

The INDITEX Group Case

The Inditex Group, self-considered world's largest fashion retailer, claims to be the precursor in integrating a model for sustainability committed to corporate social responsibility (CSR) practices in Spain. It has created an internal code of conduct that is advertised as the guide for its activities in manufacturing, distribution and sales worldwide. Inditex has been engaged in multilateral framework agreements, such as the United Nations Global Compact program¹, and the group releases an annual report with detailed information of its activities – needless to say that the corporate social responsibility component is accountable for a significant share of it. However, despite its attempts to build an image of a business highly social responsible, counterfactual evidence could lead one to argue that there are serious flaws in its corporate social responsible plan: Inditex has been involved in various scandals regarding non-compliance of labor standards that have been taking place in suppliers' plants located around the world.

The INDITEX Group



The group is composed by various subsidiaries that operate in different fields - such as retail, logistics, design and textile manufacturing; and Inditex hold eight business concepts: Zara, Pull&Bear, Massimo Dutti, Bershka, Stradivarius, Oysho, Zara Home and Uterque. These are stores with specific market focus in which Zara is the leading brand and responsible for over 64% of the group's annual revenue. According to

¹ The United Nations Global Compact is a strategic policy initiative for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labor, environment and anti-corruption. Source: <http://www.unglobalcompact.org/>. Accessed on January/2012.

Inditex's 2010 Annual Report, the group employs over one hundred thousand people and its revenue surpasses twelve millions of Euros per year. With over five thousand stores (Table 1) spread out around the world, the average turnover growth of Inditex is around 10% per year - in 2010 it reached 13%.

At 31 January 2011 the different Group formats have stores in 77 countries, as follows:

Number of stores			
	Company managed	Franchises	Total
SPAIN	1,888	37	1,925
REST OF EUROPE	1,882	204	2,086
AMERICA	325	70	395
REST OF THE WORLD	239	399	638
TOTAL	4,334	710	5,044

Table 1. Inditex's presence in the world.

The ZARA Concept

Zara is known in the apparel industry for its fast fashion philosophy. This fast fashion approach allows products to be available to consumers as they are emerging as a trend, reason it is often referred to as the quick response system. This requires a combination of components from the operational perspective as it follows:

- The production bulk should not be very large, at least the first one, since there is a high level of uncertainty about how consumers will behave towards a specific trend. Once the first bulk production arrives at the retail stores and individual behavior can be better assessed, then the supply can be more accurately matched with demand.

LAUNCH DATE	1975
CONTRIBUTION TO TOTAL SALES	64.6%
NUMBER OF STORES AT YEAR END (INCLUDES 205 ZARA KIDS STORES)	1,723
NET STORE OPENINGS DURING THE YEAR	131
COUNTRIES	77
NEW COUNTRIES IN 2010	3

- Production and distribution lead times can be twelve times faster than in the regular fashion approach. Whereas the non fast fashion business work in their products based on season, which means that garments are well thought through and, once approved for production, it can take up to six months between design and availability at the retail store; in the quick response system, these lead time can be reduced to two weeks in order to meet the arising demand for the new fad.

That said, the unquestionably Zara's successful business model is based on this operational perspective. Furthermore, although Inditex has its majority of its suppliers in Asia (Table 2), Zara keeps its production mainly in the European Union, coordination that helps to reduce the lead time between factory and retail stores, given that Europe holds the main market for Zara, Spain is the largest one, despite the growing presence of Zara in the other regions of the world (Table 3).

Given the nature of Zara's operations, it has a crucial partnership to deal with: the suppliers. The industry in which Zara runs its business is incontestably labor intensive - feature that by default increases the level of complexity in the relationship between the company and its suppliers, in terms of labor standards practices. Also, the fact that Zara is designed to be a fast fashion type of business makes the company highly dependent on these suppliers in order to be able to work in maximum efficiency as per its framework. Therefore, the corporate social responsibility element to be explored in this paper is focused on this controversial collaboration, in which whereas the suppliers are strategic for Zara's business, they are also an element that can put at stake Zara's

success in case of non-compliance standards, such as the recent labor scandals that Zara has been charged of involvement in Brazil.

Number of active manufacturers (*)	
Region	Suppliers 31/1/2011
AFRICA	118
AMERICA	63
ASIA	599
NON-EU EUROPE	99
EUROPEAN UNION	458
TOTAL	1,337

(*) Suppliers producing more than 20,000 units a year for Inditex.

Table 2. Inditex's amount of suppliers.

	Sales by format (*)	No. of stores at 2010 year end	Net openings 2010	New markets 2010	Countries with presence
ZARA	8,088	1,723 (**)	131	3	77

Table 3. Zara's figures.

Labor Scandals: the recent case in Brazil

It is not the first time that Inditex, more specifically the brand Zara, has been involved in labor scandals; many cases have taken place in suppliers facilities in Asia, which forced the group to address this issue. However, the case that took place in Brazil gained major visibility: it had high circulation on television and it was one of the main discussion topics among social media users throughout the world.

In August 2011, after a two-month investigation, the Brazilian Minister of Labor and Employment (MTE) discovered a garment factory in São Paulo that was operating illicitly and exploiting slavery work. Immigrants from Bolivia, brought to Brazil with the promise of a better life, were found working in a small room that did not have acceptable conditions for such. Aside to poor lightening, the plant did not have the

capacity to hold 16 workers, it was badly maintained in terms of sanitary standards and workers had to improvise chairs with pieces of pillows and other materials so they would have a place to sit. According to authorities, the workers were not only working in that facility, but also living there; some said that there were children involved, but this information was not confirmed by the Brazilian government. These Bolivian workers were subjected to work sixteen hours per day and receive a wage that was a lot below the minimum established by the Brazilian law, which at the time used to run around USD 340 per month, and on top of that living and trip costs were being deducted from their salaries.

This illegal factory was operating under the command of AHA – the main manufacturer for Zara in Brazil. The facility was not only producing garments for Zara, but according to the MTE, still the bulk production with Zara tags found in the facility by far represented the highest volume. The MTE notified the Inditex Group for violating 42 labor laws of the Brazilian Constitution and held it responsible for these crimes. On Zara's defense, the Inditex's spokesperson informed that Zara does not have control for the employment contracts of its suppliers and that out of the 50 manufacturers that Inditex hold in Brazil, AHA is responsible for only 0.03% of the production for Zara, therefore AHA is not the main supplier for Zara in Brazil. In a second statement, Inditex informed that AHA also violated the Conduct Code for suppliers that guide the group's relation with these external parties and that they would work with AHA in order to make sure these irregularities are fixed. However, for the MTE, Inditex holds more accountability than what it claims: it is clear for the Brazilian authorities the dependence of AHA in regards to Zara as this garment manufacturing business is pretty

much kept by the contracts they have with Zara. Therefore, for MTE, AHA is an extension of Zara's operations. The interesting piece in this whole story is that the media channels did not make any reference to AHA's response to it, which it indeed made it seem like to the audience that Zara (Inditex Group) was the sole responsible party for this situation.

As the case gained international attention, the Inditex Group released a note to the public stating that they would work closely with AHA to assure that the workers get the compensate and to avoid this situation in the future, but they did not mention if they would remove AHA from their list of trusted suppliers. As a reflection of the continuity of the debate about this scandal in the social media, Inditex's representatives went to Brazil last December to sign a commitment term to eradicate slavery work in Brazil. According to some sources, this agreement was also signed by 40 out of 50 of Zara's manufacturers in Brazil, although Inditex's CSR director claimed that this is only a protective measure, since it does not assure that the case that happened in August will never happen again.

Inditex's Corporate Social Responsibility Component

The Inditex Group first created a CSR department with the establishment of an internal code of conduct in 2001, same year the company was listed in the stock market for the first time and it started to release an annual report of its activities. Ten years later, Inditex has a CSR department, with more than one thousand staff spread out around offices (Appendix 1), that formulated what they call Sustainable Strategy Model in which customers, employees, society and suppliers have each its own set of goals (Appendix 2):

Corporate Social Responsibility – Winter 2012

- *Customers*: procedures that would develop and market products that meet health and safety standards;
- *Employees*: increase awareness among Inditex's workers about their rights and ensure that these rights are been in compliance with the UNI Global Union;
- *Society*: Inditex's attempts to cover this front by adding environmental and social variables in their Sustainable Strategic Plan. This should be performed jointly with the civil society and other parties as a way to achieve good business practices in terms of environmental causes and community development;
- *Suppliers*: Inditex claims that it has been putting an effort to strengthen the relationship with its suppliers located around the world by implementing a Code of Conduct in which suppliers must follow in order to be eligible to be a trusted supplier. Suppliers must meet environmental, labor and quality standards as stated in the Code of Conduct.

Given the situation previously described about the labor scandals in which Inditex has been charged of involvement, this paper will focus on the "Suppliers" component. This aspect also ends up being the most complex one as far as it concerns Inditex's business relationships given the amount of parties involved, which requires a lot of coordination. In addition, the failure of the CSR related to supplier can also be visibly noticed, whereas the other components are more internal to the business, such

as employees and society, therefore, in case of failure, it can suffer Inditex's intervention and be played according to its interests before it actually reaches the media channels.

CSR with Suppliers

According to the Inditex's 2010 Report, there are currently around 400 people in the CSR department that work with practices related to its relationship with suppliers. The first aspect of this component is related to the quality of final products these suppliers deliver and the second is related to labor issues. Although neither Inditex's annual report or its website explains in detail what is the methodology used for such, Inditex wants to assure that products that will be available to consumers will meet three categories, as listed in its Code of Conduct:

- *Tested to wear*: methodology for the conduct of social audits;
- *Clear to wear*: it meets the healthy standard;
- *Safe to wear*: product is safe for consumers.

The labor component, and therefore the one most relevant for this paper, is concerned about the conditions of workers in these facilities, especially those in the production line. These fundamental employment standards that Inditex's claims to promote is in accordance to the International Labour Organization (ILO) in which:

- Workers have the freedom of association: this is in respect to labor unions;
- The prohibition of all forms of forced labor;
- The minimum age for employment;
- Acceptable working conditions;

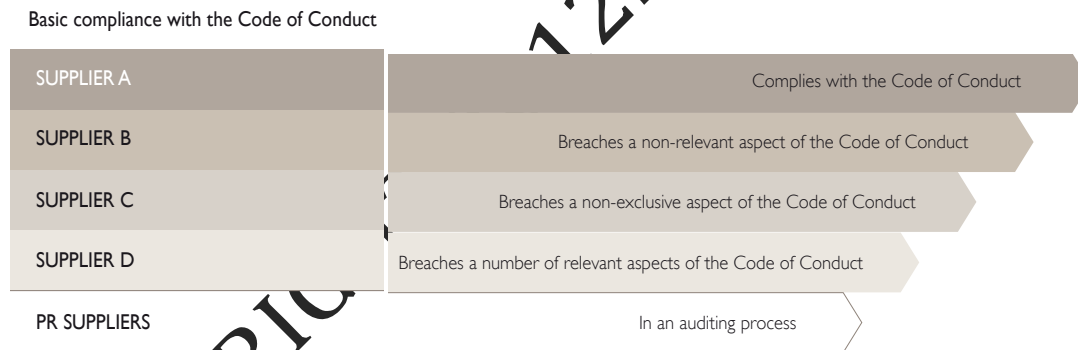
- The suppression of discrimination in employment on the basis of any difference.

These two aspects, quality of final products and labor protection, are carried simultaneously, in the sense that audits made in these manufacturers will look for information on both. Therefore, once the external audit team collected the information, it is compiled and then analyzed by the internal purchasing team. The methodology of this procedure is separated in six phases:

- i) Awareness: it is supposed to be an initial phase, which requires a positive interaction between Inditex and its suppliers in a daily basis. Inditex provide to the manufacturers the CSR tools that might work well to their environment.
- ii) Self-Assessment of Suppliers: the CSR team and the purchasing team get together with the objective of assessing a potential supplier capabilities or limitations.
- iii) Social Audit: the CSR department also carries this phase and it is considered a key process when defining a potential supplier. The audit team is composed by 240 staff and the general objective if to strengthen the Inditex production chain through audits which attempt to get to know the degree of compliance in regards to social, employment and environmental aspects. In 2010, Inditex carried over a thousand audits (Appendix 3). The figure below show the sub-phases of the audit process.



iv) Supplier rating: the findings of the audit will allow the CSR and purchasing teams to grade the supplier in accordance to its degree of compliance, as per figure below.



v) Plans of Corrective Actions: after the audits are made and suppliers are graded, auditors then determine the points for improvement. Inditex claims to give technical support to suppliers that are committed to implement corrective actions.

vi) Follow-up Audits: these are audits carried after the social audit was made as a way to monitor suppliers' level of compliance and keep their

Corporate Social Responsibility – Winter 2012

grades updated in the Inditex system. Also, these follow-up audits can be made to assure that the supplier is correctly implementing the necessary corrective actions.

The information about Inditex's CSR seems to be very restricted. The only available source of information that details its CSR operations is the company's annual report, but, still, the document does not mention in-depth how the audits are carried. It provides nice tables and graphs, but overall it gives a very simplistic view of all processes, which makes it harder to identify where are the flaws that lead Inditex's to still be involved in labor scandals. The only fact that is very clear is that they do not use third party verification; contrary, all CSR activities, including audits, are carried by the CSR department.

Final Considerations

According to the Inditex 2010 Report, the group has spent in that year 11 millions of Euros in corporate social investment, a 10% increase from the previous year. However, comparing this level of investment to the net sales revenue the company earned in 2010, which was above 12 billions of Euros, its investment in CSR loses some of its relevance, one could say. As for the quality of its CSR, the information available is very limited in terms of credibility; the group's annual reports are the only available source that explains to some extent their CSR activities and by default the results provided are likely to be biased. However, one could say that the labor scandal itself that Inditex has been involved is a reflection of its CSR flaws – evidently its one thousand factory audits per year are not being able to secure an efficient result.

In general terms, a few conclusions can draw on this case. First, it seems clear that the CSR was integrated to Inditex purely for the eyes of the shareholders and not for consumers. A simply evidence that supports such a claim is the fact that the CSR department was created in the same year that Inditex opened its capital in the stock market in 2001. The recent scandal in Brazil involving Zara has shown that despite the attention it gained in the international media, including social media, its sales did not drop after the scandal was publicly announced. This actually follows a pattern of previous years when other labor scandals involving Zara was made public; as a matter of fact, the brand has been experiencing an average growth in sales of 10% per year since 2006.

The explanation for this could be the fact that the profile of Zara's consumers is not that type that would be concerned about social and environmental issues. After all, they are consumers of fast-fashion products, therefore, their behavior is to have the latest thing and discard when it is no longer a trend. It is clear that they are guided by short-term commitment and accessible prices so they can own more, which makes them less likely to worry about the origin of a product.

On the other hand, shareholders do have a different mind-set: the company's reputation plays an important role on the stock market decision. Therefore, Inditex created the CSR department in order to build a positive image to the general public and, ultimately, the potential shareholders. Still, Inditex's stocks seems to be not very sensitive to scandals that come up every once in while; one day after the labor scandal in Brazil hit the media, its stocks value dropped 4.3% in the Madrid Stock Market,

however, most likely, this drop was due to other factors rather than the scandal as it recovered and had an overall growth of 2% for that month of August.

In addition, another analysis would be that Inditex's created a CSR department and its framework for preventive and palliative reasons. Preventive motive in the sense that just a reduction in number of non-compliance cases involving Inditex's brands would be already a positive outcome for the group. Palliative to the extent that in case Inditex's brands are caught involved in any scandals, just the fact it has an institutionalized group to address CSR helps to make the case, meaning that the public (read: shareholders) would be more likely to believe in whichever statement Inditex deliver after a scandal event. Even the Inditex's chairman mentioned during his trip to Brazil to address the labor issue at AHA that the agreement they were signing with the MTE would not be a guarantee that other cases would not happen. Therefore, he admitted he did not trust his own CSR.

Finally, the question that remains is why Inditex is still involved in labor scandals? Is it a consequence of the fact that Inditex is such a large company that deals with a labor-intensive production chain and, therefore, they are more subject to it? Is it flaws in its supplier audits? And if this is the case, why they do not fix it? The truth that seems to be more obvious is that they do not fix it because it would require more effort, not necessarily more money, and they do not have the incentives to do so: with labor scandals highlighted all over the world, still, Inditex Group's wealth increases every year and its stock share value as well, therefore, why to bother? One venture capitalist such as Inditex's chairman would say if nobody could hear him.

APPENDIX 1

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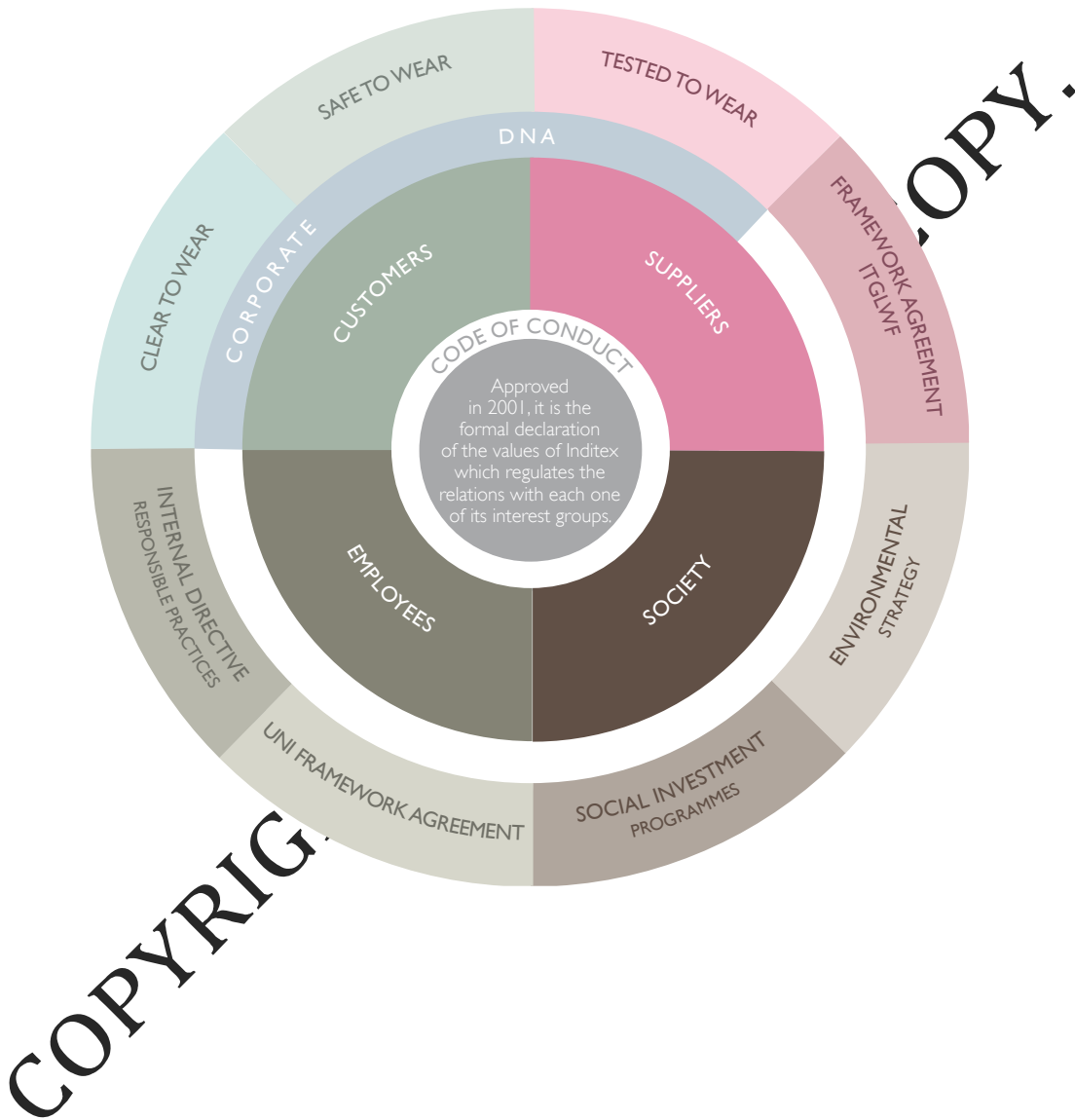
MANAGER OF CSR	
INDITEX COMPLIANCE 15 PERSONS	INDITEX HEALTH AND SAFETY 18 PERSONS
COMPLIANCE 244 PERSONS	HEALTH AND SAFETY 128 PERSONS
<p>EUROPEAN UNION ITS, PWC, Portuguese Catholic University (Porto, Portugal)</p> <p>Romania. 2 persons Bulgaria. 1 person Italy. 2 persons Portugal. 9 persons</p>	<p>EUROPEAN UNION Colormoda-Technical Advice, USC, SGS</p> <p>Spain. 19 persons</p>
<p>NON-EU EUROPE ITS, SGS</p> <p>Turkey. 7 persons The Ukraine. 1 person</p>	<p>NON-EU EUROPE Bureau Veritas, SGS</p> <p>Turkey. 80 persons</p>
<p>AMERICA ITS</p> <p>Mexico. 9 persons Argentina. 4 persons Brazil. 6 persons</p>	<p>AMERICA SGS</p> <p>United States. 1 person</p>
<p>AFRICA ITS, SGS</p> <p>Egypt. 5 persons Morocco. 6 persons</p>	<p>ASIA Bureau Veritas, SGS</p> <p>Bangladesh. 5 persons Vietnam. 5 persons China. 13 persons India. 5 persons</p>
<p>ASIA ITS, SGS, KPMG</p> <p>China. 116 persons India. 32 persons Bangladesh. 18 persons Pakistan. 4 persons Vietnam. 8 persons Thailand. 1 person Cambodia. 3 persons Malaysia. 4 persons Indonesia. 5 persons Taiwan. 1 person</p>	

INDITEX SOCIAL INVESTMENT 1 PERSON		INDITEX INTEGRATION 4 PERSONS	
EMERGENCIES 6 PERSONS		COMMUNITY DEVELOPMENT 669 PERSONS	
AMERICA Entreculturas	Haiti. 6 persons	EUROPEAN UNION MSF, Entreculturas Fe y Alegría, Cáritas	Spain. 8 persons
		AMERICA Entreculturas Fe y Alegría, S/R	Perú. 65 persons Chile. 19 persons Argentina. 12 persons Brazil. 52 persons Venezuela. 41 persons Mexico. 90 persons Uruguay. 18 persons Colombia. 43 persons Ecuador. 6 persons Panama. 4 persons
		AFRICA S/R, MSF	South Africa. 15 persons Sudan. 48 persons Central African Republic. 4 persons Burundi. 12 persons Morocco. 13 persons Somalia. 102 persons
		ASIA MSF, Cáritas	Cambodia. 40 persons India. 77 persons
		INTEGRATION 42 PERSONS	
		EUROPEAN UNION COGAMI and El Molí d'en Puigvert	Spain. 42 persons

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APPENDIX 2

INDITEX SUSTAINABILITY MODEL



APPENDIX 3

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Fernanda Luchine Ishihara
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Social audits carried out in 2010

Auditing firm and geographical area	SA 8000 Accreditation	Number of initial auditors	Number of monitoring audits	Total
INDITEX INTERNAL AUDITORS	Yes	264	158	422
BANGLADESH		71	7	78
SPAIN		6	26	32
INDIA		121	89	210
ITALY		4	-	4
MOROCCO		31	35	66
PAKISTAN		1	1	2
PORTUGAL		10	-	10
ROMANIA		4	-	4
TURKEY		16	-	16
INTERTEK GROUP	Yes	321	74	395
ALBANIA		3	-	3
ARGENTINA		8	-	8
BANGLADESH		23	5	28
BRAZIL		9	-	9
BULGARIA		4	1	5
CAMBODIA		3	-	3
CHINA		129	24	153
EGYPT		3	-	3
INDIA		72	14	86
INDONESIA		5	2	7
ITALY		8	-	8
MALAYSIA		2	-	2
MOROCCO		1	-	1
MEXICO		4	6	10
PAKISTAN		6	2	8
PORTUGAL		10	15	25
ROMANIA		15	4	19
TAIWAN		1	-	1
THAILAND		1	-	1
TURKEY		-	1	1
UKRAINE		1	-	1
URUGUAY		1	-	1
VIETNAM		12	-	12
PWC	No	2	3	5
PORTUGAL		2	3	5
UCP	No	65	60	125
PORTUGAL		65	60	125
SGS GROUP	Yes	113	27	140
CHINA		20	-	20
MOROCCO		22	13	35
TURKEY		71	14	85
TOTAL		765	322	1,087

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