

Chapter 3 - Zara: Fast Fashion from Savvy Systems

John Gallaughier - Information Systems: A Manager's Guide to Harnessing Technology, version 7.0

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## Chapter 3

### Zara: Fast Fashion from Savvy Systems

#### Section 3.1

##### True/False Questions

1. The U.S. Department of Justice needed to provide a special exemption to the Fair Factories Clearinghouse, and before doing so, had to be convinced that the effort wouldn't be used by buyers to collude and further squeeze prices from competitors.  
**True; Easy**
2. The Fair Factories Clearinghouse is subject to network effects.  
**True; Easy**
3. Making seasonal apparel decisions is a challenge because it often involves making predictions on what customers will be interested in, months in advance of clothing appearing on store shelves.  
**True; Easy**
4. Zara's dominance in the fashion industry is due to its horizontally integrated structure accompanied by a globally dispersed production model.  
**False; Easy**
5. Zara's clothing look like high fashion, but are comparatively inexpensive.  
**True; Easy**
6. Most fashion retailers place orders for a seasonal collection a few days before these lines make an appearance in stores.  
**False; Easy**
7. Maintaining large inventories is highly essential for the viability of the fashion industry.  
**False; Easy**

##### Multiple Choice Questions

8. In an industry where nearly every major player outsources manufacturing to low-cost countries, Zara is highly \_\_\_\_\_, keeping huge swaths of its production process in-house.
  - a. privatized
  - b. vertically integrated
  - c. publicly traded
  - d. subsidized
  - e. autonomous**b; Easy**
9. What was considered the source of Mickey Drexler's inventory problems at Gap?
  - a. He personally approved sweatshop-affiliated contract manufacturers
  - b. He wrote the code for Gap's disastrously broken inventory system
  - c. The firm guessed wrong about fashion, placing big bets on trends that consumers didn't want
  - d. He led a botched merger with Disney in the hopes that combining technology with the Disney Store would create a super-efficient set of shopping mall destination stores.

**c; Easy**

10. Zara holds a competitive advantage over its rivals in spite of:
- a. refusing to implement technology in its operational model.
  - b. conducting business only through online storefronts.
  - c. its globally distributed contract manufacturing model.
  - d. operating through fewer stores across the world than its closest rivals.
  - e. Keeping large portions of its production processes in-house.

**e; Easy**

11. \_\_\_\_\_ involves outsourcing production to third-party firms.
- a. Vertical integration
  - b. Long tailing
  - c. Peer production
  - d. Contract manufacturing
  - e. Viral production

**d; Easy**

12. In retail in general and fashion in particular, having \_\_\_\_\_ is considered the kiss of death.
- a. excess inventory
  - b. storefronts in expensive districts with costly rents
  - c. a large labor force
  - d. limited production runs
  - e. dispersed production facilities

**a; Easy**

13. Contract manufacturers used by the apparel industry are often criticized because:
- a. they hike up the costs of producing goods.
  - b. firms cannot maintain high profit margins by employing them.
  - c. they charge exorbitant labor costs that drive down sales.
  - d. they are known to grossly overprice their services.
  - e. of poor working conditions.

**e; Easy**

14. \_\_\_\_\_ is a non-profit organization that shares audit information on contract manufacturers among members of the apparel industry and other industries.
- a. Fair Factories Clearinghouse
  - b. Pricewaterhouse Coopers
  - c. Amnesty International
  - d. Klynveld Main Goerdeler
  - e. Transparency International

**a; Easy**

**Essay Questions**

15. What were the problems encountered by Gap in the early part of the decade following the 1990s? What were the measures taken to overcome these problems?  
Gap was an industry leader for much of the 1990s in apparel retail, with over \$1 billion in profits. However, sales declined in the early part of the following decade, prompting the firm to try revitalizing the brand. Chasing the youth market, Gap filled its stores with miniskirts, low-rise jeans,

and other offerings. But the throngs of teenagers they 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. Gap's same-store sales declined for twenty-nine months straight and profits vanished. The firm's debt was downgraded to junk status.

Closing down hundreds of stores did not work either and Gap was forced to write off much of its inventory. The marketing model used by Gap to draw customers in via big-budget television promotion also collapsed. The firm has since ceded its position as the market leader.

**Moderate**

16. What is contract manufacturing? What advantages can a firm expect to gain from contract manufacturing? What are the downsides associated with this practice?

Contract manufacturing refers to outsourcing production to third-party firms. Firms that use contract manufacturers do not own the plants or directly employ the workers who produce the requested goods. Conventional wisdom suggests that leveraging cheap contract manufacturing in developing countries can keep the cost of goods low and allow firms to leverage specialized manufacturing expertise if production is not seen as core to competitive advantage. Firms can lower prices and sell more products or maintain higher profit margins.

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. 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.

**Moderate**

### **Short Answers**

17. The U.S. Justice Department initially reviewed the Fair Factories Clearinghouse but eventually approved the effort as described in readings and class. What was the government initially concerned about?

**Price-fixing or price collusion; Easy**

### **Fill in the Blank Questions**

18. \_\_\_\_\_ is a non-profit organization that shares audit information on contract manufacturers.

**Fair Factories Clearinghouse; Easy**

19. Outsourcing production to third-party firms is called \_\_\_\_\_.

**contract manufacturing; Easy**

### **Section 3.2**

#### **True/False Questions**

20. Zara's high fashion styles are inspired by customer tastes, with technology used to gather data on preferences at given store locations.

**True; Easy**

21. Elaborate customer surveys help Zara designers predict fashion trends months into the future and design products accordingly.

**False; Easy**

22. Limited production runs ensure customers do not have to visit Zara's stores as often as they visit other stores, allowing the firm to save money through staff reductions when compared to peers.

**False; Easy**

23. Zara's IT expenditure, measured by IT workers as a percentage of total employees, is only slightly higher than the industry average.

**False; Moderate**

24. Zara's use of technology across the value chain allows the firm to manufacture more unique items than rivals H&M and Gap.

**True; Easy**

25. Zara encourages employee use of technology by tying employee salaries to sales performance.

**True; Easy**

26. Goods to be further customized based on designer/manager collaboration are called greige.

**True; Easy**

27. RFID tags allow Zara staff to take in-store inventory less frequently than rivals, saving money on staffing.

**False; Easy**

28. An information system consists of hardware, software, data, procedures, and the people who interact with and are impacted by the system.

**True; Easy**

### **Multiple Choice Questions**

29. Personal digital assistants are:

- a. transaction processing systems that capture customer purchases.
- b. small chip-based tags that wirelessly emit a unique identifying code for the item that they are attached to.
- c. systems that provide rewards and usage incentives, typically in exchange for a method that provides a more detailed tracking and recording of customer activity.
- d. handheld computing devices meant largely for mobile use outside an office setting.
- e. artificial intelligence systems that leverage rules or examples to perform a task in a way that mimics applied human expertise.

**d; Easy**

30. Zara's staff members regularly collect data from customers at its stores. This data is used to:

- a. decide the designs and styles of Zara's products for the next few seasons.
- b. determine the in-store soundtrack and layout.
- c. inform designers on customer preferences and staff on store sales results.
- d. determine where future Zara stores should be located.
- e. identify the products that customers would like to buy through discounted sales.

**c; Easy**

31. \_\_\_\_\_ are critical for capturing sales data, and are usually linked to systems which manager a firm's inventory.
- Point-of-sale systems
  - Legacy systems
  - CRM systems
  - Server farms
  - Data aggregators
- a; Easy**
32. Many firms have developed and deployed innovative information systems, only to see these systems go unused by key staff members. How has Zara helped ensure its systems will be used by staff?
- employees are monitored by in-store cameras
  - employee time on information systems is recorded each time the system is engaged
  - system use drives store success and as much as 70 percent of salaries are tied to sales performance
  - all employees must have a Fair Factories Clearinghouse account, which is used to log and report employee activity
  - systems were designed by employees, who feel a sense of ownership in the technology deployed
- c; Moderate**
33. Zara's clothing lines are designed:
- by star designers like Stella McCartney.
  - in collaboration with celebrities and pop artists.
  - by design school graduates to suit customer demand.
  - by designers who win talent shows sponsored by Zara.
  - mostly by foreign designers in European design hotspots of Paris and Milan.
- c; Easy**
34. How does Zara differ from its competitors in converting ideas into products?
- Zara concepts appear in stores in fifteen days on average compared to rivals who receive new styles once or twice a season.
  - Zara's ideas are inspired by social media, compared to the intrinsic design processes followed by its competitors.
  - Zara's design and concept teams use data from customers to predict fashion trends many months into the future and stock up inventory accordingly, as opposed to its rivals.
  - Collaborations with celebrities help Zara churn out a limited, yet profitable, volume of items every year, while rivals produce a higher volume of less fashionable items.
  - By focusing on a smaller number of products than rivals like Gap, Zara manages to limit exposure to wrong guesses.
- a; Moderate**
35. A value chain is a set of:
- similarly profitable firms competing against each other in any given industry.
  - large firms that are vertically integrated.
  - activities through which a product or service is created and delivered to customers.
  - a large number of small firms that dominate a given market.
  - robotically controlled conveyor belts that deliver product quickly from manufacturing stations to shipping containers.
- c; Easy**

36. Which of the following is not a benefit achieved through Zara's integration of technology throughout the firm?
- a. limited product runs of many unique products
  - b. higher markdowns
  - c. fewer write-offs
  - d. less need for advertising
- b; Moderate**
37. Zara store staff gain as much as three hours in prime selling time to assist customers at stores. Which of Zara's practices is instrumental in these time savings?
- a. Concepts going from ideas to appearances in stores in fifteen days on an average.
  - b. Three hundred member-strong design teams churning out up to thirty thousand items a year.
  - c. Distribution centers ironing clothes in advance and packing them on hangers, with security and price tags affixed.
  - d. Collecting data from customers on what kind of clothes to stock in stores, using PDAs.
  - e. Tweaking shipping models through Air France-KLM Cargo to coordinate outbound shipments with return legs loaded with raw materials.
- c; Easy**
38. Due to limited production runs, Zara's customers:
- a. tend to delay their shopping until the products go on sale.
  - b. visit the stores more often.
  - c. buy products at discounted rates after a few weeks.
  - d. visit stores less often.
  - e. create a greater opportunity for increased markdowns and write-offs.
- b; Easy**
39. According to an independent study, Zara books some 85 percent of its products at full price compared to the industry average markdown ratio of 50 percent. This is made possible by:
- a. keeping a major part of the production processes under direct proprietary control.
  - b. coordinating the outbound shipments of all Inditex brands with return legs loaded with return materials and half-finished items.
  - c. applying data analytics to purchase trends.
  - d. the practice of having limited production runs of its designs.
  - e. leveraging contract manufacturers to produce only staple items with longer shelf-lives, which account for one-eighth of dollar volume.
- d; Moderate**
40. Zara's IT expenditure is low by fashion industry standards and is also highly effective. Which of the following makes this possible?
- a. Targeting technology investment at points in the value chain where it has the most significant impact.
  - b. Utilizing the money spent on IT infrastructure to improve the IT skills of its employees through training programs.
  - c. Using the best and most expensive software and hardware in the market, as it lowers any maintenance costs later.
  - d. Outsourcing IT management to third-party firms which provide IT services at lower costs.
  - e. Investing IT funding in improving the infrastructure and cutting down employee overhead costs.
- a; Easy**

41. Small chip-based tags that wirelessly emit a unique identifying code for the item that they are attached to are called \_\_\_\_\_.  
a. Personal Digital Assistants  
b. Smart adaptors  
c. Trackbacks  
d. Legacy labels  
e. RFID tags  
**e; Easy**
42. High-end fashion house Prada's experiment of implementing the latest technology in its flagship store failed because:  
a. Prada targeted technology investment only at points in its value chain where it would have the most significant impact.  
b. Prada managers were enamored with technology and failed to consider implications across all components of the new information systems.  
c. the effort was unlike Prada's signature style, being more functional than fashionable.  
d. Prada skimped on spending with its IT expenditure being lesser than one-fourth the fashion industry average.  
e. the RFID technology used on items in the store were not state of the art and suffered from legacy system problems.  
**b; Moderate**
43. \_\_\_\_\_ represents an integrated solution that combines hardware, software, data, procedures, and the people who interact with and are impacted by the system.  
a. A neural network  
b. Artificial intelligence  
c. An information system  
d. Supercomputing  
e. Cloud computing  
**c; Easy**
44. ROI is a term used to represent the:  
a. return on information  
b. rate of information-generated  
c. regular order intake  
d. return on investment  
e. relay-ordered inventory  
**d; Easy**
45. The e-commerce strategy that blends online and offline sales is called \_\_\_\_\_.  
a. sales channel  
b. betterline  
c. omnichannel  
d. blended sales  
e. omniline  
**c; Moderate**



46. At Zara, clothes are ironed in advance and packed on hangers, with security and price tags affixed. This system means that employees in Zara stores simply move items from shipping box to store racks, spending most of their time on:
- outsourcing their sales activities.
  - value-added functions like helping customers find what they want.
  - wrestling with inventory during busy periods.
  - packing unsold merchandise that need to be returned to the distribution center.
  - whisking items from their stores to the staging areas.

**b; Moderate**

### Essay Questions

47. Walmart is a large firm, but some suggest that Zara has had more success implementing effective RFID. Why?

Firms from Walmart to JCPenny have struggled to effectively implement RFID, but Zara's vertical integration is an advantage here, as well. Since the entire supply chain is under Zara control and all items flow through one of two warehouses, Zara can affix tags to all products before sending them out to stores (a challenge for other retailers that have third-party suppliers ship to multiple warehouses or directly to stores). Stores then send tags back to Zara warehouses for reuse (reassigning a tag's unique item to a new clothing item). Although tags only cost ten cents, with hundreds of millions of items sold each year, these costs would easily add up, so the reusable tag system makes solid financial sense (Zara bought so many tags at launch that it actually consumed one in every six tags produced for the entire apparel industry that year).

**Moderate**

48. How does RFID improve in-store customer service?

RFID lets Zara know where products are, so if a customer asks for an item in a store (perhaps in a different size or color), staff using custom apps on an iPod Touch can immediately tell if a product is in store, in a nearby store, or if it can be ordered from the distribution center or Zara.com.

**Moderate**

49. Briefly explain the intelligence-gathering exercises carried out by Zara in its stores and the role of technology in such efforts.

Zara's designs are based on the evidence of customer demand. 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) to gather customer input, staff members regularly chat up customers to gain feedback on what they'd like to see more of.

Once stores are closed, the staff looks for trends in the piles of unsold items that customers tried on but didn't buy to spot any preferences in cloth, color, or styles offered among the products in stock.

PDAs are also linked to the store's point-of-sale (POS) system showing how garments rank by sales. Managers send updates that combine the hard data captured at the cash register with insights on what customers would like to see. All of this valuable data allows the firm to plan styles and issue rebuy orders based on feedback rather than hunches and guesswork. The goal is to improve the frequency and quality of decisions made by the design and planning teams.

**Moderate**

50. Describe how Zara's counterintuitive practice of making limited production runs is profitable and effective in maintaining a competitive advantage over the firm's rivals.

While running out of bestsellers might be seen as a disaster at most retailers, at Zara the practice delivers several benefits.

Limited runs allow the firm to cultivate the exclusivity of its offerings. Each Zara store is stocked with items tailored to the tastes of its local clientele. Limited runs encourage customers to buy right away and at full price. Customers realize that waiting for items to go on sale means the products have almost certainly been sold or moved to make room for newer stock. Zara rarely runs discount sales and this is evidenced in data which suggests that Zara books some 85 percent of its products at full price, compared to the industry average of just 50 percent.

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. This ensures that Zara spends almost nothing on advertising.

Finally, limited production runs allows the firm to reduce to a minimum the risk of making mistakes, such as stocking up on inventory with items customers would not buy and incurring losses.

#### **Moderate**

51. What role does Zara's headquarters play in the running of its stores?

Zara's store managers, armed with personal digital assistants (PDAs), gather customer input. Staff members regularly chat up customers to gain feedback on what they'd like to see more of. The staff looks for trends in the piles of unsold items that customers tried on but didn't buy to spot any preferences in cloth, color, or styles offered among the products in stock. Managers send this valuable data to Zara's headquarters which allows the firm to plan styles and issue rebuy orders based on feedback rather than hunches and guesswork. The goal is to improve the frequency and quality of decisions made by the design and planning teams. 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. This constant refinement of operations throughout the firm's value chain has helped reverse a prior trend of costs rising faster than sales.

Even the store displays are directed from the firm's headquarters outside, 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 is 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.

#### **Moderate**

52. Why has Zara been more effective in leveraging technology to enhance its operating strategies than its rivals? Provide an example to contrast Zara's handling of technology in its operations.

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. 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.

High-end fashion house Prada's efforts at its flagship Manhattan store contrast Zara's efforts.

The firm used radio frequency identification (RFID) tags on clothes in its store. 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. However, as slick as it sounded, the effort had disastrous consequences and the investment in Prada's in-store technology was simply too high, with estimates suggesting the location took in just one-third the sales needed to justify expenses. At Prada's Manhattan flagship store, the effort looked like tech chosen because it seemed fashionable rather than functional.

### **Moderate**

53. Many firms have developed innovative information systems, only to find that employees fail to adopt these tools. How does Zara encourage store managers to effectively use the systems deployed in stores?

Managers have 'skin in the game,' with compensation tied to overall store performance. Store performance is improved through manager's use of information systems that help ensure that fashions arrive in store tailored to customer feedback, requests, and preferences.

**Easy**

### **Short Answers**

54. Our analysis of Inditex's Zara stores showed the power of data to fuel competitive advantage. *List* the two acronyms for technologies that Zara uses to collect data in stores, and *describe* what the data from *each* of these respective systems 'tells' the firm.

POS – what the store is selling; PDA – what customers want to see on shelves.

**Easy**

### **Fill in the Blanks**

55. A(n) \_\_\_\_\_ is a transaction process that captures customer purchase information.

**point-of-sale system; Easy**

56. Coordinating and enabling the flow of goods, people, information, and other resources among locations is known as \_\_\_\_\_.

**logistics; Moderate**

57. An information system is an integrated solution that combines five components: hardware, software, data, \_\_\_\_\_, and the people who interact with and are impacted by the system.

**procedures; Moderate**

58. \_\_\_\_\_ are goods to be further customized based on designer/manager collaboration.

**Greige; Easy**

59. When a single firm owns several layers in its value chain, it is said to be \_\_\_\_\_.

**vertically integrated; Easy**

### **Section 3.3**

#### **True/False Questions**

60. The strengthening of the euro relative to the dollar has insulated Zara against financial vulnerabilities.

**False; Moderate**

61. Rising fuel costs are likely to make Zara's model of twice-weekly deliveries more expensive to maintain.

**True; Easy**

62. Zara also saves money by simplifying pricing. An item sold in Bangkok is likely to cost the same as a similar item sold in Barcelona.

**False; Moderate**

63. Zara's vertically integrated model is easier for rivals to copy compared to Dell's, as computing is more complex than clothing in terms of number of new models offered.

**False; Moderate**

### Multiple Choice Questions

64. Factors such as weather, natural disaster, terrorism, labor strife, or political unrest can shut down a firm's operations. Which of the following is one of the measures taken by firms to hedge such risks?
- a. Driving up profitability by increasing prices of market goods
  - b. Spreading productions facilities across the globe
  - c. Requesting government intervention in the form of subsidies or nationalization
  - d. Sourcing raw materials from countries with low labor costs
  - e. Diverting marketing and advertising budgets to accommodate greater production

**b; Moderate**

65. Zara is susceptible to any disruption in northern Spain because:
- a. it moves all of its deliveries through just two locations, both in Spain.
  - b. it conducts its trade operations based on the American dollar rather than the stronger euro.
  - c. most of Zara's products are sold in markets outside Spain and Europe.
  - d. Zara's products are sold at much lower costs around the world than in Spain, and this harms profitability.
  - e. Zara's production facilities in Asia and Central America are threatening employment in Spain.

**a; Easy**

66. Zara's production costs could rise at higher rates than its competitors because many of the firm's costs are tied to the \_\_\_\_.
- a. euro
  - b. dollar
  - c. yen
  - d. pound
  - e. franc

**a; Easy**

67. The Zara experience involves a regular supply of new stock on the shelves, because of which customers tend to visit Zara's stores more often than they visit other retailers' stores. However, such a policy will become more expensive to maintain if:
- a. star designers demand a higher fee for its designs.
  - b. PDAs are not used.
  - c. fuel costs rise.
  - d. Zara's horizontal integration fails.
  - e. Zara outsources its production process.

**c; Easy**

### Essay Questions

68. What are the operational and financial challenges that Zara faces?  
In spite of its effectiveness, Zara's Spain-centric, just-in-time manufacturing model has certain defects. By moving all of the firm's deliveries through just two locations, both in Spain, the firm

remains hostage to any disruption in the region, such as weather, natural disaster, terrorism, labor strife, or political unrest. Firms often hedge risks that could shut down operations by spreading facilities throughout the globe. If problems occur in northern Spain, Zara has no such fall back. Moreover, this 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.

Zara is liable to be overtaken by rivals who might, in time, succeed in copying its vertically integrated value chain, despite the difficulty involved. Dell's loss of market share due to the same reason can be cited a precedent for Zara's potential vulnerability in this regard.

Finally, the firm's 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, in particular, and Western Europe, in general.

**Hard**

### **Fill in the Blanks**

69. The organizational activities that are required to produce goods or services are known as \_\_\_\_\_.  
**operations; Moderate**