Ecosystem Aware Global Supply Chain Management

ZARA-Fast Fashion (HBS 9-703-497)

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ZARA

- Founded in 1963 by Amancio Ortega and First Zara shop opened in 1975 selling low price imitations of more up market fashion house.

- Zara is a part of the €4 billion Inditex group and 100% owned company, based in Barcelona. Over 80% of the group’s sales are contributed by Zara’s 600 stores.

- Women’s, men’s and children’s wear, over 724 stores in 56 countries.

- Ortega thought that customers would regard clothes as a perishable commodity - no different from yogurt or bread - to be consumed, rather than stored in closets.
Apparel Supply Chain
Apparel Supply Chains

In global apparel supply chains, the channel masters could be retailers or branded manufacturers or trading companies.
Ecosystem Aware Global Supply Chain Management

The Value Chain of Apparel Industry

- Natural fibres: Cotton, wool, silk, etc.
- Synthetic fibres: Oil, natural gas

- Textile companies
  - Yarn (spinning)
  - Fabric (weaving, knitting, finishing)

- Apparel manufacturers
  - North America
    - US garment factories (designing, cutting, sewing, buttonholing, ironing)
  - Domestic and Mexican/Caribbean Basin subcontractors
  - Asia
    - Asian garment contractors
    - Domestic and overseas subcontractors

- All retail outlets
  - Department stores
  - Specialty stores
  - Mass merchandise chains
  - Discount chains
  - Off-price, factory outlet, mail order, others

Zara’s Business System
Learning by doing was the Mantra for Achieving Favorable Outcomes.

- Zara produces and presents very limited volumes of new items in certain key stores. They are produced on a larger scale only if consumer reactions were unambiguously positive.
- Failure rates on new products were only 1%, compared to average of 10% for the sector.
- The Zara’s design teams continuously track customer preferences and use this information about sales potential based on a consumption information system to transmit repeat orders and new designs to internal and external suppliers.
- The design teams are bridged merchandising and the back end of the production process.
Four critical information-related areas that give Zara its speed include:

1. Close watch on trends & buying behaviour
   - Market research on university campuses, discos & other venues
   - Feedback from the stores
     - Sales report
     - Qualitative comments

2. Quick decisions
   - Commercial team sits with designers to use the information to create new lines and tweak existing ones
   - Deciding with the commercial team on the fabric, cut, and price points of a new garment

3. Inventory Control
   - A HQ regional managers collect and analyse the feedback.
   - Production
   - Dyeing/Finishing (if required)
   - Fabrics from stock

4. Distribution
   - Fleet to stores
   - Line in stores
   - Fabrics from stock

(source: Devangshu Dutta 2002, retail at the speed of fashion)
Zara Supply Chain- Highly Unconventional

- Zara defies most of the conventional wisdom about how supply chains should be run. Some of Zara's practices may seem questionable, if not crazy, when taken individually.
- Unlike so many of its peers in retail clothing that rush to outsource, Zara keeps almost half of its production in-house.
- Far from pushing its factories to maximize their output, the company intentionally leaves extra capacity.
- Rather than chase economies of scale, Zara manufactures and distributes products in small batches.
- Instead of relying on outside partners, Zara manages design, warehousing, distribution, and logistics itself.
Many of Zara’s day-to-day operational procedures differ from the norm.

- Zara holds its retail stores to a rigid timetable for placing orders and receiving stock.
- It puts price tags on items before they're shipped, rather than at each store. It leaves large areas empty in its expensive retail shops. And it encourages, occasional stock-outs.
- Zara sends half-empty truck across Europe, pays for airfreight twice a week to ship coats on hangers to Japan, and runs factories for only one shift.
- Zara's senior managers have stayed the course and resisted setting performance measures that would make their operating managers focus on local efficiency at the expense of global responsiveness.
Design

- Each of Zara’s product lines—for women, men, and children—had a creative team consisting of designers, sourcing specialists, and product development personnel.

- Frequent conversations with store managers, information included industry publications, TV, Internet, and film content; trend spotters who focused on venues such as university campuses and discotheques; and even Zara’s young, fashion-conscious staff.
Vertical integrated Manufacturing at Zara

- Internal manufacture was the primary responsibility of 20 fully owned factories located near Zara’s headquarters.
- Zara’s factories were heavily automated focused on the capital-intensive parts of the production process—pattern design, cutting, finishing and inspection.
- Cut garments were sent out to about 450 workshops with small operations specialized by product type.
  - Zara accounted for most if not all of their production; provided them with technology, logistics, and financial support; carried out inspections onsite.
  - The sewn garments were inspected, ironed, folded, bagged, and ticketed at Zara’s manufacturing complex, before sending to the distribution center.
Store Operations

- Zara’s stores were located in highly visible locations, often in the premier shopping streets in a local market and upscale shopping centers.
- The stores functioned as both the company’s face to the world and as information sources.
- Zara actively managed its portfolio of stores and relocates in response to the evolution of shopping districts and traffic patterns.
- Older, smaller stores may be relocated as well as updated (and typically expanded) in new, more suitable sites.
- Zara invested more heavily and more frequently than key competitors in refurbishing its store base.
Three Principles of Zara’s Supply Chain

- Transfer both hard data and anecdotal information from shoppers to designers and production staff quickly.
  - Track materials and products in real time every step of the way, including inventory on display in the stores.

- Stick to a rhythm across the entire chain: timing and synchronicity are paramount.

- Leverage the Assets: Zara produces roughly half of its products in its own factories. It buys fabric and dyestuff from Inditex firms.
  - So much Vertical Integration is out of fashion in the industry; rivals like Gap and H&M, own no production facilities.
Zara’s Competitive Economics

- Zara can sell some 80% of its products at full price — about twice the industry average.
- The ability to avoid markdowns more than compensates for any added manufacturing and distribution costs.
Zara’s product merchandising policies

- The Zara name had nevertheless developed considerable drawing power in its major markets.
- Zara shoppers even knew which days of the week delivery trucks came into stores, and shopped accordingly. About three-quarters of the merchandise on display was changed every three to four weeks, which also corresponded to the average time between visits given estimates that the average.
- Zara shoppers visited the chain 17 times a year, compared with an average figure of three to four times a year for competing chains and their customers.
Zara’s internationalization strategy
International expansion has adopted three different entry modes

- **Zara had its own subsidiaries** in most European and South American countries that were perceived to have high growth potential and low business risk.

- **Joint ventures:** In Germany and Japan the deal was on a 50-50 joint venture. In Italy Inditex held a 51% share in Zara. However, Zara has recently increased its ownership to 78% in Germany, 80% in Italy and 100% in Japan.

- **Franchising:** This strategy is chosen for high-risk countries such as Saudi Arabia, Kuwait, Andorra or Malaysia.
Comparison of the business models of Gap, Hennes & Mauritz and Bennetton, the Key Competitors with Inditex
A Business Model is not a Business Strategy

- A business strategy is specified by the answers to three questions: what is the offer, who are the customers, and how is the offer produced and delivered to the customers.

- The **how** question subsumes the **firm’s choice of business model**. Organizations can have essentially the same product or service offer (the what), aim for the same market segment (the who), and do so with different business models (the how).

- Zara’s rise to fast fashion dominance did not depend on product or market innovation. **The heart of the company’s innovation lay in its vertical integration of activities from design and all elements of the supply chain.**
Comparing ZARA with GAP & H&M

- H&M outsourced all of its production while Zara’s retained many production activities in house and kept all internal and external activities under its strict control.
- H&M’s competitive strategy different: Its prices were lower, its spending on advertising much higher, and its stores less upscale.
- Both GAP and H&M relied on a traditional “push” approach, devoting substantial resources to advertising. Zara used a “pull” approach, attracting shoppers with small collections and new weekly offerings in reaction to customers.
- At GAP, design preceded manufacturing and commercial activity, while Zara’s business model configured the same activities simultaneously by taking a team approach to the design-manufacturing-commercialization activities.
The Management Team

- The key governance team for orchestrating internal activities for each product line is a trio consisting of
  - the (final) designer (using CAD-CAM technology)
  - the commercial person (talking to the store managers and analyzing previous sales)
  - the supply chain person ensuring that the collection that would be agreed to on the table could actually be made in order to deliver new fashion to shops every week and change seventy percent of the stores.
IT at Zara

One would expect that Zara would have an impressive array of complex and expensive IT systems
Four critical information related areas that give ZARA its speed include:

- **Collecting information on consumer’s need**: Designers check the database and have access to real-time information.

- **ZARA “warehouses” the product information**: With common definitions, allowing quick and accurate design preparations with clear cut manufacturing instructions.

- **Product information and inventory management**: Gives ZARA the capability to design a garment with available stocks, rather than having to order and wait for the material to come.

- **Distribution management**: Distribution facility works with minimal human intervention. Optical reading devices sort out and distribute 60,000 items an hour.
The risks of failure of the Zara business model
Why might ZARA fail?

- How sustainable is its competitive advantage relative to the kinds of advantages pursued by other apparel retailers?
- Several different failure scenario/threats can be identified
  - Overinvestment made in Zara’s capital assets
  - If Zara grows bigger, will the complex manufacturing and distribution system scale up
  - Is International expansion possible with its model of with high fixed assets, low advertising & low working capital.
Risk of failure of the Zara business model

- The explicit, public, and general nature of a business model makes replicating another firm’s business model trivial. All evidence is to the contrary.
- The multiple failures of established airlines – Delta, Continental, and so forth – to replicate the business model of Southwest Airlines suggest the challenge of copying a model that is explicit, public, and general.
- Attempts to replicate best-practice operations typically disappoint. Replicators often fail to appreciate the complex interconnections of multiple activities that constitute a best practice.
Key Take Away

Run your business right
ZARA Business Model: Key take away

- Selling “state-of-the-art” fashion though being a fashion follower
- Integration upstream to create competitive advantages downstream
  - Relation between distribution and product development
  - Evolutionary product development and sourcing
  - Product development and distribution instead of promotion underlies brand development
- Rethink the entire supply chain
  - Reduction in mark-down can more than make up for increase in labor cost
  - Planned shortages can induce more future demand
  - Good store location, layout and product display can substitute advertising
  - Faster response eliminates inventory risks