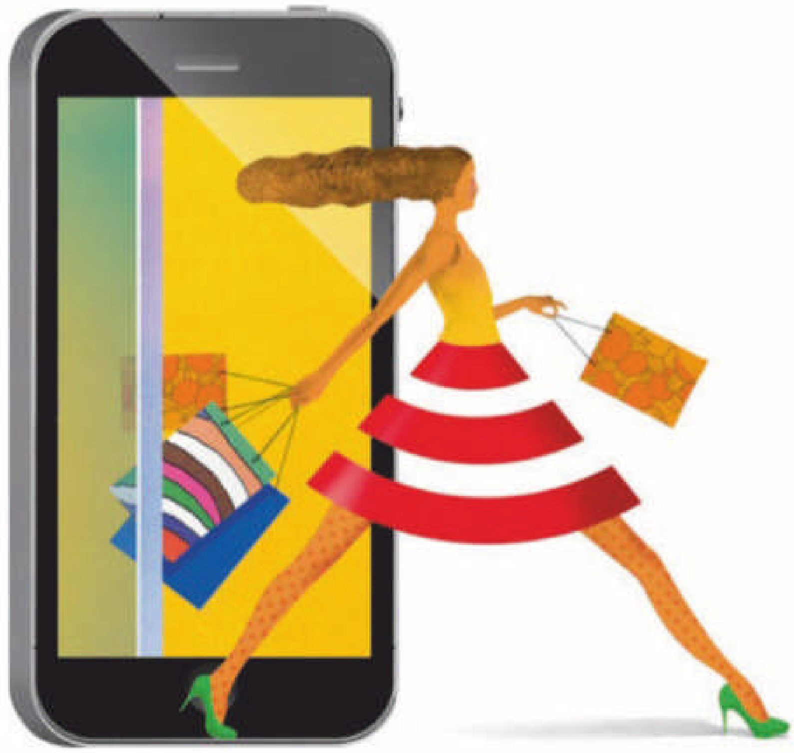
Schumpeter | Refashion model

Can the owner of Zara tailor its business to fit online shoppers?



IT HAD BEEN closed, on and off, for much of the past year. Now signs on the blacked-out windows of the Zara shop on the Champs-Elysées, the Spanish brand's early outpost in the French capital, announce it will not re-open even after covid-19 passes. Disappointed fashionistas are redirected to the label's website for all their value-for-money sartorial needs. Alternatively, they can stroll two blocks down the avenue, where another Zara shop opened a few years ago. There are three more within a half-hour's walking distance in central Paris.

Peppering city centres and malls with more outlets used to be the obvious strategy for apparel retailers seeking new customers. Inditex, Zara's owner and the world's biggest purveyor of fast fashion, grew from fewer than 750 stores at the turn of the century to around 7,500. But trends come and go in business as they do on the catwalk. In 2020, for the first time in its two-decade history as a listed company, Inditex finished the year with fewer shops than it had 12 months earlier—and suffered its first quarterly loss. Up to 1,200 outlets are in the process of being axed, compared with 300 planned openings. Inditex, the most admired firm in the sector, has not run out of ambition. Instead, Zara is chasing its young clientele to where they spend the most time: on their phones, shuffling between Instagram and TikTok. The shift to online sales, which has been turbocharged by lockdowns, will require some agile refitting of the way fashion brands do business.

Much of what it takes to flog a polka-dot dress for $27—the average selling price for the Inditex family of brands, which also includes thriftier Bershka and posher Massimo Dutti, among others—is the same in store or online. The product must be desirable, and available at the right time, right size and right price. For the bean-counters, though, the transactions are as different as sequins and flannel. Shops are giant bundles of fixed costs, starting with rent and staff, which turn profitable only once you shift enough product through them—the idea is to stack it high and sell it cheap. Websites and warehouses cost much less to run. But because retailers cough up to deliver each package, the more they sell the more such variable costs add up.

On the surface, shifting sales online looks alluring. Gross margins are a bit leaner than in shops, where it is harder for buyers to compare prices than on Google. But at the same time an online-only retailer has none of the expenses associated with stores, such as shop assistants' wages and rental payments. So online sales can end up more profitable overall. The wrinkle for established retailers is that their website often serves customers who would once have rung up the tills in physical stores, leaving them emptier. Unless at least some shops are closed, says Aneesha Sherman of Bernstein, a broker, retailers risk having to cough up new variable costs of online fulfilment while continuing to incur the fixed costs of legacy bricks and mortar.

Inditex's signal that it is reducing its store numbers is a wake-up call in the industry. Bosses dislike shutting shops. Attendant lay-offs irk politicians; write-downs and forgone sales can annoy investors. But where Inditex goes, others follow. The Spanish group has grown faster than rivals, such as Sweden's H&M or America's Gap. It surged ahead by outsourcing more of its production close to its main European market, which allowed it to respond faster to fashion trends and maintain leaner stock. Fresher inventory led to fewer end-of-season markdowns and fatter profits. Even as rivals have emulated it, Inditex has managed to keep operating margins at a plump 17%. Those of Fast Retailing, the Japanese parent of Uniqlo and the only rival to match Inditex's sales growth in recent years, are a third lower.

Few doubt Inditex will meet the target, set in June, of raising the share of online sales from 14% of the total in 2019 to at least 25% by 2022. Having arrived late to the cyber-party, Pablo Isla, the company's boss since 2005, has the zeal of a convert. His plan envisages hefty investment: over $3bn will be spent by 2022 to boost online capabilities and make sure stores and websites work seamlessly together. New technology, such as RFID chips, tracks where items are, allowing Inditex to fulfil an order from either a shop or a warehouse. It is testing an app to tell shoppers if a particular item in a particular size is available in a given outlet—and even on which of the outlet's racks to find it.

These investments ought to be easy to fund from Inditex's healthy balance-sheet and profits—certainly easier than for other retailers, which have their backs against the wall after a dud year. The Zara brand is strong enough to attract shoppers to its own app; lesser marques rely on intermediaries such as Zalando or Amazon, which crimps margins. Inditex has short leases on its stores, giving it more room to haggle over rents, or make rent payments more flexible by linking them to shops' sales.

Prêt-à-cliquer

Being an online champion inevitably brings its own headaches. Amazon is a far more fearsome competitor than H&M. Barriers to entry are low. Maybe one in three garments sold online is returned, a much higher proportion than in shops, where they can be tried on (though nudging buyers to leave unwanted frocks in stores, as Inditex does, helps cut postage costs and increase the likelihood the item can be sold again while still in fashion). Zara, which spends next to nothing on advertising, might have to start if people are not reminded of its existence by walking past its billboard-like outlets.

In time, sales per square foot in remaining shops will probably continue to fall, threatening their viability. Unlike banks, which have been pruning their high-street branches for years, clothes retailers deal with fickle fashionistas, not sticky account-holders. The industry's supermodel will probably sashay online with more grace than rivals. But it had still better watch its step. ■