

Zara's counter-intuitive business model essay sample

[Design](#), [Fashion](#)



Inditex, founded by Amancio Ortega, operates six different chains: Zara, Massimo Dutti, Pull&Bear, Bershka, Stradivarius, and Oysho. Since 2006 when the case was written, Inditex has added Zara Home and Uterque to its collection.

The retail chains were meant to operate as separate business units within a structure, which included six support areas and nine corporate departments. Each chain addressed different segments of the market, but all share the same goal: to dominate their segment using a flexible business model that could be expanded on an international scale. As the parent company, Inditex focused on providing the corporate services to its respectable chains so that they could accomplish their goals. As a global apparel firm, Inditex's main development strategy for international expansion is to become the sole or majority shareholder. However, for small or culturally different markets, it extended franchising agreements to leading local retail companies.

For countries with large barriers to entry and an appealing customer base, Inditex created joint ventures with the possibility of later buying out its partner. Despite the different approaches used to enter into the international market, Zara has shown that there is no impediment to sharing a single fashion culture. Zara, a key subsidiary of its Spain-based parent company Inditex, was established in Galicia, Spain in 1975. The brand provides an alternative outlook to the fashion retail business model by rejecting media advertising and blow-out sales, and maintaining the bulk of its production process in-house rather than outsourcing to low-cost countries. Despite the seemingly counter-intuitive business model Zara

operates, it has become one of the leading fashion retailers in the world. II.

Business Model

As the first retail chain established by Inditex, Zara has become the largest and most expansive. It had three product lines (men, women, and children), each with its own creative team of designers, sourcing specialists, and product development personnel. The creative team relied on feedback — from store managers, staff, and fashion-forward young people that populated universities and discotheques — to create the product line and to make adjustments for manufacturing later in the season. Zara's clothing line changed continuously throughout the season. Therefore, its design team had to not only create the collection months ahead of time like other apparel brands, but it must also aggregate information from market feedback using Zara's IT system to create the proper alterations to the clothes. The design teams bridged the merchandising and back-end production aspect of the retail industry, but these functions are normally performed by two separate management teams in other companies. By maintaining a flat organizational system with designs originating from multiple sources rather than one key designer, Zara was able to make adjustments to their products throughout the season and had a product failure rate of 1% compared to the industry standard of 10%. Although Zara has proven that its success comes from being a quick-response fashion follower,

that is where they draw the line in following fashion norms. In an industry where massive media advertising has always had a positively linear relationship with production sales, Zara spends only a tenth of what other

clothing brands spend to advertise their merchandise. There is no identifiable “ face” for Zara, and its clothing is first released in its stores rather than the runway. To attract its consumer base, Zara focuses heavily on the brick-and-mortar design and location of the stores as well and creates the illusion of scarcity for its products. Each store shares similar window displays and interior presentations to highlight the brand image. The location of a Zara store would always be at the center of a fashion district and would either be renovated or relocated every 3-4 years to maintain high standards. Customers possessed a sense of urgency to purchase a Zara product because the clothing had a two-week shelf life. However, there was also a freshness to Zara because the floor would be replenished with new products every two weeks. Zara segmented the product lines further by price, fashion content, and target age group to maintain variety, and its prices were also kept lower than comparable products from a competitor.

III. Supply Chain Characteristics

Zara is a vertically integrated company that owns different levels of the supply chain. From manufacturing to warehouse to retail outlets, Zara owns all of these different entities. This allows Zara to globally optimize instead of locally. This type of centralized decision making reduces the bullwhip effect on the overall supply chain. Information is also centralized allowing permeability amongst the different layers in the supply chain. However, Zara's vertical integration strategy is not entirely without its drawbacks. With having only few manufacturing facilities, Zara is unable to take advantage of economies of scale in order to produce a large amount of

apparel for a relatively cheap unit price. Also, with Zara's high replenishment rate of store selections, it needs to invest in highly flexible machinery and very skilled workforce in order to produce apparel in a quick and efficient manner. Production costs (machinery and labor) are relatively high for Zara's supply chain compared to their competitors.

Another interesting aspect about Zara's supply chain is Zara does not forecast the upcoming season's products before production. Instead, their design team observes the fashion trends at that second and reacts to consumer's taste. In order for this model to work, the supply chain has very short lead times and Zara states that it is able to go from design to final product delivery in 14 days. Zara's vertical integration structure makes this possible. Since a large amount of its production is in Spain, it has a centralized distribution center in Europe. However, Zara faces great pressure to expand globally. Low cost and market share are the major reasons why Zara wants to expand globally in order to remain competitive while other companies become global. However, with the expansion of Zara in Asia and North America, inventory management problems will be more complicated and complex as more stores are added on. Lead times to these far-reaching stores will be longer and Zara would not

be as effective in reacting to consumer's tastes and demands.

Transportation costs will also increase since the product needs to travel a longer distance to reach its end customers. While Zara has a very effective and efficient model in its home European market, it will need to make

changes in its supply chain in order to expand to other markets around the world. IV. Entering the US Market

Considering the fact that the U. S. is not as fashion forward as Europe or Asia and that there are many sub-cultures faithful to their respective fashions we feel that Zara must have both a short term and long term strategy in order to successfully weave into the fabric of American Fashion. We recommend that Zara first enter strongly through their online shopping environment. This way they can sample and observe the tastes and trends of the different demographics (city, age, occupation, etc.) in the United States. Additionally, the selection and inventory can be updated instantaneously on the website in order for Zara to quickly observe the effect of such changes in buyer behavior. By doing this, Zara can save overhead costs and effort by not taking the extra step of distributing to the retail level but instead have a more centralized distribution network from which to deliver their products via the well-established delivery systems of Fed Ex, USPS and UPS.

Zara already has a website but they must market themselves slightly more aggressively to promote online shopping at their website. This can be done in a tasteful Zara fashion by making the website experience very high quality and elegant. On top of the basic ads that spell out the website in Web and Print they can mail swatches of cloth with a USB male plug head sewn to them which customers plug into their computers and it will automatically launch Zara's website. Now while this is more aggressive than Zara

's norm, we believe it is a necessary

job to spur the United States

' relatively inert fashion scene. Especially in the United States where there are many retailers and aggressive marketing campaigns, Zara must move out of its current model of minimal advertising to a more aggressive and visible marketing campaign or else it will be lost in the competitors' noise; additionally American shoppers are accustomed to aggressive marketing campaigns. They will be most warmly accepted at the coasts: Los Angeles and New York because these cities are very densely populated and culturally vibrant which motivates the locals to be fashionable.

Once Zara has gathered enough data they can then proceed with the long-term goal of making products targeted specifically for the U. S. market. We foresee that Zara will be most fortunate if they focus on more conservative but still smart and tasteful styling for men and women; they should also retain their kids' clothing line. The reason we believe this is younger men and women all belong to ' sub-cultures' that dress accordingly and do not dress to conform to the encompassing general fashion trends. While those aged 27+ are working and settled down but still want look sophisticated for company meetings or family gatherings. So by Zara targeting the more mature and inert age categories they can capture predictable and consistent demand. Unlike the European markets that do tend to follow an encompassing general fashion trend, the young U. S. market does not.

Should Zara insist on catering to the 17-26 age bracket then perhaps they can pick and choose which sub-cultures they are going to target and be

faithful to that. Part of the long-term fold of Zara's plan of expanding into the United States' market would be to physically expand into the United States after its strategic virtual expansion. They should expand from the coasts going inwards; from areas of high demand to areas of no demand where they should not build a physical presence at all. Then in order to sustain this expanding physical presence they will need a distribution and/or refinement center in or near the United States. The distribution center would serve as the receiving and disbursing center while the refinement center will be where Zara will take modular products and refine it further or customize it for distribution.

V. Economies of Scale

One issue that posed a threat to global expansion was Zara's highly centralized distribution system. All of Zara's merchandise passes through the high-tech distribution center in Arteixo, Spain. The additional transportation cost and administrative coordination (due to direct shipment strategies) required to ship merchandise poses a major barrier to expansion. Zara prides itself on keeping new and fresh styles in its store by changing three-quarters of their merchandise on display every 3-4 weeks. Constantly changing inventory requires frequent shipment of small batches directly from the warehouse to each individual store. This direct shipment strategy is beneficial to Zara's "Fast Fashion" image because it reduces the outbound lead time, but at the same time increases the transportation costs significantly. As of 2001, 75% of Zara's merchandise by weight was shipped by truck by a third party delivery service to stores. It was only 25% of merchandise that was shipped by air.

If Zara maintains its only distribution centers in Spain and expands deeply into countries outside of Europe, then the percentage of merchandise shipped by air will need to dramatically increase; since air shipment is significantly more expensive than by truck, their transportation costs become significantly higher, especially since air shipments will need to be made frequently. Another problem to a single distribution center is the possibility of diseconomies of scale. Right now Zara is extremely quick and efficient with its distribution center. However, should Zara expand to another continent/country, there will be a permanent surge of merchandise within the distribution center. Since the article stated that no inventory stays in the center for more than three days, increasing the moving merchandise volume would complicate the pseudocross-docking process within the distribution center even further.

The excess volume may exceed the working capacity of the capital within the distribution center, and render it incapable of handling the new as well as old order demand. Since there is only one main distribution center, any internal disruption is extremely risky and could prove fatal to Zara's production. Thus, another distribution center would be beneficial not only because it can facilitate excess demand brought about by expansion, but also because having a single factory to manage all of your distribution is extremely risky. A solution to this problem would be to locate another distribution center near a promising new market. In order for this distribution center to be worth the immense fixed investment for construction, the new market would have to be vast and promise high returns. Since Inditex has not yet located a

promising market, this is a long term goal. Inditex's strategy thus far when expanding to a new country has been to test a single location and then build upon that location if it seems promising.

Only once Inditex has actually gained a decent amount of market share in any country should it consider building a new distribution facility. Galicia, Spain is a prime location because wages are extremely low and unemployment is extremely high (17%), thus Inditex always has a plentiful and cost efficient supply of labor. A distribution center in another location would almost certainly entail higher labor costs, but if the market in the other country were big enough, the decreased transportation costs would outweigh the increased labor costs. One country that Inditex could consider for another distribution center is Mexico. Labor costs would still be low and the location would be ideal for delivery to large North American (and perhaps in the future, South American) markets.

If they located a distribution center in Mexico and expanded to the United States, the new distribution center could more easily control the direct shipments. Zara should continue its "test trials" by continuing to expand to fashion forward cities in the United States, test demand, and react accordingly. In the short term, while testing out North American Markets, expansion should be limited to European countries until a breakthrough occurs. Italy, mirroring Zara's high end fashion, is an extremely promising short term goal. Italy is highly fashion forward, has the highest total sales for apparel in Europe (Italy spends €63 billion compared to an average of €21 billion), and is close to Spain (1,377 km).

VI. Refocusing Inditex's Efforts

Inditex was comprised of 6 distinct chains: Zara, Massimo Dutti, Bershka, Pull and Bear, Stradivarius, and Oysho. " Each chain was organized as separate business units within an overall structure that also included six business support areas (raw materials, manufacturing plants, logistics, real estate, expansion, and international) as well as nine corporate departments or areas of responsibility. Each individual chain, however, was responsible for its own strategy, product design, sourcing and manufacturing, distribution, image, personnel, and financial results." (Zara 8).

Thus, Inditex was coordinating not only 6 distinct chains, but also 6 distinct strategies, 6 sets of product designs, 6 sourcing and manufacturing methods, etc. In addition to Inditex essentially running six different businesses, within each " business unit" there are unique complexities as well. Zara, as mentioned before, produces 11, 000 distinct items each year (as compared to the 2, 000 - 4, 000 produced by most retailers), employs direct shipping, manages the complexities of an extremely low lead time, constantly modifies its designs, and constantly revamps their stores all to keep a fresh image. The resources within Inditex are being spread thin. Zara was the first of Inditex's chains, but still 4% of Zara's 6% total market share is directly attributed to Zara. Creating new chains is in some sense a pricing strategy in that each new and slightly differentiated chain makes people feel like they are buying something " different" from the merchandise of the other chain. For example, Hollister and Abercrombie and Fitch are owned by the same company (Abercrombie and Fitch Co.) but if you put these stores

next to each other in a shopping center they act as competitors on a local level. Inditex has attempted to apply that pricing strategy with 5 other chains, and has not found one as successful as Zara. It should stop dividing its money and resources into smaller and smaller pieces with new chains, and instead focus on investing deeply into one.

VII. Lack of Store Managers

“ The availability of store managers capable of handling these responsibilities was, according to CEO Castellano, the single most important constraint on the rate of store additions.” (Zara14) Store managers are the key figure in retail stores. They oversee in-store personnel, decide which merchandise to order and which to discontinue, and also transmit customer data and their own sense of inflection points to Zara's design teams.

It is because of store managers' acute observations of the in-store demand that enable Inditex to decide whether they will replenish or remove specific items. Since the store manager is the soul of a single retail store, if Inditex wants to expand globally, it has to make sure that it has enough innovative, strategic and responsible store managers. Although Inditex is already trying to motivate their store managers by providing them enough control and reward to let them feel that they are entrepreneurs running small businesses, the lack of store managers for future Zara stores over the world will become a huge limitation to Zara's global expansion. One solution to the problem we suggest is to develop an international education program to help Zara to search for and educate capable future store managers all over the world. An

international education program can be positioned as internship and co-op programs which intensively involve an on-site training process.

The participants' reaction to the in-store dynamics such as flow of demand, possible latent demand, interaction with colleagues and customers should be observed since these serve as the cornerstones of a successful store manager. Although the main goal of the education program is to attract passionate and innovative individuals who are able to carry out the tasks of a store manager, a systematic and proper education program such as an internship or co-op program can also raise awareness of Zara in targeted countries. Candidates of the program can be chosen from universities located in the countries whose markets Zara plans to enter. By presenting itself in career fairs and info sessions in universities, Zara can make itself known to its targeting customers, the young, trend-setting people, in a subtle way.

This also suits as a marketing strategy, as Zara values word-of-mouth referrals and invests a lesser percentage [than its competitors] in mass advertisement. Since companies that provide extensive benefits to their employees are perceived by the public to have promising futures, the education program can help Zara's public image. People who do participate in the program will also bring in new thoughts and ideas. As a highly vertically integrated supply chain, Inditex lacks local knowledge, which is a significant limitation for its plans of global expansion. Participants in the education program are prime candidates to help the company gauge what styles will satisfy local demand.

There are several concerns related to the education program. First, Zara needs to be attractive enough to the potential store managers by offering them a clear and promising career path to even have the desire to participate in the program. Second, since the result of the program might not be obvious or beneficial in the first place in terms of finding the right people, Inditex should expect a long time period before seeing the benefits. VIII.

Conclusion

Inditex should focus its energy on its current chains, specifically Zara since this chain in particular is responsible for much of Inditex's success. Because of Asia's low wages and already efficient production, North America, specifically the United States, is Inditex's most promising market to have Zara enter. Enabling shopping via the Zara website would be best for Zara to sample the market's tastes and trends. As Zara expands, a second distribution center near a promising new market is recommended to complement its existing distribution center and to alleviate the high transportation costs. Should Zara breakthrough into North American markets, a new distribution center in Mexico would be most beneficial. The success of each individual Zara store is largely attributed to each store's manager. To find prime candidates for these managerial positions, Zara may be interested in creating and investing in an internship/co-op educational program to train potential candidates.