

# The rationale of choosing the country region business essay



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In 1975, the first Zara store was opened in Coruña, Galicia, Spain. It founded by Amancio Ortega. Zara is operating more than 1700 stores in 86 countries now. (Inditex Company Profile, January 2013). Zara is one of the largest fashion companies in the world. It sells clothing, footwear, and accessories for women, men and children through its chain stores around the world. Zara is the most internationalized and leading brand of Inditex's chain. It is playing an important role of Inditex's sales and profit. Inditex owns eight retailers which are including Zara, Massimo Dutti, Pull & Bear, Bershka, Stradivarius, Oysho, Zara Home and Uterque. (Inditex Company Profile, 2013).

In 1985, Zara enters the business of fast fashion. The business joins José María Castilian, professor of business school and a lover of technology, such as Amancio Ortega's right hand, making the company as a logistic model. Zara opened its first store out of Spain, in Portugal in 1988. In 1994, he opened shop in Sweden. (Martes, 2011)

Besides that, Zara is popular of its Fast Fashion supply chain model. The latest fashions are supplied from design to delivery in just 2 weeks, compared to the 6 month industry average. Zara is able to design and produce a collection twice a week, and distributes it to each store. Its collections are small and sell out quickly, creating the feeling of exclusivity. This is to avoid the price reductions and urges customers to visit their stores frequently. Zara launch about 11, 000 new designs annually. It is a vertically integrated retailer that creates designs, makes merchandise, covey distributions and sales by their own or under their control through their extensive retail network around the world.

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Zara's core concept of the business model is selling medium quality fashion clothing at affordable prices. Vertical integration and quick-response are the keys to Zara's business model. ZARA approach is based entirely on customer feedback and to meet consumer preferences in the design and development of new products. Zara choose to develop its internal business systems.

Through the entire process, the Zara business systems are including designing, procurement, manufacturing, distribution and retailing, it presented four basic success factors: 1) short cycle time, 2) small quantities of each product 3) a wide range of various products every season and 4) heavy investment in information and communication technology.

**Zara entered China market in 2006 with the opening of its first store in Shanghai, China. (Mei Fong, 2006). Inditex is expanding rapidly in China market. Inditex opened 132 new stores in China, 30 of them are Zara stores in year 2011. It also introduced Zara Home and Oysho into China. The company has 275 stores in 42 cities in China currently. The group plan to open 150 new stores including ZARA and other brands in 2012. Zara has opened 131 stores in China by ended on May 2012, with 11 stores newly added. It also started online store in China recently. (Jina Sun, 2012). China's garment industry usually took 6 to 9 months, international brands usually took 120 days. In comparison with Zara only required 7 days at the shortest with an average of generally 12 days. Zara has managed to survive in China for more than four years and is able to beat its competitor, Uniqlo. "First-class design, the fabric of the second-rate, third- rate price" Zara stands firmly in the Chinese market and is pursued by the youngsters who love fashion. (China Economic Net, 2012)**

## **2. 1 Discuss on the rationale of choosing the country/region**

The reason why Zara expanded its business territory into China is due to the business condition in its origin country have been facing a saturated level. This is because Zara known as the largest clothing retailer by sale across the Europe. Besides, due to recently economy expansion in China which achieved its double growth Gross Domestic Product encourage Zara take further step to expand their market in China. As result of the prosperity economy in China which Gross National Income per capita \$5890 and Gross Domestic of 10. 7% together with large population in a country which is 1. 7 billion people and 85. 2% literacy rate and available skilled labor, peoples in

China have their ability to consume more and their purchasing power have been increasing. Through entering the China market, Zara able to achieve and further exploit the economies of scales due to the lower labor cost in China which allow Zara increase their production volumes by reducing the cost of production. In additional, income per capita in China have been improving, the greater purchasing power allow them to purchase middle and luxury items. Regulation in China is looser as compare to heavy regulation imposed in Europe attracted Zara invest their business in China market because most sectors have been deregulated, new textile policy haven been implemented and stable communist country. Besides, the social structure in China has divided into Urban and Rural. In abreast with the country development more urbanization happened in China and more and more people in rural have been shifting into the city looking for better job have bring more new middle class in a society. Moreover, due to the natural environment in China, government allows the textile industry to free access to natural resources for textile clothing because of the rich natural environment in China. Last but not least, due to comprehensive infrastructure and technology available in China, Zara can easy access in to China market and more advantage in financial benefits because Zara do not have to spend extra in basic necessity such as build the road and satellite to run a business.

## **2. 2 Explain and analyze the use of entry modes**

Zara have been adopting 3 different entry modes in the international expansion.

## **Own subsidiaries**

This strategy is known as direct investment strategy which is consider the most costly mode of entry because it involves high levels of control and risk in case the firm exits the market.

## **(2) Joint venture**

This strategy is known as the co-operative strategy, combination both local and foreign expertise especially in large, competitive market where there is difficult to acquire property to set up retail outlets or where there are other types of obstacles that require co-operation with local firm. (Camuñas, 2003).

## **(3) Franchising**

This strategy is only apply to the high-risk countries which are culturally distances or have small markets with low sales forecast like Saudi Arabia, Kuwait or Malaysia. (Flavian and Polo, 2000).

Zara open first store in Shanghai in 2006 and applied the joint venture strategy due to condition of China government imposed when the country joined World Trade Organization required that Foreign Direct Investment activity have to joint venture with local company. Recently the company owns stores in over 40 cities in China which covering most of the first and second tier of cities like Shanghai, Guangzhou and Beijing. Due to the rapid changing in business environment, especially online sales, Zara was co-operated together with most prevailing online websites in Taobao and Jingdong to sell its product online.

Zara expand to international market mainly through local joint ventures because it gives Zara certain types of security. There are a lot of differences in terms of lifestyle, culture, and consumer behavior that create a barrier for Zara to entry. Zara need to do Research and Development for a very long period of time to understand the differences and at the same time, Zara will waste time and money. Therefore, joint-venture with China local company can solve the problems above as well as sharing the profit or losses. Zara is willing to share profit and revenue with local partners, because Zara is earning high profit margin in China.

Besides, Zara can reduce risk by carry out business in China, because Taobao and Jingdong already have the market knowledge, so Zara can enjoy preferential market treatment and benefiting from local expertise and technical know-how. Each partner has different strengths and local expertise to help Zara to promote and understand the local tastes and preferences. Meanwhile, Zara can share potential risks such as political risk, unseen future regulations or natural disasters with partners.

However, there are some drawbacks when doing joint venture. Joint venture does not give management of Zara complete control because the final decision has to be agreed by all partners. Therefore, conflict occurs when there is no mutual agreement on certain issues. Moreover, partners are come from different country and have different company culture and policies, so it is difficult to integrate the company's resources. Therefore, Zara should choose a reliable, well-known and good reputation partners to increase the familiarity between consumers and company and obtain brand awareness and credibility in short time. Zara must choosing partners that <https://assignbuster.com/the-rationale-of-choosing-the-country-region-business-essay/>

shared values, corporate social responsibility, and commitment in a similar concept. So, Zara has chose partners which having multi-unit online business experience and strong financial resources to expand the Zara concept to prevent imitators.

## **2. 3 Issues/problems with the global strategy**

### **Treats from H&M and UNIQLO**

The main competitors of ZARA in China are H&M and UNIQLO. H & M is a Swedish multinational retail clothing company, known as fast fashion clothing for men, women, teenagers and children. UNIQLO is a Japanese casual wear designer, manufacturer and retailer. ZARA have a total of 26 outlets in China. ZARA have 13 outlets in Shanghai, 9 outlets in Beijing, andv4 outlets in Shenzhen. H&M have lesser outlets that are about 16 outlets in China, 12 in Shanghai, 2 in Beijing and 2 in Shenzhen. The biggest competitor of ZARA is UNIQLO. UNIQLO have 32 outlets in China. 18 outlets in Shanghai, 6 outlets in Beijing, 4 outlets in Shenzhen, and they even have 4 outlets in Chengdu that ZARA do not targeted.

H&M had opened the first outlets at Shanghai in 12 April 2007 as the first sales shop in China. After H&M entering the China market, they first targeted Shanghai, the city that are highly internationalize. After that, H&M had opened their store one after another quickly in second and third-tier cities such as Nanjing, Wuxi, and Changzhou. The expansion rate of H&M in China is about 10 percent to 15 percent per year. According to Rolf Eriksen who is Chief Executive Officer of H&M, “ China is a strategic and exciting market



with great fashion awareness and spending power. We therefore see a vast potential for expansion.”

UNIQLO was targeted as a fast retailing company worldwide. As early as in 2002, UNIQLO had opened the first branch in Shanghai. The face of the huge market in China, with the rise of brand strength, starting in 2008, UNIQLO will gradually accelerate new store is located in China. Due to the different product line, and positioning, its strategy is slightly different from ZARA and H&M. The goal that UNIQLO targeted is longer and wider. In a single market, UNIQLO is the bigger and stronger, steady progress, and consolidate market. Therefore, it is expected that the future direction of the expansion in China is the Yangtze River Delta, Pearl River Delta, and take deepen regional advantage in the city.

### **Failed to pass quality test**

Since August 2009, ZARA has detected quality problems seven times in China. Throughout these seven test results, ZARA failed because of two reasons. First, Product identification does not match with the actual content. Second, Ph value, color fastness and fiber components unqualified. In fact, the first touches is a small problem, this situation often happen in other Chinese and foreign brands, but ZARA too outrageous, the price of 999 Yuan feather jacket, marked with 70% of feather, but actually only consist of 51 % of feather, took away 20% degree of warmth but not to see ZARA make a discount for each purchase.

Color fastness textile quality testing is usually included in routine testing project, mainly to see the dye would shed or fade. If not compliance with the

testing, the dye molecules and heavy metal ions will attach to the skin and bring harm to the body. The Beijing Consumer Association (BCA) had announced the result on 10 April 2011. Fabric in ZARA pants did not conform to a statement on the label. The label state that the fabric is 75% cotton, 20% wool and 5% terylene. However, there are only consists of fabric 68% cotton, 10% wool and other contents.

In addition, ZARA sandals were poor color fastness and is the only folding performance that did not reach to the standard published from Shanghai Industrial and Commercial Bureau in August 2009. In June 2010, ZARAbaby jacket / coat color fastness failed. The standard of children's cloth is higher than adult in terms of material and technical requirement. If pH value is in the 4. 0-7. 5 range, non-direct contact with skin, clothing standard 4. 0-9. 0, it will irritate the skin, causing severe skin infection.

### **First time reduce price**

ZARA pricing policy in China is same as other countries, are aimed at maintaining price stability. ZARA is using cost leadership strategic. Since its product had already sold in low cost, ZARA usually will not discount anymore. However, ZARA had reduces its price in China in September 2012. The largest price cut reaches to 34%.

The prices of a lot of new clothes are averagely 100 Yuan lower than the similar old styles that sold in 2011. for example, Women's coat, which was 699 Yuan last year and now sells for 499 Yuan, men's suit jacket reduced from 899 Yuan to 699 Yuan, while children's jeans which sold at 299 Yuan in the past and now sells for 199 Yuan.

One of the reason ZARA reduces its price is because economic downturn. The economic downturn has affected consumption, and then proceeded to affect sales of the brand. The slowdown in sales led to increased inventory, inventory control, faster turnaround, ZARA forced to take the promotional price cuts. This make ZARA brand's image drop.

## **Failure of online store**

Zara officially began online store in China at September 3, 2012, thought duplicating the experience of Europe. In Europe, Zara online store daily turnover up to 500, 000 - 600, 000 Euros, almost three times the average of a physical store. However, the reactions are not only mediocre in China, but provoke a lot of criticism. ZARA are selling ladies', men's and children's clothing series at online store and the price is the same as the physical store.

Design of Zara clothing does not fit in the Chinese people's aesthetic. ZARA value just the China market, rather than the needs of Chinese consumers.

Design of ZARA clothing more suits to European and American but not Chinese. UNIQLO's online business operators fit the body shape and aesthetic of the Chinese people. ZARA online business is too late and too low key to enter China market. ZARA online action is slow compared to others competitors, such as UNIQLO.

Zara is not taking into account the differences in price sensitivity for online shoppers when online and offline. UNIQLO and other brands also performed online and offline the same price strategic. Besides, most the brand will launch online exclusive discount activities. For example, GAP launched the

promotion that can redeem coupon. ZARA online store only accept online payment and line payment penetration is not high.

## **2. 4 Use VRIO framework and assess the organization risk/opportunity**

VRIO framework is used to assess a company's existing resources and capabilities as well as to assess the potential changes of the company's success. (Barney & Hesterly, 2011). As most of the firms did, Zara also conducted the VRIO framework to assess the sustainability of its competitive advantages.

### **Value**

Zara is using vertical integration, which combined with the most valuable resources. The company manages all supply chain activities by itself rather than relying on a third party. From design, production, and provide a new clothing to China, Zara only used 15 days, the speed that is unheard of in the industry. By doing this, Zara have more competitive advantage as compare to competitors such as UNIQLO and H&M because Zara is more flexible and faster than competitor. The advantage of the vertical integral could reduce operating cost because it has excellent conceived organizational structure and value that all employees must respect. Besides, the store managers in China are giving the autonomy in decision making process by themselves.

Zara core competence is to create a unique consumer experience. Zara's stores are large as those luxury brands such as Louis Vuitton, Calvin Klein, Prada, Burberry and Armani and Zara also build its stores either next to those luxury brands or in high class shopping mall in China. However, price

of product is very low compare to competitors. Besides, Zara has showed the method and style to wear in window display. This is a faster and easy way to make Chinese customer have a guide of how to mix and match the clothing and faster to make purchase decision. So, Zara is valuable.

## **Rarity**

Zara hired 400 different nationalities and young designers to catch the latest fashion around the world. This is because different countries, the trend of fashion will not be the same. For example, design that American like, not necessarily have good sales in Chinese. Therefore, in order to collect the latest fashion information, Zara hire Chinese designers, and produce clothing with the unique design and styles that suit Chinese people.

Although most of the Zara clothing is plagiarize from various fashion occasions such as Fashion released, exhibitions and fashion catwalk, but it is one of the reasons Zara is become famous around the world. Zara are targeting fast fashion. Zara will update new products twice a week, loyal customers of Zara will know that if they do not buy the clothes on the that they shop, later the clothes will not available anymore. Therefore, they are motivated to buy immediately. Generally, popular fashion brand launch about 2000-4000 new style in a year is the limit. However, Zara promised to launched over 12, 000 styles in a year, which represents a day at least three new design is available in the market. Zara achieved rarity. Only valuable and rare resources and capabilities have the potential to provide temporary competitive advantage.

## **Imitability**

Zara applied vertical integral business model that make competitors hard to copy its business model. Vertically integrated business model cannot be achieved in a short period of time, which requires a lot of time and effort. Although suppliers provide more reliable to support the company, however, the lack of competition often leads to higher prices. This makes competitors results in fewer varieties of supply choices. Supply costs increases can be achieved through the integration outweigh any benefits.

On the other hand, Zara attaches great importance to every part of the information exchange of the entire supply chain. They communicate between departments and the design to make transfer of information easier by insert layers of bureaucracy. Market experts are in constant contact with the store managers in China and provide new design and rapid feedback and give possible market prices. So, Zara resources and capabilities are hard to imitate. Valuable, Rare and Hard to imitate resources and capabilities can create sustained competitive advantage.

## **Organizational**

Zara is organized to exploit the full competitive potential of its resources and capabilities. Zara has proof this point by increasing sales revenues and profits in China. Appropriate and comprehensive communication system makes every person engaged in every process of Zara. For example, store managers are giving autonomy and work together with human resources managers and advertising contribute to the success of a certain degree of autonomy in the decision-making process.

In addition, Zara expand its business in China through smart partnership. This is the main reason that smart partnership strategies are one of the easiest ways for the Zara to gain access in China. Knowledge, ability, professional, and knowhow of the partners make Zara would able to establish a qualified based on expanding in China.

Overall, only valuable, rare, hard-to-imitate capabilities that are organizationally embedded and exploited can possibly lead to sustained competitive advantage and persistently above average performance. So, VRIO framework of Zara showed that Zara will success in the future.

### **3. 0 Recommendation**

#### **Short term**

##### **To control quality**

In responsive ZARA's poor quality issue in China, ZARA can immediately call back the sold goods, and giving the buyer gift voucher that is equivalent to the value of the purchased goods. This will shows the sincerity of ZARA in handling this issue and let the consumers to give a second chance to ZARA.

Examining ZARA's current process line, we may found out that the whole process is too lengthy. ZARA get the design from its dynamic designer team, then sending design draft to ZARA's Headquarter, then it was process in its one and only distribution center in the world, finally it was distributed to all corners of the world. Noteworthy that all the process was done in two weeks, imagine how much work load to complete in this two weeks' time? Super-fast processing line may credit to ZARA's success, but everything is happened so fast and ZARA has loss focus in its quality control session. In order to solve

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the quality control problem, ZARA may consider duplicating its success in Europe into China.

ZARA current strategy of setting a main distribution center in Spain and distribute its product to other corners in the world turn out to be working well so far. However ZARA may consider applying some modification to its current strategy due to the rapidly changing environment and the quality problem it faced. Setting up distribution center in China helps reduce the complexity of whole processing line. Since product can now be produced in the mainland of China, ZARA will have more time in examining the quality of its product. Furthermore, China may be a market that is quite different from what ZARA has faced before; it has apparently bigger market size. Bigger market indicates greater opportunities, or risk. Business environment is quite different across two regions, Asia and Western region, ZARA will need to adapt to the China's business environment if it still want to continue its momentum in expanding.

Xiamen in China is a strategic location to set up its new distribution center. Xiamen has developed vigorously in recent years. It has become a new favorite location for foreign investor, greatly because of its advantage of near to shipping yard and it is convenient for distribution purpose in satisfying the demand of Asia region. Setting up distribution center in China may have following benefits: first, it get closer to its customers in Asia Pacific region, second, it shows that ZARA values and paying attention to Asia market, which may be the most important economic bloc in coming decades.



## **Price-cutting issue& Online Shopping**

Both of the issues happened because ZARA does not really study the China market before entered. ZARA should firstly understand what the consumers really want and desire. In order to achieve this, ZARA should survey and try to understand the consumer base of China, try to collaborate with local firm. Secondly, before the real product arrived at China, ZARA can collect respond from the local consumer first regarding about the latest design of ZARA. ZARA can selectively choosing the potential product that might be welcome by the public, and try to understand their preference.

As for those shops which are already losing money and not performing since the beginning, ZARA can choose the ultimate option by just closing down the outlet. Fashion industry is an industry that is highly depending on a brand's image. Outlet that is not performing may drag down ZARA's image and it should be close, the cost that saved up should be channeled to other outlet to expand and serve their customers better.

## **Long term**

### **Dealing with its competitors**

As mentioned above, ZARA's main competitor is H&M and UNIQLO, their main battle field will be in Shanghai, Beijing, Shenzhen, and perhaps Chengdu too.

Shanghai

Beijing

Shenzhen

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Chengdu

China(Total)

ZARA

13

9

4

0

26

H&M

12

2

2

0

16

UNIQLO

18

6

4

4

32

Table above is showing the number of outlets that Zara and competitors have in China. From the table above we may find out UNIQLO may be the greatest obstacle to ZARA while H&M is the greatest threats. In order to win this battle, ZARA may try to apply Lanchester strategy, a widely accepted business strategy used in Japan. The strategy is rather simple, try to win at separate places that you have advantage rather than head-on-head fight with your opponent. The table shown that ZARA has its advantage at Beijing now, assuming other issues has settled, ZARA can now focus its fight in Beijing first. Using all the resources that ZARA can mobilize into this area, making the area is more favorable to ZARA, trying to eliminate its opponent from this area as well. While in the other hand, ZARA should act more defensive in other area in this point of time.

After successfully making Beijing a stronghold for ZARA, ZARA can try to move on to Shanghai, which is geographically nearer to Beijing. Beijing can now be a supporting point for ZARA in conquering Shanghai. ZARA has almost equal ability with H&M in Shanghai, therefore first task of ZARA in here is to achieve greater grow than H&M, then only challenge UNIQLO after defeating H&M.

After this two battle field is settled, ZARA will have greater advantage in size compared to before, and then only ZARA can try conquering other markets as well.

## **Diversification**

Diversification in product line is also another way for ZARA to continue its journey. Currently ZARA's mother company, Inditex group has different brand that covers from lady's market, to men's wear and also children's garment. It seems like it has enough product diversification as it has cover all the needs in the industry, however look in closely we may discover that all the product is still in garment industry. ZARA may do diversification by involving itself into other related industry, since the current trend tell us that the boundary between different industry is getting more blur, it is a good timing for ZARA to enter some new market. ZARA may first consider about perfume market, not only because of its high profit margin, but also the increasing demand in more natural friendly perfume (perfume that is free from animal testing, extract from animal. ZARA's reputation in apparel industry may help much in conquering the perfume market.

## **4. 0 Conclusion**

In conclusion, Zara's success lies in total control of every part of its business including its design, production and distributes of itself. ZARA has a unique business model, which allows it expanding and competing with high quality brands at reasonable prices.

Have you ever seen a Zara commercial on a billboard or on TV? The company's founder, Amancio Ortega, believes advertising is pointless. The

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company's success is proof that it is still possible to build a huge brand without any advertising or promotion.

Furthermore, the Louis Vuitton fashion director, Daniel Piette described Zara as “ possibly the most innovative and devastating retailer in the world.” The retailer's international footprint proved the borders no restricted to a shared fashion culture.

Zara's approach to design is closely connected to its customers. Zara is familiar with its customers, who help it give ideas, trends and tastes developing in the world. This is the secret to its success among various kind of people, cultures and generations, who, regardless of their differences, all share a special fondness for fashion.