the proposed roll-out of a new apparel chain in Western Europe next year, positioned at a higher price point than existing H&M brands, looks like a smart piece of segmentation strategy. The key, of course, is to what extent the brand will help the company expand its fast fashion consumer base and unlock new opportunity in lacklustre European markets .

H&M might be missing a luxury goods opportunity

There had been industry speculation that the new brand would be positioned in the luxury goods segment . H&M has poured cold water on this, announcing last month that the business will indeed sit in a higher priced segment than its other brands, but not in luxury goods.

We now know that the chain will be called â€œ& Other Storiesâ€•, but its debut European city has still not been announced. We could see 10 standalone stores in Europe next year, which would follow a similar roll-out strategy to the company's Cos business division. Like Cos, & Other Stories will also be developed as a largely independent brand.

By not developing a luxury goods line H&M might be missing an opportunity, however. L Capital Asia, a private equity fund backed by LVMH, the world's biggest luxury goods company, recently snapped up a 10% stake in a Chinese fast fashion manufacturer called Trendy International Group. L Capital Asia operates independently from LVMH but there seems little doubt that LVMH will look to leverage Trendy's mass-market position to boost its luxury goods performance.

On the flipside, but following a parallel strategy, H&M could use its extensive knowledge of mass brands to build stepping stones to more aspirational luxury purchases. After all, one of the biggest challenges for luxury goods manufacturers is to understand how consumption culture is developing below the luxury goods radar. This is the consumer base that will be looking to trade up into luxury goods in the future, especially in the emerging markets.

Furthermore, affordable luxury has been a lynchpin of growth in developed markets since 2008, and it has developed by building bridges between mass brands and luxury brands. In particular, diffusion brands of luxury labels have helped entice middle-class consumers of mass brands into new premium-oriented buying patterns. Examples of diffusion brands include Armani Exchange, CK (Calvin Klein) and Miu Miu (Prada).

The risk of positioning in the middle ground between fast fashion and affordable luxury is that & Other Stories could find itself squeezed, above all in Western Europe where the brand needs to drive market share. There is nothing definitive about the pricing strategy yet. And it might be that H&M's new business will indeed look to tap into the burgeoning affordable luxury segment. The company need only look at Mulberry's performance in recent years to see that the model works well.

Is a fast fashion business compatible with sustainable practice?

H&M is further ramping up its competitive differentiation by attempting to promote a greener and socially responsible image. That is a tough nut to crack for such a high-profile fast fashion player because its low-price structure is hugely

dependent on keeping supply chain costs as low as possible .

Critics of the fast fashion business argue that wages paid to workers in some of the world's poorest countries are not only low but exploitative. And in recent years there have been volleys of criticism from ethical campaigners concerning excessive working hours, poor working conditions, use of underage labour and abuse of the environment.

H&M's latest sustainability report (for 2011) does appear to flex some impressive ethical credentials, however. Firstly, H&M is the leading user of organic cotton in the world (an estimated 8% of cotton used in its production process last year was organic). Secondly, eco-friendly solvents were used to make some 2.5 million pairs of shoes last year. Thirdly, the company saved 300 million litres of water in denim production compared to 2010. Fourthly, more than 2.5 million garments were donated to charity. And fifthly, over 420,000 workers in Bangladesh have been educated with regard to their employment rights since 2008.

There is additional data in the report, released this month, but these five points comprise the highlights. Going forward, the problem is that H&M â€“ no matter its sustainability ambitions â€“ is not in control of the supply chain as it does not own its own factories. As such, it will be difficult â€“ if not impossible â€“ to offer any guarantees of social and eco responsibility when factory managers are still free to flout protocol.

Crucially, the fast fashion business model â€“ which is built on rapid cycles of bulk production at rock bottom costs â€“ is largely incompatible with sustainability models. Every effort matters, of course, and even fast fashion's sternest eco critics have to acknowledge that H&M is adopting a more positive sustainability position.

And that will filter right through the fast fashion world because companies need to be competitive in every aspect of the business. Quite simply, if H&M is gaining kudos for its sustainability commitment, then Inditex, Gap and a host of others will look to ramp up their own sustainability credentials too.

Inditex is still setting the pace in fast fashion. Its gross margin was 59% of sales last year, which was higher than any of its rivals. Crucially, it has the competitive advantage of an adaptable homespun production model.

But, H&M is on the right strategic track, firstly by looking to expand its consumer base through brand segmentation and, secondly, by showing the temerity to seize the sustainability agenda. With consumer confidence going into meltdown in Spain, the home market of Inditex, H&M could be on course for a gain in market share.

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