case study

Hotel Chocolat

SWOT analysis

Linear exams make it vital to understand the ups and downs of major UK businesses. Ian Marcousé provides a case study to help you do just that

Hotel Chocolat began in 2003, founded by Angus Thirlwell and Peter Harris. Online sales were supplemented by the first Hotel Chocolat shop in 2004 and café in 2005. In 2010 growth was financed by a 'chocolate bond', which raised £4.2 million from fans of the business. In 2016 the company was floated on the London stock market and £50 million was raised from new shareholders, of which £10 million went into the business to finance further growth. The remainder went to the founders as a £20 million payout each.

Today Hotel Chocolat has more than 95 retail outlets and a Chocolat Hotel in the Caribbean. Sales turnover in 2017 topped £100 million for the first time.

Strengths

Floating the business in 2016 has transformed the balance sheet. Before, the business was stretched financially, but now it's comfortable. Figure 1 shows the turnaround in net cash between the end of June 2015 and 2016 (Hotel Chocolat floated in March 2016). In a similar way, the gearing of the business fell from 53.6% in end-December 2015 to 23.74% at the end of December 2016.

This boost to the finances of the business has occured in parallel with a major investment programme. Hotel Chocolat prides itself on a business model based on vertical integration. In other words it trys to control everything, from cocoa bean through production and distribution to end consumption (e.g. drinking a hot chocolate in a Hotel Chocolat café).

The production centre in Huntingdon, Cambridgeshire has had a capital injection to expand capacity, with local premises being used for packaging, leaving pure production to Huntingdon. In addition there was a major upgrade to the e-commerce site in early 2017, allowing for a growth in online sales to just over 25% of total revenues. This is far higher than other large chocolate producers in the UK, and may help the business sustain its growth rate.

Weaknesses

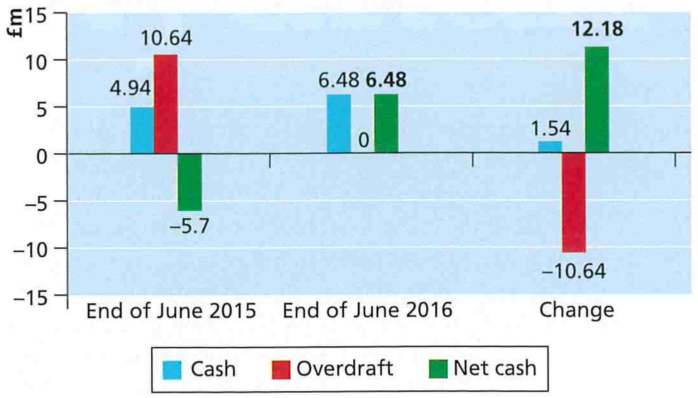
Hotel Chocolat's multi-channel approach (online, own shops, wholesale sales and a 'Tasting Club') has not yet proved itself to be profitable overseas. For 2 years the company has been trying to achieve satisfactory profits with three stores in Denmark, but this has not yet paid off.

The directors seem happy to expand in the UK, believing there is scope for more shops in more towns. It is possible, though, that this will prove difficult. At present a Hotel Chocolat 500g 'Happy Birthday' bar of milk chocolate is priced at £16 on the company's website. A 200g bar of Cadbury Dairy Milk costs £1.50 in Tesco, making the price of the Hotel Chocolat bar about four times higher per gram. For the business to enjoy long-term expansion in the UK, it will have to cut its production costs in order to move its pricing towards the mass market.

A separate weakness can be found in the pages of the annual report, which shows photos of the directors of the business. All four executive directors are middle-aged white men, as is the company chairman. The only woman is the non-executive director, i.e. she has no part to play in the day-to-day running of the business. She too is white and middle-aged. Diversity is not on offer. For a business that claims an ethos of 'Originality, Authenticity and Ethics', this is ironic — but is also poor business thinking. Modern companies need directors with a broad understanding of modern markets.

Opportunities

Hotel Chocolat prides itself on offering innovative, special chocolate products that tend to have more cocoa and less sugar



Source: Hotel Chocolat accounts

Figure 1 Hotel Chocolat net cash pre- and post flotation

than traditional brands such as Cadbury. This places the business firmly on the side of modern trends. People want to eat smaller quantities of better-quality products — especially products that are known to be fattening. A 50-g Hotel Chocolat bar might be as satisfying as 100g of another brand, if it's the right combination of smoothness and flavour.

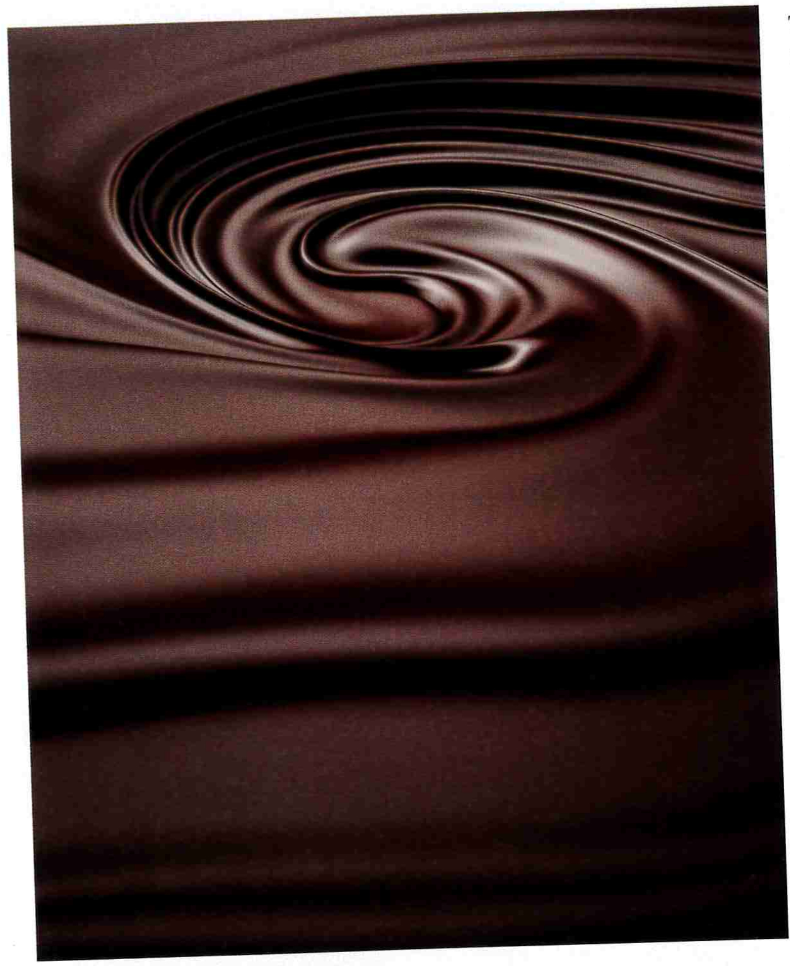
Assuming these trends continue, the UK may eventually end up a bit like Japan, where chocolate is a treasured treat to be eaten in small quantities. A Japanese Kit Kat is extraordinarily small to Western eyes and stomachs — but much loved in Tokyo, where there are Kit Kat shops that only sell Kit Kats. The Japanese love products that are stylishly wrapped, beautifully made and innovative in their underlying design. Hotel Chocolat could be a huge success in Japan, though there is no evidence that it has yet tested these waters.

Threats

Despite its vertical integration, Hotel Chocolat is entirely dependent on materials imported to the UK. Cocoa will never be grown in Britain and most of the sugar used in chocolate production is imported cane sugar. Less than 6% of sales are exported. This puts the company at risk from a fall in the value of the pound.

This has happened since the UK voted to leave the European Union, but there's an argument for saying that there may be a lot more depreciation to come if a hard Brexit becomes a reality.

Hotel Chocolat products tend to have more cocoa and less sugar than traditional brands



This would increase import costs sharply while giving no benefit from the impact of a lower pound on export prices and volumes.

In many ways it is to the company's credit that it actually manufactures chocolate instead of outsourcing to a bigger producer. More than 90% of the company's requirements come from its Huntingdon factory. But this means the business is hugely dependent on the quality and quantity of production. Many years ago a brand called Golden Wonder dominated the market for potato crisps in London. Then a devastating fire at the factory halted Golden Wonder production, allowing a little-known Midlands brand called Walkers to make dramatic gains. Lucky Walkers — poor Golden Wonder. It may be wise, in the future, to construct a second production site.

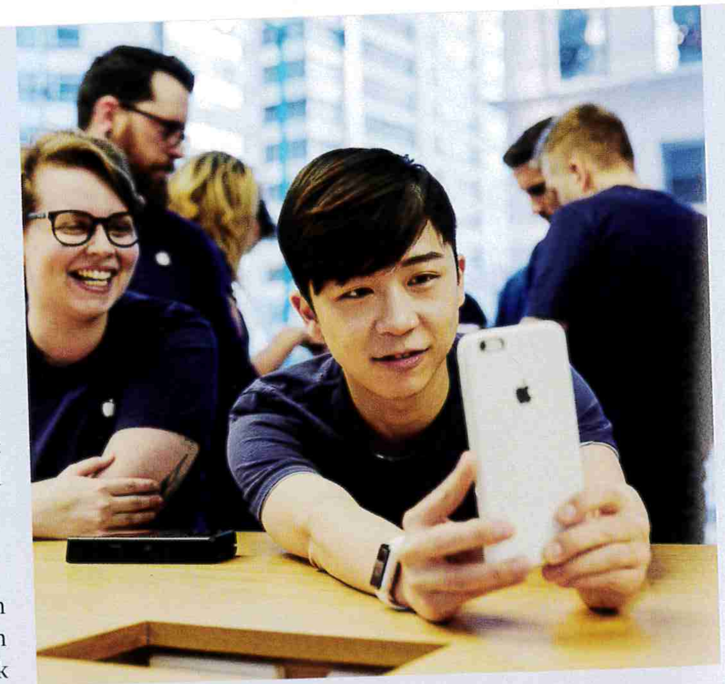
Conclusion

Hotel Chocolat has been a huge success, carving out a significant and distinctive slice of the £3 billion-a-year UK chocolate market. It could become a poster child for Brexit Britain as — unlike most brands — it has little or no established business elsewhere in the EU. So as it develops an overseas business it may look more to Japan, India and China than to the culturally easier targets of Western markets. In this it will be helped by its expertise at e-commerce chocolate sales — a fast-growing sub-sector of the chocolate market. Hotel Chocolat looks to be in a good position to enjoy a strong future.

Ian Marcousé is the founding editor of Business Review and the author of Hodder Education textbooks for AQA and Edexcel AS and A-level business.

triumphs

The iPhone



In 2007 Steve Jobs stood on stage with the first iPhone in his hands and declared that the device was going to change the world. Just over 10 years on, the various iterations of the iPhone have generated over $750 billion in revenue. With the iPhone 8 released in 2017, the overall revenues generated will only keep increasing.

Profitable phones

Given that Apple enjoys profit margins of over 30% on each device and over 1.2 billion handsets have been sold globally in the last decade, this has helped the company increase its stock market value from $100 billion in 2006 to over $814 billion. Profits have increased by an even greater percentage — up from $3.5 billion to over $45 billion in that time. The company has managed to maintain its dominant position within the market, with brand loyalty from customers and remarkably price- and income-inelastic demand, which has ensured that the prices of Apple products remain at the top end.

While rival companies such as Samsung and Google have entered the market, they are still finding it hard to challenge and knock Apple off the top spot. While the company has recently announced it is to end the popular iPod Nano and Shuffle music-only devices, the life cycle of its phone offerings is likely continue for a long time yet.