

Zara

The case describes how Zara, operating out of the Galician port of La Coruña in north-west Spain has managed to become a benchmark for speed and flexibility in the garment industry. The case offers an illustration of a fast-response global supply, production and retail network. In 2003 Zara was the only retailer that could deliver garments to its stores worldwide (507 in 33 countries) in just fifteen days after they were designed. It could do that because of its unique systems for product design, order administration, production, distribution and retailing. The unconventional approach that Zara often deploys in these areas provides interesting opportunities for discussion and learning.

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Isabelle Borges, one of the product market specialists in the women's wear department at the Zara headquarters, sensed that they were on to something. The new khaki skirt had sold out in the La Coruña store after only a few hours on the shelves and the store manager had just told her that she could have easily sold more. A small batch of 2800 skirts, just enough to "test the waters," had been sent out the previous night to a selection of Zara's worldwide network of stores. Ms. Borges called around a few of the Seville stores and discovered that sales there were also very brisk. If these market signals were not enough, she had also spotted a colleague wearing the skirt. "That's always a good sign. Employees here are tough critics," she said. As more and more reports came in from other stores, echoing the same positive customer reaction, Isabelle Borges knew that the skirt was going to be a hit and she quickly set in motion a process that within days had supplied the skirt to Zara stores on three continents.

Although many firms would claim to be responsive to the changing demands of markets and customers, few actually have the requisite agility in their supply chain to deliver on such a claim. Zara stands out. It can rapidly design, produce and ship the latest fashions to its stores in various 'upscale' locations such as Oxford Street in London, the Champs-Elysees in Paris and Lexington Avenue in New York. In May 2001, investor confidence in this capability underpinned a € 2.3 billion Initial Public Offering (IPO) of 25% of Zara's parent company, Inditex. The founder, who started his first business with 5000 pesetas, retained 61.2% of the capital after the floatation, making him the richest man in Spain. By July 2001, the stock was trading at more than 25% over its IPO price, valuing the company at over € 12 billion - more than Benetton, The Limited, or Next. How did a relatively small Spanish company operating from La Coruña - one of the most westerly points on the European mainland - achieve all this?

The Inditex Story

In 1963, Amancio Ortega Gaona started Confecciones GOA in La Coruña, to manufacture women's pajamas and lingerie products for garment wholesalers. In 1975 however, after a German customer cancelled a sizable order, the firm opened its first Zara retail shop in La Coruña. The original intent was simply to have an outlet for cancelled orders but the experience taught the firm the importance of a 'marriage' between manufacturing and retailing - a lesson that has guided the evolution of the company ever since. As a senior marketing executive reiterated in 2001, "it is critical for us to have five fingers touching the factory and five touching the customer."

From a starting point of 6 stores in 1979, the company established retail operations in all the major Spanish cities during the 1980's. In 1988 the first overseas Zara store opened in Porto, Portugal, followed shortly by New York City in 1989 and Paris in 1990. But the real 'step-up' in foreign expansion took place during the 1990s when Inditex entered 29 countries in Europe, the Americas and Asia (particularly during 1998 to 2001 when it entered 21 of these 29 countries). In parallel with its overseas expansion, Inditex diversified its retail offering by adding and acquiring new brands (e.g. Pull and Bear, Massimo Dutti, Bershka, Stradivarius) in order to target different customer segments. Each brand operates independently, with its own stores, ordering system, warehousing and distribution system, subcontractors, and organizational structure. What each brand does share is a commitment to supply 'fashion at affordable prices' and all employ similar management models for the control of the total supply chain to maximize speed to market.

By 2002 Inditex had opened 1284 stores in 39 countries, an aggressive expansion program based entirely on internal financing. Even the IPO in May of 2001 brought no additional

cash into the company. Zara's growth is based on a business model that allows it to operate with essentially "negative working capital" — in other words, it collects cash faster than it pays it out! As an illustration of the success of the model, Inditex sales grew from € 367 million in 1991 to € 3.25 billion and net profit from € 31 million in 1991 to € 345 million in 2001. In 2001 alone, while many companies in the industry were facing downturns, Inditex sales grew by 27% over 2000 and profit increased by 32%. In 2001, Inditex's EBITDA and EBIT as percentage of revenues were the highest among its peers.

ZARA

Zara is the largest Inditex division - accounting for more than 75% of total Inditex sales. By April 2003, Zara had 565 stores in 33 countries - albeit with the largest concentration still in Spain (followed by France, Portugal, Mexico, and Greece). While further flung markets such as Japan hold long term and potentially substantial growth prospects, Zara remains extremely cautious in the development of these markets. In the U.S. for instance, even though Zara opened its first store in 1989, by 2002 it still had only 8 stores. Zara owns and operates almost its entire store network. In 2001 for instance, only 12 stores were operated as joint ventures (in Japan, Mexico and Germany) and only 31 were franchises (all outside Spain).

Specific retail locations are only ever selected after extensive market research to ensure that Zara's target market segments is of sufficient size in that locality to render the store financially viable. Moreover, Zara always tries to locate its stores in the most up-market, high traffic, and prestigious locations. Even though such prime retail locations are often very expensive, most of the selling space in a typical Zara store is left empty in order to create a pleasant, spacious and uncluttered shopping environment that invites customers to walk around and browse (see Figure 1). The layout of the stores, the furniture, and even the window displays are all designed at La Coruña to give the same image worldwide and a "flying team" from headquarters is usually dispatched to a new site to set up the store: "we want our store managers to focus on sales and customers — not on things like air-conditioning," explained Mr. Borja de la Cierva, Zara's Chief Financial Officer. Location, traffic and layout are particularly

important for Zara because it spends relatively little on advertising (In 2001, 0.3% of sales turnover compared with 3.5% by its peers). According to marketing executive Miguel Diaz, "Our stores and word-of-mouth, do the advertising for us." Further emphasizing the importance of the stores, Mr. Diaz argued that the Internet would not have a radical impact on their retail operations. "[Customer's] have to try the dress to see how they look in it. In fact, that is why we don't anticipate a lot of sales through our web page."

A typical Zara store has women's, men's and children's sections, with a manager in charge of each. Women's wear accounted for almost 60% of sales, with the rest equally divided between men's wear and children's wear. The store manager is usually also the head of the women's section.

Zara places a great deal of emphasis on training its sales force and strongly emphasize internal promotion. Store employee remuneration is based on a combination of salary and bonus derived from overall store sales. Although store managers are responsible for the "profit and loss" of their respective stores, La Coruña control prices, transfer costs, and even a certain amount of merchandizing and product ordering. In practice, the critical performance measures for the store managers relate to the precision of their sales forecasts (communicated through the ordering process) and sales growth. A simple yet key measure followed by senior managers is the rate of improvement of daily sales from year-to-year — for example, sales on the third Wednesday of June 2003 compared to the third Wednesday of June 2002.

Zara's strategy requires the generation of a great deal of product variety throughout the year. "We are in the fashion business — not clothing. Our customers buy our products because they like it — not because it is Zara," explained Mr. Diaz. To its customers, Zara stores are places where you can find something new and, crucially, of limited supply. As part of this fashionably exclusive (yet low cost) image, stores hold very low levels of inventory - typically only a few pieces of each model - and this often means that a store's entire stock is on display. As a result of the low inventory policy it is not unusual to find empty racks by the end of a day's trading and therefore stores are completely reliant on regular and rapid replenishment of newly designed products.

Figure 1
Typical Layout of a Zara store (Women's section featured)



Figure 2
A Zara Design Hall



The Total Supply Chain

For Zara stores to be able to offer cutting edge fashion at affordable prices requires the firm to exert a strong influence over almost the entire garment supply chain: design, purchasing, production, distribution, and retailing.

Design and Order Administration

Zara designs all its products. It has almost 300 staff in its headquarters “commercial team” – comprising designers, market specialists and buyers. Together they produce designs for approximately 40,000 items per year from which about 10,000 are selected for production. Unlike their industry peers, these teams work both on next season’s designs and, simultaneously and continuously, also update the current season’s designs. The firm tries hard to encourage a collegial and dynamic atmosphere (e.g. there are deliberately no design ‘prima donnas’ and their average age is 26) and design inspiration is sought from myriad global sources (e.g. trade fairs, discotheques, catwalks, magazines). Extensive feedback from the store network also forms an integral part of the design process. Women’s, men’s and children’s designers sit in different halls in a modern building attached to the Inditex headquarters (see Figure 2). In each of these big open spaces – with floor to ceiling windows offering views over adjacent countryside) - designers occupy one side, market specialists the middle, and buyers (procurement and production planners) the other side. There are several big round tables in the central area of each hall for impromptu meetings and comfortable chairs and racks of the latest fashion magazines and catalogues fill the walls. There is an air of informality and openness.

Designers draw out design sketches by hand and then discuss them with colleagues — including market specialists, planning and procurement people. This process helps to retain an overall “Zara style.” The sketches are redrawn using a CAD system where further

changes and adjustments, for better matching of weaves, textures, and colors etc., are made. Before moving further through the process, it is necessary to determine whether the design can be produced and sold at a profit. The next step is to make a sample, often completed manually by skilled workers located in the small sample making shop in one corner of each hall. If there are any specific questions or problems, they can just walk over to the designers and discuss and resolve them on the spot.

Each market specialist has responsibility for dealing with specific stores. As experienced employees, who have often been store managers themselves, they recognize that it is crucial to establish personal relationships with the managers of ‘their’ stores. They are in constant contact, especially by phone, discussing sales, orders, new lines and other matters. Equally, stores rely heavily on these discussions with Market Specialists before finalizing orders. Augmenting their extensive phone conversations, store managers are supplied with a specially designed hand-held digital device to facilitate the rapid and accurate exchange of market data. Final decisions concerning what products to make, when, and in what volumes are normally made collectively by the relevant groups of designers, market specialists, and buyers and after the decision is taken the buyers (also very experienced staff) take charge of the total order fulfillment process: planning procurement and production requirements, monitored warehouse inventories, allocated production to various factories and third-party suppliers and kept track of shortages and oversupplies.

Production

Zara manufacture approximately 50% of its products in its own network of 22 Spanish factories (18 of which are located in and around the La Coruña complex) but use subcontractors for all sewing operations. These factories generally work a single shift and are managed as independent profit centers. The other half of its products are procured from 400 outside suppliers, 70% of which are in Europe, and most of the rest in Asia. Many of the European suppliers are based in Spain and Portugal, and Zara exploit this geographical proximity in order to ensure quick response to Zara orders - critical for fashion products. From Asia, Zara procure “basic” products and those for which the region has a clear cost or quality advantage. With its relatively large and stable base of orders, Zara is a preferred customer for almost all its suppliers.

The make or buy decisions are usually made by the procurement and production planners. The key criteria for making this decision are required levels of speed and expertise, cost-effectiveness, and availability of sufficient capacity. If the buyers cannot obtain desired prices, delivery terms, and quality from Zara factories, they are free to look outside. For its in-house production, Zara obtain 40% of its fabric supply from another Inditex-owned subsidiary, Comditel (Zara account for almost 90% of their total sales). Over half of

these fabrics are purchased undyed to allow faster response to mid-season color changes. To facilitate quick changes in printing and dyeing, Zara also work closely with Fibracolor (a dyestuff producer part owned by Inditex - Zara purchase 20% of its output). The rest of the fabrics come from a range of 260 other suppliers, none account for more than 4% of Zara's total production in order to minimize any dependency on single suppliers and encourage maximum responsiveness from them.

After in-house CAD controlled piece cutting, Zara use subcontractors for all sewing operations. The subcontractors themselves often collect the bagged cut pieces, together with the appropriate components (like buttons and zippers) in small trucks. There are some 500 sewing subcontractors in very close proximity to La Coruña (in the Galicia region) and most work exclusively for Zara. Zara closely monitor their operations to ensure quality, compliance with labor laws, and above all else adherence to the production schedule. Subcontractors then bring back the sewn items to the same factory, where each piece is inspected during ironing (by machine and by hand). Finished products are then placed in plastic bags with proper labels and then sent to the distribution center. A system of aerial monorails connects ten of the factories in La Coruña to the distribution center. Completed products procured from outside suppliers are also sent directly to the distribution center. Zara use a sampling methodology to control the incoming quality.

Distribution

All products pass through Zara's major distribution center in La Coruña. This 5-storey, 50,000 m² distribution centre employs some of the most sophisticated and up-to-date automated systems: many developed by Zara/Inditex staff with the support of a Danish supplier. With a workforce of 1200, the distribution center normally operates four days per week with the precise number of shifts depending on the volume of products that have to be distributed. Orders for each store are packed into separate boxes and racks (for hanging items) and are typically ready for shipment 8 hours after they have been received. Interestingly,

Figure 3
The Zara Fleet of Trucks



although in June 2001 the distribution center was only operating at around 50% of its full capacity, October 2001 saw Inditex announce the construction of a new €100 million logistics center in Zaragoza: "Don't ask me to give you the financial justification for this decision," joked Mr. de la Cierva, Zara's Chief Financial Officer. In addition to the central distribution center, Zara has three other smaller warehouses in Brazil, Argentina, and Mexico in order to cope with distance and different seasons in the Southern Hemisphere.

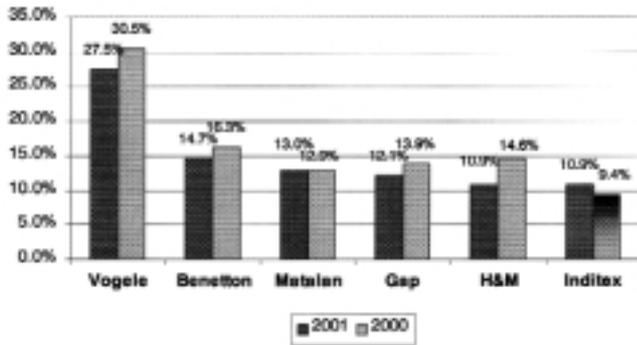
In 2001, the distribution center shipped 130 million pieces - i.e. about 400,000 pieces in a typical day. 75% of these shipments were to stores in Europe. Around 300,000 new items (SKUs or "stock keeping units") are introduced every year (the 10,000 new product designs in typically five to six colors and five to seven sizes). Fashion garments represent around 80% of Zara's products and the rest are more basic items. Contractors, using trucks bearing Zara's name (see Figure 3), pick up the merchandise at La Coruña and deliver it directly to Zara's stores in Europe.

The trucks run to published schedules (like a bus timetable). For example, an order for a store in The Netherlands catches the truck leaving La Coruña at 6 a.m. on Thursday. It is also easy to schedule a pick up at a specific destination for transport back to La Coruña (for example a shipment from China to be picked up at the port of Rotterdam). Products shipped by air are flown from either the airport in La Coruña or the larger airport in Santiago. Typically, stores in Europe receive their orders in 24 hours, the United States in 48 hours and Japan in 48 to 72 hours. Speed is clearly an overriding concern; as one of the senior managers put it: "For us, distance is not measured in kilometers, but in time." Compared to similar companies in the industry, shipments at Zara are almost flawless - 98.9% accurate with less than 0.5% shrinkage.

Retailing

Stores usually place their orders and receive shipments twice per week. Orders have to be placed at pre-designated times: stores in Spain and southern Europe on Wednesdays before 3 p.m. and Saturdays before 6 p.m. and in rest of the world on Tuesdays by 3 p.m. and Fridays by 6 p.m. If a store misses its deadline, it has to wait: "We are very strict about these deadlines. Orders must be on time," emphasized Mr. Diaz. Most items stay in the stores less than two weeks and Zara seek to minimize the risk of oversupply by keeping production volumes low at the beginning of the season and reacting quickly to orders and new trends during the season. The industry average "pre-season inventory commitment" - the level of production and procurement in the supply chain in, say, late July for the fall/winter season - ranges from 45% to 60% of anticipated sales. At Zara it is only 15% to 20%. The "in-season commitments" at Zara are 40% to 50% whereas the industry average ranges from almost nothing to a maximum of 20%. The Zara supply chain reacts faster by working with more precise forecasts and more reliable market information.

Figure 4
Comparison of Inventory as Percentage of Sales (2000 and 2001)



Those items that remain on the shelves for more than two or three weeks are normally taken out of the store and shipped to either other stores in the same country or back to Spain. "We try to keep this below 10% of store's stocks," Mr. de la Cierva explained. In practice, only an inconsequential percentage of the items are actually sent back to Spain. Rapid movement of new products through the stores, and the knowledge that some of the products may not be replenished, together create an additional incentive for customers to buy on the spot (because if a customer chooses to wait, the item might be sold out and may never be made again). All this means that Zara carries less overall inventory per unit of sales than its competitors (see Figure 4) and has less unsold items that have to be discounted in end-

of-season sales. In an industry where such discounting means that the average product fetches only 60% to 70% of its full price, Zara manages to collect 85%.

The Future?

Today Zara has nearly 600 stores worldwide and the firm continues to open about 2 new stores per week. There is also a clear strategy to make the new stores bigger to allow the firm to showcase its ever-expanding range of products. Almost 90% of the new stores are being opened outside Spain and although most continue to be wholly owned by Inditex, one-third of the planned new stores in the Zara two-year plan will be joint ventures or franchise operations. Of course, reliance on joint ventures and franchising is common practice in this industry - in 2001 Benetton, a successful pioneer in the innovative management of the fashion retail supply chain, had almost 6500 franchised stores in 120 countries - because it can help to cope with overseas expansion, secure financing, reducing regulatory risks, etc. and lowers the demand for close attention to day-to-day operations in far-flung stores. Unlike Zara however, Benetton does not own the inventory at its franchise stores.

As Zara continues to open more stores in more countries, will it have to adopt a similar policy? If it does, will these and other potential changes adversely affect Zara's tightly controlled supply chain, the system that has enabled it to achieve better results than almost all of its peers? How do the issues of the Zara case play out at your company? What the limits of Zara's model?...

COMMENTS ON THE CASE STUDY

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From a general standpoint, this article has the great merit of being very factual and quite well informed when compared to the other sources available on the Zara case. It also has the quality of bringing to light the full range of issues affecting the company, from its strategic positioning to its outbound logistics, and covering its policy for assembling collections and the internal organization of its services on the way. Zara's specific positioning is only clear when all of these elements are taken into account.

At this point, it is useful to remind ourselves of how Zara's design / procurement chain (value chain) differs from the other traditional models:

Design and creation rely extensively on re-using (copying) fashion trends observed at the fashion shows and at competitors' points of sale, allied to the very acute sense of fashion shared by its buyers and designers alike. In the vanguard of this ever-changing industry, Zara's need for a responsive design / procurement chain is absolute. The fact of being very close to fashion trends explains why this brand has a very high sell through ratio when compared to other sectors. Somewhat contrary to what is stated in the article, it should be remembered that Zara's strategy does not exclusively rely on the "Made by Zara" design but is also based on purchasing products finished by their network of "medium term" suppliers (allowing for purchasing lead times of 4 to 8 weeks).

In fact, the Zara method for designing and assembling clothing collections is simply the one which allows them to have the "right" product within the shortest possible procurement lead time. There is thus a subtle interplay, which is still not fully understood, between the supplies of finished products designed by the suppliers, and those coming from the company's own studios.

Let us remember that the greatest proportion of the procurement lead times for textiles comes from the time requirements for the raw materials (threads and cloth), which account for nearly two-thirds of the overall lead time in the case of a purchase ordered "from scratch" ("made to order" in SCOR parlance). The key for the brand names is thus to overcome this constraint, which at first sight

seems to be incompatible with a short term procurement policy (overall supply times of less than 8 weeks – shipping included).

Because of this fact, Zara's suppliers, like those for the majority of the other chains, are split into two groups:

- Volume and long term suppliers (mainly in Asia and Mexico) which offer the benefits of low prices, but generally produce less "fashionable" products
- Short and medium term suppliers (Europe, North Africa) for the more "fashionable" products.

Zara has a bigger proportion of "medium term" suppliers than its large scale competitors (H&M, GAP, The Limited, ETAM...), which explains why it is generally regarded as having a more "fashionable" positioning than its competitors.

For the first group, the forecast planning cycle is particularly important, because the fact of working on long-term cycles means that these suppliers are distanced from the demand and thus a more significant risk is created with regard to volumes. This explains why this procurement policy is applied to the more "basic" and therefore less risky products.

For the second group, either the supplier has the capacity to make the products within the specified time limits, which supposes that it has managed to resolve the issues regarding the availability and supply of materials from upstream at short notice, or Zara has to produce the raw material on its own manufacturing sites, thus having the power to control its own scheduling. This explains why Zara has integrated the "textile" part of the operations into its subsidiary activities, but not the actual making up (sewing together).

In all of the cases, there is a real bottleneck on volumes for these medium term suppliers, which results automatically from the fact of working on the most readily available goods ("made to stock" in SCOR parlance).

Because of this bottleneck in the availability of materials, there are problems regarding the purchasing of volumes upstream. While the process of estimating the volumes to be purchased does indeed depend on effective co-operation between designer/purchaser/point of sale, as is described in the article, the capacity of the purchaser and supplier to find this volume is it more uncertain. It is certain that in reality, Zara's purchasing policy draws its competitive advantages from the greater opportunism of its buyers, who seek out one or more products that are similar (or the same?) and which are ultimately suitable for providing the market with the required volumes. These elements explain the high number of products (10,000) marketed. On this point, there is no precise benchmarking, but a number of analysts agree on the fact that this figure is in excess of those for Zara's competitors.

Overall, all these factors mean that one can justifiably talk about Zara having a "one-shot" design and procurement strategy until its stocks run out, whereupon the out of stock article is replaced by one which is "nearly the same". This system of upstream procurement is therefore somewhat lacking in structure, but the financial standing of a brand such as Zara enables it to organize its suppliers effectively around this apparently makeshift strategy.

The aspect of the Zara case which remains complex and not widely understood by the experts occurs upstream from the downstream procurement and relates to the matching-up plan, which ensures the correct references and quantities of products in terms of style, material, colour and size are allocated to the different points of sale according to regional specificities (north/south, coastal/continental, urban / semi-urban, large retail outlets/medium-sized retail outlets...). Strictly speaking, however, this question does not relate to the supply chain.

From this point on, the thinking behind the operation of the downstream logistics activity is quite simple, since it is a question

of resupplying the points of sale until the stock is exhausted, and relying on the daily input of data from sales recorded on the point-of-sale terminals to operate the algorithms for the automatic restocking process.

The remaining question posed by the Zara case relates to the increased centralization of logistic resources concerning the warehouses of La Coruña and Saragossa, in particular, although this issue is not confined to clothing. In this sector as in many others, one can observe the trend towards the grouping together of logistic centres, which means they can reach considerable sizes (over 50,000 m² and up to and beyond 100,000 m²). Yet it is not certain that this rush towards economies of scale will be to everyone's benefit, especially when the whole of the European market from north to south has to be supplied from one single point.

This said, it is quite a difficult question to answer, and in Zara's case, gigantism has done nothing to weaken its performances, quite the contrary.

In the end, in taking a broader look at the case, it is interesting to wonder whether Zara's procurement policy, which is strongly linked to the development of collections, has not, in some way, reproduced on a large scale the formula which has been so successful for the Sentier in Paris or the Fashion District of New York.