An understanding of managment tools

Business

Introduction

With some 740 stores in 54 countries, the Spanish clothing retailer Zara has hit on a formula for supply chain management that works by challenging conventional wisdom. This excerpt from a recentHarvardBusiness Review profile on how Zara’s supply chain communicates, allowing it to design, produce, and deliver a garment in fifteen days.

Zara’s history began in 1963 when Amancio Ortega Gaona opened Confecciones GOA in La Coruna, to manufacture women’s pyjamas and lingerie products for garment wholesalers. In 1975, after a German customer cancelled a sizable order, the firm opened its first Zara retail shop in La Coruna. The original intention was simply to have an outlet for cancelled orders. However, the experience taught the firm the importance of a ‘ marriage’ between manufacturing and retailing – a lesson that has guided the evolution of the company ever since.

From a starting point of six stores in 1979, the company established retail operations in all the major Spanish cities during the 1980’s. In 1985, Confecciones GOA created Inditex as the head of the corporate group. In 1988, the first Zara store outside Spain opened in Porto, Portugal, followed shortly by a store in New York City in 1989 and Paris in 1990. However, the real ‘ step-up’ in foreign expansion took place during the 1990s when Inditex entered 29 countries in Europe, the Americas and Asia.

In parallel with its overseas expansion, Inditex diversified its retail offering by another adjacency expansion with new brands like Pull and Bear, Massimo Dutti, Bershka and Stradivarius to meet new customer segments. However, Zara still count for eighty per cent of Inditex's revenue. Each of Inditex's brands operates independently, but shares the commitment to supply fashion at affordable prices and all employ similar management models for the control of the total supply chain to maximize speed to market.

Fig 1 illustrates Inditex's expansion. The figure imitates the stem of a tree, which gain a new circle for every year that goes by. The circles indicate the different expansion Inditex has accomplished, moving from being a fabric to opening its first store and to opening other clothing chains. These types of expansions justify as adjacency expansion. Adjacency expansion draws the skills in the core business to build a competitive advantage in a new adjacent competitive arena in order to target different customer segments.

This adjacency expansion has lead to the need of changing Inditex's core business. Inditex has shifted from being a fabric working towards several retailers, to becoming a big concern covering most parts of the production as well as the final sale.

To grow into a new adjacency around a once-successful core business is the critical factor in 75 per cent of today's total business disasters. The American grocery chains Wal-Mart and Kmart illustrate an example on difficulties in adjacency expansion. They both open their first grocery store in 1962. Wal-Mart successfully moved into adjacency such as Sam's Club, electronics and Mexico, one by one. Kmart however, struggled more with the expansion. They moved from books to sporting goods and even to a chain of department stores in Czechoslovakia. This drifted Kmart into bankruptcy. Showing that even though they started out equally, the different choose of steps in adjacency expansion lead one to be a bigfailureand the other to be one of USA most respected companies.

Another example is Nike versus Reebok, which in 1990 had almost equal revenue. While Nike had a clear strategy, consisting of a repeatable process it had developed and refined over a decade, to attack one sport after another with the help of different famous athletes, Reebok's path was a mystery to those covering the company. They expanded in different directions and as their core shoe business was doing badly, they kept on expanding into new unconnected arias. In addition, Nike's strong adjacencies expansion made it even harder for Reebok to increase the total sale and ended up decreasing its revenue.

It is not easy to know which expansion that is the right expansion. However, after studying adjacencies expansion in over 100 companies, Chris Zook presents primary six ways to expand the boundaries of business . Fig 2 illustrates these expansions. This is trough new businesses, forward integration, new geographies, new channels, new customer segments or new products.

In parallel to Inditex's, Zara has accomplished several adjacencies expansions during its history. One of two main expansions is by moving from selling women's underwear and pyjamas to regular clothes, shoes, handbags and even make-up. This signifies product adjacencies by marketing a new product or service to core customers. This is one of the most commonly pursued and highest potential adjacencies. The other main growth is by expanding into selling men's wear and children's wear. These customer adjacencies modifying a proven product ortechnologyto enter a very new market segment and are a major adjacency move for most companies.

In addition, Zara continuously expand their business by successfully opening new stores around the world and at the same time enlarge their local industry by expanding the focused production in Spain. Geographic adjacencies move into new geographic areas, is a type of adjacency expansion that companies consistently underestimate in complexity.

Zara has also achieved new business adjacencies by opening Zara Home, a store that sell accessories to the home like kitchen wear and bedclothes. With this, it builds a new business around a strong capability and essentially repositioning it. This is the rarest form of adjacency move, and the most difficult to achieve success with. In addition, Zara has also expanded with channel adjacencies by offering a small proportion of its collection on Internet sale. Although this is more for promotion, it is still a channel adjacency expansion.

All of Zara’s different expansion fits into the primary six ways to expire the boundaries of business. Fig. 3 illustrated that Zara has expanded in every direction. Finding a repeatable method of moving into new adjacencies, one after the other has a clear benefit in the learning curve. This contributes to competitive advantage making the adjacencies better and faster each time.

Zara’s supply chain

In aninterviewwith CNN, Jose Maria Castellano, chief executive at Inditex, talked about Zara's supply chain and indicated its unusual structure by saying:

" Investment banks used to say that this model did not work, but we have shown that it gives us more flexibility in production, sales and stock management,"

At a Zara store, customers can several times a week find new products. The whole collection is in limited supply and they achieve a tempting exclusivity by only displaying a few items, even though the stores are spacious. It makes the customer think, " This green shirt fits me, and there is only one on the rack. If I don't buy it now, I'll lose my chance."

Zara has built a concept around ' fast fashion'. Moving away from the traditionally one collection per session, Zara continually design, produce and deliver new styles. They base their business on demand instead of forecasting. Picking up what people wear on the street, at the university or at a nightclub, Zara's designer's catches ideas for new styles and can present them in a Zara store only two weeks later, while most of the competitors has a lead-time over three months. This makes Zara always able to offer the latest fashion in it store, leading to more sale and fewer discounts.

Such a retail concept depends on the regular creation and rapid replacement of small batches of new goods. Zara's designers create approximately 40, 000 new designs annually and select 10, 000 of them for production. Some of them resemble the latest fashion design creations. Zara often beats the high-fashion houses to the market and offers almost the same products, made with less expensive fabric, to much lower prices.

This fast fashion system depends on a constant exchange of information throughout every part of Zara's supply chain. From customers to store managers, store managers to market specialists and designers, designers to production staff, buyers to subcontractors, warehouse managers to distributors, and so on. Most companies insert layers of bureaucracy that can bog downcommunicationbetween departments. Zara's organization, operational procedures, performance measures, and even its office layouts, all are designed to make information transfer easy.

Zara's single, centralized design and production centre is in Inditex headquarters in La Coruna. It consists of three spacious halls, one for each of the three clothing lines, women, men and children. Unlike most companies, which try to remove unnecessary labour to cut costs, Zara makes a point of running three parallel, but operationally distinct, product families. Though it is more expensive to operate three channels, the information flow for each channel is fast, direct, and unencumbered by problems in other channels, making the overall supply chain more responsive. Each clothing line has separate design, sales, and procurement and production-planning staffs. A store may receive three different calls from La Coruna in one week from a market specialist in each channel; a factory making shirts may deal simultaneously with two Zara managers, one for men's shirts and another for children's shirts.

In each hall, floor to ceiling windows overlooking the Spanish countryside reinforce a sense of cheery informality and openness. Unlike companies that sequester their design staffs, Zara's cadre of 200 designers sits right in the centre of the production process. The designers are usually in their twenties and got the job because of their enthusiasm and talent, no prima donnas allowed. Split among the three lines, they work next to the market specialists and procurement and production planners. Large circular tables play host to spontaneous meetings. Racks of the latest fashion magazines and catalogues fill the walls. A small prototype shop has been set up in the corner of each hall, which encourages everyone to comment on new garments as they evolve.

The physical and organizational proximity of the three groups increases both the speed and the quality of the design process. Designers can fast and easy check initial sketches with colleagues. Market specialists, who are in constant touch with store managers and many of whom have been store managers themselves, provide quick feedback about the look of the new designs (style, colour, fabric, and so on) and suggest possible market price points. Procurement and production planners make preliminary, but crucial, estimates of manufacturing costs and available capacity. The cross-functional teams can examine prototypes in the hall, choose a design, and commit resources for its production and introduction in a few hours, if necessary.

Once the team selects a prototype for production, the designers refine colours and textures on a computer-aided design system. If the item is to be made in one of Zara's factories, they transmit the specs directly to the relevant cutting machines and other systems in that factory. Bar codes track the cut pieces as they converts into garments through the various steps involved in production, including sewing operations, distribution, and delivery to the stores, where the communication cycle began.

Zara manufacture approximately fifty per cent of its products in its own network of 22 Spanish factories, 18 of which are located in and around the La Coruna complex, and use around 500 subcontractors located close to the head office for all sewing operations. Zara closely monitor these sewing operations to ensure quality, compliance with labour laws, and adherence to the production schedule. The subcontractors are responsible for picking up and deliver the production items to the factory. Here each piece is inspected during ironing, placed in plastic bags and sent to the distribution centre.

The other half of its products are procured from 400 outside suppliers, seventy per cent of which are in Europe, and most of the rest in Asia. Many of the European suppliers are located in Spain and Portugal, close to the headquarters. Zara exploits this geographical proximity in order to ensure quick response to Zara’s orders. From Asia, Zara procures basic products and those for which the region has a clear cost or quality advantage. Having the factories in and near Spain gives Zara a tremendous amount of control and flexibility. The location of the production can be seen as a cost trade-off with the cost saved on transportation. Although the increased cost in production will not be offset by the cost reduction in transportation concerning the labour cost is on average 17-20 times the cost in Asia.

For its in-house production, Zara obtain forty per cent of its fabric supply from another Inditex-owned subsidiary. The rest of the fabrics come from a range of 260 other suppliers, none account for more than four per cent of Zara's total production in order to minimize any dependency on single suppliers and encourage maximum responsiveness from them. Most of the fabrics are ordered un-dyed and dyed in one of Inditex manufacturing facilities. By having its own dying facility Zara can quicker respond to demands and it gain less inventory by not storing every fabric in a range of colours. Moreover, if one fabric is not used it can easily be used next season independent of the colures of the next trend.

All products pass through Zara's major distribution centre in La Coruna. In addition, it also has a smaller distribution centre in Zaragoza. The trucks, which run on a bus schedule, deliver to the stores twice a week, using a maximum of 24 hours to stores inside Europe and 48 hours in America. All in all this supply chain, as illustrated in Fig 4, is giving a lead-time on two to four weeks, with a price thirty per cent higher than its competitors and a need to discount only 18 percent of its production.

Outsource

Zara is careful about the way it deploys the latest information technology tools to facilitate these informal exchanges. Customized handheld computers support the connection between the retail stores and La Coruna. These PDA's supplement regular, often weekly, phone conversations between the store managers and the market specialists assigned to them. Through the PDA's and telephone conversations, stores transmit all kinds of information to La

Coruna, such hard data as orders and sales trends and such soft data as customer reactions and the “ buzz” around a new style. While any company can use PDA’s to communicate, Zara’s flat organization ensures that important conversations do not fall through the bureaucratic cracks.

The constant flow of updated data eases the bullwhip effect, the tendency of supply chains and all open-loop information systems to amplify small disturbances. A small change in retail orders, for example, can result in wide fluctuations in factory orders after transmitting through wholesalers and distributors. In an industry that traditionally allows retailers to change a maximum of twenty per cent of their orders once the season has started, Zara lets them adjust forty to fifty percent. In this way, Zara avoids costly overproduction and the subsequent sales and discounting prevalent in the industry.

The insistent introduction of new products in small quantities, ironically, reduces the usual costs associated with running out of any particular item. Indeed, Zara makes a virtue of stock-outs. Empty racks do not drive customers to other stores because the shoppers can always choose form new things. Being out of stock in one item helps sell another, since people are often happy to snatch what they can. In fact, Zara has an informal policy of moving unsold items after two or three weeks. This can be an expensive practice for a typical store, but since Zara stores receive small shipments and carry little inventory, the risks are small, unsold items account for less than ten per cent of stock, compared with the industry average of 17 to twenty per cent. Furthermore, new merchandise displayed in limited quantities and the short window of opportunity for purchasing items motivate people to visit Zara’s shops more frequently than they visit other stores. Consumers in central London, for example, visit the average store four times annually, but Zara’s customers visit its shops an average of 17 times a year. The high traffic in the stores circumvents the need for advertising: Zara devotes just 0. 3 per cent of its sales on ads, while its rivals spend three to four per cent.

References

ZARA Outsourcing = http://industrialeducation. blogspot. com/2009/08/study-of-supply-chain-zara-fast-fashion. html (31/03/11)