

Case 15 Zara: Super-Fast Fashion

With sales of €25.3 billion in the 12 months to January 31, 2018, Inditex, based in Arteixo, Galicia, in the north-west corner of Spain, was the world's biggest apparel supplier. Its founder and controlling shareholder, Amancio Ortega, was estimated by *Forbes* to be the world's sixth richest person (after Jeff Bezos, Bill Gates, Warren Buffett, Bernard Arnault, and Mark Zuckerberg).

Inditex is famous mainly for its biggest business, Zara, which accounted for 66% of the Group's sales in 2017. In January 2018, there were 2251 Zara stores—the great majority company-owned and operated—in 96 different countries. The Group's other businesses (ranked by sales) were Pull & Bear, Massimo Dutti, Bershka, Stradivarius, Zara Home, and Oysho. Except for Zara Home (furnishings and tableware), all the businesses are engaged in the design, manufacture, and retailing of fashion clothing (together with footwear and accessories), although each operates independently with a distinctive brand personality and a different target customer segment.

As well as being the core business of Inditex Group, Zara is also the primary exponent of Amancio Ortega's unique approach to the fashion clothing business. Zara's strategy defies most of the fashion world's conventional wisdom: it spends almost nothing on advertising, employs no super-star designers, seeks no celebrity endorsements, and undertakes most of its manufacture in Spain rather than offshoring it to low-wage locations. Instead, Zara has created a unique business system that is quick to recognize and exploit emerging fashion trends through a vertically-integrated supply chain that supports unparalleled speed and market responsiveness.

A Brief History¹

Amancio Ortega was born in Galicia in 1936. He left school at the age of 11 and by the age of 13 was working for a local shirt-maker. In his early 20s, he began producing copies of popular designer garments using inexpensive fabrics; at age 29, he opened his first Zara store selling modestly-priced, fashionable women's clothing. Here, Ortega introduced the novel idea of a continuously changing collection of garments, in contrast to the two-season per year collections that were traditional in the clothing business. As Ortega opened additional stores, he developed his "instant fashion" model involving designers replicating emerging trends, then using close integration of factories, distribution centers, and retail stores to compress the design-to-store cycle. The first Zara store outside Spain was in Portugal in 1988, and in 1989, Zara entered the United States.

By 2000, Zara had created a business system unlike that of any other fashion brand. Zara's designers, based at Inditex's Arteixo headquarters, sourced design ideas from fashion shows, celebrities, streetwear, and—most of all—feedback from the stores. Fabrics for Inditex brands were purchased by its subsidiary, Comditel, which also undertook most dying and printing of the fabric.

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Initially, most of Zara's garments were produced in-house. As its product range and volume grew, the proportion of Zara's sales produced by third-party manufacturers increased to about half.

Zara's distribution center, at Arteixo, served Zara stores throughout the world with twice-weekly deliveries, each taking a maximum of three days. Garments were shipped with price-tags attached, on rails, ready for immediate display within the stores. Each store's shipment would comprise only 3–5 units of each size and each design.

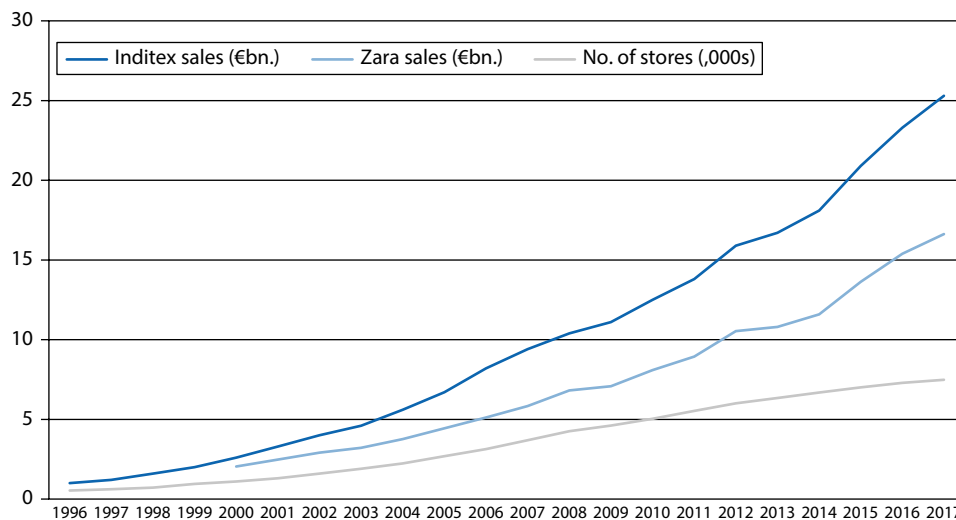
Zara's stores featured a uniform design and product presentation. Store managers oversaw ordering and providing weekly feedback. Prices were determined centrally and varied between countries according to transport costs and what the market would bear. Compared to Spain, Zara's prices were 70% higher in North America and 100% higher in Japan.

Zara's international expansion involved setting up new stores in prime locations. Zara's initial entry was often through joint venture—in Italy and Japan, joint ventures helped gain access to prime real estate; in Germany and India, joint ventures gave access to local market knowledge. However, joint venture partners were usually bought out at a later stage—according to Inditex's head of corporate development: “We don't mind investing in joint ventures to learn but prefer to go alone.”²

The time from a product's design to its arrival in a retail store could be as little as two weeks.

Figure 1 shows Inditex and Zara's growth from 1996 to 2017.

FIGURE 1 Growth of Inditex and Zara's sales and store numbers, 1996–2017



Source: Inditex.

Zara in 2018³

Zara's strategy is based upon supplying cutting-edge fashion at reasonable prices—or, as the *New York Times* explained: “. . . trendy and decently made but inexpensive products sold in beautiful, high end-looking stores. Zara's prices are similar to those of the Gap: coats for \$200, sweaters for \$70, T-shirts for \$30.”⁴ The success of the strategy is indicated by its financial performance (see Table 1).

TABLE 1 Financial performance of Zara and Inditex

	2017	2016	2015	2014	2013	2012	2011
Sales (€bn.)							
Zara	16.6	15.4	13.6	11.6	10.8	10.5	9.0
Inditex	25.3	23.3	20.9	18.1	16.7	15.9	13.8
EBIT (€bn.)^a							
Zara	3.02	2.76	2.45	2.12	2.09	2.23	1.73
Inditex	4.31	4.02	3.68	3.20	3.07	3.12	2.52
EBIT/Sales (%)							
Zara	18	18	18	18	19	21	19
Inditex	17	17	18	18	18	20	18
ROCE (%)^b							
Zara	30	30	30	29	31	37	32
Inditex	33	33	34	33	35	39	37
ROE%							
Inditex	26	26	26	25	27	30	28

Notes:^aEarnings Before Interest and Tax.^bEBIT/Average capital employed.**Source:** Inditex Annual Accounts.

Design

Designers form part of Zara headquarters' "commercial team," together with country managers and buyers. Designers tend to be young—mostly in their late 20s and early 30s and work collaboratively in an egalitarian environment. Designers are organized into three groups—women's wear, men's wear, and children's wear—each group occupying a large, open-plan hall, within which there are separate areas for different product groups. Buyers and country managers sit around a long table in the middle of each hall.

Design is a collaborative process involving numerous meetings. A product group head explains: "For new collections we meet to decide which trends we are going to follow, then how to put the collection together, then select which items to prototype, which items to produce, and in what quantity . . . the design team may come up with 500 design ideas . . . we may arrive at 40 designs to move forward, and we may actually choose to go ahead with only a few of them."⁵

In common with the rest of the fashion industry, Zara designers create collections for both fall/winter and spring/summer seasons—but typically these items cover only about 15% to 20% of Zara's sales (compared to 80% to 100% for most branded fashion companies). The pre-planned collections are continuously augmented and adapted—mainly on the basis of feedback from store managers.

The country managers play an important role in linking the stores within their country with design and production decisions. Based mainly at headquarters, they are in constant communications with their store managers.

The buyers manage sourcing, procurement, and the allocation of production to different plants and to third-party suppliers.

Production

Zara had historically concentrated its production in its own production plants close to its Arteixo base. However, as its sales have grown and its international scope widened, it has relied increasingly on a global network of about 1600 third-party suppliers—located mainly in Eastern Europe (including Turkey) and Asia.

Zara's own manufacturing plants concentrate upon products that are most sensitive to time to market. Basic items which are designed pre-season and whose sales are predictable are typically outsourced to Asia. For in-house production, Zara's plants concentrate on fabric cutting; sewing is mostly undertaken by about 200 contractors located mainly around La Coruña and elsewhere in north-west Spain. Sewn garments are then returned to Zara for quality inspection, labeling, and transfer to the main distribution center.

Distribution

By 2018, Zara had three major distribution centers: its original distribution center at Arteixo, plus its centers at Zaragoza, for women's garments, and at Meco, near Madrid, mainly for children's wear. The distribution centers are highly automated. The introduction of RFID (radio frequency identification) technology in 2014 has enabled tracking of every garment from factory to point of sale. For European stores, each store's shipment is consolidated at the Zaragoza center, and then shipped within a 24-hour window by trucks (third-party carriers, but in Zara liveried trucks). Stores outside Europe have their shipments airfreighted, usually by scheduled air service, with 48- to 72-hour shipment time. As soon as shipments arrive, they are put on display at the stores—retail stores have no back inventory.

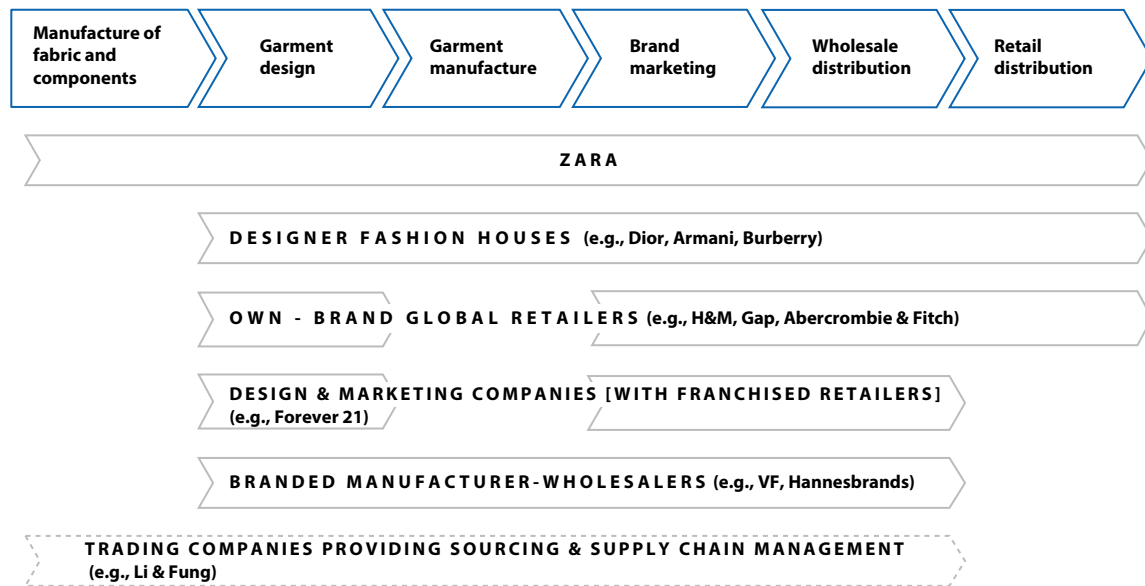
Retailing

Stores place orders and receive shipments twice-weekly at specified times. Because of the constant stream of new products, a large proportion of orders are for new items—hence the need for frequent discussion between the store manager and country head. Typically, each item spends less than two weeks in a retail store. If an item is still in a store after two or three weeks, it is removed and sent to a store within the same country where that particular item is selling faster—or even sent back to Spain for relabeling for a store in a different country.

Zara's retail stores play a critical role in Zara's brand identity. Zara targets premier retail locations: Fifth Avenue in New York, Regent Street in London, the Champs-Élysées in Paris. According to one fashion journalist:

The high street is really divided according to brand value. Prada wants to be next to Gucci, Gucci wants to be next to Prada. The retail strategy for luxury brands is to try to keep as far away from the likes of Zara. Zara's strategy is to get as close to them as possible.⁶

Zara's merchandising is designed to create a unique retail dynamic for the brand. Because Zara ships limited quantities of each product and is continually changing its

FIGURE 2 Positioning along the fashion clothing value chain

collection, it has incentivized impulse buying—buy it now or there may not be another chance! Equally, the fast-revolving collection encourages frequency of store visits.

The retail stores are important listening posts for Zara designers. Retail staff are encouraged to elicit and note customer reactions concerning what they like and dislike about specific products. Store managers report this information to their country heads so that it can be incorporated within headquarters, where it is then transmitted to designers.

The Fashion Clothing Business

The quest for cost efficiency has resulted in the value chain of the world clothing industry becoming globally distributed. The leading producing countries for fabric and components (buttons, zippers, trim, etc.) are China, the European Union, India, the United States, Turkey, and South Korea. Garment manufacture is concentrated in countries where labor costs are low, notably China, Bangladesh, Vietnam, and India. Table 2 shows the leading exporters and importers of clothing.

The complexities of managing across borders and the strategic differences between the different stages of the value chain result in different companies specializing in different stages of the chain (see Figure 2). Fabrics, both woven and knitted, are almost entirely produced by specialized textile companies. Most garment production is undertaken by cut-and-sew specialists, mainly contract manufacturers whose products are sold under their customers' brand names. Although some clothing manufacturers design clothes for sale under their own brands (e.g. VF and Hanesbrands), the biggest retailers of clothing—e.g., Walmart, Target, Macy's and TJX Companies—are mainly just retailers, with limited backward integration into previous stages of the value chain.

In the case of fashion clothing, however, the importance of branding means that there are advantages in coordination between design and retailing—not least to ensure consistency between the garments and the retail environment within which they are

TABLE 2 Major exporting and importing countries of clothing, 2015

Exports	\$bn.	Imports	\$bn.
China	175	European Union	96
European Union	28	US	96
Bangladesh	26	Japan	29
Vietnam	22	Hong Kong (mainly from China)	15
Hong Kong (re-exports)	18	Canada	10
India	18	South Korea	9
Turkey	15	Australia	7
Indonesia	7	China	7
Cambodia	6	Switzerland	6
US	6	Russia	6

Source: World Bank.

presented. Thus, mass market fashion retailers such as the Gap, H&M, Next, and Fast Retailing (Uniqlo) are primarily retailers, but also undertake design and brand marketing. Some of these companies limit their involvement in retailing to franchising (e.g., Forever 21). Table 3 shows the world's leading suppliers of branded apparel.

TABLE 3 The world's leading apparel companies, 2017^a

Company	Country	Sales (\$bn.)	Total assets (\$bn.)	Operating margin (%)	ROE ^b (%)	Inventory ^c turnover	Market value (\$bn.)
Christian Dior	France	49.4	87.3	18.8	18.2	4.0	77.1
Inditex	Spain	28.6	24.2	17.0	25.7	9.7	94.9
H&M	Sweden	23.4	13.1	9.4	23.5	6.1	23.7
Gap	US	15.9	8.0	9.3	29.2	8.3	11.7
Fast Retailing	Japan	14.6	10.3	10.7	16.5	6.7	46.2
VF Corp.	US	11.8	10.3	12.7	27.4	7.4	30.6
PVH Corp.	US	8.9	11.9	7.1	7.0	6.1	12.2
Hanesbrands	US	6.5	6.9	11.2	54.6	3.5	6.5
Michael Kors Holdings	UK	4.7	4.1	15.9	34.0	8.2	10.0
Burberry Group	UK	3.5	3.1	14.6	20.9	4.7	9.5

Notes:

^aExcludes diversified companies such as LVMH and Kering.

^bNet income/Shareholder's average equity.

^cSales/Average inventory.

Source: Companies' financial statements.

The situation is different for the up-market designer houses such as Dior, Prada, Gucci, Chanel, Yves Saint Laurent, Versace, and Armani. The importance of quality and image there requires much closer control of their value chains; hence they tend to be highly vertically integrated, undertaking much of their production in-house and directly owning and managing their retail outlets. However, their product development cycles are very long compared to the fast fashion companies. The February/March fashion shows held in New York, London, Milan, and Paris show fall and winter collections; in September, the spring and summer collections are showcased. This implies a period of about nine months from initial design sketch to retail store. Attempts to shorten cycle time include Burberry's pioneering of "see-now, buy-now" system of immediate online availability of garments from its catwalk shows.

Hence, Zara is an outlier. Its vertical integration is reminiscent of the luxury fashion houses, yet it is competing in the mass market with the likes of Gap, H&M, and Next, whose affordable pricing favor outsourcing production to contract manufacturers in southern Asia and other low-cost locations.

Meeting current and future challenges

Zara's ability to defy the conventional wisdom of the mass-market, fashion clothing business is the result of a business system whose components complement one another and are closely aligned to the company's capabilities. Zara's production of short runs of a large number of products in its own Spanish plants appear to be a recipe for high costs. However, these cost disadvantages are offset by efficiencies elsewhere in the Zara system. Zara's compressed cycles and short runs also mean that markdowns (price reductions for slow-moving products) are a fraction of those typical in fashion retailing. Small runs and frequent new changes in the collection also increase the frequency of customer visits and boost sales. A short design-to-store cycle and responsiveness to customer demand result in Inditex turning over its inventory much faster than its competitors—despite being more vertically integrated, which typically means higher levels of inventory and work in progress. Finally, the system only works because of Zara's management systems as well as its culture, which allows good communication and supports responsiveness across geographical and functional boundaries.

The effectiveness of Zara's internal communications is indicated by an incident reported by the *Financial Times*. A week before her wedding to Prince William in April 2011, a Zara store manager informed Zara headquarters that Kate Middleton had been trying on a £49.99 blue dress at the manager's London store. Eight days later, when Miss Middleton was spotted leaving Buckingham Palace in Zara dress, Zara was ready to rush additional copies of the dress to its stores worldwide.⁷

In the following year, a visiting *New York Times* reporter observed the continuous interaction at Zara's headquarters between country managers, designers, and production heads. As country managers received calls from their store managers that the same item was selling well in multiple stores in different countries, they could readily identify the emergence of a global trend and alert their designers and production managers. Similarly, if an item was not selling well, they could get feedback from customers and retail staff as to how the design might be revamped.⁸

However, as Zara grew in size, geographical scope, and product range, so its closely integrated business system and collaborative management style was threatened by the increasing complexity of the business. Consider, for example, Zara's supply chain.

Three distribution centers in Spain rather than one require that products must be shipped from the Arteixo and Meco distribution centers for consolidation at the Zaragoza center. With increased sourcing from suppliers in Asia, Zara's supply chains are increasingly stretched—most outsourced production is air freighted or shipped to the Zaragoza distribution center.

The development of online retailing further complicates Zara's business model—by 2017, Zara was offering online sales in most of the countries in which it operated stores. In January 2018, it opened its first click n' collect store. Inditex's commitment to environmental sustainability and corporate social responsibility also created additional complexity. In 2017, Zara rolled out a clothes recycling service providing collection bins in its stores. In Spain, it also provided a home collection service for used clothing.

Finally, there was the issue of whether increasing numbers of employees—particularly at headquarters—would reduce the effectiveness of Zara's informal, collaborative, non-hierarchical management model. By January 2018, Inditex had 171,839 employees representing 87 different nationalities and speaking 54 languages. Advances in information and communication technology could augment Zara's alertness to changing circumstances, but it was not clear that it could substitute for the qualitative judgments, subjective insights, and alertness to weak signals that were vital components of the Zara's management capability.

Notes

1. This section draws heavily upon "Inditex: 2000" (Harvard Business School, Case No. 9-713-538, revised March 5, 2014).
2. K. Ferdows, J. Machuda, M.A. Lewis, "Zara: The World's Largest Fashion Retailer" (The Case Centre, Case No. 615-059-1, 2015): 3.
3. This section draws upon two previous cases: Ferdows et al, op cit and "Zara: Fast Fashion," (Harvard Business School, Case No. 9-704-497, December 21, 2006).
4. "How Zara Grew Into the World's Largest Fashion Retailer," *New York Times* (November 10, 2012).
5. Ferdows et al, op cit: 8.
6. "How Zara Grew Into the World's Largest Fashion Retailer," op cit.
7. "Inditex keeps its finger on the pulse," *Financial Times* (May 23 2011).
8. "How Zara Grew Into the World's Largest Fashion Retailer," op cit.