The possible risks in apparel retailing firm zara finance essay

“ Risk is a threat that a company will not achieve its corporate objective.” (Harris Jones 1998)

“ Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.” (Bruntland, 1987)

Sustainability explores two of the most important challenges faced by organisations in the 21st century. One is the successful management of human recourses in a time of escalating staff revenue, diminishing reliability, increasing stress levels and the second is raising issues of corporate-community relations and social responsibility. Every business experiences challenging nation periods and, as this interface example demonstrates cost saving related with the move toward sustainability can provide a cushion against the normal downturns of the business cycle. “ Sustainability can also create opportunities to decrease capital cost in building or remodelling facilities. Building designed from the start to be energy efficient, with bright, airy, and well-ventilated space will decrease costs and improve efficiencies over the long term.” (Liz Walley, 2005)

This report will explain the possible risks in apparel retailing firm Zara. It will also explain how these risks affect Zara and what strategies Zara adopt to minimise their risks.

2. 0 Zara Company Profilehttp://images. google. co. uk/url? source= imgres&ct= tbn&q= http://www. armschool. com/wp-content/uploads/2009/07/zara. jpg&usg= AFQjCNEOBUk4bEyrhFKBF5weTObe9ryvaw

Zara is the flagship chain store for the Spanish Inditex (INdustrias de DIseno TEXtil, SA) group owned by the Spanish tycoon Amancio Ortega. Zara is headquartered in La Coruna, Galicia, a midsize city in northwest Spain, where the first Zara store opened its doors in 1975. In a relatively short time frame Inditex has become the world's second largest clothing retailer with 2, 692 stores spread across 64 countries worldwide by the end of January 2006. " Zara's aim is to democratise fashion by offering the latest fashion in medium at affordable prices." (Amancio Ortega, founder of Zara)

Zara has 1545 stores in 64 countries around the globe including Fifth Avenue New York, International Centre Hong Kong and Oxford Street London.

3. 0 Nature of Risk and Shareholders' value

" Risk is the view that we can reach out of the future to bring it under control is one of the most audacious in the history of humanity." (Bernstein, 1998)

Risk is profitability that a hazard will turn into a disaster. Vulnerability and hazards are not dangerous, taken separately. However, if they come together, they become risk or, in other words, the possibility that a disaster will happen. Nevertheless, risk can be reduced or managed. If we are careful about how we treat the environments, and if we are aware of our weaknesses and vulnerabilities to existing hazards, then we can use different techniques to make sure that hazards do not turn into disaster.

Shareholders part is a special part of every organisation. Therefore, risk managers try to minimise all the risks in shareholders' value. Many firms across sectors are affected by environmental liabilities. Some innovative products ring fence or cap there costs and in the process remove uncertainty for the shareholders by receiving the need to hold an on balance sheet less provision. The main apprehension or risk that shareholders face is how much the accrual return on their investment differs from their expectations. Irrespective of the nature of individual risk revelation, traditional shareholders have been more concerned with financial volatility than with the possible hazards that could harm shareholder value. Overall, risk management practices contribute to the improvement of shareholder value because they help to generate a business environment that is able to minimise both the likelihood and impact of risk occurrences that could decrease shareholder value and exploit opportunities to create value when they arise. Managing for shareholder value is therefore likely to change the direction of risk management. One, taking and managing risk is the heart of shareholder value conception. This means that risk management cannot be too suspicious and stifle risk-taking. Two, it is true that shareholders want stability managing risk has a vital role here but managers will need to go beyond the focus on hazards and look at how risk in total impact the balance sheet.

There are different types of risk associated with the companies depending upon in which field of business they are. The risk manager cannot eliminate all the risks from organisation as they are looking for more and more profit. The risk manager has a variety of objectives.

Zara is facing a lot of risks in this competitive market globally. This report will explain Zara’s few risks.

Operational risk

Legal risk

Financial risk

“ Managers must report the amount of risk in quantitative terms.” (Philips & Eccles, 2001)

4. 0 Operational Risk

Operational risk defined as “ the risk of direct or indirect loss resulting from inadequate failed internal processes, people and systems or from external events.” (James Pickford, 2001)

Operational risks covers a multitude of issues in the day-to-day running of a company’s operation, including health and safety, fraud, product failure, manufacturing breakdown or quality programmes. Zara has managed to reinvent the business model in its sector by “ conscientiously applying its supply chain vision to its business.” Instead of outsourcing its production to countries with low labour costs, as most of its competitors have, Zara manages to use local suppliers for part of its production. This has enabled Zara to become more agile responding to trends in the market. As we move into the twenty-first century, the rate of change is becoming one of the most important issues facing management. The aim of operational risk management is to ensure that the varied exposures to operational risk faced by an organisation are identified and addressed in the most efficient way possible.

Operational risk management comprises a host of activities:

Identifying the risk: what can go wrong?

Measuring the risk: Approximately how critical is a particular risk?

Preventing operational losses, e. g., Disaster standardised deal documentation.

Mitigating the loss impact after it has occurred by reducing the firm's sensitivity to the event, e. g., disaster contingency planning.

Predicting operational losses, e. g., projecting the potential legal risks and market cannibalisation associated with a new product or service.

Transferring the risk to external parties presumably better able to handle the risk, e. g., insurance, hedging, surety.

Allocating capital to cover operational risks.

Zara is strictly controlling all of their operations under the same roof of its La Coruna headquarters. . Informality rules the roost and functions such as design, production and marketing all rub shoulders with each other. By adopting these measures Zara's management is sustaining the following operational risks. It thus:

Shortens delay.

Minimizes bureaucracy.

Provides the opportunity for more immediate comment and feedback.

Allows speedier decision making.

Lessens the potential impact of changes in circumstances such as an amendment to retail orders. This reduces the risk of loss through overproduction.

5. 0 Legal Risk

“ Legal risk can be more serious than other risks. Counterparty default is generally unrelated to whether the counterparty owes money or is owed money. However, lawsuits only occur when counterparties owe money.” (Allen, 1945)

The major mitigants to legal risks are:

Thoroughly reviewing contract terms by experienced lawyers to ensure that language is properly drafted and that the contracted activities are authorised for the contracting parties.

Thoroughly documenting what terms have been agreed to.

Placing limits on exposure to legal interpretation.

Zara Law Offices are sustaining the firm’s legal risks from their multicultural background, multilingual skills, and legal expertise in all aspects commercial litigation and business law. Zara’s legal risk advisors cope efficiently with the legal risk within the firm.

6. 0 Financial risk

“ The risk that a company will not have adequate cash flow to meet financial obligations.” (Holmes, 2004)

Financial risk is the additional risk a shareholder bear when a company uses debt in addition to equity financing. Companies that issue more debt instruments would have higher financial risk than company’s finances mostly or entirely by equity. Zara is facing financial risks but their Risk managers can minimise these risks. Financial risk management typically cover the following subcategories:

6. 1 Market risk

This refers to the risk those changes in the price of stocks and/or interest rates leads to the reduction in the value of an investment portfolio or security. There are two types of market risk.

Interest rate risk

This is the risk that the value of a fixed income security will fall because of a change in market interest rates.

Equity risk

This has two components to it: the general market risk, which refers to the security of a financial instrument to the general movements in stock market indices; and specific risks, which relate to the organisation itself, its sector, management capability and so on.

6. 2 Liquidity risk

The risk that an institution cannot execute a transaction at the prevailing market price because there is temporarily no appetite for the deal. If it proves to be impossible to cancel the deal then the institution can lose substantial amounts of money.

6. 3 Credit risk

This is the risk that a counterpart defaults and the bank losses all of its market position or that part which is irrecoverable. Zara uses credit to pay for short terms supplies or to fund long-term growth. While most organisations view loans and credit lines as a necessary part of business, those who understand how to mitigate credit risk are far more likely to succeed.

Figure – Financial Risks

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7. 0 Risk Managements and Techniques

The definition of the risk manager is it is a process that identifies possible loss faced by an organisation and selects the most effective is ways to eliminate or minimise that loss. At this, it was believed that insurance is the best way to deal with the loss exposures. The risk manager's job usually predicting and controlling or prevention losses within the organisation and determing the proper amount of insurance to cover actual lose. The risk managers and risk management services first identify what the organisation potentially may lose. In a disaster like a chemical spill or fire, the company can loss physically property such as building, equipment and vehicles.

Another potential risk is liability. If the company produces something that accidentally harms its customers, the company could be liable for damages. The risk manager has a variety of objectives. The role of risk manager is consisting of following four steps:

Identify the risks

Evaluate the risks

Take action (what should be done)

Evaluating and review

Figure – Risk Management

http://i. techrepublic. com. com/blogs/Risk%20Management%20Cycle. jpg

Source: www. techrepublic. com.

Zara's risk managers used different techniques to minimize and evaluate the risk. There are few different methods used by the risk managers, which are:

7. 1 Risk control

It is consists of three different techniques which are

Risk Avoidance

This technique is use to avoid the risk in the very first step. It mainly used when there is no way that risk can be reduced or financed. This technique is not very good for the organisations as it is a negative way to deal with the risk.

Loss Prevention

This technique is use to reduce the frequency of that particular loss.

Loss Reduction

It is consist of all techniques that will help in reducing the severity of that loss.

7. 2 Risk Financing

The risk manager to finance the loss when the risk is occurred used this method. There are two different techniques used by the risk manager which are:

Risk Retention

Risk retention is a technique by which organisation have fund where they have enough money in it so that they can afford their non-insured losses. In other words risk manager retain money from the profit so that the organisation can meet with the non-insured losses if that loss occurred. This also leads to the self insurance which is also part of the retention technique. The retention technique varies with the different organisations, as big companies can afford to have money for the non-insured losses but not the same case is with the small organisations. It is very difficult to eliminate all the risks. It is not possible to cover all the risk exposures in the insurance as well.

Non Insurance Transfer

Non-insurance transfer is particular way other than insurance by which risk is transfer to another party. It can be in the form of contract that if a loss occurs then the other party have to pay the expenses.

Insurance is the effective way used by the risk managers of funding a loss. That is the safest way to cover all your losses. The risk manager has to find the best insurance policy for the organisation and to make sure that that policy covers the organisations needs.

8. 0 Summary

Thus, according to the Brundtland (1987), the theory of sustainability is very useful and efficient framework to describe and minimise the risks of the firms. Sustainable development suggest a balance among the environment, they economy and social equity. It challenges us to find approaches to business which provide to robust, long term health for the environment, for the individual, for local economies and for the business itself. It is now generally agreed that sustainable businesses are more cost and energy efficient, functionally effective, and profitable, while at the same time offering loss prevention benefits, risk reduction potential as well as reduced negative impacts on the business environment.

In Zara’s case, it is observed that the benefits of sustainable business can either be described by referring to direct or indirect financial, operational and legal specific risks. In short, a vast body of credible evidence of Zara now indicates that sustainable behaviour and responsible business practices are increasingly seen as a precondition for achieving better investment returns. Sustainability requires that a company have a corporate awareness of the principles of sustainability for all aspects of its operations. This awareness should be the basis of the companies approach to problem solving and should encourage creative ideas for new technologies, better operational process, new products or services, and so forth.