

Extreme Business-Models in the Clothing Industry

- A Case Study of H&M and ZARA

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Abstract

In the clothing industry firms compete successfully by applying different business-models. H&M and ZARA are two extremes in the clothing industry. H&M's business-model mainly focuses on outsourcing and ZARA's business-model mainly focuses on in-house production. The problem is that the existing theories alone cannot explain why two firms competing in the same environment under the same conditions choose different business-models.

The purpose of this dissertation is to further expand the idea of why the two clothing firms H&M and ZARA chose different business-models.

Our set of Complementarities for H&M and ZARA are based on the information derived from studying theories, the EU clothing industry and the two firms. Finally, Complementarities were analysed by conducting interviews.

Our Complementarities partly explain why H&M and ZARA chose different business-models. However, our analysis is applicable for H&M and ZARA since the Complementarities are based on characteristics found in these two firms. The value of Complementarities can be used by other firms if they find their specific characteristics.

Keywords: business-models, internalization, governance structure, key resources, Complementarities, EU clothing industry

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Chapter 1

Introduction

In the first chapter the background of the dissertation is described, followed by the research problem and purpose. Finally research questions, limitations and the outline are presented.

1.1 Background

In today's highly competitive business environment many firms choose to send out non-core operations to a supplier or manufacturer to be able to focus only on core operations. Firms that choose to outsource are hoping to reduce the firms' costs by specializing and making the firms' labour and resources more efficient. On the other hand, other firms constantly try to gain control over as many sections as possible by analysing its value chain. Firms that obtain control over the total production process by in-house production can achieve shorter lead-times¹.

As business students at Kristianstad's University we have a great interest in international businesses and know that it is important knowing which operations to outsource and which to keep in-house. During our three years of studies we have learned that similar firms, firms that all are very successful and even firms that are competing in the same industry adapt totally different business-models. The Swedish clothing firm, H&M, is a firm that outsource none-core operations. H&M does not own any factories, instead H&M buys clothes and other items through an abundance of detached suppliers. The business-model of the clothing firm ZARA is the opposite compared to H&M. ZARA is one of the fastest growing retailers and belonging to the Spanish Inditex Group. ZARA has developed a unique business-model and today ZARA is a vertically integrated retailer. ZARA controls every step of the value chain, only clothes with a longer shelf/fashion life time are outsourced.

During the course "International Business and Multinational Enterprises" the idea about this subject grew out of a discussion in class. As a group we believe that we possess the important and required amount of knowledge to take on a problem like this and we also share a personal interest in the fashion and clothing industry.

¹ Lead-times: in terms of a supply chain the total time needed for an order to be processed.

Therefore, we could not think of a better way than to combine our knowledge with our great interest when working together and writing our dissertation.

1.2 Problem

The problem is that existing theories alone cannot explain why two firms competing in the same field with the same conditions chose different business-models. By finding sets of Complementarities for H&M and ZARA John Roberts's descriptions of Complementarity was expanded.

The Concept of Complementarity can be unfamiliar to some; therefore, a brief introduction will be given below and the discussion of the concept will continue in the theoretical framework. Complementarity is transformations within characteristics that influence performance. The goal is to have coherence within a set of complementary and this lead to that all characteristics are set at a high level or at a low level (Roberts, 2004).

To make the Concept of Complementarity clearer an example concerning the automobile industry by Roberts's is illustrated. In the first decade of the twentieth century Ford's focus was the black Model T. The firm had a very tight product line and the production of the black Model T went on for decades. Ford's factory had low flexibility, and focused only on the Model T. To be able to change production to Model A, Ford had to do multiple changes due to the inflexible product line. Ford had created an organizational design that fitted with the strategic choice. The features of a tight production line and a low flexibility were complements to each other. Toyota presents another view. During the last decades of the twentieth century Toyota has developed very flexible plants with a wide product line. For instance, on one day one Toyota factory produced over 350 different engine/transmissions/fuel-system combinations on one single product line. The result is wide product lines and extremely flexible plants. For both these automobile firms, their separate choices were the most suitable. According to Roberts "mix and match" between the characteristics is not a combination to recommend (*ibid.*).

1.3 Purpose

The main purpose of this dissertation is to further expand the understanding of why clothing firms compete so differently. According to existing theories firms with comparable external and internal factors should apply similar business-models.

1.4 Research Questions

- Which main differences exist in the business-models of firms active in the clothing industry?
- How can it be that two leading clothing firms in the same market segment chose different business-models?
- Is it possible to find Complementarities that better explain the main factors for H&M's and ZARA's business-models choice?

1.5 Limitations

- Our dissertation focuses on the clothing industry, since this is the industry where H&M and ZARA are active.
- We chose to concentrate on three theories that we consider to be most valuable for our investigation; Internalization Theory, Transaction Cost Analysis and Resource-based View. None of these theories alone can explain the success of two such different business-models operating under the same conditions.
- The EU clothing industry was chosen to broader explain what theories missed. Only the EU clothing industry was studied since both firms home countries, Sweden and Spain are members of the EU.
- When the business-models of H&M and ZARA are mentioned, we mean the fact that H&M focuses on outsourcing while ZARA focuses on in-house production.
- During our work we discovered another limitation. H&M and ZARA were not very willing to cooperate. This made it difficult for us to collect primary data.

1.6 Outline

The dissertation has the following outline.

Chapter 2: A discussion about choice of methodology is presented. It includes research approach, data collection, both secondary and primary data, and the scientific philosophy.

Chapter 3: Arguments for why these theories can be combined. The theories Internalization Theory, Oliver Williamson's Transaction Cost Analysis, Barney's Resources-based View, and John Roberts's Complementarity are presented.

Chapter 4: A short presentation of the general EU clothing industry and specific country facts of Sweden and Spain are presented.

Chapter 5: An overview of the two firms, H&M and ZARA, are presented.

Chapter 6: The empirical method is presented. The research strategy, time horizon, sample selection, operationalization, validity, reliability, generalisability and problems associated with access are discussed.

Chapter 7: A figure with the important characteristics of the Internalization Theory, Transaction Cost Analysis and Resource-based View is created to clarify their connection to H&M and ZARA's business-models. Further, Complementarities to H&M's and ZARA's business-models were created based on facts from each firm and interviews.

Chapter 8: The conclusion is presented. A short summary of the dissertation and the applicability of the analyses are discussed. Modification, methodological criticism, practical implications, and future research are also presented.

Chapter 2

Method

In this chapter a discussion about choice of methodology, research strategy, data collection including both secondary and primary data and finally the scientific approach are presented.

2.1 Choice of Methodology

To explain why H&M's and ZARA's compete differently and why their business-models differ, the traditional theories of Internalization Theory, Transaction Cost Analysis and Resource-based View were studied. Furthermore, research was studied about the two firms and the EU clothing industry in general. None of the theories can explain both H&M's and ZARA's business-models entirely, but the theories can be a helpful tool in finding key characteristics that can explain the differences in the business-models. John Roberts's describes Complementarity as variables within industries of mass production and modern manufacturing. By expanding Roberts's Concept of Complementarity our own set of Complementarities for H&M and ZARA were created, based on the information derived from studying the two firms and from interviews conducted with experts.

2.2 Research Approach

This dissertation has a deductive approach as the main research approach. It starts out with a literature review which the Complementarities are based on. By starting out from theory a goal is to find some causality between the two different business-models and the Complementarities. The aim was also to find some Complementarities that distinguish the two business-models. To evaluate these Complementarities they were tested them by conducting interviews.

The opposite of deduction is induction, the purpose of this approach is to build a new theory from explored data and not develop existing theory. When using the inductive research approach a study of a smaller group of people would be more appropriate. In contrast a study of a larger group of people would be more suited for a deductive research approach. In this research a smaller group of people was

interviewed and therefore this dissertation has some features of the inductive approach as well. According to Saunderson's a mix of deductive and inductive research approach, called abduction, is possible and this is the most suitable approach for this dissertation (Saunders *et al.*, 2007).

2.3 Data Collection

This section describes the process of how data were collected, first secondary data will be presented followed by primary data.

2.3.1 Secondary Data

Data that have been reanalyzed from earlier studies for other purposes are called secondary data, which includes both raw data and summaries. The combination of data will form new data and new relationships can be explored (Saunders *et al.*, 2007).

Many researchers have emphasized the field of firms' business-models dealing with both outsourcing and in-house production. Several researchers have also devoted time explaining the business-models of both H&M and ZARA. For that reason the secondary data were collected through articles and books, which were originally collected for some other purpose.

Information was also collected on the traditional theories from articles and books when trying to find features that could contribute to an understanding of why H&M and ZARA choose different business-models. Internalization Theory, Transaction Cost Analysis, and Resource-based View were analysed in depth.

2.3.2 Primary Data

Data that are conducted specifically for a research project are classified as primary data. Interviews were conducted as a way of collecting primary data, the interviews had a semi-structured outline. A semi-structured interview is when the researchers have a list of questions that should be answered, but the questions may vary from interview to interview. This means that depending on the flow of the conversation

the researchers can ask more than the questions that they have prepared (Saunders *et al.*, 2007). Since our dissertation is an explanatory study, a semi-structured interview was appropriate. We wanted to go in depth when investigating H&M's and ZARA's business-models. By conducting semi-structured interviews the interviewed person could further explain unclear answers. The purpose was to get the interviewed person to talk as freely as possible. The questions varied from interview to interview depending on who was participating. The interviews were carried out on a one-to-one basis over the telephone.

2.4 Scientific Philosophy

Three philosophies are common in the research process; positivism, realism and interpretivism. The first one is the positivistic view which means that one work with an observable social reality and the result could be a law-like generalization. It is also important that the research has been done in a value free manner and the researchers should affect the research process as little as possible. The second one is realism, which means that what our senses show us that reality is the truth and that the reality is independent of the mind. Therefore, it is of great importance to realize that different forces could change peoples' perceptions of behaviour and interpretation. The last one is called interpretivism which means that one must understand differences in the human role. This is useful when the research process concerns a complex environment that cannot be generalized (Saunders *et al.*, 2007).

When using existing theories to explain the choice of business-model a set of Complementarities were created and the result was affected as little as possible. To influence the result as little as possible the information was collected in a value free manner. Based on the discussion above the dissertation consists of the positivistic philosophy. However, it was hard to exclude all of our own values and expectations in the research process (*ibid.*). The research approach does not have features of either the realistic or the interpretivistic philosophy. The realistic approach was excluded because forces that could affect peoples' behaviour were not studied. The interpretation approach was excluded because the studied environment is not too complex to be generalized.

The data collected for this research are qualitative data and are one of the two major approaches to research methodology. This data are concerned with meaning, for example reasons for various aspects of behaviour, rather than with measurement. Here the respondent can answer the questions freely in an explanatory way. The other approach to research methodology is quantitative data. This is used when the respondent must choose from already written alternatives.

In our case qualitative data helped us understand why H&M and ZARA have different business-models. To get more focused data concerning our topic, sampling qualitative data through interviews was a good way of reaching meaningful results.

Chapter 3

Theoretical Framework

This chapter presents the theories. First arguments for why these theories are chosen and how they can be combined are given. Second the theories Internalization Theory, Oliver Williamson's Transaction Cost Analysis, Barney's Resources-based View, and John Roberts's Complementarity are presented.

3.1 Choice of Theory

There are several economic theories discussing the choice of business-model for a firm. Among existing theories, Internalization Theory and Transaction Cost Analysis partly give an explanation. The theories describe why and how firms expand depending on their internal and external environment and this is what was important for us to know. These theories laid the best foundation for our investigation. Because these theories acknowledge that transaction costs arise from impediments of behavioural and environmental characteristics, which are some of the main explanatory factors for our problem. Thus, when it comes to Multinational Enterprises (MNE) these factors are of great importance to give a fair evaluation of MNE's expanding acts.

Internalization Theory and Transaction Cost Analysis are similar to each other. Both concentrate on the process of why a firm is creating a market within its own firm. These two theories combined with each other can partly explain why firms choose a certain business-model. But the theories do not explain why similar firms, active within the same industry, choose different business-models.

Key resources are what make similar firms choose different business-models. That is why key resources continue describing MNEs dissimilar business-models. The Resource-based View highlights the central idea of how key resources create sustainable competitive advantage. Key resources can be expanded with John Roberts's Concept of Complementarities. By saying that key resources are characteristics that together create Complementarity to the organizational design and the environment the two views were combined. If firms combine key resources

to Complementarity they can make the most efficient use of their resources. With inspiration from the Resource-based View Complementarities were created for our specific industry and by that reaching our final goal. To make the linkages between the theories more clear, a simple model was created, that shows how the theories are combined.

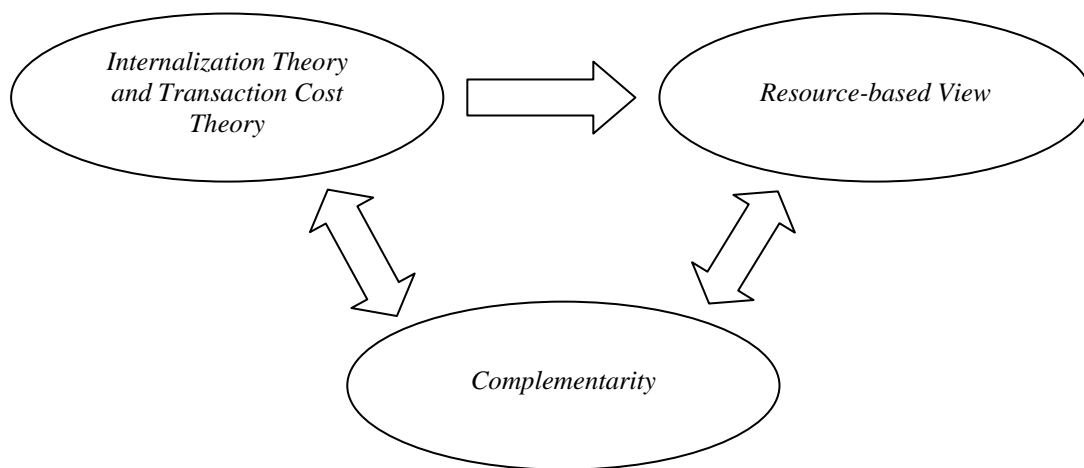


Figure 3.1 an illustration of how the theories are combined

3.2 Internalization Theory

3.2.1 Introduction

The central matter in the Internalization Theory is the firm's aim to develop own internal markets whenever transactions can be made at a lower cost within the firm. The internalization process will continue until benefits and costs of further internalization are equated to the margin. One of the major advantages of internalization is the reduction of information monopoly²; a situation when one of the parties has more valuable information than the other one. Internalization can involve a form of vertical integration bringing new operations and activities under governance of the firm, especially when natural markets are imperfect or missing (Buckely and Casson, 1993).

² Information monopoly: A situation then one of the parties has more valuable information then the other one.

3.2.2 Foreign Direct Investment - A Tool for Internalization

According to Hill the idea of Internalization Theory can also be identified as market imperfections. He explains that market imperfections are factors that are hindering the markets from working perfectly. When there are impediments to the free flow of products between nations and impediments to the sale of know-how, and it will be expensive or difficult to execute export and sale of know-how, then exporting and licensing are often replaced by Foreign Direct Investment (FDI). FDI is investment in one firm by another firm to produce and/or market a product in a foreign country (Hill, 2007).

3.2.3 Horizontal FDI and Vertical FDI

Hill further describes that FDI could be managed in two different ways, by horizontal foreign direct investment and vertical foreign direct investment. Horizontal FDI is investments in the same industry abroad in which a firm operates at home. The most common form of vertical foreign direct investment is FDI in industries that supply inputs for a firm's domestic business, the less common form of vertical FDI is FDI in industries abroad that sell the outputs of a firm's domestic business (Hill, 2007).

When the impediments to transporting products around the world are expensive, horizontal FDI can be the solution. Impediments to the free flow of goods are governmental restrictions such as tariffs and quotas on imports. The protectionist constraints on the free flow of goods increase the cost of exporting as well as increasing the attractiveness of FDI and licensing (*ibid.*).

Hill mentions that market imperfection tries to explain vertical FDI in two ways. The first has to do with impediments to the sale of know-how. When a firm has the valuable know-how it might be reluctant to sell it because of the risk of losing it to competitors. These competitors could use the specific know-how and compete against the firm they once got it from. When there is that sort of constraint on a foreign firm, then it is better for that firm to invest vertically. The second explanation of vertical FDI arises when a firm must invest in special assets, assets that perform specific tasks and whose value is considerably reduced in its next best use. Further, the assets value depends on the inputs provided by a foreign supplier.

The firm that has invested in the foreign firm is dependent on them as long as it is more economical to do business with it than with other firms. The foreign firm can act opportunistically and increase prices to the limit where they know that the other firm will go somewhere else. The hazard the firm is exposed to in these sorts of investments can be solved through vertical FDI (*ibid.*).

3.2.4 *The Protection of Know-how*

Hill describes that when firms do not want to pay for the opening of a new market licensing is a way of reaching that market instead. However, he states that when there are impediments to the sale of know-how a firm might still think it is worth keeping the strict control over the firm and engages in some sort of FDI instead of licensing. Know-how is a valuable and competitive asset and when it can be exploited and transferred without losing its value the more profit the firm can earn. Why a firm would choose FDI instead of licensing depends on export transportation costs in relation to FDI and also the complications of selling the know-how (Hill, 2007).

The Theory of Internalization seeks to explain three major drawbacks for a licensing business-model. Hill describes these drawbacks and he identifies the first drawback as, a firm that enters into a licensing relationship is taking a risk considering that it might give away valuable technological know-how to a potential foreign competitor. The second drawback is the difficulty for a firm to maintain a tight control over manufacturing and marketing that is essential to maximize the profitability. When tight control of a foreign unit is desirable the theory speaks in favour of a FDI business-model instead of licensing. The third drawback is that if the firm has a competitive advantage that relies on the management, marketing and manufacturing capabilities that shapes the product. It can be a challenge to apply these capabilities when it licenses the production to a subsidiary. There is no point of licensing when the firm can make it more efficient in-house. Thus, Hill reaches the conclusion that these three drawbacks explain that know-how can be lost in many ways through licensing because it might not be possible to protect it enough. The know-how could be lost to competitors because the tight control that is needed for the know-how to be properly exploited might not exist within the organisation (Hill, 2006).

3.2.5 Summary

The Internalization Theory focuses on how a firm can develop its own internal markets through FDI. There are impediments to export and the sale of know-how and therefore horizontal FDI is used. Vertical FDI is also used when there are impediments to the sale of know-how as well as when a firm must invest in specialized assets. Exporting impediments are tariffs and quotas. Impediments to the sale of know-how are complications when it comes to protection of transferring the knowledge. Investments in specialized assets expose the investing firms to opportunistic behaviour. The trade off between exporting, licensing and FDI depends on the specific impediments that the firm faces.

3.3 Transaction Cost Analysis

3.3.1 Introduction

When studying the field of economics, transaction costs are central features (Barney, 1986). Williamson describes the Transaction Cost Analysis as if economizing is the core problem of economic organization (Williamson, 1996). Williamson, as many others, states that Ronald Coase can be seen as the forefather of the Transaction Cost Theory. Coase explains that the exercise of the price mechanism will be followed by costs and the most visible cost of classifying production through the market mechanism is to determine the relevant prices. Due to these transaction costs it is better to manage an activity inside the institution of the firm. The costs of managing an activity within the firm must be lower than through the market and lower than within any other firm, in order to be advantageous (Madhok, 2002).

Coase recognizes markets and firms as options to organize economic activities. Further, he argues that opportunism and uncertainty are factors that increased the cost of using the price system (Barney, 1986). Coase's intention was to find an efficient governance structure to clarify why economic activity was structured as an institution inside firms (Madhok, 2002).

3.3.2 Oliver Williamson

The Transaction Cost Analysis is further expanded by Williamson from a micro analytical perspective. He has contributed with special transaction characteristics, particularly asset specificity (Madhok, 2002). Transaction Cost Analysis gives a possibility to examine and compare different governance structure and to choose a suitable governance structure (Williamson, 1996).

Williamson explains transaction costs as the costs of planning, adapting and monitoring tasks complexion in comparison under control hierarchies. Transactions are explained out of the frequency with which they occur, the degree and type of uncertainty to which they are subject and the level of asset specificity (Williamson, 1996).

3.3.3 Williamson's Model

Williamson describes his model by four general principles. First, to be able to complete transactions markets and firms are used. Second, if transactions should be distributed across or inside firms will be decided by the most efficient option. Third, people that handle the decision making and the objective properties will affect the cost of writing complex contracts between markets. Finally, both human and environmental features could prevent trade across markets (Barney, 1986).

3.3.4 Behavioural of People

Williamson uses a contractual approach when studying transaction cost economics and in contrast to many other economists he states that the behaviour of people matters. He argues that bounded rationality, moral hazard, agency and opportunism are factors that produce transaction difficulties with a self-seeking interest. For example, by agents working for a firm the result could end up in deceit due to unequal distribution of information. Two other factors that also produce transaction difficulties are irregular information and small numbers of bargain firms (Williamson, 1996).

3.3.5 Asset Specificity, Uncertainty and High Frequency

Transaction costs and inertia will increase when transactions are characterized by asset specificity, uncertainty and high frequency. These are important features that have been discussed by many and here both Williamson's and Hollensen's characteristics are going to be further examined:

- Asset Specificity: Williamson describes asset specificity as the possibility to move assets and alternatives without giving up productive value. Asset specificity can have many shapes, For example site specificity, physical asset specificity, human assets specificity, temporal specificity, and brand name (Williamson, 1996). Hollensen explains asset specificity as when consumers have specific requirements of the product transaction investments are necessary. Investments like these often occur when the product is in the introduction or growing stage of the product lifecycle, when direct contact between the product and the consumer is of importance and when the firms have proprietary knowledge (Hollensen, 1998).
- Uncertainty: There are two different kinds of uncertainty described by Williamson. The first, primary uncertainty is an uncertain strategic choice from one party. In other words, one of the parties has valuable information that it is withholding. Second, secondary uncertainty is when one of the parties has more or all information compared to the other party. Due to lack of communication secondary uncertainty is rather innocent and in contrast to primary uncertainty of non-strategic kind (Williamson, 1996).
- High Frequency of Transactions: High frequency of transactions is measured by how often the transactions occur (Williamson, 1996). Hollensen describes that high frequency of transactions are useful to limit opportunistic behaviour between the supplier and the buyer. For example, when frequencies of transaction and asset/investment specificity are high the result will be internalization with vertical integration, which is 100 percent owned subsidiaries, but when frequencies of transactions and assets/investment specificity are low only occasional transactions appear (Hollensen, 1998).

3.3.6 Svend Hollensen

Hollensen refers to Williamson's framework by stating that there are two main alternatives to control markets; externalization and internalization hierarchies. Hollensen further states that external market transactions are external to the firm and the price mechanism conveys all the necessary governance information. Internalization creates an internal market where the hierarchical control is defined by a set of internal contracts (Hollensen, 1998).

3.3.7 External and Internal Uncertainty

To decide on the precise control, Hollensen include four creations; transaction specific assets as mentioned above, external uncertainty, internal uncertainty and free-riding potential. Here specific assets, external uncertainty and internal uncertainty will be explained. Free-riding has to do with firms which invest in brand promotion; these firms are more exposed to the risk of free-riding and therefore it is not relevant in this theoretical framework (Hollensen, 1998).

External uncertainty is for example political risk, supply instability and competitive pressure. When there is a high degree of uncertainty firms often integrate less vertical and instead shift the burden of risk to outsiders. However, when there are both high uncertainty and investment specificity a tendency to internalize is common. Internal uncertainty occurs when firms expand internationally. The internal uncertainty increases because the host country is far away from the home country. Since it is hard for the home country to retain its degree of control internalization is often used to regain control (*ibid.*)

3.3.8 Vertical Integration

Hollensen highlights that the Transaction Cost Analysis helps to decide which entry mode could be the optimum in view of the different costs of transactions. However, it disregards the emphasis of social relations between transaction partners influencing business. Ultimately, an efficient entry mode is based in the sum of production and transaction costs, given the feasible set (Hollensen, 1998).

If transactions occur once, then there will be a low level of vertical integration. Distributors and importers are the main solution, in other words market transactions take place. When the transaction frequency increase contracting is common and high vertical integration will occur when transactions are regular and the optimal investment business-model involves high asset specificity. The higher the specificity and unpredictability of the environment the higher control is appropriate. The vertical integration will increase as the asset specificity become more and more important and the tighter the buyer-supplier relationship will be. The closest relationship is that of complete ownership integration (Hollensen, 1998).

Integration and control gives a firm legitimate authority to direct operations. In, general, higher degrees of control are more appropriate for entrants that closely coordinate global business-models. However, more control implies higher ex-post transaction costs, it also gives an increased chance of higher returns on the investment (*ibid.*).

Given that the Transaction Cost Analysis assumes that any action in a market is associated with costs, the question is what kind of mode of entry minimizes the transaction costs of producing and distributing a particular good or service. Transactions are efficient when the actors choose a form of organization which in total bears the lowest production and transaction costs (Hollensen, 1998).

3.3.9 Summary

The Transaction Cost Analysis explains that activities should be managed within a firm as long as the firm can manage it to a lower cost than outside providers. Transactions are characterised by asset specificity, uncertainty and frequency. According to Williamson asset specificity is the ability to move assets without losing productive value. Meanwhile, Hollensen says that some transactions require special investments to meet specific needs of consumers. Uncertainty can be of opportunistic or of non-strategic kind. Frequency is how often the transactions occur. Costs arise from writing, planning and monitoring contracts. Depending on the level of the transaction characteristics and the costs of the characteristics the firm choose the governance structure that matches the design of the firm. When

transactions occur rarely and the degree of uncertainty is low there will be a low level of vertical integration. When the transactions occur often, uncertainty degree is high and the asset specificity is important, a high level of vertical integration and level of control is appropriate.

3.4 The Resource-based View

3.4.1 Introduction

Most economic scholars consider Jay Barney as the father of the modern Resource-based View of firms. The Resource-based View emphasizes strategic choice, challenging the firm's management with the important tasks of identifying and deploying key resources to maximize returns (Barney, 1991). The Resource-based View assumes that the desired outcome of a firm is sustainable competitive advantage (Fahy, 2000) and it is based on the concept of economic rent and the view of the firm as a collection of capabilities (Hitt *et al.*, 2006).

3.4.2 Economic Rent

Economic rent is what firms earn over and above the cost of the capital employed in the firms' business. It is a way of measuring the competitive advantage, only through these advantages can firms earn economic rent. Simply, economic rent is the difference between return and what is achieved on resources invested and the cost of resources. A high economic rent means that firms have a high level of resource utilization. It is crucial for firms to find those key resources that they can do better than other firms, and that is hard for competitors to copy (Hitt, *et al.*, 2006).

3.4.3 Resources

According to Barney a firm consists of many resources but not all of them are the key resources that create sustained competitive advantage. The resources might meet various conditions in the firms but if these resources do not create value these resources are not sources of competitive advantage (Barney, 1991). Barney means that firms only have a competitive advantage when that advantage is compared to another entity or firm and when the consumers of the firm value it (Fahy, 2000).

The firms' key resources consist of tangible assets, intangible assets and capabilities. Tangible assets are for example plant, equipment and land. These tangible assets are easy to measure, duplicate and substitute, therefore seldom the key resources. The intangible assets include intellectual property which can be of great value if used in the right way, at the same time the intangible assets are hard to duplicate in the short run due to regulations. Lastly, capabilities are skills of the workers and organizational structure. Capabilities are the assets that are most likely to become sustainable competitive advantage. On the one hand, these assets are often highly tacit and therefore hard to duplicate in the short run, but on the other hand they might be hard to value because they are highly tacit (Fahy, 2000).

By continuously developing existing and creating new resources and capabilities to the rapidly changing market conditions, the firm can achieve sustainable competitive advantages. Each organization is built upon unique resources and capabilities, together these provide the basis for the business-model and the primary source of the returns (*ibid.*).

3.4.4 Sustained Competitive Advantage

The concept competitive advantage and sustained competitive advantage need to be separated. According to Barney a competitive advantage could be reached when firms implement their business-model earlier than possible or present competitors. When firms succeed with this process and their business-models additionally create value and other firms do not have the opportunity to duplicate the advantages of their business-models, it becomes sustained competitive advantage (Barney, 1991).

3.4.5 Fundamental Assumptions

Barney explains that the Resource-Based View is based on two fundamental assumptions; that resources and capabilities are heterogeneously divided between firms and that resources are imperfectly mobile. It is declared that firms cannot reach a sustained competitive advantage with homogeneous resources Due to these assumptions differences in firms' resource endowments can exist and maintain over time and result in a sustained competitive advantage (Newbert, 2006).

3.4.6 Four Empirical Indicators

Barney (1991) states four empirical indicators that resources should fulfil to generate sustained competitive advantage.

- Valuable
- Rare
- Imperfectly imitable
- Non-Substitutable

Valuable: For resources to have competitive advantage and sustained competitive advantage they have to be valuable. Resources are valuable when they can be used in a business-model that improves the effectiveness of the firm. Such business-model should either outperform its competitors or reduce its own weakness. To be able to outperform competitors the resources must have the features or attributes of being rare, inimitable, and non-substitutable (*ibid.*).

Rare Resources: To be a source for sustained competitive advantage a resource cannot be used by a large number of competitors. To enjoy a sustained competitive advantage firms must implement a value-creating business-model that differs from rivals. No firm can gain sustained competitive advantage if all can get access and exploit the resource in the same way, the outcome will then be that many firms apply a common business-model. Although, a common resource is not to be dismissed as unimportant, the valuable but common firm resource can help ensure a firm's survival (*ibid.*).

The value and rareness of a resource is what create firms' competitive advantage, it is the criteria that contribute to the efficient business-model. The ability to create a competitive business-model depends on the firms' resources, but to create a sustainable competitive advantage those resources need to be hard to attain by other firms. This is what is called imperfectly imitable (*ibid.*).

Imperfectly Imitable: When firms' resources are imitable they possess one or more of the following three characteristics:

- The ability of firms to obtain a resource is dependent upon unique historical conditions. The resource exploitation depends on the firms' place in time and space and their long term performance. Thus, where it started and how it have arrived at where it is today have made it able to implement value creating business-models that cannot be duplicated by competitors (*ibid.*).
- The link between resources possessed by a firm and a firm's sustained competitive advantage is casual ambiguously. This occurs when the resources that creates the sustained competitive advantage is unknown, not understood or only understood very poorly. It is often very complex for firms to know the resources that create sustained competitive advantage because those resources owned by firms are very complex and interdependent. This too makes it very hard for other firms to duplicate the resource that creates the sustained competitive advantage. However, if firms with the competitive advantage understand what makes the resource attain sustained competitive advantage then the other firms can also learn and overcome the knowledge disadvantage and obtain the needed resources (*ibid.*).
- The resources generating firms' advantage is socially complex. This occurs when the resources are very hard to systematically manage and influence. Examples of social complex things are interpersonal relations among managers in a firm, a firm's culture, and/or a firm's reputation among suppliers and consumers. It might be understood what creates the competitive advantage but to imitate it or duplicate it might be too time consuming and in many cases impossible. Thus, just because a resource that firms have, which creates competitive advantage, can be bought by any firm, it does not mean that it will creates the same competitive advantage for the purchasing firm (*ibid.*).

Non-Substitutable: The final requirement for firms' resource to meet to be classified as a source of sustained competitive advantage is that the resource must be non-substitutable. The idea is for a firm to have resources that are like bricks in the business-model that is hard for others to copy. Substitutability can take two forms. First, even though it may be hard for firms to imitate other firms' resources exactly, it can be possible for a firm to use similar resources leading to the same strategic

plan. Secondly, very different firm resources can be strategic substitutes. Two competing firms might have the same future vision for their firms but are using different firm resources to accomplish it. The two different visions are substitutes for each other because they are strategic equivalent, both lead to a clear vision but based on different factors (*ibid.*).

3.4.7 Ability to Succeed

Furthermore, Barney states that a firm cannot only own valuable, rare, inimitable and non-substitutable resources, a firm must also organize these in the best and most suitable way to be able to reach the goal of sustained competitive advantage (Barney, 1991).

According to Barney, the Resource-based View highlights the need for a fit between the external market in which firms operate and their internal capabilities. The internal environment in a firm is more critical to the determination of strategic action than the external environment. The Resource-based View suggests that a firm's unique resources and capabilities provide the basis for a business-model. The chosen business-model should allow a firm to exploit core competencies relative to opportunities in the external environment (Hitt, *et al.*, 2006). To be able to attain a sustained competitive advantage business-models need to be chosen and analyzed to utilize its internal strength by replying to environmental opportunities and avoiding external threats and internal weaknesses (Newbert, 2006).

Once the key resources are identified they need to be developed through different investments and once they have the value of a sustainable competitive advantage they need to be protected through trade secrets. Finally, it is important to allocate these resources and bringing them into action. They should meet industry success factors or try to create new ones (Fahy, 2000).

3.4.8 Summary

The Resource-based View highlights the importance of finding the unique key resources that create value within firms. Key resources should be valuable, rare, imperfectly imitable and non-substitutable to be able to achieve sustained

competitive advantage for the firm. Resources are valuable when they improve the efficiency in the firm, rare when they cannot be used by a large number of competitors, inimitable when they are hard to duplicate and non-substitutable when they are impossible to copy. Once the key resources are found they need to be organized in the best way. Key resources that have grown out of firms' legacy might speak for integrating firms while a similar key resource can speak for outsourcing in other firms.

3.5 John Roberts's Complementarity

3.5.1 Introduction

John Roberts's book *The Modern Firm* analyse features of organizational design, business environment and competitive advantage. Roberts points out the great importance of firms' different organizational design, business-model and the affecting environment. He describes that the features of organizational design, business environment and competitive advantages can be analysed with the help of the Concept of Complementarity.

3.5.2 Business-model, Organizational Design and Good Performance

Roberts describes that choosing a business-model is complex and difficult. It must fit the organizational design and the environment to create successful performance and in addition both technology and behaviour affects the choices and the opportunities. There are certain business-models and organizational designs that fit the environment better than others. These business-models and organizational design could produce good performance. When firms can recognize and distinguish the possibilities and constraints it will help them designing the right fit. When the relations are determined there are often not many possible paths to choose from because there are not that many possible and good constellations (Roberts, 2004).

3.5.3 Choice of Characteristics

Often the choice of characteristics will be done in a coherent manner, however problem can arise. For instance, the choice of organizational design and business-model could fit to the environment, until the environment changes. The relation

among the environmental features and the characteristics of the business-model and organization will give guidelines on which set of characteristic that will do well and which will not. The importance is to choose the most fitting one of the workable ones. This is where the key idea of Complementarity among choice characteristics comes into the picture Roberts identifies the Concept of Complementarity as the relationship between characteristics. The organization, the business-model and the environment need to fit, there are several coherent characteristics, but all of these are not automatically equal good. The coherence in the design could arise from Complementarity (*ibid.*).

Roberts describes that the Concept of Complementarity can be expanded to links between features of the environment and the design's choice of characteristics. The problems of organizational design will be facilitated because of the relations among Complementarity. If characteristics create a Complementarity and the choice of characteristics creates the perfect match for maximum performance, and then suddenly one characteristic changes alone, it could result in a bad performance. However, Roberts highlights that if all characteristics will be changed it would lead to a great increase in performance (*ibid.*).

3.5.4 Coherence in Choice of Complementarity

Important in Roberts's framework is the coherence in the choice of characteristics leads to; all of the characteristics are being set at a high level or at a low level. For example, within firms there must be a relationship of much variety and flexibility or little of both. For firms to accept the extra costs of flexibility the desired variety must be high, in addition, high level of variety will only be accepted if production system is flexible. Roberts argues that "mix and match" between several characteristics are not a good choice and will rarely improve performance. For example, high variety and low flexibility is not a "mix and match" that a firm should consider (Roberts, 2004).

3.5.5 Summary

When developing a business-model the firm must match the business-model with the organizational design and the environment to create a successful performance.

The Concept of Complementarity highlights the choice between characteristics. There are many different constellations of coherent characteristics but all of them are not equally effective. Characteristics need to complement each other to create Complementarity; therefore, “mix and match” do not work. When changing one characteristic it is beneficial to change the other characteristics only if they complement each other.

Many aspects around firms affect the choice of business-model, for example the technology development and behaviour that occurs within the industry. When firms are able to recognize and distinguish possibilities and constraints it will guide them to the right fit.

Chapter 4

The Clothing Industry

A general EU clothing industry perspective as well as country specific facts of Sweden and Spain are presented.

4.1 The EU Clothing Industry

It is important to study the clothing industry when examining why similar clothing firms choose different business-models. Since the theories alone fail to explain why similar firms choose different business-models the EU clothing industry has been used as an empirical tool. The history of the EU clothing industry partly succeeds in explaining the missing linkages of EU clothing firms' business-models.

The EU clothing industry has undergone major changes the last 40 year. These changes have institutional, technological and competitive background. An institutional decision, made by the EU, reducing quotas and tariffs increasing imports, will affect the competition. This in turn will put pressure on price reduction. To reduce prices, firms will have to produce with lower costs and, therefore, might be forced to decrease domestic employment and shift production to foreign countries. Only the employment rate within the clothing industry seems far off explaining the problem of why similar firms in the same industry compete with different business-models. However, when seen in a bigger perspective the employment rate within the clothing industry can add meaningful information.

4.1.1 Competitive Pressures

There have been some radical transformations in the clothing sector in EU over the last years. A combination of technological changes, evolution of the different production costs, and changes in competitive arrangements and consumer behaviour are the main reasons for the transformation. The EU clothing industry is a labour intense industry that has been faced with the pressure for lowering production costs for a long time. Those firms that have been successful are often those that have focused on minimizing costs. The pressure of lowering costs due to competitive arrangements still remains and now added pressure has arisen because of changes in

consumer behaviour. To stay competitive, the EU clothing industry needs to become more flexible and achieve shorter production lines, since the demand for higher quality increases (ETD, 2007).

The real pressure to lower costs started in the beginning of the 1980s when a major increase of imported goods occurred. Taplin identified that these goods came from low-wage countries that have recently been industrialized. These competitive pressures were intensified by reduced quotas and tariffs on imports. In 1995 there was a WTO Agreement on textiles and clothing that increased imports from low-wage countries due to the liberalization of the market and the removal of the quantitative restrictions. This is a threat that will speed up once quotas and tariffs are completely eliminated. However, Taplin explains that in the EU the clothing industry has been able to keep a rather large presence both when it comes to employment and Gross Domestic Product (GDP) (Taplin, 2006).

4.1.2 Relocation of Production Facilities and Subcontracting³

Firms have focused on reducing labour costs through location investments and productivity increase through investment in reorganizations, in other words, restructuring the firms. The EU clothing industry has responded to changes by improving and simplifying the production process. Further, the EU clothing industry has modernized its supply chain and inventory management. This has forced the clothing firms to put pressure on the suppliers as well so that the suppliers offer more varied goods in smaller quantities. The whole process, from supplier to wholesaler, demands that the logistics work perfectly to be able to shorten production runs. According to Taplin many firms have off-shored production to low-wage countries, outsourced its lower value-added activities to subcontractor and made domestic procedures more effective and mechanized. The domestic sub-contractors can assure a high productivity and flexibility. Another reason to keep production processes domestically is that firms' organizational model might be hard to duplicate abroad (Taplin, 2006).

³ Sub-contracts provide value for the firm since it makes the firm more efficient.

For the EU clothing industry, the factors that affected the choice of location the most are unskilled low-wage labour and tradability factors. Tradability factors are delivery times, logistic costs, tariff barriers, governmental and trade incentives. In the 1980's and even today low-wage labour can be found in Europe. Therefore, many clothing firms have sub-contracted certain phases of the manufacturing to Central and Eastern Europe. Today, also North Africa, South America and some areas of the Far East are places where nation-specific resources like low-wage labour can be found (Bolisani and Scarso, 1996).

4.1.3 Restructuring, Modernisation and Technological Progress

Not all firms follow this specific pattern even if the majority do. Those that have kept domestic production invest heavily in modernizing technologies. This will contribute to just-in-time, quick response and computer techniques that are used for value-added activities as design, cutting and finishing (Taplin, 2006).

4.1.4 Trend towards Higher Value Added Products

Many of the EU clothing firms that have kept the production process domestically have reduced and ended their mass production and simple fashion. Instead firms focus on a variety of products with a higher value. EU producers are world leaders in high quality clothing with high design content. The competitive advantages that the clothing sector in the EU has are now focused on quality and design, innovation and technology, and high value products (ETD, 2007)

Between 1980 and 1995, 40% of the people working in the EU clothing industry lost their jobs. However, Taplin explains that due to the restructuring of the organization and a more effective high-quality workforce production the decline was not as major in all European countries (Taplin, 2006). Bolisani and Scarso state that, what is interesting to note as well is that in those countries that have kept production domestically and internalized manufacturing, the employment rate has remained about the same (Bolisani and Scarso, 1996).

4.1.5 Phases of the EU Clothing Industry

The EU clothing industry consists of many phases, therefore, some of them are more appropriate for off-shoring and some of them are more appropriate to keep in the domestic market. For example if a firm is looking to build economies of scale and is facing unfavourable trade agreements, keeping all manufacturing phases in one place might be most appropriate. On the other hand, when there are no trade barriers and the firm have a flexible manufacturing process, manufacturing in many units and location might be preferred (Bolisani and Scarso, 1996).

The value that the phase brings to the final product is often what determines where the phase is completed. According to Bolisani and Scarso, in EU the clothing industry the design phase or any phase that adds value to the product will often be kept internally because it contributes a lot to the firms' success. Also fabric cut is often done internally or outsourced to subcontractors. However, assembly which is very labour intense is often relocated to low-wage countries as well as knitting and finishing since it is very capital intense and time and material consuming (*ibid.*).

4.2 Country Specific Facts

4.2.1 Sweden

The Swedish clothing industry consists mainly of off-shoring or outsourcing strategies. The Swedish clothing industry is a modern, quality-oriented industry with advanced technology, continuous product development and a strong environmental awareness. The Swedish clothing industry is international, in the supply of raw materials, product adaptation, production collaboration, marketing and export (TCS, 2007).

Sweden used to have an extensive clothing industry, with the Borås region in Southwest as the industrial core (Axelsson, 1991; cited by Hauge, 2007). During the 1960s and the 1970s the Swedish clothing industry went through remarkable structural changes. Imports of foreign produced clothes increased and employment in the clothing industry on the domestic market decreased. Meanwhile, the modern Swedish fashion industry started to grow. Production of clothing was outsourced to

low-cost countries, but value adding activities like design, marketing and distribution remained in the country. This was the foundation of the modern Swedish fashion industry. Today, most Swedish firms produce functional clothes with a sober design (Pettersson, 2001; cited by Hauge, 2007).

The increasing consumption makes Swedish fashion a growing industry. In 2005 the turnover of the domestic fashion market (including shoes and accessories) was estimated to 68 billion SEK (Industry Magazine, 2006). Sweden imported clothes for 24 billions SEK and exported 9 billion SEK in 2005. The main destinations for export are the neighbouring countries Denmark, Norway and Finland (Aronsson, 2006; cited by Hauge, 2007). Retail chains dominated both the export and the domestic market (Industry Magazine, 2006). More than half of the biggest retailers are vertically integrated, only the production of the actual garment is outsourced. Functions such as design, marketing, distribution and retail are in general incorporated in the firm. On the other hand, there are retailers that have a mix of own brands and brands bought from independent suppliers. The profit margins of clothing developed in-house are often higher, but other brands can be better known and therefore attract shoppers. There is also a group of retailers that completely focus on external brands in their supply chain (Sundberg, 2006; cited by Hauge, 2007).

Most of the Swedish fashion export is re-distribution of clothing produced abroad. Therefore, the impact on the domestic employment numbers is very low. According to the Swedish Statistiska Centralbyrå, the fashion industry has had a slight reduction in numbers of firms from 1997 to 2000, but during the same time the numbers of employees has increased. In conclusion, each firm on average employs more people. Retail is the sector where the movement towards more concentration is most evident. From the beginning of 1990s to 2005 the number of stores selling clothes was reduced by about 15%, but consumption grew in the same period. It could be said that fewer stores are selling more clothes (*ibid.*).

Within the Swedish fashion industry there are three activities areas dominating fashion firms; design-development, branding-marketing, and retailing. The Swedish fashion industry consists of two parts; on the one hand there are many small and

micro sized firms, and on the other hand there are some giants. Just a small number of the Swedish firms sell to foreign markets, but the firms that do have a large share of the Swedish export (*ibid.*).

4.2.2 Spain

Under Franco's dictatorship, 1939-1975, there was an atmosphere with traditional values, legends and Catholicism. During this time Spain's relations to other countries were few but the trade within Spain was well developed and strong (HSCI, 2007).

Spain transformed due to the political shift from a dictatorship to a democracy. Because of an overall government restructure, a transformation could also be seen within the clothing industry. After the restructuring of government in 1981-1986 and 1986-1992, the expression "Fashion from Spain" was created and Spain was able to meet the European standards both in quality and design. Spain was ready to promote its Spanish fashion to others (*ibid.*). Meanwhile, through Spain's membership in the EU in 1986 the trade between EU countries increased (EU-Upplysningen, 2007).

Within the clothing industry, Spain was positioned between two poles. On the one hand, its production was not as technically advanced as in other European countries. On the other hand, its workforce was not as cheap as in developing countries, such as Korea. Spain was forced to choose one of the two directions when entering the increasingly liberalised market of the EC⁴. Spanish clothing production depended on licensed trademarks to local distributors because of market protection and customs duties; therefore, foreign producers played an important role. If liberalised, the Spanish clothing sector would suffer, as the foreign producers would have been able to sell their goods directly in Spain. To avoid this, a competitive Spanish identity for clothing products was needed. Compared to the rest of the world Spain had to supply quality, fashion jointly with Italy, France or Great Britain (HSCI, 2007).

⁴ European Community (EC), former named European Economic Community (EEC) was founded on March 25, 1957 by the signing of the Treaty of Rome.

The world has witnessed an expansion of successful firms with different competitive identities and Spain is no exception. The Spanish MNEs seems to have common expansion modes. Not only have new political views and the EU membership raised new opportunities, also the home market of Spain seemed to be saturated. Investments in intangible assets, like brand was made, and brands and marketing know-how became important and crucial features of the international strategy of several Spanish MNEs. Spain was able to increase the added value of the Spanish clothing products and this way it could gain access to higher market segments of both the internal and the external market. The expansion process concentrated on the value of the remaining Spanish features. Therefore, the production process and the control of the firms had to be central within the Spanish business-models (*ibid.*).

4.3 Summary

Here a combination of the characteristics in the EU clothing industry and theories are presented. The main characteristics in the EU clothing industry that were identified are:

- Radical transformation
- The country history effects
- Restructuring, modernisation and technological progress
- Subcontracting, relocation of production facilities for labour intense activities
- Trend toward higher value-added products

By combining these characteristics with the theories linkages were found that explain the relationship between theory and reality. The clothing industry transformed radically due to institutional technological and competitive changes. These changes have created impediments to trade in the market. Some firms have coped with this problem by investing money in countries where these impediments arise and have relocated production facilities to these low-wage countries. Firms have invested on different levels depending on the impediments, the product involved, degree of uncertainty and the frequency to which transactions occur. Internalization Theory suggests FDI as a tool to deal with these problems while Transaction Cost Analysis points out the different levels of vertical integration. A

country's history is another possible link to the Internalization Theory. A country that has focused on domestic trade due to political views in the home society has developed a strong internal trade. Countries with more open trade agreements have faced different impediments and have overcome them by exploring opportunities overseas.

Furthermore, a connection to the Resource-based View could be drawn to the history of the country. Some countries have explored their country specific resources and adapted the firm to their domestic market by focusing on higher value added products. This has enabled firms to outperform foreign alternatives by restructuring and modernizing the technological process. Other countries have developed specific resources by focusing on their core operations. The Resource-based View is of importance considering the trend toward higher value-added products. Today, it is not enough for clothing firms to achieve mass production and simple fashion. The key resources within the firms must be discovered and sustained to create higher value-added product that satisfies the consumers' needs.

Chapter 5

Overview of H&M and ZARA

In this chapter an overview of the two firms, H&M and ZARA is presented.

5.1 H&M's Background and Development

H&M opened its first store in Västerås, Sweden in 1947. H&M was founded by Erling Persson. The idea came to him during a business trip to the US when he was introduced to the American ready-made-clothing industry, and he brought this idea back to Sweden (Pettersson, 2001). Today H&M has expanded to 1,345 stores in 28 countries, with more than 60,000 employees. H&M offers clothes, accessories, nightwear and underwear to women, men, teenagers and children and H&M also has its own cosmetic product line (H&M 1, 2007). H&M's message and philosophy is "Fashion and quality at the best price" through the same advertisement in all markets (H&M 2, 2007). To make this possible H&M has a design and purchasing department, which makes all the clothing collections. New clothes and accessories arrive to H&M's stores almost every day (H&M 1, 2007). H&M is able to move a garment from design to the hanger in just 20 days (Saminather, 2007).

H&M buys items ongoing during the year to best fit the items to the market and it is crucial for H&M to find the right lead-time. H&M's purchasing depends on what sells well and what the market situation looks like. H&M's fashion year is divided into spring/summer and fall/winter. Fashion that sells in high volumes is ordered about six months in advance; however, the trendiest clothes must reach the stores within just a few weeks (H&M 2, 2007).

In 2006 H&M's turnover was SEK 80,081 million and today the largest market is Germany, followed by the UK and Sweden. H&M does not own any factories, it outsource all production. (Saminather, 2007). However, H&M remains rather high control of all the outsourced production phases. H&M has 22 production offices in Europe, Asia, Central America and Africa. H&M coordinates approximately 700 independent suppliers mostly in Asia and Europe. Each and every production office has the responsibility to make sure that the items purchased have the right price and

good quality, and that they are produced under the right conditions and standards (H&M 3, 2007).

H&M's concept for expanding and discovering new markets is through establishment of wholly-owned subsidiaries. However, there is an exception in the Middle East. Franchising is not a part of H&M's concept except for the development of the franchising arrangement in Alshaya, which is an important retailer in the Middle East. H&M sells and delivers to Alshaya and the firm turns stocks and sell to consumers. Through this H&M reaches a region that does not possess the opportunities to set up a wholly-owned subsidiary (H&M 4, 2007).

Today H&M is importing a lot from Kina; 60% of the purchases come from China and 40% from Europe 2004/2005. It would be a big risk to only import from one country and especially a country like China, where it can take 24 days to transfer the items from China to the end location. The production in Europe will continue to remain because of its geographical presence and favourable tradability (H&M 5, 2007).

To be able to offer the consumers high fashion and quality at the best price, H&M works with few middlemen. According to H&M, the firm buys the right items in large volumes from the right markets. The firm has a deep knowledge of design, fashion and textiles and always tries to work with an economical mind. H&M has established an efficient distribution channel (H&M 5, 2007). Lastly the firm depends heavily on its IT-system to work as efficient as possible. Also, one of H&M's most valuable assets is the corporate culture that promotes flexibility and adaptation (Saminather, 2007).

5.2 ZARA's Background and Development

We have witnessed H&M's success through the years but it seems like H&M's faces tough competition from the Spanish retailer Inditex, parent firm of ZARA (Saminather, 2007).

In March 2006, ZARA succeeded to take over H&M's role as Europe's biggest fashion retailer. ZARA belongs to the apparel Industria de Diseño Textil, more

known as Inditex and it has over 3,100 stores in around 70 countries, where ZARA makes up around 1,020 of these stores in 68 countries (Strategic Direction, 2003). The whole group has approximately 32,000 employees, more than 200 designers, and a new stock with remarkable 20,000 garments, which includes women, men and children clothes. Belonging to the Inditex group, ZARA has retained a high level of synergy concerning organization and knowledge management (Saminather, 2007).

The first ZARA store was opened in 1975 in Spain, by Amancio Ortega Gaona. The ZARA “concept” first contained of look-a-like trend clothes with low-price. This resulted in a success and more ZARA stores were opened in Spain. However, design and production process needed long lead-times, often six months between the design of a garment and delivery to retailers, which limited manufactures and distributors. Due to this a new business-model was developed in 1984. The new business-model, with short lead-times reduced its design to distribution process to just 10 to 15 days (Strategic Direction, 2003). The firm developed its own in-house team designers, which made clothing based on popular fashion at the same time as producing the firm’s own design. Because of this and the fact that ZARA coordinates all ZARA’s activities from its headquarters in La Curona in Spain, enables ZARA to respond to the consumers’ demand of the latest trends and offer fresh designs at ZARA stores twice a week during the year (Saminather, 2007). This can be seen as an astonishing strategy in a time when “outsourcing” is the hottest term in the industry (Pettersson, 2004).

ZARA’s ability to create control during the production process is a crucial feature that differentiates ZARA from competitors. New technology also gave rise to the best production possibilities, warehouse procedures and stock count systems that were set up in all stores. All this enabled ZARA to keep inventories low (*Strategic Direction*, 2003).

ZARA as a whole, from operational procedures, performance measures to its office layout, is designed to make information move as effortlessly as possible. This is possible only when there are no unnecessary layers of bureaucracy which there is not at ZARA. Since ZARA has a very fast response to fashion, social blunders do not become financial burdens or hurt its profits. For example if one or two

unpopular items are produced they can easily be replaced by a new trend, since ZARA produces in small quantities and information from store managers to La Curona is reported back every day (Saminather, 2007).

The success of ZARA made it possible for Inditex to expand internationally in the end of the 1980s. By 2000 you can find ZARA stores in several European countries, for example Sweden, Portugal, Germany, France and the Netherlands, and also in the US, Argentina and Venezuela. ZARA produces around 11,000 items, which are a lot of items compared to many competitors, which produce around 2,000-4,000 items. The “ZARA concept” was developed in order for consumers to feel value, ZARA works by satisfying the consumers need by shortening the clothing lifecycle. Designs can only remain on the shop floor within a ZARA store in three to four weeks. Therefore, the consumers will visit ZARA often. Thus, this key factor becomes an important factor in ZARA’s process to succeed. When consumers enter a ZARA store they will probably buy the clothes that they like straight away because they know that the clothes will not be there next week. This competitive advantage is hard for competitors to copy because it is not a technical tool (*ibid.*).

The control over the entire production process, from design to sale has made ZARA a vertically integrated retailer. It is an ongoing development where ZARA is constantly analyzing its value chain and trying to attain control on as many sections as possible. As mentioned above, ZARA differs from most apparel retailers because ZARA controls almost every step of its supply chain. 50% of the products ZARA sells are produced in-house, 26% in other countries in Europe and 24% in Asian countries. The most high fashion clothes are made by ZARA in firm-owned factories in Spain, while low-cost basic clothes are outsourced to Asian countries (Strategic Direction, 2003).

ZARA’s marketing business-model and tactic are not similar to its competitors. ZARA does not have a formalized marketing department therefore, an advertising budget does not exist. The firm believe that the stores’ own magic and mass media are enough to draw consumers to the stores. Instead the focus lies on production and logistic business-models. ZARA’s success arises from its unique market orientation which can be describes as inter-functional and coordinated activities that are rooted within the organization. Thus, the successful implementation of the market

orientation business-model has competitors and foremost consumers in the centre and this will govern the work of the organization. In contrast, firms use market orientation as an internal firm orientation and the important issues are marketing department and the use of marketing tools. Therefore, the implementation of the ZARA market orientation business-model creates a competitive advantage for ZARA (*ibid.*).

5.3 Summary

H&M and ZARA are two successful firms in the clothing industry. The Swedish H&M has been a leading firm for several years but it seems like H&M are confronted with tough competition from the Spanish clothing firm ZARA. In 2006, ZARA succeeded to take over H&M's role as Europe's biggest fashion retailer.

The clothing industry has changed over the past years and today clothes are a mass consumption market and the low price fashion producers H&M and ZARA explore these possibilities in different ways. The secret of ZARA's success is that it has developed its own road and ignores the traditional fashion. Some argue that in the future ZARA will be forced to apply a business-model that is more similar to H&M's.

Chapter 6

Empirical Method

The research strategy followed by the time horizon, sample selection, operationalization, validity, reliability, generalisability, and problems associated with access are presented in this chapter.

6.1 Research Strategy

There are three types of research strategies; descriptive, exploratory and explanatory. When using the descriptive research strategy the purpose is to describe a phenomenon. This can be used as an extension of both explanatory and exploratory research strategies (Saunders *et al.*, 2007). To create a clear picture of H&M and ZARA literature was explored to get a good understanding of their business-models. According to Saunders's an exploratory research strategy is when your goal is to find out what is happening and to create new insight into the phenomenon.

This dissertation is an explanatory study, given that the relationship between different variables is examined (Saunders *et al.*, 2007). Our research questions and objectives guided us when choosing research strategy. The different characteristics within H&M and ZARA were defined to explain the choice of business-model. The purpose was to understand "why" H&M and ZARA choose different business-models, for this reason a case study is the most applicable strategy for our dissertation. It is stated in the dissertation that the existing theories do not fully explain H&M's and ZARA's choice of business-models. With a case study of the clothing industry focusing on H&M and ZARA the existing theories is challenged. The theories cannot alone explain why H&M and ZARA that are competing in the same industry under similar conditions chose different business-models.

As the business-models of the clothing industry are a very broad scope to study, the case study⁵ of H&M and ZARA gave a rich understanding to why the two firms compete differently. It enabled a deeper analysis than theories did. With

⁵ A detailed intensive study of a unit, such as a corporation or a corporate division that stresses factors contribution to its success or failure.

information gathered from the case study we were able to systematically analysis what affects the choice of business-model within the clothing industry.

6.2 Time Horizon

There are two types of time horizons; longitudinal studies and cross-sectional studies.

The first one can be seen as a “diary” perspective. It can be used when studying development and change. The second one is described as a “snapshot” study. It can be used when studying a particular phenomenon or to explain how different variables are related in different organizations, at a particular time (Saunders *et al.*, 2007). This dissertation has a cross-sectional time horizon, since interviews were conducted over a short period of time.

6.3 Sample Selection

It was not possible to study the entire clothing industry due to time and finance limitations. The EU clothing was chosen because both H&M’s and ZARA’s domestic countries are members of the EU. Further, H&M and ZARA were chosen because both are extreme cases of outsourcing respectively in-house production within the clothing industry.

When conducting the interviews persons were contacted that have relations to H&M and ZARA. To get as broad perspective as possible employees at H&M and independent persons with valuable insights in H&M and ZARA were interviewed. The persons that were interviewed are the following: the IR-responsible, H&M, Stockholm; stock-analyst at Swedbank, Stockholm; and stock-analyst at Handelsbanken, Stockholm. The IR-responsible and the analysts were selected after reading reports of H&M and ZARA.

6.4 Operationalization

The interviews were conducted in order to collect valid and reliable data. By doing semi-structured interviews it was partly possible to confirm the characteristics of why H&M and ZARA have different business-models. Before conducting the

interviews a list of questions was prepared and depending on the flow of the conversation, more unprepared questions were asked. The interviews were conducted by telephone and not recorded, instead key words were written down and immediately after the key words were analysed.

6.5 Validity

Validity observes the casual relationship between two variables. Validity also shows if the findings are what they appear to be. A high level of validity is a relevant sign for a good research (Saunders *et al.*, 2007). There is always a risk that the questions are misunderstood by the interviewed person or that the question is asked in a misleading way. The questions used in our interviews must be relevant for our investigation. Our main purpose with the interviews was to confirm that the Complementarities were relevant and applicable to H&M's and ZARA's business-models.

6.6 Reliability

Reliability refers to the extent to which data collection techniques or analysis procedures will yield consistent findings (Saunders *et al.*, 2007). If other researches will do it in the same way they are likely to find the same characteristics as we did when investigating H&M and ZARA. However, it is not likely to get exactly the same information from the interviews. Considering that it was difficult to get interviews we were forced to do the interviews on those days that each participant had time. The answers from the interview could have been affected by the different time of the week when they were conducted. There is also a threat to the reliability considering that one of H&M's employees was interviewed. The employee's loyalty against its own firm can have affected the answers. By ensuring the participants anonymity we hoped to decrease this threat to reliability. Since the interviews were made by different group members our individual way of asking question can also be seen as a threat to reliability. Well structured interviews can minimize the threat to reliability, therefore the questions were asked in the same order. However, depending on the flow of the conversation further unprepared questions were asked.

6.7 Generalisability

Generalisability is whether our findings are equally applicable to other research setting, such as other firms (Saunders *et al.*, 2007). Since this is a case study, that only concentrates on two firms it would not be reasonable to state that the research has a high level of generalisability. H&M and ZARA are seen as two extremes within the clothing industry and their way of managing their business-models are not easy for competitors to copy. The task is not to produce Complementarities that is generalisable to all firms in the clothing industry. We partly explain why H&M and ZARA choose their individual business-models and what makes them successful. However, the method of creating Complementarities can be used by other firms within the clothing industry. Firms can apply their specific characteristics and create own set of Complementarities.

6.8 Problem Associated with Access

Considering that H&M and ZARA are two well known firms within the clothing industry, both are often contacted by students that are doing researches. The two firms were not willing to cooperate, due to the time and resources required to participate. The interview questions are touching a sensitive subject for H&M and ZARA, since the firms do not want to evaluate any competitors' strategy. Considering this problem information was gathered in other ways. Stock-analysts were contacted to get their opinions of the firms. The stock-analysts information was a good complement since they generally were less biased, than people working within H&M and ZARA. The interviews had to be conducted by telephone, since both firms head-offices are located far away. The time limitation was a considerable fact to why we did not meet the interviewed people face-to face.

Chapter 7

Analysis

The theories' connection to H&M's and ZARA's business-models are presented. Further, the EU clothing industry and the interviews are presented through the development of Complementarities.

7.1 Introduction

The characteristics of H&M and ZARA will be clearer with an explanation of how the firms are combined with theory. However, an application of the theories on H&M and ZARA show that the theories are not enough to explain the choice of H&M's and ZARA's business-models.

7.1.1 The Characteristics

To be able to combine the two firms with the theories, the main characteristics within each theory have been identified.

- Internalization Characteristics

H&M's characteristic of "need to develop own internal markets" is set at the low level in figure 7.1 below. H&M's need to develop its own internal market, due to market impediments, is smaller compared to ZARA. H&M focuses on exploring the overall market, for example H&M chooses the supplier that best fit the production process at a certain time. ZARA's characteristic of "need to develop own internal markets" is set at the high level. ZARA concentrates on its internal market by controlling almost every step of its production process. When ZARA expanded into foreign countries, it still maintains its internal aspect and does not follow the typical clothing industry trend as H&M does. ZARA has been able to develop a tighter internal market than H&M.

Both H&M's and ZARA's characteristic of "need to overcome market imperfections" are set at the high level in figure 7.1. Both H&M and ZARA use a high level of protection of know-how. However, they have different know-how to protect. H&M and ZARA also have different amounts of know-how to protect

because of their different business-models. H&M protects many parts of its know-how, for example purchasing, design, and marketing by keeping those activities internally. At the same time H&M has dispatched production from its own value-chain and rely on other peoples' know-how for that and in turn do not need to protect it. ZARA's in-house business-model enables overcoming the market imperfection better. ZARA protects all know-how within the firm from design to ready item since it keeps all production in-house.

Both firms are investing in other countries and are therefore at the high level in the characteristic "Foreign Direct Investment" in figure 7.1. H&M has production offices in the countries where it produces and is using wholly-owned subsidiaries for expanding and exploring new markets. Where there are extreme market imperfections wholly-owned subsidiaries are not a possible solution and franchising is then used to continue the expansion. ZARA also invest in new stores in foreign countries, however, a bit more aggressively than H&M. ZARA has also been faced with extreme market imperfections and thus answered to them by using other entry modes.

H&M and ZARA show that they have different needs to develop internal markets because they focus on different activities. The firms are also exposed to market imperfections in the form of protection of know-how that they deal with differently. This shows that the Internalization Theory fails to explain the two firm's choice of business-models. The theory generalizes ways to overcome market imperfections, generalizations that neither fit an outsourcing firm or an in-house firm completely at the same time.

- Transaction Cost Characteristics

Due to tight internal control within ZARA transaction costs, the costs of planning, adapting and monitoring tasks can be reduced. The governance structure within H&M is not as concentrated as within ZARA, therefore transactions costs become higher. However, H&M's choice to outsource production and work with specific suppliers have reduced parts of transactions.

Both H&M's and ZARA's characteristic of "asset specificity" are set at the high level in figure 7.1. H&M has been placed at a high level concerning the possibility to move assets without giving up value. On the one hand, H&M possesses competitive advantage due to its employees and their special knowledge. Therefore, H&M can move employees where they fit best within the firm, without reducing value in any department. The employees' individual knowledge is placed where it creates most value for H&M. On the other hand, it is difficult for H&M to accomplish the tight control and attain the necessary and the valuable information concerning the firm's transferable assets. Furthermore, ZARA is also set at the high level, however, it should be seen a bit higher than H&M because ZARA owns more of its value chain. This gives ZARA better opportunities to reorganize and control activities without decreasing the profitability when organizing assets. Therefore, the in-house business-model compared to the outsourcing business-model facilitates for the firm when moving assets, due to the tighter control within ZARA.

H&M's characteristic of "exposed to primary and secondary uncertainty" is set at the high level in figure 7.1. H&M is more likely to be exposed to primary and secondary uncertainty, therefore, H&M is set at the high level. Since H&M uses independent suppliers it is more vulnerable due to the fact that H&M's suppliers can withhold important information. For example, H&M upholds that it did not have knowledge about child labour in Cambodia, which the firm has been accused of. If that is the truth, H&M's suppliers have not been honest in the business settlement. ZARA's characteristic of "exposed to primary and secondary uncertainty" is set at the low level in figure 7.1. ZARA decreases the risk of uncertainty since it works more internally and due to this it has more insight in the value-chain. Once again, the tighter control obtained with the in-house business-model reduces the risks when the firm is exposed to primary and secondary uncertainty.

Both H&M's and ZARA's characteristic of "high frequency of transactions" are set at the high level in figure 7.1. Both H&M and ZARA have a high frequency of transactions but in different ways. H&M's transactions have a more scattered construction. The transactions occur between several independent contributors that are working together in the production process, therefore, the level of ongoing

transactions must be high. ZARA has also a high level of transactions but they occur more frequently with the same suppliers. The frequency and how systematically transactions occur depend on the chosen business-model. The scattered construction within H&M derives from the outsourcing business-model. Meanwhile, ZARA uses the same suppliers and this originates from the in-house business-model.

According to the Transaction Cost Analysis H&M should use more vertical integration, since its transactions consist of asset specificity, high uncertainty and frequency. ZARA on the other hand follows the Transaction Cost Analysis and reduce its transaction costs by vertically integrating its firm. However, the Transaction Cost Analysis also says that managing an activity within the firm must be lower than through the market and lower than with any other firm to be advantageous. Thus, if H&M has found a way to manage activities with the lowest transaction costs through outsourcing it is aligned with the Transaction Cost Analysis. To develop this further, Hollensen says that firms have to look at the feasible set, lowest production costs and transaction costs. For H&M that is an outsourcing business-model and for ZARA that is an in-house business model. Since, H&M and ZARA compete in the same environment facing the same transaction costs they should according to the Transaction Cost Analysis use the same business-model. This is why Transaction Cost Analysis in the end fails to explain the two firms.

- *Resource-based Characteristics*

Both H&M's and ZARA's characteristic of "combining key resources efficiently" are set at the high level in figure 7.1. Both H&M and ZARA are two successful firms in the clothing industry. H&M and ZARA have key resources that are specific for their individual business-models. By combining the resources in the most suitable way the firms are able to create competitive advantages. If the key resources create value for the business-model and are hard to duplicate they create a sustained competitive advantage. Both through outsource and in-house production an efficient and successful result can be achieved.

An example of a key resource at H&M is an efficient way of using independent suppliers. By using the best suppliers H&M can offer high fashion clothes with good quality and low price. The outsourcing business-model makes H&M able to keep low prices at the same time as it offer high fashion.

An example of a key resource at ZARA is its short lead-times. Through short lead-times ZARA is able to create what is called instant fashion. Further, this makes consumers experience value because the clothes have a shorter lifecycle. The in-house business-model makes it possible to achieve shorter lead-times.

Both H&M's and ZARA's characteristic of "possible sustained competitive advantage" are set at the high level in figure 7.1. According to the Resource Based-View a firm need key resources to become successful. However, as can be seen in the example of ZARA's and H&M's key resources is often followed by another key resource. For example in H&M that is outsourcing production, independent suppliers and lower costs. For example in ZARA that is in-house production, short lead-time and consumer satisfaction. Thus, one key resource is stronger when combined with other key resources. Key resources would therefore give a better understanding to H&M's and ZARA's business-model if the resources that are key resources would complement each other and the business-model. Through this H&M and ZARA could have the possibility to a sustained competitive advantage.

7.1.2 An Application of Theories on H&M and ZARA

The application of theories on H&M and ZARA show that only the theories are not enough to explain H&M's and ZARA's choice of business-model. However, the figure below presents meaningful facts of how the theories contribute with some significant information.

| <i>Characteristics</i> | Low | High |
|--|----------------|-------------------------|
| <i>Internalization Theory</i> | | |
| -Need to overcome market imperfection | H&M | ZARA |
| - Need to develop own internal markets to protect know-how | | H&M and ZARA |
| - Foreign direct investment | | H&M and ZARA |
| <i>Transaction Cost Analysis</i> | | H&M and ZARA |
| - Assets specificity | | |
| - Exposed to primary and secondary uncertainty | ZARA | H&M |
| - High frequency of transaction | | H&M and ZARA |
| <i>Resource-based View</i> | | |
| - Combining key resources efficiently | | H&M and ZARA |
| - Possible sustained competitive advantage | | H&M and ZARA |

Figure 7.1 chart of the characteristics

7.1.3 Summary

H&M's need to develop own internal markets are lower compared to ZARA. H&M focuses on exploring the overall market, when ZARA focuses on its internal market by controlling the production process. H&M and ZARA focus differently to overcome market imperfections to protect know-how. The Internalization Theory cannot explain why firms competing in the same industry chose different business-models.

Both H&M and ZARA have a high level of asset specificity. H&M can move assets without giving up productive value, but it does not possess tight control. ZARA's opportunities to move assets without giving up productive value facilitates due to its

tight control of its value chain. H&M is more possible to be exposed to primary and secondary uncertainty compared to ZARA. ZARA is able to reduce uncertainty due to more insight in its value chain. Frequencies of transactions are high in both H&M and ZARA. H&M's transactions are scattered, and ZARA's transactions are gathered. Since H&M and ZARA compete in the same environment under similar transaction costs features it would be suitable for the firms to apply the same business-model. Therefore, the Transaction Cost Analysis fails to explain why H&M and ZARA chose different business-models

H&M and ZARA try to combine their specific key resources efficiently. Both firms have the desire to reach sustained competitive advantage. The key resources must work together to create value to the business-model. Further, the key resources must be hard to duplicate to become sustained competitive advantage. Barney's idea of key resources is the theory that gives the most suitable explanation of why H&M and ZARA choose different business-model.

Through theories a clear explanation of why H&M and ZARA choose different business-model could not be reached. The explanation includes which characteristics within the theories that are of main importance when examine what features H&M and ZARA must have to become successful. Explanations of why similar firms as H&M and ZARA, competing in the same industry, chose such different business-models, could not be found. Only the key resources could contribute with significant information. Further analyses were made and the Complementarities for H&M and ZARA were created, with the key resources as a foundation. Through this a better understanding of the problem of why similar firms choose different business-models has been reached.

7.2 The Complementarities

7.2.1 Introduction

Our chosen theories cannot alone explain H&M's and ZARA's different choice of business-models. The EU clothing industry in general and features from Barney's idea of key resources do a better job in explaining why H&M's and ZARA's chose different business-models. Based on the clothing industry and the country specific

information we found several characteristics in H&M and ZARA that can explain the two business-models of the firms. Several of these characteristics were confirmed through interviews. John Roberts's idea of Complementarity has been expanded and instead of investigating the mass production versus modern lean manufacturing an attempt to investigate the business-models of the EU clothing industry was made. The successes of the two firms are built on several characteristics that can be called Complementarities to their business-models. If doing more of one characteristic increases the returns to doing more of the other characteristic, then these two characteristics are seen as a Complementarity. One characteristic can affect another characteristic creating a Complementarity to the business-model of the firm. At the same time several characteristics are Complementarity if each of them is a complement for each of the others. These characteristics are important in their own way but grow stronger in combination with each other. The variety of characteristics that can be Complementarities to the business-models can be very broad. Examining all possible characteristics would mean taking a too big step away from the main subject. Therefore, only those characteristics that create the core Complementarities to the business-models of H&M and ZARA are mentioned.

7.2.2 H&M's Complementarities

1. Home Society and Firm Founder

H&M is a good example of a Swedish clothing firm since it has kept many of the value adding activities and outsourced the production of items. Early in H&M's growth the amount of foreign produced clothes was big. H&M considered it to be too risky to rely on only domestic producers. In Sweden at this time there was a rareness of potential domestic suppliers and those suppliers that were active was not willing to cooperate with a small newcomer as H&M. Also these domestic suppliers demanded that big orders were made during a few months every year. H&M started as early as the 1960's to spread its purchases more even throughout the year instead of buying once every season. H&M had therefore not much choice than to look abroad to find partners and to start international production. The way of spreading the risk to many suppliers, the unwillingness of domestic suppliers to cooperate and the old-fashion suppliers' demand were the starting off feature for H&M's choice of

business-model. It is clear that the characteristic, the home society Sweden and its domestic suppliers have affected H&M's choice to outsource production. A second characteristic is the firm founder, Erling Persson, he was an industry breaker. His ideas about low-price clothes and ability to purchase clothes several times a year was new to the industry. The lower price Persson demanded and the more times a year he wanted to make orders the more reluctant the domestic suppliers were to work with him. The home society Sweden and the ideas of H&M's founder, Persson, are a Complementarity to H&M's business-model. The home society is an explanatory factor for the founder's idea; by acknowledging the importance of the characteristic the home society increases the understanding for the other characteristic the founder's idea.

Through interviews with a stock-analyst the two characteristics, the home society and the firm founder, were confirmed. The analyst from Swedbank points out the importance of the domestic market and how the firms' foundation often is built upon the domestic situation. The rareness of suppliers affected H&M's choice of business-model. The analyst from Handelsbanken also confirmed the firm's domestic country as an important characteristic for the creation of business-model, some countries are more suitable for outsourcing than others. The analyst from Swedbank also points out the value of a strong ownership and the founder's role when creating a business-model. Persson's revolutionary way of thinking is essential for H&M's business-model.

2. Independent Foreign Suppliers, Outsourcing, International Production and Flexibility

Common in the EU clothing industry is to outsource lower value-added activities to low-wage countries. Lower value-added activities are often labour- and capital intense and material consuming, for example knitting and finishing. Due to the Swedish home society and the demands from the firm's founder H&M turned to work with independent foreign suppliers. These suppliers could answer and produce to the more regularly orders and lower price demands. To be worth working with these suppliers it is not enough for them to offer a low price, the supplier must also be able to meet the need for fashion, quality, quickness, and punctuality. However, the biggest challenge for the suppliers is to meet all H&M's demands and at the

same time do it in a way that is coherent to H&M's Code of Conduct⁶. With independent suppliers H&M can pressure suppliers to always be best-in-class. If a supplier is lacking behind the cost of changing to another supplier is not highly significant for H&M. It is easier to provoke competition among external suppliers than it is when the suppliers are inside the firm. Furthermore, replacing an insufficient outside supplier is also easier than getting rid of an internal supplier that is lacking behind. By using independent foreign suppliers H&M naturally turned in direction of outsourcing and international production. Independent suppliers, international production are characteristics that create a Complementarity to H&M's business-model. Further this Complementarity in a complement to flexibility. The characteristic independent suppliers increases the level of outsourcing which increases the returns to increase the characteristic international production, thus these three characteristics are a Complementarity that increases the characteristic flexibility.

Both the analyst from Swedbank and the IR-responsible at H&M confirm that both outsourcing and the use of independent suppliers are important characteristics in H&M's business-model. Through outsourcing H&M is able to follow the clothing industry development. The Swedbank analyst declares that China might not be the place for the cheapest production in 30 years from now. H&M's use of independent suppliers' gives H&M the possibilities to quickly relocate its production to the place where even cheaper production can occur. The analyst from Handelsbanken highlights H&M's ability to constantly looking for the most attractive suppliers as an advantage. H&M's outsourcing business-models reviles the opportunity to be flexible in its production process.

3. Core Activities

Common for EU clothing firms that outsource is the ability to focus on the core activities of the firm. All resources and knowledge can be focused on one or a few activities. The EU clothing firms are often focusing on the activities that are adding most value to their products. Core activities are kept internally and non-core

⁶ H&M's Code of Conduct is based on ILO conventions and the UN convention on the Rights of the Child. It includes For example, compliance with local labour law, statutory pay and working hours, and a ban on child labour.

activities are outsourced. Quality, design, innovation and technology are activities that often are kept internally. They are core activities that contribute a lot to the firms' successes.

For H&M the core activities are to create fashion and quality at the best price. During the interview the IR-responsible the creation of fashion and quality at best price was stated as one of H&M's main competitive advantages. First H&M achieves that by working with more than 100 designers that are constantly working on creating the latest fashion. Second H&M has more than 100 buyers that are structuring the range planning. Finally H&M has local production offices that are handling the practical things such as being in contact with the local suppliers, buying at the right price and assuring that the item is produced and delivered at the right time. According to the IR-responsible at H&M the pressure on short lead-times can trigger increased prices and reduced quality. By using independent foreign suppliers H&M can concentrate on the above activities that produce most value for it and outsource the rest. The characteristics independent foreign suppliers and outsourcing facilitates focusing on core activities and are a Complementarity to H&M's business-model. When increasing the characteristic independent suppliers, the return to increasing the characteristic outsourcing becomes valuable for H&M. Further, by increasing these characteristics, the returns to increasing the characteristic focus on core activities becomes more viable.

From the interview with the analyst from Swedbank H&M's focus on only one trademark was highlighted as an advantage for H&M. When concentrating on one trademark H&M is able to probe their brand to its full extension. Also, the IR-responsible at H&M explains that H&M focuses only on one concept and that is H&M; that includes women, men and children, although, recently H&M launched a new brand, COS - Collection of style.

4. Size and Bargain Power

H&M is a successful MNE much due to its focus on core activities. H&M is active in 28 countries with 1,345 stores and a turnover of SEK 80,081 million. The size of H&M is partly due to its establishment around the world and its high profitability. The size of H&M is bringing strength to its bargain power and a huge advantage

when working with suppliers. Often H&M does not have to search for potential suppliers instead the suppliers contact H&M. Therefore, the characteristic size and the characteristic bargain power are a Complementarity to H&M's business-model. An increase in size will be followed by an increase in bargain power, in other words doing more of one characteristic increase the desire to do more of the other characteristic.

H&M's size as a vital characteristic was verified by Swedbank's analyst who describes how H&M's size gives H&M an advantage over smaller firms. The size gives H&M the opportunity to put pressure on the suppliers to lower the purchasing price. Small firms do not possess this ability, since the firms are not able to purchase in the same quantities as H&M.

5. Control by Culture

H&M is focusing on core activities, however, it still manage to remain control over the whole value chain. H&M's culture is influencing the whole organization. The culture and the spirit of H&M are based on the belief that common sense, responsibility, and innovation are the guidelines for H&M's co-operators. The culture is a tool that is guiding employees and partners. When performing an outsourcing process the tight control of the different phases is most of the time lost. Therefore, a strong culture complements the control and they are important characteristic to H&M's business-model. According to the IR-responsible at H&M the culture facilitates the control and therefore they are important characteristics in the business-model. Considering this, the characteristics strong culture and control create a Complementarity to outsourcing with total control which is what H&M's business-model consists of. A strong culture provides H&M with the ability to manage issues that it is responsible for even if H&M does not own the certain production process. To maintain the balance of the Complementarity, when outsourcing more H&M needs to add further control so that the outsourced activity is managed the way H&M wants, that in turn favours an even stronger culture.

6. Logistics and IT

The IR-responsible declares the importance of IT support to be able to control the logistic-chain as efficient as possible. By using independent suppliers H&M is dependent on many departments to do their jobs accurately. The technological development is an essential characteristic that is a must for outsourcing business-models to work efficiently. For H&M the technological development is the second characteristic that enables H&M to remain control over the widely spread suppliers. Many firms that choose to outsource are for example only producers or label suppliers. To enable full control H&M uses an efficient logistic chain as well as a developed IT support. H&M has put a lot of effort into finding a logistic-chain that is working with the needs of the firm. The logistics has a crucial meaning for outsourcing firms. H&M is also continuously developing its IT system. The more widespread the different activities are the more advanced the logistics and technology need to be to coordinate and connect the different participants. The participants all need to do work that is coherent with the finished product. The analyst at Handelsbanken discusses how a well developed IT and the technological development can provide the firm with advantages. For example the transportation costs are reduced and different departments can easier communicate which makes the logistic-chain more efficient. The characteristics of a well working logistic chain as well as the characteristic advanced technology such as IT is therefore a Complementarity to H&M's business-model. Since a high level of control of its independent suppliers is desirable for H&M's business-model it is worth bearing the cost of a well developed logistic chain and an advanced technology.

7. Closeness to the Market

It is a fact that most firms that want to sell abroad cannot simply export all its products from its domestic country firms need to produce there as well. Independent foreign suppliers and international production create an advantage by placing firms closer to its markets. By outsourcing H&M gets in contact with new markets, achieve control over consumers' requirements and most importantly the transportation time is decreased. The characteristic independent foreign suppliers and the characteristic international production support the characteristic closeness to the market. Thus, the independent foreign suppliers, international production and closeness to the market are a Complementarity to H&M's business-model. To achieve closeness to the market an increase in both independent suppliers and

international production is necessary. The analyst at Swedbank points out that the closeness to the market gives H&M an advantage, because H&M then quickly can respond to consumers changing needs.

8. Lower Prices and Lower Costs

The clothing industry is a labour intense industry that has been faced with the pressure for lowering production costs to be able to lower prices. There has also been heightened pressure to offer higher quality, become more flexible and shorter production line. By using independent foreign suppliers and producing internationally firms are able to lower its costs and prices. Having the production in low-wage labour countries reduces labour costs immensely. Most of the jobs in the clothing industry are rather low-skilled therefore it is easy to teach new workers in the developing countries how to perform the work. And once the productivity has reached a high level the real benefit of low-wages arise. Low-wage labour can be found in Central and Eastern Europe, North Africa, South America and some areas of the Far East. Today big parts of Asia and mainly China are able to make almost any type clothing product at any quality level at a competitive price. Also rents, energy prices, taxes and environmental standards are all cheaper in developing countries. As mentioned above by Swedbank's analyst, H&M and its outsourcing business-models has an advantage because H&M can move production if low-wage labour relocates and can be found in other countries.

Further, tradability factors like delivery times, logistic costs, tariff barriers, governmental and trade incentives are affecting the choice of production location. The end of the trade protection, with tariffs and quotas, exports from developing countries to developed countries are faster, easier and cheaper. In this industry it seems as competing requires moving industries to countries with cheap labour. H&M is a good example of a clothing firm that has broken off manufacturing from the rest of the business and outsourced it to low-wage countries. H&M is today producing in both Eastern Europe and Asia. Further, to keep the characteristic low costs as low as possible H&M is purchasing in large volumes, using few middle men, purchasing the right item from the right market and having cost awareness in all leads. H&M answers to the pressures in higher quality, flexibility and shorter

production lines by having a deep and wide knowledge within design, fashion and textiles and having an effective distribution. Lower costs are built on the many complements mentioned above and are one of the most desirable characteristics for outsourcing firms. Lowering costs enables lowering prices on items. The demand has a tendency to increase when price decrease. Thus, the costs of outsourcing and lowering costs are covered by more sales. Therefore lower costs and outsourcing are a Complementarity to H&M's business-model.

9. Flexible Capital

Firms that are operating in financially unstable countries are adding larger risks and higher costs of capital to the firm. This makes firms more unwilling to go into long-term and heavy investments facilities with physical presence. This is also common when plants are costly to build. In an environment such as this, firms use outsourcing to reduce costs and capital. H&M is active in Eastern Europe as well as Asia and H&M has lowered its costs and capital by not owning any factories and instead outsourced activities to independent foreign suppliers. This has made H&M able to have more flexible capital than many other competing firms'. The characteristics no self-owned factories enable more flexible capital to arise. Flexible capital and outsourcing are a Complementarity to H&M's business-model. The cost of having no self-owned factories, for example less control is worthwhile only if the desired level of flexible capital is high.

10. Expansion Strategy

With the flexible capital that H&M has it can finance almost any expansion. H&M's characteristic expansion strategy complements outsourcing and is therefore a Complementarity to H&M's business-model. When increasing expansion it is crucial for H&M to increase flexible capital, the returns for H&M will then be bigger. H&M's objective is to grow in control and sustain the profit. According to the IR-responsible at H&M the firm expands by opening several stores within a few countries. By doing that H&M creates consumer awareness at the same time that it create a big demand. H&M answers to the big demand by buying in big volumes which in turn lower costs. The characteristic flexible capital is a further complement to H&M's expansion strategy, and together they are a Complementarity to H&M's business-model. Further, the analyst at Swedbank states that H&M has a powerful

impact on its surroundings due to its well established trademark. Therefore, we believe that H&M achieves the powerful impact by focusing on several stores within few countries. The analyst at Handelsbanken declares how H&M's persistency to succeed in the countries it enters creates a stronger trademark for the firm. H&M has been confronted with impediments when entering new countries. For example it took twenty years before England became a successful market and in the US H&M's success has been going up and down. With continued investments H&M has been able to turn around the negative development and made the US a successful market again.

7.2.3 Summary

The more restraint the home society is on independent suppliers and the higher the demands are from the founder of the firm the more the firm will be forced to look abroad for alternative suppliers. In an early stage H&M faced a limit amount of possible domestic suppliers in Sweden. Erling Persson had higher demands on order cycles and prices than the domestic suppliers were used to. Therefore, H&M turned to independent foreign suppliers.

The more H&M uses independent suppliers naturally the level of international production will rise. Also, the more activities H&M outsource internationally the more flexible it will become and the more it can focus on its core activities. By focusing on what H&M does best, its core activities, and efficiently outsource the rest of the activities H&M has become an attractive MNE to work with. The larger, the better established and more profitable H&M is the more bargain power it will have towards suppliers and also the more attractive it will be for suppliers to operate with the firm.

Even though H&M focuses on core activities it coordinates and keeps control over the whole value chain and its independent foreign suppliers. To achieve this H&M has a strong culture that pervades the organization. H&M is also using a well working logistic chain and a well developed IT. Thus, the more independent suppliers that are used and the more widespread the independent suppliers are, the stronger the culture and the more advanced and developed the logistic chain and IT need to be. Further by using independent suppliers, producing internationally and

having a well working logistics and IT H&M has the ability to get closer to its markets. Further, catch the latest trends, easier get around trade impediments and achieve higher direct-sales within the country.

However, using independent suppliers, producing internationally and focusing on core activities decrease H&M costs. The more low-wage labour used, the large volumes that are bought, the fewer middle men used and the better fit between ordered items and the supplier the lower the costs will be. By this H&M is able to charge lower prices

Finally, by taking advantage of the outsourcing opportunities above, as well as not owning any factories and having a high turnover H&M has achieved high flexible capital. High flexible capital makes H&M able to finance expansion completely with own funds.

Thus, success for H&M was founded in the home society and by the firm founder, developed through independent foreign suppliers and international production, focused on core activities; bring fashion and quality at the best price, managed through culture, logistics and IT, achieved through bargain power, low costs focus and will continue to grow and expand through high flexible capital, control and sustained profit.

7.2.4 Complementarities within H&M's Business-model

Below an illustration of characteristics created into Complementarities is presented to give an overview of the attempt to create Complementarities.

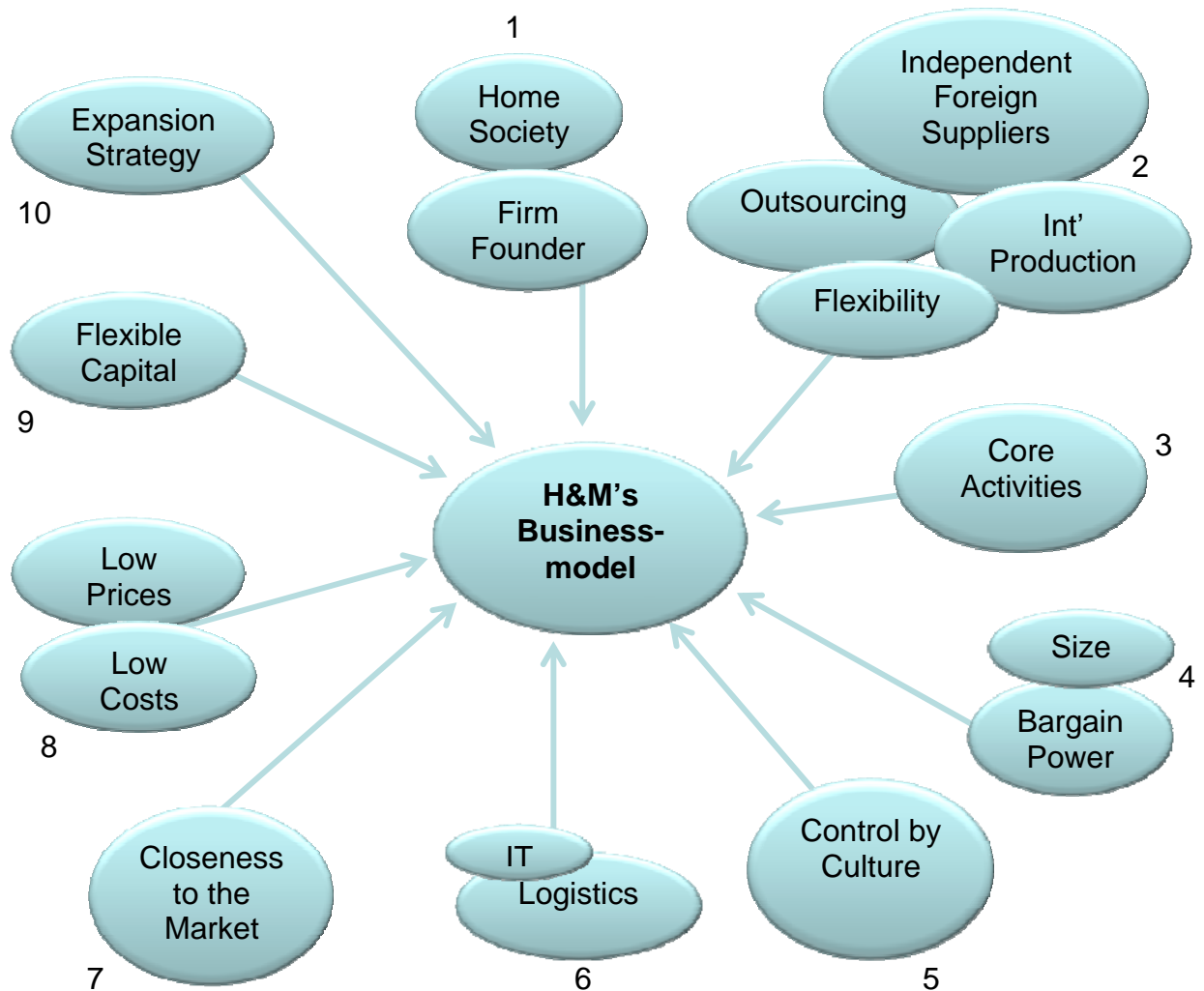


Figure 7.2 an illustration of H&M's Complementarities

7.2.5 ZARA's Complementarities

1. Closed Governance Structure, Internal Trade and In-house production

The governance structure of the home society has a critical shaping and conditioning impact on the legacy of the firm. Common for countries with dictatorships is that it creates strong internal trade since it has a more limited relationship to other countries. Due to long tradition with internal trade, even firms founded shortly after the transition from dictatorship, still remains almost the same

industry structure. ZARA was founded during a time when Spain had just shifted from dictatorship to democracy. By keeping more than half of its production process in-house ZARA is a typical Spanish firm. Much of the closed governance structure lives on in the Spanish culture. Even today Spanish firms value the domestic production when expanding abroad. Firms that have succeeded with strong internal trade value the country's own produced goods. These firms have developed specialized goods, relations, and employees. This has resulted in the efficiency to perform an in-house business-model where the internal trade has affected the choices and focuses of the firm. However, the analyst at Handelsbanken explains that an in-house business-model consist of advantages and disadvantages. A few years ago ZARA outsourced about 15% and today about 30%. The main advantage with an in-house business-model is that ZARA achieves shorter lead-times and increased ability to respond fast. Further the analyst declares that ZARA will not increase its outsourcing to get closer to its market but ZARA will outsource to decrease its costs.

The clothing industry demands for higher quality, become more flexible, and accomplish shorter production line, and ZARA has been able to answer to these demands by vertical integration. A closed governance structure rarely leaves other options for firms than high internal trade and in Spain this has often led to in-house operating firms. The characteristics closed governance structure, internal trade and in-house are characteristics that create a Complementarity to ZARA's business-model. The high level of dictatorship that could be found before in Spain leads to increasing the level of internal trade. Internal trade and in-house were optimal in the Spanish environment with its governance structure and that made ZARA build a firm that fit the environment.

The analyst at Handelsbanken points out how the firm's country of origin affects the firm's business-model. Spain's domestic opportunities make an in-house business-model beneficial for ZARA. For example, there are similarities between ZARA and the Italian brand Benetton's business-model, this is a result from the similarities between the Italian and the Spanish clothing industry. The analyst from Swedbank also highlights the influence that the domestic market has on the formation of the firm's business-model. Spain's former dictatorship is considered to

be a high relevant characteristic of ZARA's creation of business-model. The high level of internal trade in Spain is a legacy that remains from the time of dictatorship.

2. Control and flexibility

By having a more internal governance structure firms are able to have a higher level of control throughout its organization. ZARA possesses high control through vertical integration. Due to the high level of control ZARA has access to and knowledge about what is going on in the different departments. By owning almost all phases ZARA can decide itself when, what and how to produce its items. Control is a characteristic of ZARA's business-model. Derived from internal transactions and high control in ZARA's business-model, high level of flexibility arises in the organization. ZARA's flexibility can be seen as its ability to produce new trends and make changes faster than it would be able to if using outside suppliers. The analyst at Handelsbanken confirms that the control and flexibility that ZARA possesses give ZARA an advantage to correct "fashion mistakes" in an efficient way. By having a high level of flexibility ZARA is able to go from idea to finished item in four to five weeks and modify its existing items in only two weeks. In ZARA's business-model the characteristic high control facilitates the characteristic flexibility. Control and flexibility could be seen as complements and create a Complementarity to ZARA's business-model. If an increase in flexibility would mean ability to produce new trends and make changes faster than higher level of control is attractive.

The analyst at Handelsbanken confirms how ZARA's business-model creates more control and flexibility. Compared to other firms ZARA has a more integrated organisation where the communication can flow easier. ZARA's quickness, fashion and ability to follow trends are a crucial feature that gives ZARA a competitive advantage

3. Variety and Small Batches

Flexibility can be seen as for example how fast a firm can change from producing one item to another, and/or what it actually costs to change from producing one item to another. ZARA produces approximately 11,000 garments a year which is

much more than the average clothing producer. This means that ZARA has a wide item variety. Also, ZARA produces in small batches. Thus, in ZARA's business-model the characteristic flexibility is a complement to the characteristics variety and small batches. Normally when producing a wider item range, sales for the individual item will decrease due to more item choices for the consumer. That in turn will lead to more unsold items from every individual item. However, that problem is solved if a wider variety is compensated by producing less numbers of every item. For the wide variety model to work there has to be shorter production runs and more often changes from producing one item to another. Finally, that leads back to a high level of flexibility which is needed to be able to change production quicker and cheaper. Thus, when ZARA is offering a wider set of alternative items it will also benefit to have a more flexible production phase. This is because the flexible production system lowers the costs of a broader item range.

4. Firm Founder, Short Lead-times, Efficient Distribution Model and Internal Communication Systems

Amancio Ortega, ZARA's founder had early on in ZARA's growth a desire to speed up the whole process from design to ready item. Common for many leading firms are cutting edge business ideas. These leading firms break the industry standards by challenging the industry trend. Ortega did exactly this. He broke the industry trend in the clothing industry by challenging the lead-times. In the beginning of the 1980's the lead-time for clothing items was up to six months. This limited manufacturer and distributors and forced them to predict consumer tastes ahead of time. The cutting edge ideas of Ortega and shorter lead-times are two characteristics of ZARA's business-model.

It is also common for clothing firms that have kept its domestic production to invest heavily in modernizing technologies. The clothing industry is an industry where the basic technology changes rather slowly. New machines for dying and knitting will require a high capital outlay but how to run the new machine will differ little from the previous. Therefore, the former workforce or any workforce will be able to run it without any major guidance. Instead, the technology that firms can and have upgraded to which enables them compete more efficiently are the distribution model and internal communication systems. The model and systems simplify the

contact between different departments and reduce the lead-times remarkably by modernizing for example warehouse and inventory procedures.

The characteristics the firm founder Ortega's innovation led to shorter lead-times because of the design and development of the characteristics efficient distribution model and internal communication systems. Therefore the cutting edge business idea is a complement to a more efficient distribution model and internal communication system, since it lead to shortening lead times. That makes the four characteristics a Complementarity to ZARA's business-model.

The efficient distribution model and the internal communication system that ZARA has is what make it able to respond instantly to shifts in newly emerging consumer trends. The analyst at Swedbank and the analyst at Handelsbanken confirm the advantage of ZARA's short lead-times, which makes it possible for ZARA to modify its items extremely late in the production process.

However, the analyst at Handelsbanken highlights that ZARA's short lead-times definitely contribute to an advantage. On the other hand firms that outsource have today the ability to achieve almost as short lead-times as in-house based firms, For example because the transportation times have decreased remarkably. Therefore ZARA's advantage can be seen as unstable in a long-perspective.

5. Fast Response to Consumer Demand and Team of Designers

ZARA has a market orientation that especially puts the consumer in the centre. The short lead-times the distribution model creates enable ZARA to put the consumer in the very centre. Further, this has made ZARA able to go from design to finished item in 10 to 15 days, an achievement that Ortega calls instant fashion. A complement to the characteristics distribution system and short lead times are ZARA's own in-house team of designers. According the analyst at Handelsbanken ZARA has more than 200 designers, which is more than the double compared to H&M. The designers can shift the work load from a few designers as well as create the firms own design. With the in-house team of designers ZARA is able to respond almost immediately to new and upcoming consumer trends as well as to the firm's

own consumers. The fast responsiveness involves both new trends and changes to existing designs. This fast response to consumer trends makes consumer return more often to the stores to see the latest items that has arrived. That also makes misunderstandings of consumer demand less of financial burdens since unsold items are replaced with new trends often. The team of designers is a characteristic to ZARA's business-model and it is a complement to the characteristic efficient distribution model. The team of designers and the distribution model create a Complementarity to ZARA's business-model. A faster response to consumer demand requires more in-house designers and a faster distribution model. The cost of answering to the consumers demands are only worthwhile bearing the cost for if the consumers return often to the stores and purchase often.

6. High Skilled Workforce, Productivity, Quality and Higher Prices

A complement to domestic in-house production is high skilled workforce. Domestic labour might have higher wages however labour costs are only a small part of the total costs. What matters are unit labour costs in other words the value of labour needed to produce a unit of a product or service. A high skilled workforce is developed from experience and long time employment which is a result of in-house business-models and more common in developed countries than developing countries. A high skilled workforce produces more efficiently when using the latest equipment. This reduces mistakes and there is less waste of valuable materials when high skilled workers quickly repair the fault in machineries. Productivity is higher with a high skilled workforce and also the product quality is generally found at a high level. Since unit labour costs take productivity into account, high wages in developed countries can be covered by low unit labour costs. In Spain wages do not differ much from the rest of EU thus ZARA is using a rather high-wage workforce. The high-wages are compensated by higher productivity items with higher quality. Higher quality items make consumers less price sensitive and make it possible to charge a higher price. ZARA charges a higher price than many of its competitors for example H&M.

The analyst at Handelsbanken clarifies that ZARA's way of arranging its items in the stores creates an illusions that ZARA's items are more exclusive than they really are. Therefore, the consumers are prepared to pay a higher price. The items

are not as exclusive as it seems due to material. For example nylon, which affects the items negatively.

The domestic high skilled workforce gives ZARA the opportunity to compete within the intense fashion industry. The characteristic a high skilled workforce and the characteristic productivity are complements to the characteristic higher price. They are a Complementarity to ZARA's business-model if higher productivity makes quality better thus enables ZARA to charge a higher price without losing sales. Further an improvement in productivity eventually renders the ability to charge a higher price which will bear the costs of an improvement in the high-skilled workforce.

The analyst at Handelsbanken states that ZARA has a higher price on its items on foreign markets. Items can cost as much as 100% more on the foreign market compared to the domestic price. The higher price is related too the higher production costs and the higher labour costs that occur in the domestic country, Spain. The profit from a higher price on ZARA's items compensates the higher production and labour costs.

7.2.6 Summary

The more closed the country's governance structure is the more internal trade will arise due to impediments to buy and sell abroad. Common for Spanish firm's are to organize their activities in-house, which ZARA is a typical example of. ZARA owns its production phases and, therefore, has a higher control over the production process. The more production phases that are owned in-house, the more control the firm has. ZARA has a high control over its production process and is very flexible since the firm has an overview of all the phases. ZARA's flexibility is also shown in its short production runs which enable them to produce a high variety of items. Thus, the more flexible, the shorter production runs and the higher variety of items in small batches.

ZARA is also flexible due to its well developed distribution model and internal communication/computer system. These two systems were developed on Ortega's,

the founder's, request. He had a new way of thinking that revolutionized the distribution model of ZARA and shortened its lead-times remarkably. The more well developed this model and these systems get, the faster the firm can answer to the market demand. This is also facilitated by a team of designers that constantly create after the latest demands. To answer to the market demand and take advantage of the modernized technology there need to be a high level of high skilled workforce to comprehend and create from the data coming from the advanced systems. A high skilled workforce produces more efficiently and items with higher quality than a low-skilled labour would do. Finally, higher quality items can be sold at a higher price.

Thus, ZARA's success was founded in the Spanish home society by Ortega, is built on vertical integration to achieve control and flexibility, and managed through a developed distribution model and internal/communication systems. ZARA focuses on a variety of items in small batches and will remain competitive through high skilled workforce which boosts productivity.

7.2.7 Complementarities within ZARA's Business-model

Below an illustration of characteristics created into Complementarities is presented to give an overview of the attempt to create Complementarities.

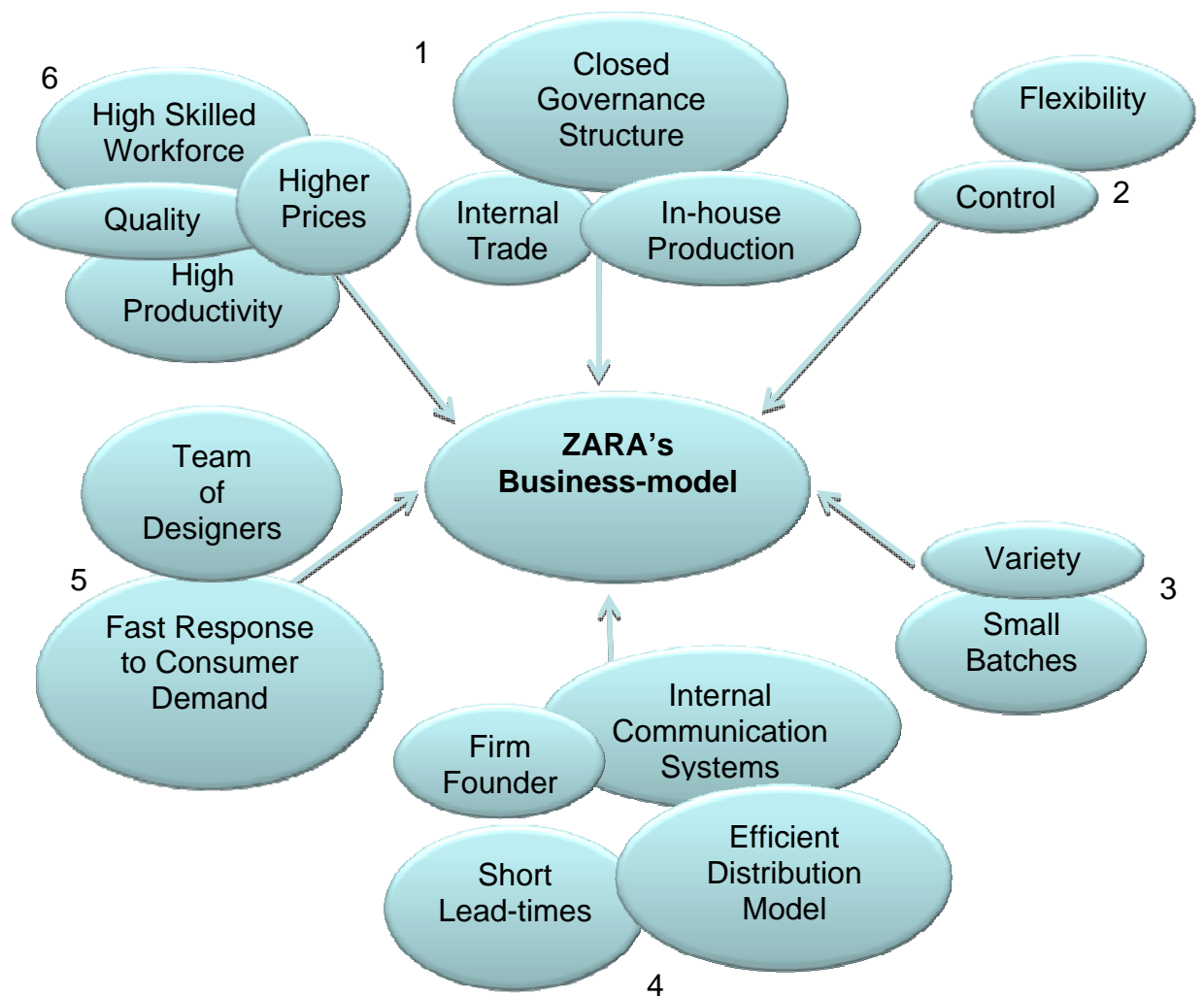


Figure 7.3 an illustration of ZARA's Complementarities

Chapter 8

Conclusion

In this chapter a summary of the dissertation is presented, followed by modification, methodological criticism, practical implication and future research.

8.1 Summary of Dissertation

The clothing industry is considered to be a highly competitive environment where many firms choose to outsource non-core operations. Outsourcing enables firms to concentrate on their core activities; thereby firms minimize their costs and become as efficient as possible. At the same time other firms concentrate on gaining control over as many sections as possible by analysing their value chain. Firms that obtain control over the total production process have an in-house based business-model, which facilitates short lead-times.

Many theories are discussing characteristics that can have value when explaining different business-models for clothing firms. The Internalization Theory explains the ability to overcome market imperfections, such as the free flow of products and sale of know-how, through FDI. The Transaction Cost Analysis explains that due to costs of transactions it can be better to manage an activity inside the firm, in other words vertical integration. Characteristics that affect the level of vertical integration are asset specificity, high level of uncertainty and how frequently the transactions are. The Resource-based View highlights the importance of identifying key resources to maximize returns and create sustainable competitive advantage. John Roberts's Concept of Complementarity is used to analyze the environment and competitive advantage from the characteristics found in the firm. These characteristics should complement each other, doing more of one is only beneficial if doing more of the other characteristic.

According to the theories, firms that are competing in the same industry should implement similar business-models. Therefore, these theories fail to explain firms that choose different business-models when they are active in the same environment, facing the same market imperfection and are exposed to the same

transaction costs. The development in the EU clothing industry has more valuable information about clothing firms' different business-models. Heightened competitive pressure has made many EU clothing firms focus on lowering costs by relocating production facilities. Firms have outsourced labour intense activities to low-wage countries. At the same time others have restructured and modernized their technological technology to create higher value clothing and keep production in the domestic country. Two extremes in the clothing industry when it comes to their business-models are H&M and ZARA.

Based on traditional theories, the general EU clothing industry, and facts about H&M and ZARA, we created a set of Complementarities to explain why the two firms choose different business-models. The purpose with this dissertation and the Complementarities is to understand why H&M and ZARA chose different business-models. The Concept of Complementarity was a way to extend the Resource-based View. It is possible that key resources can be developed through the Concept of Complementarity by identifying key resources that are complements to each other and to the firms' business model. Further these Complementarities explain why firms choose different business-models depending on which complementary characteristics they have.

To confirm the Complementarities, interviews were conducted with the IR-responsible at H&M and two stock analysts. The interviews were structured in a semi-structured way. Most of the Complementarities were confirmed by at least one of the interviewed people.

The confirmed complementarities to H&M's business-model are; home society and firm founder, Independent foreign suppliers, outsourcing, international production and flexibility, core activities, size and bargain power, control by culture, logistics and IT, closeness to the market, lower costs and lower price and expansion strategy. The Complementarity that was not confirmed was flexible capital, however, this characteristic may still contribute to the understanding of H&M's business-model.

The complementarities to ZARA's business-model are; closed governance structure, internal trade and in-house production, control and flexibility, firm

founder, short lead-times, distribution model and internal communication systems, fast response to consumer demand, high skilled workforce, productivity and higher price. The Complementarity that was not confirmed was variety and small batches. However, these characteristics may still contribute to the understanding of ZARA's business-model.

This case study shows that the Complementarities that were found in H&M and ZARA to some extent have an explanatory meaning for their choice of business-models. The characteristics found in H&M are more related to an outsourcing business-model. Therefore, H&M's choice of an outsourcing business-model is the most beneficial and efficient business-model for H&M. At the same time the characteristics that were found in ZARA are more related to an in-house business-model. Therefore, ZARA's business-model is the most beneficial and efficient business-model for ZARA. The two firms' individual characteristics creating Complementarities increase the understanding of why H&M and ZARA are using such different business-models, even though they are active in the same industry.

8.2 Modification

When creating the Complementarities possible explanatory characteristics existing in H&M and ZARA were valued. To make the presentation of Complementarities clear only core Complementarities were highlighted, in other words, Complementarities that have a direct connection to H&M's and ZARA's business-models. All characteristics that can affect the core Complementarities could not be included in our analysis. However, the importance of all the characteristics that affect the Complementarities within H&M's and ZARA's business-models have not been disregarded.

8.3 Methodological Criticism

The dissertation is based on a case study. Through the interviews the Complementarities were partly confirmed. Nonetheless, the time for analysis from when the interviews were conducted to the hand in date was rather narrow. This was to a certain degree a deliberate choice since we did not possess the required knowledge to conduct the interviews earlier.

If the interviews were conducted face-to-face instead of by telephone the result could have had a different outcome. The interviews could have presented another outcome if the interviewed persons had received the questions in advance. They would have had the chance to prepare and we could possibly have received more elaborated answers.

8.4 Practical Implication

Considering that the dissertation is focusing on H&M and ZARA. This fact creates a limitation of the dissertation practical implication. The dissertation is most meaningful for H&M and ZARA. It would not be right to say that other clothing firms can use our Complementarities without doing modifications that suits their particular business-models. However, clothing firms can use our findings to evaluate their individual characteristics which the firm's business-models are built on. Given that H&M and ZARA are successful firms within the clothing industry other firms could benchmark⁷ themselves against them. It is possible that firms can find a way to learn from H&M and ZARA and copy their way of combining key resources in a more efficient way. Also, other firms can use our method of turning key resources into Complementarities. By mastering that, firms will make the most efficient use of their key resources. Since the key resources will all complement each other and strengthen the firm's business-model.

8.5 Future Research

The Complementarities were created to investigate the underlying facts to why H&M and ZARA have chosen different business-models. It seemed as if the Complementarities could explain H&M's and ZARA's business-models. However, the Complementarities can be further expanded. Possible future research areas are:

- It would be interesting to conduct more interviews with people working at, for example the purchasing department, the marketing department and the distribution

⁷ **Benchmarking** is a process used in management and particularly strategic management, in which organizations evaluate various aspects of their processes in relation to best practice.

department at H&M and ZARA. This would bring further reliability to the Complementarities.

- Since the Complementarities are only based on two firms it would be interesting to add other existing firms considered as extremes in the clothing industry, for example Benetton, American Apparel and GAP.
- Considering that experts doubt that ZARA is going to be able to produce domestically when expanding internationally. On the other hand H&M's business-model can reach obstacles considering its low-wage labour locations, which can result in loss of intellectual property, reputation and specialized skills. Therefore, in the future it will be interesting to examine which business-model that is most durable in a long perspective for clothing firms.

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Appendix 1A

We are writing out bachelor dissertation about H&M's and ZARA's business-models. Our focus is to find components that explain the two firms' choice of business-models and what differ the two companies. Therefore, we want to ask You about Your opinions regarding H&M and ZARA.

- What do You see as H&M's competitive strengths?
- What would You say is H&M's competitive strength in comparison with ZARA?
- What do You consider being ZARA's competitive strengths?
- Do You consider H&M to have an outsourcing production strategy?
- What do You consider to be the reason for H&M's outsourcing strategy?
- Do You think that H&M will come to consider more in-house, why/why not?

Appendix 1B

Vi skriver våran kandidatuppsats om H&Ms och ZARAs affärsmodeller. Vår fokus är att hitta de komponenter som särskiljer de två företagens affärsmodeller och vad som lett dem fram till deras framgång. Därför vill vi fråga er om eran åsikt gällande H&M och ZARA.

- Vad ser Ni som H&Ms konkurrens mässiga styrka?
- Vad ser Ni som H&Ms konkurrensmässiga styrka gentemot ZARA?
- Vad anser Ni vara ZARAs konkurrensmässiga styrka?
- Anser Ni att H&M har en outsourcing strategi?
- Vad anser Ni vara anledningen till H&Ms outsourcing strategi?
- Tror Ni att H&M kan komma att producera mer in-house, varför/varför inte?

Appendix 2A

We are writing out bachelor dissertation about H&M's and ZARA's business-models. Our focus is to find components that explain the two firms' choice of business-models and what differ the two companies. Therefore, we want to ask You about Your opinions regarding H&M and ZARA.

- What do You see as ZARA's competitive strengths?
- What would You say is ZARA's competitive strength in comparison with H&M?
- What do You consider being H&M's competitive strengths?
- Do You consider ZARA to have an in-house production strategy?
- What do You consider to be the reason for ZARA's in-house strategy?
- Do You think that ZARA will come to consider more outsourcing, why/why not?
- Do You think that outsourcing will be necessary if ZARA is going to be able to continue to expand?

Appendix 2B

Vi skriver vår kandidatuppsats om H&Ms och ZARAs affärsmodeller. Vår fokus är att hitta de komponenter som särskiljer de två företagens affärsmodeller och vad som lett dem fram till deras framgång. Därför vill vi fråga er om eran åsikt gällande H&M och ZARA.

- Vad ser Ni som ZARAs konkurrensmässiga styrka?
- Vad ser Ni som ZARAs konkurrensmässiga styrka gentemot H&M?
- Vad anser Ni vara H&M konkurrensmässiga styrka?
- Anser Ni att ZARA har en in-house strategi?
- Vad anser Ni vara anledningen till ZARAs in-house strategi?
- Tror Ni att ZARA kan komma att outsourca mer, varför/varför inte?
 - Tror ni att mer outsourcing kommer att vara tvunget om ZARA ska ha möjlighet att fortsätta expandera?

Appendix 3

Intervju med analytiker på Swedbank, 071119.

- Vad ser Ni som H&Ms konkurrensmässiga styrka?

H&Ms storlek är en mycket avgörande konkurrens fördel. Tack vare H&Ms storlek får deras marknadsföring en bra genomslags kraft och de kan även förhandla fram bra inköspriser.

- Anser Ni att H&M är ett outsourcing företag?

H&M och ZARA kan ses som två extremer i klädesindustrin. H&M är i grunden ett outsourcing företag medan ZARA kan klassificeras som ett in-house företag. Det är genom outsourcing som H&M har lyckats bli framgångsrika framförallt genom deras sätt att matcha ledtider och inköpskvantitet.

- Vad skulle Ni säga är H&Ms fördelar gentemot ZARA?

Att definiera H&M stryka gentemot ZARA är inte helt lätt. H&M har en viktig styrka i sitt starka varumärke. H&M har även en fördel i att de har färre varumärken än ZARA och kan därför "pusha" sitt varumärke till en högre grad, trots att de nu börjat lansera COS. En annan fördel för H&M är att de har en större del av sin försäljning utanför den inhemska marknaden än vad ZARA har. På grund av detta kan man säga att H&M kommit längre i den internationella etableringen. En fördel som finns i de båda företagen är deras starka huvudägare. H&M har en längre historik att luta sig mot och en stark ägarebild.

- Vad anser Ni vara ZARAs konkurrens mässiga styrkor?

Zara stryka gentemot H&M är framförallt deras korta ledtider som de kan uppnå genom att de äger större delen av sina fabriker. ZARA har även ett försprång

gentemot H&M när det gäller lanseringen av ZARA-Home. H&M försöker även ta sig in på heminredningsmarkanden men har blivit försenade.

- Hur kommer det sig att H&M fokuserat på outsourcing?

Att H&M valt en outsourcing baserad business-model beror mycket på att de vill vara flexibla. H&M vill hela tiden kunna producera där kostnaderna är minst. Det har skett en förflyttning av produktions ställen genom tiden, från början tillverkades en stor del av kläderna i Sverige, sen flyttades produktionen ut till Europa och numera tillverks det mesta i Kina. Om 30 år är det inte säkert att Kina är det land med lägsta produktions kostnader. I det läget är det lätt för H&M att förflytta sin produktion tack vare att de har den största delen av produktionen outsourcad.

- Tror Ni att H&M skulle överväga att producera mer in-house, varför/varför inte?

H&M kommer inte att övergå till en mer in-house baserad strategi. De har hittat en strategi som verkar hållbar i framtiden. Däremot kan ZARA tvingas övergå till en mer outsourcing strategi om det ska kunna fortsätta expandera internationellt. I längden kommer det bli alltför kostsamt för ZARA att transportera varor från Spanien till deras butiker ute i världen.

- Tror Ni att Sverige och Spaniens historiska utveckling har påverkat H&Ms och ZARAs val av business-model?

Detta kan vara en av nyckelfaktorerna till att de två företagen kommit in på så olika spår, eftersom företagen formas till stor del av hur deras inhemska markand ser ut.

Appendix 4

Intervju med IR-ansvarige på H&M, 071115

- Vad ser Ni vara H&Ms konkurrensmässiga styrka?

H&M konkurrensmässiga styrka är framförallt de tre komponenterna som deras affärskoncept bygger på, ”mode och kvalitet till bästa pris”. Dessa tre komponenter måste balanseras mot varandra. Till exempel handlar det om att kunna lägga ut en order vid rätt tidpunkt. Det finns en avvägning mellan korta ledtider, pris, kvalitet och tid då förkortade ledtider kan leda till sämre kvalitet och ett högre pris.

H&Ms fokus på outsourcing, logistik, litet bundet kapital, lägre kostnader och internationell produktion är även de viktiga komponenterna till H&Ms affärsmodell. De kan dock inte ses i ett isolerat perspektiv utan i relation med varandra bidrar de till H&Ms framgång. H&Ms konkurrensmässiga styrka är även baserad på deras starka företags kultur och deras starka tillväxt.

- Anser Ni att H&M är ett outsourcing företag?

H&M outsourcar på ett annorlunda sätt än andra klädföretag. Många företag som outsourcar är t.ex. endast tillverkare eller varumärkes distributör. H&M å andra sidan har kontroll över hela distributionsledet från design till den färdiga varan, detta trots att de inte har några självägda fabriker. Ett ständigt uppgraderat IT system som integreras i företagets aktiviteter är viktigt för att kunna underlätta kommunikationen mellan de olika avdelningarna.

- Vad skulle Ni säga är H&Ms fördelar gentemot ZARA?

Vi på H&M pratar helst inte om konkurrerande företags likheter och skillnader då H&M ser dem själva som deras största konkurrent. H&M har dock ett lägre pris, högre lönsamhet och färre koncept än ZARA. Inditex som äger ZARA har

åta koncept förutom ZARA. H&M fokuserar endast på konceptet H&M för dam, herr och barn. H&M har dock på sistone lanserat ett nytt koncept, COS. H&M har även en annorlunda expansions strategi än ZARA. H&Ms strategi är att öppna många affärer i de länder som de går in i. På detta viset etablerar H&M sitt varumärke hos sina kunder och de har möjlighet att nå skalfördelar i produktionen. ZARA öppnar istället få affärer i många olika länder.

- Tror Ni att H&M skulle överväga att producera mer in-house, varför/varför inte?

H&M kommer att fortsätta arbeta på samma sätt som de gör idag, med självständiga leverantörer och outsourcing.

Appendix 5

Intervju med analytiker på Handelsbanken, 071127

- Vad ser Ni som ZARAs konkurrensmässiga styrka?

ZARAs snabbhet, mode och deras förmåga att följa trender är väldigt viktiga faktorer deras framgång. ZARA har utvecklat en värdefull fördel i deras sätt att använda butiken för att nå fram till sina kunder. De disponerar kläderna i butiken på ett sätt som gör att kläderna uppfattas som mer exklusiva än vad de egentligen är. ZARA har en del konstmaterial i sina varor som påverkar kvaliteten negativt. H&M och andra sidan har mer råvaror vilket gör att deras kvalitet kan anses som bättre.

ZARAs in-house strategi har lett till att de kan vara väldigt snabba. Ledtiderna kan kortas ner och kontrollen ökar. De kan lättare ha en överblick över hela sin organisation tack vare att de har en in-house strategi.

- Vad ser Ni som ZARAs konkurrensmässiga styrka gentemot H&M?

Båda företagen innehar en bra strategi som passar deras organisation. När man jämför de två företagen kan man se att de har väldigt olika expansions strategier. ZARA har inte en lika väl etablerade expansions strategi som H&M. ZARA expanderar gärna till så många länder som möjligt, vilket gör att de varit en aning snabbare än H&M. H&M och andra sidan har där emot lyckats etablera sig starkare i de länder de har gått in i. Där H&M har stött på motgångar har de fortsatt med större kraft att etablera sig och lyckats vända mindre framgångsrika marknader till succé. England kan ses som ett exempel där det tog 20 år innan marknaden blev lönsam för H&M. Liknande problem hade H&M i USA, där gick det väldigt bra till en början men framgången avtog efterhand. H&M har nu lyckats att vända det hela till sin fördel och idag är USA en väldigt viktig marknad. ZARA har ett 20-tal butiker i USA men kan ej anses som lika framgångsrika som konkurrenterna H&M.

ZARA som en del av Inditex har en förmåga till att våga ta fler risker än H&M. Till exempel var ZARA snabbare in på den ryska marknaden som är en väldigt sluten marknad. ZARA har även dubbelt så många designers som H&M vilket är en faktor till deras snabbhet.

- Vad anser Ni vara H&Ms konkurrensmässiga styrka?

H&M har en fördel i sina förmåga till att kunna vara flexibla och snabbt omlokalisera sina produktions ställen. De kan hela tiden pressa kostnaderna genom att ständigt söka fördelaktiga inköpspriser. Outsourcing har utvecklats på ett sätt som gör att det inte är tvunget att ha längre ledtider bara för att man outsourcar. Den tekniska utvecklingen har medfört att transportkostnaderna och tiderna kan minskas, avståndet mellan företagets marknader och produktionslandet är inte längre lika avgörande.

- Anser Ni att ZARA har en in-house strategi?

ZARA har definitivt en in-house strategi som både är till för och nackdel för företaget. ZARA har större produktionskostnader och lönekostnader. För endast några år sedan var andel som outsourcades 15% idag har siffran stigit till närmre 30%. Fördelen med in-house är att ZARA får kortare ledtider och därmed en ökad snabbhet.

- Vad anser Ni vara anledningen till ZARAs in-house strategi?

Faktumet att ZARA är ett spanskt företag är en av anledningarna till deras in-house strategi. Det inhemska landets utveckling påverkar företaget till en stor del. En likhet kan här ses med italienska Benetton som även de har en mer in-house baserad affärsmodell, till stor del på grund av ländernas inhemska möjligheter.

Snabbheten som finns i ZARA ger dem en fördel i att kunna korrigera modemissar på ett effektivt sätt. De korta ledtiderna är definitivt en fördel men

denna fördel har dock mer och mer försvunnit. Företag som ousourcar kan idag ha lika korta ledtider som ett in-house företag, transport tiderna har förkortas märkbart. ZARA har en väl utvecklad prisstrategi. Kläderna i en spansk ZARA butik kostar betydligt mindre än vad kläderna gör på deras utländska marknader. De högre priserna på utländska marknaderna är ett sätt för ZARA att kunna behålla sin inhemska produktion. Produktionskostanden och lönerna har stigit betydligt i Spanien, de högre klädespriserna är ett måste för att kunna ro runt en in-house baserad affärsmodell.

- Tror Ni att ZARA kan komma att outsourca mer, varför/varför inte?

ZARA kommer inte att öka sin outsourcing för att komma närmre sina marknader. Däremot kommer de outsourca mer för att kunna minska sina kostnader.