**Sidebar 6-1 Zara: A European retailer using the low-margin, high-turnover model of retailing**

Zara was founded in Spain in 1975, and in the three decades of its existence, it has built and fine-tuned a particular model of retailing that appears to balance the need to control costs with the need to meet the demands of its fashion-forward, trendy target market.

Zara's target consumer in Europe is a fashion-conscious, young, female buyer of clothing who values novelty and exclusivity but is also quite price sensitive. The most important service output demands of this consumer are therefore assortment and variety (which should be extensive and novel) and quick delivery (i.e., extremely fashion forward and available to buy). Providing a quickly changing, market-responsive assortment of reasonably priced, fashion-forward clothing has long been one of the thorniest challenges for retailers. Zara has met this challenge through a combination of strategies:

• It makes 40 percent of its own fabric and owns its own dyeing company, which per- mits it to buy undyed fabric from outsiders and postpone coloring fabric until it knows what colors are really popular in a given season.

• It owns its own production for more than 50 percent of its clothes, thus retaining control over production from start to finish.

• It concentrates all of its owned production and warehousing in one area, in Galicia in northern Spain.

• It purposely makes small amounts of product at a time, rather than large batch volumes.

• It owns its own logistics and trucking operations, which in some cases may mean sending a half-empty truck through Europe.

•It has invested in significant communications capabilities, from the store manager level back to the designers, from designers to production, from production to warehousing, and from the warehouse back to retail stores.

• It sticks to a rigid reordering, production, and shipping schedule that makes restocking stores extremely predictable to everyone in the system, including consumers.

• It favors introducing new styles over restocking Styles it has already shipped once and has invested in an extremely flexible manufacturing operation to permit this approach.

These policies actually contradict many practices throughout retailing today—from the highly vertically integrated set of operations Zara pursues, to the rigid controls it exerts throughout its logistics and ordering systems, to its small-batch production practices, to the constant revamping of product lines in the stores. So how can Zara possibly make money with such a topsy-turvy retailing system?

The answer lies in its apparently high-cost methods of operation, which actually maximize turnover and save costs in other parts of its business. Because Zara has invested in significant amounts of communication at all levels of its business (which is also possible because of its investments in vertical integration), designers at headquarters learn about new “hot" styles mid-season, before any of Zara's competitors are able to see the trends and respond to them. With its flexible manufacturing operations, its well-integrated clothing designers can work closely with manufacturing operations to create cutting edge designs and feed them to manufacturing with no delay. It also is more feasible to respond to this information, because Zara has cho- sen nor to make large batch volumes of any styles it innovates; thus, it has the space in the stores to accommodate new styles. Furthermore, it does not suffer from large overstocks and thus does not need to mark down merchandise as heavily as its competitors do. That is, it never produces large volumes of any style, and it only produces styles for which it has market-level indications of demand.

Because Zara actually cultivates slack (i.e., unused) capacity in its factories and warehouse, it can accommodate rush jobs that would cause bottle-necks in standard retail systems. And because Zara's consumers know that Zara is constantly coming out with new styles (as well as exactly when the stores are restocked), they shop more often (particularly right after a new shipment comes in), to keep up with the new styles. For example, a shopper in London visits a standard clothing store (where she shops routinely) about 4 times per year; the same shopper visits a Zara store 17 times per year! The Zara shopper feels a certain urgency to buy a garment when she sees it at the store, because she may not be able to find it again if she waits to get it. This increases sales rates and merchandise turnover.

So what are the results of Zara's retailing strategy?

1. Zara has almost no inventories in its system:

• An item sits in its warehouse only a few hours on average (not days or weeks!).

• Store deliveries occur (on schedule) twice per week to each store in the system, worldwide.

• Most items turn over in less than one week (significantly less than its competitors' inventory turn rates).

1. Zara can create a new design, manufacture it, and have it on its stores' shelves in just two weeks, versus 9-12 months for other retailers (e.g. The Gap, VF Corporation).
2. Zara's shipments are 98.9 percent accurate, and it enjoys a very low shrinkage rate of 0.5 percent (i.e., loss of inventory due to theft or damage).
3. Its designers bring over 10,000 new designs to market (versus 2,000-4,000 items introduced by The Gap or H&M) each year.
4. Zara maintains net profit margins of about 10 percent annually, as good as the best retailers in the business, even though its prices are fairly low.
5. It does little advertising, spending only 0.3 percent of sales on ads, versus the more typical 3-4 percent of sales for its competitors. It does not need to spend on advertising, because its shoppers are in the stores so many times a year that there is no need for advertising to remind them to come.
6. On average, Zara collects 85 percent of list price on its clothing items, versus an indus- try average of only 60-70 percent (including markdowns). This rate leads to higher net margins; in one year, Zara's net margin was 10.5 percent, H&M's was 9.5 percent, Benetton's was 7 percent, and The Gap's was 0 percent.

In short, Zara's formula for success rests on its highly centralized control, all the way from its input sourcing (dyes, fabrics), to design, to logistics and shipping, and finally to retailing. Given the high cost of owning all of these resources, Zara has to maximize the value created from them—which It does very well, by excelling at meeting the core service output demands of its target market namely, novel and extensive variety and assortment, quickly.