



retail

@ the speed of fashion

By Devangshu Dutta

The middle-aged mother buys clothes at the Zara chain because they are cheap, while her daughter aged in the mid-20s buys Zara clothing because it is fashionable. Clearly, Zara is riding two of the winning retail trends - being in fashion and low prices - and making a very effective combination out of it. Much talked about, especially since its parent company's IPO in 2001, often admired, sometimes reviled, but hardly ever ignored, Zara has been an interesting case study for many other retailers and fashion brands around the world. We set out to understand what are the winning elements in Zara's business model, and probably only scratched the surface of the key to their success. Here's the quick-n-dirty on Zara's recipe for growth.

Zara is the flagship brand of the Spanish retail group, Inditex SA, one of the super-heated performers in a soft retail market in recent years. When Inditex offered a 23 per cent stake to the public in 2001, the issue was over-subscribed 26 times raising Euro2.1 billion for the company. What makes Inditex so tasty? Well, for a start, it seemed to show higher profit margins than comparable retailers, and secondly, the trend seemed sustainable. Good bet for most investors.

The Awkward Factor in the Profitability Formula

Buy low, sell high. Buy on credit, sell on cash. Retail profitability often seems like a no-brainer.

If you sell at X dollars and buy at Y dollars, as long as your operating and financial costs are lower than the gross margin i.e. the difference between X (selling price) and Y (cost), you should be making money. And what with retailers running around with gross margins of 50-60 per cent (that is more than half of their retail price), making money should be no problem, right?

Wrong. In highly perishable goods such as fashion products that are susceptible to seasons, gross margin is meaningless if the product does not sell as planned. In simple terms, you make more money if you sell more, even at a lower margin 30 per cent on sales of Rs. 100 is better than 60 per cent on Rs. 10. Given the unpredictability in fashion, it is quite likely that you will end up selling a large proportion of your products at a discount. For many retailers, 35-40 per cent of the total merchandise being sold at hefty discounts is quite the norm.

Imagine fashion clothing to be like vegetables, or bread. On the first day it looks very appetising and has lots of buyers. By the

Amancio Ortega Gaona, the founder of Inditex, thought that consumers would regard clothes as a perishable commodity just like yogurt, bread or fish to be consumed quickly, rather than stored in cupboards, and he has gone about building a retail business that provides “freshly baked clothes”.



second and third day it starts to look stale, but customers may still pick it up, maybe at lower prices. By the time a week is over, the retailer is probably better off giving the bread away just to clear up space.

Working with him in the last few years, Inditex Chief Executive José María Castellano is quoted as saying, "This business is all about reducing response time. In fashion, stock is like food. It goes bad quick."

Zara, which contributes around 80 per cent of group sales, concentrates on three winning formulae to bake its fresh fashions:

- Short Lead Time = More fashionable clothes
- Lower quantities = Scarce supply
- More styles = More choice, and more chances of hitting it right

Short Lead Times: Keeping Up With Fashion

By focussing on shorter response times, the company ensures that its stores are able to carry clothes that the consumers want at that time. Zara can move from identifying a trend to having clothes in its stores within 30 days. That means that Zara can quickly identify and catch a winning fashion trend, while its competitors are struggling to catch up. Catching fashion while it is hot is a clear recipe for better margins with more sales happening at full prices and fewer discounts. In comparison, most retailers of comparable size or even smaller, work on timelines that stretch into 4-12 months. Thus, most retailers try to forecast what and how much its customers might buy many months in the future, while Zara moves in step with its customers.

A very large design team based in A Coruña in North West Spain is busy throughout the year, identifying the prevalent fashion trends, and designing styles to match the trends. Trend identification comes through constant research not just traditional consumer market research, but a daily stream of emails and phone calls from the stores to head office. Unlike other retailers, Zara's machinery can react to the report immediately and produce a response in terms of a new style or a modification within 2-4 weeks. Many other retailers have such long supply chain lead times that for them it would seem a lost cause for them to even try and respond to a sales report.

Reducing Risks

By reducing the quantity manufactured in each style, Zara not only reduces its exposure to any single product but also creates an artificial scarcity. As with all things fashionable, the less its availability, the more desirable the object becomes. When Zara opened its first store on London's Regent Street, shoppers are said to have browsed without shopping, thinking that they would come back to buy during a sale. Then the store assistants explained that the styles were changed every week, and the style liked by the customer would very likely not be available later. Subsequently, Regent Street became one of Zara's most profitable stores and more stores opened in the UK.

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The added benefit of lower quantities is that if a style does not work well, there is not much to be disposed when the season-end sale does happen. The result is that Zara discounts only about 18 per cent of its products, roughly half the levels of competitors.

Leadership in Numbers

Thirdly, instead of more quantities per style, Zara produces more styles, roughly 12,000 a year. Thus, even if a style sells out very quickly, there are new styles already waiting to take up the space.

Zara can offer more choices in more current fashions than many of its competitors. It delivers merchandise to its stores twice a week, and since re-orders are rare the stores look fresh every 3-4 days. Fresh produce, moving in step with the fashion trend and updated frequently the ingredients are just right to create the sweet smell of success.

But how does Zara achieve its three key success factors, which would be a nightmare for most other retailers: of producing small quantities of numerous styles in short time spans? Let us look at the mechanisms that enable Zara to deliver on these parameters as well as some unique aspects of the retailer's business model.

Zara's success is as much a result of its history and location, as its counter-intuitive business strategies. While it may not be possible for another company to exactly duplicate the conditions under which Zara grew and flourished, we can certainly try and learn from its experiences, its processes and its business structures.

If you thought that it is not possible to produce all this success in the same kind of set-up as other retailers, and that it also has to cost something, you would be absolutely correct on both counts. Zara follows a structure that is more closely controlled than most other retailers, and pays further by having the various business elements in close proximity to each other, around its headquarters in Spain.

Ownership and Control of Production

For one, most other retailers (like the American chain Gap and the Swedish retailer Hennes & Mauritz) completely outsource their production to factories around the world, many of them in low cost Asian countries. In contrast, it is estimated that 80 per cent of Zara's production is carried out in Europe, much of it within a small radius of its headquarters in Spain. In fact, almost half of its production is in owned or closely-controlled facilities. While this gives Zara a tremendous amount of flexibility and control, it does have to contend with higher people costs, averaging 17-20 times the costs in Asia.

Counter-intuitively Inditex has also gone the route of owning capital-intensive manufacturing facilities in Spain. In fact, it is a vertically integrated group, with up-to-date equipment for fabric dyeing and processing, cutting and garment finishing. Greige (undyed fabric) is more of a commodity and is sourced from



Spain, the Far East, India, and Morocco. By retaining control over the dyeing and processing areas, Inditex has fabric-processing capacity available "on demand" to provide the correct fabrics for new styles. It also does not own the labour-intensive process of garment stitching, but controls it through a network of subcontracted workshops in Spain and Portugal.

Supercharged Product Development

Design and product development is a highly people-intensive process, too. The heavy creative workload of 1,000 new styles every month is managed by a design and development team of over 200 people, all based in Spain, each person in effect producing around 60 styles in a year (or 1-2 styles a week).

With new styles being developed and introduced frequently, each style would provide only around 200,000-300,000 of retail sales, a far lower figure than other retailers or brands, and certainly not "cost-efficient" in terms of design and product development costs. But obviously, this higher cost of product development is more than adequately compensated by higher realised margins.

In addition, the entire product development cycle begins from the market research. This combines information from visiting university campuses, discos and other venues to observe what young fashion leaders are wearing, from daily feedback from the stores, and from the sales reports. This has meant a significant



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investment in information technology and communications infrastructure to keep streaming up-to-date trend information to the people making the product and business decisions.

At the leading edge of research are the sales associates and store managers in Zara stores, who zap orders on customised handheld computers over the Internet to Zara headquarters based on what they see selling. And not just orders, but ideas for cuts, fabrics or even a whole new line. They draw upon customer comments, or even a new style that a customer might be wearing that could be copied for Zara's stores. Traditional daily sales reports can hardly provide such a dynamically updated picture of the market.

React Rather Than Predict

What sets Zara apart from many of its competitors is what it has done to its business information and business process. Rather than concentrating on forecasting accurately, it has developed its business around reacting swiftly.

Here's a flavour of what a typical retailer or brand might do. Say, around a certain time, designers may start looking at fashion trends, and start designing a look for Winter 2004. Information and inspiration comes from forecasting agencies, trade shows, and various other places. Over a period of 3-5 months they develop the ideas into physical samples. These are also simultaneously costed. Sales budgets and stock plans are developed based on what is going on in the business right then (roughly one-year ahead of the targeted style). At various times during this "seasonal" process, there are decision-making meetings, where styles are accepted, rejected or changed, pricing and margin decisions taken and orders finalised.

Since multiple decisions factors are involved there are several meetings where a buyer / merchandiser, a designer, a technologist, a sourcing specialist and others may get involved together. No doubt, many calendars and travel schedules have to be synchronised for this to happen smoothly.

Based on a host of factors, the orders might then be placed with vendors in one or more countries around the world. Typically vendors may take a few weeks to two months to procure fabrics, have them approved by the retailer, and then produce a number of samples, and only once all approvals are finished, put the style into production.

From beginning to end, the process of defining a concept to receiving goods in the retail store might take anywhere from 9 to 12 months for a typical retailer. This one-year advance decision-making on what merchandise and how much to stock, is a bit like driving a car at speed by just looking in the rear view mirror! Amazingly, it seems to work 60-65 per cent of the time.

Zara, on the other hand, largely concentrates its forecasting effort on the kind and amount of fabric it will buy. It is a smart hedge for one, fabric (raw material) mistakes are cheaper than finished goods errors, and secondly, the same fabric could be turned into many different garments. In fact, for an extra degree of flexibility Zara buys semi-processed or un-coloured fabric that it colours up close to the selling season based on the immediate need.



As far as finished garments are concerned, rather than forecasting, it just quickly produces the least amount possible of what is hot with consumers, and moves to the next hot style fast. With its range of clothes constantly being updated, one or two slow-selling items are unlikely to hurt profits. Customers are also more likely to visit its shops regularly to see new stock.

With that edge, and a super-fast garment design and production process, it takes to the market what its customers are looking for.

Quick-Bake Recipe: Well-Mixed Ingredients

Garment styling for Zara actually starts from the email or phone call received from the stores. Thus, from the beginning Zara is responding to an actual need, rather than forecasting for a distant future.

Based on the store demand, Zara's commercial managers and designers sit down and conceptualise what the garment will look

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like, what fabric it will be made out of, what it will cost and at what price it will sell.

The designer then actually sketches the garment out, details the specifications and prepares the technical brief. Since fabrics and trims are already in Zara's warehouse, sampling takes very little time. Approvals are equally quick, since the entire team is located in the same place.

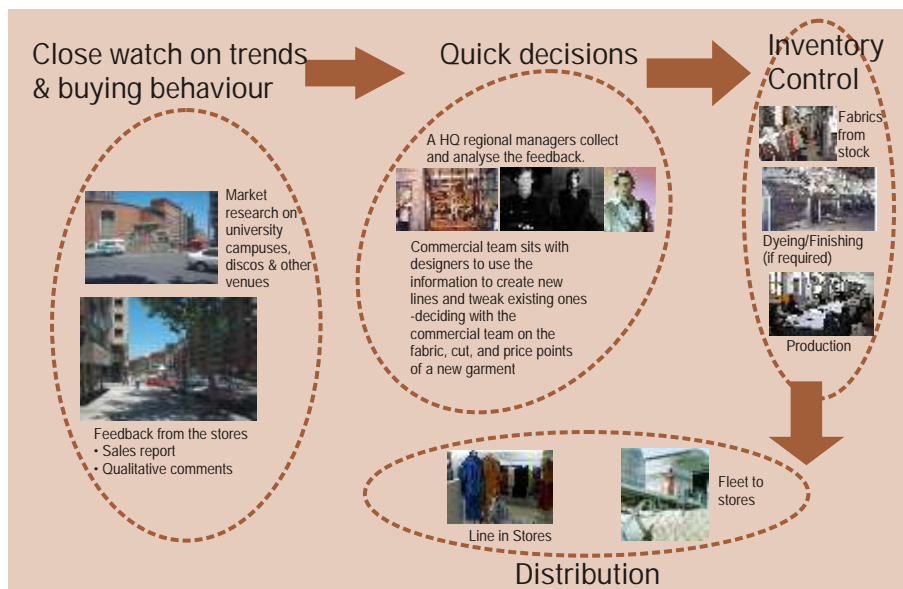
As soon as approvals are received, instructions are issued to cut the appropriate fabric. The cutting is done in Zara's own high-tech automated cutting facilities. The cut pieces are distributed for assembly to a network of small workshops mostly in Galicia and in northern Portugal these 350 workshops between them employ some 11,000 apparently grey-economy workers. None of these workshops are owned by Zara. The workshops are provided with a set of easy to follow instructions, which enable them to quickly sew up the pieces and provide a constant stream to Zara's garment finishing and packing facilities. Thus, what takes months for other companies, takes no more than a few days for Zara.

Finally, Zara's high-tech distribution system ensures that no style sits around very long at head office. The garments are quickly cleared through the distribution centre, and shipped to the stores, arriving within 48 hours. Each store receives deliveries twice a week, so after being produced the merchandise does not spend more than a week at most in transit.

Information Technology Keeps It Boiling

Information and communications technology is at the heart of Zara's business.

Four critical information-related areas that give Zara its speed include:



- Collecting information on consumer needs: trend information flows daily, and is fed into a database at head office. Designers check the database for these dispatches as

well as daily sales numbers, using the information to create new lines and modify existing ones thus, designers have access to real-time information when deciding with the commercial team on the fabric, cut, and price points of a new garment.

- Standardisation of product information different or incomplete specifications, and varying product information availability typically add several weeks to a typical retailer's product design and approval process, but Zara "warehouses" the product information with common definitions, allowing it to quickly and accurately prepare designs, with clear cut manufacturing instructions.
- Product information and inventory management being able to manage thousands of fabric and trim specifications, design specifications as well as their physical inventory, gives Zara's team the capability to design a garment with available stocks, rather than having to order and wait for the material to come in.
- Distribution management: its State-of-the-art distribution facility functions with minimal human intervention. Approximately 200 kilometres of underground tracks move merchandise from Zara's manufacturing plants to the 400+ chutes that ensure each order reaches its right destination. Optical reading devices sort out and distribute more than 60,000 items of clothing an hour. Zara's merchandise does not waste time waiting for human sorting.

Keeping Costs Down

Even while manufacturing in Europe, Zara manages to keep its costs down. None of its assembly workshops are owned by the company. Most of the informal economy workers the workshops employ are mothers, grandmothers and teenage girls looking to add to their household incomes in the small towns and villages where they live. Last year the average monthly salary of a Spanish industrial worker was about 250,000 pesetas - \$1,300 a month, excluding the state's 30.8 per cent charge for social contributions. In contrast, according to reports, the workshops working for Inditex may or may not pay the social charges. According to one estimate, the seamstresses probably get something less than half the average industrial wage, maybe \$500 a month. These are around 5-6 times typical Indian or Chinese wages, and yet offer the flexibility beyond what Asian factories can, which has a tremendous impact on ratio of full-price merchandise sales.

Further, in terms of marketing costs, Zara relies more on having prime retail locations than on advertising for attracting customers into its stores. It spends a meagre 0.3 per cent of sales on advertising compared to an average of 3.5 per cent of competitors according to the company, choosing highly visible locations for its stores renders advertising unnecessary.

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Apart from designing to the fashion-of-the-day, Zara's strategy of producing low volumes per style and changing products quickly in its stores enables it to cut down on the discounts as well. Only about 18 percent of Inditex clothing doesn't work with its customers and must be discounted. That's half the industry average of 35 percent. Zara also has two clearly time-limited sales a year rather than constant markdowns.

Lastly, since it spends effort on producing what are current fashion trends, it spends its "design" effort on interpreting rather than



creating afresh. In fact, Inditex has been constantly alleged to have knocked-off top designers' ranges, thus spending less on product development and design.

They "have a premier look because they're often copies from the top designers", according to one industry observer.

However that may be, Zara delivers fashion when it is hot, and at a fraction of the price charged by designer brands. And consumers are certainly voting with their feet and wallets.



Devangshu Dutta is a retail and fashion industry professional, and CEO of Third Eyesight (website: www.thirdeyesight.in). He has worked with retailers and consumer goods manufacturers internationally in developing and implementing strategies for new businesses, markets and products, sourcing and supply chain management and other areas.

Outside his work, he contributes articles to print and internet publications. He has been a speaker at industry forums organised by the Confederation of Indian Industry, Interstoff-Asia (Hong Kong), the Textile Institute (Manchester), WTO/ITC (Geneva), the Federation of Indian Chambers of Commerce, and others.

This article has been based on research carried out by him and out by him and Dharmendra Arora.

In the next issue Dutta will further deliberate upon his analysis "Learnings from Zara".

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Timeline

1975

ZARA begins its activity with the opening in A Coruña (Spain) of its first store, although the origins of the Group date back to 1963, the year in which Amancio Ortega Gaona, chairman and founder, begins his business activity.

1976

GOASAM is founded by the owner of the ZARA stores and continues with the opening of the first stores in Spain.

1985

The creation of INDITEX as head of the corporate group.

1988

The opening of the first ZARA store outside Spain occurs in December 1988 in Oporto (Portugal).

1989-1990

The United States and France are the next markets in which the Group begins its activity with the opening of outlets in New York (1989) and Paris (1990).

1991

The birth of the PULL&BEAR chain and the purchase of 65 per cent of the MASSIMO DUTTI Group.

1992-1994

INDITEX continues to open new international markets: Mexico in 1992, Greece in 1993 and Belgium and Sweden in 1994.

1995

INDITEX acquires the whole of the share capital of MASSIMO DUTTI. This year also sees the opening of the first store of the Group in Malta and in the following year in Cyprus.

1997

Norway and Israel join the list of countries in which INDITEX is present.

1998

The BERSHKA chain, targeting the younger female market, commences its activity in a year which also sees the opening of stores in new countries: Argentina, Japan, United Kingdom, Venezuela, Lebanon, United Arab Emirates, Kuwait and Turkey.

1999

The acquisition of STRADIVARIUS makes it the fifth chain of the Group and stores are also opened in new countries: the Netherlands, Germany, Poland, Saudi Arabia, Bahrain, Canada, Brazil, Chile and Uruguay.

2000

The opening of stores in four new countries takes place in 2000: Austria, Denmark, Qatar and Andorra. INDITEX installs its headquarters in a new building located in Arteixo (A Coruña, Spain).

2001

On 23rd May 2001 Inditex goes public and is listed on the Spanish Stock Market. During this year the group begins its activity in the following markets: Puerto Rico, Jordan, Ireland, Iceland, Luxemburg, Czech Republic and Italy.

Source: Company's Website