

Zara: fast fashion

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The Spanish retail chain Zara has unique supply chain management practices that enable it to gain a competitive advantage over other fashion retailers in the industry. Zara's rapid response time enables the firm to quickly respond to changing fashions while deliberately under producing products. This strategy, which is supported by competencies in logistic management, design and information systems, allows the company to maintain less inventory and higher profit margins and is a key factor to Zara's success. The firm should continue to add value by seeking new opportunities to expand in the retail market and maintain their sustainable growth.

Financial Analysis Being aware of a company's financial health and profitability of its competitors is highly essential for everyone interested in engaging in business with Inditex. In this part of the paper, through analysis of 4 key ratios and return on invested capital, we are going to discover some of the company's drivers of sustained competitive advantage. The 4 key ratios will focus mainly on company's liquidity, activity, solvency and profitability, while ROIC will show how well the company manages the capital invested in operations of the business.

In order to measure ability of Inditex to meet its short term obligations and to assess liquidity, it is important to calculate current ratio. As shown in exhibits section below, in 2001, Inditex had 1.02 million in current assets, while Gap and H&M had 1.48 and 3.4 million Euros in current assets for every Euro in short-term debt. This indicates that Inditex's main competitors demonstrate greater ability to meet current payments of debt; therefore liquidity is not one of the company's success drivers. When it comes to

comparing company's sales to various assets categories it is significant to take a look at the total assets turnover.

This ratio indicates how efficiently assets are being used to support sale. From 1999-2001, this ratio increased by 1. 2%; however it was still below industry performance. Currently Inditex is industry leader with total assets turnover of 1. 8. This shows that company's recourses are being well managed and that company is able to realize high level of sales from its investments in property, plant and equipment such as manufacturing facilities. Debt to equity ratio is used for solvency evaluation. The main purpose of this ratio is to show company's ability to repay long-term creditors.

As shown in exhibits section, this ratio decreased from 1999-2001, however, when compared to its rivals, Inditex confirmed to have the best leverage among them. When it comes to company's financial flexibility and profitability it is highly essential to calculate Net Profit Margin ratio. This ratio measures how successful a company has been at the business of making profit for each euro earned.

As presented in the exhibits section, Inditex was and still is an industry leader with Net Profit Margin ratio of 10. 6% in 2001 and 13. 10% in 2010 which means that company has currently € . 3 of net income for every dollar sale. In addition, according to Inditex's income statement, we could see that company is delivering higher net income due to its ability to keep operating expenses and COGS much lower than competitors. Furthermore, the company is able to gain sustained competitive advantage by making its own

products, efficiently covering lower advertising expenses and maintaining cost-effective number of employees per store. In order for Inditex to maintain continuous growth it is important to keep its profit margins at the high level.

Last but not least ROIC (Return on Invested Capital) gives a good judgment on how well a company is using its money to generate returns. Inditex ROIC varied through past couple of years but is currently able to earn around 7% on each euro invested. From the exhibit table below, we could conclude that the company is making wiser investment decisions than its competitors. SCP Analysis Zara competes in a monopolistically competitive industry due to the number of players. No business in this type of industry has total control over the market price and there are no barriers to entry and exit.

Because of its monopolistically competitive playing grounds, Zara's conduct is to increase its market power by producing demand for its heterogeneous products. Through differentiation and cost leadership, Zara attempts to increase market demand by offering new items weekly while keeping a low inventory, thus making its products unique and attractive to consumers. Because of its backward vertical integration model, Zara creates a strong synergy throughout its production process.

Zara has sustained a competitive advantage globally by expanding into new markets and becoming more efficient. In a monopolistically competitive industry, Zara is expected to make profits in the short run but will break even in the long run because demand will decrease as average total costs increase. This means in the long run, a monopolistically competitive firm,

such as Zara, will make zero economic profit (AmosWEB, 2001). Porters Five Forces Barriers to Entry: Due to the recent recession and weak economic market, many new players have avoided entering the retail industry. Zara has taken advantage of this opportunity to be the first to enter into many markets across the world before its competitors.

With the economic future improving, Zara will be facing more and more competition especially in the United States. Rather than implementing new strategies on how to differentiate itself even more, Zara will need to focus more on creating brand awareness and staying on top in the game. Zara has been the odd ball in the industry with its creative business model but with more and more retailers quickly catching on and critiquing their business model to match the economy changes, Zara faces intense competition. Unlike other retailers, for example Gap and H&M, Zara needs to fight threats around the globe.

In the states, Zara competition is intensified with American retailers because many customers still do not know who Zara is or what it offers. In Europe, Zara is like a Macys for us in the states so the brand awareness is there but competition is still also high. Many retailers in Europe offer the same products as Zara, at the same or similar prices; therefore Zara needs to find ways to keep ahead of competition. Bargaining Power of Buyers: Zara is famous for its business model of just in time inventory. No other retailer can produce a garment from scratch and have it hanging in the stores within weeks than Zara.

Zara also distributes large number of shipments to its stores around the world twice a week. All merchandise is shipped from Spain and all stores receive shipment on the same days, Monday and Thursday. Zara produces nearly 16, 000 new designs a year which is much more than leading competitors. With the constant changing apparel Zara keeps its inventory levels extremely low. Zara customers know that if they see something in the store to buy it right then and there because tomorrow that garment will not be there. US customers are still adapting to this quick turnaround time.

With their advanced technology, Zara knows what its customers want and will deliver that to them within 2 weeks' time. Bargaining Power of Suppliers: Zara manufactures all its clothing in house. This way it has control of the entire process and can make changes more quickly and efficiently when needed. After the garments are cut and ready for assembly, Zara sends out the fabric to different sewing companies to assemble the pieces. There are many competitors that Zara can choose from when deciding where they want its clothes put together which makes the bargaining power weak.

Zara also took control of this process by taking over Comditel. Comditel is in charge of nearly the entire garment process. Once the garments are ready and fully assembled they are then stored in Zara's own distribution centers. From the distribution centers they are then shipped around the globe to the thousands of Zara stores. Like many other aspects of Zara's business model, the distribution center moves even more quickly. Once the garments are in the distribution centers, they only stay there for a maximum of 3 days before be sent out to the appropriate destination.

Substitutes: Some may describe Zara as a higher end replica of fashion forward items. The items featured on Prada, Chanel, and St. John runways will be replicated in 2 weeks in Zara stores at a much more affordable price but poorer quality. Therefore, there are not many substitutes that customers can use because a majority of the products are out of the price range of many customers. This is a huge benefit for Zara because its customers are willing to pay a much less price for a lesser quality replica.

Competition: Zara's direct competitors include H&M, Gap, and Benetton. H&M offers nearly the same products as Zara to its customers, but a much lower quality and price. For those customers who are price sensitive, H&M would be their choice of retailer. The Gap possesses more competition in the states because it has been around longer and has its loyal customer base which is hesitant to shop elsewhere. Even though these retailers give Zara a run for its money, none of them can keep up with Zara's business model.

Other retailers do not have in house production like Zara and ship their production to other countries for the cheap labor costs. This does save money but it increases time. Time is money so while others are still in production stage, Zara is already selling out of the garment. VRIO Analysis We can use the VRIO framework to determine the competitive potential of Zara's resources and capabilities. As we analyze Zara's resources and capabilities, it is evident that Zara has built a highly effective, self-reinforcing business system.

Three elements in particular – (1) extensive vertical integration, (2) the company's flat management structure, and (3)

exceptional communication and coordination throughout the business system – allow Zara to successfully execute its “Very Quick Fashion Follower” business model. Each of the three make the grade of being Valuable, Rare, costly for competitors to imitate, and for which the company has organized to take advantage. Extensive Vertical Integration: Zara prides itself in its vertical integration, with near full control over its value chain through to the end-user.

The company owns or closely controls its manufacturing and distribution facilities, manages its own logistics and transportation, and wherever possible owns its own stores (except for in markets with high risk or barriers to entry). This integration brings value primarily through speed-to-market, as Zara has achieved significantly shorter cycle times than its peers. Full vertical integration is rare in the apparel industry, which typically sees companies foregoing direct involvement in elements of the value chain (e. g. , H&M outsourced all of its production, and Benetton sold the bulk of its production through licensees).

It would be extremely costly for a competitor to imitate Zara’s vertical integration, and even if they were able to do so it is unclear how much or how soon they would profit from it, as much of Zara’s advantage comes from the degree to which it has developed its integrated organization over many years. Flat Management Structure: While the drive, insight, and guidance provided by founder Amancio Ortega and other top executives have obviously been crucial to the success of Inditex, it is the structure and incentives they have put in place that truly drive Zara’s exceptionality.

Zara's management structure is very flat, with autonomy and significant incentive-based compensation for store managers, thus closely aligning their interest with that of the company. This structure adds value to the company through diligent hands-on management at the local level, something so rare that Zara's CEO noted that the availability of store managers capable of handling these responsibilities was "the single most important constraint on the rate of store additions." The structure would be highly difficult for competitors to imitate, as it has been built into the culture and processes of the company over several decades. Zara has certainly proven that it is able to organize around the flat structure model – in fact many of the company's business processes depend on the communication and input of enabled employees at the edges of the business system. Exceptional Communication and Coordination: From early on, Zara developed a focus on communicating and coordinating activities up and down the value chain and across functions.

This capability focused on speeding important information on customer preferences and trends to the store network, and feedback on successful and unsuccessful products back up the line to headquarters. Exceptional communication and coordination are crucial to maximizing the value derived from Zara's vertical integration and flat management structure. A look at the more disjointed businesses systems of peers such as The Gap and Benetton demonstrates how rare it is for all of a company's capabilities to simultaneously reinforce each other, and how difficult it would be for them to imitate Zara.

Zara has successfully organized to coordinate its activities around the fast communication of accurate information – about designs, customers, competitors, and micro- and macroeconomic factors – both up the line to top management and to the edges of the network where store managers and employees interact with its customers. Each of these three capabilities passes the VRIO test, indicating that they are indeed key competencies for Zara. Four Actions Framework In order to understand how Zara created a new value for both the buyer and the company, we utilize the Blue Ocean 4 Forces Analysis.

Starting with what factors Zara raised above standard, we see what is also Zara's key resource, the company's application of vertical integration. While Zara is involved in both backward and forward integration, what sets it apart is precisely its backward integration into manufacturing. For instance, its competitors Gap and H&M are both practicing forward integration and unlike Zara, outsourcing their production. Zara is also constantly in communication with employees at the edges of its business system such as store managers in order to better identify and track customer preferences and trends.

The company encourages increased frequency of customer visits with its short cycle times; customers flock to the stores in order to catch the current fashion trends and product lines. In addition, the company also raised responsibility and accountability for store managers by hiring experienced employees promoted within which the CEO believed was a necessary judgment especially for store additions. Zara increased market

saturation leading to better economies of scale thus significantly cutting costs and raising higher awareness and increasing sales.

On the other hand, Zara reduced several factors well below the industry standard in order to cut costs and increase customers' willingness to pay. For instance, the company decreased the failure rate for new products with its intensified product testing program which included store-level personnel in the process. Zara also reduced its cycle time for design which enabled the company to offer the customer new designs in four to five weeks and existing products in two weeks; the industry standard for this process was six months for design and three months for manufacturing.

A pioneer in its industry, Zara proudly enjoyed engendering revenues at full price with only 10%-15% of its sales generated at discount prices compared to its European industry at 30%-40%. Lastly, Zara reduced its ad spending below industry standard at 0.3% of its revenue while its competitors advertised 3%-4%. Although it is relatively unlikely for an apparel company to create factors that its industry has never offered, Zara formed a distinct vision among its competitors. The company was the first within its main rivals to saturate international markets as fast as it did.

Zara is a global apparel retailer with a truly international scope. While from 1980's to 2011 H&M added eight countries to its international expansion, and Gap five, while Zara was at thirty two countries. In the competitive apparel industry, Zara managed to eliminate what its competitors continuously took for granted. The company focused on a flat management system which allowed capturing trend preferences directly from the

customer and applying to mass markets. Eliminating the separation between merchandising and manufacturing was especially beneficial to a fast and productive design team.

Strategic Vision Based on our analysis, Inditex has proven to be financially stable and can successfully manage its capital invested in its operations. Therefore, to maintain their sustainable growth and continue to add value, Inditex should use their commercial team's micro/macro evaluations to seek new country market opportunities. They should continue to use one of the three modes of entry; company-owned stores, joint ventures, and franchises, to open additional stores in European countries that have high apparel markets.

Italy, Germany and United Kingdom are markets that show promise, especially Italy because of its high per capita spending on apparel. As discussed in our analysis, one of Zara's core competencies is its extensive vertical integration, and because the case mentioned a second distribution hub already being built in Zaragoza, Spain, it can support additional European stores without being subject to diseconomies of scale. Increasing the density of Zara's store locations in Europe will achieve logistic efficiencies.

Zara keeps transportation costs low on the supply side, since most of the production takes place in Spain. Efficient distribution and inventory systems help Zara minimize costs. Demand based production means there is very little inventory in Zara's supply chain, which results in lower working capital requirements and lower supplier opportunity costs. Another market that has

potential is the United States. With changing consumer behaviors as a result of globalization, there are growth options available for specialty retailers like Zara.

For example, Gap's current ratio of 2.18 is higher than Zara's 1.71; however Zara's 13.10% net profit margin is preferred over Gap's 8.21% (as illustrated in Exhibit A-1). Therefore, as long as Zara can maintain its low production and overhead costs, which are high for its competitors, they should be able to compete in the US market. Inditex should invest in prime locations in major cities such as New York, Chicago and Los Angeles to maintain its positioning strategy. Zara should most likely develop a second central distribution center in America.

Zara can strategically locate its central distribution center in or near countries where manufacturing can be done with cheap labor cost, such as Mexico. The close proximity of the distribution center to the American market will decrease logistics and help maintain Zara's model of fast fashion and economies of scale. Internet retailing is another market opportunity that Inditex should consider. Zara can reach consumers faster and easier in the countries they are trying to expand into.

This method can also help gauge consumer preferences from country to country. The internet retailing market will increase sales revenues and has a very low business risk considering the products are already being produced for the retail stores. Zara's online shop would complement its stores, adding an extra level of service for its customers. It would also expand its customer

base to reach areas where stores are not located. Patrons can shop from anywhere in the world and at any time of day or night.

This essentially means more shoppers and more sales for the business.

Based on our analysis, the monopolistically competitive industry structure is not the key factor driving Zara's significant performance. Zara has leveraged its key resources to combine low price with product differentiation to create value and succeed in this industry structure. Zara has been able to increase the customer's willingness to pay by constantly rotating its merchandise and creating a climate of scarcity and opportunity for customers.

In conclusion, Zara has the potential for sustainable growth due to its competitive advantage and its ability to increase customer's willingness to pay while decreasing its opportunity cost. The company keeps its operating income high, has a solid business model with unrivaled synergy and has various opportunities for expansion in the retail industry. Zara must continue to re-invent their image in order to stay fresh in the apparel industry and as long as they maintain their core competencies, they will continue to succeed.