

Zara case study

Business



Zara case study Business model Amancio Ortega Gaona, a Galicia native, opened the first Zara stores in La Coruna in 1975 and has begun international expansion ever since.

Zara is a part of Inditex, which is one of the world's largest fashion distributors. Zara is known for its fast response to ever-changing fashion trends to satisfy customers' needs. The purpose of this paper is to discuss issues and alternatives of Zara's operating system. The three key success factors in Zara's business are:

- Short lead time to reach the market
- Low quantities to create scarce supply
- More styles

By focusing on shorter lead time, the company guarantees that the stores will carry fashionable clothes that consumers want at that time. Assuming the company has the fabric in stock, in-house design, pattern making, and cutting capabilities, Zara can go from start to finish on a style production within as little as 10 days. Zara can quickly identify fashion trend by studying consumer market research and updating information from store managers.

By reducing quantity manufactured in each style, Zara reduces fashion risk as well as creating scarcity (more demand).

The customers might not be able to find their favorite clothes if they do not make immediate purchases. Clothes will not stay in one location so that they will be on sale. Instead, they are moved between locations in order to drive demands. Most competitors increase quantities per style while Zara produces more styles, about 12,000 a year.

Each style sells out quickly so new styles can take up the space. Problems
The company is facing several issues: • Inability to enter U. S. market. The management announces that significant expansion in the U. S.

arket is not a near- term goal. The differences in the tastes and preferences of American consumers, the lack of strong supply chain, distribution and production centers, and the cost of advertisements are main reasons why the company decides to focus on other markets. • Inability to acquire economies of scale. The company manages small batch production to meet the fast changing tastes of consumers. Zara only commits to 50-60% of production in advance of the season. The remainder percentage is based on rolling basis of demands which creates scarce supply.

It encourages customers to buy at a full price right away, because the stores receive new items every two weeks. Also it encourages customers to visit Zara's stores often. The average Zara's customer's number of visits is 17 times a year, compared to 3-4 times that of other competitors. • Limited advertisements due to heavily reliance on customers' word-of-mouth. Advertisement is an important part of business and it affects sales. Zara's choice of advertisement might not work in the future.

- Direct competition due to expanding into new geographic territory. High labor costs. About 80% of Zara's production is built in Europe. Almost half of its production self-owned or closely-controlled facilities which provides flexibility to control. Based on Table 9-3 Relative wage levels, the cost of hiring people in Spain is about 13 times the costs in Asia on which most other

competitors' production lines are based. • Main problem with Zara: most of the manufactured garments distribution is in Spain.

If natural disaster occurs in Spain, the company's production will be delayed.

Case analysis • Vertically integrated.

Zara's business model is vertically integrated which covers all aspects of fashion process including manufacture, design, logistics, and distribution. By practicing vertically integrated model, Zara enables to shorten turnaround times, reduce fashion risk, and gain flexibility. Based on Table 9-4 Production movement, in 2000, the company makes 44% of its own fabric and the external production rate is 56%.

The key to this business model is the ability to respond to customers' demand in the shortest time. The value chain is highly capital intensive. • Centralized distribution.

Zara is utilizing centralized distribution system and the production center is in Spain. The company has in-house team of 200 designers who are continuously research customers' demand. The company has its own factories and a wide range of experienced and long term external suppliers.

As a result, Zara can manufacture a model and have it in stores for sale in two weeks. Based on Table 9-1 Selected financial information for Inditex, the company tripled in size between 1996 and 2000, from €1, 008. 5 million to €2, 614. 7 million. • Three lines of items.

Zara sells clothes to women, men, and children.

Each line has its own creative team who is in charge of line's fashion trend. Customers are able to find 450 high-end luxury stores in 33 countries. Most of them are upscale in prime high street areas. • Target market. Based on Figure 9-1 Inditex's product positioning, Zara's target market is young and fashionable customers.

- Pricing strategy. Zara's price is based on comparable within the target market to cover the costs and a target margin. Zara switches to a new system which reflects appropriate local price Alternatives 1. Open more distribution centers and manufacturing plants throughout the globe 2.

Find alternative ways to advertise rather than using word of mouth 3. Utilize franchise or joint venture to open more stores in America or Asia Criteria 1.

Competitive advantage- quick respond to fashion trend and customers' demand, minimize transportation time, shorten turnaround time, shorten lead time 2. Increase customer satisfaction- deliver fashionable clothes to an ever- changing market, affordable price 3. Profitability- improve manufacturing and distribution efficiency 4. Increase market share 5.

Sustainable- long term Criteria | Alternatives | | | open more facilities | more ways to advertise | utilize franchise or joint venture | | | 3 | 4 | 2 | | increase customer satisfaction | 2 | 3 | 2 | | Profitability | 1 | 3 | 3 | | increase market share | 1 | 1 | 1 | | Sustainable | 2 | 2 | 3 | | Total | 9 | 13 | 11 | The numbers range from 1 to 5 in which number 1 is highest and provides the most benefits.

Total of open more facilities alternative has the lowest number. Therefore, it provides the most benefits Alternative analysis 1. The first alternative is to

open more distribution centers and manufacturing plants throughout the globe. Zara limits its distribution and manufacturing in Spain. The first Zara 500, 000 square meter distribution center is in Arteixo. The second distribution center is in Zaragoza, which is in the interior of the northwestern area of Spain.

The company's deliveries move through just two locations. The first reason to open more facilities is to have a back-up plan. What will happen if one or both distribution center shut down operation due to weather, natural disaster, politics, strife, etc. Zara's production system will be delayed? In addition, according to Table 9-3 Relative wage levels, the hourly labor costs in Spain is 14 -17 times, both in textiles and clothing industry, higher than India. Therefore, the second reason to open more distribution centers and manufacturing plants around the globe is to take advantage of lower labor costs. Another financial aspect Zara might want to address is the currency.

Since the Euro has strengthened relative to the dollar, many low-cost manufacturing geographic regions have currencies either pegged to dollar or euro. Therefore, the distribution and manufacturing center in Spain raise a higher rate compared to other competitors who have distribution or manufacturing facilities in Asia, India, or any low- wage labor countries. Another cost that Zara should notice is the increasing of transportation costs. If Zara decides to open more facilities in India or China to take advantages of low- labor costs, the transportation costs might increase due to long travel distance of products. It might also affect the lead time which is one of Zara's comparative advantages.

What might happen if Zara does not quick respond to fashion trends and consumers' demand as quickly as Zara used to.

Consumers might turn to Zara's competitors which are H, Mango, or Massimo Dutti. Zara might lose market share. The increasing of transportation costs might affect Zara's profitability and increase clothes' costs. A solution to the above problems is to focus on local market. For example, the headquarter distribution center and manufacturing plans in Spain can focus on producing and providing fashionable clothes to European customers and neighbor countries. The new open facilities in Asia can specialize in satisfying demand in Japan, America and other neighbor countries which have similar taste in fashion.

In addition, the new facilities in Asia can outsource cheaper fabric or clothing's materials than in Spain. The in-house designers can submit their forecast of fashion trends and the quantities of basic clothing to managers of Asian facilities. The managers will gather data and numbers to calculate the costs of outsourcing cheap basic clothing, materials, and transportation costs to ship to desired markets. Therefore, Zara can take advantage of cheaper labor and clothing materials costs in Asia. In addition, global expansion can provide the company a mix of locations and a back- up plan if a single region has downturns due to economic hardship. 2.

The second alternative is to advertise Zara's clothing line on media or internet rather than using word of mouth because it might not be as effective in the future. Word-of-mouth is heavily based on customer's subjective view of the company's products. Some customers will advertise that the products are very well-made. Some might say they are not. As a result, advertisement

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on the popular media such as TV or the Internet will eliminate the subjectivity.

Potential customers will see the actual products and will appreciate the products more. Therefore, they will want to purchase the products. 3. The third alternative is to utilize franchise or joint venture to open more stores in America or Asia.

According to Table 9-2 Zara store locations in 2000, Zara has 27 franchise stores and 12 joint venture stores in Germany, Poland, Japan, Dubai, Qatar, and other countries compared to 410 company owned stores. Clearly, Zara prefers to operate company owned-stored than franchise or joint venture because Zara wants to respond to fashion trend as quickly as possible to satisfy customers' demand.

Zara only has franchise and joint venture stores at small countries. The management team might think that entering these small markets can become a burden to company's image since their taste in fashion is not similar to European market. However, Zara can have franchise and joint venture at these countries to increase market share.

Zara's brand name can attract customers more and allow great savings in customer acquisition costs. The company can have lower costs in purchasing inventory and equipment since Zara is a recognized brand name with bargaining power.

I recommend using the first alternative to open more facilities throughout the globe. Zara can take advantage of lower wage labor cost, cheaper clothing materials. Facilities outside Spain can provide a mix of locations in

casa distribution and manufacturing centers if Spain has natural disaster or any downturn that might happen. Zara also needs to address currency exchange and transportation cost if they might occur in the future.