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Chapter 1

Zara: Fast Fashion from Savvy Systems

1.1 Introduction

LEARNING OBJECTIVE

After studying this section you should be able to do the following:

1. Understand how Zara's parent company Inditex leveraged a technology-enabled strategy to become the world's largest fashion retailer.

The poor, ship-building town of La Coruña in northern Spain seems an unlikely home to a tech-charged innovator in the decidedly ungeeky fashion industry, but that's where you'll find "The Cube," the gleaming, futuristic central command of the Inditex Corporation (Industrias de Diseño Textil), parent of game-changing clothes giant, Zara. The blend of technology-enabled strategy that Zara has unleashed seems to break all of the rules in the fashion industry. The firm shuns advertising and rarely runs sales. Also, in an industry where nearly every major player outsources manufacturing to low-cost countries, Zara is highly vertically integrated, keeping huge swaths of its production process in-house. These counterintuitive moves are part of a recipe for success that's beating the pants off the competition, and it has turned the founder of Inditex, Amancio Ortega, into Spain's wealthiest man and the world's richest fashion executive.

The firm tripled in size between 1996 and 2000, then its earnings skyrocketed from \$2.43 billion in 2001 to \$13.6 billion in 2007. By August 2008, sales edged ahead of Gap, making Inditex the world's largest fashion retailer. J. Hall, "Zara Is Now Bigger Than Gap," *Telegraph*, August 18, 2008. [Table 1.1 "Gap versus Inditex at a Glance"](#) compares the two fashion retailers. While the firm supports eight brands, Zara is unquestionably the firm's crown jewel and growth engine, accounting for roughly two-thirds of sales. R. Murphy, "Expansion Boosts Inditex Net," *Women's Wear Daily*, April 1, 2008.

Figure 1.1



Zara's operations are concentrated in Spain, but they have stores around the world like these in Manhattan and Shanghai.

Source: Used with permission from Inditex.

Table 1.1 Gap versus Inditex at a Glance

	Gap	Inditex
Revenue	\$14.5 billion	\$14.7 billion
Net Income	\$967 million	\$1.68 billion
Number of Stores	3,149	4,359
Number of Countries	6	73
Biggest Brand	Gap	Zara
Number of Other Brands	4	7
Based in	San Francisco, USA	Arteixo (near La Coruña), Spain
First Store Opened	1969	1975

Sources: <http://www.gapinc.com>; <http://www.inditex.com>; <http://www.marketwatch.com>; updated from C. Rohwedder, “Zara Grows as Retail Rivals Struggle,” *Wall Street Journal*, March 26, 2009.

Why Study Zara?

While competitors falter, Zara is undergoing one of the fastest global expansions the fashion world has ever seen, opening one store per day and entering new markets worldwide—seventy-three countries so far. The chain’s profitability is among the highest in the industry. D. Sull and S. Turconi, “Fast Fashion Lessons,” *Business Strategy Review*, Summer 2008. The fashion director for luxury goods maker LVMH calls Zara “the most innovative and devastating retailer in the world.” J. Surowiecki, “The Most Devastating Retailer in the World,” *New Yorker*, September 18, 2000.

Zara’s duds look like high fashion but are comparatively inexpensive (average item price is \$27, although prices vary by country). C. Rohwedder, “Zara Grows as Retail Rivals Struggle,” *Wall Street Journal*, March 26, 2009. A Goldman analyst has described the chain as “Armani at moderate prices,” while another industry observer suggests that while fashions are more “Banana Republic,” prices are more “Old Navy.” J. Folpe, “Zara Has a Made-to-Order Plan for Success,” *Fortune*, September 4, 2000. Legions of fans eagerly await “Z-day,” the twice-weekly inventory delivery to each Zara location that brings in the latest clothing lines for women, men, and children.

In order to understand and appreciate just how counterintuitive and successful Zara's strategy is, and how technology makes all of this possible, it's important to first examine the conventional wisdom in apparel retail. To do that we'll look at former industry leader—Gap.

Gap: An Icon in Crisis

Most fashion retailers place orders for a seasonal collection months before these lines make an appearance in stores. While overseas contract manufacturers may require hefty lead times, trying to guess what customers want months in advance is a tricky business. In retail in general and fashion in particular, there's a saying: inventory equals death. Have too much unwanted product on hand and you'll be forced to mark down or write off items, killing profits. For years, Gap sold most of what it carried in stores. Micky Drexler, a man with a radar-accurate sense of style and the iconic CEO who helped turn Gap's button-down shirts and khakis into America's business casual uniform, led the way. Drexler's team had spot-on tastes throughout the 1990s, but when sales declined in the early part of the following decade, Drexler was left guessing on ways to revitalize the brand, and he guessed wrong—disastrously wrong. Chasing the youth market, Drexler filled Gap stores with miniskirts, low-rise jeans, and even a much-ridiculed line of purple leather pants. J. Boorstein, "Fashion Victim," *Fortune*, April 13, 2006. The throngs of teenagers he sought to attract never showed up, and the shift in offerings sent Gap's mainstay customers to retailers that easily copied the styles that Gap had made classic.

The inventory hot potato Drexler was left with crushed the firm. Gap's same-store sales declined for twenty-nine months straight. Profits vanished. Gap founder and chairman Dan Fisher lamented, "It took us thirty years to get to \$1 billion in profits and two years to get to nothing." P. Sellers, "Gap's New Guy Upstairs," *Fortune*, April 14, 2003. The firm's debt was downgraded to junk status. Drexler was out and for its new head the board chose Paul Pressler, a Disney executive who ran theme parks and helped rescue the firm's once ailing retail effort.

Pressler shut down hundreds of stores, but the hemorrhaging continued largely due to bad bets on colors and styles. L. Lee, "Paul Pressler's Fall from The Gap," *BusinessWeek*, February 26, 2007. During one holiday season, Gap's clothes were deemed so off target that the firm scrapped its advertising campaign and wrote off much of the inventory. The marketing model used by Gap to draw customers in via big-budget television promotion had collapsed. Pressler's tenure saw same-store sales decline in eighteen of twenty-four months. J. Boorstein, "Fashion Victim," *Fortune*, April 13, 2006. A *Fortune* article on Pressler's leadership was titled "Fashion Victim." *BusinessWeek* described his time as CEO as a "Total System Failure." L. Lee, "Paul Pressler's Fall from the Gap," *BusinessWeek*, February 26, 2007. and Wall Street

began referring to him as DMW for Dead Man Walking. In January 2007, Pressler resigned, with Gap hoping its third chief executive of the decade could right the ailing giant.

Contract Manufacturing: Lower Costs at What Cost?

Conventional wisdom suggests that leveraging cheap **contract manufacturing**¹ in developing countries can keep the cost of goods low. Firms can lower prices and sell more product or maintain higher profit margins—all good for the bottom line. But many firms have also experienced the ugly downside to this practice. Global competition among contract firms has led to race-to-the-bottom cost-cutting measures. Too often, this means that in order to have the low-cost bid, contract firms skimp on safety, ignore environmental concerns, employ child labor, and engage in other ghastly practices.

The apparel industry in particular has been plagued by accusations of employing sweatshop labor to keep costs down. Despite the fact that Gap audits contract manufacturers and has a high standard for partner conduct, the firm has repeatedly been taken to task by watchdog groups, the media, and its consumers, who have exposed unacceptable contract manufacturing conditions that Gap failed to catch. This negative exposure includes the October 2007 video showing Gap clothes made by New Delhi children as young as ten years old in what were described as “slave labor” conditions. E. Cho, “Gap: Report of Kids’ Sweatshop ‘Deeply Disturbing,’” *CNN.com*, October 29, 2007, <http://www.cnn.com/2007/WORLD/asiapcf/10/29/gap.labor/index.html#cnnSTCVideo>.

Gap is not alone; Nike, Wal-Mart, and many other apparel firms have been tarnished in similar incidents. Big firms are big targets and those that fail to adequately ensure their products are made under acceptable labor conditions risk a brand-damaging backlash that may turn off customers, repel new hires, and leave current staff feeling betrayed. Today’s manager needs to think deeply not only about their own firm’s ethical practices, but also those of all of their suppliers and partners.

1. Outsourcing production to third-party firms. Firms that use contract manufacturers don’t own the plants or directly employ the workers who produce the requested goods.

Tech for Good: The Fair Factories Clearinghouse

The problem of sweatshop labor has plagued the clothing industry for years. Managers often feel the pressure to seek ever-lower costs and all too often end up choosing suppliers with unacceptably poor practices. Even well-meaning firms can find themselves stung by corner-cutting partners that hide practices from auditors or truck products in from unmonitored off-site locations. The results can be tragic for those exploited, and can carry lasting negative effects for the firm. The sweatshop moniker continues to dog Nike years after allegations were uncovered and the firm moved aggressively to deal with its problems.

Nike rival Reebok (now part of Adidas) has always taken working conditions seriously. The firm even has a Vice President of Human Rights, and has made human dignity a key platform for its philanthropic efforts. Reebok invested millions in developing an in-house information system to track audits of its hundreds of suppliers along dimensions such as labor, safety, and environmental practices. The goal in part was to identify any bad apples, so that one division, sporting goods, for example, wouldn't use a contractor identified as unacceptable by the sneaker line.

The data was valuable to Reebok, particularly given that the firm has hundreds of contract suppliers. But senior management realized the system would do even more good if the whole industry could share and contribute information. Reebok went on to donate the system and provided critical backing to help create the nonprofit organization Fair Factories Clearinghouse. With management that includes former lawyers for Amnesty International, Fair Factories (FairFactories.org) provides systems where apparel and other industries can share audit information on contract manufacturers. Launching the effort wasn't as easy as sharing the technology. The U.S. Department of Justice needed to provide a special exemption, and had to be convinced the effort wouldn't be used by buyers to collude and further squeeze prices from competitors (the system is free of pricing data).

Suppliers across industries now recognize that if they behave irresponsibly the Fair Factories system will carry a record of their misdeeds, notifying all members to avoid the firm. As more firms use the system, its database becomes broader and more valuable. To their credit, both Gap and Nike have joined the Fair Factories Clearinghouse.

KEY TAKEAWAYS

- Zara has used technology to dominate the retail fashion industry as measured by sales, profitability, and growth.
- Excess inventory in the retail apparel industry is the kiss of death. Long manufacturing lead times require executives to guess far in advance what customers will want. Guessing wrong can be disastrous, lowering margins through markdowns and write-offs.
- Contract manufacturing can offer firms several advantages, including lower costs and increased profits. But firms have also struggled with the downside of cost-centric contract manufacturing when partners have engaged in sweatshop labor and environmental abuse.

QUESTIONS AND EXERCISES

1. Has anyone shopped at Zara? If so, be prepared to share your experiences and observations with your class. What did you like about the store? What didn't you like? How does Zara differ from other clothing retailers in roughly the same price range? If you've visited Zara locations in different countries, what differences did you notice in terms of offerings, price, or other factors?
2. What is the "conventional wisdom" of the fashion industry with respect to design, manufacturing, and advertising?
3. What do you suppose are the factors that helped Gap to at one point rise to be first in sales in the fashion industry?
4. Who ran Gap in the 1990s? How did the executive perform prior to leaving Gap? Describe what happened to sales. Why?
5. Who was the Gap's second CEO of this decade? How did sales fare under him? Why?
6. Where do Gap clothes come from? Who makes them? Why? Are there risks in this approach?
7. Describe the Fair Factories Clearinghouse. Which firm thought of this effort? Why did they give the effort away? What happens as more firms join this effort and share their data?

1.2 Don't Guess, Gather Data

LEARNING OBJECTIVE

After studying this section you should be able to do the following:

1. Contrast Zara's approach with the conventional wisdom in fashion retail, examining how the firm's strategic use of information technology influences design and product offerings, manufacturing, inventory, logistics, marketing, and ultimately profitability.

Having the wrong items in its stores hobbled Gap for nearly a decade. But how do you make sure stores carry the kinds of things customers want to buy? Try asking them. Zara's store managers lead the intelligence-gathering effort that ultimately determines what ends up on each store's racks. Armed with **personal digital assistants (PDAs)**²—handheld computing devices meant largely for mobile use outside an office setting—to gather customer input, staff regularly chat up customers to gain feedback on what they'd like to see more of. A Zara manager might casually ask, What if this skirt were in a longer length? Would you like it in a different color? What if this V-neck blouse were available in a round neck? Managers are motivated because they have skin in the game. The firm is keen to reward success—as much as 70 percent of salaries can come from commissions.K. Capell, "Zara Thrives by Breaking All the Rules," *BusinessWeek*, October 9, 2008.

Another level of data gathering starts as soon as the doors close. Then the staff turns into a sort of investigation unit in the forensics of trendspotting, looking for evidence in the piles of unsold items that customers tried on but didn't buy. Are there any preferences in cloth, color, or styles offered among the products in stock?D. Sull and S. Turconi, "Fast Fashion Lessons," *Business Strategy Review*, Summer 2008.

PDAs are also linked to the store's **point-of-sale (POS) system**³—a transaction process that captures customer purchase information—showing how garments rank by sales. In less than an hour, managers can send updates that combine the hard data captured at the cash register with insights on what customers would like to see.C. Rohwedder and K. Johnson, "Pace-Setting Zara Seeks More Speed to Fight Its Rising Cheap-Chic Rivals," *Wall Street Journal*, February 20, 2008. All of this valuable data allows the firm to plan styles and issue rebuy orders based on feedback rather

2. Handheld computing devices meant largely for mobile use outside an office setting. Examples include devices from Palm, Apple's iPhone, and devices running the Windows Pocket PC operating system.

3. Transaction processing systems that capture customer purchases. Cash registers and store checkout systems are examples of point-of-sale systems. These systems are critical for capturing sales data, and are usually linked to inventory systems to subtract out any sold items.

than hunches and guesswork. The goal is to improve the frequency and quality of decisions made by the design and planning teams.

Design

Rather than create trends by pushing new lines via catwalk fashion shows, Zara designs follow evidence of customer demand. Data on what sells and what customers want to see goes directly to “The Cube” outside La Coruña, where teams of some three hundred designers crank out an astonishing thirty thousand items a year versus two to four thousand items offered up at big chains like H&M (the world’s third largest fashion retailer) and Gap.M. Pfeifer, “Fast and Furious,” *Latin Trade*, September 2007; and “The Future of Fast Fashion,” *Economist*, June 18, 2005. While H&M has offered lines by star designers like Stella McCartney and Karl Lagerfeld, as well as celebrity collaborations with Madonna and Kylie Minogue, the Zara design staff consists mostly of young, hungry *Project Runway* types fresh from design school. There are no prima donnas in “The Cube.” Team members must be humble enough to accept feedback from colleagues and share credit for winning ideas. Individual bonuses are tied to the success of the team, and teams are regularly rotated to cross-pollinate experience and encourage innovation.

Manufacturing and Logistics

In the fickle world of fashion, even seemingly well-targeted designs could go out of favor in the months it takes to get plans to contract manufacturers, tool up production, then ship items to warehouses and eventually to retail locations. But getting locally targeted designs quickly onto store shelves is where Zara really excels. In one telling example, when Madonna played a set of concerts in Spain, teenage girls arrived to the final show sporting a Zara knock-off of the outfit she wore during her first performance. “The Future of Fast Fashion,” *Economist*, June 18, 2005. The average time for a Zara concept to go from idea to appearance in store is fifteen days versus their rivals who receive new styles once or twice a season. Smaller tweaks arrive even faster. If enough customers come in and ask for a round neck instead of a V neck, a new version can be in stores with in just ten days.J. Tagliabue, “A Rival to Gap That Operates Like Dell,” *New York Times*, May 30, 2003. To put that in perspective, Zara is *twelve times* faster than Gap despite offering roughly *ten times* more unique products!M. Helft, “Fashion Fast Forward,” *Business 2.0*, May 2002. At H&M, it takes three to five months to go from creation to delivery—and they’re considered one of the best. Other retailers need an average of six months to design a new collection and then another three months to manufacture it. VF Corp (Lee, Wrangler) can take nine months just to design a pair of jeans, while J. Jill needs a year to go from concept to store shelves.L. Sullivan, “Designed to Cut Time,” *InformationWeek*, February 28, 2005. At Zara, most of the products you see in stores didn’t exist three weeks earlier, not even as sketches.J.

Surowiecki, “The Most Devastating Retailer in the World,” *New Yorker*, September 18, 2000.

The firm is able to be so responsive through a competitor-crushing combination of **vertical integration**⁴ and technology-orchestrated coordination of suppliers, just-in-time manufacturing, and finely tuned logistics. Vertical integration is when a single firm owns several layers in its **value chain**⁵. Definition from the “father” of the value chain, Michael Porter. See M. Porter, “Strategy and the Internet,” *Harvard Business Review* 79, no. 3 (March 2001): 62–78, among others. While H&M has nine hundred suppliers and no factories, nearly 60 percent of Zara’s merchandise is produced in-house, with an eye on leveraging technology in those areas that speed up complex tasks, lower cycle time, and reduce error. Profits from this clothing retailer come from blending math with a data-driven fashion sense. Inventory optimization models help the firm determine how many of which items in which sizes should be delivered to each specific store during twice-weekly shipments, ensuring that each store is stocked with just what it needs. C. Gentry, “European Fashion Stores Edge Past U.S. Counterparts,” *Chain Store Age*, December 2007. Outside the distribution center in La Coruña, fabric is cut and dyed by robots in twenty-three highly automated factories. Zara is so vertically integrated, the firm makes 40 percent of its own fabric and purchases most of its dyes from its own subsidiary. Roughly half of the cloth arrives undyed so the firm can respond as any midseason fashion shifts occur. After cutting and dyeing, many items are stitched together through a network of local cooperatives that have worked with Inditex so long they don’t even operate with written contracts. The firm does leverage contract manufacturers (mostly in Turkey and Asia) to produce staple items with longer shelf lives, such as t-shirts and jeans, but such goods account for only about one-eighth of dollar volume. N. Tokatli, “Global Sourcing: Insights from the Global Clothing Industry—The Case of Zara, a Fast Fashion Retailer,” *Journal of Economic Geography* 8, no. 1 (2008): 21–38.

All of the items the firm sells end up in a five-million-square-foot distribution center in La Coruña, or a similar facility in Zaragoza in the northeast of Spain. The La Coruña facility is some nine times the size of Amazon’s warehouse in Fernley, Nevada, or about the size of ninety football fields. M. Helft, “Fashion Fast Forward,” *Business 2.0*, May 2002. The facilities move about two and a half million items every week, with no item staying in-house for more than seventy-two hours. Ceiling-mounted racks and customized sorting machines patterned on equipment used by overnight parcel services, and leveraging Toyota-designed logistics, whisk items from factories to staging areas for each store. Clothes are ironed in advance and packed on hangers, with security and price tags affixed. This system means that instead of wrestling with inventory during busy periods, employees in Zara stores simply move items from shipping box to store racks, spending most of their time on value-added functions like helping customers find what they want. Efforts like this

4. When a single firm owns several layers in its value chain.

5. The “set of activities through which a product or service is created and delivered to customers.”

help store staff regain as much as three hours in prime selling time.C. Rohwedder and K. Johnson, “Pace-Setting Zara Seeks More Speed to Fight Its Rising Cheap-Chic Rivals,” *Wall Street Journal*, February 20, 2008; and K. Capell, “Zara Thrives by Breaking All the Rules,” *BusinessWeek*, October 9, 2008.

Trucks serve destinations that can be reached overnight, while chartered cargo flights serve farther destinations within forty-eight hours.K. Capell, “Zara Thrives by Breaking All the Rules,” *BusinessWeek*, October 9, 2008. The firm recently tweaked its shipping models through Air France–KLM Cargo and Emirates Air so flights can coordinate outbound shipment of all Inditex brands with return legs loaded with raw materials and half-finished clothes items from locations outside of Spain. Zara is also a pioneer in going green. In fall 2007, the firm’s CEO unveiled an environmental strategy that includes the use of renewable energy systems at **logistics**⁶ centers including the introduction of biodiesel for the firm’s trucking fleet.

Stores

Most products are manufactured for a limited production run. While running out of bestsellers might be seen as a disaster at most retailers, at Zara the practice delivers several benefits.

First, limited runs allow the firm to cultivate the exclusivity of its offerings. While a Gap in Los Angeles carries nearly the same product line as one in Milwaukee, each Zara store is stocked with items tailored to the tastes of its local clientele. A Fifth Avenue shopper quips, “At Gap, everything is the same,” while a Zara shopper in Madrid says, “you’ll never end up looking like someone else.”K. Capell, “Fashion Conquistador,” *BusinessWeek*, September 4, 2006. Upon visiting a Zara, the CEO of the National Retail Federation marveled, “It’s like you walk into a new store every two weeks.”M. Helft, “Fashion Fast Forward,” *Business 2.0*, May 2002.

Second, limited runs encourage customers to buy right away and at full price. Savvy Zara shoppers know the newest items arrive on black plastic hangers, with store staff transferring items to wooden ones later on. Don’t bother asking when something will go on sale; if you wait three weeks the item you wanted has almost certainly been sold or moved out to make room for something new. Says one twenty-three year-old Barcelona shopper, “If you see something and don’t buy it, you can forget about coming back for it because it will be gone.”K. Capell, “Fashion Conquistador,” *BusinessWeek*, September 4, 2006. A study by consulting firm Bain & Company estimated that the industry average markdown ratio is approximately 50 percent, while Zara books some 85 percent of its products at full price.D. Sull and S.

6. Coordinating and enabling the flow of goods, people, information, and other resources among locations.

Turconi, “Fast Fashion Lessons,” *Business Strategy Review*, Summer 2008; and K. Capell, “Fashion Conquistador,” *BusinessWeek*, September 4, 2006.

The constant parade of new, limited-run items also encourages customers to visit often. The average Zara customer visits the store seventeen times per year, compared with only three annual visits made to competitors. N. Kumar and S. Linguri, “Fashion Sense,” *Business Strategy Review*, Summer 2006. Even more impressive—Zara puts up these numbers with almost no advertising. The firm’s founder has referred to advertising as a “pointless distraction.” The assertion carries particular weight when you consider that during Gap’s collapse, the firm increased advertising spending but sales dropped. P. Bhatnagar, “How Do You Ad(dress) the Gap?” *Fortune*, October 11, 2004. Fashion retailers spend an average of 3.5 percent of revenue promoting their products, while ad spending at Inditex is just 0.3 percent. “Zara, A Spanish Success Story,” *CNN.com*, June 15, 2001, <http://edition.cnn.com/BUSINESS/programs/yourbusiness/stories2001/zara>.

Finally, limited production runs allows the firm to, as Zara’s CEO once put it “reduce to a minimum the risk of making a mistake, and we do make mistakes with our collections.” C. Vitzthum, “Zara’s Success Lies in Low-Cost Lines and a Rapid Turnover of Collections,” *Wall Street Journal*, May 18, 2001. Failed product introductions are reported to be just 1 percent, compared with the industry average of 10 percent. N. Kumar and S. Linguri, “Fashion Sense,” *Business Strategy Review*, Summer 2006. So even though Zara has higher manufacturing costs than rivals, Inditex gross margins are 56.8 percent compared to 37.5 percent at Gap. C. Rohwedder, “Zara Grows as Retail Rivals Struggle,” *Wall Street Journal*, March 26, 2009. For labor cost comparison, K. Capell, “Zara Thrives by Breaking All the Rules,” *BusinessWeek*, October 9, 2008, reports that workers in Spain earn an average of \$1,650/month versus \$206/month in China’s Guangdong Province.

While stores provide valuable front-line data, headquarters plays a major role in directing in-store operations. Software is used to schedule staff based on each store’s forecasted sales volume, with locations staffing up at peak times such as lunch or early evening. The firm claims these more flexible schedules have shaved staff work hours by 2 percent. This constant refinement of operations throughout the firm’s value chain has helped reverse a prior trend of costs rising faster than sales. C. Rohwedder and K. Johnson, “Pace-Setting Zara Seeks More Speed to Fight Its Rising Cheap-Chic Rivals,” *Wall Street Journal*, February 20, 2008.

Even the store displays are directed from “The Cube,” where a basement staging area known as “Fashion Street” houses a Potemkin village of bogus storefronts meant to mimic some of the chain’s most exclusive locations throughout the world. It’s here that workers test and fine-tune the chain’s award-winning window

displays, merchandise layout, even determine the in-store soundtrack. Every two weeks, new store layout marching orders are forwarded to managers at each location. C. Rohwedder and K. Johnson, "Pace-Setting Zara Seeks More Speed to Fight Its Rising Cheap-Chic Rivals," *Wall Street Journal*, February 20, 2008.

Technology ≠ Systems. Just Ask Prada

Here's another interesting thing about Zara. Given the sophistication and level of technology integration into the firm's business processes, you'd think that Inditex would far outspend rivals on tech. But as researchers Donald Sull and Sefano Turconi discovered, "Whether measured by IT workers as a percentage of total employees or total spending as a percentage of sales, Zara's IT expenditure is less than one-fourth the fashion industry average." D. Sull and S. Turconi, "Fast Fashion Lessons," *Business Strategy Review*, Summer 2008. Zara excels by targeting technology investment at the points in its value chain where it will have the most significant impact, making sure that every dollar spent on tech has a payoff.

Contrast this with high-end fashion house Prada's efforts at its flagship Manhattan location. The firm hired the Pritzker Prize-winning hipster architect Rem Koolhaas to design a location Prada would fill with jaw-dropping technology. All items for sale in the store would sport with **radio frequency identification (RFID) tags**⁷ (small chip-based tags that wirelessly emit a unique identifying code for the item that they are attached to). Walk into a glass dressing room and customers could turn the walls opaque, then into a kind of combination mirror and heads-up display. By wirelessly reading the tags on each garment, dressing rooms would recognize what was brought in and make recommendations of matching accessories as well as similar products that patrons might consider. Customers could check inventory, and staff sporting PDAs could do the same. A dressing room camera would allow clients to see their front and back view side-by-side as they tried on clothes.

It all sounded slick, but execution of the vision was disastrous. Customers didn't understand the foot pedals that controlled the dressing room doors and displays. Reports surfaced of fashionistas disrobing in full view, thinking the walls went opaque when they didn't. Others got stuck in dressing rooms when pedals failed to work, or doors broke, unable to withstand the demands of the high-traffic tourist location. The inventory database was often inaccurate, regularly reporting items as out of stock even though they weren't. As for the PDAs, staff reported that they "don't really use them anymore" and that "we put them away so tourists don't play with them." The investment in Prada's in-store technology was also simply too high, with estimates suggesting the location took in just one-third the sales needed to justify expenses. G. Lindsay, "Prada's High-Tech Misstep," *Business 2.0*, March 1, 2004.

7. Small chip-based tags that wirelessly emit a unique identifying code for the item that they are attached to. Think of RFID systems as a next-generation bar code.

The Prada example offers critical lessons for managers. While it's easy to get seduced by technology, an **information system (IS)**⁸ is actually made up of more than *hardware* and *software*. An IS also includes *data* used or created by the system, as well as the *procedures* and the *people* who interact with the system. A. Sanchenko, "Foundations of Information Systems in Business" (lecture, October 13, 2007), <http://www.scribd.com/doc/396076/Foundations-of-Information-Systems-in-Business>. Getting the right mix of these five components is critical to executing a flawless information system rollout. Financial considerations should forecast the **return on investment (ROI)**⁹—the amount earned from an expenditure—of any such effort (i.e., what will we get for our money and how long will it take to receive payback?). And designers need to thoroughly test the system before deployment. At Prada's Manhattan flagship store, the effort looked like tech chosen because it seemed fashionable rather than functional.

KEY TAKEAWAYS

- Zara store management and staff use PDAs and POS systems to gather and analyze customer preference data to plan future designs based on feedback, rather than on hunches and guesswork.
- Zara's combination of vertical integration and technology-orchestrated supplier coordination, just-in-time manufacturing, and logistics allows it to go from design to shelf in days instead of months.
- Advantages accruing to Inditex include fashion exclusivity, fewer markdowns and sales, lower marketing expenses, and more frequent customer visits.
- Zara's IT expenditures are low by fashion industry standards. The spectacular benefits reaped by Zara from the deployment of technology have resulted from targeting technology investment at the points in the value chain where it has the greatest impact, and not from the sheer magnitude of the investment. This is in stark contrast to Prada's experience with in-store technology deployment.

8. An integrated solution that combines five components: hardware, software, data, procedures, and the people who interact with and are impacted by the system.

9. The amount earned from an expenditure.

QUESTIONS AND EXERCISES

1. In what ways is the Zara model counterintuitive? In what ways has Zara's model made the firm a better performer than Gap and other competitors?
2. What factors account for a firm's profit margin? What does Gap focus on? What factors does Zara focus on to ensure a strong profit margin?
3. How is data captured in Zara stores? Using what types or classifications of information systems? How does the firm use this data?
4. What role does technology play in enabling the other elements of Zara's counterintuitive strategy? Could the firm execute its strategy without technology? Why or why not?
5. How does technology spending at Zara compare to that of rivals? Advertising spending? Failed product percentages? Markdowns?
6. What risks are inherent in the conventional practices in the fashion industry? Is Zara susceptible to these risks? Is Zara susceptible to different risks? If so, what are these?
7. Consider the Prada case mentioned in the sidebar "Technology ≠ Systems." What did Prada fail to consider when it rolled out the technology in its flagship location? Could this effort have been improved for better results? If you were put in charge of this kind of effort, what factors would you consider? What would determine whether you'd go forward with the effort or not? If you did go forward, what factors would you consider and how might you avoid some of the mistakes made by Prada?

1.3 Moving Forward

LEARNING OBJECTIVES

After studying this section you should be able to do the following:

1. Detail how Zara's approach counteracts specific factors that Gap has struggled with for over a decade.
2. Identify the environmental threats that Zara is likely to face, and consider options available to the firm for addressing these threats.

The holy grail for the strategist is to craft a sustainable competitive advantage that is difficult for competitors to replicate. And for nearly two decades Zara has delivered the goods. But that's not to say the firm is done facing challenges.

Consider the limitations of Zara's Spain-centric, just-in-time manufacturing model. By moving all of the firm's deliveries through just two locations, both in Spain, the firm remains hostage to anything that could create a disruption in the region. Firms often hedge risks that could shut down operations—think weather, natural disaster, terrorism, labor strife, or political unrest—by spreading facilities throughout the globe. If problems occur in northern Spain, Zara has no such fall back.

In addition to the **operations**¹⁰ (the organizational activities that are required to produce goods or services) vulnerabilities above, the model also leaves the firm potentially more susceptible to financial vulnerabilities as the Euro has strengthened relative to the dollar. Many low-cost manufacturing regions have currencies that are either pegged to the dollar or have otherwise fallen against the Euro. This situation means Zara's Spain-centric costs rise at higher rates compared to competitors, presenting a challenge in keeping profit margins in check. Rising transportation costs are another concern. If fuel costs rise, the model of twice-weekly deliveries that has been key to defining the Zara experience becomes more expensive to maintain.

10. The organizational activities that are required to produce goods or services. Operations activities can involve the development, execution, control, maintenance, and improvement of an organization's service and manufacturing procedures.

Still, Zara is able to make up for some cost increases by raising prices overseas (in the United States, Zara items can cost 40 percent or more than they do in Spain). Zara reports that all North American stores are profitable, and that it can continue to grow its presence, serving forty to fifty stores with just two U.S. jet flights a week. J. Tagliabue, "A Rival to Gap That Operates Like Dell," *New York Times*, May 30, 2003. Management has considered a logistics center in Asia, but expects current

capacity will suffice until 2013. C. Rohwedder and K. Johnson, "Pace-Setting Zara Seeks More Speed to Fight Its Rising Cheap-Chic Rivals," *Wall Street Journal*, February 20, 2008. A center in the Maquiladora region of northern Mexico, for example, may also be able to serve the U.S. markets via trucking capacity similar to the firm's Spain-based access to Europe, while also providing a regional center to serve growth throughout Latin America should the firm continue its expansion across the Western Hemisphere.

Rivals have studied the firm's secret recipe, and while none have attained the efficiency of Amancio Ortega's firm, many are trying to learn from the master. There is precedent for contract firms closing the cycle time gap with vertically integrated competitors that own their own factories. Dell (a firm that builds its own PCs while nearly all its competitors use contract labor) has recently seen its manufacturing advantage from vertical integration fall as the partners that supply rivals have mimicked its techniques and have become far more efficient. T. Friscia, K. O'Marah, D. Hofman, and J. Souza, "The AMR Research Supply Chain Top 25 for 2009," *AMR Research*, May 28, 2009, <http://www.amrresearch.com/Content/View.aspx?compURI=tcm:7-43469>. In terms of the number of new models offered, clothing is actually more complex than computing, suggesting that Zara's value chain may be more difficult to copy. Still, H&M has increased the frequency of new items in stores, Forever 21 and Uniqlo get new looks within six weeks, Renner, a Brazilian fast fashion rival, rolls out mini collections every two months, and Benetton, a firm that previously closed some 90 percent of U.S. stores, now replenishes stores as fast as once a week. M. Pfeifer, "Fast and Furious," *Latin Trade*, September 2007; and C. Rohwedder and K. Johnson, "Pace-Setting Zara Seeks More Speed to Fight Its Rising Cheap-Chic Rivals," *Wall Street Journal*, February 20, 2008. Rivals have a keen eye on Inditex, with the CFO of luxury goods firm Burberry claiming the firm is a "fantastic case study" and "we're mindful of their techniques." C. Rohwedder and K. Johnson, "Pace-Setting Zara Seeks More Speed to Fight Its Rising Cheap-Chic Rivals," *Wall Street Journal*, February 20, 2008.

Finally, firm financial performance can also be impacted by broader economic conditions. When the economy falters, consumers simply buy less and may move a greater share of their wallet to less-stylish and lower-cost offerings from deep discounters like Wal-Mart. Zara is particularly susceptible to conditions in Spain, since the market accounts for nearly 40 percent of Inditex sales. J. Hall, "Zara Is Now Bigger Than Gap," *Telegraph*, August 18, 2008. as well as to broader West European conditions (which with Spain make up 79 percent of sales). C. Rohwedder, "Zara Grows as Retail Rivals Struggle," *Wall Street Journal*, March 26, 2009. Global expansion will provide the firm with a mix of locations that may be better able to endure downturns in any single region.

Zara's winning formula can only exist through management's savvy understanding of how information systems can enable winning strategies (many tech initiatives were led by José Maria Castellano, a "technophile" business professor who became Ortega's right-hand man in the 1980s). C. Rohwedder and K. Johnson, "Pace-Setting Zara Seeks More Speed to Fight Its Rising Cheap-Chic Rivals," *Wall Street Journal*, February 20, 2008. It is technology that helps Zara identify and manufacture the clothes customers want, get those products to market quickly, and eliminate costs related to advertising, inventory missteps, and markdowns. A strategist must always scan the state of the market as well as the state of the art in technology, looking for new opportunities and remaining aware of impending threats. With systems so highly tuned for success, it may be unwise to bet against "The Cube."

KEY TAKEAWAY

- Zara's value chain is difficult to copy; but it is not invulnerable, nor is future dominance guaranteed. Zara management must be aware of the limitations in its business model, and must continually scan its environment and be prepared to react to new threats and opportunities.

QUESTIONS AND EXERCISES

1. The Zara case shows how information systems can impact every single management discipline. Which management disciplines were mentioned in this case? How does technology impact each?
2. Would a traditional Internet storefront work well with Zara's business model? Why or why not?