

CASE 3-4 Continued Growth for Zara and Inditex

CIRCA 2008

ARTEIXO, Spain—Zara stores have set the pace for retailers around the world in making and shipping trendy clothing. Now Pablo Isla, chief executive of parent company Inditex SA, says Zara needs to speed up. As rivals catch up, Mr. Isla is attempting one of the fastest global expansions the fashion world has ever seen, opening hundreds of new stores and entering new markets. To do that, as an economic downturn threatens sales, Inditex is changing the systems that have driven its success at Zara and its other store brands, to save time and money. Among the innovations, it is introducing new methods to enable store managers to order and display merchandise faster and adding cargo routes for shipping goods. "There has been a clear change of mentality in the company," Mr. Isla, a former tobacco executive who arrived at Inditex in 2005, said in an interview at the company's headquarters here.

The world's second largest clothing retailer by sales after Gap Inc., Inditex is responding to a predicament shared by other companies that come up with game-changing formulas: Eventually competitors catch up, forcing the pioneers to do even better to keep their edge. Low-cost carrier Southwest Airlines Co. is making big changes to fend off rivals that have copied its efficient operating model. Inventory-control methods at Walmart Stores Inc. are being mimicked around the world, and Google Inc. is updating its search engine to keep users loyal.

The consumer slowdown is adding pressure. Inditex shares have fallen nearly 24 percent in the last 12 months, in large part because investors are worried about an economic downturn in Spain, where Inditex generates over a third of its \$12 billion in annual sales. The company is pressing ahead with its expansion plans even as consumers are slowing down. In the U.S., retailers had their worst monthly sales results in nearly five years in January, and some chains are planning to close stores and cut jobs. U.K. retailer Marks & Spencer PLC recently reported its worst quarterly sales performance in two years, and warned the pain could extend into 2009.

The industry is watching the company's logistical makeover. Though it sells inexpensive trendy clothing—"fast fashion" in industry parlance—Zara has been so successful in luring high-paying customers that luxury fashion brands such as Gucci, Burberry and Louis Vuitton have overhauled their own practices to send new fashions to stores more frequently. "They're a fantastic case study in terms of how they manage to get product to their stores so fast," Stacey Cartwright, chief financial officer of Burberry Group PLC, says of Zara. "We are mindful of their techniques."

In recent years, competitors across the globe have adopted Zara's methods. Italy's Benetton Group SpA now replenishes stores up to once a week. Los Angeles-based Forever 21 Inc. and Japanese apparel giant Fast Retailing Co., owner of the Uniqlo chain, can get new looks to their stores within six weeks. Even outdoor clothing maker Patagonia Inc. has doubled the number of new styles it offers every year. As the popularity of cheap-and-chic

chains has zoomed, Zara's rivals Hennes & Mauritz AB of Sweden and Mango of Spain have also become fixtures on U.S. shopping streets.

In addition to Zara, which makes up 60 percent of its business, Inditex owns seven smaller store brands, including the more upscale Massimo Dutti and the youth-oriented Bershka. In the last 12 months Inditex added 560 stores, including entering new markets in Croatia, Colombia, Guatemala, and Oman, to reach 3,691 stores in 68 countries. It plans expansion of a similar scope over the next year.

The first Zara store opened in 1975 in La Coruña, a port town near Arteixo in a remote corner of northern Spain. Its two key traits were an eye for customer tastes and a production process that started with the final price and worked backward to the most-efficient production. In the mid-1980s, local business-school professor José Maria Castellano, a technophile, joined Inditex as right-hand man to founder Amancio Ortega Gaona, and the company became a world-class logistical outfit, peddling "fast fashion." The first foreign store, in Portugal, opened in 1989, followed by New York. In 2001, Mr. Ortega took Inditex public and its stores are now on prime shopping streets around the world.

Stores are stocked with new designs twice a week. Collections are small and often sell out, creating an air of exclusivity and cutting down on the need for markdowns. The company ships clothes straight from the factory to stores. Unlike competitors who manufacture most of their wares in Asia, Inditex makes two-thirds of its goods in Spain and nearby countries such as Portugal, Morocco and Turkey. The retailer says the higher labor costs are offset by the flexibility of having production close to its warehouses and distribution centers, which are all in Spain.

At "the Cube," as employees call their futuristic-looking headquarters outside La Coruña, sales managers sit at a long row of computers, monitoring sales at every store around the world. When a garment sells well—or flops—they quickly tell designers sitting nearby to whip up fresh designs. In the basement, stylists decide store layouts and window displays. One room is built like a shopping street, its walls lined with lit and decorated store windows that dictate how storefronts will look from New York's Fifth Avenue to London's Regent Street. Every two weeks, new decorations are photographed and e-mailed to stores to replicate.

To speed up new store openings, Mr. Isla needed to cut start-up costs. Inditex now avoids store openings in slow months such as August. In the past, stores opened year-round, accruing costs from the first day even if sales took longer to build. Mr. Isla's goal is for Inditex to reverse a trend of costs growing faster than sales. It met that target in the first half ended July 31, 2007, when costs grew 16 percent over the same period the previous year, while sales increased 19 percent.

In another move to cut costs, Mr. Isla installed software in store computers to schedule staff based on sales volume at different times. As a result, more salespeople work at peak times such as lunchtime or the early evening. Inditex says the more flexible schedules shaved 2 percent off the hours staff work. Alarm tags

are now attached to garments at the factories. In the past, at a big Zara location such as the four-floor store on Madrid's Alberto Aguilera shopping street, 10 people spent an average of 12 hours a week putting on the tags. Now, Inditex estimates, those salespeople spend 3 percent more time serving customers. "In the past, a shipment would come in the morning, and the staff wouldn't have it unpacked till noon. They were just giving away three hours of prime selling time," Mr. Isla says.

Shipping papers now label the newest collections "NEWC." Those pieces are often rushed to the shop floor on plastic shipping hangers and only later switched to Zara's customary light wood hangers. Zara regulars know to look for the black plastic hangers with the latest looks, says Dilip Patel, U.K. commercial director for Inditex. Store managers also use new hand-held computers that show how garments rank by sales, so clerks can re-order best-sellers in less than an hour—a process that previously took about three hours. These orders arrive, together with new pieces, two days later.

Also, each of the company's various store brands shipped merchandise separately in the past, concerned that mixing even behind the scenes could dilute their images. Combining the brands into larger volumes has allowed Mr. Isla to launch twice-weekly air shipments with Air France Cargo–KLM Cargo. Planes from Zaragoza, Spain, land in Bahrain with goods for Inditex stores in the Middle East, fly on to Asia, and return to Spain with raw materials and half-finished clothes. The company also started new shipments with Emirates Airline.

Despite Mr. Isla's efficiency gains, some experts caution that Zara faces challenges it is not addressing. Keeping a large amount of production close to home, some warn, loses its benefits when a growing number of stores are far away. "The efficiency of the supply chain is coming under more pressure the farther abroad they go," says Nirmalya Kumar, a professor at London Business School.

For now, the company makes up for some of the cost by charging more for goods sold overseas. In the U.S., for instance, Zara clothes cost up to 40 percent more than they do in Spain. However, that could lead to an inconsistent brand image, a risky strategy in a globalizing world, some critics warn. Mr. Isla says that when he joined the company, he considered a logistics center in Asia, where the company produces around a third of its goods, but decided it would only make sense if Zara had more stores in the region. He says the group's current logistics capacity will suffice until 2013.

CIRCA 2009

Inditex SA, Europe's biggest fashion retailer by revenue, said Wednesday it plans a major push online for its flagship Zara brand, as it reported a 7.6 percent decline in net profit for the fiscal first half.

Inditex, which also owns the Massimo Dutti, Pull and Bear, and Bershka brands, is known for savvy use of information technology to tightly control production and inventories. It collects data from its 4,430 stores in 73 countries to detect trends and tweaks products based on consumer tastes.

Compared with its main competitor, Sweden's Hennes & Mauritz AB, however, Inditex is a bit of a latecomer to the Internet. It started operating an online store for furnishing brand Zara Home in 2007, but had so far shied away from the Web for Zara clothing because of the complexity of managing

and selling its fast-changing collections online. So it caught many by surprise when it said Wednesday that it will launch online sales next year for Zara's Autumn/Winter 2010 collection. "There had been some concern that Inditex was falling behind competitors on e-commerce," said Anne Critchlow, an analyst at Société Générale.

Initially, the company plans to launch the online store www.zara.com in Spain, France, Germany, Italy, the U.K. and Portugal. Later, it will roll it out in all of Zara's remaining markets. In the medium term, Inditex may also launch its other six formats online, said Chief Executive Pablo Isla. "The Internet is becoming a more and more relevant channel, so it would be logical to continue expanding online with the other formats," he said. Neither H&M nor Inditex disclose what proportion of sales comes from their online outfits. U.S. rival Gap Inc. generated about 8 percent of its Gap-branded sales in the U.S. on the Web.

For the first half ended July 31, Inditex's net profit dropped to €375 million (\$550.4 million) from €406 million a year earlier, while sales were up 6.6 percent at €4.86 billion. Sales in stores open at least a year, however, shrank by an annual 2 percent in the fiscal first half, compared with a decline of .7 percent in second half, and operating costs grew 8 percent as Inditex continued to expand its empire. The retailer opened 166 new stores in the first half, down from 249 a year earlier. Inditex's gross margin fell to 55.3 percent of sales from 56.4 percent a year earlier. Analysts attributed the decline to a stronger dollar, which is making it more costly to source materials, and pricing pressures in the company's main market, Spain.

The retailer gave a resilient trading outlook, saying sales in the first weeks of its fiscal third quarter were up 9 percent when stripping out currency fluctuation, the same growth rate as in the first half. Inditex's much smaller U.K. rival, Next PLC, which launched online sales in 1998, meanwhile, posted a 6.9 percent increase in first-half net profit. Cost savings helped push net profit up to £131.8 million (\$217.5 million) from £123.3 million a year earlier, as revenue inched up to £1.51 billion from £1.5 billion.

Next, which like Inditex sells clothes and home wares, warned, however, that like-for-like retail sales are likely to decline between 3.5 percent and 6.5 percent in the second half. At Directory, its catalogue and online-shopping business, which generates about 40 percent of operating profit, Next said it expects sales to rise by up to 2 percent. The retailer nevertheless raised its full-year forecast, saying it now expects to deliver pretax profit "close" to last year's £429 million, subject to its sales performance in the fourth quarter, which includes Christmas.

CIRCA 2010

Spanish fashion retailer Inditex SA launched its Zara online store in the United States in the fall of 2011, seeking to widen its clientele beyond the big cities where it currently operates, chief executive Pablo Isla said. Early indications showed the online launch may have traction in the U.S. market. A Zara application for Apple Inc.'s cell phone the iPhone has been downloaded by more prospective clients in the U.S. than in any other market, Isla said.

Speaking to Dow Jones Newswires after the presentation of Inditex's 2009 results, Isla said that more than a million iPhone users have downloaded the App since it was first released in December. "It's a market where Internet sales are

very important, and it's a way of accessing all those clients that are interested in Zara," said Isla. The App allows shoppers to check out what's new in the Zara collection, and to find the nearest shop.

Inditex, based in La Coruna, northwestern Spain, last year soared past Gap Inc. to become the most-selling fashion retailer in the world, with more than 4,600 stores. Zara, which is present in 76 countries, will roll out its online store first later this year in six European countries, and then progressively add the remaining countries where Zara operates. Inditex entered the United States early, in 1994, but has expanded rather slowly, focusing store openings in large cities like New York, Miami and Los Angeles. It currently has 48 stores there. Isla said Inditex plans to grow "selectively" there in the coming three years.

"We have to prioritize at every step, and ours are twofold: Growing in Europe and in Asia," Isla said. Inditex is opening almost all of its new stores outside its Spanish home market, which currently accounts for 31.8 percent of group sales. By 2013, Inditex expects the weight of Spain to drop to 20 percent of total sales, while Europe, excluding Spain, is expected to rise to 50 percent and Asia, 20 percent. The remaining 10 percent will come from the Americas.

QUESTIONS

1. What are the ways that Inditex ensures that "fast fashion" is truly fast?
2. What are the important attributes of a "fast fashion" retailer to customers? To store managers?
3. Why would a retailer introduce its online store country-by-country? Why was Inditex slow to embrace online sales when it is so tech-savvy in other ways?
4. Briefly describe five opportunities for continued growth during the next five years for Zara's parent, Inditex, SA.
5. Pick one of the five opportunities and outline the advantages and disadvantages of pursuing it.
6. Take a look at its new U.S. website. What is good and what is bad about it?

Sources: Cecile Rohwedder, "Pace-Setting Zara Seeks More Speed to Fight Its Rising Cheap-Chic Rivals," *The Wall Street Journal*, February 20, online; Christopher Bjork, "Zara Is to Get Big Online Push," *The Wall Street Journal*, September 17, online; Christopher Bjork, "Zara Has Online Focus for U.S. Expansion, Inditex CEO Says," *Dow Jones Newswires*, March 17, 2010; Armored Kenna, "Zara Plays Catch-Up with Online Shoppers," *Bloomberg BusinessWeek*, August 29, 2011, pp. 24–25.