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DISSERTATION

GROWTH AND INTERNATIONALISATION STRATEGY – FRANCHISING OF THE INDITEX GROUP

LUÍS FILIPE SOARES LOPES

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LISBOA SCHOOL OF ECONOMICS & MANAGEMENT

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SUPERVISION:
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Abstract

Through the years franchising has been playing a major role in the growth of companies. The main purpose of this dissertation is to evaluate the importance of franchising to Inditex growth and internationalization and explain how market selection and entry strategy of franchised units is developed by the company. In this dissertation we proceeded to a frequency analysis of the number of units between 2002 and 2013 taking into consideration Inditex's different brands, different geographic locations and different types of exploration (franchising or company-owned units). We also proceeded to a financial analysis that allowed us to conclude that there is no relationship between the group financial indicators and the type of exploration chosen. Moreover, the frequency analysis previously mentioned allowed us to develop a correlation study where we also took into consideration economic, political, legal and demographic variables. We concluded that there is a higher relationship between the location and the type of exploration and a certain relationship, more weakly, between the location and the type of brand. Moreover, we found out that in countries where the purchasing power is lower and/or there is asymmetric, income franchising agreements are more common as well as in countries with higher perception of corruption and unstable political environment.

Keywords: Inditex, franchising, strategy, growth, internationalisation.

Resumo

Ao longo dos anos o *franchising* tem vindo a desempenhar um papel importante no crescimento das organizações. O principal objetivo desta dissertação é avaliar de que modo o *franchising* tem vindo a contribuir para o crescimento e internacionalização do grupo Inditex e de que forma a companhia seleciona os mercados e como determina a entrada nesses mercados. Nesta dissertação procedeu-se à análise de frequências do número de unidades entre 2002 e 2013 tendo em conta as diferentes marcas do grupo Inditex, as diferentes localizações geográficas e os diferentes tipos de exploração (lojas *franchising* em oposição a lojas próprias). Seguidamente, procedemos igualmente a uma análise financeira que nos parece indicar que não existe relação entre os indicadores financeiros e o tipo de exploração escolhida. A análise de frequências anteriormente mencionada permitiu-nos o desenvolvimento de um estudo de correlações onde são também tidas em conta variáveis económicas, políticas, legais e demográficas. Concluímos que há uma grande relação entre a localização e o tipo de exploração e uma relação não tão linear entre a localização e a marca. Além disso, concluímos que em países onde o poder de compra dos consumidores é mais baixo e/ou o rendimento é assimétrico, os contratos de *franchising* são mais comuns assim como em países com uma perceção mais elevada dos níveis de corrupção e uma política interna instável.

Palavras-chave: Inditex, franchising, estratégia, crescimento, internacionalização.

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Glossary

APC – Average Period Cash

APP – Average Period of Payments

CPI – Corruption Perceptions Index

EBIT – Earnings Before Interests and Taxes

EFF – European Franchise Federation

EU – European Union

FCF – Free Cash Flow

GDP – Gross Domestic Product

ICRG – Internacional Country Risk Guide

INDITEX – Industria de Diseño Textil S.A.

ISEG – Instituto Superior de Economia e Gestão

NPV – Net Present Value

NWC – Net Working Capital

PCO – Proportion of Company-owned Outlets

PPP – Purchase Power Parity

PRS – Political Risk Service

ROA – Return on Assets

ROE – Return on Equity

ROS – Return on Sales

USA – United States of America

USDOC – United States Department of Commerce

WACC – Weight Average Cost of Capital

1. Introduction

We developed this dissertation within the scope of the Master in Finance. Our main goal is to analyze in what extent franchising enhances the growth and internationalization of a company. We intend to analyse this topic in the specific case of Inditex, a Spanish fashion group well knowed all over the world.

The world of fashion is dynamic and full of changes and consequently Inditex faces huge challenges in answering to new market needs every day. The main reason why I decided to explore this topic of franchising is because I found great interess by the study how franchising can be used by companies, as a tool to efficiently fulfill market expectations at a faster speed and in different countries simultaneously.

This dissertation starts with an overview of the main literature concerning the meaning of franchising, its different types and main advantages and disadvantages from the franchisee and franchisor perspective. We end this chapter with a reflection of why companies franchise their business analyzing two theories with opposite approaches, the Resource Scarcity Theory and the Agency Theory, and a third theory, which is a mix of these two, the Plural Organization Theory.

In the third chapter, we start with a brief description of Inditex different brands (what type of product they offer, their target and their price and quality level) and then we proceed with a unit frequency analysis. To develop this analysis we divided the countries where Inditex is present up, into six groups (Spain, Rest of Europe, Asia, Africa, North America & Australia and South America) and then we computed the frequency of units by brand, location and type of exploration between 2002 and 2013. Moreover in chapter 4, we developed a financial analysis of Inditex Group that allowed us to conclude that there is no relationship between the financial strategy and the type of exploration chosen. Subsequently, through correlation studies we tried to enable valuable conclusions concerning the existence or not of a relationship between the brand and the location, between the brand and the type of exploration and between the type of exploration and the location and, moreover, between the type of exploration and economic, political, legal and demographic variables.

In Chapter 5 we present our conclusions, limitations and our recommendations for future research followed by the bibliography used in this dissertation.

2. Literature Review

2.1. What is franchising?

Franchising is a contractual agreement between two independent parties, (Alon, Alpeza, & Erceg, 2007) which gives to the franchisee, a person or a group of persons with legal activity open, the right to sell the franchisor's product or service using its trademarks and their operating methods in a certain location and for a specified period of time (Blair & Lafontaine, 2005).

Combs, Michael & Castrogiovanni (2004) defined franchising as a form of business where one firm (the franchisor) sells to a second firm (the franchisee) the right to transact their own goods or services, to third parties under their brand name and using its business processes. Franchising is an example of organizational business since franchisor has a degree of ownership and control over the trademark, operational methods and the location of units, but gives to franchisees the opportunity to operate these last ones (Shane, 1996).

Typically in order to start any franchise business, the franchisee has to pay to the franchisor a small fixed fee at the beginning of the contract. This fee is paid only once and after that franchisor demands payments, typically royalties - monthly payments[1] - calculated usually as a fixed percentage of the franchisee's gross sales or obtained profits throughout the life of their contracts (Blair & Lafontaine, 2005).

2.1.1. Types of Franchising

According to the United States Department of Commerce (USDOC) we need to distinguish two types of franchises: the traditional and the business-format. According to Beshel (2005) the distinction is between product distribution[2] and business-format type[3].

2.2. Advantages and disadvantages of franchising

2.2.1. From the franchisee's perspective

European Union decided to promote entrepreneurship with its Europe 2020 strategy, recognizing it as a key for social and economic development (European Commission, 2012). In order to make the right decision before starting their own business, entrepreneurs need to choose carefully between being a franchisee or an independent business owner (Beshel, 2005).

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[1] Note: In business-format type depends of the signed contract and in traditional/product distribution type this does not occurs.

[2] In product distribution format [Beshel (2005)] or traditional format [USDOC] the franchisor only sells their products to franchisees, they do not provide all methods to run their business. Franchisor exercises less control than in business-format method once franchisee is free to choose their business and distribution strategy.

[3] In business-format method the franchisor provides all the information necessary for franchisees to run their business. Franchisor's product and/or service is sold but beyond that, franchisees have also assistance and support from the chain. This is the most common type of franchising.

> *"Franchising appeared to offer the dual benefits of facilitating entry into business in an unfamiliar industry for inexperienced operators as well as providing a vehicle for growth and expansion for investors with previous corporate management experience".*
>
> (Bennett, Frazer, & Weaven, 2009; 1)

In Figure 6 it is possible to find a summary of the characteristics, backgrounds and attitudes of investors according with the business model chosen.

A study developed by Williams (1998) compares these two alternatives, "starting a franchising versus starting an own independent business", and concludes that franchisees generate in average lower profits. Moreover, franchisees have less information than franchisors, encouraging franchisee to make bad investment decisions, while allowing franchisors to engage in what he calls "*pre-contract opportunism*" (Grimes 1996; Williams, 1998). Also Martin (1998) sited in his paper James Brickley and Fredick Dark's (1987) argued that franchised units are more likely to be located in rural and small areas than company-owned units. Those are located generally in large urban areas with less risk.

> *"The current interest in increased franchise legislation is a direct result of presumed changes in ownership patterns and implied opportunistic behavior of franchisors*"
>
> (Lafontaine & Kaufmann, 1994; 110)

To avoid this, it is important that franchisees ask for full disclosure of documents that will allow them to forecast the business cash flows (Blair & Lafontaine, 2005). Nevertheless, there are several advantages of being a franchisee. It is particularly interesting to note that, this business development method give to the entrepreneur, an opportunity to start a solid business that has already been tested and, therefore, has a reduced risk of failure (Edwards, 2011; Manitoba[4] Law Reform Commission, 2008). However, entrepreneurs must be aware to the risks in which they may be involved. It is not everything given on a silver platter (Yozi, 2009). The risk of new franchisees is larger than the risk of starting an own business, but the risk of opening a new independent business is larger than the risk of opening a new multi-unit franchisees (Bates, 1998). So, franchisees should select from the market all opportunities of investment and should previously compare all profits cash flows that might create (Blair & Lafontaine, 2005). Franchising offers to the entrepreneur a pre-opening support such as initial training, design and site selection, operating manuals and continuous assistance like training, advertising, assistance, supervision and continuous management support (Hunt, 1977; Norton, 1988). Alon et. al., (2007) stressed economies of scale and less probability of mistakes in business processes, due to training and standardized process as other advantages of franchising from a franchisee's point of view. However, the main advantage of a franchising is the recognized brand and trademark, although this can be a double-edged sword. If franchisor does bad advertising campaigns, this also becomes a franchisee problem (Hunt, 1977). Business-format franchising is not completely independent once it has lack of flexibility, is temporarily limited and has smaller profit margins. Besides that, according to Beshel (2005), a franchisor's problem may become a franchisee problem and performance of each unit will be reflected on the performance of all other units of the same brand (Sorenson & Sørensen, 2001). Also Yozi (2009) points in his dissertation, Justis and Judd (2002) and Nieman (1998), franchisor's dependence and how poor performance of other franchises affect all business and could be the main disadvantages for the franchisee.

[4] Canadian province

2.2.2. From the franchisor’s perspective

There are many reasons to franchise and many favorable arguments from the franchisor’s perspective to expand their business through franchising. To Alon et al., (2007) relative low business risk, reinforcement of the brand through geographic dispersion, less human resources and increased competitiveness, are some of them. Also Abizadeh (2010) and Manitoba Law Reform Commission (2008) points as an advantage the fact that franchising enables franchisor to enter into new markets with relative low business risk and initial investment.

Holmes (2003) outlines from the franchisor’s point of view the following advantages:

(i) Strategic advantages (rapid expansion, easier access to great unit locations, national and international market penetration in order to gain market share, greater value when franchisor goes public);

(ii) Financial advantages (royalties and fees, easier access to borrow capital, easier sales through the chain);

(iii) Marketing advantages (system-wide marketing support could be paid by franchisees);

(iv) Ownership advantages (mentality and attitude of franchisee as a business owner and their openness to participate and to help with his suggestions to improve the operation or distribution system of the whole chain).

Also Yozi (2009), points in his dissertation, the possibility of franchisor achieve a fast expansion without having to access financial markets to require capital, as an advantage of franchising from the franchisor’s perspective. Furthermore, he also points out as another advantage, the economies of scale achieved due to the franchisor purchasing power. Franchising is not always the best business model for the franchisor (Britz,

2005) and also has its disadvantages and risks (Manitoba Law Reform Commission, 2008). Alon et al. (2007) identify as major disadvantage, the franchisor's loss of control over the franchise network and also mention other disadvantages such as: (i) lower profits, (ii) possibility of having a bad relationship with franchisees and (iii) not capability to guide how franchisees recruit their collaborators.

Moreover, franchisor's perspective and goals may not be in line with the ones of franchisee, creating a conflict of interests. In some Cases, franchisor may perceive a less profitable franchisee unit as a problem that will bring a bad image to the chain. Not standardized operation methods in the whole chain in order to achieve uniformity, could be a disadvantage and could damage the brand (Yozi, 2009). When franchisor is thinking to use franchising as an internationalization method, according to Holmes (2003), huge and different legislations across countries, could mean legal expenses and constraints. The difficulty and the uncertainty to find qualified franchisees, can delay business expansion not following market demands (Holmes, 2003; Manitoba Law Reform Commission, 2008). In addition to the disadvantages from the franchisor's point of view, franchising has some difficulties arising from commercial and legal pitfalls. For the franchisor's point of view, is important to select the right country to target in order to be able to withdraw funds with no problem after a mutual understanding between the parties (franchisor and franchise). Other commercial pitfalls are related with not recognising local differences which leads to lack of customers' appreciation, higher costs than established, wrong time entrance and product defects (Pengilley, 1986). Assuming general legal insights and not analysing deeply each country, each commercial decision is a legal pitfall which occurs when franchisors are internationalizing their business (Pengilley, 1986).

2.3. Why do companies franchise their businesses?

> "*Among the U.S. firms that franchise, 70% of retail outlets are operated by franchisees. The remaining 30% are corporately owned and operated (Franchising in the Economy, 1987)*"
>
> (Carney & Gefajlvic, 1991; 608)

Agency Theory and Resource Scarcity Theory are two popular theories that explain why companies use franchising and the factors associated with the proportion of franchises (Alon, 2006). In Figure 7 we present the major assumptions and predictions of these theories. According to Diaz-bernardo (2012), a third theory as appear: the Plural Organizational Theory. We have a lot of franchised companies competing with companies that never franchised and both sides are growing, so these three theories answer the question why companies franchise their business (Diaz-bernardo, 2012).

2.3.1 Resource Scarcity Theory

Resource Scarcity Theory was developed by Oxenfeld and Kelly (1996) and states that franchising is the best way to grow fast and for franchisor to have access to financial and managerial resources (Combs, Michael, & Castrogiovanni, 2004). Basically, it allows the franchisor to access strategic resources achieving economies of scale and market share in a short time (Alon, Bordonaba-juste, Lucia-palacios, & Polo-redondo, 2008). According to Diaz-bernardo (2012), franchising contributes not only to start the growth operation through fees and royalties that franchisor receives, but provides a stability of capital (the scarcity of resource) to continue the operations.

The creators of this theory (Oxenfeld and Kelly) published in 1968 a paper namely *Will Successful Franchise System Ultimately Become Wholy-Owned Chains?* where they conclude that the answer is yes. Franchisor only uses this business model to solve their scarcity resource problems and to solve their lack of capital to grow. However, in an advanced stage, when this lack of capital is not a problem, franchisors will claim the contract and proceed to an *ownership redirection* (Alon et al., 2008). This theory assumes that, in the long term, almost one hundred percent of the franchised companies will be company-owned chains (Diaz-bernardo, 2012).

2.3.2 Agency Theory

Agency Theory[5] is another theory that tries to explain and complete a logical reasoning around franchising. There is empirical evidence that even when a company has lots of resources, they use franchising. Resource Scarcity Theory is corroborated faced with this fact (Diaz-bernardo, 2012).

An unquestionable incentive given by franchising is that the franchisee, is the owner of their unit. Therefore, it is expected that the franchisee work more and better in order to optimize their resources doing the best in terms of management (Hunt, 1977). *"Franchisees operate efficiently because they have a piece of the pie"* (Bradach & Eccles, 1989; 114). Franchising business format aligns the interests of both, franchisor and franchisee, so once franchisee has their personal interests, franchisor will not have monitoring costs checking franchisee's behavior and effort. It is an option to reduce monitoring costs that would exist to avoid shirking and excessive consumption of leisure in company ownership – agency costs (Diaz-bernardo, 2012; Ehrmann & Spranger, 2005; Rubin, 1978; Shane, 1996). Franchisee's motivation is higher than any variable compensation upon the performance of franchisor manager, that we might think

[5] Agency Theory is a theory that helps to study the way that a franchisor and franchisee work together. This theory determines the benefits and incentives for both agents in order to favor lucrative transactions. Adapted May 1, 2014 from: http://www.businessdictionary.com/definition/agency-theory.html

about (Diaz-bernardo, 2012).

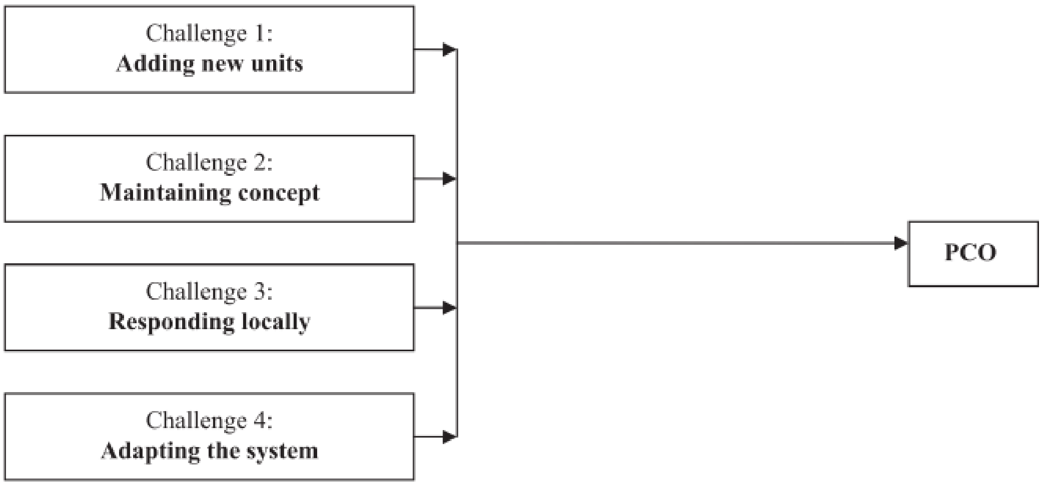
Agency Theory suggests that larger and older franchising networks will use more and more franchised units in order to ensure their sustainable growth (Alon et al., 2008).

2.3.3 Plural Organization Theory

Plural Organizational Theory is another theory that shows up to explain why companies franchise their business once there is no empirical evidence to supporting 100% franchised chains (Agency Theory) or 100% company-owned chain (Resource Scarcity Theory) in the long term. This theory appears after analyzing most franchising business keeping a mix of franchised and company-owned units (Diaz-bernardo, 2012) needed to be successful (Sorenson & Sørensen, 2001). In fact, it is a complementary theory, developed by Bradach (1997) and defined by Bradach and Eccles (1998), in order to show that a plural form network, has competitive advantage when compared with franchised or all company-owned chains (Cliquet & Pénard, 2012; Sorenson & Sørensen, 2001) due to the positive synergies created by this mixed strategy (Bradach & Eccles, 1989).

Choosing the right proportion of company-owned outlets (PCO), decreases the risk of franchisors and increases financial performance (Burkle & Posselt, 2008). As a franchisor network becomes bigger, franchisors should increase in the same scale the proportion of franchisees (Alon et al., 2008). According to Bradach (1998) adding new units to the system, maintaining uniformity in the concept across all units, responding locally and making system wide adaptations are four key goals (see Figure 1) that franchisor should achieve to survive and to benefit from Plural Form network (Cliquet & Pénard, 2012).

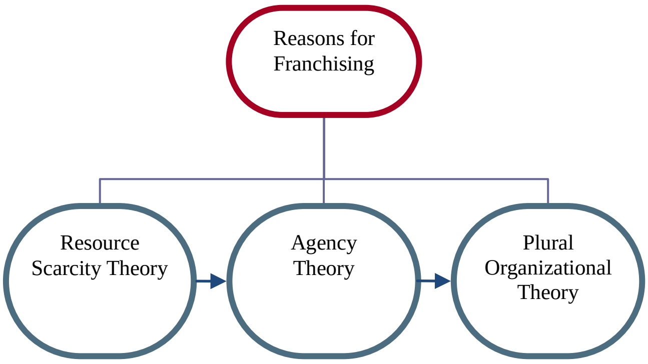
Figure 1: A model relating Bradach's four challenges to PCO



Source: Cliquet & Pénard, 2012

Through these three theories above, there are none that can full explain why companies franchise their business. According to Diaz-bernardo (2012), there are a learning process: companies move from an exclusively economic motivation (Resource Scarcity Theory), to have better and motivated managers (Agency Theory) and finally move to the third step (Plural Form), due to strategic reasons, decreasing risk and increasing financial performance (see Figure 2).

Figure 2: Reasons for Franchising

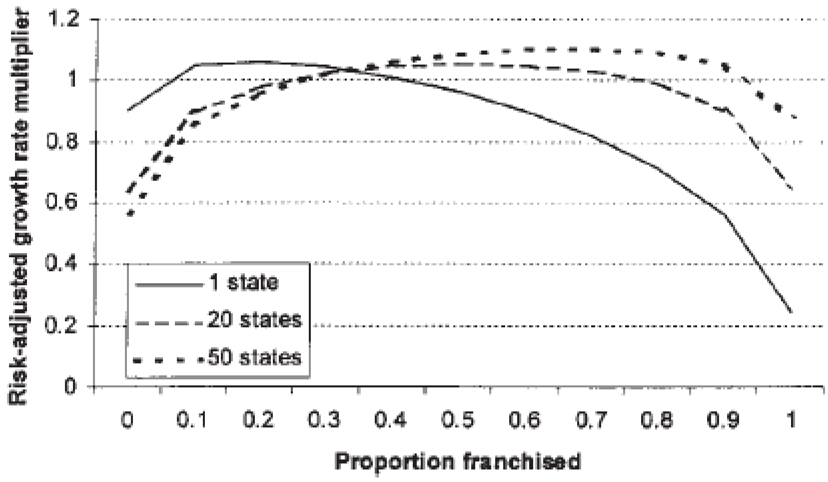


Source: Authors' design

> "*In general, survival companies are older, larger chains with lower proportion of company-owned units and with greater international expansion*"
>
> (Alon et al., 2008; 8)

Figure 3 is the result of a study developed by Sorenson & Sørensen (2001) covering 152 restaurant chains during seven years. This study shows the expected performance of a chain, according to dispersion of outlets and their franchised proportion. The optimal mix of company-owned versus franchised units, depends on the heterogeneity of each specific environment. When the chain is in a homogeneous environment, companies achieve higher levels of performance with lower proportion of franchised units and improvements are made through exploitation[6]. On their turn, heterogeneous environments demand chains to *"respond locally"* (the third challenge of Bradach model described above) and consequently, the number of franchised units is higher in order to allow more exploration[7]. As geographic dispersion increases, the company's growth tends to increase exponentially.

Figure 3: Expected performance (risk-adjusted) by mix and dispersion



Source: Sorenson & Sørensen, 2001

[6] Exploitation relies on the improvement of a company's performance by adopting standardized practices.
[7] Exploration relies on the use of different routines depending on the characteristics of each specific environment.

3. Inditex Presentation

Throughout this section I will present Inditex (Industria de Diseño Textil S.A.), a holding company located in Arteixo, a village in the province of La Coruña in Galicia (North West of Spain). Inditex enter into the fashion industry market in 1963 as a clothing manufacturer[8] and its first unit was only launched in 1975, with their first brand – Zara[9]. Nowadays, Inditex is a global fashion retailer that designs, manufactures, takes care of logistics and sells clothing, footwear, accessories and household textiles through their units around the world.

In 2013 Inditex had a total of 6340 units (see Table 14) in 87 markets (see Table 15) of which 87% are company-owned units and 13% franchising units (see Table 18). However, in terms of market the differences taking into account the type of exploration are not so meaningful. There are 40 markets with franchising and 48 markets with company-owned structure (includes Spain that has in 2013 franchising and company-owned units) - (see Table 20).

Inditex business system has four fundamental key success factors that add value to the customers: (i) daily sales and customers' feedback analysis, (ii) regular changes in the collection based on demand thanks to small production batches, (iii) deliveries made twice per week worldwide and (iv) investment in information and communication technology. Each of Inditex's brands offer different products with different targets, age, groups and styles (see Table 17).

[8] Inditex Glance. Accessed July 22, 2014. http://www.inditex.com/en/our_group/at_glance
[9] Inditex History. Accessed July 22, 2014. http://www.inditex.com/en/our_group/our_history

3.1. Zara

Zara is the flagship brand of the holding company. As the largest and most internationalized Inditex brand, Zara is the main driver of growth and internationalization contributing for more than 60% of Inditex's total sales (see Table 16). In 1975 Inditex opened its first Zara unit in Coruña, Spain. Since then, Zara offers the last fashion trends for woman, men and children (see Table 17). According to Inditex founder, Amancio Ortega, Zara offers to customers the latest fashion in medium quality with affordable prices. Their strong growth and international presence through the years (see Table 14 and Table 15), justifies their success and allow us to conclude that there are no cultural boundaries that prevents Inditex from dressing people around the world, due to its extreme flexibility and adaptation to the market needs.

3.2. Pull & Bear

Pull & Bear is an Inditex brand focused on young man and women, offering to customers a casual style (see Table 17). Pull & Bear was launched in 1991. In 2013, 15% of the 853 units around the world, were franchising (see Table 18). Following the trend of the group, there are no franchised units in Spain and there are a total of 387 units in the rest of Europe; only 6% of these ones are franchising. Pull & Bear have a weak presence in Africa, with 7 units and in South America with 9 units, but all of these are franchised. Between 2002 and 2013, Pull & Bear revealed a market penetration with exponential growth entering in 47 new markets (see Table 15). However, the contribution of Pull & Bear to Inditex total sales has remained stable, ranging between 6,3% and 7,1% (see Table 16).

3.3. Massimo Dutti

Massimo Dutti is the brand with upscale retail format for women and men between 25 and 45 years old. It offers higher quality with a higher price segment, in comparison with the other Inditex brands (see Table 17). In 2013, 92 of the total 665 units all over the world are franchised. From these 92 franchised units, 4 are located in Spain, 17 in rest of Europe, 56 in Asia, 6 in Africa (with market penetration in Morocco and Egypt only through franchising), 5 in North America & Australia and 4 in South America (with Ecuador and Colombia through franchising) – (see Table 18).

3.4. Bershka

Bershka, founded in 1998, also targets young people as Pull & Bear but the age group is even younger, between 13 to 23 years old and the style targeted to customers is avant-garde (see Table 17). After Zara, Bershka is the Inditex brand with the second highest contribution to total sales (9,3% in 2013) - (see Table 16). According to location and type of business, Bershka profile is very similar with Pull & Bear (see Table 18). There are 954 Bershka units around the world, 15% of them are franchised. However, Bershka has a higher market penetration (see Table 15). Since 2002, Bershka was entered in 57 new markets.

3.5. Stradivarius

Stradivarius was founded in 1999 and it is very similar with Bershka and Pull & Bear. This brand offer products to young people that desire to have a trendy style (see Table 17). There are 858 Stradivarius units around the world and 19% of them are franchised, making of Stradivarius the Inditex brand with higher percentage of franchised units (see Table 18). Curiously, in Spain, 11% of the total of Stradivarius units are franchised, making the bigger difference in term of type of exploration in the all group. Stradivarius contribution to total sales is around 6% (see Table 16).

3.6. Oysho

Oysho is an Inditex brand focused on youth, that offers lingerie and intimate fashion (see Table 17). This brand was launched in 2001 and in 2013, around 11% of the total 549 units around the world were franchising (see Table 18). Following the group's trend, in Spain there is only one franchised unit of this brand. In the rest of Europe there are a total of 230 units and only 4% are franchised. Oysho still has a weak presence in Africa (6 units) and in South America (2 units), but all the units are franchised. Oysho revealed a market penetration with exponential growth entering in 32 new markets between 2002 and 2013 (see Table 15).

3.7. Zara Home

Zara Home completely differs from the other Inditex's brands once its core product is not cloth, but instead contemporary decorative articles and linens (see Table 17). Zara Home was founded in 2003 and during the period in study, this brand faced a huge increase reaching a total of 394 units around the world (see Table 14) and entering in 45 markets (see Table 15). Although this growth, the contribution of Zara Home to Inditex total sales is low, 2,7% in 2013 (see Table 16). Like other brands, Zara Home is only present in Africa through franchising and the percentage of franchised units is also high in Asia (53%). However, the percentage of franchised units around the world is low (only 11%) – (see Table 18).

3.8. Uterqüe

Uterqüe offers products with medium-high quality at a medium-high price exclusively for women (see Table 17). This brand was the last Inditex brand to be launched (2008). In 2013, Uterqüe had 76 units (see Table 14) in 15 markets (see Table 15). In Spain and North America & Australia the entrance was done through company-owned units and, on the contrary, in Asia, only 2 from 14 units are company-owned. In the Rest of Europe the number of franchised units is very low (16%) and in Africa there is only one Uterqüe unit which is franchised (see Table 20). This brand is not present in South America. Based on this facts, Uterqüe contribution to Inditex total sales is very low (0,42%) – (see Table 16).

4. Internationalization of the Group Inditex

To survive is the main goal of every company (Alon et al., 2008). However, to be able to survive in the long term and to be competitive in the marketplace, companies need to internationalize their businesses (Abizadeh, 2010) in order to penetrate and gain market share in overseas markets (Smith, 2012).

The franchising business format model is one of the most popular and successful strategy to enter into new markets and expand operations (Abizadeh, 2010; Smith, 2012). The saturation of the domestic economy and companies competition, unrolled the motivation for franchisor to expand their business and enter in international markets (Pizanti & Lerner, 2003).

More and more businesses are using franchising as a strategy method for job creation, economic development (Pizanti & Lerner, 2003; Yozi, 2009), business growth (Chen, Justis, & Chong, 2004; Pizanti & Lerner, 2003; Preble & Hoffman, 1995; Shane, 1996; Yozi, 2009) and to increase a brand’s visibility. But this business growth and internationalization strategy requires a significant increase of resources both at financial and human level (Lafontaine & Kaufmann, 1994). For instance, if a growing market is badly managed this can make the franchisor lose control over the franchisees and not provide the right support to them (Holmes, 2003).

Thus, the penetration into international markets should be done in two stages:

(i) The initial stage should be made in nearby countries or in countries with similar culture and legal processes. Similar cultural, social and ethical factors contribute to a well succeeded entrance in other countries (Preble & Hoffman, 1995).

(ii) After that first international contact, the franchisor should enter into countries that reveal drastic difference in terms of culture and legal processes (Pizanti & Lerner, 2003).

> "*Numerous international franchisors have been successful in transferring their franchising systems to other markets with only minor adaptations to account for differing tastes, habits, or preferences*"
>
> (Preble & Hoffman, 1995; 87)

According to Baronchelli and Cassia (2008), we can identified two main models in the internation approach: the Product Life Cycle Theory[10] and the Uppsala International Model[11]. The internationalization of Inditex seems to follow the Uppsala model[12], mixed with economic, financial and political factors.

Inditex started by selling its products in the home market (Spain in 1975 thought Zara) and only after that expanded to new countries (Portugal in 1988, USA in 1989, France

[10] Companies usually introduce new products only in their home markets. Only when products reach the maturity phase in the home market, they eventually are implemented abroad.
[11] Companies gain experience from domestic market before they move to foreign markets. When this experience is achieved companies start their activity in cultural and/or geographically close countries and move gradually to culturally and geographically more distant countries.
[12] The first country chosen to begin Zara expansion was Portugal. This is totally in accordance with Uppsala model, once Portugal is next to Spain and there are linguistic and cultural similarities. If we look to the next additional steps (entries in new markets between 1989 and 1996), these do not necessarily follow the Uppsala model but follow one of its assumptions, greater knowledge of the market and in turn greater commitment (João et al., 2010).

in 1990, Mexico in 1992, Greece in 1993, Belgium in 1994 and Sweden in 1994 only through owned Zara units). Only in 1995 Zara started their internationalization process thought franchising (Malta in 1995 and Cyprus in 1996). If we look to another brand, for instance Pull & Bear, the situation was similar but at a faster speed. Pull & Bear started selling its products in 1991 in their home market (Spain) and in 1992 expanded to Portugal through company-owned units. In 1995 Pull & Bear started its expansion though franchising in Malta. More recently we have the even faster case of Uterqüe, following the same logic. Uterqüe opens the first unit in Spain in 2008 and in this same year, opened units in Portugal and Greece. In 2009 Uterqüe shows an aggressive expansion through franchising (Belgium, Cyprus, Kuwait, Lebanon, Qatar, Saudi Arabia, United Arab Emirates) and though company-owned in Mexico.

Each brand moved through a learning process. If we analyze the leading and the first brand of the group (Zara), we can perfectly see different phases or stages:

(i) The first stage (1975-1988) was reluctance and trial once Zara searched and focused in other markets after the experienced gained on domestic market. Their first unit abroad was in 1988 in Oporto, Portugal.

(ii) Between 1989 and 1996 Zara entered in another stage, expanding the business but with caution. During this stage, Zara expanded into markets with geographical proximity (Europe – France, Greece, Belgium, Sweden, Malta and Cyprus), linguistic similarities (Mexico) or in markets where economic and political environment was developed and stable (Europe and United States of America) adding only one or two markets per year.

(iii) Lastly, Zara presented an aggressive expansion since 1997 until now. The experience gained in international environment, made Zara grow rapidly regardless of the environment selected. Zara entered into 8 new markets in 1998 (Argentina, Japan, Kuwait, Lebanon, Turkey, United Arab Emirates, United Kingdom and Venezuela), 9 in 1999 (Bahrain, Brazil, Canada, Chile, Germany, Netherlands, Poland, Saudi Arabia and Uruguay), 4 in 2000 (Andorra, Austria, Denmark and Qatar), 3 in 2001 (Czech Republic, Iceland and Luxembourg) and 6 in 2002 (Dominican Republic, El Salvador, Finland, Italy, Singapore and Switzerland). In Table 15 it is possible to see that in average Zara, entered into 4 new markets per year moving from 40 markets to 87.

4.1. Units frequency analysis

We collected observation of Inditex Group by brand - Zara + Zara Kids (ZaraZaraKids), Pull & Bear (PullBear), Massimo Dutti (MassimoDutti), Bershka, Stradivarious, Oysho, Zara Home (ZaraHome) and Uterqüe (Uterque) – grouped by location – Spain, Rest of Europe, Asia, Africa, North America & Australia and South America and by type of exploration – company-owned or franchised units - from 2002 to 2013[13]. It was also collected information concerning economic, political, legal and demographic indicators listed in Table 19, in order to explain the choice between franchising and company-owned units. It is important to say that, all the primary data, were obtained through the reports and accounts of Inditex Group and developed all by ourselves.

[13] All values presented in this paper include January of the following year.

Table 1: Frequency of units by location

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Spain	918 59%	1130 59%	1321 59%	1461 54%	1628 52%	1747 47%	1896 44%	1900 41%	1925 38%	1932 35%	1930 32%	1858 29%
Rest of Europe	407 26%	520 27%	622 28%	848 32%	1033 33%	1362 37%	1660 39%	1856 40%	2086 41%	2314 42%	2544 42%	2744 43%
Asia	88 6%	100 5%	116 5%	170 6%	213 7%	279 8%	358 8%	465 10%	611 12%	805 15%	995 17%	1122 18%
Africa	0 0%	0 0%	2 0%	2 0%	5 0%	9 0%	12 0%	20 0%	27 1%	48 1%	52 1%	60 1%
North America & Australia	102 7%	122 6%	133 6%	163 6%	199 6%	232 6%	261 6%	280 6%	300 6%	328 6%	365 6%	411 6%
South America	43 3%	50 3%	50 2%	48 2%	53 2%	62 2%	77 2%	86 2%	95 2%	100 2%	123 2%	145 2%
Total	**1558**	**1922**	**2244**	**2692**	**3131**	**3691**	**4264**	**4607**	**5044**	**5527**	**6009**	**6340**

Source: Authors' compilation

Table 1 shows that in 2013, 29% of the units are in Spain, 43% in Rest of Europe, 18% in Asia, 6% in North America & Australia, 2% in South America and finally 1% in Africa. It is also clear that the group bet on Africa (grew almost 3000% relatively to 2004), Asia (grew more than 1000% relatively to 2002) and in Rest of Europe (grew more than 500% relatively to 2002).

Table 2: Frequency of units by brand

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Zara + Zara Kids	590 38%	729 38%	852 38%	1001 37%	1175 38%	1361 37%	1520 36%	1608 35%	1723 34%	1830 33%	1925 32%	1991 31%
Pull&Bear	296 19%	350 18%	371 17%	427 16%	467 15%	519 14%	583 14%	626 14%	682 14%	747 14%	816 14%	853 13%
Massimo Dutti	250 16%	297 15%	326 15%	369 14%	399 13%	426 12%	470 11%	497 11%	530 11%	573 10%	630 10%	665 10%
Bershka	197 13%	253 13%	302 13%	368 14%	433 14%	510 14%	591 14%	651 14%	720 14%	811 15%	885 15%	954 15%
Stradivarius	153 10%	191 10%	227 10%	263 10%	304 10%	381 10%	456 11%	515 11%	593 12%	684 12%	780 13%	858 14%
Oysho	72 5%	76 4%	104 5%	154 6%	201 6%	290 8%	374 9%	392 9%	432 9%	483 9%	524 9%	549 9%
Zara Home	0 0%	26 1%	62 3%	110 4%	152 5%	204 6%	239 6%	261 6%	284 6%	310 6%	357 6%	394 6%
Uterqüe	0 0%	0 0%	0 0%	0 0%	0 0%	0 0%	31 1%	57 1%	80 2%	89 2%	92 2%	76 1%
Total	**1558**	**1922**	**2244**	**2692**	**3131**	**3691**	**4264**	**4607**	**5044**	**5527**	**6009**	**6340**

Source: Authors' compilation

From Table 2 we note that, in 2013, the distribution by brands, was organized as follow: 31% of the total units are Zara + Zara Kids, 13% Pull & Bear, 10% Massimo Dutti, 15% Bershka, 14% Stradivarious, 9% Oysho, 6% Zara Home and 1% of units are Uterqüe.

Table 3: Number of units by type of exploration

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Own	1350	1684	1981	2387	2784	3237	3721	3983	4334	4854	5246	5508
	87%	88%	88%	89%	89%	88%	87%	86%	86%	88%	87%	87%
Franchise	208	238	263	305	347	454	543	624	710	673	763	832
	13%	12%	12%	11%	11%	12%	13%	14%	14%	12%	13%	13%
Total	**1558**	**1922**	**2244**	**2692**	**3131**	**3691**	**4264**	**4607**	**5044**	**5527**	**6009**	**6340**

Source: Authors' compilation

After deciding to enter into a new market, it is necessary to choose the entry mode. Each brand chooses, per country, one type of entry mode. So, if the brand decides to enter into a certain market through franchising they have a master franchise to explore and develop its own units at an exclusive geographic area. This does not mean that the brands cannot migrate from one type of exploration to another in the long term[14]. From Table 3, it is possible to find out that Inditex Group fostered its growth and internationalization, but always maintaining the same ratio of owned versus franchised units. Throughout this paper we will analyze this information by brand and location in more detail.

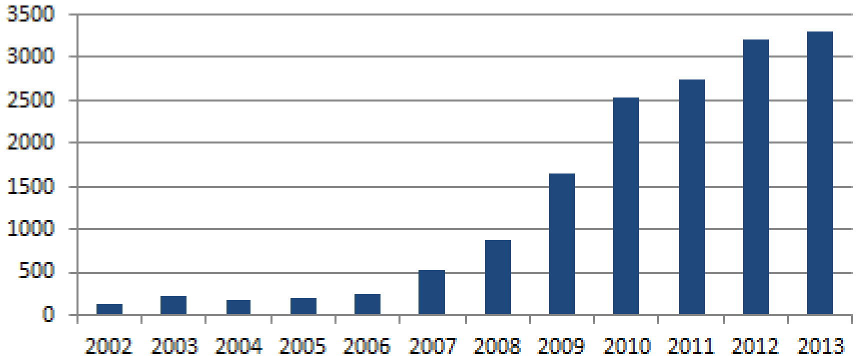
[14]In Russia in 2006 there was an acquisition of Zara, Pull & Bear and Stradivarious franchised units. All franchised units became company-owned units and two new brands entered in this market (Russia) through company-owned explororation units (Massimo Dutti and Bershka).
In 2011 Inditex purchased all franchised operations units in Serbia and Montenegro.
In Kazakhstan in 2013 there was an acquisition of Zara, Pull & Bear, Massimo Dutti, Bershka and Stradivarius franchised units. Also in 2013 Oysho and Zara Home enters into this market through company-owned units.

4.2. Financial Analysis

In order to accomplish this financial analysis we collected information about Inditex's Income Statement and Balance Sheets from 2002 to 2013 and we used liquidity, economic/profitability and financial structure ratios to understand and evaluate the financial situation of Inditex Group.

We started analyzing liquidity risk though liquidity ratios (the current and reduced) and through the calculation of Net Working Capital (NWC). This shows us that in general Inditex Group has capacity to honor their accomplishments in the short run.

Figure 4: Net Working Capital (in millions of €)



Source: Developed by authors through Inditex Annual Reports

As observed from the NWC, Inditex Group always presents positive and increasing values, revealing stability and capability to pay off its short-term liabilities almost immediately, reducing the liquidity risk. The Group reveals a huge potential growth because it has always available resources for its strategic management.

If we look to each rubric in more detail, we can see that current assets increased proportionally more than current liabilities over the years. In order to confirm this argument we could use the current liquidity ratio. If the ratio is higher than 1, Inditex Group has capacity to pay their short term liabilities (see Table 4). How it is possible to see through this analysis, Inditex Group presents from 2002 until 2013 capacity to pay their short term debt (current liquidity).

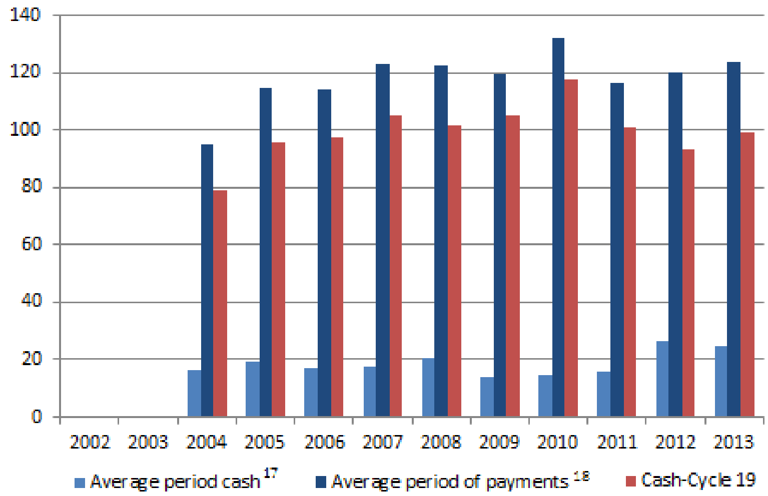
Table 4: Liquidity Ratios

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Acid-test[15]	--	--	0,76	0,74	0,7	0,8	0,92	1,28	1,49	1,54	1,47	1,47
Current Liquidity [16]	1,13	1,21	1,14	1,11	1,14	1,21	1,37	1,71	1,94	2,01	1,92	1,95

Source: Developed by authors through Inditex Annual Reports

As observed from Table 4 Inditex Group presents a big difference between current liquidity and the acid-test, that can indicate the importance of the stock management, that can cause higher costs than desired. One of the strengths of the Group is the inventory turnover that is normal in this industry. This business is fundamentally a business of liquidity where the "acid-test ratio"[17] is huge.

Figure 5: Cash-Cycle (in number of days)



Source: Developed by authors through Inditex Annual Reports

As we can see through Figure 5 Inditex cash-cycle is between 78 and 118 days which mean that it takes 78-118 days between customer payment and Inditex payment to his suppliers. Another interesting point to analyze is the growth of APC ratio in 2012. This could be explained by the entrance in new markets, in developing countries where credit card culture is not a usual method of payment.

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[15] Reduced Liquidity = (Current Assets – Inventory) / Current Liabilities
[16] Current Liquidity = Current Assets / Current Liabilities
[17] It means current assets are highly dependent on inventory.
[18] APC = (Receivables/Sales)*360
[19] APP = [Payables/(Cost of goods – Initial Inventory + Final Inventory)]*360
[20] Cash-cycle = (Receivables/Sales)*360 – (Payables/Purchases)*360

As we have already seen, liquidity ratios are very large and are growing over time. The Group has negative working capital needs due to the fact that it gets earlier paid than it pays to its suppliers and due to the fact that has their stocks very controlled. Stock management is, in our opinion, one of the strategic variables of its operational management.We also developed DuPont Model in order to observe the Inditex's performance. This model is decomposed into three basic components: return on assets, leverage effect and the fiscal effect.

$$\boldsymbol{ROE = ROA \times Leverage\ Effect \times Fiscal\ Effect}$$

From that decomposition it is possible to analyze separately the effects of each ratio.

$$ROA = \frac{EBIT}{Sales} \times \frac{Sales}{TotalAssets}$$

The first part corresponds to the Return on Sales measuring Inditex ability to sell products at higher profit margins. The second part of this ratio refers to the effective use of assets, assets turnover. As shown in the Table 5, Inditex Group presents a relatively constant ROS. However, from 2012 to 2013 ROS decreased from 20% to 18% mostly due to the lowest increase in sales since 2002 (only 5%). Furthermore, operating expenses did not decrease proportionality to the low sales increase, justifying the EBIT decrease (1%). Despite the decrease of 2% of assets turnover (2012 to 2013), also caused by the mentioned lowest increase in sales, Inditex presents a high total assets turnover which signals a strong asset management. As ROA is directly influenced by assets turnover and ROS it is logical that it also suffered a decrease.

Table 5: Return on Assets decomposition

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
EBIT/Sales (ROS)	17%	14%	17%	16%	17%	18%	15%	16%	18%	18%	20%	18%
Sales/Total Assets	132%	131%	132%	130%	143%	133%	134%	133%	127%	126%	124%	122%
ROA	22%	18%	22%	21%	24%	23%	21%	21%	23%	23%	24%	22%

Source: Developed by authors through Inditex Annual Reports

The Leverage Effect is obtained, as follow:

$$Leverage\ Effect = \frac{Total\ Assets}{Equity} \times \frac{Profit\ before\ taxes}{EBIT}$$

As we can see through the Table 6 Leverage Effect slightly decreases from 2008 until 2013. This is because the equity has proportionally increased more than the debt. This means that Inditex proportionally trusts more in equity to finance its activity than in debt. It is possible to see that Inditex Group is leveraged (>1,00).

Table 6: Leverage Effect decomposition

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Total Assets/Equity	1,71	1,67	1,76	1,78	1,65	1,68	1,64	1,55	1,53	1,47	1,52	1,48
Profit before taxes/EBIT	0,93	0,98	0,97	1,01	0,99	1,00	0,99	1,00	1,01	1,01	1,00	0,99
Leverage Effect	1,60	1,63	1,71	1,79	1,63	1,68	1,62	1,56	1,55	1,49	1.,53	1,47

Source: Developed by authors through Inditex Annual Reports

Finally, the Fiscal Effect is obtained, as follow:

$$Fiscal\ Effect = \frac{Net\ Income}{Profit\ before\ taxes}$$

Table 7: Fiscal Effect

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Fiscal Effect	0,72	0,73	0,72	0,74	0,75	0,76	0,80	0,76	0,75	0,76	0,76	0,78

Source: Developed by authors through Inditex Annual Reports

The final result of this model, allow us to obtain the ROE by multiplying all the ratios we have obtained before. ROE shows how well Inditex uses their investments funds to generate earnings growth. The return obtained in the period in study, is greater than 20% (see Figure 8).

Taking into consideration our analysis of the liquidity, economic/profitability and financial structure ratios, we are able to conclude that the group will be able to continue growing, remaining only the doubt if this should be done through franchising or company-owned units.

In order to understand if a specific unit is a profitability investment in a certain location and with a certain type of exploration, we should calculate the Net Present Value of that investment.

The formula to calculate is:

$$\boxed{NPV = -I_0 + \frac{CF_1}{1+R_{WACC}} + \frac{CF_2}{1+R_{WACC}} + \frac{CF_3}{1+R_{WACC}} + \frac{CF_4}{1+R_{WACC}} + \cdots + \frac{CF_N}{1+R_{WACC}}}$$

We should subtract the initial investment and sum our discounted future cash flows taking into account the discounted rate (using Weight Average Cost of Capital) which means that the structure of capital is taken into account.

If we have full access to financial data divided by franchised and company-owned units it will be interesting to analyze and to understand what is the Net Present Value of a specific unit in terms of type of exploration, location and brand. We believe that we will see strong differences among them. We will not do this calculation in detail because we do not have data to calculate the Free Cash Flow[21], the initial investment and respectively discounted cash-flows of a company-owned or franchised unit.

We believe that, despite the lack of data, the NPV of a franchised or a company-owned unit is almost the same. In Table 8 we structured our expectation about the differences in terms of analysis from the Group perspective.

Table 8: NPV from Group perspective

	Franchised units	Company-owned units
I_0	Lower	Higher
FCF	Lower	Higher
R_{WACC}	Lower	Higher

Source: Developed by authors

[21] FCF = EBIT*(1-T) + Depreciation & Amortization – Changes in Net Working Capital – Capital Expenditure

From Inditex Group perspective the initial investment in franchised units is lower than investing in company-owned units. Free Cash Flows in franchised units are lower than in company-owned units because royalties are less than the margin of company-owned units. Finally, the cost of capital is higher for company-owned units, according to the structure of capital of the company. As for the Group perspective franchising did not have investment and debt, the cost of capital is the inherent risk of the country which are inserted.

4.3. Market Selection and Entry Strategy - Correlational Studies

This section was done to understand if there are economic, political, legal or demographic reasons that explain how each brand chooses which new market to enter and through which type of exploration (franchise vs. company-owned units).

Table 9: Contingency table of the distribution by brand and location

			Location						
			Rest of Europe	Asia	Africa	North America & Australia	South America	Spain	Total
Brand	ZaraZarakids	Count	406	194	27	104	72	12	815
		Adjusted Residuals	-2,1	-2,5	0,5	5,1	7,1	-4,2	
	PullBear	Count	242	128	9	33	16	13	441
		Adjusted Residuals	0,8	1,0	-1,4	-0,8	-0,9	-1,1	
	MassimoDutti	Count	255	146	13	28	9	24	475
		Adjusted Residuals	0,3	1,9	-0,5	-2,2	-2,9	1,4	
	Bershka	Count	263	96	10	35	20	18	442
		Adjusted Residuals	2,9	-2,8	-1,1	-0,4	0,1	0,2	
	Stradivarius	Count	191	104	14	18	8	24	359
		Adjusted Residuals	0,1	0,8	1,0	-2,5	-2,2	2,9	
	Oysho	Count	126	73	6	19	5	13	242
		Adjusted Residuals	-0,3	1,1	-0,6	-0,4	-1,9	1,2	
	ZaraHome	Count	129	68	10	20	7	11	245
		Adjusted Residuals	-0,1	0,2	1,0	-0,2	-1,2	0,5	
	Uterque	Count	30	31	6	5	0	6	78
		Adjusted Residuals	-2,6	2,5	2,4	-0,7	-1,9	1,7	
Total		Count	1642	840	95	262	137	121	3097

Source: Developed by authors

Chi-square test (Maroco, 2010) was used to understand the relationship between the brand and location variables. We obtained a p-value = 0,000, which leads us to reject the hypothesis of independence. It can be concluded that *there is a certain relationship between the brand and the location* despite the value of Person's coefficient ϕ was small (0,216). Proceeding to a residual analysis[22] it is possible to find out which brand is better established in the different markets (Spain, Rest of Europe, North America & Australia, South America, Asia and Africa) by taking into consideration the other brands penetration in those markets and the total units of the considered brand to analysis around the world. From Table 9 we observe that Zara + Zara Kids (ZaraZarakids)[23] is well established in South America and North America & Australia, Massimo Dutti in Asia, Bershka in Europe (excluded Spain), Stradivarious in Spain, Uterqüe in Asia and Africa. On the other hand the implementation of Pull & Bear (PullBear), Oysho and Zara Home (ZaraHome) do not depend on the location.

Table 10: Contingency table of the distribution by brand and type of exploration units

			Type of exploration		
			Own	Franchising	Total
Brand	ZaraZarakids	Count	430	385	815
		Adjusted Residuals	2,6	-2,6	
	PullBear	Count	192	249	441
		Adjusted Residuals	-2,4	2,4	
	MassimoDutti	Count	213	262	475
		Adjusted Residuals	-1,9	1,9	
	Bershka	Count	234	208	442
		Adjusted Residuals	1,8	-1,8	
	Stradivarius	Count	149	210	359
		Adjusted Residuals	-3,0	3,0	
	Oysho	Count	127	115	242
		Adjusted Residuals	1,2	-1,2	
	ZaraHome	Count	135	110	245
		Adjusted Residuals	2,0	-2,0	
	Uterque	Count	34	44	78
		Adjusted Residuals	-0,9	0,9	
Total		Count	1514	1583	3097

Source: Developed by authors

[22] If the adjusted residual in absolute value is equal or higher than 1.96 (for a significance level of 5%) there are no independence so we must reject the hypothesis of independence in that cell.
[23] Zara chose to expand in South America through company-owned units once there are a high potential of growth and low development risk (João et al., 2010; Lopez & Fan, 2009).

Still using the chi-squared test (Maroco, 2010), we obtained a p-value = 0,000, which leads to reject the hypothesis of independence. We rejected this hypothesis because the sample is big and all the variables will be significant. However, Person's coefficient ϕ is very low (0,098) which may mean that the decision of entering through franchising or owned units is not influenced by the type of brand but is probably dependent of the type of location (fact that is tested below in Table 11)[24]. So in fact, it can be concluded that *there is no relationship between the type of exploration and the type of brand.*

Table 11: Contingency table of the distribution by location and type of exploration units

Location * Type of exploration Crosstabulation

			Type of exploration		
			Own	Franchising	Total
Location	Rest of Europe	Count	1141	501	1642
		Adjusted Residuals	24,4	-24,4	
	Asia	Count	96	744	840
		Adjusted Residuals	-25,4	25,4	
	Africa	Count	3	92	95
		Adjusted Residuals	-9,1	9,1	
	North America & Australia	Count	113	149	262
		Adjusted Residuals	-1,9	1,9	
	South America	Count	72	65	137
		Adjusted Residuals	0,9	-0,9	
	Spain	Count	89	32	121
		Adjusted Residuals	5,5	-5,5	
Total		Count	1514	1583	3097

Source: Developed by authors

Similarly, the chi-square test (Maroco, 2010) provided us a p-value = 0.000, which leads us to reject the hypothesis of independence. It can be concluded that *there is a relationship between the location and the type of exploration units*. The value of Pearson's coefficient ϕ is 0.528, which is already a high value.

Proceeding again to a residual analysis, in Table 11 it is possible to see that in Spain or in Rest of Europe there is a tendency to implement company-owned units. On the

[24] Note: However, if the Person's coefficient ϕ was higher we would be able to make conclusions by analyzing the adjusted residuals. For instance, in Table 10 we can see that Zara + Zara Kids (ZaraZarakids) and Zara Home entered into new markets as company-owned units while Pull & Bear (PullBear), Massimo Dutti (MassimoDutti) and Stradivarious entered into new markets as franchising. Bershka, Oysho and Uterqüe enter into the market regardless the type of exploration.

contrary, in Asia, Africa or in North America & Australia there are a tendency to implement units through franchising.

Franchising strategy is chosen for high-risk countries which are culturally distant or if they represent small markets with low sales forecast (João, Freddo, Figueiredo, & Maiochi, 2010; Lopez & Fan, 2009). Following this reason we chose some variables, not financial ones (we already justify above why), to explain how Inditex chose which countries to enter and how it chose to enter, through franchising or company-owned units.

Therefore, when deciding whether or not to implement units through franchising, the location is the most important factor to take into consideration and after that what type of brand to implement according to the local market requirements. This is the reason why the same brand could be present around the world in the form of franchising or company-owned units.

It is important to notice the successful implementation of Massimo Dutti in Asia through franchising and of Stradivarius in Spain through company-owned units.

We also produce in Table 12 the study of the relationship between the type of exploration and the various indicators described in Table 19.

Table 12 provides us a correlation matrix. As a matter of fact, considering the dimension of the sample almost all correlations are significant. Despite that, we proceed to an analysis of the magnitude of the Pearson correlation coefficient. As we can see through the table above, the sample of each indicator is different because there is not yet information available for some years and countries. That is the reason why the sample is not always composed by 3097 variables.

Table 12: Table of correlations between indicators, the type of exploration and the number of units

Correlation

		Units	Population	GDPpercapita	CPI	PPP	GINI	PSAV	GovE	RQ	RL	Franchising
Units	Pearson Correlation	1	-0,050**	0,058**	0,113**	0,192**	-0,038	-0,092**	0,104**	0,063**	0,085**	-0,274**
	Sig. (2-tailed)		0,01	0,001	0,000	0,000	0,061	0,000	0,000	0,002	0,000	0,000
	N	3097	2662	3097	3017	2931	2448	2542	2542	2542	2542	3097
Population	Pearson Correlation	-0,050**	1	0,290**	0,270**	-0,034	0,95**	0,227**	0,171**	0,184**	0,124**	0,011
	Sig. (2-tailed)	0,010		0	0,000	0,090	0,000	0,000	0,000	0,000	0,000	0,580
	N	2662	2662	2662	2590	2566	2085	2542	2542	2542	2542	2662
GDPperca pita	Pearson Correlation	0,058**	0,290**	1	0,717**	0,690**	-0,273**	0,375**	0,547**	0,430**	0,607**	-0,170**
	Sig. (2-tailed)	0,001	0,000		0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000
	N	3097	2662	3097	3017	2931	2448	2542	2542	2542	2542	3097
CPI	Pearson Correlation	0,113**	0,270**	0,717**	1	0,730**	-0,342**	0,405**	0,787**	0,588**	0,693**	-0,198**
	Sig. (2-tailed)	0,000	0,000	0,000		0,000	0,000	0,000	0,000	0,000	0,000	0,000
	N	3017	2590	3017	3017	2926	2448	2542	2542	2542	2542	3017
PPP	Pearson Correlation	0,192**	-0,034	0,690**	0,730**	1	-0,368**	0,107**	0,748**	0,388**	0,552**	-0,462**
	Sig. (2-tailed)	0,000	0,090	0,000	0,000		0,000	0,000	0,000	0,000	0,000	0,000
	N	2931	2566	2931	2926	2931	2396	2513	2513	2513	2513	2931
GINI	Pearson Correlation	-0,038	0,95**	-0,273**	-0,342**	-0,368**	1	-0,115**	-0,337**	-0,256**	-0,613**	0,329**
	Sig. (2-tailed)	0,061	0,000	0,000	0,000	0,000		0,000	0,000	0,000	0,000	0,000
	N	2448	2085	2448	2448	2396	2448	2045	2045	2045	2045	2448
PSAV	Pearson Correlation	-0,092**	0,227**	0,375**	0,405**	0,107**	-0,115**	1	0,230**	0,443**	0,300**	0,081**
	Sig. (2-tailed)	0,000	0,000	0,000	0,000	0,000	0,000		0,000	0,000	0,000	0,000
	N	2542	2542	2542	2542	2513	2045	2542	2542	2542	2542	2542
GovE	Pearson Correlation	0,104**	0,171**	0,547**	0,787**	0,748**	-0,337**	0,230**	1	0,530**	0,555**	-0,267**
	Sig. (2-tailed)	0,000	0,000	0,000	0,000	0,000	0,000	0,000		0,000	0,000	0,000
	N	2542	2542	2542	2542	2513	2045	2542	2542	2542	2542	2542
RQ	Pearson Correlation	0,063**	0,184**	0,430**	0,588**	0,388**	-0,256**	0,443**	0,530**	1	0,513**	-0,061**
	Sig. (2-tailed)	0,002	0,000	0,000	0,000	0,000	0,000	0,000	0,000		0,000	0,002
	N	2542	2542	2542	2542	2513	2045	2542	2542	2542	2542	2542
RL	Pearson Correlation	0,085**	0,124**	0,607**	0,693**	0,552**	-0,613**	0,300**	0,555**	0,513**	1	-0,133**
	Sig. (2-tailed)	0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000	0,000		0,000
	N	2542	2542	2542	2542	2513	2045	2542	2542	2542	2542	2542
Franchising	Pearson Correlation	-0,274**	0,011	-0,170**	-0,198**	-0,462**	0,329**	0,081**	-0,267**	-0,061**	-0,133**	1
	Sig. (2-tailed)	0,000	0,580	0,000	0,000	0,000	0,000	0,000	0,000	0,002	0,000	
	N	3097	2662	3097	3017	2931	2448	2542	2542	2542	2542	3097

** Correlation is significant at the 0,01 level (2-tailed)

Source: Developed by authors

From Table 12 we can observe that the highest correlations concerning the type of exploration are with PPP (r = -0,462), GINI (r = 0,329), GovE (r = -0,267), CPI (r = -0,198), GDPpercapita (r = -0,170) and RL indicators (r = -0,133). So franchising agreements are more common in countries where purchasing power is lower (GDPpercapita, PPP), where the perception of corruption is higher (CPI) or when government policies are more unstable, reflecting a perception of lower trust in relation to law and order (GovE, RL) but also if income distribution is more asymmetric (GINI)[25]. It is also possible to check that there is no correlation between franchising and population density (Population) which means that Inditex is interested in investing in markets where there is potential of growth (GDPpercapita, PPP and GINI).

In summary, Inditex expands internationally through company-owned units in countries where there are high growth perspectives and/or low business risk.

5. Conclusion, Limitations and Future Work

Franchising is a form of business that allows companies to enter into new markets with a lower business risk and demanding a lower initial investment once this is shared with the franchisees through the payment of an initial fee and royalties. Franchising allows companies to expand their business and increase their national and international market penetration at a faster speed due to an easier adaptation to different cultures.

However, for companies it is not that linear the decision of franchising or not franchising their business and there are a wide range of variables that must be taken into consideration when doing it.

[25] In Spain, Inditex products are affordable to a huge percentage of Spaniards (GINI 2013 = 34,66) but if we look to Brazil (GINI 2013 = 58,66) or South Africa (GINI 2013 = 60,85, the highest inequality market where Inditex exist) only upper class and the middle class can afford these products. Once Inditex brands have medium-low/medium prices, upper class may not be interested in this type of products (see Table 17).

After performing a units frequency analysis and correlation studies, we were able to extract some valuable conclusions concerning the specific case of Inditex franchising strategy. First of all, we concluded that there is a certain correlation between the type of brand and its location. For instance, we found out that, taking into consideration the other brands penetration in a certain location and the global presence of the brand considered for analysis, Zara + Zara Kids is better established in South America and North America & Australia and Massimo Dutti in Asia. However, this inference is not linear once we did not find any dependence for Pull & Bear (PullBear), Oysho and Zara Home (ZaraHome).

Secondly, we concluded that there is not relationship between the type of exploration and the type of brand, but the same is not true when considering the correlation between the type of exploration and location. For instance, in Spain there is predominance of company-owned units and on the contrary in Africa there is a predominance of franchised units. Therefore, location is the most important factor to take into consideration when deciding to expand through franchising or company-owned units.

Moreover, once franchising is a popular strategy when entering culturally distant countries or small markets, we decided to study the correlation between the type of exploration and economic, political, legal and demographic indicators. We found out that franchising is popular when purchasing power is low or/and the income distribution is asymmetric. Additionally, when the perception of corruption is high or there is lack of political stability, franchising is the preferred entry mode. Finally, we concluded that demographic indicators such as population density do not influence the type of exploration chosen.

One of the main limitations we found is that we were only able to have access to data since 2002 and the first Inditex brand, Zara, was launched in 1975. Although we know in which countries Inditex was present between this period (from 1975 until 2002), we did not have access to data concerning the number of units per country, brand and type of exploration. This data is somehow relevant once it was through Zara that Inditex began its internationalization process through franchising. The other Inditex brands started their internationalization process faster than Zara and it was not possible for us to conclude if this was due to the experience acquired due to Zara presence in those countries or other factors.

We found another limitation when developing the financial analysis of the group. Once we were not able to have access to the income statement divided by type of exploration, we had to develop an assumption that might not be accurate.

For future research, it would be interesting to take into consideration in analysis the market value of each Inditex brand for costumers. Moreover, it would be interesting to develop clusters by age and country, once each brand has its own target, and try to find out if there is a relationship with the type of exploration chosen. At last, another recommendation we have is to ask Inditex to provide financial data by country, brand and type of exploration in order to verify if our assumption that financial indicators do not influence market selection and entry strategy is correct.

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Appendix

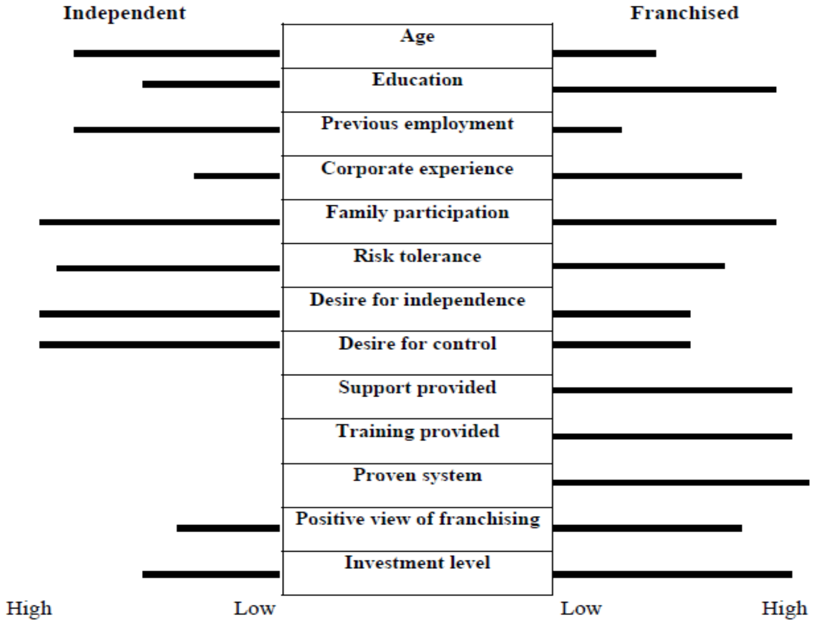

Figure 6: Business Choice Model

Source: Bennett, S., Frazer, L., & Weaven, S. (2009). Is the franchising model attractive to independent small business operators? In *23rd Annual International Society of Franchising Conference* (pp. 1–19). Manchester Grand Hyatt, San Diego, U.S.A. (February 12-14).

	Major assumptions	Major predictions
Resource Scarcity Theory	- Large chains possess substantial scale advantages; - Firm ownership is more profitable than franchisee ownership; - Franchisee labor (i.e., managerial ability and local market knowledge) and capital is easier to obtain than alternatives.	- Small/young firms are more likely to grow through franchising; - Franchising is related to growth and survival, but not necessarily profitability; - Mature firms will grow through firm ownership and by repurchasing existing franchises.
Agency Theory	- Economic actors are rational and self-interested; - Economic actors have different goals but are otherwise homogeneous; - Franchising substitutes powerful ownership incentives for costly direct monitoring; - Employee-managers in company-owned outlets will shirk (vertical agency); - Franchises that do not depend on repeat business will free ride on the brand-building efforts of others (horizontal agency).	- Firms will franchisee those outlets that would be costly to monitor and where the potential for free riding (horizontal agency) is low; - Franchise contracts will provide franchisees with a quasi-rent to keep them in the contract and optimally motivated; - Firms that franchise where it is most efficient to do so will have greater performance.

Table 13: Major assumptions and predictions about franchising by resource scarcity and agency theory

Source: Combs, J. G., Michael, S. C., & Castrogiovanni, G. J. (2004). Franchising: A Review and Avenues to Greater Theoretical Diversity. *Journal of Management*, *30*(6), 907–931

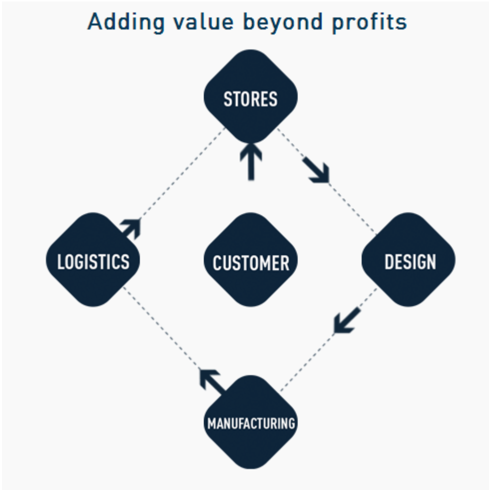

Figure 7: Inditex Business Model

Source: Inditex Business Model. Accessed July 22, 2014.
http://www.inditex.com/en/our_group/business_model

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Z	590	729	852	1001	1175	1361	1520	1608	1723	1830	1925	1991
PB	296	350	371	427	467	519	583	626	682	747	816	853
MD	250	297	326	369	399	426	470	497	530	573	630	665
B	197	253	302	368	433	510	591	651	720	811	885	954
S	153	191	227	263	304	381	456	515	593	684	780	858
O	72	76	104	154	201	290	374	392	432	483	524	549
ZH	0	26	62	110	152	204	239	261	284	310	357	394
U	0	0	0	0	0	0	31	57	80	89	92	76
Total	**1922**	**1922**	**2244**	**2692**	**3131**	**3691**	**4264**	**4607**	**5044**	**5527**	**6009**	**6340**

Table 14: Number of units by brand

Z = Zara; PB = Pull&Bear; MD = Massimo Dutti; B = Bershka; S = Stradivarius; O = Oysho; ZH = Zara Home; U = Uterqüe

Source: Author's compilation

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Z	40	46	54	59	63	68	72	74	77	82	86	87
PB	16	18	19	23	27	35	39	44	46	49	59	63
MD	23	23	25	27	29	32	38	44	50	51	60	63
B	9	13	14	20	24	35	40	44	50	57	62	66
S	9	9	10	14	19	24	31	37	43	46	52	56
O	7	8	8	10	12	22	23	23	25	31	35	39
ZH	0	4	6	14	15	20	24	25	27	30	35	45
U	0	0	0	0	0	0	3	11	16	17	18	15

Table 15: Number of markets by brand

Z = Zara; PB = Pull&Bear; MD = Massimo Dutti; B = Bershka; S = Stradivarius; O = Oysho; ZH = Zara Home; U = Uterqüe

Source: Author's compilation through Inditex Annual Reports from 2002 to 2013

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Z	74,8%	71,9%	69,5%	68,2%	67,6%	66,4%	65,6%	63,8%	64,6%	64,9%	66,11%	64,4%
PB	6,7%	6,3%	6,6%	6,6%	6,3%	6,5%	6,9%	7%	6,8%	6,9%	6,81%	7,12%
MD	7,2%	8,5%	8,5%	7,9%	7,5%	7,4%	6,9%	7,1%	7,2%	7,3%	7,11%	7,73%
B	7,5%	8,6%	9,1%	9,5%	9,7%	9,8%	9,9%	10,6%	10%	9,5%	9,31%	9,3%
S	3,1%	3,5%	4,3%	5,1%	5,2%	5,5%	6,1%	6,3%	6,2%	6,3%	6,03%	6,02%
O	0,6%	1%	1,3%	1,5%	2%	2,3%	2,3%	2,5%	2,4%	2,3%	1,97%	2,11%
ZH	-	0,2%	0,7%	1,2%	1,7%	2,1%	2,1%	2,3%	2,3%	2,3%	2,2%	2,7%
U	-	-	-	-	-	-	0,2%	0,4%	0,5%	0,5%	0,46%	0,42%

Table 16: Contribution by brand to Inditex total sales

Z = Zara; PB = Pull&Bear; MD = Massimo Dutti; B = Bershka; S = Stradivarius; O = Oysho; ZH = Zara Home; U = Uterqüe

Source: Author's compilation through Inditex Annual Reports from 2002 to 2013

	Zara	Pull & Bear	Massimo Dutti	Kiddy's Class	Bershka	Stradivarius	Oysho	Zara Home	Uterqüe
Year of foundation	1975	1991	1991[26]	1993	1998	1999	2001	2003	2008
Target	Women, men and children, ages 0-45	Women and men, ages 14-28	Women and men, ages 25-45	Children, ages 0-16	Women and men, ages 13-23	Women, ages 15-25	Youths	N.A.	Woman
Product	Fast-fashion clothing	Casual clothes	Quality and conventional fashion	Children's fashion	Avant-garde clothing	Trendy clothing	Lingerie	Household clothing	Accessories and fashion complements
Price	Medium-low	Medium-low	Medium-high	Medium-low	Medium-low	Medium-low	Medium-low	Medium-low	Medium-High
Quality	Medium	Medium	Medium-high	Medium	Medium	Medium	Medium	Medium	Medium-High

Table 17: Inditex's brand portofolio

Source: Adapted from Lopez, C., & Fan, Y. (2009). Internationalisation of the Spanish Fashion Brand Zara. *Journal of Fashion Marketing and Management*, *13*(2), 279–296.

[26] Although the brand was created in 1985 but it was only acquired by Inditex Group in 1991.

2013	Zara+ZaraKids			Pull & Bear			Massimo Dutti			Bershka			Stradivarious			Oysho			Zara Home			Uterque			Inditex		
	O	F	% F	O	F	% F	O	F	% F	O	F	% F	O	F	% F	O	F	% F	O	F	% F	O	F	% F	O	F	% F
Spain	454	0	0%	262	0	0%	228	4	2%	255	1	0%	262	32	11%	184	1	1%	143	0	0%	32	0	0%	1820	38	2%
Rest of Europe	826	30	4%	355	23	6%	248	17	6%	426	26	6%	354	23	6%	221	9	4%	161	6	4%	16	3	16%	2607	137	5%
Asia	302	122	29%	67	77	53%	59	56	49%	83	71	46%	70	76	52%	42	40	49%	20	23	53%	2	12	86%	645	477	43%
Africa	4	11	73%	0	7	100%	0	6	100%	0	9	100%	0	10	100%	0	6	100%	0	6	100%	0	1	100%	4	56	93%
North America & Australia	139	12	8%	45	8	15%	38	5	12%	54	9	14%	13	8	38%	39	5	11%	21	5	19%	10	0	0%	359	52	13%
South America	67	24	26%	0	9	100%	0	4	100%	0	20	100%	0	10	100%	0	2	100%	6	3	33%	0	0	-	73	72	50%
Total	**1792**	**199**	**10%**	**729**	**124**	**15%**	**573**	**92**	**14%**	**818**	**136**	**14%**	**699**	**159**	**19%**	**486**	**63**	**11%**	**351**	**43**	**11%**	**60**	**16**	**21%**	**5508**	**832**	**13%**

Table 18: Number of units in 2013 by brand, location and type of explorations

Source: Developed by authors

	Abbreviation	Variable Name	Selection Criteria	Description	Source
	GDPpercapita	GDP per capita (current US$)	Economic	GDP per capita is gross domestic product divided by midyear population. Data are in current U.S. dollars.	http://data.worldbank.org/indicator/NY.GDP.PCAP.CD
	Population	Population density (per sq. km)	Demographic	Population density per square kilometer is population divided by land area in square Kilometers.	http://data.worldbank.org/indicator/EN.POP.DNST
	CPI	Corruption Perceptions Index	Political	The Corruption Perceptions Index ranks countries based on how corrupt their public sector is perceived. The scale is from 0 (highly corrupt) to 100 (very clean). This does not tell us the full story of corruption in a country because CPI is only an indicator of perception of public sector corruption so it is limited but in a global way is a good measure to rank corruption across the various countries.	http://www.transparency.org/cpi2013/results
	PPP	PPP conversion factor (GDP) to market exchange rate ratio	Economic	PPP conversion factor is the number of a country's currency required to buy the same basket of goods or services in the domestic market as dollars would buy in United States.	http://data.worldbank.org/indicator/PA.NUS.PPPC.RF
	GINI	Gini Index	Economic	Gini index measures the distribution of income in a country. The scale is from 0 (perfect equality) to 100 (perfect inequality). Since the price range is medium-low for all brands with the exception of Massimo Dutti classified as Medium-high price (see Table 17) this indicator could be a good measure.	http://data.worldbank.org/indicator/SI.POV.GINI
Data from PRS Group provides a decision-focused political and legal risk model drawn from two risk methodologies (PRS and ICRG). PRS Group analyse each level thought 17 risk components.	**PSAV**	Political Stability and Absence of Violence	Political	PSAV measures perceptions of the probability that the government will be destabilized or overthrown by unconstitutional or violent means. PRS uses the follow measures: - Government stability - Internal conflict - External conflict - Ethnic tensions	http://info.worldbank.org/governance/wgi/pdf/PRS.xlsx * Description of PRS variables withdraw from http://info.worldbank.org/governance/wgi/index.aspx#doc
	GovE	Government Effectiveness	Political	GovE quantifies the quality of public services and their degree of independence from political pressures. Measures the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. PRS uses the follow measures: - Bureaucratic quality	
	RQ	Regulatory Quality	Political	RQ captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. - Investment profile	
	RL	Rule of Law	Legal	RL captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts. - Law and order	

Table 19: Selection criteria of Independent Variables
Source: Developed by authors

	Zara+Zarakids		Pull & Bear		Massimo Dutti		Bershka		Stradivarius		Oysho		ZaraHome		Uterque	
	O	F	O	F	O	F	O	F	O	F	O	F	O	F	O	F
Europe	32	11	17	17	18	15	22	14	16	13	11	8	13	4	4	3
Asia	5	14	3	13	3	13	3	14	2	13	1	8	3	10	1	6
Africa	1	4	0	2	0	2	0	3	0	2	0	2	0	2	0	2
North America & Australia	5	6	1	6	2	6	1	6	1	6	1	3	1	5	1	0
South America	4	4	1	2	0	2	1	2	0	2	0	2	2	2	0	0
Spain	1	0	1	0	1	0	1	0	1	0	1	0	1	0	1	0
Total	**48**	**39**	**23**	**40**	**24**	**38**	**28**	**39**	**20**	**36**	**14**	**23**	**20**	**23**	**7**	**11**

Table 20: Number of markets per entry mode and respective brand

O =Own units; F = Franchise units
Source: Developed by authors

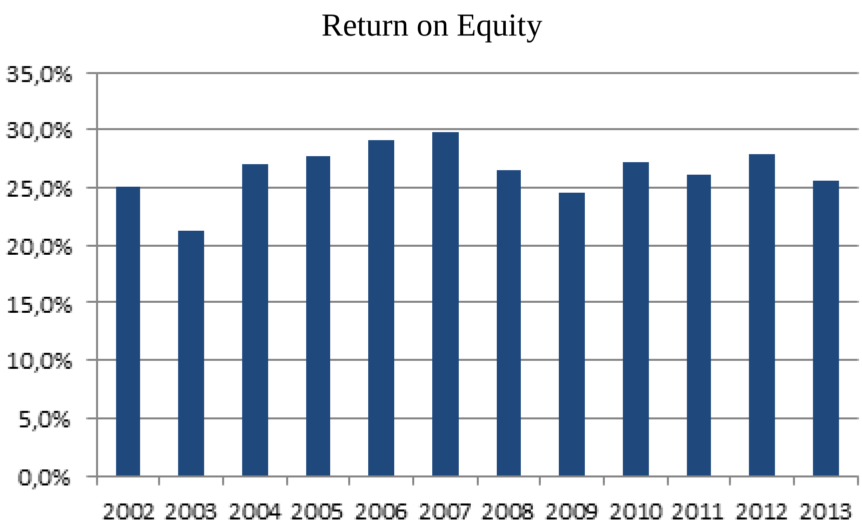

Figure 8: Return on Equity
Source: Inditex Annual Reports from 2002 to 2013