

Títol : Zara and Benetton: Comparison of two business models

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CHAPTER 1

INTRODUCTION

The aim of this study is to analyze how two companies, in this case Zara and Benetton, have achieved their success through various business strategies and how they influenced each other. In particular, the work will focus on gradual change and development of the relationship between suppliers and retailers in order to increase enterprise efficiency and customer satisfaction.

In that regard, the aim is to demonstrate the important role played by IT to achieve the proposed results.

This project was born from a desire to implement the knowledge acquired during my university studies in Engineering Business Management at the University La Sapienza in Rome and apply them in a digital environment, making use also of my studies at faculty FIB in Barcelona.

The project, despite has an economic approach, wants to highlight how the computer branch may be well placed in this context, where for the computer branch not only means the area of programming but also the importance of technology and innovation. Developed separately, this project is complementary to my colleague Chiara Pirone that will analyze mainly the vertical integration. In this way we want to give an overview of the functioning of the two companies.

Below is described how the project is structured.

The next chapter will explain the entire project and the various reasons for which it was developed.

Chapter 3 has the purpose to give an overview of the basic concepts behind the study of a company that operates in fast fashion, to facilitate the understanding of following chapters.

Chapter 4 and 5 study in great detail the performance of enterprises, respectively Zara and Benetton, emphasizing their business model and therefore their strengths and weaknesses.

Chapter 6 puts the target on improving efficiency of the company for a major success with clients. In this regard we will study the strategy of continuous replenishment program and related technologies which enable to use them.

Chapter 7 studies the management of the project both from an economic and temporal point of view.

Chapter 8 argues the project conclusions.

And finally, chapter 9 lists all sources necessary for the project.

CHAPTER 2

THE PROJECT

2.1 PROJECT DESCRIPTION

This project analyzes the fast fashion industry by studying two large European companies: ZARA and BENETTON.

The project has two main purpose:

- Compare the two companies on commercial profile: analyze and confront their marketing strategies that led them to international success.
- Study how the commercial relationship developed between manufacturers and retailers, focusing particularly on the strong influence by information technologies in order to improve enterprise efficiency and customer satisfaction.

2.2 PROJECT MOTIVATIONS

The development of this project comes from the following reasons:

- Interest in companies operating in the fashion market
- Application of knowledge acquired during university studies in Engineering Business Management.
- Interest in the study of Spanish firms, examined closely during my stay in Barcelona.
- Interest in information systems increased in the FIB.

CHAPTER 3

COMPETITIVE ADVANTAGE IN THE FAST FASHION

Fast fashion is a term used to describe clothing collections which are based on the most recent fashion trends presented at Fashion Week in both the spring and the autumn of every year. These trends are designed and manufactured quickly and cheaply to allow the mainstream consumer to take advantage of current clothing styles at a lower price. In the current scenario, fashion industry, and to be more particular, the fashion apparel segment proves to be very volatile in nature. With new trends springing up every now and then, consumers preferences keep changing in the wink of an eye. Currently business environment is going through a phase of unprecedented changes. Businesses have to respond to changes in the market, and changing consumer preferences, to remain successful and to sustain their share in the pie. Majority of the population belongs to the middle, and upper middle income category. Consumers are fashion conscious, and at the same time expect affordable prices as well. They want to adapt themselves to the changing fads, and simultaneously do not want to feel the heat on their budget. This has motivated them to go in for fast fashion apparels. Need for drastic changes in consumer demand and fashion trend is more apparent for retailers. The main strategy to do a fast fashion business is the ability to respond very quickly to the fast changing needs of the target customers, identify the trends in advance, and meet the market requirements in a rapid speed. One of the constraints for the retailers in responding quickly is the combination of inflexible systems, and lack of timely information. Adding to the pressure, merchandisers and buyers keep juggling their plans several times in a season. The main focus of fast fashion is its sustainability. Apart from financial, there are social, and environmental concerns associated with it. Maybe, the latest trend clothes are available at affordable prices. But what if they fall apart after a couple of washes? Are these apparels manufactured using a sustainable model? Some critics do argue that rather than buying clothes that look trendy to match with the latest fads, it is wise to buy a classic outfit with long term appeal. Today shopper seeks to buy clothing in a way that looks fashionable, and does not break the bank as well. Fast fashion raises the value of fashion designers. But still, it is always better to give a second thought about the cost involved, and the long term benefits before one goes for a buying decision regarding fast fashion apparels.

This chapter highlights the sources of competitive advantage that may exist inside the field of fast fashion, as shown in Figure 3.1, studying in detail the major players who are part of: H&M, Gap, Zara and Benetton.

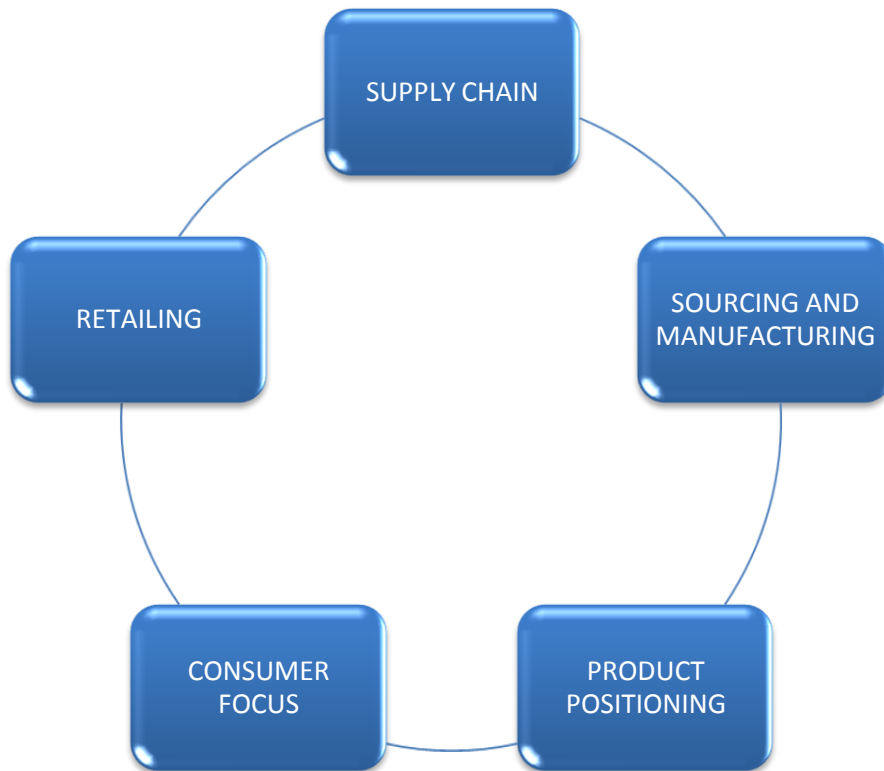


FIGURE 3.1 : THE SOURCES OF COMPETITIVE ADVANTAGE

3.1 SUPPLY CHAIN

A supply chain is a system of organizations, people, technology, activities, information and resources involved in moving a product or service from supplier to customer. Supply chain activities transform natural resources, raw materials and components into a finished product that is delivered to the end customer. In sophisticated supply chain systems, used products may re-enter the supply chain at any point where residual value is recyclable.

Supply chains are increasingly being seen as integrated entities, and closer relationships between the organizations throughout the chain can bring competitive advantage, reduce costs, and help to maintain a loyal customer base.

There are two main differences to value chains:

- Supply chains are more detailed since they incorporate not only activities.

- Supply chains connect intra-organizational value chains by products, services, and information flows.

Supply chains underlie value-chains because, without them, no producer has the ability to give customers what they want, when and where they want, at the price they want. Producers compete with each other only through their supply chains, and no degree of improvement at the producer's end can make up for the deficiencies in a supply chain which reduce the producer's ability to compete.

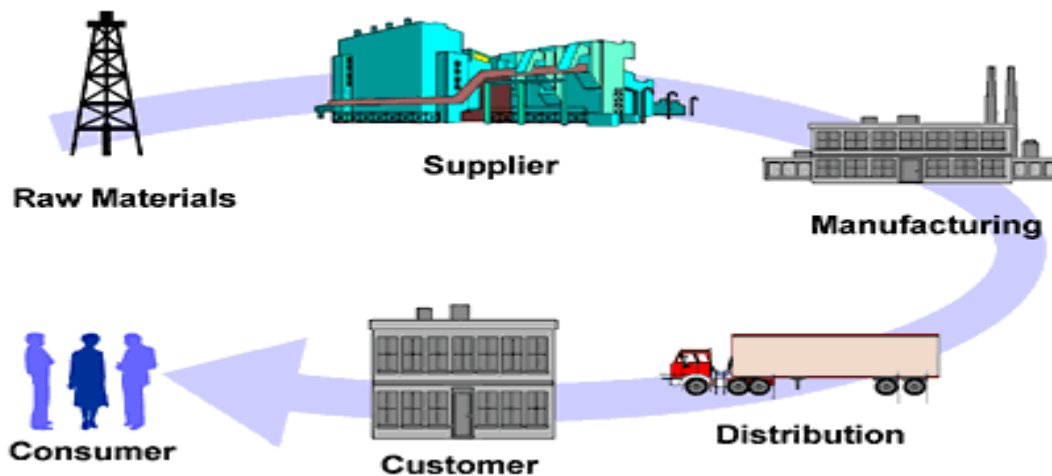


FIGURE 3.2: EXAMPLE OF SUPPLY CHAIN

A typical supply chain begins with ecological and biological regulation of natural resources, followed by the human extraction of raw material, and includes several production links (e.g., component construction, assembly, and merging) before moving on to several layers of storage facilities of ever-decreasing size and ever more remote geographical locations, and finally reaching the consumer.

All organizations have supply chains of varying degrees, depending upon the size of the organization and the type of product manufactured. These networks obtain supplies and components, change these materials into finished products and then distribute them to the customer.

Managing the chain of events in this process is what is known as supply chain management. The Council of Supply Chain Management Professionals (CSCMP) defines Supply Chain Management as follows “Supply Chain Management encompasses the planning and management of all activities involved in sourcing and procurement, conversion, and all logistics management activities. Importantly, it also includes coordination and collaboration with channel partners, which can be suppliers,

intermediaries, third-party service providers, and customers. In essence, supply chain management integrates supply and demand management within and across companies. Supply Chain Management is an integrating function with primary responsibility for linking major business functions and business processes within and across companies into a cohesive and high-performing business model. It includes all of the logistics management activities noted above, as well as manufacturing operations, and it drives coordination of processes and activities with and across marketing, sales, product design, finance and information technology.”

Effective management must take into account coordinating all the different pieces of this chain as quickly as possible without losing any of the quality or customer satisfaction, while still keeping costs down.

The first step is obtaining a customer order, followed by production, storage and distribution of products and supplies to the customer site. Customer satisfaction is paramount. Included in this supply chain process are customer orders, order processing, inventory, scheduling, transportation, storage, and customer service. A necessity in coordinating all these activities is the information service network.

In addition, key to the success of a supply chain is the speed in which these activities can be accomplished and the realization that customer needs and customer satisfaction are the very reasons for the network. Reduced inventories, lower operating costs, product availability and customer satisfaction are all benefits which grow out of effective supply chain management.

Furthermore, market demands, customer service, transport considerations, and pricing constraints all must be understood in order to structure the supply chain effectively. These are all factors, which change constantly and sometimes unexpectedly, and an organization must realize this fact and be prepared to structure the supply chain accordingly.

Today's supply chain leaders are working with their business partners to design, develop, move, store, sell and service their products with ever greater speed and economy. Now, more than ever, supply chains are regarded as sources of business value and competitive advantage. Differentiated supply chain models are emerging to address different merchandise characteristics. "One size fits all" no longer applies. Short-lifecycle fashion products require a supply chain that can cope with fast lead-times and accelerated time-to-market — tight integration with the supply base is critical. Repeatable continuity products demand integrated and optimized replenishment and forecasting. Regardless of type, all supply chains need to be supported by effective core processes and capabilities.

Supply chain leaders develop robust basic processes and disciplines, and then add new and differentiating capabilities that drive supply chain excellence. These new capabilities enable leading retailers to transform and differentiate their supply chains. Creating change in an existing supply chain can be daunting. Given the breadth and depth of impact, virtually all areas of a business are affected.

3.1.1 DECISIONS ON THREE LEVELS

Supply chain management decisions are often said to belong to one of three levels; the *strategic*, the *tactical*, or the *operational* level.

Figure 3.3 shows the three level of decisions as a pyramid shaped hierarchy. The decisions on a higher level in the pyramid will set the conditions under which lower level decisions are made.



FIGURE 3.3: HIERARCHY OF SUPPLY CHAIN DECISIONS

On the *strategic* level long term decisions are made. These are related to location, production, inventory, and transportation. Location decisions are concerned with the size, number, and geographic location of the supply chain entities, such as plants, inventories, or distribution centers. The production decisions are meant to determine which products to produce, where to produce them, which suppliers to use, from which plants to supply distribution centers, and so on. Inventory decisions are

concerned with the way of managing inventories throughout the supply chain. Transport decisions are made on the modes of transport to use. Decisions made on the strategic level are of course interrelated. For example decisions on mode of transport are influenced by decisions on geographical placement of plants and warehouses, and inventory policies are influenced by choice of suppliers and production locations. Modeling and simulation is frequently used for analyzing these interrelations, and the impact of making strategic level changes in the supply chain.

On the tactical level medium term decisions are made, such as weekly demand forecasts, distribution and transportation planning, production planning, and materials requirement planning.

The operational level of supply chain management is concerned with the very short term decisions made from day to day.

DECISION MAKING LEVEL	TIMELINE	TYPE OF DECISIONS MADE
STRATEGIC	3 TO 10 YEARS	<ul style="list-style-type: none"> - Investment on plants and capacities - Introduction of new products - Creation of a logistics network
TACTICAL	3 MONTHS TO 2 YEARS	<ul style="list-style-type: none"> - Inventory policies to use - Procurement policies to be implemented - Transportation strategies to be adopted
OPERATIONAL	DAY TO DAY	<ul style="list-style-type: none"> -Scheduling of resources -Routing of raw materials and finished products. -Solicitation of bids and quotations

FIGURE 3.4: DECISION-MAKING LEVELS IN SUPPLY CHAINS

3.1.2 DRIVERS OF SUPPLY CHAIN

Drivers determine supply chain performance and are the managerial levers on which to guide the operational process. For each driver manager must make tradeoffs between efficiency (cost) and responsiveness.

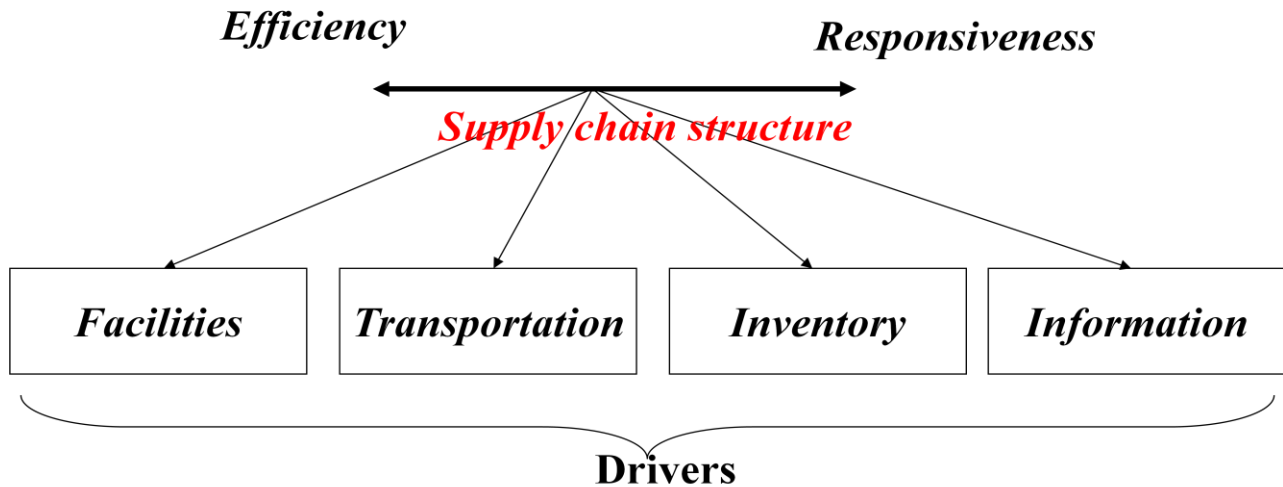


FIGURE 3.5: DRIVERS OF SUPPLY CHAIN

Facilities

Are the actual physical locations in the supply chain network where product are stored, assembled or fabricated. The two major types of facilities are:

- Production sites(factories)
- Storage sites (warehouse).

Components of facilities decisions are:

- Location: centralize to gain economies of scale (major efficiency) or decentralize to be more responsive. Other issues include quality and cost of workers, cost of facility, infrastructure, taxes, quality of life, etc.
- Capacity: excess capacity allows a company to be more responsive to changes in the level of demand (major flexibility), but at the expensive of efficiency.
- Manufacturing methodology: decisions between a product or functional focus, between flexible or dedicated capacity.
- Warehousing methodology: choose between:
 - ✓ SKU storage: stores all of one type of product together,
 - ✓ Job lot storage: stores different products together to satisfy a particular customer or job,
 - ✓ cross-docking: product is not actually warehoused in the facility, instead the facility is used to house a process where trucks from suppliers arrive and unload large quantities of different products. These large lots are then

broken down into smaller lots. Smaller lots of different products are recombined according to the needs of the day and quickly loaded onto outbound trucks that deliver the product to their final destination.

Inventory

Inventory encompasses all the raw materials, work in process, and finished goods within a supply chain. Changing inventory policies can dramatically alter the supply chain's efficiency & responsiveness.

There are three basic decisions to make regarding the creation and holding of inventory:

- *Cycle Inventory*: this is the amount of inventory needed to satisfy demand for the product in the period between purchases of the product.
- *Safety Inventory*: inventory that is held as a buffer against uncertainty. If demand forecasting could be done with perfect accuracy, then the only inventory that would be needed would be cycle inventory.
- *Seasonal Inventory*: this is inventory that is built up in anticipation of predictable increases in demand that occur at certain times of the year.

Inventory has different impacts:

- Can increase amount of demand that can be met by increasing product availability
- Can reduce costs by exploiting economies of scale in production, transportation, and purchasing.
- Can be used to support a firm's competitive strategy. More inventory increases responsiveness, less inventory increases efficiency (reduces cost).
- Can significantly affect material flow/cycle/throughput time because if you move your inventory faster, you don't need as much inventory (inventory velocity).

Transportation

Transportation entails moving inventory from point to point in the supply chain.

Components of transportation decisions are:

- *Mode of transportation*: is the manner in which a product is moved (air, truck, rail, ship, pipeline, electronic). Each mode differs with respect to speed, size of shipments, cost, and flexibility.
- *Routes and networks selection*: are respectively paths along which a product can be shipped and a collection of locations and routes.
- *In house or outsource* the transportation function. Many companies use third-party logistics provider (3PL) to perform some or all of their transportation activities.

Faster transportation allows a supply chain to be more responsive but generally less efficient. Less than full truckloads allows a supply chain to be more responsive but generally less efficient. Transportation can be used to support a firm’s competitive strategy. Customers may demand and be willing to pay for a high level of responsiveness.

Information

Information serves as the connection between various stages of a supply chain, allowing them to coordinate & maximize total supply chain profitability. It is also crucial to the daily operations of each stage in a supply chain for a production scheduling system.

Components of information decisions are:

- *Push versus pull*: push systems (like MRP) need information on anticipated demand to create production and purchasing schedules. Pull systems (like JIT) need accurate and quick information on actual demand to move inventory and schedule production in the chain.
- *Enabling technologies*: many technologies exist to share and analyze information in the supply chain:
 - ✓ EDI: electronic data interchange.
 - ✓ ERP: enterprise re source planning.
 - ✓ SCM software: Supply Chain Management Software
 - ✓ Internet
- *Forecasting & planning* to anticipate and meet future demands. Available information is used to make tactical forecasts to guide the setting of monthly and quarterly production schedules & time table
- *Coordination and information sharing*

Information allows supply chain to become more efficient and more responsive at the same time (reduces the need for a trade-off)

<i>Driver</i>	<i>Efficiency</i>	<i>Responsiveness</i>
Inventory	Cost of holding	Availability
Transportation	Consolidation	Speed
Facilities	Consolidation / Dedicated	Proximity / Flexibility
Information	What information is best suited for each objective	

FIGURE 3.6: CONSIDERATIONS FOR SUPPLY CHAIN DRIVERS

3.1.3 SCOR

The Supply Chain Operations Reference Model (SCOR Model) is one of the very few dedicated methods for supply chain modeling and has also a high relevance for many industries. The model has been developed by The Supply-Chain Council (SCC), an independent not-for-profit firm with more than 1,000 corporate members. It was first introduced in 1996 and is now available in version 8.0.

In contrast to generic process modeling methods, SCOR is actually a reference model, because it defines activities that can be found in any supply chain. In that sense, it can be regarded as a successor to the value chain model by Porter.

The SCOR model covers the followings levels of abstraction:

- Top level (level 1)
- Configuration level (level 2)
- Process element level (level 3)
- Implementation level

SCOR Framework Levels

SCOR®
Supply-Chain Council

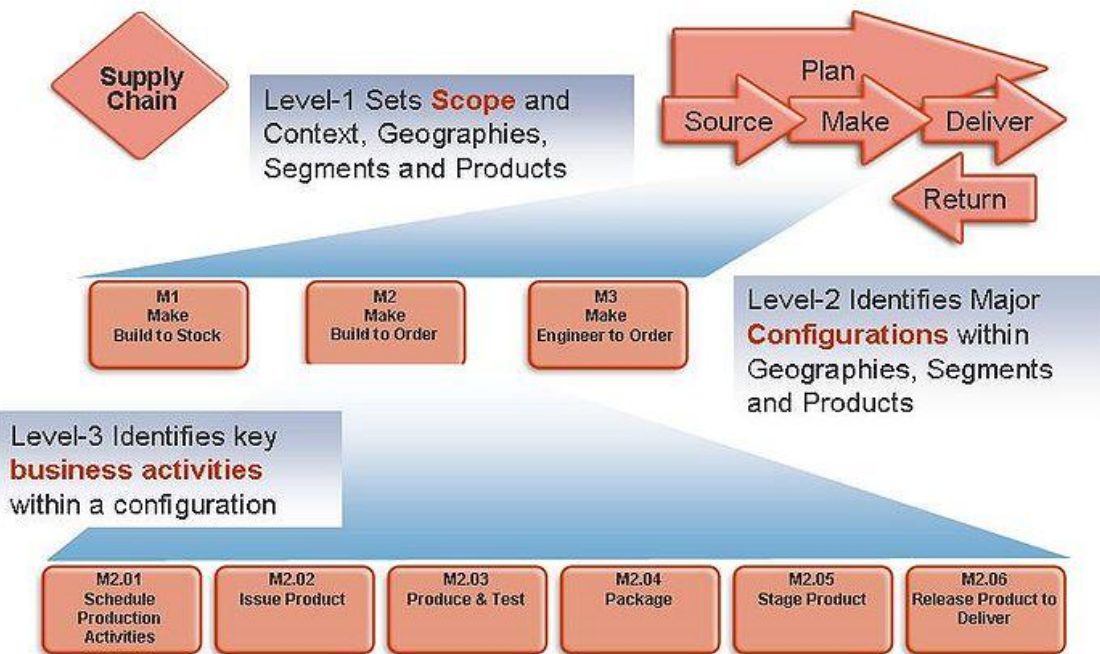


FIGURE 3.7: SCORE PROCESS FRAMEWORK

Top level

SCOR defines five core management processes called process types that are relevant for all firms in a supply chain (scope of the model). Three of these process types form a sequence of source, make, and deliver. The process types are:

- Source (S) Processes that procure goods and services to meet planned or actual demand.
- Make (M) Processes that transform a product or service to a finished state to meet planned or actual demand.
- Deliver (D) Processes that provide finished goods and services to meet planned or actual demand, typically including order management, transportation management, and distribution management.
- Return (R) Processes associated with returning or receiving returned products for any reason. These processes extend into post-delivery customer support.

The top level, however, cannot be instantiated, thus this level defines only the scope of the SCOR model. The modeling of actual or planned supply chains starts on the next level.

Configuration level

Beyond the five main processes, there is a further classification of processes into three categories:

- Planning: processes that plan resources to meet demand in appropriate time intervals. are repeated periodically and have a great influence on the response time of the supply chain.
- Execution: processes as executive involved in the activities of scheduling, sequencing, processing, testing, and handling of products, affecting the cycle time of the order fulfillment.
- Enable: processes involving information and managerial aspects that affect the other two processes.

From five main processes the SCOR model identifies 26 processes of second level, each belonging to one of three process type defined above.

For instance, categories for 'source' are:

- S1 'source stocked product': The procurement, delivery, receipt and transfer of raw material items, subassemblies, product and/or services.
- S2 'source make-to-order product': The procurement and delivery of a product that is built to a specific design or configured based on the requirements of a particular customer order.
- S3 'source engineer-to-order product': The negotiation, procurement and delivery of engineer-to-order assemblies or specialized product or services that

are designed and built based on the requirements or specifications of a particular customer order or contract.

By selecting the relevant process categories, a firm can represent its operational strategy. For instance, the relevant source categories need to be selected and mapped to respective products and/or services (thus a firm can implement multiple source categories reflecting diverse sourcing strategies).

Process element level

The process element level decomposes the process categories by adding process element definitions, process element information inputs/outputs, process performance metrics, and best practices. SCOR does not define functions and organizational entities for these elements, thus it strictly focuses processes.

Implementation level

Implementation level aims to implement management practices, defining the elements necessary to gain a competitive advantage and adapt to changes.

3.1.3.1 METRICS

SCOR defines metrics that measure effectiveness and efficiency of a supply chain. For this purpose, metrics form a hierarchy along the SCOR levels:

- Level 1 metrics relate to the overall planning of a supply chain (thus these metrics are differentiated to source, make etc.).
- Level 2 and 3 metrics decompose the level 1 and 2 metrics respectively.

Each level 1 metric contribute to realizing a performance attribute. A performance attributes is a characteristics of the supply chain that permits it to be analyzed and evaluated against other supply chains with competing strategies. For instance, a supply chain is reliable to a certain degree or not. The level 1 metrics and associated performance attributes are defined as follows:

METRIC	DEFINITION	PERFORMANCE ATTRIBUTE
Perfect Order Fulfilment	The percentage of orders meeting delivery performance with complete and accurate documentation and no delivery damage. The performance is considered “perfect” if the original commitment made to a customer is met through the supply chain.	Supply Chain Reliability: delivering the correct product, to the correct place, at the correct time, in the correct condition and packaging, in the correct quantity, with the correct documentation, to the correct customer.

Order fulfilment cycle time	The average actual cycle time consistently achieved to fulfil customer orders. For each individual order, this cycle time starts from the order receipt and ends with customer acceptance of the order.	Supply Chains Responsiveness: the speed at which a supply chain provides products to the customer.
Upside supply chain flexibility	The time required to achieve an unplanned sustainable 20% increase in quantities delivered	Supply Chain Flexibility: the ability of a supply chain to respond to changes in supply, demand, competition, and environment. (*Note: Figure is an arbitrary number provided for benchmarking purposes.)
Upside supply chain adaptability	the maximum sustainable percentage increase in quantity delivered that can be achieved in 30 days	
Downside supply chain adaptability	The reduction in quantities ordered sustainable at 30 days prior to delivery with no inventory or cost penalties	
Supply chain management cost	The sum of the costs associated with the SCOR level 2 processes to plan, source, deliver and return	Supply Chain Costs: the costs associated with operating the supply chain. (Note: These costs do not include raw material and make costs.)
Cost of goods sold	The cost associated with buying raw materials and producing finished goods. This cost includes direct costs (labour, materials) and indirect costs (overhead).	
Cash-to-cash cycle time	The time it takes for an investment made to flow back into a company after it has been spent for raw materials (service: time from the point where a company pays for the resources consumed in the performance of a service to the time that the company received payment).	Supply Chain Asset Management: the effectiveness of a firm in managing assets to support demand satisfaction; includes all assets, i.e., fixed and working capital.
Return on supply chain fixed assets	Measures the return an organization receives on its invested capital in supply chain fixed assets.	
Return on working capital	Measures the magnitude of investment relative to a company's working capital position versus the revenue generated from a supply chain.	

FIGURE 3.8: THE LEVEL 1 METRICS

3.2 SOURCING AND MANUFACTURING

Fashion industry has short product life cycles, tremendous product variety, volatile and unpredictable demand, long and inflexible supply processes. Therefore, it's difficult to understand what customers want and the market demands.

The first stage in developing supply chain agility takes into consideration what and how many products to produce, and what, if any, parts or components should be produced at which plants or outsourced to capable suppliers. These strategic decisions regarding production must also focus on capacity, quality and volume of goods, keeping in mind that customer demand and satisfaction must be met.

Next, an organization must determine what their facility or facilities are able to produce, both economically and efficiently, while keeping the quality high. But most companies cannot provide excellent performance with the manufacture of all components. Outsourcing is an excellent alternative to be considered for those products and components that cannot be produced effectively by an organization's facilities. Companies must carefully select suppliers for raw materials. When choosing a supplier, focus should be on developing velocity, quality and flexibility while at the same time reducing costs or maintaining low cost levels. In short, strategic decisions should be made to determine the core capabilities of a facility and outsourcing partnerships should grow from these decisions.

The industry increasingly contracts out its production work to foreign suppliers to take advantage of lower labor costs in other countries. In its place, a growing number of apparel manufacturers are performing only the entrepreneurial functions involved in apparel manufacturing such as buying raw materials, designing clothes and accessories and preparing samples, arranging for the production and distribution of the apparel, and marketing the finished product.

One advantage the fashion industry has is its closeness to the market and its ability to react to changes more quickly than its foreign competitors can. Also, as retailers consolidate and become more cost conscious, they require more apparel manufacturers to move toward a just-in-time delivery system, in which purchased apparel items are quickly replaced by the manufacturer rather than from a large inventory kept by the retailer. Through electronic data interchange—mainly using barcodes—information is quickly communicated to the manufacturers, providing information not only on inventory, but also about the desires of the public for fashion items.

3.2.1 PUSH VS PULL

In the last twenty years the supply chain has undergone drastic changes. The traditional push system, in which consumer demand outweighed supply, has transformed into a pull system or what some have coined—the demand chain. The consumer is now empowered and they are demanding a continuous supply of new innovative products at low, low prices.

Push strategy is a classical distribution strategy in which firms produce goods according to the estimated levels of demand, then place the goods in warehouses of the factories, distribution centers, and retailers, waiting for consumers to purchase the product.

Pull strategy expects the presence of a clear market need to enable the transfer of goods. Furthermore, demand-pull enables a firm to produce only what is required, in the correct quantity and at the correct time.

Figure 3.9, as shown below, helps to understand, graphically the difference between pull and push strategy.

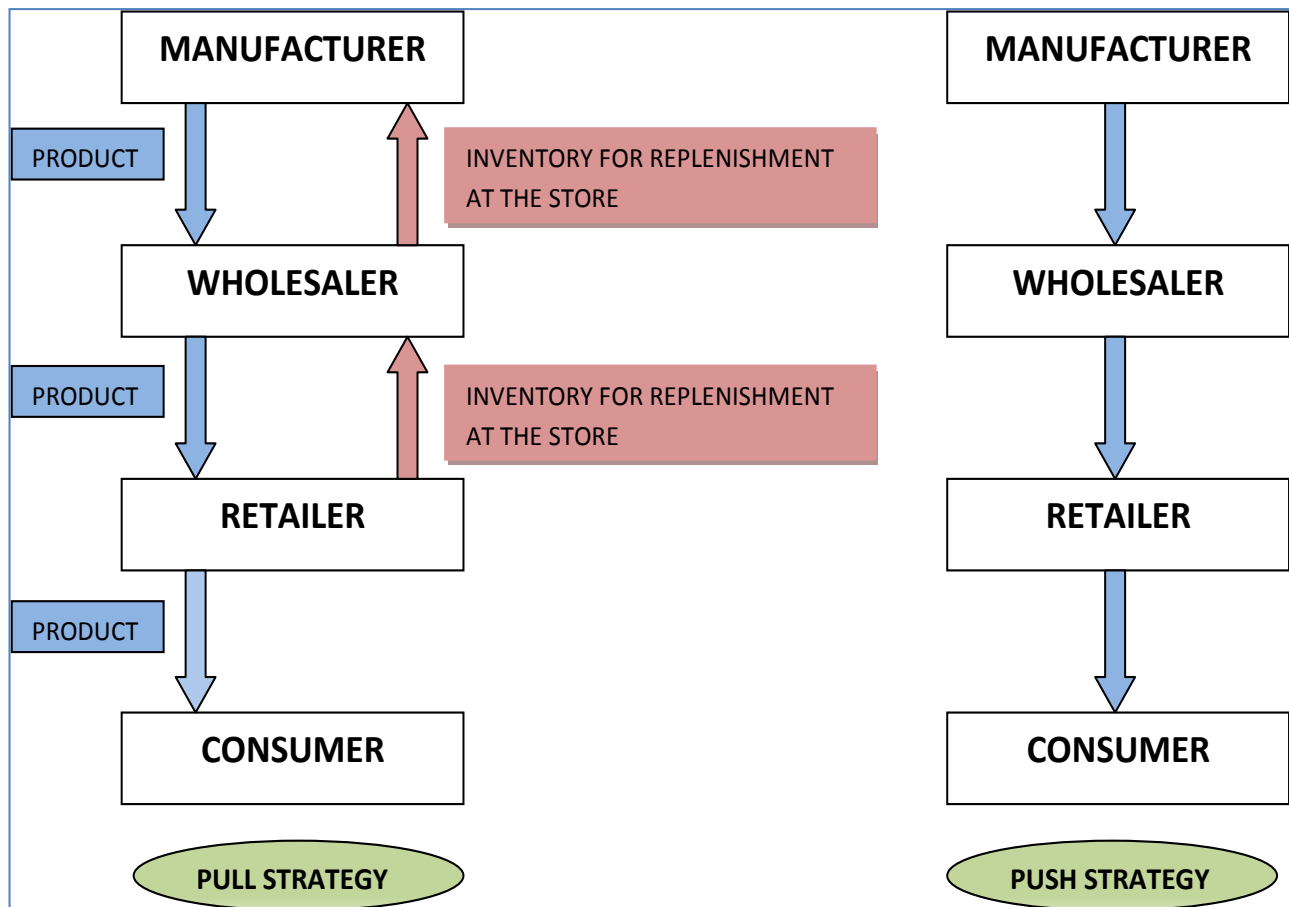


FIGURE 3.9: PULL AND PUSH STRATEGY

The transformation from a push to a pull system can be attributed in part to an oversupply of inexpensive products. Consumers can now pick and choose. The phenomenon of branding has also helped to usher in the pull system. In the past, trends and colors were forecasted by the spinners, weavers and knitters—far back into the supply chain and far removed from the consumer. Forecasting has changed hands. Today, large organized brand designers who are close to the consumer are effectively taking over forecasting duties—pulling the goods through the supply chain.

3.2.2 JIT

JIT is a “pull” system of production, where actual orders provide a signal for when a product should be manufactured. It can be considered as a philosophy for waste reduction and continuous improvement, a method which to control and reduce inventory, a way of increasing throughput, and a production scheduling system. In manufacturing, JIT is essentially a management philosophy where the primary objective is to achieve zero or minimum levels of inventory.. The advantages of JIT include elimination of waste, enhanced product quality, improved employee morale and increased customer satisfaction.

JIT is a shop floor-control tool that allows the scheduling of inventory movement through the shop floor with the use of a Kanban, a materials movement tracking device. The Kanban can take the form of a card, a box, or a marked off area on the floor. These Kanbans are used as an authorization to move materials or to produce new product. JIT also focuses on the basic principle of receiving production parts as needed, rather than building up inventories of these components. Using the JIT production planning approach, managers reduce inventory to a minimum level, keeping on hand only the amount needed in production until the next order arrives. One of the most important aspects of the JIT process is cooperation. Just-in-Time thrives on open, honest communication and trust among all people involved in the process. Employees must work together to improve the product and the process and they must give incentives to do so. Management must be open minded and willing to help in the change.

3.3 PRODUCT POSITIONING

Product’s position is important because represents the place the product occupies in consumers’ minds relative to competing products: is the key of the success in selling the product.

Product positioning is a marketing tool used by a company to gain competitive advantage in the market. It helps the company to differentiate its product offering

from that of its competitors and ensure that the same reaches the exact market profile for which it is intended. Positioning involves the formulation of a definitive marketing strategy around which the product at hand would be finally marketed amongst the target audience.

Product positioning strategy is critical in today's hyper-competitive marketplace where everybody competes for the same shrinking budget and differentiation is hard to come by.

The customer is attracted by the inherent characteristics of the product itself, either due to its low cost, which provides a price advantage to the custode, or due to its differentiation, which introduces unique features that the customers value and for which they are willing to pay a premium.

In the fashion business analysis position is usually developed using the matrix value-clothing styles, that allows to translate the reading of the market positioning decisions coherent, considering the choices of competition. On horizontal axis are placed clothing styles (classic / traditional, contemporary, avant-garde) whereas on vertical axis is placed the market segmentation based on price (couture-designer-diffusion-bridge-better).

3.4 CONSUMER FOCUS

Consumer focus is an organizational orientation toward satisfying the needs of potential and actual customers. It is considered to be one of the keys to business success. Achieving customer focus involves ensuring that the whole organization, and not just frontline service staff, puts its customers first. All activities, from the planning of a new product to its production, marketing, and after-sales care, should be built around the customer. Every department and every employee should share the same customer-focused vision. This can be aided by practicing good customer relationship management and maintaining a customer relations program.

The results of a survey of one hundred companies, clearly, indicate that the companies with high Consumer Satisfaction will have financial results statistically more favorable than companies with low Consumer Satisfaction.

In apparel retailing, a mature and intensely competitive market with increasingly diverse and well-informed customers, competitive differentiation is more important and more difficult to sustain than ever. In the minds of apparel customers, where they shop and what they wear are cultural touchstones. Customers define their identities by the stores where they shop and the brands they endorse or reject. They project their affinities, their societal status and their tastes via the clothes they purchase.

However, apparel retailers are confronting the increased pace and complexity impacting their industry and are challenged to emerge with a clear value proposition for their customers. A great deal is changing. The focus on fast-fashion and constantly rotating styles makes accurate, timely category and merchandise planning an imperative. Missing key fashion trends means losing relevancy with consumers.

Furthermore, brands today are tiered and nested in each other, forcing the customer to decipher which comes first: the store brand, the label or the garment itself. Meanwhile, clothing designers are opening their own branded stores, and even top designers are broadening their reach and creating offers for value-oriented retailers. This leaves retailers to determine which coattails to grab to best differentiate themselves. Yet, this is no small task as clothing vendors and designers are spending millions in brand advertising in an apparel landscape muddled by a proliferation of offerings. Figuring out the brand puzzle, as well as how to merchandise fashionably and quickly – all in a way that delivers to customers what they want in a timely manner – is critical to retailer differentiation.

This is true regardless of whether customers buy their clothes from an upscale boutique or at the same place they purchase their groceries. The expansion of alternate retailing channels and category competition mirrors the changing tastes, needs and behaviors of the customer base. One of the most notable evolutions in consumer shopping behavior is polarization and specialization in their shopping patterns that drives them to shop at different stores for different reasons.

Consumers today trade up and down across categories based on what they value. For example, they shop at a big-box retailer for casual and children's clothing and a high-end apparel store for a special-occasion dress.

3.4.1 QUICK RESPONSE

Quick Response (QR), a program developed by textile and apparel manufacturers and retailers around 1985 as a way to cope with problems challenging the apparel industry, uses a combination of strategies to reduce inventory levels, improve merchandise quality, increase worker productivity, increase stock turnover, and reduce merchandise markdowns and inventory costs. Fundamentally, QR is a way to gather information about consumer preferences and to reflect them in production decisions in a timely manner. To comply with consumers' needs, QR relies on sales data. Through computerized information systems, sales data are transmitted and transformed as useful information that reveals consumers' preferences and reactions, and decisions are then made promptly to respond to what consumers want. The QR strategy links all activity to real time demand. It is customized by the individual retailer or manufacturer and is particularly suited to small and medium-sized firms. It is designed to be context

specific and to be contingent upon the setting. Quick Response as an operations strategy is designed to overcome the impact of seasonality in operations.

It is created to increase consumer satisfaction and survive increasing competition from new competitors. It intends to shorten the lead time from receiving an order to delivery of the products and increase the cash flow. Larger apparel retailers had also played the leading role in promoting quick response. QR required changes that spanned functional, geographic, and organizational boundaries but could help retailers reduce forecast errors and inventory risks by planning assortments closer to the selling season, probing the market, placing smaller initial orders and reordering more frequently, and so on. QR had led to significant compression of cycle times, enabled by improvements in information technology and encouraged by shorter fashion cycles and deeper markdowns, particularly in women's wear. QR in the clothing sector has been defined in different ways and from different perspectives. Lawson (1999) define QR as 'a state of responsiveness and flexibility in which an organization seeks to provide a highly diverse range of products and services to a customer/consumer in the exact quantity, variety and quality, and at the right time, place and price as dictated by real-time custode /consumer demand.' Forza and Vinelli define QR as 'modifying the current organizational system of the chain and speeding up the physical and information flows, in both directions, between all the phases of the value operative chain system.'

The potential benefits of QR initiatives have been noted by a number of researchers - increased sales volumes, reduced markdowns, reduced stock-outs, reduced costs and prices, greater price validity in retail stores, and improved financial performance and increased competitiveness.

Retailers improve the profitability of their business by using rotation of stock as leverage (replenishment of orders), which helps to minimize forced markdowns and discounts and ensure more sales take place at the normal retail price. However, such responsiveness may result in a reduction in order sizes, higher ordering frequency and a requirement for shorter lead times than in conventional supply systems.

The clothing industry now operates with global supply networks, presenting greater challenges for Quick Response. Global Quick Response (GQR) and define it as follows: Global Quick Response (GQR) is a strategy that seeks to achieve accurate, rapid and cost effective response to specific markets dynamically by leveraging the potential of dispersed global supply and production resources through lead time compression, effective real time information management, flexible pipeline management and optimal logistics and distribution systems.

GQR strives to combine cost and scale efficiencies by sourcing globally with quick and accurate response to specific market requirements derived from information

management, dynamic planning and strong logistics. GQR requires that the complexities, risks and additional coordination inherent in managing International supply routes with multiple linkages are absorbed if sales opportunities are to be maximized and the risks of supplying the wrong products minimized.

3.5 RETAILING

Irrespective of whether they internalized most cross-border functions, retailers played a dominant role in shaping imports into developed countries: thus, direct imports by them accounted for half of all apparel imports into West Europe. The increasing concentration of apparel retailing in major markets was thought to be one of the key drivers of increased trade. In the United States, the top five chains came to account for more than half of apparel sales in the course of the 1990s, and concentration levels elsewhere, while lower, also rose during the decade. Increased concentration was generally accompanied by displacement of independent stores by retail chains, a trend that had also helped increase average store size over time. By the late 1990s, chains accounted for about 85% of total retail sales in the United States, about 70% in West Europe, between one-third to one-half in Latin America, East Asia, and East Europe, and less than 10% in large but poor markets such as China and India.

Apparel retailing was relatively globalized, particularly the fashion segment. Apparel retailing chains from Europe had been the most successful at cross-border expansion, although the U.S. market remained a major challenge. Their success probably reflected the European design roots of apparel, somewhat akin to U.S.-based fast food chains' international dominance, and the gravitational pull of the large U.S. market for U.S.-based retailers. Thus, The Gap, based on its sales at home in the United States, dwarfed H&M and Inditex combined. The latter two companies were perhaps the most pan-European apparel retailers but had yet to achieve market shares of more than 2%-3% in more than two or three major countries.

Retailing comprises about 40% of the U.S. economy, and is a major economic engine of the world economy. While the retail sector has always been very competitive, in recent years, the competitive nature of the field has increased dramatically. Customers too have become more exacting, demanding ever-increasing levels of service. Retailers have responded by increasing the variety of their products, becoming more price competitive, striving towards higher service levels, and utilizing advances in computing capabilities and information technologies to improve their supply chain efficiency. However, these developments have also greatly increased the complexity of managing the retail business environment. Consequently, most retailers have struggled to maintain profitability. Rigorous analytical methods have emerged as the most

promising solution to many of these complex problems. Indeed, the retail industry has emerged as a fascinating choice for researchers in the field of supply chain management.

In Retail Supply Chain Management, leading researchers provide a detailed review of cutting-edge methodologies that address the complex array of these problems. Excellent retail supply chain management revolves around understanding and balancing three key dimensions of availability, inventory and cost. Managing these trade-offs efficiently can result in supply chains that improve business performance and drive competitive advantage. One example: Spanish retail giant Zara. At Zara the supply chain is the business model. Rapid growth and profitability are clearly linked to an uncompromised approach to supply chain management that has delivered a world class three week "design to shelf" capability and fueled the company's 20percent annual growth and profit margins. UK food retailer Tesco has developed continuous, within day, replenishment capabilities to underpin their fresh food offer and consistently deliver on-shelf availability of more than 98 percent.

For these retailers, supply chain is a strategic differentiator that delivers a competitive edge. No longer just concerned about cost control, companies view supply chain as a key element of their business strategy.

3.6 KEY INTERNATIONAL COMPETITORS

Fast-fashion specialty retailers with exceptional speed-to-market have outperformed department stores and less nimble specialty stores not only in their profit margins, but also in their pace of revenue growth, according to a study by The Sage Group LLC's Apparel and Retail Group.

The mayor comparable players that compete in fast fashion at international level are:

- Inditex -Zara
- Benetton
- H&M
- Gap

Each of them has a vertical scope and sell clothing for men, women and children, and women section is the major section of these clothing retailers.

Zara owns much of its production and most of its stores, the Gap and H&M, which were the two largest specialist apparel retailers in the world, ahead of Inditex, own most of their stores but outsource all production. Benetton, in contrast, has invested relatively heavily in production, but licensees ran its stores.

The four competitors are also positioned differently in product space from Inditex's chains. Inditex's flagship brand, Zara, is relatively perceived as more fashionable than all the other three and prices less than Benetton and Gap but higher than H&M. In these four competitors, Benetton and Gap place a relatively less fashionable and higher price, while Zara and H&M is more fashionable and price lower, as shows figure 3.9.

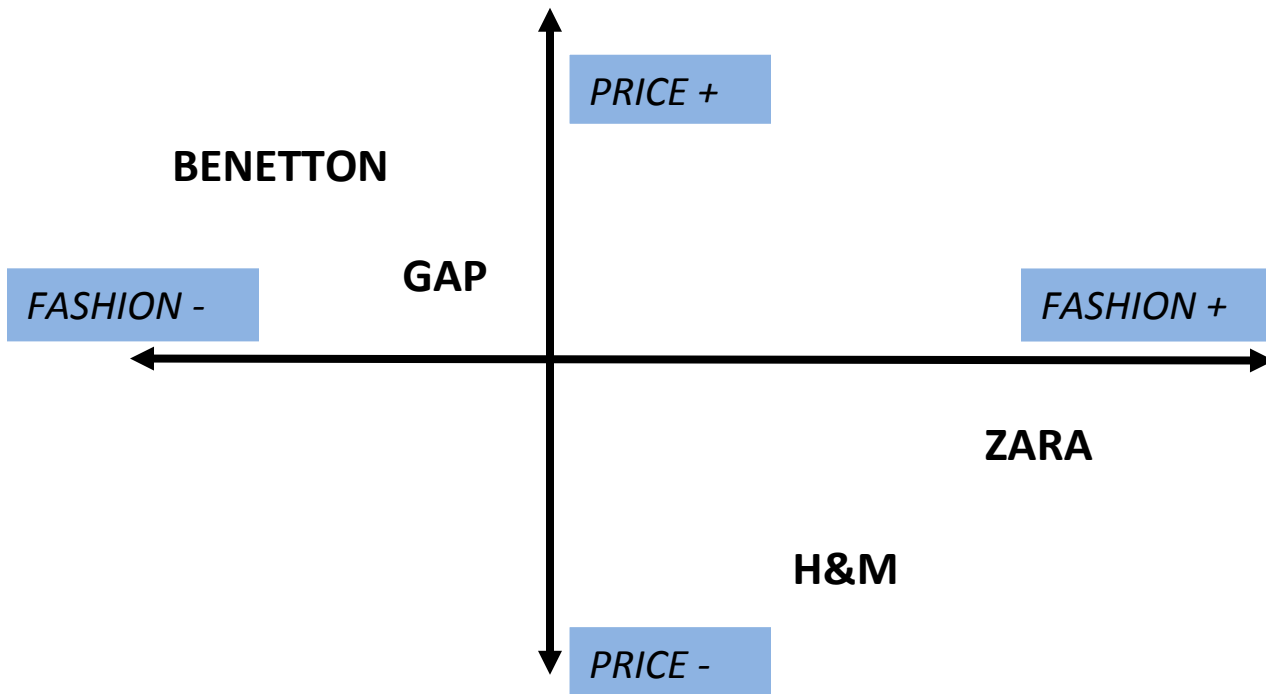


FIGURE 3.10: A PRODUCT MARKET POSITIONING MAP

INDITEX-ZARA

Zara was the largest and most internationalized of Inditex's chains. Inditex is one of the world's largest fashion retailers, welcoming shoppers at its eight store formats - Zara, Pull and Bear, Massimo Dutti, Bershka, Stradivarius, Oysho, Zara Home and Uterqüe - boasting 4.607 stores in 74 countries. The Inditex Group is made up of more than 100 companies operating in textile design, manufacturing and distribution. The group's success and its unique business model, based on innovation and flexibility, have made Inditex one of the biggest fashion retailers in the world. The first Zara shop was launched in 1975 at La Coruna, Galicia and at present it operates more than four hundred owned stores globally. In the previous five years they have witnessed sales up by 25 percent year on year.

Zara runs its own design and production unit in La Coruna, Spain, which leads cancellation of the large out-sourcing operations, like H&M does in over nine hundred firms. It is modern, offering up-to-date lifestyle yet standard clothing lines for men, women and children. Zara offers reasonably priced, radical clothing, however, not of the top quality, which will last only for some seasons.

Zara welcomes shoppers in 74 countries to its network of 1.395 stores in upscale locations in the world's largest cities. The retailer's international footprint proves that national borders are no hindrance to a shared fashion culture.

Zara's approach to design is closely linked to our customers. A non-stop flow of information from stores conveys shoppers' desires and demands, inspiring our 200-person strong creative team.

Zara is in tune with its customers, who help it give shape to the ideas, trends and tastes developing in the world. This is the secret to its success among a wide range of people, cultures and generations, who, despite their differences, all share a special fondness for fashion.

BENETTON

Benetton, incorporated in 1965 in Italy, empathized brightly colored knitwear. It achieved prominence in the 1980s and 1990s for its controversial advertising and as a network organization that outsourced activities that were labor-intensive or scale-insensitive to subcontractors. But Benetton actually invested relatively heavily in controlling other production activities. Where it was investment-light was downstream: it sold its production through licensees, often entrepreneurs with no more than \$100,000 to invest in a small outlet that could sell only Benetton products. While Benetton was fast at certain activities such as dyeing, it looked for its retailing business to provide significant forward order books for its manufacturing business and was therefore geared to operate on lead times of several months. Benetton's format appeared to hit saturation by the early 1990s and profitability continued to slide through the rest of 1990s. In response, it embarked in a strategy of narrowing product lines, further consolidating key production activities by grouping them into "production poles" in a number of different regions, and expanding or focusing existing outlets while starting a program to set up much larger company-owned outlets in big cities. 'Benetton' marched on high street with, offering colorful designer clothing for the whole family. Their strategy resulted affirmative with noticeably contemporary window showcase in all stores with independent units. The company was successful in Britain, however, having a long standing in the market, they witnessed failure to keep up pace with the accelerated high fashion pressure by the other European competitors, which are now the known as Gap, H&M and Zara.

The rise of these competitors on high street has been witness successful because of a higher demand for fast fashion. Styles showed in magazines and other advertorials are what people wish to wear. Top designers have created collection extensions, which cater people who can afford to spend their hard earned cash on triple figure. This resulted success to the affordable collection of European fashion brands.

H&M

A Swedish player, H&M offered readymade clothing stores – stocked with fashionable collection at reasonable costs. Its successful strategy was its own slogan ‘fashion & quality at the best price’ innovative design, reasonably priced and competent logistics. Based in Stockholm, a team of 100 fashion designers assures that nothing has been imitated from the runway platforms. They are mostly inspired from street-trends, movies, magazines and exhibitions. Impressively, the designs reach retail shelves within 2-3 weeks. H&M’s high profile designer tie-ups with Karl Lagerfield and Stella McCartney have resulted entire collections available to the mass people at lower prices. This strategy is supported by huge advertising campaigns, which easily compete with the major brand.

H&M is Inditex’s largest competitor, and it attributes its results to better control of its margins and to the opening of 76 new shops. H&M now has 1,134 shops around the world. During the second half of this year, H&M is planning to open 70 new outlets, mainly in the United States and Canada, while closing 10 of its other shops. The chain is also studying the possibility of selling products by mail and through the Internet in Holland.

GAP

The Gap, based in San Francisco, had been founded in 1969 and had achieved a stellar growth and profitability through the 1980s and much of the 1990s with what was described as an “unpretentious real clothes stance,” comprising extensive collections of T-shirts and jeans as well as “smart casual” work clothes. Gap earned a profit of \$1.150 billion during fiscal 2005, which ended in January, up 11.7% from the previous year. Its sales rose 2.6% to \$16.267 billion. According to a report by BBVA, the Spanish bank, Gap is a multi-platform brand based on a single image. Its business model is similar to that of H&M, focusing on its own design and sales but outsourcing its production to others. The company has enjoyed strong growth in the United States but it has only a minor share of the market in Europe. Its positioning is less tied to style than that of Inditex, and its pricing is less aggressive. Some years ago, the chain indiscriminately opened shops in several European countries. It was forced to close some, including several in Spain.

The pace of these companies in responding to changing consumer demands is an ideal proof to the retailing, producing and logistics skills needed in fast fashion industry. These new strategies are set up to develop aptitude to take advantage of the challenges of a competitive world market. Besides the diversification in product assortments there is one thing common in all these brands that is “intelligent logistics”. Well-organized communication between sales staff directly to the headquarters and producers lead them to match steps with high speed turnover. The fact is that buyers are becoming preference savvy and smarter in order to what they shop. Even though they always have their preferred designer, they are also acquainted that a throwaway piece of fast fashion from a retail chain store will complete their outfit choices. At so reasonably priced all of these retail perceptions play on Friday nights when people feels they have nothing to wear. Retailers are sent in a scuffle to make-out the major catwalk trends from the drawing sheets to the sales shelves as fast as possible. In the figure below are summarized the main characteristics of the four companies studied.

	H&M	ZARA	GAP	BENETTON
PRICE	LOW	LOWER-MIDDLE	MEDIUM	MIDDLE-HIGH
QUALITY	LOWER-MIDDLE	MIDDLE-HIGH	MIDDLE-HIGH	MIDDLE-HIGH
CONTENT “FASHION”	HIGH	HIGH	LOW	LOW
AGE GROUP SERVED	FOR AGES 15-30	FOR AGES 15-40	ALL AGES	FOR AGES 12-40
TYPE OF SUPPLY	ESPECIALLY CASUAL	FROM CASUAL A FORMAL	CASUAL	CASUAL
BRAND RECOGNITION	GOOD	UNDER DEVELOPMENT	HIGH AND GLOBAL	HIGH AND GLOBAL
PRODUCTION	OUTSOURCED	60%IN HOUSE, 40%OUTSOURCED	OUTSOURCED	IN HOUSE
PRODUCTION LEAD TIMES	HIGH	LOW	HIGH	HIGH

FIGURE 3.11: COMPARISON BETWEEN THE COMPETITORS.

Positioning in the fashion industry all have general characteristics, such as type of supply, age group served o quality, similar. The real differentiation is in production strategies chosen. Zara is the only one with a lead time low, in fact, this characteristic

makes it more competitive than the other and has encouraged its success. Also is the only one with a varied production, because 40% of its production in in-house, the rest in outsourcing. Others outsource their production except Benetton, that produce entirely in-house.

The figure below shows financial differences between the companies studied.

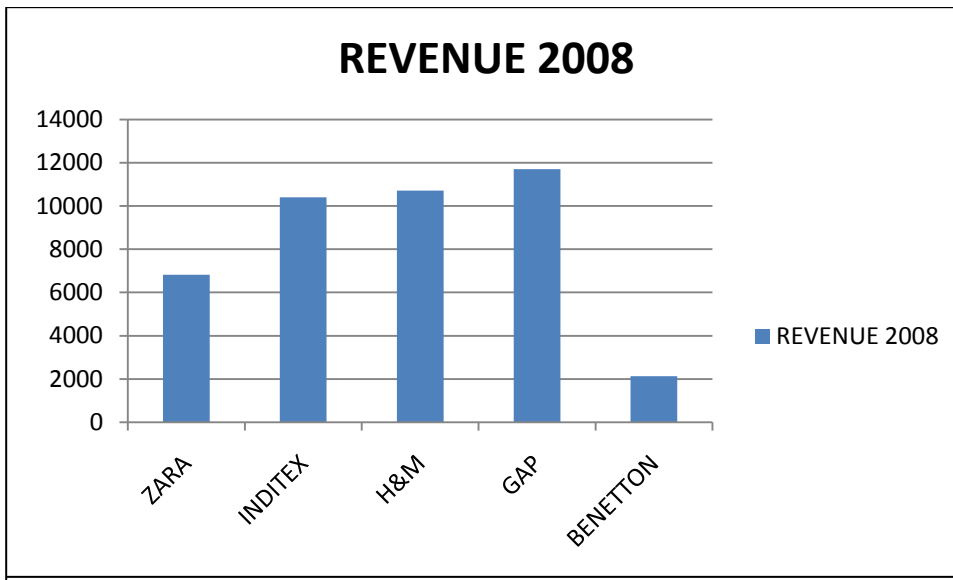


FIGURE 3.12: REVENUE 2008

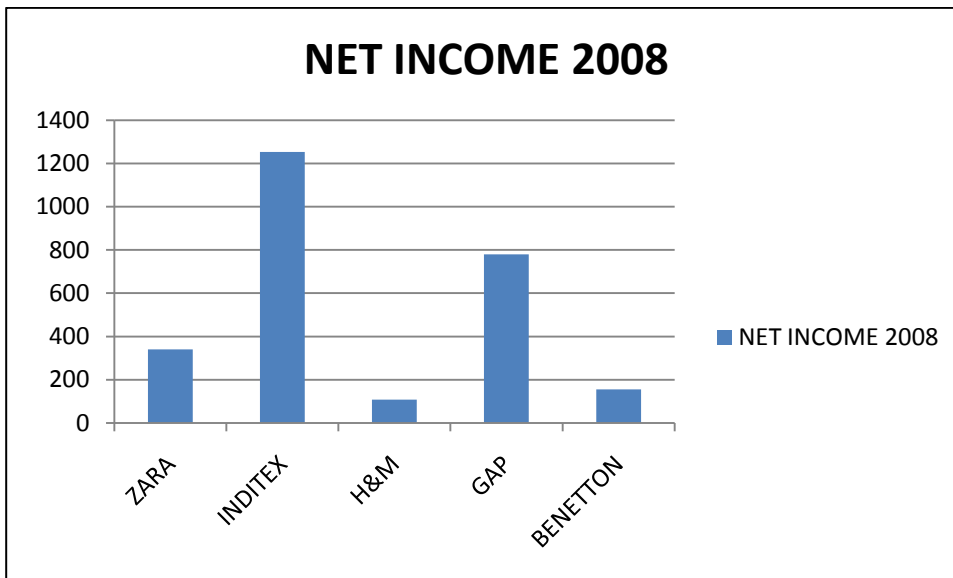


FIGURE 3.13: NET INCOME 2008

CHAPTER 4

ZARA CASE STUDY

This chapter aims to study in detail, from every point of view, the features of the Spanish firm Zara. In particular we will focus on its strategy, which made it one of the companies more competitive globally and that made it successful.

4.1 ORIGINS

Zara is the flagship chain store of Inditex Group, owned by Spanish tycoon Amancio Ortega Gaona, that between 1963-1974 begins his career as a clothing manufacturer. The business grows steadily over the decade until Ortega owns several factories, which distribute their merchandise to other European countries. Inditex is one of the world's largest fashion retailers, welcoming shoppers at its eight store formats Zara, Pull and Bear, Massimo Dutti, Bershka, Stradivarius, Oysho, Zara Home and Uterqüe- boasting of 4.607 stores in 74 countries. The Inditex Group is made up of more than 100 companies operating in textile design, manufacturing and distribution.

At the beginning it started to produce underpants and bathrobes, then Ortega had a genial idea: to shamelessly copy the collections of the most known and prestigious marks, manufacturing suits of low quality but with an indisputable merit, the torn price. When he had to invent a name to commercialize his products (always manufactured to low cost thanks to the thick appeal to the home job), Ortega thought to "Zorba" but in the register of the commercial societies Zorba already was a recorded mark, then conceived "Zara".

The group's success and its unique business model, based on innovation and flexibility, have made Inditex one of the biggest fashion retailers in the world. Its approach to fashion - creativity, quality design and rapid turnaround to adjust to changing market demands - has allowed us to expand internationally at a fast pace and has generated an excellent public response to our retailers' collections.

The first Zara store opened in 1975 in A Coruña (Spain), a city in which the Group first began doing business and which is still home to its Headquarters. To attract the clients he filled the showcase of chickens and rabbits; the passers-by, became curious, entered. That was his first, and only, advertising campaign. Its first store featured low-priced lookalike products of popular, higher-end clothing fashions. The store proved to be a success, and Ortega started opening more Zara stores in Spain. During the 1980s, Ortega started changing the design, manufacturing and distribution process to reduce

lead times and react to new trends in a quicker way, in what he called "instant fashions". The company based its improvements in the use of information technologies and using groups of designers instead of individuals.

4.2 INTERNATIONAL EXPANSION

International strategy at Zara is defined by the combined generic strategy of cost leadership and differentiation strategy.

Zara had historically looked for new country markets that resembled the Spanish market, had a minimum level of economic development, and would be relatively easy to enter. To study a specific entry opportunity, a commercial team from Headquarters conducted both the macro and micro analysis. Macro analysis focused on a local macroeconomic variables and their likely future evolution, particularly in terms of how they would affect the prospects for stores (tariffs, taxes, legal costs, salaries and property prices/rents). Micro analysis, performed onsite, focus end on sector-specific information about local demand, channels, available store locations, and competitors. The explicitly competitive information gathered included data on levels of concentration, the formats that would compete most directly with Zara, and their potential political or legal ability to resist/retard its entry, as well as local pricing levels. According to Castellano, Zara- unlike its competitors- focused more on market prices than on its own costs in forecasting its prices in a particular market. These forecasts were then overlaid on cost estimates, which incorporated considerations of distance, tariffs, taxes, and so forth, to see whether a potential market could reach profitability quickly enough (often within a year or two of opening the first store). The actual application of this template for market analysis varied somewhat from country to country. For example, in Germany when Zara conducted market analysis at the country level, it had made an exception by separately analyzing seven large German cities.

In 1975 Zara opened its first store in Coruña. Between 1976 and 1984 Zara's approach to fashion is well received by the public, which prompts the retailer to extend its network of stores to major Spanish cities.

By the beginning, the company preferred to invest a percentage of revenues in opening new stores.

Its International expansion can be divided into two periods:

- Between 1988 and 1997, it entered about one country per year (at a median distance of 3.000 kilometers from Spain):
 - ✓ In 1988, the company started its international expansion through Oporto, in northern Portugal.

- ✓ In 1989 they entered in the United States opening its first store in New York.
 - ✓ In 1990 in France, opening its first store in Paris.
 - ✓ In 1992 in Mexico.
 - ✓ In 1993 in Greece.
 - ✓ In 1994 in Belgium and Sweden.
- Since 1998, countries has been added more rapidly:
 - ✓ In 1998-1999 in 16 countries (at a median distance of 5.000 kilometers).
 - ✓ In 2000-2001 in 8 countries (at a median distance of 2.000 kilometers).

In 2002 the Group opened its first outlets in Finland, Switzerland, El Salvador, the Dominican Republic and Singapore.

In 2003 Inditex opens Zara's second distribution hub, Platform Europe, in Zaragoza, Spain, to complement the distribution centre in Arteixo (A Coruña, Spain). Also, the Group celebrated its first store openings in Slovenia, Slovakia, Russia and Malaysia.

In 2007 Zara celebrated the launch in Florence (Italy) of Zara shop number 1,000.

Inditex's management sometimes described this pattern of expansion as an "oil stain" in which Zara would first open a flagship store in a major city and, after developing some experience operating locally, added stores in a adjoining areas. This pattern of expansion had first been employed in Spain and had been continued in Portugal. The first store opened in New York was intended as a display window and listening post but the first store in Paris anchored a pattern of regional- and then National- expansion that came to encompass about 30 stores in the Paris area and 67 in France by the end of 2001. CEO José María Castellano explained the approach: "for us it is cheaper to deliver to 67 shops than to one shop. Another reason, from the point of view of the awareness of the customers of Zara, is that it is not the same if we have one shop in Paris compared to having 30 shops in Paris. And the third reason is that when we open a country, we don't have advertising or local warehouse costs but we do have Headquarters costs".

4.2.1 MARKET ENTRY

If the commercial team's evaluation of a particular market was positive, the logical next step was to assess how to enter it. In contrast to Spain, where all of Zara's stores were company-owned and managed, three different modes of market entry were used internationally: company-owned stores, joint ventures, and franchises. Zara usually employed just one of these modes of market participation in a particular country, although it did sometimes shift from one to another. For example it had entered

Turkey via franchising in 1998, but had acquired ownership of all its Turkish stores in 1999. Zara had originally expanded internationally through company-owned stores. It typically establishes company-managed stores in key, high-profile countries with high growth prospects and low business risk. It adopted this strategy for most European and South American countries.

Zara tends to use franchisee in countries that were small, risky, or subject to significant cultural differences or administrative barriers that encouraged this mode of market participation: examples included Andorra, Iceland, and Poland in Europe and the Middle Eastern countries that the chain has entered (where restrictions on foreign ownership ruled out direct entry).

Zara uses joint ventures in larger, more important markets where there are barriers to direct entry, most often ones related to the difficulty of obtaining prime retail space in city centers. At the end of 2001, 20 Zara stores in Germany and in Japan were managed through joint ventures, one in each country. Interests in both ventures were split 50:50 between Zara and its partners: Otto Versand, the largest German catalog retailer and a major mall owner, and Bigi, a Japanese textile distributor.

In addition, Zara had been presented with opportunities to acquire foreign chains but had rejected them because of overlapping store networks, physical and cultural impediments to retrofitting its model on to them, and the difficulty of meeting profitability targets after paying acquisition premia.

The figure below shows the increase of Zara's stores from 2003 to 2009.

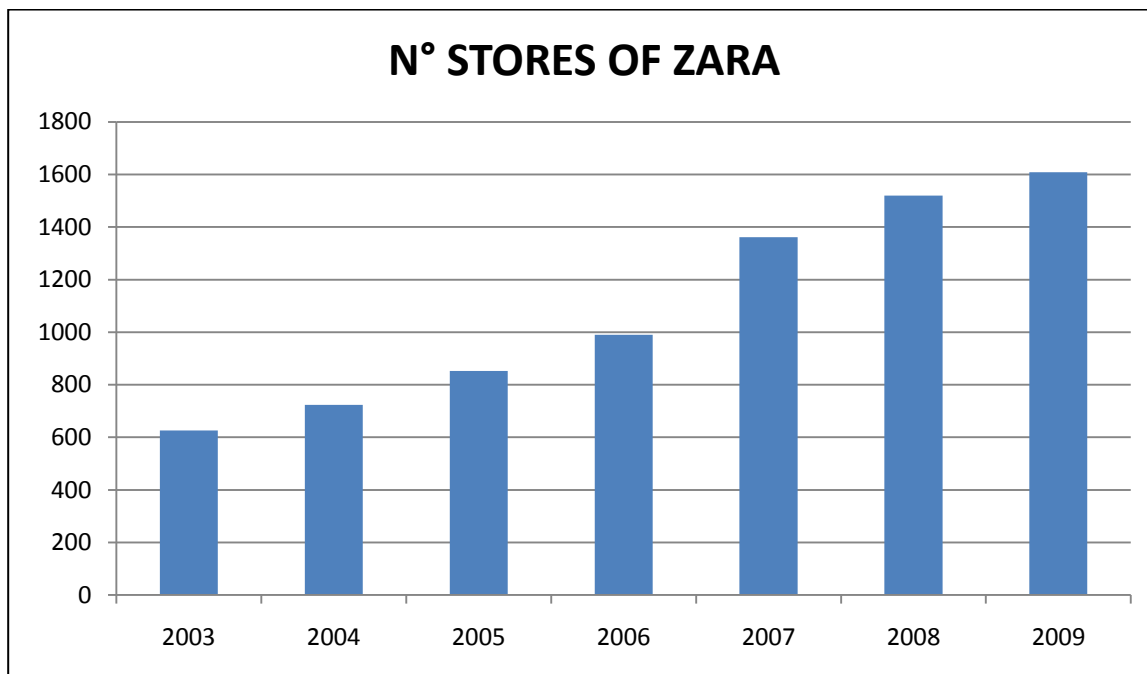


FIGURE 4.1: N° STORES OF ZARA FROM 2003 TO 2009

From the beginning of its expansion Zara has always focused more on the European market than other markets for its profit save, and because of its closeness to consumer tastes, in fact European customers has an appetite for fashion. This can be seen in figures 4.2 and 4.3. In the course of time this situation has not changed but in recent years Zara is trying to concentrate on the Asian market and especially on the American market. In fact in 2010 many of the 400 stores that Zara will open during the year, will be established in New York, California and Florida.

The Spanish company is aiming much to the global market because of stagnant results of the mother country due to heavy recession in Spain. Most of its stores are in Europe. The following figures show the difference of the division between countries of the international expansion of Zara in 2003 and in 2009:

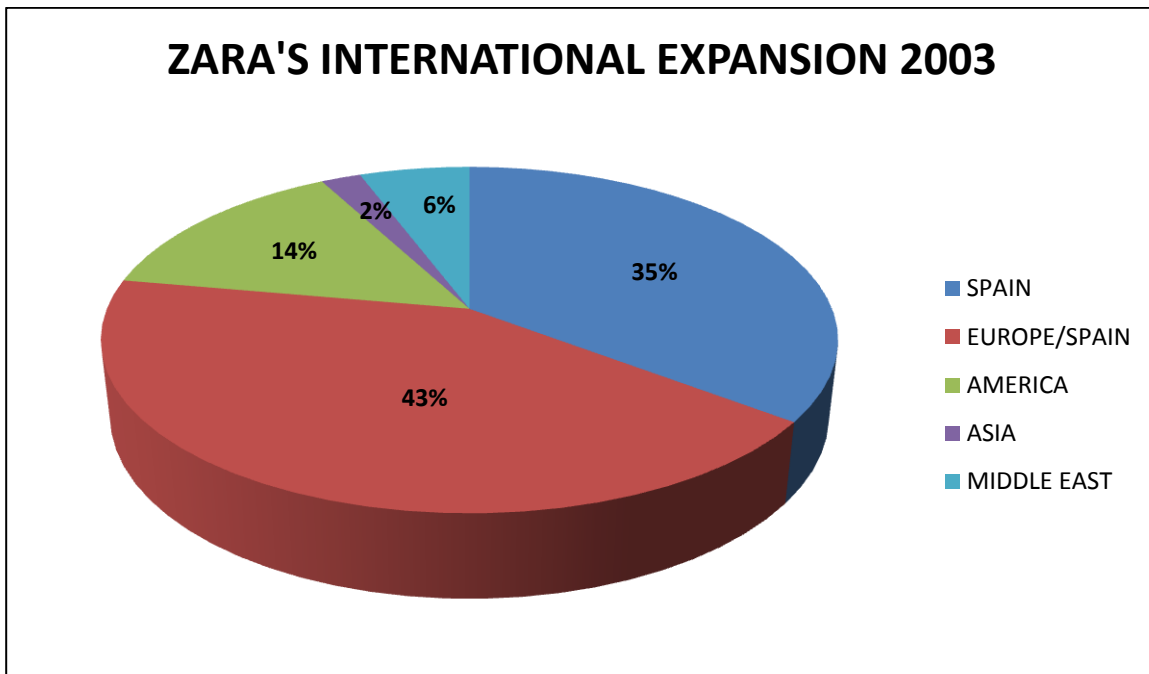


FIGURE 4.2: ZARA'S INTERNATIONAL EXPANSION 2003

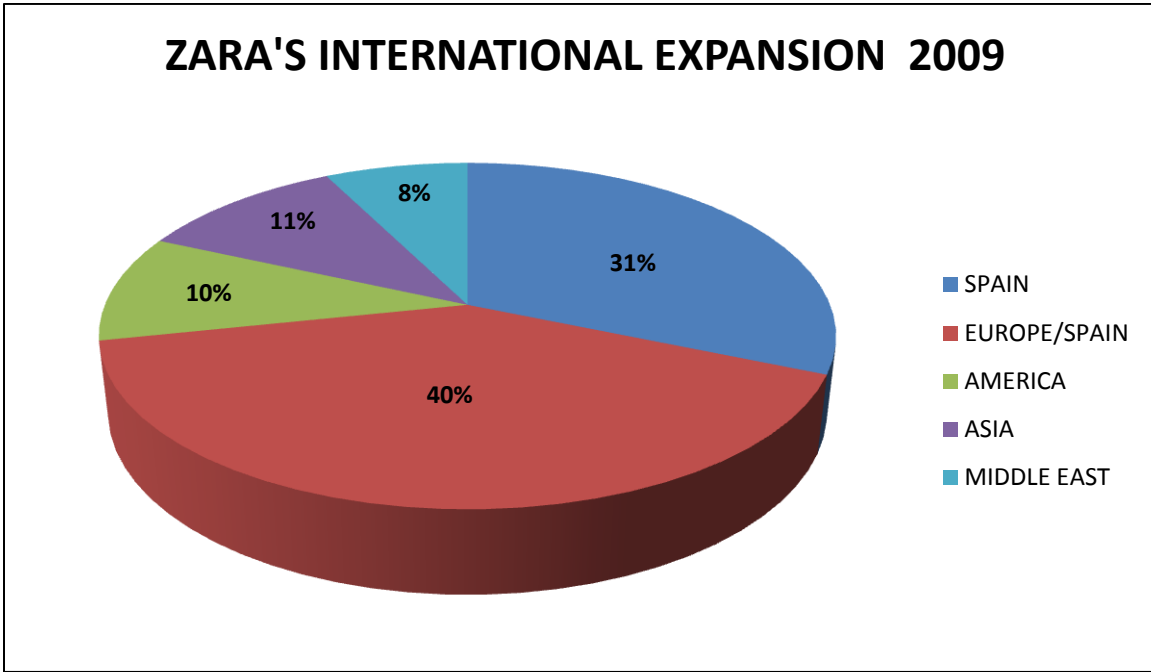


FIGURE 4.3: ZARA'S INTERNATIONAL EXPANSION 2009

4.3 FINANCIAL DATA

The figure below shows how Zara on time has improved its revenues, due to its international expansion and mostly to its successful achieved in different countries.

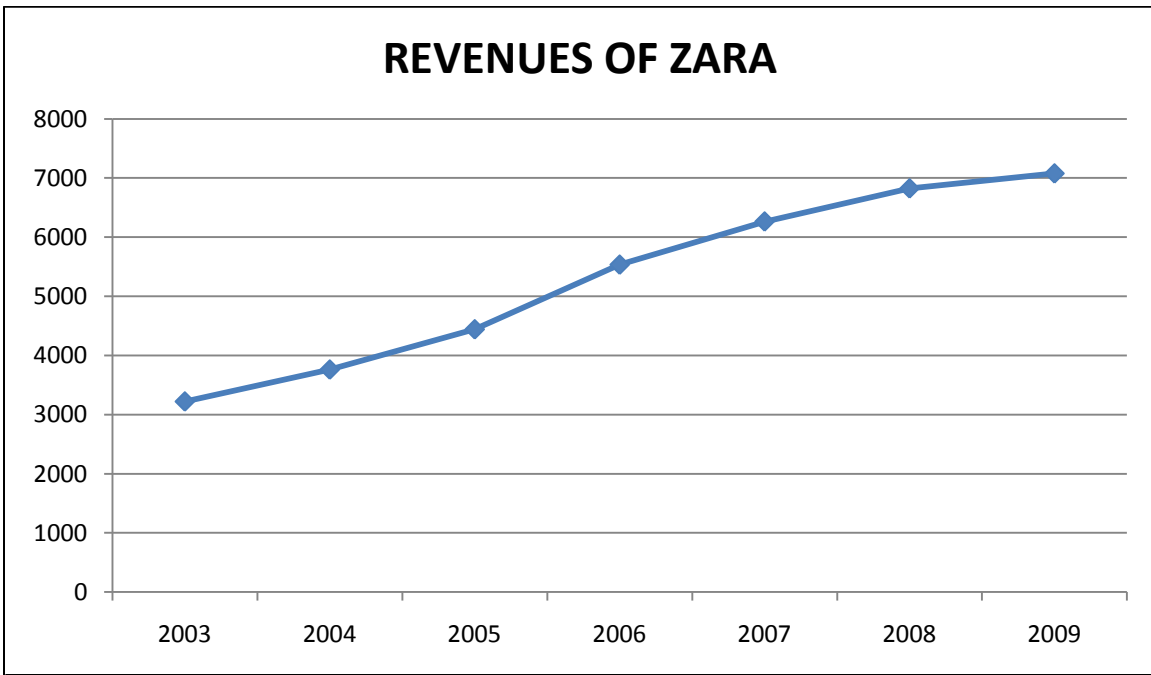


FIGURE 4.4: REVENUES OF ZARA

Zara represents most of 70% of Inditex revenues, in fact over time Zara has improved the financial situation of its mother-enterprise.

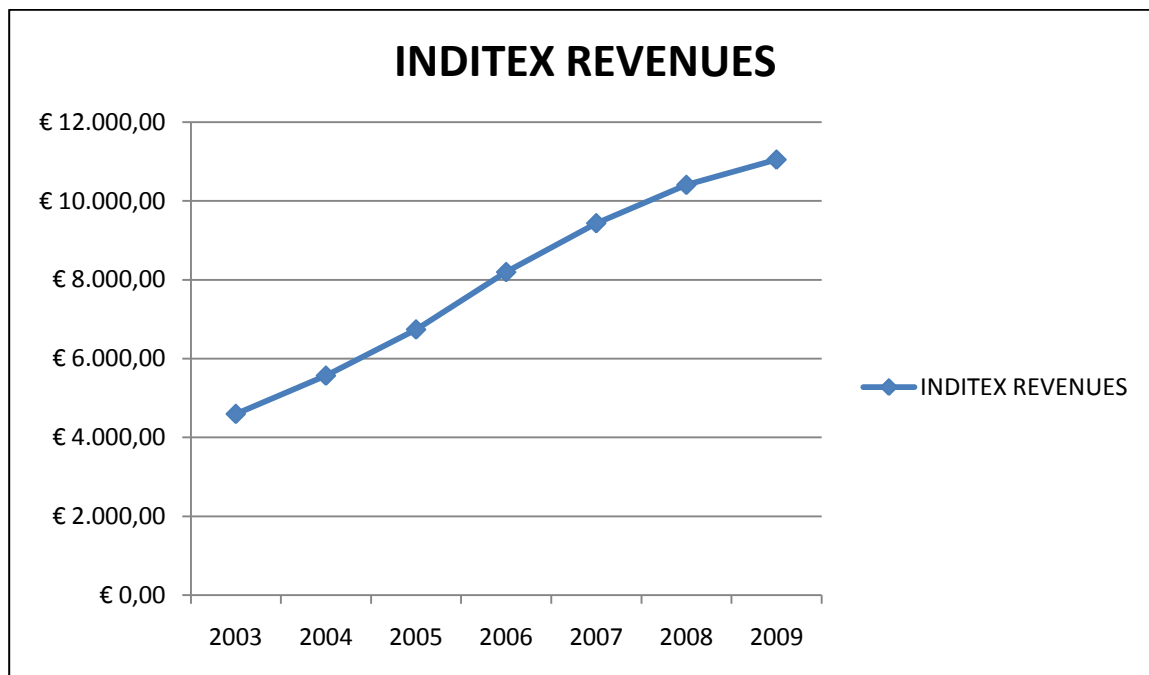


FIGURE 4.5: REVENUES OF INDITEX

4.4 BUSINESS MODEL

The Zara business model is characterized by a high degree of vertical integration compared to other models developed by our international competitors. It covers all phases of the fashion process: design, manufacture, logistics and distribution to its own managed stores. It has a flexible structure and a strong customer focus in all its business areas.

The key element in the organization is the store, a carefully designed space conceived to make customers comfortable as they discover fashion concepts. It is also where we obtain the information required to adapt the offer to meet customer demands.

The key to this model is the ability to adapt the offer to customer desire in the shortest time possible. For Zara, time is the main factor to be considered, above and beyond production costs. Vertical integration enables us to shorten turnaround times and achieve greater flexibility, reducing stock to a minimum and diminishing fashion risk to the greatest possible extent.

Its business model, very different from other companies operating in the same industry, has been fundamental to its success. For this, today it is studied and taken as reference by companies would enter the market.

The figure below shows the business model of Zara, that will be discussed in detail later.

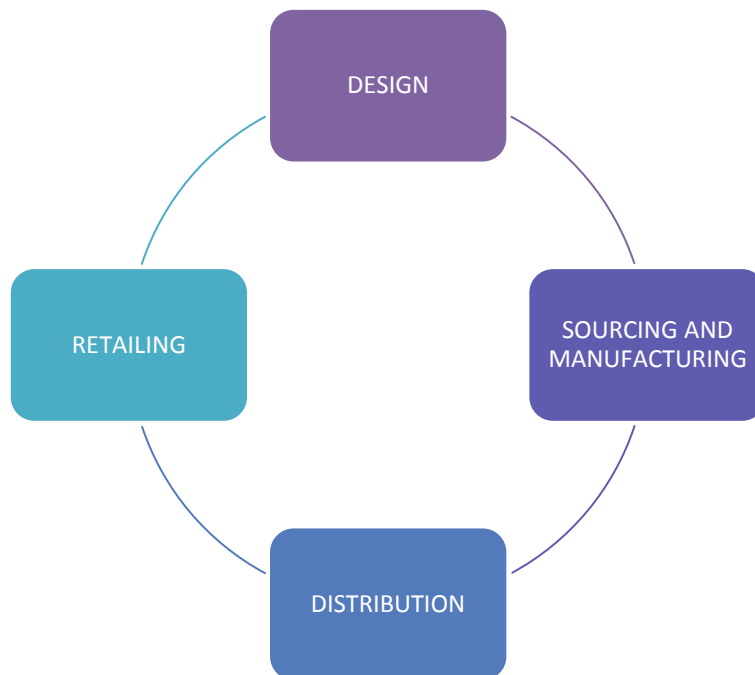


FIGURE 4.6: ZARA'S BUSINESS MODEL

4.4.1 DESIGN

The success of Zara's collections lies in the ability to recognize and assimilate the continuous changes in fashion, constantly designing new models that respond to customer desires. Zara uses its flexible business model to adapt to changes occurring during a season, reacting to them by bringing new products to the stores in the shortest possible time.

The models for each season –over 40,000 last year- are developed in their entirety by the creative teams of the different chains. Over 200 designers take their main inspiration from both the prevailing trends in the fashion market and the customers themselves, through information received from the stores.

Each of Zara's three product lines- for women, men and children- had a creative team consisting of designers, sourcing specialists, and product development personnel. The creative teams simultaneously work on products for the current season by creating constant variation, expanding upon successful product items, and continuing in-season development, and on the following season and year by selecting the fabrics and product mix that would be the basis for an initial collection. Top management stress that instead of being run by maestros, the design organization is very flat and focuses on careful interpretation of catwalk trends suitable for the mass-market.

Zara creates two basic collections each year that are phased in through the fall/winter and spring/summer Seasons, starting in July and January respectively. Zara's design attends trade fairs and ready-to-wear fashion shows in Paris, London, Milano, and New York referred to catalogs of luxury brand collections, and works with store managers to begin the develop the initial sketches for a collection close to nine months before the start of a season. Designers then select the fabrics and other complements and, simultaneously, the relative price at which a product would be sold is determined, guiding further development of samples. Samples are prepared and presented to the sourcing and product development personnel, and the selection process begins. As the collection comes together, the sourcing personnel identifies production requirements, whether an item would be insourced and outsourced, and a timeline to ensure that the initial collection arrives in stores at the start of the selling season.

The process of adapting to trends and differences across markets is more evolutionary, ran through most of the selling season, and places greater reliance on high-frequency information. Frequent conversations with store managers are as important in this regard as the sales data captured by their IT system. Other sources of information include industry publications, TV, Internet, and film content, trend-spotters who focus on venues such a university campuses and discotheques, and even Zara's young, fashion-conscious staff. Product development personnel plays a key role in linking the designers and the stores, and are often from the country in which the stores they dealt

with are located. On average, several dozen items are designed each day, but only slightly more than one-third of them actually goes into production. Time permitting, very limited volumes of new items are prepared and presented in certain key stores and produced on a larger scale only if consumer reactions are unambiguously positive. As a result, failure rates on new products are supposed to be only 1% compared with an average of 10% for the sector. Learning by doing is considered very important in achieving such favorable outcomes.

Overall, then, the responsibilities of Zara's design team transcend design, narrowly defined. They also continuously track customer preferences and use information about sales potential based, among other things, on a consumption information system that support detailed analysis of product life cycles, to transmit repeat orders and new designs to internal and external suppliers. The design teams thereby bridge merchandising and the back-end of the production process. These functions are generally organized under separate management teams at other apparel retailers.

4.4.2 SOURCING AND MANUFACTURING

Zara sources fabric, other inputs, and finished products from external suppliers with the help of purchasing offices in Barcelona and Hong Kong, as well as the sourcing personnel at headquarters. While Europe had historically dominated Zara's sourcing patterns, the recent establishment of three companies in Hong Kong for purposes of purchasing as well as trend-spotting suggested that sourcing from the Far East, particularly China, might expand substantially.

About one-half of the fabric purchased is undyed to facilitate in-season updating with maximum flexibility. Much of this volume is funneled through Comditel, a 100%-owned subsidiary of Inditex, that dealt with more 200 external suppliers of fabric and other raw materials. Combitel manages the dyeing, patterning and finishing of undyed fabric for all of Inditex's chains, not just Zara, and supplies finished fabric to external as well as in-house manufacturers for 45%. The remainder of the purchases of fabric comes from external suppliers group, located more in Europe (95%) and marginally in Asia (4%) and Central America (1%). This process, reminiscent of Benetton's, means that it takes only one week to finish fabric.

Outside the distribution center in La Coruña, fabric is cut and dyed by robots in 23 highly automated factories. Zara is so vertically integrated, the firm makes 40 percent of its own fabric and purchases most of its dyes from its own subsidiary. Roughly half of the cloth arrives undyed so the firm can respond as any mid-season fashion shifts occur. After cutting and dyeing, many items are stitched together through a network of local cooperatives that have worked with Inditex so long they don't even operate with

written contracts. The firm does leverage contract manufacturers (mostly in Turkey and Asia) to produce staple items with longer shelf lives, such as t-shirts and jeans, but this volume accounts for only about 1/8th of dollar volume.

Zara manufactures 60% of its own products. By owning its in-house production, Zara is able to be flexible in the variety, amount, and frequency of the new styles they produce. Traditional retailers lack this flexibility and they are obligated to place production orders to manufacturers overseas at least 6 months in advance of the season. Fifty percent of the items that Zara sells are manufactured in Spain, 28% in the rest of Europe, and 24% in Asia and the rest of the world.

The most fashionable items tended to be the riskiest and therefore are the ones that are produced in small lots internally or under contract by suppliers who are located close by, and reordered if they sold well. More basic items that are more price-sensitive than time-sensitive are particularly likely to be outsourced to Asia, since production in Europe is typically 15%-20% more expensive for Zara. About 20 suppliers accounts for 70% of all external purchases. While Zara had long-term ties with many of these suppliers, it minimizes formal contractual commitments to them.

Zara's in-house production purposely creates a rapid product turnover since its "runs are limited and inventories are strictly controlled". This rapid product turnover creates a climate of scarcity and opportunity in Zara's retail stores. The climate also increases the frequency and rapidity with which consumers visit the stores and buy the products. Regular customers know that new products are introduced every two weeks and most likely would not be available tomorrow. Zara's global average of 17 visits per customer per year is considerably higher than the three visits to its competitors. The high traffic in the stores circumvents the need for advertising: Zara devotes just 0,3% of its sales in advertising, far less than the 3%-4% its rivals spend. Therefore, Zara's scarcity climate allows the company to sell more items at full price. This strategy minimizes Zara's total cost because it reduces 15-20% of markdown merchandise compare to a traditional retailer.

Furthermore, Zara's unique quick response system, composed of human resources as well as information technology, allows Zara to respond to the demand of its consumer better than the competition. Zara, who focuses on the ultimate consumer, places "more emphasis on using backward vertical integration to be a very quick fashion follower than to achieve manufacturing efficiencies". It is extremely important for Zara to speed the information flow of consumer desires to their apparel designers. For that reason, Zara has human resource teams in the retail and manufacturing environment that work exclusively toward this goal.

The firm is able to be so responsive through a competitor-crushing combination of vertical integration and technology-orchestrated coordination of suppliers, just-in-time

manufacturing, and finely-tuned logistics. Inventory optimization models help the firm determine how many of which items in which sizes should be delivered to stores during twice-a-week shipments, ensuring stores are stocked with just what they need. By constantly refreshing the collection, and manufacturing items in high-intensity short runs, Zara was able to prevent the accumulation of non-saleable inventories.

The average time for a Zara concept to go from idea to appearance in store is 15 days vs. rivals who receive new styles once or twice a season. Smaller tweaks arrive even faster. If enough customers come in and ask for, say a round neck instead of a “v” neck, a new version can be in stores with in just 10 days. To put that in perspective, Zara is twelve times faster than its competitors. Zara is able to make a new line from start to finish in anywhere between two and five weeks, depending on the type of garment. Furthermore, generally has a lead time of 4-5 weeks for new garments and 2 weeks to restock. As a result, Zara is responsive to fashion items that are selling well during the season, and to discontinue those that are not.

Other retailers need an average of six months to design a new collection and then another three months to manufacture it. At Zara, most of the products you see in stores didn't exist three weeks earlier, not even as sketches.

Figure 4.7 shot the change of the cycle time from 1990 to 2000 through quick response.

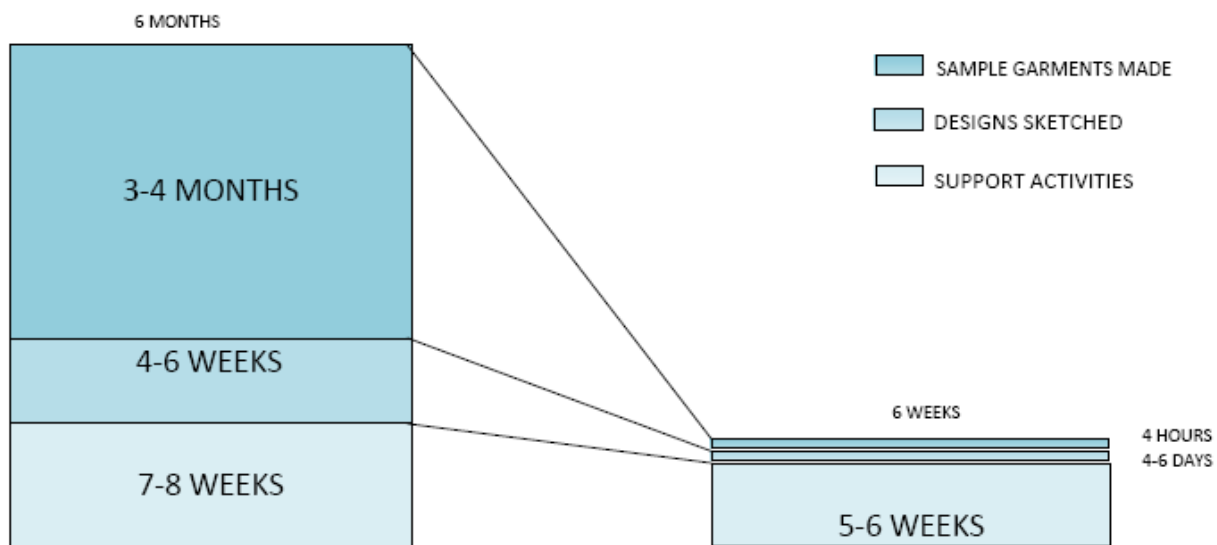


FIGURE 4.7: CYCLE TIME COMPRESSION THROUGH QUICK RESPONSE.

The activities of design and procurement start from three to six months before the selling season in order to capture the availability of approximately 65% of the needs of fabrics, the rest depends on market trends. It was estimated that Zara committed just 15%-25% of production before the season began(from three to six months before),

50%-60% at the start of the season, and the remainder was manufactured in season. Percentage of Zara sales consisting of markdowns was 15%-20%. Similarly, even the predominant part of the collection produced in-house (about 85%) depends on the sale trends. With regard, however, deliveries to shops, at the start of the season is sent the "basic collection", 15-20% of the overall supply, usually placed on the market, which is then continually revised and supplemented with extraordinary rapidity based on commercial information collected by the shops.

	6-month Pre-season	Start of season	In-season	Sales% not at full price
Traditional Industry Model	45 - 60 %	80 - 100 %	0 - 20 %	30 - 40 %
		Advertisement	Advertisement + Markdowns	
Zara	15 - 25 %	50 - 60 %	40 - 50 %	15 - 20 %
			Fresh items	

FIGURE 4.8 PRODUCTION COMMITMENT AND MARKDOWN

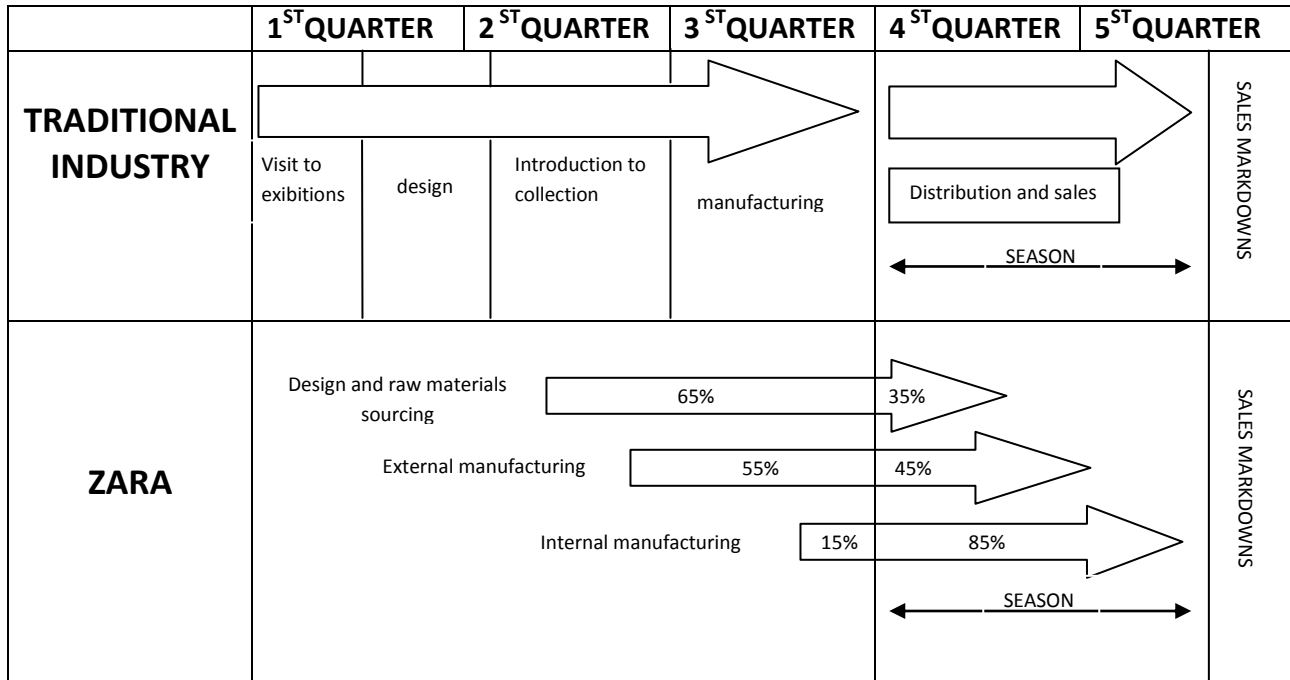


FIGURE 4.9: PRODUCT PRECOMMITMENTS:ZARA VS. TRADITIONAL INDUSTRY

4.4.3: DISTRIBUTION

Zara has a centralized distribution system that gives the chain a competitive advantage by minimizing the lead-time of their goods. Zara’s system consists of an approximately 600.000 square meter facility located in Spain and much smaller satellite centers in Argentina, Brazil, and Mexico that consolidate shipments from Spain.

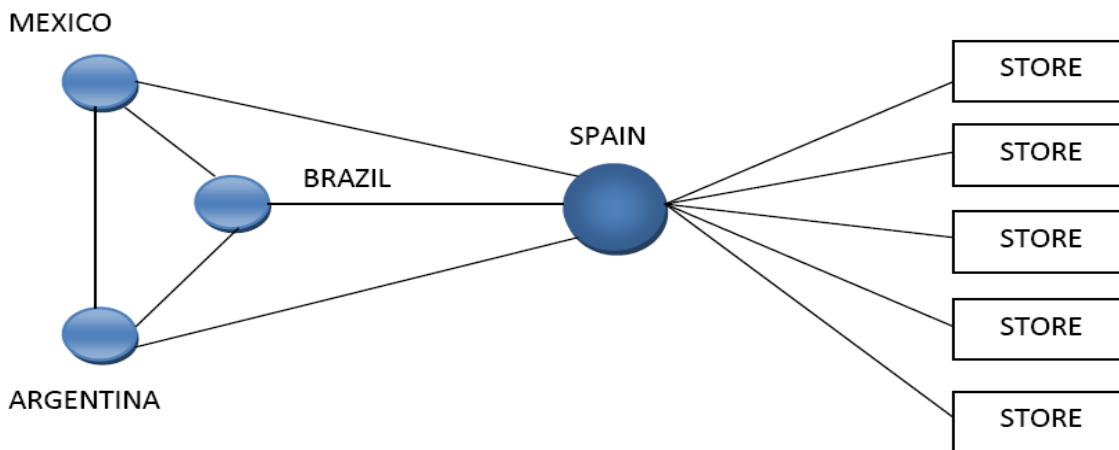


FIGURE 4.10: DISTRIBUTION’S SYSTEM

Zara uses a supply chain consisting of four warehouses located in Spain (summarized in figure 4.10) which periodically receive shipments of finished clothes from internal and external suppliers, and ship replenishment inventory directly to every Zara store in the

world twice a week during regular periods and thrice weekly during the sales season . Each delivery always includes new models, so that the stores are constantly refreshing their offer.

In the distribution center, products are inspected and immediately shipped, since. Lorena Alba, Inditex’s director of logistics, regarded the warehouse as a place to move merchandise rather than to store it. According to her, “the vast majority of clothes are in here only a few hours”, and none ever stayed at the distribution center for more than three days. Of course the rapidly expanding store network demanded constant adjustment to the sequencing and size of deliveries as well as their routing. Then, to increase delivery speed, the shipments are scheduled by time zones and shipped by way of air, and land.

LOCATION OF THE DISTRIBUTION CENTER	SURFACE
GALICIA (ARTEIXO)	280.000 m ²
LEÓN	40.000 m ²
MADRID	160.000 m ²
ZARAGOZA	125.000 m ²

FIGURE 4.11: LOGISTICS PLATFORM

The logistics system, based on software designed by the company’s own teams, means that the time between receiving an order at the distribution centre to the delivery of the goods in the store is on average 24 hours for European stores and a maximum of 48 hours for American or Asian stores.

With this system it’s possible ship 45.000 folded garments per hour. The facilities move about 2.5 million items a week. Trucks serve destinations that can be reached overnight, to be more precise in Europe, while chartered cargo flights serve farther destinations. The firm recently tweaked its shipping models through Air France-KLM Cargo and Emirates Air, so flights can coordinate outbound shipment of all Inditex brands with return legs loaded with raw materials and half-finished clothes items from locations outside of Spain. Zara is also a pioneer in going green. In Fall 2007, the firm’s CEO unveiled an environmental strategy that includes the use of renewable energy systems at logistics centers including the introduction of biodiesel for the firm’s trucking fleet.

4.4.4 RETAILING

Zara aims to offer fresh assortments of designer-style garments and accessories- shoes, bags, scarves, jewelry- for relatively low prices in sophisticated stores in prime locations in order to draw masses of fashion-conscious repeat customers. Despite its tapered integration into manufacturing, Zara places more emphasis on using backward

vertical integration to be a very quick fashion follower than to achieve manufacturing efficiencies by building up significant forward order books for the upstream operations. Production run are limited and inventories strictly controlled even if that means leaving demand unsatisfied. Both Zara's merchandising and store operations help reinforce these upstream policies.

4.4.4.1 MERCHANDISING

Zara's product merchandising policies, emphasize broad, rapidly changing product lines, relatively high fashion content, and reasonable but not excessive physical quality: "clothes to be worn 10 times" some said. Product lines were segmented into women's, men's, and children's line. The first line is divided into three sets of offerings that varied in terms of their prices, fashion content, and age targets. Process, which are determined centrally, are supposed to be lower than competitors for comparable products in Zara's major market, but percentage margins are expected to hold up not only because of the direct efficiencies associated with a shortened, vertically integrated supply chain but also because of significant reductions in advertising and markdown requirements.

It is claimed that Zara needs just two weeks to develop a new product and get it to stores, compared with a six-month industry average, and launches around 10,000 new designs each year. Zara has resisted the industry-wide trend towards transferring fast fashion production to low-cost countries. Perhaps its most unusual strategy was its policy of zero advertising; Zara's advertising investment is 0.3% as compared to traditional retailers who expends 3 – 4%. Zara's cuts in advertising investments reduce total expenses, which make the international expansion more economical. This also signifies that Zara relies mainly on its stores to project their image. For that reason, Zara has a department, which exclusively works in acquiring global prime real estate locations. In addition, this department is responsible for the frequent refurbishing of store layouts, as well as the creation of a common window display for Zara's global stores. The display positions Zara in the industry with a prestigious and elegant image(Zara).

Nor do Zara exhibit its merchandise at the ready to wear fashion show: its new items are first displayed in its stores. The Zara name had nevertheless developed considerable drawing power in its major markets. Zara's drawing power reflects the freshness of its offering, the creation of a sense of scarcity and an attractive ambience around them, and the positive word of mouth that results. Freshness is rooted in rapid product turnover, with new designs arriving in each twice-weekly shipment. Devout Zara shoppers even know which days of the week delivery trucks come into stores, and

shop accordingly. About three/quarters of the merchandise on display is changed every three to four weeks.

Luis Blanc, one of Inditex's international directors, summarized:

“we invest in prime locations. We place great care in the presentation of our storefronts. That is how we project our image. We want our clients to enter a beautiful store, where they are offered the latest fashions. But most important, we want our customers to understand that if they like something, they must buy it now, because it won't be in the shops the following week. It is all about creating a climate of scarcity and opportunity.”

Items that are slow to sell are immediately apparent and are ruthlessly weeded out by store managers with incentives to do so. Returns to the distribution center are either shipped to and sold at other Zara stores or disposed of through a small, separate chain of close-out stores near the distribution center. The target is minimize the inventories that have to be sold at market down prices in Zara stores during the sale period that end each season.

Zara is estimated to generate 15%-20% of its sales at marked down prices, compared with 30%-40% for most of its European peers.

The relentless introduction of new products in small quantities, ironically, reduces the usual costs associated with running out of any particular item. Indeed, Zara makes a virtue of stock-outs. Empty racks don't drive customers to other stores because shoppers always have new things to choose from. Being out of stock in one item helps sell another, since people are often happy to snatch what they can. In fact, Zara has an informal policy of moving unsold items after two or three weeks. This can be an expensive practice for a typical store, but since Zara stores receive small shipments and carry little inventory, the risks are small; unsold items account for less than 10 percent of stock, compared with the industry average of 17 percent to 20 percent. Furthermore, new merchandise displayed in limited quantities and the short window of opportunity for purchasing items motivate people to visit Zara's shops more frequently than they might other stores.

4.4.4.2 STORE OPERATIONS

The point of sale is not the end of the process but rather its restart, as the stores act as market information gathering terminals, providing feedback to the design teams and reporting the trends demanded by customers. Both the interior and exterior of the store design are given the highest priority. Here, the shop windows play a major role, acting as authentic advertising for our chains in the world's main shopping streets. As for the interior design, the aim is to create a well-lit space where the clothes take pride of place, eliminating all barriers between the garments and the customers. In every city

in the world all stores have the same layout: a predominantly white, modern and spacious store, well-lit and walled with mirror. It conveys a sense of continuity and reliability to customers, ensures uniformity in store management criteria and a global image in the eyes of customer around the world.

The stores were typically located in highly visible locations, with more than 100.000 inhabitants, often including the premier shopping streets in a local market and upscale shopping centers. Zara had initially purchased many of its stores sites, particularly in Spain, but had preferred long-term leases (10-20 years) since mid-1990s, except when purchase was necessary to secure access to a very attractive site. Stores were occasionally relocated in response to the evolution of shopping districts and traffic patterns. More frequently, older, smaller stores might be relocated and updated in new, more suitable sites. The average size of the stores had gradually gone up as Zara improved the breadth and strength of its customer pull.

This ensures uniformity in store management criteria and a global image in the eyes of customer around the world.

4.5 THE REASONS FOR SUCCESS

The Zara fashion chain is the world's most successful clothing chain. Zara, which in 2009 contributes around 80% of sales of Inditex, has helps its parent grow from obscurity in the mid 90s to the world's third largest pure-play retailer after the Swedish H&M and US- based Gap Inc. with financial performance well ahead of these rivals.

With 1608 shops in 2009 in 74 countries, Zara appears to have found the formula for success: give the public what it wants, at the lowest possible price, in the shortest time possible. This is made possible through a total control of every part of the business.

The sources of the competitive advantage are:

- Vertical integration
- Short lead time
- Information technologies
- Lower quantities and more styles
- Policy pricing
- Target market

4.5.1 VERTICAL INTEGRATION

At its heart Zara is building on a vertically integrated demand and supply chain. A company that operates in a vertically integrated strategy has total control of all

business activities from designing, manufacturing, sourcing, distribution to retail stores. It enables company to short turnaround times and achieves greater flexibility, reducing stock to a minimum and diminishing fashion risk to the greatest possible extent. The strategy is to produce and release products in number or limited in a store, a store may only receive ten of the new product. This strategy closely emulates a 'make to order environment'. This strategy this builds up customer's anticipation of the next product or design to be release, making the next product highly anticipated by customers.

Zara does not focus in advertising their product, because Zara does not focus in building brand image, there target is production and the customer's anticipation of their product. Instead on the focusing their strategy in product advertisement, the company focuses on product design and quality. The balance in fabric supply and manufacturing of the product itself contributes in the company's success. While in manufacturing, Zara has the most products manufactured. All the products of Zara are transported from the company's main central site in Spain. Most of the products are shipped from the "A Coruña depot". All stocks are not held for long periods and are sent out to all the Zara stores twice a week. For international deliveries, the stocks are delivered to the border of Spain, and the logistic provider in charge for that country takes over the distribution to the stores. The ideas and design of a product came from the designer. The designer gets the idea of what product to design next by means of its sales from stores and customers feedback and comments. The company's success is because of the total control in every aspect of the business, from designing, to production, and to distribution. By having total control of the entire process, the company can quickly react to the fast changing fashion trend and customer taste, this provides the company an idea of the latest fashion trend. Having total control in all business activities allows Zara to produce and release new design in a short span of time. All of the functions of the business continuously works together to produce new collections and designs which are updated and completed on a weekly basis, this allows the company to release new product easily. Zara shop managers report to designers in La Coruña in a daily basis on what has and has not sold. This report is used to determine if a product is to be kept or altered, and whether new lines are to be created. This happens in just a few days. The designers mostly rely on product sales, feedbacks and comments from customers.

Stores order their stocks from an offer they received twice a week from the commercial manager who then orders the stock to the logistic who handles the stock. Stores are ranked according to sales and forecast accuracy; this rank will determine the level of priority for store order. If a product is not selling, the company stops the manufacturing. By this means no stock will over pile. If a product is not selling a certain store the company stops manufacturing the product, this avoids over stock of non-

selling products. Shoppers addicted to the Zara brand know exactly when the deliveries will be arriving at their local shop and some even turn up before opening time on delivery days to be the first to pick up the latest lines. Because products are released limitedly, customers regularly visit a store to see if a new stock has arrived. Some product in a region may not be high selling unlike in some region. In Asian market some design are kept and maintain, while in most European country where fashion is at constant change design must be constantly new therefore releasing new product constantly. Customers in other region tend to embrace what is the latest design in Europe, being the fashion capital of the world, these proves that a product can be market in other region such as Asia.

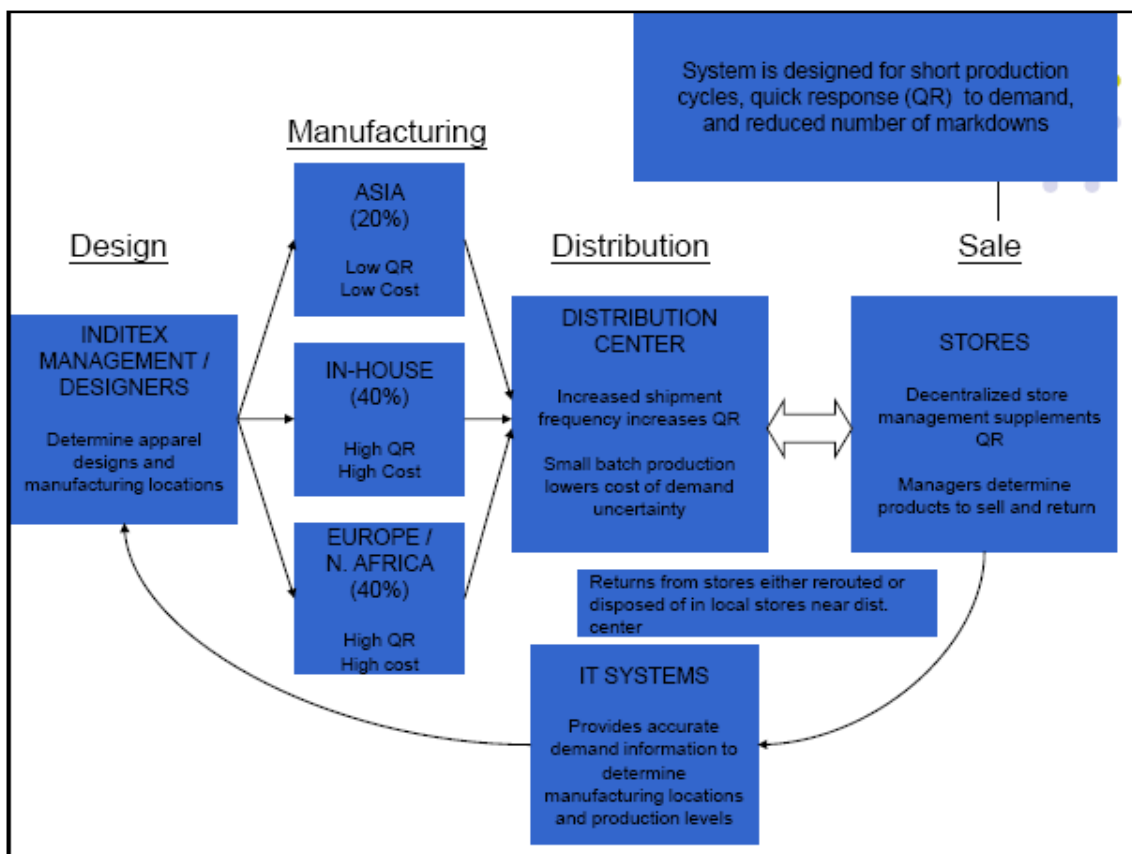


FIGURE 4.12: ZARA'S VERTICAL SUPPLY CHAIN

4.5.2 SHORT LEAD TIME

The key objective of the company is “ to get the shortest time to the market”. By focusing on shorter response times, the company ensures that its stores are able to carry clothes that the consumers want at that time. Zara can move from identifying a trend to having clothes in its store within 30 days. That means that Zara can quickly identify and catch a winning fashion trend, while its competitors are struggling to catch

up. Catching fashion while it is hot is a clear recipe for better margins with more sales happening at full prices and fewer discounts. In comparison, most retailers of comparable size or even smaller, work on timelines that stretch into 4-12 months. Thus, most retailers try to forecast what and how much its customers might buy many months in the future, while Zara moves in step with its customers (pull system). Trend identification comes through constant research not just traditional consumer market research, but a daily stream of emails and calls from the stores to head office. Unlike other retailers, Zara's machinery can react to the report immediately and produce a response in terms of a new style or a modification within 2-5 weeks. Zara chooses manufacturers that can provide speed over cost and is very customer focused. They monitor what is being sold and seek customer input. They try to capture lost sales and potential opportunities. They have twice weekly shipments of small batches to their 1608 stores, and they have made substantial financial investments in information technology and logistics. Zara owns 40% of their production facilities, and they have a very close relationship with their other manufacturers. Zara's relationship with their manufacturers, proximity to market, and logistics skills, combined with their concurrent product development process, help them achieve short lead times. Because of their short lead times and small batches, they can correct most problems resulting from forecasting errors before they have a large impact. Another advantage of having short lead times is that their working capital requirements are reduced. An important rule to have a short lead time is played by information technologies because they inform designers about what consumers want.

4.5.3 INFORMATION TECHNOLOGIES

Information and communications technology is at the heart of Zara's business. Four critical information-related areas that give Zara its speed, include:

- Collection information on consumer needs: trend information flows daily, and is fed into a database at head office. Designers check the database for these dispatches as well as daily sales numbers, using the information to create new lines and modify existing ones thus, designers have access to real-time information when deciding with the commercial team on the fabric, cut, and price points of a new garment.
- Standardization of product information different or incomplete specifications, and varying product information availability typically add several weeks to a typical retailer's product design and approval process, but Zara "warehouses" the product information with common definitions, allowing it to quickly and accurately prepare designs, with clear cut manufacturing instructions.

- Product information and inventory management being able to manage thousands of fabric and trim specifications, design specifications as well as their physical inventory, gives Zara’s team the capability to design a garment with available stocks, rather than having to order and wait for the material to come in.
- Distribution management: distribution facility functions with minimal human intervention to ensure each order reaches its right destination. Optical reading devices sort out and distribute more than 60000 items of clothing an hour.

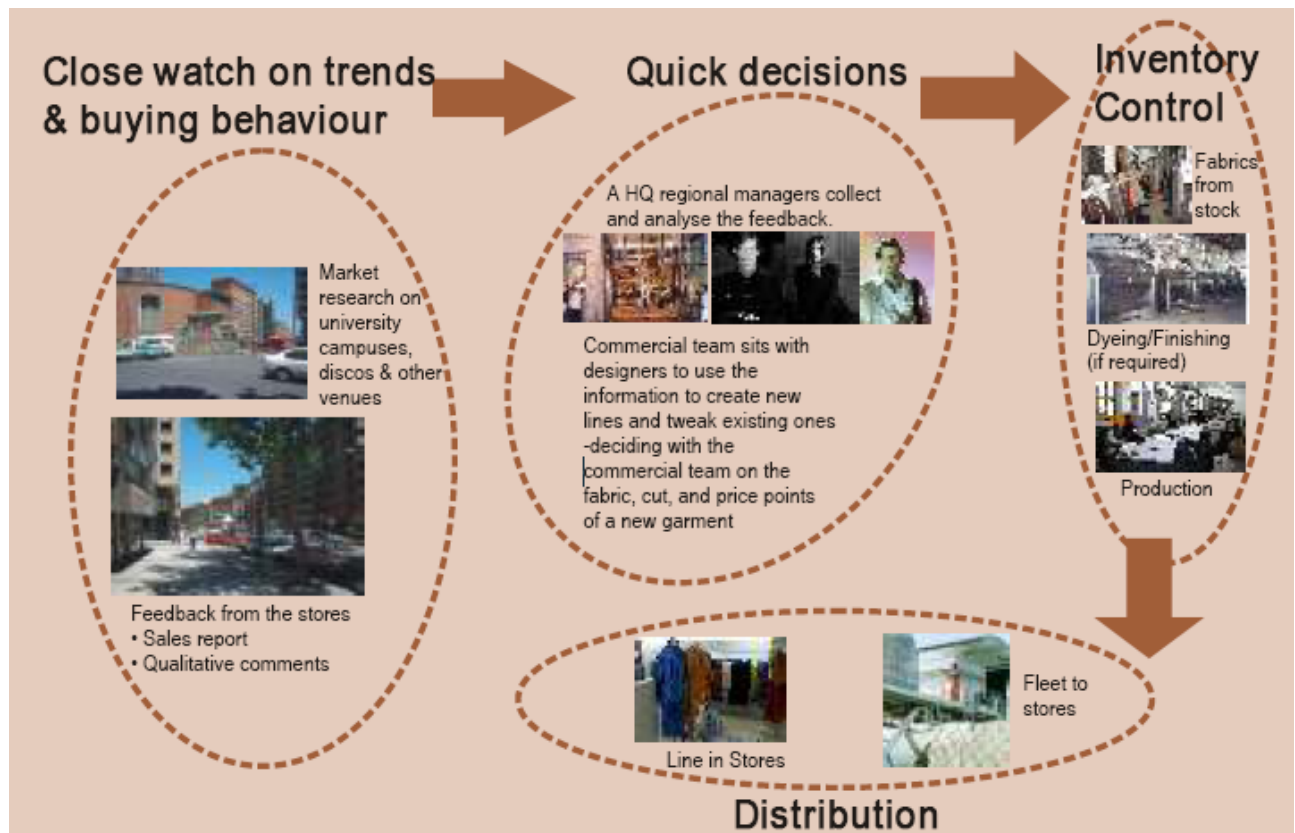


FIGURE 4.13: CRITICAL INFORMATION-RELATED AREAS

Information travels from the stores to the designers, transmitting the demand and concerns of the customers. Zara's shops use Information Technology to report directly to its production centers and designers in Spain.

Shop managers use PDAs to check on the latest clothes designs and place their orders in accordance with the demand they observe in their stores. Thus, they directly contribute to a streamlined fashion collection of the entire company. The designers at Headquarters collect and evaluate these suggestions and they arrive, produce designs on their computers, and, when finalized, send them over the company intranet to a

factory. The result is that Zara designs and produces as many as 10.000 new items every year.

The constant flow of updated data mitigates the so-called bullwhip effect—the tendency of supply chains (and all open-loop information systems) to amplify small disturbances. A small change in retail orders, for example, can result in wide fluctuations in factory orders after it's transmitted through wholesalers and distributors. In an industry that traditionally allows retailers to change a maximum of 20 percent of their orders once the season has started, Zara lets them adjust 40 percent to 50 percent. In this way, Zara avoids costly overproduction and the subsequent sales and discounting prevalent in the industry.

4.5.4: LOWER QUANTITIES AND MORE STYLES

By reducing the quantity manufactured in each style, Zara not only reduces its exposure to any single product but also create an artificial scarcity. As with all things fashionable, the less availability, the more desirable the object becomes. The assortment changes 70-90% each month in Zara's retail stores. They use no advertising and prefer to pick "great" locations for their stores.

The added benefit of lower quantities is that if a style does not work well, there is not much to be disposed when the season-end sale does happen. The result is that Zara discounts about 18% of its products, roughly half the levels of competitors. Zara has very limited sales and no clearance racks.

Instead of more quantities per style, Zara produces more styles, roughly 10.000 a year. Thus, even if a style sells out very quickly, there are new styles already waiting to take up the space.

Zara can offer more choices in more current fashions than many of its competitors. It delivers merchandise to its stores twice a week, and since re-orders are rare the stores look fresh every 3-4 days. Fresh produce, moving in step with the fashion trend and updated frequently the ingredients are just right to create the sweet smell of success.

4.5.5 TARGET PRICING

While management stressed that Zara used the same business system in all the countries in which it operated , there was the same variation in retailing operations at the local level. The first store opened in each market-often a flagship store in a major city-played a particularly critical role in refining the marketing mix by affording detailed insights into local demand. The marketing mix that emerged there was applied to other stores in the country as well.

Pricing was marked-based. However, if a decision "was" taken to enter a particular market, customers effectively bore the extra costs of supplying it from Spain. Prices

were, on average, 40% higher in Northern European countries than in Spain, 10% higher in other European countries, 70% higher in the Americas, and 100% higher in Japan. Zara and historically marked local currency prices for all the countries in which it operated on each garment's price tag, making the latter an "atlas" as its footprint expanded. The higher prices outside Spain did imply a somewhat positioning for Zara overseas, particularly in emerging markets. Castellano explained the situation with an example: in Spain, with the prices we have and the information available to the public, about the 80% of Spanish citizens can afford Zara. When we go to Mexico, for cultural reasons, for incremental reasons, for economic reasons—because the average income in Mexico is \$3000 compared to \$14000—our targeted customer base is narrower is the upper class and the middle class. That is the class that knows fashion, that is accustomed to buying in Europe, or in the United States, in New York or Miami. In Mexico we are targeting 14 million inhabitants, compared to 35-36 million in Spain [out of populations of 100 million and 40 million respectively. But 14 million is more than enough to put in a network of stores there. Differences in positioning also affected the stores in which products were sold and Zara's overall image. For example, in South America, Zara products had to present a high-end rather than a mid-market image and it was emphasized that they were "made in Europe".

Zara's promotion policies and product offerings varied less internationally than did its prices or positioning. Advertising and other promotional efforts were generally avoided worldwide except during the sales periods, which were typically biannual, in line with West European norms.

4.5.6 TARGET MARKET

Zara's target market is very broad because they do not define their target by segmenting ages and lifestyles as traditional retailers do. Its target market is a young, educated one that likes fashion and is sensitive to fashion. Today, people around the world through various communication devices have more access to information about fashion.

Therefore, fashion has become more globally standardized and Zara uses this to their advantage by offering the latest in apparel. For that reason, 80- 85% of the products that the company offers globally are relative standardized fashionable products.

The international strategy of this fashion chain is excellent because it adopted a balanced mixture of standardization and customization. Figure 4.13 shows the Zara's positioning according to the process and the customization.

ZARA POSITIONING

PROCESS	High customization	Some customization	High standardization
Manual shop	High fashion (Chanel, D&G)		
Batch flow	ZARA	Mark & Spenser	
Rigid line flow			Mass merchants

FIGURE 4.14: ZARA’S POSITIONING ACCORDING TO THE PROCESS AND THE CUSTOMIZATION.

4.6 STRATEGIC DRAWBACKS

Although Zara has a successful business model that differs from that of traditional retailers, it also has disadvantages that can affect its sustainable growth. Due its model, Zara’s weaknesses also differ from the traditional retailer. Zara holds around 80% of Inditex’s total international sales-a significantly high number for an organization that has seven other chains. With that, Inditex is putting all of their eggs into one basket by sinking a great deal of capital into Zara. Inditex has contributed their extensive international sales to Zara and said “Zara was the principal reason Inditex’s sales were increasingly international” . If Zara fails in the future, Inditex will have to totally re-formulate their firm’s strategies and may possibly face an internal meltdown.

Zara also has an inability to penetrate the American apparel market. This may be due to American tastes that differ from European preferences. More importantly, however, Zara has not been able to develop a strong supply chain strategy in the U.S. like they have in Europe. Their European strategy includes, having a strong production and distribution facility in their home country in order to have short production and lead times. Zara has not invested in distribution facilities in the Americas, which is a threat to their U.S. selling abilities since the U.S. makes up 29% of the total apparel market. This may make them “subject to diseconomies of scale”, which means that though are aware of how to quickly supply 1,000 stores, they may not be able to supply more retail locations due to their “centralized logistics model”.

Zara’s strategy also creates some weaknesses. Their vertical integration has more advantages than drawbacks but it is important to recognize its limitations. Vertical

integration often leads to the inability to acquire economies of scale, which means they cannot gain the advantages of producing large quantities of goods for a discounted rate.

Higher costs are then incurred for the Inditex Corporation. Inditex also has to support their own high capital investments for their chains and be able to financially back their “technology and skills beyond those currently available within the organization”. Zara’s speedy and recurrent introduction of new products incurs increased costs as well. They have higher research and development costs. They also have elevated costs due to the constant changeover of production techniques to create their different apparel lines. That also means that employees must be trained in order to use the new manufacturing techniques, which again leads to increased costs. Traditional retailers do not experience higher costs in all of these areas.

4.6.1 POSSIBILITIES FOR FAILURE

Like traditional retailers, Zara has a threat of failure that can harm its growth.

The European switchover to the common currency called the euro has created the potential threat for the Spanish Zara chain. In July 2002 the euro was the only currency accepted for all transactions in member countries of the European Union. If the euro becomes stronger against the American dollar, than production costs will increase for European producers. The euro switchover will increase Zara’s cost of production. That cost increase will be carried over to the consumer with higher prices. This threat of the euro may also create a threat of decreased sales because apparel prices will be too high for the traditional Zara shopper.

Zara’s direct competition may be their largest threat, especially when expanding into new geographic territory. Almost any retailer can be a threat to Zara due to their wide range of merchandise categories. Zara offers clothing and accessories for men, women, maternity, children, and baby. Many other retailers also offer goods to one or all of those merchandise groupings. The Gap is one of these competitors because they are also international and sell the same range of merchandise with a less trendy style. H&M (Hennes and Mauritz) is probably Zara’s most similar and threatening competitor. They too have been quick to “internationalize”, which allows them to gain sales in countries outside their native Sweden. H&M also is more attentive when entering new markets and tends to enter one country at a time, as opposed to Zara who multitasks globally. H&M builds distribution centers in their international locations in order to cut down lead times and potential logistical costs.

Another threat to Zara is that H&M carries trendy clothing choices that they have designed based on the melding of international apparel tastes. However, H&M offers

these styles at a cheaper rate than Zara. H&M also uses more advertising than Zara, but not as much as the Gap, which may aid them in entering new markets successfully because the local customer is aware of H&M's merchandise mix.

A final threat to Zara is the issue of cannibalization. Zara's extensive location strategy involves putting multiple Zara stores that carry the same merchandise in the same cities. That means Zara is trying to sell the same exact merchandise to the same people that reside in that city.

For example, the five hundred and four Zara stores in Spain can cannibalize sales from each other especially if multiple locations are within the same city. Also, the other 1900 Inditex stores located in Spain can cannibalize Zara's sales since the majority of the chains have a similar target market to Zara. This is similar to the challenges faced by the Gap versus Old Navy: Gap's sales were cannibalized by Old Navy's lower prices.

4.7 OPPORTUNITIES

The best way for Zara to maintain their sustainable growth is to seek new opportunities in the apparel market. With changing consumer behaviors as a result of globalization, and U.S. department stores suffering, there are growth options available for specialty retailers like Zara.

Zara has the opportunity to be one of the trendiest/low priced retailers that America has seen recently. Zara should most likely develop a second central distribution center in the Americas to decrease logistics in order to deliver fashionable goods in a faster manner. Their second central distribution facility should be an expansion of one of their smaller distribution centers located in Argentina, Brazil or Mexico. The close proximity of the distribution center to the American market will allow them to effectively interpret the particular American fashion and to obtain shorter lead time. The distribution center will also allow them to have additional funds to spend in other areas of business such as advertisements: a necessary feature to penetrate the American market.

Another market opportunity for Zara is to invest in Internet retailing especially directed toward the U.S. market. Though Zara is wary of overexposure, Americans like to be able to purchase all goods including apparel from the comfort of their own homes at any time they chose.

Therefore, since Zara is looking to expand in the U.S. market they could realize the potential for a direct Internet selling strategy. That form of direct marketing will reach more consumers faster and easier. Though it may be difficult to display all of Zara's

ever-changing fashions online, it may prove profitable for shoppers to purchase a moderate selection of trendy Zara pieces along with some of their staple basics.

A final recommendation for Zara is to offer specialized products for different geographic locations within the same city. Zara already does this to an extent for different international preferences but more specialization will increase consumer demand and will motivate them to visit more Zara locations within their own region. In some cities the company is possibly experiencing cannibalization because there are too many Zara stores that carry the same product within one city. Zara could differentiate its product from location to location to increase shopper traffic. This would work because shoppers would hear about new/different products (possibly from word of mouth or increased advertising) that another Zara store is carrying across the city and they would be intrigued to pay a visit. That way sales wouldn't be stolen from their own Zara stores, decreasing cannibalization for the chain.

In conclusion, Zara has the potential for sustainable growth due to its competitive advantage and its ability to face the challenges of the apparel industry. The company keeps its operating income elevated, has a strong and unique business model, and has various opportunities for expansion in the retail industry.

CHAPTER 5

BENETTON CASE STUDY

5.1 HISTORY

The company was born in 1965 in Ponzano Veneto (in the Treviso province), from the artisan knitting workshop of the Benetton siblings.

In the beginning, Benetton was only a small company that was producing sweaters for local independent retailers. In 1966 opened its first “Benetton’s shop” in Belluno and in just few years Benetton’s stores covered all Italian’s province.

In the 1960s and the 1970s, Benetton’s promotional strategy was focused on shops, advertising huge expenditures being out of reach at the time.

The first ‘My Market’ shop format was designed by Tobia Scarpa, son of the famous architect Carlo Scarpa. He suggested to eliminate the counter, arrange all the sweaters on shelves, and open the window towards the interior of the shop. This way, the same room could be used for stocking, selling and displaying merchandise. Most of the shops were not company-owned, but informally franchised to shopkeepers paying no royalties and granted no exclusive right. Independent agents recruited franchisees and collected their orders. The presence of several shops in the same urban area produced a positive iteration effect on final customers, and a dissuasive effect on competitors. The creation of a franchisee-shops network selling many-coloured classical-cut sweaters (serially weaved, sewed outside, and then dyed) can explain the competitive advantage the ‘Benetton formula’ enjoyed since the late 1960s.

In 1968 was opened in Paris the first store outside Italy, a first step in the international expansion and development programmed outside Italy.

In 1969 was created the first line for kids, in response to demand from adult customers already loyal to Benetton's multicolor products.

In the 1970s, the company started producing also jeans and velvet trousers, shirts and T-shirts, in order to allow customers to find a coordinate set of apparel inside its shops. With its combinable collections, Benetton helped developing Italian casual style. Product differentiation brought about target differentiation, and a multiplication of shop formats as ‘012’ for kids, ‘Merceria’ for young customers’ mothers, ‘Jean’s West’ for jeans, or ‘Tomato’ for penniless young people, and others.

In these years it aimed to conceal its expansion, in order to escape social and political tensions, prevent unions from meddling with its informal production and distribution network, and keep on moving as a little family business despite its growth.

In 1974 Benetton Group enlarged its brand portfolio, expanding product offerings, with the Sisle Brand adding a new target to its consumer base.

Benetton's name never appeared on the sign of the shop, but only on single items (with the wool-knot logo that became famous in the 1980s). Low visibility allowed not to alarm competition, and marked off the company from shopkeepers commercial policies.

At the end of the 1970s Benetton met its first difficulties in sales. This crisis made the entrepreneurs aware the company had reached a threshold in scale, and that a reorganization was needed in order to avoid a downsizing. Awareness came along tentatively, buying and then selling shops and plants, and trying to expand in Europe in order to make up for the saturation of Italian market.

Indeed, it was only in the attempt to expand sales abroad that franchising was used on purpose to enter new markets, and became the driving element of a new strategy for growth.

From the low-profile attitude of the 1970s, Benetton moved in the 1980s towards an explicit brand promotion and an increasing transparency, in view of listing on the stock exchange. Sales promotion abroad needed to use the Italian-style appeal of Benetton name; in Italy too, Benetton unified different existing shops under the Benetton, 012 and Jean's West signs: too much differentiation threatened to frustrate brand-advertising efforts.

Visibility was also a result of the choice to take family-business clothes off, and to turn Benetton into an international company with solid relationship with politics and finance. Thanks to its camouflage ability, in the 1970s the company had been able to enjoy State facilities without undergoing the limitations big businesses suffered. In the different political context of the 1980s, it became a respectable interlocutor for national institutions, politicians and bankers.

In 1980 Benetton expands sales in the Americas (NY) and in 1982 in Asia (Japan) adopting a new step-by-step entry strategy, firstly licensing local producers to use its trade mark, then entering in joint venture with them, and establishing a local branch of the company only when the market had shown its development capacity. In this project, brand promotion was a basic point: advertising expenditures increased then more, in order to promote a colored, multi-ethnic and *global* image of the company.

In the second half of the 1980s, the success of commercial expansion in Europe urged an adjustment of international strategy. Western Europe had become Benetton's real domestic market. The Group continued its international expansion and by the end of 1985 Benetton sold its products in approximately 60 countries through 3,200 stores evolving towards an industrial company, with manufacturing operations in Italy and outside the domestic market.

Since 1983 advertising design had been entrusted to the Parisian agency Eldorado, employing the photographers Bruno Sutter and Oliviero Toscani. In the 1984 campaign 'All the Colours of the World' Toscani put together white and black young models wearing coloured clothes. He introduced then the 'United Colors of Benetton' slogan, explicitly identifying the company's globalization strategy with the ideal of a peaceful, multi-ethnic world, which after the international political changes of the second half of the 1980s seemed at hand. In 1989 this slogan became the logo of the company, and Toscani was hired by Benetton, breaking the contract with Eldorado.

In the following campaigns, any reference to the product disappeared, and advertising focused on topical social issues.

In 1984, Benetton was planning to build up a communication system collecting both orders and payments from franchisees' sales records. This project failed because of the (mostly passive) resistance shopkeepers and agents offered to what they saw as a threat to their autonomy.

In 1985 the firm was quoted in Milano's stock's exchange and later in the New York's stock's exchange (from whose quotation it was withdrawn in 2007).

In 1987 was born the "Study and Research Benetton's Foundation", presided by Luciano Benetton and directed by Domenico Luciani. The principal field where it works it concerns the government and the sketch of the landscape, of the places that are around us and of those of every other part of the world, particularly in Europe and in the Mediterranean. The foundation organizes seminars, courses and trips of study, experimental laboratories on the life and the form of the places, for their knowledge, safeguard, exploitation.

In the 90's Benetton leveraged its manufacturing capabilities to offer high quality products at accessible prices, adopted a pioneer approach to some emerging markets, and further enlarged its consumer target, including in its portfolio the leisure brand Playlife.

The inflation of Benetton's image in the first 1990s was also enhanced by the success of the Formula 1 stable the company acquired in 1984, which in 1994 and 1995 won the World Championship (Mantle 1998). The company also owned basket, rugby, volley and water-polo teams: in 1979 Benetton first sponsored their local rugby team, A.S. Rugby Treviso, in 1982 the company bought its local basketball team, Pallacanestro Treviso, now commonly known as Benetton Basket, and their Sisley brand sponsors the local volleyball team, Sisley Volley Treviso.

In 1991 was born Colors review at the hands of Luciano Benetton and Oliviero Toscani, sold in forty countries and written in four distinctive languages.

In 1992 Luciano Benetton stood as candidate for and was elected to Parliament, with a move allowing him an insider knowledge of economic policy decisions in those troubled years for Italy, and putting again his company in the limelight.

In 1994 was born Fabrica, a communications research center concentrated on communication projects ranging from cinema to graphics, from industrial design to music, from publishing to new media to photography. Luciano Benetton describes Fabrica as: “ a bridge between a visionary dream: between utopia and the reality a world facing changes that would have been unimaginable only a few years ago.” Fabrica invited students from different countries, with creative talents, offering them year-long fellowships.

Indeed, troubles were not only for policy makers: in the 1990s Benetton’s market position was challenged by international retailers such as The Gap and Zara. Company reacted by adjusting the dimensions of shops to the need of a total-look offer including licensed apparel and accessories, from spectacles to cosmetics. Average shop area increased from 50 to 200 square meters, and new *megastores* were opened in big cities all over the world. The megastore project forced the company to buy valuable real estate in order to fill strategic commercial positions; still, in perspective also megastores were to be franchised to independent shop owners. Early 2000’s, the apparel industry started to see a new, demanding and sophisticated consumer: Benetton introduced a new market approach to compete in the arena, adding to the core wholesale business some directly operated stores. The group is currently a market-driven company that can leverage its manufacturing know-how and industrial efficiency, with consistent focus on improving quality and innovating processes to serve 6.300 stores in over 120 countries.

5.2 FINANACIAL DATA

The Group's revenues in 2009 amounted to 2,049 million compared with 2,128 million in the comparative year, reporting a slight reduction of 3.7% partly due to:

- a different contribution from the collection mix, reflecting prudent consumer spending in the market as a whole;
- an unfavorable trend in emerging country currencies against the Euro's exchange rate (15 million), particularly by the Korean won, Turkish lira, Russian rouble and Indian rupee;
- a net positive impact from the opening of directly operated stores.

The figure below shows the trend of the revenues in the last ten years.

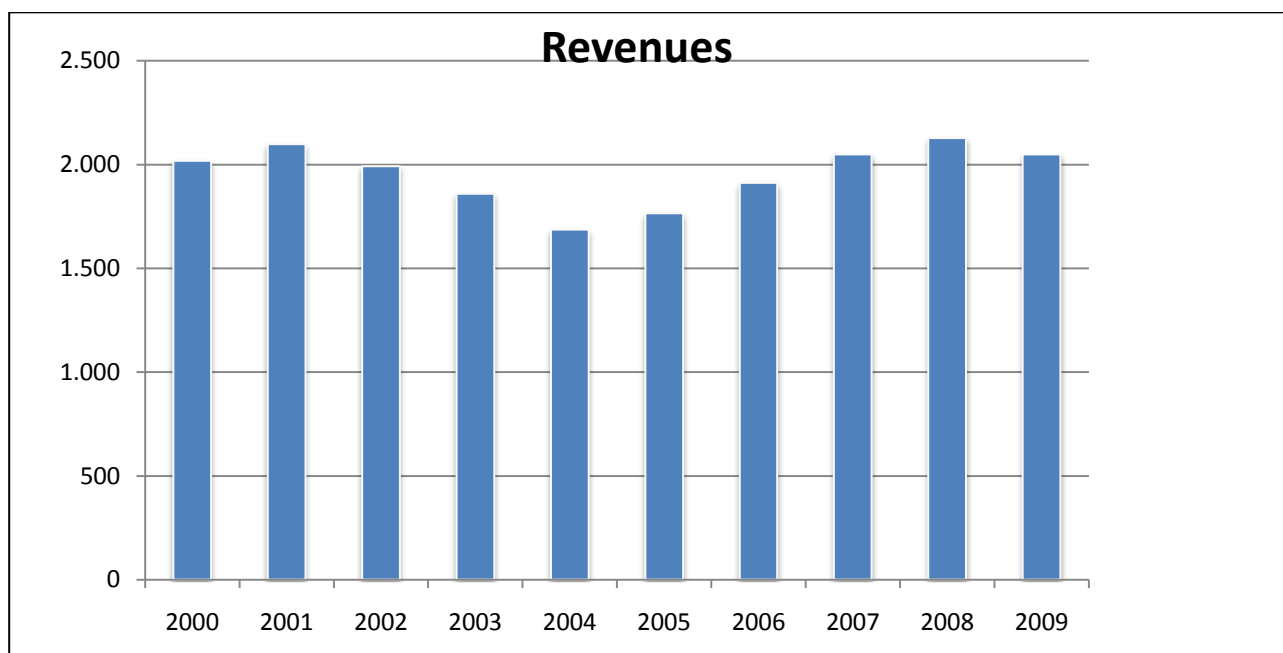


FIGURE 5.1: REVENUES (mln €)

As shown in figure, in the last decade revenues fluctuate over two million euro except in 2004 when there was a sharp decrease consolidating revenues of 1,686 million euro due by the sale of the sports equipment business [completed during the first half of 2003] and by continuing unfavorable trends in the principal foreign currency exchange rates.

The apparel segment reported 1,947 million in revenues from third parties, representing a reduction of 87 million on 2008.

The textile segment increased its revenues from third parties by 8 million to 102 million, 8.2% more than in the comparative year, benefiting from the new commercial initiatives already started in 2008 which partially offset lower sales of wool yarn.

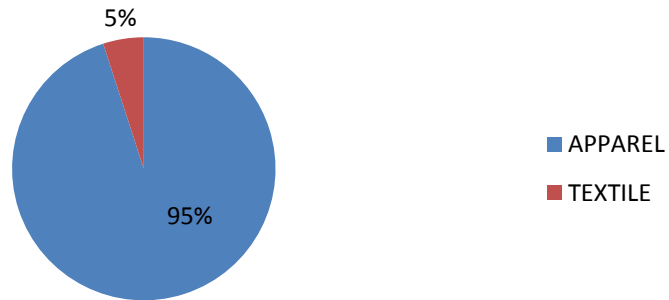


FIGURE 5.2: REVENUES FROM THIRD PARTIES BY ACTIVITY (%)

Benetton produced 150 million items (garments and clothing accessories, such as footwear, bags, belts, etc.). About half of the Benetton's production was sold in the Italian market, Benetton sold its products in 124 countries through 5800 mono-brand stores, 95% of which are in franchising.

In the beginning almost all Benetton production was sold on the domestic market and exports became significant toward the end of the 70s with stores opened in France, Germany, United Kingdom, Holland and Belgium. Between 1973 and 1979, the Benetton's sales increased from 31 to 287 million Euros.

Today, in a highly depressed economic environment, constant currency revenues fell by just 3%, in 2009. The decrease in turnover on mature markets was limited to 5% on a constant currency basis. In particular, the Group generally defended its performance in Italy, where revenues contracted by just 4% and which continued to be its principal market accounting for 48% of revenues. This is a good result, achieved thanks to the excellent level of collaboration with the Group's agents and customers, by following a strategy that focuses on large stores in the major cities, and a wide presence in other cities and secondary towns (over 2,500 stores) giving deep market knowledge. The rest of continental Europe performed in line with the general sector trend, accounting for 34% of revenues. Markets in the Iberian peninsula slowed, after being more severely hit than others by the economic and financial crisis. In Asia, excellent results were achieved on the Korean market with strong double-digit growth, consolidating 14% of revenues.

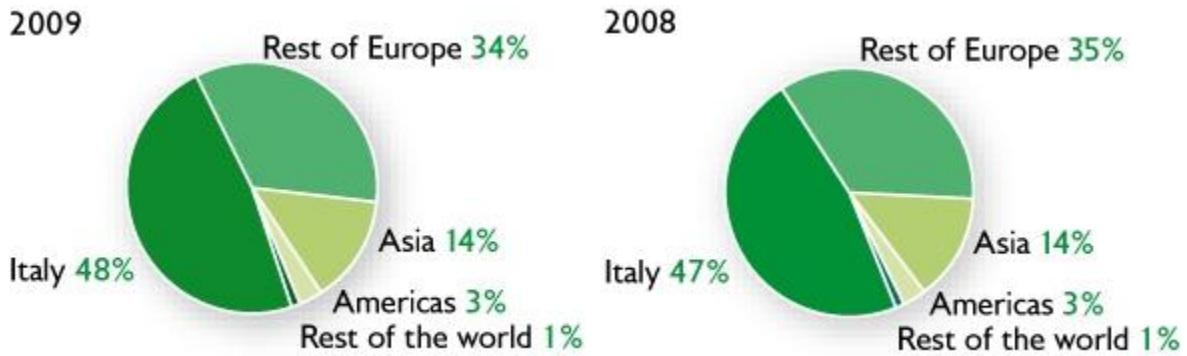


FIGURE 5.3: SALES BY REGION

The following illustration shows the profitability indicators established by the group during the last ten years:

- ROS (Return on sales): is the ratio of operating income divided by net sales, usually presented in percent.
- ROI (Return on investment): is a performance measure used to evaluate the efficiency of an investment or to compare the efficiency of a number of different investments.
- ROE (Return on Equity): measures the rate of return on the ownership interest (shareholders' equity) of the common stock owners. It measures a firm's efficiency at generating profits from every unit of shareholders' equity. It shows how well a company uses investment funds to generate earnings growth.

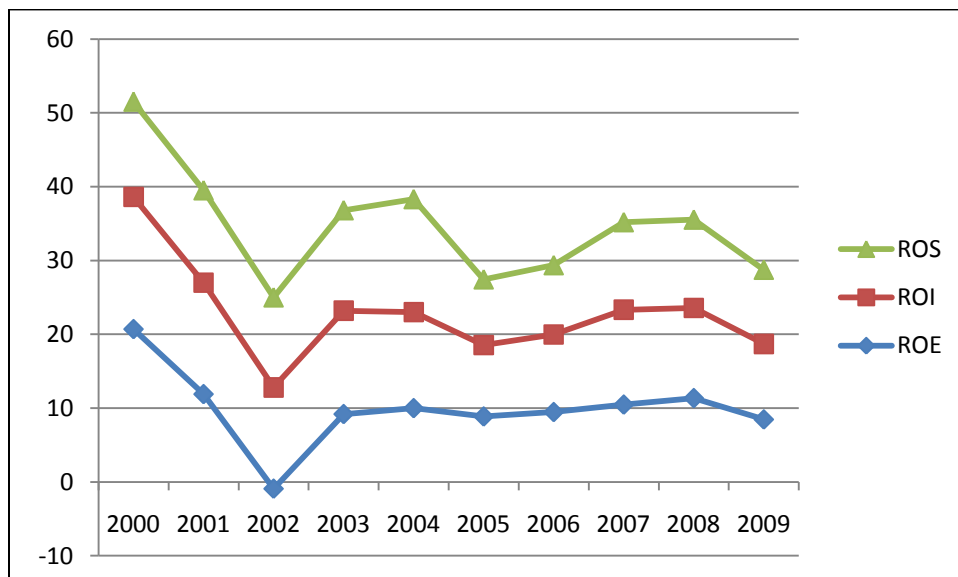


FIGURE 5.4: FINANCIAL RATIOS (%)

As showed, in 2002 there was a marked decrease of the indices of profitability due by the strategic decision to focus Benetton's activity on the core business of casual

clothing and sportswear. This resulted in an extensive reorganization of the sports equipment division, with the objective of bringing the Nordica, Prince and Rollerblade brands to a substantial break-even and starting a program for their disposal, duly completed in the early part of 2003.

In numerical terms, the steep decrease in turnover in the sports sector hurt the Group's overall performance: total sales in 2002 amounted to approximately 2.0 billion euro, down from 2.1 billion in 2001.

The program for the disposal of the sports equipment business resulted in the booking of extraordinary and non-recurring costs. While these had a limited impact on financial flows, they were the main reason for the small loss for the year of some 10 million euro.

5.3: ITS BRANDS

Benetton, the Italian retailer was engaged in the manufacturing and distribution of clothing, undergarments, shoes, cosmetics and accessories. Benetton also licensed its brand name to various manufacturers of sunglasses, stationery, cosmetics, linens, watches, toys, steering wheels, golf equipment, designer condoms and luggage. The group's important brands included United Colors of Benetton (UCB), Undercolors of Benetton, Sisley, and PlayLife.

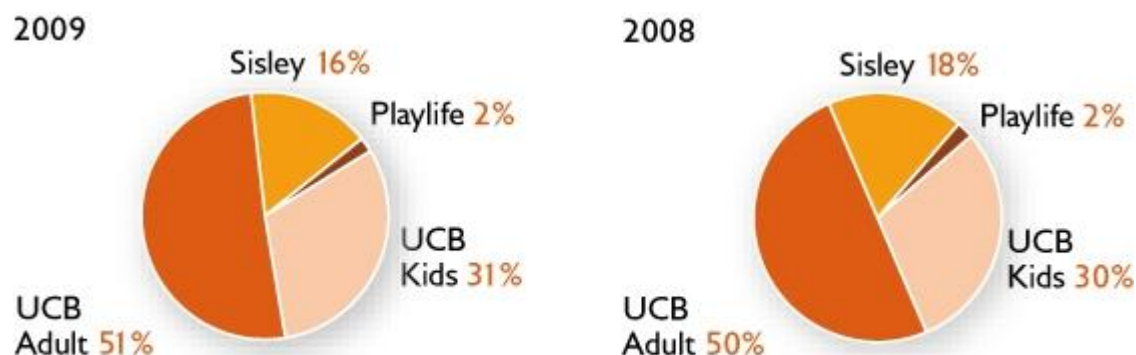


FIGURE 5.5: SALES OF CORE PRODUCTS BY BRAND

5.3.1 UNITED COLORS OF BENETTON

United Colors of Benetton, the iconic Group's global brand, and one of the most well known in the world, has an international style that combines color, energy and comfort. All these key elements find their expression in the brand's core value: Passion

for Quality, with a strong commitment to comfort and style. Each season the womenswear, menswear, childrens-wear and underwear collections offer a total look for everyday, for work and for leisure, in the city and outdoors. The Benetton Baby label is a new product line dedicated to the prenatal and the under-fives world. The brand is present in many other sectors, from the elegant accessories to the eyewear lines and perfumes, from the home collection to baby products. The above products are available in selected specialized shops worldwide.

UCB woman collection is both for women who work and demand an easy and elegant wardrobe and those who want to create alternative looks with a mix&match style.

UCB man collection is a blend of elegance and originality, completely in tune with the mood of the brand.

5.3.1.1 UCB KIDS

Collection segments different categories:

- New born (0-1 year), targets the smallest consumers, proposing fun and taking inspiration from a the adult wardrobe, all with a constant attention to typical infant characteristic;
- Toddler (1-5 years), offers a touch of glamour in comfortable, cosy and resilient items for tomorrow's adults;
- Kids & Young (6-12 years), proposes ideas for the pre-teenagers, very demanding when it comes to fashion and fit.

The collections are completed by mothers-to-be line, with comfortable, soft, easy and unique clothes, meeting future mothers' requirements throughout the day.

Even in the difficult 2009 UCB Children improved its performance by 1.4% and celebrated forty years of business with a major event in Rome.

Sales of UCB Children have almost doubled in the past ten years, with the brand exceeding 30% of the Group's turnover in 2009. Thanks to this constant growth the brand is no longer perceived as an extension of UCB Adult, but rather as a specialized brand which has satisfied customer demands and won their loyalty. Year after year, the focus has been on segmenting the offer, knowing that children have different demands according to their age group, and on designing the collections in a consistent fashion.

5.3.1.2 UNDERCOLORS OF BENETTON

Undercolors of Benetton is an extension of the Benetton brand, featuring underwear, beachwear and sleepwear collections, as well as accessories for women, men and children. A wide selection of recurring basic colors is enriched every season with the latest trends. Undercolors is available in its own chain of stores which now has more than 500 locations in thirty countries and in selected Benetton Shops.

5.3.2 SISLEY

The encounter with Benetton occurred in 1974, when the Group, perceiving the potential, bought exclusive rights to use the name, but it was not until 1985 that Sisley took on its own personality within the Group.

This is the Group's most fashion forward brand. Sisley presents elegant and seductive collections, with special attention given to the choice of design, fabrics and new shapes. Its creative artists and independent sales teams concentrate their efforts on its image and on strong-impact advertising campaigns. The brand has created the very fashionable Sisley Young line for children from 8 to 12 years old.

5.3.2.1 SISLEY YOUNG

Is a sophisticated, detailed and rich collection inspired by the looks of up-to-the minute fashions, styled to suit younger crowd.

Available for children from 3 to 12, but concentrating on the 8-12 age group, it plays on sensations, emotions and creativity, all of which are reworked, filtered and adjusted to the young age of our very modern little women and men.

5.3.3 PLAYLIFE

Playlife is the Benetton leisurewear brand that redefines a style. With its clean and elegant collections Playlife blends an exclusive exploration of styles and allusions and a strong sense of individuality. Playlife is a laboratory of new styles and brands which are flexible and embrace total interpretative freedom, offering romantic, sporty and relaxed chic styles for both men and women. This applies both to him and her, as both are given the opportunity to use their fantasy and creativity to develop an increasingly more personal style. The strengthening of the commercial network in recent years, particularly in Mediterranean Europe, has helped to sustain turnover. The brand's new store concept reflects the same values, highlighting their emotional content.

5.4 OPERATIONS STRATEGY

Benetton's innovative and almost pioneer operations strategy was the key of its success for almost three decades until late 90's. A mix of unique resources and competences, acquired and constantly improved over time started being imitated by emerging global competitors (Zara's sales are now four times Benetton's).

Benetton was ahead in dyeing, but was far behind in designing. Upstream vertical integration was offset by a retail strategy relying only on franchisees. It then reshaped its operations strategy by focusing on speed and quality, reduced time-to-market of its

more than 100 collections per year from two months to two weeks, and now promises a least 7% annual sales growth over the next ten years.

In describing Benetton's actual operations strategy, the main changes occurred in product design, supply and production, distribution and retail have great importance.

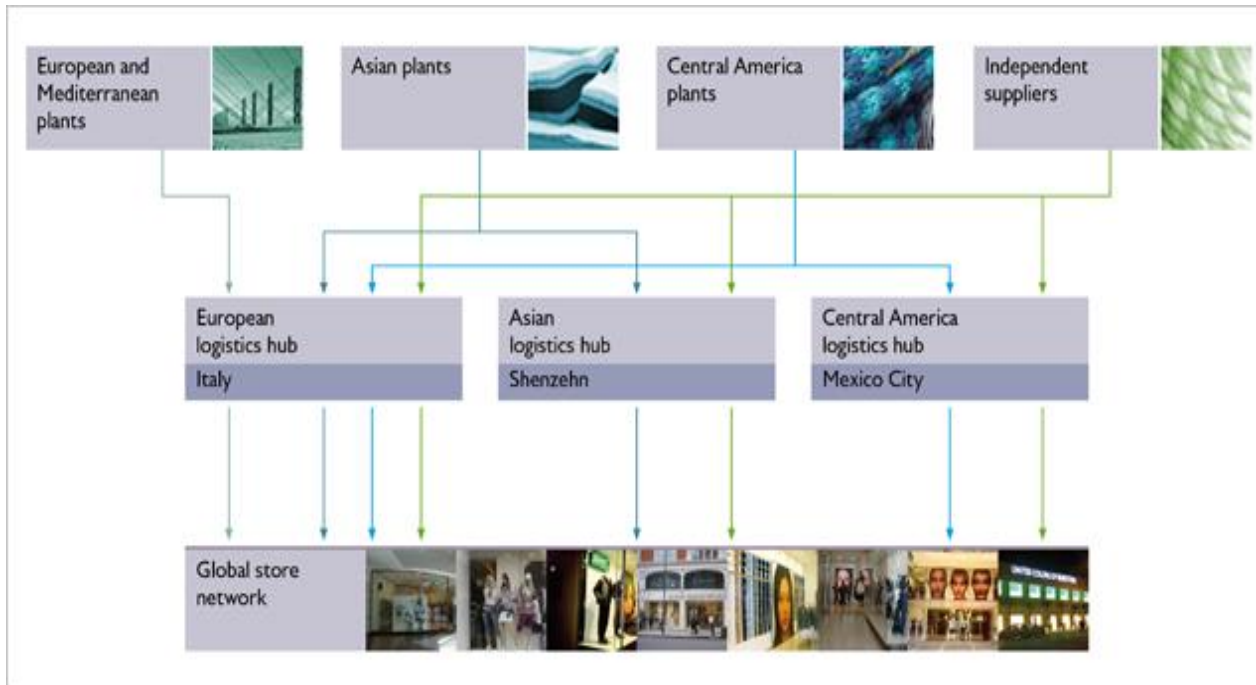


FIGURE 5.6: OPERATIONS BUSINESS MODEL

5.4.1 DESIGN

Up until 2000 Benetton used to launch two main seasonal collection per year (spring-summer and autumn-winter), which did not effectively meet customers satisfaction by providing the latest fashion trends, as competitors like Zara were already doing. Benetton reduced the number of pieces by 30% in the standard collections and introduced new “flash” collections during the season according to the latest fashion trends and customer preferences. The products re-design also involved a streamlining of brands by eliminating some previous, and a rationalization of collections, now divided by age in four groups (men, women, children and expectant mothers).

A staff of 300 designers from all over the world creates the collections for the Group's global brand *United Colors of Benetton*, the glamour oriented *Sisley* and the contemporary brand *Playlife*.

The work of the design team begins with research. Its designers travel the world capturing new trends and ideas.

Following the research process, the themes and look of the collections are designed: color, fabrics and quality materials characterize its apparel and accessories.

While the dyeing area conceives the colors, the product department hand-draws the entire collections, turned into sketches from the most sophisticated graphics programs. Finally, creates the samples utilizing the fabrics selected.

The design center of Ponzano Veneto, which employs 250 designers, brings together a sophisticated and diversified set of abilities, representing different design and fashion cultures. But at the same time it is strictly divided into three design sectors: 50 designers, or "product-men", work on the product with a commercial outlook; another group is concerned with researching fabrics; and a third is responsible for graphics.

After the design process, model makers draw all the pieces of each item of clothing on the computer, and prototypists are then able to realize the model in any fabric, ensuring both its industrial feasibility and the firm function "times and methods", thus completing the so called "board". The fabric then arrives at the departments, which produce the sample books, about 80-100, to be showed to the sales force. Product development comprises as well any machine modifications required by the drawings. These challenges are met jointly by engineers (Japanese industrial engineers are often present) and designers.

The process has a high level of flexibility which keeps being similar to that of a big workshop, but allows for the orderly and careful participation of many specialists. These two aspects are mentioned in interviews with the staff members:

"In the organization chart of the product department, all the persons involved in the creation of an article of clothing have to be flexible, have to be able to occupy any position in the production chain, from model maker to garment maker and so on."

"The projects develop through a computer data system, and all the employees involved have access to all the information about what's going on, retaining thus an element of control."

The product department is the link between all the areas involved in the development, manufacture and distribution of its collections. In addition, it cooperates with research centers, universities and laboratories for continuous innovation and the development of new processes.

5.4.1.1 COLLECTIONS

Our product, operations, and commercial departments work together to create a full collection for each brand, structured according to a preordained but flexible calendar to ensure a constant flow of new garments to stores on a precise and timely basis.

In 2005 the structure and the number of collections changed radically. Until 2003, the production was based on two seasonal collections (Spring/Summer and Autumn/Winter) that were designed much in advance of the selling season and 80% of the production was decided on the basis of orders collected before the season by

Benetton's agents. The remaining 20% came from reorders. The products designed during the selling seasons "flashes" were a very small part of the production and were made just to "refresh" the shop windows. This organization did not permit taking advantage of the market opportunities, and was not encouraging consumers to pay more visits to the shops in search of the last fashion trends. Following the success of Zara, able to offer constantly updated products in its stores, Benetton changed its collections timetable.

The traditional seasonal collection was split taking the names of *Contemporary1* and *Contemporary2*. Each one of these collections has a time-to-market that varies between 4 and 8 months and is articulated in 4 launches: Spring, Summer, Autumn and Winter. Additionally, during the selling season, Benetton introduced three collections: "Trend" a collection more sensitive to the fashion tendencies with time-to-market between 1 and 4 months and the collections "Capsule", capable of presenting fashion-forward garments and accessories at any time during the season, and "Continuative items" that use standardized raw materials ("Continuative items" is manufactured on stock) and are brought to the market in a very short time (7 days if the products are made in Italy and 15 days if imported from abroad). While "Capsule" aims to satisfy fashion sensitive consumers, "Continuative items" guarantees that a collection's core products are restored in a very short while.

The two collections *Contemporary1* and *Contemporary2* represent 75% of the annual production sold under the brand United Colors of Benetton. The collections *Trend*, *Capsule* and "Continuative items" have instead a greater relevance for the fashion-oriented brand Sisley and they represent 50% of the total production under this brand.

5.4.1.2 R&D

Benetton's R&D efforts focus on style, new materials and technology.

Quality can only be expressed through continuous research. On the one hand, Benetton's R&D efforts focus mainly on style and new materials, on the other on technology, researching innovative solutions for its production processes. This includes research and the selection of raw materials. So it's possible to have not only the classic, high-quality natural fibers, but also innovative fabrics that are able to combine quality and competitive costs in response to market demands.

With innovative raw materials, colors that represent the latest fashions, and new, fashion-forward tailoring, Benetton strives to design collections that evoke the history and tradition of its brands.

The research costs, incurred by the Group in 2009 for the creation of new collections, have been allocated in full in the 2009 income statement for a significant amount of Euro 30 million.

5.4.1.2.1 RECENT DEVELOPMENTS

Benetton's considerable expertise in the processes and technology has been used to develop a finer, lighter wool thread fully in line with market demands. For example, it has developed a complete range of colored, reasonably priced knitwear in a light cashmere whose lightness and softness allow them to also be worn in the spring and summer. This thread truly encapsulates the company's values of know-how, quality, and teamwork, values that also extend to include collaboration with commercial partners and university institutes.

Benetton has gone beyond typical sponsorship achieving a true partnership in high-tech research with companies in its core business: Shima Seiki, a Japanese textile machinery multinational, and Huntsman, Clariant and Dystar, companies specializing in the dyeing of yarns and fabrics.

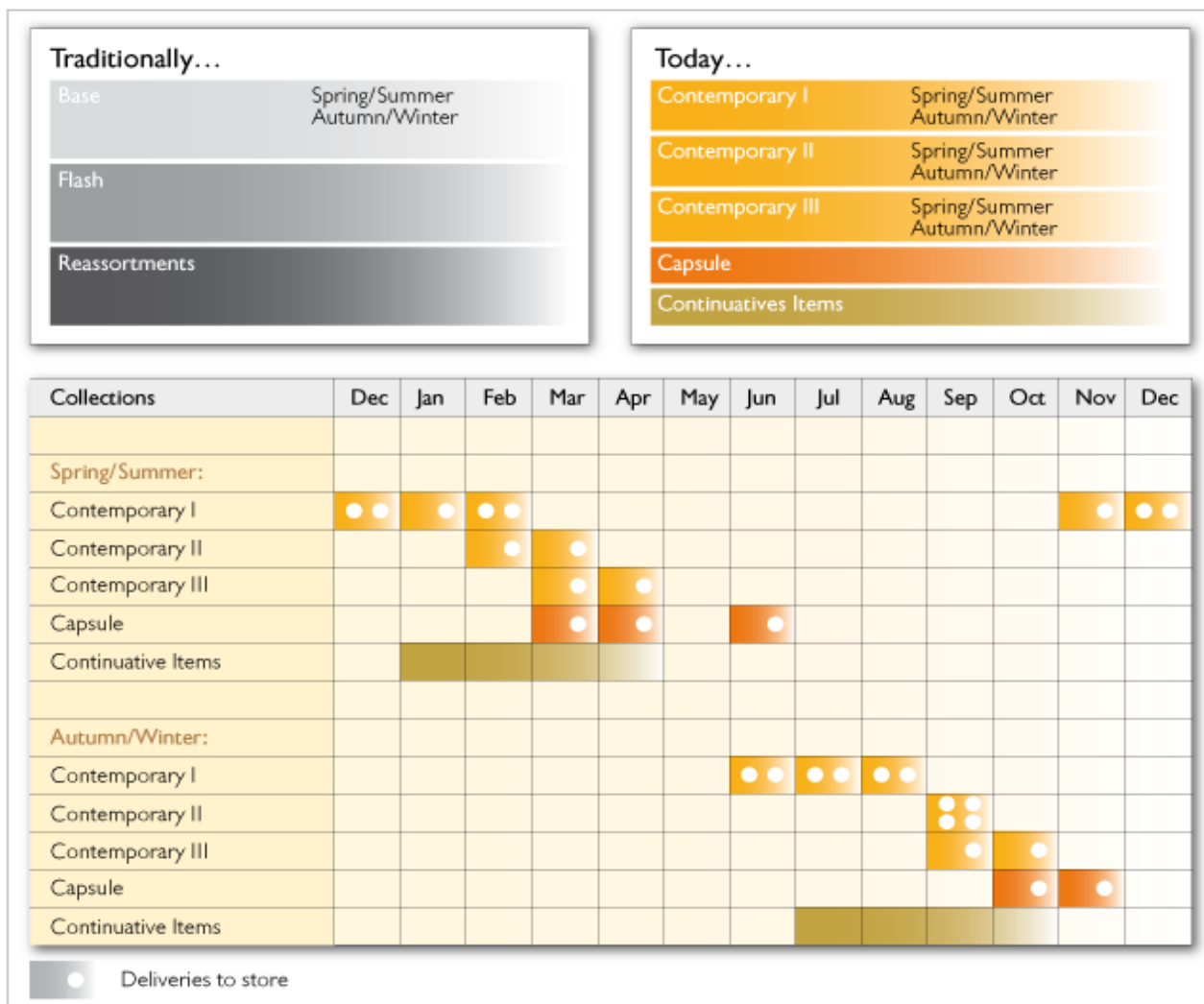


FIGURE 5.7: COLLECTIONS STRUCTURE

5.4.2 SUPPLY AND PRODUCTION

Benetton is one of the largest European garment producers and its core business consists of designing, producing and selling garments for men, women and children in wool and cotton.

In the beginning, Benetton was only a small company that was producing sweaters for local independent retailers.

The keys to the success consisted in some innovations related to the product and its distribution and to an efficient production organization based on the work of a large network of small local subcontractors specialized in knitting, cutting and sewing garments. The fully fashion knitwear was made on cotton looms and it was strictly in plain colour. In this way it is possible to knit plain wool into sweaters and postpone dyeing the entire stock just before going to the market, according to the latest fashion trends. Retailers could order plain sweaters in advance and specify the colour during the selling season.

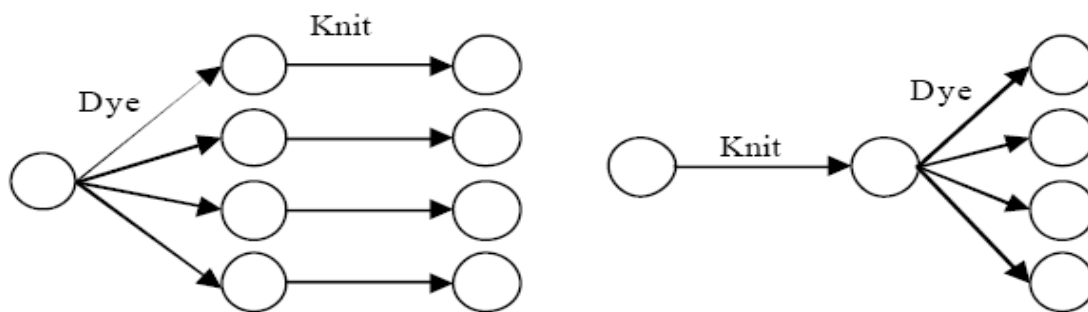


FIGURE 5.8: OPERATIONS REVERSAL AT BENETTON: SINGLE PRODUCT STYLE WITH FOUR COLORS CHOICES

Together with the advantage of a rapid response to the fashion market, the dyeing postponement process allowed a drastic reduction of costs due to less expensive inventories and to a smaller unsold stock. This process was made possible thanks to an advanced dyeing process set up by Benetton, able to offer an wide number of colors and the guarantee that garments did not lose their colors when washed. Benetton internalized the dyeing process to take advantage fully of its dyeing know how.

Shortly after the production of knitwear, followed the production of shirts and jeans. In the beginning Benetton sold them under different brands (Tomato, Jeans West, etc.) because the quality of these new products was not yet comparable to the one obtained for the sweaters and there was a fear that it might damage the reputation that the firm had achieved as a knitwear producer.

It is estimated that in the second part of the seventies around 60-70% of the overall Benetton production was made by a hundred of subcontractors located mainly in

Treviso and in the surrounding provinces of Veneto. The activities such as design, quality control and the manufacturing stages which required greater investments (such as knitting, cutting and dyeing), were instead undertaken in the two factories of Villorba and Monzambano which employed about 1000 workers.

In those years, Benetton contributed to the creation of the casual style, targeted at the beginning for young people, but shortly after spread to other age groups. In the seventies, thanks to Benetton and to other firms that followed the trail of its success, Italy became the major producer of knitwear in Europe.

Until the 80s all the Benetton products were made in Italy. The beginning of Benetton's foreign production can be traced back to 1982 with factories established in France, Scotland and United States. The US factory was linked to a failed attempt to enter in the North American market. In the beginning of the 90s, the factories in Scotland and in the United States closed and two new plants opened in Spain and Portugal. The share of the foreign production rose to 20%, a limited percentage if compared to that of other large Italian clothing brands. During the 90s, in consequence of the growth of sales the number of Benetton's Italian subcontractors increased and reached its maximum of 866 units in 2000. Therefore, in that period production remained mainly in Italy and the strategy of producing abroad, rather than for reducing costs, was driven by the desire to move production closer to the consumption market avoiding the currency exchange risk.

Starting from the second half of the 90s, Benetton faced an increase in competition, in particular from Zara, H&M and Mango, whose products had generally lower prices. The yarn and fabrics produced by Olimpias became expensive compared to the ones sold in the market. Furthermore, the export advantages due to the weak Lira exchange ended in 1995 with the decision of Italy to peg the Lira rate of exchange in order to enter the European Monetary Union two years later. The fixed exchange rate made impossible to Italian companies to transfer the increase of production costs on higher export prices and the progressive opening of the Eastern European markets to foreign investments induced Benetton to follow the strategy, already adopted by other Italian firms, to delocalize production first in Hungary, then in Rumania and Croatia. Also Tunisia was interested by this process, mostly for cotton sweaters and jeans, in which this country is specialized. The manufacturing factories in France, Spain and Portugal lost their importance little by little and stopped their activity. At the beginning of 2000, Benetton speeded up the process of changing the production organization, in consequence of the strong competition mainly coming from Zara, H&M and Mango, which are the main foreign brands to have their own stores in Italy. The process of restructuring was extremely fast: in 2003, 48% of the volume of production was still manufactured abroad and 62% in Italy. Production abroad increased in just one year, between 2004

and 2005, by 13 million items and the employment in Benetton's Italian subcontracting firms shrank, from 2003 to 2005, by 3100 workers. This great shift was due to the decision taken in 2004 to move production to China. The recourse to Asian suppliers with a large autonomy in managing a broader range of manufacturing functions, including the sourcing of inputs and sometimes logistics, is described as "full package production". Benetton provides the design, often a simple sketch, and buys the final product that is delivered to its warehouse and then distributed to the stores. In 2007, Benetton's full package production represented, in terms of volume, 37.6% of the total and the increasing importance of this form of sourcing has made Benetton much more similar to the large clothing international retailers than to a clothing manufacturer.

In 2005 Benetton's organization shifted from a system based on productive units referring to the different product categories (such as wool, cotton, etc.), to a structure based on the different activities (such as design, quality control, marketing etc); a move that underlines the change in the governance of the value chain.

In 2009, Benetton produced 150 million items (garments and clothing accessories, such as footwear, bags, belts, etc.), for a turnover of 2,049 million Euros. About half of the Benetton's production was sold in the Italian market, 34% in other European countries, 14% in Asia and a minor part in the Americas. Benetton sold its products in 124 countries through 5800 mono-brand stores, 95% of which are in franchising.

The production activities are carried out by the Benetton's affiliate Benind, which governs, through its own subsidiaries, factories and logistic platforms in Hungary, Croatia, Tunisia, India, and purchases full package products from the Benetton's Asian suppliers through the Group's trade company Asia Pacific.

		Purchases of finished products (1)	Sales of raw material and accessories (2)	Manufacturing value (3)=(1)-(2)	Main activity
Benetton Hungary*	Nagykálló	183.1	74.6	108.6	Garments and footwear
Benrom Romania *	Sibiu	36.8	18.7	18.1	Cotton garments
Benetton Croatia *	Osijek	36.3	14.8	21.5	Wool garments, cotton knitwear, dyeing
Benetton Istria *	Labin	62.9	30.9	32.1	Knitwear, wool garments, samples (part of)
Benetton Tunisia*	Sahline	139.9	48.6	91.3	Cotton garments, knitwear, dyeing
Benetton Asia Pacific**	Hong Kong	231.0	-	-	Cotton garments, knitwear and accessories
Benetton India*	Gurgaon	2.3	0.2	-	Cotton garments
Total		692.2	187.7		

*outward processing production; **full package production; *Source: Annual Report. Benind Spa, 2007: 43-*

FIGURE 5.9: INTRA-TRADE BETWEEN THE BENETTON'S COMPANY BEHIND AND ITS FOREIGN AFFILIATED COMPANIES IN 2007 (IN MLN €)

The garments manufactured abroad are imported from Benind and then sold to Bencom (the commercial division of the Group), which distributes them to the stores. In 2007 Benind sold raw materials to its foreign affiliates (Benetton India and Asia Pacific excluded) for 188 million Euros and imported from all foreign companies finished garments and clothing accessories for 692 million Euros. In the same year, Benind purchased garments from Italian subcontractors and paid dye-work services for a total of 103 millions.

The following table sets forth the significant subsidiaries owned, directly or indirectly, by Benetton Group S.p.A, the holding company of the Benetton Group companies.

The significant subsidiaries in the Group are:

Company	Country	Ownership
Bencom S.r.l.	Italy	100%
Benind S.p.A.	Italy	100%
Bentec S.p.A.	Italy	100%
Olimpias S.p.A.	Italy	100%
Benetton Croatia D.O.O.	Croatia	100%
New Ben GmbH	Germany	50%
Benetton Ungheria Kft.	Hungary	100%
Benetton Japan Co., Ltd.	Japan	100%
Benetton Korea Inc.	Korea	50%
Benetton International S.A.	Luxembourg	100%
Benetton Real Estate International S.A.	Luxembourg	100%
Benetton Holding International N.V. S.A.	The Netherlands	100%
Benetton International Property N.V. S.A.	The Netherlands	100%
Benetton Manufacturing Holding N.V.	The Netherlands	100%
Benetton Manufacturing Tunisia S.à r.l.	Tunisia	100%
Benetton Giyim Sanayi A.S.	Turkey	50%
Benetton Trading USA Inc.	U.S.A.	100%

In 2007, 32.4% of Benetton's production, in terms of volume, was produced in Asia, 20% in Tunisia and 28.5% in East European countries. Italy produced only 10.3%.

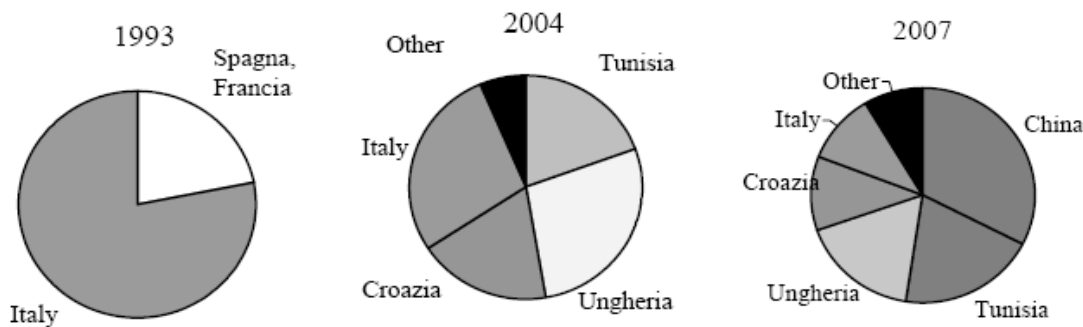


FIGURE 5.10: PERCENTAGE DISTRIBUTION OF GARMENTS AND ACCESSORY ITEMS PRODUCED BY BENETTON (N° OF ITEMS)

	2006		2007	
	Million of items	%	Million of items	%
Italy	19.7	14.9	15.0	10.3
Eastern Europe	43.0	32.5	41.4	28.5
Tunisia	26.1	19.7	29.0	20.0
Asia	34.9	26.3	47.1	32.4
Other countries	8.8	6.6	12.7	8.7
Total	132.5	100.0	145.2	100.0

Source: interviews with Benetton staff

FIGURE 5.11: N° OF GARMENTS AND ACCESSORY ITEMS PRODUCED BY BENETTON

Benetton's production system operates in Italy, Eastern Europe, the Mediterranean area and in Asia. Two manufacturing approaches:

- Own industrial production: in Italy, East Europe, Tunisia, India. During the last few years, investments were directed, above all, towards the expansion of Benetton's production centers in Croatia and Tunisia, which operate complete production cycles (from raw materials to the finished product), and to quality control systems to fully meet strict Benetton Group quality standards. Benetton relies on the outsourcing of labour-intensive phases of production (e.g. tailoring, finishing, and ironing) to small and midsize enterprises (SMEs) directly controlled by the Italian and foreign production sites, and keeps in-house strategic activities and operations that require heavy automation (e.g. dyeing, weaving, and quality control). The manufacturing organization is also characterized by an upstream vertical integration, controlling 100% of a textile group called Olimpias, involved in 2 main activities:
 - Transforming raw materials into spinning and fabrics, from spinning to finishing.

- Ennobling.
- Sourcing the finished product: in recent years special attention has also been focused on the "Sourced Products" areas, with outsourcing of production in countries like China, India and Thailand, Turkey. Three main areas of sourcing:
 - China coordinated from Hong Kong;
 - South East Asia (Thailand, Cambodia, Laos, Vietnam, Indonesia) coordinated from Bangkok;
 - India (coordinated from Bangalore).

The balance between quality, cost and time to market drives this sourcing allocation, and the on-going scouting of third party vendors allows the Group to maximize total benefits, as in the industrialized production system. As of June 2009 sourced products represented approximately 40% of total production.

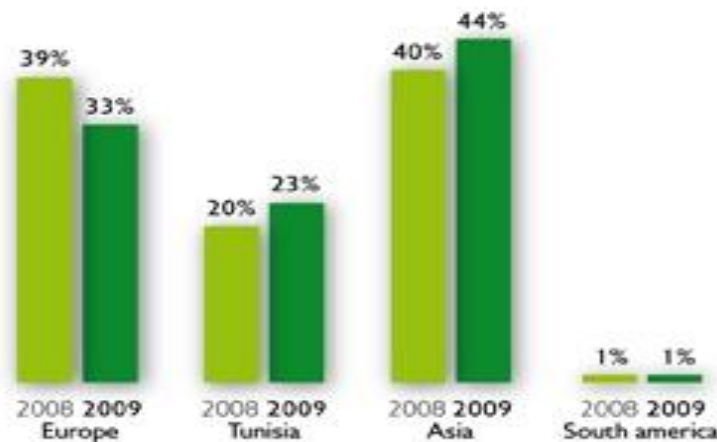


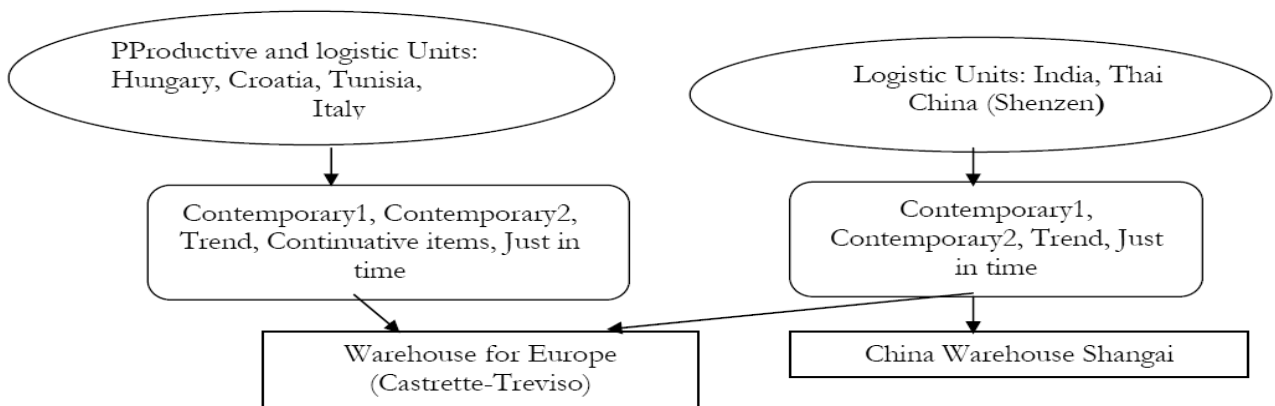
FIGURE 5.12: SUPPLY-GEOGRAFIC BREAKDOWN

5.4.2.1 OUTSOURCING

The choice of the outsourcing countries depends on several factors: labor cost, economic and fiscal incentives, availability of skilled labor, flexibility and time-to-market. Shifting production from Europe to Asia has cut the unit cost of production because of the lower cost of labor, the use of cheaper local raw materials, and because several Asian countries have their currencies linked to the weak dollar. The increasing full package imports from Asia have reduced, as well, transactional costs simplifying the control of the production value chain. From 2003, in spite of the presence of a yearly sale growth of 8-9%, and even if a large part of production moved to Asia was to the detriment of East European countries, there has been a further reduction in the level of activity performed in Italy. This is because the recourse to full package production reduces the activities carried out by Italian workers (employed both by Benetton and by its subcontractors) such as quality control and logistics that were connected to the sourcing of part of the manufacturing production in Tunisia and in Eastern Europe. In

addition, the amount of raw materials produced by the Benetton textile-knitting division and sent to the European and Tunisia factories, has declined and this has further reduced the value of production made in Italy.

At present, Benetton’s production is organized according to two supply chains (figure 5.10). The first one uses Italian, European and Tunisian suppliers to produce fast fashion and more complex products, while the second one employs Asian suppliers for more standardized production, made on long runs and planned in advance. The majority of Asian production is imported in Treviso where, thanks to a fully robotized warehouse, is efficiently stocked and sent to the worldwide shops. The warehouse in Shangai serves mainly the Asian markets.



Source: interviews with Benetton Staff

FIGURE 5.13: THE GLOBAL VALUE CHAIN OF THE BENETTON GROUP

5.4.2.2 THE ITALIAN PRODUCTION

Between 2003 and 2007 the Italian share of Benetton’s production, in terms of volume, shifted from 38% (41.3 millions of units) to 10.5% (15 millions of units) with a reduction of 26.3millions items.

years	Production (millions)		Italian subcontractors		Production		Employees
	total	Italy	firms	employees	Italy/total	per firm	per firm
2003	108.7	41.3	525	8249	38.0%	78667	15.7
2004	109.4	30.6	458	5884	28.0%	66812	12.8
2005	113.0	20.3	327	5136	18.0%	62080	15.7
2006	134.0	18.0	351	n.a.	13.4%	51282	n.a.
2007	145.2	15.0	295	n.a.	10.5%	50847	n.a.

Source: data supplied by the Trade Unions

FIGURE 5.14: BENETTON’S ITALIAN SUBCONTRACTORS

Between 2000 and 2007 the number of Benetton's Italian subcontractors has shrunk from 580 to 295, while the number of employees, between 2003 (first year for which data are available) and 2005, has declined from 8249 to 5136. In the last three years, the number of subcontracting firms in Treviso diminished from 208 to 116, while their employment in 2005 (last available data) was of 2085 units. At present 80% of Benetton's Italian subcontractors are located in Veneto.

Between 2003 and 2007 the average dimension of the Benetton's orders per subcontracting firm fell from 79 thousand to 51 thousand items, a volume of production that a subcontractor of average size can deal in 3-5 months. The majority of the firms, that in the past used to work exclusively for Benetton, has now diversified their client's portfolio. Furthermore, the only orders which remain in Italy are products made on small runs and with short delivery time. Nowadays, Italian subcontractors have the role to guarantee flexibility to the value chain, solving problems that arise in dealing with distant sourcing: transport delays, errors in production plans, product faults, etc..

In 2006, 37% of Benetton's Italian suppliers was located in Treviso where it represented a share of 30% of the number of the clothing subcontractors.

5.4.2.3 PRODUCTION IN EASTERN EUROPEAN COUNTRIES AND IN TUNISIA

Benetton owns in Europe five logistic-productive platforms: two in Hungary, two in Croatia and just one in Tunisia. Raw materials are distributed from Italy to the local subcontractors mainly specialized in sewing, ironing, wrapping the final product that is sent back to Italy ready to be distributed to the shops. In Tunisia and in European countries all the production occurs according to an outward processing model that uses raw materials sent from the buyer and requires a continuous technical assistance to keep up the quality and fulfill the delivery times. This is possible thanks to the presence of skilled employees placed at the end of the productive lines.

In 2007, the five platforms of Benetton employed 1047 workers and the relative value chains involved 312 foreign suppliers with 19,500 workers (Tab. 5.13). The average size of the foreign firms is three times bigger than that of the firms that work for Benetton in Italy and the reduction in number of subcontractors is undoubtedly an element of organizational simplification.

	Benetton employees	Subcontracting firms	Employees in the subcontracting firms	Number of employees per firm
Hungary and Romania	281	126	9200	73.2
Croatia	375	43	2800	65.1
Tunisia	391	143	7500	52.4
Total	1047	312	19500	62.5

Source: Interviews

FIGURE 5.15: BENETTON'S LOGISTIC PLATFORMS AND SUBCONTRACTING FIRMS IN EAST EUROPE AND TUNISIA

5.4.2.3.1 EAST EUROPE

41.4 million garments are produced in the Eastern European countries, equal to 28.5% of the whole volume made from Benetton. Production is organized by four logistic-productive platforms. The ones of Nagikallo in Hungary and of Sibiu in Romania employ 281 workers and manage a network of 126 suppliers localized in several Eastern European countries (Hungary, Romania, Poland, Moldavia, Slovakia and Ukraine) for a total of 9,200 employees. In addition, the Hungarian plant carries out cutting and printing operations. The third and fourth platforms are located in Croatia (Osijek and Labin) and make dyeing and knitting, employing 375 employees. The garments production is made by 43 local suppliers with 2,800 employees²⁰.

In the last few years, production in Hungary has started to decline, while that in Croatia has increased specializing on fast response production. For this reason Croatia today has become a formidable competitor for Italian subcontractors.

5.4.2.3.1 TUNISIA

In Tunisia, the local network of subcontractors, mainly specialized in sewing and upstream operations, is managed by the Benetton's platform of Sahline. Here Benetton owns two factories with 391 workers which make cotton fabric, knitting, dyeing and special finishing (like printing, stone wash, stone bleach, etc). The subcontractors' network is made of 143 firms employing 7,500 employees that produce yearly 29 millions of garments, mainly knitwear.

The production in Tunisia has recently increased and 20 million Euros are to be invested in a new factory that will produce knitted cotton fabrics, representing 23% of Benetton's total production. The new production, estimated in 3.6 million kilos will serve local subcontractors, with a decline in unit cost and increase in efficiency (the network forecasted production will increase of 21 million garment units). The present preference toward the Tunisian suppliers rather than the Eastern European ones is due to the fiscal benefits allowed to the new factories, to a lower and stable cost of labor and to the high competences available in Tunisia.

5.4.2.4 PRODUCTION IN ASIA

In Asia production is commissioned to more autonomous local subcontractors which purchase directly the necessary raw materials, often from selected producers, whose production process is monitored by Benetton. In East Europe and in Tunisia the subcontractors receive the fabric (made in Italy or in other countries as Turkey) directly from Benetton and all accessories as well with a detailed manufacturing schedule. In Asia are produced, as well as garments all Benetton's accessories such as shoes, bags belts, umbrellas, toys, perfumes, etc. The imports from Asia have largely increased in the last few years and today they represent 44% of Benetton's total production.

Benetton's network of Asian suppliers is managed by Asia Pacific, an affiliated trade company established in Hong Kong, which controls the logistic platforms of Shenzhen and Shanghai. Only a small part of the products manufactured in Asia is sold on the domestic market, the majority is imported in Italy (231 million Euros over a total of 248).

A growing amount of Asian production is manufactured in Vietnam, Cambodia and Bangladesh and is governed by the recently established logistic platform of Bangkok. At present, the number of garments produced in these three countries is around two million items, with a forecasted reach of 18 million items by 2011. The increase of production in these countries is explained by a labor cost which is lower than that of China. Full package production makes the outsourcing organization simpler and, in the case of standardized products made on stock, such as a great part of the accessories, permits a short delivery time too.

In India production occurs according to a network model that combines vertical integration and subcontracting. In Gurgaon (close to New Delhi) the Benetton's factory employs 300 workers and organizes the work of many local subcontractors that employ 5,000 workers. The subcontractors receive the raw materials and a precise technical schedule and they produce about 50% of the entire Benetton's Indian production. Differently from China, almost all the production made in India (about 6 million units) is targeted to the domestic market.

5.4.3 LOGISTIC AND DISTRIBUTION

In the late 1990s Benetton restructured its distribution network in order to implement a new system that would integrate a logistics system in which the warehouses are the system's junction and are part of the distribution system rather than just places for storing facilities. The new system would eliminate fragmentation of inventories across the world by concentrating the finished goods in three sorting centers, one in the US (Mexico city), one in Italy and one in the Far East (Shenzehn, Asia).

Benetton has direct control of the logistics phase for both own manufactured and sourced products, and has invested in modeling, organization, and automation of logistic processes in order to completely integrate the entire production cycle, from client orders, to packing and delivery.

The state-of-the-art logistics operation at Castrette (Italy) has a fully automated innovative sorting system, whose propulsion is based on electromagnetic fields, capable of handling individual orders for over 6,300 Benetton shops worldwide.

Folded and hanging garments are automatically sorted, packed into boxes and sent through a one-kilometer tunnel to the Automated Distribution Center. This covers an area of 30,000 square meters, has a total capacity of 800,000 boxes and can handle 120,000 incoming/outgoing boxes a day with a workforce of only 28 (compared to the 400 required in a traditional operation).

The European Platform optimizes delivery and quality of service to the store network, thanks to its geographical position, close to the domestic market and European countries, and to the use of innovative technologies.

The functionality, effectiveness and efficiency of Benetton' s logistic organization is completed by the Company's hubs in Shenzhen and Mexico City; the multi-hub model is supported by a centralized IT system which is able to coordinate and optimize product deliveries customized according to required dates and destinations worldwide. This system assures timeliness of information and better control of the business.

In view of the expected increase in the number of items being shipped, in 2007 Benetton Group started to invest around 50 million euro in the automated hub at Castrette. The strategic geographical position and use of innovative technologies confirmed the functionality, effectiveness, efficiency of Castrette in the centralized receipt of goods.

The investments allowed the distribution capacity of the Group to almost double, thanks to the development of new warehouse areas within the existing structure, and an innovative sorting system using electromagnetic propulsion.

5.4.4 SALES CHANNELS

The passage from a production planned well in advance to a flexible one, with a reduction of the time-to-market and an increase in the number of collections, required a new selling organization. The independent retailers, in fact, have to bear the risk of the end of season markdown and they put the orders only after having seen the products. There is in fact the need for the agents to visit the retailers more than one time a season to show the collections and this implies high transactional costs and difficulties in planning production. A direct control of the shops, instead, guarantees a better coordination of the entire value chain reducing the time needed for the

independent retailers to decide their purchases. For this reason, Benetton, in the last few years, has increased the number of its own stores that now sell about a quarter of the value of total sales. Furthermore, in the last two years Benetton invested a great deal of resources in retailing activities, opening new stores in new markets, giving economic incentives to the franchisees and linking the production, logistic and retailing units through a new information system, in order to receive information about the sell-out and the retailers can have immediate confirmation and guaranteed delivery times for their orders.

This shift of focus from production to retail activities confirms the transformation of Benetton from a manufacturing to a buying company. This strategy was also confirmed recently by a financial analyst:

“Benetton is implementing new organizational procedures, with a better coordination among all the stages of the value chain, without focalizing exclusively on the production efficiency. The result will lead to improve the variety of the offer and to reduce the lead time. Benetton is changing its own organization with the focus on retailing and not on production ...”.

The Benetton Group is present in over 120 countries around the world. The commercial network of over 6,300 contemporary stores worldwide is characterized both by prestigious locations in historic and commercial centers and a widespread presence across the domestic market, universally proposing a high level of quality and colorful products.

Benetton owns only 300 stores that sell a proportionately larger amount of overall sale value, about 21%. In order to keep relations with its many independent retailers Benetton maintains a large network of agents (some of them own several shops) coordinated by a team of area managers.

The Group's commercial organization is based on a flexible business approach, different market development strategies are implemented according to the two different sales channels:

- Wholesale, 78% of total Apparel sales.
- Retail, 22% of total Apparel sales.

Over 6,300 stores in 120 Countries



FIGURE 5.16: SALES CHANNELS

5.4.4.1 WHOLESALE

Benetton's global presence relies principally on a network of independent partners, coordinated by independent sales representatives (agents), as well as a dedicated team of area managers directly employed by Benetton.

Commercial partners do not pay Benetton any fees for establishing a Benetton store, nor for the use of the Group's brands, and there are no royalties based on a percentage of sales or profits. Instead, commercial partners purchase, display and sell Benetton-branded goods according to Benetton guidelines.

Agents receive commission on sales realized by Benetton in their territories.

5.4.4.2 RETAIL

From early 2000's, Benetton Group added a new market approach to the core wholesale business, introducing directly operated stores, which now operate in a total of 20 countries, including Germany, Japan, Spain and USA.

The direct sales channel represents a tactical approach, mainly to develop its presence in areas of potential growth where no partners are operating, or to open flagship stores which serve as an attraction for the final customer and as an incubator of ideas that can subsequently be rolled out across the network.

The direct sales approach is also introduced in areas where partners, for various reasons, are not performing in line with company expectations. In order to readdress its presence, Benetton begins to manage the store network directly.

Benetton's market driven approach focuses on improving store attractiveness, maximizing the consumer experience and strengthening the Group's image and market share.

In order to provide a distinctive and appropriate shopping environment, the evolution of the interior design elements in the stores represents a specific focus for the Company. Through the use of different materials, colors and design features, the furnishing concepts emphasize the various themes of the collections by means of suitably characterized spaces. The children's lines, for example, have recently seen the introduction of the new Benetton Baby and Sisley Young concepts, while the Esagram concept was introduced for the Sisley adult in 2008.

Contemporary stores are situated in prestigious locations, in historic and commercial centers, and a widespread presence across the domestic market, universally proposing a high level of quality and colorful products.

5.4.4.2.1 STORES

The shops, generally of small size constituted an innovation in the Italian market because they offered, at good price, good quality and highly fashionable sweaters which were displayed in a way so that customers were able to pick them up from the shelves, touch and try them. Even if the retailers worked with a limited mark-up, the selling activity was profitable as it guaranteed a high turnover per square meter and per worked hour.

The growth of Benetton depended more and more on the capacity to increase the number of stores under its own brands involving in the business some of its agents who became owners of many stores.

5.5 SUCCESS FACTORS

The Benetton success has been inextricably linked with the different types of innovation that had been developed from the Group. Precisely, distinguish itself by:

- Product innovation
- Process innovation
- Organizational innovation

5.5.1 PRODUCT INNOVATION

In the seventies Benetton' competitive advantage was grounded on product innovations based on the use of bright colours. Right from the beginning, Benetton offered a new product characterized by bright colors and targeted to young people.

Benetton's strategy is a truly global one. The same garments are sold throughout the world through the same small boutique-style shops, merchandised within strict corporate guidelines, and supported heavily with print media using identical advertisements worldwide. The strategy is to brand a "total look"--from the colour coordinated garments to the ambience of the small stores --rather than individual products. In those years, Benetton contributed to the creation of the casual style, targeted at the beginning for young people, but shortly after spread to other age groups.

Beyond Benetton achieved the process of horizontal integration. The strategy of total look was completed with the introduction of products such as shoes, spectacles, perfumes, watches and, most recently, jewellery. This strategy was carried out both through acquisitions, as in the case of "Calzaturificio di Varese" in 1988, and through production licences as in the case of perfumes, spectacles and watches.

5.5.2 PROCESS INNOVATION

Traditionally, the manufacture of clothing started with the dyeing of the yarn followed by the knitting of the garment. The problem inherent in this sequence is that the knitting process is slow--so that to meet customer service expectations requires high levels of inventory of finished garments.

The likely result of the traditional approach, as anyone who has been responsible for managing inventory will know, is that invariably the desired colours will be out of stock while there are excess inventories of the unpopular colours. In a market characterized by very short product life cycles, this mismatch of inventory and customer demand cannot be corrected using a traditional manufacturing approach. The typical result is the end of season mark-down. The obvious answer technically is not a simple one and involved Benetton in process innovation. Then, in order to better meet customer latest tastes, in 1964 Benetton introduced the postponement technique that basically reversed the traditional dye-first-knit-after mode into knit-first-dye-after. The garments are first knitted in natural color and then stored until information about latest color trends are provided from the retailers.

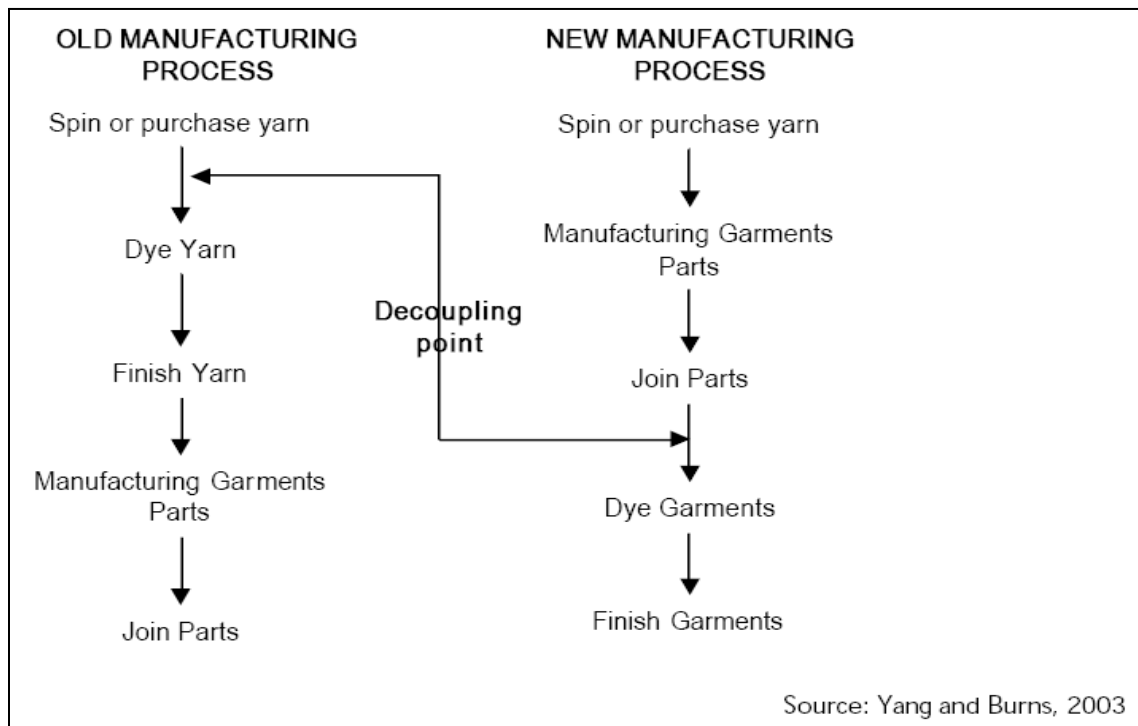


FIGURE 5.17: POSTPONEMENT APPLICATION IN BENETTON

Doing so Benetton extended the concept of “just in time” production from the supplier to final assembler to the manufacturer to retailer stage. However, this system has absolutely benefits compared to the traditional one in the case of increased product types/specifications and knitting time reduction related to technological improvements.

The postponement strategy delayed the decoupling point and increased the efficiency and effectiveness of the supply chain, reducing costs through less expensive inventories and a smaller unsold stock and developing a rapid response to the fashion market. The production of a complete, seamless sweater is in half an hour, thanks to the modern knitting machines and in house software development.

5.5.3 ORGANIZATIONAL INNOVATION

The real competitive advantage taken over time by Benetton is due to its organizational innovation including its distribution strategy, marketing and complete control of the supply chain.

5.5.3.1 VERTICAL INTEGRATION

Benetton grew through a strategy of vertical and horizontal integration. At the end of the 70s Benetton’s organization could be defined as “quasi-vertical integration” as the company controlled the whole value chain, even if various activities were not organized

through an exclusive hierarchical control. In fact Benetton represented the main, if not the only, client of its subcontractors and could decide the price paid and the general terms of supply. As in the case of the franchisees, there was no a written contract and the orders were tacitly replaced at every season. Benetton established with its subcontractors long-term relationships based on cooperation and trust. Although there was an evident asymmetry in the negotiation power (subcontractors employed an average of 15-20 workers), Benetton, thanks to the constant growth of sales, was able to renew and increase the orders at every season, favoring the subcontractors who updated their equipment. Benetton used to advise its subcontractors about new machines that were most profitable and provided to some of them financial assistance through its leasing and factoring company.

It was at the end of the 80s that Benetton started the process of entering directly into the upstream stages of the clothing value chain⁶. It acquired important textile and knitting factories through the affiliated company Olimpias that today owns, in several Italian provinces, ten plants supplying the majority of the raw materials necessary to the Group's clothing division. The control of the entire value chain was then completed: from retailing to clothing and textile manufacturing, to which also the wool production was added later.

In 1991 in fact, the Benetton family acquired the company Tierras Del Sur Argentino, becoming the owner of 900 thousand hectares of breeding area for sheeps, for a total production of over 6 million kilos of wool.

5.5.3.2 DUAL SUPPLY CHAIN

The Industrial set-up has developed in order to offer high quality products at accessible prices, satisfying the needs of an ever more demanding and sophisticated consumer, and increase the relevance of the time to market offering.

The fulfillment of these successful key factors have been achieved through the introduction of a "double supply chain", a system of industrial operations that balances efficiency and speed:

- Sequential Supply Chain: a better calibrated and more efficient system, based on a logical sequence of activities for minimizing costs and optimizing efficiency.
- Integrated Planning System, a more rapid system with better response capabilities, optimizing, in parallel, the activities of R&D, product design, production and sales.

For standard garments delivered before the beginning of the season, Benetton uses a sequential dual supply chain based on push-demand. During the season, flash collections are conversely delivered using an integrated pull-demand focused supply chain, hence responding to customer latest feedbacks.

This system through a more efficient logical flow of activities and an integrated planning system allows reduced costs and lead time. It maintains its core in Italy for the most strategic activities, like design and planning, while looks outside for production/logistic efficiency and cost control.

Production thus responds quickly and effectively to the needs of a market-driven company, with modern scheduling and planning systems that are capable of managing complex situations associated with medium and long-term supply.

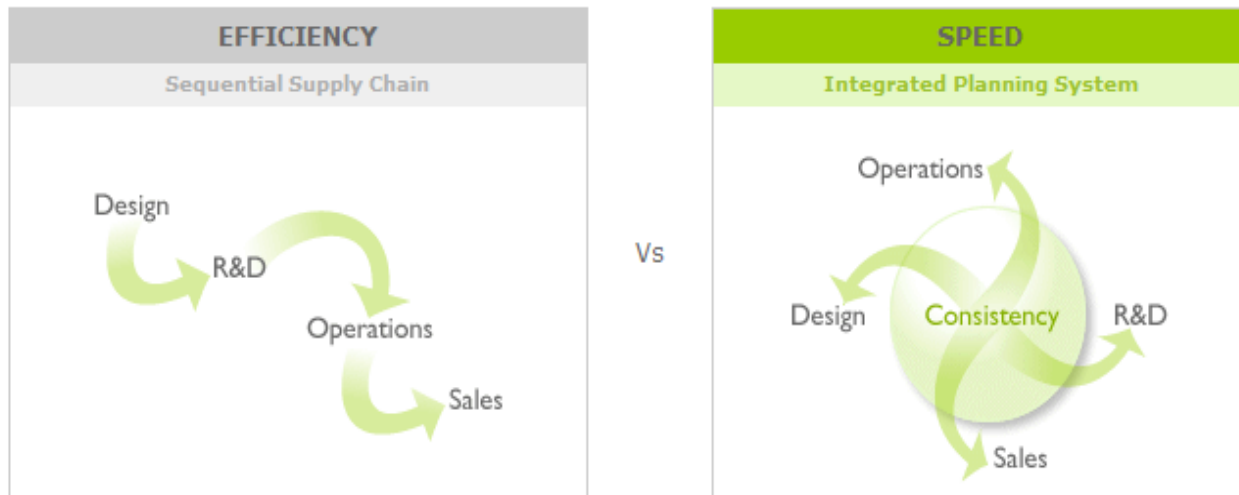


FIGURE 5.18: DUAL SUPPLY CHAIN

Despite dual supply-chain positively impacting on performances, increased outsourcing might impact on Benetton's performance objectives. Quality control is becoming more complex as the network of suppliers is expanding from the company's core. To offset the impact of geographic distance on speed and dependability and to further reduce costs, Benetton is increasing logistic hubs. However the increased flexibility in number of collections might raise total costs.

5.5.3.3 COMMUNICATION AND ADVERTISING

Communication and advertising is another small but meaningful area of innovation in the Benetton system. Since 1984-5, advertising has been completely separate from the product and enjoys total freedom to express social and global messages. Benetton's communication campaigns have provoked debate and sometimes bitter controversy around the world, while at the same time winning praise and awards. Many cultural institutions have organized expositions of Benetton images, among them the Old England of Brussels, the Corporate Art Museum of Tokyo, the Biennial exhibition of Saõ Paulo in Brazil and the Cable Factory of Helsinki.

Benetton's communications strategy was developed, as a result of the company's desire to produce images of global concern for its global customers. The communication strategy targets issues rather than clothes as the leading player, with a portion of the advertising budget devoted to communicating themes relevant to young and old people worldwide. The company claims, "We realized some time ago that we had a unique tool for communicating worldwide, as we are present in 120 countries, and that it would be cynical to waste it on self-serving product promotion. We trusted in the intelligence of our customers worldwide and decided to give space to issues over redundant product claims."

Benetton believes it is important for companies to take a stance in the real world rather than use its advertising budget to encourage consumers to think they will be happy through the purchase of the company's products. This strategy challenges Benetton to come up with a selling theme that appeals to *all* consumers and overcomes local biases. Through this strategy, the Benetton Group has developed advertising campaigns that are international, homogeneous, and characterized by universal themes, which have been not only a means of communication but also an expression of the time. Through its universal impact, the company has succeeded in attracting the attention of the public and in standing out among the current clutter of images.

Until the 1980s, Benetton advertisements had largely focused on its products and logo (stylized knot of yarn with word Benetton printed under it, contained within a dark green rectangle). In 1982, Luciano hired Oliviero Toscani, a prominent fashion and advertisements photographer to head Benetton's advertising department. Toscani's initial advertisements were conventional. They showed groups of young people wearing Benetton clothing. But Luciano and Toscani soon realized that Benetton advertisements had to stand apart from the rest of the competition. They decided to promote Benetton as a life style brand.

Toscani's first theme featured teenagers and kids from culturally diverse nations. Colorfully dressed in Benetton attire, the kids engaged in a variety of playful acts (as shown in figure 5.18). By linking the varying colors in the Benetton collection to the diverse "colors" of its world customers, Toscani portrayed a picture of racial harmony and world peace. It was from these advertisements that the trademark "United Colors of Benetton" emerged.



FIGURE 5.19: FIRST IMAGE ADVERTISING

Some of Benetton's most memorable advertisements were a priest and a nun kissing, a just born baby with uncut umbilical cord, a black stallion and a white mare mating, a colorful mix of condoms, a black woman breast-feeding a white baby, the photo of an AIDS victim and his family taken moments before his death, the bloody uniform of a dead Bosnian soldier.

Benetton was well known for its colorful and provocative advertisements (Benetton termed its advertising and marketing activities as Communication Strategy). The company employed unusual, controversial advertising techniques and themes that used "shock value" and the power of photography to grab viewers' attention. Unlike most advertisements which centered around a company's product or image, Benetton's advertising campaigns focused on social and political issues like racial integration, AIDS awareness, war, poverty, child labor, death, pollution etc. Benetton aims at informing people about what is happening around them in the world, rather than promoting sales of their products. The advertisements initially succeeded in raising the brand's profile, but eventually began to cause dissatisfaction among customers, retailers, government bodies and various international non-profit organizations.

5.5.3.3.1 Fabrica

Fabrica is the future of Benetton communication; its meaning, in Latin, is "workshop" and in this sense Fabrica is a production site: no courses or seminars are held and there are no teachers or final degrees. Fabrica is a research center, a workroom/school where ideas are given form: a communication research center at the disposal of about 20 students selected from around the

world. The young artists-designers-researchers do learn, of course, but they learn while doing. Each person's ideas are discussed and verified in real terms. Creativity, at Fabrica, is not an abstraction: it is an idea which must be put into practice. Artist/researchers explore new languages, sound and sight communication, and work on global issues such as racism, fear, famine, etc. Fabrica prefers not to be relegated in the traditional circles of cultural and artistic elites, aiming instead at a larger audience via the media channels. Graphics, photography, sound, video, design and cinema are the tools of contemporary communication. Projects develop through team effort: multicultural variety is ensured by the multiethnic provenance of the creative group.

5.5.3.3.2 Colors

Benetton communicates through its award winning, bi-monthly magazine, Colors. It is distributed in six bilingual editions in Europe, the United States, Latin America, and Asia.

5.5.3.4 RETAILING SYSTEM

Benetton was the first Italian firm to apply a quasi-franchising system to retailing. This system permitted a fast growth of sales thanks to the fact that there was no need to have great financial resources to open new stores. That was good for Benetton that at the beginning of its success lacked the necessary capital.

The first Benetton's shop opened in Belluno in 1966 and in just few years Benetton's stores covered all Italian's provinces. In the beginning of the 70s, there were about 500 stores under different Benetton's brands (as well as Benetton, also Tomato, My Market and Merceria). The relationships with the retailers were similar but not equal to those of the franchising contract. In fact, there was not a written contract and royalties were not requested. On the other hand Benetton did not guarantee the retailers an exclusivity of territory, did not repurchase the unsold products and imposed the retail prices.

During the last decade, Benetton has shift its focus from production to retail activities because of the passage from a production planned well in advance to a flexible one, with a reduction of the time-to-market. To face this challenge Benetton has invested a great deal of resources retailing activities, increasing in the last two years the number of its owns shops and at the same time granting to the independent retailers greater mark-up margins (bearing a heavy cost) in order to strengthen the retail network and receive from the retailers a better feedback (information on sell-out, support for the many seasonal proposals, etc.).

The retail network has so experienced a process of increasing hierarchical control.

5.6 RISK FACTORS

In carrying out its business activities, Benetton is subject to the following risks:

- competitive pressure:

The Group operates in an industry, the apparel sector, which is highly competitive as far as production, sales and distribution are concerned. The number of competitors has grown considerably in the last few years, and companies manufacturing out of countries with a low cost base now play an important role.

To contain this risk, the Group maintains a strategic focus on production and organizational efficiency policies related to the process of production decentralization, completion of production cycles in overseas units, and organizational cost reduction. Increased competition could lead to price pressure, which would have a significantly negative impact on the Group's financial standing and performance.

As far as distribution is concerned, competition could increase given that there are few barriers to entry. Benetton competes against local, national and global department stores, specialized retailers, independent retailers and manufacturing companies, as well as against mail order companies which use catalogues to target customers.

Benetton focuses mainly on quality, breadth of product range and merchandising, customer service, store ambience, and sales and marketing programs. The Group also competes to secure prime retail sites and the best lease and purchase conditions.

- the sales network's buy-in:

The substantial incentive scheme in place for the network of commercial partners, in line with the business model, seeks to enable partners to increase their investment capacity in order to open new stores, renew existing ones, and increase competitiveness in terms of price to the final consumer. The success of this strategy depends on the ability to motivate and manage the network by setting specific objectives and monitoring progress on a regular basis.

It is to be noted that the Group's business model is linked to a risk of late payment from customers and, generally speaking, payment collection risk.

- ability to develop the business in emerging markets:

The Group is strengthening its new commercial strategies. Special emphasis is being placed on certain emerging markets, such as China and India, including through agreements with large-scale retailers for the opening of "stores in stores" in large department stores in the largest cities. The Group's initiatives include the creation of new partnerships to manage and develop commercial activities.

- changes in customer spending habits:

They can be influenced, amongst other things, by business outlook, interest rates, taxation, local economic conditions, uncertainty over future economic prospects and a

shift of spending habits towards other goods or services. Consumer preferences and economic conditions may change from time to time in each and every market in which the Group operates.

- Inadequate expansion strategy:

To strengthen Benetton's image and market share, investments have been made in recent years to sell products through directly-owned retail stores, even if the Group has traditionally distributed its products through a capillary network of franchise stores. These retail stores have, however, led to an increase in fixed and operating costs. These investments expose the Group to the additional risk that some of the chosen locations may turn out to be inadequate because of changes in the area's demographic profile or the location of shopping districts.

- foreign exchange rate and interest rate fluctuations:

The Group's sales and operating income will continue to be influenced by foreign exchange rate fluctuations in the sale currencies, which in turn impact on the prices of products sold, the cost of sales, and operating income. Foreign currency exchange rate variations against the euro may have a negative effect on sales, operating results, and the international competitiveness of the production facilities of the various business units. Even an appreciation of the euro could have an adverse effect on the Group's sales and operating income. Given that Benetton makes use of hedging in order to manage currency exposure, the strategies adopted may not be sufficient to protect income from the negative effects of future fluctuations. Benetton also holds assets and liabilities which are sensitive to interest rate variations and are necessary in managing liquidity and financial needs. These assets and liabilities are exposed to interest rate risk, which is, at times, managed through the use of derivative financial instruments.

CHAPTER 6

BUSINESS STRATEGIES

Business strategies concern the last piece of the chain of a business. As interface with the customer have a particular importance for the success of the company.

In this chapter we focus on those that are strategically choices taken in recent periods and their impact and in particular the strategic role played by information technologies.

6.1 EFFICIENT CONSUMER RESPONSE (ECR)

Efficient consumer response is a grocery industry management strategy designed to make the industry more efficient and responsive to consumer's needs.

The ECR movement beginning in 1993 was characterized by the emergence of new principles of collaborative management along the supply chain. It was understood that companies can serve consumers better, faster and at less cost by working together with trading partners. The dramatic advances in information technology, growing competition, global business structures and consumer demand focused on better choice, service convenience, quality, freshness and safety, made it apparent that a fundamental reconsideration of the most effective way of delivering the right products to consumers at the right price was much needed. Non-standardized operational practices and the rigid separation of the traditional roles of manufacturer and retailer threatened to block the supply chain unnecessarily and failed to exploit the synergies that came from powerful new information technologies and planning tools. In other words, ECR allows companies to seek a competitive advantage by demonstrating their superior ability in working together with trading partners to add value to the consumer. In fact ECR is about, *"Working together to fulfill consumer wishes better, faster and at less cost"*.

ECR encourages companies to pursue continuous improvements under three focus areas: supply side, demand side and enabling technologies. Also a special note on Category Management and Electronic Catalogue has been briefly covered.

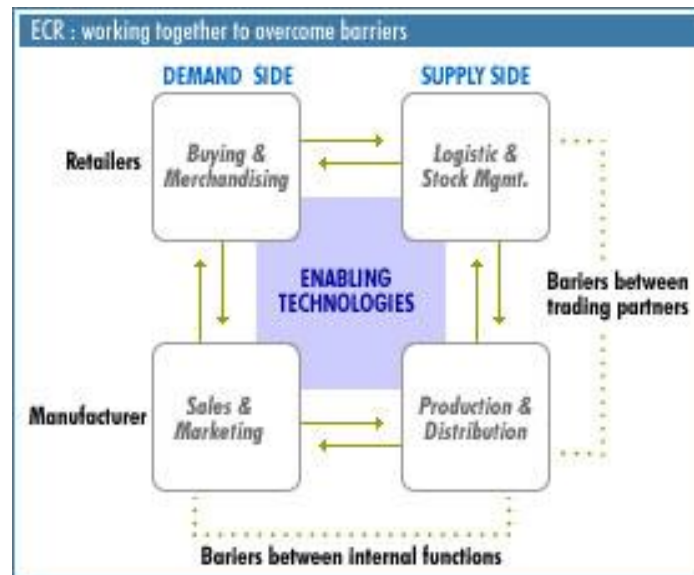


FIGURE 6.1: ECR: WORKING TOGETHER TO OVERCOME BARRIERS

ECR approach push the participants to eliminate or reduce existing barriers, internal and external.

Embedded in this simple statement are two fundamental principles that guide all ECR efforts,

- **Focus on Consumers:** A commitment to the belief that sustained business success stems only from providing consumers with products and services that consistently meet or surpass their demands and expectations;
- **Working together:** Recognition that the greatest consumer value can be offered only when organizations work together, work internally and with their trading partners, to overcome barriers that erode efficiency and effectiveness.

ECR is a grocery industry supply chain management strategy aimed at eliminating inefficiencies, and excessive or non-value-added costs within the supply chain, thus delivering better value to grocery consumers. It is designed to re-engineer the grocery supply chain away from a "push system" in which manufacturers "push" products into stores, towards a "pull system" in which products are "pulled" down the supply chain into the store by consumer-demand information captured at the point of sale.

Although originating in the USA, ECR has also attracted attention and interest in many other countries, like Europe and Australia. Research papers published in the last few years suggest that there has been an increasing level of interest among European manufacturers and retailers in the ECR initiative. The importance and applicability of ECR to the European grocery industry became more noticeable in 1994 with the

establishment of the ECR Europe Executive Board, which promotes and advances the ECR initiative in Europe.

In Australia, however, very little research has been conducted regarding the applicability of the ECR initiative, indicating that ECR would be effective in improving the state of the Australian grocery industry.

6.1.1 ECR AS A COLLABORATIVE SOLUTION

ECR is demand driven, initiating the manufacture and shipment of goods based on consumer purchase activity. ECR reduces the cycle time from purchase to replenishment, reduces the cost of warehousing excess inventory, and assists retailers, wholesalers, and manufacturers in determining the optimum product mix. ECR predicts the impact of a product promotion on retail demand and production requirements. ECR is dependent upon the efficient and timely sharing of data along the supply chain beginning with sales information collected at a point-of-sale terminal. Given thin margins on average transactions and significant expenditures on warehouse space, some food and drug retailers resist manufacturers' ECR initiatives.

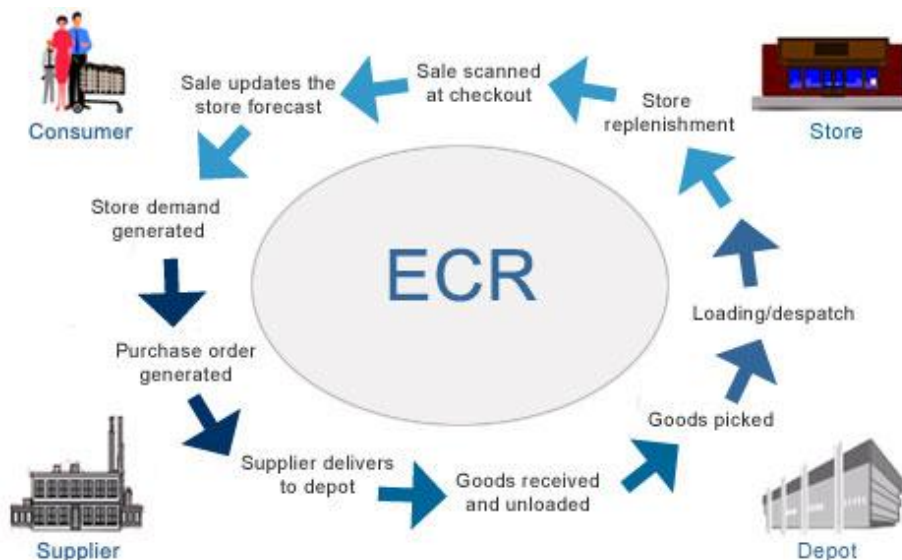


FIGURE 6.2: ECR

The concept on which ECR is based actually originated from the quick response (QR) strategy, already existing in the textile and apparel industries. QR, in turn, is based on the manufacturing just-in-time (JIT) concept. The JIT concept was simple: to deliver raw material to production areas in the exact required amount at the precise time it was needed. The use of raw material pulls new raw material into the production process. During the mid-1980s the JIT manufacturing concept was applied to the US textile and apparel industries in an attempt to combat market penetration by overseas

manufacturers. This textile and apparel industries initiative was termed “quick response” and attempted to reduce the amount of inventory held within the apparel supply chain. Quick response required the retailer to share point-of-sale-scanned data with manufacturers to improve the flow of product through the supply chain. The grocery industry noted the success of the quick response approach to managing supply chain data and proposed a similar stock replenishment system called ECR.

The ultimate goal of ECR is to produce a responsive, consumer-driven system which allows distributors and suppliers to work together in order to eliminate inefficiencies within the grocery industry supply chain, maximize consumer satisfaction and minimize cost. In order to achieve the goal, ECR proposes changes in nearly all the grocery industry business practices to make them efficient. The technologies, which are primarily electronic commerce (ecommerce) components, are used to automate these efficient business processes, as well as to enhance the communication and relationships between companies. ECR is thus an application of ecommerce within the grocery supply chain.

Furthermore, in order to achieve the goal introduces strategic initiatives in four areas: Efficient Store Assortment; Efficient Product Introduction; Efficient Promotion; and Efficient Product Replenishment. These strategies are supported by two programs and five enabling technologies as shown in Figure 6.3 below. The figure, also demonstrates via arrows how subordinate ECR factors contribute to super-ordinate factors and, finally, to the practice of ECR overall.

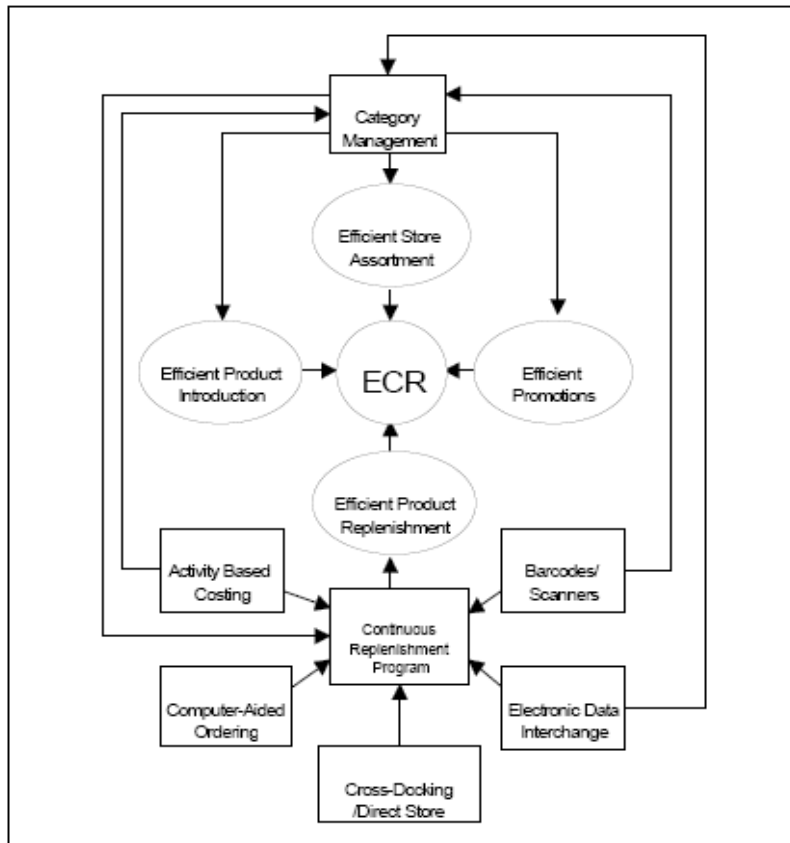


FIGURE 6.3: ECR FACTORS AND RELATIONSHIP

6.1.1.1 STRATEGIES

6.1.1.1.1 Efficient store assortment

The objective of this initiative is to optimize the productivity of inventory and shelf management at the consumer interface - the store level. Optimal allocation of goods on supermarket shelves (known as “store assortment”) maximizes consumer satisfaction by providing the best products and services while, at the same time, ensuring the most efficient use of available space to increase manufacturer, distributor and retailer profitability. The relationship between manufacturers, distributors and retailers is crucial in achieving efficient store assortment. To streamline business practices in the area of store assortment, manufacturers, distributors and retailers need to adopt a “category management” strategy.

6.1.1.1.2 Efficient promotion

The efficient promotion initiative aims at maximizing the total system efficiency of trade and consumer promotions. Efficient promotion attempts to eliminate inefficient

trade promotions (forward buying and diverting) by introducing better alternative trade promotions such as “pay for performance” and “forward commit”:

- pay for performance is concerned with rewarding retailers on the basis of how many products they sell to consumers, rather than how many products they buy from manufacturers;
- forward commit relates to spreading the actual shipment of one order over several physical deliveries. This allows retailers to take the pricing benefits offered by manufacturers at a particular period in time (just as in the case of forward buying), without having to carry the inventory. In essence, this technique operates on “virtual inventory” which will be transformed into “real inventory” when required.

The use of paper-based coupons as a consumer promotion technique can be replaced with electronic coupons, frequent shopper systems, every day low price (EDLP) policies and other efficient incentive programs. Thus, the efficient promotion initiative endeavors to remove excessive costs by reengineering promotion practices, and is also supported by the “category management” strategy.

6.1.1.1.3 Efficient product introduction

The objective of the new product introduction initiative is to maximize the effectiveness of new product development and introduction activities in order to reduce costs and failure rates in introducing new products is achieved by the involvement of wholesalers/distributors, retailers and consumers at an early stage of the new product development process. Manufacturers, distributors and retailers must work together as allies to reduce the costs of product development and to produce only products anticipated and demanded by the consumer marketplace. Once again, the “category management” strategy plays a crucial role in achieving this initiative, because of its contribution to an understanding of successful existing products.

6.1.1.1.4 Efficient product replenishment

The efficient product replenishment initiative is the fundamental platform which supports the overall ECR strategy and it represents more than half the total savings projected from ECR implementation within the US grocery industry. The objective of this initiative is to optimize time and cost in the replenishment system by the provision of the right product to the right place at the right time in the right quantity and in the most efficient manner possible. In order to remove inefficiencies in product replenishment (for example, high inventory levels and carrying costs and sporadic manufacturing schedules), a “continuous replenishment program (CRP)” approach is required.

6.1.1.2 PROCESSES

To achieve these four efficiencies, ECR requires the following major processes:

- category management;
- continuous replenishment program (CRP);

6.1.1.2.1 Category management

The term category management first appeared in 1987 when certain organizations, such as Procter & Gamble, began moving from “brand” management to management “by category”. Category management has evolved to mean a process that involves managing product categories as business units and customizing them on a store-by-store basis to satisfy consumer demands. A category is a group of products having a common consumer end use and includes such things as household cleaners, dairy and frozen foods, paper products, health and beauty care products, soft drinks, etc. Category management allows the category manager to operate a category like a business so as to identify optimal product mix; and to stock each store with specific products that demographic and point-of-sale (PoS) information indicates customers wish to purchase. Category management is supported by EDI and barcode applications.

6.1.1.2.2 Continuous replenishment program (CRP)

Continuous replenishment, usually managed by the manufacturer, is a program used to control and monitor the movement of goods from the manufacturer to the warehouse/distributor. CRP involves the manufacturer (rather than the retailer’s warehouse) taking responsibility for replenishing the warehouse inventory, with the buyer supplying actual warehouse inventory withdrawal data and data on “stock-keeping units” (individual line items) to the manufacturer. CRP programs reduce costs in distributors’ inventory, but can increase some costs, such as transportation costs, if the manufacturer ships smaller truck loads more frequently. Successful CRP implementation is dependent on effective trade relations, requiring shared business practices and information systems which rely heavily on EDI.

6.1.1.3 ENABLING TECHNOLOGIES

To support the two process ECR utilizes four enabling technologies:

- computer-assisted ordering (CAO);
- flow-through distribution (cross docking);
- integrated electronic data interchange (EDI);
- activity-based costing (ABC);
- barcodes/scanners.

6.1.1.3.1 Computer-assisted ordering (CAO)

Computer-assisted ordering, also known as “computer-aided ordering”, covers the second half of the overall inventory supply chain - the movement of goods from the warehouse/distribution centre to the retail store. The aim of CAO is to generate store replenishment orders automatically, with minimal management intervention, based on such things as current and historical PoS scan data, delivery data and sales forecasts. The benefits of CAO have been identified as labour savings and dependability, warehouse and shipping improvements, and inventory reduction. Traditionally, stores have based their orders on the re-order clerk manually inspecting the store shelves and scanning the shelf-tag barcodes for those items with limited stock on the shelf. The re-order amount entered by the clerk is based on the actual shelf amount and the ideal shelf quantity. The re-order clerk is not in a position to take into account PoS data, inventory which has already been scheduled for delivery, or likely future trends based on forecasting. Integrated CAO systems are designed to minimize (and even eliminate) these problems.

6.1.1.3.2 Flow-through distribution (cross-docking)

According to Garry (1994) the purpose of flow-through distribution is to hasten the flow of products from the supplier to the retail store by reducing storage and handling of products at the distribution centre or warehouse. It involves the breaking down of pallets at the distribution centre, reassembling them for store delivery and then shipping them to the retail store without ever storing the product in the warehouse. This requires significant investment in technologies such as EDI, barcoding and scanning of pallets and cases; and warehouse design changes such as lower ceilings and less racking. The key EDI transaction required for cross-docking is the Advanced Shipping Notice (ASN), to inform the distributor of the merchandise that is about to arrive. The automation of the warehouse inventory management system using barcodes means that inaccuracies can be eliminated.

6.1.1.3.3 Integrated electronic data interchange (EDI)

EDI is the computer-application to computer-application communication of structured, formatted messages based on international standards, using electronic transmission media with no manual intervention. EDI is a technology which allows structured information to be shared among organizations in the supply chain resulting in significant reductions in transaction costs and enabling the organizations to adopt new and more effective and efficient business strategies, such as ECR. EDI is viewed as the essential effective enabler of the ECR management strategy because it focuses on

achieving integration across organizational functions and between organizations in the grocery supply chain.

6.1.1.3.4 Activity-based costing (ABC)

Activity-based costing provides the cost and operating information necessary to support innovative management improvement initiatives such as ECR. The focus of ABC is on accurate information about the true cost of products, services, processes, activities, distribution channels, customer segments, contracts and projects. ABC supplies information about profits (where the money is being made) rather than about costs. Traditional accounting systems use gross margin calculations that spread operating costs across all products based on unit purchase price regardless of the actual value chain through which the product passes. ABC focuses management's attention on controlling the source of costs, decisions that create activities, rather than squeezing budgets. Therefore ABC as part of ECR can increase the profitability of the supply chain by removing or reducing those cost activities that do not add value. This cannot be done with traditional systems because they do not reflect costs accurately.

6.1.1.3.5 Barcodes/Scanners

The use of barcodes and scanners is a fundamental element for ECR implementation in the grocery industry as it allows accurate and faster information capture to be obtained, which in turn can be shared with trading partners.

Now, we will study in detail the role of CRP (continuous replenishment program) and its impacts on different levels and the role of information sharing.

6.2 CONTINUOUS REPLENISHMENT PROGRAM (CRP) AND INFORMATION SHARING

The advent of e-business has enabled the emergence of new and advanced forms of information sharing and collaboration, creating several challenges and opportunities in the supply chain environment.

The Internet has made it easier to share information among supply chain partners and the current trend is to try to leverage the benefits obtained through information sharing (also called visibility) across the supply chain to improve operational performance, customer service, and solution development.

Since the early 1990s, there has been a growing understanding that supply chain management should be built around the integration of trading partners. Firms collaborate in the sense of "leveraging benefits to achieve common goals".

Anthony (2000) suggests that supply chain collaboration occurs when “two or more companies share the responsibility of exchanging common planning, management, execution, and performance measurement information”. Anderson and Lee (1999) state that industry participants “collaborate on planning and execution” of supply chain strategy to achieve a “synchronized supply chain”.

In retailing, supply-chain collaboration has taken the form of practices such as Continuous Replenishment Program (CRP), Vendor Managed Inventory (VMI) and Collaborative Planning, Forecasting and Replenishment (CPFR).

VMI is a technique developed in the mid 1980s, whereby the manufacturer (supplier) has the sole responsibility for managing the customer’s inventory policy, including the replenishment process, based on the variation of stock level in the customer’s main warehouse or distribution centre. VMI is probably the first trust-based business link between suppliers and customers.

CRP moves one step ahead of VMI and reveals demand from the retailers’ stores. The inventory policy is then based on the sales forecast, built from historical demand data and no longer purely based on the variations of inventory levels at the customers’ main stock-holding facility.

Collaborative Planning, Forecasting and Replenishment (CPFR) can be seen as an evolution from VMI and CRP, addressing not only replenishment but also joint demand forecasting and promotions planning, focusing on promotions and special-line items. CPFR is based on extended information sharing between retailer and supplier, including point-of-sales (POS) data, forecasts and promotion plans.

6.2.1 CONTINUOUS REPLENISHMENT PROGRAM

CRP is an efficient replenishment concept within the Efficient Consumer Response arena. It focuses on improving the flow of the products in the supply chain, both forward to the customer and eventually the end consumer, and backward to the supplier.

The goals of CRP are to:

- Increase inventory turns
- Reduce inventory levels
- Decrease stock-outs
- Improve customer service levels
- Boost warehouse efficiency
- Enhance your trading partners' perception of value.

CRP helps in eliminating non value added costs throughout the channel, reduces inventory levels, eliminates forward buying, provides higher average inventory turns, reduces warehouse stock-out and reduces transportation costs. CRP would help develop good inter-organizational relationship and shift perspective to a long term win-win view.

CRP provide closer collaboration between the manufacturer and the retailer. In addition to information sharing, CRP requires the manufacturer to implement a continuous replenishment process with the retailer; that is, increase the frequency of replenishments.

The basic principle in CRP is to continuously update and monitor inventory data for accurate and timely replenishment practice. In fact, it can be described as in the definition below:

“Continuous Replenishment Program (CRP) is an initiative in inventory management in which companies continuously update and monitor inventory data so that inventory depletion can be detected quickly in order to maintain product availability with minimum inventory costs. The continuous update of data is done by continuously passing actual data from Point-Of-Sales (POS) to the people/function/organization/computer application that performs the inventory control and releases Purchase Orders (POs) for inventory replenishment in a real time guided by predefined procedures to minimize waste.

To summarize, the principles of CRP implementation are as follow:

1. Continuous update of stock level made possible by continuous data flow from POS terminals to the replenishment decision-making point (people / function / organization / computer application),
2. Continuous monitoring of stock levels by responsible party (people / function / organization / computer application) to ensure appropriate decisions in inventory replenishment,
3. The use of predefined procedures and settings in decision-making to avoid any waste caused by forward buying activity.

CRP is a way to cope with demand uncertainly because it coordinates the supply chain players to work with common forecasts. CRP restructures the supply-chain ordering process in two fundamental ways. First, it requires the retailers to share inventory level, which is traditionally viewed as sensitive and secret information. Second, under CRP, the retailer inventory management is performed by the manufacturer and not by the retailer, then responsibility to manage retailers' inventory is delegated to suppliers. In this regard, CRP can be considered an initiative that involves transferring responsibility for buyer replenishment to the supplier who is provided with actual warehouse inventory withdrawal information or consumption at the stock-keeping unit

level. The supplier re-supplies the buyer's inventory to mutually agreed upon and predefined inventory levels".

Returning to the first way, the information sharing is made possible by use of technology EDI (Electronic Data Interchange), which will be discussed in the next paragraph. For this, CRP emerges as an EDI- based system supporting the objectives of Efficient Replenishment, which are to maximize product availability with a minimum of inventory and handling through the supply chain. It extends the use of EDI links to accommodate the exchange of inventory information. In the most form of CRP retailer's central warehouse sends an inventory report to the supplier, including information such as stock availability, store orders and product in-transit. By processing this information based on product flow predictions, the system at the supplier's side issues a suggested order and sends it back to the retailer. The aim is to ensure that the retailer's warehouse can meet the predicted demand, while keeping inventory levels as low as possible.

Summarizing the key features of CRP are as follows: (1) Retailers provide the manufacturer with real time access to their inventory positions (information sharing). (2) Based on this information, the manufacturer replenishes retailer inventory (VMI: vendor managed inventory). And, (3) products are sold to retailers at an everyday low price (EDLP). In CRP, retailer orders are essentially eliminated because manufacturers determine quantities to ship to retailers based on observed retail sales.

When there is no CRP, the retailers communicate only their orders to the manufacturer. Under CRP, the manufacturer has real-time access to participant retailers' inventory levels, and the manufacturer replenishes the inventory for each participant retailer.

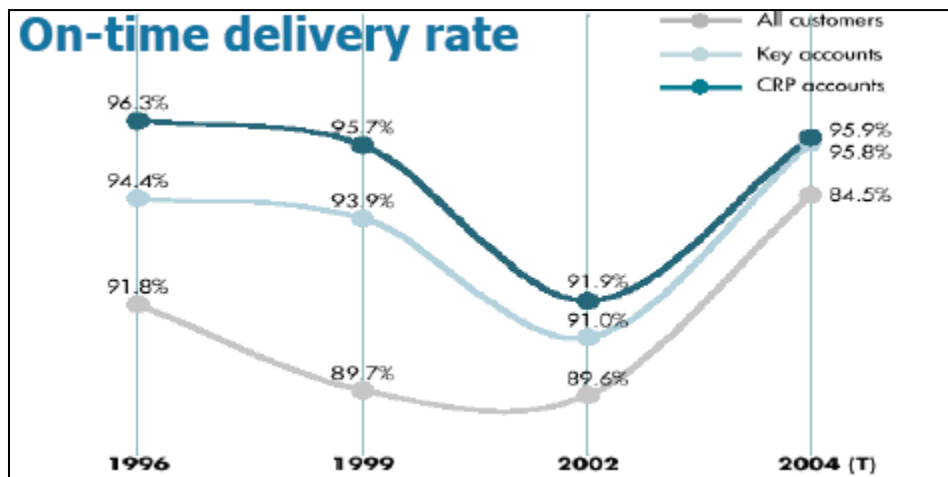
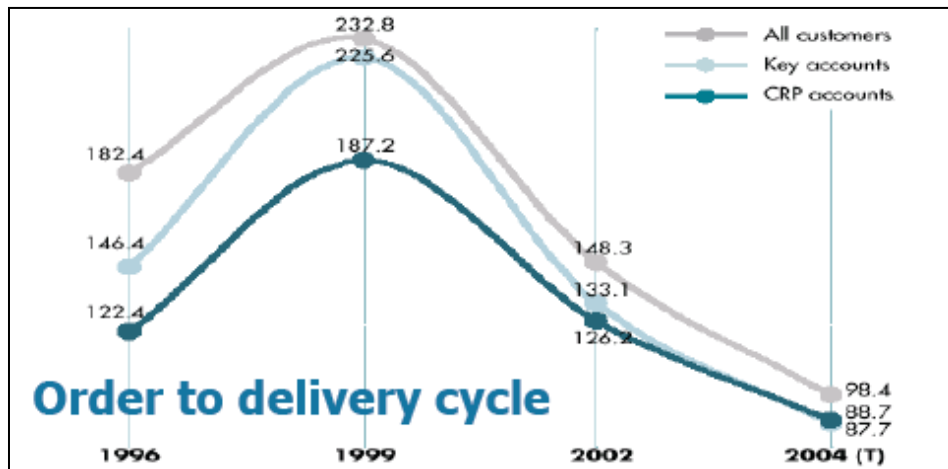
CRP enables the supplier to respond more efficiently to everyday situations. The automated posting of orders, the elimination of errors and the reduction of ordering time facilitates the issuing and processing of orders and increased the supplier's responsiveness. The automated posting of orders also affects the work of sales managers, since they do not longer need to go to the retailers' central warehouse, to take the orders. They have thus more free time to deal with more important issues as sales initiatives.

The use of CRP also improves the supplier's production management, logistics and inventory management, resulting in better planning of deliveries, cost savings and better utilization of warehouse space.

These improvements enable them to deal better with crisis situations. They can thus respond more efficiently to unusual events, without being constrained by lack information, storage and products.

The successful results are summarized below in terms of different indicators:

- order to delivery cycle: Time period between acceptance of an order and final delivery of the product
- on-time delivery rate
- order completeness rate
- orders fill rate



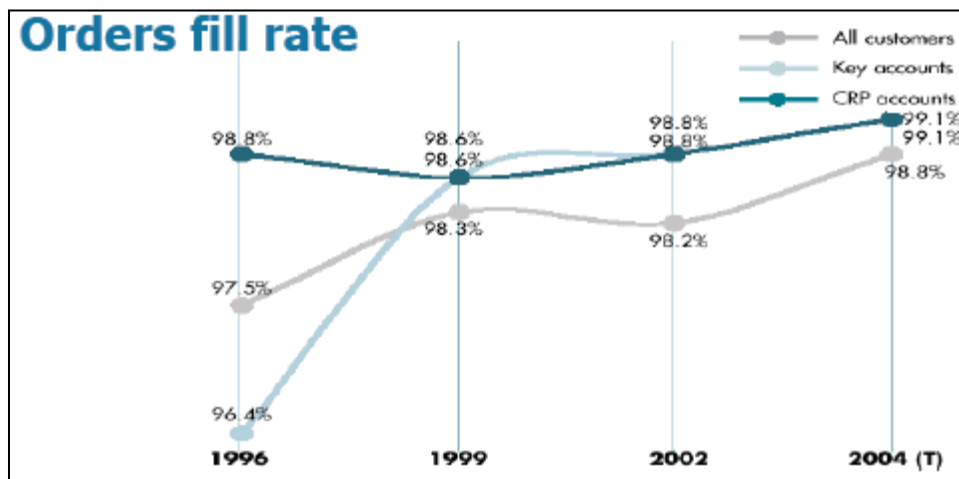
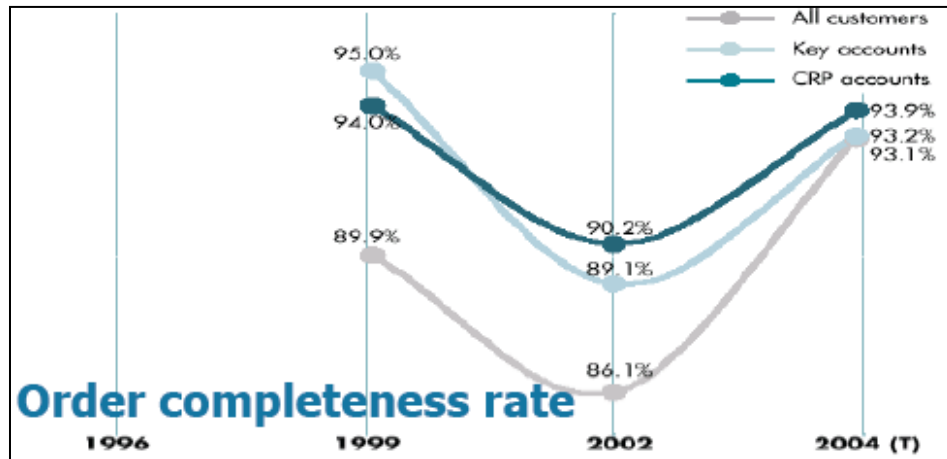


FIGURE 6.4: CRP'S SUCCESSFUL IMPLEMENTATION RESULTS *Source: GMA Survey 2002.*

In a report on ECR the benefits of CRP implementation were seen to be more than \$12B (US dollars). Vergin and Barr (1999) interviewed 10 consumer products manufacturing companies which had applied CRP. The results show that the 10 companies and their retailers reduce on average 32% of their inventory costs and decrease on average 55% of their out-of-stocks costs.

Case studies of CRP implementation speculated that for continuous replenishment systems to work effectively, demand must either be stable or reasonably predictable. Products that change frequently such as seasonal goods may not be appropriate for the CRP approach.

6.2.1.1 BENEFITS

The benefits acquired from the use of CRP are significant and the service's first objective is to optimally utilize any allocated space in the retailer's warehouse so as the consequently achieve higher satisfaction for the final buyer through the reduction of over exaggerated reserves while simultaneously controlling any shortages. A further

benefit in using CRP is that within the online environment, inter-party communication is easily achieved. Therefore, by achieving economies of scale, every supplier purchases a ready-made solution, which supports connectivity with all retailers and for a very competitive price.

SUPPLIER BENEFITS

- Visibility to the customer's point-of-sale data simplifies forecasting.
- Promotions can be more easily incorporated into the inventory plan.
- Customer ordering errors, which in the past would often lead to a return, are reduced.
- Stock level visibility helps identify priorities (replenish stock versus a stock-out).
- The supplier can see the potential need for an item before the item is ordered.
- Reduced risk of excess inventory.
- Better manage customer demands.
- Ensure quality customer service.

RETAILER BENEFITS

- Fill rates from the supplier, and to the end consumer, improve.
- Reduced Out-Of-Stocks (OOS).
- Reduced inventory days.
- Planning and ordering costs decrease since the responsibility is shifted to the supplier.
- Lower logistics and transportation cost.
- Elimination of product returns.
- Elimination of order mistakes.
- Shorter lead time.
- The overall service level is improved by having the right product at the right time.
- The supplier is more focused than ever on providing superior service.
- Maximization of space utilization.

DUAL BENEFITS

The benefits provided by the system, both to retailers and suppliers, comprise a reduction in the cost and time take for ordering, improve inventory management, cost savings due to stock optimization, better management and scheduling of deliveries and improved customer service. Summarizing dual benefits are:

- Data entry errors are reduced due to computer-to-computer communications.
- Overall processing speed is improved.
- Both parties strive to offer better service to the end consumer. All parties involved benefit when the correct item is in stock when the end consumer needs it.
- A true collaborative partnership is formed between the supplier and the customer.

- Long-term benefits include more efficient promotion handling, improved product introductions, more efficient product distribution and an eventual increase in sales.

6.2.1.2 DRAWBACKS

The use of CRP, however, can also produce constraints, regardless of the trading partner's efficiency. The sending of messages, at a specific time, limits the adaptability of the operation and prevents sending corrective or supplementary orders. In order to deal with these situations and overcome the technological constraints, staff usually need to side-step the system and communicate via telephone.

Another limitation imposed by CRP is that it requires specialized and well trained people, especially at the supplier's side. This supplier creates a special role (CRP analyst) within the sales department, with responsibility for the system. Besides technical skills these analysts also need a knowledge of the market. They check the automatically produced order, identify mistakes in the customer's inventory report and decide whether the suggested order needs to be changed. For sales promotions or seasonal products they work closely with sales managers to determine the optimum quantities for customers. These specialized skills and knowledge mean that they are difficult to replace.

Smaller companies are generally less able to implement CRP. A supplier's sales manager suggested that this is due to a lack of technological awareness and appropriate infrastructure, as well as the high cost of installation and maintenance.

Another limitation is that CRP requires absolutely a strong relationship between supplier and retailer.

6.2.2 INFORMATION SHARING

Information sharing (IS) is a collaborative program in which the downstream firm (referred to as a retailer herein) agrees to provide demand and inventory status in real time to the upstream firm (referred to as a manufacturer herein). In this case, the manufacturer no longer observes consumer demand through the retailer's order quantities but determines it directly from end consumers, though the manufacturer still receives orders from the retailer (i.e., the retailer is responsible for placing orders). Information sharing is generally facilitated through the use of either electronic data interchange (EDI) or the Internet. Shared information includes point-of-sale, demand, and inventory information among firms in the supply chain. For example, in EDI-enabled IS, CRP, or VMI, there are two EDI transactions at the heart of the information exchange process. The first is the Product Activity Record, which is often referred to by the Uniform Code Council (UCC) standard as UCS 852. UCS 852 contains sales and inventory information segmented into various classifications, such as inventory-on-

hand, inventory-on-order, committed inventory, and back orders. UCS 852 is sent by the retailer to the manufacturer on a prearranged schedule, typically daily.

The other transaction is the Purchase Order Acknowledgement sent from the manufacturer to the retailer, or UCS 855. UCS 855 contains the product numbers and quantities ordered by the manufacturer on the retailer's behalf.

The information sharing between supplier and retailer is very important because decreases the negativity of bullwhip effect.

The value of sharing demand information can be quite high, particularly when demands are significantly correlated over time. Raghunathan (2001), however, points out that the value of information sharing can be insignificant if the manufacturer uses the order history to forecast the retailer order quantity. Demand information sharing is a significant part of CRP implementation and can improve the fill rate by as much as 42%. Although there are various collaborative projects between the supplier and the retailer, information sharing usually plays a crucial role in the collaboration of the supply chain. IT applications play a supporting role in implementing the supply chain collaboration. For example, QR, ECR and VMI apply IT systems, such as POS, EDI, and EOS (electronic ordering system), to access mutual information of the supply chain members. Leonard and Davis (2006) exploited the relationship of the supply chain replenishment and EDI implementation, and concluded that EDI supply chains were more successful than non-electronic (manual or paper) supply chains in the performance of order cycle time, product availability, product price, and transaction cost. As the internet fully emerges, information sharing becomes more prevalent through an inter-organization internet network. Danese (2004) adopted the quantity method to analyze the effect of E-business on the supply chain performance. Danese (2006) studied the relation of the CRP and information communication technologies (ICTs). His observation illustrates that when the number of interacting partners is low, less sophisticated ICTs are required to support CRP collaboration. Similarly, when the number of interacting partners is high, more sophisticated ICTs are needed to support CPFR collaboration. Overall, the findings of Danese (2006) provide a framework for managers to handle anticipated changes in ICTs when companies do implement CPFR collaborations.

The benefit of information sharing to the manufacturer comes primarily from the manufacturer's ability to forecast more accurately the size of retailer's future orders and/or the actual timing of the future order placement.

6.2.2.1 EDI (ELECTRONIC DATA INTERCHANGE)

Efficient information and data exchange is the most essential requirement for implementing the collaborative practices as CRP. In the traditional ordering process, retailers provided manufacturers with only data on quantities of goods required once a

week (through ordering). VMI/CRP and CPFR dramatically increase the total volume of information transmitted between retailers and suppliers.

Electronic data interchange (EDI) has been a key enabling technology for efficient replenishment and supply chain coordination.

Without EDI, CRP wouldn't have been economically viable, as the amount of daily information processed and transmitted in the channel is too large to handle manually. Information technology is a necessary condition for the CRP innovation, thus serving as an enabler for this new form of inter-organizational relationships and joint channel process redesign.

However, EDI is also expensive and too complicated compared to the alternatives that have emerged lately for secure and reliable communication over the Internet and for information exchange in XML format. Furthermore, EDI confines the exchanged information to certain types, as defined by the respective standard EDI messages (e.g. Inventory Report (INVRPT) message supporting CRP), whereas new forms of supply-chain collaboration require many more types of information to be exchanged between the trading partners and these types may vary significantly in different occasions.

In order to cope with this increasing need for extended information exchange, the retail sector has started moving away from EDI to new ways of information exchange, mainly enabled by Internet-based communication platforms and retail exchanges (Sparks and Wagner, 2003), also referred to as electronic marketplaces (e-marketplaces).

Such exchanges are characterized by the retailers' direct access to distributors and suppliers, enabling businesses to interact via a neutral intermediary (the exchange) to conduct either one-to-one or multiple transactions. Thus, suppliers gain access to more buyers, and buyers can contact many suppliers. Such exchanges also hold out the hope of a more efficient supply system, through better and more rapid communications facilitating improvements in planning, deployment of transport fleets, warehouse management and procurement procedures.

For many suppliers, producers, distributors and retailers worldwide, EDI has become the backbone for computerized business-to-business communication. Meanwhile, the use of the Internet has exploded and new technologies, such as extensible Markup Language (XML), have recently surfaced.

Many people are concerned that the benefits of electronic commerce standards such as EDI will be swept away by the excitement of the Internet. However, we believe that it is not realistic that EDI will be replaced by the new technologies overnight. It will probably be a gradual process, where XML is used further back down the supply chain, possibly with second- or third-tier suppliers, where EDI has been too complex and

expensive to implement. Or, XML might be used when real worldwide standards are available to enable the new technologies to provide more flexible and responsive communication between the parties.

EDI benefits the buyer primarily by reducing shipment discrepancy, inventory, and ordering costs.

"EDI (Electronic data interchange)" is indispensable for QR (Quick Response) and ECR (Efficient Consumer Response). Both QR and ECR require EDI as a fundamental technology for exchanging order placement/receipt data and billing/payment data between manufacturers and distributors.

When a supply chain is carried out among different companies, transaction data needs to be exchanged amongst computers through communication lines. At that time, even though manufacturers and distributors have the same concept, EDI cannot be realized if they use different computers. EDI is a breakthrough for this technical bottleneck. In EDI, various arrangements that need to be made among interested parties should be based on widely-agreed standard conventions as much as possible.

While EDI is an infrastructure of a supply chain management system for QR and ECR, it is also a technology that supports concepts such as computer-aided design (CAD) and computer-aided acquisition and logistic support (CALs), a higher-level concept of CAD. EDI is based on standardization of electronic data exchange. There are many organizations that make rules for the standardization, such as ANSI (American National Standards Institute), EDIFACT (Electronic Document Interchange For Administration, Commerce and Transportation), CII (Center for the Informatization of Industry), EIAJ (Electronics Industries Association of Japan), and VICS (Voluntary Inter-industry Commerce Standards Association). The rules differ depending on the types of applications for each industry that are installed on the infrastructure of EDI. It is well known that traditional EDI reduces transaction costs and errors. In theory, it would seem that information sharing alone, which could be implemented by traditional EDI without requiring CRP, could provide significant benefits to the supply chain. Although the benefits of EDI for ordering were widely publicized, few firms in the retail industry had experienced significant savings from using EDI to automate the existing ordering process. Many authors have also noted that EDI must involve changes in business processes to realize savings enabled by the EDI innovation. Retail grocery product demands are relatively stable and are effectively managed by CRP (Clark 1994b).

Use EDI to support CRP as the volume of data transmitted, frequency of transmission, and quality of data transmitted has increased.

Typically, the manufacturer reviews inventory stock balances daily by receiving EDI files from the distributor or retailer. The manufacturer then uses the inventory information along with other known information, such as sales forecasts and promotional activities, to calculate and create an anticipated replenishment order for the customer. After receiving an electronic acknowledgment of the planned replenishment, the manufacturer ships the order. When the product is received at the customer site, payment is made with an electronic funds transfer from the customer's bank. Another common scenario is that the customer receives an invoice only after sending a sales report EDI message to the manufacturer.

In the CRP process, these EDI messages can usually be seen:

- Inventory report
- Sales forecast
- Order response
- Dispatch advice
- Sales report
- Invoice.

Uncertainties and inventory can be reduced. Kurt Salmon and Associate (1993) reported that this would reduce inventory days from 104 to 61 in the total supply chain. This would also contribute to as much as 4% from the total 11% of sales price reductions made by retailers.

6.3 ENTERPRISE RESOURCE PLANNING (ERP)

The Enterprise Resource Planning system is an enterprise information system designed to integrate and optimize the business processes and transactions in a corporation. The ERP in an industry-driven concepts and systems, and it is universally accepted by the industry as a practical solution to achieve integrated enterprise information systems, concerning supply chain, customers, human resource, finance, and accounting.

Information Technology (IT) integrates with the core business processes of a corporate house to streamline and accomplish specific business objectives. Consequently, ERP is an amalgamation of three most important components; Business Management Practices, Information Technology and Specific Business Objectives. In simpler words, an ERP is a massive software architecture that supports the streaming and distribution of geographically scattered enterprise wide information across all the functional units of a business house. It provides the business management executives with a comprehensive overview of the complete business execution which in turn influences their decisions in a productive way.

At the core of ERP is a well managed centralized data repository which acquires information from and supply information into the fragmented applications operating on a universal computing platform. Information in large business organizations is accumulated on various servers across many functional units and sometimes separated by geographical boundaries. Such information islands can possibly service individual organizational units but fail to enhance enterprise wide performance, speed and competence. The term ERP originally referred to the way a large organization planned to use its organizational wide resources. Formerly, ERP systems were used in larger and more industrial types of companies. However, the use of ERP has changed radically over a period of few years. Today the term can be applied to any type of company, operating in any kind of field and of any magnitude.

Today's ERP software architecture can possibly envelop a broad range of enterprise wide functions and integrate them into a single unified database repository. For instance, functions such as Human Resources, Supply Chain Management, Customer Relationship Management, Finance, Manufacturing Warehouse Management and Logistics were all previously stand alone software applications, generally housed with their own applications, database and network, but today, they can all work under a single umbrella - the ERP architecture. In order for a software system to be considered ERP, it must provide a business with wide collection of functionalities supported by features like flexibility, modularity & openness, widespread, finest business processes and global focus.

6.3.1 INTEGRATION

Integration is an exceptionally significant ingredient to ERP systems. The integration between business processes helps develop communication and information distribution, leading to remarkable increase in productivity, speed and performance. The key objective of an ERP system is to integrate information and processes from all functional divisions of an organization and merge it for effortless access and structured workflow. The integration is typically accomplished by constructing a single database repository that communicates with multiple software applications providing different divisions of an organization with various business statistics and information. Although the perfect configuration would be a single ERP system for an entire organization, but many larger organizations usually deploy a single functional system and slowly interface it with other functional divisions. This type of deployment can really be time-consuming and expensive.

Vertical integration of ERP systems needs technologies that can consolidate data from operational applications and combines the information with external data sources. Data warehouse and data mining are applications for extracting information from

databases of current ERP systems. As an example in the field of supply chain management, data warehousing allows customers to understand their supplier relationships by consolidating and classifying their purchasing data. To meet the requirements of extracting remote data like purchasing data from more than one source, warehousing over the web is a new form of analyzing this information. The term Total Information Solutions (TIS) expresses the necessity of integration of external data and internal data. These systems will enable businesses to monitor and collect data about external business conditions and extract business intelligence. Extracting information about competitors and their changes in the suppliers' structure is an example for the importance of integrating external and internal information sources.

6.3.2 IMPROVEMENTS

ERP Systems Improve Productivity, Speed and Performance.

Prior to evolution of the ERP model, each department in an enterprise had their own isolated software application which did not interface with any other system. Such isolated framework could not synchronize the inter-department processes and hence hampered the productivity, speed and performance of the overall organization. These led to issues such as incompatible exchange standards, lack of synchronization, incomplete understanding of the enterprise functioning, unproductive decisions and many more.

For example: The financials could not coordinate with the procurement team to plan out purchases as per the availability of money.

Hence, deploying a comprehensive ERP system across an organization leads to performance increase, workflow synchronization, standardized information exchange formats, complete overview of the enterprise functioning, global decision optimization, speed enhancement and much more.

6.3.3 IMPLEMENTATION

Implementing an ERP system in an organization is an extremely complex process. It takes lot of systematic planning, expert consultation and well structured approach. Due to its extensive scope it may even take years to implement in a large organization. Implementing an ERP system will eventually necessitate significant changes on staff and work processes. While it may seem practical for an in-house IT administration to head the project, it is commonly advised that special ERP implementation experts be consulted, since they are specially trained in deploying these kinds of systems.

Organizations generally use ERP vendors or consulting companies to implement their customized ERP system. There are three types of professional services that are

provided when implementing an ERP system, they are Consulting, Customization and Support.

Consulting Services - are responsible for the initial stages of ERP implementation where they help an organization go live with their new system, with product training, workflow, improve ERP's use in the specific organization, etc.

Customization Services - work by extending the use of the new ERP system or changing its use by creating customized interfaces and/or underlying application code. While ERP systems are made for many core routines, there are still some needs that need to be built or customized for a particular organization.

Support Services - include both support and maintenance of ERP systems. For instance, trouble shooting and assistance with ERP issues.

The ERP implementation process goes through five major stages which are Structured Planning, Process Assessment, Data Compilation & Cleanup, Education & Testing and Usage & Evaluation.

- **Structured Planning:** is the foremost and the most crucial stage where an capable project team is selected, present business processes are studied, information flow within and outside the organization is scrutinized, vital objectives are set and a comprehensive implementation plan is formulated.
- **Process Assessment:** is the next important stage where the prospective software capabilities are examined, manual business processes are recognized and standard working procedures are constructed.
- **Data Compilation & Cleanup:** helps in identifying data which is to be converted and the new information that would be needed. The compiled data is then analyzed for accuracy and completeness, throwing away the worthless/unwanted information.
- **Education & Testing:** aids in proofing the system and educating the users with ERP mechanisms. The complete database is tested and verified by the project team using multiple testing methods and processes. A broad in-house training is held where all the concerned users are oriented with the functioning of the new ERP system.
- **Usage & Evaluation:** is the final and an ongoing stage for the ERP. The lately implemented ERP is deployed live within the organization and is regularly checked by the project team for any flaw or error detection.

6.3.4 ADVANTAGES

There are many advantages of implementing an EPR system. A few of them are listed below:

- A perfectly integrated system chaining all the functional areas together.

- The capability to streamline different organizational processes and workflows.
- The ability to effortlessly communicate information across various departments.
- Improved efficiency, performance and productivity levels.
- Enhanced tracking and forecasting.
- Improved customer service and satisfaction.
- Reduced inventory
- Standardizes and speed up manufacturing.

Tangible Benefits Realized From ERP Program

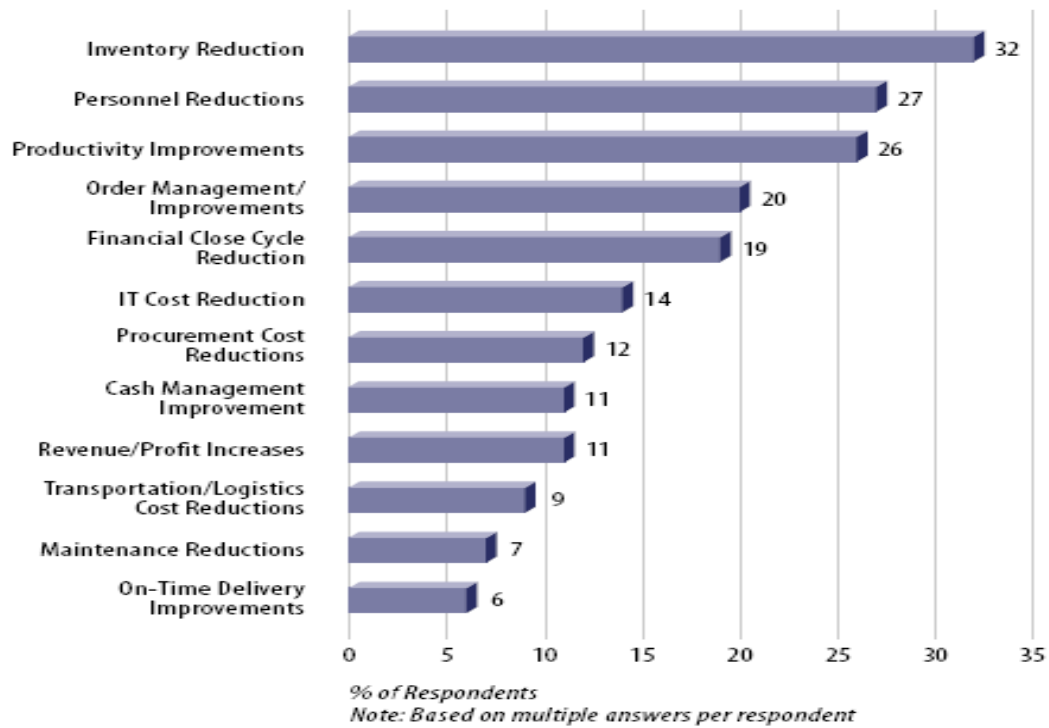


FIGURE 6.5: TANGIBLE BENEFITS FROM ERP PROGRAM

Intangible Benefits Realized from ERP Program

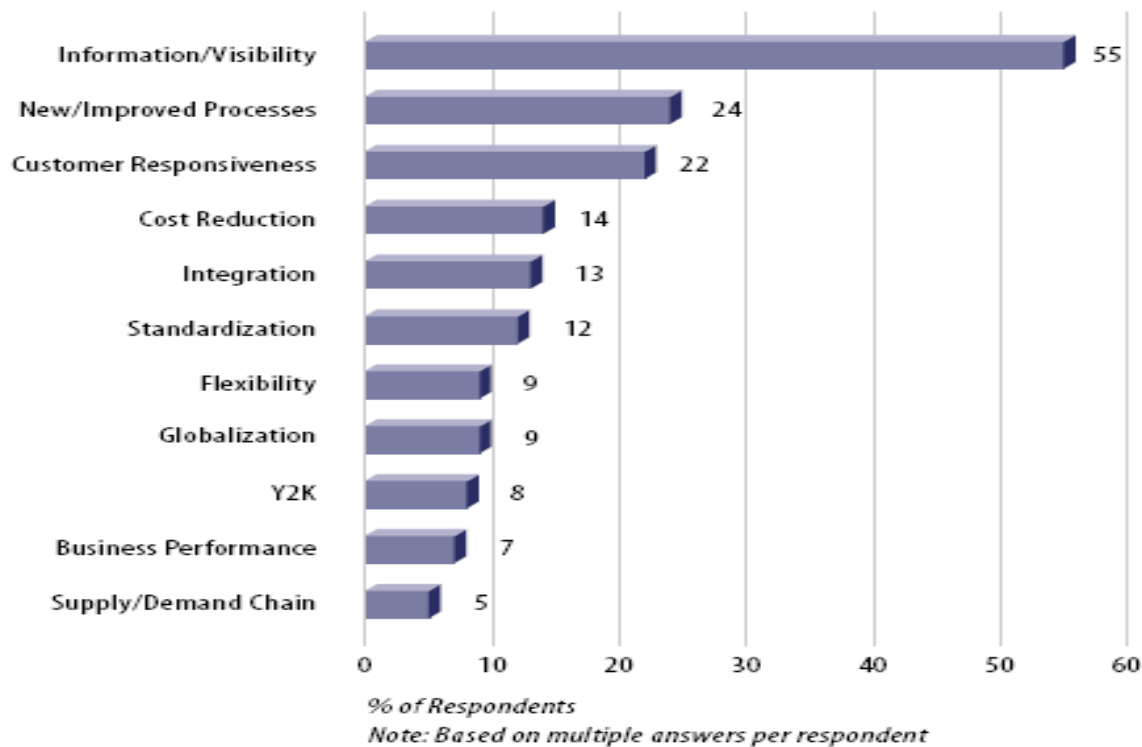


FIGURE 6.6: INTANGIBLE BENEFITS REALIZED FROM ERP PROGRAM

6.3.5 DISADVANTAGES

While advantages usually outweigh disadvantages for most organizations implementing an ERP system, here are some of the most common obstacles experienced:

- The scope of customization is limited in several circumstances.
- The present business processes have to be rethought to make them synchronize with the ERP.
- ERP systems can be extremely expensive to implement.
- There could be lack of continuous technical support.
- ERP systems may be too rigid for specific organizations that are either new or want to move in a new direction in the near future.

CHAPTER 7

PROJECT MANAGEMENT

This chapter will describe the planning time and cost of all stages that made up the project.

7.1 PLANNING TIME

To study the planning time were drawn up two tables: one reflects the initial planning and estimates the project, the following represent the actual planning.

7.1.1. INITIAL PLANNING

The initial planning shows time estimates of various activities that make up the project.

ACTIVITIES \ WEEKS	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
PLANNING	█														
“INFORME”		█													
INTRODUCTION			█												
HISTORY AND ORIGINS			█												
BOOK READING*				█	█	█									
ARTICLES READING		█	█	█	█	█	█	█							
ZARA BUSINESS MODEL					█	█	█								
BENETTON BUSINESS MODEL					█	█	█								
ZARA’S STRATEGIES								█	█						
BENETTON’S STRATEGIES										█	█				
ZARA’S EXIT STRATEGIES								█	█						
BENETTON’S EXIT STRATEGIES										█	█				
COMPARISON OF TWO MODELS												█	█		
DEVELOPMENT OF AN INFORMATION SYSTEM													█	█	
CONCLUSIONS															█
BIBLIOGRAPHY															█
REVIEW															█

FIGURE 7.1: INITIAL PLANNING

* Arnaldo Hax & Wilde II, 2003 The Delta Project. Palgrave Macmillan

The project began the 1st March for a total duration of 15 weeks. Whereas we consider 6 working days, each of 10 hours, excluding Saturdays of 6 hours. So it have been established:

$$15 \cdot 5 \cdot 10 + 15 \cdot 6 = 840 \text{ hours}$$

As discussed below have been made many changes than planned.

7.1.2 ACTUAL PLANIFICATION

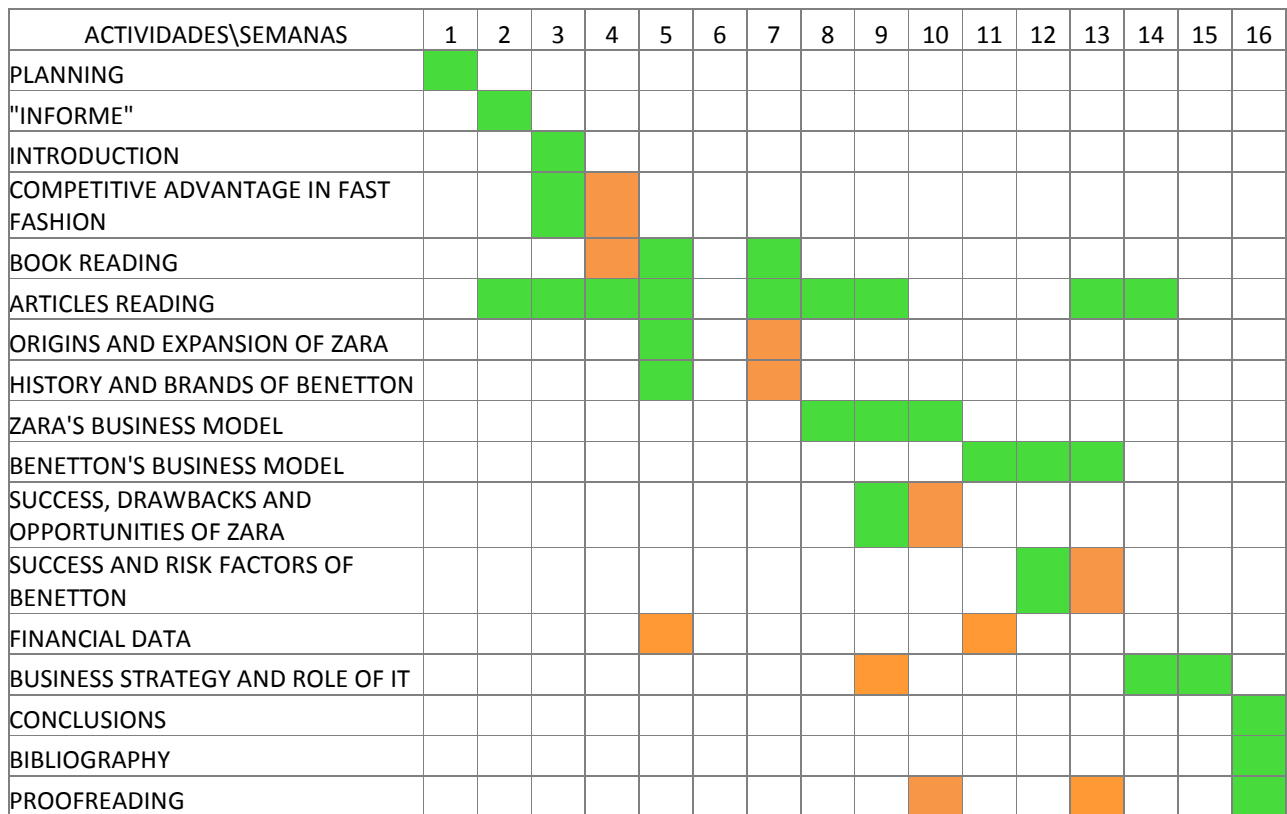


FIGURE 7.2: ACTUAL PLANNING

The actual planning is very different from that planned because during the development of the thesis, Italian supervisor requested a change of focus and therefore a relative change of the phases. Everything is explained in the index.

Regarding the management of time and hours was followed the initial planning. As you can see in the sixth week there is no work because I went in my city to talk with the Italian professor on development of the thesis and to spend the Easter holidays. For this reason, to achieve the same work hours was added to the sixteenth week.

The green boxes are the entire week of work for a phase while the orange boxes are more or less mid-week.

* Arnaldo Hax & Wilde II, 2003 The Delta Project. Palgrave Macmillan

7.2 ECONOMIC PLANNING

Economic planning is the study of costs incurred to develop this project.

The project has been developed by one engineer, whose return in Rome is 30,00 euro per hour.

For the development of this project were needed:

- A PC, estimated value of € 980.00
- Connection to internet, with a cost of € 29.90 per month.
- The release of important documents, with a cost of 0.03 per page.
- The purchase of a book, which costs amounts € 26.00.

Now we will study in detail the individual cost items.

ENGINEER

Hours worked = 840

Cost / hour = € 30.00

TOT Cost = € 25,200.00

PC

Estimated cost = € 980.00

Life = 3 years \approx 156 weeks

Residual value = 150 €

Usage Time = 15 weeks

Quote weekly amortization = $(980-150) / 156 \approx$ € 5.32

Quote amortization 15 weeks = $5.32 \cdot 15 \approx$ € 79.81

INTERNET

The cost of internet connection is fix and monthly, the use has been almost 4 months so we have:

Connection cost = $29.90 \cdot 4 =$ € 119.60

PRINT

The printed sheets were 175, at a cost of 0.03 cents each. Then:

Printing cost = $175 \cdot 0.03 =$ 8.25 €

BOOK

The price of the book is € 26.00

In summary we obtain the following table with the total cost for the project: € 25,433.66.

VOICE	COST
ENGINEER	25.200,00 €
PC	79,81 €
Internet	119,60€
Print	8,25 €
Book	26,00 €
TOTAL	25.433,66 €

FIGURE 7.3: ECONOMIC PLANNING

CHAPTER 8

CONCLUSIONS

In a world full of changes, which also changes consumer buying behavior, it's very important that the company is equipped with a flexibility that allows it to adjust and adapt to changes very quickly, but even more if able to anticipate and predict them. For this reason, companies in the fast fashion, like Zara and Benetton, operate in the pull system, which tend to produce only as requested by customers, and this is made thanks to a good relationship between producer and retailer. It is precisely this relationship that companies seek to improve efficiency and customer satisfaction. As shown in Chapter 6, an important role in this regard is provided by information technologies that allow the exchange of information from the downstream area of chain to the upstream area. In this way we found many advantages in terms of cost and time.

CHAPTER 9

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