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## Zara's Sustainability Dilemma

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With €27.7 billion in 2021 sales and over 6,650 stores globally, Inditex was one of the most valuable fashion companies in the world.<sup>1</sup> The company's growth was remarkable, considering that just two decades earlier, Inditex had just 622 stores and €1.2 billion in sales across fashion and home goods retail.<sup>2</sup> The company's success was predicated on what analysts referred to as a "fast-fashion" retailing strategy – which was deployed primarily through its flagship brand, Zara – prompting many other fashion retailers to replicate the model across the world.

In June 2022, Zara launched its first limited-edition "sustainable fashion" line. Textiles used in collection were produced using a technique that transformed carbon-dioxide emissions – that would have escaped into the atmosphere – to create low-carbon polyester yarn.<sup>3</sup> The release of its sustainable fashion collection was a major shift for Inditex. Zara was a pioneer of fast fashion, an innovative model of fashion design, production, and distribution that was adopted a wave of retailers such as such as H&M and Asos. Yet, for years, Zara faced criticism from consumers and investors alike that this very model contributed to the acceleration of climate change through its supply chain practices, which entailed overproduction, waste, and excessive fossil fuel emissions. In response, Inditex issued its first annual sustainability report in 2019 committing to several long-term goals, including net zero carbon emissions by 2040.<sup>4</sup>

As the pressure to clean up its production processes intensified, Inditex was also grappling with the emergence of ultra-fast fashion companies. Consumers were increasingly attracted to brands like Shein, a digital-first fashion retailer headquartered in Nanjing, China, that achieved even quicker turnaround and release times than Zara, becoming a fixture for Gen Z shoppers. In April 2022, Shein's valuation was estimated at \$100 billion, exceeding Inditex's market capitalization of \$77 Billion at the same period.<sup>5</sup> Between sustainability-conscious

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consumers pushing for Zara to slow down and competition from even faster competitors pressuring Zara to speed up, Zara was caught in a dilemma: in which direction should the company adapt its strategy? Which stakeholders were most important for Zara to sustain long-term competitive advantage?

## The Origins of Zara

Industria de Diseño Textil (Inditex) was founded in 1963 in Spain. The company was founded by Amancio Ortega, who began by making and selling dresses and dressing gowns. In 1975, the first Zara store opened in La Coruña, in northwest Spain, a region known for its concentration of textile factories. More Zara locations were opened throughout Spain, and in 1988 Zara expanded internationally, opening a store in Porto, Portugal.

By 2021, Inditex had 2,220 stores in 88 countries. Via its eight retail concepts, Zara, Pull & Bear, Massimo Dutti, Bershka, Stradivarius, Oysho, Zara Home, and Uterqüe, Inditex offered its customers “the latest fashion trends (clothing, footwear, accessories and household textile products) at attractive prices, in due time and with high quality and sustainability standards.”<sup>6</sup> Inditex operated what its management described as a “fully integrated online and store business,”<sup>7</sup> and each of its retail concepts was carried out through a store and online model. Zara, Inditex’s flagship retail concept, contributed 66% of the company’s sales and 70% of Ebitda. (See Exhibit 1 for a company timeline, Exhibit 2 for Inditex’s historic sales growth, Exhibit 3 for a financial summary for each retail concept and a breakdown of sales by country, and Exhibit 4 for a breakdown of Zara stores by country.)

## Zara’s Business Model

### PRODUCT DESIGN

*Commercial and design teams have a clear customer orientation. Inditex listens and transmits the demands of the clients both in stores and online to the teams...[who] use this information to react quickly, manufacturing the desired items in very short lead times, in order to make them available for sale as soon as possible.*<sup>8</sup>

—Inditex 2017 Annual Report

Inditex employed more than 700 designers, based exclusively at its headquarters in Spain. These designers produced 65,000 new designs per year, utilizing technology, such as radio frequency identification (RFID) chips embedded in Inditex products, to understand consumer demand. This “hard data” on which styles, colors, etc. were selling was supplemented by the use of “soft data.” Soft data included feedback from frontline store personnel on what customers in the stores were saying. Inditex had worked hard to ensure that information flowed efficiently throughout the company.<sup>9</sup> One article described that this was reinforced by:

...getting various business functions to sit together at the headquarters and also by encouraging a culture (through structures and processes) where people continuously talk to each other. The sales and marketing teams who receive trend feedback talk regularly with designers and merchandisers. It is important that there

is constant two-way communication so that sales and marketing teams can talk about new lines to customers and designers/merchandisers have a strong visibility of customers' needs and preferences enacted at a store level.<sup>10</sup>

## **MANUFACTURING AND DISTRIBUTION**

It took 15 business days on average for Inditex's designs to move "from drawing board to store."<sup>11, 12</sup> This compared with industry norms of a six- to nine-month product cycle for "basic items" and 16 weeks for seasonal items.<sup>13</sup> One analyst explained that the quick product cycle enabled Inditex to "exist on the curve, evaluating trends first, then following."<sup>14</sup>

Inditex would generally cut fabric in its company-owned factories and then ship the fabric pieces out to small studios to be sewed. The completed garment would then be returned to the factory, where it was ironed, wrapped in plastic, and shipped.<sup>15</sup> Fifty-nine percent of Inditex's products were manufactured in factories and studios in Spain, Portugal, North Africa, and Turkey, many of which Inditex owned.<sup>16</sup> By contrast, competitors like Gap sourced almost exclusively from countries in Asia and Latin America through partnerships.<sup>17</sup> (See Exhibit 5 for labor costs in the textiles industry globally.) Overall, Inditex worked with 824 suppliers in 7,210 factories in 47 countries. Factories farther from Inditex's Spanish headquarters produced items considered to be less trendy—and, as such, time to market was less of a concern. They also produced large quantities of unfinished "greige goods," raw fabric that had not yet been dyed or printed, which sat ready so that finishers could quickly transform it into products for sale based on demand. This kept waste to a minimum, lowering material costs. Inditex's factories generally operated very leanly on a 4½-day workweek, allowing for excess capacity to respond to increased demand as needed.<sup>18</sup> (See Exhibit 6 for a list of countries in which Inditex factories were located.)

New merchandise was delivered to each Inditex store at least two times per week.<sup>19</sup> From its 10 company-owned logistics centers in Spain,<sup>20</sup> Inditex was able to get products to every company store in less than 48 hours via the selected use of air shipping.<sup>21</sup> That way, if a particular color was selling out or a style was selling slowly, the company could adjust its orders accordingly. Airfreight was also used selectively to transport goods from factories in Asia to distribution centers in Europe. One analyst estimated that 36% of Inditex's inbound shipments to the Americas, Asia, and Africa traveled via air, and 15% of goods traveling inbound to Europe were shipped via airfreight.<sup>22</sup> By contrast, traditional fashion retailers relied almost entirely on sea-based shipping. A study by the World Bank concluded that airfreight was "typically priced 4–5 times that of road transport and 12–16 times that of sea transport."<sup>23</sup>

Inditex produced most items in small batches. Because of this, one industry observer commented, "With Zara, you know that if you don't buy it, right then and there, within 11 days the entire stock will change. You buy it now or never."<sup>24</sup> Inditex embedded RFID chips in the plastic security tags attached to each garment (allowing the chips to be reused, because the security tags were detached at the point of sale). RFID was piloted by Inditex in 2007, and the company eventually purchased 500 million RFID chips in order to roll out the technology to all its stores.<sup>25</sup> The chips emitted radio signals to scanners transmitting detailed product

information. This allowed inventory to be tracked real-time and allowed for automated inventory reordering. A periodic stock take could be completed in half the time—with store personnel simply waving a scanner as they walked across the floor to pick up the RFID chip data. (Previously, each item’s tag would have been individually scanned.) Sales associates also used the RFID chip data to help customers find items not available at a particular store. While many other retailers were experimenting with RFID technology, Inditex was the first to implement it on a wide-scale basis.<sup>26</sup>

In 2015, Stanford professor Dr. Warren H. Hausman analyzed data from 53 businesses in an effort to understand the impact that promotional and markdown strategies had on prices. He determined that discounted items at U.S. apparel retailers and department stores generally constituted 50% to 70% of total items. However, Zara typically discounted only 15% of total items. The percentage discount that Zara employed on marked-down items also tended to be lower than that of its competitors. Hausman dubbed this differential the “Zara Gap.”<sup>27</sup> (See Exhibit 7 for more details on this gap.)

### **STORE NETWORK**

Inditex’s stores were largely company owned. (See Exhibit 8 for a breakdown of company-owned and franchised stores.) The company utilized an “oil stain” pattern when launching in a new market; it would open a large flagship store and follow up with smaller stores in the same market, allowing for greater economies of scale.<sup>28</sup> Inditex’s communications director, Jesus Echevarría, elaborated, “When we open a market, everyone asks, ‘How many stores will you open?’ ...Honestly, I didn’t know. It depends on the customer and how big the demand is. We must have the dialogue with the customers and learn from them. It’s not us saying you must have this. It’s you saying it.”<sup>29</sup>

Stores were in high-profile shopping areas, often next to high-end designers like Gucci and Prada. The company made its stores look like designer boutiques; with the appearance and positioning of these stores effectively acting as brand advertising,<sup>30</sup> and each of Inditex brand’s stores had a “distinctive store aesthetic.”<sup>31</sup> As the company website stated, “Our stores are where our relationship with customers is forged... Everyday face-to-face interaction between our customers and store staff is all-important for our fashion decisions, helping us understand customer needs.”<sup>32</sup> This focus on the customer experience was important to Zara’s strategy. As one industry analyst noted, shoppers visited Zara stores two to three times more frequently than a typical women’s apparel retailer.<sup>33</sup>

In 2011, Inditex paid \$324 million for retail space in 666 Fifth Avenue, one of New York’s most high-profile commercial addresses.<sup>34</sup> The company had invested in other highly visible and costly metropolitan locations globally. Between 2014 and 2017, Inditex’s leasing costs averaged 10% of revenues. And capital expenditure, which was largely driven by the opening of new physical space, averaged 7.5% of revenues.<sup>35</sup>

### **MARKETING**

Inditex did very little marketing. However, the firm had worked to develop a strong brand—Zara ranked number 24 on Interbrand’s Best Global Brands of 2017.<sup>36</sup> One analyst described the company’s approach to marketing: “Our billboards are our store windows.”<sup>37</sup> Whereas

most fashion retailers spent 3% to 4% of sales on advertising, Inditex’s advertising expense was just one-tenth of this industry average.<sup>38</sup>

(See Exhibit 9 for selected financial data for Inditex.)

## Apparel Industry

The global apparel and footwear market generated \$1.4 trillion in sales in 2021 and was forecasted to grow at a 2.6% CAGR through 2028. Geographically, the biggest growth markets over the next few years were expected to be India and China.<sup>39</sup> (See Exhibit 10 for a breakdown of industry sales by category and region.)

The retail fashion landscape included a range of players: department stores (e.g., Macy’s, Nordstrom), discount stores (e.g., Target), online-only retailers (e.g., Shein, Amazon, ASOS, Boohoo), and specialty retailers (e.g., Zara, Gap, H&M). Globally, specialty retailers accounted for 58% of apparel and footwear sales, representing the largest retail channel. Department stores accounted for 15% of sales.<sup>40</sup>

### SELECTED COMPETITORS

#### *Gap*

The first Gap store was opened in 1969 in San Francisco. The company went public in 1976. In 1993, it acquired Banana Republic (an apparel chain with a more upscale focus), and in 1994 Gap launched Old Navy (an apparel chain with a discount focus). Gap also owned Athleta, an athletic apparel retailer, and Intermix, a retail concept focused on younger customers and up-and-coming third-party designers.

It achieved high growth and profitability through the 1980s and much of the 1990s, with its extensive collections of T-shirts, jeans, and “smart casual” work clothes. More than 90% of Gap’s production was outsourced from outside the United States and shipped to its stores, most of which were based in the United States. Like many typical industry competitors, it had long lead times between design, manufacturing, and in-store arrival.

Gap had experienced challenging results in recent years. Supply chains had become too long, the market was saturated, and the company lacked a clear positioning. A failed attempt to reposition to more fashion-forward clothing in 2001 led to the departure of its CEO. In June 2015, Gap announced it would close 25% of its North American stores over the next few years.<sup>41</sup> One analyst complained that the company’s response to weak sales growth had been to take the “easy” way out of this problem by pushing lower-priced products in order to generate sales rather than focusing on its higher-end brand, Banana Republic.<sup>42</sup> Moreover, while Gap’s sticker prices tended to be, on average, similar to those at Zara, Gap relied heavily on promotional pricing, including “Gap Cash,” where customers who purchased goods could credit a percentage of that purchase price when buying items at a later date. Art Peck, who was named CEO of Gap in 2015, had described attempts to wean customers off the constant promotional pricing cycle as a “game of chicken”—with decreased promotional activity leading to weak sales.<sup>43</sup>

As of 2017, Gap had 3,165 company-owned and 429 franchised locations in North America, Europe, and Asia. Gap's products were manufactured by third party factories, none of which Gap owned. The company utilized 800 vendors in 50 countries. Substantially all of these factories were outside the United States, with 25% of 2017 inventory purchases from factories in Vietnam, and 22% from China.

Peck favored a decentralized approach to product design. Following the 2015 departure of Gap's creative director, Rebekka Bay, who had joined the company in 2012 from H&M, Peck opted not to replace her and to let go of the creative directors for the company's other brands, calling them "false messiahs." In their place, Peck installed operational executives at the head of each of the company's brands and pushed product teams to focus on increasingly available data on customer tastes. "There is now science and art, and they can come together," Peck stated.<sup>44</sup> Peck also focused on reducing product lead times. In 2017, he announced that the time frame from design board to store on some products had fallen from 10 months to 10 weeks.<sup>45</sup>

Gap began selling clothes online in the United States in 1997 and started online sales outside the United States in August 2010. To support its online operations, Gap had invested in local distribution centers in the U.K., from which it serviced online operations in Europe, Canada, China, and the United States. Additionally, in countries where some Gap brands did not have a physical presence, Gap partnered with online vendors.<sup>46</sup> Approximately 16% of Gap's total sales were online.<sup>47</sup> In the United States, Gap charged \$7 for standard shipping on orders below \$50; shipping was free on orders of \$50 or more. Items purchased online could be returned or exchanged online or in store for no charge.

(See Exhibit 11 for selected financial data.)

### *Hennes & Mauritz*

Hennes & Mauritz (H&M) was founded in Västerås, Sweden, in 1947. By 2018, H&M had more than 4,700 stores in 69 markets. Only 219 of the company's stores were franchised. Franchised stores were primarily in the Middle East. The company also offered online sales in 44 markets. H&M had a number of retail concepts, including H&M; COS; Weekday; Cheap Monday; Monki; H&M Home; & Other Stories; and Arket. H&M put out a spring and a fall collection, in line with traditional apparel industry practices, but also offered a number of sub-collections to keep merchandise fresh.

In 2008, H&M expanded into home furnishings. Over the years, H&M had launched a number of high-profile collaborations with well-known designers, including Karl Lagerfeld, Stella McCartney, Viktor & Rolf, Roberto Cavalli, Marimekko, Matthew Williamson, and Jimmy Choo. The company had also released clothing collections designed with pop stars, including Madonna and Kylie Minogue.

Like Zara, H&M was considered a "fast-fashion" retailer. It aimed to "offer fashion and quality at the best price in a sustainable way."<sup>48</sup> H&M's sticker prices were slightly below Zara's, and its stores tended to offer a larger product assortment, i.e., more stock keeping units (SKUs). At

H&M, however, stock was replenished less frequently. And its customer base was younger than the typical Zara customer—15 to 25 years old, versus 18 to 35 for Zara.<sup>49</sup>

H&M had a team of approximately 150 designers and 100 buyers based in Sweden who created its clothing collections. Production was outsourced to a network of 800 suppliers; 40% of production was done in Europe, and 60% in Asia. (At Inditex, on the other hand, 59% of items were produced at factories in Spain and neighboring countries.)<sup>50</sup> Product logistics were managed by a network of nearly 30 production offices, close to the company's suppliers. These offices selected suppliers, reviewed samples, and checked quality. Similar to the method employed by Inditex, trendier products with shorter lead times were produced in Europe.<sup>51</sup>

H&M's online business accounted for 13% of the company's total 2017 sales, and 22% of H&M profits.<sup>52</sup> Analysts criticized the lack of integration between H&M's online and physical shopping channels—in-store pickups were available only in the U.K., and in-store returns were available in only one-third of markets where H&M had an online presence.<sup>53</sup> In the United States, H&M offered free shipping on orders over \$40. Below that amount, standard shipping was \$3.99 per order. Items could be returned in store (no charge) or via mail (at a cost of \$5.99).<sup>54</sup> In the United Kingdom, H&M launched H&M Club in 2017. Shoppers who signed up for this free loyalty program earned points with every purchase and received other perks, such as free online shipping and birthday discounts.<sup>55</sup>

In recent years, H&M had struggled. Sales grew only 4% in 2017, and profits declined. Analyst Michael Dart commented,

Consumers have felt that H&M has been somewhat drab and not on trend as much as competitors...With a slower supply chain (unlike super-fast Zara), they have not responded as quickly to rapid shifts in taste and increasing fragmentation in the consumer market with many more small segments. As a result, they have had more markdowns, promotions and less inspiration for the consumer. It's a formula for sagging results.<sup>56</sup>

In response to its recent challenges, H&M had launched a turnaround plan that included improved online offering and improved stock management using RFID technology.<sup>57</sup> Looking forward, company targets included 10% to 15% sales growth in local currencies, diversification of categories to reduce dependence on apparel, expansion of its brand portfolio, and online growth.<sup>58</sup>

(See Exhibit 12 for selected financial data.)

## A Sustainability Dilemma

### ENVIRONMENTAL ACTIVISM AND FAST FASHION

Led by Zara, the fast fashion sector was valued at close to \$99 billion USD in 2022.<sup>59</sup> Yet, even before Zara rose to market prominence, social activists had publicized the risks that the dominant business practices of fashion retail posed to the natural environment. According to

a Morningstar report in 2022, the fashion industry was responsible for 10% of annual carbon emissions worldwide, 20% of wastewater is used for fabric dyeing and treatment, and 190,000 metric tons of microplastic pollution from textile manufacturing each year end up in the Earth's oceans (about 35% of the total).<sup>60</sup> In addition, as fast fashion retailers like Zara shifted away from natural materials, such as cotton, toward synthetic fabrics, such as polyester, fast fashion's per-garment carbon footprint was 25% larger than the traditional fashion retailer. Finally, the same Morningstar report found that "85% of the clothing that Americans consume is sent to landfills as solid waste...per year", most of which is non-biodegradable.<sup>61, 62</sup> Therefore, although the average fast fashion retailer produced about same total volume of apparel each year as an average traditional fashion retailer, its rapid turnover of clothing lines encouraged more frequent buying and consequently, more waste.

Although climate change activists had long surfaced the harms that the fashion industry posed to the environment, until 2015, the issue lacked widespread exposure among the general public. A watershed moment came on April 24, 2015 when the documentary film *The True Cost* premiered at the Cannes Film Festival, coinciding with Fashion Revolution Day. The documentary aimed to shed light on labor practices and the environmental cost of fast fashion's business model. Although it received mixed critical reviews, the film ultimately reached tens of millions of viewers across streaming platforms. By 2018, other climate change activism organizations, such as the Sunrise Movement in US and Extinction Rebellion in the UK had attracted millions to their protest campaigns, explicitly targeting fashion retailers. In the years since, climate change protests had become fixtures outside of major fashion events. These protests achieved social media virality on October 5, 2021 when a climate activist associated with Extinction Rebellion walked the entire length of runway at the Louis Vuitton show during Paris Fashion Week, carrying a banner with the words "Overconsumption = Extinction."<sup>63</sup>

### **ZARA'S PLEDGES AND PRACTICES**

In addition to pressure from social activists, Inditex and its competitors also faced calls from shareholders and investors that were increasingly benchmarking their performance against emerging ESG (environment, social, and governance) standards. For example, in 2022, among public companies, 33% of shareholder resolutions concerning social and environmental impact were approved, an increase from a 22% approval rate just five years earlier.<sup>64</sup> Influential shareholders, such as Blackrock, had also pledged to vote against appointing directors who did not commit to acting meaningfully on issues such as climate change. The wave of shareholder activism was felt especially in the fast fashion sector. Even private companies like Shein sought to appoint new executives focused on raising its ESG profile as it prepared to go public out of concern that investors would object to the company's supply chain practices.<sup>65</sup>

Inditex's most public response to critics came in the form of an announcement in July 2019 to commit to several goals.<sup>66</sup> Most of its commitments concerned the usage of materials, including converting to 100% sustainable cotton, zero waste in offices and logistics centers, and eliminating single-use packaging by 2023. By 2025, the company promised to use



sustainable linen across all production lines, move to 100% recycled polyester, and reduce water use by 25%. The loftiest goal Inditex set for itself was to reach zero emissions by 2040.<sup>67</sup>

To enforce these commitments, Zara pledged to work with its manufacturing and supplier partners to restructure their sourcing, design, and production processes. Doing so, however, required sustained long-term investments of both human and financial capital, raising the company's costs significantly. The high cost of producing sustainable fashion, according to industry analysts, was largely why only luxury or niche brands, which had considerably larger profit margins, chose to engage in sustainable production.

Furthermore, although Zara was public in its commitments, other critics suggested that Zara's goals were simply another case of "greenwashing": deploying seemingly environmentally responsible strategies that are mainly meant to market the "greenness" of a company's practices while actually improving the company's environmental performance only marginally, if at all.<sup>68</sup> Although many acknowledged that these were steps in the right direction, Zara's proposed changes did not address the core reason behind the environmental harm imposed by the company and its competitors: the fast-fashion business model itself. Because the company relied on quick turnovers, its profitability came from customers buying *and discarding* large amounts of Zara clothing, which in turn meant excessive amounts of waste. In other words, the sheer volume of production was the main culprit for many climate change activists while the culture of widespread affordable yet trendy clothes made it harder for consumers to quit fast fashion.

Zara and other fast fashion retailers faced an even more vexing dilemma with the growing buying power and cultural influence of younger consumers. Gen Z shoppers – defined as those born between 1997 and 2012 – were among the loudest voices in agitating for environmental action. Climate change was often being their number one issue concern when polled across public opinion surveys.<sup>69</sup> Likewise, among fashion resale and thrifting companies such as Depop, Gen Z shoppers also composed the majority of their consumer base.

Yet, at the same time, younger shoppers were also a major consumer force sustaining the growth and popularity of fast fashion retailers, which included both established players like Zara and newcomers like Shein. Driving the attraction to fast fashion was the prominence of social media and creator platforms. In particular, fashion influencers, with millions of followers on TikTok and Instagram, frequently displayed their latest purchases, channeling sales directly to the very companies that many of their peers castigated for their poor environmental performance.<sup>70 71</sup>

### **SHEIN: FASTER AND CHEAPER**

On top of pressure from climate change activists and young consumers pulling the company in opposite directions, Zara also contended with the emergence of an influential global rival. Launched in 2012 in Nanjing, China, Shein was an online-only fast fashion retailer that had cultivated a sprawling network of suppliers across China. Although compared to Zara, there were cheaper fast fashion retailers, such as Primark, and faster digital-first retailers, such as Boohoo, by 2018, no competitor could rival Shein in both speed and affordability. Whereas Zara's design team delivered tens of thousands of designs per year, Shein produced designs

at a rate of 700 to 1000 per day.<sup>72</sup> In terms of product releases, whereas Zara's online presence touts 600 new products each day, Shein's online inventory introduces 6,000 new items daily.<sup>73</sup> The sheer scale meant that almost a nearly identical piece on Shein was orders of magnitudes cheaper than it was on Zara (see Exhibit 13 for an example of a "Zara vs Shein" price comparison video on TikTok).

Moreover, Shein's marketing, design, production, and distribution were tightly anchored to its presence on social media, amassing data from trendsetting fashion influencers and integrating their insights directly into the design process. The ultra-fast fashion model pioneered by Shein, however, also meant greater reliance on even less durable synthetic materials in production and a higher proportion of shipping by air freight in distribution. As a result, a mounting backlash intensified against the company as climate activists and some fashion influencers alike discouraged shoppers from buying clothes from Shein.<sup>74</sup> Despite these activist efforts, Shein remained steadfast toward a planned IPO in 2024, as the private company was valued at \$100 Billion in its latest round of financing in April 2022, exceeding the market capitalization of Inditex and H&M combined.

## Looking Ahead

As Inditex eyed its goal of achieving net zero emissions by 2040, it was caught between two extremes. On the one hand, its efforts to achieve greater sustainability performance was criticized as greenwashing by environmental activists as not doing enough. On the other hand, restructuring Inditex production and supply chain to be more sustainable opened the door wider for ultra-fast rivals like Shein to seize greater market share. Furthermore, alternative business models, such as ThredUp and TheRealReal, which innovated in the resale market, and Rent the Runway, which encouraged reuse, were positioned as greener alternatives while also growing in popularity among consumers, creating the possibility that completely novel business models might offer a considerable challenge to fast fashion. With these contravening pressures, executives at Inditex faced a critical strategic decision about the future direction of the company.

## Guiding Questions

1. In traditional retail, does Zara have a competitive advantage over competitors like Gap and H&M? If so, what trade-offs make Zara's strategy difficult for competitors like Gap and H&M to implement?
2. Would you describe Zara's manufacturing and distribution strategies as efficient vis-à-vis Gap and H&M? Why or why not?
3. Going forward, which competitors should Zara view as its main rivals – (1) brick-and-mortar fashion retailers like Gap and H&M, (2) online only fast fashion retailers like Shein and Boohoo, (3) alternative fashion reuse/resale/rental players like Rent The Runway and ThredUp?
4. To what extent should Zara transform its business model and operations to achieve greater sustainability performance? What are the strategic trade-offs of doing less or doing more?

## Exhibits

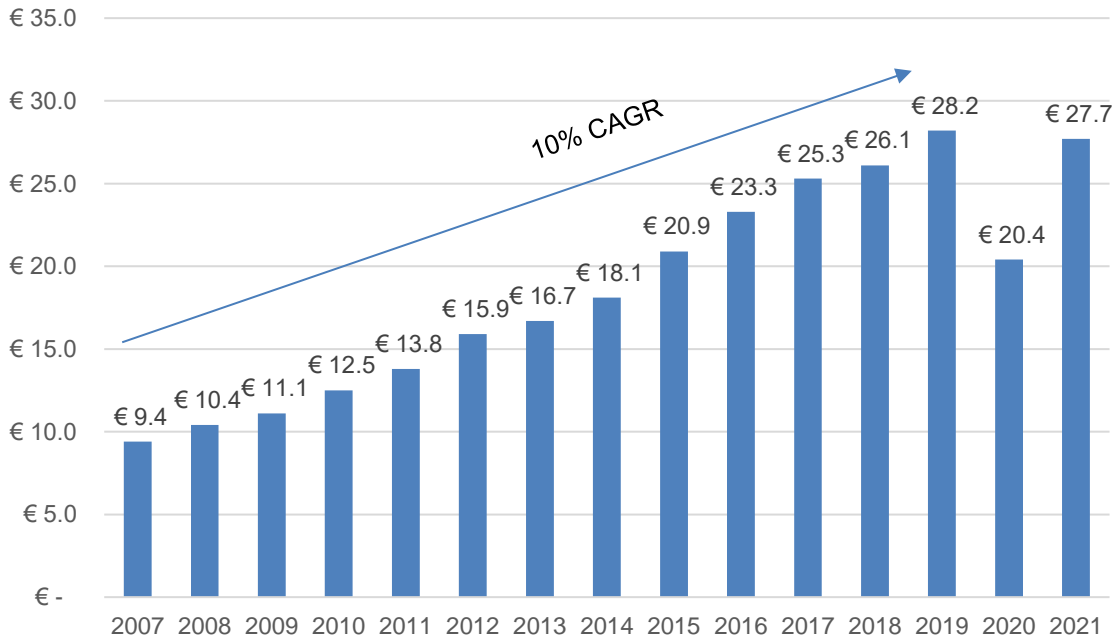
### Exhibit 1

#### Inditex—Time Line

|      |   |
|------|---|
| 1963 | Inditex is founded in La Coruña, northwest Spain.   |
| 1975 | The first Zara store opens.   |
| 1983 | Zara expands across Spain.  |
| 1984 | Zara builds a state-of-the-art logistics center in Arteixo, Spain.  |
| 1988 | Zara goes international, opening a store in Porto, Portugal.  |
| 1989 | Zara goes transatlantic, opening its first U.S. store on Lexington Avenue in NYC.   |
| 1991 | Pull&Bear and Massimo Dutti join Inditex.   |
| 2001 | Oysho is launched, and Inditex goes public.   |
| 2003 | Zara Home is launched.  |
| 2004 | Inditex reaches the 2,000-store milestone.  |
| 2005 | Pablo Isla becomes deputy chairman and CEO.   |
| 2007 | Zarahome.com launches, becoming Inditex's first online store.   |
| 2008 | Inditex creates its eighth brand, Uterqüe.  |
| 2010 | Zara begins to sell its products online in September, and by the end of 2010, the online platform is live in 16 European markets. |
| 2013 | Inditex opens new high-profile flagship stores: Zara on the Champs-Élysées in Paris, Oysho and Zara Home in Shanghai, etc.        |
| 2014 | Inditex opens a new logistics center in Cabanillas, Spain.  |
| 2015 | Inditex reaches the 7,000-store milestone and starts a profit-sharing plan for employees.   |
| 2017 | Zara.com is launched in India, Malaysia, Singapore, Thailand, and Vietnam.  |
| 2019 | Inditex releases first annual sustainability report, committing to net zero emissions by 2040                                     |

Source: Case writer from company website, <https://www.inditex.com/about-us/our-story>.

## Exhibit 2 Inditex—Sales Growth



Note: CAGR calculated based on 2007-2021 revenue data.

Source: Company financials.

## Exhibit 3

### Inditex—Segment Financial Summary and Sales by Region

(Euros in millions)

Segment Financials, 2021

|                               | Zara /<br>Zara Home | Bershka | Other | Inter-segment | Total  |
|-------------------------------|---------------------|---------|-------|---------------|--------|
| Sales to third parties        | 19,714              | 2,178   | 5,955 | (131)         | 27,716 |
| Profit before taxes           | 2,838               | 330     | 991   | 39            | 4,199  |
| Amortization and depreciation | 2,040               | 233     | 623   | 5             | 2,901  |
| Segment total assets          | 23,693              | 1,426   | 3,826 |               | 28,945 |
| ROCE                          | 25%                 | 32%     | 37%   |               | 28%    |
| Number of stores              | 2,489               | 971     | 3,017 |               | 6,477  |

Sales by Region, 2021

|                            | Net Sales     |               | Non-current assets |               |
|----------------------------|---------------|---------------|--------------------|---------------|
|                            | 2021          | 2020          | 31/01/2022         | 31/01/2021    |
| Spain                      | 4,267         | 3,229         | 4,657              | 4,449         |
| Rest of Europe             | 14,051        | 10,430        | 5,901              | 6,068         |
| Americas                   | 4,877         | 2,763         | 2,051              | 2,032         |
| Asia and rest of the world | 4,521         | 3,980         | 1,215              | 1,255         |
| <b>Total</b>               | <b>27,716</b> | <b>20,402</b> | <b>13,824</b>      | <b>13,805</b> |

Source: Inditex Annual Report 2021.

## Exhibit 4

### Zara Locations by Country in 2022

|                |     |                |    |                    |             |
|----------------|-----|----------------|----|--------------------|-------------|
| SPAIN          | 256 | UKRAINE        | 12 | GUATEMALA          | 3           |
| MAINLAND CHINA | 133 | ARGENTINA      | 11 | JORDAN             | 3           |
| FRANCE         | 116 | CROATIA        | 10 | LATVIA             | 3           |
| UNITED STATES  | 99  | IRELAND        | 10 | LEBANON            | 3           |
| ITALY          | 92  | CHILE          | 9  | LUXEMBOURG         | 3           |
| RUSSIA         | 86  | TAIWAN, CHINA  | 9  | PUERTO RICO        | 3           |
| MEXICO         | 80  | EGYPT          | 9  | DOMINICAN REPUBLIC | 3           |
| JAPAN          | 75  | PHILIPPINES    | 9  | ARMENIA            | 2           |
| PORTUGAL       | 72  | HUNGARY        | 9  | BAHREIN            | 2           |
| GERMANY        | 70  | MALAYSIA       | 8  | BELARUS            | 2           |
| UNITED KINGDOM | 59  | SINGAPORE      | 8  | MACAO SAR          | 2           |
| SAUDI ARABIA   | 45  | SWEDEN         | 8  | COSTA RICA         | 2           |
| BRAZIL         | 43  | CYPRUS         | 7  | ECUADOR            | 2           |
| POLAND         | 42  | KUWAIT         | 7  | ESTONIA            | 2           |
| GREECE         | 39  | SERBIA         | 7  | HONDURAS           | 2           |
| TURKEY         | 39  | BULGARIA       | 6  | NORTH MACEDONIA    | 2           |
| SOUTH KOREA    | 37  | FINLAND        | 6  | PANAMA             | 2           |
| CANADA         | 32  | QATAR          | 6  | URUGUAY            | 2           |
| NETHERLANDS    | 28  | SOUTH AFRICA   | 6  | VIETNAM            | 2           |
| BELGIUM        | 27  | KAZAKHSTAN     | 5  | ALBANIA            | 1           |
| ISRAEL         | 25  | LITHUANIA      | 5  | ANDORRA            | 1           |
| ROMANIA        | 25  | NORWAY         | 5  | ARUBA              | 1           |
| INDIA          | 21  | CZECH REPUBLIC | 5  | EL SALVADOR        | 1           |
| SWITZERLAND    | 20  | TUNISIA        | 5  | ICELAND            | 1           |
| AUSTRALIA      | 18  | DENMARK        | 4  | MALTA              | 1           |
| INDONESIA      | 16  | SLOVAKIA       | 4  | MONACO             | 1           |
| UAE            | 15  | SLOVENIA       | 4  | MONTENEGRO         | 1           |
| MOROCCO        | 13  | GEORGIA        | 4  | NICARAGUA          | 1           |
| AUSTRIA        | 12  | PERU           | 4  | NEW ZEALAND        | 1           |
| HONG KONG SAR  | 12  | ALGERIA        | 3  | OMAN               | 1           |
| COLOMBIA       | 12  | AZERBAIJAN     | 3  | PARAGUAY           | 1           |
| THAILAND       | 12  | BOSNIA         | 3  | <b>TOTAL</b>       | <b>1939</b> |

Note: Store count is as of January 2022.

Source: Inditex Annual Report 2021.

## Exhibit 5

### Hourly Labor Cost Textile Industry, 2014

|             | USD /<br>Hour | Indexed to<br>U.S. = 100 |                | USD /<br>Hour | Indexed to<br>U.S. = 100 |
|-------------|---------------|--------------------------|----------------|---------------|--------------------------|
| Switzerland | \$51.36       | 290                      | Estonia        | \$8.09        | 46                       |
| Australia   | \$38.67       | 218                      | Czech Republic | \$7.89        | 45                       |
| Austria     | \$35.42       | 200                      | Latvia         | \$7.25        | 41                       |
| Belgium     | \$34.77       | 196                      | Poland         | \$5.70        | 32                       |
| France      | \$31.61       | 179                      | Turkey         | \$5.48        | 31                       |
| Germany     | \$30.03       | 170                      | Argentina      | \$3.82        | 22                       |
| Ireland     | \$25.33       | 143                      | Colombia       | \$3.27        | 18                       |
| Japan       | \$25.10       | 142                      | Brazil         | \$3.22        | 18                       |
| UK          | \$24.01       | 136                      | Tunisia        | \$3.18        | 18                       |
| Italy       | \$22.67       | 128                      | Morocco        | \$3.12        | 18                       |
| Spain       | \$19.37       | 109                      | Mexico         | \$3.06        | 17                       |
| U.S.        | \$17.71       | 100                      | South Africa   | \$2.94        | 17                       |
| Israel      | \$12.86       | 73                       | Peru           | \$2.78        | 16                       |
| Taiwan      | \$10.61       | 60                       | China          | \$2.65        | 15                       |
| South Korea | \$10.22       | 58                       | Bulgaria       | \$2.33        | 13                       |
| Portugal    | \$9.64        | 54                       | Thailand       | \$2.26        | 13                       |
| Slovenia    | \$9.39        | 53                       | Malaysia       | \$2.12        | 12                       |

Source: Werner International, <http://www.werner-newtwist.com/en/news1-vol-011/index.htm>.



## Exhibit 6

### Suppliers and Factories by Country

|   | Spain  | Portugal | Morocco | Turkey  | India   | Bangladesh |
|---|--------|----------|---------|---------|---------|------------|
| Suppliers with purchase during the year | 208    | 170      | 121     | 175     | 136     | 94         |
| Active factories in the year            | 466    | 1,357    | 283     | 1,427   | 394     | 262        |
| Workers in active factories             | 10,298 | 49,714   | 73,772  | 192,173 | 200,139 | 479,859    |

|   | Vietnam | Cambodia | China   | Brazil | Argentina | Pakistan |
|---|---------|----------|---------|--------|-----------|----------|
| Suppliers with purchase during the year | 4       | 1        | 393     | 15     | 45        | 42       |
| Active factories in the year            | 134     | 125      | 1,654   | 65     | 83        | 107      |
| Workers in active factories             | 152,101 | 126,843  | 368,428 | 10,712 | 5,099     | 125,316  |

Source: Company website, [http://static.inditex.com/annual\\_report\\_2016/en/our-priorities/sustainable-management-of-the-supply-chain/strategic-plan-2014-2018-2016-review.php](http://static.inditex.com/annual_report_2016/en/our-priorities/sustainable-management-of-the-supply-chain/strategic-plan-2014-2018-2016-review.php).

## Exhibit 7

### The “Zara Gap”

| Zara         | Typical European Specialty Apparel Retailer | Typical U.S. Specialty Apparel Retailer | Typical U.S. Department Store |
|--------------|---|---|-------------------------------|
| 15% of items | 40% of items                                | 60% of items                            | 70% of items                  |
| 15% markdown | 30% markdown                                | 40% markdown                            | 40% markdown                  |

Source: Bain & Co., from “The Zara Gap: Retail’s Big Arbitrage,” October 28, 2014, <https://sourcingjournal.com/topics/retail/zara-gap-retails-big-arbitrage-18976/>.

## Exhibit 8

### Inditex—Company Managed and Franchised Stores, 2022

Store count

| Concept       | Company Managed | Franchised   | Total        |
|---------------|-----------------|--------------|--------------|
| Zara          | 1,684           | 255          | 1,939        |
| Zara Kids     | 68              | -            | 68           |
| Zara Home     | 402             | 80           | 482          |
| Pull&Bear     | 706             | 158          | 864          |
| Massimo Dutti | 560             | 122          | 682          |
| Bershka       | 804             | 167          | 971          |
| Stradivarius  | 717             | 198          | 915          |
| Oysho         | 472             | 84           | 556          |
| <b>Total</b>  | <b>5,413</b>    | <b>1,064</b> | <b>6,477</b> |

Sales %

| Concept                   | Company Managed | Franchised |
|---------------------------|-----------------|------------|
| Zara (Zara and Zara Home) | 88%             | 12%        |
| Pull&Bear                 | 82%             | 18%        |
| Massimo Dutti             | 84%             | 16%        |
| Bershka                   | 82%             | 18%        |
| Stradivarius              | 77%             | 23%        |
| Oysho                     | 84%             | 16%        |
| <b>Total</b>              | <b>86%</b>      | <b>14%</b> |

Source: Inditex Annual Report 2021.

## Exhibit 9

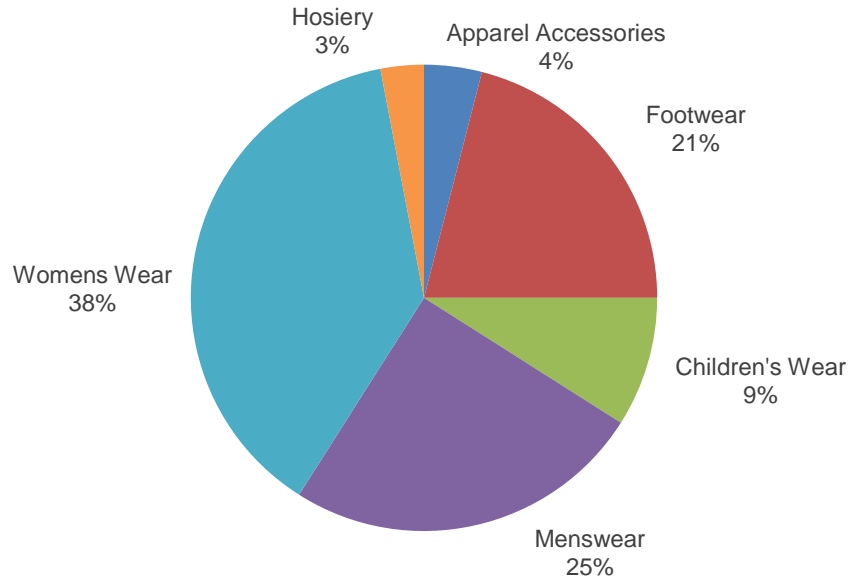
### Inditex: Selected Financial Data (€ in millions)

|                                   | Fiscal year ended January 31* |        |        |        |        |
|-----------------------------------|-------------------------------|--------|--------|--------|--------|
|                                   | 2022                          | 2021   | 2020   | 2019   | 2018   |
| <b>Income Statement Key Items</b> |                               |        |        |        |        |
| Revenues                          | 27,716                        | 20,402 | 28,286 | 26,145 | 25,336 |
| COGS**                            | 11,902                        | 9,013  | 12,479 | 11,329 | 13,878 |
| Gross Profit                      | 15,814                        | 11,390 | 15,806 | 14,816 | 11,458 |
| Gross Margin                      | 57.10%                        | 55.80% | 55.90% | 56.70% | 45.20% |
| SG&A                              | 8,596                         | 6,807  | 8,176  | 9,329  | 6,142  |
| EBITDA                            | 7,183                         | 4,552  | 7,598  | 5,457  | 5,511  |
| EBITDA Margin                     | 25.92%                        | 22.31% | 26.86% | 20.87% | 21.80% |
| Operating Income                  | 4,282                         | 1,507  | 4,681  | 4,357  | 4,429  |
| Net Income                        | 3,250                         | 1,104  | 3,647  | 3,448  | 3,368  |
| <b>Balance Sheet Key Items</b>    |                               |        |        |        |        |
| Total Assets                      | 28,945                        | 26,418 | 28,391 | 21,684 | 20,231 |
| Total Cash and ST Investments     | 9,395                         | 7,574  | 7,919  | 6,795  | 6,403  |
| Total Receivables                 | 1061                          | 972    | 954    | 928    | 888    |
| Inventories                       | 3,042                         | 2,321  | 2,269  | 2,716  | 2,685  |
| Total Current Assets              | 13,602                        | 10,957 | 11,414 | 10,620 | 10,147 |
| Net Property Plant & Equipment    | 7,481                         | 7,401  | 8,355  | 8,339  | 7,644  |
| Accounts Payable                  | 4,636                         | 3,436  | 3,985  | 3,744  | 3,577  |
| Total Current Liabilities         | 6,338                         | 6,338  | 7,306  | 5,383  | 5,173  |
| LT Debt & Capital Leases          | 1                             | 3      | 6      | 5      | 4      |
| Total Liabilities                 | 13,187                        | 11,867 | 13,442 | 7,064  | 6,709  |
| Total Equity                      | 15,759                        | 14,550 | 14,949 | 14,682 | 13,522 |
| Common Shares Outstanding         | 3,114                         | 3,115  | 3,114  | 3,114  | 3,114  |

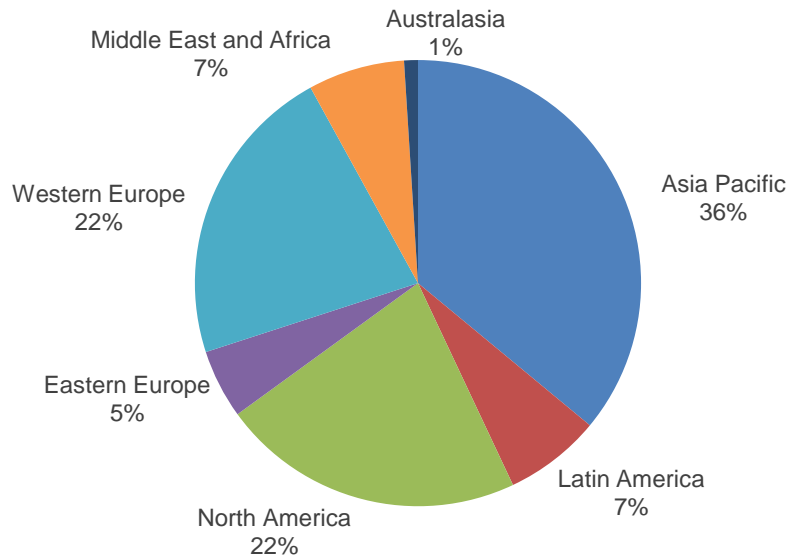
Source: Inditex Annual Reports, 2018-2021

## Exhibit 10

### Global Apparel and Footwear Sales—By Category and Region



Source: "World Market for Apparel and Footwear," Euromonitor International, April 2018.



Source: "World Market for Apparel and Footwear," Euromonitor International, April 2018.

## Exhibit 11

### Gap: Selected Financial Data (\$ in millions)

|                                   | Fiscal year ended: |         |         |        |        |
|-----------------------------------|--------------------|---------|---------|--------|--------|
|                                   | 1/29/22            | 1/30/21 | 1/31/20 | 2/1/19 | 2/3/18 |
| <b>Income Statement Key Items</b> |                    |         |         |        |        |
| Revenues                          | 16,670             | 13,800  | 16,383  | 16,580 | 15,855 |
| COGS *                            | 9,514              | 8,601   | 9,700   | 9,693  | 9,789  |
| Gross Profit                      | 7,156              | 5,199   | 6,683   | 6,887  | 6,066  |
| Gross Margin                      | 42.93%             | 37.67%  | 40.79%  | 41.54% | 38.30% |
| SG&A                              | 5,854              | 5,003   | 5,117   | 4,982  | 4,562  |
| EBITDA                            | 1,302              | 196     | 1,566   | 1,905  | 2,063  |
| EBITDA Margin                     | 7.81%              | 1.42%   | 9.56%   | 11.49% | 13.01% |
| Operating Income                  | 323                | (1102)  | 528     | 1,322  | 1,424  |
| Net Income                        | 256                | (665)   | 351     | 1,003  | 848    |
| <b>Balance Sheet Key Items</b>    |                    |         |         |        |        |
| Total Assets                      | 12,761             | 13,769  | 13,679  | 8,049  | 7,989  |
| Total Cash and ST Investments     | 877                | 2,398   | 1,654   | 1,369  | 1,783  |
| Total Receivables                 | 399                | 363     | 316     | 359    | 282    |
| Inventories                       | 3,018              | 2,451   | 2,156   | 2,156  | 1,997  |
| Total Current Assets              | 5,165              | 6,008   | 4,516   | 4,251  | 4,568  |
| Net Property Plant & Equipment    | 3,037              | 2,451   | 3,122   | 2,912  | 2,805  |
| Accounts Payable                  | 1,951              | 1,743   | 1,174   | 1,126  | 1,181  |
| Total Current Liabilities         | 4,077              | 3,884   | 3,209   | 2,174  | 2,461  |
| LT Debt & Capital Leases          | 1,484              | 2,216   | 1,249   | 1,249  | 1,249  |
| Total Liabilities                 | 10,039             | 11,155  | 10,363  | 4,496  | 4,845  |
| Total Equity                      | 2,722              | 2,614   | 3,316   | 3,553  | 3,144  |
| Common Shares Outstanding         | 371                | 374     | 371     | 378    | 389    |

\*COGS include occupancy expenses.

Source: Gap Annual Reports, 2018-2021.

## Exhibit 12

### H&M: Selected Financial Data (SEK in millions)

|                                   | Fiscal year ended November 30 |         |         |         |         |
|-----------------------------------|-------------------------------|---------|---------|---------|---------|
|                                   | 2021                          | 2020    | 2019    | 2018    | 2017    |
| <b>Income Statement Key Items</b> |                               |         |         |         |         |
| Revenues                          | 198,967                       | 187,031 | 232,755 | 210,400 | 200,004 |
| COGS                              | 93,961                        | 93,487  | 110,302 | 99,513  | 91,914  |
| Gross Profit                      | 105,006                       | 93,544  | 122,453 | 110,887 | 108,090 |
| Gross Margin                      | 52.78%                        | 50.02%  | 52.61%  | 52.70%  | 54.00%  |
| SG&A                              | 69,048                        | 66,440  | 94,626  | 86,281  | 87,521  |
| EBITDA                            | 35,958                        | 27,104  | 27,827  | 24,606  | 29,793  |
| EBITDA Margin                     | 18.07%                        | 14.49%  | 11.96%  | 11.69%  | 14.40%  |
| Operating Income                  | 15,255                        | 3,099   | 17,346  | 15,493  | 20,569  |
| Net Income                        | 11,010                        | 1,243   | 13,443  | 12,227  | 16,184  |
| <b>Balance Sheet Key Items</b>    |                               |         |         |         |         |
| Total Assets                      | 185,263                       | 179,781 | 185,289 | 171,754 | 106,562 |
| Total Cash and ST Investments     | 27,403                        | 27,471  | 35,298  | 23,434  | 9,718   |
| Total Receivables                 | 14,134                        | 12,787  | 12,185  | 12,070  | 9,049   |
| Inventories                       | 39,331                        | 37,306  | 36,867  | 35,866  | 33,712  |
| Total Current Assets              | 83,138                        | 78,986  | 85,014  | 71,749  | 55,746  |
| Net Property Plant & Equipment    | 81,018                        | 79,662  | 79,073  | 82,412  | 39,818  |
| Accounts Payable                  | -                             | 20,382  | -       | -       | 7,215   |
| Total Current Liabilities         | 63,749                        | 61,177  | 62,849  | 56,456  | 40,723  |
| LT Debt & Capital Leases          | 57,067                        | 54,557  | 54,060  | 55,785  | 350     |
| Total Liabilities                 | 124,548                       | 119,763 | 120,880 | 116,114 | 46,849  |
| Total Equity                      | 60,715                        | 60,018  | 64,409  | 55,640  | 59,713  |
| Common Shares Outstanding         | 1,655                         | 1,655   | 1,655   | 1,655   | 1,655   |

Source: H&M Annual Reports, 2018-2021.

## Exhibit 13

### Screenshot of Influencer Video Posted to TikTok Comparing Zara and Shein Clothing



Source: Video posted on TikTok by @luciniastyle on December 29, 2021, <https://www.tiktok.com/@luciniastyle/video/7047264703201971461>.

## Endnotes

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