BUSINESS MODEL DESIGN AND ITS IMPORTANCE IN SUCCESSFUL STRATEGY – THE CASE OF ZARA

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1. Introduction

Developments in the global economy have changed the traditional balance between customer and supplier. New communications and computing technologies, and establishment of more open global trading regimes mean that customers have more choices and can easily articulate their expectations. The new environment requires that business re-define their value proposals to the both present and prospective customers. The new ways of „approaching" the customer must be worked on and new methods of value capturing form delivering products and services must be „engineered". These problems are embedde in the concept of the busines model.

Over the past few years „business models" have surged into management vocabulary. But, while it has become quite fashionable to discuss business models, there is still much confusion about what business models are and they can be used. In fact, business models can serve a positive and powerful role in corporate management.

A business model articulates the logic and provides the data and other evidence that demonstrates how a business creates and delivers value to customers. It also outlines the architecture of revenues, costs, and profits associated with the business enterprise delivering that value.

There are numerous definitions of „business model", but none appears generally accepted. This lack of consensus may be in part attributed to interest in the concept from a wide range of disciplines. The theoretical aspects of the problems still require conceptual work. Simultneously, numerous case studies from a variety of sectors should be analyzed to contribute the understanding the role played by business models.

The issues related to business models are essential to the fundamental problems of how to build a sustainable competitive advantage and create value. There are numerous examples - just to mention companies like Apple, Gilette, Starbucks or Zara – whose success is atributable to innovative business models. These companies introduced innovative business models. These models were going against previous „common sense" business logic, i.e. against accepted by almost all market players ways of managing operations within value chains or value creating networks.

2. Business model – some data supporting importance of the concept

The concept of business model has grown in popularity during the last two decades. In particular, it is linked to the development of Internet and e-business. Generally, the category of business model refers to the descriptions of relationships between elements, the existence of which is necessary for creation and delivery of value to the customers, and to an enterprise [1, p.210].

The anaysis od different business strategie leads to a conclusion that very often the innovative business model is a key factor behind market success of a company. According to some research, for every 11 out of 27 firms created during the past 25 years, and included in the Fortune 500 list of biggest companies, the market success can be attributed essentially to an innovative business model [2, p.52].

Apple is a very good example of a company, the market success of which is a direct consequence of introduction of an innovative business model. Apple launched in 2003 the iPod as well as a music store iTunes, revolutionizing the market for digital mobile music players.
The combination iPod/iTunes has become a market product worth 10 billion USD, generating about

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50% of Apple's revemues. During the period 2003 – 2007 the market value of Apple has grown from 1 billion USD to 150 billion USD.

Analyzing the success of Apple one should notice, that this firm was not a pioneer in the market for digital mobile music players.

Already in 1998 the company Diamond Multimedia has launched a digital mobile music player with a brand name Rio, and in 2000 a similar product called Cabo 64 was launched by Best Data company. Both products were of high quality and well designed. The advantage of Apple over competitors has been that the company offered to the customers much more than just a new technology and a nice design; the new technolgy has beeen packed ino an innovative business model.

The true innovation of Apple has been that the company made the proces of recording and listening to the music to be comfortable and „user friendly". Within the new business model the company packaged the hardware (iPod), the software (iTunes) and a reliable after-sale service. Buying of a relatively expensive iPod was giving access to cheap „buy opportunity" for music (iTunes). Apple's business model is sometimes referred to as well known Gillette's strategy but „in revers". Apple has offered cheap „razor blades" (very low margin for music bought in iTunes) so as to be able to charge high margins for „razors" (iPod). One can say that Apple has creatively redifined the concept of value, offering its customers a new concept of satisfying their needs.

3. Business model definition and interpretation

Although the term business model has been introduced to the literature only recently, the terms similar to it, from conceptual standpoint, were introduced earlier. In the first place, one should mention the concept of „dominant logic" introduced in 1986 by Bettis and Prahalad (Prahalad, Bettis; 1986). According to these authors, dominant logic is a set of heuristics, norms and principles which govern the behavior of managers. This logic helps managers to focus their activities on the search of new business opportunities as well as on good organization of their firms. As noted by numerous author, this logic – today usualy referred to as business model – defines the way in which the firm creates value and retains value [3, p.358].

During the last two decades numerous publications devoted to the problem of business models appeared in world literature of different areas: books and articles, reasearch results, consulting firms reports (e.g. Mahadevan, 2000; Timmers 2000; Boulton, Amit i Zott, 2001, 2007, 2008, 2010; Chesbrough i Rosenblom, 2002; Chesbrough, 2010; Shafer, Smith, Linder, 2005; Demil, Lecocq, 2010; Teece, 2010)

The definitions of business models are numerous and varied. Shafer and co-authors, after the analysis of twelve different definitions, conclude that one can distinguish four different components common to all definitions [4, p.202]:

- stategic choices;
- value nets;
- process of value creation;
- process of value appropriation.

Literature overview allows to identify a couple of different approaches to the concept of business model. First, one has to mention definitions making reference to the concept of value chain (e.g. Mahadevan, 2000; Timmers, 2000). Second, there are definitions reflecting the resource based view (RBV) of the company (e.g. Boulton and co-authors, 2000; Hamel, 2000). Third, the most recent approach where business model is interpreted as a design or business architecture, with a focus on the process of value creation.

For instance, according to Teece and co-authors business model defines the mechanisms of creating

and delivering value to customers [5, p.173]. It should also define financial as well as organizational architecture of a company.

Smith and co-authors define business model as a „configuration", which is used by the company to make startegic choices helping in the process of value creation and appropriation [6, p. 450].

Amit and Zott define business model as a „substance, structure and governance system of transactions designed to create value through exploitation of business opportunities" [7, p.511]. The substance of transactions refers to products and types of information which are subject to exchange, as well as to resources and skills required to perform transaction. The structure of transaction describes the companies which are parties to the transaction as well as relationships between them. Structure also describes the sequence of gtransactions and characteristics of mechanisms allowing for exchange. The governace of transaction accounts for the way in which the flow of information, resources and products is controlled by parties to the transaction.

Amit and Zott contend that business model can be treated as a specific template explaining how the firm operates its business, how it delivers value to stakeholders and how it coordinates markets for production inputs and outputs [8, p. 222].

It is worth highlighting that the concept of business model is different from the concept of strategy. Business model helps to analyze, test and justify strategic choices. As such it is a broader concept compared to strategy. One of the key differences between the two is that the starting point for business model development is the idea of creating value to the customers and the construction of the model is based on the process of delivering the value to customers. Strategies, on the other hand, tend to focus on the problem of creating value to shareholders and, as a consequence, focus more, as compared to business models, on financial aspects of the business. Strategies also highlight the importance of creating and maintaining competitive position, a necessary prerequisit of harnessing an economic rent and, hence, creating value.

4. Zara – an innovative business model

Zara is one of the brand names of Spanish group Inditex. Other brands owned by Indites include: Stradivarius, Pull & Bear, Massimo Dutti, Bershka, Oysho, Zara Home i Uterqüe. Zara is by far the best known and most important brand of the group. It generates approximately 80% of all the revenues. The group owns over 100 firms, positioned along all value chain, i.e. from design and R&D down to retail shops. Towards the end of 2011 Inditex had over five thousands of stores in more than eighty countries. Inditex annual turnover is around 12,5 billion euro. It is only in 2010 that Inditex opened new stores in 45 countries. In January of 2012 Zara opened its first shop in Peru. Since 2010 Zara is selling also online. On March 7th, 2012, Zara started to sell onlina also in Poland, which increased to seventeen the number of countries in which this form of purchase has been made available to customers. Over the years Inditex has been developing at a fast pace. Table 1 contains just a fraction of statistics that support this satement

Tab. 1. Selected Inditex performance data for the period 2009-2010

	2010	**2009**	**2010/2009**
Net sales	12 527	11 084	13%
Net profit	1 732	1 714	32%
Number of shops	5 044	4 607	9%
Number of employees	100 138	92 301	8%

The origins of Inditex can bre traced back to 1975 when Armando Ortega – currently the

owner of Inditex, and the seventh reachest man in the world accordin to Forbes Magazine – opened a little shop, called Zara, in La Coruna, Spain.

Ortega based his business on the idea of very tight control along all element of value chain. In his own words: „you need to have five fingers touching the factory and five touching the customer”.

This “dominant logic” has been underpinning Zara’s and, as a consequence, the whole Inditex group business operations until today.

The company is vertically integrated (unlike competitors, e.g. H&M, Gap, Benetton), owning design and R&D units, production facilities, distribution centers, transportation fleet and shops. To compare, the close competitors (H&M, Benetton, etc) do not own any production facilities or shops (all shops operate as franchises).

The strategy of vertical integration continues in January of 2012 the Inditex Group has decided to buy fashion retailer Massimo Dutti’s store networks, which operated until now under franchise agreements, in Belgium (22 stores) and Portugal (45 locations). Both deals are valued at a combined 103 million euro. This acquisition means that Inditex has taken direct management control of 100% of the shops of all Inditex retailers in Portugal and Belgium. Massimo Dutti’s international presence spans more than 560 stores in 51 countries.

Long before the new economy made catchwords of speed, customization, supply-chain management, and information sharing, Spanish clothing retailer Zara was carrying out a revolution of its own. By translating the latest trends into designs that are manufactured in less than 15 days — and delivering them to its stores twice a week – Zara pioneered a new kind of quick, custom-made retailing that has transformed the relatively low-profile retailer into a global powerhouse

Not only has Zara — the flagship store of private textile company Inditex — distinguished itself by tightly integrating its design and manufacturing systems, but its clothing has filled an untapped niche. "Armani at moderate prices," according to one Goldman Sachs analyst.

Zara derives its competitive advantage from an astute use of information and technology. All of its stores are electronically linked to the company's headquarters near La Coruna, a midsized city on the northwest coast of Spain.

Store managers monitor how merchandise is selling and transmit this information, as well as customer requests, to headquarters. Together with trend-spotters who travel the globe in search of new fashion, store managers make sure their designers have access to real-time information when deciding with the commercial team on the fabric, cut, and price points of a new garment.

In addition, Inditex's production system truly differentiates Zara from its competition.

While the Gap and H&M outsource most of their manufacturing, Zara produces 60% of its merchandise in-house. Fabric — which comes from places like Spain, the Far East, India, and Morocco — is cut and colored at the company's state-of-the-art factory. Then, using information gathered from stores, production managers decide how many garments to make and which stores will get them.

Finally the fabric is sent to local shops to be assembled before being shipped around the world. This combination of real-time information sharing and internalized production means that Zara can work with almost no stock and still have new designs in the store twice a week, as opposed to the six weeks that it traditionally takes most competitors.

The three principles upon which Zara’s business is built are summed up as follows:

1. Close the communication loop.

2. Stick to the rhythm across the entire supply chain.
3. Leverage your assets.

Zara's supply chain is organized to transfer both hard data and anecdotal information quickly and easily from shoppers to designers and production staff. It is also set up to track materials and products in real time every step of the way, including inventory on display in the stores.

The goal is to close the information loop between the end users and the upstream operations of design, procurement, production, and distribution as quickly as possible.

In Zara stores customers can always find new products, but they are in limited supply. Usually there are only a few items are on display even though the stores are spacious (the average size is around 1,000 square meters). Such a retail concept depends on the regular creation and rapid replenishment of small batches of new goods. Zara's designers create approximately 40,000 new designs annually, from which 10,000 are selected for production. The relentless introduction of new products in small quantities, ironically, reduces the usual costs associated with running out of any particular item. Being out of stock in one item helps to sell another. In fact, Zara has an informal policy of moving out unsold items after two or three weeks. This can be an expensive practice for a typical store, but since Zara stores receive small shipments and carry little inventory, the risks are small. Unsold items in Zara account for less than 10% of stock (compare with industry average of 17% to 20%).

Zara's customers visit its shops an average of 17 times a year (industry average is 4 shop visits annually). High traffic in the stores circumvents the need for advertising. Zara devotes just 0.3% of its sales on ads, whereas its rivals spent 3% to 4%.

Unlike majority of the companies in retail clothing industry, Zara keeps more than half of its production in-house.

The company intentionally leaves extra capacity in its factories. Rather than chase economies of scale, Zara manufactures and distributes products in small batches. Instead of relying on outside partners, the company manages all design, warehousing, distribution, and logistics functions itself.

Zara's managers reason that investment in capital assets increases the organization's overall flexibility. It normally operates its factories for only a single shift. These highly automated factories can operate extra hours if need be to meet seasonal unforeseen demands.

In distribution, allocation of resources such as space floor, layout, and equipment follows the same logic that Zara applies to its factories. Storing and shipping many of its pieces on racks, for instance, requires extra warehouse space and elaborate material-handling equipment. Having ample capacity in its first distribution center, Zara opened o new, 100 million EUR, 120,000-square-meter logistics center in Zaragoza.

The reason for this investment is thatZara's managers follow a fundamental rule of queing models, which holds that waiting time shoots up exponentially when capacity is tight and demand is variable. By tolerating lower capacity utilization in its factories and distribution centers, Zara can react to peak and unexpected demand faster than its rivals.

Thanks to the responsiveness of its factories and distribution centers, Zara has dramatically reduced its need for working capital. Because the company can sell its products just a few days after they're made, it can operate with negative working capital. The cash thus freed up helps to offset the investment in extra capacity.

5. Conclusions

Then survival and prosperity of all for-profit organizations is directly linked to their ability to

both create and capture value. Therefore, business models are applicable to all these. Business models provide a powerful way for executives to analyze and communicate their strategic choices. However, one should remember that the process of making strategic choices ad testing business models should be ongoing and iterative.

The innovative business model of Zara, going “against conventional wisdom” of the textile industry clearly deserves attention. Thanks to the responsiveness of its factories and distribution centers, Zara has dramatically reduced its need for working capital. Because the company can sell its products just a few days after they’re made, it can operate with negative working capital. The cash thus freed up helps to offset the investment in extra capacity.

The tacit knowledge accumulated over the decades of perfect implementation of “simple rules” has led Zara to the position of global leader in fast fashion business.

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Summary

The purpose of the article is to highlight the growing importance of the business model concept. The importance of the issue is linked to the changing balance between customer and supplier in the new economy and the consequent drive for new business concepts, structures, strategies and ways of managing the process of value creation. To help better understand business model concept this paper reviews the relevant literature, classifies the components of business models and illustrates the importance of business models using the case of Spanish retailer brand Zara. The resulting conclusion is that innovative business models, in particlur these going against „common sense“ business logic, may dramatically improve competitive position and financial standing of an enterprise.

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