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UNIQLO: A SUPPLY CHAIN GOING GLOBAL

Teaching Notes

Synopsis

In less than 20 years, Uniqlo has become the leading fast-fashion retailer in Japan and a strong player in other Asian countries like China, Korea and Taiwan. Since 1998, the company has expanded sales at double-digit rates, thanks to an aggressive pricing policy combined with a high level of quality, a mix that proved hard to resist for Asian customers. Key to Uniqlo's strategy and success was an agile supply chain inspired by the "fast-fashion" model pioneered by Inditex and also utilized by H&M, the two largest fashion retailers in the world.

In early days, Uniqlo relied on major Japanese trading companies to procure its garments in China at competitive prices. In its first stage, the company focused on retail expansion, but, in 1994, Uniqlo management implemented a program to take direct control of its supply chain with no intermediaries. In 1998, production offices were opened in Shenzhen and Shanghai to supervise and assist the narrow base of suppliers the company was employing in Mainland China.

While Uniqlo demanded competitive prices from its suppliers, it also offered them continual technical assistance in developing and perfecting their manufacturing techniques, and supported them with a high flow of orders. Uniqlo's Takumi team was unique in the industry. It was formed by experienced Japanese technicians who spent thousands of hours assisting suppliers in the production of Uniqlo garments, to ensure superior quality and efficiency throughout the supply chain.

Nineteen ninety-eight was an important year for Uniqlo, as the opening of a flagship store in one of the hottest fashion districts of Tokyo projected the brand in Japan at a national level. At product level, a partnership with Toray, one of the world's leading producers of composite and synthetic fibers, resulted in garments that had performance and properties no natural material could match. Working with Toray forced Uniqlo to refine its supply chain further, as the fiber manufacturer requested full utilization of available production capacity. As a result, Uniqlo's

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supply had to become "just-in-time," mimicking that of other highly competitive Japanese companies.

Despite this strong performance, in 2015, the company still had no significant presence in the US and Europe, two markets that were key to Fast Retailing's objectives of becoming a global company and the largest fashion retailer in the world by 2020. With an efficient but regional supply chain, Uniqlo faced rising manufacturing costs in China and was experimenting with new supply chain models in low-cost locations like Bangladesh. Uniqlo's supply chain had proved effective in the Asia Pacific region, but could the same model be scaled worldwide? Despite its excellent results and expansion rate, the company was set to change its supply chain to become global. Was the low growth rate Uniqlo experienced in the US, and particularly Europe, also due to the limitations of its current supply chain?

Conceptual Foundation and Teaching Objectives

Uniqlo's supply chain mimics the model of other successful Japanese firms. These develop competitive advantage across the whole supply chain through a hybrid form of governance, different from direct ownership of production assets or purely market-driven relationships. The hybrid governance system model suggests that competitive advantage may lie in inter-company procedures and routines developed from relationships that are more complex than typical commercial transactions. The formation of partnerships in a hybrid governance supply chain leads to common policies agreed upon between parties, and generates investment in assets that are relationship-specific rather than firm-specific, to the mutual advantage of all participants.

The hybrid governance model Uniqlo employs is one important aspect of its supply chain. Internationalization is the other aspect critical to Uniqlo's future performance. Uniqlo was born as a global company, as its supply chain has been entirely outside Japan since the company started operation

Uniqlo's business model focuses on an efficient supply-chain system and a holistic view of the business. By selling a limited range of products designed to satisfy real customer needs rather than fashion trends, Uniqlo offers only a limited assortment of merchandise. With a lean but extremely targeted product range, the retailer is able to leverage its supply chain fully, with very limited direct production-asset investment.. Uniqlo's "born-global" nature allows it to gather competitive advantages of different types and internalize them:

- Low-cost production in China, a competitive advantage related to location
- Know-how from the Japanese garment industry, transferred to Chinese producers by means of the Takumi team, also constituting a location-based competitive advantage
- Narrow product range, focused on customer feedback and needs, fully leveraging the supply chain.

The supply chain is central to Uniqlo's business model and the Japanese retailer's core competence is the creation or "editing" of a product range able simultaneously to satisfy customers' needs and fully leverage the supply chain. Uniqlo differentiates itself strongly from its competitors by giving fashion and fashion trends marginal importance in product design, focusing instead on elements like garment performance that can be managed and addressed with less uncertainty.

Teaching objectives

- Responsive supply chains: alternative models of supply chain orchestration, such as the hybrid governance system, for improved responsiveness and flexibility
- "Born-global" firms: supply chain a strategic element of success, with other company functions subordinated to it

Conclusion

Uniqlo chooses to compete on price and quality, keeping the former low and the latter high. To achieve its goals, the retailer focuses on a narrow product line or "assortment" that can still satisfy customers. Feedback from Uniqlo shoppers becomes the central driver of product development, while fashion, style and other trend-related aspects are secondary. A reduced product assortment allows the Japanese retailer to organize its supply chain so as to minimize transaction costs, maintain price competitiveness, and minimize opportunistic and agency behavior by its suppliers, while maintaining high product quality.

Uniqlo successfully tries to merge the advantages of common, traditional governance models: the hierarchical, used by Inditex, which is vertically integrated, and the market-governance model, used by H&M, which relies on a vast number of suppliers engaged in arms-length transactions, reducing transaction costs while remaining flexible. Employing a hybrid governance model, similar to that of other Japanese companies like Toyota, Uniqlo competes successfully in Asia, emerging as a top player. The structure of the firm and its being a "born-global" company allows it to gather competitive advantages and create superior operational performance.

Talking Points

The hybrid governance model

The hybrid governance model is central to the development of Uniqlo's supply chain. A governance model defines the "way or mode a transaction between parties is organized."[1] In other words, a governance model determines if a firm chooses to "make or buy," by integrating vertically in the case of "make," or adopting sourcing strategies in the case of "buy."

In the vertical-integration case, ownership of production assets eliminates the variability always present in open-market purchasing. Variability originates from opportunistic and agent-type behavior by suppliers. Vertical integration reduces such behavior by eliminating transactions with third parties, but at the cost of reducing market-condition flexibility. In the outsourcing case, a firm has the ability to increase or reduce quantities ordered to match market demand, but the firm and its suppliers are constantly negotiating in order to adapt to a rapidly-changing environment Selection of and negotiation with suppliers require resources, and increase overall transaction costs.

In the post-2008 financial-crisis world, there has been a marked shift in economic conditions. Western economies' growth rates have stagnated, and Asia and other emerging markets have become central to business development and expansion. Growth remains spotty and credit in general is harder to obtain. In such a volatile economic environment, the ownership of

[1] Usui, T. (2014) "Dynamic Development of Competitive Hybrid Governance Structure in Supply Chain: A Longitudinal Qualitative Data Analysis," http://www.law.nihon-u.ac.jp/publication/pdf/seikei/51_1/06.pdf (accessed on July 13th 2015

production assets can become a financial burden and limit adaptation to a quickly-changing environment.

The hybrid form of governance arises as an intermediate organizational model between the hierarchical or "make" model and the market or "buy" model. In a hybrid governance model, all firms that constitute a supply chain develop joint objectives and shared policies to meets targets. The relationships are bilateral and generally driven by a win-win approach, with collaboration bringing benefit to all parties.

A hybrid governance relationship can be open-ended or fixed, but in any case enjoys higher flexibility than a hierarchical governance model, and relatively lower transaction costs than a market governance model. All this leads to lower transaction costs and higher flexibility overall. From a strategic perspective, the hybrid governance model can be source of competitive advantage in either a bilateral relationship or a supply network, The development of so-called inter-company assets, created with long term joint investment from all parties involved, are usually not replicable by a single firm, and lead to a strengthening of each party's core competences through better interfacing with the network.

A strategic hybrid governance network is therefore defined as a principal firm and the firms in its supply chain organized through neither a hierarchical nor market governance model, but by "relational competence." Through relational competence, the principal firm avoids ownership of production assets that cannot be adequately leveraged in a volatile environment, but at the same time invests in relationship-specific, inter-company assets to maintain and develop manufacturing competence. The goal is to reduce transaction costs to a minimum.[2]

Transaction cost analysis and resource-based view: theoretical framework

Theoretical frameworks underlying a hybrid governance model are a firm's Transaction Cost Analysis (TCA) and Resource Based View (RBV). The goal of both governance models is to minimize transaction costs. Market governance lets a firm take advantage of technological developments that become available by selecting new suppliers, but costs related to information-seeking, partner-searching, monitoring, and contractual enforcement may lead to higher overall transaction costs. Hierarchical governance internalizes production assets, minimizing transaction costs and reducing opportunistic behavior by suppliers, but is not flexible, as new technology cannot be rapidly adopted.

The traditional TCA model postulates rigid inter-company barriers that limit the extent of collaboration and investment-sharing. Assuming rigid inter-company barriers and accepting the consequence that investments necessary to develop a relationship are planned, executed and owned by only one of the parties, the TCA model concludes that only one firm will come to own specific assets strategic to the relationship. As a consequence, that firm will develop opportunistic behavior, and its partner will be forced to sustain additional transaction costs related to relationship-monitoring and administration. Asset specificity creates "lock-up" or "hold-in." Although the firms are part of the same supply chain, the assumption remains that their behavior toward one another is competitive.

RBV instead postulates a more collaborative approach in the deployment of investments beneficial to a relationship, placing them in an inter-company perspective. While proprietary rights to physical assets remain with a single firm, investments are planned jointly so to yield benefits for the relationship as a whole rather than only for that firm. As a consequence, investments become Relationship Specific Assets (RSAs) that are functionally effective only

2 Ibid

the fashion element is dominant in Inditex and H&M, it is only secondary in Uniqlo, where a more holistic view of the firm and its relationship with the market dominates.

As a "born-global" firm, Uniqlo has excelled in internationalizing its supply chain, but the company has only been partially successful in internationalizing its sales. Uniqlo's ability to optimize its SCS depends on a limited assortment. This is its strategy's limiting factor and might impede the company's expansion into markets like the US and Europe, where cultural factors like fashion influence apparel retailing to a greater extent than in Asia. In the same markets, its competitors Inditex and H&M have a far stronger presence.

The "LifeWear" philosophy Uniqlo adopted results in a limited range of products, allowing it to optimize the supply chain and track customer feedback. The same model would not be possible if the number of products were increased, and this seems the fundamental barrier to expansion that Uniqlo faces. It is possible to assume that European and US customers will have different needs than their Asian counterparts, who are currently Uniqlo's key market, and this will lead to an increase in the "assortment."

How could Uniqlo reorganize its current supply chain? Could it use its Asian supply chain to manufacture European and US merchandise as well, or re-create a more localized supply web specific to each market, for example, one for the US and one for Europe?

In managing its supply chain, Uniqlo is inspired by companies like Toyota, using the key principles of parsimony, avoiding waste in every aspect of production, producing only what the market requires, and collaboration.

The distinction between Uniqlo and its suppliers' core tasks is marked by the type of assets owned. While Uniqlo has no or minimal investment in physical production assets, the company is fully invested in its retail network, and in all other assets related to the activity of a Speciality Store Retailer of Private Label Apparel (SPA).

Uniqlo's core competence is therefore the "selection or editing of the assortment" of its product line. The retailer designs and sets prices and quality standards for its merchandise. It sources parts and materials for production, but does not take direct part in the manufacture of goods. In other words, Uniqlo considers every Stock Keeping Unit (SKU) sold at its stores as a commoditized component of the marketing process. Marketing the product so that it satisfies customers is what adds value to each SKU.

The retailer's merchandising function is what determines its success. By designing and selecting successful SKUs, Uniqlo sustains its sales. The capacity to select SKUs that match customer' requests, and are sold at a profit in growing volume, is the real "production process" or value-adding activity of an SPA retailer.

This selection process or "editing the assortment" therefore has a double function of satisfying market demand while minimizing marketing expenses, and maximizing supply-chain capability while minimizing production costs. The physical garment-production process or supply chain, and "editing of the assortment," taken together, are the retailer's Supply Chain System (SCS). The two main SCS objectives are therefore reduction of marketing costs to maximize sales prices, and full utilization of supply-chain capabilities to minimize costs.

Uniqlo's decision to follow a functional approach to garment design and collect extensive customer feedback results in an assortment of only 300-400 SKUs, which is only 10 to 30% of its competitors'. Uniqlo's strategic choice to give fashion and trend elements only secondary value in garment design is entirely centered on the necessity of optimizing the SCS and the supply chain in particular. In fact, the narrower the assortment, the narrower the merchandising, sourcing and producing activity, resulting in a truly responsive supply chain that is far less complex to administer.

Uniqlo reinforces this optimizing behavior by its advanced stock monitoring capabilities and dynamic pricing policy, which aims at improving turnover of slow-moving items. Sales data is fed back into the design process to continuously reduce the discrepancy between supply and demand, under the constraints of a limited assortment.[6]

Fast Retailing's organizational assets are profoundly different from those of Inditex and H&M. The Japanese retailer focuses on holistically executing an SCS, minimizing transaction costs with suppliers via a supply chain governed by a hybrid model, and minimizing SKU costs via a limited assortment that also allows close monitoring of inventory levels and intense feedback from customers, which molds the design of its limited offerings.

From a conceptual perspective Uniqlo is the "McDonald's" of fashion retail. Barriers to purchase are lowered as much as possible under the constraint of a limited assortment. While

[6] Takahide Yamaguchi, Hiroyuki Yoshida (2002) "Fast Retailing: an analysis of FDI and supply chain management in fashion retailing", Henley Business School www.henley.reading.ac.uk accessed on July 23rd 2013

function has been considered the key driver of internationalization. The literature considers physical distance, defined as differences in language, business practices, legislation, education and culture, as a major obstacle in accessing foreign markets. To overcome physical barriers and sustain overseas expansion, a company acquires knowledge of the foreign target market, formulating a strategy for entering it.

Traditionally, international expansion of the sales function begins with minimum investment, through use of an agent. The more knowledge the firm gains, the more it invests in the market, setting up distribution agreements, then subsidiaries and eventually production facilitates to serve the market directly, once this is justified by economies of scale. The tenure and size of the investment a firm is committed to is directly proportional to knowledge of the target market.

Fundamentally, it is assumed that for a firm to become a Multi-National-Corporation (MNC), it must be able to compete in a foreign market or overcome competition. In other words, it must transfer the competitive advantage it enjoyed in its own country to the new market.

In recent times, thanks to the internet and other low-cost digital distribution channels, the cost of information acquisition has been immensely reduced. At the same time, the speed of information gathering has increased considerably, rendering obsolete the traditional view that MNCs are companies able to compete abroad thanks to their "home-brew" competitive advantages. Companies that seek competitive advantage by localizing their R&D or production functions in foreign countries would not be considered multi-national companies according to the traditional definition, but in effect they are.

This paradigm change is significant, and Uniqlo is a clear example of it. If the traditional literature considers MNCs to be firms that have a share of foreign sales higher than 25% of turnover after three years in operation, then Uniqlo would be considered a local company. However, Uniqlo operations are clearly international, and in general a business or organization that from its inception seeks to derive significant competitive advantage from the use of resources and sale of output in multiple countries should be called a "born-global" company.

Uniqlo qualifies since its inception, even though the retailer did not sell outside Japan. A "born-global" company does not necessarily compete in foreign markets from the start, as in Uniqlo's case. The fundamental assumption of traditional theory that MNCs compete successfully by transferring competitive advantages they created at "home" to foreign markets is reversed in the Uniqlo case. In fact, by localizing production in China, the retailer aimed at accessing low-cost production capacity and labor, seeking so to internalize cost advantages. At the same time, Uniqlo transferred otherwise inaccessible technical know-how to its Chinese suppliers, creating the Takumi team. This improved or revitalized its suppliers' technical capabilities, while maintaining control of its supply chain with a hybrid governance model and avoiding direct investment in production assets.

From a strategic perspective, the retailer added value by orchestrating the supply chain rather than creating it through direct investment. The orchestration consists of supplying organizational capabilities to coordinate business processes.

In the Uniqlo context, organizational capabilities can be broadly categorized as:

- Manage physical performance of the supply chain, assuring merchandise conforms to design, price and quality and is delivered as needed;
- Manage product range and retail network to maximize business-expansion and supply-chain potential.

coercive power. The principal firm not only helps improve its suppliers' performance, but gains valuable knowledge of the manufacturing abilities and potentials of all suppliers in the network, as well as the capacity to judge potential new suppliers at low cost.

Uniqlo manages its supply chain using non-coercive power exercised through the continual flow of two types of rewards:

1. A growing volume of business that guarantees partners economic rewards: Uniqlo has, during its post-1998 expansion phase, maintained a supplier base limited to 60 partners, while increasing order size.
2. Through the Takumi team, Uniqlo has supplied hard-to-obtain, codified knowledge to its suppliers: over the years, Chinese garment manufacturers supplying the Japanese retailer have become highly skilled, producing merchandise of superior quality. Uniqlo-trained-suppliers can apply their new expertise to other customers throughout the enterprise.

Trust is the second important component in a hybrid governance model without direct asset ownership. Trust is defined as the confidence one party has in the other. This entails, among other things, the willingness to be vulnerable, despite uncertainties about motives and intentions. Trust facilitates information exchange and in particular increases the effectiveness of organizational activities such as resource-acquisition and value-creation. The level of trust is dependent on the principal firm's economic and referent power.

The theoretical framework develops from the level of non-coercive power the principal firm is able to exercise on its suppliers, mixed with supplier competence and collaborative behavior.[4]

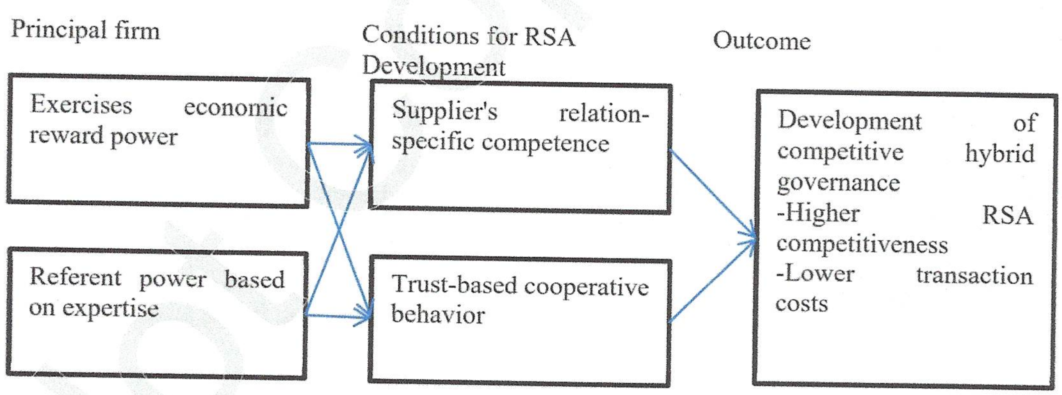

Figure one: hybrid governance model framework[5]

How could a principal firm apply referent power other than through economic reward and know-how-sharing, while maintaining the same level of control?

"Born-Global" companies: supply-chain centrality and the gathering of competitive advantages

Firm globalization and internationalization have traditionally being associated with expansion of sales functions in places other than the company's home country. Traditionally, the sales

[4] Ibid.
[5] Ibid.

within a specific relationship between specific partners. In other words, RSAs cannot be utilized in other relationships.

Creation of competitive advantage therefore spans across firms within the supply chain, and, as in the Japanese car-manufacturing industry, specific assets and organizational procedures that create core competences are supply chain-specific rather than firm-specific. Overall productivity of the firm and its supply chain is increased through RSA investments, rather than single-firm proprietary investments. Co-specialization in the inter-company space allows for easier product differentiation and innovation via joint, idiosyncratic contributions and complementary resources. The nature of an RSA is therefore different from that of traditional single-firm investments. RSAs are created in long-term relationships and result from joint investment. They are functionally effective exclusively within the relationship, to which both parties contribute complementary resources.

Hybrid governance requires a cooperative stance between parties. Without joint control of RSA assets, the principal firm would still face the challenge of controlling opportunistic behavior by suppliers, and would at the same time find it difficult to develop specific internal competencies. Hybrid governance without direct ownership of assets requires the principal firm to frame the partnership in terms of power and trust.[3]

In Uniqlo's case, the distribution of production among a limited number of suppliers is key to enabling the deployment of a hybrid governance model. A limited number of suppliers is the first requirement to implementing a hybrid governance model, and the second is a stable relationship that allows RSA development.

Will it be possible to Uniqlo to respect these two conditions while expanding its supply chain worldwide? This is the key question Uniqlo has to answer to chart the direction of future supply chain expansion. The Bangladeshi JV suggests that a modest degree of ownership in production assets might provide extra control in locations where different cultural and developmental levels create conditions that limit referent power (see below).

Power and trust as control drivers in a hybrid governance model

Sources of power allow a principal firm to maintain high levels of control over its suppliers when there is no joint ownership of assets. Power is defined as the ability to make someone do something he or she would not have otherwise done. A higher level of power generates conflicts along a marketing or supply channel, especially if coercive power is used. Coercive power is based on legitimate punishment rights over others. Power can also be exerted in a non-coercive manner, by offering expertise and assistance to others, in which case it minimizes rather than create conflicts.

By increasing the volume of business to a supplier over time, a principal firm exerts non-coercive power by means of economic reward. Similarly, by providing technical assistance and specific knowledge that increases the technical competence of a supplier, a principal firm creates so-called "referent power."

Referent power is based on a partner's identification with the principal firm. The process operates by creating a feeling of "oneness" with the principal firm. By increasing its technical proficiency, a partner in turn provides better service to the principal firm, while the principal firm, thanks to its technical assistance, has generated advantages for its suppliers. As a result of collaborative behavior, the relationship's RSAs become more relevant for all parties, reinforcing the partnership. A continuous flow of rewards is fundamental in maintaining non-

[3] Ibid.