

Make or Buy?

The Zara dilemma



Assignment Nr 5

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Introduction

Zara is a clothing store with a main focus on Women apparel. Zara believes that fashion culture has no boundaries.

Zara(Business Concept; Online)moves at the pace of society, fashion ideas, and trends that society itself has natured. Hence its success among people, cultures and generations that, in spite of their differences, share a special sensitivity for fashion.

Zara started out as a small lingerie retailer in La Coruna, Spain. With its global approach and high interconnected operations, it grew out to be the multinational fashion retailer it is today.

The problem

Zara has booked some considerable success in the recent years. The business is planning to expand its operations overseas. With this decision, many challenges come along and Zara has to carefully reflect on them. Are there changes that need to be applied to the current business model? How should the company ensure a successful expansion in the US? These are the main questions which will be considered.

Zara's current business model highlights

To get a clearer picture of the company's image, we consider some basic facts about it;

The company's value proposition could be described as:

For the modern women and men of today who want to keep in tune with the latest fashion trends, Zara is the ultimate fashion store providing the very latest trends, straight from the catwalk for a moderate price.

Zara's primarily differentiation can be stated as follows:

Unlike other leading fashion stores who deliver their fashion lines once a month at best, Zara provides a complete new fashion line every two weeks.

Other details:

- The company produces its main fashion line in-house.
- Zara clothing stores are mostly located in high street shopping locations, with a distinctively classical ambiance in the shops.
- The prices of Zara clothing and accessories are slightly higher than from its main competitor H&M. But the fact that the customer gets a rare piece, the collections are changing fast, compensates that difference.
- Zara has relatively low advertising costs.
- The Company depends heavily on the latest technology and widely spread information systems.

Outsourcing vs. In-house production

Two major elements in the business structure play an important role: Outsourcing and In-house production. Zara currently implements the second structure, namely In-house production. What are the main differences between the two; which advantages and downsides do they have?

Outsourcing	In-house
<p>Advantages:</p> <ul style="list-style-type: none"> - Less investment in capital needed - More focus on core business competencies - Increases company's productivity <p>Disadvantages:</p> <p>Higher risk of miscommunication, Which may lead to;</p> <ul style="list-style-type: none"> - Lower quality - Longer time to market - Missed sales and thus huge losses 	<p>Advantages:</p> <ul style="list-style-type: none"> - Can provide more quality control - May speed up time to market - Faster information exchange <p>Disadvantages:</p> <p>Rigid business model which can result in high costs to keep up with changes in:</p> <ul style="list-style-type: none"> - Technology - Governmental Policies - Market trends

Now that we have a clearer overview of the two structures, we know what kind of complications Zara has to deal with. Nevertheless, outsourcing the complete production process is not a wise decision for Zara:

- According to the Fisher matrix approach (*See appendix A*), a company has to align its supply chain with its product characteristics if it wants to become truly successful (*Operations Management for Competitive Advantage*; R.B Chase et al.). Zara has Functional products (casual wear), which demand a stable supply chain, but also Innovative products (fashion wear), which require an efficient and responsive supply chain.

Outsourcing the whole product line would mean that the innovative products won't get the responsive supply chain which they have now. No sourcing company can match the rapidness of Zara's supply chain. This will leave Zara with even more costs (lost sales), which outweigh the cost savings! This is why keeping the current business model is crucial for Zara; it is its main competitive advantage.

Zara's expansion into the US market

Expanding into the US market is a very wise decision for a growing company such as Zara. What makes it so attractive?

Demographic

The target market is very big in the US.

Estimated Total US population:	
288,378,137	
Male	Female
288,378,137	147,103,173
Male 20-44 years old	Female 20-44 years old
7.475.536	8.148.318

(*Estimation US pop. 2005*; American Census Bureau)

Economic

America is by far, one of the biggest and advanced economies of the world. It has a personal disposable income of \$27,188 per head and personal consumption expenditure of \$25,408. This makes the US consumer to have high purchasing power.

(*Country Briefings*; US; Economist Intelligence Unit; Online)

Customer Tastes

American fashion tastes always differed from the European in that Americans had a more casual way of dressing. This can be clearly reflected by comparing some US designers as Calvin Klein and Tommy Hilfinger with EU designers such as Dolce and Gabbana and Dior. But, this doesn't mean there is no demand for this specific style. The US market always had a certain fascination for Europe. Due to the fact that the US market is so big, different styles of fashion manifest themselves easier.

Technological

The US is one of the countries who play an important role in information technology development and technical innovation. Delivering services and goods over the internet is very popular. This development is often called the 'New Economy' which is driven by information and communications technology. (*Country Briefings; US*; Economist Intelligence Unit; Online)

Governmental and Legal

The US has low government interference when it comes to foreign investment. The government does not interfere in foreign investment issues, except when it comes to areas such as the military, airfreight or natural gas etc. The legislation has also low restrictions on foreign investment, especially none in the textiles/fashion manufacturing. (*Legislation for Foreign Investment Statutes in Countries in the Americas*; Online)

Manufacturing in North America?

America is definitely an attractive market which is worth the extra spending. On the other hand, it shouldn't cost the company too much. This brings us to the fact that Zara wanted to build a manufacturing and distribution center in North America. This is not a wise decision because of the high costs of building or buying the manufacturing/ distribution space. Apart from this, the wages are also relatively high, especially when compared with what Zara pays its employees now in Spain.

A better choice would be Central or South- East US. These regions have lower wages and in general lower costs than North America nowadays.

Conclusion

Although it might seem that Zara is less efficient than its competitors, it has the most efficient business model in the long run. As consumer tastes and demands are changing more rapidly, a responsive supply chain is required. This responsive supply chain is saving a lot of costs because of its adaptability to the market demands.

"Every dollar of investment in responsiveness of the supply chain, usually results in a decrease of more than a dollar in cost of stock outs, forced markdowns or excess inventory."

(*Operations Management for Competitive Advantage*; R.B Chase et al)

The more efficient point of view should be applied to the Casual wear department of the company, such as basic T-shirts and the like. Those may be outsourced and sold for a low price.

The higher price compared to its competitors could be justified because of the relatively limited number of pieces which are produced of one garment. This makes Zara's clothes unique when comparing with H&M's, which are produced en-masse and thus sold for a longer period.

Expanding its business model in the US is a worthwhile consideration. It is a big market which will expand its customer base substantially. But Central or South East US should be put into consideration, rather than the Northern part, because of higher set-up and operating costs.

Appendix A

The Fischer Matrix

	Quality/ Innovative Products	Functional/ Commodity Products
Responsive Supply Chain	FIT	NO FIT
Functional Supply Chain	NO FIT	FIT

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Further Reading

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