
Analysis of Value Chain and Sources of Differentiation in International Fashion Markets

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Abstract:

This paper analyzes the value chain of the Galician textile-clothing sector and the main sources of differentiation. To respond to these objectives, 40 in-depth interviews with executives were carried out followed up by a questionnaire. Results indicate that the differentiation focused on specific segments must be the foundation on which companies compete in international fashion markets. Among the variables that contribute most to the creation of that differentiation are the brand and the design. The latter is a strategic variable of the value chain that should not be subcontracted. Galician companies need to have better control of the operations in the value chain, especially the finishes and control of end quality.

Key Words: *Value Chain, Differentiation, Brand, Competitive Strategy, Fashion*

JEL Classification: *M31, M16, L1*

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1. Introduction

The growing liberalisation of foreign trade for clothing products, tied to greater internationalisation of the economy, have notably changed the environment in which Galician companies operate. On the one hand there are commercial opportunities for growth in foreign markets, as well as the possibility of finding raw materials and low labour costs. However, there is growing competition from Southeast Asian countries such as China, India, Hong Kong which, thanks to their very low labour costs, are absorbing more and more both basic clothes-making tasks as well as those tasks that generate greater value (Buelens, 2005) –e.g. clothing products that have a high value-added-. Within this new international context, it is very appropriate to analyse the entire value chain to detect both those strategic activities (and stages of the chain) as well as the competitive factors. This will enable greater orientation of both production decisions –e.g. subcontracting- as well as commercialisation decisions.

Therefore, this paper aims to make progress in the strategic analysis of the value chain of the textile-clothing sector. This aspect is extremely important, especially if we analyse international markets, given that some value chain activities may be subcontracted or relocated in other markets. Thus, those liberated resources would be concentrated on those activities that could potentially generate greater value-added, which would lead to greater competitiveness and a better market focus. More specifically, the aim of this paper is to address three issues. Firstly, to define those priority or basic activities of the value chain, which would enable us to know which activities should be subcontracted and which ones should not. At the same time, we aim to identify the competitive factors on which Galician companies must act to improve their competitive position in the international fashion and clothing market. Next, we attempt to analyse the sources of competitive advantage on which companies will build the strategy, as well as defining the main sources of differentiation. Lastly, using the Treadgold (1990) methodology, we will analyse the international projection of different companies. To satisfy these aims, our research involved in-depth interviews and questionnaires targeted at executives from the Galician clothing and textile sector. We start with a review of the literature that covers the main concepts used in this paper and the principal findings which, at an empirical level, have been carried out in the research into internationalisation of the textile-clothing sector. More specifically, those related to the study of the value chain, strategy and subcontracting decisions. The methodology and the results we hope to achieve are explained hereunder.

2. Review Literature

2.1 Value Chain and Internationalisation

The value chain of the textile-clothing sector comprises three levels: fibres and textiles, apparel or clothing and distribution (Dicken, 2003). In turn, two very

different activities can be clearly distinguished: textile and clothing. Firstly, the textile sector is capital intensive, and there are barriers to access in the form of investments in technology, innovation and development of new materials (synthetic, chemical or artificial fibres) or in new manufacturing techniques or fabric production. Elsewhere, the clothing sector is labour-intensive and easy to access. The countries where these tasks are carried out have reduced labour costs, such as the case of Southeast Asian countries (China, India, Bangladesh, and Singapore) or Eastern Europe, mainly the former. These countries have a clear advantage in terms of cost and have developed labour-intensive tasks, while more developed countries have focused on capital intensive tasks. However, as we will see, the current dynamics are changing for some territories or regions, such as the specific case of China.

In turn, clothing articles can be separated into basic products and fashion product, with the latter contributing greater value-added and thus a higher price. Industrialised countries, such as the EU-25, have excellent prospects in value-added textile and clothing products, as there is qualified and relatively low-cost labour, mainly in countries that have recently joined (Poland, Czechoslovakia and Romania -particularly Romania-) (Boudier-Bensebaa and Andreff, 2004). This workforce is used to manufacture quality products. Elsewhere, there are reasons why European companies keep their factories in Europe. These companies have decided to maintain R&D centres because of the complementary nature between local production and production carried out in other countries, as well as the possibility of producing small batches or catering to urgent orders. However, recent literature has shown that countries from East Asia, mainly China, have developed a powerful export sector based on low labour costs and increased quality and capacity / speed of delivery (Ge, 1999). This factor means that the Chinese export sector is becoming the most competitive sector on the international stage and is rivalling countries from the East and from the Mediterranean region in the production of high value-added garments (Abernathy, Volpe, and Weil, 2006). This fact would confirm that there are other factors, such as government policies, attracting foreign capital, or political stability, to explain the greater international competitiveness of certain regions, territories or countries (Kilduff and Chi, 2007).

So, the competitiveness factors that allow or ensure survival in these markets must be targeted at an extremely changeable market in which there are potentially global segments that are not just sensitive to the price factor but also to the fashion factor. Responding to this market requires huge production flexibility and distribution straight to the consumer as well as the quickest time to market (Ge, 1999). To respond to these challenges, manufacturers have integrated themselves vertically and forwards and have taken on the distribution activities. One example that synthesises these variables is the ZARA case in which the flexible production and just-in-time systems not only enable stock to be reduced to the absolute maximum (Lopez and Fan, 2009) but also provide the market with any new item or fashion concept in a very short space of time. By the same token, clothing products,

especially those with the highest value-added, must include a differentiation factor (Knight and Kim, 2006).

This differentiation factor is usually a very distinctive style. Recent literature adds the identification of segments or niches to these success factors (Parrish, Cassill, and Oxenham, 2006). Elsewhere, the cost is the determining factor for very basic clothing and apparel. As the basis for defining the competitive strategy, the choice of the cost factor or differentiation factor reveals the importance of creating a competitive advantage as well as identification of those vital activities of the chain that provide the end product with high value from the consumer's point of view. *Viz.*, what should be the source of competitive advantage on which companies should build their strategy? We will delve into this in the next section.

2.2. Competitive Strategy: Competitive Advantage and Sources of Differentiation

According to Porter (1990), there are two ways of obtaining a competitive advantage. Firstly, the cost, which attempts to minimise the production cost, enabling products to be offered to the market at a very low price, and secondly, the differentiation that seeks to provide unique value for which the consumer is prepared to pay the corresponding higher price. When the level of differentiation is very clear, this price premium can be extremely high. Apart from being able to differentiate the supply properly, it is also necessary to be able to select and define the segment or niche at which the supply is targeted, especially in clothing and fashion markets (Parrish, Cassill, and Oxenham, 2006). This global niche- or segment-focused supply can compete against low-cost imports from Asian countries.

In fashion markets, the consumer looks for a product with social significance, but the same time a product that is functional and, above all, which has a distinctive style (Knight and Kim, 2006). This distinctive style is one of the criteria that enable the consumer to recognise and distinguish one offer from another. To this end, the differentiation strategy may be backed or supported through those activities of the chain that provide the highest differential value to the end product. Research into the sources of differentiation in the textile sector has focused on the brand (Wigley and Moore, 2006), although attention is currently being diverted to other variables such as product quality or service quality.

2.3 International Projection

Although we could understand that the value chain of fashion is influenced and controlled by manufacturers and producers that control all of the tailoring, clothes making or manufacturing and finishing activities, this is notably influenced by distributors (Gereffi, 1999). As explained in the first part of this section, because the clothing and fashion market is very changeable, it is these agents -the distributors- that are best positioned to discover new trends, tastes and preferences in this market. Elsewhere, and as we also explained, factors like economic globalisation, the disappearance of commercial barriers and the formation of large

economic spaces have shaped huge global segments, with similar tastes and needs in different countries (Levitt, 1983). The perception of this business opportunity tied to the non-existence of opportunities for growth in domestic markets has led distributors to seek international growth. This process of distribution internationalisation (e.g. Carrefour, Wall-Mart, etc.) has reinforced the negotiating position with clothing retailers, which have had to react with the development of new formats and concepts such as fashion brand manufacturers without factories (Mango, Nike) or manufacturers of fashion brands with their own distribution chains (Inditex or H&M). This process of manufacturers seeking international projection can be explained by the variables of geographic presence -concentrated, disperse, multinational and global internationalisation- and, therefore, by the control exercised throughout the chain -high, medium and low- (Treadgold, 1990). Selecting these criteria is vital in understanding the international projection of companies. The initial criterion places emphasis on the possibility of a uniform supply to the market (the last link called the global market would be the best example). The second criterion is essential in understanding the importance of controlling activities throughout the chain. So, as control of operations increases, the possibility of providing an efficient and appropriate response to the market grows.

3. Research Methodology

To respond to the objectives put forward, we divided the fieldwork into two clearly different stages. Firstly, there was an in-depth interview followed up by a questionnaire which included both closed questions as well as the occasional open question that was added after the interview stage. The companies that finally took part in the study were Adolfo Dominguez, Roberto Verino, Caramelo, Carolina Herrera, Purificacion Garcia, Kina Fernandez, Florentino and Antonio Pernas. Similarly, four executives were chosen from the company Inditex (two from Zara, one from Bershka and another from Pull and Bear) who were included in the study as they can provide very valuable information on sector dynamics and knowledge.

3.1 In Depth Interview with Executives

This in-depth interview was used to define the activities and/or stages of the value chain (supply of materials, production -which in turn includes the design, pattern, cutting, sewing/tailoring, finishing off and quality control-, distribution and marketing, as well as the most relevant strategic decisions (subcontracting, diversification, etc.) and the most obvious competitiveness factors in each stage. The interviews were carried out individually so that none of the executives or specialists was aware of how the others had responded. This initial stage was used to structure and organise the different stages of the value chain as well as identify the main variables, procedures and routines of each of these stages. All this output was pooled together to compile a questionnaire for sector executives which is explained below.

3.2 Questionnaire for Executives: Preparation of the Questionnaire and Measurement of Variables

The questionnaire was drawn up on the basis of previous interview. The variables and measurement scales are shown in Table 1. In addition to measuring the factors of competitiveness and differentiation, we also analysed the strategy – obtaining an advantage and focus-, decisions on subcontracting and organisation of the value chain (stages or activities). Lastly, we included classification variables such as the size of the company, turnover, number of employees, and international competitiveness indicators.

Table 1. Selection of variables, items and measurement scales used in the Research (In-depth Interview and Questionnaire)

| Main And Strategic Interest Aspects | Items Used | General Purpose/Measurement Scale |
|--|---|---|
| Stages of production and subcontracting decision (information obtained following the in-depth interview) | <ol style="list-style-type: none"> 1. Design 2. Pattern 3. Tailoring 4. Finishing off 5. Quality control | <ol style="list-style-type: none"> 1. Own Activity 2. Subcontracting |
| Competitiveness factors in different stages: Production / Logistics /Distribution and marketing (Information obtained following the in-depth interview) (Own compilation) | Open question in the initial stage of qualitative research (2009) and then the executive assessed how each of these items contributed to the company's competitive capacity | <p>The presence of these factors contributes to the company's competitiveness...:</p> <p><i>Measurement scale: 1. Totally disagree...5. Totally agree</i></p> |
| Competitive strategy at international level (Porter, 1990) | Sources of competitive advantage | <ol style="list-style-type: none"> 1. Cost 2. Differentiation |
| | Scope or focus | <ol style="list-style-type: none"> 1. The entire market 2. Segment |
| Factors of differentiation (Own compilation) | Open questions to executives in the initial stage of qualitative research (2009) and then the executive assessed the company's potential for differentiation | <p>The following items contribute to differentiation of its supply over competing rivals</p> <p>Quality of the finishes - Quality of the materials - Brand-design - Design of the point of sale - Brand image - Service quality at points of sale</p> <p><i>Measurement scale: 1. Totally disagree...5. Totally agree</i></p> |

| (cont'd) Main And Strategic Interest Aspects | Items Used | General Purpose/Measurement Scale |
|--|--|--|
| Degree of internationalisation and operating strategy (Treadgold, 1990) | International presence | 1. Concentrated internationalisation 2. Scattered 3. Multinational 4. Global |
| | Control of operations (according to strategy employed in the internationalisation process –market entry strategies-) | 1. High costs / High control 2. Medium costs / Medium control 3. Low costs / Low control |

Source: Own elaboration

4. Results

4.1 Value Chain and Competitiveness Factors

As shown in Table 2, which includes the average values of the scores given by the executives to the different variables of each of the value chain stages, there are three prominent results. First of all, the competitiveness factors rated by the executives and tied to distribution must be focused on looking for or improving market accessibility, and making this as direct as possible ($X_{5Distr}=4,32$) and to reinforcing the image of the ensign or chain ($X_{4Distr}=4,18$). Another of the most influential variables is currently the extent and penetration of the network ($X_{2Distr}=3,35$).

Secondly, there is a very positive assessment of brand-related assets. The first of these, brand image ($X_{3Comer}=4,71$), and the other one which the executives have called brand-design ($X_{4Comer}=4,82$). This latter result is particularly outstanding and there are two reasons why we would like to emphasise it. First, because the design highlights a new area in brand equity management, and then, because it may be presented as a very important differentiation factor for companies. In fact, the strategy of developing haute couture brands and design has been a success strategy for leading brands such as Versace, Armani, Chanel, etc. (Fernie, Moore, Lawrie, and Hallsworth,1997; Moore, Fernie, and Burt, 2000). In effect, and as the executives indicated in the qualitative stage, the design very often includes a distinction or touch that lends that extra ‘something’ to their collections. Lastly, another of the marketing variables that has also been emphasised by the executives is management of the point of sale ($X_{2Comer}=4,28$). This not only includes customer service but also obtaining first-hand information on market trends, viz., market research function (e.g. analysis of trends, fashionable colours, new creations or new styles).

Table 2. Average values of the core competitiveness factors for the different stages of the value chain in the textile-clothing sector identified by executives (n=36)

| X_{Prod} | Production and Supply Variables | X_{Dist} | Distribution Variables | X_{Logist} | Logistic Variables | X_{Comer} | Commercialization Variables |
|------------|--|-------------|---|--------------|-------------------------|-------------|---|
| 2,91 | Supply of materials or fabrics | 3,24 | Cooperation with customers | 4,1 | **Time to market | 3,98 | Direct sale to the consumer (own network) |
| 3,29 | Cooperation with suppliers (materials) | 3,35 | Extent of the distribution network | | | 4,28 | Management of the point of sale |
| 3,40 | Low unit production costs | 3,71 | Penetration of the distribution network | | | 4,71 | *Brand image |
| 3,97 | **Production flexibility | 4,18 | * Image of the ensign or chain | | | 4,82 | * Brand-Design |
| 4,7 | * Design (e.g. pattern, fashion design, etc.) | 4,32 | * Direct distribution | | | | |

Source: Own compilation, based on the in-depth interview (2009) and the questionnaire (2010)

* values that were prominent within the different stages of the value chain (in bold);

** The time-to-market value reached 4,9 and production flexibility 4,5 for companies of the Inditex group

The third item of interest is the very high score that executives gave to logistics -which was also defined as the consumer response time or time to market- ($X_{1Logist}=4,1$). What underlines this data is the importance of providing an immediate and efficient response to the end consumer, given that a very changeable market means that the capacity to respond is a determining factor. In this regard, we should point out that this variable, in the case of the multinational Inditex, occupies a privileged place as a competitiveness factor in the executives' opinion. This company has developed just-in-time production systems, which provide an immediate response to market needs and, therefore, reduce production stock to the maximum. Finally, the most prominent result in production is the design ($X_{5Prod}=4,7$). This figure verifies the previous result and is presented as a variable with high potential for differentiation. Other results that are worthy of mention are the fact that the rating of the unit production cost is not so high ($X_{3Prod}=3,40$) and that flexible production is valued highly ($X_{4Prod}=3,97$).

A further objective that we wanted to respond to was analysing the decision to subcontract production stage activities or tasks. To do this, we carried out a difference of proportions test for each of the production stage activities. The results are given in Table 3. The executives immediately identified those stages that should

not be subcontracted, such as design and pattern. This was ratified in the data analysis. However, quality control was an activity where there was a certain discrepancy. Most executives said there should be strict and rigorous control by the company involved, especially in high-end garments. This is not always the case, however. This means that the company's supply, and therefore the brand, does not offer consistent and constant quality for all garments.

Table 3. Difference of proportions test and percentage of subcontracting within the different production chain stages (n=36)

| Variables | Subcontracting | Own Activity | Total |
|-------------------|----------------|----------------|-----------|
| Design* | 0% (0) | 100% (36) | 36 |
| Pattern* | 13.88% (5) | 86.11% (31) | 36 |
| Cutting* | 88.89% (32) | 11.11% (4) | 36 |
| Tailoring/Sewing* | 100% (36) | | 36 |
| Finishing off* | 72.2% (26) | 21.8% (10) | 36 |
| Quality Control** | 58.33% (21) | 41.66% (15) | 36 |

Source: Own elaboration
Difference of proportions test: * significant ($p < 0.05$); ** not significant ($p > 0.05$); in parenthesis number of observations

4.2 Competitiveness Strategy and Differentiation Variables

After the value chain analysis, the executives were asked to name the competitive advantage on which the strategy should be based. Here there was a unanimous response. Executives from Galician companies pointed to segment-focused differentiation (92.5%); while the executives from the multinational Inditex said that the better strategic option would be cost leadership with a segment approach (7,5%) (table 4). It is clear that the strategic option which should be chosen by Galician companies is differentiation with a segment approach, which is coherent with preliminary research (Parrish, Cassill, and Oxenham, 2004).

Table 4. Source of competitive advantage identified by executives of Galician companies (n=40)

| | | ADVANTAGE | | | |
|----------------------------------|---------------------|-----------|--|--------------|--|
| | | % | Cost | % | Differentiation |
| F O C U S | Whole Market | | Cost leadership. The entire market (0) | | Differentiation: The entire market (0) |
| | Segment | 7.5% | Leadership in segment cost (4) | 92,5% | Segment differentiation (36) |

Source: Own elaboration based on the questionnaire given to executives (2010); the entire sample (n=36 - companies of same strategic group- and n=4 -Inditex-); in parenthesis number of observations

Having emphasised the differentiation strategy, they were asked which of those variables had the greatest potential for differentiation. Besides to research the competitive factors for different stages of value chain, different items were selected to measure the contribution of differentiation of the supply over competing rivals (table 1). In the main, executives highlighted the marketing variables, with prominence given to brand-design (4,91), brand image (4,82) and design of the point of sale (4,68) (figure 2). By the same token, the most outstanding production variable is control of the production process, especially the quality of the finishes (4,5). Nevertheless, product quality (4,0) and service quality (4,0) did not receive, in relative terms, a high evaluation. The biggest factor is the importance of marketing variables, especially the brand and the design, as intangible assets on which the company should act to provide a distinguished and new offer.

4.3 International Projection

As Figure 1 shows, Galician companies position themselves in two quadrants. Firstly, in the concentrated internationalisation quadrant, an approach used by companies with a lower degree of internationalisation (Caramelo, Pernas, and Purificacion Garcia) and which exercise low control over operations. In the upper quadrant are the companies Adolfo Dominguez and Carolina Herrera, which are pursuing scattered internationalisation but which, unlike the foregoing, have a higher control of operations in the value chain. The two companies also have a higher percentage of sales abroad and – in the opinion of the executives – their forecast is to continue growing. This will require greater control of operations. The multinational Inditex is in the lower left quadrant. This company has developed just-in-time production systems that provide an immediate response to market needs and, therefore, reduce production stock to the maximum. This means the company exercises high control over the chain operations. As it has been explained before, this is one of the key factors of success for this company (Lopez and Fan, 2009), which, in accordance with the Treadgold methodology, would be rated as a global company.

**Figure 1. International projection of Galician companies from the textile-clothing sector:
degree of internationalisation and control of operations**

| | HIGH COSTS / HIGH CONTROL | MEDIUM COSTS / MEDIUM CONTROL | LOW COSTS / LOW CONTROL |
|--------------------------------------|------------------------------|----------------------------------|--|
| CONCENTRATED INTERNATIONALIZATION | | |  |
| SCATTERED INTERNATIONALIZATION | | | |
| MULTINATIONAL | | | |
| GLOBAL COMPANY | ZARA | | |

Source: Own elaboration based on Treadgold (1990)

5. Managerial Implications and Conclusions

This paper has contributed notably to defining factors of competitiveness and sources of differentiation, as well as analysing the value chain and the role brands have in defining the strategy and in creating greater value for the company. The context has been restricted to Galician textile-clothing companies that operate in international markets, mainly companies. The main implications have been organised in accordance with the main sections that have been revealed in section 2. We will start with the factors of competitiveness and the value chain.

5.1 Factors of Competitiveness, Value Chain and Internationalisation

The results obtained from the interview with executives have revealed how important the commercialization stage is in becoming more competitive. The conclusion we can draw from this analysis is that manufacturers need to focus their efforts on creation of their own network of shops or franchises, preferably the former, as this will enable greater control of the market evolution. In fact, the own network of shops appeared to be the most valued competitiveness factor in the commercialization stage.

In addition to this factor, the executives emphasised brand-related assets. More specifically, the brand image and what they have called brand-design. There are two main implications for the company. First of all, that this activity and those directly related to it, such as pattern design, should not be subcontracted. Secondly, production and marketing need to be reinforced with designers, pattern designers and stylists. These agents should not only achieve an innovative, authentic and distinguishing design, but also continually examine the market to identify the latest trends for inclusion in new collections. Another of the marketing variables emphasised by the executives is management of the point of sale. Thus, in addition to providing customer service, it is also necessary to obtain first-hand information on market evolution, viz., strengthen the market research function (for example, analysis of trends, fashionable colours, styles, etc.).

Lastly, a further variable that companies need to reinforce is quality control. This is because the activity, vital in generating value, is very often deficient and quality control is extremely important in obtaining a distinguished product.

5.2 Competitive strategy and differentiation variables

In this section, executives of Galician companies were unanimous with regard to the different options they were given. Apart from the multinational Inditex, the executives' perception focused on the importance of segment-focused differentiation, a result that is in line with recent research (Parrish, Cassill, and Oxenham, 2006). This differentiation should be based on a value offer tied to a very distinctive style. In addition, the style should be transmitted by the brand and must be coherent and present in all products offered by the company. This implication is coherent and goes a long way to reinforcing the previous implication. The brand, its image and design, play a fundamental role as differentiation factors. These variables should be the basic pillars on which the company builds its strategy. A synthesis of the implications described can be seen in Figure 2, which provides a detailed analysis of the value chain, the activities to be subcontracted and the key sources of differentiation.

5.3. International projection of companies

Despite displaying growth in international markets, Galician companies need to have better control of the operations in the value chain, especially the finishes and control of end quality. By the same token, they need to develop new

point-of-sale formats, a fact that is shown as the differentiation factor as yet unexploited by companies from this strategic group.

Figure 2. Analysis of the value chain of the textile-clothing sector in international markets: Assessment of the basic or value generating activities, tasks to be subcontracted and the key sources of differentiation



Source: Own elaboration

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